

# A Budget for growth, Darling?

In the 2009 Pre-Budget Report, the Chancellor focused on the UK's long-term fiscal challenges, balancing the need for growth with the need to reduce public spending and deal with the economic deficit through measures such as taxation. Let PwC help you consider the impact on you and your business.

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The Chancellor's Pre-Budget Report 2009

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In a much anticipated and politically charged 2009 Pre-Budget Report (PBR), the Chancellor delivered what he described as “fiscally neutral” measures, with the clear focus being the state of the economy, inter-weaving themes around the green agenda, support for business and certain revenue generating measures aimed at those with “broad-shoulders”.

In the Chancellor's own words, this was a PBR aimed at “securing recovery, reducing borrowing, and through targeted investment, providing a springboard for long term growth”. Increased national insurance contributions (NICs) and a targeted measure to stem high bonuses paid by banks may grab the headlines, but what else did the Chancellor have to say amongst the detail of the press releases?

## Outlook for the economy and the public finances

As expected, the Treasury has marked down its Budget forecasts for economic growth this year from -3.5% to -4.75%, but has maintained its growth forecast of around 1-1.5% in 2010, which looks plausible. The Treasury then projects that GDP growth will rebound to an average of 3.5% per annum in the following three years, which looks relatively optimistic although not impossible in the upturn phase of the economic cycle.

Public sector net borrowing is now estimated to be around £178 billion in 2009/10 (12.6% of GDP) and £176 billion in 2010/11 (12% of GDP), up slightly from the Budget forecasts but not by much. But with a rapid economic recovery thereafter, the Treasury is expecting buoyant tax revenues to reduce public borrowing in 2014/15 to around £84 billion (4.4% of GDP). This is possible, but if a more cautious view is taken of medium-term economic growth potential in line with the view of PwC and most other independent forecasters, then borrowing may well remain higher than the Treasury expects.

The Treasury forecasts that net public debt will rise to a peak of around 78% of GDP in 2014/15 before stabilising. The current budget deficit will not return to balance until 2017/18, which would be a long time for the bond markets to wait. The risk is that financial market worries about this rise in public debt (to almost £1.5 trillion by March 2015) could eventually lead to significantly higher long-term UK interest rates.

The Treasury has proposed only relatively modest net tax rises in the PBR, amounting to a net increase of around £5 billion by 2012/13. But there must be a significant risk that further tax rises will be needed after the general election next year, whichever party wins.

The Treasury largely confirmed earlier plans for total public spending to be broadly flat over the three years to 2013/14 in real terms although the initial level of spending has been increased somewhat. These projections would imply a significant real cut in departmental spending over this period after allowing for rising debt interest costs and projected social security benefits and tax credits. With some areas like health, schools and police being protected from real cuts, however, other areas are likely to see double digit real spending squeezes in the three years to 2013/14.

The era of fiscal austerity is likely to extend throughout the next Parliament and quite probably beyond given the difficult state of the public finances. This will certainly be a long and painful process: the PBR has not done much to close the fiscal gap so there will be further tough choices to be made on tax and spending after the general election.

## Personal taxes

### Income taxes

For the tax year 2010/11 all tax allowances and thresholds will be the same as for 2009/2010. The much anticipated 50% tax rate will apply to income over £150,000 from 6 April 2010, as announced by Budget 2009.

For the tax year 2012/13, the higher rate threshold (the point at which someone starts to pay higher rate tax) will be frozen at the 2011-12 amount. The personal allowance will be increased and the basic rate limit will be reduced by the same amount.

### Banking payroll tax

A one-off new bank payroll tax of 50% has been introduced on all discretionary and contractual bonuses (cash or otherwise) on any excess over £25,000 (one-off or in aggregate) awarded by banks, building societies and financial businesses to their employees between 9 December 2009 and 5 April 2010. This tax is payable by the employer by 31 August 2010 and cannot be deducted in the calculation of the banks' taxable profits. There is an exemption for contractual bonus entitlements where the employer has no discretion as to the amount of the bonus due to an existing contractual obligation as at 9 December 2009. Draft legislation has been published on the HMRC website including detailed anti-avoidance rules.

### National insurance contributions

A further increase of 0.5% on employer's and employees' NICs has been announced (to apply from 6 April 2011). This increase is in addition to the 0.5% increase to employer's and employees' NICs announced in the 2008 Pre-Budget Report.

From 6 April 2011:

- The main rate of Class 1 (for employees) and Class 4 (for self-employed) NICs will be 12% and 9% respectively up to the upper income limit (currently £844 per week or £43,888 pa).
- Class 1 employer's NICs will be 13.8%. The increased rate will also apply to Class 1A contributions (on benefits) and 1B contributions (on PAYE settlement agreements).
- The additional rate of Class 1 and 4 NICs for higher income levels will be 2%.

### Employment taxes

#### Workplace canteens

With effect from 6 April 2011, the income tax exemption for providing free or subsidised meals in a canteen or on business premises will be removed in circumstances where employees are in effect using a designated amount of their gross remuneration to fund the purchase of food and drink at work.

#### Tax reliefs for electric vehicles

As part of a wider package aimed at encouraging carbon emission reductions, the following changes will take effect from 6 April 2010:

- electric cars will be exempt from company car tax for a period of five years; and,
- electric vans will be exempt from van benefit charge for five years.

#### Scale rates for company car benefits

With effect from 6 April 2012, the lowest emissions threshold will be reduced to 99g/km (currently 120g/km)

such that cars with emissions below that level will have a scale rate of 10%. The other existing thresholds in the banded table will be reduced by 5g/km.

#### Fuel benefit tax

The figures used as the basis for calculating the benefit of fuel provided for private use of a company car or van are being increased to £18,000 and £550 from 6 April 2010, respectively.

## Pensions

### Pensions restrictions

It was announced at Budget 2009 that, from 6 April 2011, tax relief on all pension contributions, including employers' contributions, would be restricted on a tapered basis for those with annual total incomes of £150,000 and over with full loss of higher rate relief for those with income of £180,000 or more. It is now proposed that 'income' will include the value of employer contributions – i.e. pension benefits funded by, or eventually funded by, the individual's employer.

Individuals with pre-tax incomes of less than £130,000 (including their own pension contributions and charitable donations but excluding employer contributions), will be excluded from the restriction and will not need to value their employer-funded benefits (reducing uncertainty and administration costs). Details of this and various other aspects of the restriction, including the valuation of employers' contributions to defined benefit schemes, are set out in a detailed consultation document.

Additional anti-forestalling provisions have been added to those already in force from 22 April 2009 for this affected group and are in immediate effect.

### Enterprise investment schemes (EISs) and venture capital trusts (VCTs)

Some technical changes detailed in the PBR today. Draft legislation was published to enact changes required to obtain EU state aid approval for schemes:

- Companies need only have a permanent establishment in the UK.
- Enterprises in difficulty are excluded.
- VCTs may be listed on any regulated European market.
- VCTs have to increase equity stake in qualifying holdings.

There is a new definition of small enterprise – which is more complex and is based on EU guidelines. Related enterprises will have to be aggregated in applying the employee and balance sheet total tests. In addition, EIS companies may not trade in partnership.

### Corporate taxes

As opposed to any wholesale changes to corporation tax, the PBR has addressed some specific themes:

#### Research and development (R&D) tax relief

The Government has announced a specific relaxation of the rules for qualifying R&D expenditure for small and medium sized companies. Legislation will be introduced in Finance Bill 2010 to abolish the condition for small and medium sized enterprises (SMEs) which required that any intellectual property deriving from the R&D expenditure be owned by the company making the claim.

#### Patent box regime

The Chancellor announced a policy measure to introduce a 'patent box' regime for UK companies. The Government will consult with taxpayers regarding the proposals which are to be introduced as part of the 2011 Finance Bill. Detailed announcements have not yet been issued but it is intended that following consultation, the regime will apply a reduced corporation tax rate of 10% to income arising from 1 April 2013 for patents registered from that date. The Treasury's announcements estimate that the eventual cost to the Treasury of the regime will be £1.3 billion.

#### Controlled foreign company (CFC) reform

The Government has stated that it remains committed to reforming the CFC regime with publication of its proposals early in 2010.

#### Capital gains for corporates

A further consultation document will be published in early 2010 for the simplification of the capital gains legislation for groups of companies.

#### Capital allowances

The enhanced 40% first-year capital allowance for expenditure incurred in 2009-10 will come to an end as planned in April 2010. The £50,000 annual investment allowance will still be available. In addition, a 100% first-year allowance will be provided for the purchase of new unused electric vans, subject to HMRC confirming compatibility with state aid rules.

#### Tax and accountancy

There continue to be further changes proposed to the International Financial Reporting Standards for the accounting treatment of financial instruments. To ensure

it can keep the relevant tax legislation in line with these changes, the Government is putting provisions in place to allow secondary legislation to be drafted as necessary outside the normal Finance Bill timetable.

#### Debt cap

Draft legislation is published today incorporating the changes announced on 9 November 2009 following consultation with business.

### Anti-avoidance measures

An increasing theme for both main Budgets and Pre-Budget Reports has been the introduction of targeted anti-avoidance rules. This year's PBR is no different:

#### Risk transfer schemes

Measures will be introduced with effect from 1 April 2010 to restrict loss relief on certain group hedging transactions such that losses are limited to the real economic losses suffered by the group concerned, are ring fenced, and can only be offset against profits from the same arrangements.

#### Insurance premium tax

New measures will be introduced with effect from 9 December 2009 to prevent the avoidance of insurance premium tax (IPT) on insurance provided to individuals, by splitting the premium between two contracts, one being predominantly for the administration charges (which would not attract IPT).

Other specific anti-avoidance measures have been introduced targeted at inheritance tax, index linked gilt-edged securities, stamp duty land tax and sale of lessor companies to name a few.

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### Indirect taxes

As previously announced, the standard rate for VAT will return to 17.5% from 1 January 2010. There are special rules for sales which span the change of rate which apply to goods and/or services which are provided before the change of rate and invoiced afterwards.

In addition where an invoice is issued before 1 January 2010 and where any one of the following conditions is met additional provisions are in place to prevent VAT being accounted for at the lower rate of 15%:

- you supply the goods or services to a connected person (such as another business controlled by you); or
- you provide or arrange funding of your customer's payment; or
- you issue a VAT invoice to your customer that does not have to be paid in full within six months; or
- the payment or VAT invoice is in excess of £100,000, and this is not normal commercial practice.

The flat rate of VAT applied by traders using the 'flat rate scheme' will also change from 1 January 2010 to reflect the change in the standard rate.

No announcements have been made about any further increases to the VAT rate in future.

### Indirect taxes and the 'green' agenda

Indirect taxes have also been used to drive the Government's 'green' agenda further:

- Climate change levy (CCL) – the reduced rate of CCL which is provided for under climate change agreements will be increased from 20% to 35%. It is intended that this new rate will come into force from 1 April 2011.

- Supporting low-carbon growth – the PBR provides for a further £400million to support both business investment in low-carbon growth and help households reduce energy costs. These benefits will be of value to both businesses and individuals and will be phased in over the next three years.
- Road fuel duty – main road fuel duty rose by two pence per litre on 1 September 2009. As announced at Budget 2009, fuel duty will also increase by one penny per litre in real terms on 1 April each year from 2010 to 2013.

Other changes introduced by the PBR included a landline duty from 1 October 2010 at a rate of 50p per month for each line, and bingo duty being reduced from 22% to 20% from April 2010!

### Other measures introduced by the PBR

The Pre-Budget Report and the associated press releases included measures in a number of other areas as well as providing an update on ongoing consultative processes:

#### Tax avoidance disclosure (TAD)

The Government has announced a consultation – 'Disclosure of Tax Avoidance Schemes' – aimed at strengthening the current disclosure regime. The measures proposed include changes to ensure early and more regular disclosure of both schemes and

users, increased penalties for non-compliance and an extension to the types of schemes required to be disclosed. HMRC has asked for responses to the consultation by 19 February 2010.

#### Offshore evasion

The PBR announced robust measures to tackle offshore tax evasion. Legislation will be brought forward to ensure that those who fail to declare UK tax on offshore accounts will face the tough penalties attracted by deliberate tax evasion. There will also be a new requirement to notify HMRC when opening offshore bank accounts in certain jurisdictions, supported by a separate penalty regime. Evading tax offshore could therefore result in combined penalties of up to 200% of the unpaid tax.

#### Business support

The Government has pledged its continued support for businesses in a number of areas including:

- it will continue to offer its 'business payment support service' to help businesses which are struggling with their cash flow by offering more flexible payment terms for tax liabilities;
- the small companies' rate will remain at 21% until 31 March 2011 and thereafter the proposed rate will be 22%; and
- empty properties with a rateable value of up to £15,000 will be exempt from paying business rates for 2009-10.

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