Personal Tax

Tax rates

As previously announced, the government proposes significant changes to the system of personal allowances and tax rates. These changes which were announced last year mainly impact on those with higher levels of income. Significant changes have now been made to the original proposals.

Allowances and rates 2009/10

The 2009/10 personal allowance will be £6,475. The basic rate limit will be £37,400. Therefore an individual will pay 40% tax rather than the basic rate of 20% when their total income exceeds £43,875.

The 10% starting rate for savings income band (£2,440) is only available where an individual's non savings income (broadly earnings, pensions, trading profits and property income) does not exceed the starting rate limit.

Changes for 2010/11

The Chancellor has not only brought forward proposals which were to take place in 2011, he has also made changes to his original announcements.

The personal allowance will be subject to an income limit of £100,000. An individual's personal allowance will be reduced by £1 for every £2 of adjusted net income above the income limit. The personal allowance will be reduced to nil from this income limit instead of the proposed two stage reduction announced in 2008.

Adjusted net income for these purposes is broadly all income after adjustment for pension payments, charitable giving and relief for losses.

Instead of introducing a 45% top rate of tax in 2011, a new rate of income tax will be introduced of 50% from 6 April 2010. This will apply to taxable income above £150,000.

Dividend income is currently taxed at 10% where it falls within the basic rate band and 32.5% where liable at the higher rate of tax. A new rate of 42.5% will be introduced for dividends which fall into the income band above £150,000.

Example

The effect of the basic changes can be illustrated as follows (this assumes that the basic rate band remains unchanged):

	2009/10		**2010/11**	
		tax		tax
	£	£	£	£
Non dividend income	200,000		200,000	
Personal allowance	(6,475)		Nil	
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Taxable income	193,525		200,000	
	---------		---------	
Taxable at 20%	37,400	7,480	37,400	7,480
Taxable at 40%	156,125	62,450	112,600	45,040
Taxable at 50%			50,000	25,000
		---------		---------
Total tax liability		£69,930		£77,520
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Trust rate

The trust rate will be increased from 40% to 50% and the trust dividend rate from 32.5% to 42.5%. These changes will take effect from 2010/11 and will apply to all trust income.

National Insurance Contributions (NICs)

The NIC thresholds have been increased but the rates of Class 1 and 4 contributions have been held at their 2008/09 levels.

An increase in the rates of national insurance is proposed from April 2011. An increase of 0.5% will apply to the rates applicable to employers', employees' and the self-employed.

Foreign dividends

Individuals in receipt of foreign dividends are generally entitled to a non-repayable tax credit of one ninth of the distribution. This treatment applies to individuals who own less than a 10% shareholding in the company.

From Budget Day individuals with shareholdings in excess of 10% will also be eligible for the non-repayable tax credit. The tax credit will not be available where the source country is not a qualifying territory. A qualifying territory is one which has a double taxation agreement with the UK, with a non-discrimination article. Anti-avoidance measures will be introduced to ensure these new rules are not subject to abuse.

Individuals in receipt of distributions from offshore funds will also be eligible for the non-repayable dividend tax credit regardless of the percentage shareholding.

Pensions – freezing of allowances

The annual allowance (AA) which effectively limits the amount of pension contributions which can be made by and on behalf of an individual had previously been set for all tax years up until 2010/11, with the amount for 2010/11 being £255,000. The AA will be frozen from 2011/12 to 2015/16 at £255,000 per annum.

Pension scheme members, not having existing transitional protection, who take pension and lump sum benefits are subject to a lifetime allowance (LA). The amount of the LA had previously been set for tax years to 2010/11, with the amount for 2010/11 being £1.8 million. The LA will be frozen from 2011/12 to 2015/16 at £1.8 million.

Removal of higher rate relief on pension contributions

Pension contributions made by an individual are usually paid net of basic rate tax and where the individual is a higher rate taxpayer further relief is due which significantly reduces the net cost of the premium. For example a cash contribution of £100 receives a basic rate credit of £25 which is added into the pension fund. The gross contribution of £125 then attracts relief at 40% of £50. After taking into account the basic rate relief already given, the individual has further tax relief of £25 which takes the net cost of the contribution down to £75.

The government has announced its intention to restrict tax relief on pension savings with effect from 6 April 2011 for people with taxable income of £150,000 or more. The relief will be tapered down until it is 20%.

Legislation will be introduced to prevent those potentially affected from seeking to forestall this change by increasing their pension savings in excess of their normal regular pattern, prior to that restriction taking effect.

The forestalling measures will apply to individuals with incomes of £150,000 or more who from Budget Day, change:

- their normal pattern of regular pension contributions, or
- the normal way in which their pension benefits are accrued, and
- their total pension contributions or benefits accrued exceed £20,000 a year.

Venture Capital Trusts

Legislation will be introduced to make improvements to the scheme to relax the time limits concerning the employment of money by companies receiving investment to two years or if later two years from the commencement of the qualifying activity.

Enterprise Investment Scheme (EIS)

Changes will be made to the EIS to:

- relax the time limits concerning the employment of money invested to two years from the issue of the shares or if later two years from the commencement of the qualifying activity
- remove the link to other shares of the same class issued at the same time as the qualifying shares
- extend the period for carry back of relief and allow the full amount subscribed (subject to the overriding limit of £500,000) to be carried back
- correct an anomaly regarding the capital gains position for investors in the event of a share for share exchange.

Individual Savings Accounts (ISAs)

In 2009/10 the ISA limits for people aged 50 and over will be raised to £10,200, of which £5,100 can be held in cash. This change will be made from 6 October 2009. The current ISA limits (£7,200 of which a maximum of £3,600 can be held in cash) will be increased for all investors to the same amount from 6 April 2010.

Remittance basis

Individuals who are resident but not domiciled or not ordinarily resident in the UK have the option of using the remittance basis of taxation. Significant changes were made to the remittance basis in 2008. Following consultation minor changes will be made to these rules.

Personal allowances for non-resident individuals

Legislation will be introduced from 2010 to withdraw the entitlement for individuals to personal allowances and relief's solely by virtue of being a Commonwealth citizen. It is expected that the majority of individuals affected will still benefit through other means, for example Double Tax Treaties.

Financial Services Compensation Scheme (FSCS)

Individuals will be charged to income tax on the payment of accrued interest paid as part of compensation from the FSCS. This measure applies to payments made by the FSCS on or after 6 October 2008.

Furnished Holiday Lettings (FHL)

Unlike general property rental businesses, FHL are treated as a trade for certain taxation purposes, which is generally more preferential in terms of loss relief's and CGT relief's. A key condition for property to qualify as FHL is that it is situated in the UK. Due to the possible incompatibility of the rules with European law, two significant announcements have been made. The current law on FHL is to be repealed with effect from 2010/11 but until then FHL situated in the European Economic Area (EEA) are qualifying FHL provided they meet the other conditions.