

PRIVATE CLIENT UPDATE

BUDGET 2009

The Chancellor's budget yesterday heralded various changes targeting high net worth individuals which will increase the tax cost for many private clients. The main changes are summarised in this update.

Income tax rates and personal allowances

The Chancellor announced that, with effect from 6 April 2010, a new higher rate of income tax of 50% will be introduced for taxable income above £150,000. In addition, the higher rate of tax on dividends will increase from 32.5% to 42.5%.

The tax rate applicable to discretionary trusts will be increased from 40% to 50% irrespective of the level of taxable income. Dividends received by discretionary trusts will be taxed at 42.5%.

Also announced was a tapered reduction in personal allowances for individuals. From 2010-11 an individual will have their personal allowance reduced by £1 for every £2 of taxable income over £100,000.

Non-resident individuals who have previously been entitled to a personal allowance solely by virtue of their Commonwealth citizenship will no longer be able to benefit from the allowance with effect from 6 April 2010.

Restriction of pension contribution relief

To tie in with the introduction of the

new top rate of income tax, measures are being simultaneously introduced to prevent individuals from avoiding the higher rate of tax by making contributions to their personal pension schemes.

Initially, transitional measures are being introduced which will only affect individuals with taxable income above £150,000 (in the year of contribution or the two preceding years) who make contributions in excess of a special annual allowance of £20,000. Those who currently make regular contributions (i.e. three monthly or more frequently) are not caught by these transitional measures.

Previously, individuals have been able to benefit from tax savings at their marginal rate of tax on any contributions made up to the annual allowance (£245,000 in 2009-10). However, with immediate effect no additional relief will be available for those who increase their regular pattern of contributions and contribute in excess of the £20,000 limit. Single contributions which exceed the limit, either alone or in conjunction with a pattern of regular contributions will also be caught. Excess contributions will have relief restricted to the basic rate of tax only.

These transitional measures will apply until a new regime is introduced with effect from 6 April 2011. From that date, individuals who have income less than £150,000 will still be able to claim higher rate tax relief on their

contributions. However, relief will be tapered for those with income up to £180,000, beyond which tax relief is restricted to basic rate only. Further guidance and draft legislation is expected from HMRC to clarify the new regime.

ISAs

The annual ISA limit for individuals aged over 50 at any stage during the current tax year is to be increased from 6 October 2009 from £7,200 to £10,200, of which £5,100 may be saved in cash. The new limit will come into force for all other individuals for 2010-11.

Foreign tax credits on non-UK dividends

Since 6 April 2008, individuals were able to benefit from a one ninth tax credit on dividends received from non-UK resident companies only if the individual held less than 10 per cent of the company's issued share capital. The Chancellor has relaxed these rules with immediate effect such that all individuals will be able to benefit from the non-repayable tax credit, regardless of the size of their shareholding.

These rules have been extended to cover dividends received from non-transparent offshore funds whose underlying investments comprise at least 40% equities.

Charities and substantial donors

The definition of substantial donors

has been relaxed, with immediate effect, to include any individual who makes donations to a charity either annually in excess of £25,000 or totalling £150,000 or more over a period of six years.

Certain transactions between substantial donors and the charity can be treated as non-charitable expenditure and give rise to a tax charge for the charity.

Publication of deliberate tax defaulters

New rules are due to be introduced to enable HMRC to publish the names and details of individuals, trustees and companies who are penalised for deliberate defaults leading to losses of tax in excess of £25,000. An exemption will be granted to those who make a full, prompt disclosure to HMRC.

HMRC penalty regime

The regime for penalties is currently being revised to treat late filing and late payment of tax as separate offences. In contrast to the previous regime, tax returns now filed late, even where the tax has been paid on time, will still incur a penalty which cannot be repealed. HMRC are expected to publish further information on this change, including the effective date, later this year.

Offshore disclosure

Further to 2007's amnesty for disclosure of offshore accounts, a New Disclosure Opportunity has been announced with immediate effect. Holders of offshore accounts have until March 2010 to make voluntary disclosure to HMRC if they have unpaid tax or duties.

Non-domiciliaries - remittance basis

A number of refinements to the 2008 legislation dealing with remittances by non-domiciliaries were expected. However the Chancellor announced only very minor changes to these rules.

PRIVATE CLIENTS AND THEIR ASSETS

Furnished Holiday Lettings overhaul

Two significant changes to the furnished holiday lettings regime have been announced.

With immediate effect, the definition of a furnished holiday let has been extended to include properties situated in the European Economic Area assuming that all other conditions are met.

Furthermore, from 6 April 2010 the furnished holiday letting rules will be repealed and the letting of such properties will no longer be treated as a trade. The impact of this is significant and the main implications are as follows:

- Holiday lets will no longer benefit from entrepreneurs relief for capital gains tax;
- Trading losses suffered on holiday lets will not be relievable against other income.

Whilst the Budget announcements did not make reference to the future availability of Business Property Relief ('BPR') for inheritance tax purposes for furnished holiday it is likely to become very difficult to successfully claim BPR once the income tax rules are repealed.

Agricultural Property Relief extended to Europe

Agricultural Property Relief (APR) is available to reduce the chargeable value of an estate for inheritance tax purposes. Currently to qualify for APR the agricultural property must be situated in the UK. This has been extended to include agricultural property situated in the European Economic Area.

Stamp Duty Land Tax – extension of holiday

The Chancellor has extended the SDLT holiday, whereby residential

properties sold for no more than £175,000 are exempt from SDLT, until 31 December 2009.

Carry back of EIS income tax relief

The rules governing carry-back claims for income tax relief on EIS investments have been relaxed.

Previously an individual has been able to claim income tax relief on EIS shares issued prior to 6 October following the end of the tax year up to a limit of the lower of £50,000 and 50 per cent of the investment. It will be possible to carry back larger amounts, but the precise rules need to be clarified by draft legislation.

The total EIS investment on which income tax relief can be claimed in any tax year with effect from 2009-10 is £500,000.

PRIVATE CLIENTS AND THEIR BUSINESSES

Extension of carry back for trading losses

Previously, individuals and companies who incur trading losses have been able to relieve them against other income of the current year or the prior year.

The Chancellor has announced an extension to these rules for trading losses incurred in 2008-09 and 2009-10. In addition to the usual loss relief claims, these losses may be carried back to the prior year and then also, subject to a £50,000 cap, to the two preceding years.

Temporary re-introduction of first year capital allowances

After the major overhaul of the capital allowances regime announced in the Finance Act 2007 the Chancellor has re-introduced first year allowances for plant and machinery acquired in the year ended 5 April 2010.

The first £50,000 of qualifying expenditure will continue to attract 100%

relief under the Annual Investment Allowance. Qualifying expenditure on plant and machinery in excess of this amount, which would previously have been subject to a writing down allowance of 20%, will now be eligible for a first year allowance of 40%.

VAT – general changes

Numerous changes were announced by the Chancellor during the Budget, of which the highlights are summarised as follows:

- The standard rate of VAT will revert to 17.5% from 15% with effect from 1 January 2010;
- In respect of certain services, the place of supply for VAT purposes is changing from the place where the supplier is established to the place where the service is consumed with effect from 1 January 2010;
- The threshold of taxable turnover for compulsory VAT registration has been increased from £67,000 to £68,000 with effect from 1 May 2009.

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