

Insight: London Employment & Benefits

22 April 2009

Budget - April 2009

Introduction

The Chancellor of the Exchequer announced earlier today in his Budget 2009 speech a number of changes which will directly impact individual UK taxpayers and businesses. We have summarised below some changes which are likely to be important for UK resident individuals and their employers.

Please note that information set out in this note remains subject to further parliamentary approvals and consents. Until the proposed changes are set out in the Finance Bill 2009 and given Royal assent (which is likely to happen during July) such provisions remain subject to amendment.

1. Additional Rate of Income Tax

With effect from 6 April 2010, UK resident individuals will be subject to a higher income tax rate of 50% on all taxable income above £150,000.

The two existing main rates of income tax will continue to apply. This means that (applying the current bands for 2009/10) taxable income up to £37,400 will remain taxed at 20% and the 40% rate will apply to taxable income between £37,400 and £150,000.

In addition, from 6 April 2010, individuals with taxable income above £100,000 will no longer be entitled to receive in full the basic personal allowance - this may be reduced to nil. Currently, income up to £6,475 (in the case of individuals below the age of 65) is exempt from income tax.

Instead, the amount of personal allowance will be reduced by £1 for every £2 received above the £100,000 income limit. The effect of this is that an individual earning above £112,950, based on current figures, will not have the benefit of a personal allowance.

2. Restriction on Tax Relief for Pension Contributions

Individuals currently enjoy tax relief on contributions to registered UK pension schemes up to an annual contribution allowance, which is, currently, the lesser of 100% of their salary and £235,000. Tax relief at the basic rate of income tax is generally given through the pension scheme and higher rate taxpayers can then claim relief at the higher rate through their tax returns under self-assessment.

The announced increase in income tax on earnings over £150,000 would be likely to encourage affected individuals to increase their contributions to their pension schemes in order to reduce their overall tax liability. The Government has therefore announced that it intends to restrict tax relief for individuals with an income of £150,000 or more



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with effect from 6 April 2011. It proposes that relief will be tapered away so that, for those earning over £180,000, relief will be worth 20 per cent, the same as a basic rate taxpayer.

3. Special Annual Allowance Charge

The Government has announced the immediate introduction of a new charge that will apply to those with an annual income of £150,000 or more in any tax year from 2007/2008 who increase the level of their pension savings on or after today beyond their normal, ongoing regular savings (i.e. savings made on at least a quarterly basis). Such increases are effectively limited to £20,000 and any excess over this amount will be subject to a special annual allowance charge of 20%, designed to recoup the difference between relief at the basic rate and the current higher rate of income tax. This may increase to 30% in line with the proposed increase in the higher rate.

Pension schemes will be permitted to refund contributions in certain circumstances to employees who have been unexpectedly caught by the requirements.

4. Taxation of Personal Dividends

Legislation will be introduced later this year to make changes to the system of taxation for individuals who own foreign shares.

Currently, individuals in receipt of dividends from UK resident companies are entitled to a non-payable dividend tax credit. However, individuals with shareholdings in non-UK resident companies have previously only been entitled to a non-payable tax credit if their shareholding is less than 10%.

From 22 April 2009, individuals with shareholdings of 10% or more who are in receipt of dividends of non-UK resident

companies will become entitled to a non-payable tax credit, subject to certain conditions.

The tax credits will only be available if the source country is a "qualifying territory." A territory is a "qualifying territory," if there is a double taxation agreement with the UK, with a non discrimination article. We understand that the legislation will include anti-avoidance measures, to ensure that these new rules are not subject to abuse.

5. Comment

The pension changes have cut off the obvious avenue for those earning over £150,000 to mitigate the effect of the announced rise in income tax. It is notable that no increase has been announced to the capital gains tax rate, which remains at 18%. This is likely to make compensation arrangements that deliver value on a capital rather than an income basis even more attractive to both employees and employers.

The difference in the applicable rates is especially acute when one considers the increases in employer's and employee's national insurance contributions announced in the pre-budget report, which will see the combined tax and national insurance burden for employer and employee on the top level of income increase to around 65%.

At first sight, there are a number of potential difficulties with the special annual allowance charge that could prove a trap for the unwary. In particular, those who switch between pension schemes, those whose accrual rate under a defined benefit scheme is altered and those who have in the past made lump sum rather than regular contributions may unwittingly fall within the charge. Further issues will no doubt become apparent in the coming weeks.

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