Technical Connection

BUDGET ISSUE CONTENTS

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INTRODUCTION

For the past few months it had looked as if George Osborne's fourth Budget would be a non-event. Last December's Autumn Statement was widely seen as more of a mini-Budget and in it the Chancellor set several tax parameters through to 2015/16.

Much of the important Budget announcements therefore focused on changes that we already knew about from the Autumn Statement and covered issues such as:-

- Income tax rates.
- Personal allowances.
- An increased IHT spouse exemption on transfers to non-UK domiciled spouses.
- Changes to business tax .
- Tax avoidance and evasion.

However, the Chancellor also announced new changes in the following areas:-

- New rules to restrict the deductibility of a debt in calculating the value of a person's IHT taxable estate.
- New CGT rules on the disposal of a UK residential property by an offshore company.

INCOME TAX

1. Rates of tax

(i) The limit for the 10% starting rate for savings income increases to £2,790.

(ii) The basic rate of income tax remains at 20%. The basic rate limit reduces to £32,010 so that the higher rate tax threshold [ie. the basic rate limit (£32,010) plus the basic personal allowance (£9,440)] becomes £41,450.

(iii) The basic rate of tax will apply to income in the band £1 to £32,010. Taxable income in excess of £32,010 will be taxed at 40% or 32.5% (dividends) up to the threshold of £150,000 when the additional rate tax applies.

(iv) The additional rate of income tax (which applies to taxable income in excess of £150,000) is 45% (37½% for dividends).

(v) Trustees of discretionary trusts are subject to income tax at 45% (37.5% on dividend income) on income above their standard rate band (normally £1,000).

2. Personal allowances

- The basic personal allowance is increased from £8,105 to £9,440. Where an individual's adjusted net income exceeds £100,000, the level of the basic personal allowance will be reduced by £1 for each £2 over £100,000 until it reaches zero. This means that the basic personal allowance will reduce to zero where adjusted net income is £118,880 or more.

- The age allowance is £10,660 (for those born before 6 April 1938) and £10,500 (for those born after 5 April 1938 but before 6 April 1948). These allowances were frozen in the 2012 Budget.

- The level of income that a person can enjoy before a cut back in age allowance occurs is £26,100, up from £25,400.

- The married couple's allowance (MCA) for those aged 75 and over (provided at least one spouse was born before 6 April 1935) has been increased to £7,915. In calculating the reduction in age allowance when income exceeds £26,100, the increased MCA will not be cut back below £3,040 (the "minimum amount").

- Relief in respect of the MCA and maintenance payments continues to be given as a tax credit at the rate of 10%.

Budget announcements

(a) Increase in the income tax personal allowance for 2014/15

From 2014/15 the personal allowance for those born after 5 April 1948 will be increased to £10,000. From 2015/16 the allowance will be increased each year by inflation as measured by the increase in the Consumer Prices Index.

The increase will take 257,000 individuals out of tax altogether. 24.5 million individuals will be £50 better off in real terms, while 0.47 million individuals will have an average loss of £50.

(b) Change to the basic rate limit for 2014/15

The basic rate limit will be reduced to £31,865. This is a consequence of the increase in the higher rate tax threshold by 1% to £41,865 (announced in the Autumn Statement) which, after the deduction of the increased personal allowance of £10,000, leaves £31,865 as the basic rate limit.

CHILDCARE

As announced on 19 March and confirmed in the Budget, a new childcare scheme will be introduced to support working families with their childcare costs from 2015. Parents will be offered a tax-free childcare allowance worth up to £1,200 per child. This will be conferred by giving basic rate tax relief on the first £6,000 they spend on childcare (i.e. £6,000 x 20% = £1,200). The new system will be phased in from Autumn 2015. From the first year of operation, all children under 5 will be eligible. The scheme will build up over time to include children under 12 by about 2020. For those who qualify this will save a typical working family with two children up to £2,400 a year.

The existing workplace childcare vouchers scheme, which is currently subsidised by the taxpayer, will be closed to new claimants from 2015 and phased out. To be eligible under the new scheme, both parents, or a single parent in work, must be each earning less than £150,000 a year and must not already receive support through tax credits or the new universal credit. Support will be provided through a childcare account redeemable at any registered childcare provider.

Details of the scheme will be finalised after a consultation period.

NATIONAL INSURANCE CONTRIBUTIONS

The Upper Earnings and Upper Profits Limits (beyond which employee NICs are charged at 2%) reduce from £42,475 to £41,450, in line with the higher rate tax threshold.

The main rates for 2013/14 are as follows:-

- The Employee's Primary Class 1 National Insurance rate is **12%** on earnings between the Primary Threshold (£149 per week - £7,755 pa) and Upper Earnings Limit (£797 per week - £41,450 pa).

- Employees, in addition, pay **2%** Primary Class 1 National Insurance on all earnings above the Upper Earnings Limit (£41,450 pa).

- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£148 per week - £7,696 pa) is **13.8%**. This rate applies also to Class 1A and Class 1B contributions.

- The self-employed Class 4 rate on profits between the Lower Profits Limit (£7,755 pa) and Upper Profits Limit (£41,450 pa) is **9% and 2%** above £41,450.

Budget announcements

(a) The Employment Allowance

From April 2014 every business and charity will be entitled to an annual £2,000 Employment Allowance towards their employer NICs bill. The Allowance will be delivered through standard payroll software and HMRC's Real Time Information System. Having confirmed their eligibility through their regular payroll processes this will trigger a deduction of £2,000 from the employer NICs liability over the course of the year's PAYE payments.

(b) The collection of Class 2 contributions

The Government will consult on options to simplify the administrative process for the self-employed by using Self Assessment to collect Class 2 NICs alongside income tax and Class 4 NICs.

CAPITAL GAINS TAX

- The annual exempt amount is increased to £10,900 for individuals and to £5,450 for trustees (subject to dilution when the same settlor has created more than one trust).

- The lifetime limit on gains qualifying for capital gains tax (CGT) entrepreneurs' relief is kept at £10 million as is the 10% rate of CGT for such gains.

- For individuals, the rate of CGT remains at 18% where total taxable gains and income are less than the basic rate limit (£32,010). The 28% rate applies to gains (or any parts of gains) above this limit. For trustees and personal representatives of deceased persons, the rate of CGT remains at 28%.

Budget announcements

(a) Annual exemption

The annual exempt amount of £10,900 for 2013/14 was actually announced in the Budget.

(b) Capital gains tax and employee shareholder status

As announced in the Autumn Statement the Government will exempt gains up to £50,000 on shares acquired by an "employee shareholder" under their employee shareholder agreement (the so-called "employee shareholder" shares).

(c) Capital gains tax on residential property

It has been confirmed that CGT will be payable at 28% by certain non-natural (broadly companies, partnerships, collective investment schemes) persons who dispose of UK residential property valued at over £2 million, which is subject to the Annual Tax on Enveloped Dwellings (ATED).

INHERITANCE TAX

(i) The inheritance tax (IHT) nil rate band will remain at its current level of £325,000 for tax year 2013/14.

(ii) The IHT exempt amount which can be transferred from a UK domiciled spouse to a spouse or civil partner domiciled outside the UK (or treated as such for IHT purposes) will be increased to £325,000 from its current level of £55,000. Furthermore, from 6 April 2013 a non-UK domiciled spouse can elect to be treated as UK domiciled for IHT purposes.

Budget announcements

(a) Freezing the nil rate band

The nil rate band is frozen at £325,000 until 2017/18.

(b) Limiting the deduction for liabilities – anti- avoidance

Legislation will be introduced in Finance Bill 2013 to tighten the IHT provisions which allow a deduction from the value of an estate for liabilities owed by the deceased on death. This is an apparent response to avoidance schemes and arrangements which exploit the current rules that allow a deduction regardless of whether or not the liabilities are paid after death, or how the borrowed funds have been used.

Broadly, IHT is payable on the net value of a deceased's estate after deducting any taxes, liabilities and reliefs. In respect of a liability, the deduction is given for the full value and not for the amount of the liability that is actually repaid. Therefore, for example if an individual had an outstanding liability of £100,000, yet on his death his estate can only repay £80,000, under the current rules the full amount of the liability of £100,000 would still be deducted in determining the taxable estate.

The new legislation will introduce restrictions in the way in which a deduction for a liability will be allowed in the following circumstances:

- A deduction for a liability will only be allowed to the extent that it is actually repaid to the creditor – unless there is a commercial reason for not repaying the liability i.e. the reason it has not been repaid is not to avoid tax.

- A deduction for a liability will not be allowed to the extent that it has been incurred – either directly or indirectly - to acquire property which would not be chargeable to IHT i.e. excluded property for the purposes of IHT.

- If the liability is incurred to acquire assets on which relief, such as business property relief (BPR), would be otherwise available, the liability will reduce the value of those assets which can qualify for relief, therefore reducing the amount on which BPR will be available. This is because the deduction for the loan will be matched against the assets acquired and relief will be restricted to the net value of the assets – any excess liability will, however, be allowable as a deduction against the estate. Currently an individual could benefit from a double reduction on the estate, i.e. the amount of the loan itself and the amount which qualifies for 100% BPR.

These rules will also apply to settled property with the exception that it will not be possible to deduct debts for the purposes of the ten-year anniversary charge.

The measure will have effect for deaths and chargeable transfers occurring on or after the day the 2013 Finance Bill receives Royal Assent.

(c) Exit and periodic charges

The Government announced that it would shortly publish a response to the July 2012 consultation on simplifying the IHT periodic charge and exit charge on relevant property trusts, which it did on 22 March. However, as announced in the Budget no firm conclusions have been reached and the Government will consult further on this with a view to introducing legislation in the Finance Bill 2014.

SAVINGS AND INVESTMENTS

(a) Individual Savings Accounts (ISAs)

For tax year 2013/14 the maximum contribution for all investments into ISAs has been raised to £11,520 (of which up to £5,760 may be in cash).

Budget announcements

- Consultation is under way to extend ISA eligibility to include small company shares e.g. Alternative Investment Market (AIM) shares.

- The Government will consult on options for transferring savings held in Child Trust Funds into Junior ISAs with a view to incorporating details in the 2014 Finance Act.

(b) VCTs and EISs

Budget announcement

No new changes were proposed.

(c) The seed enterprise investment scheme (SEIS)

Budget announcement

The Chancellor announced that he would extend to 2013/14 the CGT exemption on reinvesting gains in SEIS shares, provided the gains are reinvested in 2013/114 or the following tax year. The extension of the relief will be limited to half the qualifying reinvested amount.

(d) Alternative investment market (AIM)

Budget announcement

Following consultation, the Government will abolish stamp tax on shares in companies quoted on growth markets such as the AIM and the ISDX Growth Market from April 2014. The legislation confirming this is to be included in the 2014 Finance Act.

(e) Other investment-related Budget announcements

- *Offshore funds*

Regulations will be introduced to close an avoidance loophole in relation to the operation of offshore funds to ensure that investors in offshore reporting funds are taxed on the correct proportionate share of income.

- *Withholding tax rules on interest distributions from bond funds*

The Government will consult on a proposal to remove the requirement to withhold tax on interest distributions on UK domiciled bond funds when sold via reputable intermediaries and marketed only to non-UK investors.

LIFE POLICYHOLDER TAXATION

Legislation in force from 6 April 2013 will:

- Restrict the amount of premiums that can be paid in any 12 month period to qualifying policies – see out June 2012 Bulletin for details.

- Change some of the rules that apply to time-apportionment relief – see our August 2012 Bulletin for details.

Budget announcement

No new changes were proposed

BUSINESS TAX

Financial year commencing 1 April 2013

The rates of corporation tax will be as follows:

- The small profits rate of corporation tax for companies with profits of up to £300,000 remains at 20%.
- The main rate of corporation tax for companies with profits of more than £1,500,000 will be reduced to 23%.
- For profits of between £300,001 and £1,500,000 marginal rate relief applies. This operates to increase the overall rate of tax on the profits to somewhere between the small profits rate of 20% and the main rate of 23%. Profits in excess of £300,000 up to £1,500,000 will effectively bear tax at the marginal rate of 23.75%.

Budget announcements

(a) The main rate of corporation tax

The main rate is to fall to 20% from 1 April 2015.

(b) The single rate of corporation tax

The small profits rate and the main rate of corporation tax will be unified from 1 April 2015 at 20%. This means (from 1 April 2015) that there will no longer be any need for marginal relief or the calculation of the "effective marginal rate" on profits between £300,001 and £1,500,000.

(c) Corporate deductions for employee share acquisitions

Legislation will be introduced in Finance Bill 2013 to clarify the rules that govern the corporation tax (CT) deductions available where companies grant share options or award shares to their employees.

(d) Loans from close companies to their participators

Arrangements have sought to use perceived loopholes in the legislation by making loans and other payments to participators via intermediaries, such as Limited Liability Partnerships (LLPs), partnerships and trusts, in which the close company and at least one participator in the close company are members, partners or trustees.

Legislation will be introduced in Finance Bill 2013 to apply a tax charge to any loans from close companies to participators made via partnerships (including LLPs) in which the close company and at least one partner/member is a participator (or associate of a participator). There will be appropriate exceptions and relief from the charge. Similar provisions will apply to certain trustees.

Where there is an extraction of value from a close company and the value is transferred to a participator, there will be a 25% tax charge on the close company on the amount of the payment to the participator. There will be exceptions to the charge, and relief if the value transferred is returned to the close company.

Other arrangements seek to prevent the tax charge becoming due and payable with a repayment of the loan before the end of the nine month period which is very shortly followed by a withdrawal of a 'new' loan on similar terms. In this connection the rules will be amended to deny this tax relief, subject to de minimis limits, where repayments and re-drawings are made within a short period of time of each other, or there are arrangements (or there is an intention) to make further chargeable payments at the time the repayment is made (and there are subsequent re-drawings).

PENSIONS

Most of the pension announcements in the 2013 Budget (e.g. reduction in the annual and lifetime allowance from 2014/15, the abolition of the 'family pension' loophole and the change to the maximum capped drawdown income) had already been made either in the 2012 Autumn statement or in the draft clauses of the Finance Bill 2013.

However, the following two new announcements were made regarding:

- The Government's request to the Government Actuary's Department (GAD) to review the pension drawdown table and its underlying assumptions to ensure that they continue to reflect the annuity market.

- The Government's exploration with interested parties on whether the conversion of unused space in commercial properties in high streets and town centres to residential use could be encouraged by amending the Investment Regulated Pensions Schemes rules. The Treasury said any amendments "would need to be consistent with sound public finances and the Government's wider pensions strategy." It will be interesting to see whether SIPPs and SSASs will be able to invest in such residential property without triggering the taxable property rules. The likelihood is that schemes will have to sell their residential property after conversion and that this is not a green light to the much-hyped pre-A Day idea of a buy-to-let SIPP.

A revised Tax Information and Impact Note on the 2014/15 changes to the annual and lifetime allowances was also issued alongside the Budget. This provided the following new information:

- An individual, who elected for enhanced and/or primary protection but did not have any protected cash (i.e. his cash entitlement as at 5 April 2006 was £375,000 or less), will be able to take a PCLS of up to 25% of £1.5 million.

- An individual with primary protection will be given an underpinned lifetime allowance of £1.5 million, to ensure that their benefits are not reduced when the lifetime allowance is reduced to £1.25 million from 2014/15. This looks an extremely odd proposed change as individuals with primary protection were given an 'underpinned lifetime allowance' of £1.8 million when the lifetime allowance was reduced from £1.8 million to £1.5 million in 2012/13. It therefore seems that their benefits are being reduced.

No information has yet been provided on how the reduction in the standard lifetime allowance will impact on the calculation of scheme specific protected cash.

The Finance (No.2) Bill 2013 was issued on 28 March 2013 and includes the following pension clauses:

11. Exemption from income tax of contributions to pension schemes. This change removes the loophole in respect of 'family pension' arrangements from 6 April 2013.

46. Lifetime allowance charge – power to amend the 2012 fixed protection provisions. This new power will be used to help ensure that individuals do not lose 2012 fixed protection in circumstances outside their control.

47. Lifetime allowance charge 2014/15 onwards. This covers the reduction in the lifetime allowance to £1.25 million from 2014/15 and is accompanied by Schedule 21 which provides further details regarding transitional protection in respect of this change, including the 2014 fixed protection.

48. Annual allowance 2014/15 onwards. This covers the reduction of the annual allowance to £40,000 from 2014/15.

49. Capped drawdown pensions. This sets out the changes relating to the increase in the maximum capped drawdown income from 100% to 120% of the relevant annuity from the first drawdown year commencing on or after 26 March 2013. The changes are as previously announced except that HMRC had previously indicated that where an individual, subject to a five year review period under the transitional provisions set out in the Finance Act 2011, transfers their drawdown benefits to another drawdown provider in a drawdown year that ends on or after 26 March 2013, there will be no change to their maximum income, nor to their five year review period. The Finance (No.2) Bill now indicates that that this will apply in respect of drawdown years ending on or after *25 March* rather than the 26 March as previously indicated.

50. Bridging pensions. This will enable a registered pension scheme to continue to pay a bridging pension until a member's State Pension Age, whereas currently a bridging pension has to be reduced by age 65.

51. Consequential amendments as a result of DC contracting out. The pensions tax legislation in the Finance Act 2004 is being amended to remove any references no longer required as a result of the end of DC contracting out.

52. Overseas pension schemes: general. The changes enable HMRC to require overseas pension schemes to provide information which is necessary to ensure the proper operation of the legislation relating to QROPS. In addition there are some new rules about when a pension scheme may be excluded from being a QROPS.

53. Overseas pension schemes: information and inspection powers. The changes enable HMRC to require overseas pension schemes to provide information which is necessary to ensure the proper operation of the legislation relating to QROPS. In addition there are some new rules about when a pension scheme may be excluded from being a QROPS.

CAPITAL ALLOWANCES

With effect from 1 January 2013, for a period of 2 years, the Annual Investment Allowance was increased from £25,000 to £250,000. Otherwise there were no changes.

CHARITIES

From April 2013 certain charities that receive small donations of £10 or less will be able to apply for a Gift Aid-style repayment without the need to obtain Gift Aid declarations for those donations. The amount of small donations on which the new repayment can be claimed will be capped at £5,000 per year, per charity.

PROPERTY TAX

Budget announcements

(a) Stamp duty land tax (SDLT)

The Chancellor announced that legislation would be introduced to close down two specific SDLT avoidance schemes, which abuse the transfer of rights (or 'subsale') rules contained in section 45 Finance Act 2005 and are used particularly, but not exclusively, for residential properties. The new legislation, which will apply retrospectively to 21 March 2012, puts beyond doubt HMRC's view that the schemes do not produce the tax result claimed.

(b) Annual tax on enveloped dwellings (previously known as the annual residential property tax)

Other than a change of name (from Annual Residential Property Tax (or ARPT) to Annual Tax on Enveloped Dwellings (or ATED)), there were no significant changes to what was already known about the package of taxes targeted at high value residential properties held by non-natural persons which apply from April 2013.

TAX AVOIDANCE

Budget announcements

(a) Targeted anti-avoidance proposals:

Action has been proposed in respect of:

- Loans to participators (see corporation tax)

- SDLT avoidance (see property tax)

- IHT avoidance (see inheritance tax)

(b) Tax avoidance and evasion

Publication: Levelling the tax playing field: compliance report – March 2013

Avoidance:

The Government has confirmed its campaign against avoidance this year will incorporate consultation on measures to target high-risk promoters of tax avoidance schemes, the introduction of further specific "loophole closing" measures through targeted anti-avoidance provisions and the introduction of the (all important) GAAR. The compliance report emphasises the importance of a "joined up" approach to ensure that the maximum impact is achieved.

Evasion:

Through a mixture of targeted task forces, publicity and technology, significant effort has been poured into stemming evasion – a substantial contributor to the "Tax Gap" (the difference between the tax due and the tax collected estimated by HMRC in 2011/12 as £32 bn). There is very special focus on offshore evasion.

DOMICILE AND RESIDENCE

From April 2013 the statutory definition of tax residence and abolition of ordinary residence will apply for most tax purposes.

Budget announcement

Overseas workday relief will be made available to any non-domiciled individual who arrives in the UK following a period during which they have been non-resident for at least three tax years.

INCOME WITHDRAWAL RATE FOR APRIL 2013

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in April 2013 is 2.5%.

As usual, the contents of this Bulletin are based solely on the proposals put forward by the Chancellor in his March 2013 Budget and need to be approached with caution as details may change during the passage of the Finance Bill through Parliament.