

Budget Impacts

Many private investors earning less than £100,000 a year will be able to heave a sigh of relief after the Chancellor's 2009 Budget. ISA allowances are to be increased; and most pension contributions will continue to be eligible for higher rate tax relief and will permit the withdrawal of at least 25% of the benefits in the form of tax-free cash. However, those with higher earnings or more complicated arrangements may need to reconsider their financial plans.

Income tax

With effect from 6 April 2010, the income tax personal allowance for people whose income exceeds £100,000 p.a. will be progressively reduced to nil when earnings reach £113,000 p.a.. In addition, income tax will be levied at 50% on earnings (and pensions receipts) in excess of £150,000 p.a.

The 50% income tax rate will also apply to trusts, which re-affirms the advantages of holding the investments of discretionary trusts in an Investment Bond wrapper, from which withdrawals of 5% p.a. can be made without any immediate liability to tax.

Accountants KPMG have calculated that as a result of the reducing personal allowance, someone earning between £100,000 and £112,950 could find themselves paying tax at the "eye-watering" marginal rate of 60%!

For owners of small businesses, the increased gap between personal tax rates and corporation tax could prompt a shift to corporate status.

ISAs

The annual ISA investment allowance will be increased from £7,200 to £10,200 with effect from 6 April 2010, but those aged 50 or over will be able to take advantage of this increase as from 6 October 2009.

Investors will continue to be permitted to allocate up to half the allowance to cash deposits, and will be able to top-up ISAs arranged before October to the new limit, provided that the additional investment is made with the same institution.

Clearly, freedom from income tax (and capital gains tax) is an attraction of ISAs, but arguably an equally great advantage is that returns from ISAs do not have to be reported to the Revenue.

Pensions

At present, all pension contributions attract tax relief. For every £100 contributed, the Government provides a top-up of £25 basic rate tax, and 40% tax-payers are then able to claim a further £25 relief. This means that a £75 pension contribution buys a pension asset worth £125.

With effect from 6 April 2011, tax relief on pension contributions for those earning more than £150,000 p.a. will reduce progressively and will be limited to the basic rate of 20% for those earning £180,000 p.a.. This could well mean that some will pay a higher rate of tax on their pension receipts than they have saved on their contributions, and that they will therefore be looking for alternative means of funding their retirement needs.

Anticipating pre-emptive action by pension savers, those earning over £150,000 p.a. will be subject with immediate effect to a 20% tax charge on any personal contributions which exceed £20,000, unless there is a record of regular contributions of this magnitude having been made in the past.

Some employees might have sought to side-step this charge by arranging with their employers for a 'salary sacrifice', whereby the employer would agree on a regular basis to divert a proportion of earnings to pension funding, with incidental savings in National Insurance contributions. However, the Government has stopped this potential loophole by providing that salary sacrificed under new schemes set up after Budget day will be added back to income for the purpose of calculating the £150,000 salary which triggers the charge.

EIS

Enterprise Investment Schemes, which provide tax relief on investments in individual small companies which satisfy certain criteria, have become relatively more attractive than their collective investment counterparts, Venture Capital trusts, and EIS have been given a further boost in the Budget.



Up-front income tax relief of 20% is available to EIS investors, and currently £50,000 of the investment can be carried back to the previous tax year. As a result of the Budget, however, it will in future be possible to carry back the full maximum annual EIS investment of £500,000.

Other advantages of EIS are ongoing, most notably the 100% relief from inheritance tax for investments which have been held for at least two years. By virtue of the type of investment involved, EIS holdings are of course at the high end of the risk spectrum.

Other investments

The new 50% supertax on high earners underlines the relative advantage which capital gains (which are taxed at a flat 18%) offer over income. Capital withdrawal schemes could prove attractive and among the other options which might be considered is property investment, the market for which, according to some commentators, may now have passed its low point.

Foot-in-mouth disease

"A weak currency arises from a weak economy, which in turn is the result of weak Government"

Gordon Brown, 1992

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No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns.

The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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