



Financial planning considerations from the 2010 budget

"The bottom line is that the budget was simply a holding operation. The momentous task of tackling the UK's fiscal crisis will get under way after the election – and it's going to hurt."

Jonathan Loynes, Economist, Capital Economics

It is fair to say that we did not expect a huge amount from the recent budget and in that respect, we were not disappointed. Indeed, if the (first) 2010 budget is remarkable for any reason, it is the measures that were not addressed such as the much anticipated increase in Capital Gains Tax (CGT), rather than the items that were.

Clearly composed with an eye to the general election, the speech included details of a Stamp Duty Land Tax exemption for first time buyers and a little more relief for entrepreneurs, whilst CGT was left alone at a very competitive 18%.

The state of the economy means that there was very little that the Chancellor could offer to entice voters, though he did manage to pick the pockets of the wealthy to some extent, prompting the Daily Telegraph to label it a 'Robin Hood' budget.

Also included among the variety of announcements that accompanied the budget speech were a number of measures which, when viewed collectively, reinforce the tough stance that Government is taking on the collection of tax, including new penalties on undeclared offshore income and capital gains tax liabilities and even a new power to open parcels.

In the analysis that followed, it was clear that further measures will be required to convince many commentators and potentially to ensure that Britain's AAA credit rating is secure. The Chancellor's post 2011-12 borrowing forecasts have been widely criticised as too optimistic and more details of the deficit-cutting measures are required. As Bridget Rosewell, chief economic adviser to the Greater London Authority, put it *"There are two enormous elephants cavorting out there – the trade deficit and its cousin, the fiscal deficit. Yet the detail on how either of these is to be tamed is thin"*.

What does seem likely, with the country expected to go the polls on 6 May, is that this will not be the last budget of 2010. The Conservative party is committed to introducing a new budget within 50 days of the election if they win, but regardless of the result we can expect a bigger, more contentious budget early in the new Parliament.

In the meantime, our analysis of the substance as it relates to wealth planning is detailed over.

Business Taxation

Entrepreneurs Relief

This relief was increased from £1,000,000 to £2,000,000. Whilst it was criticised in some quarters as an enticement for entrepreneurs to sell their businesses, many individuals will be very happy with this gift, worth up to £80,000 in Capital Gains Tax savings.

Personal Taxation

Income Tax

As previously announced, there will be a new 50% top rate of Income Tax on income over £150,000. In the case of dividends the rate is 42.5%.

In addition, the Personal Allowance will be restricted by £1 for every £2 of taxable income over £100,000. This means taxpayers with income between £100,001 and £112,950 will suffer a 60% marginal rate of tax.

The one NI threshold which is not frozen is the Lower Earnings Limit, which will rise in line with the Basic State Pension. This will increase the number of people who will no longer qualify for credits towards their Basic State Pension unless they are able to increase their earnings.

National Insurance will increase by 1% from April 2011, on employee, employer and self-employed payments, though this plan will be amended for lower earners if the Conservative party are returned to Government.

Capital Gains Tax

The rate of capital gains tax for 2010/11 remains at 18%. The capital gains tax annual exemption has also been frozen at £10,100, with the exemption for trusts generally set at £5,050.

There are a number of planning strategies which can mitigate the effect of these increases including making use of pension and charity contributions. Now perhaps more than ever in recent years, it is important to pursue a thorough and coordinated strategy for portfolio management to maximise the benefits available.

Where assets are held in trust, they may not be affected by the proposed income tax increases, as in many cases, tax will fall to be charged on a lower taxpaying settlor or beneficiary. In addition, bonds retain advantages in some circumstances as income tax can be deferred, for example until a lower tax rate applies on encashment, say, in retirement. In addition to this, bonds can be given away without triggering a tax charge, which can be particularly useful for making gifts into trust and for appointing benefits out of trust to beneficiaries, who may pay a lower rate of tax on encashment.

Stamp Duty Land Tax (SDLT)

SDLT will increase by 1% for properties over £1,000,000 from April 2011, and measures have been announced to counter some of the SDLT avoidance schemes used by wealthier property owners. First time buyers during the next two years will not pay SDLT on properties under £250,000, which is a doubling of the existing threshold.

Although the 1% increase for bigger properties was included as a measure to pay for the extension of the relief for first time buyers, it seems unlikely that it will be reduced in two years when the first time buyer allowance disappears.

Pensions

It was confirmed that the lifetime allowance will be frozen at £1.8 million and the annual allowance will be frozen at £255,000 from 2011/12 to 2015/16 inclusive. The freezing of the Lifetime Allowance is of particular significance to investors with pre A-Day protected tax free cash, as the benefit of this protection is gradually whittled away.

From 2011/12 tax relief on pension contributions will be restricted for:

- Employees with total annual income of £130,000 or over before deduction or relief for pension contributions and charitable donations and whose income (before such deductions or relief) together with the value of any employer pension contributions is £150,000 or over; and
- Other individuals with total income of £150,000 or over before deduction or relief for pension contributions and charitable donations.
- Relief will be tapered so that for those with gross income of £180,000 or more, tax relief will be restricted to 20%.
- The budget confirmed that tapering will apply at the rate of 1% withdrawn for every £1,000 of gross income above £150,000.

The detailed provisions to implement the regime will be contained in the Finance Bill 2010. The Government will consult during the summer on measures it proposes to prevent employers from mitigating the effects of these changes.

Although the rules can be complex, planning strategies remain to ensure that retirement plans are funded as efficiently as possible, particularly where individuals have variable income. For example, if your income is between £130,000 and £150,000 and you have been making regular monthly or quarterly contributions since before 9 December 2009 (even above the £20,000 threshold) you should be able to continue to make these and obtain 40% tax relief.

Other opportunities include Salary Sacrifice or Salary Exchange and funding alternative arrangements including other vanilla tax planning schemes such as Individual Savings Accounts and Venture Capital Trusts.

Individual Savings Accounts (ISA)

The ISA limit, which is now £10,200 for older investors, will increase to this level for all investors from 6 April and will increase with inflation (to the nearest £120) from April 2011.

Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCT)

There will be consultation on allowing AIM investments similar tax benefits to ISA investments, and on widening the range of companies that can benefit from EIS and VCT investments.

A number of technical changes that were announced in the December Pre-Budget Report have been dropped. The most significant of these is the scrapping of the intention to use the EU's definition of a small-medium enterprise (SME). Whilst this technical change is largely of concern to scheme providers it does potentially widen the pool of allowable investments.

Tax Avoidance Schemes

There will be a tightening of the disclosure regime for tax avoidance schemes. This includes a requirement to report the scheme earlier, increased penalties for non-disclosure, an extension of the "hallmarks" of a tax avoidance scheme, a requirement for introducers to identify the scheme promoters, and a requirement for promoters to provide HMRC with additional information.

Share Incentive Plans

Legislation will be introduced to deny a corporation tax deduction to companies that pay money to Share Incentive Plan (SIP) trustees to buy shares from director-shareholders, but no real value is transferred to employees under the SIP. The measure is directed at avoidance schemes and will have effect for payments made and alterations to share capital or rights attached to shares taking place from 24 March 2010.

We hope that the information in this note is useful. The management of significant assets brings with it a host of complex issues and when formulating a strategy it is important to consider all of the viable options and their potential consequences. The world of finance moves at a rapid pace and we recognise that many affluent investors need sophisticated advice and strategic guidance to preserve, grow and transfer their wealth as efficiently and fruitfully as possible.

Please do not hesitate to contact us if you would like to discuss the issues raised, or indeed any other matter.

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