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Pre-Budget Report December 2009

Personal tax highlights

9 December 2009

Over the last few days the speculation over the contents of the 2009 Pre-Budget Report has reached fever-pitch, with talk of increases in capital gains tax, VAT and the abolition of inheritance tax reliefs giving way to the proposed 'supertax' on bankers' bonuses. In the end, the supertax has proved to be the main story, but it will apply much more widely than had been contemplated by even the most far-sighted observers (including the FSA). It seems the entire financial services sector will bear the brunt of paying for the recession.

While the headlines will focus on bankers there is good and bad news for other employees, with tax relief on subsidised workplace canteens being withdrawn, but perhaps this will be an opportunity for workers to grab a sandwich and spend their lunch breaks at their local bingo hall, where Bingo Duty will be cut to 20% next year.

Bank payroll tax – sweeping new bonus supertax legislation

The Chancellor announced today a sweeping new 50% supertax to be applied to banker's bonuses, with immediate effect. In political terms the legislation was presented as discouraging excessive risk taking within banks, but on examination it goes much further than this and applies not just to banks but to a lot of other financial institutions are well. As drafted, the proposed legislation will catch family offices, UK investment managers of hedge funds, private equity funds and many more, not just the banks who received financial support (directly or indirectly) from the UK taxpayer. It is understood this is not necessarily the Treasury's intention and it remains to be seen whether the scope of the legislation will be restricted and targeted at just those banks. This potential confusion is unwelcome, and it is hoped it will be reviewed properly by Parliament, particularly given the potentially wide impact of this measure.

The supertax has initially been introduced for a limited period to 6 April 2010, although the Government may consider extending the period for which the charge applies until the Financial Services Bill comes into effect. Of course bonuses deferred until after 5 April 2010 will be subject to the 50% income tax rate which will apply to high earners.

Institutional level

The tax applies to all bonus awards over £25,000 and will be levied at the bank level. In addition, the employee will still be subject to income tax on the bonus after the 50% new supertax has been levied. In practice therefore, if a bonus of £200,000 is declared, £175,000 will be subject to the supertax. The remaining £112,500 will be subject to income tax at 40% and national insurance at 1%, leaving the employee with net bonus of £66,375, which means an effective rate of 67% including employee national insurance. This will apply irrespective of whether the employee is UK resident and domiciled or not.

Share awards

Surprisingly, all share awards other than two narrow categories of approved schemes will be caught by the supertax. It has previously been understood that share awards were to be encouraged as they provide long term reward and encourage a more cautious approach, so it is difficult to reconcile this with the inclusion of share awards within the supertax net.

Anti-avoidance and deferral

The supertax comes equipped with a raft of anti-avoidance measures, which aim to ensure structuring around it will not be straightforward. It seems that all loans which may be disguised bonuses will be caught, and simply deferring the payment of a bonus until after April 2010 where the award has been decided on prior to then will not escape the tax.

Also, it seems that most discretionary bonuses which have already been decided on but not yet paid will be caught, as will all discretionary bonuses, even comprising a mixture of cash and shares, which are decided on before 6 April.

It remains to be seen whether a number of banks will simply choose to declare no bonuses until after 5 April, (although there remains the risk of the supertax applying beyond then) and their employees will pay tax at the higher 50% rate when they receive them after 5 April.

Reporting

All financial institutions subject to the so called bank payroll tax will have to report all bonuses over £25,000 awarded between 8 December 2009 and 6 April 2010, irrespective of whether they consider the supertax actually applies to them. In addition, records will have to be maintained of all bonuses over £25,000 awarded during the supertax period, and failure to do so or to submit the required returns will result in penalties being imposed. This means it is absolutely crucial that the scope of the tax is made abundantly clear, and that financial institutions to which it may apply are aware of their obligations.

Code of Practice on Taxation for Banks

In addition, to the supertax on bonuses, a voluntary Code of Practice on Taxation for Banks was published today. This aims to establish the way in which banks and HMRC should work together, and includes the idea that banks should comply with the spirit as well as the letter of the law. The Code of Practice indicates that, in order to comply with it, banks will need to consider 'whether the tax results of a transaction are contrary to the intentions of the Parliament which introduced or amended the legislation'.

Particularly, where acting as principal, banks should not structure a transaction where the tax results are not consistent with the economic results, unless statutorily encouraged, and they should not promote arrangements when acting as intermediary unless they believe that the tax result of the arrangements are not contrary to what Parliament intended. However, the obligation on banks to initiate dialogue with HMRC has been replaced with a voluntary regime under which banks are encouraged to discus with HMRC any proposed arrangements which concern the bank or its clients which in the 'reasonable belief' of the bank achieve aims which are contrary to the intentions of Parliament. The test for this is whether the bank believes that the tax result could be considered as 'too good to be true'. This is expressed to be a 'common sense' test!

This means banks will have to make potentially difficult decisions, and also raises some interesting questions as to how one should interpret the intention of Parliament in tax planning situations.

Other tax changes

The main surprise in the Pre-Budget Report was the lack of tax increases, with income, capital gains and inheritance tax rates all remaining unchanged and VAT only reverting to 17.5% rather than the 19% or 20% that had been widely anticipated. However, there have been some important changes, particularly to tax thresholds.

Income tax

Income tax rates remain unchanged. However, the thresholds at which the higher rates apply are also frozen, meaning that with wage inflation, more taxpayers will pay higher rates of tax.

National Insurance Contributions ('NICs')

The most dramatic changes to NICs are saved until after the General Election. From 6 April 2011, NICs will be increased by a further 0.5% (in addition to the initial 0.5% increase proposed in the 2008 Pre-Budget Report) and will affect all employers, employees and the self-employed. The NIC rates for Class 1 and Class 4 NICs will be 12% and 9% respectively, the Class 1 employer rate will be 13.8%. The increased rate will also apply to Class 1A and Class 1B contributions and the additional rate of Class 1 and Class 4 NICs will be 2%.

Pensions

The Finance Act 2009 introduced a special tax charge on those people with incomes over £150,000 whose annual pension contributions exceeded the special annual allowance of £20,000 (or in some cases £30,000) who varied their normal pattern of contributions. From today, the tax charge will also apply to those with incomes above £130,000 who make additional pension savings above their regular pattern of pension savings. For those people with incomes over £150,000, the £150,000 income definition will include the value of any employer pension contributions.

The special annual allowance and the associated tax charge apply to total contributions made by the individual, their employer and any third party. Where a person's regular pension savings are below the special annual allowance, the tax charge on any additional savings will only apply to the excess over the special annual allowance. The new rules will not affect tax relief on contributions for those people with incomes below £130,000 (before the inclusion of contributions by employers).

From 6 April 2010, the tax charge will be set at the 'appropriate rate', which will be determined by the rate of tax relief given on pension savings above the individual's special annual allowance. This will effectively restrict tax relief on the excess amount to the basic rate (20%).

From 6 April 2010, where a registered pension scheme repays tax-relieved contributions to a member who has had less than 2 years service, tax will be deducted from the refund at a rate of 20 % on the first £20,000 and at 50% on the remainder. A 50% tax charge will also be payable by an entity, which is not an individual, on receipt of certain benefits received from Employer-Financed Retirement Benefits Schemes.

Inheritance tax

There were minimal changes to inheritance tax. However, the proposed increase in the nil rate band amount from £325,000 to £350,000 next April has been shelved.

Anti-avoidance rules will also be introduced to prevent structures designed to reduce the value of assets transferred to trusts that would be subject to an up front 20% inheritance tax charge.

Index linked gilt-edged securities

Rules to counter tax avoidance using index linked gilt-edged securities will be introduced to close a tax loophole for companies where such securities are linked to the RPI.

Furnished holiday lettings

As announced in the Budget earlier this year, from 6 April 2010, the furnished holiday lettings rules will be withdrawn.

Disclosure of tax avoidance schemes – Stamp Duty Land Tax

With effect from no later than 6 April 2010, the obligation to disclose SDLT avoidance schemes (which already applies to commercial property) is to be extended to residential properties worth at least £1 million. In addition there will be a new reporting requirement for users of such schemes, as well as promoters (as is currently the case).

Further consultations

A number of consultation papers were issued with the Pre-Budget Report today, the highlights are below.

Offshore tax evasion

Building on from the 'New Disclosure Opportunity' and the 'Liechtenstein Disclosure Facility' a wide-ranging consultation paper on tackling offshore tax evasion has been released. The main points include:

- Greater penalties for non-compliance ranging from 20% for an unprompted disclosure, 35% where the disclosure is prompted, 70% when there is no disclosure and up to 100% where funds were actively concealed offshore to apply from 6 April 2011.
- A requirement for UK taxpayers (other than non-domiciliaries on the remittance basis) to notify HMRC of the existence of offshore bank accounts in jurisdictions without automatic exchange or information treaties with the UK. This notification requirement would be separate from any tax return obligations and would be made when an account is opened or reached a certain balance. Daily penalties will apply for failing to comply.
- The proposals for trusts established by UK resident settlors from the 2007 PBR are also resurrected. HMRC consult on whether the existing information obligations in relation to non-resident trusts should be extended. They also ask whether UK resident settlors should have an obligation to notify HMRC of transfers of value to offshore trusts or subsidiary companies. However no firm proposals are made.

Disclosure of tax-avoidance schemes

A number of changes to the Disclosure of Tax Avoidance Scheme rules are proposed to ensure that they are 'fit for purpose', including:

- bringing forward the point at which schemes need to be disclosed;
- including 'introducers' within the requirement to disclose;
- increasing the penalties for failing to disclose; and

- revising the 'hallmarks' that are used to identify schemes that need to be disclosed to cover, in particular, those:
  - which seek to avoid tax in relation to employment income;
  - which seek to gain a tax advantage by turning income into capital; and
  - where a tax advantage relies on a transaction involving a territory on an OECD list o uncooperative tax jurisdictions.

Further information

For further information in relation to anything covered by this Stop Press, please speak to your primary contact at Withers, or to:

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