



The UK Budget 2009 — Personal Taxation

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On 22 April the Chancellor of the Exchequer presented his 2009 Budget to Parliament. In the face of a global downturn and an unprecedented burden of public debt, the Chancellor's announcements are said to be intended to help the UK recover from recession. But how will the Budget affect personal UK taxpayers?

The headline changes for individuals are:

- › A new higher income tax rate of 50% will apply to taxable income over £150,000 from 6 April 2010. This rate will apply to individuals and trustees, but to trustees irrespective of their income level.
- › From 6 April 2011 taxpayers with earnings in excess of £150,000 per annum will have restricted tax relief on their pension contributions.
- › From 22 April 2009 inheritance tax agricultural property relief and woodlands relief will apply to property held in the European Economic Area.

Income Tax

From 6 April 2010 a new 50% rate of income tax for taxable income above £150,000 will apply. The measure has been justified by the Government as a means of reducing the UK's borrowing. It is unclear whether increasing the higher rate of tax will discourage individuals considering the UK as a permanent base, or encourage those already considering ceasing UK residence to leave. The 20% rate will continue to apply to income up to £37,400, and the existing higher rate of 40% will apply to taxable income between £37,400 and £150,000.

A new higher tax rate of 42.5% will apply to dividend income. The existing rates of 10% and

32.5% remain applicable to dividends received as part of the first £150,000 of taxable income.

From 6 April 2010 the basic personal allowance for income tax (£6,475 for the tax year 2009/2010) will be reduced gradually to nil if a taxpayer has "adjusted net income" of more than £100,000. The allowance will be reduced by £1 for every £2 of income above the £100,000 income limit, so that a taxpayer with adjusted net income of £113,490 (based on the 2009/2010 personal allowance) will not receive any personal allowance in 2010/2011. As a result, income between £100,000 and £113,490 will be taxed at an effective rate of 61.5% (taking account of national insurance).

The rate applicable to trusts will also increase from 6 April 2010 to 50%, with the trust dividend rate increasing to 42.5%. This is further evidence of the UK Government's penalisation of trusts.

The 2008 Pre-Budget Report announced that, from 6 April 2011, there will be a 0.5% increase in the employer, employee and self-employed rates of national insurance.

Pensions

The Chancellor also announced measures affecting higher-earners' pensions, which have now been incorporated into Finance Bill 2009.¹ From 6 April 2011, tax relief on pension contributions will be restricted to the basic rate of income tax for individuals whose annual income is £150,000 or higher. In order to restrict higher rate tax relief on pension contributions, new rules will apply from 22 April 2009 to people:

- › whose income is £150,000 or higher,
- › who alter the "normal" pattern of their pension savings and
- › whose total annual pension savings exceed £20,000.

The rules (set out in Schedule 35 to Finance Bill 2009) are intended to prevent high-earners from reducing their tax exposure by making increased pension contributions before the new restrictions begin to apply in 2011.

From 22 April 2009 a "special annual allowance" of £20,000 will be introduced. This is the upper limit on the amount of additional pension savings for which full tax relief at the higher rate of tax can be given. Additional pension contributions above the special annual allowance will be allowed tax relief at the basic rate of tax only. All high-income individuals will be liable to pay the special annual allowance charge whether or not the individual is not resident, not ordinarily resident or not domiciled in the UK.

The following examples show how the limit will apply.

Example

A has income of £158,000 in 2010/2011 and makes contributions to his personal pension scheme of £24,000 during the year, at £2,000 per month, something he has done for the past two years. His income exceeds the £150,000 threshold. His pension contributions are more than the £20,000 special annual allowance. However, they will not be subject to the special annual allowance tax charge because they reflect his normal, regular contributions.

B has income of £170,000 in 2010/2011 and makes total pension contributions of £50,000 to her personal pension scheme. The contributions reflect a regular monthly contribution of £2,000 (as for past years) and a single payment of £26,000. B's income exceeds the £150,000 threshold, and her pension contributions are more than the £20,000 special annual allowance. However, her monthly contributions of £24,000 are not subject to the annual allowance charge because they reflect her normal, regular contributions. The additional single contribution of £26,000 will be subject to the special annual allowance tax charge and therefore will receive tax relief only at the basic rate.

The tax charge will be collected through a self-assessment tax return.

Taxpayers who have income in excess of £150,000 may be able to claim a refund of contributions paid after 6 April 2009 depending on the nature of the pension arrangements and whether the pension provider wishes to offer the option. Refunds can be made only for contributions made in the tax year 2009/2010 onwards, and all refunds will be paid after deducting 40% tax to reverse the tax reliefs given on the contributions.

Where a taxpayer made non-regular pension savings between 6 April 2009 and 21 April 2009, these savings will not of themselves be subject

to the special annual allowance tax charge. However, they will reduce the amount of special annual allowance available for 2009/2010.

Individual Savings Accounts (ISAs)

The existing ISA² regulations provide that the annual subscription limit for an ISA is £7,200, of which up to £3,600 can be saved in a cash ISA with one provider. These limits are frozen for those under the age of 50 in the tax year 2009/2010. From 6 October 2009, however, the ISA limit for people aged 50 and over in 2009/2010 will increase to £10,200, of which up to £5,100 can be saved in cash. From 6 April 2010, the increased ISA limit will apply to all ISA investors.

Capital Gains Tax

The flat rate of capital gains tax is maintained at 18% for 2009/2010. The annual exemption is £10,100, an increase of £500 from the previous tax year.

Inheritance Tax

The nil-rate band threshold for inheritance tax has not been amended. The threshold for 2009/2010 is £325,000, and for the tax year starting 6 April 2010 £350,000.

Inheritance Tax: Agricultural Property Relief (APR) and Woodlands Relief

The Budget did not bring bad news alone. The Chancellor has extended the scope of both APR and woodlands relief. With effect from 22 April 2009 APR and woodlands relief will apply to property in the European Economic Area (EEA).³ Property qualifying for the extended inheritance tax relief will also qualify for capital gains tax hold-over relief.

Prior to Budget day, APR was restricted to property in the United Kingdom, the Channel Islands and the Isle of Man. The extension will apply with retrospective effect to the extent that any inheritance tax due or paid on or

1. Clauses 71–74 and Schedule 35.

2. A tax-efficient wrapper subject to small annual subscription limits in which stock market-based investments or cash can be held. Any interest earned or capital gains made on the investment will be tax-free.

3. Clause 121.

after 23 April 2003 in relation to agricultural property located in an EEA State at the time of the chargeable event will become eligible for relief. Finance Bill 2009 provides that the earliest deadline for reclaiming tax overpaid on such property will be 21 April 2010.⁴ This extension of APR will be of direct benefit to UK domiciliaries who have farmland in Ireland that would have been eligible for APR but for the territorial limitation.

As part of HMRC's review of time limits, the statutory time limit for making a claim for repayment of overpaid inheritance tax is reduced from six years to four, which will affect repayment claims for overpayments where inheritance tax has been paid and agricultural property relief is now available. However, the new time limits will not apply to claims made before 21 April 2011.

Where conditions are met, woodlands relief allows inheritance tax to be deferred on the value of timber or underwood until it is sold. Before 22 April 2009, woodlands relief applied only to land in the United Kingdom. For deaths before 22 April 2009, property in an EEA State will become eligible for woodlands relief subject to a time limit of (usually) two years after the date of death. The Finance Bill 2009 provides that the earliest deadline for reclaiming overpayments on such property will be 21 April 2010.⁵

Hold-over relief enables the taxpayer to defer a capital gains tax charge on a gift (or sale at undervalue) of a business asset until the asset is disposed of by the recipient. This relief will now be extended to apply to agricultural property in an EEA State where it has been farmed by a person other than the owner. Hold-over relief will also become available for past disposals of agricultural property located in a qualifying EEA State.

The time limit for claiming hold-over relief is five years from 31 January following the tax year to which the claim relates. Claims for relief in respect of the tax year 2003/2004 can therefore be made until 31 January 2010. Finance Act 2008 provides that time limits for hold-over relief claims will be reduced to four years (rather than five) from 1 April 2010.

Furnished Holiday Lettings (FHLs)

Landlords with income from furnished holiday accommodation in the UK are currently treated as trading for certain income and capital gains tax purposes, as long as they satisfy certain tests. This has proven to be a valuable relief, enabling the owners of second homes that meet the FHL rules to offset the costs against other income or gains. However, landlords with income from furnished holiday accommodation located in an EEA State cannot currently qualify for the same treatment. This is thought to be economically discriminatory.

The Government has decided to repeal the FHL rules from 6 April 2010, withdrawing the relief for second-home owners who currently meet the FHL rules from that date. Until then, property anywhere within an EEA State can potentially qualify as a FHL and take advantage of the relief. The withdrawal of the rules will prove to be a huge disadvantage to the many second-home owners in the UK who are currently able to offset tax against the costs of running the second home.

Taxation of Dividends from Foreign Shares

Legislation has been introduced in Finance Bill 2009⁶ to amend the system of taxation for individuals who own foreign shares. Currently, individuals receiving dividends from UK-resident companies are entitled to a non-repayable dividend tax credit. Since 6 April 2008, individuals with shareholdings of less than 10%

in non-UK-resident companies have also been entitled to a non-repayable tax credit. From 22 April 2009, individuals with shareholdings of 10% or more in a non-UK-resident company will become entitled to a non-repayable tax credit on dividends received, subject to certain conditions.

Offshore Funds and Distributions

Finance Bill 2009 has introduced a new definition of an "offshore fund" for UK tax purposes.⁷ The new definition uses a characteristics-based approach to determine whether an entity is an offshore fund. The new regime will have effect from 1 December 2009. Grandfathering transitional rules have been introduced for investors in existing arrangements. Partnerships and limited liability partnerships will not be affected by the new legislation as they are specifically excluded from the definition of offshore funds.

As mentioned above, since 6 April 2008 individual shareholders with shareholdings of less than 10% in non-UK-resident companies have been entitled to a non-repayable dividend tax credit. However, the tax credit was withdrawn for offshore funds as some collective investment schemes were locating their cash or bond fund ranges offshore so as to secure a tax advantage. New rules have been introduced in Finance Bill 2009⁸ in relation to all holdings in offshore funds (whether less than 10%, 10% or more), so that the non-repayable dividend tax credit will apply to offshore funds that are largely invested in equities.

The new legislation also provides that, where the offshore fund is substantially invested in interest-bearing assets, individuals receiving distributions will be treated for tax purposes as having received interest and not a dividend or other type of distribution. This will mean that no tax credit will be available and the higher rate applicable to interest will apply.

4. Clause 121(8).

5. Clause 121(9).

6. Clause 40 and Schedule 19.

7. Schedule 22, Part 1.

8. Schedule 22, Part 2.

The new legislation will not affect the taxation of UK investors in offshore funds that are transparent for the purposes of tax on income, i.e. partnerships etc. In such cases the investor is taxed on a share of the underlying fund income according to the type of income received and not on the distribution made.

Employee Living Accommodation and Lease Premiums

Finance Bill 2009 has introduced provisions⁹ to curb attempts to avoid tax on the benefit of employment-related living accommodation through the payment of a lease premium. Where an employee is provided with accommodation, there is a tax charge on the benefit to the employee. Where rent is paid by the employer, the benefit-in-kind charge is usually based on the actual rent paid. Some employers have significantly reduced the tax exposure by paying the landlord a substantial premium at the beginning of the lease and a modest annual rent thereafter.

The new rules provide that, where a lease premium is paid for a lease of ten years or less, the lease premium will be treated as if it were actual rent paid. The value of the benefit will be computed by adding the lease premium to the amount of any rent paid by the employer, less any amount made good by the employee.

Personal Allowances and Reliefs for Non-Resident Commonwealth Citizens

The UK Government has been advised that allowing UK personal allowances and reliefs to non-resident individuals who are Commonwealth citizens is not compliant with the UK Human Rights Act. Therefore, legislation will be introduced to withdraw the entitlement for non-resident individuals who currently qualify for UK personal allowances to reliefs from income tax due only by virtue of being a Commonwealth

citizen. The Government has reported that the vast majority of individuals affected will still benefit through other means — for example, double taxation treaties.

The legislation¹⁰ will take effect from 6 April 2010 and will affect citizens of the Bahamas, Cameroon, the Cook Islands, Dominica, the Maldives, Mozambique, Nauru, Niue, St Lucia, St Vincent and the Grenadines, Samoa, Tanzania, Tonga and Vanuatu.

Amendments to the Remittance Basis of Taxation

Finance Act 2008 introduced significant changes to the remittance basis regime for UK-resident, non-UK-domiciled individuals. Further minor changes to the rules are included in the 2009 Finance Bill.¹¹

Certain UK-resident, non-domiciled individual employees working in the UK (generally, seasonal workers such as agricultural workers) will not be obliged to file a UK tax return with effect from 6 April 2008 if various conditions are met, such as their overseas employment income is less than £10,000 and overseas bank interest is less than £100 in any tax year, and all the income in question is subject to foreign tax.

With effect from 6 April 2008 certain kinds of property funded out of foreign employment income or foreign chargeable gains can be brought into the UK for personal use or temporary purposes without triggering a remittance. Previously, this exemption had applied only to property funded out of foreign investment income.

Finance Act 2008 introduced significant changes to the remittance basis regime for UK-resident, non-UK-domiciled individuals. Further minor changes to the rules are included in the 2009 Finance Bill.

Finance Act 2008 included transitional provisions preventing income treated as having arisen to a settlor before 6 April 2008 from being taxed as a remittance if brought into the UK on or after that date. Legislation has been introduced¹² to clarify the interaction between the remittance basis regime and the tax rules applicable to settlor-interested trusts. The changes will have effect from 22 April 2009.

Charities: Substantial Donors

Where a charity enters into a specified transaction with a “substantial donor” or someone connected to a

substantial donor, the transaction is treated as non-charitable expenditure and can result in a tax charge for the charity. With effect from 23 April 2009 the threshold of relievable gifts that a person or company may make to a charity before becoming a substantial donor will increase from £100,000 over six years to £150,000 in the same period. The annual threshold of £25,000 will remain the same.

Miscellaneous

The standard rate of VAT will revert to 17.5% with effect from 1 January 2010.

Following the case *Boscawen v Mason* [2008] EWHC 3100 (Ch) the Agricultural Holdings Act 1986 has been amended to ensure that a change in the rate of VAT (including opting for tax) will **not** restart the three-year rent review cycle.

Royal Assent of Finance Act 2009 is scheduled for 21 July 2009.

9. Clause 70.

10. Clause 5 and Schedule 1.

11. Clauses 51 and 52 and Schedule 27, Finance Bill 2009.

12. Part 2 of Schedule 27.