



2011 BUDGET NEWSLETTER

Analysis and planning opportunities



INVESTORS AND SAVERS

Shifting Tax Bands

The income tax bands and allowances for 2011/12 were announced last December by the Treasury. The Budget contained no changes, so for the new tax year:

- The personal allowance will increase by £1,000 to £7,475, as initially promised in last June's Budget. However, it will continue to be phased out if your 'total income' exceeds £100,000. If your 'total income' exceeds £114,950 in 2011/12, you will not receive any personal allowance.
- The £1,000 increase in the personal allowance is being counterbalanced by a reduction of £2,400 in the size of the basic rate tax band. Thus, if you are only entitled to a personal allowance the starting point at which you begin to pay higher rate tax will fall from £43,875 in 2010/11 to £42,475 in 2011/12. The Institute for Fiscal Studies says that as a result the number of higher rate taxpayers will rise by 750,000.
- Other income tax allowances have risen by about 4.7%, broadly in line with September 2010 RPI inflation. For example, the basic age allowance for those aged between 65 and 74 will increase from £9,490 to £9,940.
- The 10% income tax band, only accessible to a few, also rose by a little under 5%. However, the starting point for the 50% income tax rate (referred to as the 'additional rate') remains at £150,000: the legislation which introduced this top rate did not include automatic indexation.
- The personal allowance will increase by a further £630 to £8,105 on 6 April 2012. Whilst this increase will be balanced by a reduction in the threshold at which higher rate tax begins, the reduction will be such that a number of higher rate taxpayers will benefit from all or part of this increase in personal allowance and none will be worse off.

The shifting sands of tax are important to your investment decisions:

- Make sure you know what tax rate you are paying at the margin: if you earn an extra £1 of investment income, how much will you be left with after the Treasury takes its slice? Income yields, other than for UK shares, are usually quoted before deduction of tax.
- The higher you move up the tax rate scale, the more tax attractive capital gains become than income. Remember, in 2011/12 you could move from basic to higher rate, even if your income is unchanged from 2010/11. Where there is an expectation of income in the chosen portfolio in the form of interest and/or dividends then an investment such as an insurance investment bond can represent an appropriate structure to defer taxation until such time as tax rates have generally reduced or your personal tax rate is lower. These products are provided by both UK and offshore insurance companies and both can provide tax efficient access to the investment. An investor in one of these products could withdraw up to 5% of the amount originally invested each year for twenty years with no tax

payable at that time. The amounts withdrawn would have to be added back to calculate the taxable gain when the investment was finally encashed though. However, if the investor is paying a lower rate of tax in the future, this capability to access funds but defer tax could prove to be valuable. This may be especially so for additional rate taxpayers in light of the Chancellors expressed view that he sees the 50% rate as “temporary”.

- For married couples and civil partners, who holds which investment is more important than ever. At its simplest, a non-earning spouse could receive £7,475 of interest tax-free while, if the partner is a higher rate taxpayer, the same interest would be worth only £4,485 net. The introduction of the 50% tax band in 2010/11 has meant that high income couples who both suffered higher rate tax and for whom independent taxation carried few benefits, could now save tax by reviewing their investment ownership.
- If you will be 65 or over by 5 April 2012, you could be entitled to age allowance of around £10,000. However, the extra allowance above the basic personal allowance is phased out by £1 for each £2 that your ‘total income’ is above £24,000. As a result, how you generate investment returns – and who owns the investments – can affect the level of tax allowance you enjoy.

Capital Gains Tax (CGT)

Last June’s emergency Budget reinstated the treatment of capital gains as the top slice of income just over two years after Alistair Darling had abandoned the idea. The change meant that since 23 June 2010, for individuals, gains have been taxable at 18% to the extent that they fall in the basic rate band and 28% if they fall into the higher or additional rate bands. Trustees suffer the 28% tax rate, regardless of the trust’s income.

In the run up to last June’s Budget there had been rumours that CGT rates would be increased to match income tax rates and that the annual exemption would be slashed. Fortunately, both predictions proved to be wrong. In this year’s Budget the annual exemption was increased by £500 to £10,600 (up to £5,300 for most trusts) for 2011/12, in line with normal indexation rules. From 6 April 2012 the inflation adjustment for the annual CGT exemption will be the CPI rather than the RPI as it is currently.

It remains the general case that investment returns in the form of capital gains are more favourably taxed than investment income. The annual capital gains exemption will often mean that there is no tax to pay. Even when the exemption is exceeded, the tax rates are normally lower. CGT also has the benefit of not being subject to the same payments on account rules as income tax: you simply pay your full capital gains tax on 31 January in the tax year following the one in which the gains arose, e.g. 31 January 2013 for gains made in the coming 2011/12 tax year.

While the tax tail should never wag the investment dog, the case for favouring capital gains over income when setting your investment goals is a strong one. Strange though it may seem, for the same underlying investments, some financial product structures provide income returns while others produce capital gains. The selection of the right structure could therefore significantly reduce, defer (see above) or eliminate your tax bill.

The Office for Tax Simplification (OTS) suggested in its final report that CGT was a candidate for reform alongside inheritance tax, but drew back from making any suggestions on capital gains tax because the regime had only just been re-worked last summer. No reference to such ‘root and branch’ reform was made in this year’s budget.

Individual Savings Accounts (ISAs)

From 6 April 2011 the annual ISA investment limit will rise by £480 to £10,680 (of which up to £5,340 may be in cash). The number may look odd, but it stems from the new rules for annual index linked ISA increases, which take effect on 6 April 2011.

The original ISA investment ceiling, set in April 1999, was £7,000 and it remained at that level until 2008/09, when it increased by £200. Anyone who has been able to contribute to the maximum each year up to and including 2010/11 could by now have placed £87,600 into their ISAs and largely out of the taxman’s reach. The reduction in the pension annual allowance to £50,000 in 2011/12 and the cut in the lifetime allowance to £1.5m from 6 April 2012, both mean the importance of ISAs as a tax-efficient investment route has increased.

If you are looking for income from an existing cash ISA, the one-way option of a switch from a cash ISA to a stocks and shares ISA could be worth considering. For example, an investment in a corporate bond fund could produce 5% or more, while a UK equity income fund could offer upwards of 3.5%. Both yields are tax free via an ISA. The quid pro quo for the immediate extra income is that you lose the capital security of the cash ISA and your new higher income – like the cash ISA’s income – could fall as well as rise.

“Juniors ISAs”

This year's budget gave a little more detail on the proposed 'replacement' for the Child Trust Fund – the Junior ISA. Some further consultation with potential providers of this product is taking place but it is expected that draft legislation will be published along with the 2011 Finance Bill with a view to these plans being available from the autumn of this year.

There is still no indication of what the investment limit will be but one would expect it to be at least as much as the allowable voluntary contributions to the Child Trust Fund.

While, as for ordinary ISAs, there will be no tax relief on the amount invested, the income and capital gains generated by the ISA will be tax free. Junior ISAs will be available for all UK resident children under the age of 18 who do not have a Child Trust Fund.

The launch of the Junior ISA will represent a useful addition to the tax efficient armoury of the parent or grandparent looking to plan for the ever increasing costs of higher education. Other strategies that might be considered would include growth based collectives held in a bare trust for children and offshore insurance bonds held in trust or assigned by the investor to the child after the child has reached age 18. With the benefit of careful financial planning both strategies can provide tax efficient growth and tax free or tax reduced realisation of gains.

Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs)

An increase in the rate of relief available for EIS investment from 20% to 30% was announced to take effect from 6 April 2011. This change supplements amendments to the rules for VCTs and EISs to comply with EU State Aid rules which were included in the third of 2010's Finance Acts (yes, there were three), having been originally announced in the December 2009 Pre-Budget Report. These changes come into force on 6 April 2011 i.e. after the end of the current tax year:

- Currently VCTs can be invested in shares and cash/fixed interest stock. From 6 April 2011, the minimum amount that a VCT must hold in shares will increase sharply. At present, 'eligible shares' in unlisted companies must represent at least 30% of a VCT's qualifying investments (which in turn have to be at least 70% of the VCT). In the next tax year, the eligible shares minimum holding will more than double to 70%.
- The definition of VCT "eligible shares" will be extended to include shares which may carry certain preferential rights.
- It will become possible for a VCT to be listed on any EU/EEA investment market rather than being limited to a UK listing.
- Shares in companies that are 'in difficulty' will cease to be qualifying for the purposes of the VCT and EIS rules.
- For EISs and VCTs, the existing requirement that a company must have a qualifying trade carried out wholly or mainly in the UK will change to one that it need only have a permanent establishment in the UK.

The main impact of these changes will be on 'limited life' VCTs, which aim to return funds to investors shortly after the five year tax relief claw back period ends. Typically, these types of VCT have minimised equity investment in favour of loan capital. Fortunately, as the new rules only apply to new VCT share capital raised from 6 April 2011, if you have invested in a limited life VCT before that date, you will be unaffected.

It is perhaps not surprising that the Chancellor chose to attack certain 'limited life' VCTs further. Some of the most recent 'limited life' issues had focused for example, on creating solar panel and wind farm 'farms' to exploit the government's feed-in tariff scheme, as well as access VCT relief. The Government has announced plans to place such businesses into the 'excluded activities' list from April 2012 which is hardly the high risk category of investment which VCTs were originally intended to target.

A range of wider changes to EIS and VCT schemes were proposed to take effect from 6 April 2012. For example:-

From April 2012 the Government will double the annual EIS investment limit for individuals to £1 million and increase the qualifying company limits to 250 employees and gross assets to £15 million for VCTs and EIS. The Government will also increase the annual investment limit for qualifying companies by 400% to £10 million for both vehicles.

Interest Rates

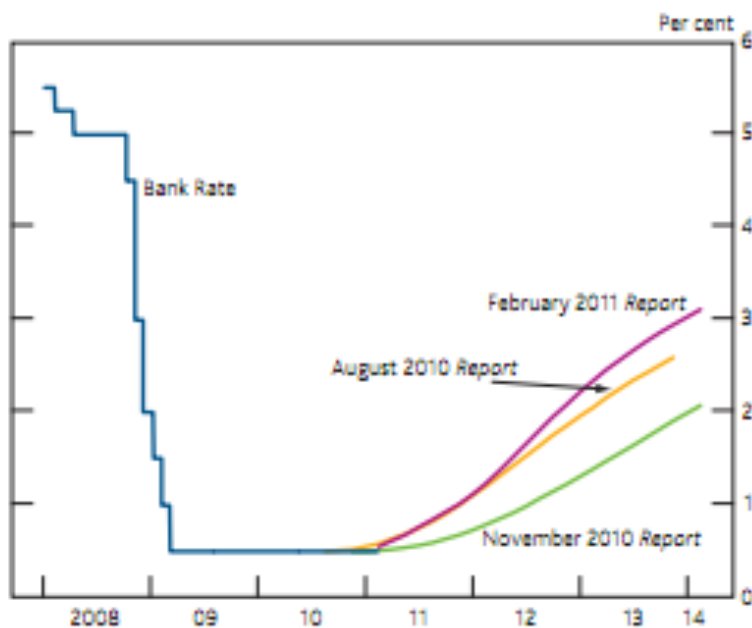
What has the Budget told us about the path of interest rates?

In theory, the business of setting interest rates resides with the Bank of England, not the Chancellor. In practice, the Chancellor influences interest rates indirectly by the tax and spending decisions that he makes. Those decisions were basically all made last June, albeit many are yet to be implemented. The Office for Budget Responsibility (OBR), the quasi-independent monitor of the public finances, considers that the Budget leaves the government still largely on course to bring annual spending and tax revenue into balance by 2015/16.

Nevertheless, we are still a long way from such a fiscal paradise. The OBR expects the government to borrow £122 billion in 2011/12, down from a projected £145.9 billion this year, but still a substantial sum of money to raise. So far the government has had no difficulties in selling the necessary gilts, not least because the markets have taken a benign view of Mr Osborne's austerity programme. But if inflation does not start falling soon, the markets could show their capricious side.

The high inflation numbers (4.4% CPI and 5.5% RPI) mean that an increase in interest rates is likely later this year. Until the events in Japan, the markets had been pencilling in a rate rise for May, when the Bank of England issues its next Quarterly Inflation Report. The Bank's last Report included its usual market-based graph of future short-term interest rates which now suggests rates may reach 3% by the beginning of 2014 (see below). However, concerns about the impact of the earthquake in Japan now mean the markets are expecting the Bank to act in August.

Short Term Interest Rate Projections – February 2011



Sources: Bank of England and Bloomberg.

Non-Domiciliaries

As well as announcing the commencement of consultation with a view to creating a (some would say, long overdue) statutory test of residence, further reform to the taxation of the foreign income and gains of UK resident non-domiciliaries (non-doms) was proposed.

Broadly speaking, under the law as it stands, UK resident non-doms are subject to tax on their foreign income and gains as they arise, whether they are brought into (remitted) to the UK or not.

However, the payment of a £30,000 so called remittance basis charge each year absolves them of the need to pay UK tax on foreign income and gains unless they remit such income or gains to the UK.

The Government have proposed that from April 2012 the existing £30,000 annual charge should increase to £50,000

for non-doms who have been UK resident for 12 or more years and who wish to retain access to the beneficial tax regime (the remittance basis). The £30,000 charge will be retained for those who have been resident for at least seven of the past nine years and fewer than twelve years

In addition, the Government are looking to simplify some aspects of the current tax rules for non-doms to remove undue administrative burdens and remove the tax charge when they remit foreign income or capital gains to the UK for the purpose of commercial investment in UK businesses. This is designed to address the disincentive to inward investment.

The lack of detail surrounding these changes makes interpretation very difficult at this stage. A consultation document will be issued in June when much needed further detail will doubtless emerge. The Government have confirmed that there will be no other substantive reforms to the taxation of non-doms during the remainder of this Parliament.

Tax planning for UK resident non-doms requires careful thought and expert advice.

Subject to this though, as the law stands at present non-doms should give careful thought to the merits of:-

- offshore bonds as a legitimate means of avoiding income and capital gains being subject to the arising basis of assessment or causing a non-dom to consider paying the remittance basis charge to avoid it

and/or

- the use of an excluded property trust of non-UK assets (or UK authorised unit trusts/OEICs) established while non-domiciled as a means of providing continuing IHT freedom even if the settlor subsequently becomes UK domiciled in the future.

Of course, any strategy implemented now would need to be reviewed, and possibly refined/changed, when the likely shape of any new provisions become clear.

ESTATE PLANNERS

Encouraging charitable giving

The Government announced that to further encourage charitable giving, for deaths after 5 April 2012, the 40% rate of inheritance tax (IHT) will reduce to 36% provided the deceased leaves 10% or more of their net estate (the estate after deducting the nil rate band and any exempt transfers) to charity. Consultation will now take place with a view to developing the detail necessary for the final rules to take effect from 6 April 2012.

Nil Rate Band Frozen

The inheritance tax (IHT) nil rate band will be unchanged for 2011/12 at £325,000. It was fixed at that level on 6 April 2009 and, in his final Budget, Mr Darling announced that the nil rate band would remain frozen until 5 April 2015. Mr Osborne had spoken of a £1m nil rate band while in opposition, but the complexities of coalition government meant that the promised freeze went ahead.

In theory, keeping the band frozen will mean more people being dragged into the IHT net and more IHT paid by those already in it. Were the nil rate band index-linked, it would rise to about £340,000 next month. In practice, the performance of the residential property market will probably have a more significant impact on IHT receipts, given that it accounts for half of all estate assets according to HMRC statistics.

The freeze in value of the nil rate band reduces the effective value of the IHT saving available to a surviving spouse whose estate benefits from a transferable nil rate band. It may therefore be appropriate for spouses to give greater consideration to using the nil rate band on the first death by the first to die creating a discretionary nil rate band in his/her Will.

The nil rate band freeze makes it all the more important to take advantage of the yearly exemptions (see box over page).

The IHT Yearly Exemptions

There are three yearly exemptions which are available for IHT planning:

- The £3,000 annual exemption. Any unused part of this exemption can be carried forward one tax year, but it must then be used after the £3,000 exemption for that year. So, for example, if you made a gift of £1,000 covered by the annual exemption in 2009/10, you can make gifts totalling £5,000– if you act quickly!
- The £250 small gifts exemption. You can make as many outright gifts of up to £250 per individual per tax year as you wish free of IHT, provided that the recipient does not also receive any part of your £3,000 annual exemption.
- The normal expenditure exemption. Any gift that you make is exempt from IHT if:
 - it forms part of your normal expenditure; and
 - taking one year with another it is made out of income; and
 - it leaves you with sufficient income to maintain your usual standard of living.

The normal expenditure exemption is often forgotten. You may be making regular gifts which you think are covered by the £3,000 annual exemption, but which could actually be counted as normal expenditure, leaving your £3,000 exemption unused. For example, if you pay premiums for a life policy held under trust, such payments frequently satisfy all the conditions to be treated as normal expenditure, leaving the £3,000 exemption available for other gifts.

The normal expenditure exemption will potentially become more useful in the future, when used in conjunction with flexible income drawdown from pensions (see Pensions section below).

Pensions and Estate Planning

Last year's Emergency Budget set in train a raft of changes to pensions, many of which take effect from 6 April 2011. From an estate planning viewpoint, the most important of these was the revised treatment of death benefits. These are described in the 'Pensioner/At Retirement' section below. Whether or not it was the government's intention, the indirect result of the reforms will be to increase the value of pensions as an estate planning tool, particularly once age 75 has been reached.

Inheritance Tax Mk II?

Last year the government established the Office for Tax Simplification (OTS) with a remit to examine UK tax reliefs, exemptions and allowances with a view to simplification. The OTS made an initial trawl which discovered no less than 1,042 reliefs, exemptions and allowances, 89 of which related to IHT. The OTS subsequently focused its efforts on 155 reliefs which it believed warranted greater scrutiny, of which 27 involved IHT.

The OTS did not make any recommendations in respect of particular IHT reliefs, although it did in passing note that 'the exemptions for monetary gifts on the occasion of marriage or civil partnerships... have not increased since 1975 and the annual exemption... has been £3,000 since 1981.' Instead of proposing tweaks to individual reliefs, the OTS took a more radical view, concluding that 'there should be a proper review of inheritance tax, whether by HMRC, HM Treasury or the OTS. This would clearly be a longer term project. In short, this is a tax that needs a 'top down' review...'

The political sensitivity of IHT meant that nothing was said in the Budget, but it is likely that work will go on in the background. IHT was introduced in 1986 by Nigel Lawson, although its roots are a dozen years older, in the Capital Transfer Tax regime created by Denis Healey. A recent review of IHT on behalf of the Institute for Fiscal Studies, which was quoted by the OTS, said IHT was 'a somewhat half hearted tax, with many loopholes and opportunities for avoidance though careful organisation of affairs'.

Any replacement estate tax might be rather less friendly, so if you want to undertake any planning or gifting, it may be best to start now.

Two issues that often concern would-be donors are those of future control of the assets gifted and, for many, the ability to access the gift – perhaps by drawing some kind of income.

A gift to a discretionary trust can provide a solution to the need for control so that the donor, as a trustee can retain an element of control over who benefits from the gift and when.

Other trust arrangements can enable you to:

- retain access to the original capital used in the planning while effectively “giving away future growth” on the amount invested; or
- retain the right to regular capital payments throughout life while still making an immediate tax-effective gift

For any liability that remains unreduced it may be possible to tax effectively provide for the liability through appropriate life assurance written in trust. The relevance and attraction of any of these solutions will depend on the circumstances of each case. Your financial adviser can help to explain these options for planning to you.

BUSINESS OWNERS

Corporation tax rates

The main rate of corporation tax falls to 26% (not 27% as was announced in the June 2010 budget) from 1 April 2011 and the small profits rate (formerly smaller companies’ rate) will also drop by 1% to 20%, as previously announced. While the main rate will continue to drop by 1% a year, reaching 23% in 2014.

New NIC Rates: Dividends and Salary

National Insurance Contribution (NIC) rates and bands will be revised from 6 April 2011. The 1% increase in all the main rates is one of the revenue-raising measures George Osborne chose to carry across from his predecessor. However, the changes to the NIC bands are largely the Chancellor’s own work and stem from:

- A desire to limit the impact of the rate increase on those with modest earnings and their employers; and
- The reduction in the starting point for higher rate tax, which also sets the upper point for full NIC rates.

The Cost of £100

The new NIC rates will mean that in 2011/12 the marginal cost to an employer of putting an extra £100 net into the wage packet of a basic rate taxpaying employee will typically be over £167:

	Employer £	Employee £
Salary	£147.06	£147.06
Income tax at 20%		(29.41)
NIC at 13.8% / 12%	20.29	(17.65)
Total	167.35	100.00

If you are a private company owner, the revised NIC rates further tip the scales in favour of drawing income from your business in the form of dividends rather than salary or bonus, as the table below shows. The cut in the small profits rate has also helped the case for dividends, as there is now no tax 'leakage': £100 of gross profit can become £80 of dividend (net of basic rate tax) rather than £79.

Dividends versus Bonus

Brendan has £50,000 of gross profits in his company which he wishes to draw, either as bonus or dividend. Assuming the company pays corporation tax at the 2011 small profits rate of 20% and Brendan has annual income in excess of £42,475, his choice can be summarised thus:

	Bonus £		Dividend £	
	40% tax	50% tax	40% tax	50% tax
Marginal gross profit	50,000	50,000	50,000	50,000
Corporation tax @ 20%	N/A	N/A	(10,000)	(10,000)
Dividend	N/A	N/A	40,000	40,000
Employer's National Insurance contributions £43,937 @ 13.8%	(6,063)	(6,063)	N/A	N/A
Gross bonus	43,937	43,937	N/A	N/A
Brian's NICs £43,937 @ 2%	(879)	(879)	N/A	N/A
Income tax *	(17,575)	(21,969)	(10,000)	(14,444)
Net benefit to Brendan	25,483	21,089	30,000	25,556

*after allowing for 10% tax credit on dividends

The benefit of the dividend route is due to the savings in NICs; more tax (corporation tax and income tax) is payable under the dividend route.

New NIC Rates: Employing the Spouse

The increase in the personal allowance and the secondary NIC threshold (at which an employer starts to pay NICs for an employee) have both increased the tax-saving opportunity for business owners who employ their spouses or partners. The most important points to watch are:

- Earnings should be at least £102 a week in 2011/12, as this level gives entitlement to state pension rights and other social security benefits.
- The maximum earnings should be £136 a week. Anything above this will start to attract employer NICs at 13.8% and, usually once £139 a week is breached, employee NICs at 12%.
- The employment must be genuine. HMRC will take a dim view if a wife is said to be employed by her husband's business, but in practice does nothing.

See box over page:

It pays to Employ your Spouse

Bill's company, BillCo Ltd, has decided to employ his formerly non-working wife, Jane, at a salary of £7,000 a year. Bill, who is a higher rate taxpayer, agrees to forgo £6,151 in salary. This will save BillCo £7,000 a year once employer NICs (£6,151 @ 13.8% = £849) are taken into account.

Jane will:

- Receive an income of £7,000 a year. As she has less than £475 per annum in other income from investments, there will be no tax to pay on her earnings.
- Not have any NICs to pay and neither will BillCo as her earnings are below the relevant thresholds.
- Accrue rights to the basic state pension and the state second pension (S2P). Each year's employment could earn her state pension rights of about £250 a year in today's terms.
- If BillCo wished, it could also contribute to a private pension for Jane.

While Jane is £7,000 better off, Bill's loss from the salary reduction is much less:

Gross Salary	£6,151
Tax @ 40%	£2,460
NICs @ 2%	£123
Net Income Lost	£3,568

Combining NICs and Income Tax

Bringing together income tax and NICs was suggested by the OTS and would recognise the fact that NICs are de facto income tax. However, for politicians the semantics have been everything and NICs have regularly been used as a way of raising revenue on earned income without the electoral embarrassment of increasing the headline income tax rate. There have been half-hearted attempts at alignment in the past, largely confined to linking the NIC and income tax thresholds, but even these have failed to last – witness the 2011/12 array of thresholds, where employer's NIC, employee's NIC and the personal allowance are all different, but within a narrow band between £7,072 and £7,475, while the earnings threshold for benefits is generally £5,304.

The Chancellor's announcement of a review is a start, but this will be a difficult system to consolidate, which is why the issue has so often been kicked back into the long grass. For example, if there is one combined rate, does that mean the overall tax on investment income will rise? Hopefully not. Reassuringly the Government have stated in the Overview of Tax Legislation and Rates published on budget day, that they will

- consult extensively and start the process with a consultation document published later this year
- aim to improve fairness for individuals
- not extend the "NIC part" of a merged rate to individuals above State Pension Age or to other forms of income such as pensions, savings and dividends

Capital Allowances

Various new proposals on capital allowances were announced generally improving the position for specific "encouraged" investments such as energy saving technologies.

It's also worth remembering that the Chancellor also revealed in last June's Budget that there would be changes from April 2012:

- The Annual Investment Allowance (AIA), which gives 100% initial relief for investment in plant and machinery, will drop from £100,000 to £25,000.
- The main writing-down allowances will drop by 2% for periods of account ending on or after 1 April 2012 (companies), and on or after 6 April 2012 (other businesses).

These reductions mean the timing of a business investment needs to be considered carefully. It may be wiser to bring forward major purchases to maximise the use of the AIA rather than defer investment until 2012/13.

Pension Changes

All businesses need to be aware of the pension tax changes which start to operate from April 2011. These are considered in more detail below in the 'Retirement Planner' section. Alongside the tax changes, businesses will also need to allow for other retirement-related issues:

- The phasing out of the default retirement age of 65, which will begin on 6 April 2011;
- The phased introduction of NEST pension scheme, starting in October 2012; and
- The further changes to state pension age (SPA), which will begin to affect women from May 2016 and men from December 2018. By 6 April 2020 SPA will be 66 for men and women.

Selling your business

The unexpected but welcome increase in the entrepreneurs' relief limit from £5m to £10m, on the face of it, increases the appeal of building up the value of a business with a view to realising a low-taxed gain.

Of course, reliance on one's business as the sole or main means of providing financial security in the future may represent an excessively undiversified and, thus, high risk strategy. Business owners contemplating or adopting this route (and it may have appeal to a greater number in the light of the £10 million threshold) should be encouraged to consider some alternative, supplementary, means of providing for the future including, as appropriate, pensions and other suitable investments so as to diminish risk through diversification.

It is one thing having a hugely beneficial tax regime for gains made on business sale but quite another achieving and realising the gain in the first place!

Company Cars

The company car benefit scales are subject to a variety of changes for 2011/12, all of which relate back to Mr Darling's term as Chancellor:

- There is a 5g/km decrease to 125g/km for the lower threshold (15% for petrol). As a result in 2011/12 the maximum 35% scale charge will apply to any petrol car with emissions of over 224g/km and any diesel with emissions exceeding 209 g/km.
- The reduced rates for LPG, E85 and dual fuel vehicles will end, as will the 3% scale reduction for pre-2006 Euro IV diesels. All diesels will have a 3% addition (subject to the usual maximum total of 35%)
- The £80,000 list price ceiling used in determining car benefit will also disappear with the beginning of the new tax year. A Bentley will no longer be the tax-efficient company car it once was.

There will be another turn of the company car tax screw in 2012/13. A 5g/km cut will again be made in the main threshold, taking it down to 120g/km and the scale will be extended downwards. As a result, the 10% petrol car and 13% diesel car factors, which in 2010/11 apply to cars with emissions of up to 120g/km, will only apply to cars with emissions of above 75g/km but no more than 99g/km.

If you are due to change your company car in the near future, check first how the scale changes will affect you. In the case of a petrol car with 120g/km emissions, your tax bill will increase by 50% in 2012/13.

HOME OWNERS AND BUYERS

Stamp Duty Land Tax (SDLT)

There were no changes to the SDLT rates announced in the Budget. As a result:

- The normal residential property SDLT threshold remains at £125,000 (£150,000 for properties in disadvantaged areas). According to Nationwide, the average UK property price is now around £161,000: only one of the thirteen UK regions in the Nationwide's quarterly price survey has an average property price below £125,000.
- A new 5% SDLT rate will apply on residential property purchases above £1m from 6 April 2011.
- The first-time buyer SDLT threshold of £250,000 is due to continue for another year, ending on 24 March 2012.

The Chancellor did announce new SDLT anti-avoidance measures. This was only to be expected, as SDLT avoidance schemes have become widespread and since 1 April 2010 all schemes involving residential property with a value of at least £1m have had to be disclosed to HMRC.

Interest Rates

Approximately 90% of all mortgages are now on variable rates, according to a recent economic commentary from Legal & General Investment Management. This has come about because many borrowers who were on fixed rates have been unable or unwilling to remortgage and have fallen back on their lender's standard variable rate (SVR). New borrowers – of which there are relatively few – have also been tempted by variable rate loans and tracker loans because initial interest costs on such loans are currently lower than the fixed rate alternatives.

When interest rates rise – from current levels, it is not a question of 'if' – anyone with a variable rate loan will be given a rude reminder of what variable means. One of the side effects of ultra-low rates is that an increase in rates has a proportionately larger effect. If you have a 2.5% variable rate mortgage and interest rates rise by 0.5%, then your monthly mortgage interest bill will be a fifth higher. The market is expecting such a rise will start well before the end of 2011.

Nothing that the Chancellor said has significantly changed the outlook on interest rates, so if you are one of those variable rate borrowers, be prepared!

Capital Repayment

Two years of 0.5% base rates should have allowed those 90% of borrowers with variable rate loans to divert some of their interest savings into reducing their mortgage debt. In practice, many will have simply accepted the lower mortgage payments as useful financial assistance in difficult times, especially as pay increases have not been keeping pace with inflation.

In the longer term, for many borrowers there remains the issue of how the outstanding mortgage capital, as opposed to interest, will eventually be repaid. Before the credit crisis, many loans were arranged on an interest only basis with neither borrower nor lender that concerned about capital repayment. The situation has changed for lenders, who now want to see a means of capital repayment on new loans, but many borrowers remain in denial about existing loans. Even where some form of investment is in place to repay debt, difficult investment market conditions and, for with profits policies, low bonus rates, can imply prospective shortfalls.

Furnished Holiday Lettings

For those who own furnished holiday lettings (FHL) it is important to note that the rules are changing.

From 6 April 2011, any loss arising from an FHL business can only be offset against income from the same business. Before 6 April 2011 such losses can be offset against other income – including employment income. If possible it is therefore worth maximising such losses before 6 April 2011.

With effect from 6 April 2012, it is proposed that the definition of FHL will change.

If possible it will be worth satisfying these rules because the business will then qualify for

- entrepreneurs' relief (up to £10 million of capital gains taxed at 10%) and
- inheritance business relief at 100% with two years ownership (provided it can be shown that the business does more than simply hold investments)

To currently qualify, the property must be let for 70 days a year and be available for letting for 140 days with no single let longer than 31 days. From April 2012 it must actually be let for 105 days, an equivalent of 15 weeks, and be available for 210 days or 30 weeks. Businesses meeting the actual let threshold in one year may elect to be treated as having met it in the two following years ("period of grace") providing certain criteria are met.

These tests may represent more difficult conditions to satisfy in certain parts of the UK where lettings are on a seasonal basis.

In conclusion therefore, there are tax advantages to be gained by persons who run furnished holiday letting businesses in the run up to 6 April 2011. If you own a holiday or an FHL property then it will be important that you strive to satisfy the new qualifying rules to retain the ongoing tax advantages that will continue to apply.

RETIREMENT PLANNER

The Annual Allowance Shrinks....

Last June's Emergency Budget set in train a variety of reforms to the tax treatment of pensions, many of which take effect from 6 April 2011. If you are still building up funds for your retirement, the most significant change is probably the revisions to the rules on the pension tax allowances:

- The special annual allowance (SAA), which broadly speaking potentially affects those with total income of £130,000 or more, will cease from 6 April 2011. The SAA was a temporary measure, designed to restrict tax relief to basic rate on some pension contributions in the run up to 6 April 2011 .
- The state of government finances meant that the SAA could not be left to die without some other measure to constrain tax relief on large pension contributions. The previous government had legislated for a son-of-SAA, but the mechanism was so complex that George Osborne abandoned it in favour of a reform to the annual allowance (AA). The AA effectively sets a tax-efficient limit on the total pension savings and accruals from all sources for an individual during a tax year. For 2010/11 it is £255,000, making it of relevance only to a very few high earners with substantial pension contributions/accrual.
- From 2011/12 the AA will be cut to £50,000, where it is likely to remain for at least five tax years. A revised annual allowance charge will mean that all tax relief on personal contributions above the available AA will effectively be lost and all excess employer contributions will be taxed in full on the employee. In some instances the tax charge can be met by the pension scheme, with a corresponding reduction in the individual's pension benefits/fund.
- The 80% reduction in the AA is tempered by new rules which allow you to carry forward any unused annual allowance for up to three tax years. This concession is backdated to tax years since 2008/09, but based on a deemed annual allowance of £50,000, not the actual amounts for the previous tax years (as the example below shows). Nevertheless, if you receive a one-off boost to your pension, for example on early retirement/redundancy, carry forward may provide a complete escape from the annual allowance charge.

The new annual allowance rules complicate pension planning and encourage regular contributions rather than large one-off payments shortly before retirement. They increase the importance of taking advice before considering any change to your pension contributions.

After the Special Annual Allowance...

Graham, who in 2011/12 expects to have earnings of £155,000, was caught by the special annual allowance in 2009/10 and 2010/11, with the result that in those two tax years he restricted his pension contributions to £20,000 a year, compared with the £38,000 he had paid in 2008/09. In 2011/12 he can use the new carry forward rule to make contributions of up to £122,000 without any tax relief penalty, as the table below shows.

TAX YEAR	CONTRIBUTION	ANNUAL ALLOWANCE*	CARRIED FORWARD TO NEXT YEAR	TOTAL CARRIED FORWARD
2008/09	£38,000	£50,000	£12,000	£12,000
2009/10	£20,000	£50,000	£30,000	£42,000
2010/11	£20,000	£50,000	£30,000	£72,000
2011/12	£122,000	£50,000	Nil	Nil

* For carry forward calculation purposes only in 2008/09-2010/11.

If Graham does not contribute at least £62,000 in 2011/12, he will lose part of the £12,000 unused allowance carried forward from 2008/09. The rules offset his contribution first against the current year's allowance and then against the carried forward amounts, oldest year first.

....The Lifetime Allowance Shrinks, too.....

The lifetime allowance (LA) will also undergo a contraction in size as part of the reforms to replace the SAA. From 6 April 2012, the LA will be reduced from £1.8m to £1.5m and frozen at that level for an indeterminate period. A new 'fixed protection' option will be available to allow you to secure the £1.8m level, but the downside is that this protection will be lost if any further benefits accrue or contributions are made after 2011/12. So the coming tax year may be one in which to maximise and then cease contributions.

Fixed protection is not available if you have primary or enhanced protection. If you already have enhanced protection, you will be unaffected by the lower LA. If you have primary protection, this will continue, based on a £1.8m LA.

Details of how to claim 'fixed protection' are still awaited, but HMRC has said the option will only be available until 5 April 2012. If you think you might need 'fixed protection', it makes sense to begin a review of your pensions early in the new tax year.

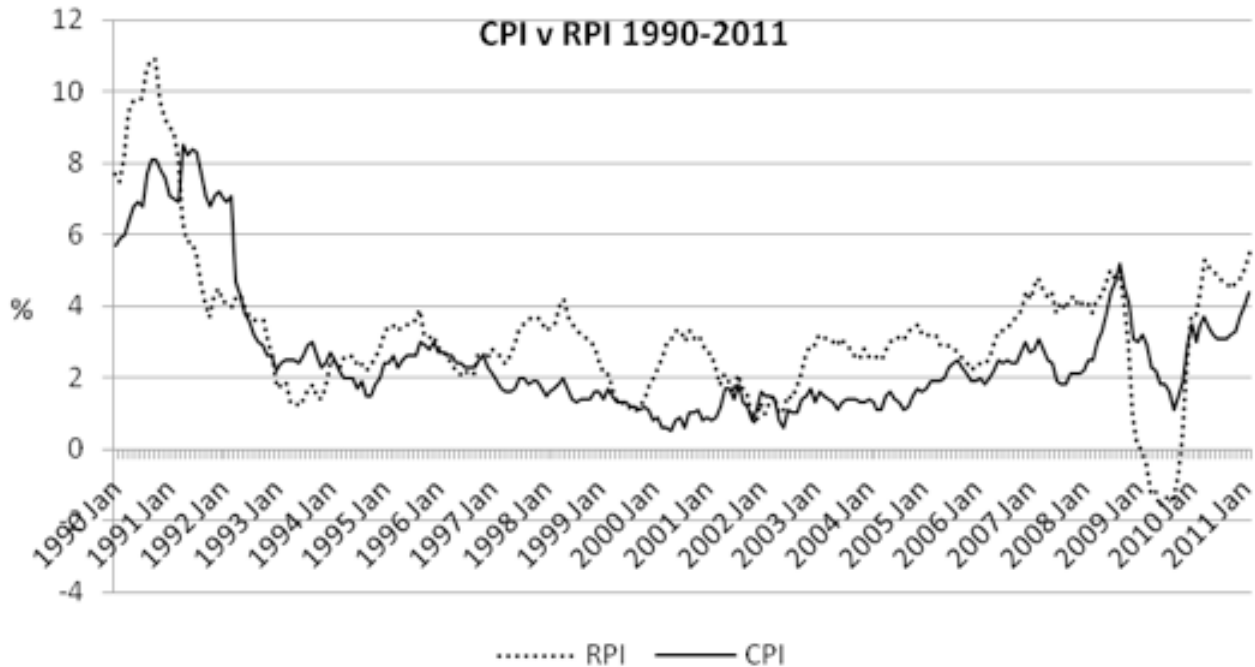
...And the Obvious Escape Route has been Closed

The special annual allowance stimulated employers to use employer-financed retirement benefits schemes (EFRBS) as an alternative method of providing pension benefits for some senior employees. The tax rules for EFRBS were set in 2006 and, at the time, looked relatively unattractive. However, as the tax treatment of contributions to HMRC registered pension arrangements was restricted, so EFRBS became more appealing.

There was a warning in last June's Budget that EFRBS and Employee Benefit Trusts (EBTs), which have a similar tax treatment, would be attacked and, on 9 December, the Treasury effectively closed both with the announcement of a new set of tax rules for 'disguised remuneration.' While these will not take effect until 6 April 2011, anti-forestalling measures came into force from the announcement date to prevent people taking advantage before then.

CPI, not RPI

One of the more technical changes which Mr Osborne set in train last June was a switch from using the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) for indexation of most state benefits and public sector pensions, starting this April. The measure was primarily a cost-cutting one: over the last 20 years CPI inflation has averaged 0.5% a year less than RPI inflation. In fact, the gap for the first round of increases affected by the change is much wider: RPI inflation in the benchmark month of September 2010 was 4.6%, whereas the CPI figure was 3.1%.



Subsequent to the June Budget move, the government announced that CPI rather than RPI would apply to private sector final salary pension scheme statutory increases, both before and after retirement. This caused much consternation, not least because over two thirds of private sector pension schemes had 'hard wired' reference to the RPI into their rules and faced having to give increases based on whichever index was the higher. By December the government had backed down a little. It issued a consultation paper suggesting that schemes would not be bound to match the higher index, but neither would there be any legislation to override scheme rules.

If you are a member of any final salary pension scheme – even of a former employer – the sensible course of action is to check what the scheme is doing, as it could have a significant effect on your eventual retirement benefits.

State Pension Ages

Changes to state pension age (SPA) were another measure that started with an announcement in the June Budget. These will become law, once the Pensions Bill 2011 goes through Parliament. The changes, shown in the tables below, are particularly bad news if you are woman who has just celebrated your 57th birthday. This time last year, your SPA was 6 March 2018 (age 64), now it is 6 March 2020 (age 66).

Women: Date of birth	Date State Pension Age Reached
6 April 1953 to 5 May 1953	6 July 2016
6 May 1953 to 5 June 1953	6 November 2016
6 June 1953 to 5 July 1953	6 March 2017
6 July 1953 to 5 August 1953	6 July 2017
6 August 1953 to 5 September 1953	6 November 2017
6 September 1953 to 5 October 1953	6 March 2018
6 October 1953 to 5 November 1953	6 July 2018
6 November 1953 to 5 December 1953	6 November 2018

Women and Men: Date of birth	Date State Pension Age Reached
6 December 1953 to 5 January 1954	6 March 2019
6 January 1954 to 5 February 1954	6 July 2019
6 February 1954 to 5 March 1954	6 Nov 2019
6 March 1954 to 5 April 1954	6 March 2020
6 April 1954 to 5 April 1960	66th birthday

At Retirement Changes

The changes to the annual allowance and lifetime allowance have been accompanied by new tax rules about how benefits may be drawn from a pension plan. These are considered in more detail in the next 'Pensioner/At Retirement' section. In brief, the changes:

- Remove the requirement to buy an annuity;
- Allow much greater income flexibility, provided you have other secure sources of pension income;
- Scrap the 82% tax rate which could apply to death benefits from age 75; and
- Open up new avenues for using your pension in estate planning.

PENSIONER/AT RETIREMENT

CPI, not RPI Again

There has been a change in the inflation index used as a basis for increasing some pensions in payment, as explained above in the 'Retirement Planner' section.

The basic state pension will rise in line with the RPI (4.6%) from April 2011, but other state pensions, such as the state additional pension (SERPS and S2P), rise in line with the CPI (3.1%). From 2012, the CPI will replace the RPI as one of the three components (price inflation, earnings growth and 2.5%) of the 'triple-lock' increase to the basic state pension.

Income Drawdown

In the June 2010 Budget, the Chancellor announced a temporary change to the rules for income drawdown, pending consultation on a new structure to allow pension income to be drawn directly from a pension fund. The consultation process ended in December and the government's new drawdown rules will begin on 6 April 2011. The main features are:

- There will be no upper age limit for income drawdown. Until recently age 75 had been the end date.
- The maximum level of income that can be taken each year under drawdown will change, falling by about 17% for 'capped drawdown'. There will continue to be no requirement to take an income in any year.
- If your total annual secure pension income (basically scheme and state pensions plus pension annuities) is at least £20,000, you can opt for 'flexible drawdown' instead of the capped version. This removes the ceiling on what you can withdraw – in theory, you could withdraw your entire pension fund in one payment. However, all withdrawals will be fully taxable as income.
- Future reviews of capped drawdown plans will move to a three yearly cycle up to age 75 and yearly thereafter.
- The flat rate recovery tax charge on lump sum death benefits will rise to 55% from 35%. The same rate will apply from age 75 whether or not income is being drawn from the pension arrangement. However, any lump sum will be free of IHT.
- Alternatively secured pensions, which were the only escape route from annuity purchase at age 75, will be scrapped as income drawdown can continue throughout life.

If you are already taking income drawdown or drawing an alternatively secured pension, broadly speaking you will move across to the new rules on drawing income when your income level is next subject to review.

Unfortunately, many pension providers are unable to cope with these changes at present, not least because the necessary legislation is still only in draft and the fine print could change on its way through Parliament.

Lifetime Allowance

The lifetime allowance changes from April 2012 (see 'Retirement Planner' section above) may be relevant to you, if you are under age 74 and have not yet bought an annuity. The value of your pension benefits will be tested against the new lifetime allowance when you reach age 75 or earlier if, for example, you buy an annuity after 5 April 2012.

If you have a substantial fund, you might need to elect for the new 'fixed protection' by 5 April 2012 to avoid, or at least limit, any lifetime allowance charge. The calculations involved can be complex and professional advice is vital.

MAIN INCOME TAX ALLOWANCES AND RELIEFS

	2010/11	2011/12
	£	£
Personal allowance – standard	6,475	7,475
- Age 65 – 74	9,490	9,940
- Age 75 and over	9,640	10,090
Personal allowance reduced if total income exceeds †	100,000	100,000
Married couple's allowance – minimum amount*	2,670	2,800
- Age 75 and over*	6,965	7,295
Age-related allowances reduced if total income exceeds °	22,900	24,000
Maintenance to former spouse Δ	2,670	2,800
Employment termination lump sum limit	30,000	30,000

† For 2011/12 the reduction is £1 for every £2 additional income over £100,000. As a result there is no personal allowance if total income exceeds £114,950 (£112,950 for 2010/11).

* Relief at 10%. Minimum amount applies for age allowance purposes only.

° For 2010/11 and 2011/12 the reduction is £1 for every £2 additional income over the total income threshold. Standard allowances(s) only are available if total income exceeds:-

Δ Relief available at 10% only if at least one of the couple was born before 6 April 1935.

	2010/11	2011/12
	£	£
Taxpayer aged 65 - 74 [personal allowance]	28,930	28,930
Taxpayer aged 75 and over [personal allowance]	29,230	29,230
Taxpayer aged 75 and over [married couple's allowance]	37,820	38,220

Income Tax Rates

	2010/11	2011/12
	£	£
Starting rate on savings income- 10%	1 – 2,440	1 – 2,560
Basic rate	20%	20%
Maximum tax at basic rate†	7,480	7,000
Higher rate - 40%	37,401-150,000	35,001-150,000
Tax on first £150,000*	52,520	53,000
Additional rate – 50%	Over 150,000	Over 150,000
Discretionary and accumulation trusts (except dividends) °	50%	50%
Discretionary and accumulation trusts (dividends) °	42.5%	42.5%
Ordinary rate on dividends	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	42.5%	42.5%

† Assumes 10% band not available. £6,744 on first £35,000 (£7,236 on first £37,400 in 2010/11) and £52,744 (£52,276 in 2010/11) on first £150,000 if full 10% band is available.

* Up to the first £1,000 of gross income is generally taxed at the standard rate, ie. 20%, or 10% as appropriate.

Car Benefits

The charge is based on a percentage of the car's "price". "Price" for this purpose is the list price at the time the car was first registered plus the price of extras. For 2010/11 only this was capped at £80,000.

For cars first registered after 31 December 1997 the charge, based on the car's "price", is graduated according to the level of the car's approved CO₂ emissions.

For petrol cars with an approved CO₂ emission figure.

CO ₂ g/km	% of price subject to tax		CO ₂ g/km	% of price subject to tax		CO ₂ g/km	% of price subject to tax	
	10-11	11-12		10-11	11-12		10-11	11-12
75 or less	5	5	155-9	20	21	195-9	28	29
76-120	10	10	160-4	21	22	200-4	29	30
121-129	15	15	165-9	22	23	205-9	30	31
130-134	15	16	170-4	23	24	210-4	31	32
135-9	16	17	175-9	24	25	215-9	32	33
140-4	17	18	180-4	25	26	220-4	33	34
145-9	18	19	185-9	26	27	225-9	34	35
150-4	19	20	190-4	27	28	230-	35	35

Notes

1. The exact CO₂ emissions figure should be rounded down to the nearest 5 g/km for levels of 125g/km or more (130g/km or more in 2010/11).
2. For all diesels add 3%, subject to maximum charge of 35%. For 2010/11 no surcharge applied to diesels meeting Euro IV and registered on or before 31 December 2005.
3. For 2010/11 only, hybrid petrol/electric cars are subject to a 3% reduction, with a minimum 10% charge.
4. For 2010/11 only, LPG, dual LPG/petrol and E85 cars are subject to a 2% reduction, with a minimum 10% charge. Reduction does not apply to LPG conversions.
5. There is no charge for any car which cannot produce CO₂.

Car Fuel Benefits

For cars with an approved CO₂ emission figure, the benefit is based on a flat amount of £118,800 (£18,000 for 2010/11). To calculate the amount of the benefit the percentage figure in the above car benefits table (that is from 10% to 35%) is multiplied by £18,800. The percentage figures allow for a diesel fuel surcharge. For example, in 2011/12 a petrol car emitting 162 g/km would give rise to a fuel benefit of 21% of £18,800 = £3948.

Inheritance Tax

	Cumulative chargeable transfers [gross]		tax rate on death %	tax rate in lifetime* %
	2010/11 (£)	2011/12 (£)		
Nil rate band†	325,000	325,000	0	0
Excess	No Limit	No Limit	40	20

* Chargeable lifetime transfers only

† On the death of a surviving spouse on or after 9 October 2007, their personal representatives may claim up to 100% of any unused proportion of the nil rate band of the first spouse to die (regardless of their date of death).

Capital Gains Tax

Main exemptions and reliefs

	2010/11 £	2011/12 £
Annual exemption	10,100*	10,600*
Principal private residence exemption	No limit	No limit
Chattels exemption	£6,000	£6,000
Entrepreneurs' relief	To 22/6/2010: 4/9ths of business gain Lifetime limit £2,000,000 From 23/6/2010: Lifetime limit £5,000,000 Gains taxed at 10%	Lifetime limit £10,000,000 Gains taxed at 10%

* Reduced by at least 50% for most trusts.

Stamp Duty and Stamp Duty Land Tax

Main exemptions and reliefs

Residential	Commercial	Rate
£125,000* or less	£150,000 or less	Nil
Over £125,000* up to £250,000	Over £150,000 up to £250,000	1%
Over £250,000 up to £500,000	Over £250,000 up to £500,000	3%
Over £500,000 up to £1,000,000	Over £500,000	4%
Over £1,000,000	N/A	5%
*£250,000 for first-time buyers where completion is before 25/3/2012, £150,000 for property in disadvantaged areas		
Stamp Duty (including SDRT): stocks and marketable securities		0.5%
No charge unless the duty exceeds £5		

Corporation Tax

	Year Ending 31 March	
	2011	2012
Main rate	28%	26%
Small profits rate *	21%	20%
Small profits limit *	£300,000	£300,000
Upper marginal level	£1,500,000	£1,500,000
Effective marginal rate	29.75%	27.5%

* Formerly the small companies' rate/limit

Tax-Privileged Investments (Maximum Investment)

	2010/11 (£)	2011/12 (£)
ISA Overall per tax year:	10,200	10,680
Cash component:	5,100	5,340
Stocks and shares component: Balance up to	10,200	10,680
Maximum in cash for 16 and 17 year olds	5,100	5,340
ENTERPRISE INVESTMENT SCHEME (20% income tax relief 2010/11, 30% 2011/12) ^o	500,000*	500,000*
Maximum carry back to previous tax year for income tax relief	500,000	500,000
VENTURE CAPITAL TRUST (30% income tax relief)	200,000	200,000

* No limit for CGT reinvestment relief.

^o 30% relief for 2011/12 subject to State aid approval

Pensions

	2010/11	2011/12
Lifetime allowance*	£1,800,000	£1,800,000
Lifetime allowance charge: Excess drawn as cash Excess drawn as income		55% of excess 25% of excess
Annual allowance	£255,000	£50,000
Annual allowance charge	40% of excess	20%-50% of excess
Special annual allowance	£20,000 - £30,000	N/A
Special annual allowance charge	20%-30% ⁺	N/A
Maximum relievable personal contribution	100% relevant UK earnings or £3,600 gross if greater	

* May be increased under transitional protection provisions

+ Depends on taxable income: effect is to reduce relief to basic rate

National Insurance Contributions

Class 1 Employee Not Contracted Out of State Second Pension (S2P)				
	2010/11		2011/12	
	Employee	Employer	Employee	Employer
Main NIC rate	11%	12.8%	12%	13.8%
No NICs on first	£110 pw	£110 pw	£139 pw	£136 pw
Main NIC charged up to	£844 pw	No limit	£817 pw	No limit
Additional NIC rate on earnings over	1% £844 pw	N/A	2% £817 pw	N/A
Certain married women	4.85%	12.8%	5.85%	13.8%

Contracted Out Rebates				
	2010/11		2011/12	
	Employee	Employer	Employee	Employer
Rebate on	£97.01 – £770 pw		£102.01 – £770 pw	
Salary-related scheme	1.6%	3.7%	1.6%	3.7%
Money purchase scheme	1.6%	1.4%	1.6%	1.4%
Personal pension	No reduction		No reduction	

Limits and Thresholds				
	2010/11		2011/12	
	Weekly (£)	Yearly (£)	Weekly (£)	Yearly (£)
Lower earnings limit	97	5,044	102	5,304
Secondary earnings threshold	110	5,715	136	7,072
Primary earnings threshold	110	5,715	139	7,225
Upper accrual point	770	40,040	770	40,040
Upper earnings limit	844	43,875	817	42,475

Self Employed and non-employed		
	2010/11	2011/12
Class 2		
Flat rate	£2.40 pw	£2.50 pw
Small earnings exception	£5,075 pa	£5,315 pa
Class 4 (Unless over state pension age on 6 April)		
	£5,715 – £43,875 pa: 8%	£7,225 – £42,475 pa: 9%
	Over £43,875 pa: 1%	Over £42,475 pa: 2%
Class 5 (Voluntary)		
Flat rate	£12.05 pw	£12.60 pw

IMPORTANT NOTE

This newsletter is provided strictly for general information only and is based on Technical Connections' understanding of the 2011 Budget. No action must be taken or refrained from based on its contents alone. Accordingly, no responsibility can be assumed for any loss occasioned in connection with the content hereof and any such action or inaction.

Professional advice is necessary for every case; therefore, please get in touch with your usual financial adviser.