Emergency Budget 2010 — personal tax highlights

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Flanked by Nick Clegg and Danny Alexander, George Osborne took to the Dispatch Box today to deliver the Coalition's 'austerity budget'. Heralding a new era of responsibility, freedom and fairness, the Chancellor delivered on his promise to focus on spending cuts rather than tax increases, with the only significant tax raising measures being the widely anticipated increases in capital gains tax and VAT and the introduction of a new levy on banks.

Tax increases aside, one of the most significant announcements today was a consultation on future tax policy changes, seeking to make them more considered and transparent. The impact of this in creating an environment of stability and certainty may be the most significant legacy of this Budget.

Capital gains tax

A new top rate of 28%

That oft repeated quote that 'I pay less tax than my cleaner' came back to haunt entrepreneurs and investors today, with the widely anticipated increases in capital gains tax being announced. From midnight tonight, the capital gains tax rate for taxpayers whose income and gains exceed £43,875 (the higher rate threshold) will increase to 28%. While still a substantial increase, this is considerably lower than the 40% or 50% rates that had been mooted before the Budget.

Trustees and personal representatives will be subject to the top rate of 28% irrespective of the level of their income or gains.

Immediate application

The greater shock was perhaps that the increase will take effect for disposals made on or after 23 June 2010. An increase in direct tax rates in the middle of a tax year is unprecedented, but perhaps emphasises the 'emergency' nature of the Budget.

However, the nature of a mid tax year change in rates will present a considerable challenge to the draftsmen. There will need to be transitional rules for the apportionment of losses, the annual exempt amount and deferral reliefs (for instance where investments are made in EIS or VCTs) where a taxpayer has pre and post 23 June 2010 gains. They will also need to deal with the myriad tax rules that simply refer to gains being deemed to accrue 'in a tax year' rather than on a particular date (such as remittances made by non-doms and charges to beneficiaries on the distribution of gains from offshore trusts).

Extension of Entrepreneurs' Relief

At the same time the Chancellor extended the availability of entrepreneurs' relief to the first £5 million of gains. He rejected all proposals for taper or indexation reliefs (which characterised capital gains tax before 2008), as the 'complexity and administration involved would have been self-defeating'.
While many investors will breathe a sigh of relief that the increase in rates was not as dramatic as had been feared, the lack of any incentive (such as a taper or indexation relief) for long-term investment may be something that the Government will want to revisit in time.

Annual exempt amount

There had also been speculation that pressure from the Lib-Dems would lead to a cut in the annual exempt amount of £10,100, but this did not transpire.

Value added tax (VAT)

As has been widely anticipated, the rate of VAT is to rise from 17.5% to 20% on 4 January 2011 (the first business day of 2011), allowing for consumers to benefit from the January sales before the austerity starts to bite. The scope of VAT will not be extended, so items such as food and children's clothing remain exempt and the 5% reduced rate that applies to domestic fuel is unaltered.

Tax policy review

A potentially far reaching set of proposals were published today, in a discussion document entitled 'Tax policy making: a new approach.
Taking the importance of fostering an environment conducive to business, economic recovery and stability as its cornerstone, this document sets

out a potentially radical change in the way in which tax laws may be drafted and tax policy formulated.

The key precept on which the new approach will be based is restoring predictability, stability and simplicity to the UK tax system. This is to be achieved by measures including consulting a wide range of interested parties including business, advisers and professional bodies, and when there is to be no consultation on a proposed change, providing an explanation of why that decision has been made.

Other measures proposed include publishing the Finance Bill or draft legislation three months before it comes into effect so that interested parties have an opportunity for comment.

Strategic policy

Hand in hand with reforming tax policy formulation goes 'a strategic approach to tax avoidance'.

This may include the introduction of a general anti-avoidance rule ('GAAR'), which would mark a huge shift in the tax planning landscape. One would expect a GAAR to be principle rather than rule based, and this is to be welcomed to the extent that it avoids the need for regular technical changes, and would also assist in bringing further stability to the UK tax system. Of course, the success of any GAAR will depend on its being sufficiently widely drafted so as not to be easily abused, but not so widely drafted that it prohibits standard tax planning.

A good thing?

Overall, the measures proposed today are to be welcomed, but as ever the devil lies in the detail. For a true reform of tax policy making to work, the Government will need to have a very clear tax strategy, and it is hoped that just such a coherent strategy will emerge. A good way to demonstrate commitment to reform would be to give clear guidelines about the scope of the review of the taxation of non-doms which was announced a few weeks ago, and about which very little further detail has since emerged.

On balance though the best test of whether the new approach succeeds may well be if the size of the books of tax statutes reduces in the years to come!

Taxation of the banking industry

A new bank levy

Banks are to make 'a more appropriate contribution' to tax revenues. A non-deductible bank levy of 0.07% will be introduced with effect from 1 January 2011 (with a reduced rate of 0.04% applying in 2011) and is expected to raise more than £2bn per annum. The levy will apply to institutions with aggregate liabilities of more than £20bn, so only the larger banks will be affected. While this levy is independent of any EU or G20 initiative, a joint statement with Germany and France issued today indicated that they will introduce a similar levy in due course.

Bonuses and remuneration

A consultation on a remuneration disclosure scheme for banks has been announced and the Government will explore the costs and benefits of a Financial Activities Tax on profits and remuneration. The FSA (as part of its review of its Remuneration Code) will also consider imposing more stringent requirements on the deferral and award of variable pay, examine ways to strengthen performance and remuneration to ensure that incentives are aligned with long-term performance and consider how to vary capital requirements to offset risk in remuneration practices.

Pensions

Annuities

The Coalition's Programme for Government announced the intention to remove the requirement for pensioners to buy annuities at 75 and today's Budget introduced the first step towards this by increasing the age to 77. These are only interim changes and there will be further consultation on this issue.

Limit on contributions

Following his theme of simplifying the tax system, the Chancellor announced that the Government will seek to avoid the complexity of the 'high income excess relief charge' which is due to take effect from 6 April 2011, which will limit the availability of tax relief on pension contributions for the highest earners. Instead the Government has suggested that this might be replaced by a cap on the maximum level of pension contributions that qualify for tax relief (the 'annual allowance') at '£30-45,000', down from the current limit of £255,000.

Other points to note

Corporation tax

From 1 April 2011 the full rate of corporation tax rate will be reduced over the subsequent years by 1% each year until it reaches 24%. The small companies' rate of 21% will also be cut to 20% from 1 April 2011. Other measures to encourage investment will also be introduced. Also announced was a five year plan to review the corporation tax system to reduce the administrative burden on business.

Cigarettes and alcohol

Taxpayers keen to drown their sorrows will be pleased to note that (with the exception of 'long' cigarettes) rates of duty on cigarettes and alcohol have not been increased and the 10p increase in duty on cider announced in the March Budget has been dropped.

Income tax

The personal allowance for those aged under 65 will be increased to £7,475 in 2011/12, up from £6,475 this year. Those aged over 65 already have an annual exemption of £9,490 and those over 75 £9,640. This will be matched by a reduction in the basic rate threshold (currently £37,400) to ensure that higher rate taxpayers do not benefit from the increase. Those earning over £100,000 already have their personal allowance progressively reduced by £1 for every extra £2 earned and those earning above £112,950 (or £114,950 in 2011/12) lose it entirely.

National insurance thresholds and exemptions

Modest changes were announced to the secondary threshold for employers NICs, which is increased by an extra £21 above inflation.

Office for Budget Responsibility

As previously announced, the Office for Budget Responsibility will be formally constituted by primary legislation and its functions enshrined in law.

Furnished holiday lettings

The previously announced decision to abolish the tax reliefs for furnished holiday lettings is to be reversed.

Inheritance tax

The Conservatives proposal to increase the nil rate band to £1 million did not make the Budget. The only mention of inheritance tax in was in the context of a proposal to extend the Disclosure of Tax Avoidance Scheme rules to inheritance tax planning using trusts. No further details have been announced.

The Civil List

Mirroring the treatment of public servants, the amount of the Civil List has been frozen at the existing level of £7.9m. This freezing of the Civil List gives further credence to the Government's desire for all sections of society to share the burden of spending cuts!

MPs' expenses

And finally, perhaps the only exceptions to the austerity regime are MPs, for whom new rules will be introduced to ensure that expenses paid under the new scheme will continue to be specifically excluded from taxation.

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