



## It's Payback Time

### Emergency Budget 2010—Overview

In a controversial “emergency” Budget aimed at reducing the UK’s spiralling debts, Chancellor of the Exchequer George Osborne announced sweeping – and contentious – cuts in spending on benefits and public services, accompanied by higher taxes.

The Chancellor instigated average real budget cuts of 25% to most government departments over four years. Elsewhere, changes to the welfare system are expected to save £11bn by 2014/15. From 2011, tax credits, benefits and public service pensions will increase in line with the Consumer Price Index rather than the Retail Prices Index (RPI), which tends to be higher.

Child benefit will be frozen for three years and tax credits cut for families earning more than £40,000. Housing benefit will be capped at a maximum of £400 per week. Meanwhile, from April 2011, the basic state pension will rise in line with earnings, prices or 2.5% – whichever is the largest.

The threshold at which employers begin to pay National Insurance will rise from April 2011 by the rate of inflation plus £21 per week. Turning to the financial sector, the Government is set to introduce a bank levy that it expects to raise £2bn per year. It will apply to UK banks, building societies and the UK operations of overseas banks, but will not apply to smaller banks.

### Headline Tax Rise

The biggest headline tax rise was in the VAT rate, from 17.5% to 20%. In this, the Chancellor said he was focusing on spending – which is to some extent discretionary – rather than on higher income taxes, which are not.

As a result, income tax saw fewer changes. The personal allowance for under-65s was raised £1,000 to £7,475. To pay for this, the basic rate tax band will be frozen until 2013/14, bringing more people into the higher rate band. Notably, the Chancellor left some of his predecessor’s measures untouched. There was no review of the 50% tax band or the tapered reduction of the personal allowance for those earning over £100,000, which both remain in place.

There were also changes to the National Insurance (NI) limits to bring them in line with the income tax bands. Based on current RPI forecasts, the lower limit will be reduced by £2,500 and the higher limit by £1,650. The previous Government’s employee NI rises remain in place.

Prior to the Budget, much attention had been focused on capital gains tax (CGT). A rise in the tax had been a key pillar of Liberal Democrat policy and therefore rumours were rife of a rise to 40% or even 50% plus a reduction in the annual exemption to as low as £2,000.

In the event, none of this happened. Osborne raised the tax to 28% for higher-rate taxpayers and left the annual exemption at £10,100. He said the annual exemption would continue to rise with inflation. Low and basic rate taxpayers will continue to pay the current rate of 18%.



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## It's Payback Time (cont.)

For the coalition's plans to be successful in avoiding a double-dip recession, the private sector needs to pick up the baton of growth from the public sector. Chancellor Osborne therefore reduced corporation tax in a bid to improve the competitiveness of the UK as a place to do business. It will fall incrementally from 28% today to 24% in 4 years time, putting the UK in line with the European average of 25%.

### Mixed reaction

Reaction to the Budget was mixed, with the Confederation of British Industry hailing it as "the UK's first important step on the long journey back to economic health". However, opponents protested that the Chancellor's measures risked triggering a "double-dip" recession.

For its part, the Institute for Fiscal Studies described the Budget as "a mixed bunch of positive reforms, backward steps and missed opportunities." Looking ahead, the UK economy is forecast to expand by 1.2% in 2010, 2.3% in 2011 and 2.8% in 2012. Debt is expected to peak at 70% of GDP in 2013/14, while the budget deficit is forecast to be in balance by 2015/16.

## A more measured approach

A rise in capital gains tax (CGT) was a key tenet of Liberal Democrat policy. In order to address the discrepancy between the top rate of CGT (18%) and the top rate of income tax (50%), a rise to 40% or even 50%, plus a significant reduction in the annual exemption had been mooted. As it was, Chancellor George Osborne was more measured in his actions.

In the end, CGT was raised to 28% for higher rate tax-payers and maintained at 18% for everyone else. Osborne suggested any further hike would serve to reduce the yield to the Exchequer from CGT rather than increase it. He also maintained the annual exemption at £10,100, adding this would rise with inflation each year as before.

Although this was a lighter increase than expected, many were disappointed the Chancellor did nothing to adjust the regime for assets held over the longer term. However, he specifically noted the reintroduction of taper relief and/or indexation would prove too complicated. The Chancellor did retain business reliefs and, in some cases, extended them. For example, the 10% CGT rate for entrepreneurial business activities will be extended from £2m to £5m of qualifying gains over a lifetime.

The property and equity markets may have slowed, but those investors who have held assets for a long time may still face a large bill after this Budget. As such, many of the tax planning measures used pre-Budget will now be even more important: Using the annual exemption each year, plus that of a spouse, rather than crystallising a large gain in a single year can help mitigate CGT. Equally, investors should ensure they have made prudent use of the principal private residence relief.

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Assets held within SIPPs and ISAs are exempt from CGT, so it is worth investing up to the annual contribution limits. Also, given the discrepancy between the CGT rate for lower and higher rate taxpayers, deferring a sale may be worthwhile if someone is moving from being a higher rate taxpayer to a lower rate taxpayer – for example, on retirement.

The CGT changes may also alter the playing field for investment bonds. Following the reduction in CGT in 2008, sales of investment bonds dropped as payouts were subject to income rather than CGT. Although they remain at a disadvantage, the new CGT rules bring the rates closer together and there may be more circumstances in which investment bonds are an appropriate investment.

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## Tax rises bear the strain

Chancellor George Osborne has made it clear more than three-quarters of his deficit reduction proposals will stem from spending cuts. This still leaves some 25% of the deficit reduction to come from tax rises and these were outlined in the emergency Budget . The biggest headline rise was in the VAT rate, from 17.5% to 20%. The Chancellor said he was focusing on spending – which is to some extent discretionary – rather than on higher income taxes, which are not.

As a result, income tax saw fewer changes. The personal allowance for under-65s was raised £1,000 to £7,475 but to pay for this, the basic rate tax band will be frozen until 2013/14. Notably, the Chancellor left some of his predecessor's measures untouched. Both the 50% tax band and the tapered reduction of the personal allowance for those earning more than £100,000 remain in place.

There were also changes to the National Insurance (NI) limits to bring them in line with the income tax bands. Based on current RPI forecasts, the lower limit will be reduced by £2,500 and the higher limit by £1,650. However, the previous Government's employee NI rises remain in place.

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Some issues remain up in the air. Osborne has ordered a review of the taxation of non-domiciled individuals and is also consulting with the pensions' industry on the reduction of pension reliefs proposed by the former administration. Stamp duty land tax for first-time buyers is also under review while more pain looks likely from the Comprehensive Spending Review this autumn.



## UK House Prices

The UK housing market has experienced tough times since the credit crunch took hold in 2007, and house prices fell by more than 20% between the middle of 2007 and mid-2009. The recovery in house prices since then has largely been attributable to unusually low interest rates and a lack of supply as potential buyers delayed putting their houses up for sale, deterred by concerns about negative equity and the possibility of disappointing profits.

However, many people might not realise that, despite recent problems in the housing market, the first decade of the 21st century remains the best-performing decade since the 1950s, according to data compiled by mortgage lender Halifax. During the last decade, UK house prices rose in real terms by 62%, narrowly beating the 61% increase recorded in the 1980s. By contrast, the poorest performing decade in the last 50 years was the 1990s, in which prices fell by 22% in real terms!



## Regeneration Game

Chancellor George Osborne is banking on a regeneration of the private sector to compensate for the swath of public sector cuts. As such, he said that he wanted his budget to show that Britain was 'open for business' and included a number of measures designed to encourage entrepreneurialism and business growth in the Budget.

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The most significant measure was a cut in corporation tax. Rates will decline by 1% a year from 28% now to 24% in four years. This will bring the UK more in line with the European Union average of 25% and is designed to boost the UK's attractiveness as a place to do business. Equally, the smaller company tax rate – which applies to businesses with profits below £300,000 – will fall from 21% to 20%.

The Chancellor also announced an increase in the threshold for employers' National Insurance from April 2011. This is designed to decrease the cost of hiring lower-paid or part-time workers, which should encourage businesses to hire. There will be further National Insurance breaks for businesses starting up outside the South east and Eastern regions.

The Chancellor also said that changes would be made to intellectual property rules, research and development and overseas income to help support businesses. These measures are designed to encourage innovation. The 10% capital gains tax rate for entrepreneurial businesses was extended from the first £2m to the first £5m of qualifying gains made over a lifetime.

However, the news was not all good for small businesses. The Chancellor scrapped the tax relief for the video games industry as proposed by Labour. There will also be a reduction in capital allowances from 2012. Allowances for investments in plant and machinery will decline from 20% to 18%, while the annual investment allowance will decline from £100,000 to £25,000.

The VAT increase may also be a tough pill to swallow. Small businesses will almost certainly have to pass it on to customers and that may reduce demand for their products, particularly in consumer-facing businesses. The other option, reducing margins, would be equally unpalatable. Also, there is an administration cost involved. The Federation of Small Businesses says that when VAT was cut to 15% at the end of 2008, the average cost to small businesses was £1,500.

The Budget was generally welcomed by business leaders. The Institute of Directors said that the budget was 'courageous'. The ABI said that it 'wholly supported the commitment to make the UK the most competitive location in the G20 by the end of this Parliament'. The Confederation of British Industry said: "The 5-year road map for Corporation Tax provides much-needed consistency and certainty. Taken together with consultation on foreign profits and intellectual property, these will help prevent and could even reverse the flow of companies overseas."

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