

Introduction

The Chancellor's proposals in the Coalition Government's first Budget have been well publicised in various forms since he gave his Budget speech. However, based on past experience we have found that our clients and others have welcomed our summary of the proposals that will have a particular impact on financial planning.

This summary also includes comments where appropriate which we hope you will find helpful.

Some of these proposals may change before they are enacted. However, it is important that financial plans are reviewed in the light of the likely changes detailed here.

The Chancellor said that "this Emergency Budget deals decisively with our country's record debts. It pays for the past and it plans for the future."

UK Economy

The Chancellor **lowered the UK's economic growth forecast** for the next five years. Unveiling what he called an 'unavoidable' Budget, the Chancellor said economic growth this year would be 1.2%, in line with Darling's forecasts in March of between 1% and 1.25%. But, in 2011, he said growth would be 2.3%, much lower than Darling's estimate of between 3% and 3.5%. After that, GDP (Gross Domestic Product) growth will be 2.8% in 2012, 2.9% in 2013 and 2.7% in both 2014 and 2015.

The Chancellor said that **consumer price inflation is expected to reach 2.7% by the end of 2010** before "returning to target in the medium term". The inflation target remains at 2%, as measured by the Consumer Prices Index (CPI).

Comment: The CPI was 3.4% in May, down from 3.7% in April. If the Chancellor's forecast is correct then inflation is not going to be the problem that many expected. On the other hand the Retail Prices Index (RPI) is a better index for many people as it includes mortgage payments, council tax and other housing costs. The RPI was 5.1% in May, down from 5.3% in April (*Office for National Statistics*).

At these levels there seems little point in leaving large amounts of capital on deposit, apart from that required as an emergency fund.

The Chancellor said that "the bulk of the deficit reduction must come from lower spending rather than higher taxes", declaring "the nation is in economic trouble because of overspending, not under-taxing." The Chancellor said that "cuts would be derived from 77% of total consolidation spending and 23% tax increases."

Comment: This has been no ordinary recession because it was caused by an asset bubble bursting. The favoured method historically of getting a country out of recession by Government spending does not apply. The way out of this recession is to be mainly by 'belt-tightening', both by Government and by individuals. There is strong evidence that many families are already reducing debt and increasing their savings. This, of itself, will tend to push inflation down.

In an unexpected move, the Chancellor also confirmed that **the UK would not be joining the euro**.

Gilt Issuance

The UK's planned gilt sales in 2010/11 have been revised down by £20.2bn to £165bn due to the Government's debt reduction programme outlined in the Budget.

Comment: In April, the total gilt issuance for this financial year was projected to hit £185.2bn. Most analysts were correct in predicting gilt issuance would be reduced by £20bn. The gilt market has so far reacted positively with a small increase in prices although for those holding gilts this does mean a small reduction in their income.

Value Added Tax (VAT)

VAT is to **increase to 20% from 4 January 2011**. The current zero-rated items are to remain exempt for the whole of the current Parliament.

Comment: Following the increase the main rate of VAT will still be below the European Union average

Capital Gains Tax (CGT)

CGT is to **increase for higher-rate taxpayers to 28% from 23 June 2010**. CGT is to remain 18% for basic-rate taxpayers.

Comment: The increase to 28% is lower than the anticipated rates of up to 40% and 50% linked to income tax. It is also lower than the top rate of 40% that was in place before the 18% rate was introduced three years ago.

The increase emphasises the benefit of building up as much capital as possible in ISAs which are free of CGT.

It is important to note that a basic-rate taxpayer could easily find themselves paying 28% CGT because this rate applies to "those with total income and taxable gains above the higher rate threshold."

The CGT tax-free allowance is to remain at £10,100 for the current tax year.

Comment: Keeping the £10,100 annual allowance is very welcome as there was some fear that this would be reduced to £2,500 as proposed by the LibDems.

The Chancellor said that he had considered 'taper relief' but that it was "too complicated".

The CGT entrepreneur's rate of 10% is to be extended to the first £5 million of lifetime gains.

For trustees and personal representatives of deceased persons, the trust rate will be 28%. The trust annual exemption will remain at £5,050.

Income Tax

The personal income tax allowance (applicable to those under age 65) is to **be increased by £1,000 in April 2011 to £7,475**. The upper basic rate limit (currently £37,400) will be reduced by £2,500 so that higher rate taxpayers will not benefit, although the actual reduction will not be known until September's RPI figure is known.

Comment: Many will be disappointed that the personal allowance was not immediately increased to £10,000 as the LibDems had wanted. However this is a long objective of the Government and we have been told to expect progress towards that goal every year.

Inheritance Tax (IHT)

No changes were announced so that we must assume that the nil rate band will remain frozen at £325,000 until 2014/15 as previously announced.

Comment: Those who have delayed taking action on inheritance tax will have known before the Budget that the £1 million nil rate band manifesto pledge had been sacrificed by the Conservatives to enable them to form a Government with the LibDems. It is possible that there is now not going to be a major change in the nil rate band for some years.

The message has to be that anyone with an estate in excess of £650,000 (if married or widowed) or £325,000 (if single) needs to investigate the options for reducing the value of their estate for IHT purposes as a matter of some urgency.

Insurance Premium Tax (IPT)

Insurance premium tax is to be **increased from 4 January 2011**. The higher rate is to be 20%, and the standard rate 6%.

Individual Savings Accounts (ISAs)

From 2011/12 ISA subscription limits will be indexed.

Comment: This is welcome and with the rise in CGT higher rate tax payers, in particular, should make full use of their ISA allowance each year.

Although basic rate tax payers do not benefit as much through their use of ISAs there are still good reasons for using the maximum allowance, currently £10,200 per person, where possible and not just the Cash ISA allowance, currently £5,100.

Venture Capital Trusts (VCTs)

The Government is to introduce the final changes to VCTs which were previously agreed with the European Union.

The Budget sets out the changes which will be included in a Finance Bill to be introduced as soon as possible after Parliament's summer recess.

The main changes are:

- VCTs will be able **to list their shares in any EU/EEA country**. At the moment they can only be listed in the UK.
- VCTs will **have to own at least 70% of their investments in companies in eligible shares**, up from the current 30%. However, the definition of eligible shares will change to allow VCTs to include shares which may carry certain preferential rights to dividends.
- Qualifying investments must **only have a permanent establishment in the UK**, rather than the current requirement that all or most of its business is carried out in the UK.

Comment: Although there is nothing new here it is good news that there has been no reduction in the benefits of VCT investment.

Personal Pensions

The Government has stated that from April 2011 it will **end the existing rules on compulsory annuity purchase at age 75**. Furthermore, under separately announced transitional rules, **the age 75 requirement changes with immediate effect to age 77** (but only for individuals who have not yet reached age 75).

These interim changes have been introduced to allow those reaching age 75 on or after Budget day (22 June 2010) to **defer their decision on what to do with their pension savings** until after the new rules are finalised next year.

Comment: There are many reasons why someone might want to delay the purchase of an annuity with their pension fund as long as possible. Prior to this anyone reaching age 75 either had to purchase an annuity or else go into a highly taxed alternatively secured pension.

For those reaching age 75 on or after 22 June 2010, the income limits and tax treatment on lump sum death benefits that applied up until age 75 will apply up until age 77.

This change will hopefully encourage many people to save larger sums for their later life.

The April 2011 introduction of a gradual reduction on higher rate tax relief on pension contributions by high earners is to be reviewed.

Comment: The restrictions to tax relief on pension contributions made by high earners, introduced by the last Government, are overly complicated. It is good news that these are to be reviewed.

We do not expect that the restrictions will be lifted but that a much more straightforward system will be introduced, although that will not help those who will have to struggle with the present rules for the current tax year.

There has been no suggestion that higher rate tax relief on pension contributions will be removed altogether, as the LibDems wanted.

State Benefits and Pensions

Benefits, tax credits and public service pensions are to be **increased in line with the Consumer Prices Index (CPI)** rather than the Retail Prices Index (RPI) from 2011.

State Pensions will be guaranteed to rise **in line with the best of three measures** from April 2011, that is, earnings, prices (CPI) or 2.5%, whichever is highest.

To ensure the value of a Basic State Pension is at least as generous as under the previous uprating rules, the Government will increase the Basic State Pension from April 2011 **by at least the equivalent of the RPI**.

The increase in the **state pension age to 66** is to be accelerated.

National Employment Savings Trust (NEST)

The section on this simply says that "changes will be made to pensions tax legislation in the Finance Bill introduced in the autumn to enable the National Employment Savings Trust (NEST) to register as a pension scheme for tax purposes."

Businesses

Corporation tax is to be cut to 27% in 2011 and by 1% a year over the following three years to 24%.

The small companies' rate is to be **cut to 20% in 2011**.

The employer's national insurance (NI) threshold is to increase by £21 a week above indexation from April 2011.

Comment: These reductions in the rate of corporation tax will provide a much needed boost for UK plc. Nearly all of the growth in the UK economy in recent years has been the result of Government spending rather than private business growth which has remained flat.

Bank Levy

A bank levy is to be introduced from 1 January 2011 to apply to the balance sheets of UK banks and building societies and UK operations of foreign banks.

Public Sector Pay

There is to be a two year public sector pay freeze to be introduced on staff earning more than £21,000.

People earning less than £21,000 are to receive a flat pay rise worth £250 in each of the two years.

These Budget notes are intended as a guide only. The information given is based on our understanding of the Chancellor's proposals. Whilst we believe our interpretation of the proposals to be correct, we cannot be responsible for the effects of any future legislation or any change in interpretation or treatment.

You should not make changes to your financial planning on the strength of these Budget notes but talk through your personal situation with an independent financial adviser such as ourselves.

Please note that this information does not constitute personal advice and should not be treated as a substitute for specific advice based on your circumstances.

For personal advice

If you would like to receive advice on your investments, pensions, or financial planning generally, please ask your usual Arch adviser or contact us via one of the following:

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