

THE 2010 BUDGET BULLETIN

INTRODUCTION

As for last year we had “prior knowledge” of many, but by no means all, of the changes that would take effect in the coming tax year.

New changes announced (that we didn’t know about) include:

- A doubling of the “lifetime limit” for entrepreneurs’ relief from £1m to £2m.
- Lots more (fairly intricate) anti-avoidance provisions.
- A freezing of the IHT nil rate band at £325,000 for four years.
- A doubling of the Annual Investment Allowance delivering a 100% corporation tax deduction for qualifying purchases of plant and machinery.

...And we didn’t get any change to the CGT flat rate of 18%.

The following is what we already knew about:

- The continued removal of higher rate tax relief for pension contributions for those with relevant income of £130,000 or more through the imposition of a special allowance charge.
- The introduction, from 2010/11, of a 50% income tax rate (and 42.5% rate on dividends) for those with taxable income of £150,000 or more.
- The gradual reduction, from 2010/11, of the basic personal allowance for those with an income over £100,000.
- The increase of the trust tax rate to 50% and 42.5% for dividends – regardless of trust income levels.
- The increase of the annual ISA allowance to £10,200 from 2010/11 for all qualifying individuals.
- The retention of the small companies’ corporation tax at 21% for another year.

Our budget bulletin concentrates on the changes that we believe to be of most relevance to the financial services sector in general, and financial planners in particular.

As ever, being aware of and able to effectively communicate relevant changes will be a powerful means of differentiation. The ability to identify opportunities to improve the financial position of individual, trustee and corporate clients will take the differentiation process to an even higher level.

We hope and trust that this year's bulletin will help you to do just that.

YOUR GUIDE TO THE BUDGET BULLETIN

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The contents of this Budget Bulletin are based on the proposals put forward by the Chancellor in his Budget speech. These need to be approached with caution as the details may change during the passage of the Finance Bill through Parliament.

2. INCOME TAX

The most important changes for 2010/11 (announced and legislated last year) made in connection with income tax were confirmed as

- (a) the introduction of a 50% rate of income tax (the additional rate)
- (b) the gradual withdrawal of the basic personal allowance for persons with income in excess of £100,000 with its complete removal at £112,950
- (c) the freezing of the personal allowance and higher rate threshold

We will now look at

- personal allowances
- basic tax rates
- higher rate tax

and

- the additional rate tax

together with appropriate planning strategies for each.

2.1 PERSONAL ALLOWANCES AND TAX RATES

2.1.1 PERSONAL ALLOWANCES

As announced in the December Pre-Budget Report, allowances and thresholds for 2010/11 have been held at their level in 2009/10.

This means:

- The personal allowance is £6,475.

From 6 April 2010, where an individual's "adjusted net income" exceeds £100,000 the level of the personal allowance will be reduced by £1 for each £2 over £100,000 until it reaches zero.

Adjusted net income is calculated in a series of steps. The starting point is "net income" which is the total of the individual's income subject to income tax less specified deductions, the most important of which are trading losses and payments made gross to pension schemes. This net income is then reduced by the grossed-up amount of the individual's Gift Aid contributions and the grossed-up amount of the individual's pension contributions which have received tax relief at source. The final step is to add back any relief for payments to trade unions or police organisations deducted in arriving at the individual's net income.

- The limit for the 10% starting rate for savings will remain at £2,440.
- The age allowance is £9,490 (for those aged 65 – 74) and £9,640 (for those aged 75 and over).
- The level of income that a person can enjoy before age allowance is cut back is £22,900.
- The married couple's allowance (MCA) for those aged 75 and over (provided at least one spouse was aged 65 or over before 6 April 2000) remains at £6,965. The MCA for those aged 65 to 74 is no longer relevant
- The universal MCA was, of course, withdrawn from 6 April 2000. In calculating the reduction in age allowance when income exceeds £22,900, the increased MCA is cut back to not less than £2,670 (the "minimum amount").
- Tax relief for maintenance payments will be available only where at least one party was 65 or over at 5 April 2000. The relief remains at £2,670.
- Relief in respect of the MCA and maintenance payments continues to be given as a tax credit at the rate of 10%. Where one of a couple is a higher rate or additional rate taxpayer and one isn't

WHICH MEANS THAT ...

- The fact that each person has their own personal allowance and their own starting and basic rate tax bands means that worthwhile overall income tax saving opportunities exist for 2010/11. This is especially so in regard to income that falls between £100,000 - £112,950 – causing the removal of the personal allowance and an effective tax rate of 60%. For all couples, as a bare minimum, both personal allowances and starting/basic rate tax bands should be used to the full. This is particularly beneficial where income can be legitimately shifted from a higher or additional rate paying spouse to a non, starting, or basic rate taxpaying spouse. For those with cash and investments this will usually be facilitated by a transfer of income producing investments from the higher tax paying spouse. Any such transfers would be CGT and IHT neutral. Transfers between spouses living together are treated as transfers on a no gain/ no loss basis for CGT. Transfers between UK domiciled spouses (living together or not) are exempt from IHT.

Business owners with greater control over "income flow" might consider, in relation to their spouses who are non/lower taxpayers:

- employing them (although deductibility of the amount paid would be subject to showing that the expense was incurred wholly and exclusively for the purpose of the trade), or
- bringing them fully into partnership (sharing in capital and profits), or

- transferring or issuing fully participating shares (ie. shares with rights to capital, voting and income) to them which would carry the right to dividends

as a means of tax effectively ensuring that income distributed from the business bears as low a personal tax rate as possible

- Age allowance applies separately to a husband and wife as does the total income limit of £22,900 above which the allowance reduces. By careful planning both spouses can possibly each qualify for a full age allowance. When investment income is in the “age allowance trap” it can suffer an effective rate of tax of 30% so reinvestment in non-income producing assets should be considered. Insurance investment bonds, capital growth oriented collectives and ISAs may be attractive as, (subject to guarding against “capital erosion”), “income” can be taken without loss of age allowance. With the capital investment bond, this will commonly be by use of the 5% annual withdrawal facility. In some cases, more than 5% can be taken (without an addition to total income which may impact on the age allowance) provided the first withdrawal is made in the second policy year.

Under current tax rules care should be exercised on final encashment of the bond or on part encashment over the cumulative unused 5% allowances as the entire chargeable event gain without top-slicing relief will count as income for age allowance purposes. However, careful advance planning can help to substantially reduce this problem.

In the case of collectives, units or shares can be regularly encashed to make use of the annual capital gains tax exemption to produce tax effective “income supplements”.

- In relation to trusts established by a parent for a minor unmarried child not in a civil partnership, where that child has a vested right to income, if the income exceeds £100 gross in a tax year it is automatically taxed on the parental settlor irrespective of whether the income is paid to or for the child’s benefit. However, scope exists for trusts for grandchildren where consideration should be given to investing in offshore reporting funds to obtain the benefit of gross dividends or distributions. If it is desired to achieve tax effective accumulation of income from UK investments held in a trust under which the grandchild has a right to income, subject to investment considerations, it will be necessary to invest in areas that produce income other than UK dividend income. As well as interest from cash deposits, this will include income from corporate bonds and certain collectives whose income payments are treated as interest distributions rather than dividends ie. those where more than 60% of the fund is invested in debt based investments

2.1.2 RATES OF TAX (2010/11)

(i) The starting rate of income tax

The starting rate of 10% for the tax year 2010/11 applies to the first £2,440 of taxable savings income (i.e. after allowances and reliefs).

If an individual’s taxable non-savings income is more than £2,440 then the 10% savings rate will not apply. This is because in calculating tax, savings income “sits on top” of non-

savings income. So if, for example, taxable non-savings income were £1,500 then £940 of savings income would benefit from the 10% rate.

(ii) The basic rate of income tax

For 2010/11, the basic rate of income tax has been held at 20%. The higher rate threshold remains at taxable income of £37,400. The basic rate of tax will apply to taxable income in the band £1 to £37,400 but subject to 2.1.1 above. The basic rate of tax is relevant to:-

- individual contributions to registered pension schemes which operate basic rate tax relief at source.
- charitable covenants and Gift Aid. For qualifying Gift Aid donations made before 6 April 2011 the Government will make an additional repayment to the charity so that the overall effect is that the 22% basic rate of tax (which applied up to 5 April 2008) still applies for repayment purposes.
- annual payments.

It should be noted that discretionary trusts and accumulation and maintenance trusts will, in general, qualify for a £1,000 standard rate tax band for tax year 2010/11.

WHICH MEANS THAT ...

As for planning to maximise the benefit a couple can secure from both their personal allowances, by allocating income, between them (particularly where the income is currently concentrated in the hands of one spouse and especially for those where one spouse pays income tax at a higher rate than the other), it is possible to save considerable amounts of tax by ensuring that maximum use is made of basic and starting rates of tax. This reallocation can be achieved by unconditionally transferring assets (including capital investment bonds to be encashed) from one spouse to the other. There is no better time than the beginning of the tax year to implement “income splitting” plans.

(iii) The higher rate threshold

The higher rate threshold for taxable income remains at £37,400. Taxable income in excess of this will be taxed at 40% or 32.5% (UK dividend income) up to the threshold (£150,000) for the additional rate of 50%..

WHICH MEANS THAT ...

Increasing numbers will be “fiscally dragged” into higher rate tax resulting in more needing advice to minimise its impact. Where a person is or is likely to be a higher rate taxpayer, consideration should be given to:-

- Reducing taxable income by offsetting pension contributions against earned income.
- Individual savings accounts (ISAs).

- Investments which secure tax relief on investment (such as enterprise investment schemes and venture capital trusts), that can be used to reduce the investors tax liability.
- Capital growth oriented collectives.
- Life insurance investment bonds – providing useful tax deferment

2.2 THE ADDITIONAL RATE OF TAX

- It was announced last year that from 6 April 2010 the rate of tax on taxable income in excess of £150,000 would be 50%. It is a little confusing that the new 50% rate is called an “Additional Rate” as this implies that it will be applied “in addition” to some other rate. It won’t. It is a stand-alone rate applying to income over £150,000.

From 6 April 2010 dividends received by individuals will be taxed as follows:

Basic rate taxpayer	10%
Higher rate taxpayer	32.5%
50% taxpayer	42.5%

WHICH MEANS THAT ...

Some thoughts follow on planning in light of the above changes particularly as the capital gains tax rate remains at 18%.

Many of these thoughts are a re-statement of tax planning that higher rate taxpayers should already be considering-but heightened by the additional “10%” on the higher rate of tax for those whose income may be over the £150,000 threshold next year.

- Consider investing for capital growth (taxed at 18% after the annual exemption) rather than income (taxed at 50%).Of course, tax should not be the sole determinant of investment planning strategy but a 10% increase in the income tax rate for wealthier taxpayers cannot be ignored.
- For those investors affected by the new rate, to the extent that investment returns arise predominantly from capital growth, the “Bonds v Collectives” balance would tip further in favour of collectives. Despite indexation allowance being available within the UK life fund, the tax payable by a 50% taxpayer on chargeable event gains realised under UK capital investment bonds would be 30% -up from 20%. And this rate will apply to gains that are already depleted by whatever the effective rate is on gains and income inside the UK life fund. Gains realised under offshore bonds would be assessed at the full rate of 50% with no tax credit – but with no ‘internal’ fund taxation.

A capital investment bond would, however, continue to represent a more tax attractive home for reinvested income as it currently does. Inside a UK bond, UK dividend income would bear no further tax and other income would be subject (broadly speaking) to a 20% tax rate at life fund level. There would be a 20% tax credit when a

chargeable event gain was realised and, of course, tax effective withdrawals using the “5% rule” would be possible.

As well as the “5% rule” more attention will undoubtedly be focused on tax planning strategies to minimise the tax on taking benefits from the bond. Those who anticipate being able to exercise a strong element of control over their income at the time of any future bond encashment may be able to implement an attractive strategy of tax deferment during the period of accumulation followed by tax minimisation on withdrawal of benefits.

As is the case now, there will continue to be a number of issues to take into account in determining the most effective tax wrapper for a particular portfolio. The balance between income and gains on the portfolio in question will, as it is now, be a particularly important one.

- The attraction of the tax free investment growth and income secured inside a registered pension scheme and an ISA will increase for people suffering 50% tax on income. And from 6 April 2010 the ISA annual contribution limit will be raised to £10,200 for investors of all ages, with the increase applying from 6 October 2009 for those aged 50 and over in tax year 2009/10. The annual limit is set to increase by RPI in future years.
- Where higher rate tax relief on pension contributions remains for an individual until 5 April 2011 (see section 13 for more detail) and assuming that, where appropriate, relief will be available at the new highest rate, then the immediate and continuing appeal of such contributions will be obvious. However, if the contribution is made when relief is secured at 40% but the emerging income is taxed at 50% then the tax attraction, while still strong (given the greater sum invested as a result of the tax relief and the tax freedom of the underlying fund) will be somewhat diminished. This will be even more so if the relief is limited to basic rate.
- There has been increased interest over the last year in the use of employee benefit trusts and family benefit trusts as a means of securing access to funds without immediate income tax or NIC cost. HMRC action to limit the attraction of EBTs now seems likely.
- Company owner/managers may well see merit in reinvesting into their business (rather than taking sums out by way of dividend or salary). The sums reinvested will have borne corporation tax only (possibly at the “held” small companies’ rate of 21%) instead of income tax, and if the value of the business is increased as a result of the reinvestment then up to £2 million of the gain (up from £1 million) eventually realised will, with the benefit of entrepreneurs’ relief, only be taxed at effectively 10% and at 18% for any gains over the new lifetime capital gains limit of £2 million. Of course, despite the undoubted tax attraction of an effective 10% tax rate on capital gains of up to £2 million, there is an inherent risk in relying on one’s business as the SOLE source of future financial security....however tax attractive that strategy may be.
- Still on the company owner/managers theme, the dividend v salary decision would have been made even easier than it is now for those wishing to minimise the “outflow to the authorities” if the 50% rate only applied to earnings. However, a comparable

42.5% rate applies to dividends so that the dividend v salary choice would remain as it is now with the dividend having the (often overwhelming) advantage on tax/NIC grounds.

- A 50% tax rate may give greater incentive to those “affected” business owner/managers to “shift” income – see earlier.
- Subject to the new provisions aimed at increasing the “risk element” of the investment, VCTs may look even more attractive given that dividend payments from them are tax free. The tax relief on input will not be affected by the new 50% rate. Of course, one must consider the risk element of such investments.

3. NATIONAL INSURANCE

3.1 RATES

(A) 2010/11

The National Insurance rates and contribution limits announced in the 2009 Pre-Budget Report apply as follows for 2010/11:-

- The Employee's Primary Class 1 National Insurance rate is 11% on earnings between the Primary Threshold (£110 per week) and Upper Earnings Limit (£844 per week).
- Employees, in addition, pay 1% Primary Class 1 National Insurance on all earnings above the Upper Earnings Limit (£43,875 per annum).
- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£110 per week) is 12.8%.
- The self-employed Class 4 rate on profits between the lower (£5,715 pa) and upper profits limit (£43,875 pa) is 8%.
- The self-employed Class 2 flat rate contribution is £2.40 per week.
- The self-employed, in addition, pay Class 4 contributions at a rate of 1% on all profits above the upper profits limit (£43,875).
- The Class 3 voluntary contribution rate is £12.05 per week.

(B) 2011/12

Changes, effective from 6 April 2011, already announced in the 2009 Pre-Budget Report are as follows:-

- The main rate of Class 1 and Class 4 NICs will be increased by 1% to 12% and 9% respectively.
- The Class 1 employer rate of NICs will be increased by 1% to 13.8%. The increased rate will also apply to Class 1A and Class 1B contributions.
- The additional rate of Class 1 and Class 4 NICs will be increased by 1% to 2%.

As announced in the 2008 Pre-Budget Report:-

- The NICs Primary Threshold will be broadly aligned with the basic personal allowance.

WHICH MEANS THAT ...

The proposed future changes, should give advisers an incentive to visit their business clients to discuss effective methods of remuneration.

Those running their business through a company may well consider paying themselves dividends as opposed to salary. The main reason for this will, of course, be that dividends are not subject to National Insurance. The pros and cons of dividends and salary have been well rehearsed many times in the past and these should be revisited before any meetings are arranged with clients. This is covered in greater detail in section 14 - Remuneration strategies.

In addition, a review of the opportunities for payment of salary to working spouses could be beneficial. In any remuneration planning for a spouse it is important that payments, in order to be fully tax deductible, can be justified on the basis of work carried out.

Any planning carried out with a view to taking a spouse into partnership (where appropriate) or issuing shares to a spouse in order to pay dividends must be carefully discussed with professional advisers.

There may be an additional benefit to incorporation in the shape of the avoidance of the “unlimited” 1% Class 4 NICs on earnings over £43,875 that could be avoided on profits that accrue to a company. NICs could continue to be legitimately avoided, even if the money leaves the company, provided it is paid to the shareholders by way of dividend. Of course, before taking this important step (incorporating an unincorporated business), there are many other factors to be taken into account and professional advice is essential.

4. CAPITAL GAINS TAX

Ahead of this Budget there was considerable speculation that the rate of capital gains tax (CGT) would increase to make it more closely aligned to the higher rate of income tax. That fear was unfounded and the rate of CGT will remain at 18% - although this area is likely to be revisited in future Budgets.

The Chancellor also announced that there would be no increase in the level of the annual CGT exemption which will remain at £10,100.

In a further unexpected move he announced a doubling in the threshold of entrepreneurs' relief from £1 million to £2 million from 6 April 2010.

WHICH MEANS THAT ...

4.1 BUSINESS OWNERS

The Government introduced entrepreneurs' relief as a response to strong protests over the removal of business assets taper relief in April 2008.

In brief terms, the relief applies so that in the event of the disposal of a qualifying business, a shareholding director/employee, partner or sole proprietor (as appropriate) will now benefit from an effective rate of CGT of 10% on the first cumulative £2 million of gains. Balance gains will be taxed at 18%.

The relief only applies to businesses that are trades and in certain cases there are restrictions to the relief where the business holds non-trading assets/investments. Employees / directors must own at least 5% of the shares and, for relief to apply, the conditions must be satisfied throughout the 1 year period before disposal.

The relief is cumulative throughout the life of the business owner and so the cumulative gains on the disposals of all businesses are taken into account in determining the level of relief.

The increase in the limit of the relief applies from 6 April 2010. This means that where qualifying gains are made above the previous £1 million limit before 6 April 2010, no additional relief will be allowed for the excess above the old limit. But if further qualifying gains are made after 5 April 2010, it will only be possible to claim relief on up to a further £1 million of those additional gains, giving relief on accumulated qualifying gains up to the new limit of £2 million.

This will be a welcome announcement for many owners of qualifying businesses – particularly those who, in order to avoid high levels of income tax on remuneration from companies, are preferring to retain profits inside the company and suffer a lower rate of corporation tax. Subject to those retained profits being put to trading use, they will currently only suffer a further effective CGT rate of 10% on sale/disposal of the company up to the £2 million “lifetime” allowance for entrepreneurs' relief.

Of course, it should not be forgotten that entrepreneurs' relief operates as a reduction in the gains subject to charge. So if CGT rates go up, so will the rate that applies to gains covered by entrepreneurs' relief.

4.2 PLANNING FOR INVESTORS

(i) Individuals

- The annual CGT exemption has traditionally been an important weapon in an individual's CGT planning armoury. Whilst the value of it was diminished with the reduction of the CGT rate to 18%, if CGT rates increase in the future the CGT annual exemption will become more valuable as a result.

Each individual (in a family this means a separate annual CGT exemption for each spouse and each child) can realise gains each tax year within his/her annual CGT exemption tax free. The maximum saving from use of the allowance by an individual is £1,818.

A simple way for parents and grandparents to facilitate use of the annual exemption by children is for investments, such as growth-oriented unit trusts/OEICs, to be held on an absolute (or bare) trust or for the designated benefit of the child. In this way, the child's annual CGT exemption can be used to cover capital gains of the trust.

It needs to be borne in mind though that bare trusts offer little legal control to the investor should there be a desire to prevent the child from accessing funds on attaining the age of majority. This, in effect, is the price one pays for the ability to use the child beneficiary's annual CGT exemption.

Where greater control is required, a discretionary trust may be suitable. A discretionary trust can be established for a minor child of the settlor with the trustees eligible for an annual CGT exemption (as opposed to the gains being assessed on the parental settlor) but this will generally be at half the level available to the bare trust ie. £5,050. Gains above the available exemption will currently be taxed at 18% in either case. The CGT 'price' to pay for discretion could thus be quantified at a maximum of £909 which many may find acceptable.

- Transfers between spouses living together continue to be treated as being made on a "no gain/no loss" basis. This means that as long as any transfer is outright and unconditional, a prior transfer from a spouse holding investments to a spouse with no investments could effectively double the use of the family's annual exemption. The same rules apply to transfers between registered civil partners. Although these days it is harder to utilise the annual exemption through "bed and breakfast" transactions, "bed and spouse", "bed and ISA" and "bed and SIPP" arrangements can still work.

Special anti-avoidance rules exist to prevent CGT advantages arising on transfers between a husband and wife which have been made purely to take advantage of loss relief with neither party substantially changing their fiscal position.

(ii) Trustees

Trustees will be entitled to an annual CGT exemption of £ 5,050 but where a settlor has created more than one trust, then this £ 5,050 is diluted by the number of trusts concerned, subject to a minimum exemption of £ 1,010. There are certain planning points that arise out of the use of the trustees' annual exemption, as follows:-

- If trustees wish to invest in ways in which they can effectively use the annual CGT exemption growth-oriented UK or offshore collective investments may be appropriate.
- In the case of larger trusts, if the trustees are likely to realise capital gains that exceed their annual exemption, the rate of CGT on such gains will be 18%. Where portfolio management without personal CGT risk is desired then a UK or (more likely) an offshore bond may be thought "tax suitable" to shelter gains that could arise simply through portfolio management. Of course, gains realised by the manager of the collective will be CGT free. Only realisation by the investor will give rise to the potential for personal taxation .

The choice of the most tax effective investment wrapper will be substantially portfolio dependent though and the overall effective rate of return on the investment (taking account of fund and trustee tax) will need to be taken into account in comparing investment wrappers. For other than bare trusts, the same factors as are relevant for higher rate taxpayers will need to be considered in making investment wrapper choices - see (iii) below.

- With the rates of income tax on discretionary trusts increasing to 50% (42.5% on dividends) from 6 April 2010, it is even more important for underlying trust investments to be tax efficient.

(iii) Investment product wrapper choice

The abolition of taper relief and indexation allowance and its replacement with the 18% flat rate caused much debate on the choice of investment wrapper. The introduction of a 50% income tax rate from 6 April 2010 will necessitate another review as a result of the consequent widening of the gap (for those investors with high incomes) between the taxation of income and capital gains.

In the financial services sector the debate over the most appropriate investment product wrapper for a particular portfolio is one that has been well aired.

As things stand currently,(and as was always the case), the choice of the most appropriate investment wrapper remains dependent on the circumstances of each case. At relatively lower levels of investment it is arguable that wrapper choice makes little tax difference. However, it is clear that with more substantial sums the difference that product wrapper choice can make can be appreciable.

Key variables impacting on the decision are investment term, investor tax, the availability or otherwise of the CGT annual exemption, RPI, and the extent to which investment growth is driven by income (and what sort of income) or capital gains. In general, all other things being equal, one will find that where the investment growth is driven substantially by capital gain, collectives will look “tax best” and where there is high reinvested income, insurance products (bearing no internal tax on reinvested dividends) can look attractive – especially for higher rate taxpayers. As indicated above this conclusion will be even easier to arrive at in respect of those who will be caught by the higher rates of tax – especially the new 50% rate.

Offshore bonds look “tax good” for deferment but less appealing if fully encashed when the investor is a UK resident higher rate taxpayer – especially if the rate is 50%

And, of course, tax is not the only determinant of wrapper choice. Everything starts with portfolio choice. In the current environment there is still interest in income-producing funds with income from interest on corporate and government bonds being particularly popular. The importance of reinvested dividends on equity funds has also been reinforced recently. In both cases the insurance structure will look more tax appealing to a higher rate taxpaying investor.

There is also administrative simplicity and appropriateness to hold in trust to consider though. Of course, collectives can be held in trust, it’s just that they may be a little more difficult to administer. How and when benefits are withdrawn is also a factor to take into account in choosing investment wrappers. Bonds (UK and offshore) offer the “5% tax-deferred withdrawal” facility and collectives offer the use of the CGT annual exemption for tax free withdrawals of capital. And there’s the scope for “tax arbitrage” between married couples and registered civil partners. Assignment of a collective between these persons gives rise to no chargeable disposal for CGT. It will usually be designed to secure use of another CGT annual exemption to set against the gain made on the collective investment to be disposed of. With an 18% flat rate, though, it is no longer possible to access a lower CGT rate through “spousal assignment”.

Bonds, on the other hand, being insurance contracts can be assigned from anyone to anyone (provided the assignee can give a valid discharge), and lower tax rates can then be accessed and (for offshore bonds) even the personal allowance.

In conclusion then, what these changes tell us is that, more than ever, advice will be necessary when making decisions over the choice of investment wrapper – especially for the more substantial sums and tax will rarely be the only factor to take into account. We have touched on some of the “other” factors above. There is also the not unimportant issue of charges, reductions in yield and total expense rates to take into account.

When the penalty for getting the choice of wrapper wrong is so harsh – reflected in potentially significantly lower post-tax returns – it’s worth taking some time over the choice and then documenting the “reasons why”.

And to the extent that there is uncertainty regarding the variables impacting on the choices, then the principle of “wrapper allocation” will be well worth considering to compliment a risk reducing investment strategy founded on asset allocation.

5. INHERITANCE TAX

5.1 NIL RATE BAND LEVEL

The Chancellor has announced that the inheritance tax (IHT) nil rate band will remain at its current level of £325,000 for tax year 2010/11 and will remain at this level until the end of tax year 2014/15.

WHICH MEANS THAT ...

For a person with assets of £325,000 or more, the nil rate band can produce an IHT saving of £130,000. Coupled with the transferable nil rate band (see 5.2 below) for a married couple or registered civil partners this can mean that (at current levels) up to £650,000 of the combined estate could pass free of the IHT. Assets that exceed this value on death will be taxed at 40%.

5.2 TRANSFERABLE NIL RATE BAND

The Finance Act 2008 introduced legislation to allow a claim to be made on the death of the survivor to transfer any unused **nil rate band** on the death of the first of a couple to die to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007.

These provisions, known as the transferable nil rate band (TNRB), apply to anyone who dies on or after 9 October 2007, regardless of when their spouse died (including deaths before 1986 when IHT was introduced).

While the nil rate band level is to remain frozen, the potential validity and effectiveness of planning using the transferable nil rate band remains.

WHICH MEANS THAT ...

It may be reasonable to conclude that couples with combined assets of up to twice the nil rate band (£650,000 currently), especially those whose main asset is their home, may not need, or be interested in, IHT planning. Others may still be interested in “first death nil rate band planning” though. One example of this may be where it is thought that the value of the assets to be left on first death will increase at a rate faster than the expected increase in the nil rate band. Another may be where the surviving spouse has already inherited (from an earlier marriage) a 100% multiplier of the nil rate band.]

And even where the TNRB is to be used, the use of an Immediate Post-Death Interest Trust (IPDI), with the immediate life interest being given to the surviving spouse, can ensure that there is certainly over the final destination of the trust assets.

Section 5.3.(2) below gives further consideration of inheritance tax planning for those who wish to pursue it either during lifetime or through the Will on the first death.

5.3 IHT PLANNING

There are signs that following the recession, asset values are beginning to increase again and so more and more people will become concerned about inheritance tax. This is particularly the case as the nil rate band has been frozen for the next 4 years.

With asset values having reduced, now may be a good time to consider lifetime gifts for those people who are worried about inheritance tax. In practice, of course, the feasibility of this is likely to depend on the capital and income needs of the would-be donor. The reduction in asset values may have increased these needs. Another challenge to consider is that if we have a change of government the impact of IHT may be reduced. This needs to be carefully borne in mind with any planning that is being carried out now although even if the Conservative party do come to power, a substantial increase in the IHT nil rate band may be well down their list priorities.

As things stand a number of opportunities for mitigating IHT still exist and so, for those who wish to plan, it is important to make maximum use of the current rules for those who believe that they will still have a liability to IHT which they will want to do something about.

In very brief terms the main advantages of the current inheritance tax regime are as follows:-

- a new nil rate band is, in effect, available every 7 years
- the potentially exempt transfer rules remain on the statute book but, in general, only apply to outright gifts and certain gifts to absolute trusts and trusts for the disabled.
- a 100% maximum level of business property relief and agricultural property relief is available, subject to satisfying the appropriate conditions
- planning using deeds of variation can still take place – although the “retrospective” use of the nil rate band in this way is likely to be less well used following the introduction of the transferable nil rate band
- lump sum inheritance tax schemes (eg. discounted gift trusts (DGTs) and loan trusts) that avoid the gift with reservation rules and the rules on pre-owned assets can still be implemented with beneficial results
- there are advantageous rules for excluded property trusts for non-UK domiciliaries who may become UK domiciled or deemed domiciled in the future.

(1) Lifetime gifts

Individuals who have a potential inheritance tax liability may well be inclined to use their nil rate band sooner rather than later. This will get investment growth out of the estate and open up the chance of being able to use a fresh nil rate band after 7 years. This means making lifetime gifts.

The 2006 reform of trust taxation severely reduced the scope for making PETs via a trust. Of course, those who are happy to make an outright gift or a gift to an absolute trust will still benefit from the PET treatment ie. that there will be no IHT at all, regardless of the size of the gift, if the donor survives the gift by 7 years. Even if death occurs within 7 years, provided the donor survives for at least 3 years taper relief will apply to reduce any tax charge. Anybody contemplating making substantial lifetime gifts in order to save IHT should sensibly consider doing so whilst PET treatment is available.

Where the potential donor prefers to maintain an element of control over the asset being gifted, this can be achieved by making a gift to a trust. As long as the donor's nil rate band is not exceeded, there will be no immediate IHT to pay. And remember that between them, a husband and wife/civil partners who had not made previous gifts could still transfer £650,000 in this way. Indeed this would increase to £662,000 if they hadn't previously used their £3,000 annual exemptions.

The choice of trust will naturally have to be considered and discretionary trusts are popular because of their flexibility. Remember though that although most trusts (other than bare trusts) are now subject to the same IHT and CGT regime, income tax consequences differ considerably in that they are generally more straightforward for interest in possession trusts. Proper advice should be sought when making any gift to a trust.

Life assurance can be effected to cover any potential IHT liability on the death of the donor within 7 years. Careful consideration needs to be given to the CGT implications of making gifts and the CGT cost of making a gift balanced against the potential IHT saving. However, CGT hold-over relief is now available on gifts to most types of trust.

Detailed consideration of insurance-based plans can be found in (5) below.

(2) Will planning

The continuation of the availability of the transferable NRB (see above) means that many couples will be content with their entire estate passing to the survivor on the first death as it will no longer, in most cases, mean the loss of one NRB. However, it is clear that the predicted extinction of nil band trusts as a means of planning is somewhat exaggerated.

The following circumstances give examples of situations when a first death discretionary Will trust may be appropriate:-

- (i) The partners may each be in a second marriage and each of the couple may wish to benefit his/her children from a former marriage on the first death or it may just be that each of the couple does not want the survivor to have complete legal and beneficial control of the assets following first death. Whilst this could technically be achieved using a life interest trust in the Will – known as an immediate post-death interest trust, (with income payable to the surviving spouse and capital held for the children from the first marriage), that route lacks flexibility especially if there is an intention to make capital payments to the widow/widower by way of interest-free loans.
- (ii) There may be a desire to avoid assets being available to the local authority in the event of the survivor going into care. By leaving assets to a trust on the first death

those assets will not count as part of the surviving spouse's resources for the purposes of the local authority charge. Indeed, the split ownership of certain assets between a trust and surviving spouse may reduce the value of the assets in the hands of the surviving spouse- for example in the case of a private residence.

- (iii) It may be desired to avoid children inheriting assets outright. By passing assets to them via a trust it will mean that they are protected from the claims of creditors and ex-spouses.
- (iv) Further IHT savings could be secured by the trustees of the Will trust making loans to the surviving spouse if and when funds are needed which create debts and so reduce the taxable estate of the survivor on his/her subsequent death. Here, one would need to identify whether the surviving spouse had previously made lifetime gifts to the deceased because in those circumstances there could be a restriction on the ability to deduct the loans from the survivor's taxable estate. (see section 103(1) Finance Act 1986).
- (v) Where a person has remarried after his/her former spouse has died without using his/her nil rate band, the surviving spouse may have a nil rate band of, currently, up to £650,000 available on his/her death first. Clearly, it would be important to utilise this because otherwise up to £325,000 of the nil rate band could be lost on the survivor's death.
- (vi) It may be felt that investments made subject to the Will trust on the first death will increase in value at a greater rate than the increase in the nil rate band.

Also, even if a discretionary Will trust does come into existence on the first death and, after the first death, this is not required there would, within 2 years of death, be scope to appoint absolutely out of that discretionary trust and achieve the same IHT results as if the asset had passed directly under the Will (see below).

Planning after the first death

In cases where the first of a couple has already died then, clearly, if there was a trust in the Will this will now have come into effect. If the surviving spouse feels that he or she would have had a better inheritance tax position by having available the whole of the nil rate band of the first to die, and the trust is a discretionary trust, the trustees can within 2 years of its creation (on the first death) make an absolute and irrevocable appointment in favour of the surviving spouse. Under section 144 IHT Act 1984 this will mean that such an appointment will be treated for IHT purposes as if the asset was left under the Will directly to the spouse on the first death. This will mean that the assets would be treated as passing directly to the surviving spouse on the first death and so the spouse exemption would apply and all of the nil rate band of the deceased would be freed up for use on the second death.

Three other points arise out of this:-

- (i) An outright appointment should not be made within 3 months of the deceased's death because in those circumstances section 144 will not apply.

- (ii) If it was still desired to use a trust (to control the destination of assets after the survivor's death) yet secure ongoing entitlement to the whole of the deceased's nil rate band, an interest in possession trust could be used. Technically this would be treated as an IPDI (immediate post-death interest) trust and would secure the spouse exemption.
- (iii) As ever, all the tax implications of the appointment would need to be considered – including capital gains tax.

Married couples alive now both with Will trust clauses

In cases where married couples have already made Wills which use the nil rate band on the first death, and both are still alive, it will make sense to consider whether the nil rate band clause is still valid. If they decide, for whatever reason, that it isn't they should:-

- (a) consider amending their Wills now – if they are certain that none of the circumstances described above apply; or
- (b) make sure they can rely on section 144 IHT Act 1984 and appoint benefits within 2 years of the first death to the surviving spouse. This will mean that the nil rate band of the first to die can then be used by the survivor.

(3) Pilot trusts

Given that IHT calculations for trusts generally depend on the value of the gift, the occasion when the trust is created and the subsequent value of the trust property, it will often be advantageous to have more than one trust created on different occasions. For this reason “pilot trusts” have become more popular since 2006.

A pilot trust is a trust set up with a nominal gift (but there must be a transfer of some property to the trustees) with the intention of subsequently adding to it. Such trusts can currently be particularly useful to avoid the related property provisions when it is intended to create more than one trust on death. By having a number of unrelated pilot trusts set up on different days during lifetime it is, under current legislation and case law, in effect possible to use the available nil rate band on death to “seed them” but with each trust being entitled, in effect, to its own nil rate band.

(4) Deeds of variation

Under current legislation, within two years of a person's death, it may be possible for the beneficiary(ies) of a gift under a Will (or on an intestacy) to vary the destination of the gift. Such a variation can, depending on the circumstances, save IHT.

In the past this provision has been successfully used to establish a nil rate band discretionary trust under the Will of the first spouse to die, when he or she has left all of his/her estate to the surviving spouse.

In these circumstances, if there was a variation in a Will that creates a discretionary nil rate band trust, in the light of the availability of a transferable nil rate band (see above) this will to

a greater or lesser extent mean that there will be a loss in the proportion of the transferable nil rate band available on the second death.

But what if a variation has already been made to use the nil rate band and one is still within the two year period since the testator died? Can another variation on that same property be made to rectify the problem and so reinstate the whole of the transferable nil rate band? Well, in these circumstances, aside from needing to obtain the consent of all the beneficiaries affected by the variation, this “double variation” will not work because an instrument will not fall within section 142 IHT Act 1984 if it further redirects any item that has already been redirected by an earlier instrument. However, as explained above, an appointment in favour of the surviving spouse within 2 years will have the result of effectively reinstating the transferable NRB

(5) Lump sum inheritance tax plans

Retention of the right to income and/or capital by the donor (or settlor) of a gift will normally mean that the gift with reservation (GWR) provisions will neutralise any IHT benefit of a gift. If the GWR provisions are avoided, then the POAT (pre-owned assets tax) charge is likely to bite. Certain lump sum inheritance tax plans, usually based on capital investment bonds, seek to overcome both of these problems and, so far and despite the number of provisions introduced to combat IHT planning, have not been neutralised.

These plans, of which there are a number, will often enable an investor to establish a trust and enjoy some form of “income” (normally in the form of capital payments), possibly provide a level of access to capital and provide some control and flexibility via a trust. Ignoring annuity/life assurance (back to back) arrangements, there are two primary forms of lump sum inheritance tax plan, both based on the combination of a trust and a capital investment bond:-

- (a) The gift and loan (or “loan only”) scheme – a gift is made to a trust (or a trust declared with no gift) and an interest-free loan, repayable on demand, made to the trustees. The trustees invest in a capital investment bond. “Income” is enjoyed in the form of tax free loan repayments financed by the trustees making annual 5% part surrenders from the bond. The investment growth is outside the investor’s taxable estate and free of IHT. HMRC has confirmed to the ABI that this type of arrangement remains effective for IHT and is not caught by the gift with reservation rules and the POAT charges.
- (b) A discounted gift plan – a bond is made subject to a trust where “income rights” in the form of payments of capital are held for the absolute benefit of the settlor (funded by withdrawals from the underlying bond) with the remaining part of the investment held either on a bare trust or a discretionary trust for family. Part of the initial investment (the discounted gift) is either a PET (if the trust is a bare trust) or a chargeable lifetime transfer. In the latter case it is important to ensure that the chargeable transfer does not cause the settlor to exceed his IHT nil rate band or a 20% IHT charge will arise on the excess. As with the loan plans in (a) above, HMRC has confirmed that, in general, the gift with reservation and POAT charges will not apply to this type of plan.

There is little doubt of the appeal that lump inheritance tax schemes hold for people who have investment capital and wish to plan to reduce inheritance tax but wish to retain some access to “income” or capital.

The question of which type of scheme is most appropriate will depend on all the personal and financial circumstances of an investor – not least the age of the investor and the flexibility he or she requires over the future rights to “income”/capital. In larger cases it may well be appropriate for a combination of plans and trust types to be effected in order to achieve the balance between access, “income”, IHT effectiveness and flexibility that any particular client requires.

For those who are concerned that the need for IHT planning may be diminished under a future Conservative government and who wish to make a substantial gift but retain access to the funds given, there may be more of a temptation to use loan trusts as opposed to discounted gift trusts. This is because loan trusts give more flexible access to the whole of the original capital invested and so, if circumstances change, the donor can recoup all of the initial investment.

(6) Business/agricultural property relief

Currently most business and agricultural assets qualify for 100% relief, subject to certain conditions being satisfied, which effectively removes the assets from the inheritance tax net.

Therefore making lifetime gifts will not reduce any potential liability and will generally only be made if it is desired to pass assets to the next generation who are involved in the business.

On the other hand, holdings of shares in non-listed companies where the donor is not personally involved may offer significant planning opportunities – remember these also qualify for 100% BPR after two years of ownership. Care needs however to be exercised in connection with the definition of “listed” for the purposes of IHT business property.

(7) Excluded property trusts

Where a person, who is non-UK domiciled (for inheritance tax purposes), establishes a (normally discretionary) trust and that trust invests in non-UK situs property or UK authorised unit trusts or OEIC funds, under current law the trust will be outside the IHT net forever – even if the settlor later becomes UK domiciled for IHT purposes. This is what is known as an excluded property trust and the trust will not be subject to IHT even if the settlor is a potential beneficiary.

While sweeping changes have been introduced to the taxation of income and gains of the non-domiciled UK residents, (and these clearly need to be taken into account) the rules on excluded property and IHT treatment of excluded property trusts are not changing and so this presents a continuing opportunity.

(8) Protection

And let’s not forget that to the extent that a prospective IHT liability is left unreduced (possibly as a result of prevarication due to the prospect of a £1 million nil rate band under a

future Conservative government) the provision for that liability through appropriate life assurance in trust can, in the right circumstances, provide an effective solution.

6. CORPORATION TAX

6.1 RATES OF CORPORATION TAX

The rates of corporation tax for the financial year starting 1 April 2010 are as follows:

- The small companies' rate of corporation tax is maintained at 21% and applies where a company has profits of up to £300,000.
- The main rate of corporation tax is maintained at 28% and applies to profits of a company of more than £1,500,000. The Government have announced that this rate will continue to apply from 1 April 2011.
- Between £300,001 and £1,500,000 marginal rate relief applies. This operates to increase the overall rate of tax on the profits to somewhere between the small companies' rate of 21% and the main rate of 28%. Profits in excess of £300,000 will effectively bear tax at the marginal rate of 29.75%.

WHICH MEANS THAT ...

Subject to a company having a corporation tax liability, the structure and form of effective corporate tax reducing strategies can continue to be relevant. In particular, contributions to registered pension schemes (covered in section 13 of this bulletin) can be particularly effective.

It will also be necessary to take full account of the relevant corporate tax rates in determining the best way to take funds from the business i.e. by salary or dividends or pension contributions. This is covered in section 14 - remuneration strategies.

For companies where the profit is in excess of £300,000, any strategy (such as making a deductible employer contribution to a registered pension scheme or incurring expenditure qualifying for 100% capital allowances) to reduce profit in excess of £300,000 will result in an effective corporation tax saving of 29.75%. So, for example, if a company with profits of, say, £350,000 made a £50,000 allowable pension contribution its corporation tax bill would fall by £14,875 making the net cost of the contribution £35,125.

In all pension planning for those members whose relevant income exceeds £130,000 due account needs to be taken of the potential for a special allowance charge (see section 13 for more detail).

6.2 CHANGES IN ACCOUNTING STANDARDS

Legislation will be introduced in Finance Bill 2010 to allow regulations to be made to amend the corporation tax rules on loan relationships and derivatives where, as a consequence of a "change in accounting standards" there is a "relevant accounting change".

The regulations will not come into force before the Finance Bill 2010 has received Royal Assent. However, where a change of accounting treatment is effective in an accounting period beginning before that date, such regulations may apply retrospectively

Smaller companies that have adopted the FRSSE (Financial Reporting Standard for Small Entities) rules are less likely to be affected by this change.

7. CAPITAL ALLOWANCES

ANNUAL INVESTMENT ALLOWANCE ON PLANT & MACHINERY

Few changes were announced to the system of capital allowances in this Budget. The most relevant announcement was the doubling of the annual investment allowance.

In April 2008 a new annual investment allowance (AIA) was introduced. This gave 100% tax relief for the first £50,000 of a business's expenditure on most plant and machinery each year. In order to encourage investment the Chancellor announced that from 1 April 2010 (for those chargeable to corporation tax) or 6 April 2010 (for all others) the annual investment allowance will increase to £100,000.

The AIA is available to:

- any individual carrying on a qualifying activity (this includes trades, professions, vocations, ordinary property businesses and individuals having an employment or office);
- any partnership consisting only of individuals; and
- any company (subject to certain limitations).

Where businesses spend more than £100,000 in any chargeable period, any additional expenditure will be dealt with under the normal capital allowances regime, entering either the special rate or main pool, where it will attract writing down allowances (WDAs) at the appropriate rate.

Anti-avoidance legislation is to be introduced to disallow property loss relief against general income to the extent the loss is attributable to the annual investment allowance. The legislation will apply to arrangements entered into after 23 March 2010.

WHICH MEANS THAT ...

Capital allowances continue to be an important feature of tax life for businesses. Of course, as for any expenditure, businesses should consider carefully the commercial appropriateness of any investment. As ever, the tax tail should never be allowed to wag the dog - however attractive the tail is! Advisers must be fully aware of the capital allowance system so that they can properly advise their business clients on the tax impact of various items of expenditure.

Especially at a time when businesses may be "cash constrained" there may well be "competition" for available expenditure say between making a pension contribution and purchasing capital equipment. While tax is important it should never be the determinant. Especially with interest rates at their current low levels some businesses with occupational pension schemes may consider the merits of trying to secure "the best of both worlds"

through a deductible pension contribution and (subject to satisfying the usual conditions) loan back to make the purchase of capital equipment qualifying for 100% annual investment allowance. Of course, before making such a decision all of the implications, commercial and tax must be carefully weighed up.

8. LIFE POLICYHOLDER/LIFE COMPANY TAXATION

8.1 LIFE POLICYHOLDER TAXATION

8.1.1 Deficiency (Loss) Relief

When a chargeable event gain calculation on termination of a life assurance policy gives rise to a deficiency (ie. a loss) that deficiency can be attributed to income of the policyholder subject to tax in the same tax year. The amount of the deficiency that can be so attributed is restricted to an amount not exceeding previous chargeable event gains under the same policy (regardless of whether any tax was actually paid on those previous chargeable event gains) that have arisen to the person on whom any chargeable event gain arising on termination, if there were one, would be assessed to tax.

Deficiency relief is given by way of a tax reduction but is not available for policies owned by companies, policies held in a trust created by a company or policies held in trust where the tax liability falls on the trustees.

For tax year 2009/10, in order to calculate the tax reduction, the deficiency is attributed first to income subject to the dividend upper rate then income subject to the 40% upper rate. The amount of tax due on this income is then compared to the amount of tax on that income calculated at the dividend ordinary rate or basic rate, as appropriate. The excess is the tax reduction available.

The rules applies in the same way to those who own non-UK policies, even though they will not have been entitled to the 20% tax credit.

With the introduction of the 50% additional rate of income tax and 42.5% dividend additional rate, a deficiency which arises on a chargeable event on termination which occurs on or after 6 April 2010 will be attributed to income in the following order:-

First: Income subject to the 42.5% dividend additional rate

Second: Income subject to the 50% additional rate

Third: Income subject to the 32.5% dividend upper rate

Fourth: Income subject to the 40% upper rate

The amount of tax due on this income is then compared to the amount of tax on that income calculated at the dividend ordinary rate or basic rate, as appropriate. The excess is the tax reduction available.

The entitlement to deficiency relief will be subject to a targeted anti-avoidance provision, also effective for termination chargeable events occurring on or after 6 April 2010 which give rise to a deficiency. The provision will apply where the main purpose, or one of the main purposes, of arrangements made on or after 22 April 2009 is to secure a tax advantage.

Such a tax advantage will be secured where there is a deficiency and the amount of the tax reduction would exceed the “related income tax liability”. The related income tax liability is the tax liability on all previous chargeable event gains under the same policy less any basic rate tax credits that were available.

Where this provision applies deficiency relief will not be given at the additional rates but will be restricted to the tax due on previous gains ie. the related income tax liability.

The provision will not apply where any gain included in the total amount of all previous chargeable event gains arose on a chargeable event more than five years before the termination event.

8.2 LIFE COMPANY TAXATION

8.2.1 Apportionment of income and gains

In the 2009 Pre-Budget Report an announcement was made of the modification of rules, effective from 9 December 2009, used when apportioning income and gains of a non-profit fund between categories of insurance business, to block an avoidance scheme.

It seems these modified rules can themselves be avoided so a further modification will be introduced in the Finance Bill 2010.

9. TAX AVOIDANCE

As has become a feature of recent Budgets the Chancellor announced a series of anti-avoidance measures.

As might be expected, the measures apply to some complex transactions. Set down below are the areas affected, with a reference to the relevant Budget Note if further information is required.

	BN
• Sale of lessor companies: option to elect	14
• Countering double tax relief avoidance	17
• Insurance Premium Tax: premium splitting	18
• Stamp Duty Land: Tax Partnerships	26
• The remittance basis: Relevant person	38
• Share Incentive Plans	39
• Company Share Option Plans	40
• Transactions in securities	41
• Disclosure of Tax Avoidance Schemes	64
• Review of HMRC power, deterrents and safeguards – tackling offshore evasion	68

We have covered the provisions on share incentive plans and company share option plans in more detail (along with the announcement of anti-avoidance provisions for employee trusts and similar arrangements) in the Employee Benefits section of this Budget Bulletin.

10. STAMP DUTY LAND TAX / STAMP DUTY

10.1 FIRST TIME BUYERS

At present the SDLT rate is 1% for residential purchases where the consideration is more than £125,000. The Chancellor has announced that for completions that take place on or after 25 March 2010 and before 25 March 2012, where the purchaser(s) are first time buyer(s) and intend to occupy the property as their only or main home, relief will apply so that no SDLT will be payable if the consideration does not exceed £250,000.

10.2 PURCHASES OF RESIDENTIAL PROPERTY FOR MORE THAN £1 MILLION

At present the highest SDLT rate of 4% applies to a property purchase where the consideration is more than £500,000. For completions that take place on or after 6 April 2011, the Chancellor has announced that a rate of 5% will apply where the consideration is more than £1 million.

10.3 SDLT PARTNERSHIPS

Some companies and individuals currently exploit the SDLT partnerships rules to artificially reduce the SDLT payable on some land transactions.

Legislation will be introduced in the Finance Bill 2010 to ensure that the existing SDLT anti-avoidance rules apply to prevent this. The rules will apply to notional land transactions created by the anti-avoidance rules that have an effective date on or after 24 March 2010 subject to transitional rules.

11. TRUST TAXATION

The Chancellor has announced that where a settlor of a settlor-interested trust receives a repayment of tax:

- (a) this tax repayment must be paid to the trustees, and
- (b) the payment to the trustees will be disregarded for IHT purposes

BACKGROUND

For income tax purposes, a settlor-interested trust is one under which the settlor or settlor's spouse is a beneficiary.

With settlor-interested trusts, the settlor is liable for all income tax due on income received by the trustees, even income that is not paid out to the settlor. However, the trustees are required to pay the tax, as the recipients of the income.

The income tax rate applied depends on the type of trust that has been set up. If it is an accumulation or discretionary trust, the rate for that type of trust will apply ie. standard rate tax (effectively basic rate tax) on the first £1,000 of trust income and, currently, 32.5% on dividend income and 40% on all other income. This increases to 42.5% (dividend income) and 50% (other income) from 6 April 2010.

If the trust is an interest in possession trust, the trustees are liable for basic rate tax with the beneficiaries entitled to income normally liable to tax at the higher rate (if appropriate). However, with a settlor-interested trust such a liability will not arise because it will fall on the settlor.

Although the settlor is liable for all the tax due on income from such trusts, the trustees must complete a Trust & Estate Tax Return and pay tax on all of the income arising from the trust. Trustees should provide the settlor with a statement of the income they have received showing the rates of tax charged on it, bearing in mind that the income might be taxed in part at the basic rate as well as the special trust rates. There is currently no HMRC form for doing this and form R185 (Trust Income) is not appropriate for this purpose. HMRC are developing a new form to address this need which should be available in time for the 2009-10 return.

The settlor must then enter on their personal tax return details of the income tax the trustees have paid on their behalf. They do this using form SA107 Trusts etc - the trusts supplementary pages of the main SA100 Tax Return form.

With the rates of income tax for discretionary trusts increasing to 42.5% (dividends) and 50% (other income) from 6 April 2010, it will frequently be the case that the tax paid by the trustees will be greater than the tax liability of the settlor and so a tax reclaim will be appropriate.

In such circumstances, this new Budget provision will mean that, from 6 April 2010, the tax repayment must be paid to the trustees but it will be disregarded for IHT purposes.

Of course, where the trust investments are non-income producing, such as single premium bonds, much of the above complexities are avoided.

12. SAVINGS AND INVESTMENTS

12.1 OVERVIEW

Managing one's investments (incorporating appropriate asset allocation) to produce acceptable returns, whilst managing risk, takes absolute priority in portfolio planning. However, maximising the tax efficiency to minimise tax on investments can substantially add to the bottom line – especially for those who will suffer the new additional rate of tax or the effective 60% rate of tax.

We cover pensions and life assurance policies elsewhere in this bulletin but in this section we will look at

- ISAs
- The Child Trust Fund
- Venture Capital Trusts and Enterprise Investment Schemes
- Offshore funds

Changes were proposed to all of these.

12.2 ISAs

(i) Individual Savings Accounts (ISAs)

The ISA is still the main non-pensions method of investing savings with freedom from income tax and capital gains tax. It was announced in last year's Budget that from 6 October 2009 the maximum contribution for those aged 50 and over would be raised to £10,200 (for the 2009/10 tax year), with the maximum contribution in cash being £5,100.

From 6 April 2010 the new limits will apply to all ISA investors.

It has been announced in this year's Budget that from 6 April 2011 the ISA limits will be increased in line with the Retail Prices Index (RPI) on an annual basis. The new limits will be rounded to the nearest multiple of £120. The RPI used will be that for the previous September.

WHICH MEANS THAT...

The substantial increase in the investment limit (for older investors only in 2009/10), while valuable to all who qualify, will be particularly welcome for those who will be adversely affected by the removal of higher rate tax relief on pension contributions and those who will pay the higher 50% (or effective 60%) rate of tax on income.

The value of the tax freedom on income delivered by the ISA will effectively increase for this category of investor.

The ISA/pension comparison was one that was valid even for 20% and 40% taxpayers. It is even more so for those who will pay 50% tax on income - especially where they will receive only basic rate relief on their pension contributions.

The appeal of making a contribution attracting 20% relief but paying tax on income at (possibly) 40%/50% will be questionable. This is especially so where the investor can secure tax free growth and income in the ISA.

It is thus thought that the combination of the increasing of the ISA input limit together with the introduction of the 50% tax rate and limitation of pensions tax relief to basic rate for certain high earners will serve to give the ISA market a significant boost.

12.3 VENTURE CAPITAL SCHEMES

In this Budget the government announced the final four changes to the EIS and VCT schemes agreed with the European Commission as a condition for their approval by the Commission as approved State aids.

The Government intends to legislate this measure in a Finance Bill to be introduced as soon as possible in the next Parliament. The changes generally will have effect on and after the date that the legislation receives Royal Assent, with the exception of the definition of eligible shares for VCTs, which will not affect monies raised by the VCT before that date.

VCTs only

The current legislation at section 274 of the Income Tax Act 2007 (ITA) requires the shares making up a VCT's ordinary share capital are included in the official UK list throughout the relevant accounting period. This will be replaced with a requirement that the shares instead are admitted for trading on any EU regulated market. The effect is that VCTs will be able to be listed on markets throughout the EU/European Economic Area (EEA).

The current legislation at section 274 of ITA requires that at least 30 per cent of the VCT's qualifying holdings is represented throughout the relevant accounting period by holdings of eligible shares. Section 285(3) of ITA defines "eligible shares" for this purpose. The new legislation will increase the eligible shares holdings requirement to 70 per cent, but will also change the definition of "eligible shares" to allow VCTs to include shares which may carry certain preferential rights to dividends.

EIS and VCTs

The new legislation will exclude shares in a company from qualifying for the purposes of the EIS or VCT legislation if it is reasonable to assume that the company would be treated as an "enterprise in difficulty" for the purposes of the European Commission's Rescue and Restructuring Guidelines.

The current legislation, at sections 179 (for EIS) and 291 (for VCTs) of ITA requires that there is a qualifying trade carried on wholly or mainly in the UK. For shares issued on or after the commencement date of the legislation, the requirement will be that the company issuing the shares must simply have a permanent establishment in the UK.

“Permanent establishment” will be defined based on Article 5 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and Capital.

WHICH MEANS THAT...

Interest in VCTs that can offer a lower risk exposure by virtue of the current rules has been stronger in anticipation of these changes.

VCT “veterans”, especially those preferring the lower end of the risk spectrum will need to seriously re-evaluate choices in the new environment.

12.4 REAL ESTATE INVESTMENT TRUSTS

Proposals have been announced which will allow UK REITs to issue stock dividends in lieu of cash dividends in meeting the requirement to distribute 90 per cent of the profits from the property rental business of the REIT.

The Government intends to legislate this measure in a Finance Bill to be introduced as soon as possible in the next Parliament. The legislation will have effect for property income distributions made on or after the date that it receives Royal Assent.

A UK REIT is a qualifying group or company with a property rental business that elects to join the UK REITs regime. The principal benefit of joining the regime is that the profits and gains arising from the property rental business are exempt from corporation tax.

The UK REITs legislation requires that a UK REIT distributes, for each accounting period, 90 per cent of the profits from its property rental business by way of a dividend. This is known as the distribution requirement. The distribution itself is known as a property income distribution.

In the hands of the shareholders a property income distribution is taxed as though it was income from property. This is to give investors a return similar to investing in property directly and assists in making the regime cost neutral to the Exchequer.

Currently stock dividends do not count as property income distributions and so are not able to be used by UK REITs to meet the distribution requirement.

A change to primary legislation will be made to allow UK REITs to issue stock dividends in lieu of cash dividends for the purpose of the distribution requirement. The recipients of stock dividends paid to meet the distribution requirement will be taxed in the same way as the recipients of property income distributions paid in cash.

13. PENSIONS

The main Budget pension highlights are:

- The restrictions on pension tax relief for high income individuals will go ahead from 6 April 2010, assuming the Government are re-elected.
- Changes are to be made to the pension taxation rules to resolve a number of issues regarding the launch of the National Employment Savings Trust (NEST) and the automatic enrolment provisions.
- Confirmation of the restriction of the standard lifetime allowance and annual allowance at their 2010/11 levels for the following five tax years.

In addition to these aspects it is important to remember that there a number of highly significant pension changes, which have already been announced, that take effect from 6 April 2010.

13.1 RESTRICTED TAX RELIEF FOR HIGH INCOME INDIVIDUALS

The Government announced in its 2009 Budget that it proposed to introduce restrictions on the pension tax relief available to high income individuals from 6 April 2011. It also introduced anti-forestalling measures in respect of tax years 2009/10 and 2010/11 to ensure that high income individuals would be unable to pay significant tax-relieved pension contributions in those tax years prior to the introduction of the new provisions.

From April 2011 tax relief on pension contributions will be restricted for individuals with gross incomes of £150,000 and over (where gross income incorporates all pension contributions, including those provided by an employer). Tax relief will gradually be tapered away (The Government has decided that a stepped taper of one per cent of relief for every £1,000 of gross income is the most appropriate way to taper down the rate of relief available. The Government intends that legislation in Finance Bill 2010 will reflect this) so that for those on incomes of £180,000 and over it is worth 20 per cent, the same rate received by a basic-rate income taxpayer. To provide more certainty for individuals around whether they are affected, and to reduce administrative burdens for schemes, this will be subject to an income floor at £130,000 of pre-tax income (excluding the value of any employer pension contributions).

The Government issued a consultation document, alongside the 2009 Pre Budget Report, on how it proposed to apply the restricted tax relief from April 2011, and it has now published its response to that consultation. The Government's main proposals have remained largely unchanged.

The Government intends to legislate for the core aspects of the policy in the Finance Bill 2010. These are:

- who the restriction will apply to – that is, the income definitions and thresholds, and how the taper will operate to determine the rate of relief to which individuals are entitled; and

- what the restriction applies to – that is, both an individual’s own pension contributions, and those made for their benefit by an employer, with the age related factors (ARFs) method being used to value the deemed contribution to a defined benefit (DB) pension scheme. Details of the scale of ARFs will be issued ahead of the introduction of the restriction.

The Government intends to consult further on a number of issues raised during the consultation and will consult further on these. Among the aspects it will consider further include:

- How a redundancy payment should be assessed when calculating relevant income. At present the Government is minded only to exempt the first £30,000 non taxable element of the redundancy payment although it “will consider the options raised by stakeholders and will bring forward regulations if it judges that these can balance the interests of fairness without creating avoidance opportunities.”
- How the restriction of relief should apply in the year a member draws benefits. The basis to apply in such cases will be set out in the Finance Bill 2011.

A detailed analysis of the revised restricted tax relief provisions, following the consultation, will be provided shortly.

The confirmation that the new restricted relief provisions are to go ahead from April 2011 makes it even more important for high income individuals to take full advantage of what pension contribution/accrual opportunities that apply under the anti-forestalling (special annual allowance) provisions.

The special annual allowance sets an upper limit on the amount of non-regular pension savings for which full income tax relief at rates above basic rate can be given. All an individual’s pension savings (including savings in non-UK pension schemes that benefit from UK tax relief) will be taken into account in assessing whether the special annual allowance has been breached. The special annual allowance tax charge is set at a rate of 20% for 2009/10. For 2010/11 the ‘appropriate rate’ applies, ie. the rate necessary to reduce the amount of tax relief to basic rate on pension savings which exceed the individual’s special annual allowance.

The charge will *only* apply to pension savings where both the following circumstances apply:

- The individual has “relevant income” of £130,000 or more in either tax year 2009/10 or tax year 2010/11 or in either of the two tax years prior to the tax year in question (ie. tax years 2007/08 and 2008/09 in respect of tax year 2009/10, and tax years 2008/09 and 2009/10 in respect of tax year 2010/11),

and

- increases their pension savings from 22 April 2009 (in the case of an individual with ‘relevant income’ of £150,000 or more), or from 9 December 2009 (in the case of an individual with ‘relevant income’ of £130,000 or more but less than £150,000) beyond the greater of their “protected pension input” and their “special annual allowance”.

For the above purposes:

“Relevant income” is very broadly an individual’s total income, earned and unearned, less normal deductions but not the personal allowance. It should particularly be noted that an individual’s “relevant income” can be reduced by up to £20,000 of contributions paid personally to a registered scheme in the tax year in question, or by gift aid contributions.

An individual’s “protected pension input” will be the aggregate of:

- Any regular contributions to a money purchase scheme, at a frequency of quarterly or greater, than were being paid prior to 22 April 2009 (in the case of an individual with ‘relevant income’ of £150,000 or more), or prior to 9 December 2009 (in the case of an individual with ‘relevant income’ of £130,000 or more but less than £150,000), and
- Any benefits accruing under a defined benefit scheme of which the individual was a member prior to 22 April 2009 (in the case of an individual with ‘relevant income’ of £150,000 or more), or prior to 9 December 2009 (in the case of an individual with ‘relevant income’ of £130,000 or more but less than £150,000). This is subject to their being no material changes to the benefits under the defined benefits scheme in respect of the individual, and
- Any pension contribution and/or pension accrual, not otherwise protected as above, which was paid or accrued prior to 22 April 2009 (in the case of an individual with ‘relevant income’ of £150,000 or more), or prior to 9 December 2009 (in the case of an individual with ‘relevant income’ of £130,000 or more but less than £150,000)

The “special annual allowance” is normally set at £20,000, but where an individual has paid “infrequent money purchase contributions” the allowance can be increased up to a maximum of £30,000. “Infrequent money purchase contributions” are contributions paid less regularly than quarterly (eg annual or ad-hoc). Where the average of such contributions paid in the three tax years 2006/07 to 2008/09 exceed £20,000 the special annual allowance will be increased to that average level, subject to an upper maximum of £30,000. The same base years are used to calculate the three-year average for both 2009/10 and 2010/11, ie. the three year period is *not* rolled forward by a year.

Although the anti-forestalling rules have substantially reduced the pension contributions of high income individuals, the proposed restriction on pension tax relief, due to take effect from 6 April 2011, is even more severe. For example, unlike the anti-forestalling rules there will be no protected input amounts and no special annual allowance. Therefore high income individuals, looking to maximise their pension provision in the most tax efficient way should consider the following:

- Anyone with “relevant income” of below £130,000 in tax years 2009/10 and 2010/11 should seek to maximise their pension contributions while there is no restriction on their available tax relief. This is particularly important for anyone who is likely to fall foul of the income limits applicable from 6 April 2011.
- Anyone with “relevant income” of £130,000 or over should take full advantage of their special annual allowance (ie. normally £20,000 but potentially up to £30,000)

where “infrequent money purchase contributions” have been paid in tax years 2006/07 to 2008/09 inclusive) in both tax years 2009/10 and 2010/11.

13.2 AUTO ENROLMENT/NEST RELATED CHANGES

The following taxation changes are to be made in a Finance Bill, to be introduced as soon as possible in the next Parliament, to deal with a number of issues arising as a result of the introduction of NEST and the automatic enrolment provisions:

- Pension schemes must be registered under Part 4 of the Finance Act 2004 for their members and contributing employers to benefit from tax relief on contributions and investment growth. This change will enable NEST to register with HMRC for tax purposes, and be subject to the same tax rules as other tax registered schemes.
- Under the automatic enrolment provisions, due to start taking effect from October 2012, an employer will be required to pay at least minimum contributions in respect of automatically enrolled jobholders. Where such contributions are paid late (ie. generally after the 19th day of the month following that in which they were due) the employer may, at the discretion of the Pensions Regulator, be asked to pay interest to their jobholder’s pension account. Under section 369 of the Income Tax (Trading and Other Income) Act 2005 the jobholder would be taxed on any such interest paid by his employer. The changes in the legislation will remove this tax charge on the jobholder.
- To provide a regulation-making power to deal with any unintended tax consequences that may emerge as a result of the implementation of NEST and the introduction of the employer duties regarding automatic enrolment.
- Under the current rules, borrowing repaid out of the sums or assets of a registered pension scheme will incur a tax charge if it exceeds half of the value of the fund. Changes will be made so that borrowing linked to the cost of establishing and operating a registered pension scheme will be excluded from this charge, subject to certain conditions.

13.3 TAXATION CHANGES

The Registered Pension Schemes (Standard Lifetime and Annual Allowances) Order 2010 – SI 2010/922 confirms that the standard lifetime allowance and the annual allowance will be capped at their respective levels of £1.8 million and £255,000 applicable in tax year 2010/11 for the immediately following five tax years (ie. up to and including tax year 2015/16).

It has also been confirmed that other benefits which are determined in relation to the standard lifetime allowance (e.g the trivial commutation limit and those with scheme specific protected cash) will also be capped as a result of this restriction.

Although not referred to in this Budget the following tax changes, announced in the 2009 PBR, take effect from 6 April 2010:

- The rates for the tax charge on short service lump sum refunds and EFRBS payments, other than to individuals are to be increased, while new rates for the special annual allowance charge apply with effect from 6 April 2010.
 - A tax charge arises where a registered pension scheme repays tax-relieved pension contributions to a member who has completed less than two years service. The pension scheme deducts tax currently at 20 per cent on the first £10,800 of the refunded contributions and 40 per cent thereafter. Regulations have changed the rates to 20 per cent on the first £20,000 and 50 per cent thereafter on refunds made on or after 6 April 2010.
 - A tax charge is payable where certain lump sums, gratuities or other benefits are received from an EFRBS by an entity who is not an individual. The tax charge is payable by the recipient and the rate is currently set at 40 per cent. This rate will be increased to 50 per cent for benefits received on or after 6 April 2010.
- Where a special annual allowance charge arises in respect of tax 2010/11 it will be set at the ‘appropriate rate’. The ‘appropriate rate’ is determined by the rate of tax relief given on the amount of their pension savings which exceeds their special annual allowance and will restrict tax relief on that excess to the basic rate of income tax.

13.4 TRIVIAL COMMUTATION

The Budget 2008 announced changes to the tax rules to enable small occupational pension pots (£2,000 or less) to be taken as a lump sum, which were introduced by the Registered Pension Schemes (Authorised Payments) Regulations 2009 – SI 2009/1171. The Government did not extend the same flexibility to non occupational pension schemes in order to minimise avoidance. However, the Government has indicated it remains open to proposals for further simplification provided they would not increase Exchequer costs or add significant costs for HMRC, and would not be open to manipulation.

The Government is also open to proposals consistent with these principles for couples to pool small pension pots to achieve better value by purchasing a joint life annuity.

13.5 STATE BENEFITS

Although the Basic State Pension is normally increased in April each year, based on the increase in the RPI in the year to the previous September, it will in April 2010 be increased by 2.5% as the RPI was negative in September 2009. The revised weekly figures are respectively £97.65 for a single person and £156.15 for a married couple.

The pension credit figures will also be given an above inflation increase to:

- Guarantee credit
£132.60 p w (single person),
£202.40 p w (married couple)
- Savings credit threshold

£98.40 pw (single person)
£157.25 pw (married couple)

Although not announced in the Budget or the 2009 PBR the following significant changes to state pension benefits take effect from 6 April 2010:

- The commencement of the gradual increase in the female state pension age, which will be equalised with the male state pension age at 65 by 6 April 2020.
- The reduction in the number of qualifying years for a person reaching state pension age on or after 6 April 2010 to qualify for a full rate basic state pension. Such an individual will only need 30 qualifying years.
- The removal of the current minimum NI contribution conditions required to obtain a basic state pension.
- The introduction of new weekly credits for parents and carers replacing the previous HRP provisions.
- The abolition of adult dependency increases in respect of the basic state pension.
- Changing the rules to enable husbands and civil partners (as well as wives) to get a basic state pension based on a spouse's or civil partner's NI contribution record. This will apply from 6 April 2010 provided the spouse/civil partner, whose NI record is being used for this purpose, was born on or after 6 April 1950.
- The merging of the middle and upper bands of State Second Pension accrual into one band accruing at 10% in respect of an individual's earnings between £14,100 and £40,810 (ie. 53 x the upper accrual point of £770 per week).

13.6 RISK SHARING

The Government has taken steps to simplify pension regulation, through the deregulatory review of private pensions, and remains committed to supporting innovation in the development of risk sharing arrangements between employers and employees. In order to inform choices about future pension provision, the Government will shortly publish an Information Note to help employers understand available risk sharing options. The Government will continue to work with industry to explore further facilitation of risk sharing between employers and employees, in both defined benefit and defined contribution pension schemes.

13.7 DEFAULT RETIREMENT AGE

Currently employers have the legal right to require individuals to retire at 65. The Government's Ageing Strategy, Building a Society for All Ages document, published in summer 2009, announced that the Government's planned review of this legislation would be brought forward. Following the evidence submitted to this review, the Government intends shortly to launch a formal consultation on reforms to the Default Retirement Age, including considering options for: removing it; increasing it; and reforming the legislative framework to strengthen the position of the employee. No changes will be made before April 2011.

14. TAXATION OF SHAREHOLDING DIRECTORS

14.1 RELEASE OF LOANS TO SHAREHOLDING DIRECTORS

From Budget day where a close company releases or writes-off a loan or advance of money made to a relevant person who is a participator (which in most cases means shareholder) in that company or an associate of such a participator tax relief will no longer be given as a corporation tax deduction.

Currently when a close company makes a loan or advances money to a participator in the company or an associate of a participator, section 455 of Corporation Tax Act 2009 imposes a charge equivalent to corporation tax on that company.

Under the loan relationship rules governing corporate debt the company may be entitled to a full deduction against its corporation tax liability. Broadly, these rules provide that the taxable and relievable credits and debits brought into account arising to a company under its loan relationships are those arising under generally. From Budget Day this deduction will no longer be available.

In the hands of the shareholder (participator) the written-off loan will continue to be treated and taxed as a distribution.

WHICH MEANS THAT...

It is thought that this measure has been brought in to combat the practice of close companies granting a loan to a director/shareholder who, from 6 April 2010, is a 50% taxpayer with a view to the loan being written off at a later date when income tax rates reduce.

14.2 REMUNERATION STRATEGIES

14.2.1 DIVIDENDS V SALARY

The variables that have an impact on the relative attraction of dividends and salary as a means of extracting benefits from a company for a shareholding director are

- (i) the NIC rate (personal and corporate)
- (ii) personal tax rates
- (iii) the corporate tax rates

While the bands and thresholds for income tax, NIC and corporation tax have not changed, we have the introduction of a 50% income tax rate from 6 April 2010 (42.5% on dividends).

Determining the so called “remuneration strategy” for shareholding directors is an area where a financial adviser can add significant value - especially when working together with the client’s accountant. The recent increase in the burden of NICs as a result of the raising of the upper earnings limit effective from 6 April 2009, the increase in income tax rates for high earners from 6 April 2010 and the increase in the rates of employer and employee NIC

scheduled for 2011/12 give an opportunity to focus on appropriate remuneration strategies for working owner managers of private limited companies.

Especially towards the company year end, shareholding directors will value information and guidance on how best to extract funds from their business. For most, day-to-day income will be taken by way of salary (although regular interim dividends are possible). So in the majority of cases the dividend/salary debate is concerned with the extraction of profits over and above regular payments.

Comparisons of the relative merits of dividend -v- salary are summarised below.

For example, assuming that a company pays corporation tax at the small companies' rate of 21% and wishes to use £10,000 for the benefit of a shareholding director who is a 40% taxpayer and earning above the employee's upper earnings limit (£43,875), the following will be the position in respect of both dividends and salary for tax year 2010/11.

Dividend (40% taxpayer)

Company:

Pre-tax profit	£10,000
CT @ 21%	£ 2,100
Net to distribute	<u>£ 7,900 (1)</u>

- (1) Because the dividend is not deductible the corporate tax liability for the company remains at 21% ie. £2,100, so £7,900 is available for distribution.

Shareholding director:

Director receives		£7,900
Grossed up by 10% (net dividend x 0.111)	£ 878	
Taxable	<u>£8,778(1)</u>	
Tax @ 32.5%	£2,853 (2)	
Less tax credit	£ 878	
Net tax to pay		<u>£1,975 (3)</u>
Net dividend		£5,925 (4)(5)
Effective rate of tax		40.75%

- (1) The dividend is £7,900 grossed up by 10% (tax credit) to £8,778. This is simply done by multiplying the net dividend by 1.111.
- (2) The rate of tax payable on the gross dividend by a higher rate taxpayer is 32.5%.
- (3) Tax of £878 is already deemed to have been paid via the tax credit and so the balance tax liability is £1,975.

- (4) The director is left with a net dividend of £5,925. The dividend has therefore suffered an effective rate of tax of 40.75%.
- (5) A “short cut” to arriving at the additional tax payable on the dividend is to multiply the net dividend by 25%. The result will be £1,975.

Salary (40% taxpayer)

Company		
	£	
Salary	8,865 (1)	
Employer’s NIC	1,135	
	<hr/>	
	10,000	all deductible
Director		
Salary	8,865	
Higher rate tax	3,546 (2)	
NIC	89	
	<hr/>	
Net received		5,230 (3)
Effective rate of tax		47.7%

- (1) Where the £10,000 is paid by way of salary, the whole amount is deductible. However out of the £10,000, employer’s National Insurance of 12.8% is payable (again deductible).

So taking account of £1,135 employer’s National Insurance, £8,865 is available as a bonus.

- (2) The director will suffer 40% higher rate tax and the 1% NIC charge via the PAYE system on the salary and this liability equals £3,635.
- (3) The director is left with £5,230 net in his hands. The £10,000 available in the company has effectively suffered tax at 47.7%.

In these circumstances therefore, purely on tax grounds alone (and there are other factors to consider), the dividend will look most attractive and, in all cases, payment of a dividend will on tax grounds be preferable to paying a salary.

For a basic rate taxpayer the choice of dividend over salary for money that is to be extracted from the company for expenditure is even easier. Here, the fact that not only employer’s but also employee’s NICs will be due is a significant financial reason for seriously considering payment by way of dividend rather than salary as the difference in the effective rate of deduction is bigger than for a higher rate taxpayer.

This is best illustrated by an example that shows the effective rates of deduction (ie. combined income tax and National Insurance) borne by both higher and basic rate taxpayers receiving dividends from companies paying respectively the small companies', main and marginal rates of tax.

The assumptions used are as follows:-

- (i) £10,000 available to the company pre tax.
- (ii) 12.8% employer NICs payable in all salary examples.
- (iii) 11% employee NICs payable on salary only by 20% taxpayers.
- (iv) 1% employee NICs payable on salary over (£43,875 only by 40% taxpayers).

		NET DIV £	ERD*	NET SAL £	ERD*	BEST OPTION? DIVS OR SALARY
(a) 21% Taxpaying Company						
(i)	20% personal tax rate	7,900	21%	6,117	38.83%	DIV
(ii)	40% personal tax rate	5,925	40.75%	5,230	47.7%	DIV
(b) 28% Taxpaying Company						
(i)	20% personal tax rate	7,200	28%	6,117	38.83%	DIV
(ii)	40% personal tax rate	5,400	46%	5,230	47.7%	DIV
(c) 29.75% Taxpaying Company						
(i)	20% personal tax rate	7,025	29.75%	6,117	38.83%	DIV
(ii)	40% personal tax rate	5,268	47.32%	5,230	47.7%	DIV

* ERD = effective rate of deduction.

Despite the immediate attraction of dividends, in many cases (though there are obviously exceptions) it is essential that any taxpayer, in deciding how to extract funds from his company, makes the decision being fully aware of all the facts, including the impact that choosing dividends over salary can have on pension provision.

For non-taxpayers dividends will be positively disadvantageous as they will be unable to reclaim the tax credit.

It should be noted that the position for salary/bonus will worsen in 2011/12 when the proposed increase 1% in the rate of employer/employee's NICs take effect.

In the following examples the company pays tax at the small companies' rate of 21% and wishes to utilise £10,000 for the benefit of its shareholding director who pays tax at 50%.

Dividend (50% taxpayer)

Company	
Pre-tax profit	£10,000
CT @ 21%	£ 2,100
Net to distribute	<u>£ 7,900 (1)</u>

- (1) Because the dividend is not deductible the corporate tax liability for the company remains at 21% i.e. £2,100 so £7,900 is available for distribution.

Now looking at the director's position:

Director receives	£7,900	
Grossed up by 10%	£ 878	
Taxable	<u>£8,778 (1)</u>	
Less tax @ 42.5%	£3,730 (2)	
Less tax credit	£ 878	
Net to pay		<u>£2,852 (3)</u>
Net dividend		£5,048 (4)
Effective rate of tax		49.52%

- (1) The dividend is £7,900 grossed up by 10% (tax credit) to £8,778.
- (2) The tax rate payable on the gross dividend by a 50% taxpayer is 42.5%.
- (3) Tax of £878 is already deemed to have been paid via the tax credit and so the balance liability is £2,852.
- (4) The director is left with a net dividend of £5,048. The dividend has therefore suffered an effective rate of tax of 49.52%.

Salary (50% taxpayer)

Company		
Bonus	£	
Employer's NIC	8,865 (1)	
	1,135	
	<u>10,000</u>	all deductible
Director		
Bonus	8,865	
50% tax	4,432 (2)	
NIC	88	
Net received		<u>4,345 (3)</u>

Effective rate of tax

56.55%

- (1) Where the £10,000 is paid by way of bonus, the whole amount is deductible. However out of the £10,000, employer's National Insurance of 12.8% is payable (again deductible).

So taking account of £1,135 employer's National Insurance, £8,865 is available as a bonus.

- (2) The director will suffer 50% higher rate tax and the 1% NIC charge via the PAYE system on the bonus and this liability equals £4,520.
- (3) He is left with £4,345 net in his hands. The £10,000 available in the company has effectively suffered tax at 56.55%.

And for the sake of completeness, the following "cumulative" table shows how at all combinations of corporate and personal tax, extraction of funds by way of dividend represents the most tax and NIC effective method. Of course, before making any decision on how to extract funds professional advice is essential and all of the relevant factors (not just tax and NIC) need to be taken into account.

The assumptions used are as follows:-

- (i) £10,000 available to company pre tax
(ii) 12.8% employer NICs payable in all "salary" examples
(iii) 11% employee NICs payable on salary only by 20% taxpayers.
(iv) 1% employee NICs payable on salary over £43,875 only by higher rate taxpayers.

					BEST OPTION?
	NET DIV £	ERD*	NET SAL £	ERD*	DIVS OR SALARY
(a) 21% Taxpaying Company					
(i) 20% personal tax rate	7,900	21%	6,117	38.83%	DIV
(ii) 40% personal tax rate	5,925	40.75%	5,230	47.7%	DIV
(iii) 50% personal tax rate	5,048	49.52%	4,345	56.55%	DIV

(b) 28% Taxpaying Company

(i)	20% personal tax rate	7,200	28%	6,117	38.83%	DIV
(ii)	40% personal tax rate	5,400	46%	5,230	47.7%	DIV
(iii)	50% personal tax rate	4,600	54%	4,345	56.55%	DIV

(c) 29.75% Taxpaying Company

(i)	20% personal tax rate	7,025	29.75%	6,117	38.83%	DIV
(ii)	40% personal tax rate	5,268	47.32%	5,230	47.7%	DIV
(iii)	50% personal tax rate	4,488	55.12%	4,345	56.55%	DIV

* **ERD** = effective rate of deduction.

14.2.2 PENSION CONTRIBUTIONS

Where the object of “extraction” of funds from the company is for the individual director/shareholder to make an investment then the option of a direct employer contribution into a registered pension scheme should be considered. This will facilitate maximum investment to provide for the director’s future financial security with no NIC/income tax depletion. Account will need to be taken of the implications of any contribution for the individual’s Annual Allowance and Lifetime Allowance. It should be noted that any tax relief on an employer contribution is now determined under the “wholly and exclusively for the purposes of the trade” provisions and this is now considered. For those whose relevant income exceeds £130,000 consideration will need to be given to the new additional special annual allowance charge (see Section 13.1 for more detail).

And by way of a reminder... deductibility of employer pension contributions - HMRC guidance

Since 6 April 2006 (“A-Day”) the clarity on the availability of tax relief on employer contributions has been removed.

Tax relief is available on unlimited contributions paid to a registered pension scheme provided they meet the general rules on allowable deductions (ie. under Case I of Schedule D) other than the rule disallowing capital expenditure. This means they must pass the “wholly and exclusively” for the purposes of the trade test.

HMRC has issued guidance in its Business Income Manual (BIM) which seeks to clarify the position regarding the availability of relief on employer contributions.

In this HMRC confirms that tax relief on employer contributions (including contributions by a former employer) to a registered pension scheme is given in accordance with the normal tax rules for the deductibility of the expenses of a trade or profession, except that

- contributions are not treated as capital payments for tax purposes

- the timing of the deduction for a contribution does not follow its accounting treatment. Relief on a pension contribution will only be allowed in the accounting period in which it is paid and not the period it is recognised in the accounts.

HMRC has indicated that “it will be relatively rare in the context of pension contributions to have to consider whether there is a non-trade purpose for the employer’s decision to make the contribution.” This means that in the vast majority of cases an employer pension contribution will be tax relievably although in certain cases, particularly in the case of controlling directors and relatives, and contributions paid where a company is winding up, the position needs to be considered more closely.

When assessing whether an employer contribution for a controlling director, or close friend or relative of such a director is allowable under the “wholly and exclusively” rules it is important to consider:

- Whether the level of the remuneration package is excessive for the value of the work undertaken by that individual for the employer. In assessing the overall remuneration package this should take account of all aspects, and not simply the employer pension contribution. BIM 46035 indicates that *“on occasion an employer may make an increased pension contribution on the basis that a scheme is under funded. It is important when comparing contributions between periods to consider the full facts, including the history of remuneration and contributions, before challenging a deduction based solely on annual comparatives. It should be borne in mind that the significant increase in qualifying limits with effect from 6 April 2006 will in itself facilitate and encourage an increase in contributions over earlier periods”*. General guidance on deductions for remuneration paid to close relatives of directors can be found at BIM47105 and BIM47106.

Where the remuneration package paid to the controlling director (or close relative/friend of that director) is comparable with that paid to unconnected employees performing duties of similar value it will be accepted that the employer pension contributions are paid “wholly and exclusively” for the purposes of the trade. Where there are no employees whose duties are genuinely comparable HMRC has indicated that the guidance set out in BIM 47105 should be followed.

BIM 47106 indicates that *“controlling directors are often the driving force behind the company. Where the controlling director is also the person whose work generates the company’s income then the level of the remuneration package is a commercial decision and it is unlikely that there will be a non-business purpose for the level of the remuneration package. It should be noted that remuneration does not include entitlement to dividends etc arising in the capacity of shareholder”*.

When considering that action should be taken regarding an excessive remuneration package for a director, or an employee who is a close relative or friend of a controlling director, BIM 47106 states as follows.

“If the amounts involved and the facts established indicate that a remuneration package is demonstrably in excess of what is commercially reasonable, then there may be other avenues to consider in addition to the question of whether an element of the payment is other than wholly and exclusively for the purposes of the trade. In

particular it may also be appropriate to consider whether the settlements legislation might apply or if payment is in fact part of the controlling director's remuneration or the proprietor's drawings rather than the market rate remuneration of the relative/friend employee".

If a payment or part of a payment to a relative or close friend of a director appears not to form part of their remuneration, to the extent to which it appears to exceed what is reasonably commercial, then HMRC argue it may actually be part of the director's own remuneration. Therefore although the payment may be 'wholly and exclusively' for the purposes of the trade, it will in the following circumstances be taxable on the director rather than the employee if:

- the spouse or close relative is simply acting as a conduit for the director (in which case it may be taxable as earnings of the director), or
- the payment is made to a relative or a member of the director's family or household (in which case it may be taxable on the director under the benefits legislation)

If there is any doubt about the deductibility of a pension contribution, it will be best to seek professional advice.

15. EMPLOYEE BENEFITS

15.1 OVERVIEW

For financial planners the main announcements of interest are in connection with

- Share incentive plans (SIP)
- Company share option plans (SOP)
- Enterprise Management Incentives (EMI)

and

- Employee benefit trusts (EBTs) and other arrangements

Especially given the restriction of higher rate tax relief on pension contributions made by or on behalf of higher earners, there has been an increase in interest in all of these arrangements – especially so called EBTs.

15.2 SHARE INCENTIVE PLANS

Section 989 of the Corporation Tax Act 2009 (CTA) allows companies (subject to conditions) to obtain a CT deduction where they pay money to SIP trustees to purchase shares from non-corporate shareholders for use in the SIP. The deduction may be withdrawn if insufficient shares are appropriated to employees under the SIP within set time limits; but there is no provision for the deduction to be withheld at the outset in cases where the company made the payment without intending that shares would genuinely be passed to employees under the SIP.

This has given rise to avoidance schemes where the company making the payment does so with the main purpose of obtaining the CT deduction. As a result of transactions by the company which alter the share capital or the rights attaching to the shares, employees in the SIP receive few if any shares carrying real value. The transactions have the effect of stripping away the value of shares held in the SIP.

Legislation will be introduced in Finance Bill 2010 to combat abuse of the corporation tax (CT) deduction provision, where companies pay money to SIP trustees to buy shares from director-shareholders, but no real value is transferred to employees under the SIP.

The measure will also close potential loopholes in the provisions allowing HM Revenue & Customs (HMRC) to withdraw approval of a SIP where alterations to share capital or changes in rights attaching to shares materially affect the value of participants' plan shares.

This change will not affect companies that are not involved in avoidance, and which make payments with the purpose of genuinely enabling their employees to obtain shares under the SIP.

15.3 COMPANY SHARE OPTION PLANS

Paragraph 17(1)(c) of Schedule 4 to the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) allows shares in a company which is under the control of a listed company to be shares to which an approved CSOP scheme could apply. Provided the requirements of the scheme are met, there will be no charge to income tax or National Insurance Contributions on the exercise of the options. Under CSOP, an individual can be awarded options over shares with a market value of up to £30,000 at the time of grant.

HM Revenue & Customs (HMRC) have found that arrangements are being used which fall under the general description of “geared growth” and which can be used to deliver additional reward to employees, beyond that intended under the schemes. This avoidance involves share options granted over shares in companies which are under the control of a listed company.

The measure proposed will, from 24 March 2010, counter this avoidance by restricting the type of shares which can be used in CSOP. Paragraph 17(1)(c) of Schedule 4 to ITEPA will be amended so that shares in a company which is under the control of a listed company will no longer be shares to which an approved CSOP scheme could apply.

The measure allows companies a transitional period of six months to amend their scheme rules to bring them into line with this change, if an amendment is necessary.

15.4 ENTERPRISE MANAGEMENT INCENTIVES

This measure amends the requirement that a company granting qualifying EMI options to its employees must operate “wholly or mainly” in the UK. A company granting EMI options will now be required instead to have a “permanent establishment” in the UK.

The Government intends to legislate this measure in a Finance Bill to be introduced as soon as possible in the next Parliament

15.5 TRUSTS AND OTHER VEHICLES USED TO REWARD EMPLOYEES

The provisions restricting higher rate tax relief on pension contributions and accruals for higher earners have caused an increase in interest in

- employee benefit trusts (and variation on the theme – family benefit trusts)

and

- employer funded retirement benefit schemes (EFRBS)

Both arrangements are, typically, founded on a trust (often offshore). The contribution to the arrangement is not deductible for the employer but also not assessable on the member. Member assessment is deferred until benefits are received.

Under some EBTs members can take (typically) interest free loans – currently without triggering any tax charge on the amount borrowed.

A liability would however arise on the benefit of the interest not paid but, especially at the current low interest rates, this may not be seen as significant.

EFRBS tend to reflect pension arrangements in their “look and feel” and so, typically, do not offer loans. In Treasury Press Notice 3 and in the Treasury document “Securing the Recovery” it stated that there is to be future action to tackle the use of arrangements to reward employees through the use of trusts or other intermediaries, with the purpose of avoiding, deferring or reducing liabilities to income tax and NICs or avoiding restrictions on pensions tax relief. The Government will consider options for tackling these avoidance arrangements with the intention of introducing any necessary legislation to take effect from April 2011.

WHICH MEANS THAT...

Anybody considering arrangements that could fall within this broad ambit needs to pay close attention to what emerges as a result of this attack. It is to be hoped that “ordinary” EFRBS will remain available as a valid alternative means of funding for retirement benefits other than through a registered scheme.

Given the HMRC/Treasury attitude to EBTs evidenced by their views expressed in the Sempra Metals case and statements made in “Spotlights” and Tax Bulletins (especially on EBTs for substantial shareholders in close companies) one would expect those aspects of EBTs that are not to the “liking” of the authorities (eg. loans to members) to be targeted.

16. DOMICILE AND RESIDENCE

The Government have announced that with effect from 6 April 2010, the definition of a relevant person for the purposes of the remittance basis will include the subsidiary of a non-UK resident company which would be a close company if it was resident in the UK.

Background

Prior to 6 April 2008, a person who was UK resident but non UK domiciled could be taxed on the remittance basis for overseas income and gains without restriction. This means that such income / gains are only subject to UK tax if they were brought back to the UK.

The Finance Act 2008 introduced major changes in the taxation of non-UK domiciled persons who are resident in the UK. For such persons who were adult, had overseas income and gains of at least £2,000 in a tax year and had been resident in the UK for at least 7 out of the last 9 years, they can now only be taxed on the remittance basis on overseas income/gains if they pay an annual remittance basis charge of £30,000.

The Finance Act 2008 also tightened up the definition of when a remittance is made to the UK. The concept of relevant person was introduced to ensure that any foreign income or gains of an individual which are remitted to the UK by way of any relevant person, or for the benefit or enjoyment of any relevant person, are taxed on the non-domiciled individual. A relevant person is widely defined and includes the individual, their spouse, civil partner, children and grandchildren under the age of 18. It also covers close companies and their subsidiaries in which such persons are participators.

However, the rules are not clear that references to a close company are intended to include subsidiaries of non-resident companies which would be close companies if they were resident in the UK. To remove any uncertainty, and to remove the potential for abuse, the Government has announced that legislation will be amended to make clear that a subsidiary of a non-UK resident company which would be a close company if it was resident in the UK will be treated as a relevant person for the purposes of the remittance basis.

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 (A)	N/A	£100,000
Married couple's allowance (MCA) – minimum amount	2,670 (C)	2,670 (C)
- Age 75 and over	6,965 (D)	6,965 (D)
Age-related allowances reduced if total income exceeds (E)	22,900	22,900
Maintenance to former spouse for all orders provided one party was aged 65 or over before 6 April 2000	2,670 (B)	2,670 (B)
Tax-free employment termination lump sum limit	30,000	30,000

- (A) 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.
- (B) Relief at 10%.
- (C) Minimum amount of MCA applies for age allowance purposes only.
- (D) Relief available at 10% only if at least one of the couple was born before 6 April 1935.
- (E) For 2010/11 the reduction is £1 for every £2 additional income over £22,900 [£22,900 for 2009/10]. 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%	1 - 37,400	1 - 37,400
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 (basic rate taxpayer)	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	N/A	42.5%

* Only applies if total taxable non-savings income is less than £2,440, otherwise 20%.

** Assumed 10% band not available in 2009/10 and 2010/11. £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. 10% or 20% as appropriate.

CAR AND CAR FUEL 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 emissions in grams per kilometre (g/km)	Percentage of car's "price" charged to tax	
	2009/10	2010/11
120 or less	10*	10*
121-134	15*	15*
135-139	15*	16*
140-144	16*	17*
145-149	17*	18*
150-154	18*	19*
155-159	19*	20*
160-164	20*	21*
165-169	21*	22*
170-174	22*	23*
175-179	23*	24*
180-184	24*	25*
185-189	25*	26*
190-194	26*	27*
195-199	27*	28*
200-204	28*	29*
205-209	29*	30*
210-214	30*	31*
215-219	31*	32*
220-224	32*	33**
225-229	33**	34***
230-234	34***	35****
235 +	35****	35****

Notes

- (1) * Diesel supplement = + 3%
 ** Diesel supplement = + 2%
 *** Diesel supplement = + 1%
 **** No diesel supplement - maximum charge of 35% already applies.
- (2) The exact CO₂ emissions figure should be rounded down to the nearest 5 g/km for levels of 125g/km or more.

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

There is a 3% supplement for diesel subject to the maximum charge of 35%.

CAR FUEL BENEFITS

For cars with an approved CO₂ emission figure, the benefit is based on a flat amount of £18,000 for 2010/11 (£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, a petrol car emitting 160 g/km in 2010/11 would give rise to a petrol benefit of 21% of £18,000 = £3,780.

VALUE ADDED TAX

From	1 Dec 2008	1 May 2009	1 Jan 2010	1 April 2010
Standard rate	15%	15%	17.5%	17.5%
Annual turnover limit for registration	£67,000	£68,000	£68,000	£ 70,000

INHERITANCE TAX

	Cumulative chargeable transfers [gross]			% tax rate on death	% tax rate in lifetime *
	2008/09	2009/10	2010/11 – 2014/15		
	£	£	£		
Nil rate band **	0 – 312,000	0 – 325,000	0 – 325,000	0	0
Excess	No limit	No limit	No limit	40	20

* Chargeable lifetime transfers only.

** On the death of a surviving spouse on or after 9 October 2007, their 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 & RELIEFS

	2009/10	2010/11
	£	£
Annual exemption	10,100 *	10,100 *
Principal private residence exemption	No limit	
Chattels exemption	£6,000	
Entrepreneurs' relief 4/9ths of business gain to give an effective rate of 10%	Lifetime limit £1,000,000 cumulative gains	Lifetime limit £2,000,000 cumulative gains

* Reduced by 50% for most trusts.

RATES OF TAX

Individuals: 18%

Trusts and personal representatives: 18%

TAPERING CHARGEABLE GAINS – RELIEF WITHDRAWN FOR DISPOSALS TAKING PLACE AFTER 5 APRIL 2008

Gains on business assets		Gains on non-business assets	
Number of complete years after 5.4.98 for which asset held	Percentage of gain chargeable	Number of complete years after 5.4.98 for which asset held *	Percentage of gain chargeable
<i>(i) Disposals before 6.4.2002</i>		<i>All disposals</i>	
0	100	0	100
1	87.5	1	100
2	75	2	100
3	50	3	95
4 or more	25	4	90
		5	85
<i>(ii) Disposals after 5.4.2002</i>		6	80
0	100	7	75
1	50	8	70
2 or more	25	9	65
		10 or more	60

* Assets held on 16 March 1998 qualify for a bonus year of ownership.

CORPORATION TAX

	Year ending 31 March	
	2010	2011
Main rate	28%	28%
Small companies' rate	21%	21%
Small companies' limit	£300,000	£300,000
Upper marginal level	£1,500,000	£1,500,000
Effective marginal rate	29.75%	29.75%

TAX PRIVILEGED INVESTMENTS (MAXIMUM INVESTMENT)

		2009/10 £	2010/11 £												
ISA															
<ul style="list-style-type: none"> ▪ Overall per tax year: <table style="display: inline-table; vertical-align: middle; margin-left: 10px;"> <tr> <td style="padding-right: 10px;">Born after 5 April 1960</td> <td style="text-align: center;">7,200</td> <td style="text-align: center;">10,200</td> </tr> <tr> <td style="padding-right: 10px;">Born before 6 April 1960</td> <td style="text-align: center;">10,200</td> <td style="text-align: center;">10,200</td> </tr> </table> 	Born after 5 April 1960	7,200	10,200	Born before 6 April 1960	10,200	10,200									
Born after 5 April 1960	7,200	10,200													
Born before 6 April 1960	10,200	10,200													
Maximum in															
<ul style="list-style-type: none"> - Cash: <table style="display: inline-table; vertical-align: middle; margin-left: 10px;"> <tr> <td style="padding-right: 10px;">Born after 5 April 1960</td> <td style="text-align: center;">3,600</td> <td style="text-align: center;">5,100</td> </tr> <tr> <td style="padding-right: 10px;">Born before 6 April 1960</td> <td style="text-align: center;">5,100</td> <td style="text-align: center;">5,100</td> </tr> </table> - Stocks and shares: <table style="display: inline-table; vertical-align: middle; margin-left: 10px;"> <tr> <td style="padding-right: 10px;">Born after 5 April 1960</td> <td style="text-align: center;">Balance up to 7,200</td> <td style="text-align: center;">Balance up to 10,200</td> </tr> <tr> <td style="padding-right: 10px;">Born before 6 April 1960</td> <td style="text-align: center;">Balance up to 10,200</td> <td style="text-align: center;">Balance up to 10,200</td> </tr> </table> 	Born after 5 April 1960	3,600	5,100	Born before 6 April 1960	5,100	5,100	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			
Born after 5 April 1960	3,600	5,100													
Born before 6 April 1960	5,100	5,100													
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

FAMILY TAX CREDITS 2010/11

The main features of the tax credits 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.

- 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 (£5,044 per year).

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 tax years the Upper Accrual Point is fixed at £770 per week (£40,040 per year).

Upper Earnings Limit (UEL) the upper level of earnings on which an employee will pay full rate Class 1 National Insurance contributions. The reduced 1% NI contributions will apply to earnings above this level. For tax year 2010/11 this is £844 per week (£43,875 per year).

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 (i.e. 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 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 (£5,715 per year).

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 (£5,715 per year).

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

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. Please see examples after the table for how this works.

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

<u>Weekly Earnings</u>	<u>Contracted In</u>	<u>Contracted Out</u>	
		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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Examples of Class 1 NI Contributions for Employees Contracted Out Under Occupational Schemes

1. David Lovell earns £150 per week. He is contracted out of S2P under a final salary occupational scheme. David's weekly National Insurance contributions are as follows:

Up to £110 per week - Nil

£110 per week to £150 per week - $9.4\% \times £40 = \underline{£3.76 \text{ per week}}$.

However this is reduced by the employee Rebate (1.6%) payable on earnings between the LEL (£97 per week) and the Primary Threshold (£110 per week).

i.e. $£13 \times 1.6\% = \underline{£0.21 \text{ per week}}$.

David's revised NI liability is £3.55 per week (i.e. $£3.76 - £0.21$).

His employer's weekly National Insurance contributions are:

Up to £110 per week - Nil

£110 per week to £150 per week - $9.1\% \times £40 = \underline{£3.64 \text{ per week}}$

However, this is reduced by the employer Rebate (3.7%) payable on earnings between the LEL (£97 per week) and the Secondary Threshold (£110 per week) - i.e. $£13 \times 3.7\% = \underline{£0.48 \text{ per week}}$.

The employer's revised NI liability is £3.16 per week ($£3.64 - £0.48$)

2. Jane Redfearn earns £100 per week. She is contracted out of S2P under a final salary occupational scheme.

Jane pays no National Insurance contributions as her earnings are below the Primary Threshold.

However, the employee Rebate is available in respect of Jane's earnings between the LEL (£97 per week) and £100 per week. (i.e. $1.6\% \times £3 = \underline{£0.05 \text{ per week}}$).

As Jane is not paying any National Insurance contributions the £0.05 will be used to reduce the employer's overall National Insurance contribution liability.

Her employer will pay no National Insurance contributions in respect of Jane as her earnings are below the Secondary Threshold. However, the employer's Rebate is still available in respect of Jane's earnings between the LEL (£97 per week) and £100 per week. (i.e. $3.7\% \times £3 = \underline{£0.11}$). This will be available to reduce the employer's overall National Insurance contribution liability.