



Talking Tax

Delivering wealth management solutions to personal and corporate clients

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Income tax shock

The scale and timing of the income tax increases set out by the Chancellor on 22 April 2009 took many by surprise, particularly given announcements made in the preceding Pre-Budget Report.

The two main changes are the increase in the rates of income tax applying to "high earners", discussed below, and the planned withdrawal of higher rate income tax relief on pension contributions (considered overleaf).

Top rate tax

From 6 April 2010, a year earlier than previously announced, the top rate of tax for individuals will be increased to 50% (rather than 45%) and will apply to all income except dividends above £150,000. Anyone affected and anticipating a bonus should ensure it is paid by 5 April 2010.

Also from 6 April next year, dividends above the £150,000 threshold will be subject to tax at a new rate of 42.5%. The higher rate increases the effective rate of tax on dividends from 25% to 36.11%; hence it is still likely to be more tax efficient for business owners to extract profits by way of dividends rather than salary. The trust rates of income tax will also be raised from 6 April 2010 to 50% (42.5% on dividends).

The personal allowance, worth £2,590 to a higher rate taxpayer in 2009/10, is to be withdrawn by £1 for every £2 of taxable income above £100,000 from 6 April 2010, which effectively means the allowance disappears altogether once income exceeds £112,950. Those with taxable income between £100,001 and £112,950 will see their marginal tax rate increase from 41% in 2009/10 to 61% in 2010/11.

Looking further ahead, employees' and employers' national insurance contributions will increase by 0.5% from 6 April 2011.

Capital incentive

In stark contrast to the income tax rates, capital gains tax is levied at a flat rate of 18% and from 6 April 2010 there will be more incentive than ever for individuals to look for ways of converting income receipts into capital. One possibility may be to make use of Revenue approved company shares schemes such as the Company Share Ownership Plan, Enterprise Management Incentive scheme or Share Incentive Plan. Another strategy to consider for those at the margins

of the new upper thresholds is the use of salary sacrifice schemes where these are offered by an employer. However, HMRC has already indicated it will act to prevent those with earnings over £150,000 exploiting these arrangements.

Although the above tax increases have been widely reported as targeting high "earners", they apply equally to unearned income, such as rental profits. Also, individuals operating businesses through unincorporated vehicles, such as a sole trader, will suffer the new 50% tax rate even earlier than someone in employment owing to the way tax is calculated for those businesses. The new 50% rate is likely to cause many to reconsider whether unincorporated status is the best medium for their business, as the standard rate of corporation tax will be 22% below the top rate of income tax.

The changes planned for 2010/11 leave the UK with one of the highest top income tax rates in the EU and the highest in the G7. The Chancellor must be aware of the risks of mobile high earners leaving the UK, or taking ever more aggressive steps to reduce their tax bills through avoidance arrangements. In this respect, the Chancellor's timing of the closure of a number of "loopholes" and the promise to name and shame those caught indulging in non-compliant behaviour need to be borne in mind.

Marginal income tax rates 2010/11

Taxable income	Marginal rate (tax and NI)		
	2009/10	2010/11	2011/12
£6,000 to £6,475*	11%	11%	11.5%
£6,476 to £44,000**	31%	31%	31.5%
£44,001 to £100,000	41%	41%	41.5%
£100,001 to £112,950	41%	61%	61.5%
£112,951 to £149,999	41%	41%	41.5%
£150,000+	41%	51%	51.5%

* Estimated figures for 2010/11 and 2011/12

** Estimated basic rate threshold/upper earnings limit for 2010/11 and 2011/12



ISA boost

The government is showing its generous side by raising the ISA tax-free saving limits, with those over 50 set to benefit first.

From 6 October 2009, individuals aged 50 and over will be able to increase their contributions to Individual Savings Accounts from the current £7,200 per annum to £10,200 per annum, of which £5,100 may be invested in a cash ISA. So if you are aged 50 and over in 2009/10, you will be able to invest up to £7,200 between now and 5 October 2009 (or the date of your 50th birthday) and an additional £3,000 in the run up to the new tax year. This is good news for anyone, such as the retired, relying on investment income and hard hit by current low interest rates.

The £3,000 increase to the annual allowance will be extended to all eligible ISA investors from 6 April 2010. This is welcome, because ISAs remain attractive for all savers. Cash ISAs typically offer much higher interest rates than ordinary savings accounts because of the limited annual amount any individual can pay in. With the stock market currently reasonably priced, those taking a longer term investment view and willing to take some equity risk may also be attracted by stocks and shares ISAs. Investments in slightly safer assets such as gilts and bonds can also be held in the ISA wrapper.

Pensions in perspective

Tax relief on pension contributions may have been cut for the highest paid, but pension saving remains an essential and government-supported action.

From midnight on 22 April 2009, draconian rules on the level of tax relief available on pension contributions were introduced. These affect individuals with annual earnings over £150,000 who contribute more than £20,000 to pension schemes if they have not been paying regular premiums – regular being defined as at least on a quarterly basis.

How the rules work

The new rules restrict higher rate tax relief on pension contributions for individuals:

- whose income from all sources, including income given up by salary sacrifice, is £150,000 or higher;
- who change their normal ongoing regular pension savings; and
- whose total pension savings exceed £20,000 per annum.

The rules introduce a special annual allowance, set at £20,000 for the 2009/10 and 2010/11 tax years, before the introduction of the main changes on 6 April 2011. Tax relief on contributions above this amount will be restricted to the basic rate of tax through the use of a special annual allowance charge equal to the difference between the highest rate of income tax and the basic rate, currently 20%. The special annual allowance charge will not apply if an individual's normal regular ongoing pension contributions are over £20,000 provided they are not increased and were paid at least quarterly into an arrangement prior to 22 April 2009. Any increase will be subject to the special allowance charge.

The main changes will set an upper limit on the amount of additional pension contributions upon which full tax relief at the highest rates of tax can be given, which will depend on earnings. This will be applied on a sliding scale for individuals earning between £150,000 and £180,000 and will mean that anyone earning over £180,000 per annum will only receive 20% income tax relief on pension contributions. As mentioned above, the earnings figure will include all sources of income including rental income, all investment and dividend income and will be adjusted to include any contributions made by employers to pensions by way of salary sacrifice.

Room for manoeuvre?

Is there anything that can be done if you are a high earner who was planning to make a major one-off pension contribution this tax year? Sadly not. The rules had immediate effect, removing the opportunity



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for anyone to make a fast pension contribution that would receive the 40% relief.

Nor are there too many other attractive investment options to rival pensions, particularly over the long term. Investors in Venture Capital Trusts can receive income tax relief at 30%, but this is at the riskier end of the portfolio spectrum. So are Enterprise Investment Schemes, which offer income tax relief of 20%.

So the rule change is bad news for anyone who is a high earner. £20,000 is a relatively low level for removing maximum tax relief since it is widely accepted that a 15%-20% p.a. contribution level is required to provide a reasonable pension in retirement.

Any knee jerk reaction against pension saving should be resisted. A tax break – even a 20% one – is still a tax break. Better to have 20% relief going into your pension fund than 50% of your income going into the government's coffers. That relief is available on contributions of up to £245,000 for 2009/2010. So making pension contributions still makes sense – it just may not feel quite so painless.



New dividend tax regime

Major changes to the taxation of dividends received by UK companies were confirmed in the Budget.

From 1 July 2009, dividends from non-UK companies will generally be exempt from UK corporation tax. Two changes from the Pre-Budget Report proposals are that:

- the exemption will apply to "small" UK companies not just "large" and "medium" companies; and
- the new regime will apply to dividends paid by UK companies, as well as those paid by foreign companies.

Extending the new regime to dividends paid by UK companies ensures that it applies to all dividends and therefore complies with the non-discrimination articles of relevant treaties, particularly in relation to the European Union.

Proposed changes

It is proposed that from 1 July 2009, a dividend received by a small company generally will be exempt from corporation tax provided that:

- the payer is solely tax resident in the UK or in a territory with which the UK has a double tax treaty which includes a non-discrimination article;
- the payer, if overseas, is not entitled to a deduction by reference to the dividend; and
- the dividend is not made as part of a tax advantage scheme (i.e. a scheme the main purpose, or one of the main purposes, of which is to obtain a tax advantage).

A dividend received by a company which is not small generally will be exempt from corporation tax provided that:

- (i) the payer (if overseas) is not entitled to a deduction by reference to the dividend;
- (ii) it falls within one or more of the five exempt classes set out below; and
- (iii) the dividend does not fall within the anti-avoidance provisions.

A dividend falls within an exempt class if:

- (a) the recipient solely or jointly with one other person controls the payer and, in the case of a jointly controlled company, each person has at least a 40% interest (and the other person has not more than a 55% interest) in the payer;
- (b) the dividend is paid in respect of non-redeemable ordinary shares;
- (c) the recipient owns 10% or less of the payer;
- (d) the dividend is not paid out of profits diverted from another company where they would have been subject to corporation tax; and



- (e) the dividend is paid in respect of shares that are accounted for under GAAP as loan relationships.

A dividend received by a medium or large company will not be exempt if it is made as part of a tax advantage scheme and it is a prescribed scheme. The seven prescribed schemes are those:

- (i) involving manipulation of the controlled company rules (see (a) above);
- (ii) involving quasi-preference shares;
- (iii) involving manipulation of the portfolio holdings rule (see (c) above);
- (iv) involving payments not on arm's length terms;
- (v) involving payments for distributions;
- (vi) in the nature of loan relationships; and
- (vii) involving diversion of trade income.

Planning considerations

Where possible, the payment of dividends by overseas companies should be deferred until after 30 June 2009.

Where a dividend paid by a UK company will be taxable under the new regime it should, if possible, be paid before 1 July 2009.

Other changes

New rules are to be introduced to cap the deductibility of interest payable by UK group companies that are part of an international group, to change the CFC rules, and to replace the Treasury consent regime.

Personal tax accountability

One announcement in the Budget that has generated surprisingly little publicity is a proposal to make senior accounting officers of large companies personally accountable for the effectiveness of their accounting systems for tax reporting purposes.

Legislation will be introduced in Finance Bill 2009 to require senior accounting officers of large companies to:

- establish and monitor accounting systems within their companies that are adequate for the purposes of accurate tax reporting; and
- certify annually that the accounting systems in operation are adequate for the purposes of accurate tax reporting or to specify the nature of any inadequacies and confirm that those inadequacies have been notified to their auditors.

Large companies will have to notify HM Revenue & Customs of the identity of the senior accounting officer.

These new obligations will be supported by penalties chargeable on the senior accounting officer personally and on the company for a careless or deliberate failure and for the giving of a carelessly or deliberately incorrect certificate or notification. They will apply to returns for accounting periods beginning on or after the date that Finance Bill 2009 receives Royal Assent (expected to be 21 July 2009). Transitional arrangements may be considered.

As well as satisfying themselves as to the adequacy of their accounting systems, senior accounting officers of large companies may wish to review the adequacy of their Directors and Officers liability insurance.



Who to contact

For more information, contact your usual Moore Stephens partner, or log on to www.moorestephens.co.uk

Compliance alert

Continuing the ongoing theme of increasing HMRC's powers, the Budget included a number of proposed compliance changes.

The changes align with the Revenue's plan to spend 25% or £1 billion of its annual budget on enforcement and compliance. However, they have been counterbalanced, to some extent, by confirmation that an HMRC charter will be introduced.

Penalties

A new penalty regime will be introduced for the submission of tax returns and the payment of tax liabilities for income tax, corporation tax, PAYE, NIC, the construction industry scheme, stamp duty land tax/reserve tax, inheritance tax, pension schemes and petroleum revenue tax.

A £100 penalty will automatically apply if a return is filed after the due date. In addition, £10 per day penalties will be charged if the return remains outstanding for three months (for a maximum of 90 days). An additional 5% of the tax due will be charged on each occasion if the return is outstanding after six and twelve months. As a last resort, HMRC can charge a 100% penalty if the return is outstanding for more than twelve months and the taxpayer has deliberately concealed information.

For late payment of tax, 5% surcharges on unpaid tax will be applied one, six and twelve months after the due date.

The monthly penalties for CIS returns have been increased and a statutory basis introduced for penalties for late payment of PAYE and NIC by employers, with a rising penalty loading depending on the number of defaults over a twelve month period.

Penalties will not be charged where a time to pay arrangement has been agreed with HMRC.

Compliance checks

The compliance checks regime which currently applies to mainstream taxes is being extended to environmental taxes, insurance premium tax, SDLT, SDRT, IHT and petroleum revenue tax. This includes the power to visit business premises and to inspect records, assets and premises, as well as appeal rights against any penalty. The record keeping requirements for these taxes will also be adjusted where necessary in line with the mainstream taxes. These changes are expected to be introduced from 1 April 2010.

Time limits for claims currently vary between taxes and it is expected that these will be aligned from 1 April 2011, creating a standard framework.



Reclaiming tax

Changes are being made to the deadlines for reclaiming income tax, capital gains tax and corporation tax from 1 April 2010. Currently the time limit for making such claims is between five years ten months and six years. This limit is being reduced to four years. The grounds for which such a claim can be made will also be updated.

Interest harmonisation

HMRC aims to harmonise the rates of interest charged on late paid tax and on repayments across different types of tax.

HMRC charter

Future legislation will require HMRC to introduce a charter by 31 December 2009 setting out the standards of behaviour and values it should meet. HMRC will be required to report annually on its performance.

New tribunal system

Meanwhile, a new two tier tax tribunal system became operational on 1 April 2009. The First Tier Tribunal deals in the first instance with many of the issues previously heard by the General or Special Commissioners or VAT Tribunal. The Upper Tribunal deals predominantly with appeals from the First Tier Tribunal and more complex cases.

Appeals from the First Tier to the Upper Tribunal can only be made on a point of law and with the permission of the Upper Tribunal – a more limited system for the taxpayer than previously. Appeal from the Upper Tribunal is to the Court of Appeal (or Scottish or Northern Ireland equivalent) and is permitted only where it would raise an important point of principle or practice, or there is some other compelling reason. New rules also apply to the awarding of costs.

We believe the information in Talking Tax to be correct at the time of going to press, but we cannot accept any responsibility for any loss occasioned to any person as a result of action or refraining from action as a result of any item herein.

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