



ST. JAMES'S PLACE
WEALTH MANAGEMENT

TAX & TECHNICAL SUPPORT

Budget 2009 Summary

23 April 2009

Introduction

The Chancellor delivered his Budget this year against a backdrop of burgeoning Government debt and challenging economic conditions. Many of the changes had previously been announced in the Pre-Budget report in November but several significant announcements were made that will have an impact for the financial services sector. The key headlines and opportunities are:

- Identify and contact those individuals affected by the changes to higher rate relief on Pensions (see Retirement Planning Briefing Note).
- Clients with taxable income in excess of £100,000 per annum will be looking to reduce their tax burden particularly at the margins. Solutions could include pensions via salary sacrifice, Enterprise Investment Schemes, Venture Capital Trusts, capital growth unit trusts and bonds.
- With trustees looking at an income tax rate of 50% from April 2010, higher and earlier than anticipated many will and could be encouraged to review their investment portfolio. Growth unit trusts and bonds should play an integral part going forward.

Other key issues include:

- The removal from 6 April 2011 of higher rate tax relief for pension contributions for those with income of £150,000 or more.
- The complex transitional provisions connected with the special allowance charge on pension contributions to prevent perceived abuse in the intervening period.
- The introduction from 2010/11 of a 50% income tax rate (and 42.5% on dividends) for those with income of £150,000 or more.



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- The reduction, from 2010/11 of personal allowances for those earning over £100,000.
- The increase of the trust tax rate to 50% and 42.5% for dividends, regardless of income levels.
- The increase of the annual ISA allowance to £10,200 from 2010/11 and from 6 October 2009 for those 50 and over.
- The retention of small companies corporation tax at 21% for another year.

This note provides you with more detail on some of the high level announcements. Full details of the pension changes are set out in a separate Retirement Planning Briefing Note.

Income Tax

The two most important announcements made in connection with income tax were, from 2010/11:

- the introduction of a 50% rate of income tax.
- the removal of the personal allowance for persons with income in excess of £100,000.

Personal Allowances (2009/2010)

- The personal allowance is increased from £6,035 to £6,475.
- An increase in the level of age allowance from £9,030 to £9,490 (for those aged 65 – 74) and from £9,180 to £9,640 (for those aged 75 and over).
- 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) will increase to £6,965. The MCA for those aged 65 to 74 is not relevant for tax year 2009/10 and beyond as those eligible for this allowance in 2008/09 will attain age 75 at some time in tax year 2009/10 in which case they will qualify for the age 75 and over MCA.



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The starting rate of income tax (2009/2010)

The starting rate of 10% for the tax year 2009/10 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.

The basic rate of income tax (2009/2010)

For 2009/10, the basic rate of income tax has been held at 20%. The higher rate threshold has been increased to £37,400.

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 2009/10.

The higher rate threshold (2009/2010)

The higher rate threshold has been raised to £37,400. Taxable income in excess of this will be taxed at 40% or 32.5% (UK dividend income).

Although there has been a reasonable increase in the higher rate tax threshold this year, over the last 10 years or so the number of higher rate taxpayers has increased because the higher rate tax threshold has not increased in line with earnings.

Personal allowances and tax rates in 2010/11

It was announced that from 6 April 2010 that the rate of tax on taxable income in excess of £150,000 would be 50%. This brings forward and increases the 45% rate, which had been proposed in the Pre-Budget Report 2008 to apply from 6 April 2011.

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.



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

Basic rate taxpayers will pay 10% whilst for higher rate taxpayers the rate will be 32.5% unless their income exceeds £150,000 when a rate of 42.5% will apply.

Which means that:-

- Both personal allowances and starting/basic rate tax bands should, if possible, be used to the full, particularly where only one of the spouses is a higher rate taxpayer.
- As well as a transfer of investments, considerable scope may exist for a business owner to employ his or her spouse and possibly then provide a pension for him/her. Care should be exercised to ensure that all payments made will be a deductible expense for the payer.
- 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.
- Consideration should be given to investing in non-income producing assets such as Investment Bonds. There would be a 20% tax credit when a chargeable event gain was realised and, of course, tax deferred withdrawals using the 5% allowance would be possible.
- The attraction of the tax free investment growth and income secured inside 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.
- Where higher rate tax relief on pension contributions remains for an individual until 5 April 2011 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. (For further details see the Retirement Planning Briefing Note).



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- Company owner/directors 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 £1 million of the gain eventually realised will, with the benefit of entrepreneurs’ relief, only be taxed at effectively 10% and at 18% for any gains over the lifetime capital gains limit of £1 million. Of course, despite the undoubted tax attraction of an effective 10% tax rate on capital gains of up to £1million, 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.
- 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. The risk element of such investments has to be considered.
- Clearly there is little action that a taxpayer can take to secure their personal allowance if they enjoy sizeable earned income. However, for those with investment income which causes their gross income to be just over the £100,000 threshold, they could consider reinvesting into capital growth orientated investments or investments that produce tax-free income (e.g. ISAs).

Vat

The standard rate of value added tax (VAT) will be 15% from 1 December 2008 until 31 December 2009, reverting to 17.5% from 1 January 2010. The zero rate and 5% rate are unaffected.

Stamp Duty Land Tax/Stamp Duty

In September 2008 the Chancellor announced a “holiday” from stamp duty land tax (SDLT), which exempted from SDLT any acquisitions of residential property for not more than £175,000. The measure applied to acquisitions between 3 September 2008 and 2 September 2009 inclusive.



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The Chancellor has announced that regulations will be introduced to confirm that the starting threshold for SDLT on residential property will increase from £125,000 to £175,000 on transactions made between 22 April 2009 and 31 December 2009 inclusive. After that date the SDLT threshold for residential property will revert to £125,000.

Individuals who are purchasing residential property between 22 April 2009 and 31 December 2009 will therefore not pay SDLT where the chargeable consideration for the property is no more than £175,000.

Non-UK Domiciliaries

Although there were a few technical clarifications to the new rules on the remittance of income and gains for non-UK domiciliaries introduced by the Finance Act 2008, there have been no significant amendments to the rules specifically affecting these individuals. Certain exemptions relating to the remittance of property purchased with foreign income or gains have been extended, some anti-avoidance provisions have been confirmed and the application of remittance basis with trust legislation has been clarified.

Which means that:-

When considering planning opportunities for UK resident non-domiciled investors Partners should keep in mind the continuing opportunities for deferring taxation on income and gains through offshore bonds and tax planning opportunities through some offshore trusts.

Pensions

As well as introducing the 50% rate for those with income of £150,000 or more, it was also announced that income tax relief on pension contributions will be restricted for such individuals relief will be progressively reduced to the basic rate of 20% as of 6 April 2011. Measures were also announced to deprive higher rate income tax relief on contributions made from today for taxpayers with income of £150,000 or more who, between now April 2011, either change their pattern of payment contributions or change the way their benefits are accrued, where benefits or contributions exceed £20,000 per year. An analysis of these changes and the implications for clients has been detailed in a separate Retirement Planning Briefing Note.



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Which means that:-

Any Partners operating in the pensions market, or those with clients earning in excess of £100,000, who have made no or little pensions provision, or work in a profession where within the next few years their income could be at these levels should digest the implications of the Retirement Planning Briefing Note and identify clients and opportunities.

Capital Gains Tax

Most of you will be aware that major changes in the taxation of capital gains for individuals and trustees took place from 6 April 2008.

In this Budget the main change was the increase in the annual exemption. This is increased from £9,600 (2008/09) to £10,100 for individuals and personal representatives. For trustees the exemption increases from £4,800 to £ 5,050 although this is still apportioned between other trusts created by the settlor since 6th June 1978.

Inheritance Tax

Nil Rate Band Level

Increases in the nil rate band from 6 April 2008 until 2011 were announced in Budgets 2006 and 2007. For tax year 2009/10 the inheritance tax (IHT) nil rate band has been increased from £312,000 to £325,000. The threshold is to be increased to £350,000 in 2010/11.

Which means that:-

For a person with assets of £325,000 or more the increase in the level of the nil rate band in 2009/10 will produce an increased IHT saving of £5,200. For a married couple or registered civil partners this can mean that up to £650,000 of the combined estate could pass free of the IHT. Additionally, it may provide further scope for lifetime gifting with discretionary trusts, including DGPs, whilst ensuring the Settlor's cumulative gifts in seven years are within the available NRB.



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Extension of Agricultural Property/Woodland Relief to land in the EEA

The Chancellor announced provisions to extend agricultural property relief (APR) and woodlands relief to property in the European Economic Area (EEA) whereas at present it applies only to the UK, Channel Islands and the Isle of Man. This will apply for tax events on and after 22 April 2009.

Furthermore, IHT due or paid on or after 23 April 2003 in relation to agricultural property located in an EEA state at the time of the event will become eligible for relief. The Finance Bill 2009 will provide that the earliest deadline for reclaiming overpayments on such property will be 21 April 2010.

Which means that:-

Clients who hold such property in an EEA state will now obtain relief for IHT and estates on which IHT has been paid on such property since 2003 may be able to reclaim the tax. In practice, it may be that many such individuals are non domicile by origin and thus may not have paid tax at death on the asset as it is non UK sited.

Trusts

In the Pre-Budget report in November 2008, the Chancellor announced that the trust tax rate would increase to 45% with effect from 6 April 2011. However, in his Budget speech the Chancellor has not only further increased the tax rate that will apply to trusts but has also brought forward the date of implementation to 6 April 2010.

With effect from 6 April 2010, the 40% trust rate will increase to 50% (with the dividend rate increasing to 42.5% from 32.5%). This is a large increase for trustees and, unlike the increased rates for individual taxpayers, it is not restricted to income that exceeds £150,000.

For all trusts there will be an increase in tax on trust income although it should be remembered that discretionary trusts, in general, will qualify for the £1,000 standard rate tax band for tax year 2009/10 within which income is taxed at basic rate depending on its source (i.e. 10% dividends, 20% savings income).



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Which means that:-

Trustees should undertake a review of their current portfolio and may wish to take action to reduce their exposure to the new higher rate tax. Such action could be the following, although all of which should be considered in relation to the trustees duties, powers and trust terms:-

- Reinvesting in capital growth orientated assets with a view to reducing taxable income and replacing it with assets that will produce capital gains. Use of the trustees' annual CGT exemption together with an 18% CGT rate on excess gains may be more appealing than the new income tax rates.
- Trustee Investment Bonds will provide significant tax planning advantages to the extent that the timing and person liable can be carefully planned. For a UK bond, broadly speaking, the fund will be taxed at 20% whereas there will be no tax for an offshore bond. The tax rates on encashment (for the settlor, trustees or beneficiaries as appropriate) will, however, rise to 30% for the settlor assuming they earn in excess of £150,000 and 50% for the trustees. The usual strategies to minimise tax on withdrawing benefits will be appropriate and, in particular, the potential to assign policies to potentially lower rate taxpaying beneficiaries before encashment occurs. Additionally, the ability to have any tax fall on the settlor at their personal rates of tax may provide more benefits than before particularly if earning less than £150,000 although care should be taken in respect of reclaiming any such tax paid from the trustees as this will result in a further tax liability.
- Where the trust generates income and has non-taxpaying or 10%/basic rate taxpaying beneficiaries, it may be appropriate for the trustees to mandate income to the beneficiaries to enable them to recover some of the higher rate tax suffered by the trustees, with the exception of the 10% tax credit on dividends.

A full note on this subject will follow from Tax & Technical Support.



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Corporation Tax

The rates of corporation tax for the financial year starting 1 April 2009 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.
- 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 can be particularly effective and 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.

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, 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.

However, in all pension planning for those members whose income exceeds £150,000 any decision on corporation tax strategies should take account of the potential for a special allowance charge under new anti avoidance legislation in respect of pension contributions.



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Carry Back of Trading Losses

It is currently possible to offset trading losses incurred in one trading year against profits made in the preceding trading year. There is no cap on the loss that can be carried back in this way.

The Chancellor announced a new measure by which companies and unincorporated businesses will be able to offset their trading losses against profits that have arisen in any of the three previous years.

For companies the trading loss must be incurred in the accounting periods ending between 24 November 2008 and 23 November 2010 and for unincorporated businesses this relief will be available for trading losses for the tax year 2008/09 and 2009/10. While the amount of loss that can be carried back to the preceding year will be unlimited, there will be a maximum of £50,000 of the balance of unused losses that can be carried back to the earlier two years.

Which means that:-

Where an owner director company has significant retained profit, it may be possible to make a pension contribution that creates a loss this year that can be carried back to offset profits made in the three previous years. For example:

Penn and Sons Ltd have a company year end of 31 December. It has retained profit of £300,000 and is on track to make a profit of £70,000 this year. The company achieved profits of £80,000 in the last trading year (2008/09), £40,000 profits in the 2007/08 year and £40,000 in the 2006/07 trading year.

Following discussions with the accountant, the company decides to make a contribution of £200,000 in respect of the owner director, Mr Penn. This means that the company incurs a trading loss of £130,000 in the current year (2009/10).

Current rules allow this year's trading loss to be carried back to the 2008/09 year. As the profit last year was £80,000, the maximum amount that can be carried back in this way is £80,000. The proposed legislative changes would also allow Penn and Sons Ltd to carry back £40,000 of this year's trading loss to 2007/08 and £10,000 of loss to 2006/07.



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Savings and Investments

Individual Savings Accounts (ISAs)

ISAs remain as a method of investing savings with freedom from income tax and capital gains tax. From 6 April 2009 the annual contribution limit is maintained at £7,200, with the maximum contribution to a cash ISA being £3,600.

However, the Chancellor announced in his speech that from 6 October 2009 the maximum contribution for those aged 50+ (born before 6th April 1960) is 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 regardless of age.

Which means that:-

This substantial increase in the investment limit (for older investors first and later for all), while valuable, 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% rate of tax on income.

The value offered to investors by the product's freedom from tax on income will increase for those likely to become 50% taxpayers under new legislation.

This should provide a welcome boost to the ISA market either from investors who already maximum fund their ISA and will wish to add further funds or from new investors looking to benefit from tax free income on a further £3,000 capital which may currently be held on deposit eroded by inflation and 20% tax deducted at source.

Child Trust Fund

Every eligible child born on or after 1 September 2002 has a Child Trust Fund account. Family and friends can contribute up to £1,200 into the account each year until the child's 18th birthday.



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In this Budget, it is proposed that the Government will make payments of £100 per year into the Child Trust Fund accounts of all disabled children and £200 per year for severely disabled children (those who receive the High Care element of Disability Living Allowance). Importantly, these payments will not count towards the £1,200 yearly contribution limit.

Enterprise Investment Scheme

Currently an investor may carry back income tax relief to the previous year by claiming that qualifying shares are treated as having been issued in the previous year.

This is restricted to shares issued before 6 October in the tax year and subject to a limit of one half of the subscriptions in that period, up to an overall limit of £50,000 subscribed.

As detailed in the Budget notes although not mentioned in the Chancellor's speech, the Finance Bill 2009 will remove these restrictions.

However, the total investment that can be taken into account for the purposes of calculating income tax relief for any particular year will remain subject to a limit, currently £500,000 subscribed.

Which means that:-

This change should provide greater flexibility and planning opportunities in respect of income tax savings although full details are expected in the Finance Bill 2009.

A further note will be issued on the subject of Enterprise Investment Schemes from Tax & Technical Support and will be made available on the intranet.

UK funds more competitive

Legislation has been proposed aimed at enhancing the UK's competitiveness as a domicile for authorised investment funds through the newly created 'tax elected funds regime'. This moves the point of taxation from the fund to the investor thereby allowing them to be marketed and attractive to exempt investors worldwide.

Legislation

The Finance Bill 2009 is due to be published on 30 April 2009 and Royal Assent is anticipated to be given on 21 July 2009.

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Tax Rates

| | 2008/2009 | 2009/2010 | 2010/2011 | 2011/2012 |
|-----------------------------------|-----------|---|---|---|
| PERSONAL TAX | | | | |
| Income Tax Rates | | | | |
| Starting 10% (for savings only) | | £0-£2,440 | Taxable non-savings and savings income above £150,000 | Taxable non-savings and savings income above £150,000 |
| Basic 20% (dividends 10%) | | £0-£37,400 | | |
| Higher 40% (dividends 32.5%) | | Over £37,400 | | |
| Upper 50% (dividends 42.5%) | | | | |
| Income Tax Allowances | | | | |
| Personal Allowance (pa) | | | £100,000 limit | |
| - under 65 | £6,035 | £6,475 | (£1 for every £2 of gross income above limit up to max of 100% of pa) | |
| - 65 -74 | £9,030 | £9,490 | | |
| - 75 and over | £9,180 | £9,640 | | |
| Married Couple's Allowance - | | | | |
| under 75 & born before 6/4/35 | £6,535 | Not applicable | | |
| - 75 and over | £6,625 | £6,965 | | |
| - Minimum amount | £2,540 | £2,670 | | |
| Age Allowance income limit | £21,800 | £22,900 | | |
| Blind Person's Allowance | £1,800 | £1,890 | | |
| Income Tax Trust Rate | 40% | 40% | 50% | |
| Dividend Trust Rate | 32.5% | 32.5% | 42.5% | |
| Tax Credits (Child Tax Credit) | | £2,235 per child £545/ yr/family | | |

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| | 2008/2009 | 2009/2010 | 2010/2011 | 2011/2012 |
|--|---------------|---------------------------------------|--------------|------------------------------|
| PERSONAL TAX (cont'd) | | | | |
| Pensions (relief on annual amount) | £235,000 | £245,000 | £255,000 | £255,000 until 2015/2016 |
| Special annual allowance | n/a | £20,000 | £20,000 | n/a |
| Lifetime Allowance on members without existing transitional protection | £1.65 million | £1.75 million | £1.8 million | £1.8 million until 2015/2016 |
| NATIONAL INSURANCE CONTRIBUTIONS | | | | |
| Employees | | | | |
| Lower Earnings Limit, Primary Class 1 | | £95 per week | | |
| Upper Earnings Limit, Primary Class 1 | | £844 per week | | |
| Primary Threshold | | £110 per week | | |
| Secondary Threshold | | £110 per week | | |
| Employees' Primary Class 1 Rate | | 11% of £110.01 to £844 per week | | |
| | | 1% above £844 per week | | |
| Employees' contracted out rebate | | 1.6% | | |
| Married woman's reduced rate | | 4.85% | | |
| Employer's secondary class 1 rate | | 12.8% on earnings above £110 per week | | |
| Employer's contracted-out rebate, salary related schemes | | 3.7% | | |
| Employers' contracted-out rebate, money-purchase schemes | | 1.4% | | |
| Self Employed | | | | |
| Class 2 rate | | £2.40 per week | | |
| Class 2 small earnings exception | | £5,075 per year | | |
| Class 3 rate | | £12.05 per week | | |
| Class 4 rate | | 8% of £5,715 to £43,875 a yr | | |

Please note that Tax Focus Cards can be ordered from our Marketing Department.

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| | 2008/2009 | 2009/2010 | 2010/2011 | 2011/2012 |
|---|--|--|-----------|-----------|
| Inheritance Tax | | | | |
| Nil rate band | £312,000 | £325,000 | £350,000 | |
| Business Tax | | | | |
| Corporation Tax: small companies' rate | 21% | 21% | 22% | |
| VAT | | | | |
| Until 30 November 2008 | 17.5% | 15% to 31/12/09 | | |
| From 01/12/08 to 31/12/09 | 15% | 17.5% from 01/01/10 | | |
| Capital Gains Tax | | | | |
| Annual Exemption | £9,600* | £10,100* | | |
| Entrepreneurs Relief Tax due on 5/9 th of the qualifying gains to give an effective rate of 10% | First £1 million of cumulative lifetime qualifying gains | First £1 million of cumulative lifetime qualifying gains | | |

* reduced by 50% for most trusts