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What will the Emergency Budget bring?

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As the Coalition Government puts the final touches to its Emergency Budget we examine the prospects for changes in the UK tax system to be announced next week.

Capital gains tax

Headline rates

An increase in the headline rate of capital gains tax from the current rate of 18% has been widely trailed. However, we do not expect CGT rates to match the top income tax rate of 50%, a rate of 35% to 40% would seem more likely. We also anticipate that any change will only be effective from 6 April 2011, avoiding the need for complex transitional provisions (that would be needed if there were to be an immediate increase) and also allowing taxpayers to dispose of assets before the rate change creating a one-off boost to revenues (similar to that in 2007/08).

Thresholds

Further speculation has centred on a reduction in the annual exempt amount of £10,100. This may well be one Lib-Dem initiative too far for the Conservatives, although matching exempt amounts for capital gains and income taxes (with the income tax threshold set to rise) may be a possibility.

Taper relief

There has been more recent speculation has been around the possibility of reviving Gordon Brown's taper relief mechanism that rewarded long term holders of assets with lower rates rather than short term 'speculators' as a way of watering down the effect of a high headline rate.

Reliefs for entrepreneurs

To alleviate the effects of an increased headline rate of tax, wider exemptions are likely to be made available for a reduced rate of CGT, possibly the 10% rate that currently applies for Entrepreneur's Relief and possibly adopting the old taper relief definition of a business asset. Employees owning shares are likely to come within the new definition, but given the Lib-Dem antipathy to second homes, extending it to buy-to-let investments is probably a step too far.

Principal private residence relief

The ability to change the designation of a main residence for capital gains tax purposes and avoid tax on the sale of a property came into sharp focus during the MPs' expenses scandal (Hazel Blears being a noted exponent). Again with the Government looking to focus the application of CGT, this ability to designate and redesignate which of a number of properties should be exempt at any time may well be restricted and taxpayers with the ability to elect between properties should do so now.

VAT

Given the level of the deficit, significant additional tax revenues will be required. With income tax and VAT raising the greatest revenues and, income tax thresholds being slated to increase, it seems almost certain that VAT will be increased, we expect to 20% (or close to), with an announcement being made on Budget day and implementation likely before Christmas.

Non-doms

It has already been announced that there will be a review of the taxation of non-domiciled individuals, with the process likely to be announced on Budget day rather than an outcome. However we do expect substantial changes to result, although given that only about 4,300 people are paying the new £30,000
charge, raising a total of £130 million, these changes may be politically rather than fiscally motivated.

Inheritance tax

The Conservatives would like to increase the nil rate band from £325,000 to £1 million, but this is likely to be too bitter a pill for the Lib-Dems to swallow now and so remains unlikely in the short-term.

Corporation tax

The Conservatives want to reduce the top rate of corporation tax to 25% from 28%. That is likely to be too much of a cut for the Emergency Budget, but we may well see the first in a programme of graduated cuts over the next few years. Unlike CGT, corporation tax is not based on tax years, so this could be an
immediate reduction.

Pensions

Higher earners should expect further restrictions on higher rate relief for pension contributions as the government looks to cut down on existing reliefs.

Gift Aid

Recently there has been speculation that, as part of a crackdown on tax reliefs, gift aid may be restricted for higher rate taxpayers. However, with the Culture Secretary committing the Government to strengthening Gift Aid and looking to major philanthropists to fill the gap left by funding cuts to the arts, and, measures that make giving to charity more expensive would seem very unlikely. In the longer term it looks likely that there will be some reform to the unnecessarily complex gift aid and substantial donor rules and the Emergency Budget may give the first hints as to how this may be manifested.

Cigarettes and alcohol

As Liam Gallagher sang “all I need are cigarettes and alcohol” but, even the pleasure of drowning their sorrows may be denied to taxpayers, or at least made more expensive, with increases in duty being mooted. However the Coalition may be mindful of the backlash generated by the announcement of a 10p increase in the tax on cider in the last Budget and may decide that this is an austerity measure too far.

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