

Budget Alert 2009

Widely hailed as a make or break budget for the Chancellor, today's speech was one of the shortest in recent years, lasting for only about 50 minutes. It included all the anticipated bad news about the economy – delivered as quickly as possible – and very little good news for anyone. Those with higher incomes have, perhaps not unexpectedly, been particularly hard hit. In a move calculated to put pressure on the Tories, Alastair Darling has accelerated to next April and increased to 50% the tax rate on earnings over £150,000.

This will accentuate the differential between investment gains that are liable to capital gains tax (18%), and those liable to income tax (up to 50%), and may have an artificial impact on investment decisions.

As a targeted group, non-UK domiciles have escaped further attack, but does a 50% top tax rate, combined with a loss of personal allowances and an immediate reduction in relief for pension contributions, make Switzerland look even more attractive?

As usual, much of the Chancellor's speech highlighted the give-aways, albeit minimal, as compared with coverage of the tax increases, but the detailed press releases contain little extra bad news. For once, most of it was announced in Parliament itself!

Income tax rates and personal allowances

An additional income tax rate of 50% has been introduced for those with taxable income, other than dividend income, of more than £150,000. The new tax rate will come into effect from April 6, 2010. In addition, personal allowances will be reduced by £1 for every £2 of income above £100,000. These rates replace those announced in the Pre-Budget Report in November, and represent a significant hike in tax rates for wealthier individuals.

From April 6, 2010, there will also be an additional higher rate of tax for dividend income. Dividend income received by those with income of more than £150,000 will be taxed at a new rate of 42.5%.

Discretionary trusts will be particularly hard hit by the rate increases, as they will be liable to the new 50% on all trust income above the standard rate band (currently £1,000). This will include Will trusts and both onshore and offshore trusts (UK source only). Beneficiaries of life interest trusts are liable to tax on their income entitlement at their personal rates.

NIC rates and thresholds

It was announced in November's Pre-Budget Report that employers' and employees' NICs will be increased by 0.5% from April 6, 2011. These proposals remain unchanged.

Pensions changes

In a significant move, the Chancellor has changed the way in which tax relief will be given on pension contributions by the higher paid. For those who make contributions greater than £20,000 per annum, their tax relief will effectively be halved.

The Chancellor indicated that the restrictions would be introduced from 2009/10 onwards. However the background documents reveal that they effectively bite from today in an unusual procedure called "anti-forestalling".

As from April 22, higher rate tax relief will be restricted on pension contributions made by those:

- Whose income is £150k or higher, and
- Who change their normal ongoing regular pensions savings, and
- Whose total pension savings exceed £20k

There are extensive detailed provisions defining what qualify as 'normal ongoing regular pensions savings'. Significantly, savings cannot be regular unless they have been made on at least a quarterly basis. This will hit the self-employed who typically contribute on an annual basis when they have determined their profits and also those who make contributions out of their annual bonus.

By way of a minor, perhaps slightly ironic, change, the maximum amount on which tax relief can be claimed (called the annual allowance), will be increased to £245,000 for 2009/10 and £255,000 for 2010/11.

These restrictions on tax relief are likely to discourage the higher paid from contributing to their pensions. Not only will they have to use (partially) tax paid income to contribute to a pension scheme, but they will also be taxed when they receive their pensions. In the short term this move may increase tax revenues and boost spending, but in the longer term it is likely to increase reliance on the state pension, which is already under considerable pressure.

Tax avoidance

The Chancellor announced that tax of £1 billion has been “rescued” for the Treasury each year by blocking various avoidance schemes. He also announced that blocking further schemes, plus changes to alcohol and tobacco duties, will save a further £3 billion a year by 2011/12. It is very difficult to untangle from the figures how much of this saving will come from the 2% inflation based increases in duty, compared to actual savings from blocking fraud and avoidance!

Most anti-avoidance measures confirmed today apply to companies and will be of no relevance to individuals. However, it will no longer be possible to sell the right to receive future income in order to pay CGT at 18% rather than income tax at up to 50%. Artificially created losses on insurance policies will not be available to set against other investment income, and arrangements intended to avoid a tax charge on the occupation of company property by employees are being blocked.

Two measures that have previously been announced stand out as being particularly significant. The first of these is the removal of interest relief on loans taken out to invest in a business, where the investor is almost guaranteed to make either a commercial profit, or, if not, to receive tax relief greater than his original investment, leaving him in profit either way.

The second measure relates to artificially generated employment losses. In a highly unusual step, confirmed in the Budget, HMRC later published retrospective amendments so that planning that was perfectly legal and effective when it was undertaken will fail because of later changes in the law. If this precedent is accepted, it will be possible for HMRC to change the law after the event whenever it wishes, throwing the whole UK tax system into a chaos of uncertainty. It is very disappointing that the Budget has not taken any notice of the protests against this most unwelcome move, and it is inevitable that there will be challenges through the courts if HMRC does not back down.

Tax evasion

HMRC have announced that there will be a second tax amnesty (or “New Disclosure Opportunity” in Government speak) for individuals with undeclared offshore income. The amnesty will run until March 2010 and will be combined with steps by HMRC to obtain offshore account details from all major banks.

Deliberate tax evaders are to be “named and shamed” where they have understated tax of more than £25,000. This measure is intended to encourage cooperation and voluntary disclosure of undeclared tax, because doing so will avoid publicity for the offender. This sounds like a good idea in theory, but we do wonder whether individuals who are willing to break the law by deliberately evading tax are going to be put off by the threat that, if caught, their names will be published on an obscure HMRC website.

Non-UK domicile: the remittance basis

The Finance Act 2008 introduced significant changes to the remittance basis of taxation for UK resident but non-domiciled individuals. Following consultation with professional bodies, a number of amendments have now been made to “clarify matters”.

A number of exemptions allow property purchased using relevant foreign income to be remitted to the UK without a tax charge. However, relevant foreign income does not include foreign employment income or foreign gains. In a welcome move, this error has been corrected, backdated to April 6, 2008.

HMRC has confirmed that no formal claim is required for the remittance basis where unremitted foreign income and gains are less than £2,000, or where an individual has less than £100 of income and gains in the UK and makes no remittances.

We are told that further legislation will be introduced to clarify the interaction of the remittance basis of taxation and offshore trusts, but at this stage HMRC has not explained what will be involved.

There have also been relatively minor amendments and clarifications to issues such as claiming Gift Aid, remitting assets that form part of a set, and some statutory definitions. Such ‘clarifications’ now seem to form an inevitable part of all substantial new tax legislation: the law as originally enacted often feels like a rough draft rather than the finished article.

Investments

To encourage investment in EIS companies, HMRC has extended the limits for carry back relief, allowing investors to carry back the full amount invested to the previous tax year. EIS companies and VCTs have also been given longer to use the funds they raise.

Dividends

Changes have been announced to the way in which individuals with a substantial shareholding are taxed on dividends from non-UK companies and offshore funds. Since April 6, 2008, only shareholders with an interest of less than 10% in an offshore company received a 10% tax credit on dividends. Investors in offshore funds were not entitled to any dividend tax credit.

From today, investors in offshore funds and those owning more than 10% of non-UK companies will be able to claim the 10% dividend tax credit, provided there is a double taxation agreement between the UK and the company’s country of residence.

ISAs

For those aged 50 and over, the ISA limit will rise on October 6, 2009 to £10,200, of which £5,100 can be cash. This will be extended to all investors from April 6, 2010.

Child Trust Funds (CTFs)

Alistair Darling has announced that the Government will contribute additional annual payments of £100 into Child Trust Funds of children with disabilities (£200 if the disability is particularly severe) to help with the additional financial needs arising from "their transition to adulthood". Children born before September 1, 2002 are not entitled to anything.

Stamp duty land tax

The stamp duty land tax exemption on acquisitions of residential property of up to £175,000, announced by the Chancellor in September 2008, will be extended to December 31, 2009. From January 1, 2010, the basic SDLT threshold will return to £125,000. It is likely that this will result in a boost to the housing market later in the year, with a downturn in the new year.

It is a shame that the Government did not take the opportunity to replace the SDLT bands with a stepped system. The current approach makes no real sense and distorts the market significantly, SDLT on a house sold for £250,001 is £5,000 more than on a house sold for £2 less.

VAT

The Chancellor has confirmed that the temporary reduction in the rate of VAT to 15% will continue until December 31, 2009. As announced and from January 1, 2010, the rate will revert to 17.5%.

Furnished holiday lettings

Legislation is to be introduced to align the tax treatment of income from furnished holiday lets in the UK and those elsewhere in the European Economic Area (EEA). Landlords of furnished holiday accommodation in the UK are currently treated as if they are trading for certain tax purposes resulting in the availability of certain reliefs and beneficial tax treatment.

These rules only apply to income from furnished holiday property in the UK. As the difference in the tax treatment is not compliant with European law, they are to be repealed from 2010/11. Until then the current rules will be extended to apply to furnished holiday accommodation anywhere in the EEA.

Technical amendments

Chargeable gains and offshore funds

There have been some technical amendments to the way in which some offshore funds are taxed, which should make life simpler for a small number of UK investors. There has been an announcement about the long awaited amendments to the offshore fund taxation regime, which will take effect from December 1, 2009, the details still remain unclear at this stage.

Alternative finance investment bonds

A helpful piece of legislation will be introduced for those wishing to obtain finance by issuing Alternative Finance Investment Bonds (AFIBs) using land assets as securities under the arrangements. AFIBs include sukuk or Islamic bonds, but can also refer to other financial instruments with similar characteristics. The effect of the new rules will be to remove stamp duty charges that can currently apply to AFIBs and that make them expensive to execute.

Extension of agricultural property/woodlands relief

Agricultural property relief (APR) reduces the IHT value of agricultural property in the British Isles by either 50% or 100%. Capital gains on the gift of agricultural property can be held over, avoiding an immediate tax charge.

The Finance Bill 2009 will now extend both types of relief to agricultural property or woodlands situated anywhere in the EEA.

Non-UK residents and personal allowances

Individuals who are non-UK resident, but who claim UK personal allowances and reliefs as Commonwealth citizens, have fallen foul of the Human Rights Act. As from April 6, 2010, they will no longer be entitled to claim such allowances unless they also qualify on other grounds.

Tax overpayments

Currently, individuals and companies can only reclaim overpaid tax from previous years if the overpayment was the result of a mistake in a tax return. The Finance Bill 2009 will lift this restriction and increase the circumstances in which a taxpayer may reclaim overpaid tax.

HMRC payments, repayments and debt

HMRC has taken account of the current economic climate and is looking to bring in changes to the way in which tax is collected, including managed payment plans for taxpayers struggling to pay tax on time, and requirements for third parties to disclose address details of tax debtors with whom HMRC has lost contact.

Business tax

From today, all businesses will be able to carry trading losses back against profits of earlier years in order to get a tax repayment. The measure will apply to losses arising in 2008/09 and 2009/10. Loss carry back will be extended to a period of up to three years, with a maximum of £50,000 allowed to be carried back to the earlier two years.

Enhanced first year capital allowances

In order to help businesses, an enhanced capital allowance of 40% has been introduced from April 2009 for new expenditure. At this stage no time limit or maximum amount has been mentioned.

Vehicle scrappage scheme

The Chancellor has allocated £300m to be spent on a temporary scheme to fund a £2,000 discount for owners of vehicles more than ten years old to purchase a new car. We wonder whether new car prices will rise by approximately £2,000 in the weeks running up to the launch of the scheme, and whether anyone wishing to take up this offer who does not have the cash to purchase a new car outright will be able to get credit to do so.

Further tax simplification

There is to be a further stage in what is called tax 'simplification'. We wait with baited breath to find out how many more pages of new legislation this will introduce!

HMRC charter

HMRC is committed to introducing a charter this year, setting out "standards of behaviour and values to which HMRC will aspire in dealing with taxpayers and others". This is the first time such a charter has been a statutory requirement, and it will be interesting to see what effect, if any, this rather vaguely worded undertaking has.

Louise Somerset

RBC International Wealth Planning
+44 (0)1242 548 448
louise.somerset@rbc.com

Andrew Robins

RBC International Wealth Planning
+44 (0) 1242 548 403
andrew.s.robins@rbc.com

Rachel de Souza

RBC International Wealth Planning
+44 (0) 20 7029 7756
rachel.desouza@rbc.com

www.rbcwminternational.com



This publication has been issued by RBC International Wealth Planning.

RBC International Wealth Planning is the trading name of RBC Wealth Planning International Limited. Registered Office: La Motte Chambers, St Helier, Jersey, Channel Islands, JE1 1PB, registered company number FC023283

The summary contained herein has been carefully prepared based upon information that is believed to be accurate at the time of writing and is intended for general guidance only. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the authors. On any specific matter you are advised to take professional advice.