assessing the impact

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Following the 2009 Budget proposals and subsequent Finance Bill, Colin Jelley identifies the areas where time would be well spent with clients.

Colin Jelley
Head of Tax and Financial Planning

In recent years, the Chancellor's Budget changes have been signposted in the preceding Pre-Budget Report (PBR). This year's Budget was no different except that, due to the challenging economic environment and the Government's need to increase revenues, many of the proposals mentioned in November have had their timescales brought forward and the tax rates increased.

So what are the key areas for advice in the coming weeks and months?

individual income tax rates (2009/10)

It would be easy to assume the 10% tax rate was abolished a year or so ago. However, for some individuals this rate can still apply to the first £2,440 of their savings income. As the personal allowance for 2009/10 is £6,475, where an individual's non-savings income is more than £8,915 (£6,475 plus the 10% band of £2,440) the 10% starting rate will not apply.

Beyond this rate, the basic rate of income tax has remained at 20% and the higher rate at 40%, with the basic rate threshold increased to £37,400. The PBR had already mooted a new rate of income tax at 45%, but we were all surprised to see the arrival of a 50% rate and starting a year earlier than previously announced.

In addition to the new 50% rate for incomes of £150,000 and above, advisers must also consider the loss of personal allowances for those with incomes above £100,000.

tax rates for dividend income

The rates for dividends were unchanged for 2009/10, with the 10% tax credit satisfying the liabilities of basic-rate and non-taxpayers and an additional rate of 32.5% for higher-rate taxpayers. However, from 2010/11 a new rate is applicable on incomes above £150,000 which include dividend income.

From 6 April 2010, dividends received by individuals will be taxed according to their tax band, as follows:

Basic-rate band	10%
Higher-rate band	32.5%
50% band	42.5%

impact of the loss of personal allowance

For individuals whose income exceeds £100,000, the level of the personal allowance will be reduced by £1 for every £2 of income over £100,000, until the allowance reaches zero.

The effective impact of this change is to tax income over £100,000 at a higher than expected rate. Assuming no increase in the personal allowance for the 2010/11 tax year, this would provide the following effective income tax rates:

Taxable Income	Effective rate of income tax paid on income above £100,000
£112,950	60.00%
£120,000	52.95%
£130,000	48.63%
£140,000	46.47%

It may be possible to reduce the effective rate of tax suffered by an individual through for example pension contributions, salary sacrifice or Gift Aid.

trust taxation

The changes announced for individuals will clearly affect trusts and those advising on trustee investments.

As with other proposals contained in the PBR, the Chancellor also changed the effective date of these changes. From 6 April 2010, the current 40% income tax rate for trusts (above the rate for the first £1,000 of trust income) will increase to 50%. The rates applicable to dividends will also increase from 32.5% to 42.5%. As the £150,000 threshold for trust income does not apply, this is a very steep increase in tax.

Opportunities for trustee investments have always existed, but clearly where dividends are being received it is necessary to reconsider the planning landscape. The asset generating the dividends might be more tax-efficient inside another wrapper, or the trust structure could be changed to allow some tax recovery.

offshore funds

Many clients could see the changes to the distributor and non-distributor status rules as a positive outcome. Principally, UK investors in an offshore distributor fund will now be taxed like a UK collective, with the following distinctions.

- Where the fund is an equity fund, the distribution will be accompanied by a 10% non-payable tax credit. A basic-rate taxpayer will have no further tax liability. A higher-rate taxpayer's liability would be 25% of the actual dividend received (ie 32.5% of the sum of the dividend).
- Where the fund is not an equity fund (ie it invests more than 60% of its assets in interest-bearing securities, cash deposits etc), the distribution will be treated as an interest payment.
- Future realised gains will be subject to capital gains tax (CGT).

One area to consider when looking at non-UK domiciled funds is whether the fund will benefit from any double taxation agreements on income received by it, as this may impact performance.

capital gains tax and inheritance tax

Although this year's Budget appears to leave CGT alone, the 18% rate introduced in 2008 now looks out of place against the changes to income tax rates. With the CGT allowance increasing to £10,100, where used effectively it can save £1,818 in tax or £3,636 for a married couple.

Use of this allowance to maximum effect must be managed against costs of disposal and reinvestment. Additionally, realising losses today may well be a good strategy if you feel the 18% rate is likely to increase in future years, when any future gains could be offset with losses created in a 'lower-tax era'.

With regard to inheritance tax (IHT), the introduction of transferable nil-rate bands has seen a reduction in IHT receipts. With the IHT threshold of £325,000 for 2009/10, a married couple will now have £650,000 of assets exempt from IHT.

national insurance

National Insurance (NI) has become more complex in recent years. Combining proposed NI increases for 2010/11 with planned 2010/11 income tax increases produces an effective tax rate of up to 61.5% for employed individuals who have incomes over £100,000.

The changes create some clear advice opportunities where earnings can be managed through salary versus dividend planning.

From the beginning of the current tax year, the peak for the higher band rate of accrual for the State Second Pension (S2P) is capped. There is now an Upper Accrual Point of £40,040, which falls below the £43,875 level at which full NI is paid by both employer and employee. For individuals with earnings above the Upper Accrual Point, there is an argument for using salary sacrifice to increase private retirement provisions, while the employer may well be prepared to fund part or all NI savings as additional contributions to an individual's registered pension scheme.

ISAs

We all welcome the increase in the savings limits to £10,200 from April 2010, but the transitional period for over 50s from October 2009 looks unnecessary.

The increase in funding levels for clients should present an excellent opportunity to move more funds to tax-efficient environments.

pensions

Within the Finance Bill, the major issues affecting the private pension regime concern the Government's attempt to restrict ongoing tax relief under the simplified pension regime. This has been targeted through a combination of the following proposals:

- The freezing of the Lifetime Allowance at £1.8 million from the 2010/11 tax year to the end of the 2015/16 tax year.
- The introduction from the 2011/12 tax year of restricted tax relief on accrual within registered pension schemes for those with income in excess of £150,000.
- The introduction of anti-forestalling legislation for the 2009/10 and 2010/11 tax years to restrict full tax relief to accruals of £20,000 in each year (or higher levels of recent pension savings) for those with relevant income of £150,000 or more.

Detailed analysis of the pension proposals were set out in the May issue of informer, available at **www.skandia.co.uk/sites/informer/**

The issues outlined here demonstrate the growing need for advice enabling clients to fully understand how changes relate to their own financial planning; an excellent opportunity for those advisers with the necessary technical knowledge to identify and meet client needs.

This article was written before the Finance Bill received Royal Assent.

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at July 2009. We believe this interpretation to be correct but cannot guarantee it.

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