

Taking Account

MARSHALL ROCHE
Newsletter – Spring /Summer 2010

BUDGET COMMENT

This time last year, we said that everyone should brace themselves for higher taxes after the election. For most of us, this consists of a 2% increase in National Insurance (1% on Employer's + 1% on Employee's contributions, from April 2011) and a 2.5% increase in VAT (from 4 January 2011). However, the new government has made it clear that this only accounts for around one third of the deficit, the rest being made up by cutting government spending and benefits.

The net effect of this is going to be dramatic, as money is taken out of the economy to repay the nation's debts.

The government is optimistic that increased economic activity will make up for this. Because it is now more expensive to buy things abroad, the hope is that people will "Buy British", including foreigners, who now find it cheaper to buy our goods, because they get more pounds for their Euros or Dollars etc.

Either way, it means that we are all going to have to work harder for less, while the nation's debts are paid off. The risk, of course, is that people react badly to this idea and we see strikes (or even riots, as we have in Greece), or people simply choose to claim benefits rather than working harder for less money. If this happens, then we shall see a downward spiral, as tax revenues fall further and government spending increases – precisely the opposite of the government's intention.

So the likely success or failure of this budget is not so much down to the economic competence of the government – it's all textbook stuff, after all – **the more important factor is the government's ability to 'sell' the proposition to the public.**

The public perception therefore, that the VAT rise disproportionately hits lower paid people, could be a sticking point, particularly if people are losing benefits on the one hand and having to pay more in VAT with the other. Whilst keeping income tax rates low undoubtedly helps to encourage enterprise and hard work, a small rise in income tax rates might have been easier to sell to the public as 'progressive'. After all, economic worries amongst the public translate into economic problems for the country.

Maybe what is needed is a concerted effort, such as the "I'm backing Britain" campaign of the 1960s.. (and it might help if we had a decent football team too – like we had back then!)

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Capital Gains Tax

It seems that CGT is doomed to remain a complex tax. Having ditched indexation relief for taper relief, the last government then did away with that, leaving a simple flat rate of 18% tax on any gains over the annual allowance. However, **this was never politically sustainable in the longer term, as it meant that multimillionaires making multi-million pound gains were paying tax at a lower rate than someone on average income.**

In order to try to rectify this, the government has reintroduced a link to overall income, but instead of using the 40% higher rate of income tax, the higher rate on capital gains has been set at 28%.

Note that this rate only applies to disposals after 22 June 2010 - a change in the tax rate mid-year is almost unheard of and is going to create considerable headaches for those who design tax return software!

What many will have missed is that, whilst they may not be higher rate taxpayers under normal circumstances, someone with a substantial capital gain could easily find themselves paying tax at the higher rate of 28%, because the gain is added to their income for the purposes of working out whether or not the higher rate applies. So, in rough terms, a basic rate taxpayer on around £25,000 per annum would find that the first £10,100 of capital gains in a tax year would be tax-free, the next £20,000 taxed at 18% and anything above that would be taxed at 28%.

The special rate of 10% entrepreneurs relief still applies for someone selling their business, with the lifetime limit raised to £5 million.

Capital allowances

The last government introduced 100% capital allowances for small businesses investing up to £50,000 on capital equipment in any one year. Known as the Annual Investment Allowance (AIA), this was increased to £100,000 for 2010/11, but from April 2011 the allowance reduces to £25,000.

This change is unfortunate as it is likely to hit small manufacturing companies who are trying to expand. However, for most small self-employed businesses the reduced figure will easily cover any capital expenditure. **Note that this allowance does not include cars or any equipment that has an element of private use.**

The annual writing-down allowance on anything not covered by the AIA will reduce to 18% from April 2012 (8% for cars over 160g/km of CO²).

Corporation Tax and dividends

From April 2011 the small-company Corporation tax rate falls to 20%. This is good news for those who draw their income as a dividends, because it brings the rate into line with the basic rate of income tax.

At the same time, while dividends remain exempt from National Insurance, the rise in employee NI that comes into effect in April 2011 will not affect those who draw dividends instead of salary. However, with the Lib-Dem side of the coalition particularly keen to curb tax avoidance, it can now only be a matter of time before they come up with some way of "rectifying" this situation...

Tax thresholds

The Chancellor announced an increase in the amount you can earn tax-free by £1,000 to £7,475 as from April 2011. However, so that higher rate taxpayers do not get the benefit of this, he will reduce the threshold for higher rate tax by £2,500.

Company cars

The taxable benefit as a percentage of the list price (when it was new) increases by 1% for all cars emitting more than 129 g/km CO², except that the maximum will remain at 35% of list price.

Furnished holiday lets

The Chancellor announced that the existing rules will continue for the current tax year and a review will be carried out. It is likely that arrangements such as claiming tax relief against other income, for losses on a holiday property/caravan, are likely to disappear as from April 2011.

Tax data cards

With all the key tax rates and allowances for 2010/11 being left the same as 2009/10, we have taken the decision to save the rainforests and keep costs down by not printing new cards for the current year. Full details are available on our web-site www.MarshallRoche.co.uk.

Keep tax return costs down ...

Time presses on and tax returns will soon be due again. Please try to get it all to us before your summer holiday, so you can relax.

Please see our web-site for our tax return helper / checklist.