

the bottom line

BUDGET 2011

In George Osborne's Budget statement on Wednesday 23 March 2011 he said that the "Budget is about reforming the nation's economy, so that we have enduring growth and jobs in the future".

Towards the end of last year the government issued the majority of the clauses, in draft, of Finance Bill 2011 together with updates on consultations. The publication of the draft Finance Bill clauses is part of the government's improvements in the way tax policy is developed, communicated and legislated. The Budget updates some of these previous announcements and also proposes further measures. Some of these changes apply from April 2011 and some take effect at a later date, so the timing needs to be carefully considered.

Our summary focuses on the issues likely to affect you, your family and your business. If you have any questions please do not hesitate to contact us for advice.

PERSONAL TAX Personal allowances, tax bands and rates

For those aged under 65 the personal allowance will be increased by £1,000, from £6,475 to £7,475 for 2011/12. However a new concept of withdrawing the personal allowance for those with adjusted net income over £100,000 was introduced in 2010/11 and will continue for 2011/12. The reduction in the allowance is by £1 for every £2 of adjusted net income above the income limit. Adjusted net income for this purpose is broadly all income after adjustment for pension payments, charitable giving and relief for losses.

The basic rate limit will be reduced from the current £37,400 to £35,000. Therefore an individual will pay 40% tax rather than the basic rate of 20% when their total income exceeds £42,475. The 50% rate of income tax (the 'additional rate') will continue for 2011/12. This applies to taxable income above £150,000. Dividend income as part of total income is taxed at 10% where it falls within the basic rate band, 32.5% where liable at the higher rate of tax and 42.5% where liable to the additional rate of tax.

For 2012/13 for those aged under 65 the personal allowance will be increased from £7,475 to £8,105. The basic rate limit will be reduced from £35,000 to £34,370 for 2012/13.

National Insurance Contributions (NICs)

Changes to the rates of NICs had been announced by the previous government and the current government confirmed that the rate changes would be made. From 6 April 2011 a further 1% will apply to the rates applicable to employers, employees and the self-employed. Changes to the thresholds at which NICs are payable will increase significantly from 6 April 2011. The level at which employees start to pay contributions will increase to £139 per week (the primary threshold) and for employers the weekly limit will be £136 (secondary threshold). The primary and secondary thresholds were aligned at £110 for 2010/11. The upper earnings limit and the upper profits limit will continue to be aligned with the income tax higher rate threshold of £42,475.

Income tax and NICs reform

The government has announced it will consult on the options, stages and timing of reforms to integrate the operation of income tax and NICs.

Furnished Holiday Lettings (FHL)

The tax treatment of FHL has been advantageous for many years. Provided that certain conditions are met, FHL are treated as a trade. This can be preferable to the tax regime for normal let property in a number of specific areas. Currently the FHL treatment potentially applies to properties in the EEA but certain conditions need to be satisfied including that the property must be available for letting for at least 140 days a year and actually let for at least 70 days.

From April 2011 there will be two types of FHL business; a UK FHL business consisting of properties in the UK and an EEA FHL business consisting of properties in one or more EEA states. FHL losses will only be able to be set against income from the same FHL business. From April 2012 the property must be available for letting for at least 210 days a year (generally the tax year) and actually let for at least 105 days.

A 'period of grace' will be introduced to allow businesses that do not continue to meet the 'actually let' requirement for one or two years to elect to continue to qualify throughout that period.

Junior Individual Savings Account (Junior ISA)

The government will introduce a new Junior ISA product which will be available for UK resident children under the age of 18 who do not have a Child Trust Fund account. Junior ISAs will be tax advantaged and will have many features in common with existing ISAs. They will be available as cash or stocks and share based products. The government expects that Junior ISAs will be available from autumn 2011.

Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs)

EIS and VCTs are designed to encourage private individuals to invest in smaller high-risk unquoted trading companies. While the EIS requires an investment to be made directly into the shares of the company, VCTs operate by indirect investment through a mediated fund. Currently EIS investors may be given income tax relief at 20% on their investments of up to £500,000 a year. Legislation will be introduced to increase the rate of tax relief to 30% for shares issued on or after 6 April 2011, subject to State aid approval.

Subject to State aid approval, legislation will be introduced to make the following changes to the EIS and for shares issued on or after 6 April 2012.

- The thresholds for the size of the company which may benefit from both types of investment will be increased to fewer than 250 employees and £15 million gross assets before the investment.
- The annual amount which can be invested in an individual company is to rise to £10 million.



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- The annual amount that an individual can invest through EIS is to increase to £1 million.

Non-domiciled taxation review

The government will consult on measures to introduce the following reforms from April 2012. The measures will:

- remove the tax charge when non-domiciles remit foreign income or capital gains to the UK for the purpose of commercial investment in UK businesses
- increase the existing £30,000 annual charge to £50,000 for non-domiciles who have been UK resident for 12 or more years and who wish to retain access to the remittance basis of tax
- simplify some aspects of the current rules to remove undue administrative burdens.

PENSIONS

Restriction on tax relief for pension contributions

The new tax regime for pension contributions will take effect for the 2011/12 tax year. The legislation is included in Finance Bill 2011. The basic proposal is that an annual allowance (AA) will be set at £50,000. Any contributions in excess of the AA would be charged to tax on the individual as their top slice of income. Contributions include contributions made by an employer. The rules will apply for the 2011/12 tax year and, in particular, to pension input periods (PIPs) ending in the tax year 2011/12 but beginning earlier. A PIP does not have to be the same as the tax year and if a person has several schemes, each scheme can have a different PIP. Special transitional rules may apply to pension savings made before 14 October 2010 that fall into 2011/12 PIPs.

Carry forward of unused AA

To allow for individuals who may have a significant amount of pension savings in a tax year but smaller amounts in other tax years, a carry forward of unused AA will be introduced. The broad effect is that unused AA of up to £50,000 per year can be carried forward for the next three years. When looking at whether there is unused AA to bring forward from 2008/09, 2009/10 and 2010/11, the AA for those years is deemed to have been £50,000.

Members of defined benefit schemes

In a defined benefit scheme, individuals accrue a right to an amount of annual pension when they retire. This right does not necessarily equate with the contributions made by themselves and their employers. Therefore the proposals require a notional value of contributions to be computed. The notional contributions should reflect the amounts needed to be invested in a money

purchase scheme to deliver the extra annual pension accruing in a defined benefit scheme. A 'flat-factor' method will be used and will be set at 16. In some situations, the individual will be able to require the tax bill to be met by the pension fund (with a commensurate reduction in the pension entitlement).

The lifetime limit

The lifetime limit sets the maximum figure for tax-relieved savings in pension funds and rose to £1.8m for 2010/11. The government has announced that the limit for 2012/13 will be reduced to £1.5 million. Those with savings above £1.5 million or who believe the value of their pension fund will rise above this level through investment growth without any further contributions or pension savings, will be able to apply for a new personalised lifetime allowance of £1.8 million, providing they cease accruing benefits in all registered pension schemes before 6 April 2012.

Requirement to buy an annuity

Legislation will be introduced in Finance Bill 2011 to remove pensions tax rules that currently create an obligation for members of registered pension schemes to secure an income, usually by buying an annuity, by age 75. It will involve changes to annuitisation requirements, pensions tax treatment and rules applying to income drawdown arrangements.

Inheritance tax (IHT) and drawdown

With effect from 6 April 2011:

- IHT will not typically apply to drawdown pension funds remaining under a registered pension scheme, including when the individual dies after reaching the age of 75.
- IHT anti-avoidance charges that apply to registered pension schemes and Qualifying Non UK Pension Schemes where the scheme member omits to take their retirement entitlements (eg a failure to buy an annuity) will be removed.

BUSINESS TAX

Corporation tax rates

Legislation will be introduced in Finance Bill 2011 to reduce the main rate of corporation tax from 28% to 26% for the Financial Year commencing 1 April 2011 and then to 25% for the Financial Year commencing 1 April 2012. The main rate of corporation tax generally applies to companies with profits of more than £1.5 million. It had previously been announced that the main rate would reduce from 28% to 27% followed by further 1% graduated reductions until it reached 24% by 1 April 2014. Instead the main rate is set to reduce to 23% by 1 April 2014.

The small profits rate of corporation tax, which generally applies to companies with up to £300,000 of profits, is to reduce from 21% to 20% also with effect from 1 April 2011. This had already been announced.

The effective marginal corporation tax rate

for profits between £300,000 and £1.5 million will be 27.5% from 1 April 2011.

Associated companies for corporation tax rates

The upper and lower limits for corporate tax rates are divided equally between a company and its 'associated' companies. A company is associated with another company if one of them has control of the other or if both are under the control of the same company or person(s). The shares of direct relatives, business partners and some trustees can be attributed to a person for the control test. For example if a husband owns no shares in a company, he may be deemed to own the company via his wife's shareholding. A change to the associated company rules will be included in Finance Bill 2011 with effect for accounting periods ending on or after 1 April 2011.

It is proposed to amend the circumstances in which rights held by linked persons are attributed between them to establish control. Attributions will only be made where there is 'substantial commercial interdependence' between the businesses being run in the companies. When considering whether there is 'substantial commercial interdependence' HMRC will have regard to the degree of financial, economic or organisational links which exist, or have existed, or might be expected to exist between the relevant activities/companies involved.

The Corporate Tax Road Map

The government's aim is to create the most competitive corporate tax regime of the major world economies.

The Corporate Tax Road Map sets out how the government intends to approach reform of the corporate tax system over the next five years.

The principles it will adopt include:

- lowering corporate tax rates but reducing the reliefs and allowances available
- avoiding unnecessary changes to tax legislation and ensuring that any changes improve the long-term stability of the corporate tax system
- adapting the tax system for the effects of globalisation and technological developments over the last 20 years.

The focus of the Road Map is on large corporates as these increasingly operate across national borders and may choose not to have their headquarters in the UK.

The main areas of tax changes in the next five years will be to the:

- Controlled Foreign Company (CFC) regime
- taxation of innovation and intellectual property (IP)
- taxation of foreign branches.

CFC reform

Currently the CFC rules may apply where a UK company has a subsidiary which operates in a country with a relatively low rate of corporate tax. In certain

circumstances the profits of the subsidiary may be subject to UK corporate tax.

Interim improvements to the existing CFC rules will be introduced in Finance Bill 2011 and more fundamental proposed changes have been announced for consultation with interested parties. The legislative outcomes of the proposals will be included in Finance Bill 2012. The main interim improvement will be to exempt a CFC which carries on a range of 'foreign to foreign' activities involving transactions wholly or partly with other group companies. The new rules will have effect for accounting periods beginning on or after 1 January 2011. The more fundamental proposed changes will operate in a targeted and more territorial way by bringing within a CFC charge only the proportion of overseas profits that have been artificially diverted from the UK. A consultation document describing the new regime is to be published in May 2011 followed by draft legislation in autumn 2011 for inclusion in Finance Bill 2012.

Taxation of innovation and IP

The government is consulting on a preferential regime for profits arising from patents, to be known as a Patent Box. The intention is to introduce a 10% corporation tax rate for profits arising from patents from 1 April 2013. A consultation document will be issued in May 2011 with legislation proposed for Finance Bill 2012.

Research and Development (R&D) Tax Credits

Subject to State aid approval, legislation will be introduced in Finance Bill 2011 to increase the rate of the additional deduction for expenditure on R&D for companies that are small or medium-sized enterprises (SMEs) from 75% to 100% for expenditure incurred on or after 1 April 2011, giving a total deduction of 200%. The rate of Vaccine Research Relief for SMEs will be reduced to 20% from the same date.

The government also plans to introduce further changes subject to consultation and State aid approval in Finance Bill 2012 in respect of expenditure incurred on or after 1 April 2012 as follows:

- to abolish the rule limiting a company's payable R&D tax credit to the amount of PAYE and NICs it pays
- to abolish the £10,000 minimum expenditure condition
- to change the rules governing the provision of relief for work done by subcontractors under the large company scheme
- to increase the rate of the additional deduction for expenditure on R&D for SMEs by a further 25% to give a total deduction of 225%
- Vaccine Research Relief will not be available for SMEs.

Taxation of foreign branches

A foreign branch exists when a UK

company carries on part of its trade in another country without establishing a separate trading subsidiary. Legislation will be introduced in Finance Bill 2011 to exempt the profits of foreign branches of UK resident companies from corporation tax, precluding the need for credit relief to prevent double taxation. The exemption will only apply if companies irrevocably elect to opt into the exemption regime. The election will apply to all present and future branches of the company. Otherwise the existing rules will apply.

Corporate capital gains simplification

Following extensive consultation on simplification of the capital gains rules for groups of companies, legislation will be introduced to modernise the 'degrouching charge' rules. Under current law, if a company leaves a group holding an asset acquired from a fellow group member within the previous six years, any gain or loss that had been deferred on that asset acquisition is reinstated as a chargeable gain or loss (a degrouching charge) separate to any gain or loss incurred on the disposal of the shares in the company.

It is proposed that where a company leaves a group as a result of a disposal of its shares, any degrouching charge will be treated as additional consideration for the disposal. This ensures that shareholder reliefs, such as the substantial shareholdings exemption, will also apply to the degrouching charge. Changes to the degrouching charge rules will apply to deemed disposals made on or after Royal Assent.

Other proposed changes to corporate capital gains are to:

- remove some existing restrictions on the use of capital losses within a group of companies after acquisition of a business
- replace a complex set of anti-avoidance rules on 'value shifting' with a clearer purpose-based rule.

Capital allowance changes

Finance Bill 2011 will include the following previously announced reductions to capital allowances from April 2012:

- a reduction in the Annual Investment Allowance from the current £100,000 to £25,000
- a reduction in the writing down allowance rates from 10% and 20% to 8% and 18% respectively.

Short life asset extension

Legislation is to be introduced to enable businesses incurring expenditure on an item of plant or machinery from April 2011 onwards to make a short life asset (SLA) election in respect of that item if they expect to sell or scrap it within an eight year cut-off period. This is an extension from the current four year cut-off period. The cut-off period starts at the end of the chargeable period in which the expenditure is incurred.

The impact of an SLA election is that the

item is placed into a single asset pool. Entitlement to capital allowances until the asset is sold or scrapped follows normal rules but on disposal any remaining balance after taking account of disposal proceeds is allowed as a further allowance. This is the advantage of such an election but a charge can arise instead where overall allowances and disposal proceeds exceed the original expenditure.

Review of green technology lists

Businesses purchasing designated plant and machinery which is energy saving, reduces water use or improves the quality of water are eligible for 100% capital allowances. The qualifying technologies are reviewed annually. The main change this year includes the addition of a new technology - efficient hand dryers. Also the qualifying criteria for automatic metering and targeting equipment will be simplified.

Review of IR35

Following publication of the Office of Tax Simplification's review of small business tax, the government has decided to retain IR35 as abolition would put substantial revenue at risk. The government will however make improvements in the way IR35 is administered. The improvements will include guidance on those types of cases HMRC view as outside the scope of IR35.

EMPLOYMENT ISSUES Approved mileage allowance payments (AMAP)

The AMAP rates can be used to claim the cost of business mileage in an employee's own vehicle. The rates cover cars, vans, motorcycles and bicycles. Where an employer pays less than the published rates, employees can make a claim for tax relief for the shortfall. With effect from 6 April 2011 the rate of the AMAP for cars and vans will be increased from 40p per mile to 45p per mile for the first 10,000 miles of business travel in the tax year. The rate for mileage above 10,000 miles will remain at 25p per mile.

An allowance for passenger payments currently in place for employees at 5p per passenger per mile will be extended to volunteers who carry passengers as part of their volunteering duties. This extension will apply with effect from 6 April 2011.

Company car fuel benefit charge

Employees and directors who are provided with a company car and who also receive free fuel from their employers are subject to the fuel benefit charge. The benefit charge is determined by multiplying a set figure by the appropriate percentage for the car based on its CO2 emissions. The current set figure of £18,000 will be increased to £18,800 from 6 April 2011.

Company car tax rate 2013/14

Legislation will be introduced in Finance Bill 2011 to increase the appropriate

percentages by 1% for all vehicles with CO2 emissions between 95gm/km and 220gm/km from April 2013. Zero emission cars will remain at 0% and ultra low emissions cars with emissions up to 75gm/km will remain at 5%.

Employer-supported childcare

Changes had previously been announced to the tax breaks for employer-supported childcare. There is currently a £55 per week limit on the amount of exempt income associated with childcare vouchers and directly contracted childcare for employees in an employer's scheme. This will be restricted in cases where an employee joins a scheme on or after 6 April 2011 and their earnings and taxable benefits are liable to tax at the higher rates.

Employers will be required, at the beginning of the relevant tax year, to estimate the level of contractual employment earnings that their employee is likely to receive during that year, ignoring potential bonus and overtime payments, but including other known taxable benefits. Income for the purpose of the calculation will be reduced by the personal allowance as shown on the individual's tax code for the relevant employment. The effect will be to ensure that the monetary equivalent of tax relief entitlement for all taxpayers will be £11 per week.

Anyone in a scheme by 5 April 2011 will not be affected by these changes as long as they remain within the same scheme.

Disguised remuneration

Legislation will be introduced from 6 April 2011 to tackle arrangements using trusts and other vehicles to reward employees which seek to avoid, defer or reduce tax liabilities. In many cases these third party arrangements allow an employee to enjoy the full benefit of a sum of money paid or assets provided while arguing that, because of the structure of the arrangements, there is no legal right to the money or assets.

Legislation will be introduced to ensure that where a third party makes provision of what is in substance a reward or loan, in connection with the employee's employment, the employer will be required to account for PAYE and NICs. This will be based on the sum of money made available or the cost or value of the reward. The legislation may catch arrangements made on or after 9 December 2010 and before 6 April 2011 unless the employee repays sums or returns assets before 6 April 2012. The scope of the legislation will include Employer Financed Retirement Benefit Schemes, in keeping with the restriction of pensions tax relief on registered pension schemes.

Third party arrangements that are not tax-avoidance will be excluded, in so far as this is

possible without creating additional avoidance risks, from the effect of this measure.

CAPITAL TAXES Capital Gains Tax (CGT) annual exemption

The annual exempt amount for CGT will increase from £10,100 to £10,600 with effect from 6 April 2011. Legislation will be introduced in Finance Bill 2012 to provide that the annual exemption will rise in line with the consumer prices index (CPI) instead of the retail prices index. This automatic indexation using the CPI will continue to be subject to override if Parliament determines that a different amount should apply.

Entrepreneurs' Relief (ER)

ER was introduced in April 2008. Subject to satisfying certain conditions, including the current lifetime limit of £5 million, capital gains on qualifying business disposals by individuals and certain trustees are eligible for ER. Qualifying gains are liable to CGT at 10%. The lifetime limit is applied to the aggregate of gains that benefit from ER, whatever the year in which the disposal took place. Any gains in excess of the lifetime limit are liable to CGT at the same rates as other chargeable gains.

The lifetime limit will increase to £10 million with effect for qualifying business disposals on or after 6 April 2011. Where individuals or trustees make qualifying gains above the £5m limit before 6 April 2011, no additional relief will be allowed for the excess.

Inheritance Tax (IHT)

The IHT nil rate band is frozen at £325,000 until 2015. The government has announced that from 2015/16 increases in this figure will again be based on CPI. Reduced rate of tax.

The government has announced that a reduced rate of IHT will apply where 10% or more of a deceased's net estate (after deducting IHT exemptions, reliefs and the nil rate band) is left to charity. In those cases the current 40% rate will be reduced to 36%. The new rate will apply to deaths occurring on or after 6 April 2012. The government will be consulting on the detailed implementation of this measure and will issue a consultation document before the summer.

Stamp Duty Land Tax (SDLT)

Legislation will be introduced in Finance Bill 2011 to provide a relief for purchasers of residential property who acquire interests in more than one dwelling. Where the relief is claimed the rate of SDLT is determined not by the aggregate consideration but instead by the mean consideration (ie by the aggregate consideration divided by the number of dwellings) subject to a minimum rate of 1%.

OTHER MATTERS Tax Simplification - review of reliefs

Based on recommendations made by the Office of Tax Simplification's review of tax reliefs, and continuing work by HMRC, the government intends to abolish 43 tax reliefs whose rationale is no longer valid. A minority (which are redundant) will be repealed in Finance Bill 2011. The other reliefs will be removed after consultation.

Enterprise Zones

The government announced the location of ten new urban Enterprise Zones within the following Local Enterprise Partnership areas: Birmingham and Solihull; Leeds City Region; Sheffield City Region; Liverpool City Region; Greater Manchester; West of England; Tees Valley; North Eastern; the Black Country; and Derby, Derbyshire, Nottingham and Nottinghamshire. In addition, London will have an Enterprise Zone and be able to choose its site.

The government will make a range of policy tools available to all zones including:

- a 100% business rate discount worth up to £275,000 over a five year period for businesses that move into an Enterprise Zone during the course of this Parliament
- government and local authority help to develop radically simplified planning approaches in the zone.

It will consider, in a limited number of cases, the scope for introducing enhanced capital allowances.

Business premises renovation allowance

The government has confirmed it will extend the business premises renovation allowance for a further five years from 2012.

Anti-avoidance

The government has published 'Tackling Tax Avoidance', which:

- initiates reviews of legislation which have been subject to repeated attempts at tax avoidance
- outlines proposals to counter the continued use and marketing of artificial tax avoidance schemes.

The Budget also includes immediate measures which target specific avoidance schemes. These include:

- measures to address the abuse of stamp duty land tax rules
- amendments to the sale of lessors anti-avoidance legislation
- clarifying the degrouping charge rules affecting corporate gains.

Contacts:

For further information about the issues raised in this newsletter or if you would like to find out about the range of services that we can offer, please contact Stephen Dabby, Morisha Christy, Tony Sian, Nick Nicolaou, Alex Green or Paul Bradley.