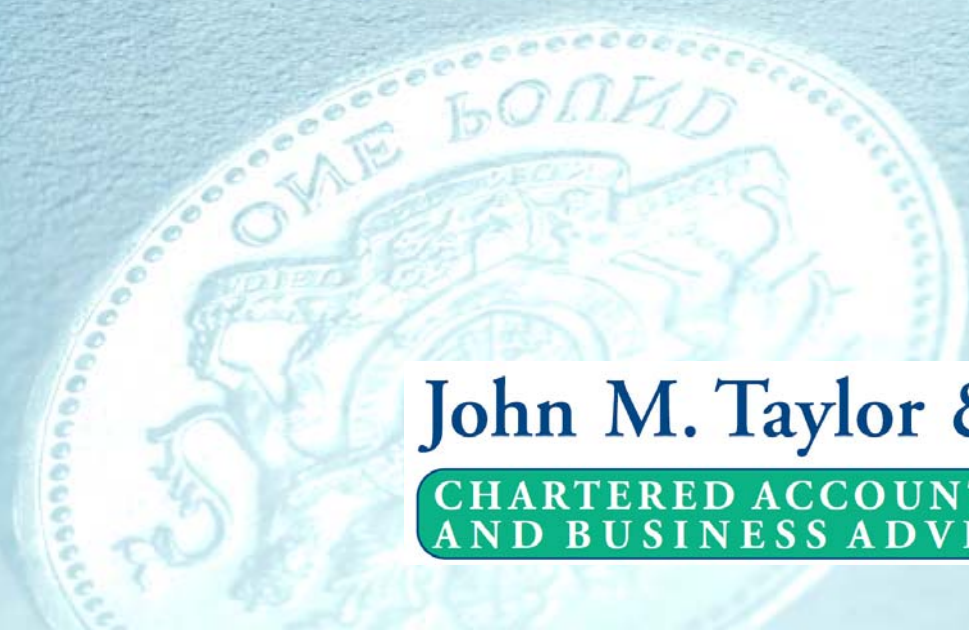


# Emergency Budget

June 2010



**John M. Taylor & Co**

**CHARTERED ACCOUNTANTS  
AND BUSINESS ADVISORS**



# Budget 2010



## Summary

Ever since the Conservatives and Liberal Democrats found enough common ground to form a coalition, the Treasury team has been preparing the public for austerity: spending cuts and tax increases. We have been told to expect the worst – so we should not be unpleasantly surprised. When he stood up for his first Budget speech, the new Chancellor announced that he would be "tough but fair": everyone will have to pay to restore the country's finances, but the rich will bear a higher proportion than the poor.

We will have to wait to see if that turns out to be true. The largest revenue-raising measure is an increase in the rate of VAT to 20%, to take effect on 4 January 2011; the poor tend to suffer disproportionately from VAT increases, because a tax on spending takes up a larger slice of their disposable income. On the other hand, there were several measures to reduce the tax burden on the lowest earners, as well as an increase in the rate of tax on capital gains. Traditional Conservative priorities such as reductions in Inheritance Tax were noticeably absent.

Mr Osborne said that 77% of his deficit reduction will be achieved through spending cuts, while only 23% will come from tax increases. There are major reforms in benefits and tax credits to reduce costs, but the largest numbers are cuts in public spending. These include a two-year pay freeze for all civil servants earning over £21,000, and 25% reductions in the budgets for some departments – this will hit those affected as hard as any of the tax proposals. Labour claim that cutting this much this quickly runs the risk of sending the country back into recession: we can only hope that they are wrong.

As usual, the speech itself does not tell the full story. Many important details are hidden in press releases issued by HM Revenue & Customs and the Treasury after the Chancellor sits down. This booklet summarises the main changes and outlines their likely effect on the average taxpayer.

## Significant points

- Increase in standard rate of VAT to 20% with effect from 4 January 2011
- Above-inflation increase in personal allowances for 2011/12
- Reduction in tax credits for middle-income families from 2011/12
- Rethinking of the restriction of higher rate pensions tax relief in 2011/12
- Reform of requirement to use pension funds to buy an annuity at age 75
- Immediate increase in rate of CGT to 28% for higher rate taxpayers
- Increase in lifetime limit for Entrepreneurs' Relief to £5m
- Cuts in corporation tax rates from April 2011 – main rate down to 24% over four years
- Employer's NIC holiday for new businesses in some parts of UK from September 2010

22 June 2010

## Other Points of Interest:

- Small companies rate of CT to reduce to 20% from 1 April 2011
- NIC rates to increase by 1% from 2011 as announced in March.
- IHT nil rate band remains frozen at £325,000.
- Annual Investment Allowance to be cut to £25,000 per annum from April 2012.
- 100% FYA on zero emission commercial vehicles.
- 2% reduction in writing down allowances (main rate and special rate) from April 2012.
- New legislation intended for April 2011 to tackle tax avoidance through the use of EBT's and EFRBS.
- The abolition of the Furnished Holiday Letting rules have been scrapped with a redraft of the rules planned for April 2011.

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## PERSONAL TAX

### Tax Rates & Allowances

The Chancellor has made no changes to rates and allowances for the current year to April 2011. The figures in the table are those confirmed by Alistair Darling in his March Budget.

The Coalition Agreement between the Conservatives and the Liberal Democrats includes a long-term objective to take many low earners out of taxation by raising the starting point for income tax to £10,000. From 6 April 2011, the personal allowance will be raised by £1,000, significantly more than the usual inflationary rise, as a first step towards this aim.

Higher rate taxpayers will not benefit from this increase: the threshold for paying higher rate tax will be reduced, after taking inflation into account, so that the overall benefit to them is the same as for a basic rate taxpayer. The extra allowance will reduce tax but the reduction in the higher rate

threshold will mean that more tax is paid at 40% to compensate.

The Upper Earnings Limit, at which National Insurance Contributions fall from the full rate to 1% (2% in 2011/12), will be reduced so that the threshold for higher rate tax and lower NIC is the same. Lowering the threshold therefore increases income tax but reduces NIC.

As no other changes have been announced to personal allowances, the new rules which withdraw the benefit to those with incomes over £100,000 will take effect in 2010/11 as expected. For every £2 by which income exceeds £100,000, £1 will be deducted from personal allowances – so the basic allowance will be reduced to nil by the time income reaches £112,950. In this income band, the combined effect of the 40% tax rate and the withdrawal of allowances means that the marginal rate of income tax is 60%.

Individuals with total income in the range £100,000 to £113,000 will pay an effective rate of tax of 60% on income falling within this bracket.

### Other Issues

#### Tax Credits

Tax Credits will undergo a number of changes from 6 April 2011 including:-

- Eligibility for CTC for families with income above £40,000 will be reduced.
- The child element of CTC will be increased, but the rate at which it is withdrawn for higher incomes will also be increased.
- The "baby element" (which doubles CTC in the year a child is born) will be abolished.
- The "income disregard" (which ignores increases in income from one year to the next when finalising a credit entitlement) will be cut from £25,000 to £10,000.

Further changes to Tax Credits are expected in 2011/12.

#### Child Trust Funds

Payments made to Child Trust funds will be reduced from August 2010 and no new vouchers will be issued after 31 December 2010. Existing CTF accounts will continue to enjoy tax exempt status for the time being.

#### Pensioners

The State retirement pension will no longer increase in line with the retail prices index. Instead it will go up annually by the highest of 2.5%, the percentage rise in average earnings and the percentage rise in average prices. This will be a popular measure with campaigners on behalf of the elderly, who have protested that some recent rises in pensions have been derisory.



## National Insurance Contributions

### Rates and limits

No general changes have been made to the rates of NIC for 2010/11. Two important changes were announced to take effect from 6 April 2011:

A reduction in the upper earnings limit (UEL) to match the reduction in the threshold for 40% income tax – this means that less NIC will be charged at the full rate and more will be charged at the lower rate that applies above the UEL, so there will be a small cut in contributions.

The secondary threshold, which is the point at which employers start to pay employer contributions, will increase by £21 above the effect of inflation.

At present, employers and employees both start to pay NIC when pay exceeds £110 per week. The change to the threshold will mean that no employer's NIC will be payable until the employee earns the 2011/12 equivalent of £131 per week, saving approximately £140 a year for all workers and taking the lowest paid out of employer's NIC altogether. However, the use of different thresholds for employees' and employer's contributions may increase complexity for those who

still calculate NIC without using a computer.

These changes are in addition to two other measures which were announced by Mr Darling and which are also set to take effect on 6 April 2011:

- A 1% increase in the rates of NIC so that employers will pay 13.8%, employees will pay 12% (2% above the UEL), and the self-employed will pay 9% (2% above the UEL).
- An increase in the primary threshold (in 2010/11: £110 per week) to compensate lower earners for the increase in rates.

Although the increases in employer's NIC rates were attacked during the election campaign as "Labour's tax on jobs", it appears that they will be implemented.

Class 1A NIC are charged on taxable benefits in kind, and are due from the employer on 19 July following the tax year to which they relate. As the rate will have gone up by July 2011, the Class 1A NIC for 2010/11 will be levied at 13.8%, even though this will relate to a year in which the rate was 12.8%.

### Holiday for New Businesses

New businesses set up from 22 June 2010 will not have to pay the first £5,000 of employer's NIC for each of the first 10 employees hired in the first year of business. That covers all the employer's NIC on a salary of about £40,000, so in effect it is a year's holiday on employer contributions for anyone earning up to that level.

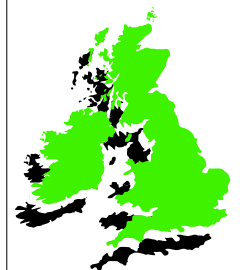
The scheme is aimed at promoting more private sector employment in

parts of the United Kingdom which are particularly reliant on public sector employment (and which will presumably therefore be worst affected by the public sector expenditure cutbacks). It will therefore be restricted to new businesses in Scotland, Wales, Northern Ireland, the North East, Yorkshire and the Humber, the North West, the East Midlands, the West Midlands and the South West. Details of the scheme will be announced shortly.

#### Tax Tip

**Can you benefit from setting up business in a tax-favoured area?**

Good news for businesses is that the lower earnings limit above which Employer's NIC becomes payable will increase by £21 per week above inflation from 6 April 2011. This is tempered by the news that the planned increase of 1% in all rates of NIC will go ahead as planned from 6 April 2011.



New Businesses outside the Southeast will save up to £5,000 in Employer's NIC per employee for the first year of business.



Previously anyone with a pensions scheme had to buy an annuity by age 75. This age limit will be scrapped and the IHT penalties on death will be reduced substantially giving taxpayers more flexibility with their pensions.

## SAVINGS

### Pension contributions

No changes were announced to the rules on pension contributions. This means that the maximum amounts for the current year remain unchanged, and extra contributions over £20,000 made by people earning over £130,000 may also be subject to a clawback of relief if made before 6 April 2011.

This clawback was introduced to prevent people paying early contributions to get around the restriction of higher rate pensions tax relief for those earning over £150,000 currently planned to come into force on 6 April 2011. The new Government has reservations about the complexity of the mechanism through which relief will be withdrawn and will discuss with interested parties whether there might be a simpler and fairer way of doing this. An alternative method may involve restricting the maximum amount that can be paid into a tax-favoured scheme to a much smaller figure (say £40,000 instead of the current £255,000). More details will be published later in the year.

In the meantime, anyone paying a large pension contribution out of earnings of over £130,000 still needs to take advice to understand the tax consequences – but the rules next year may be quite different from what we were expecting.

### Pension Benefits

Up to now, anyone with a tax-favoured pension scheme has been required to buy an annuity or start an "alternatively secured pension" (ASP) no later than their 75th birthday. An annuity may cease on the death of the pensioner or may continue to be payable to a dependant for a set period. An ASP preserves the identity of the pension fund, which may be passed on to the pensioner's dependants on death, but it is currently subject to heavy tax charges if this happens. If pension benefits have not commenced by the time an individual dies, it is normally possible to leave the fund to the dependants tax-free.

The Government has announced that it will end the effective requirement to buy an annuity with effect from 2011/12. As an interim measure, the age requirement for purchasing an annuity (or starting an ASP) will be increased to 77 for anyone who has not reached the age of 75 by 22 June 2010. The IHT charges that would previously have applied on a death will be substantially reduced.

Further details of these important changes will be announced shortly, and will be enacted in the legislation following the next Spring Budget.

### Tax Trap

Review pension contributions but watch the anti-avoidance rules.

## OTHER MEASURES

### Individual Savings Accounts

The annual limit on investment in tax-free ISAs was increased from £7,200 to £10,200 on 6 April 2010 (6 October 2009 for those aged 50 and over). This limit is to be increased annually in line with inflation in future, starting in 2011/12. The precise amount of the increase will not be known until the retail price index for September is published, as the calculation uses the annual measure of inflation to that month.

The limit will be rounded to a convenient multiple of £120 so that regular savers can fix a round monthly amount to pay into their ISA.

## CAPITAL GAINS TAX

The Liberal Democrats had pressed for a significant increase in the rate of CGT, and some expected it to rise to the same level as the higher rates of income tax (40% or 50%). There was also speculation about the possible reintroduction of relief for inflation or for length of ownership (tapering). It is encouraging that Mr Osborne rejected these on grounds of complexity: the computation of CGT was significantly simplified by the abolition of taper relief in 2008, and its reintroduction would have required yet another redesign of stockbrokers' software.

Instead, the Chancellor implemented an immediate rise in the CGT rate to 28%, to apply to disposals after midnight on Budget day, but only affecting those who pay higher rate income tax. It is unprecedented to change the CGT rate during a tax year, and the details of how this works for people who have made disposals both be-

### Entrepreneurs' Relief (ER)

ER allows an effective rate of CGT of 10%, instead of 18% or 28%, on qualifying disposals which give rise to gains up to a lifetime maximum. Mr Osborne has increased ER to £5m from £2m with effect from 23 June 2010. Earlier disposals on which ER has been given will be deducted from the lifetime allowance for future sales. ER has up to now achieved an effective rate of 10% by deducting 4/9 from the chargeable gain ( $5/9 \times 18\% = 10\%$ ). As there will now be two possible rates of CGT, this will no longer work, so gains qualifying for ER will simply be charged at 10%.

Qualifying disposals include business disposals, share disposals in a trading company by employees/directors who own 5% or more of the issued shares, or the disposal of a business asset when the business ceases.

fore and after 23 June 2010 are complicated. Deductions, reliefs and the annual exemption can be allocated by the taxpayer in the most beneficial way, so that the maximum amount of gain is charged at the old 18% rate and the minimum at the new higher rate.

Basic rate taxpayers will continue to pay CGT at 18%. Where a gain is large enough to take someone over the higher rate income tax threshold, the 28% rate will apply to the excess.

The annual exemption for 2010/11 remains unchanged at £10,100, and Mr Osborne announced that it will increase in line with inflation in future years as it has done in the past. However, he has said that the rate of CGT will be reviewed in the next Budget, so there is a possibility that the rate could rise again for the next tax year

### Furnished Holiday Lets

The Chancellor confirmed that the favourable tax treatment of furnished holiday lettings will be retained for 2010/11. Compared with other rental income, FHL sources benefit from more generous relief for losses and can be used to pay pension premiums. The disposal of FHL properties enjoys a number of CGT advantages, including potentially qualifying for Entrepreneurs' Relief (gains taxed at 10%).

The Government will consult during the summer in order to consider what the FHL rules should be in 2011/12. It seems likely that the favourable treatment will be retained (and will apply to properties anywhere in the European Economic Area), but the qualifying conditions may be tightened, for instance by increasing the number of days for which properties must be available and must be let.



Business Owners will now pay Capital Gains Tax at only 10% on the first £5 million of any gains resulting from the sale of qualifying assets.

**From 4 January 2011 the standard rate of VAT will increase to 20%. Similarly those operating within the flat rate scheme will see an increase in their applicable flat rate. Please consider the impact of this on your business early so you are ready to implement it from 4 January 2011.**

## VALUE ADDED TAX

### Standard rate

As widely expected, Mr Osborne's major tax-raising measure was an increase in the standard rate of VAT. This will go up from 17.5% to 20% on 4 January 2011.

Following the temporary cut in the standard rate to 15% between 1 December 2008 and 31 December 2009, traders have recent experience of the complexities of implementing a VAT rate change. At least the Chancellor appears to have noted that changing the VAT rate at midnight on New Year's Eve, as Mr Darling did, poses a number of practical difficulties.

There will be measures to prevent businesses which cannot recover all the VAT on their expenses, such as banks and insurance companies, from artificially bringing forward expenditure in order to pay 17.5% rather than 20%.

The effect of this increase dwarfs all the other tax changes in the Budget. The increase in the CGT rate is expected to raise just under £1bn by 2014/15; the VAT increase is supposed to be raising over £13bn a year by then. This shows that this is not a temporary measure, but something that is expected to remain at the same level for the whole of the Parliament.

### Flat Rate Scheme (FRS)

Small businesses with turnover of up to £150,000 may apply to use the FRS. This simplifies their VAT accounting because they do not claim input tax credit on expenses; instead, they keep some of the output tax they charge to customers rather than paying it all to HMRC. The percentage which must be paid to HMRC varies according to the type of business.

The flat rates change when there is a change of standard rate, and the new rates which will apply from 4 January 2011 have been published in the Budget Notes. Any business which uses the FRS should make sure that it is aware of the new rate and has checked whether the scheme remains beneficial. If you are unsure of what rate is applicable to your business from 4 January please contact us for assistance.

### Scope of the tax

Mr Osborne stated that there would be no extension of VAT to those items which are currently not charged to the tax such as children's clothes, food, newspapers and books. These reliefs are intended to reduce the impact of the tax on lower earners, who otherwise suffer the effect of VAT increases disproportionately.

### Tax Trap

Changing the VAT rate is an administrative headache – be prepared.

## INSURANCE PREMIUM TAX

To match the increase in VAT, the higher rate of IPT will rise from 17.5% to 20% on 4 January 2011. Higher rate IPT is charged on insurance contracts which are sold with VATable goods, such as extended warranties on household appliances and cars, and also on travel insurance.

The new rate will apply to premiums received or policies written by the insurer from 4 January onwards.

The standard rate of IPT, which applies to general insurance products such as household and motor insurance, will go up from 5% to 6% at the same time.

## CORPORATION TAX

### Rates and Thresholds

In a recent speech Mr Osborne promised to make the UK tax system one of the most competitive in the G20. He followed this up yesterday with a stepped reduction in the main rate of Corporation Tax to achieve a rate of 24% by FY 2014. It will be cut for the Financial Year 2011 (commencing 1 April 2011) to 27%, then to 26% for FY 2012, 25% for FY 2013 and 24% for FY 2014. This indeed represents the lowest rate within the G7 and the 5th lowest rate within the G20.

Over recent years a number of large companies have relocated their headquarters overseas to lower tax countries. This move should make

the UK more competitive internationally and help entice companies to move into the UK.

The small companies' rate was scheduled to rise from 21% to 22% from 1 April 2011. Instead, it will fall to 20%, where it last stood for the year to 31 March 2008.

The main rate of Corporation tax will continue to apply to companies with profits in excess of £1.5m and the small companies rate to companies with profits of less than £300,000. Marginal Rate Relief continues to operate as previously for companies with profits falling between the two thresholds.

## CAPITAL ALLOWANCES

### Writing Down Allowances

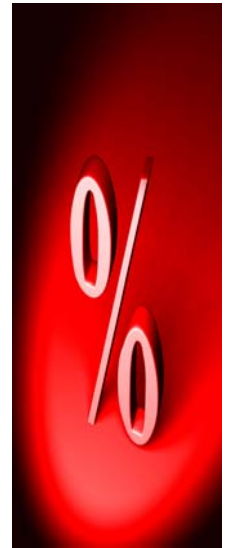
The rates of writing down allowances (WDA) will be reduced for chargeable periods ending on or after 1 April 2012 (companies) or 6 April 2012 (unincorporated trades). The "general pool" will be written down at 18% rather than 20%, and the "special rate pool" (typically longer-life assets and cars with carbon dioxide emissions rating above 160g/km) at 8% rather than 10%.

At the same time, the Annual Investment Allowance (AIA) – the amount of expenditure on plant and machinery that qualifies for a 100% immediate deduction – will be reduced from £100,000 to £25,000. It rose from £50,000 to £100,000 in April 2010.

There are complex rules for computing both the WDA and the AIA for chargeable periods which straddle a change in rate, and these will need to be consulted in 2012 for traders whose year ends do not match the tax year.

### Zero-emission goods vehicles

The last Labour Budget introduced nil taxable benefits for company cars which do not emit carbon dioxide, for five years starting in 2010/11. The new Budget brings in 100% first year allowances for the purchase of goods vehicles with zero emissions. It applies for purchases for five years from 1 April 2010 (companies) or 6 April 2010 (unincorporated). The vehicle must be new and unused, not second-hand.



**As anticipated, the small companies rate of Corporation Tax will reduce to 20% from 1 April 2011. Similarly the main rate of Corporation Tax will reduce by 1% per annum from 1 April 2011 until it reaches 24%. This is a boost to UK Companies and will boost UK competitiveness internationally.**

### Tax Tip

With the planned reduction in writing down allowances, its essential that you consider the tax impact of any new car purchases, particularly within a company structure. If in doubt please give us a call.

## OTHER MEASURES

### Penalties for late filing and payment

The March Budget included an announcement that HMRC is working on the reform of penalties for late filing of returns and payment of tax. This is part of the ongoing rationalisation of rules which formerly applied to different taxes administered by different departments (e.g. income taxes by the Inland Revenue and VAT by Customs & Excise). Several recent Finance Acts have reformed and rationalised interest on late tax payments and penalties for late filing and payment.

The latest Budget confirms that these measures will be extended to VAT and other indirect taxes, but does not set out a detailed timetable. Although the penalties for lateness in direct taxes are generally harsher than what they are replacing, the penalties under the existing default surcharge regime for VAT will be reduced after the changes.

### Anti-avoidance

There was less detail on anti-avoidance provisions than is usual in a Budget, presumably because HMRC included most of the measures they wanted in March. However, there is a proposal to clamp down on the use of trusts and other vehicles to avoid, defer or reduce liabilities to income tax and NICs on earnings, or to seek to avoid restrictions on pensions tax relief. The

most obvious targets are Employee Benefit Trusts and Employer Funded Retirement Benefit Schemes (EFRBS). The Government is considering measures to close down these schemes, and intends to introduce new legislation to take effect from 6 April 2011. Those who use these planning devices have been warned.

### Bank levy

After Labour's tax on bankers' bonuses in 2009/10, the new administration is introducing a levy on the balance sheets of large banks. It follows a joint policy statement issued with the French and German governments – Mr Osborne is keen to ensure that such a levy does not simply drive the banks to set up their operations in countries that do not charge similar taxes. It remains to be seen whether the levy will raise as much as he hopes.

### Research & Development Tax Relief

For accounting periods ending on or after 9 December 2009, companies which are involved in Research and Development will no longer have to own the intellectual property in order to be able to claim R&D Tax Relief. This measure was announced previously and it is now intended to be legislated for later in the summer.

**Qualifying Plant and Machinery purchases up to a total of £100,000 per annum now attract a 100% writing down relief rather than the £50,000 per annum that applies currently.**

### Tax Tip

Given the pressure on the government to raise finances compliance is a key issue, now more than ever. HMRC are becoming increasingly aggressive with Tax Enquiries. Critical to a taxpayer's defence in an enquiry is being able to show that they took reasonable care in their record keeping and reporting.

If you are unsure what records you should be keeping or whether or not they are sufficient to demonstrate reasonable care we can undertake a compliance review and suggest any improvements that are necessary.

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