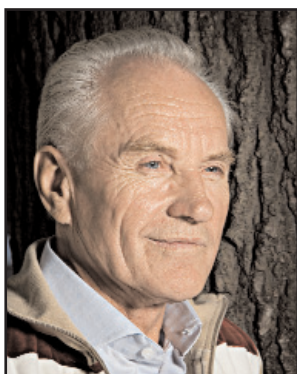


Spring 2010 - Budget special edition

Welcome to Mercer & Hole's special Budget edition of Tax Plus. We have taken a different approach on this occasion in considering the Chancellor's Budget announcement on 24 March 2010. With this edition we have highlighted how some of the changes will impact on the 'TAX' family... introduced below.

Impact of the 2010 Budget on the 'TAX' Family: Tom, Andrew and Xena



Tom (father)
Aged 68



Andrew (son)
Aged 30



Xena (daughter)
Aged 35

Tom, aged 68, has spent the last six months in negotiations over the sale of his printing company for £2million. Tom started the business from scratch 25 years ago but would like to take a well earned retirement and depending on how much cash is left after tax, he would like to make some cash gifts to his two children.

Based on advice from his trusted accountants, Mercer & Hole, Tom has been pressing to finalise the sale ahead of the 2010 Budget. He is conscious that the capital gains tax rate is at an historic low of 18% and that the first £1million of gain would effectively be taxed at only 10%. Unfortunately the purchaser had last minute problems in getting bank finance and the paperwork was not signed before the Chancellor stood up on 24 March.

Tom was on the phone to Mercer & Hole without delay to find out what had been announced and how his sale would be affected. He was relieved to hear that the capital gains tax rate was unchanged and extremely pleased to hear about a change to Entrepreneurs' relief. Tom was advised that he would now pay £80,000 less tax if the deal goes through in the next tax year. In addition the tax due would be payable 12 months later than he anticipated. What a result for Tom!

Entrepreneurs' relief

Entrepreneurs' relief was introduced in 2008, with a lifetime limit of £1million for qualifying capital gains on the disposal of a business or shares, made on or after 6 April 2008.

This lifetime limit has been doubled in the Budget to £2million for qualifying gains arising on or after 6 April 2010. The relief works by reducing the chargeable gain by 4/9 (see the example below). With the 'normal' capital gains tax rate at 18% this gives an effective 10% tax rate for qualifying gains of up to £2million.

	£
Chargeable gains	2,000,000
Less: Entrepreneurs' relief	<u>-888,889</u>
Net chargeable gain	<u>1,111,111</u>
 Tax payable at 18%	 £200,000

...continued

The 'TAX' Family: Tom, Andrew and Xena

Following the sale of the company, Tom found himself with more surplus cash than expected and after working out the numbers, he decided that he could afford to give away £250,000 to each of his children. Before the sale of his business, the shares would have been 100% exempt for inheritance tax if he died and having sold them, the cash value would be fully taxable in his estate. Given the announcement in the 2010 Budget on inheritance tax, Tom is even more convinced that he is right to make some lifetime gifts. The £500,000 gifted will be fully exempt from inheritance tax and out of Tom's estate if he survives for seven years.

Inheritance tax (IHT)

In the 2009 Pre Budget Report, the Chancellor announced that the IHT nil rate band would be frozen at £325,000 for 2010/11 instead of rising to £350,000 as previously expected. In the 2010 Budget, Alistair Darling announced that the freeze at £325,000 has been extended to 2013/14. This amounts to an effective IHT hike as the nil rate band fails to keep pace with inflation.

Tom's son, **Andrew**, is not terribly good at managing his money but has built up a small courier business. Up until now Andrew has relied on a bookkeeper to prepare his business accounts, but he has been getting increasingly concerned about the recent telephone calls and letters that have been received from the Revenue. He also wants to expand geographically and needs to buy five new vans and is not sure whether the business can afford it. Andrew knows that his father intends to make a gift but because he is still living at home, Andrew wants to buy a property to prove to his father that he has acted responsibly. He makes an appointment to see Mercer & Hole to discuss his position.

The meeting divides into two parts; in talking about the business side and the investment in the property. On the business side, there are a number of Budget measures which are relevant. The Government have asked the banks to make finance more readily available for small businesses and in particular there are increases to capital allowances which will be helpful with Andrew's expansion plans.



Andrew

Annual investment allowance

A business can currently claim a 100% allowance for qualifying capital expenditure of up to £50,000 per annum. The allowance has doubled to £100,000 for expenditure on or after 1 April 2010 for corporation tax and 6 April 2010 for income tax. For a business with an accounting period straddling the change in rate, there are transitional measures that apportion these limits pro rata between the periods before and after the date of change.

In discussing the issues arising with the Revenue, Andrew discovers that although the Government have extended the scheme which gives a business in financial difficulty time to pay tax and VAT payments, it comes with an increased penalty regime. Andrew takes note of the changes about late filing penalties and the new action that can be taken by the Revenue regarding non payment. He also makes a mental note that he needs to talk to his bookkeeper!

Increased penalties for VAT and PAYE

The first of these measures will be introduced later this year whilst the second is expected to become law in April 2011.

- (1) Businesses that do not file their VAT returns on time could face fixed fines of up to £400 plus the imposition of tax geared penalties of up to 5% of the VAT covered by the return, both six and twelve months after the due date. Further penalties of 5% again can be levied if the tax itself is not paid by six and twelve months from the due date. Finally, there is potentially another penalty of up to the amount of tax on the return if the Revenue can show that the delay constituted 'deliberately withholding' information that would allow the VAT liability to be calculated.**
- (2) Where employers have a history of not paying PAYE to the Revenue on time, the Revenue will be able to insist on taking personal security from employers, where it feels there is a serious risk that the PAYE will not be paid. Fines of up to £5,000 will be imposed on those who refuse to provide the required security.**

Andrew explains that he is looking to spend his father's gift on a property so that he can move out of his father's house. The good news for Andrew is that there is a temporary relief from Stamp Duty Land Tax for first time buyers. He goes into the estate agents after he leaves Mercer & Hole with a spring in his step!

...continued

The 'TAX' Family: Tom, Andrew and Xena

Stamp Duty Land Tax (SDLT)

A new relief, for a two year period, has been introduced for first time buyers who purchase a property and intend to occupy it as their only or main home. This relief applies where the completion of the property purchase takes place on or after 25 March 2010, where the consideration is between £125,000 and up to £250,000, and the purchasers have not previously acquired an interest in a property. The SDLT rate remains otherwise at 1% for residential purchases falling between £125,000 and up to £250,000.

A new higher rate of 5% was also announced, to take effect from 6 April 2011, for residential purchases in excess of £1million.

Tom's daughter, **Xena**, is settled in her highly paid job in the City. She earns £200,000 per year, has a flat of her own, but has so far made very little pension or savings provision. She would like to use the cash gift from her father to invest in pensions as she is anxious to do whatever planning she can. At the same time she would like to avoid the new 50% income tax rate on her earnings. Based on her father's recommendation, she contacts Nightingale Associates, the financial services side of Mercer & Hole and arranges a meeting.

At the meeting Nightingale Associates talk to Xena about the restrictions to higher rate relief for pension contributions announced last year. Although, technically it is still possible for her to contribute 100% of earnings as the maximum annual pension allowance is £255,000, higher rate tax relief is limited by reference to rules based on previous levels of earnings and contributions. Xena has made no regular contributions and has earned over £130,000 each year for the last three years. She can therefore only claim higher rate tax relief on contributions of £20,000 before 5 April 2011. Unfortunately her plan to pay higher pension contributions is simply not going to work as a means of mitigating the 50% income tax rate.



Xena

They discuss with her other tax saving measures including possible investments in venture capital trusts or enterprise investment schemes, as well as the wisdom of using the maximum ISA allowance in each year to accumulate tax free savings.

Pensions, ISAs and 50% tax

Only basic rate tax relief will be available on pension contribution made by individuals with an income over £180,000 from 6 April 2011. Anti-avoidance measures have been introduced since 6 April 2009 to stop high earners pre-empting these new rules and affect those with income over £130,000. The definition of 'income' for these purposes will be extended from 2011 to include employers' pension contributions.

The lifetime allowance, which limits the overall amount in an individual's pension funds, will be held at £1.8million for the next five years up to and including 2015/16.

The Finance Bill will also include the increase in the top rate of tax to 50% for income over £150,000 and the tapered withdrawal of personal allowances where income exceeds £100,000. There are potential planning opportunities using investment strategy or spreading income across family members if the circumstances allow.

The increased ISA limit of £10,200 (of which £5,100 can be invested in cash) will apply to all UK residents from 6 April 2010. From now on the limits will be indexed annually in line with the RPI for September preceding the tax year.

Xena leaves the meeting with a lot to think about. She heads for the pub for a consolation glass of cider. She does not allow herself to think for too long about the fact that the rate of duty on cider is now something like 54.04p per litre for still and £2.18 for the sparkling version - after all there is more to life than taxes!

We are all conscious of the fact that the March Budget was delivered ahead of a general election. If there is a change of government, the Conservatives have already stated that there will be another 2010 Budget. Further and perhaps more punitive tax charges cannot be ruled out.

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