

# WATSON FRENCH LTD

## BUDGET 2010: CONTENTS AND CONSEQUENCES

Alistair Darling's third and probably final Budget was inevitably a political exercise first and foremost, given the impending General Election. Like last year's Budget, much of its contents were clearly sign-posted in the Pre-Budget Report (PBR). This brings the politics in again: whatever the Chancellor wanted to do, the reality of legislative timetabling means he can only put through an anodyne Finance Bill before Parliament is prorogued after returning from its Easter break. Even the HMRC Budget notes spoke about two Finance Bills: one now and one 'as soon as possible in the next Parliament'

UK and global economic conditions have improved slightly since last December's PBR. The final quarter of 2009 produced 0.3% economic growth in the UK, the first positive number since the first quarter of 2008. Growth has also returned strongly to the USA, although in the Eurozone growth in the last three months of 2009 was only 0.1%.

Mr Darling still expects the UK economy to grow by 1%-1.5% in 2010, after an overall *contraction* of 3.3% in 2009. That may prove to be optimistic given the cold start the first quarter suffered. For 2011, the Chancellor's prediction of 3%- 3.5% growth remains well above the 2.1% consensus figure. As has frequently been the case, the Chancellor needs a bullish growth assumption to make his projections work. Less growth means less tax revenue and although the 2009 deficit is expected to be £11bn below last December's estimate, it is still £167bn and will only fall to £110bn by 2012/13.

The headline-grabbing moves announced in the Budget were:

- A rise in the stamp duty land tax threshold to £250,000 for first-time buyers for two years from 25 March 2010.
- A permanent rise to 5% in stamp duty land tax for properties valued over £1m, starting on 6 April 2011.
- A doubling of the entrepreneurs' relief lifetime gains limit to £2m from 2010/11.
- No other changes to capital gains tax, despite many rumours.
- A 100% increase in the annual investment allowance to £100,000 from April 2010.
- New incentives to encourage the use of low emission and zero-emission vehicles.
- Confirmation that the replacement legislation to restrict pension tax relief will be in the Finance Bill and take effect from 2011/12.

In this Bulletin we look at the main changes that will affect individuals and businesses and examine some of the related planning issues. If any of these strike a chord, you are strongly recommended to consult your financial adviser.

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*The contents of this Bulletin are based on the proposals put forward by the Chancellor in his Budget speech and explained in documents subsequently published by HMRC and the Treasury. All Budget proposals may be subject to change before the relevant Finance Act is passed (which may not be until after the Election).*

*References to spouse, husband and wife and married couples include references to registered civil partners and civil partnerships.*

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## Personal Income Tax and National Insurance Contributions

The income tax bands and allowances and National Insurance Contributions (NICs) rates for 2010/11 were announced in last December's Pre-Budget Report. The Budget contained no changes, so for the coming tax year:

- There are no increases to allowances or 10%, basic rate or higher rate tax bands from 2009/10. However, for 2010/11 there are two new additions to the income tax structure:
  - the phasing out of personal allowances for high income taxpayers; and
  - the introduction of the 50% income tax band.

Both of these were legislated for in last year's Finance Act.

- The personal allowance will be phased out at the rate of £1 for each £2 of income in excess of £100,000. The definition of income is, broadly speaking, gross taxable income less specified deductions, such as pension contributions and Gift Aid payments. The result of this restriction is that the band of income between £100,000 and £112,950 will be subject to a marginal tax rate of up to 60%.
- The starting point for the new 50% income tax rate (referred to as 'additional rate') is £150,000 of taxable income. For dividends, the corresponding rate is 42.5%. Trusts which accumulate income will also normally be subject to these new rates on income above their standard rate band of up to £1,000. However, where the settlor is liable to tax on income rather than the trustees, from 2010/11 the settlor will be required to pay over to the trustees any difference between their personal tax liability on that income and the trustees' additional rate. Such payments will be disregarded for inheritance tax purposes.
- The basic rate of tax remains at 20% (10% for dividends).
- The lower earnings limit for National Insurance Contributions will rise to £97 a week, broadly in line with the increase in the basic state pension. Other main NIC limits and rates are unchanged.
- For 2010/11 there is also a change in the state second pension scheme (S2P) rules, which will affect some employees contracted out via personal or stakeholder pensions. Those earning above about £32,200 could see their rebate payments fall because of a halving of the S2P accrual rate (and corresponding rebate) above this level.

If you are not contracted out, the S2P benefit you accrue in 2010/11 will be based on earnings between £97 and £770 a week, ie £74 a week below the unchanged full NICs threshold. If your earnings are under £14,100, then for S2P purposes you will be deemed to be earning that amount.

The S2P accrual change is one of a raft of major reforms to state pensions which come into effect on 6 April 2010.

Allowing for the tax and NIC changes, it is clear that high earners will be worse off in 2010/11, but those with incomes of under £100,000 will be unaffected:

Earnings £	2009/10		2010/11		Overall Budget Change*
	Income Tax £	NICs £	Income Tax £	NICs £	
10,000	705	471	705	471	0
15,000	1,705	1,021	1,705	1,021	0
20,000	2,705	1,571	2,705	1,571	0
25,000	3,705	2,121	3,705	2,121	0
30,000	4,705	2,671	4,705	2,671	0
40,000	6,705	3,771	6,705	3,771	0
50,000	9,930	4,259	9,930	4,259	0
75,000	19,930	4,509	19,930	4,509	0
100,000	29,930	4,759	29,930	4,759	0
125,000	39,930	5,009	42,520	5,009	-2,590
150,000	49,930	5,259	52,520	5,259	-2,590
175,000	59,930	5,509	65,020	5,509	-5,090
200,000	69,930	5,759	77,520	5,759	-7,590
250,000	89,930	6,259	102,520	6,259	-12,590

\* Based on an employee under age 65 with a single personal allowance who is contracted in to the State Second Pension. Tax credits are ignored.

The Chancellor announced in the 2009 PBR that from 2011/12 all NIC rates will rise by 1.0%. Thus someone with earnings of over £150,000 in that tax year will only retain £48.00 out of each £100 of earnings above £150,000.

### **Tax credits**

Working tax credits (WTCs) generally rise by 1.5% for 2010/11. There are also rises of up to 2.9% for certain elements of Child Tax Credit. However, the most widely claimed credit, the family element of Child Tax Credit, will again remain at £545, the level at which it was first set in 2003/04. There was also a freezing of the childcare payments and the income threshold (£6,420) above which credits start to be withdrawn, other than for people claiming only Child Tax Credit.

From 6 April 2011, people aged 60 and over will qualify for WTC if they work at least 16 hours a week. Currently those aged 60 and over qualify for WTC if:

- they work 30 hours or more a week;
- they work 16 hours or more a week and they have dependent children, or qualify for the disability element;
- they work 16 hours or more and they are returning to work after being on certain benefits for six months or more (only available to the over 50s)

## Planning Points

From 2012/13 the *child* element of Child Tax Credit will be increased by £4 a week for each child aged one or two. For children under the age of one there is already a baby addition to the *family* element equivalent to £10.50 a week.

### **Company Cars**

The company car benefit scales are subject to a variety of changes for 2010/11:

- There is a 5g/km decrease to 130g/km for the lower threshold (15% for petrol).
- A new band with a lower scale charge (5% for petrol) will apply for cars with CO<sub>2</sub> emissions above 0 g/km but not more than 75g/km. At present the government's own website ([www.vcacarfueldata.org.uk/](http://www.vcacarfueldata.org.uk/)) shows that no such non-electric vehicle exists.
- For cars (and vans) which cannot produce CO<sub>2</sub> emissions – which means electric vehicles at present – there will be no benefit charge for five years from 2010/11.
- The multiplier for calculating car fuel benefit in 2010/11 increases by £1,100 to £18,000 and the flat amount for van fuel benefit rises by £50 to £550.

In 2011/12 a further 5g/km threshold reduction to 125g/km will be made and all the current scale-rate reductions for alternatively-fuelled cars (eg LPG) will be abolished, other than for zero-emission vehicles. The £80,000 upper limit on list price will also disappear.

The following year, 2012/13, will see another 5g/km cut made in the threshold and the scale will be extended downwards. As a result, the 10% petrol car and 13% diesel car factors, which currently 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.

### **HMRC powers and deterrents**

A variety of measures were announced to target errant taxpayers and strengthen HMRC's hand. These included:

- Stricter rules on the disclosure of tax avoidance schemes, including higher penalties for non-compliance. These are due to take effect from autumn 2010.
- Penalties of up to 200% of tax due for taxpayers who, from 1 April 2011, fail to provide a full account of their income tax or capital gains tax liabilities, 'where the failure is linked to an offshore matter'. The maximum 200% penalty only applies if the offshore jurisdiction has not agreed exchange of information with the UK.

- From 6 April 2011 HMRC will be able to require financial security from employers where amounts due under PAYE and NICs are 'seriously at risk'. Similar provisions already exist for VAT.

### ***Turning the tables on the basic personal allowance restriction***

The phasing out of the basic personal allowance once total income exceeds £100,000 is the latest in a long line of tax increases which add complexity to an already over-complicated tax system. The Chancellor could alternatively have chosen a lower starting threshold for the 50% tax rate and left the personal allowance untouched. However, politics would not let him: the 50% threshold would have come too close to £100,000 for comfort. Instead we have a system under which the marginal rate of tax in the £100,000 - £112,950 band of income is 60% - a fifth higher than the new 'additional rate' of 50%.

The corollary is that if your income is in that band, or marginally above it, you may be able to obtain 60% tax relief on some pension contributions, as the example below shows.

<b>60% Tax Relief</b>				
In 2010/11 Bill has income of £110,000, all of which consists of earnings and interest. He is not affected by the special annual allowance rules, so can happily make a £10,000 gross pension contribution. Depending upon whether he makes the pension contribution, his tax bill would be:				
	<b>No Pension Contribution</b>		<b>Pension Contribution</b>	
	£	£	£	£
Gross income	110,000		110,000	
Pension contribution	-		10,000	
Personal allowance	<u>1,475</u>		<u>6,475</u>	
Taxable income	108,525		93,525	
Basic rate tax	37,400 @ 20%	7,480	37,400 @ 20%	7,480
Higher rate tax	71,125 @ 40%	<u>28,450</u>	56,125 @ 40%	<u>22,450</u>
<b>Total tax</b>		<b><u>35,930</u></b>		<b><u>29,930</u></b>
Thus a gross pension contribution of £10,000 will save Bill £6,000 in tax, an effective 60% rate of relief.				

### ***The age allowance trap***

Your entitlement to age allowance depends upon your total income if you are 65 or over by 5 April 2011. You receive the full allowance provided your total income does not exceed £22,900. Above that level your allowance entitlement is reduced by £1 for each £2 of income, although the allowance cannot be reduced below the basic personal allowance. With the basic rate at 20% in 2010/11, the age allowance reduction means that at the margin you could be a 30% taxpayer, paying tax on £2 of income plus a further £1 because of the lost allowance.

A similar rule applies to the husband if you and/or your spouse were born before 6 April 1935 and are therefore eligible for the married couple's age allowance. However, the relief given by this allowance is at a rate of only 10%, so the effective tax loss is at a rate of 25%. Not surprisingly, the married couple's allowance is reduced only *after* all the personal age allowance is lost.

The sharp increase in age allowances over several years before 2010/11 means that bands in which the 25% and 30% tax rates could apply are now surprisingly wide. For a single person or married couple aged under 75, the 30% band now stretches from £22,900 to £28,930, while for the husband of a married couple aged 75 or over, the two bands extend from £22,900 to £37,820.

If you are 65 or over and have a total income above £22,900, you may be able to regain some or all of your age allowance, and thus save tax, by rearranging your investments. This need not mean reducing your spendable income – the key is to reduce your *taxable* income. There are a variety of ways in which a suitable reduction can be achieved, including the use of ISAs and investment bonds.

### ***Turning tax credit claw back to your advantage***

While you may think of tax credit as relevant only for the lower paid, many higher rate taxpayers are eligible for an element of tax credit. Usually this is the family element of Child Tax Credit, worth up to £10.50 a week (£21.00 for a child under age 1), but there may be additional credits, eg the childcare element of Working Tax Credit, which can be worth up to £240 a week.

The calculation of tax credit entitlements is complex, but if you are a higher rate taxpayer there are two important rules to watch:

- The family element of Child Tax Credit is clawed back at 6.67% of family income (broadly taxable income) over £50,000 or, if greater, the level at which all other tax credits are extinguished.
- Tax credits, other than the family element of Child Tax Credit, are clawed back at a rate of 39% in 2010/11.

The combined effect of higher rate tax and tax credit claw back can therefore be 46.67% or 79%. In other words, an extra £1 of taxable income could mean you lose 40p in tax and 39p in tax credit, leaving a net 21p.

The reverse is also true: £1 less of taxable income could imply only 21p less net income. So, for example, if you reduce your taxable income by making a pension contribution, you may be securing £1 of retirement benefit at an effective cost of 21p.

### ***Think ahead to 2011/12***

2011/12 is currently set to see a 1% increase in National Insurance Contribution rates across the board, although there will be an increase in the NICs starting point which means those with incomes under £20,000 are no worse off. If you have a choice of receiving earnings in 2010/11 or 2011/12 then, all other things being equal, opting for this year will save NICs. If you are employed, your employer would also save NICs.

## Capital Gains Tax

The 18% flat rate for capital gains tax (CGT) now looks something of an anomaly when set against a top income tax rate of 50%. There were some rumours that Mr Darling would raise the CGT rate, but he made a point in his speech that he would not do so. However, a rate rise remains a possibility for a future Chancellor. On this occasion there was no increase in the annual exemption, which remains at £10,100 for individuals and up to £5,050 for most trusts.

### ***Entrepreneurs' relief***

There was an unexpected improvement to entrepreneurs' relief, which effectively taxes capital gains on the sale of certain businesses and business-related assets at 10%. The relief was introduced two years ago with a lifetime ceiling of £1m of gains realised after 5 April 2008. From 2010/11 onwards the ceiling is doubled to £2m. Where an individual realised gains of over £1m before 2010/11, there is no retrospective tax reduction, but there will be the benefit of an additional £1m limit going forward.

## Planning Points

### ***18% is better than 20%, 40% or 50%***

Unless you are one of those lucky few who are able to benefit from the 10% savings rate on interest, 18% is the lowest tax rate that you will pay on your investment returns. In 2010/11 it looks even more of a bargain now there is the new 50% top rate of income tax. There is also a £10,100 annual capital gains exemption, which is not tapered away. As if that were not enough, capital gains tax is not subject to the same payments on account rules as income tax: you pay your full capital gains tax on 31 January in the tax year following the one in which the gains arose.

Although the tax tail should never wag the investment dog, the case for favouring growth over income when setting your investment goals is now stronger than ever. There are many anti-avoidance rules which prevent income being transformed into capital gains, but it remains a fact that some financial product structures provide income returns while others produce capital gains even though the underlying investments are the same. Selecting the right structure could therefore more than halve your tax bill.

## ***Use your annual exemption***

Would you waste a tax exemption worth up to £1,818 a year?

That is what your full annual capital gains tax exemption is worth in terms of tax saving. As far as possible it is important to use the exemption each year (and for your spouse to do the same) because, if unused, it cannot be carried forward.

If you do not systematically use your annual exemption, you are more likely to reach a point where some of your gains are subject to tax. Unfortunately you cannot simply crystallise a gain by selling and then repurchasing an investment - so called bed-and-breakfasting. However, there are other ways of achieving similar results:

- *Bed-and-ISA* You can sell an investment, eg shares in an open-ended investment company, and buy it back immediately within an ISA. For 2010/11 the maximum ISA investment is £10,200.
- *Bed-and-SIPP* This is a similar process to bed-and-ISA, but the cash realised is used to make a contribution to a self-invested personal pension (SIPP). The reinvestment is then made within the SIPP. This approach has the added benefit of income tax relief on the contribution and may also offer a higher reinvestment ceiling than an ISA, depending on your earned income and other pension contributions. However, if you have 'relevant income' of £130,000 or over, the rules restricting pension tax relief must be borne in mind (see below).
- *Bed-and spouse* You can sell an investment and your spouse can buy the same investment without falling foul of the rules against bed-and-breakfasting. However, you cannot sell your investment to your spouse – the two transactions must be separate.

## ***Keeping down your CGT bill***

There is a variety of tactics that can be used to limit your exposure to capital gains tax, including:

- Maximising the use of ISAs, where there is no capital gains tax. Do not forget that from 6 April 2008, all existing PEPs became stocks and shares ISAs.
- Using funds of funds rather than individual fund holdings. Fund changes made *within* a fund of funds do not create any immediate gain for the investor.
- Sharing your gains. Transfers between spouses living together are on a no gain/no loss basis, so if your spouse has not fully used their annual capital gains tax exemption and you have, together you could save tax.
- Take advantage of venture capital trusts (VCTs) and enterprise investment schemes (EISs). These are high risk investments, but they are generally free of capital gains tax.

## ***Replace 40% CGT with 18% CGT***

If you paid CGT at a rate of more than 18% on gains made in 2007/08, you could consider using an EIS investment now to claw back the tax you have paid and bring the gains into the 18% tax world.

An investment in an EIS allows you to claim reinvestment relief for any capital gain (*before* taper relief) that you have made in the previous three years. This enables you to reclaim any tax you have paid on the gain or defer any tax that is due. When you sell the EIS shares, the gain you have reinvested is crystallised and becomes chargeable, but at *current* tax rates. So you might be able to turn a former 40% tax liability into an immediate tax repayment and an 18% deferred tax liability. The maximum amount of EIS investment that qualifies for income tax relief is £500,000 in 2010/11, but there is no limit to investment where the claim is only for CGT reinvestment relief.

### ***Mind your losses***

The FTSE 100 index today is still below the level it was in early 2006 and nearly 20% below its end 1999 peak. Many long-term holdings could thus still be standing at a loss, despite the strong rally in the market since March 2009. This means that you cannot afford to ignore the rules on the tax treatment of capital losses as well as the (hopefully) more familiar rules about capital gains. The combined rules contain a trap for the unwary – see the box below.

#### **Beware the Wasted Loss**

If you realise a gain and a loss *in the same tax year*:

- The loss will be set off against the gain, even if the gain is within your annual exemption.
- As a result you could end up wasting the loss.

However, if you carry forward a loss *from a previous tax year*:

- The carried forward loss is only used up to the extent that it reduces your overall gains to the level of your annual exemption.
- The loss is therefore only used when necessary.

The lesson is that you should always take care before realising gains and losses together in a single tax year.

### ***Identification matters***

When the flat rate of CGT was introduced in 2008/09, taper relief was scrapped and with it most of the complex identification rules for share/fund transactions. If you sell a holding in a single company or investment fund, for CGT purposes the disposal is matched:

1. First to acquisitions made on the same day;
2. Second to acquisitions made in the next thirty days (the rule which blocks bed-and-breakfasting); and
3. Thirdly all other acquisitions, taken together as one pool.

The pooling provision means that you no longer identify a sale with a recent purchase – the so-called last in-first out (LIFO) rule has disappeared. This can make quite a difference to the calculation, as the example below shows.

### A Chilly Pool

Helen bought 6,000 shares HSBC in December 2006 for £56,000 – equivalent to 933.33p a share. In March 2009, she took up the HSBC rights issue and bought another 2,500 shares at a cost of £6,350 (254p each - it was a deeply discounted issue!).

With the HSBC share price now around 700p, Helen is thinking of taking some profits on the shares she bought last year. She reckons that if she sells 2,264 shares, she will make enough gain to match her annual exemption, ie:

$$2,264 \times (700\text{p} - 254\text{p}) = \text{£}10,097.$$

Helen's calculation ignores the changes introduced from April 2008. The correct calculation pools together her two share purchases:

$$\text{Total number of shares} = 6,000 + 2,500 = 8,500$$

$$\text{Total cost} = \text{£}56,000 + \text{£}6,350 = \text{£}62,350$$

$$\text{Average cost} = \frac{\text{£}62,350}{8,500} = 733.53\text{p}$$

So the reality is any sale at 700p will be at a *loss* of 33.53p a share.

## Inheritance Tax

The inheritance tax nil rate band was due to rise to £350,000 on 6 April 2010, a measure put in place by Gordon Brown in his final Budget back in 2007. However, in last December's PBR Mr Darling announced that the nil rate band would remain frozen for 2010/11 at £325,000. In his Budget statement he went further and announced that the nil rate band would remain at £325,000 until 5 April 2015. The extra revenue would go towards meeting care costs, according to the Chancellor.

Ironically, Mr Brown's original decision to fix the 2010//11 nil rate band three years early was viewed at the time as a measure to kick the issue of IHT into the post-election long grass. It failed miserably and IHT reappeared as an election issue in autumn 2007, when the Conservatives announced their plans to raise the nil rate band to £1m. This forced the hand of Mr Brown's successor as Chancellor to introduce the transferable nil rate band.

### Planning Points

#### ***Time to review your estate planning***

The introduction of the transferable nil rate band in October 2007 made inheritance tax planning considerably simpler for many married couples. It is now no longer necessary to ensure that your nil rate band is used on first death to minimise IHT liabilities. This reform can result in significantly reduced IHT bills for widows (and widowers), even if their spouse died many years ago.

Not everybody has benefited from the change. If you had already planned (and had the resources) to use the nil rate band on first death, you are no better off as the result of the introduction of transferability. If you are not married, you cannot benefit, other than as a widow/widower.

If you have not reviewed your estate planning and Wills in the last three years, you should do so now. It may be that no change needs to be made to your existing arrangements but, as ever with estate planning, it is better to be safe than sorry. Even though a revised plan may not reduce your IHT bill, it could simplify estate administration by, for example, removing the need to include a complex trust in your Will.

#### ***Regular and out of income....***

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 2008/09, you can make gifts totalling £5,000 covered by the annual exemption in 2009/10.

- *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 exemption, but which could actually count under 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.

### ***Planning, politics and IHT***

The Conservatives have said that they would raise the nil rate band to £1m, although they have not given any indication when they would do so. Mr Darling's decision to freeze the band for four years and hypothecate the extra tax to care costs underlines the political battleground that IHT has become,

IHT raises a little under £2.5bn a year, so any easing of the burden in the short term looks unlikely, even if Mr Osborne is the next Chancellor. From an estate planning viewpoint that means it would be unwise to rely on a £1m nil rate band to solve your estate planning problems. Estate planning for today should be based on *today's* tax structure, albeit with as much flexibility built in as practical to cope with possible changes. For example, life assurance to cover the potential IHT liability on your estate can usually be written on a short-term renewable basis. Choosing this route allows you to continue cover for as long as necessary at a lower immediate premium cost and gives more flexibility than would be the case if you had opted for a whole of life policy.

## Investments

A range of investment tax changes has taken place over the last year. Some have been the result of much consultation and have received little attention.

### ***Individual Savings Accounts (ISAs)***

The most important change on the investment front was the revision of the ISA limits:

- From 6 October 2009, the 2009/10 limit rose to £10,200 (of which up to £5,100 may be in cash), if you are aged 50 or over by the end of the current tax year (ie born before 6 April 1960).
- From 6 April 2010, the age 50 restriction will disappear and the new higher limits will apply for all eligible investors in the new tax year.
- From 2011/12 onwards the investment limits will be increased in line with the RPI. The resultant annual limit will be rounded to the nearer £120, to make the corresponding monthly limits divisible by £10.

As the original ISA investment ceiling was £7,000 in April 1999, the 2010/11 limit is already higher than it would have been if RPI linking had existed from day one (which would have made it about £9,360). ISAs have become a more important investment tool, given the new tighter restrictions on pension provision and 50% income tax.

### ***Offshore funds***

The rules for offshore funds were changed in December 2009, following a long period of consultation. The changes mean that offshore funds which accumulate income rather than pay dividends are no longer automatically subject to income tax on gains. The flip side is that to qualify for the gains being subject to CGT, the accumulated income must be taxed annually.

This reform, alongside changes to offshore fund dividend tax treatment introduced in last year's Budget, has increased the appeal of offshore funds.

### ***Venture Capital Trusts and Enterprise Investment Schemes***

The rules for Venture Capital Trusts (VCTs) will be amended as a result of changes needed to comply with EU State Aid rules. The amendments, to be introduced in the first Finance Bill of the next Parliament, will:

- Change the minimum amount VCTs must hold in eligible shares. 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). The eligible shares minimum holding will more than double to 70%.

- Revise the definition of VCT 'eligible shares' to include shares which may carry certain preferential dividend rights.
- Allow a VCT to be listed on any EU/EEA investment market rather than just be restricted to a UK listing.
- Prevent shares in companies that are 'in difficulty' from qualifying for the purposes of the VCT and Enterprise Investment Scheme (EIS) rules.
- For EISs and VCTs, change the existing requirement that a company must have a qualifying trade carried out wholly or mainly in the UK to one that it need only have a permanent establishment in the UK.

These changes were the subject of a consultation paper issued alongside the 2009 Pre-Budget Report and were expected to come into effect from 6 April 2010. However, the Budget Day press release says that the changes will take effect from Royal Assent of the post-election Finance Bill.

## Planning Points

### *ISAs*

Since 6 April 2008 it has been possible to transfer the cash component of an ISA, including anything from a former TESSA, into the stocks and shares component. When this option was first announced, it was widely viewed as a rather pointless facility, as for most investors the value of the income tax saving from the cash component was greater than any tax savings offered by the stocks and shares component.

The world has changed since this switch facility first became available. We have now had a base rate of just 0.5% for over a year, with little sign that there will be any significant increase soon. Many existing cash ISAs are paying well under 1%, with some paying just 0.1%. There have been press reports suggesting that it is the banks rather than depositors who are gaining from the cash ISA's tax break.

If you are looking for income from your ISA, a switch from cash to the stocks and shares component now has much more appeal. For example, an investment in a sterling corporate bond fund could produce 5% or more, while a UK equity income fund could offer upwards of 4%. 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 could fall as well as rise. Before making the switch – which is irreversible – you should always take independent advice.

## ***Venture Capital Trusts***

The change to VCTs will potentially alter the nature of the VCT market. In the last few months, limited life VCTs have proved popular. These VCTs, which aim to wind up a little after the end of the five year tax relief claw back period, are at the lower end of the VCT risk spectrum – which means they are still high risk, but not quite such high risk. One way they limit risk is to maximise their investment in secured loans rather than equity. Before the Budget some VCT providers said that as the proportion of loans that can be included would fall, limited life VCTs will become more difficult to construct and less readily available.

The fact that the change to minimum equity holdings has been delayed until after the Election suggests there may be an opportunity to invest in limited life VCTs early in 2010/11 and still benefit from the current rules. Wait until the tax year end rush in March 2011 and it will be too late.

## Business Tax

There were no major changes to corporation tax announced in the Budget. The mainstream rate of corporation tax remains at 28% for the 2010 and 2011 financial years, while the small companies' rate benefits from an extra year's freeze at 21% for 2010.

### ***Capital allowances***

The Annual Investment Allowance (AIA), which gives 100% initial relief for investment in plant and machinery, will be doubled to £100,000 from April 2010. With a few minor technical exceptions, there are no other changes to capital allowances. Where a business's chargeable period falls either side of the April increase date (1 April for corporation tax, 6 April for income tax), the AIA for the year is proportioned accordingly. For example, a company with a year end of 31 December would have an AIA for 2010 of:

$$\frac{3}{12} \times £50,000 + \frac{9}{12} \times £100,000 = £87,500$$

### ***Income-shifting***

The controversial subject of 'income-shifting' did not receive a mention in the Budget papers, which suggests that the government might now have decided to leave the issue on the shelf.

### ***Time to pay***

The 'Time to Pay' scheme through which HMRC has assisted over 200,000 businesses to spread their tax payments will be extended for the life of the next Parliament. However, all requests to use the facility more than once will be referred to a specialist team to ensure a 'consistent basis' of treatment. There is some anecdotal evidence that HMRC are now adopting a tougher stance to those asking for a second round of help.

### ***Dividends or Salary ... or Pension Contribution?***

The new additional rate of tax and the tapering of personal allowances have altered the mathematics of the choice between dividends and salary for those with income of £100,000 and more. If you are in a position to choose between the two and not caught by the IR35 personal company rules, a dividend remains the more efficient choice, as the example below shows. However, a pension could avoid all immediate tax and NIC costs, provided the special annual allowance is not an issue.

#### **Still Worth It**

Brian 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 2010 small companies' rate of 21% and Brian has annual income in excess of £43,875, his choice can be summarised thus:

	<b>Bonus £</b>		<b>Dividend £</b>	
	<b>40% tax</b>	<b>50% tax</b>	<b>40% tax</b>	<b>50% tax</b>
Marginal gross profit	50,000	50,000	50,000	50,000
Corporation tax @ 21%	N/A	N/A	(10,500)	(10,500)
Dividend	N/A	N/A	39,500	39,500
Employer's National Insurance contributions £44,326 @ 12.8%	<u>(5,674)</u>	<u>(5,674)</u>	N/A	N/A
Gross bonus	44,326	44,326	N/A	N/A
Brian's NICs £44,326 @ 1%	(443)	(443)	N/A	N/A
Income tax *	<u>(17,730)</u>	<u>(22,163)</u>	<u>( 9,875)</u>	<u>(14,264)</u>
<b>Net benefit to Brian</b>	<b><u>26,153</u></b>	<b><u>21,720</u></b>	<b><u>29,625</u></b>	<b><u>25,236</u></b>

*\*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. The difference between the 40% and 50% numbers explains why so many companies with substantial private shareholders brought forward their dividends payments to before 6 April 2010.

### ***Capital allowances timing issue***

The increase to £100,000 for the 100% Annual Investment Allowance (AIA) in plant and machinery and the reversion to a flat 20% writing down allowance for most excess from April 2010 means the timing of a major investment needs to be considered carefully.

It may be wiser to stage major purchases over two or more years to maximise the uses of the AIA rather than make one large investment. On the other hand, the Conservatives favour reducing capital allowances to pay for a cut in corporation tax rates, so there is potentially also an incentive not to delay.

## Pensions

Last year saw a major change in pension tax law with the arrival of the special annual allowance, restricting higher rate tax relief on some pension contributions. This was announced in the late April Budget and then amended less than eight months later at the time of the Pre-Budget Report. The result has been something of a mess, with the Treasury earlier this year almost simultaneously issuing final regulations and draft Finance Bill clauses which will amend the changes made by the new regulations.

As a reminder, the special annual allowance will only affect you in 2010/11 if:

- Your **'relevant income'** is £130,000 or over in the current tax year or either of the two preceding tax years;  
*and*
- You increase your **'normal regular ongoing pension savings'**  
*and*
- Your **'total pension savings'** during a tax year exceed your **special annual allowance**, which is normally £20,000, but can be up to £30,000.

**'Relevant income'** is defined as your total income less normal deductions (other than the personal allowance) and reliefs (eg trading losses) and Gift Aid, but with any deduction for pension contributions made personally limited to a maximum of £20,000.

**'Normal regular ongoing contributions'** to a pension arrangement are:

*For money purchase schemes, such as personal pensions*

- The total annual amount of your contributions to the arrangement, provided that the contributions were made at least quarterly before 22 April 2009. This deadline is extended to 9 December 2009 if your relevant income was at least £130,000 but less than £150,000 in 2009/10 or either of the two preceding tax years;  
*plus*
- Any increase in your regular contributions that was agreed before 22 April 2009/9 December 2009.

For an individual pension arrangement, such as a personal pension, a 'normal regular ongoing contribution' must be made to the existing (pre-22 April 2009/9 December 2009) arrangement. If you keep the total level of your total regular contributions the same, but pay them to different arrangements, then such contributions count as 'normal regular ongoing contributions' only in limited circumstances.

*For defined benefit arrangements, e.g. final salary pension schemes*

- All your pension savings (which are measured by reference to the change in value of your accrued benefits from one tax year's end to the next). This is subject to the proviso that the way your benefits are calculated under the scheme rules does not change on or after 22 April 2009/9 December 2009, except in certain limited circumstances.

The requirement that money purchase scheme contributions are made quarterly or more frequently means that no account is taken of annual payments in determining regular contributions. However, they (and one-off lump sums) can impact on the level of the special annual allowance.

**'Total pension savings'** are all of your pension savings (from whatever source) that receive UK tax relief, including employer contributions. The pension savings value placed on your benefit accrual under a final salary scheme is 10 times the increase in pension plus any increase in a separate cash lump sum. For example, an extra £5,000 pension accrual is deemed to be £50,000 of pension savings.

**'Special annual allowance'** is the greater of:

- £20,000  
and
- The average over 2006/07, 2007/08 and 2008/09 of any infrequent (ie less than quarterly) money purchase contributions, subject to a maximum of £30,000.

The special annual allowance is therefore a minimum of £20,000 and a maximum of £30,000.

If you are caught by the special annual allowance rules, then:

- You will receive full tax relief on your 'normal regular ongoing contributions';  
*but*
- Any *additional* pension contributions (from whatever source) or the value of any *additional* benefit accrual will effectively be restricted to basic rate relief to the extent that your 'total pension savings' in the tax year exceed the greater of your special annual allowance and your 'normal regular ongoing contributions'. This means a claw back of 20% tax relief for 2009/10 contributions and between 20% and 30% for 2010/11 contributions, depending upon your level of income.

## The Special Annual Allowance Charge in Practice

### *High income, no special annual allowance charge*

Ann has gross income of £138,000 in 2010/11 and made an individual pension contribution of £10,000, to which her employer added another £15,000. Her gross income in earlier years was under £130,000. Although her gross income exceeds the £130,000 threshold in 2010/11, her 'relevant income' is under £130,000 after deduction of her £10,000 pension contribution, so Ann is not subject to the special annual allowance tax charge.

### *High income, special annual allowance charge*

David has 'relevant income' of £145,000 in 2010/11 and has a self-invested personal pension to which total pension contributions of £40,000 were made by himself and his employer. The contributions were David's regular monthly contribution of £2,000 (as in the previous four years) and a single employer payment of £16,000. In the previous four years the employer had made one-off contributions of no more than £15,000 a year. David's 'relevant income' exceeds the £130,000 threshold and his special annual allowance is £20,000. David's 'total pension savings' thus exceed his special annual allowance. His 'normal regular ongoing contributions' of £24,000 are not subject to any charge, but the additional employer contribution of £16,000 will be subject to a special annual allowance tax charge of £3,200 (£16,000 x 20%). David will pay this via his 2010/11 self assessment tax return on 31 January 2012.

### *High income, special annual allowance charge*

Eric has 'relevant income' of £250,000 in 2010/11, of which only £22,000 is earned income. He has a personal pension to which he has regularly contributed £500 a month. In 2010/11 he makes an additional contribution to the plan of £26,000. This is his first additional contribution since 2005/06. Eric's income exceeds the £130,000 threshold. His special annual allowance is £20,000, as he made no one-off payments in 2006/07-2008/09. Therefore his 'total pension savings' are more than his special annual allowance. His 'normal regular ongoing contributions' of £6,000 are not subject to the special annual allowance charge. However, the additional single contribution brings his 'total pension savings' up to £32,000 and £12,000 of this (£26,000 + £6,000 - £20,000) will be subject to a special annual allowance tax charge of £3,600 (£12,000 x 30%). If Eric had limited his additional contribution to £14,000 he would have avoided the tax charge.

The complex special annual allowance rules will finish at the end of 2010/11, to be replaced by new measures, to be legislated for in the pre-election Finance Bill. A consultation document issued last year pointed to the 2011/12 regime being harsher and this has been confirmed in a paper issued alongside the Budget. The present rules protect existing regular contributions and allow full tax relief for at least £20,000 of contributions each year whereas the new regime will scale back relief on *all* contributions if you fall within it. This will be the case if you are either:

- An employee member of a registered pension scheme, with:
  - total annual income of £130,000 or over before deduction or relief for pension contributions and charitable donations; and

## Planning Points

- your income (before deduction or relief for pension contributions and charitable donations) together with the value of any employer pension contributions is £150,000 or over.  
*or*
- A contributing member of a registered pension scheme and have a total income, before deduction or relief for your pension contributions and charitable donations, of £150,000 or over.

In either case, the tax relief on pension contributions made by you or on your behalf will effectively be restricted above the £150,000 threshold through the levy of a 'recovery charge'. The charge will taper relief to basic rate only at £180,000 or more.

If you are a member of a defined benefit (final salary) pension scheme, then the notional value of the contributions made to the scheme will be calculated using factors based on your age and your scheme's normal retirement date. In many cases these factors are likely to produce higher amounts than the current special annual allowance rules, which use a single (and rather crude) £10 per £1 benefit factor.

### Taper Away

John has income before pension contributions and gift aid payments of £135,000 in 2012/13. He is a member of a non-contributory defined benefit pension scheme and his prospective pension benefits increase during the tax year by £2,000. As he is relatively close to the scheme's retirement age of 60, let us assume that the valuation factor for his pension increase is 15:1, implying a notional contribution of £30,000. This brings his income and pension contribution total to £165,000.

The tax relief he is entitled to on his employer's contributions is therefore limited to:

$$20\% + \frac{(\pounds 180,000 - \pounds 165,000)}{(\pounds 180,000 - \pounds 150,000)} \times 30\% = 35\%$$

As a result John will have to pay a recovery charge of:

$$\begin{aligned} (\pounds 150,000 - \pounds 135,000) @ (40\% - 35\%) &= \pounds 750 \\ (\pounds 165,000 - \pounds 150,000) @ (50\% - 35\%) &= \pounds 2,250 \\ &\underline{\pounds 3,000} \end{aligned}$$

He will have to pay this tax personally – it cannot be deducted from his pension scheme unless the charge is over £15,000.

## ***Beating the Special Annual Allowance Charge***

The special annual allowance charge can never apply if your 'relevant income' (see above) for the current and two preceding tax years is under £130,000. If your relevant income is below the £130,000 threshold for 2008/09 and 2009/10, then it could pay you to keep your 'relevant income' down in 2010/11 if you want to make substantial pension contributions. Stay below the £130,000 threshold and there is no risk of losing higher rate tax relief.

There are a number of ways you can limit your 'relevant income', for example:

- Personally making pension contributions of up to £20,000. These can be deducted when calculating relevant income, so can be useful if you are on the margins of being caught.
- Transferring income-generating assets to your spouse. Such transfers would be beneficial, even if you both pay higher rate tax. They may even help you reclaim your personal allowance if your income exceeds £100,000.
- Restructuring investments to produce less taxable income.
- Making Gift Aid contributions.
- If you are self-employed, taking advantage of the £100,000 annual investment allowance to buy plant and machinery, possibly bringing forward planned investments from later years.

## APPENDIX – TAX FACTS AND FIGURES AND NICs

### MAIN INCOME TAX ALLOWANCES AND RELIEFS

	2009/10	2010/11
	£	£
Personal allowance – standard	6,475	6,475
- Age 65 – 74	9,490	9,490
- Age 75 and over	9,640	9,640
Personal allowance reduced if total income exceeds ∞	N/A	100,000
Married couple's allowance – minimum amount*	2,670	2,670
- Age 75 and over*	6,965	6,965
Age-related allowances reduced if total income exceeds ¶	22,900	22,900
Maintenance to former spouse □	2,670	2,670
Employment termination lump sum limit	30,000	30,000

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

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

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

¶ For 2009/10 and 2010/11 the reduction is £1 for every £2 additional income over £22,900. Standard allowance(s) **only** are available if total income exceeds:-

	2009/10	2010/11
	£	£
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	37,820

## INCOME TAX RATES

	2009/10	2010/11
	£	£
Starting rate on savings income- 10%	1 – 2,440	1 – 2,440
Basic rate	20%	20%
Tax on first £37,400†	7,480	7,480
Higher rate - 40%	Over 37,400	37,401-150,000
Tax on first £150,000†	52,520	52,520
Additional rate – 50%	N/A	Over 150,000
Discretionary and accumulation trusts (except dividends) °	40%	50%
Discretionary and accumulation trusts (dividends) °	32.5%	42.5%
Ordinary rate on dividends	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	N/A	42.5%

† Assumes 10% band not available. £7,236 on first £37,400 and £52,276 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

1. The list price at the time the car was first registered plus the price of extras.
2. Where the "price" exceeds £80,000, the "price" used is restricted to £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 CO<sub>2</sub> emissions.**

*For petrol cars with an approved CO<sub>2</sub> emission figure.*

CO <sub>2</sub> g/km	% of price subject to tax		CO <sub>2</sub> g/km	% of price subject to tax		CO <sub>2</sub> g/km	% of price subject to tax	
	09-10	10-11		09-10	10/11		09-10	10-11
75 or less	10	5	160-4	20	21	200-4	28	29
76-120	10	10	165-9	21	22	205-9	29	30
121-134	15	15	170-4	22	23	210-4	30	31
135-9	15	16	175-9	23	24	215-9	31	32
140-4	16	17	180-4	24	25	220-4	32	33
145-9	17	18	185-9	25	26	225-9	33	34
150-4	18	19	190-4	26	27	230-4	34	35
155-9	19	20	195-9	27	28	235+	35	35

## Notes

1. The exact CO<sub>2</sub> emissions figure should be rounded down to the nearest 5 g/km for levels of 125g/km or more.
2. For diesels not meeting Euro IV emissions standards or registered after 31 December 2005, add 3%, subject to maximum charge of 35%.
3. Hybrid petrol/electric cars are subject to a 3% reduction, with a minimum 10% charge.
4. 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. For electric only cars, a 9% charge applies in 2009/10 only. For 2010/11 there is no charge for any car which cannot produce CO<sub>2</sub>.
6. Maximum list price is £80,000.

*For cars with no approved CO<sub>2</sub> emissions figure, the charge is based on engine size.*

Engine Size (cc)	Percentage of car's price charged to tax
0 – 1,400	15
1,401 – 2,000	25
2,001 and more	35

## CAR FUEL BENEFITS

For cars with an approved CO<sub>2</sub> emission figure, the benefit is based on a flat amount of £18,000 (£16,900 for 2009/10). 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 £18,000. The percentage figures allow for a diesel fuel surcharge. For example, in 2010/11 a petrol car emitting 160 g/km would give rise to a fuel benefit of 21% of £18,000 = £3,780.

## VALUE ADDED TAX

From	1 Dec 2008	1 May 2009	1 Jan 2010	1 April 2010
Standard rate	15.0%	15.0%	17.5%	17.5%
Reduced rate (eg domestic fuel)	5.0%	5.0%	5.0%	5.0%
Annual turnover limit for registration	£67,000	£68,000	£68,000	£70,000
Deregistration threshold	£65,000	£66,000	£66,000	£68,000
Flat rate scheme turnover limit	£150,000	£150,000	£150,000	£150,000
Cash accounting and annual accounting limits	£1,350,000	£1,350,000	£1,350,000	£1,350,000

## INHERITANCE TAX

	Cumulative chargeable transfers [gross]		tax rate on death %	tax rate in lifetime* %
	2009/10 £	2010/11 £		
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 legal 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

	2009/10 £	2010/11 £
Annual exemption	10,100*	10,100*
Principal private residence exemption	No Limit	No Limit
Chattels exemption	£6,000	£6,000
Entrepreneurs' relief	<sup>4</sup> / <sub>9</sub> ths of business gain Lifetime limit £1,000,000	<sup>4</sup> / <sub>9</sub> ths of business gain Lifetime limit £2,000,000

\* Reduced by at least 50% for most trusts.

### Rates of tax

Individuals: 18%

Trusts and personal representatives: 18%

## STAMP DUTY AND STAMP DUTY LAND TAX

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	Over £500,000	4%
<i>*£250,000 for first-time buyers, £150,000 for property in disadvantaged areas</i>		
<b>Stamp Duty (including SDRT):</b> stocks and marketable securities		0.5%
No charge unless the duty exceeds £5		

## CORPORATION TAX

	Year Ending 31 March	
	2010	2011
Main Rate	28%	28%
Small Companies' Rate	21%	21%
Small Companies' Limit	£300,000	£300,000
Upper Marginal Level	£1,500,000	£1,500,000
Effective Marginal Rate	29.75%	29.75%

## TAX PRIVILEGED INVESTMENTS [MAXIMUM INVESTMENT]

	2009/10 £	2010/11 £
<b>ISA</b>		
Overall per tax year: Born after 5 April 1960	7,200	10,200
Born before 6 April 1960	10,200	10,200
Cash component: Born after 5 April 1960	3,600	5,100
Born before 6 April 1960	5,100	5,100
Stocks and shares component: Born after 5 April 1960	Balance up to £7,200	Balance up to £10,200
Born before 6 April 1960	Balance up to £10,200	Balance up to £10,200
Maximum in cash for 16 and 17 year olds	3,600	5,100
<b>ENTERPRISE INVESTMENT SCHEME</b> (20% income tax relief)	500,000*	500,000*
Maximum carry back to previous tax year for income tax relief	£500,000	£500,000
<b>VENTURE CAPITAL TRUST</b> (30% income tax relief)	200,000	200,000

\* No limit for CGT reinvestment relief.

## PENSIONS

	2009/10	2010/11
Lifetime allowance*	£1,750,000	£1,800,000
Lifetime allowance charge:		
Excess drawn as cash		55% of excess
Excess drawn as income		25% of excess
Annual allowance	£245,000	£255,000
Annual allowance charge		40% of excess
Special annual allowance		£20,000 - £30,000
Special annual allowance charge	20%	20%-30%*
Lifetime allowance charge:		
Excess drawn as cash		55% of excess
Excess drawn as income		25% of excess
Max. 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

## WORKING AND CHILD TAX CREDITS

The main features of the tax credits are:

### 1. Child tax credit

- Eligibility is assessed on household income.
- The claimant must be responsible for one or more children aged 16 or under, or at least one child under age 20 and in full-time non-advanced education.
- The family element of the tax credit is £545 per annum and is doubled in the first year of a child's life.
- The child element is £2,300 per annum for each child.
- The disabled child element is £2,715 per annum (where relevant).
- HMRC will pay the CTC to the main carer for the child.

### 2. Working tax credit

- The claimant, or one of the joint claimants, must be in qualifying remunerative work.
- The amount of WTC will be based on circumstances which are primarily the number of hours worked and the income of the claimant (or joint income for a couple).

- The age and working hours conditions are not straightforward. Generally, the minimum weekly working requirement will be:
  - a) 16 hours for families with children and workers with a disability. The claimant can be aged 16 or over.
  - b) 30 hours for workers with no children and no disability. The claimant has to be aged 25 or over.
- The basic element of the tax credit is £1,920 per annum.
- The couple or lone parent element is £1,890 per annum.
- A 30 hour element of £790 per annum is payable where the claimant or one of the claimants works at least 30 hours a week (couples with children may aggregate their hours for this purpose).
- A disabled worker element of £2,570 per annum or more is available where the claimant, or his or her partner, has a disability.
- There is 50-plus element and a childcare element, worth 80% of care costs, subject to an eligible maximum of £300.
- For employees, payment will normally be made by their employer with their wages (except the childcare element which is paid direct to the main carer). For the self-employed, payment is made directly by HMRC.

### **3. Calculating the credits**

It is necessary first to total the various elements available to arrive at the maximum available amount of tax credits before any reduction on account of income. All elements can be reduced at the rate of 39% (ie 39p per £1 of income), except the family element of CTC which is reduced at a rate of 6.67%.

## NATIONAL INSURANCE CONTRIBUTIONS FOR TAX YEAR 2010/11

### Definitions

#### Lower Earnings Limit (LEL)

the minimum level of earnings at which an employee will qualify for a State Second Pension (S2P). This is also the lower level of earnings which will be used in determining any NI Rebate.

For tax year 2010/11 the Lower Earnings Limit is £97 per week.

#### Upper Accrual Point (UAP)

the upper level of earnings on which an employee's S2P entitlement is based (or on which any NI Rebate is determined). For tax year 2010/11 and subsequent years the Upper Accrual Point is fixed at £770 per week.

#### Upper Earnings Limit (UEL)

the upper level of earnings on which full NICs are charged. The reduced 1% NI contributions will apply to earnings above this level. For tax year 2010/11 the Upper Earnings Limit is £844 per week.

#### NI Rebate

the Rebate of employer's and employee's National Insurance contributions that is available where an employee is contracted out of S2P. This is based on the employee's earnings between the Lower Earnings Limit (LEL) and Upper Accrual Point (UAP).

The Rebate will vary depending on the type of pensions vehicle used to contract out of S2P. Where this is a final salary occupational scheme this will be 3.7% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP.

Where this is a money purchase occupational scheme or contracted out money purchase stakeholder pension scheme the Rebate will be 1.4% (employer) and 1.6% (employee) in respect of the employee's earnings between the LEL and UAP. The aggregate Rebate will be determined on an age related basis (varying from 3.0% to 7.4%) and any further Rebate due (ie over and above the amounts mentioned earlier in this paragraph) will be paid by the HMRC NICO to the scheme after the end of the tax year.

Where this is a personal pension or stakeholder scheme National Insurance contributions will be paid at the contracted in rate and the Rebate, which will be determined on an age related basis, will be paid directly to the member's personal pension by the HMRC NICO after the end of the tax year to which it relates.

The Rebates will also vary in accordance with an individual's earnings, in each of the following two bands:

<u>Band</u>	<u>Age related Rebate</u>
1 (£5,044 - £14,100)	9.4% - 14.8%
2 (£14,101 - £40,040)	2.35% - 3.7%

Primary Threshold the level of earnings at which employees start to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week.

Secondary Threshold the level of an employee's earnings at which the employer starts to pay Class 1 National Insurance contributions.

For tax year 2010/11 this is £110 per week.

### **Employees - Class 1**

Contracted in Nil on first £110 per week (i.e. up to Primary Threshold)  
11% of £110.01 per week to £844 per week.

1% on earnings above £844 per week.

Contracted out via occupational scheme Nil on first £110 per week (i.e. up to Primary Threshold)

9.4% of £110.01 per week to £770 per week

11% of £770.01 per week to £844 per week.

1% on earnings above £844 per week.

The employee's NI Rebate is still payable in respect of the employee's earnings between the LEL and UAP including those in excess of the LEL and up to and including the Primary Threshold. In the first instance, the Rebate reduces the National Insurance contributions payable by the employee. However, where the National Insurance contribution payable by the employee is reduced to nil, the excess Rebate will be available for the employer to set against his overall National Insurance contribution bill.

Married Women and Widows Reduced Rate 4.85% of £110.01 to £844 per week.

1% on earnings above £844 per week.

### **Employer - Class 1 Contributions**

<u>Weekly Earnings</u>	<u>Contracted In</u>	<u>Contracted Out</u>	
		COSR	COMP**
	%	%	%
On first £110	Nil	Nil	Nil
£110.01-£770	12.8	9.1	11.4
Over £770	12.8	12.8	12.8

