

JUNE BUDGET 2010: CONTENTS AND CONSEQUENCES

George Osborne's first Budget was always destined to be a painful one. It is one of the unspoken traditions of political life that the first Budget *after* the General Election is the time to raise taxes, squeeze expenditure and then blame your predecessor for having to do both. The logic is simple: that initial Budget is furthest away from when the electorate next has a chance to change government. With luck, all will be forgotten by the time the polls reopen.

The strategy does not always work - witness Gordon Brown's first Budget raid on pension funds. Mr Osborne's premiere may prove equally durable in parts. For once we did not have a Pre-Budget Report (PBR) to give us some guidance on what to expect. Aside from the drip of leaks, the best steer was the final Coalition Agreement which provided only the broadest of outlines. Who would have worked out that 'taxing non-business capital gains at rates similar or close to those applied to income' would result in a 28% tax rate for 50% taxpayers?

Mr Osborne can argue, with some justification, that he had no alternative but to turn the fiscal screw. The hole in the UK's finances is large, even if the 2009/10 budget deficit came in at £155.4bn according to the latest National Statistics data, rather than the £163.4bn Mr Darling had forecast in his March Budget. At 62.2% of GDP, total UK government debt is little more than half the level of Greece's. However, the March Budget projection of an 11.6% deficit for 2010/11 is higher than Greece's post-austerity programme figure. Markets and ratings agencies have both been waiting for the post-Election Budget before making their decisions on the UK: disappointment could have seen the country joining the ranks of the so-called PIGS (Portugal, Ireland, Greece and Spain).

One difference about the numbers in this Budget is that they are not purely the work of the Treasury insiders. The new government has established the Office for Budget Responsibility (OBR) to make independent assessments of the public finances and the economy. The OBR – currently consisting of three members (based in the Treasury), but due to grow – should limit the scope for the Treasury to choose their economic assumptions on the basis of the projections the Chancellor wishes to reveal.

The headline-grabbing changes announced in the Budget were:

- A rise in the rate of capital gains tax to 28% for higher and additional rate taxpayers from 23 June 2010.
- An increase in the lifetime limit for entrepreneurs' relief to £5m and the effective retention of a 10% capital gains tax rate on eligible gains.
- An increase in the standard rate of VAT to 20%, effective from 4 January 2011.
- An increase in the basic personal allowance by £1,000 for 2011/12.

- A cut in the 2011/12 starting point for higher rate tax by about £1,500. This is designed to remove the benefit of the increased basic personal allowance from higher rate taxpayers.
- Confirmation of the additional 1% to NICs from 2011/12, together with revised employer and employee contribution bands to limit the impact of the increase.
- A reduction in the main rate of corporation tax by 1% a year for four years from April 2011, bringing it down to 24% by 1 April 2014, accompanied by a cut in the small profits rate to 20% in 2011.
- A cut of 2% in the main writing down allowances and a 75% reduction in the annual investment allowance to £25,000, both from April 2012.
- Substantial reforms to tax credits, including a change spread over two years which will greatly reduce the numbers receiving the family element of child tax credit.

In this Bulletin we look at the main changes that will affect individuals and businesses, and examine some of the related planning issues. If any of these strike a chord, you are strongly recommended to consult your financial adviser.

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The contents of this Bulletin are based on the proposals put forward by the Chancellor in his Budget speech and explained in documents subsequently published by HMRC and the Treasury. All Budget proposals may be subject to change before the relevant Finance Acts are passed. This may not be until late in 2010.

References to spouse, husband and wife and married couples include references to registered civil partners and civil partnerships.

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Personal Income Tax and National Insurance Contributions

The income tax bands and allowances and National Insurance contributions (NICs) rates for 2010/11 were announced by Alistair Darling in last December's Pre-Budget Report and confirmed in his March Budget. The June Budget did not propose any immediate revisions, although it did announce changes from 2011/12.

For 2010/11, the situation remains as follows:

- There have been no increases to allowances or 10%, basic rate and higher rate tax bands from 2009/10. However, for 2010/11 two new features have been added to the UK's already labyrinthine income tax structure:
 - Personal allowances are now phased out for high income taxpayers; and
 - A new 50% income tax band. The new rate is called additional rate, to distinguish it from higher (40%) rate.

Both of these were legislated for in Finance Act 2009.

- The basic personal allowance is phased out at the rate of £1 for each £2 of income in excess of £100,000. The definition of income is, broadly speaking, gross taxable income less specified deductions, such as pension contributions and Gift Aid payments. The result of this restriction is that in 2010/11 the band of income between £100,000 and £112,950 is subject to a marginal tax rate of up to 60%.
- The starting point for the 50% income tax rate is £150,000 of taxable income. For dividends, the corresponding rate is 42.5%. Trusts which accumulate income are also normally subject to these rates on income above their standard rate band of up to £1,000. However, where the settlor is liable to tax on income rather than the trustees, the settlor is now required to pay over to the trustees any difference between their personal tax liability on that income and the trustees' additional rate. Such payments are disregarded for inheritance tax purposes.
- The basic rate of tax is 20% (10% for dividends).
- The lower earnings limit for National Insurance contributions is £97 a week while other main NIC limits and rates are unchanged from 2009/10.

For 2011/12 the new Chancellor announced a range of amendments to his predecessor's plans for income tax and NICs:

- The basic personal allowance will rise by £1,000 to £7,475. However, the benefit of this change will be counterbalanced, for higher rate taxpayers, by a reduction in the basic rate limit (currently £37,400). From tables published by the Treasury in the Budget Red Book,

the basic rate band in 2011/12 is projected to be £34,900. In turn this would make the starting point for higher rate tax in 2011/12 £42,375 against the current £43,875. The net result is that most higher rate taxpayers will pay an extra £100 income tax if their income is unchanged between 2010/11 and 2011/12.

Additional rate taxpayers and those higher rate taxpayers who have had their personal allowance phased down to nil will be £500 a year worse off because they will start paying 40% tax at a level £2,500 lower.

- The new point at which higher rate tax becomes payable in 2011/12 will be frozen for 2012/13 (as proposed by the previous government). To this fix, the June 2010 Budget has added the proposal that in 2013/14 the size of the basic rate band will be frozen.
- The 1% increase in all NIC rates will still go ahead, but its full impact will be dampened:
 - The starting point for employer's Class 1 NICs will rise by £21 a week above inflation to approximately £125 a week.
 - The starting point for employee's Class I NICs will rise to around £7,200 a year (£138 a week). There will be a corresponding increase for Class 4 NICs.
 - The upper earnings limit (UEL) and upper profits limit (UPL) beyond which the Class 1 employee and Class 4 NIC rates fall to 2% will be reduced to match the lower starting point for higher rate tax.

Tax credits

Working tax credits (WTCs) generally rose by 1.5% for 2010/11, although the family element of Child Tax Credit (CTC) remained frozen at £545, the rate originally set in 2003.

The Chancellor announced several important changes to tax credits, primarily designed to create savings for the Exchequer. The reforms taking effect in 2011/12 are:

- The income threshold at which the family element of Child Tax Credit (CTC) is withdrawn will fall from £50,000 to £40,000 and the rate of withdrawal will rise from 6.67% to 41%. Thus no family element will normally be paid once income exceeds £41,329, whereas for this tax year the limit is generally £58,171.
- The abolition of the baby addition to CTC, currently worth up to £545 a year from April 2011.
- Indexation of tax credits will be based on the annual change in the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). On average, the CPI measure of inflation has been about 0.9% a year *lower* than the RPI yardstick since 2000.
- An increase in the child element of CTC by £150 above CPI inflation in 2011/12.
- An increase in the withdrawal rate for all tax credits from 39% to 41%. Thus an extra £1 of earnings could be worth only 27p to a basic rate taxpaying employee once tax (20p), NICs (12p) and tax credit claw back (41p) are taken into account.

- A reduction in the income disregard from £25,000 to £10,000. This is the in-year increase in income which does not reduce tax credit entitlement for that tax year. The figure was raised to £25,000 from £5,000 in 2006/07 when the whole tax credit system threatened to collapse under the administrative weight of mid-year claw backs.

From 2012/13 further changes will be made:

- The family element of CTC will be withdrawn immediately after the exhaustion of the child element. Based on *current* levels of tax credit this would imply that a working couple with two children at school (ie. with no childcare costs) would not receive any tax credits if their total income is much over about £30,000.
- The proposed CTC addition for children aged 1 and 2, announced in the March Budget to take effect from 2012/13, will be scrapped.
- A new £2,500 disregard for income *decreases* will be introduced.
- An increase in the child element of CTC by £60 above CPI inflation.
- A reduction in the maximum period of backdating for tax credit claims from three months to one.

The combined effect of all these reforms is significant. It is probably fair to say that they will remove any entitlement to tax credits from many middle-earning couples.

Company Cars

The company car benefit scales were subject to a variety of changes for 2010/11:

- There was a 5g/km decrease to 130g/km for the lower threshold (15% for petrol).
- A new band with a lower scale charge (5% for petrol) now applies for cars with CO₂ emissions above 0 g/km but not more than 75g/km. The government's own website (www.vcacarfueldata.org.uk/) shows that no such non-electric vehicle currently exists.
- For cars (and vans) which cannot produce CO₂ emissions – which means electric vehicles at present – there is no benefit charge for five years from 2010/11.
- The multiplier for calculating car fuel benefit in 2010/11 has increased by £1,100 to £18,000 and the flat amount for van fuel benefit has risen by £50 to £550.

Further changes are due in 2011/12 and subsequent years, including the abolition of the £80,000 upper limit on list price.

Mr Osborne made no new announcements on this topic.

Furnished Holiday Lets

The previous government got itself in a mess on furnished holiday lets (FHLs). In April 2009 HMRC announced that it would extend the favourable tax treatment of furnished holiday lets (FHLs) from just UK property to all property in the European Economic Area. It had no real choice because the UK-only restriction was almost certainly not compliant with UK law.

To limit the potential loss of revenue, the government simultaneously announced that it would scrap the FHL rules from 2010/11. The necessary legislation made it to the Finance Bill 2010, but was thrown out in the rush to pass a Finance Act 2010 before the Election.

The new Chancellor has now said that the FHL rules will not be withdrawn. However, Spanish apartment owners should not cheer too soon. Mr Osborne promised a review this summer of new FHL provisions ‘to ensure the tax rules meet EU legal requirements in a fiscally responsible way, by changing the eligibility thresholds and restricting the use of loss relief’.

Planning Points

Turning the tables on the basic personal allowance restriction

The phasing out of the basic personal allowance once total income exceeds £100,000 is the latest in a long line of tax increases which add complexity to an already over-complicated tax system. The motivation was primarily political: it would have been much simpler but less politically palatable just to start the 50% rate at a lower level. Instead, we have a system under which the marginal rate of tax in the £100,000 - £112,950 band of income is 60% - a fifth higher than the 50% rate which starts at £150,000. In 2011/12 the increased personal allowance will widen the 60% band – from £100,000 to £114,950.

The corollary is that if your income is in the 60% band, or marginally above it, you may be able to obtain 60% tax relief on some pension contributions, as the example below shows.

60% Tax Relief

In 2010/11 Bill has income of £110,000, all of which consists of earnings and interest. He is not affected by the special annual allowance rules, so can happily make a £10,000 gross pension contribution. Depending upon whether he makes the pension contribution, his tax bill would be:

	No pension contribution		Pension contribution	
	£	£	£	£
Gross income	110,000		110,000	
Pension contribution	-		10,000	
Personal allowance	<u>1,475</u>		<u>6,475</u>	
Taxable income	108,525		93,525	
Basic rate tax	37,400 @ 20%	7,480	37,400 @ 20%	7,480
Higher rate tax	71,125 @ 40%	<u>28,450</u>	56,125 @ 40%	<u>22,450</u>
Total tax		<u>35,930</u>		<u>29,930</u>

Thus a gross pension contribution of £10,000 will save Bill £6,000 in tax, an effective 60% rate of relief.

starting point at which you pay higher rate will *fall* by about £1,500. It will be frozen at that level for the following tax year and, in 2013/14, rise only by the increase in the personal allowance.

The net effect will be to bring more people (perhaps 700,000) into higher rate tax. If you are a basic rate taxpayer now, but close to the starting point for higher rate tax (£37,400 of taxable income after allowances and other deductions), then you could well become a higher rate taxpayer in the next few years. In such circumstances you should start planning now to reduce your taxable income, for example by:

- Transferring investments to a lower-taxed spouse.
- Increasing pension contributions (the revised rules from 2011/12 are unlikely to affect you).
- Choosing tax-efficient investments such as ISAs.
- If you are a company owner, reviewing your remuneration mix of dividends and salary.

Turning tax credit claw back to your advantage

The tax credit reforms proposed in the Budget have highlighted the fact that currently many higher rate taxpayers are eligible for an element of tax credit. Usually this is the family element of Child Tax Credit, worth up to £10.50 a week (£21.00 for a child under age 1 in 2010/11 only). However, there may be additional credits, eg the childcare element of Working Tax Credit, which can be worth up to £240 a week.

The calculation of tax credit entitlements is complex, but if you are a higher rate taxpayer there are two important rules to watch:

- In 2010/11 the family element of Child Tax Credit is clawed back at 6.67% of family income (broadly taxable income) over £50,000 or, if greater, the level at which all other tax credits are extinguished. In 2011/12 these figures will change to 41% and £40,000.
- Tax credits, other than the family element of Child Tax Credit, are clawed back at a rate of 39% in 2010/11 and 41% from 2011/12.

The combined effect of higher rate tax and tax credit claw back can therefore be 46.67% or 79% this tax year and 81% in 2011/12. In other words, an extra £1 of taxable income could mean you lose 40p in tax and 41p in tax credit, leaving a net 19p. If that extra income is earnings, there would also usually be 2% NICs in 2011/12, taking the net figure down to just 17p.

The reverse is also true: £1 less of taxable income could imply only 19p-17p less net income. So, for example, if you reduce your taxable income by making a pension contribution, you may be securing £5 of retirement benefit at an effective cost of under £1.

Watch your NICs in 2011/12

2011/12 will see a 1% rise in National Insurance contribution (NICs) rates across the board, although increases in the NICs starting points mean neither individuals nor employers will face the full brunt of the higher rates. If you have a choice of receiving earnings in 2010/11 or 2011/12 then, all other things being equal, opting for this year will save NICs. If you are employed, your employer would also save NICs.

Capital Gains Tax

The 18% flat rate for capital gains tax (CGT), introduced in April 2008, always looked doomed once Alistair Darling announced an increase in the top rate of income tax. That it survived his final Budget probably had much to do with the way it was announced in the October 2007 Pre-Budget Report. Mr Darling was forced into an embarrassing climb down on his original proposals, so would not have wanted to bury the flat rate just two years later.

The Liberal-Democrat election manifesto proposed taxing capital gains as income to counter the obvious incentive to convert income into gains. At the same time (but not in the manifesto), the LibDems suggested that the annual exemption (currently £10,100) should fall to £2,000. The inclusion in the Coalition Agreement of a promise to bring the CGT rate close to income tax rates was one of the first surprises delivered by the new government.

In the event the Budget changes to CGT were less draconian than expected:

- Gains are to be taxed as the top slice of income, as they were before 6 April 2008.
- Gains falling within the basic rate band are taxable at 18%.
- Gains falling in the higher and/or additional rate bands are taxed at 28%.
- There is no indexation allowance and no taper relief, so the simplicity of Mr Darling's regime remains.
- The annual exemption stays at £10,100 and will be indexed in line with the RPI next year, as usual.
- Entrepreneurs' relief becomes a flat 10% tax rate on eligible gains, with the lifetime limit increased to £5m from £2m.

All these changes take effect from 23 June 2010 – two and a half months into the tax year. This should make for an interesting 2010/11 tax return, but only if you need to report your gains and losses. Gains realised before 23 June are subject to the old rules and are ignored when looking at any post-Budget gain calculations. The taxpayer can choose which gains should benefit from their 2010/11 annual exemption or any losses, to minimise their tax bill.

CGT Old and New

Mervyn is a basic rate taxpayer with taxable income of £32,400 in 2010/11. He bought 10,000 shares in Barclays in January 2009, for which he paid £5,000. As at 22 June 2010 they were worth £31,000. He could have sold them then, but he was unable to get through to his stockbroker, so he is now thinking of selling them under the new CGT rules. The busy line cost him £1,090, assuming the share price has not moved since (which it has – downwards!):

	22 June 2010	23 June 2010 or later
	£	£
Gain: £31,000 - £5,000	26,000	26,000
Less annual exemption	(10,100)	(10,100)
Taxable gain	<u>15,900</u>	<u>15,900</u>
Tax on gain	£15,900 @ 18% =	5,000 @ 18% = 900
	£2,862	10,900 @ 28% = <u>3,052</u>
		3,952

Planning Points

Keeping the CGT rate down

The revised CGT rules represent a partial return to the regime that existed before April 2008. Thus a number of strategies which had been consigned to history are now set to reappear while some of the bright ideas of the last two years warrant re-examination.

- *Tax deferred is tax saved.* Capital gains tax can only normally arise on the disposal of an asset or investment. Thus structures and strategies which allow you to avoid disposals have become more valuable. For example, investment made via collective funds allows active investment management to take place without changes to the underlying portfolios giving you a personal CGT liability.
- *Maximise the use of ISAs* ISAs are free of capital gains tax. Now that gains and income are taxed at much the same rates, the CGT shelter offered by ISAs has become more valuable. If you hold cash ISAs, earning interest of perhaps 1% or less, you should at least review whether it would now make sense to make the irrevocable switch to a stocks and shares ISA. You would lose the capital security of a deposit investment, but your potential tax savings could be much greater.
- *Remember the spouse* In the 18% world, it did not matter whether you or your spouse realised gains – if they were subject to CGT, the rate was the same. Now a link between the rates of capital gains tax and income tax has been restored, once again the logic is to put taxable gains into the hands of the lower (basic or less) taxed spouse, as far as practically possible. Even if you are both taxed at the same rates, there is still the opportunity to use two annual exemptions rather than one and limit the scope for a part of any gain to be pushed into the 28% band.

- *Income tax plan for CGT* With gains once again taxed as the top slice of income, reducing your taxable income could mean a lower capital gains tax bill, if you can bring the total of your taxable income and gains into the basic rate band. So, for example, a pension contribution could reduce your CGT bill.
- *Life assurance based investments* The introduction of 18% CGT reduced the relative tax efficiency of investment bonds, whether onshore or offshore. As the rate of tax charged within life companies has not been changed, for 28% CGT payers the tax balance has now moved back in the direction of investment bonds and away from collective funds. However, the calculations are complex and there is no substitute for an individual assessment of any planned investment using specialist software.

One type of life policy – the maximum investment plan (MIP) – that was enjoying a new lease of life as a result of the restrictions on pension tax relief has become even more attractive for high earners willing to make long-term regular savings. Within a life company, MIP funds are subject to a maximum of 20% UK tax on income and post-inflation gains. There is no personal tax liability, provided the MIP runs and premiums are paid for at least seven and a half years,

- *Venture capital trusts (VCTs) and enterprise investment schemes (EISs)* VCTs and EISs can offer income tax relief on your initial investment. Both are also generally free of capital gains tax, a feature which has now become more valuable. EISs can also allow you to defer tax on capital gains. When you sell the EIS shares, the gain you have reinvested is crystallised and becomes chargeable, but at then current tax rates. These tax attractions are not given away lightly by the Treasury – VCTs and EISs involve high risk investments in small companies and are not appropriate for many investors.

Use your annual exemption

Would you waste a tax exemption worth up to £2,828 a year?

One corollary of the higher CGT rate for higher and additional rate taxpayers is that the annual exemption (£10,100 of gains in 2010/11) has potentially become more valuable. It could now save you £2,828 in tax.

As far as possible it is important to use the exemption each tax year (and for your spouse to do the same) because, if unused, it cannot be carried forward. If you do not systematically use your annual exemption, you are more likely to reach a point where some of your gains are subject to the new, higher tax rate. Unfortunately, you cannot simply crystallise a gain by selling and then repurchasing an investment - so called bed-and-breakfasting. However, there are other ways of achieving similar results:

- *Bed-and-ISA* You can sell an investment, eg shares in an open-ended investment company, and buy it back immediately within an ISA. For 2010/11 the maximum ISA investment is £10,200.
- *Bed-and-SIPP* This is a similar process to bed-and-ISA, but the cash realised is used to make a contribution to a self-invested personal pension (SIPP). The reinvestment is then made within the SIPP. This approach has the added benefit of income tax relief on the

contribution and may also offer a higher reinvestment ceiling than an ISA, depending on your earned income and other pension contributions. However, if you have 'relevant income' of £130,000 or over, the rules restricting pension tax relief must be borne in mind (see below).

- *Bed-and spouse* You can sell an investment and your spouse can buy the same investment without falling foul of the rules against bed-and-breakfasting. However, you cannot sell your investment to your spouse – the two transactions must be separate.
- *Bed-and-something-similar* There are plenty of funds that have similar investment objectives or, in the case of tracker funds, identical objectives. So, for example, if you sell the ABC UK Tracker fund and buy the XYZ UK Index fund, the nature of your investment and the underlying shareholdings may not change at all, but because the fund providers are different, you will not be caught by the rules against bed-and-breakfasting.

Mind your losses

The FTSE 100 index today is still about 1,500 points below the level of ten years ago. Many long-term holdings could thus still be standing at a loss. Combine this fact with a higher rate of tax on gains for some investors and the oft-forgotten rules on the tax treatment of capital losses assume a new importance. The combined rules, which were not changed in the June Budget, contain a trap for the unwary – see the box below.

Beware the Wasted Loss

If you realise a gain and a loss *in the same tax year*:

- The loss will be set off against the gain, even if the gain is within your annual exemption.
- As a result you could end up wasting the loss which will now be more valuable because you now face 28% tax on future gains above your annual exemption.

However, if you carry forward a loss *from a previous tax year*:

- The carried forward loss is only used up to the extent that it reduces your overall gains to the level of your annual exemption.
- The loss is therefore only used when necessary.
- Uniquely, in this tax year you can choose whether to offset the loss against pre-23 June gains or those made later in the tax year.

The lesson is that you should always take care before realising gains and losses together in a single tax year.

Identification matters

When the flat rate of CGT was introduced in 2008/09, taper relief was scrapped and with it most of the complex identification rules for share/fund transactions. If you sell a holding in a single company or investment fund, for CGT purposes the disposal is matched:

1. First to acquisitions made on the same day;
2. Second to acquisitions made in the next thirty days (the rule which blocks bed-and-breakfasting); and
3. Thirdly all other acquisitions, taken together as one pool.

The pooling provision means that you no longer identify a sale with a recent purchase – the so-called last in-first out (LIFO) rule has disappeared. This can make quite a difference to the calculation, as the example below shows.

A Mis-engineered Pool

Helen bought 15,000 shares in GKN in June 2006 for £40,500 – equivalent to 270p a share. In July 2009, she took up the GKN rights issue and bought another 18,000 shares at a cost of £9,000 (50p each - it was a deeply discounted issue!).

With the GKN share price now around 120p, Helen is thinking of taking some profits on the shares she bought a year ago. She reckons that if she sells 14,428 shares, she will make enough gain to match her annual exemption, ie.:

$$14,428 \times (120\text{p} - 50\text{p}) = \text{£}10,099.60$$

Helen's calculation ignores the changes introduced from April 2008. The correct calculation pools together her two share purchases:

$$\text{Total number of shares} = 15,000 + 18,000 = 33,000$$

$$\text{Total cost} = \text{£}40,500 + \text{£}9,000 = \text{£}49,500$$

$$\text{Average cost} = \frac{\text{£}49,500}{33,000} = 150\text{p}$$

So the reality is that any sale at 120p will be at a *loss* of 30p a share.

Inheritance Tax

In the March Budget statement Alistair Darling announced that the nil rate band would remain at £325,000 until 5 April 2015. The measure was passed in the hastily approved Finance Act 2010: the Conservatives chose not to challenge it.

Subsequently the Conservatives' Election manifesto proposed a nil rate band of £1m. However, this was abandoned when the Coalition Agreement was struck. The Agreement states 'We will prioritise (increases in the personal allowance) over other tax cuts, including cuts to Inheritance Tax'. Hence the June Budget raised next year's personal allowance by £1,000 but made no mention of Inheritance Tax.

Planning Points

Time to review your estate planning

The introduction of the transferable nil rate band in October 2007 made inheritance tax planning considerably simpler for many married couples. It is now no longer necessary to ensure that your nil rate band is used on first death to minimise IHT liabilities. This reform can result in significantly reduced IHT bills for widows (and widowers), even if their spouse died many years ago.

Not everybody has benefited from the change. If you had already planned (and had the resources) to use the nil rate band on first death, you are no better off as the result of the introduction of transferability. If you are not married, you cannot benefit, other than as a widow/widower.

If you have not reviewed your estate planning and Will in the last three years, you should do so now. It may be that no change needs to be made to your existing arrangements but, as ever with estate planning, it is better to be safe than sorry. Even though a revised plan may not reduce your IHT bill, it could simplify estate administration by, for example, removing the need to include a complex trust in your Will.

Regular and out of income....

There are three yearly exemptions which are available for IHT planning:

- *The £3,000 annual exemption.* Any unused part of this exemption can be carried forward one tax year, but it must then be used *after* the £3,000 exemption for that year. So, for example, if you made a gift of £1,000 covered by the annual exemption in 2009/10, you can make gifts totalling £5,000 covered by the annual exemption in 2010/11.
- *The £250 small gifts exemption.* You can make as many outright gifts of up to £250 per individual per tax year as you wish free of IHT, provided that the recipient does not also receive any part of your £3,000 annual exemption.

- *The normal expenditure exemption.* Any gift that you make is exempt from IHT if:
 - it forms part of your normal expenditure; and
 - taking one year with another it is made out of income; and
 - it leaves you with sufficient income to maintain your usual standard of living.

The normal expenditure exemption is often forgotten. You may be making regular gifts which you think are covered by the £3,000 exemption, but which could actually count under normal expenditure, leaving your £3,000 exemption unused. For example, if you pay premiums for a life policy held under trust, such payments frequently satisfy all the conditions to be treated as normal expenditure, leaving the £3,000 exemption available for other gifts.

Planning, politics and IHT

The Conservatives said during the Election campaign that they would raise the nil rate band to £1m. In theory this could still happen, although not until after the *next* Election. In practice, some commentators feel that abandoning the £1m nil rate band as part of the Coalition deal was canny politics: in an era of austerity, a promise to cut the tax on large estates was an easy target for the rival parties.

It would be unwise to rely on a £1m nil rate band arriving in 2015 or later to solve your estate planning problems. Today's estate planning should be based on *today's* tax structure, albeit with as much flexibility built in as practical to cope with possible changes. For example, life assurance to cover the potential IHT liability on your estate can usually be written on a short-term renewable basis. Choosing this route allows you to continue cover for as long as necessary at a lower immediate premium cost and gives more flexibility than would be the case if you had opted for a whole of life policy.

Investments

A range of investment tax changes has taken place over the past couple of years. Some have been the result of much consultation and have received little attention. The June Budget did not add any more changes, However, it did confirm some proposals which were made in the March Budget but were not legislated for because of the Election.

Individual Savings Accounts (ISAs)

For 2010/11 the ISA investment limit is £10,200, of which up to £5,100 may be placed in the cash component. The 2009/10 age 50 threshold for this level of investment has fallen away.

Mr Osborne confirmed that he would be following his predecessor's proposal that from 2011/12 onwards the ISA investment limits will be increased in line with the RPI. The resultant annual limit will be rounded to the nearer £120, to make the corresponding monthly limits divisible by £10. Mr Osborne's one new piece of information was that the annual RPI used would be that of the previous September (the same as currently used for tax allowances and bands).

As the original ISA investment ceiling was £7,000 in April 1999, the 2010/11 limit is already higher than it would have been if RPI linking had existed from day one (which would have made it about £9,440). ISAs have become a more important investment tool, given the restrictions on pension provision and 50% income tax.

Offshore funds

The rules for offshore funds were changed in December 2009, following a long period of consultation. The changes mean that offshore funds which accumulate income rather than pay dividends are no longer automatically subject to income tax on gains. The flip side is that to qualify for the gains being subject to CGT, the accumulated income must be taxed annually.

This reform, alongside changes to offshore fund dividend tax treatment introduced in the 2009 Budget, has increased the appeal of offshore funds.

Venture Capital Trusts and Enterprise Investment Schemes

The March Budget confirmed that the rules for Venture Capital Trusts (VCTs) would be amended as a result of changes needed to comply with EU State Aid rules. However, legislation to put through the revisions did not make the 'wash-up' Finance Act. Mr Osborne said that he would bring in the changes later this year, although no specific date was given. Thus there is a limited window of time during which advantage can be taken of the existing rules.

The measures will ultimately:

- Change the minimum amount VCTs must hold in eligible shares. At present ‘eligible shares’ in unlisted companies must represent at least 30% of a VCT’s qualifying investments (which in turn have to be at least 70% of the VCT). The eligible shares minimum holding will more than double to 70%. However, the new limit will not apply to money raised before the change takes effect.
- Revise the definition of VCT ‘eligible shares’ to include shares which may carry certain preferential dividend rights.
- Allow a VCT to be listed on any EU/EEA market rather than be restricted to a UK listing.
- Prevent shares in companies that are ‘in difficulty’ from qualifying for the purposes of the VCT and Enterprise Investment Scheme (EIS) rules.
- For EISs and VCTs, change the existing requirement that a company must have a qualifying trade carried out wholly or mainly in the UK to one that it need only have a permanent establishment in the UK.

Planning Points

ISAs

Since 6 April 2008 it has been possible to transfer the cash component of an ISA, including anything from a former TESSA, into the stocks and shares component. When this option was first announced, it was widely viewed as a rather pointless facility, as for most investors the value of the income tax saving from the cash component was greater than any tax savings offered by the stocks and shares component.

The world has changed since this switch facility first became available. We have now had a base rate of just 0.5% for over 15 months, with little sign that there will be any significant increase soon. Many existing cash ISAs are paying well under 1%, with some paying just 0.1%. Consumer Focus, a statutory consumer body, has made a super-complaint to the Office of Fair Trading about cash ISAs. It says that ‘15 million cash ISA holders could be losing out in interest worth up to £3 billion a year because of the way the market operates’.

If you are looking for income from your ISA, a switch from cash to the stocks and shares component now has much more appeal. For example, an investment in a sterling corporate bond fund could produce an income of 5% or more, while a UK equity income fund could offer more than 4%. Both yields are tax free via an ISA. The quid pro quo for the immediate extra income is that you lose the capital security of the cash ISA and your new higher income could fall as well as rise. Before making the switch – which is irreversible – you should always take independent advice.

Venture Capital Trusts

The change to VCTs will potentially alter the nature of the VCT market. In the last few months of the previous tax year, limited life VCTs proved very popular. These VCTs, which aim to wind up a little after the end of the five year tax relief claw back period, are at the lower end of the VCT risk spectrum – which means they are still high risk, but not quite such high risk. One way they limit risk is to maximise their investment in secured loans rather than

equity. Some VCT providers have said that when the proportion of loans that can be included falls, limited life VCTs will become more difficult to construct and less readily available.

The fact that the change to minimum equity holdings has been delayed means that there is an opportunity to invest in limited life VCTs now and still benefit from the current rules. However, it does mean that if you wait until the tax year end rush in March 2011, you could be too late.

Business Tax

There were important changes to corporation tax and capital allowances announced in the Budget, although they are staggered across several years, starting from April 2011.

Corporation tax rates

The main rate of corporation tax remains at 28% for the 2010 financial year. For 2011 it will fall to 27% while the small profits rate (formerly small companies rate) will be cut to 20%, instead of rising to 22%, as the previous Chancellor had planned. There will be three more cuts in the main rate of tax, bringing it down to 24% for the financial year starting on 1 April 2014.

Capital allowances

The Annual Investment Allowance (AIA), which gives 100% initial relief for investment in plant and machinery, was doubled to £100,000 from April 2010. Where a business's chargeable period falls either side of the April increase date (1 April for corporation tax, 6 April for income tax), the AIA for the year is proportioned accordingly. For example, a company with a year end of 31 December would have an AIA for 2010 of:

$$\frac{3}{12} \times £50,000 + \frac{9}{12} \times £100,000 = £87,500$$

The Chancellor announced that AIA will stay at £100,000 for the 2011 financial year but from 2012 it will be cut to £25,000. At the same time the writing down allowances for plant and machinery will be reduced by 2% to 18% for the main rate pool and 8% for the special rate pool (which includes long life assets and integral features).

The reductions in allowances partially fund the cuts in corporation tax rates.

New business NIC incentive

The Chancellor announced an incentive for new UK businesses set up outside the 'Greater South East' (ie. London, South East England and the East of England). For a three year period, new businesses will not have to pay the first £5,000 of Class 1 employer NICs due in the first twelve months of employment for each of the first 10 employees hired in the first year of business. The scheme is intended to start no later than September 2010, but any new business established from 22 June 2010 which meets the relevant criteria will benefit from the scheme. Further announcements are due shortly.

Planning Points

Dividends or Salary ... or Pension Contribution?

The additional rate of tax and the tapering of personal allowances have altered the mathematics of the choice between dividends and salary for those with income of £100,000 or more. If you are in a position to choose between the two and not caught by the IR35 personal company rules (which the Government is reviewing), a dividend remains the more efficient choice, as the example below shows. However, a pension could avoid all immediate tax and NIC costs, provided the special annual allowance is not an issue. Indeed, a large employer pension contribution could be particularly attractive now, before the next change to the pension relief rules due in April next year.

Still Worth It

Brian has £50,000 of gross profits in his company which he wishes to draw, either as bonus or dividend. Assuming the company pays corporation tax at the 2010 small companies' rate of 21% and Brian has annual income in excess of £43,875, his choice can be summarised thus:

	Bonus		Dividend	
	£		£	
	40% tax	50% tax	40% tax	50% tax
Marginal gross profit	50,000	50,000	50,000	50,000
Corporation tax @ 21%	N/A	N/A	(10,500)	(10,500)
Dividend	N/A	N/A	39,500	39,500
Employer's National Insurance contributions £44,326 @ 12.8%	<u>(5,674)</u>	<u>(5,674)</u>	N/A	N/A
Gross bonus	44,326	44,326	N/A	N/A
Brian's NICs £44,326 @ 1%	(443)	(443)	N/A	N/A
Income tax *	<u>(17,730)</u>	<u>(22,163)</u>	<u>(9,875)</u>	<u>(14,264)</u>
Net benefit to Brian	<u>26,153</u>	<u>21,720</u>	<u>29,625</u>	<u>25,236</u>

**after allowing for 10% tax credit on dividends*

The benefit of the dividend route is due to the savings in NICs; more tax (corporation tax and income tax) is payable under the dividend route. The difference between the 40% and 50% numbers explains why so many companies with substantial private shareholders brought forward their dividend payments to before 6 April 2010.

The mathematics of dividends will become even more favourable next year because of the rise in NICs (1% for employers and employees) and the reduction in the small profits rate (to 20%).

Capital allowances timing issue

The large reduction in the 100% AIA in plant and machinery and the cuts in writing down allowance from 2012, together with the tax rate reductions from 2011, mean the timing of a major investment needs to be considered carefully.

It may be wiser to bring forward major purchases now to maximise the use of the AIA and writing down allowances rather than spread investment over several years – exactly the opposite strategy to the one which applied after the March 2010 Budget.

Pensions

2009 saw a major change in pension tax law with the arrival of the special annual allowance, restricting higher rate tax relief on some pension contributions. This was announced in the 2009 Budget and then amended less than eight months later at the time of the 2009 Pre-Budget Report. The result is something of a mess, not helped by the fact that the special annual allowance itself was due to be replaced from April 2011 by the ‘high income excess relief charge’.

To this complex pension scenario Mr Osborne added some proposals of his own:

Pension contribution tax relief

For 2010/11, the December 2009 variant special annual allowance regime remains in force. As a reminder, the special annual allowance will only affect you in the current tax year if:

- Your **‘relevant income’** is £130,000 or over in the current tax year or either of the two preceding tax years;
and
- You increase your **‘normal regular ongoing pension savings’**
and
- Your **‘total pension savings’** during a tax year exceed your **special annual allowance**, which is normally £20,000, but can be up to £30,000.

‘Relevant income’ is defined as your total income less normal deductions (other than the personal allowance) and reliefs (eg trading losses) and Gift Aid, but with any deduction for pension contributions made personally limited to a maximum of £20,000 gross.

‘Normal regular ongoing contributions’ to a pension arrangement are:

For money purchase schemes, such as personal pensions

- The total annual amount of all contributions to the arrangement, provided that the contributions were made at least quarterly before 22 April 2009. This deadline is extended to 9 December 2009 if your relevant income was at least £130,000 but less than £150,000 in 2009/10 or either of the two preceding tax years;
plus
- Any increase in your regular contributions that was agreed before 22 April 2009/9 December 2009.

For an individual pension arrangement, such as a personal pension, a ‘normal regular ongoing contribution’ must be made to the existing (pre-22 April 2009/9 December 2009) arrangement. If you keep the total level of your total regular contributions the same, but pay them to different arrangements, then such contributions count as ‘normal regular ongoing contributions’ only in limited circumstances.

The requirement that money purchase scheme contributions are made quarterly or more frequently means that no account is taken of annual payments in determining regular

contributions. However, they (and one-off lump sums) can impact on the level of the special annual allowance.

For defined benefit arrangements, e.g. final salary pension schemes

- All your pension savings (which are measured by reference to the change in value of your accrued benefits from one tax year's end to the next). This is subject to the proviso that the way your benefits are calculated under the scheme rules does not change on or after 22 April 2009/9 December 2009, except in certain limited circumstances.

'Total pension savings' are all of your pension savings (from whatever source) that receive UK tax relief, including employer contributions. The pension savings value placed on your benefit accrual under a final salary scheme is 10 times the increase in pension plus any increase in a separate cash lump sum. For example, an extra £5,000 pension accrual is deemed to be £50,000 of pension savings.

'Special annual allowance' is the greater of:

- £20,000
and
- The total over 2006/07, 2007/08 and 2008/09 of any infrequent (ie. less than quarterly) money purchase contributions, divided by 3. This annual average is subject to a maximum of £30,000.

The special annual allowance is therefore a minimum of £20,000 and a maximum of £30,000.

If you are caught by the special annual allowance rules, then, subject to the normal tax relief rules:

- You will receive full tax relief on your 'normal regular ongoing contributions';
- You will not be taxed on your employer's or any third party contributions;
but
- Any *additional* pension contributions (from whatever source) or the value of any *additional* benefit accrual will effectively be restricted to basic rate relief to the extent that your 'total pension savings' in the tax year exceed the greater of your special annual allowance and your 'normal regular ongoing contributions'. This means a claw back of between 20% and 30% for 2010/11 contributions, depending on your level of income.

If you are *not* caught by the special annual allowance charge, 2010/11 is set to be the last opportunity that you have to benefit from the current annual allowance, which can permit pension contributions of up to £255,000 to be made for your benefit without any tax penalties.

The complex special annual allowance rules will finish at the end of 2010/11 and were due to be replaced by new measures legislated for in the pre-Election Finance Act 2010. The present rules protect existing regular contributions and allow full tax relief for at least £20,000 of contributions in 2010/11 whereas the Finance Act 2010 regime would have scaled back relief on *all* contributions if you fell within it.

The Chancellor had been heavily lobbied to rethink the Finance Act 2010 rules, which pension experts saw as overly complex, costly to administer and liable to further reduce employer interest in pension provision. However, the Liberal Democrats' manifesto proposed the complete abolition of higher rate relief, which the party said would save £5.5bn a year. Mr Osborne chose a compromise course which had been suggested by a number of pension experts: from 2011/12 the amount of the annual allowance will be reduced substantially and the Finance Act 2010 legislation scrapped.

What the annual allowance reduction will be and how the replacement rules will apply are not yet known. The Chancellor has made clear that he does not want to lose any of the tax revenue which the previous measures would have produced. The Budget Red Book says 'Provisional analysis suggests that an annual allowance in the range of £30,000 to £45,000 would raise the necessary yield'. Relying upon the annual allowance to limit higher/additional rate tax relief means that the complex income thresholds planned for the high income excess relief charge will disappear, but the corollary is that the new limit will apply to everyone, not just the highest earners.

The Special Annual Allowance Charge in 2010/11

High income, no special annual allowance charge

Ann has gross income of £138,000 in 2010/11 and made an individual pension contribution of £10,000, to which her employer added another £35,000. Her gross income in earlier years was under £130,000. Although her gross income exceeds the £130,000 threshold in 2010/11, her 'relevant income' is under £130,000 after deduction of her £10,000 pension contribution, so Ann is not subject to the special annual allowance tax charge. However, a similar total contribution in 2011/12 could mean she falls foul of the new rules, depending upon their final structure.

High income, special annual allowance charge

David has 'relevant income' of £145,000 in 2010/11 and has a self-invested personal pension to which total pension contributions of £40,000 were made by himself and his employer. The contributions were David's regular monthly contribution of £2,000 (as in the previous four years) and a single employer payment of £16,000. In the previous four years the employer had made one-off contributions of no more than £15,000 a year. David's 'relevant income' exceeds the £130,000 threshold and his special annual allowance is £20,000. David's 'total pension savings' thus exceed his special annual allowance. His 'normal regular ongoing contributions' of £24,000 are not subject to any charge, but the additional employer contribution of £16,000 will be subject to a special annual allowance tax charge of £3,200 (£16,000 x 20%). David will pay this via his 2010/11 self assessment tax return on 31 January 2012. It might have been wiser to delay the employer contribution to 2011/12, depending upon how the new rules pan out.

High income, special annual allowance charge

Eric has 'relevant income' of £250,000 in 2010/11, of which only £42,000 is earned income. He has a personal pension to which he has regularly contributed £500 a month. In 2010/11 he makes an additional contribution to the plan of £26,000. This is his first additional contribution since 2005/06. Eric's income exceeds the £130,000 threshold. His special annual allowance is £20,000, as he made no one-off payments in 2006/07-2008/09. Therefore his 'total pension savings' are more than his special annual allowance. His 'normal regular ongoing contributions' of £6,000 are not subject to the special annual allowance charge. However, the additional single contribution brings his 'total pension savings' up to £32,000 and £12,000 of this (£26,000 + £6,000 - £20,000) will be subject to a special annual allowance tax charge of £3,600 (£12,000 x 30%). If Eric had limited his additional contribution to £14,000 he would have avoided the tax charge. Eric might also have gained from delaying £12,000 of his contribution to 2011/12, depending upon the new rules.

Annuities and age 75

The simplified (sic) pension tax regime introduced in April 2006 removed the previous requirement that for personal pensions and other money purchase pension schemes an annuity had to be purchased by age 75 at the latest. However, the non-annuity option, the alternatively secured pension (ASP) is so unattractive and the death benefits so highly taxed that it has seen little take up. In practice buying an annuity by age 75 has remained a *de facto*

requirement. Indeed, the Coalition Agreement said ‘We will end the rules requiring compulsory annuitisation at 75’.

Mr Osborne has now put that pledge into being, albeit on an interim basis. Age 75 has effectively been replaced by age 77 while consultation takes place and the appropriate new legislation is drawn up for 2011/12. In the meantime, for money purchase pension scheme members who reach age 75 on or after 22 June 2010:

- If they are already using income drawdown, they can continue to draw income without having to apply the ASP income limits until their 77th birthday.
- If they have not started to draw benefits from an arrangement, immediately before reaching age 75, they will become entitled to income withdrawal and a (tax free) pension commencement lump sum. Thus it will remain the case that the lump sum must be drawn before age 75.
- On death after age 75, a 35% flat tax charge will apply to lump sum death benefits rather than the ASP provisions, which can result in a total tax charge of 82% of the residual pension fund.

It is unclear what the exact position is or will be for those people who started drawing income via ASP before 22 June 2010.

State Pensions

There were three important announcements on state pensions:

- In 2011/12 the basic state pension will be increased by the greater of RPI inflation, earnings increases and 2.5%, as promised in the Coalition Agreement. From 2012/13 onwards CPI inflation will replace RPI inflation in this ‘triple lock’ formula.
- For other state pensions (eg state second pension and graduated pension), from 2011/12 annual increases will be based on the CPI, not the RPI currently used. This potentially means increases will be reduced by slightly below 1% a year based on the gap between CPI and RPI inflation since January 2000.
- The state pension age will be raised to 66, as promised in the Coalition Agreement. This will follow consultation and is likely to be from 2016 for men and 2020 for women.

Default retirement age

As promised in the Coalition Agreement, the Government also plans to ‘quickly phase out the Default Retirement Age from April 2011’ so that employees can continue to work beyond age 65.

Planning Points

Beating the 2010/11 Special Annual Allowance Charge

The special annual allowance charge can never apply if your 'relevant income' (see above) for the current and two preceding tax years is under £130,000. If your relevant income is below the £130,000 threshold for 2008/09 and 2009/10, then it could pay you to keep your 'relevant income' down in 2010/11 if you want to make substantial pension contributions. Stay below the £130,000 threshold and there is no risk of losing higher rate tax relief.

There are a number of ways you can limit your 'relevant income', for example:

- Personally making pension contributions of up to £20,000. These can be deducted when calculating relevant income, so can be useful if you are on the margins of being caught.
- Transferring income-generating assets to your spouse. Such transfers would be beneficial, even if you both pay higher rate tax. They may even help you reclaim your personal allowance if your income exceeds £100,000.
- Restructuring investments to produce less taxable income.
- Making Gift Aid contributions.
- If you are self-employed, taking advantage of the £100,000 annual investment allowance to buy plant and machinery, possibly bringing forward planned investments from later years.

Beating the 2011/12 Annual Allowance Charge

The special annual allowance charge cannot apply if you are not caught by the 'relevant income' test described above. However, the planned move to a lower annual allowance – probably £45,000 at most – will affect you if contributions made by you or on your behalf exceed the new threshold, regardless of your income. Any contributions exceeding the annual allowance will be subject to the annual allowance charge, currently set at 40%, but probably rising to 50% in 2011/12.

For example, if you escape the special annual allowance charge, in theory during 2010/11 pension contributions of up to £255,000 (the current annual allowance) could be made by you and your employer without any tax penalty arising. From 2011/12 the penalty-free limit will be less than a fifth as much.

This window of opportunity could be particularly important if the planned contribution is an 'in specie' transfer of valuable assets, eg a personal portfolio of investments or property owned by your employer. This is an area which requires expert advice: you should not make any move until the outline of the new rules has been published.

Drawing retirement benefits

If you are near to the point of drawing benefits from your pension arrangements, the change to the annuitisation rules has added another layer of complexity to your decision:

- Before June 22, the nearer you were to age 75, the more sense it made to opt for an annuity because once 75 was reached there was no real alternative.
- 77 has now replaced 75 on an interim basis, but it is not clear what the final structure will be:
 - It is possible that there will be a new annuity-or-ASP age of, say, 80. The older you are, the higher the income an annuity can guarantee relative to income withdrawals. By 80, that gap is significant. The Coalition Agreement pledge was only to end compulsory annuitisation at age 75, not to stop it completely.
 - The Chancellor might decide that beyond a certain age an inheritance tax charge should apply in addition to the 35% tax charge on lump sum death benefits, making an effective total tax charge of up to 61%. Under the previous government the Treasury was very wary of pension monies being used for any purpose other than the provision of retirement benefits. The Treasury's argument was that the tax paid on retirement income was the quid pro quo for tax relief on contributions.

The best course of action may be to delay drawing benefits until details of the new regime emerge. If that is not possible, then where death benefits are a potentially important factor, choosing drawdown would keep your options open. Buy an annuity today and you cannot change your mind afterwards.

APPENDIX – TAX FACTS AND FIGURES AND NICs

MAIN INCOME TAX ALLOWANCES AND RELIEFS

	2009/10	2010/11
	£	£
Personal allowance – standard	6,475	6,475
- Age 65 – 74	9,490	9,490
- Age 75 and over	9,640	9,640
Personal allowance reduced if total income exceeds ∞	N/A	100,000
Married couple’s allowance – minimum amount*	2,670	2,670
- Age 75 and over*	6,965	6,965
Age-related allowances reduced if total income exceeds ¶	22,900	22,900
Maintenance to former spouse □	2,670	2,670
Employment termination lump sum limit	30,000	30,000

∞ For 2010/11 the reduction is £1 for every £2 additional income over £100,000. As a result there is no personal allowance if total income exceeds £112,950.

* Relief at 10%. Minimum amount applies for age allowance purposes only.

□ Relief available at 10% only if at least one of the couple was born before 6 April 1935.

¶ For 2009/10 and 2010/11 the reduction is £1 for every £2 additional income over £22,900. Standard allowance(s) **only** are available if total income exceeds:-

	2009/10	2010/11
	£	£
Taxpayer aged 65 - 74 [personal allowance]	28,930	28,930
Taxpayer aged 75 and over [personal allowance]	29,230	29,230
Taxpayer aged 75 and over [married couple’s allowance]	37,820	37,820

INCOME TAX RATES

	2009/10	2010/11
	£	£
Starting rate on savings income- 10%	1 – 2,440	1 – 2,440
Basic rate	20%	20%
Tax on first £37,400†	7,480	7,480
Higher rate - 40%	Over 37,400	37,401-150,000
Tax on first £150,000†	52,520	52,520
Additional rate – 50%	N/A	Over 150,000
Discretionary and accumulation trusts (except dividends) °	40%	50%

Discretionary and accumulation trusts (dividends) °	32.5%	42.5%
Ordinary rate on dividends	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	N/A	42.5%

- † Assumes 10% band not available. £7,236 on first £37,400 and £52,276 on first £150,000 if full 10% band is available.
- ° Up to the first £1,000 of gross income is generally taxed at the standard rate, ie. 20%, or 10% as appropriate.

CAR BENEFITS

The charge is based on a percentage of the car's "price". "Price" for this purpose is

1. The list price at the time the car was first registered plus the price of extras.
2. Where the "price" exceeds £80,000, the "price" used is restricted to £80,000.

For cars first registered after 31 December 1997 the charge, based on the car's "price", is graduated according to the level of the car's approved CO₂ emissions.

For petrol cars with an approved CO₂ emission figure.

CO ₂ g/km	% of price subject to tax		CO ₂ g/km	% of price subject to tax		CO ₂ g/km	% of price subject to tax	
	09-10	10-11		09-10	10/11		09-10	10-11
75 or less	10	5	160-4	20	21	200-4	28	29
76-120	10	10	165-9	21	22	205-9	29	30
121-134	15	15	170-4	22	23	210-4	30	31
135-9	15	16	175-9	23	24	215-9	31	32
140-4	16	17	180-4	24	25	220-4	32	33
145-9	17	18	185-9	25	26	225-9	33	34
150-4	18	19	190-4	26	27	230-4	34	35
155-9	19	20	195-9	27	28	235+	35	35

Notes

1. The exact CO₂ emissions figure should be rounded down to the nearest 5 g/km for levels of 125g/km or more.
2. For diesels not meeting Euro IV emissions standards or registered after 31 December 2005, add 3%, subject to maximum charge of 35%.
3. Hybrid petrol/electric cars are subject to a 3% reduction, with a minimum 10% charge.
4. LPG, dual LPG/petrol and E85 cars are subject to a 2% reduction, with a minimum 10% charge. Reduction does not apply to LPG conversions.
5. For electric only cars, a 9% charge applies in 2009/10 only. For 2010/11 there is no charge for any car which cannot produce CO₂.
6. Maximum list price is £80,000.

For cars with no approved CO₂ emissions figure, the charge is based on engine size.

Engine Size (cc)	Percentage of car's price charged to tax
0 – 1,400	15
1,401 – 2,000	25
2,001 and more	35

CAR FUEL BENEFITS

For cars with an approved CO₂ emission figure, the benefit is based on a flat amount of £18,000 (£16,900 for 2009/10). To calculate the amount of the benefit the percentage figure in the above car benefits table (that is from 10% to 35%) is multiplied by £18,000. The percentage figures allow for a diesel fuel surcharge. For example, in 2010/11 a petrol car emitting 160 g/km would give rise to a fuel benefit of 21% of £18,000 = £3,780.

VALUE ADDED TAX

From	1 May 2009	1 Jan 2010	1 April 2010	4 January 2011
Standard rate	15.0%	17.5%	17.5%	20.0%
Reduced rate (eg domestic fuel)	5.0%	5.0%	5.0%	5.0%
Annual turnover limit for registration	£68,000	£68,000	£70,000	£70,000
Deregistration threshold	£66,000	£66,000	£68,000	£68,000
Flat rate scheme turnover limit	£150,000	£150,000	£150,000	£150,000
Cash accounting and annual accounting limits	£1,350,000	£1,350,000	£1,350,000	£1,350,000

INHERITANCE TAX

	Cumulative chargeable transfers [gross]		tax rate on death %	tax rate in lifetime* %
	2009/10 £	2010/11 £		
Nil rate band†	325,000	325,000	0	0
Excess	No Limit	No Limit	40	20

* Chargeable lifetime transfers only

† On the death of a surviving spouse on or after 9 October 2007, their legal personal representatives may claim up to 100% of any unused proportion of the nil rate band of the first spouse to die (regardless of their date of death).

CAPITAL GAINS TAX

Main exemptions and reliefs

	2009/10 and 2010/11 up to 22 June 2010 £	2010/11 from 23 June 2010 onwards £
Annual exemption	10,100*	10,100*
Principal private residence exemption	No Limit	No Limit
Chattels exemption	£6,000	£6,000
Entrepreneurs' relief	⁴ / ₉ ths of business gain taxable	All business gain taxed at 10%
Lifetime limit	2009/10: £1,000,000 2010/11: £2,000,000¶	£5,000,000

* Reduced by at least 50% for most trusts.

¶ To 22 June 2010

Rates of tax

Taxpayer	2009/10 and 2010/11 up to 22 June 2010	2010/11 from 23 June 2010 onwards
Individual	18%	Below higher rate band: 18% Within higher or additional rate bands: 28%
Trustees and personal representatives	18%	28%

STAMP DUTY AND STAMP DUTY LAND TAX

Residential	Commercial	Rate
£125,000* or less	£150,000 or less	Nil
Over £125,000* up to £250,000	Over £150,000 up to £250,000	1%
Over £250,000 up to £500,000	Over £250,000 up to £500,000	3%
Over £500,000	Over £500,000	4%
<i>*£250,000 for first-time buyers, £150,000 for property in disadvantaged areas</i>		
Stamp Duty (including SDRT): stocks and marketable securities		0.5%
No charge unless the duty exceeds £5		

CORPORATION TAX

	Year Ending 31 March		
	2010	2011	2012
Main Rate	28%	28%	27%
Small Companies' Rate	21%	21%	20%
Small Companies' Limit	£300,000	£300,000	£300,000
Upper Marginal Level	£1,500,000	£1,500,000	£1,500,000
Effective Marginal Rate	29.75%	29.75%	28.75%%

TAX PRIVILEGED INVESTMENTS [MAXIMUM INVESTMENT]

	2009/10 £	2010/11 £
ISA		
Overall per tax year: Born after 5 April 1960	7,200	10,200
Born before 6 April 1960	10,200	10,200
Cash component: Born after 5 April 1960	3,600	5,100
Born before 6 April 1960	5,100	5,100
Stocks and shares component: Born after 5 April 1960	Balance up to £7,200	Balance up to £10,200
Born before 6 April 1960	Balance up to £10,200	Balance up to £10,200
Maximum in cash for 16 and 17 year olds	3,600	5,100
ENTERPRISE INVESTMENT SCHEME (20% income tax relief)	500,000*	500,000*
Maximum carry back to previous tax year for income tax relief	£500,000	£500,000
VENTURE CAPITAL TRUST (30% income tax relief)	200,000	200,000

* No limit for CGT reinvestment relief.

PENSIONS

	2009/10	2010/11
Lifetime allowance*	£1,750,000	£1,800,000
Lifetime allowance charge:		
Excess drawn as cash	55% of excess	
Excess drawn as income	25% of excess	
Annual allowance	£245,000	£255,000
Annual allowance charge	40% of excess	
Special annual allowance	£20,000 - £30,000	
Special annual allowance charge	20%	20%-30% ⁺
Lifetime allowance charge:		
Excess drawn as cash	55% of excess	
Excess drawn as income	25% of excess	
Max. relievable personal contribution	100% relevant UK earnings <i>or</i> £3,600 gross if greater	

* May be increased under transitional protection provisions

⁺ Depends on taxable income: effect is to reduce relief to basic rate

WORKING AND CHILD TAX CREDITS

The main features of the tax credits for 2010/11 are:

1. Child tax credit

- Eligibility is assessed on household income.
- The claimant must be responsible for one or more children aged 16 or under, or at least one child under age 20 and in full-time non-advanced education.
- The family element of the tax credit is £545 per annum and is doubled in the first year of a child's life.
- The child element is £2,300 per annum for each child.
- The disabled child element is £2,715 per annum (where relevant).
- HMRC will pay the CTC to the main carer for the child.

2. Working tax credit

- The claimant, or one of the joint claimants, must be in qualifying remunerative work.
- The amount of WTC will be based on circumstances which are primarily the number of hours worked and the income of the claimant (or joint income for a couple).
- The age and working hours conditions are not straightforward. Generally, the minimum weekly working requirement will be:
 - a) 16 hours for families with children and workers with a disability. The claimant can be aged 16 or over.
 - b) 30 hours for workers with no children and no disability. The claimant has to be aged 25 or over.
- The basic element of the tax credit is £1,920 per annum.
- The couple or lone parent element is £1,890 per annum.
- A 30 hour element of £790 per annum is payable where the claimant or one of the claimants works at least 30 hours a week (couples with children may aggregate their hours for this purpose).
- A disabled worker element of £2,570 per annum or more is available where the claimant, or his or her partner, has a disability.

- There is 50-plus element and a childcare element, worth 80% of care costs, subject to an eligible maximum of £300. This element will be withdrawn from 2012/13.
- For employees, payment will normally be made by their employer with their wages (except the childcare element which is paid direct to the main carer). For the self-employed, payment is made directly by HMRC.

3. Calculating the credits

It is necessary first to total the various elements available to arrive at the maximum available amount of tax credits before any reduction on account of income. All elements can be reduced at the rate of 39% (ie. 39p per £1 of income), except the family element of CTC which is reduced at a rate of 6.67%.

NATIONAL INSURANCE CONTRIBUTIONS FOR TAX YEAR 2010/11

Definitions

Lower Earnings Limit (LEL) the minimum level of earnings at which an employee will qualify for a State Second Pension (S2P). This is also the lower level of earnings which will be used in determining any NI Rebate.

For tax year 2010/11 the Lower Earnings Limit is £97 per week.

Upper Accrual Point (UAP) the upper level of earnings on which an employee's S2P entitlement is based (or on which any NI Rebate is determined). For tax year 2010/11 and subsequent years the Upper Accrual Point is fixed at £770 per week.

Upper Earnings Limit (UEL) the upper level of earnings on which full NICs are charged. The reduced 1% NI contributions will apply to earnings above this level. For tax year 2010/11 the Upper Earnings Limit is £844 per week.

NI Rebate

the Rebate of employer's and employee's National Insurance contributions that is available where an employee is contracted out of S2P. This is based on the employee's earnings between the Lower Earnings Limit (LEL) and Upper Accrual Point (UAP).

The Rebate will vary depending on the type of pensions vehicle used to contract out of S2P. Where this is a final salary occupational scheme this will be 3.7% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP.

Where this is a money purchase occupational scheme or contracted out money purchase stakeholder pension scheme the Rebate will be 1.4% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP. The aggregate Rebate will be determined on an age related basis (varying from 3.0% to 7.4%) and any further Rebate due (ie over and above the amounts mentioned earlier in this paragraph) will be paid by the HMRC NICO to the scheme after the end of the tax year.

Where this is a personal pension or stakeholder scheme National Insurance contributions will be paid at the contracted in rate and the Rebate, which will be determined on an age related basis, will be paid directly to the member's personal pension by the HMRC NICO after the end of the tax year to which it relates.

The Rebates will also vary in accordance with an individual's earnings, in each of the following two bands:

<u>Band</u>	<u>Age related Rebate</u>
1 (£5,044 - £14,100)	9.4% - 14.8%
2 (£14,101 - £40,040)	2.35% - 3.7%

Primary Threshold the level of earnings at which employees start to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week.

Secondary Threshold the level of an employee's earnings at which the employer starts to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week.

Employees - Class 1

Contracted in Nil on first £110 per week (i.e. up to Primary Threshold)
11% of £110.01 per week to £844 per week.

1% on earnings above £844 per week.

Contracted out via occupational scheme Nil on first £110 per week (i.e. up to Primary Threshold)

9.4% of £110.01 per week to £770 per week

11% of £770.01 per week to £844 per week.

1% on earnings above £844 per week.

The employee's NI Rebate is still payable in respect of the employee's earnings between the LEL and UAP including those in excess of the LEL and up to and including the Primary Threshold. In the first instance, the Rebate reduces the National Insurance contributions payable by the employee. However, where the National Insurance contribution payable by the employee is reduced to nil, the excess Rebate will be available for the employer to set against his overall National Insurance contribution bill.

Married Women and Widows Reduced Rate 4.85% of £110.01 to £844 per week.

1% on earnings above £844 per week.

Employer - Class 1 Contributions

Weekly Earnings

Contracted In

Contracted Out

		COSR	COMP**
	%	%	%
On first £110	Nil	Nil	Nil
£110.01-£770	12.8	9.1	11.4
Over £770	12.8	12.8	12.8

Although the reduced level of National Insurance contributions only applies to the employee's earnings in the band between the Secondary Threshold (£110 per week) and the UAP (£770 per week), the NI Rebate is still available in respect of the employee's earnings between the LEL and UAP, including those earnings between the LEL (£97 per week) and the Secondary Threshold (£110 per week). Employers are able to reduce their overall National Insurance contributions liability to reflect the Rebate applicable to the employer's contributions on the employee's earnings between £97 per week and £110 per week.

** Where a COMP (Contracted Out Money Purchase Occupational Scheme) is involved the Rebate is determined on an age related basis and any additional Rebate due over and above that shown above will be payable by HMRC NICO to the scheme after the end of the tax year. This will also apply to a Contracted Out Money Purchase Stakeholder Pension Scheme (COMPSHP).

COSR is a Contracted Out Salary Related Occupational Scheme.

Self-Employed

Class 2 (lower profits limit)	£2.40 per week flat rate. (applicable where profits are less than £5,075 per annum)
Class 4	8% of profits between £5,715 p.a. and £43,875 p.a. 1% on profits above £43,875 p.a.

Voluntary Contributions

Class 3	£12.05 per week
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