

**Briefing document**

**24 November 2008**

## GES NewsFlash: Pre-Budget Special

Alistair Darling's statement today focused on three key aims:

- protecting and supporting business;
- taking action to boost recovery by fiscal loosening; and
- bringing public finances back in line in the medium term.

Although no major employment tax changes were announced, the statement is unlikely to be welcomed by employers as the Chancellor introduced significant increases in National Insurance Contributions (NICs) and the income tax burden for higher earners.

The income tax changes come in two forms; from April 2010 highly remunerated employees will now face a reduction or loss of their personal allowances, and from April 2011 a potential increase in their top income tax rate to 45%. Both employee and employer National Insurance rates will increase by 0.5% from April 2011.

### **Our View**

The higher tax and National Insurance rates will make the UK a less attractive location for internationally mobile employees. Planning is likely to be considered by many employers to accelerate the payment of discretionary awards to before 6 April 2011 to minimise employee and employer tax charges. With the differential in tax rates between capital and income also being increased we expect employers to focus once more on remuneration strategies designed to deliver capital rather than income returns.

### **Tax Rate Changes**

There are no changes to income tax rates for 2009/10 and 2010/11, apart from the anticipated increases in tax rate thresholds. However, a new 45% income tax rate will take effect from 2011/12 and will apply to savings and non-savings income in excess of £150,000.

In addition to the introduction of the 45% rate band, higher earners will also lose entitlement to the tax-free personal allowance with effect from 2010/11. The Chancellor announced that the personal allowance will be partially phased out for individuals earning more than £100,000 and completely phased out for those earning £140,000 or more. In fact, complete phase-out does not occur until earnings reach £146,480.

For every £2 of income in excess of £100,000, £1 of the personal allowance is forfeited, up to a maximum of one half of the personal allowance. If the income is in excess of £140,000, there is a further reduction in the allowance by £1 for every £2 of income earned, until a complete phase out occurs at £146,480.

## Equalised employees

The impact for expatriate employers from the increase in the top rate of income tax to 45% will be compounded where employees are tax equalised as the top grossed-up income tax rate will rise from 67% to 81% (assuming NICs are not also payable).

For tax-equalised employees receiving £150,000 net, the impact of the tax rate increase combined with the loss of personal allowance is an increase of approximately 9% to the effective grossed-up tax payable by employers. The impact is more pronounced for more highly paid assignees on say a £500,000 net package, where the effective tax rate increases by approximately 13%.

### **Our View**

The increase places the UK top rate of tax amongst the highest globally, and the relatively low income at which the new rates are triggered makes the UK very expensive for high earning tax equalised assignees. By contrast, the top tax rate in Germany of 45% (excluding solidarity surcharge and the Church Tax) only applies to earnings in excess of £422,000. The top US Federal rate of 35% is triggered at approximately £240,000.

Although adding significantly to the tax cost of tax-equalised assignees, the loss of the personal allowance makes the changes announced last year on the remittance basis of taxation somewhat easier to administer. The loss of the personal allowance will simplify employer tax equalisation policy decisions for higher earners.

## Pension savings: lifetime allowance and annual allowance to be frozen for five years from 2011/12

The lifetime allowance for the current tax year is £1.65m and is due to increase to £1.75m for 2009/10 and £1.8m for 2010/11. The Chancellor today announced that the allowance will then be frozen at £1.8m for 2011/12 through to 2015/16 inclusive.

The annual allowance is also being frozen for the tax years 2011/12 to 2015/16 inclusive, at £255,000. The annual allowance provides a cap on the total annual amount of tax-relieved contributions, or benefit accrual, that may be made into one or more registered pension schemes by or on behalf of an individual. The rate for the current tax year is £235,000, rising to £245,000 in 2009/10 and £255,000 in 2010/11.

The increase to the top rate of income tax for individuals earning in excess of £150,000 to 45% from 2011/12 appears to mean that these individuals will be able to obtain tax relief at 45% on contributions to registered pension schemes out of the top slice of their taxable income.

### **Our View**

The freezing of the lifetime allowance means that it will be even more important for those individuals with pension rights built up in approved schemes before 6 April 2006 to protect them, where appropriate, from the lifetime allowance charge. The deadline for doing so is 5 April 2009.

Those individuals for whom transitional protection (as above) is not appropriate, and who are aiming to save up to the lifetime allowance, will need to carefully assess their future contributions bearing in mind that the growth of their pension funds will count towards the lifetime allowance.

With pressure on annuity rates due to increasing longevity, anticipated low inflation and interest rates, retirees will potentially need to look for other savings vehicles to fund their retirement.

The potential increase in tax relief on pension contributions for those within the new 45% tax bracket from 2011/12 will mean that those individuals will have an extra 5% tax rebate to either spend or invest. This may explain in part why the pension allowances have been frozen.

## National Insurance Contribution proposals

Prior to the Chancellor's speech, rumours were circulating that National Insurance Contributions (NICs) would be reduced. Surprisingly, what was announced was a major rise in NICs from April 2011. Employer, employee and self-employed rates increase by 0.5 per cent from that date. The employer rate will go up from 12.8% to 13.3% before tax relief. More particularly the employee rates will go up from 11% (not contracted-out rate) to 11.5% up to the upper earnings limit and from 1% to 1.5% above that limit. Likewise the self-employed rate will increase from 8% to 8.5% and from 1% to 1.5% above the upper profits limit.

For 2009/10 the rates remain unchanged and most of the limits increase in line with inflation. However the upper earnings limit for the employed and the upper profits limit for the self employed will be aligned with the point at which higher rate income tax becomes payable. From April 2011 the threshold at which people start to pay NICs will also be aligned with the income tax personal allowance.

### **Our View**

This is a significant cost increase from April 2011, not just to employers, but for all earners. Employers in particular will need to ensure they have robust payroll systems and procedures in place since the cost of a tax and NICs settlement will become even more expensive than at present.

## Employee share schemes - nil and partly paid shares

Following the review announced in the 2007 Budget, HMRC have proposed changes to the anti-avoidance provisions applying to nil and partly paid shares.

Currently, where nil or partly paid shares are disposed of, employees are subject to income tax on the amount of a 'notional loan' equal to the amount of the outstanding unpaid amount at the time of disposal. This means that employees can suffer income tax even if the purchaser subsequently pays up the full market value of the shares out of the sale proceeds or if they sell the shares to a purchaser who assumes the responsibility to pay up further instalments.

Additionally, where an employee holds nil or partly paid shares and receives further shares in proportion to their existing holding as a result of a rights or bonus issue, an income tax charge can arise in relation to the additional shares notwithstanding that no additional value was received.

HMRC have confirmed that these potential charges will be removed for transactions taking place on or after Royal Assent to the Finance Act 2009.

### **Our View**

In practice the current provisions do not affect many employee share arrangements. However the proposed changes which remove legislative anomalies are welcome.

## Tax relief on Company Car Expenditure

The Government have confirmed the introduction of a new system for claiming tax relief on company car expenditure. In addition they have clarified the transitional rules from the current to the new system.

From April 2009, the current rules for "expensive cars" are replaced with a CO<sub>2</sub> emissions based pooling system. The rate of writing-down allowance (WDA) for purchases and the restriction on allowable lease rentals for businesses that lease or hire cars will be based on the CO<sub>2</sub> emissions of the car.

### **New rules**

Expenditure incurred on or after 1 or 6 April 2009 on cars will be allocated to one of the two general plant and machinery pools, depending on the cars' CO<sub>2</sub> emissions. Expenditure on cars with CO<sub>2</sub>

emissions over 160g/km will be dealt with in the special rate pool and will attract WDA at 10 per cent.

Cars that have an element of non-business use will continue to be dealt with in a single asset pool to enable the private use adjustment to be made, but for expenditure incurred from April 2009 onwards the rate of WDA will be determined by the cars CO<sub>2</sub> emissions.

Expenditure incurred before April 2009 will, in general, continue to be subject to the old "expensive" car rules for a transitional period of up to five years.

The lease rental restriction will be changed to a flat rate disallowance of 15 per cent of relevant payments and apply only in respect of cars with CO<sub>2</sub> emissions above 160g/km. Expenditure on leases that commenced prior to April will continue to be subject to the "old" rules.

#### **Our view**

The new rules further align the tax cost of company cars for businesses with their CO<sub>2</sub> emissions in line with the Government's green agenda. Employers should consider reviewing their current car fleet as historical decisions may no longer be valid and may lead to increased costs under the new tax regime.

## **Disabled company car drivers**

### **Updated legislation**

Company car tax is calculated by applying the appropriate percentage based on the CO<sub>2</sub> emissions of the car. This percentage is then multiplied by the list price of the car to calculate the benefit. The employee pays tax on this figure and the company pay Class 1A National Insurance on it. Often automatic cars have a higher list price and CO<sub>2</sub> emissions than equivalent manual cars.

Currently disabled company car drivers of automatic cars who hold a blue badge are able to use the carbon dioxide emissions figure of an equivalent manual car when calculating their company car benefit charge. From 6<sup>th</sup> April 2009 they can use the list price of an equivalent manual car to measure the benefit.

#### **Our View**

Employers who provide automatic company cars to disabled drivers holding blue badges should calculate the car benefit using the lower list price of a manual car from April 2009.

## **Countering abuse of employee travel & subsistence deduction rules**

For the time being, the Government has decided not to introduce anti-avoidance legislation to restrict the deduction of travel & subsistence arrangement for agency and "umbrella company" workers. HMRC will focus their efforts on identifying non compliant arrangements

#### **Our view**

We welcome the decision to focus instead on more rigorous compliance.

## **Proposed new penalties for late payment of PAYE in-year**

HMRC proposes a tougher penalty regime for employers who pay over PAYE deductions after the monthly due date. Currently, large employers with more than 250 staff are subject to a small penalty charge after more than two late payments. This is calculated on their total PAYE remittances. HMRC proposes instead that all employers who miss more than one monthly payment due date would be subject to what looks like a much more significant penalty on late-paid PAYE. It would be geared initially to the number of defaults, but become tax-geared where payment is more than 6 months late. Interest would also be charged on PAYE/NIC paid late during the year. Employers would identify total payments for each month in their end of year returns.

## **Our View**

Although HMRC is consulting at this stage it is clearly aiming at introducing legislation to this effect in the 2009 Finance Bill. This may affect not just cash-strapped employers who deliberately defer payment, but employers who fail to pick up in sufficient time remuneration paid on their behalf by third parties, including on an overseas payroll.

## **Find out more...**

To find out more about any aspect of the above, please discuss with your Deloitte contact who will be happy to help and can provide you with access to Deloitte's network of tax specialists.

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