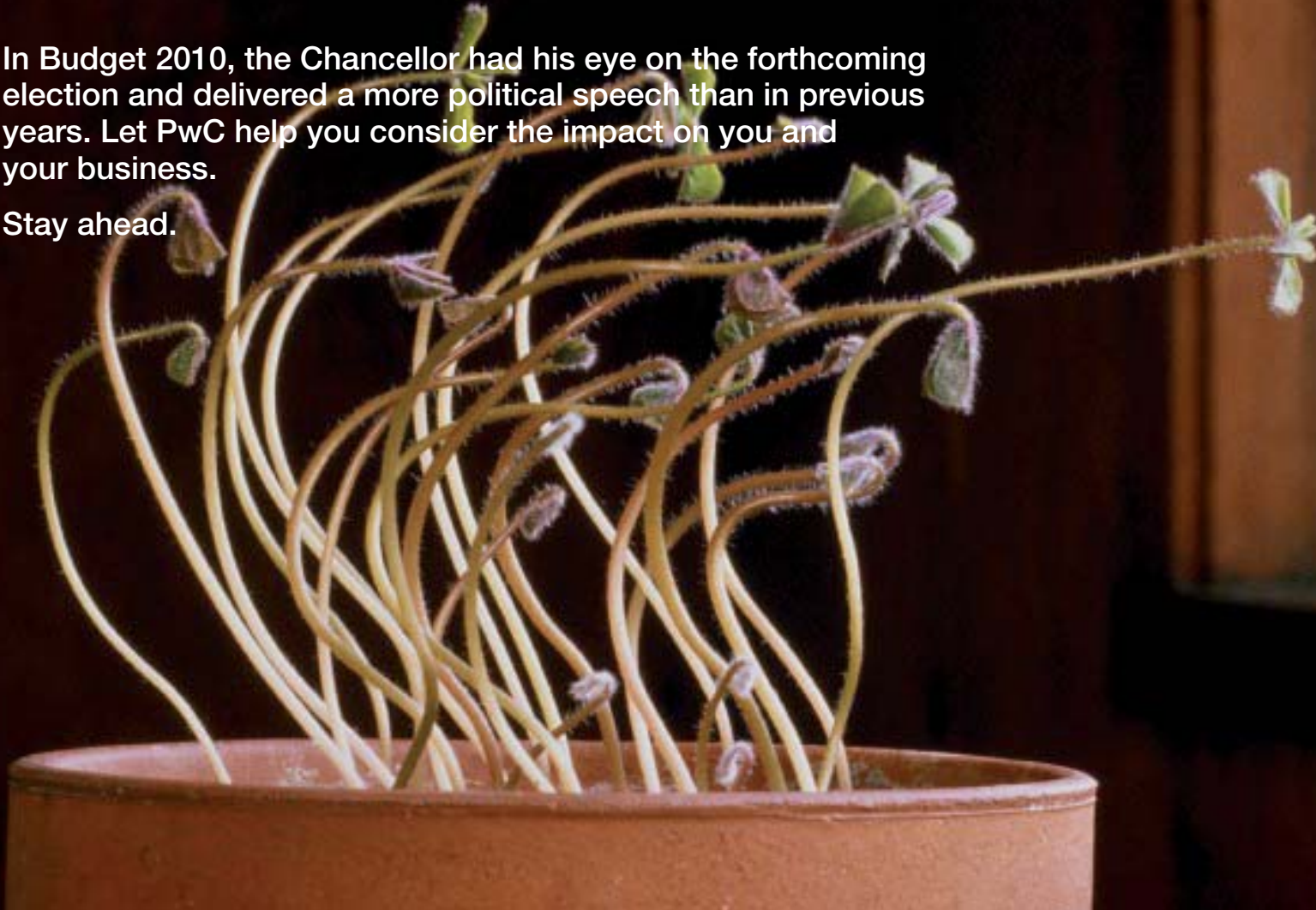


A Budget for growth, Darling?

In Budget 2010, the Chancellor had his eye on the forthcoming election and delivered a more political speech than in previous years. Let PwC help you consider the impact on you and your business.

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A Budget for growth, Darling?

The Chancellor's Budget 2010

Alistair Darling's Budget speech on 24 March 2010 was set on a stage ahead of a general election, in the shadow of the recession and rising fiscal debt and with the uphill climb facing the UK economy set to be a steep one. Understandably, the Chancellor had his eyes on the forthcoming election and delivered a more political speech than in previous years.

Chancellor Darling himself described the UK economy as being 'at a crossroads' and was delivering a Budget to 'secure the recovery' and provide 'targeted support' where it is needed. The centrepiece of this Budget seems to be a £2.5bn package for small and medium business, funded primarily by better than expected receipts from the one-off tax on bankers' bonuses.

Although the Chancellor's speech lacked headline grabbing tax changes, the Treasury still managed to produce 71 specific Budget Notes detailing the changes set out across 161 pages and we summarise some of these changes here.

Despite the absence of further fundamental tax changes, we must not forget the deferred changes which will come into effect as of April 2010 (and beyond), which have been introduced by previous Budgets.

Outlook for the economy and public finances

The Treasury kept its forecast for growth in 2010 unchanged from the Pre-Budget Report 2009 (PBR) in December at 1-1.5%. However, the forecast for 2011 was reduced slightly from 3.25-3.75% to 3-3.5%. This moves the Treasury forecast for 2011 closer to that of the Bank of England, but still leaves it well above the average independent forecast for that year of 2.1%. The Treasury's medium term economic forecasts remain unchanged at around 3.25-3.75% on average for 2012 to 2014. This medium term growth forecast appears optimistic relative to the average independent forecast for this period of around 2.5%.

Public sector net borrowing forecasts were revised downwards relative to the PBR, although the level of borrowing remains high in absolute terms. The previous expectation of £178 billion borrowing in 2009/10 (12.6% of GDP) has been reduced to £167 billion (11.8% of GDP), while the PBR forecast of a £176 billion deficit in 2010/11 (12% of GDP) has been reduced to £163 billion (11.1% of GDP). Higher than expected tax revenues and lower than expected social security benefit payments explained most of the positive revision. The deficit profile for the medium-term has also been scaled back, although by less than the short-term borrowing projections.

The temporary fiscal operating rule is for public borrowing as a share of GDP to be halved in four years. It is now expected to decline to 5.2% of GDP in 2013/14, so more than halving from the 11.8% of GDP estimate for 2009/10. As the Chancellor noted in his speech, should growth exceed expectations, the deficit profile will be further reduced. But he failed to emphasise that the opposite is also true. Should

growth disappoint on the downside, as we and most other forecasters think is more likely, then the deficit will decline more slowly than the Treasury is forecasting.

The Treasury forecasts that net public debt will rise to a peak of around 75% of GDP in 2014/15 before stabilising. This is in line with the G7 average as forecast by the International Monetary Fund. Again, the debt profile will depend on whether economic growth over or under-performs relative to the Chancellor's expectations.

The 2010 Budget contained a large number of tax and spending initiatives, but most have only a small fiscal impact and, in combination, they were broadly fiscally neutral. Overall, the initiatives amounted to £1.4 billion (0.1% of GDP) of net fiscal loosening in 2010/11, followed by net fiscal tightening of £0.2 billion in 2011/12 and £0.7 billion in 2012/13. Changes of this magnitude will have almost no impact on the path of the government deficit or the growth rate of the economy as a whole.

Overall, we continue to expect that significant further fiscal tightening through additional tax rises and/or spending cuts will be needed after the general election, irrespective of its outcome.

Personal taxes

Income tax

There were no new announcements in relation to income tax and personal allowances and these are set out in the section below (a recap on tax changes). This produces an effective income tax rate of 60% on income between £100,000 and £112,950, comfortably the highest in the G20.

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Capital gains tax and entrepreneurs' relief

The Chancellor confirmed that the capital gains tax rate would not be increased as part of his measures and this would remain at the flat rate of 18%.

The lifetime limit for entrepreneurs' relief will increase to £2m for disposals on or after 6 April 2010 meaning an effective CGT rate of only 10% on the first £2m of qualifying gains – providing an additional tax saving of £80,000.

Pensions

The tapered restriction to basic rate from 6 April 2011 of tax relief on higher-income individuals' pension contributions (with employer contributions as taxable benefits) is to proceed as outlined in PBR. After consultation, decisions have been made on various details – for example the use of age-related factors, varying by both age and normal pension age, to value deemed contributions to defined benefit schemes.

Legislation in Finance Bill 2010 will target those with total income of £150,000 or over, including the value of any employer contributions, but excluding employees who save in a registered pension scheme and have total annual income below £130,000 excluding employer contributions.

Savings

As previously announced, from 6 April 2010 the ISA annual subscription limits will increase for all savers to £10,200 (of which £5,100 can be saved in cash). In addition, from 6 April 2011, the annual ISA limits will increase annually in line with RPI.

Bank payroll tax

The Government confirmed that a one-off tax, payable by the company, will apply to bonuses awarded by banks, building societies and certain financial businesses from 9 December 2009 to 5 April 2010. Originally forecast to generate £550m, so far this has yielded £2bn.

Corporate taxes

Capital distributions

It was confirmed that new legislation will be introduced (“as soon as possible in the next Parliament”) confirming that company distributions will not be prevented from falling within the UK dividend exemption because they are capital in nature. The legislation will be retrospective and there will also be an option for companies to elect for the retrospective application to be disappplied.

Worldwide debt cap legislation

Following consultation with UK businesses, a number of changes have been made to the debt cap legislation to clarify areas of uncertainty and so the rules work as originally intended.

Annual investment allowance (AIA)

From 1 April 2010, the AIA for capital expenditure on items qualifying for capital allowances will be doubled to £100,000. The relief will be increased for income tax purposes from 6 April 2010. However, a new anti-avoidance rule will be introduced that will disallow property losses to the extent that they are due to AIA, if the losses arise as a result of relevant tax avoidance arrangements. It is worth noting that the current 40% FYA rules have not been extended.

Tax breaks for zero and low emission vehicles

As announced in PBR, 100% first year allowances will be available on the purchase of new goods vehicles that are not capable of producing CO₂ emissions. The relief will be available for companies incurring such expenditure on or after 1 April 2010 and before 1 April 2015 (6 April 2010 and 6 April 2015 for individuals).

Similarly, there will no taxable benefit for an employee that is provided with a zero emission van or car and a reduced taxable benefit percentage of 5% for an employee provided with a car that produces less than 75g/km of CO₂. These reductions will apply from 6 April 2010 to 5 April 2015.

Indirect taxes

Stamp taxes

Residential property

The Budget introduced a relief from stamp duty land tax (SDLT) for purchases of residential property of up to £250,000 by first-time buyers from 25 March 2010 for two years. To fund this additional relief a higher SDLT rate of 5% will be introduced from 6 April 2011 for purchases of residential property exceeding £1 million.

VAT

Although the rate of VAT remains at 17.5%, a number of changes were announced:

- Supplies of postal services by the Royal Mail which are not made under a licence duty (e.g. Parcelforce) and services provided on terms and conditions that have been freely negotiated, will, from 1 January 2011 be subject to VAT at 17.5% rather than being VAT exempt.

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- The definition of aircraft for zero-rating purposes will change from 1 September 2010, such that supplies of aircraft will be zero-rated only where used by 'airlines operating for reward chiefly on international routes'.
- To minimise fraud, a reverse charge on the sale of emissions allowances is effective from 1 November 2010. This means that VAT will be accounted for by the customer. The interim zero-rating for such services will be removed.
- The 'Lennartz' principle, which allows taxpayers who use immovable property, boats and aircraft for both business and non-business purposes to recover all the VAT on such assets up front and pay for private use through ongoing charges is to be removed.
- VAT fuel scale charges have been amended and will be introduced from 1 May 2010.
- The VAT registration threshold will increase to £70,000 from 1 April 2010.

As set out in PBR 2009, the rate of Bingo duty will reduce from 22% to 20% for accounting periods beginning on or after 29 March 2010. Amusement machine licence duty will increase on new licences from 26 March 2010 and gaming duty bandings will increase in line with inflation from 1 April 2010.

Sustainability and 'green' taxes

The Budget's focus on the green agenda was disappointingly low. In his speech, the Chancellor referred to the "green bank" scheme trailed recently in the press. While the measures proposed under this scheme will be welcome in making available funding to businesses in the renewables sector, the mechanisms for doing so are limited.

In addition to this headline scheme, more detailed measures included in the Budget to increase rates of green indirect taxes and the introduction of a new green tax were:

- the introduction of a landline tax (physical electronic communication networks) from 1 October 2010 at a rate of 50p per line per month;
- increases to landfill taxes and a review of material subject to the lower rate;
- increases to rates in relation to climate change levy;
- an increase in the aggregates levy rates;
- amendments to hydrocarbon oil duty rates; and
- an increase of air passenger duty rates for travel on or after 1 November 2010 – including for those who have already booked tickets.

Other measures introduced

Anti-avoidance measures

A number of anti-avoidance measures have been introduced as part of the Budget tackling various forms of planning and we flag the material areas below:

Employment related securities

Anti-tax avoidance legislation will be introduced in relation to share incentive plans (SIPs) and company share option plans (CSOPs), effective immediately. In relation to SIPs, corporation tax deductions will not be allowed where companies pay money into a SIP as part of a tax avoidance scheme. In relation to CSOPs, new grants of CSOP options over unlisted shares in a company which is under the control of a listed company will not be permitted.

During 2010, there will also be a consultation in relation to the taxation of employment related "geared growth arrangements", e.g. hurdle shares.

The Government has also announced that it intends to take action to tackle avoidance of tax through employee benefit trusts and other vehicles, effective 6 April 2011.

SDLT and partnerships

Rules are being introduced in relation to SDLT applying to transactions between members of a partnership. Existing anti-avoidance rules currently apply SDLT in respect of 'notional land transactions' and these rules are being extended to prevent the special partnership rules from applying to such transactions.

Loans to participators

Legislation effective from 24 March 2010 will deny a corporation tax deduction for the amount of the release, or write-off, of a loan made by a close company to a relevant person (participator). The release or write-off will continue to be treated as a distribution in the hands of a relevant person.

Disclosure of Tax Avoidance Schemes (DOTAS or TAD)

Legislation will be introduced to revise the DOTAS rules to increase penalties for non-compliance and to "fine-tune" some of the notification requirements. The revised regulations will extend the DOTAS "hallmarks" and similar provisions relating to national insurance will be aligned with these changes.

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Tax administration

The announcements continued the theme of previous Budgets, with further refinement and streamlining of tax administration rules:

- *Late filing and payment of returns* – Measures will be introduced to encourage filing and payment by the correct dates by introducing an escalating series of penalties depending upon the number of failures within a set penalty period. Further penalties will arise if there is a prolonged delay in filing returns or paying the tax due.
- *Financial security for late payment of PAYE and NIC* – Legislation is to be introduced to allow HMRC to require a financial security from employers where amounts due under PAYE or NICs obligations are seriously at risk. This would be in line with the current practice for VAT.
- *Penalties for offshore tax avoidance* – Finance Bill 2010 will introduce larger penalties for taxpayers who fail to provide a full account of their income tax or capital gains tax liabilities, where the failure is linked to an offshore matter.

A recap on tax changes introduced in previous Budget speeches...

With the wealth of deferred measures being introduced by previous Budget speeches, here is a refresher of some of the key measures scheduled to take effect from 6 April 2010 (except where noted):

Personal taxes

Income tax

- A new additional rate of income tax at 50% for income over £150,000.
- Tax allowances and thresholds will be the same in tax year 2010/11 as for 2009/10. Personal allowances will also be withdrawn from those with adjusted net income above £100,000 (reducing by £1 for every £2 of income above £100,000).
- A one-off bank payroll tax at 50% payable to the employer on all discretionary and contractual bonuses awarded by banks, building societies and financial businesses to their employees between 9 December 2009 and 5 April 2010.
- Dividends potentially liable to the 50% rate of tax will be taxed at a new rate of 42.5%.
- The overall annual ISA subscription limit goes up from £7,200 to £10,200.

NICs

- From 6 April 2011, employer's NIC will increase by 1.0% to 13.8% and, for employees, NIC will increase by 1.0% bringing the rate for those above the upper earnings limit to 2.0%.

Pensions

- The pensions annual allowance increases to £255,000 and the lifetime allowance to £1,800,000, but will then remain at the same level up to 2015/16.
- Income tax relief for pension contributions made by high earners (or by their employers on their behalf) is to be reduced from 6 April 2011 alongside the introduction of a 'benefit-in-kind' charge (see below) – details have yet to be finalised.

- Special annual allowance charge (SAAC or forestalling charge), intended to stop people paying abnormal contributions ahead of this planned restriction continues to apply in 2010/11, but now to certain individuals with relevant income as low as £130,000.

Benefits-in-kind

- Membership of a company pension arrangement becomes taxable like a benefit-in-kind from 6 April 2011 – affecting individuals with relevant income of £130,000 per annum or more; and gross income (including the pension benefit-in-kind), of £150,000 per annum or more, the charge operating between 0% and 30% with a taper for gross income between £150,000 and £180,000. The details are still under consultation.
- The provision of free or subsidised meals in a canteen or on business premises will no longer be income tax exempt from 6 April 2011. Exactly how the benefit will be assessed on those employees eligible to use, or who actually use, the subsidised canteen remains unclear.

Inheritance tax (IHT)

- Nil rate band will, contrary to previous announcements, remain at £325,000.

Corporation tax

- The extended £50,000 loss carry-back of up to three years ends for accounting periods ending before 23 November 2010.
- The debt cap which restricts UK interest relief within a group by reference to a comparison of the level of relevant UK group companies' finance expense and worldwide indebtedness of the group, came into effect from 1 January 2010.

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- The UK Government's discussion document published on 26 January 2010 contained proposals for reform of the controlled foreign company (CFC) rules, with planned introduction in Finance Bill 2011.
- Company tax returns filed on or after 1 April 2011 (in respect of periods ending on or after 1 April 2010) must be filed online and payment made electronically. The iXBRL format will be required not only for the return but also for the accompanying accounts.
- A 'patent box' regime for UK companies will be introduced as part of the 2011 Finance Bill, seeking to apply a reduced corporation tax rate of 10% to income arising from 1 April 2013 for patents registered after the regime is enacted.
- Industrial/agricultural/hotel buildings allowances reduce to 1%, on the way to disappearing from 2011.

Indirect taxes

- All businesses with turnover in excess of £100,000 and all newly-registered businesses, whatever their turnover, will be required to file VAT returns online and pay electronically (obligatory e-filing extended for all taxpayers in 2012).

HMRC powers, time limits for claims and other changes

- Harmonised interest regime for overdue/overpaid tax, along with regime for penalties and information extended.
- Various tax claims will be subject to new rules. The circumstances in which various claims can be made will be narrowed and the time limit for making certain 'error or mistake' claims is to be reduced from six years to four years.
- The common law route for restitution of tax paid under a mistake of law will cease to be available with effect from 1 April 2010 – from that date it will only be possible to reclaim tax overpaid from HMRC using Taxes Act procedures.

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