

Budget 2010

As anticipated, the Budget did see the confirmation of a number of measures previously announced in the Pre-Budget Report last December. Most notably the imposition of the 50% top tax rate which will be felt from next month as planned.

Against the backdrop of a fragile economic recovery and the need to take steps to reduce the Budget deficit, this pre-election Budget did not add further to the woes of the non-domiciled, bankers and higher paid individuals. We have written extensively about the UK's residence rules becoming increasingly unworkable. Recognition that a statutory residence test is needed is at least acknowledged but remains too hard to take forward at present. We will await a post-election Budget for this perhaps.

There is warning of measures that target higher paid taxpayer shelters from a 50% income tax rate either by deferral or conversion to capital gains. In light of this it was surprising the capital gains tax rate remains at 18%.

While much was made in the Chancellor's speech of helping small businesses during this period of recovery, the Budget was ultimately short on new significant measures in this area although there was a welcome increase to entrepreneurs' relief from capital gains.

Freezes/No Change

Previously announced plans to freeze personal allowance (£6,475 for those under 65) and the level at which individuals pay 40% tax at £37,400 were restated. Also confirmed were the freezing of the nil rate band threshold for inheritance tax at £325,000 for 2010/11, and the annual allowance for pension purposes at £255,000 through to 2015/16. Corporation tax rates remain unchanged at 21% and 28% and the limit for compulsory VAT registration increased marginally from £68,000 to £70,000.

Income Tax and National Insurance

The Budget saw the Chancellor renew his commitment to the 50% top rate of tax for individuals with taxable income over £150,000 with effect from 6 April 2010, along with the phasing out of the personal allowance for those with income over £100,000. From recent commentary it would seem that despite arguments regarding the impact on London's standing as a leading financial centre, these measures are now likely to come into effect irrespective of the result of the widely anticipated general election on 6 May 2010.

Increases to the national insurance rates which are to come into force in 2011/12 have also been confirmed. For employees, employers and the self-employed this means an increase of 1% on all earnings or profit.

For those earning over £150,000 these combined measures represent a 11-12% tax increase seeing more money going to the taxman than reaching the pockets of individuals. However, this is not all doom and gloom and with likely increases in US taxes in 2011, for those who pay tax in the US the overall effect on their worldwide tax position may not be as severe as those who only pay tax in the UK.

Pension Contributions

We also saw confirmation of the reduction to the availability of higher rate tax relief on non frequent pension contributions by reducing the original £150,000 per annum income limit to £130,000. Further changes to the rules due to come into effect 6 April 2011 are currently in draft legislative format and it has been announced will form part of the Finance Bill 2010. The current proposal is a phased reduction in income tax relief on all pension contributions for those whose taxable income exceeds £150,000. Relief will be restricted to the basic rate where an individual's income exceeds £180,000.

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Employee Benefit Trusts (EBTs), Employer Funded Retirement Benefit Schemes (EFRBS) and Employment Related Securities

As widely anticipated by commentators, HM Revenue & Customs (HMRC) have stated that they will be taking action to prevent attempts to avoid the 50% tax rate and increased national insurance contributions through the use of EBTs and EFRBS. Any proposed legislation will take effect from 6 April 2011. In addition during 2010 there will also be a review and consultation of the rules relating to employment related securities. Running alongside this in trying to prevent the conversion of income to capital is the extension of the rules regarding the disclosure of tax planning arrangements, to cover those relating to employment income and the conversion of such income to capital gains.

Bank Payroll Tax

The Budget announcement included final details of the bank payroll tax applying to bonuses over £25,000 received by bank and building society employees between 9 December 2009 to 5 April 2010. This was mainly in connection with the extent of its application, including the definition of companies and individual employees to whom it would apply, and the mechanics of payment. Although widely criticised in the financial sector when announced, similar policies have now been introduced in the US and a number of other European states.

Residency

Following talks between HMRC officials and representatives from the tax profession and commerce, it was hoped that a statutory residence test, based on similar principles to the substantial presence test in the US, was going to be agreed in time for inclusion in the Finance Bill 2010. HMRC have confirmed that this has not been possible. They have accepted that there is a need to clarify the rules in this area to allow certainty for taxpayers and that this will continue to be worked on.

Capital Gains Tax

It was widely expected that an increase in the capital gains tax rate would be included in the Chancellor's speech. Instead we have an incentive for those with business assets as the entrepreneurs' relief, which currently allows an effective rate of tax at 10% for the disposal of business assets up to £1million in a lifetime will be increased to a £2million lifetime allowance for disposals on or after 6 April 2010. For those who have already utilised their £1million threshold, a further £1million will be available for disposals after 5 April 2010. For US nationals this increase is of limited use as the gain would still be subject to US tax at 15%.

Associated Company Rules

Companies under common control are deemed to be associated for tax purposes. An associated company has the effect of reducing the tax rate bands determining the rate of corporation tax. The legislation currently works by treating companies controlled by family members as associated. A concession is already in place to exclude siblings where there is no interdependence between the companies. It was confirmed that legislation will be introduced to remove other family members from the control test in the Finance Bill 2011 subject to the same provisions regarding interdependence.

Charity Donations

UK tax legislation in respect of deductions available for charitable donations has long been discriminatory in only allowing deductions for donations made to UK registered charities. It has been announced that deductions will now be available for both businesses and individuals in respect of donations made

to charitable organisations in the European Union (EU) and the European Economic Area (EEA). Unfortunately it is not being extended to US based charities and donations made to such charities will continue to be ineligible for relief unless the charity is also UK registered.

Capital Allowances/Tax Depreciation

The first year allowance introduced in the Budget 2009 is to end 31 March 2010 as initially planned. The recently introduced Annual Investment Allowance (AIA) that allows for full a deduction on expenditure on most plant and machinery is to be doubled to £100,000 for expenditure after 1 April 2010 for corporation tax, and 6 April 2010 for income tax which should be some compensation.

Loss Relief

The ability to carry losses of up to £50,000 back three years has been extended. It will now apply for losses in accounting periods ending before 23 November 2010 for corporation tax purposes and for losses arising in the tax year 2009/10 for income tax purposes.

Stamp Duty Land Tax (SDLT)

First time buyers are the winners on the SDLT front with a 100% increase on the relief from SDLT for purchases of residential property, rising from £125,000 to £250,000 for transactions on or after 25 March 2010 and before 25 March 2012. The losers are those who are purchasing properties for consideration of £1million or more. There will be a 5% SDLT rate on consideration over £1million for purchases completed after 6 April 2011.

HMRC Powers

A review of HMRC powers, including penalty procedures, was first introduced in the Finance Act 2009 covering late filing and payment of tax for the direct taxes including income tax and corporation tax. This has now been extended to include VAT, though the proposed changes to be staged over a number of years. HMRC will also be given the power to require financial security from employers that have a history of serious PAYE non-compliance. The intended date for this to come into effect is 6 April 2011, subject to a consultation period.

2009 saw the introduction of the New Disclosure Opportunity, the Liechtenstein Disclosure Facility and Tax Health Plan to encourage taxpayers with undisclosed offshore income to 'pay up' with the benefit of reduced penalties on unpaid tax. Following on from this, legislation will be introduced for periods commencing on or after 1 April 2011 to provide for larger penalties for those taxpayers who fail to disclose their income tax and capital gains tax liabilities where the unpaid tax relates to offshore income. Tax geared penalties will be determined by the jurisdiction in which the non-compliance arises. These penalties can be more than 100% of the tax due.

Summary

In summary, this is likely to be perceived as a cautious, 'wait and see' Budget, focused on closing perceived loopholes and abuses and encouraging taxpayer compliance; it is more striking for the measures which were not introduced, than those that were. As has been the case in more recent Budgets given by Alastair Darling, the devil is in the detail and we will need to await the details of the Finance Bill 2010. Further commentary will be provided on the draft Finance Bill in our summer edition of Focus when the impact of any General Election result will also be clearer.

If you have any questions on this subject, or any other tax related issues, please seek further advice from your usual Frank Hirth contact.