



# Budget Newsletter June 2010





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George Osborne has delivered his first budget speech to the nation this afternoon promising to deliver a fair economy which rewards work and enterprise. The scale of the budget deficit however has meant that most of the headline grabbing items have been tax rises.

The main giveaways have been to basic rate tax payers with income tax thresholds rising by £1,000 and for companies which will see the main rate of corporation tax fall by 4% by 2014.

In order to fund these measures however a number of items have been altered which will have a large impact on everyone, VAT will increase to 20% from 4 January 2011, and there will be major reform of the way tax credits operate. The expected rises in Capital Gains Tax and abolition of Annual Investment Allowance have not turned out to be as bad as expected, with Capital Gains Tax for higher rate tax payers increased to 28% on non business assets and Annual Investment Allowances for plant and machinery reduced to £25,000.

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### VAT rate to increase to 20%

The standard rate of VAT will increase to 20% from 4 January 2011. This will affect all businesses which sell to the general public, or which cannot reclaim their own VAT.

The chancellor did not announce any plans to charge VAT on items which are currently VAT free, such as children's clothing, some food items and books.

Once we get closer to the year end, there will be scope to raise invoices early, or take advance deposits so as to charge VAT at 17.5% on sales which will take place after 4 January 2011. However, advice should be taken before following this course of action, as anti-avoidance rules exist which may make such planning ineffective.



## Capital Gains Tax

The Chancellor decided not to link the Capital Gains Tax (CGT) rates to the Income Tax rates as had been predicted, however, he did announce an increased 28% rate on disposals made by higher rate tax payers from midnight tonight (22 June 2010).

Gains made before this announcement will continue to be taxed at 18% and where more than one disposal is made in the current tax year, the annual exemption, which will not be increased, can be set against later gains which are subject to tax at the higher rate.

Net gains (after the annual exemption) made from 23 June 2010 will be added to taxable income for 2010/2011 to determine the rate(s) of CGT payable (earlier gains are not included in the calculation). Those gains falling within the basic rate band will be taxed at 18% and the remainder at 28%.

As part of his measures to reward Entrepreneurs, the lifetime limit for gains was increased to £5 million and any gains which qualify for entrepreneurs' relief will continue to be taxed at 10%. These measures will also take place from midnight on 22 June 2010.

Qualifying gains made pre 22 June 2010 will be subject to the £2 million limit and have an effective tax rate of 10%, however, after this date there will be no 4/9 reduction of the gain and a flat CGT rate of 10% will apply to the gain.

Where qualifying gains have been made before 22 June 2010 which have exceeded the previous £2 million limit, no additional relief will be allowed on the excess. If however, further gains are made on or after 23 June 2010 a further £3 million relief can be claimed on these gains to give relief up to the new limit of £5million.

When determining the rate(s) of CGT payable, gains qualifying for entrepreneurs' relief are set against any unused basic rate band before any non-qualifying gains.



## Corporation Tax

The main rate of corporation tax is to be reduced to 24% by 2014, which will be the lowest rate it has ever been. The change is to be phased in over the next 4 years, with the current rate of 28% being reduced by 1% per annum.

The small companies rate of tax (which broadly applies to companies with profits of less than £300,000 per annum) is to be reduced by 1% to 20% with effect from April 2011.

Company structures continue to be a very tax efficient vehicle, with the new corporation tax rates of 20% and 24% being significantly lower than the 28% CGT and 50% income tax rates that apply to individuals.

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## Capital Allowances – Reduction in rates and Annual Investment Allowance

Contrary to some media reports, the total removal of the Annual Investment Allowance (AIA) did not come to fruition. However, with effect from April 2012 there will be a significant cut to the annual investment limit which will be reduced from £100,000 to £25,000.

In addition to this, there will be a reduction in the writing down allowance on qualifying capital assets for accounting periods ending on or after 1 April 2012 (for companies) and 6 April 2012 (for businesses). The current rates vary dependent on the type of asset that is acquired, with the current rate for plant and machinery being 20%, and special assets being 10%. Special assets are in most circumstances long life assets, integral features and cars with CO2 emissions of more than 160 g/km.

The classification of assets into the differing pools will remain the same, however the rate applied against the 20% pool will be reduced to 18% and the rate applied against the 10% pool will be reduced to 8%.

The government have indicated that a hybrid rate will be calculated and applied in circumstances where a business year end spans the implementation date. Therefore, a company with a year end of 30 September 2012, will use a rate of either 19% (being 6 months at 20% and 6 months at 18%) for plant and machinery, or 9% (being 6 months at 10% and 6 months at 8%) for the special assets.

The somewhat delayed introduction date of the new rates and reduction of the AIA could invite businesses to acquire qualifying capital assets before April 2012, to ensure that they receive relief for their expenditure sooner rather than later against their profits.



It is important to note that the reduction in rates is not a withdrawal of what can be claimed by a business, but simply a delay in the period to which a business receives relief against its profits for the total cost incurred.

## Main Changes to Child & Working Tax Credits

Several changes have been announced with regard to the current Child and Working Tax Credits system. Listed below are some of the main amendments:

### Reduction in tax credits for higher earners

The government will reduce tax credit eligibility for families with household income above £40,000 by reducing the family element threshold from £50,000 to £40,000 from April 2011. The Government will increase both withdrawal rates to calculate the reduction to payments above the income thresholds to 41% (previously 39%)

### Reduction to the income disregard for increases in income

Tax credits awards are based on the household income of the previous tax year. Currently a claimant only has their award recalculated if the income of the current turns out to be more than £25,000 higher than the previous year. When finalising the previous year's award any income increase below £25,000 is ignored. This £25,000 income disregard is going to reduce on 6 April 2011 from £25,000 to £10,000 and on 6 April 2013 from £10,000 to £5,000

### Introduction of a new income disregard for falls in income

From 6 April 2012 a new income disregard of £2,500 for falls in income will be introduced. This means that from 2012/13 any reduction in income in a tax year of less than £2,500 will have no impact on a tax credits award so no additional lump sum payments will be made where this is the case.



### **Reducing the backdating provision for new claims**

The backdating provisions for new tax credits claims will be shortened to one month with effect from 6 April 2012. A claim can currently be backdated for 3 months. This means that there will be lower lump sum backdated payments available to new claimants so it will be even more important to claim straight away if you think you are eligible.

### **Removal of the 50+ returning to work element**

Currently a claimant who is 50 or over and who has returned to work after receiving a qualifying out of work benefit for at least 6 months can qualify for the 50+ element of working tax credit. This only applies for the first 12 months of returning to work. From 6 April 2012 this element will be withdrawn

### **Working Tax Credits for the over 60s**

The government has confirmed that from 6 April 2011 people aged 60 and over will qualify for working tax credits if they work at least 16 hours per week and meet the income eligibility tests.

### **Removal of the baby addition element**

Currently a claimant is entitled to the baby addition of child tax credits for the first 12 months after the child is born. From 6 April 2011 this baby addition will be removed.

### **Child tax credits for those with children aged one or two**

The government has decided to reverse the decision announced in the March 2010 budget to increase the child tax credit element for those families with children aged one or two. This change will take effect from 6 April 2012.

### **Future payment rates**

The child element of child tax credits will increase in April 2011 by £150 and in April 2012 by £60 above indexation. Rates of tax credits and other benefits which are normally changed in line with the Retail Price Index (RPI) will instead be increased by the Consumer Price Index (CPI) from 2011/12 onwards. The current rate of child benefit has been frozen for three years until April 2014.



## Income Tax Personal Allowance Increase

The Budget announced a £1,000 increase in the personal allowance for those aged under 65. The new personal allowance level from 6 April 2011 will be £7,475.

The basic rate threshold will be reduced so that higher rate taxpayers will not benefit from the increase.

The exact figures of the income tax bands will be announced after the publication of the retail price index for September 2010.

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## National Insurance Rates

Legislation will be introduced to provide for the following National Insurance Contributions (NICs) changes for the tax year 2011-12:

- the alignment of the Upper Earnings/Profits Limit (UEL/UPL) with the higher rate tax threshold (the total of the personal allowance for those aged under 65 and the basic rate limit) will be maintained by reducing the UEL/UPL; and
- the secondary threshold, which is the point at which employers and employees start to pay Class 1 NICs, is to be increased by an extra £21 per week above indexation.

The planned increase of 1% on NIC rates will still be applied from April 2011 (12% and 2% employees NI, 13.8% employer's NI, 9% and 2% Class 4 NI).

The bands for 2011-12 will be announced after the publication of the retail price index for September 2010.



## Employer's National Insurance Contribution Holiday For New Businesses

A scheme is to be introduced to help new businesses in targeted areas of the UK. The scheme will last for three years.

Within the qualifying period, eligible employers will not have to pay the first £5,000 of Class 1 employer NICs due in the first twelve months of a person's employment. This will apply for each of the first 10 employees hired in the first year of business, and could save new businesses up to £50,000.

The countries and regions which will benefit will be Scotland, Wales, Northern Ireland, the North East, Yorkshire and the Humber, the North West, the East Midlands, the West Midlands and the South West.

Subject to meeting the necessary legal requirements, the scheme is intended to start no later than September 2010. Any new business set up from 22 June which meets the criteria will benefit from the scheme.

Full details of how the scheme will work and who is eligible to participate will be made available shortly.

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## Furnished Holiday Lettings

The Furnished Holiday Letting rules will not be withdrawn, as had been proposed by Labour.

However, over the summer, they will consult about plans to change the tax treatment of Furnished Holiday Lettings from April 2011.

They will look to increase the number of days that a property has to be let before it will qualify for the relief. At the moment a property has to be available for let for 140 days in a year and actually let for 70 days to qualify.

They will look at how loss relief is given – we expect that they will look at the tax deductibility of interest payments in arriving at a loss.

The rules will apply to properties in both the UK and the EEA (European Economic Area) – this has been the situation for the last couple of years, whereas previously the rules only applied to UK properties.



## Pensions Annual Allowance

The Labour Government had introduced legislation that would be effective from April 2011 to restrict the amount of higher rate tax relief individuals would receive on pension contributions. The rules are very complicated, and there has been a lot of lobbying to simplify the rules, whilst still achieving the objective of reducing the tax benefits to the very well off. The lobbying was ignored by the Labour Government in its March budget.

This Government has said that it has listened to the points put forward and will look into this further over the summer, with the objective of introducing replacement legislation that will have effect from April 2011.

The new simpler restrictions are likely to work by reducing the annual allowance for which higher rate tax relief on pension contributions can be made, from the current limit of £255,000 per annum to a much lower level of between £30,000 and £45,000 per annum. There is a lifetime limit of £1,800,000.

There will also be consideration given to how such restrictions will apply to those in defined benefit schemes, where there is no "annual contribution" as such from the employer.

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## Changes To Pensions – Requirement To Buy An Annuity

The Government will end the rule whereby a member of a pension scheme is under an obligation to buy an annuity at the age of 75. This requirement will end in April 2011 and there will be consultation on the details of the changes needed.

There will be transitional arrangements for those who are not yet 75 at the date of the budget, 22 June 2010, but will be 75 before the new rules come into place.

The transitional arrangements simply temporarily increase the age at which it is necessary to buy an annuity to age 77. The scheme member will not be subject to the strict maximum and minimum income withdrawals. This means that no one who is 75 in the meantime will be forced to buy an annuity, they can wait until the new changes are fully in place before making their pension decisions.

If they die after 22 June 2010 when they are aged over 75 and lump sum death benefits are paid out, then there will be a charge of 35% tax on the death benefits, but the specific IHT charges are withdrawn.



This 35% is lower than the 40% IHT rate of tax that would apply if the assets were in the individual's estate, provided that the estate assets exceed the nil rate band threshold.

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## Individual Savings Accounts

In the current tax year (2010/11) an individual can save up to £10,200 in an ISA, of which £5,100 can be saved in cash.

From 6 April 2011 onwards the annual subscription limits will be linked to the Retail Price Index (RPI), with any increase being in multiples of £120 to make it easier for monthly savers to work out their payments.

The limits will be calculated by reference to the RPI in the September before the beginning of each new tax year. If the RPI is negative then the annual subscription rate will remain unchanged.

If you have not already used your 2010/2011 ISA allowance and would like to discuss your investment strategy please contact our sister company Dodd Murray Ltd on 01228 522258 who will be pleased to help.

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## Company Consortium Relief

The government has refined the rules that allow Company Consortia to transfer tax losses to other members in the group, in proportion to their respective ownership interests.

It has been indicated that two measures will be introduced by the impending Finance Bill, which will firstly allow for companies that are established within the European Economic Area to be included in a Consortium and allow losses to be transferred from them to other members.

Secondly a further criteria will be added when considering the amount of losses that can be transferred. Currently the amount of loss that is calculated and available for transfer is based on the lower of:

- Percentage of share capital owned;
- Percentage of profits entitled to;
- Percentage of assets to which the company would be entitled to on winding up.



The Finance Bill will add a further element to establish the lower percentage, by looking at the percentage of voting rights that the consortium member holds.

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## Zero Emission Goods Vehicles

The government has introduced a 100% First Year allowance for businesses who incur capital expenditure on new and unused (not second hand) zero emission goods vehicles.

The relief will be available for 5 years, starting from 1 April 2010 for companies and 6 April 2010 of businesses.

To qualify, the vehicles must meet the following criteria:

The vehicle cannot under any circumstances produce CO<sub>2</sub> emissions when driven;

It is of a design primarily suited to the conveyance of goods or burden; and

The expenditure is incurred during the period noted above.

Importantly, such vehicles that are acquired under leasing agreements will not qualify for the above relief.

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## HMRC penalties and powers

Measures were introduced in the emergency budget which will see the completion of the reform of the penalties regime for the late filing of returns and late payment of tax for VAT, other indirect taxes and duties. This announcement requires changes to the internal systems of HMRC and the introduction of these measures will take place over a number of years.

The penalties for late filing of the returns will initially be flat rate amounts (for quarterly returns), but if the failures are prolonged then additional penalties of 5% of the tax on the return will also be levied. Deliberate withholding of a return will see a penalty of up to 100% of the tax shown on the return.

Where payments are late the penalty will be a percentage of the unpaid tax (but there will be no penalty for the first failure), rising with each failure in a penalty period to 5%.



## Tax Adjustments Between Settlers And Trustees

Where there is a settlor interested trust, the income of the trust may be taxed on the settlor. Where the rate of tax paid by the settlor is lower than the rate of tax paid by the trustees, the settlor will receive a tax refund, and the settlor is required to pay this tax refund back to the trustees of the settlor.

This addition of funds to the trust by the settlor could be seen as a further gift for inheritance tax purposes.

New legislation is to be introduced to disregard these payments into the trust by the settlor, for the purposes of inheritance tax. This change will be effective from 6 April 2010.

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## Changes to tax rules for qualifying carers

### Capital Gains Tax – Private Residence Relief – Adult Placement Carers

Private residence relief, which exempts any gains which arise on the sale of a home, is not available on any part of a home which has been used exclusively for business purposes.

Somebody in business as a foster carer, who cares for an adult under a local authority placement scheme, may be required to set aside rooms for the exclusive use of the adult they are caring for. This requirement has previously meant that some capital gains tax may be due on the ultimate disposal of the property. The Government will legislate in an upcoming Finance Bill for the private residence relief to be preserved if it is requirement in a carers contract for exclusive use rooms to be set aside.

Once legislated this will cover disposals made on or after 9 December 2009.

### Income Tax – Special Guardianship Orders

Income from providing care is normally taxed as business income and a simplified arrangement exists for certain carers whereby they are allowed to deduct a fixed amount per week from their income when calculating their taxable profits.

However, the government will legislate, in an upcoming Finance Bill, that from 6 April 2010 qualifying guardians will be exempt from income tax on any qualifying payments they receive.



A qualifying guardian is one who cares for one or more children placed with them under a special guardianship order or a residence order, where the individual is not the child's parent or step parent.

### **Income Tax Relief – Shared Lives Carers**

A shared life carer is somebody who provides accommodation, care and support for up to 3 individuals who have been placed with them under a local authority shared lives placement scheme.

An upcoming Finance Bill will provide qualifying shared lives carers with the same income tax relief as foster carers in that their receipts from providing care will be exempt from income tax if it falls under the tax free allowance. If it exceeds the allowance they will be able to choose to pay tax on their total receipts less the tax free allowance or their actual profits as computed using normal business rules.

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### **Increase in VAT flat rate percentages**

The increase in the VAT rate to 20% will mean increases in flat rate percentages for businesses which use the flat rate scheme. The new rates will need to be used from 4 January 2011, which will inconveniently fall within the middle of a VAT period. The new flat rate percentages are available on HMRC's website: [www.hmrc.gov.uk/budget2010/bn45.htm](http://www.hmrc.gov.uk/budget2010/bn45.htm).

The income threshold for businesses having to leave the scheme will increase from £225,000 to £230,000.

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### **Insurance premium tax increase**

The standard rate of insurance premium tax will increase from 5% to 6% for contracts entered into on or after 4 January 2011.

The higher rate of insurance premium tax, which applies to insurances such as travel insurance and extended warranties, will increase from 17.5% to 20% on the same date.



## REITs – Stock Dividends

REITs are Real Estate Investment Trusts. When an individual invests in a REIT then the tax consequences on the individual investor are the same as if he directly invested himself in the underlying property, the REIT is “looked through” for tax purposes.

This treatment is provided that the REIT distributes at least 90% of its profits each year.

Where a REIT makes a distribution by way of stock dividend, instead of cash, then this stock dividend has not counted as part of the 90% of profits distributed. With effect from 1 April 2010 then the stock dividend will count towards the 90% of profits required to be distributed.

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## PAYE Review

The Government is to carry out a consultation over the summer with employers and payroll providers, to see if there is a way to reduce costs in administering PAYE and to make the system easier for employers and HMRC.

They are looking to see if it is also possible to get more real time and frequent data from the system.

There was a report a few weeks ago that the Government were considering moving the operation of the PAYE system to the banks, so that the whole of the deductions were simply deducted from wages as they went through the banks. This is clearly very radical, and it will be interesting to see what comes from this review.

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## Time To Pay

Contrary to media speculation prior to the budget, it appears that the Government has not removed the Time To Pay facility that has been available to businesses over the past years. The Time to Pay facility was introduced by the prior government, and enabled business who were financially struggling to spread their tax liabilities over periods of up to 12 months.

Recent experiences by Dodd & Co have indicated the Revenue are reviewing applications with a lot more scrutiny, but as the relief has not been totally withdrawn, this is welcome news for businesses who are still struggling to meet tax demands during the current economic climate.



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