



Budget Alert 2010

The speech

Sometimes you can learn a lot from a little. Ever since the Election campaign, the Conservatives have been promising an “Emergency Budget”, which carries overtones of a nation in crisis and the need to take urgent and drastic action. In the Budget itself, the Chancellor provided us with his sound bite of this being the “Unavoidable Budget” – the explicit message being that his proposals represent the only way forward, but with an equally clear subtext of “don’t blame me – it’s not my fault”.

The Budget itself set out sweeping reductions to benefits (up to £11 billion a year), VAT increases of £13 billion a year (which equates to an increase in VAT of around £425 a year for an average household), and spending cuts averaging 25% for most departments of central government over the life of this Parliament.

As the preamble to the Treasury’s Budget Notes puts it:

“Today the Chancellor of the Exchequer George Osborne has set out his Budget with a comprehensive five-year plan to rebuild the British economy. The plan sets out tough but fair action to tackle the unprecedented budget deficit, introduce a fairer tax system, encourage enterprise and support long-term growth across the economy.”

So, no pressure there, then!

The real test will be in seeing how well the Coalition holds together in the face of an anticipated five years of combining benefit cuts that go against the grain for many Liberal Democrats, and tax rises that conflict with the fundamental philosophy and beliefs of many Conservatives. The Chancellor has made a bold start, but it remains to be seen whether the reality will match the rhetoric, and whether it proves as easy to achieve savings in public spending as it is to announce them.

Capital Gains Tax (CGT)

The major announcement in the Budget was, of course, that from June 23 there will be two headline rates of CGT.

The rate of CGT remains unchanged at 18% for anyone whose net taxable income and gains in a year is less than the upper rate limit of the basic income tax band (£37,400 for 2010/11). For higher rate taxpayers, trustees and personal representatives, the rate will increase to 28% for all gains made from midnight today.

Gains arising before June 23 will not be taken into account when determining the rate at which an individual’s gains after June 23 will be charged, ensuring that the new rates are applied fairly, but adding to the headache of anyone preparing a tax return.

These changes result from steering a middle course between the pressures from the Left and Right. They will result in additional tax being payable by many investors, but not at the punitive rates we feared could apply. The Chancellor commented in the Budget that the Treasury had projected that any further increase in rates would result in a decline in tax yield, and this feels right: a tax charge of 28% is still low enough to make investing for capital growth attractive, even though it is no longer as tax efficient as previously.

A complete reversal of attitude to utilising capital losses and the annual exemption was another welcome announcement. Taxpayers will be able to deduct losses and the annual exemption in whatever way minimises the tax due, softening the blow of the increase in rate part way through the year for the less wealthy, who have been unable to take advantage of pre Budget planning ideas.

Entrepreneurs' relief

The Chancellor has increased the lifetime limit for gains qualifying for the 10% entrepreneurs' rate of CGT. From June 23, the first £5 million of gains on the sale of qualifying business assets will be charged at 10%, rather than the current limit of £2 million. Where individuals or trustees have already made business gains of more than the current limit, they will receive a new "pot" of £3 million to set against future qualifying gains.

It is good news that the limit for business gains has been increased, but disappointing that there is no sign of a loosening in the definition of a business asset. It seems particularly harsh that many employees who acquire shares in their employer will still not benefit from entrepreneur's relief and now will have to pay CGT at the new rate of 28%.

VAT

The other significant change is, of course, the increase in VAT – to 20% from January 4, 2011. An alternative – or an addition – to the Chancellor's decision to raise VAT across the board would have been to introduce a significantly higher rate of VAT on 'luxury goods' such as expensive cars and designer clothes and handbags. This approach has been adopted in other EU countries, and would have shifted more of the burden onto those who can more easily afford to pay. However, he decided to go for a simple increase, and although this has many disadvantages, such as its inflationary effect, it compares favourably with NIC as the best way to get the largest increase in revenues with the smallest effort.

Pensions

The provisions restricting higher rate tax relief on pension contributions are currently due to come into force on April 6, 2011. It was announced today that the Government wishes to repeal this legislation, and that they will do so soon, but not until they have decided how to replace it. Mr Osborne announced that his intention was to retain the tax take at £3.5 billion, but he has obviously listened to the concerns of the pension industry with regard to the administrative complications that the proposed provisions will introduce. Interested parties will be consulted first, but it appears likely that annual contribution limits will be restricted to between £30,000 and £45,000 and lifetime contribution limits may also be scaled back.

The existing anti-forestalling legislation applying to the current and previous tax year will unfortunately remain in effect.

There was a much hoped-for announcement that the requirement to purchase an annuity by age 75 would be removed from April 6, 2011. A transitional concession appears to apply to those reaching 75 between the Emergency Budget and April 6, 2011, so that they will not be obliged to buy an annuity. However, as a minor note of caution, the Budget Note is very opaque, and we will need to see the draft legislation before the actual effect of the proposals becomes completely clear.

Anti-avoidance

Unusually, this Budget does not contain a long list of anti-avoidance measures. However, it does have some very interesting things to say about the new Government's philosophy.

The first point that leaps out from a reading of the Notes accompanying the Budget is that the Government intends to take a more strategic approach to dealing with tax avoidance, in order to try to avoid ever increasing complexity and constantly rewritten tax legislation. This "grown-up" approach to countering avoidance is very much to be welcomed if it means that taxpayers are able to rely on the law as it is written, rather than on HMRC interpretation and shifting practice.

The second significant comment on anti-avoidance is the intention to undertake a review of the use of a "general anti-avoidance rule" or GAAR. This is a concept which the Liberal Democrats proposed in their election manifesto and in some ways is a logical extension of the first statement, but it is hard to greet with as much enthusiasm. A GAAR is likely to work by providing that any transaction intended to produce a tax benefit will have that benefit reversed. Unless the legislation also includes provisions to enable taxpayers to get HMRC clearance in advance that a specific proposed transaction will not be caught, a GAAR can lead to huge uncertainty. If clearances are funded by the taxpayer having to pay to make an application, it will also favour the better off over the less wealthy, creating a new source of tax inequality at the very time that the Chancellor is publicly claiming to be reducing this.

There are no specific anti-avoidance announcements that will immediately impact individual taxpayers, but the Government has announced its intention to introduce additional anti-avoidance legislation from April 6, 2011. This will be designed to counter schemes that avoid or defer tax and national insurance contributions on employment income, employment related securities and pensions contributions through the use of trusts and other vehicles. The new legislation will affect certain employer funded retirement benefit schemes ("EFRBS") but it is not clear what else will be affected – for example, employee benefit trusts are not mentioned.

Income Tax

There were no surprises sprung in relation to income tax rates and allowances, with the only real change being the anticipated £1,000 increase in personal allowances to £7,475 for 2011/12. As this was a Lib-Dem policy to help the poorest in society, it is not surprising that the amount of income taxed at the basic rate has also been reduced to minimise the benefit to higher rate tax payers. The change will make no difference to anyone with an income of more than £100,000, and will result in tax savings of £200 for most other taxpayers.

Taxation of non-doms

The Treasury's statement on its latest thinking on the taxation of non-doms is worth quoting in full:

"The Chancellor has announced that the Government will review the taxation of non-domiciled individuals. This reiterates a statement made previously in the Coalition Agreement."

So now we know!

Corporation Tax

One area where taxes are not set to rise is the corporate world. In order to make the UK appear more internationally attractive, the main rate of corporation tax will be reduced by 1% a year from April 2011, reaching 24% from April 2014. The tax rate for small companies will also be reduced - from 21% to 20% from April 2011 - but the limit above which the full benefit of this rate is lost will not be increased from £300,000, the same level as when Labour took power in 1997. When taken together with the extension of the period over which capital allowances are given that will take effect from April 2012, the headline reductions in corporate tax rates are not quite as generous as they initially appear!

Furnished Holiday Lets

The Chancellor has confirmed that the favourable tax regime for furnished holiday lets, which has included qualifying lettings throughout the EEA since April 2009, will not be withdrawn from April 6, 2010 and will apply for the 2010/11 tax year. This means that proprietors can continue to set losses from holiday lets against other income for tax purposes.

The Government will undertake a public consultation over the summer to look at toughening the rules for relief, and how losses can be used after April 2011.

Bank Levy

The details of exactly how the new bank levy will be calculated have not yet been released, but from what we know so far they look likely to leave the tax departments of UK banks reaching for the aspirin when working them out. In outline, the levy (which is estimated to raise £2 billion a year when fully operational) will apply from January 1, 2011, and will be calculated as a percentage of each bank's balance sheet.

Cleverly, the Chancellor was able to announce that both France and Germany have agreed today to introduce a similar levy, thus reducing the risk of foreign banks moving to more fiscally friendly jurisdictions in Europe.

Trust income

The settlor of a trust is sometimes liable to pay tax on the trust's income. If his marginal tax rate is lower (eg 40%) than that suffered by the trustees (50%), he will be entitled to a tax refund. As announced by the previous Government, the settlor will, from April 6, 2010, be required to pay this refund back to the trust. Previously, he was able to keep it. The good news, however, is that the reimbursement is not treated as a taxable event for inheritance tax purposes!

Alcohol duties

There was good news for cider drinkers around the country – the 10% above inflation increase in cider duty announced in the March 2010 Budget has been reversed so that the increase in cider duty now matches that on other alcohol. The reversal will be effective from June 30, 2010 so postpone your cider drinking for a few more days.

There have been no extra rises in fuel, alcohol and tobacco duty.

Aviation duty

The Coalition had already announced its plans to replace the current per-passenger duty on air travel with a new per-plane duty, which is intended to target airlines that operate inefficient, half-empty, flights. However, no date has yet been announced for this, and today's Budget merely reiterates that changes will follow at a later stage.

EIS and VCT

There will be minor changes to EIS and VCT schemes to bring them into line with EC guidelines on state aid. As announced in the March Budget, there will also be a significant change to the proportion of qualifying investments that VCTs can hold, although the date from which this will bite has not yet been confirmed. New VCTs must hold at least 70% of these (up from 30%). This will significantly increase the volatility of many VCT investments, and is likely to make them much less attractive to investors.

ISAs

The ISA allowance increased to £10,200 from April 6, 2010. From April 2011, the allowance will increase annually in line with the RPI.

UK Real Estate Investment Trusts

As previously announced in the March Budget, changes to REIT legislation will allow profits to be distributed as stock dividends in place of cash dividends. The stock dividends will be taxed as property income.

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