Profile

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April 2009

The Chancellor's Budget 22 April 2009

Chancellor Alastair Darling delivered his second budget on Wednesday 22 April 2009 and announced that the UK economy is facing its worst year since the end of the second-world war. This Profile looks at the Chancellor's main announcements as they impact investment and retirement provision.

Pensions

Higher-rate tax relief on pension contributions

The government announced its intention to reduce tax relief on pension contributions for individuals with income of £150,000 a year or more from 5 April 2011. Relief will be tapered down so that it is 20% once income reaches £180,000 a year. HM Treasury will consult on the implementation of this measure.

In order to foil attempts to circumvent this change in the run up to 2011, the Chancellor also announced interim "anti forestalling" provisions. These apply from 22 April 2009 until 5 April 2011 to individuals:

- whose income is £150,000 or more in the current or either of the two preceding tax- years
- who change their "normal ongoing regular pension savings", and
- whose total pension savings following any change, including employer contributions, exceed £20,000 a year

If contributions before any change were less than £20,000 a year, individuals in these circumstances will suffer a 20% tax charge on the excess over £20,000. If contributions already exceeded £20,000 then the tax charge will be on the increase. Efforts to reduce income below £150,000 using salary sacrifice will be disregarded if the sacrifice arrangement was implemented after 21 April 2009. The charge is expected to increase to 30% from 6 April 2010 when the new 50% income tax rate (see later) is introduced.

Whilst this move will affect a small number of individuals, the pensions industry has been successful in heading off plans that the government were considering to scrap higher-rate tax relief on pension contributions altogether. The interim proposals appear to have a greater effect on the self employed who, because of irregular earning patterns, tend to make special pension contributions.

The interim rules are complex, as witnessed by the 52-page technical document from HMRC, and will no doubt generate considerable confusion among advisers and customers. The devil of the April 2011 measures will be in the detail, all of which will hopefully be in the implementation consultation documents. A Profile will be issued on the whole subject in due course.

New limits affecting registered pension schemes:

Confirmation that the limits from 6 April 2009 are:

- the annual allowance increases to £245,000;
- the lifetime allowance increases to £1,750,000.

... and remember, these limits will be frozen from 6 April 2010 when the limits will be £255,000 and £1,800,000 respectively.

Pensioner Savers

Several measures have been introduced to target support on lower income pensioners who may have seen a fall in their income from savings.

From this autumn:

- the first £10,000 (currently £6,000) of savings held by pensioners will not be taken into account for assessment of their entitlement to Pension Credit, Housing Benefit and Council Tax Benefit. This will help around 500,000 pensioners who will benefit by around £4 a week;
- people receiving Pension Credit who may have overpaid tax on their savings income in the past six years will be contacted as part of a 'taxback' campaign encouraging them to claim tax back on savings income and, where possible, register to avoid overpaying in future - those who claim are expected to receive an average of around £200.

Grandparents

The Chancellor announced that grandparents of working age and other adult family members who care for members of their family aged 12 or younger will qualify for credits towards the basic state pension from 2011.

Financial Services Compensation Scheme (FSCS): Payments representing interest

To date, compensation payments made by the FSCS to individual customers of defaulting financial institutions have included an amount representing accrued interest from the last date interest was paid to the customer by that institution, to the date of default (or, in relation to a fixed term deposit, to the date of maturity if this is later than the date the financial institution defaults).

Up to now it has been unclear how this part of any compensation payment received under the FSCS should be treated for tax purposes and in the absence of any legislation that identifies such sums as interest for income tax purposes, the normal tax rules cannot apply.

Consequently, Finance Bill 2009 will introduce legislation to ensure that customers of defaulting financial institutions, who receive compensation payments under the FSCS, will be charged income tax on that element of the payment as represents the accrued interest.

This measure will have effect in relation to payments made by the FSCS on or after 6 October 2008.

Investments

Individual Savings Accounts (ISAs)

As anticipated, new limits were announced for ISAs. The maximum subscription into a cash ISA will increase to £5,100 (previously £3,600) with the total ISA subscription being raised to £10,200 (previously £7,200). There is a slight twist in that this higher level will only be available from 6 October 2009 to the over 50s for the 2009/10 tax-year and then to everyone in the 2010/11 tax-year.

This increase in subscription limits is a welcome if overdue change to the ISA regime.

Taxation and Trusts

Capital gains tax (CGT)

The annual exemption has been increased to £10,100 for the tax year 2009/10 and the current flat rate of CGT for both individuals and trusts of 18% remains unchanged.

Income tax and personal allowances

The changes to the rate of income tax proposed in the last pre-Budget report were not due to take effect until 6 April 2011. However, the proposed increase in the rate of tax for top earners has not only been brought forward to take effect from 6 April 2010 but has also been increased.

So, from 6 April 2010 the rate of tax for individuals with taxable income over £150,000 will be 50% and dividend income received by top earners will be taxable at 42.5%.

In addition, with effect from 6 April 2010, the single person's allowance will be subject to an income limit of £100,000. Where an individual's adjusted net income exceeds this limit the allowance will be reduced by £1 for every £2 over the income limit. This replaces the two stage reduction in allowance proposed in the pre-Budget report.

This will make investment bonds attractive investment wrappers because of their income tax deferral benefits and their tax deferred 5% a year withdrawal facility.

The Budget has also made changes to the circumstances under which non-UK resident Commonwealth citizens can claim personal allowances against UK source income. It will now no longer be possible for non-resident individuals to claim personal allowances, simply by virtue of them being a commonwealth citizen. However, the majority of persons affected by this change will still be able to claim relief for tax paid under the relevant Double Taxation Agreement.

Income tax and trusts

The rate of income tax payable by trustees (rate applicable to trusts or RAT) has also been increased to 50% for non-dividend type income and 42.5% for dividends from 6 April 2010.

For existing trusts with investments that will trigger the 50% and 42.5% tax rates, the choice of investment wrapper becomes even more important. If the settlor of the trust is alive and UK resident then the chargeable event gains on an investment bond are taxed on him at his rate of tax. If he is a 40% taxpayer then gains from the bond will be taxed at 40% despite the fact that the investment bond is held in trust.

Even if the trustees are taxable on the bond because the settlor is dead or non-UK resident the trust benefits from income tax deferral and the tax deferred 5% a year withdrawal facility.

Inheritance tax (IHT)

As previously announced, the IHT nil rate band for 2009/10 of £325,000 remains unchanged.

Changes have been made to the rules for Agricultural Property Relief and Woodlands Relief with effect from 22 April 2009, to extend the scope of the relief to qualifying property in the European Economic Area. The change in relief is retrospective and claims for any IHT paid on assets on or after 23 April 2003 which would now qualify can be reclaimed from HMRC.

Property which qualifies for the extended relief will now also qualify for Holdover Relief for capital gains tax purposes.

National insurance contributions

No further changes to national insurance were announced.

Full details of tax and national insurance rates and allowances can be found at -
http://www.hmrc.gov.uk/budget2009/pn02.pdf

Non-UK dividends

Individuals in receipt of dividends from UK resident companies are entitled to a non-payable dividend tax credit. Since 6 April 2008, individuals with shareholdings of less than 10% in non-UK resident companies have also been entitled to the credit.

From 22 April 2009, individuals with shareholdings of 10% or more in receipt of dividends from non-UK resident companies will become entitled to a non-payable tax credit. There are certain conditions that have to be fulfilled.

Also from 22 April, individuals receiving dividends from offshore funds will benefit from the non-payable dividend tax credit provided that the fund does not hold 60% or more of its assets in interest bearing form.

Tax avoidance schemes using offshore bonds

Measures effective from 6 April 2009 will be introduced to counter schemes, which created artificial losses designed to exploit income tax loss relief rules. These used offshore life assurance bonds to help create these losses and these measures will put beyond any doubt that such relief does not arise on these policies. The closure of this scheme does not affect the usual tax benefits of offshore bonds.

Tax elected funds

UK Authorised Investment Funds (AIFs) are normally chargeable to corporation tax on taxable income at 20%. From 1 September 2009 UK AIFs, provided they meet certain conditions, can elect to be treated as Tax Elected Funds (TEF). TEFs will be required to make two types of distribution of the income they receive; a dividend and a non-dividend distribution. A UK investor in a TEF will be treated as receiving UK dividend income and a payment of interest.

Corporation tax

For the financial year starting 1 April 2009 the corporation tax rates are as follows:

- the rate applicable to small companies with profits of up to £300,000 is maintained at 21%;
- the full rate of corporation tax that applies once profits exceed £1,500,000 remains unchanged at 28%;

- profits falling between the small companies rate limit and the full rate threshold will be taxed at an effective marginal rate of 29.75% to clawback the benefit of the smaller companies' rate by the time the upper profits limit is reached.

Legislation is to be introduced to extend into 2010 the ability of business to carry trading losses back against profits of earlier years for the purposes of reclaiming tax refunds. Currently businesses can offset unlimited trading losses against profits in the preceding year and reclaim any tax paid. Finance Bill 2009 will extend the period for which trading losses can be carried back and offset against profits in preceding years from one to three years on the basis of the loss being offset against any later year's profit first.

Stamp Duty

Following the considerable decline in the housing market during 2008, the Chancellor introduced a temporary reprieve from Stamp Duty Land Tax (SDLT) in September 2008 in relation to purchases of residential property for amounts of £175,000 or less. It was intended that this easement would have effect during the period 3 September 2008 and 2 September 2009 inclusive.

This temporary increase in the threshold at which SDLT in respect of residential property acquisitions will begin to be charged (£175,001 and above) is to be extended so as to cover purchases made up to and including 31 December 2009. After that date the starting threshold for SDLT in relation to residential property purchases will once again revert to £125,000.

Venture Capital Schemes

Proposals have been made for legislation to be introduced in Finance Bill 2009 that is intended to have a beneficial impact on:

- investors receiving tax relief under the Enterprise Investment Scheme (EIS), Corporate Venturing Scheme (CVS) and the Venture Capital Trust (VCT) scheme;
- companies attracting investment under those schemes;
- Venture Capital Trusts, and
- EIS Investment Funds.

In relation to EIS the effect of the proposals would be to:

- relax the time limits concerning the employment of money raised by way of the issue of new shares. The proposal is that all funds raised by the issue of shares be wholly employed within two years of the issue of shares or, if later, within two years of the commencement of a qualifying activity;
- remove the link to other shares of the same class issued at the same time (i.e. on the same day) as the qualifying shares. It is intended that there will be no restriction on the use of funds raised by the issue of non-EIS shares;
- extend the period for carry back of income tax relief and allow the full amount subscribed (subject to the overriding limit) to be carried back. Currently the carry back of relief is restricted to shares issued before 6 October and subject to a limit of half of the subscriptions in that period up to an overall limit of £50,000 subscribed. The proposals would enable the total amount subscribed to be taken into account for the purposes of calculating income tax relief for any particular year, subject to the current maximum subscription limit of £500,000;
- correct an anomaly regarding the capital gains position for investors in the event of a share for share exchange.

For VCT and CVS, the proposals relax the time limits concerning the employment of money by companies receiving investment:

- currently an investee company must employ at least 80% of the money it receives wholly for the purposes of the relevant trade within 12 months and the balance within a further 12 months. It is intended to replace these rules with a single requirement that all the money raised must be wholly employed within two years, or, if later, 24 months of the commencement of the qualifying activity.

Legal & General will issue further bulletins, if appropriate, as details concerning the Budget announcements become clearer.

If you wish to contact one on the technical teams please e-mail:

- Pensions team - pensions.technical@landg.com
- Investments team - investmenthelpdesk@landg.com
- Taxation and Trusts team – tax.estateplanning@landg.com