

taxangle

Budget Special Issue 1



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Bad News is Good News

George Osborne's first Budget was widely trailed in the media so most of the 'bad news' leaked beforehand.

However, we must remember that this is the second budget this year. Alistair Darling raised taxes for next year by £8bn and for 2014-15 by £16bn. George Osborne has now added another £6bn next year and £8bn in four years time. Total additional tax revenues over four fiscal years in excess of £75bn: that is a lot of tax! Given a population of 60 million it represents £1,250 per person. If tax is only 23% of the equation, as per his announcement, then public expenditure cuts will cost each person £4,185. Now cuts and taxes do not affect everyone evenly but apart from the lower paid, everyone will be worse off.

The only tax breaks in the Budget were for business in reducing corporation tax rates and reducing NIC for low paid employees. The lower paid were also rewarded by a significant rise in personal allowances.

I was disappointed on the tax credit front in two respects. The cut-backs only really affect middle-income

families earning over £40,000 pa: I thought this could have been lower and combined with even higher personal allowances. I cannot see the economic sense of taxing a person on the one hand then giving it back on the other. Administrative costs and fraud make this very expensive. Also George Osborne has increased the rate at which tax credits are withdrawn, giving a potential marginal rate of tax (and benefits) of 90%! This is hardly going to encourage people to earn more. If a tax system is going to be "fair" as he promised, then marginal tax rates must be lower. The Government says 130,000 families have a marginal rate of 90% and for a staggering 1,935,000 families it is over 60%. This simply does not make sense.

Behind the headlines are lots of discussion documents, consultation periods and 'think tanks' on everything from public pensions, tax relief on pension contributions to general anti-avoidance rules and non-UK domiciled individuals (again). All of this bodes yet more changes at next year's Spring Budget. The new CGT rates of 10%, 18% and 28% (or

even 44.8% for some) are only here for the remainder of this tax year: room has been left to change them again in March.

There was no backtracking on Darling's rises in Stamp Duty Land Tax, Tonnage Tax, Inheritance Tax (by freezing nil rate bands), and Company Car Tax: whoever you are and whatever you do, it will cost you more, mostly in extra tax hidden in the cost of what you buy.

Many clients I am pleased to say successfully pre-empted the CGT rises with our help. Cyprus is still a viable option for CGT planning and my holiday apartment there now qualifies as a business – so if I ever make a gain it will be tax at 10%: happy days.



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No Exchequer Gain Without Some Pain?

Mr Osborne will certainly be hoping in part that my adapted version of the popular proverb applies to his rise in Capital Gains Tax (CGT).

The change in the CGT rate will certainly spell pain for some higher rate taxpayers, but it is perhaps not as penal as widely anticipated. The Chancellor seems to have taken into consideration research that suggests that substantial increases in the CGT rate actually produce falls in CGT revenues. He will be hoping that he has struck a balance that will positively benefit the Exchequer's coffers.

Changes effective from 23 June 2010:

- A new rate of 28% will apply to gains where an individual's (or trustee's) total taxable income and gains are above the upper limit of the basic rate income tax band. The 18% rate of CGT will, however, be retained for those with total

income and gains below that level. Of course, we can not rule out further increases in later Budgets.

- The Entrepreneurs' Relief lifetime limit has been increased from £2m to £5m. The relief previously functioned by reducing qualifying gains by 4/9ths resulting in an effective 10% CGT rate (i.e. 5/9ths of 18%). As we now have two tiers of CGT, the 4/9ths calculation is abolished and instead a flat 10% rate applies to all qualifying gains.
- The CGT Annual Exemption remains unchanged and will be index linked.

The extension of the Entrepreneurs' Relief limit will certainly be applauded by shareholders in owner managed businesses, whom also stand to indirectly benefit from Corporation Tax cuts. It does, however, raise the question as to whether the Chancellor's stated intention of reducing the incentive to convert income into capital gains will be achieved – I would

certainly wish to pay 10% CGT (or even 28% CGT) rather than potentially 50% income tax!

It would have been reassuring to see employees in company share incentive schemes shielded from the CGT rise as they will often not qualify for Entrepreneurs' Relief. Unfortunately no such protection has been announced.

A certain Mr Capello will also be hoping that a little pain (a strict training camp in his case) produces positive results when England return to the football pitch tomorrow. Personally I can cope with sitting through two Budget Statements in the space of four months but I am not sure if my pain threshold can withstand another abject England performance!

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Mr Osborne's Indirect Tax Increase is Very Direct!

The Chancellor announced an increase in the UK's standard VAT rate to 20% from 4 January 2011 – with anti-forestalling provisions.

The VAT flat rate scheme percentages are increased accordingly

Given the size of the deficit, increased VAT is probably one of the most efficient ways of raising additional revenue – and has been the most trailed. Expected to raise an additional £13bn per year, this measure puts our standard rate in the middle of the permitted range of EU standard rates.

There are anti-forestalling provisions to prevent abuse for transactions from today until January. An initial inspection of the guidance shows they are similar to those from the last increase.

Zero-rates, exemptions and reduced rates to remain (largely) unchanged

The Chancellor announced that there is no intention to change the UK zero-rates for products such as food, children's clothing,

newspapers and books during the life of this Parliament.

In spite of the potential fiscal upside of imposing VAT on some currently zero-rated, there were always two challenges to a change: politically it would be unpalatable to impose VAT on food (even at a lower rate) and also once UK zero-rates are gone, they're gone forever. The UK retained zero rates on joining the EEC in 1973 and is out of step with the VAT directives.

Insurance Premium Tax Rates rise – standard rate to 6%, higher rate to 20% from 4 January 2011

The higher rate is increased to be in line with the VAT rate change, while the 1% basic rate increase represents an effective rate increase of 20%.

Penalties for late submission and payment of returns

As previously announced, the final change to the penalty regime as HMRC harmonises the penalty regimes.

Fixed penalties for initial late filings will be followed by tax-g geared penalties for prolonged default. Late payment penalties are based on a percentage of tax paid late.

There were also several announcements confirming previous measures from the March 2010 Budget, including changes to both VAT treatment of gas imports and zero-rating criteria for aircraft and restrictions on Lennartz accounting arrangements.

Finally, a range of measures for environmental taxes and duties includes proposals to stabilise fuel prices at the pump with a 'Fair Fuel Stabiliser'.

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A Cut In Corporation Tax – But Where Is The Payback?

Prior to the election, the Conservatives had indicated that they aspired towards a general reduction in corporation tax rates, to be paid for by reduction in certain unspecified reliefs – all in the interest of promoting tax competitiveness.

However, the extent of the cut in the rate of corporation tax that was announced over the life of the Parliament, and the speed with which this will be introduced, was a surprise. The rate will reduce by 1% to 27% from 1 April next year, with three further cuts of 1% to follow, bringing it down to 24% by 1 April 2014. This is further than most people expected the Government to go and will mean that the UK has one of the lowest rates in the developed world.

In addition, the small companies rate of tax, which is broadly paid by companies with profits below £300,000, is to be reduced by 1% to 20%. It had been scheduled to increase to 22%.

This is a sensible move as it aligns the rate with the basic rate of income tax.

So, how will the rate reductions be paid for? The one concrete move to recoup some of the tax rate giveaway is to reduce capital allowances – the tax relief that businesses receive on their investment in plant, machinery and equipment. Currently most of this expenditure attracts relief at a rate of 20% per year. This will be reduced to 18%. For certain types of investment (so called 'long life' assets and features integral to buildings) the rate is currently 10%. This will come down to 8%. However, these reductions are deferred until April 2012 – so businesses will have a full year of benefit from the lower rate of tax before the reduction in allowances kicks in. In addition, the Annual Investment Allowance will also be reduced. This allows the first £100,000 of expenditure in a year to be offset in full. This will be reduced to £25,000 (having only recently gone up from £50,000!). Whether these reductions will act as a disincentive for businesses to invest, remains to be seen.

The Chancellor made it clear that these changes are part of an ongoing reform of corporation tax. A more detailed reform programme will be set out in the autumn, with the emphasis on competitiveness (lower rates) and a 'territorial' approach (only taxing income that properly attaches to the UK). This will include areas which are already subject to consultation such as the notoriously complicated controlled foreign companies' rules, and the taxation of foreign branches of UK companies. A business forum will be set up to consult with major multinational companies on long-term reform. This can only be a good thing if it leads to better thought out legislation. However, as a tax practitioner, I have long been dubious about whether any such good intentions actually lead to simplification. Perhaps this time will be different. Then again, perhaps not....

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Property – A Building Blocks Budget

The eagerly awaited Emergency Budget from the new Chancellor has finally been revealed, the theme being creating building blocks for the future.

But what do the various new tax measures mean for property owners? No doubt the property industry was crying out for some relief (tax or otherwise). I think it is fair to say that this mixed Budget has some good news and some less helpful implications.

The increase in Capital Gains Tax (CGT) from 18% to 28% for higher rate taxpayers is not good news for investment property owners but it is not as bad as feared as pre-Budget discussions implied it could go up to 40% or 50%.

Entrepreneurs' Relief has been retained and extended but it is not uncommon for individuals to hold property personally but use it in their trade and some fail to qualify for Entrepreneurs' Relief on that property

due to poor planning. It is now even more important that people organise their business in the most tax efficient manner and plan for their exit. The cost of not doing so could be CGT at 28% rather than 10%.

The 4 January 2011 increase in VAT from 17.5% to 20% will also have implications for the property industry, especially for tenants/purchasers of commercial property where the landlord/seller has opted to charge VAT.

There is good news for owners of 'furnished holiday lets' who will still benefit from various business reliefs that do not apply to standard investment properties (e.g. Entrepreneurs' Relief and beneficial loss reliefs). There were plans to abolish furnished holiday let status but the Chancellor has confirmed that it will remain. Properties in the EEA may also qualify.

There were fears that certain Stamp Duty Land Tax (SDLT) reliefs that allow purchasers to structure acquisitions extremely tax efficiently might be amended

or withdrawn. With no amendments to SDLT, these planning opportunities are very much alive. SDLT is still due to increase to 5% from 6 April 2011 for acquisitions of property worth more than £1m.

So, a mixed bag for property owners. Owners of investment properties may not be rejoicing but it is not as bad as many thought it was going to be. Owners of properties used in their business, however, can feel satisfied that they could pay as little as 10% CGT, even on high value properties.

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NIC to be Regionalised

The Chancellor announced that from next year there will be a significant increase of £21 per week to the threshold at which National Insurance contributions are paid, but more importantly, he announced that businesses outside of London, the South East and the Eastern region are to get National Insurance relief for the next three years. In his Budget he declared that anyone starting a business will be exempt for up to £5,000 of employer National Insurance payments for each of their first ten employees. He also confirmed that the Government aims to have the scheme in place by September and that any qualifying new business set up from today will also receive help. The Treasury estimates that some 400,000 businesses will benefit.

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Income Tax Changes

Good news for the basic rate taxpayer as the personal allowance for those aged under 65 is due to rise from £6,475 to £7,475 from April 2011. The Government is still committed to the objective to raise the personal allowance to £10,000 in this Parliament.

- The higher rate income tax threshold will be frozen until 2013-14. The amount will be confirmed when the September RPI is known.
- The 50p rate of income tax which took effect from April 2010 will remain in place for the time being.
- The Government will review the taxation of non-domiciled individuals as announced in the Coalition agreement.

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