Deloitte.

Prosper Newsflash
If it counts, it's covered

22 June 2010

Contents

"The capital gains tax changes were not as bad as had been feared but future increases have not been ruled out."

Paula Higgleton,
Head of Deloitte PCS

For detailed coverage and comment on the Budget visit **www.ukbudget.com**.

Introduction

As widely anticipated the current favourable rate of capital gains has been increased for higher rate taxpayers, albeit the marked increase in the limit for entrepreneurs' relief to £5 million is welcomed. The proposed increase in capital gains tax rates as from midnight of Budget day came as surprise to many.

The staged reduction in the mainstream rate of corporation tax to 24% over the course of the lifetime of this parliament, and the surprise reduction in the small companies' rate to 20%, is likely to prove very popular, as will be moves to take low earners out of the income tax net. Whilst some of the changes announced have been raised in consultation documents issued some time earlier, others, such as the increase in VAT to 20%, were widely anticipated in the media.

Our commentary on the Budget statement in March this year indicated that the proposed tax changes should be seen as a work in progress. Against a backdrop of fiscal tightening and budgetary cuts, the same could be said about the announcements made by the Chancellor in the light of his ambitious proposals to reduce public borrowing. High net worth taxpayers should review their tax affairs with this in mind.

1. Capital gains tax

Legislation will introduce a new 28% rate of capital gains tax (CGT) which will apply to higher rate and certain other taxpayers. However, the lifetime limit on gains qualifying for entrepreneurs' relief will increase to £5 million from £2 million. Entrepreneurs' relief results in qualifying gains up to the lifetime limit being taxed at a rate of 10%.

For gains not covered by entrepreneurs' relief, individuals will continue to pay CGT at 18% where their total taxable income and gains are below the upper limit of the income tax basic rate band (£37,400 for 2010/11). Gains will be calculated as before, net of available capital losses and the annual exemption. The new 28% rate applies to gains above that limit. Trustees and personal representatives of deceased persons will pay CGT at a flat rate of 28% as will all individuals who pay the remittance basis charge, regardless of the level of their taxable income or gains. The new measures will apply to disposals on and after 23 June 2010.

Whilst a rise in the rate of CGT for higher rate taxpayers was expected, it has not been aligned with the rate of income tax as first anticipated. However, a further increase has not been ruled out for 2011/12. The increase in the lifetime limit on gains qualifying for entrepreneurs' relief will no doubt come as welcome news for many taxpayers.

2. Personal allowances and National Insurance

The personal allowance for those aged under 65 will increase by £1,000 to £7,475. There will be a reduction in the basic rate limit of £2,500 (although this may change when the final figures are released in due course) to prevent higher rate taxpayers from benefiting from the increased personal allowance.

The secondary threshold (ie the point at which employers start to pay Class 1 National Insurance) will increase by an additional £21 per week above indexation. The change to the secondary threshold is in addition to the increase in the primary (employee) threshold already planned for 2011/12 and the previously announced 1% increase in National Insurance rates.

The upper earnings/ profits limit will maintain alignment with the income tax higher rate threshold. This is expected to involve a reduction in the upper earnings/profits limit by £1,650 (the exact amount will be confirmed after the release of September's retail price index).

Whilst the reduction in the basic rate limit will mean that higher rate taxpayers will pay additional income tax of up to £500, the changes in the National Insurance thresholds will partly alleviate this cost at the lower levels.

3. VAT increase

The standard rate of VAT will increase from 17.5% to 20%. Anti-forestalling legislation will also be introduced.

Zero-rated supplies (eg children's clothing, basic food items and books), exempt supplies (eg health and education) and supplies subject to the 5% reduced rate (eg domestic fuel and power) will not be affected by the change.

The new 20% VAT rate will apply to any supply made on or after 4 January 2011 and any acquisition or importation that takes place on or after 4 January 2011.

4. Furnished holiday lettings

The previous government had stated that the furnished holiday lettings rules would be withdrawn with effect from 6 April 2010. It has been announced today that this change will now not take place.

The measure affects individuals, partnerships, trustees and companies who let furnished holiday accommodation situated within the UK or anywhere else within the European Economic Area, and who are liable to UK tax on the income and capital gains from the property.

The beneficial rules will continue to apply during the tax year ended 5 April 2011 in the same way as they previously applied. However, the government is considering introducing changes to the rules with effect from 6

April 2011. This might include increasing the number of days that qualifying properties have to be available and actually let as commercial holiday letting.

5. Pensions : removal of compulsory annuitisation

The government has confirmed that (following adverse feedback) from 6 April 2011 it will end the effective requirement to convert an individual's pension fund to an income at the age of 75. Interim changes come into effect tonight for all those about to turn 75: the stricter minimum and maximum limits on income withdrawal will be deferred to age 77 instead of the current age 75. The new rules will be finalised next year.

6. Pensions tax : restricting higher rate relief

The government intends to do away with the previous government's proposals to restrict higher rate tax relief for those with incomes over £150,000. It is considering a simpler regime which caps the annual allowance at between £30,000 and £45,000, subject to discussion with interested parties. The anti-forestalling measures for 2009/10 and 2010/11 will not be disturbed.

The annual allowance limits the pension savings that can be made by or on behalf of an individual, with tax relief at the individual's highest marginal rate. Pension savings in excess of this amount attract an annual allowance charge, currently of 40%.

The government will also consult on other measures to alleviate some of the harsher aspects of such a restriction on those with variable earnings and members of final salary schemes.

7. Individual Savings Account limits

From 6 April 2011 the Individual Savings Account (ISA) limits (currently £10,200, of which £5,100 can be in cash) will be increased annually in line with the retail prices index (RPI). The limits will be calculated by reference to the RPI for the September before the start of the tax year. The new limits will be announced in advance of the start of each new tax year. If the RPI is negative, the ISA limit will remain unchanged. As is the case currently, the cash ISA limit will be half the value of the stocks and shares ISA limit.

8. Bank levy

The Chancellor announced that a bank levy, intended to encourage banks to move to less risky funding profiles, will be introduced with effect from 1 January 2011. The levy will be based on banks' balance sheets and it is proposed that the levy will be set at a rate of 0.07%, with a lower initial rate of 0.04% in 2011.

The levy will apply to the following entities, whose relevant liabilities (subject to certain exclusions) amount to £20 billion or more:

- UK banking groups and building societies;
- foreign banks and banking groups operating in the UK; and
- UK banks in non-banking groups.

The levy will not be deductible for corporation tax purposes and there will be anti-avoidance provisions to prevent avoidance of the levy. The government will consult over the summer, with final details of the levy being published later this year, following the consultation.

The government has also announced that it will explore the costs and benefits of a Financial Activities Tax, on profits and remuneration, working with international partners to secure agreement.

9. Corporation tax rates

The Chancellor announced reductions in both the main rate and small companies' rate of corporation tax. The current main rate of corporation tax of 28% will be reduced to 24% over the course of four years. The main rate will be reduced to 27% in 2011/12, reducing by a further 1% per annum, to 26% in 2012/13, 25% in 2013/14 and 24% in 2014/15.

The Budget reduces the small companies' rate of corporation tax from 21% to 20% from April 2011. This reduction replaces a planned increase in the rate to 22%, as announced in the 2007 Budget and deferred to 2011/12 in the 2009 Pre-Budget Report.

10. Capital allowances

The main rate of writing down allowances for expenditure on plant and machinery will be reduced from 20% to 18% per annum and from 10% to 8% per annum for expenditure allocated to the special rate pool (eg long life assets).

The reduced rates will apply from 1 April 2012 for businesses within the charge to corporation tax and from 6 April 2012 for businesses within the charge to income tax.

The maximum annual investment allowance will be reduced from £100,000 to £25,000. The £100,000 limit was only introduced in April 2010.

11. Enterprise Management Incentive

This measure confirms the announcement made in the Budget in March 2010 regarding changing the current requirement that a company granting qualifying Enterprise Management Incentive (EMI) options to its employees must operate "wholly or mainly" in the UK. The criteria are to be relaxed with the company granting the EMI options now being required to have instead a "permanent establishment" in the UK. The change will have effect in respect of EMI options granted on or after the date that the legislation receives Royal Assent.

12. Venture capital schemes

Changes are to be made to the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) schemes. The measures are to be introduced in a Finance Bill as soon as possible after the summer recess. These changes are necessary in order to ensure that the schemes satisfy the European Commission rules concerning state aid.

In order to qualify for relief there was a requirement that a VCT's ordinary shares were included in the UK Official List. In future shares listed on any EU regulated market will qualify. The new rules will also increase the requirement as regards 'eligible shares' from a minimum of 30% to 70%. The definition of such shares will also change to include shares with preferential rights to receive dividends.

In the case of both EIS and VCTs new rules will be introduced to exclude investments in companies which would be classed as an 'enterprise in difficulty' under European Commission rules. In addition, under current rules there must be a qualifying trade which is carried on wholly or mainly in the UK. This will be amended so that the company issuing the shares is simply required to have a permanent establishment in the UK.

13. Non-UK domiciled individuals

It has been announced that the taxation of non-UK domiciled individuals will be reviewed which reiterates a statement previously made in the Coalition Agreement. However, no further details are available as yet and no specific timeframe was mentioned.

14. Anti-avoidance consultations

The government has announced that it will be undertaking consultation with interested parties in relation to a potential General Anti-Avoidance Rule. It will also consult on bringing inheritance tax on trusts within the Disclosure of Tax Avoidance Schemes regime.

15. Life assurance deficiency relief

Life assurance deficiency relief allows policyholders to claim a loss arising on the surrender or maturity of a policy against their higher rate liability and dividend upper rate of tax. The loss is only allowable to the extent that earlier part surrenders have produced policy gains, and cannot be used to reduce the policyholder's basic rate tax liability. From 6 April 2010, the government will not allow this relief to reduce the policyholder's additional rate (50%) liability. This confirms the treatment announced in March 2010.

16. Income tax adjustments between settlors and trustees

A settlor who is assessable on the income of the trust can receive repayments of tax on trust income if their personal income tax rate is lower than that of the trustees. A person will be assessable on the income of trusts that they have created if they or their husband/wife/civil partner can benefit from the trust or if their minor children actually do receive a benefit from the trust.

The measure outlined requires that any repayment received has to be paid over to the trustees by the settlor for repayments received in respect of income tax chargeable from 6 April 2010. The repayment paid to the trustees will not have inheritance tax implications which might otherwise arise from making payments to a trust.

17. Changes to tax credits and child benefit

From April 2011 the consumer prices index will be used to index tax credits. The rates of child benefit for the first and subsequent children will be frozen for three years from April 2011.

From April 2011 there will be an acceleration in the rate at which the tax credits will be withdrawn and a reduction in the second income threshold from £50,000 to £40,000 with further reductions in the following year. Additionally, the baby element and 50+ element will be removed from 6 April 2011 and 6 April 2012 respectively.

18. Child trust funds

The Government announced on 24 May 2010 that it intends to reduce and then stop all government contributions to Child Trust Funds. Subject to legislation, the Government intends to reduce government contributions at birth, and to stop government contributions at age 7, from August 2010.

Deloitte contacts

Aberdeen - Derek Buchan
Tel:01224 847 713
Email: **dbuchan@deloitte.co.uk**

Belfast - Glenn Roberts
Tel: 02890 531 136
Email: **gleroberts@deloitte.co.uk**

Birmingham – Jonathan Croxford
Tel: 0121 695 5220
Email: **jcroxford@deloitte.co.uk**

Bristol – Sam Hart
Tel: 0117 984 2764
Email: **sahart@deloitte.co.uk**

Cambridge – Kirsten Tassell
Tel: 01223 259 575
Email: **ktassell@deloitte.co.uk**

Cardiff – Karen Griffin
Tel: 029 20 264 383
Email: **kagriffin@deloitte.co.uk**

Edinburgh – Donald Campbell
Tel: 0131 535 7694
Email: **donald.campbell@deloitte.co.uk**

Glasgow – Liz Wright
Tel: 0141 304 5686
Email: **liwright@deloitte.co.uk**

Leeds – Adam Waller
Tel: 0113 292 1581
Email: **awaller@deloitte.co.uk**

London – Paula Higgleton
Tel: 020 7007 5569
Email: **phiggleton@deloitte.co.uk**

Patricia Mock
Tel: 020 7007 3595
Email: **pmock@deloitte.co.uk**

Manchester – Andrew Shepherd
Tel: 0161 455 8957
Email: **ashepherd@deloitte.co.uk**

Newcastle – David Hicks
Tel: 0191 202 5380
Email: **dahicks@deloitte.co.uk**

Nottingham – Jonathan Croxford
Tel: 0121 695 5220
Email: **jcroxford@deloitte.co.uk**

Reading – Claire Webster
Tel: 02380 354 248
Email: **clwebster@deloitte.co.uk**

Southampton – Claire Webster
Tel: 02380 354 248
Email: **clwebster@deloitte.co.uk**