

BUDGET NEWSLETTER 23 MARCH 2011

Once more, this is the budget newsletter that tries to look behind the headlines, highlighting matters of interest to our predominantly small and medium sized business client base. Most of it derives from today's budget, but we have included a number of earlier announcements as well as current news items which are not necessarily budget-related.

Increasingly, changes are flagged up well in advance, and we are seeing changes to the changes. This makes it a lot harder to determine the economic impact of some of these measures – particularly those affecting Corporation Tax and National Insurance Contributions, as the impact of new measures is measured in smaller slices. We have done our best!

Just to give you some idea of the order of magnitude of different taxes, these are some of the planned receipts for next year:

Income Tax	£158 billion
National Insurance	£101 billion
VAT	£100 billion
Corporation Tax	£ 48 billion

CGT and IHT are too small to feature on the Treasury's pie chart!

Income Tax

The big news in this year's budget, widely anticipated, is that there is going to be "consultation" on merging Income Tax and NIC. Given the current disparity of treatment between employees, employers, the retired and others, this will be a major event. Meanwhile, we just have to wait for a consultation document to be published later this year.

For 2011-12, the personal allowance goes up from £6,475 to £7,475. But the starting point for paying tax at the higher rate goes down from £37,400 to £35,000 – so the benefit will only be felt by basic rate taxpayers, not by higher or additional rate taxpayers. In fact, there will be 400,000 more higher rate taxpayers as a result. The Treasury's budget briefing says that the budget does not create any additional higher rate taxpayers – but that 400,000 figure came from last Autumn's announcement; we have to be very watchful. What they really mean is that the budget does not make any further change.

This, and associated measures, will cost the Exchequer around **£3.5bn** next year.

Just for interest (since I doubt whether any LFF clients are involved) there are to be changes to the taxation of "disguised remuneration", targeting complex schemes used by 5,000 or so employers and benefitting about 50,000 employees. The revenue yield is expected to be around £750m – a much bigger impact than some other matters reported in this summary.

Officially, the top rate of tax (on earnings in excess of £150,000) remains at 50%. But personal allowances are progressively withdrawn once income reaches £100,000, so that the effective income tax rate on the next £15,000 of income is **60%**. This is not addressed by any of this year's budget press releases, and it will probably not be on the front page of any newspaper tomorrow morning. It ought to be!

National Insurance Contributions (NICs)

The changes applying next month are complex, with some thresholds going up and others down. Rates, however, are going up – generally by 1% for employees and another 1% for employers.

An employee earning £43,888 (which is the Upper Earnings Limit for 2010-11) will pay about £60 more in NIC next year. His or her employer, however, has to pay another £174.

Increase earnings to £100,000 and employee and employer are each contributing another £560, making a total of £620 for the employee and £734 for the employer, so £1,354 altogether. It's another 2% on the higher rates of income tax. If they ever manage to merge these taxes the impact of NIC will be a lot more obvious.

A self-employed taxpayer also earning £43,888 will be caught for an extra £150 in NIC next year. If we increase earnings, again, to £100,000 the extra cost is £715. For the well-heeled self-employed, the NIC increase is only equivalent to 1% on the top rate of income tax.

People earning less than £43,888 will generally pay less in tax and NIC in 2011-12. The increases have all been targeted at higher earners.

Enterprise Investment Scheme (EIS)

Tax relief is given on subscriptions for new shares in qualifying EIS companies, to encourage investment in smaller, generally, riskier, businesses. From 6 April the rate of relief increases from 20% to 30%. In addition, there are CGT advantages provided conditions are met.

The additional tax relief will cost the Exchequer something in excess of **£100m** per annum from 2012-13.

Mileage allowances

For quite some years now, tax free reimbursement for using your car for your employer's business has been limited to 40p per mile (reducing to 25p after the first 10,000 miles). At last, someone has noticed that running costs have gone up, and the higher rate increases to 45p. The lower rate remains at 25p.

PAYE – payments after leaving, including bonuses and compromise agreements

We often find ourselves advising on the tax implications of “compromise agreements” when an employee leaves. These are generally negotiated with a view to avoiding any possibility of a subsequent Employment Appeals Tribunal claim. Additionally, employees are sometimes due bonuses that are paid after a leaving date, so this is another common reason for a “payment after leaving”.

From 6 April 2011, an employer must withhold tax from a payment made after the P45 has been issued at the normal “marginal” income tax rates as if the employee has no allowances. The previous rule was that basic rate tax only would normally be deducted. The new rule also affects tax on the earnings of new employees who do not produce a P45.

This is an administrative change, which does not produce any more revenue for the Exchequer. If in doubt, talk to our payroll specialists or email them at payroll@lffuk.com and they will contact you to discuss the issue.

Pension contributions

It was announced a few months ago that the annual limit on pension contributions is reduced from £255,000 to £50,000. This looks a bit drastic at first sight, but it replaces provisions of impressive complexity introduced by the last government; it has to be regarded as a welcome simplification on one hand, and less drastic than it might have been on the other.

The lifetime allowance will be reduced to £1.5m from April 2012. Anybody who thinks their pension “pot” (with growth in investment value) will exceed £1.5m will be able to apply for a “personalised” limit of £1.8m, provided they stop accruing benefits before April 2012. If you think you may be in this position then talk to us or your IFA, ideally both, well before 5 April 2012.

The economic impact of this on the Treasury depends very much on what set of rules you think you are starting from, but they reckon it’s a gain (to the Exchequer) of **£4bn** per annum, so this compounds the tax squeezing of pension savings that has been going on since the mid 1990s.

The requirement to turn your pension pot into an annuity at age 75 will be abolished from April 2011. Whether or not this turns out to be a good thing depends very much on your reaction to a new set of rules (with draw-down limits) that I have no intention of reproducing here. It will be essential to consult your IFA.

Inheritance Tax will not generally apply to sums remaining in your pension fund when you die, provided that the pension scheme trustees have discretion over who benefits. The economic impact of this change is expected to be negligible, so perhaps it is good news just for a very few!

Services provided by Intermediaries (IR35)

This short newsletter cannot go into detail on IR35 – and if you have never heard of it, you probably don’t need to. HMRC have not been as successful with it as they would have liked; this has, if anything, added to taxpayers’ uncertainty. Accordingly, they have been considering their position. The decision is that abolition would put “considerable” tax revenue at risk (suggesting that it has not been as unsuccessful as some interested parties would have you believe), so the legislation will be retained and “simplified”.

There will be a dedicated helpline and more published guidance. Reviews will be restricted to “high risk” cases carried out only by specialist teams (no, we’re not sure what that really means either) and (joy for somebody, no doubt) HMRC will engage with interested parties through an “IR35 Forum”.

Luncheon Vouchers

Most of you will have forgotten that luncheon vouchers are still tax free up to 15p per day. If you are of a nostalgic turn of mind you will be sorry to hear that this relief will be abolished in the course of the next year. Treat this as an indication of the seriousness with which the Office of Tax Simplification is undertaking its duties.

Life Assurance Premium Relief (LAPR)

We might have one or two clients still benefitting from LAPR on very ancient policies. This relief will also be simplified away to nothing next year.

Furnished Holiday lettings

The tax position has been changing in the last year or two, mainly because we are no longer allowed to discriminate between properties let in the UK and properties in the European Economic Area. The new rules are that income from lettings meeting revised criteria will continue to be treated as trading

income (with income tax and CGT advantages), except that losses can only be set against profits from the same trade. From April 2012, the property must be available for letting for 210 days per year (previously 140) and actually let for 105 days (previously 70). It's sunny today; even so, I wonder how long the summer letting season is in the UK.

Gift Aid

There are proposals to enable charities to make limited Gift Aid claims with little or no paperwork. There will be consultation this coming summer, but our suspicion is that these proposals will not set the world of charities on fire.

More immediately useful are plans to introduce an on line system for Gift Aid tax claims in 2012-13.

Churches and charities should note that the "transitional" relief that compensated for the last reduction on the basic rate of income tax runs out on 5 April 2011. Thereafter, the charity's effective tax recovery falls from about 28% of the net gift to 25% (or 20/80^{ths}). So that's an income reduction that they must budget for.

Employer-Supported Childcare Schemes

These schemes have become popular in recent years, and allow an employer to make tax-free contributions to child-care for working parents. New joiners to such schemes after 6 April will now be limited to the equivalent of the basic rate of tax, so that higher rate taxpayers will receive no additional benefit. At basic rate, the maximum relief will be £900 per year.

Inheritance Tax (IHT)

Anything you leave to a charity in your will is free of IHT. By way of encouragement, if you leave 10% of your estate to charity, the tax rate applicable to whatever part of your estate is then taxable will fall from 40% to 36% - a useful reduction and an incentive to think about charities in your will. To benefit from this, you need to stay alive at least until 6 April 2012; we are unable to advise on what you need to do to achieve this.

The nil rate band remains at £325,000.

Capital Gains Tax (CGT)

The lifetime limit for Entrepreneur's Relief (tax at 10%) started out at £1m, and then increased in stages to £2m and £5m. From 6 April, it doubles to £10m.

It is important to remember that this relief applies in a far narrower range of circumstances than the "business asset" rate of taper relief which it replaced. Many of us had hoped for some relaxation of these restrictions, but it is not to be. If there is a tax that just cries out to be torn up and started again, it is Capital Gains Tax.

The annual CGT allowance goes up from £10,100 to £10,600 next year. The main rate continues to be 28%.

Corporation Tax

The main rate of Corporation Tax falls from 28% to 26% from April – a surprise, as the original plan was to reduce it to 27%. It falls again, to 25% in April 2012, and is expected to reach 23% in April 2014. For the Exchequer, this will reduce yields by around **£2bn** per annum.

The rate for companies with smaller profits (generally less than £300,000) falls from 21% to 20% and no plans for any further change have been announced. But it's worth noting that the Office for Tax Simplification (it's a form of Doublespeak) has the lower rate of Corporation Tax in its sights, and would quite like to abolish it, so watch this space.

A number of our clients are caught between the thresholds that determine which rate of Corporation Tax they pay (that is, profits fall between £300,000 and £1,500,000). For those companies, the tapering calculations effectively apply a higher rate of tax on the top slice of profits. For 2010-11 that top slice rate is 29.75%, but this falls to 27.5% next year, with further reductions to come.

These lower tax rates trade off against lower capital allowances, the impact of which will be felt much more by some businesses than others. While the Corporation Tax rate reductions will cost the Exchequer **£0.5bn** from 2011-12, the capital allowances changes below will bring in more than **£2bn** from 2012-13.

Capital Allowances

Writing down allowances, which have fallen from a historic level of 25% to 20% in recent years, reduce further in **April 2012**: to 18% on most assets and a lower rate of 8% (currently 10%) on a more restricted range of assets. At the same time, the Annual Investment Allowance (which is particularly valuable for small businesses) falls from the present level of £100,000 to only £25,000.

From April 2011 we will be able to make separate claims for assets with an expected life of less than 8 years, to avoid a tail of unclaimed expenditure lingering long after the asset itself has departed. This is likely to impact on IT equipment, in particular. Smaller businesses whose annual capital expenditure is covered in full by the Annual Investment Allowance will not benefit.

Research and Development (R&D)

SME's currently benefit from a tax "uplift" of 75% on qualifying R&D expenditure. This increases to 100% from April 2011 and 125% from April 2012.

From 2012 the £10,000 "minimum expenditure" rule will be abolished.

VAT

In a move that seems to be aimed directly at Amazon's Jersey operation, the limit for posting goods into the UK without accounting for VAT is going down from £18 to £15 on 1 November – and they are going to continue looking at this. So order your Christmas DVDs now.

The registration threshold goes up from £70,000 to £73,000 on 1 April.

Foreign branches

Foreign branches have some tax advantages over the more obvious alternative of overseas subsidiaries for smaller companies. It is proposed that these branches will be able to "opt out" of the UK tax regime.

Electronic filing of company accounts

From 1 April, we are required to submit company accounts to HMRC in an electronic format known as iXBRL – a sort of HTML or XML on steroids. If you have read about this in the press, you may know that not all of the specialist software suppliers have managed to write the complex software required before the deadline. The good news is that our supplier is one of the successful ones, so we are (in theory at least) ready for anything. You should not see any difference.

At some point, (probably within the next couple of years) this format is likely to be used for Companies House as well, as more and more services move online.

We are upgrading just about all of our business software, and clients will be seeing both company and personal tax returns in a new format this year. We have already dealt with the really difficult bit, so

there is no particular reason why any new problems in managing the change should become your problems, but please be nice to us if we get something wrong.

Tax Enquiries

We offer (through a third party insurer, CCH) an insurance scheme designed to meet the cost of our fees in the event of your tax return being enquired into by HMRC. HMRC are threatening to pursue their enquiries with renewed vigour, and their reported revenue targets from such work run to many billions. Whether their increasingly smaller and demoralised workforce can “deliver” is open to question, but we are all on notice that they intend to try.

So far, we have seen little impact of these initiatives; enquiries are really not running at a high level. But HMRC are being open about their targets (only a small proportion of which will be selected at random) so we ought to expect to see more activity. If you are interested in insuring yourself or your company against a tax enquiry, talk to us – the policy is due for renewal on 1 May.

If you would like further information on this insurance scheme please send us an email via the contact form at <http://www.lffuk.com/default.asp?p=103> . Next year's rates are not yet final, but when they are we will put them on our website at www.lffuk.com.

LFF isn't moving

... but we are expanding sideways. From 1 April, we are taking on the office next door, thus more than doubling our office space. When we have worked out how to use the space, we shall enjoy much better meeting facilities for clients. This feels like rather a brave step, even though we are certain that it is the right one. We shall be looking for new business – so please recommend us to your friends and business contacts!

Right now, we'd like to take on more payroll work. We have a dedicated and expert payroll team, who can take all the pain of payroll preparation from your business. Outsourcing your payroll makes good sense for a lot of businesses and is not expensive.

Whatever your problem is, come and talk to us.

John Francis

On behalf of

THE LFF TEAM: