Budget 2013: Contents and Consequences

After the Autumn Statement that seemed to have enough detail for three Budgets, you might have thought George Osborne's fourth Budget would be a relatively quiet affair. That expectation was reinforced by the downgrading of the UK's credit rating to Aa1 delivered by Moody's last month, which some read as implying there was nothing the Chancellor could do.

A dull Budget was also on the cards after last year's less than sparkling performance by Mr Osborne. The 'omnishambles' of pasty tax, charitable gift capping et al is not something he would want to repeat. In the event there were a few surprises, many of which were deferred to future years, such as the new tax free childcare regime.

The Chancellor's Budget announcements made virtually no difference to the government's finances, which remain problematic. The Autumn Statement suggested that government borrowing for the current fiscal year would fall, something which surprised most economists until it was noticed that the Chancellor had included an anticipated £3.5bn proceeds from the 4G spectrum auction in his calculations. That guesstimate proved wrong and the spectrum raised £2.3bn, meaning any hope of a reduced deficit figure had disappeared. The outcome now is that the deficit, which was £121 billion in 2011/12 is set to be virtually the same for 2012/13 and 2013/14.

For all the pain experienced so far, the UK austerity programme is still at an early stage of its execution. According to the well-respected Institute for Fiscal Studies, as at April 2013, 79% of the planned tax increases and 67% of the planned cuts to investment spending will have been implemented, but only 32% of the planned cuts to benefit spending and 21% of the cuts to day-to-day spending on public services will be in place.

The economic backdrop against which the bulk of the spending cuts and remaining tax rises will occur is once again worse than was expected 12 months ago. The UK economy contracted 0.3% in the final quarter of 2012, leaving it about the same size in inflation-adjusted terms as it was at the end of 2006. Economic growth this year is forecast by the Office for Budget Responsibility to be 0.6%, half the 1.2% forecast it made in December at the time of the Autumn Statement. The lower number is now more in line with the market consensus.

Annual inflation, measured on the government's favoured CPI basis, is now set to remain above its 2% target for the next two years, if the latest Bank of England forecasts are to be believed. CPI inflation was 2.8% for February and in the near term could breach the 3% level. That is less of a concern for the Chancellor than previously, given that he has fixed increases to many working age benefits yearly at just 1% for the three years from April 2013. However, 2%+ inflation will continue to squeeze the economy when annual earnings increases are around 1.5%.

The headline-grabbing moves announced (or, more commonly, re-announced) in the Budget included:

- A rise of £1,335 in the personal allowance to £9,440 for 2013/14 and a further increase to £10,000 in 2014/15
- A £1,025 reduction in the higher rate threshold for 2013/14, with increases of only 1% in each of the following two tax years
- The freezing of the personal age allowances and their date of birth triggers – steps on the path to eventual abolition
- The introduction, on a phased basis, from autumn 2015 of a new tax-free childcare regime, eventually worth up to £1,200 per child per year
- An increase to £10,900 for the capital gains tax annual exemption in 2013/14, followed by £100 increases in 2014/15 and 2015/16
- A new employment allowance of £2,000 a year for all businesses and charities from April 2014 to offset employer national insurance contribution (NIC) costs
- A package of measures to boost the housing market, including £130bn of government guarantees from 2014
- The bringing forward of the start date for the single-tier state pension to April 2016
- Reductions in the pensions lifetime allowance to £1.25m and the annual allowance to £40,000 from 2014/15
- The effective creation of a single unified 20% rate of corporation tax from April 2015
- Yet another freezing of an impending fuel duty increase

In this Bulletin we look at the main changes that will affect individuals and businesses and examine some of the related planning issues. If any of these strikes a chord, you are strongly recommended to consult your financial adviser.

Contents

The contents of this Bulletin are based on the proposals put forward by the Chancellor in his Budget speech and explained in documents subsequently published by HMRC, the Treasury and the Office for Budgetary Responsibility. All Budget proposals may be subject to change before the relevant Finance Act is passed (which for the Finance Bill 2013 is expected to be in July).

References to spouse, husband and wife and married couples include references to registered civil partners and civil partnerships.

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Personal Income Tax and National Insurance Contributions

The income tax bands and allowances and National Insurance contributions (NICs) rates for 2013/14 were announced last December by the Treasury. The Budget contained no changes to these, so for the new tax year:

- The personal allowance has risen by £1,335 to £9,440, a £235 increase on the figure announced in the 2012 Budget. The allowance will continue to be phased out where total income exceeds £100,000. As a result, you will not receive a personal allowance if your total income in 2013/14 exceeds £118,880. For 2014/15 the allowance will rise by another £560 to the coalition government's oft-stated goal of £10,000.

- A quid pro quo for the increase in the personal allowance in 2013/14 is a reduction of £2,360 in the size of the basic rate band. Thus, if you are only entitled to a personal allowance, the starting point at which you pay higher rate tax will fall by £1,025 to £41,450. The net effect will be to increase the number of higher rate taxpayers again. HMRC's latest statistics suggest that nearly one in seven income tax payers are taxed at the higher rate. In 2014/15 the higher rate threshold will rise, but only by £415 (1%) to £41,865.

- As part of the process to phase out personal age allowances, these have been frozen, but a year has been added to the minimum age: the allowances are now banded at 66-75 (£10,500) and 76 and above (£10,660). Nevertheless, the income threshold at which allowances start to be reduced was raised in line with RPI inflation, as was the almost extinct married couple's age allowance.

- The 10% tax band, only accessible to a few, rose by 3.0%, again in line with RPI inflation. However, the starting points for the additional rate and the phasing out of personal allowances were unchanged: the legislation which introduced these did not include automatic indexation.

- The basic rate of tax remains at 20% (10% for dividends).

- The additional rate has fallen by 5%, as announced last year, to 45% (37.5% for dividends).

- There are no major changes to NIC rates this year, but the bands have been adjusted in line with inflation:

    - If you are an employee or self-employed, the starting point at which you begin to pay Class 1 or Class 4 NICs has risen by £3 a week, to £149 a week (£7,755 a year). The upper earnings and upper profits limits, beyond which the NIC rate falls to 2%, remain at £41,450, in line with the reduced starting point for 40% tax.

    - For employers the corresponding starting threshold for NICs has risen by £4 a week, to £148 a week.

  The lower earnings limit has increased by £2 a week to £109 a week.

Allowing for the tax and NIC changes, most people in employment will be £285 a year better off in 2013/14, as illustrated in the table below, because of the increased personal allowance and higher NICs starting point. Those with incomes between about £117,000 and £157,000 will be marginally worse off, but their maximum loss will be £351. Above £157,000, the 5% cut in the additional rate tax overcomes the other changes and means net income is increased.

Earnings £	2012/13		2013/14		Overall Change* £
	Income Tax £	NICs £	Income Tax £	NICs £	
10,000	379	287	112	269	+285
15,000	1,379	887	1,112	869	+285
20,000	2,379	1,487	2,112	1,469	+285
25,000	3,379	2,087	3,112	2,069	+285
30,000	4,379	2,687	4,112	2,669	+285
40,000	6,379	3,887	6,112	3,869	+285
50,000	9,884	4,335	9,822	4,214	+183
75,000	19,884	4,835	19,822	4,714	+183
100,000	29,884	5,335	29,822	5,214	+183
125,000	43,126	5,835	43,598	5,714	- 351
150,000	53,126	6,335	53,598	6,214	- 351
175,000	65,626	6,835	64,848	6,714	+899
200,000	78,126	7,335	76,098	7,214	+2,149
250,000	103,126	8,335	98,598	8,214	+4,649

* *Based on an employee under state pension age with a single personal allowance who is contracted in to the State Second Pension. Tax credits are ignored.*

Tax credits

Some elements of working tax credits (WTCs) rise by around 2.2% for 2013/14, in line with the CPI to September 2012, while many others, such as the basic element and family element, are frozen. One significant change is that the income disregard level for increased income during the tax year is halved from £10,000 to £5,000. This will mean more people suffering a claw back of tax credits as a result of increased earnings.

The tax credit system is due to be replaced by Universal Credit over the coming years. A 'pathfinder' system is being launched now and a national system will start in October 2013, with all *new* claims going onto Universal Credit from April 2014. Existing tax credit claimants will then be transferred in stages to the new system by the end of 2017.

Child Benefit

In 2013/14 the benefit is worth an unchanged £20.30 a week for the first child and £13.40 a week for each additional child. However, 2013/14 will be the first full tax year in which the new Child Benefit tax applies in full, with an effective 1% reduction in benefit for each £100 of income over £50,000. Thus, at £60,000 or more, the tax and the benefit cancel each other out. If you are in that position, HMRC would prefer you to elect not to receive child benefit, rather than have one part of government pay the benefit and another collect it back as tax. However, HMRC is struggling to persuade many of those affected to take up this option. The abstainers will have to complete a self-assessment tax return, although a good proportion will already do so.

Tax-free childcare payment

A new payment for working parents was announced just before the Budget, but will only start to be phased in from autumn 2015. It will be worth 20% of childcare costs up to a value of £1,200 per child per year under age 5 initially, but rising to under age 12. Over time it will replace the existing childcare vouchers system. For couples it will only be available if both partners are working. An income limit of £150,000 will apply for both partners – three times the level at which Child Benefit effectively starts to be removed.

Company Cars

The company car benefit scales are subject to another set of changes in the new tax year. The (theoretical) 5% rate for cars with CO_2 emissions of 75g/km or less stays, but above that level the rate is 10% to 94g/km (down 5g/km from 2012/13), rising thereafter by 1% for each additional 5g/km. The 3% addition remains for diesels, subject to an overall maximum rate of 35%. The same percentages apply for car fuel benefits. There are more (revenue-raising) changes scheduled for future years.

Planning points

Turning child benefit tax to your advantage

January 7 saw the introduction of an effective tax on Child Benefit (CB) where at least one of a couple has income of over £50,000. In 2013/14 this tax will have effect for the whole year. If either of you has income of £60,000 or more, then the tax charge will equal the CB unless you choose to stop receiving CB payments. If the higher income partner has income between £50,000 and £60,000 then, as a general rule, for each extra £100 of earned income:

- Income tax is at £40;
- NICs are £2;
- You lose £10.56 of CB for your first child and £6.97 for each subsequent child.

So if you have two children eligible for CB, £59.53 of your £100 extra earned income will pass to HMRC, equivalent to an effective tax rate of nearly 60%.

The reverse is also true: £100 less of taxable income could imply only £40.47 less net income. So, for example, if you reduce your taxable income in exchange for your employer making a corresponding pension contribution, you may be securing £100 of retirement benefit at an effective cost of £40.47 (or even less if your employer takes account of *their* NIC savings).

Turning the tables on the basic personal allowance restriction

The impact of the phasing out of the basic personal allowance once total income exceeds £100,000 has again been exacerbated by the above-inflation increase in the personal allowance. We now have a system under which the marginal rate of tax in the £100,000 - £118,880 band of income is 60% on non-dividend income - a third higher than the new top rate of 45%.

The corollary is that if your income is in that band, or marginally above it, you may be able to obtain 60% tax relief on some pension contributions, as the example below shows.

60% Tax Relief

In 2013/14 Frank has income of £118,000, all of which consists of earnings and interest. His current pension contributions are under £30,000. He can thus make an extra £18,000 gross pension contribution without tax penalty because the aggregate contributions of £48,000 would still fall within the £50,000 annual allowance. Depending upon whether he makes the pension contribution, his tax bill would be:

	No Pension Contribution		Pension Contribution	
	£	£	£	£
Gross income	118,000		118,000	
Pension contribution	-		18,000	
Personal allowance	440		9,440	
Taxable income	117,560		90,560	
Basic rate tax	32,010 @ 20%	6,402	32,010 @ 20%	6,402
Higher rate tax	85,550 @ 40%	34,220	58,550 @ 40%	23,420
Total tax		**40,622**		**29,822**

Thus a gross pension contribution of £18,000 will save Frank £10,800 in tax, an effective 60% rate of relief.

Capital Gains Tax

For 2013/14, the Chancellor made no significant changes. He allowed CPI indexation to take its course, raising the capital gains tax annual exempt amount to £10,900. In April 2014 and April 2015 indexation will be withdrawn again and the annual exemption will increase in each year by just £100.

Entrepreneurs' relief

The Budget confirmed that from 6 April 2013 entrepreneurs' relief will cover gains made on disposals of qualifying shares acquired through the exercise of Enterprise Management Incentive (EMI) options,

Planning points

18% is better than 20% and 28% is superior to 40% or 45%

Unless you are one of those lucky few who are able to benefit from the 10% rate on savings income, investment returns in the form of capital gains are usually taxed at a lower rate than income. There is also a £10,900 annual capital gains exemption, which is not tapered away. Although capital gains are taxed as the top slice of income, the rates are lower and capital gains tax is not subject to the same payments on account rules as income tax: you pay your full capital gains tax on 31 January in the tax year following the one in which the gains arose.

While the tax tail should never wag the investment dog, the case for favouring growth over income when setting your investment goals is a strong one. There are many anti-avoidance rules which prevent income being transformed into capital gains, but it remains a fact that some financial product structures provide income returns while others produce capital gains, even though the underlying investments are the same. Selecting the right structure could therefore significantly reduce your tax bill.

Use your annual exemption

Would you waste a tax exemption worth up to over £3,000 a year?

That is what your full 2013/14 annual capital gains tax exemption could be worth in terms of tax saving, if you pay tax at above the basic rate. As far as possible it is important to use the exemption each year (and for your spouse to do the same) because, if unused, it cannot be carried forward.

If you do not systematically use your annual exemption, you are more likely to reach a point where some of your gains are subject to tax. Unfortunately, you cannot simply crystallise a gain by selling and then immediately repurchasing an investment – what used to be called bed-and-breakfasting. However, there are other ways of achieving similar results:

- *Bed-and-ISA* You can sell an investment, eg shares in an open-ended investment company, and buy it back immediately within an ISA. For 2013/14 the maximum ISA investment is £11,520.

- *Bed-and-SIPP* This is a similar process to bed-and-ISA, but the cash realised is used to make a contribution to a self-invested personal pension (SIPP). The reinvestment is then made within the SIPP. This approach has the added benefit of income tax relief on the contribution and may also offer a higher reinvestment ceiling than an ISA, depending on your earned income and other pension contributions.

- *Bed-and-spouse* You can sell an investment and your spouse can buy the same investment without falling foul of the rules against bed-and-breakfasting. However, you cannot sell your investment to your spouse – the two transactions must be separate.

- *Bed-and-something-very-similar* The growing number of funds which track the main global stock market indices has created an opportunity to replicate the tax benefit of the old bed-and-breakfast strategy. For example, if you hold the ABC S&P 500 Fund, you could sell it and immediately reinvest in the XYZ S&P 500 Fund. Your underlying investment – shares in the constituents of the S&P 500 index – will not alter, but because the fund provider has changed, you will escape the rules against bed-and-breakfasting.

Keeping down your CGT bill

There is a variety of tactics that can be used to limit your exposure to capital gains tax, including:

- Maximising the use of ISAs, where there is no capital gains tax.

- Using funds of funds rather than individual fund holdings. Fund changes made *within* a fund of funds do not create any immediate gain for the investor.

- Sharing your gains. Transfers between spouses living together are on a no gain/no loss basis, so if your spouse has not fully used their annual capital gains tax exempt amount and you have, together you could save tax.

- Use pension contributions to bring your marginal rate of income tax down to basic rate. Pension contributions cannot be offset directly against capital gains, but to the extent that they remove income from higher rate tax, they can cut your capital gains tax bill.

- Take advantage of venture capital trusts (VCTs), enterprise investment schemes (EISs) and seed enterprise investment trusts (SEISs). These are high risk investments, but they are generally free of capital gains tax. While they offer income tax relief at 30% or

50% for SEIS (see below), they do not reduce your income for tax purposes, so they cannot cut your capital gains tax bill in the same way that a pension contribution can.

Inheritance Tax

The inheritance tax nil rate band has now been at £325,000 since 6 April 2009. If it had been indexed-linked, as it used to be, the band would now be about £365,000. In the Autumn Statement the Chancellor said the band would increase to £329,000 on 6 April 2015. However, even this minimal rise has now been revoked and the Budget confirmed that the band will remain frozen until 2017/18.

The Chancellor made no comment about the reform of IHT, even though the Office of Tax Simplification has called for a radical review of the tax, possibly combining it with capital gains tax. However, there is one interesting twist on IHT which emerged as a proposal in the Autumn Statement and is due to be legislated for later this year. AIM shares will become eligible for ISA investment. The Treasury has said AIM shares within an ISA will be eligible for IHT business property relief (BPR), subject to the normal BPR rules. As a result, ISAs could ultimately become IHT-free, as well as UK income tax and CGT free.

Planning points

Regular and out of income....

There are three yearly exemptions which are available for IHT planning:

- *The £3,000 annual exemption.* Any unused part of this exemption can be carried forward one tax year, but it must then be used *after* the £3,000 exemption for that year. So, for example, if you made a gift of £1,000 covered by the annual exemption in 2012/13, you can makes gifts totalling £5,000 covered by the annual exemption in 2013/14.

- *The £250 small gifts exemption.* You can make as many outright gifts of up to £250 per individual per tax year as you wish free of IHT, provided that the recipient does not also receive any part of your £3,000 annual exemption.

- *The normal expenditure exemption.* Any gift that you make is exempt from IHT if:

  - it forms part of your normal expenditure; and
  - taking one year with another it is made out of income; and
  - it leaves you with sufficient income to maintain your usual standard of living.

The normal expenditure exemption is often forgotten. You may be making regular gifts which you think are covered by the £3,000 exemption, but which could actually count under normal expenditure, leaving your £3,000 exemption unused. For example, if you pay premiums for a life policy held under trust, such payments frequently satisfy all the conditions to be treated as normal expenditure, leaving the £3,000 exemption available for other gifts.

Investments

A range of investment tax changes has taken place over the last few years, with some important changes from 6 April 2012. For 2013/14 there are few changes scheduled.

Individual Savings Accounts (ISAs)

The main ISA investment limits are now inflation linked, albeit the link is to the CPI rather than the RPI. For 2013/14 the annual limit is £11,520 (of which up to £5,760 may be in cash). The numbers are not round hundreds because the limit is rounded to the nearer £120, so that the corresponding monthly limits are divisible by £10.

The original ISA investment ceiling, set in April 1999, was £7,000 and it remained at that level until 2008/09, when it increased by £200. It jumped to £10,200 in 2010/11 and has broadly followed some measure of inflation since then. Anyone who was able to contribute to the maximum each year, up to and including 2012/13, would by now have placed £109,560 into their ISAs and largely out of the taxman's reach.

The introduction of 28% CGT in 2010, the arrival of additional rate tax and the reductions – past and future – in both the pension annual allowance and the lifetime allowance have all increased the importance of ISAs as a tax-efficient investment wrapper.

The government has confirmed that AIM and similarly listed shares will be eligible for inclusion in ISAs and is now consulting on the process to achieve this. An added bonus is that stamp duty on the purchase of such shares will be abolished from April 2014.

Junior ISA

The Junior ISA (JISA) was launched in November 2011 for all children under 18 who were not eligible for the Child Trust Fund (CTF). The exclusion of CTF holders means Junior ISA eligibility is limited to any child born before 1 September 2002 or after 2 January 2011. So far JISAs have been a failure, with very limited take up. The maximum annual contribution to a JISA is £3,720 for 2013/14 and, unlike CTFs, JISA contributions are based on tax years.

The Budget revealed that there will be a consultation on allowing Child Trust Funds to be transferred into JISAs, a move which has long been anticipated.

Venture Capital Trusts and Enterprise Investment Schemes

Long-heralded changes to the rules for Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) finally arrived with the Finance Act 2012 and took effect from 6 April 2012. For 2013/14 there are no further changes planned.

Seed Enterprise Investment Schemes

The Seed Enterprise Investment Scheme (SEIS) was legislated for in last year's Finance Act and has as yet had little impact. The SEIS is a junior version of the EIS, aimed at young, very small businesses. Its key features are:

- The maximum total individual investment in SEIS will be £100,000 per tax year, which will qualify for 50% income tax relief given by way of a reduction in the amount of income tax otherwise payable by the investor in the tax year of investment. Relief is initially available for shares issued between 6 April 2012 and 5 April 2017.

- Initially, for 2012/13 only, there was a capital gains tax exemption where gains realised in the tax year were re-invested in a SEIS. Thus total tax relief could be 78%. This has been extended to 2013/14, but with relief for only half of reinvested gains, reducing the maximum theoretical total tax relief to 64%.

- An eligible SEIS company must:

  - Be no more than two years old;

  - Conduct a genuine new business;

  - Have fewer than 25 full-time equivalent employees;

  - Have gross assets of not more than £200,000; and

  - Raise no more than £150,000 in total (*not* per tax year).

While it is still early days for the SEIS, evidence so far suggests that the low maximum capital raising limit of £150,000 per company has been a disincentive for many would-be entrepreneurs.

The relative benefits and features of VCT, EIS and SEIS for 2013/14 are shown in the table below.

	VCT	EIS	SEIS
TAX ASPECTS			
Income tax relief	30%	30%	50%
Maximum personal investment per tax year	£200,000	£1,000,000 for income tax relief, no limit for CGT deferral relief	£100,000
Tax relief clawback	5 years	3 years	3 years
Backdating to previous tax year?	No	Yes, up to 100% of investment.	Yes, up to 100% of investment.
CGT reinvestment relief	No	Yes, deferral for gains made 3 years before/1 year after EIS investment	Yes, 50% exemption for gains realised in 2013/14 and reinvested in 2013/14 or 2014/15
Investor capital gains tax liability	Nil at any time	Nil after 3 years, except for reinvested gains	Nil after 3 years
Dividends	Tax-free, but no tax credit reclaim	Taxable	Taxable
IHT business property relief	No	Yes, after 2 years	Yes, after 2 years
INVESTMENT ASPECTS			
Structure	Authorised investment trust company	Unlisted company	Unlisted company less than two years old
Listing	Must be listed on main market	May be listed on AIM, not main market	May be listed on AIM, not main market
Liquidity	In theory tradeable as listed shares, in practice market may be very thin	Usually nil unless AIM listing. Exit may be by takeover or liquidation.	Probably nil
Qualifying companies for investment	Unlisted small trading companies, subject to various restrictions	Unlisted small trading companies, subject to various restrictions	Unlisted small trading companies, subject to various restrictions
Investments in qualifying companies	At least 70% of qualifying investments must be shares. Balance can be debt.	100% shares	100% shares
Maximum holding in any one company	15% of value	100% - single company structure	100% - single company structure
Non-qualifying investments	Up to 30%, eg in gilts	Ultimately none	Ultimately none
Maximum period to acquire qualifying investments	3 years	80% 1 year, balance 2 years	3 years

Planning points

ISAs

In April 2008 it became possible to transfer the cash component of an ISA, including anything from a former TESSA, into the stocks and shares component. The option was generally viewed as a somewhat pointless facility when it was first announced: for most investors the value of the income tax saving from the cash component was greater than the combined income and CGT tax savings offered by the stocks and shares component.

Now, after more than four years of a 0.5% base rate, the facility to move out of cash looks rather more useful. There are no signs that the Bank of England will start increasing rates soon and the latest market projections do not envisage base rate reaching the dizzying heights of 1% until 2016. Meanwhile, many existing cash ISAs are offering rates of below 1%, with some paying just 0.1%. If you put money in a cash ISA a year ago at a rate of around 3%, you would be well advised to check what interest rate you are now receiving. Most of the headline-catching rates incorporated a substantial 12 month bonus, which will have now ended.

If you are looking for income from your ISA, a switch from cash to the stocks and shares component now has much more appeal. For example, an investment in a corporate bond fund could produce 4% or more, while the typical UK equity income fund offers a similar yield. Income from either type of fund is tax free via an ISA. The quid pro quo for the immediate extra income is that you lose the capital security of the cash ISA and your new higher income could fall as well as rise. Before making the switch – which is irreversible – you should always take independent advice.

Venture Capital Trusts (VCTs)

Recent Budgets have placed a range of constraints on pension planning for high earners. From 2011/12 the annual allowance was slashed from £255,000 to £50,000, while on 6 April 2012 the lifetime allowance was cut by a sixth. Both allowances will fall again from 6 April 2014. HMRC is now busy challenging a range of non-pension tax avoidance schemes, with some success to judge by recent headlines.

This background has increased the relative attraction of the tax breaks still available for investments totalling up to £200,000 per tax year in VCTs:

- 30% income tax relief on subscription to new VCT shares. This relief is clawed back on disposals within the following five years.
- Dividends are free of income tax, although the 10% tax credit cannot be reclaimed.
- Any gains made on disposal of shares are free of capital gains tax.
- Within the VCT there is no tax on gains.

The changes to VCTs introduced last year have further enhanced the appeal of VCTs by increasing the size and hence number of companies eligible for investment. At the same time, the still-cautious lending policy of the mainstream banks has left VCTs in a good position to choose where they place their investors' funds.

Business Tax

The major change to corporation tax, initially announced last December, was a 2% cut in the mainstream rate of tax to 21% from 1 April 2014. For the financial year starting on 1 April 2013 the rate is 23%, while the small profits rate remains at 20%, as it has been since 2011.

Capital allowances

The Annual Investment Allowance (AIA), which gives 100% initial relief for investment in plant and machinery, was doubled to £100,000 from April 2010 then cut to £25,000 from 1 April 2012 (6 April for unincorporated businesses). However, in the Autumn Statement the Chancellor announced that for two years from 1 January 2013 the AIA amount would be increased to £250,000.

Small unincorporated business taxation
For 2013/14 all unincorporated small businesses with receipts below the VAT registration threshold (and some with income up to twice that level) will be able to benefit from a new simplification in how they calculate taxable income. In previous years virtually all businesses have had to follow the accruals basis in accordance with Generally Accepted Accountancy Practice, with deductions made for capital allowances and expenses, apportioned for personal use where necessary.

Under the new simplified system, a business will be able to decide that its taxable income will be calculated on a cash basis, with simplified expenses for business mileage. This will mean that small unincorporated businesses will generally not have to distinguish between revenue and capital expenditure.

Employment Allowance
A new employment allowance of £2,000 a year for all businesses and charities will be introduced from April 2014 to offset employer national insurance contribution (NIC) costs.

Planning points

Dividends or Salary ... or Pension Contribution?

Regular changes to National Insurance contributions and tax rates have altered the mathematics of the choice between dividends and salary, and the latest changes to the additional rate have done the same for 2013/14. If you are in a position to choose between salary and dividend, and not caught by the IR35 personal company rules, a dividend remains the more efficient choice, as the example below shows. However, a pension could avoid all immediate tax and NIC costs, provided the annual allowance is not an issue. It could also make sense to arrange a contribution in 2013/14 before the cut in the annual allowance to £40,000 from 2014/15.

Capital allowances timing issue

The increase to £250,000 for the 100% AIA in plant and machinery from 1 January 2013 means the timing of a major investment needs to be considered carefully. The change are pro-rated across business years so, for example, if your company year end is 30 June, its AIA in the current financial year is:

$^1/_2$ x £25,000 + $^1/_2$ x £250,000 = £137,500

It may therefore not be wise to bring forward all of a major purchase to the current financial year and better to defer beyond your financial year end to maximise the use of the AIA.

Still Worth It

Brian has £50,000 of gross profits in his company which he wishes to draw, either as bonus or dividend. Assuming the company pays corporation tax at the 2013 small profits rate of 20% and Brian has annual income in excess of £41,450, his choice can be summarised thus:

	Bonus £		**Dividend £**	
	40% tax	**45% tax**	**40% tax**	**45% tax**
Marginal gross profit	50,000	50,000	50,000	50,000
Corporation tax @ 20%	N/A	N/A	(10,000)	(10,000)
Dividend	N/A	N/A	40,000	40,000
Employer's National Insurance contributions £43,937 @ 13.8%	(6,063)	(6,063)	N/A	N/A
Gross bonus	43,937	43,937	N/A	N/A
Brian's NICs £43,937@ 2%	(879)	(879)	N/A	N/A
Income tax *	(17,575)	(19,772)	(10,000)	(12,222)
Net benefit to Brian	**25,483**	**23,286**	**30,000**	**27,778**

**after allowing for 10% tax credit on dividends* —

The benefit of the dividend route is due to the savings in NICs; more tax (corporation tax and income tax) is payable under the dividend route.

Pensions

There has been a raft of changes to pension tax rules in the past couple of years, with more scheduled to take effect on 6 April 2014:

- The annual allowance will be cut again from £50,000 to £40,000. However, the current £50,000 will continue to apply for tax years up to and including 2013/14 for carry forward calculation purposes.

- The lifetime allowance will also be cut again, dropping from the current £1.5m to £1.25m. Ahead of the change there will be an option to take advantage of two new transitional protection measures.

Before these allowance changes come into being, the capped income drawdown limits are due to increase from 100% of the HMRC/GAD rate to 120%. As confirmed in the Budget, this will take effect for drawdown years beginning on or after 26 March 2013. The change will help those whose drawdown ceiling has been hit by falling gilt yields and lacklustre investment performance. There will also be a review of the drawdown limits basis by the Government Actuary's Department (GAD), although this is likely to produce only a small change, if any.

There will be a consultation on allowing self-invested pensions (SIPPs and SSASs) to take advantage of the concessions for converting commercial property for residential use. In other words, SIPP buy-to-let investment might be back on the agenda after being effectively scrapped in 2006.

One non-tax pension announcement was confirmed in the Budget, having been 'leaked' by the Chancellor on the Andrew Marr programme last Sunday: the single-tier state pension will start from April 2016, rather than "April 2017 at the earliest" as stated in January's White Paper. The earlier start date has one useful advantage for the Exchequer which the Chancellor failed to mention: the bringing forward to 2016/17 of the projected £6bn NICs increase from the ending of contracting out rebates.

Planning points

Don't waste your 2010/11 annual allowance…

Gina's pension contributions were caught by the special annual allowance in 2009/10 and 2010/11, with the result that in those two tax years she restricted her pension contributions to £20,000 a year. In 2008/09 she paid £58,000. In the pension input periods ending in 2011/12 and 2012/13 she contributed £50,000 each year to her pension. In the pension input period ending in 2013/14 she can use the carry forward rule to make contributions of up to £80,000 without any annual allowance tax charge, as the table below shows. However, she will have lost the chance to mop up the £30,000 unused annual allowance from 2009/10, which could only be carried forward to 2012/13.

Tax Year	Contribution	Annual Allowance*	Carried Forward to Next Tax Year	Total Carried Forward
2008/09	£58,000	£50,000	Nil	Nil
2009/10	£20,000	£50,000	£30,000	£30,000
2010/11	£20,000	£50,000	£30,000	£60,000
2011/12	£50,000	£50,000	Nil	£60,000
2012/13	£50,000	£50,000	Nil	£30,000
2013/14	£80,000	£50,000	Nil	Nil

** For carry forward calculation purposes only in 2008/09-2010/11.*

Unless Gina contributes £80,000 to a pension arrangement with a pension input period ending in the current tax year, the unused annual allowance from 2010/11 will also be lost because the maximum carry forward period is three years.

Appendix – Tax Facts and Figures and NICs

Main Income Tax Allowances and Relief

	2012/13	2013/14
	£	£
Personal allowance – standard	8,105	9,440
- Born between 6 April 1938 and 5 April 1948	10,500	10,500
- Born before 6 April 1938	10,660	10,660
Personal allowance reduced if total income exceeds ∞	100,000	100,000
Married couple's allowance* – minimum amount	2,960	3,040
– maximum amount	7,705	7,915
Maintenance to former spouse *	2,960	3,040
Age-related allowances reduced if total income exceeds ¶	25,400	26,100
Employment termination lump sum limit	30,000	30,000

∞ For 2012/13 and 2013/14 the reduction is £1 for every £2 additional income over £100,000. As a result there is no personal allowance if total income exceeds £118,880 (£116,210 for 2012/13).

* Relief at 10%. Available only if at least one of the couple was born before 6 April 1935.

¶ For 2012/13 and 2013/14 the reduction is £1 for every £2 additional income over the total income threshold. Standard allowance(s) **only** are available if total income exceeds:

	2012/13	2013/14
	£	£
Taxpayer born between 6 April 1938 and 5 April 1948 [personal allowance]	30,190	28,220
Taxpayer born before 6 April 1938 [personal allowance]	30,510	28,540
Taxpayer born before 6 April 1935 [married couple's allowance]	40,000	38,290

Income Tax Rates

	2012/13	2013/14
	£	£
Starting rate on savings income- 10%	1 – 2,710	1 – 2,790
Basic rate	20%	20%
Maximum tax at basic rate†	6,874	6,402
Higher rate - 40%	34,371-150,000	32,011-150,000
Tax on first £150,000†	53,125.60	53,598.00
Additional rate on income over £150,000	50%	45%
Discretionary and accumulation trusts (except dividends) °	50%	45%
Discretionary and accumulation trusts (dividends) °	42.5%	37.5%
Ordinary rate on dividends	10%	10%
Higher rate on dividends	32.5%	32.5%
Additional rate on dividends	42.5%	37.5%

† Assumes 10% band not available. £6,123 on first £32,010 (£6,603 on first £34,370 in 2012/13) and £53,319 (£52,854.60 in 2012/13) on first £150,000 if full 10% band is available.

° Up to the first £1,000 of gross income is generally taxed at the standard rate ie. 20%, or 10% as appropriate.

Car Benefits

The charge is based on a percentage of the car's "price". "Price" for this purpose is the list price at the time the car was first registered plus the price of extras.

For cars first registered after 31 December 1997 the charge, based on the car's "price", is graduated according to the level of the car's approved CO_2 emissions.

For petrol cars with an approved CO_2 emission figure.

CO_2 g/km	% of price subject to tax		CO_2 g/km	% of price subject to tax		CO_2 g/km	% of price subject to tax	
	12-13	13-14		12-13	13-14		12-13	13-14
75 or less	5	5	130–4	17	18	180–4	27	28
76–94	10	10	135–9	18	19	185–9	28	29
95–99	10	11	140–4	19	20	190–4	29	30
100-4	11	12	145–9	20	21	195–9	30	31
105-9	12	13	150–4	21	22	200–4	31	32
110-4	13	14	155–9	22	23	205–9	32	33
115-9	14	15	160–4	23	24	210–4	33	34
120	15	15	165–9	24	25	215–9	34	35
121-4	15	16	170–4	25	26	220+	35	35
125–9	16	17	175–9	26	27			

Notes

1. The exact CO_2 emissions figure should be rounded down to the nearest 5 g/km for levels of 95g/km or more (100g/km or more in 2012/13).

2. For all diesels add 3%, subject to maximum charge of 35%.

3. There is no charge for any car which cannot produce CO_2.

Car Fuel Benefits

For cars with an approved CO_2 emission figure, the benefit is based on a flat amount of £21,100 (£20,200 for 2012/13). To calculate the amount of the benefit the percentage figure in the above car benefits table (that is from 10% to 35%) is multiplied by £21,100. The percentage figures allow for a diesel fuel surcharge. For example, in 2013/14 a petrol car emitting 147 g/km would give rise to a fuel benefit of 21% of £21,100 = £4,431.

Value Added Tax

From	1 April 2012	1 April 2013
Standard rate	20.0%	20.0%
Reduced rate (eg domestic fuel)	5.0%	5.0%
Annual turnover limit for registration	£77,000	£79,000
Deregistration threshold	£75,000	£77,000

Inheritance Tax

	Cumulative chargeable transfers [gross]		tax rate on death %	tax rate in lifetime* %
	2012/13 £	2013/14 £		
Nil rate band†	325,000	325,000	0	0
Excess	No Limit	No Limit	40∞	20

* Chargeable lifetime transfers only.
† On the death of a surviving spouse on or after 9 October 2007, their personal representatives may claim up to 100% of any unused proportion of the nil rate band of the first spouse to die (regardless of their date of death).
∞ 36% where at least 10% of net estate before deducting the charitable legacy is left to charity.

Capital Gains Tax

Main exemptions and reliefs

	2012/13 £	2013/14 £
Annual exemption	10,600*	10,900*
Principal private residence exemption	No limit	No limit
Chattels exemption	£6,000	£6,000
Entrepreneurs' relief	Lifetime cumulative limit £10,000,000. Gains taxed at 10%	Lifetime cumulative limit £10,000,000. Gains taxed at 10%

* Reduced by at least 50% for most trusts.

Rates of tax

Individuals:	18% on gains within basic rate band, 28% for gains in higher and additional rate bands
Trustees and personal representatives:	28%

Stamp Duty and Stamp Duty Land Tax

Residential	**Commercial**	**Rate**
£125,000 or less	£150,000 or less	Nil
Over £125,000 up to £250,000	Over £150,000 up to £250,000	1%
Over £250,000 up to £500,000	Over £250,000 up to £500,000	3%
Over £500,000 up to £1,000,000	Over £500,000	4%
Over £1,000,000 up to £2,000,000	N/A	5%
Over £2,000,000	N/A	7%*
** 15% for purchases by certain non-natural persons*		
Stamp Duty (including SDRT): stocks and marketable securities		0.5%
No stamp duty charge unless the duty exceeds £5		

Corporation Tax

	Year Ending 31 March	
	2013	**2014**
Main rate	24%	23%
Small profits rate *	20%	20%
Small profits limit *	£300,000	£300,000
Upper marginal level	£1,500,000	£1,500,000
Effective marginal rate	25%	23.75%

* Formerly the small companies' rate/limit

Tax-Privileged Investments [Maximum Investment]

	2012/13 £	**2013/14 £**
ISA		
Overall per tax year:	11,280	11,520
Cash component:	5,640	5,760
Stocks and shares component:	Balance up to 11,280	Balance up to 11,520
Maximum in cash for 16 and 17 year olds	5,640	5,760
Junior ISA	3,600	3,720
ENTERPRISE INVESTMENT SCHEME (30% income tax relief)	1,000,000*	1,000,000*
Maximum carry back to previous tax year for income tax relief	1,000,000	1,000,000
SEED ENTERPRISE INVESTEMENT SCHEME (50% income tax relief)	100,000¶	100,000¶
VENTURE CAPITAL TRUST (30% income tax relief)	200,000	200,000

* No limit for CGT reinvestment relief.
¶ 100% CGT reinvestment exemption in 2012/13 and 50% exemption in 2013/14

Pensions

	2012/13	2013/14
Lifetime allowance*	£1,500,000	£1,500,000
Lifetime allowance charge:		
Excess drawn as cash	55% of excess	
Excess drawn as income	25% of excess	
Annual allowance	£50,000	£50,000
Annual allowance charge	20%-50% of excess	20%-45% of excess
Max. relievable personal contribution	100% relevant UK earnings *or* £3,600 gross if greater	

* May be increased under 2006 or 2012 transitional protection provisions

Working and Child Tax Credits

Working and Child Tax Credits will gradually be replaced by Universal Credit, which begins to be phased in in 2013/14. For the time being the main features of the tax credits are:

1. Child tax credit

- Eligibility is assessed on household income.
- The claimant must be responsible for one or more children aged 16 or under, or at least one child under age 20 and in full-time non-advanced education.
- The family element of the tax credit is £545 per annum.
- The child element is £2,720 per annum for each child.
- The disabled child element is £3,015 per annum (where relevant).
- HMRC will pay the CTC to the main carer for the child.

2. Working tax credit

- The claimant, or one of the joint claimants, must be in qualifying remunerative work.
- The amount of WTC will be based on circumstances which are primarily the number of hours worked and the income of the claimant (or joint income for a couple).
- The age and working hours conditions are not straightforward. Generally, the minimum weekly working requirement will be:

  a) 24 hours for families with children and workers with a disability. The claimant can be aged 16 or over. One of the couple must work at least 16 hours.

  b) 30 hours for workers with no children and no disability. The claimant has to be aged 25 or over.

- The basic element of the tax credit is £1,920 per annum.
- The couple or lone parent element is £1,970 per annum.

- A 30 hour element of £790 per annum is payable where the claimant or one of the claimants works at least 30 hours a week (couples with children may aggregate their hours for this purpose).

- A disabled worker element of £2,855 per annum or more is available where the claimant, or his or her partner, has a disability.

- For employees, payment will normally be made by their employer with their wages (except the childcare element which is paid direct to the main carer). For the self-employed, payment is made directly by HMRC.

3. Calculating the credits

It is necessary first to total the various elements available to arrive at the maximum available amount of tax credits before any reduction on account of income. All elements can be reduced at the rate of 41% (ie. 41p per £1 of income).

National Insurance Contributions For Tax Year 2013/14

Definitions

Lower Earnings Limit (LEL)	the minimum level of earnings at which an employee will qualify for a State Second Pension (S2P). This is also the lower level of earnings which will be used in determining any NI Rebate. For tax year 2013/14 the Lower Earnings Limit is £109 per week.
Upper Accrual Point (UAP)	the upper level of earnings on which an employee's S2P entitlement is based (or on which any NI Rebate is determined). For tax year 2013/14 (and subsequent years) the Upper Accrual Point is fixed at £770 per week.
Upper Earnings Limit (UEL)	the upper level of earnings on which full NICs are charged. The reduced 2% NI contributions will apply to earnings above this level. For tax year 2013/14 the Upper Earnings Limit is £797 per week.
NI Rebate	the Rebate of employer's and employee's National Insurance contributions that is available where an employee is contracted out of S2P via a final salary occupational scheme. This is based on the employee's earnings between the Lower Earnings Limit (LEL) and Upper Accrual Point (UAP). The rebate is 3.4% (employer) and 1.4% (employee) in respect of the employee's earnings between the LEL and UAP. Since 2012/13 contracting out has not been possible via a money purchase occupational scheme or a personal pension scheme.
Primary Threshold	the level of earnings at which employees start to pay Class 1 National Insurance contributions. For tax year 2013/14 this is £149 per week.
Secondary Threshold	the level of an employee's earnings at which the employer starts to pay Class 1 National Insurance contributions. For tax year 2013/14 this is £148 per week.

Employees - Class 1

Contracted in	Nil on first £149 per week (i.e. up to Primary Threshold) 12% of £146.01 per week to £797 per week. 2% on earnings above £797 per week.
Contracted out via final salary occupational scheme	Nil on first £149 per week (i.e. up to Primary Threshold) 10.6% of £149.01 per week to £770 per week 12% of £770.01 per week to £797 per week. 2% on earnings above £797 per week. The employee's NI Rebate is still payable in respect of the employee's earnings between the LEL and UAP including those in excess of the LEL and up to and including the Primary Threshold. In the first instance, the Rebate reduces the National Insurance contributions payable by the employee. However, where the National Insurance contribution payable by the employee is reduced to nil, the excess Rebate will be available for the employer to set against his overall National Insurance contribution bill.

Employer - Class 1 Contributions

Weekly Earnings	Contracted In %	Contracted Out %
On first £148	Nil	Nil
£148.01-£770	13.8	10.4
Over £770	13.8	13.8

Although the reduced level of National Insurance contributions only applies to the employee's earnings in the band between the Secondary Threshold (£148 per week) and the UAP (£770 per week), the NI Rebate is still available in respect of the employee's earnings between the LEL and UAP, including those earnings between the LEL (£109 per week) and the Secondary Threshold (£148 per week). Employers are able to reduce their overall National Insurance contributions liability to reflect the Rebate applicable to the employer's contributions on the employee's earnings between £109 per week and £148 per week.

Self-Employed

Class 2 (lower profits limit)	£2.70 per week flat rate. (applicable where profits are less than £5,725 per annum)
Class 4	9% of profits between £7,755 p.a. and £41,450 p.a. 2% on profits above £41,450 p.a.

Voluntary Contributions

Class 3	£13.55 per week
Married Women and Widows Reduced Rate	5.85% of £149.01 to £797 per week. 2% on earnings above £797 per week.

Do not act on this information alone!

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