



Pre Budget Report

09 December 2009

PRE BUDGET NEWS 2009

Introduction

The Chancellor's pre-budget report today was very low key compared to what some were expecting after the hype in the press in recent weeks. The announcement that a new 50% supertax is to be imposed on the payment of bank bonuses in excess of £25,000 has sent a clear message to the banking sector to cut down on this bonus culture. For individuals and smaller businesses, the extra 0.5% increase in National Insurance rates from April 2011 will not be appreciated, and neither will the freeze to income tax allowances and thresholds which will be frozen at 2009/10 levels for the 2010/11 tax year. The VAT rate will however revert back to 17.5% from 1 January 2010 whereas many were expecting an increase to 20%. Maybe the VAT rate will go up after the election! There were some encouraging measures for smaller businesses especially those in difficulty, such as an extension of the successful time to pay arrangement for those struggling to pay their tax liabilities on time.

Tax Rates & Allowances

As announced in the previous year's pre-budget report, the tax allowances and thresholds for 2010/11 will remain the same as the current tax year and there will be a 50% rate of tax on those earning in excess of £150,000.

National Insurance

In addition to the 0.5% increase to Class 1 and 4 contributions that was previously announced to take effect from 2011/12, the Chancellor announced a further increase of 0.5%. This increase will also take effect from 6 April 2011. The impact of the latest change, will however only be felt by those who earn over £20,000. This is because the primary threshold/lower profits limit for the year have been increased so that a higher level of income is needed before you come within the National Insurance regime.

Bank Payroll Tax

As widely expected, a new tax will be introduced specifically targeted at bonuses that are paid to "bankers" (broadly speaking, employees working for banks, building societies and similar financial businesses).

The new 50% payroll tax will have a relatively short shelf-life, as it will only apply until 5 April 2010.

The level at which the tax will start to bite is perhaps somewhat surprising, as it will apply to any bonus that exceeds £25,000 per individual (irrespective of the level of income of the individual). The individual will not actually suffer this new tax, as it will be the employer who will be subject to the charge.

The employer will have to pay the 50% tax to HMRC on 31 August 2010 and there is a small sting in the tail in the sense that the payment will not be allowable for corporation tax purposes (which is in contrast to normal payroll PAYE and NIC payments). However, this point is perhaps somewhat academic given that many banks will not be paying corporation tax in 2010 (in view of the significant losses that they have incurred in 2008 and which can be carried forward and set against future profits).

The new rules are widely drawn in the sense that not only will they apply to bonuses that are paid in the form of cash and shares, but also bonus payments that are paid by way of “loans” (which is a tax planning strategy that is sometimes used to avoid PAYE and NIC liabilities).

Corporation Tax

Corporation tax rates will remain at their current levels for 2010, which are:

21% - for profits up to £300,000

29.75% - for profits in excess of £300,000

28% - for profits in excess of £1,500,000

The above 21% tax rate is to be increased to 22% from 1 April 2011.

These rates are not only low in comparison to other G7 countries, but are very low when compared to personal income tax rates (29% differential when compared to the new 50% personal tax rate that applies from 6 April 2010). Hence, we expect to see limited company structures becoming increasingly used as a tax planning tool to reduce the overall tax burden on individuals and businesses.

A new 10% tax rate will apply to companies in relation to any profits that are derived from patents (but this new low rate of tax will not be introduced until April 2013).

The government has indicated that it is going to review the capital gains rules for corporate groups, with a view to simplifying the rules.

The chancellor also announced that the “time to pay” initiative, whereby individuals and businesses can agree with HMRC to defer their tax payments by up to 12 months, will continue into next year. Many of our clients have taken advantage of this scheme and they will be pleased to hear that their tax payments in 2010 can now also be deferred, which will help with their cash flow planning.

Company Cars & Vans - Taxable Benefits

The Chancellor has again announced reduced benefits in kind for employees who are provided with environmentally friendly vehicles. With effect from 6 April 2010, the taxable value of benefits for electric vans and vehicles will be reduced to nil, and will remain at that rate for the following 5 years to 5 April 2015.

However, from April 2012, the base rate of CO2 emissions will be reduced by a further 5 g/km and an introduction on a new sliding scale which starts at 99 g/km. This will therefore mean that

employees will have an increased benefit in kind when compared to their current 2010 and 2011 taxable benefit.

The effect of this will be the withdrawal of the current 10% flat rate percentage for vehicles with CO2 emissions of less than 120 g/km.

The Chancellor has also increased the fuel benefit charge on vehicles and vans that are provided for private use by employers. With effect from 6 April 2010, the annual base figure on which the charge for the provision of fuel on cars is calculated will increase from £16,900 to £18,000, while the flat rate fuel charge for vans will increase from £500 to £550.

Capital Allowances On Vans

The government have introduced a new 100% First Year Allowance on the acquisition cost of new and unused (no second hand) electric vans. This allowance can be claimed after the application of a business' £50,000 Annual Investment Allowance.

However, it has been noted that this relief is subject to scrutiny from the EU and will therefore need further approval at that level.

Tax Relief On Pension Contributions

In the April 2009 Budget the Chancellor announced that from April 2011 he would restrict the tax relief on pension contributions to basic rate for those individuals who earned in excess of £150,000 p.a.

To prevent "forestalling" by individuals deciding to make very large pension contributions in advance of the change, tax relief is restricted for 2009/10 and 2010/11 on any irregular pension contribution made by a high earner.

For these "forestalling" rules to apply it was necessary to have income over £150,000 in the relevant tax year or either of the 2 preceding tax years.

It was not clear whether EMPLOYER pension contributions had to be taken into account when determining whether someone was a higher earner. To look at an extreme example, was it possible for someone who earned only £100,000 p.a. to have their employer make a special contribution of £100,000 (total income over £150,000) and not be caught?

The Pre Budget Report has introduced changes to make it clear that from 6 April 2011, when the new rules are fully in place, employers' pension contributions are taken into account in determining whether the income of an individual is £150,000 or over.

However, a floor is to be provided so that if the person's income without the employer's pension contribution is below £130,000, then they will not be caught.

So this will mean in our extreme example they will not be caught, as their income without the employer pension contribution is below £130,000. But if someone has an income of £140,000

before an employer pension contribution and an employer pension contribution of £25,000 then they will now be caught.

HMRC have issued draft legislation, on which we have based the above comments, and they have also issued guidance.

Separately the PBR includes changes to the anti-forestalling rules.

Now, with effect from 9 December 2009, the anti-forestalling rules will apply to individuals with income over £130,000 in 2009/10 or 2010/11, or in either of the 2 preceding years.

The income is calculated ignoring employers' pension contributions, and so the £130,000 limit is simply a lowering of the limit for these years. That means that anyone who has income over £130,000 is limited to contributions of between £20,000 and £30,000, depending on their circumstances and regularity of contributions.

Inheritance Tax

Inheritance Tax is payable on the value of an estate at date of death that exceeds the nil rate band threshold, at a rate of 40%. The nil rate band threshold for 2010/11 was due to rise to £350,000 – this had been announced in the 2007 budget.

The Chancellor has said that the current economic climate does not permit this increase and so the threshold for 2010/11 will be the same as for the current year 2009/10, which is £325,000.

Husbands and wives can transfer any amount of the nil rate band that is unused after the death of the first of them to die to the survivor, so that on the death of the second of them it is possible to have the benefit of 2 nil rate bands. This would currently give a maximum of £650,000 on the second death, if no nil rate band is used on the first death.

This applies to married couples and civil partners – but not co-habitees. To get the benefit of this it is necessary to get married!

VAT Rate Change

The VAT rate will return to 17.5% on 1 January 2010.

However, it may still possible to charge VAT at 15% on work to be done or goods to be sold in 2010. This may be advantageous for businesses which sell to customers who are not registered for VAT, such as members of the public or charities. For further information on how this can be achieved contact Faye Armstrong.

The increase in the VAT rate will also mean that:

Motor vehicle scale charges will increase, and

Flat rate scheme percentages will increase

There will be a temporary extension of the 15% VAT rate for businesses such as restaurants and bars which are open at midnight on 31 December. These businesses will be able to use the 15% VAT rate until 6am on 1 January 2010 or until they close on new year's morning, whichever is earlier.

VAT Flat Rate Scheme

All flat rate percentages, other than that for computer repair services, are to increase from 1 January 2010. The new rates can be found on <http://www.hmrc.gov.uk/pbr2009/pbrn33.pdf>.

Any businesses which find that the new flat rate will result in higher VAT bills than would be the case under the normal VAT scheme are free to leave the flat rate scheme, and HMRC are to be sympathetic to applications to withdraw retrospectively.

Furnished Holiday Lettings

Current legislation provides some valuable tax reliefs for people who own furnished holiday lettings (FHL), as long as certain conditions are met.

The favourable treatment means that they are entitled to more flexible loss relief, additional capital allowances, certain capital gains reliefs and the income is classed as relevant earnings for pension purposes.

From 6 April 2010 the FHL rules will be withdrawn and instead they will be taxed under the normal rules for property businesses.

Any FHL losses brought forward as at 6 April 2010 which have not been relieved as at that date will be available to reduce profits from the property business of the 2010/2011 tax year or future years.

The FHL business will cease to be treated as a business as at 6 April 2010 for capital gains tax purposes. If the FHL property is sold any period prior to 6 April 2010 where the qualifying conditions are met will be deemed to be a business asset whereas any periods after this date will not qualify for the business asset status. This change affects the availability of certain capital gains tax reliefs such as business asset roll-over relief, reliefs for gifts of business assets and entrepreneurs' relief.

If any expenditure is incurred after 6 April 2010 on acquiring plant and machinery for use within the FHL it will no longer be possible to claim capital allowances on the acquisition cost. Instead those letting FHL will be entitled to claim a 10% deduction per annum for wear and tear of the plant and machinery within the property. If however items were purchased prior to 6 April 2010 then capital allowances may continue to be claimed in the normal way and existing plant and machinery pools will simply continue.

The changes do not affect the VAT treatment. FHL businesses will still need to charge VAT at the standard rate if its income is above the VAT registration threshold.

The Inheritance Tax (IHT) rules are not affected by the change. IHT business property relief (BPR) applies only to non-investment businesses where the conditions of the relief are satisfied. The tax authorities believe that the short term letting of furnished holiday accommodation is primarily an investment activity and resist claims for relief from Inheritance Tax. The actual position however depends on the facts of the case. Speak to your normal contact at Dodd & Co for a review of your position.

Working Tax Credits For The Over 65s

There has been a significant change to the number of hours an individual aged 65 and over needs to work to qualify for working tax credits.

From 6 April 2011, people aged 65 and over will qualify for working tax credits if they work at least 16 hours a week.

Currently, those aged 65 and over qualify for working tax credits if:

They work 30 hours or more a week; or

They work 16 hours or more a week and they have dependent children, or qualify for the disability element, or

They work 16 hours or more and they are returning to work after being on certain benefits for 6 months or more (only available to the over 50s)

Reducing the required number of weekly hours worked from 30 hours to 16 hours, which forms the majority of cases, should mean that more part time workers aged 65 and over are now eligible for working tax credits. This will be a welcome announcement for people reducing the number of hours worked after reaching their 65th birthday as tax credits will help their cash flow if they have a relatively low income.

Other Changes to the Tax Credits System

From 6 April 2010:

The child element in the Child Tax Credit award will increase to £2,300 per year, from £2,235 per year in 2009/10.

The disabled elements of Child Tax Credit will increase by 1.5%

The elements of the Working Tax Credit (except the childcare element) will increase by 1.5%

Maximum amounts for child care, family and baby element for Child Tax Credit and the income disregard remain unchanged

The income threshold for those receiving child tax credit only rises to £16,190

Stamp Duty Land Tax

The SDLT holiday for residential properties to the value of £175,000 will end on 31 December 2009. After that date any properties sold which have a value of over £125,000 will be liable to a charge to Stamp Duty Land Tax.

The Chancellor also announced the introduction anti-avoidance measures which require the disclosure if schemes are being used to avoid SDLT.

Time To Pay

On a positive note, the government announced in last year's pre budget report the introduction of the Time To Pay arrangements, which enabled businesses to spread their tax liabilities over extended periods to ease their cash flow demands. This was welcomed by many businesses throughout the country, and has eased the cash flow position of business owners during the economic downturn experienced over the past year. The government have seen the positive benefits of the arrangements and have advised that this scheme will continue for "as long it is needed" for UK individuals and businesses.

Insurance Premium Tax

Legislation is to be introduced to stop insurers avoiding insurance premium tax by charging a separate administration fee in addition to the insurance premium.

The change will affect insurers who issue a separate contract for services which would either:

Normally be provided as part of main insurance contract, or

Be expected or required to be taken out alongside the main insurance contract.

If either of these conditions apply, the fee for the administration contract will be liable to insurance premium tax as well as the insurance premium itself.

Shared Lives & Adult Placement Schemes

Income tax and capital gains tax changes have been announced for those who provide, in their own home, accommodation, care and support under a local authority "Shared Lives" or "Adult Placement" scheme.

Shared Lives – income tax changes

There will be a new tax free allowance similar to the current Foster Care Relief. Earnings under the Shared Lives scheme will be exempt from income tax if they are below the new allowance, which will be as follows from 6 April 2010:

£10,000 fixed amount per tax year

£200 per week per placement under 11 years old

£250 per week per placement over 11 years old

Where earnings exceed these limits, the carer can choose to pay tax either on:

total receipts less the tax free allowance, or

actual profits using normal rules for calculating business profits

Where Foster Care Relief is also claimed the household is only entitled to one £10,000 exemption.

The new rules will replace the current simplified arrangements for Shared Lives care providers, in which a fixed rate of expenses is claimed. The simplified arrangements remain until the change takes effect in April 2010.

Adult Placement – capital gains tax changes

Individuals who set aside part of their house exclusively for use under a local authority adult placement scheme will benefit from confirmation that when their house is sold principal private residence relief for capital gains tax purposes will be available, even though part of the home has been used for a business. The relief will apply to houses disposed of from 9 December 2009 onwards. Under current legislation where part of the home is used exclusively for business purposes private residence relief is restricted. Carers may have a contract with the local authority which requires part of the home to be set aside. However, the new measures to be included in the Finance Bill 2010 remove the restriction to the capital gains tax relief available.



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