

Issue: Pre-Budget Report

A window of opportunity



With the budget deficit for 2009/10 predicted to rise even further to £178bn, there will surely be significant tax rises after the next election. The Pre-Budget Report (PBR) did little to lift the lid on these, with the only significant tax rise being National Insurance. Until the political battle has been fought and won, there is now a window of opportunity to organise your affairs to limit future tax increases.

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Further National Insurance rises

In April 2011, all National Insurance Contributions (NIC) were due to rise by 0.5%. The rise has now been increased to 1%. This will see employee contributions rise to 12%, employers contributions rise to 13.8% and self-employed rates rise to 9%.

The additional charge, payable by employees and the self-employed on earnings/profits above the upper limit (currently £43,875), will now rise to 2%.

Measures will be introduced to compensate those earning less than £20,000 for these rate increases.

NIC is another form of income tax as it applies to all earnings/profits and will have a significant effect on the net income of the working population. Employers are faced with a double whammy, as they have to bear the cost of these rises on the pay of their employees, plus their own remuneration.

Take action before April 2010

With the rises in NIC from 2011, the 50% top rate of income tax from 2010 and the potential for capital gains tax to rise above 18%, it has never been more important to plan your affairs. The next Budget in March 2010, and potentially a second Budget after the election, could see more tax rises so you should be taking action now. The key issues to address before April 2010:

- Lock in capital gains at the current 18% rate.
- Secure Entrepreneur's Relief at the effective 10% capital gains tax rate.
- Wind up investment companies.
- Bring forward future years' income to avoid the 50% income tax rate.
- Strip out surplus profits from your business.
- Reorganise your affairs with your spouse to limit income taxed at 50%.

Also covered:

- Bonus super tax
- Tackle the "tax gap"
- Changing pensions
- SME news
- Going green
- Round up

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“Super tax” on bank bonuses

It was no surprise that the much coveted super tax on bank bonuses materialised in the PBR. Under the rules, which take effect immediately, a 50% levy will be imposed on banks where bonuses are paid to employees exceeding £25,000. The charge only applies to bonuses awarded prior to 5 April 2010, with the Bank Payroll Tax payable by the Bank on 31 August 2010.

The new rules appear relatively wide in application. In particular, the definition of a ‘Bank’ includes building societies, as well as various other organisations regulated under the Financial Services and Markets Act 2000. The rules also anticipate various methods that might be applied to try and circumvent the rules and therefore, also target non-monetary payments, payments made through intermediaries, deferred bonus agreements and loans.

The super tax is not tax deductible for the bank. Their employees will be subject to income tax and NIC charges in the normal way.

Anti-avoidance: tackling the “tax gap”

It was notable that the Chancellor refrained from imposing swinging tax increases, which were widely expected to be a pre-requisite to addressing the massive fiscal deficit. Whilst many believe that the bad news has simply been deferred for now, it is notable that HMRC sought to release a document entitled ‘Protecting Tax Revenues 2009’ at the same time.

This document notes that the Government has set HMRC an ‘ambitious target’ to reduce tax losses by £7bn over the period from 2007-2008 to 2010-2011. It also estimates that the ‘tax gap’ arising from tax errors, evasion and criminal attacks in 2007-2008 was around £40 billion, or 8% of the total tax that should have been collected. Furthermore, it estimates that 35% of the tax gap is driven by avoidance and evasion.

In response to this, the PBR notes further measures to tackle avoidance. These include rules to punish those who fail to disclose offshore liabilities with penalties of up to 200% of the unpaid tax, and a new requirement for those opening bank accounts in certain offshore jurisdictions to notify HMRC, or face further penalties.

With HMRC’s current offshore disclosure facility extended to 4 January 2010, and HMRC likely to receive account details from another 308 banks shortly, time is running out to own up and benefit from a more lenient treatment.

All change for pensions...AGAIN!

The 2009 Budget announced a restriction on higher rate tax relief for individuals earning over £150,000, taking effect from 6 April 2011. To avoid a flood of contributions prior to that date, ‘anti-forestalling rules’ were enacted from 22 April 2009. These rules impose a ‘special’ tax charge where individuals with an annual income of more than £150,000 in the current or past two years change their normal pattern of contributions.

The changes announced in the PBR tighten the rules even further. Firstly, they reduce the £150,000 threshold to £130,000 for the purpose of the anti-forestalling provisions, bringing many more taxpayers into the regime. Secondly, they extend the definition of ‘income’ for the rules applying after 6 April 2011 to include Employer pension contributions, but only where an individual earns £130,000 or more.

EXAMPLE

Before the PBR where an employer made a one-off £30,000 pension contribution for an individual earning £130,000, the special tax charge did not apply. However, under the new rules, if the contribution is made after 9 December 2009, a one-off income tax charge of 20% will now apply on the excess of contributions over the available Special Annual Allowance of £20,000, i.e. a tax charge of £2,000.

It is more important than ever that employers, as well as individuals, understand the implications of the new rules on pension contributions, which are already in operation. In particular, a one-off contribution by an employer can create an unexpected income tax charge for an employee who may not necessarily be considered a high earner.



Mixed news for small businesses

For small businesses, the PBR appears to be a bit of a mixed bag. On the plus side, the Chancellor has introduced various measures to assist struggling businesses and promote innovation. However, these are somewhat overshadowed by the impact of the 1% increase in NIC from April 2011.

To assist small business, the planned 1% rise in the Small Company rate of Corporation Tax to 22% in April has been deferred for another year. In addition, HMRC has extended its Business Payment Support Service to enable viable businesses, which face financial difficulties, to spread their tax payments out over an agreed period. Empty Property Relief has also been extended for a further year, removing the requirement to pay business rates on vacant commercial property with rateable values up to £18,000.

On the innovation front, R&D tax credits have been extended to cover expenditure where the company does not actually own the intellectual property. This enables qualifying businesses to claim a 175% or 150% corporation tax deduction for R&D expenditure or claim cash back where the company is making losses. In addition, from April 2013, income derived from patents will be taxed at a reduced corporation tax rate of 10%.

As expected, the VAT rate will return to 17.5% on 1 January 2010 (apart from those few who are open past midnight!) and at the same time the flat rate scheme rates will be adjusted into line.

Going green

This year's PBR includes several measures to encourage us to go green. Changes to the company cars tax rules will extend the current car tax bands down to include a new 10% band, which will apply to emissions of up to 99g/km. It is worth remembering that there are some desirable cars within this emission band, including the BMW 118 diesel.

Another upshot of the changes, is that electric cars and vans will become tax free benefits from April 2010. In addition to this, electric vans will attract a 100% first year allowance for businesses, resulting in them being a very tax efficient investment!

For home owners, a new boiler scrappage scheme will provide a £400 incentive to help up to 125,000 households upgrade old inefficient boilers to the latest energy efficient models. Furthermore, anyone earning income from electricity generated for their own use could have this paid tax free, provided they meet certain conditions.

Round up of the rest

- The current personal allowances and income tax bands are already set to remain unchanged from 2009/10 to 2010/11. For 2012/13, the higher rate threshold (the point at which someone starts to pay higher rate tax) will be frozen at the 2011/12 amount. The personal allowance will still increase but the basic rate band will reduce.
- The government has made small changes to the tax rules governing EIS, VCT and EMI as a consequence of negotiations with the EU, to ensure the continued availability of these venture capital reliefs.
- The planned rise in the Inheritance tax threshold from £325,000 to £350,000 will now not take place.
- The increased stamp duty land tax exemption for residential property acquisitions up to £175,000 will come to an end on 31 December 2009 as planned. From 2010, only acquisitions up to a value of £125,000 will be exempt from stamp duty land tax.
- If you run a furnished holiday letting business, you are entitled to generous tax reliefs as if you were a trading business. From April 2010 these special rules are being removed and your letting will be treated as an investment rather than a trade. This will lead to higher capital taxes and no offset of income losses.

For more information on these or any other tax-related topics, please do not hesitate to contact us.

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