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United Kingdom budget 2010: Securing the recovery

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The 2010 UK Government budget was handed down on 24 March. It was titled “Securing the recovery” and did not contain any surprises, nor changes to the corporate tax regime that will have a dramatic impact on business in the UK. This is not surprising, in the light of the general state of the economy and the upcoming election, which is widely expected to be on 6 May. There is likely to be another budget following the election, with more substantive changes.

Taxation of businesses

The budget did not contain any pre-election handouts for businesses, although it is aimed to support sustainable growth. There are to be no changes to the main rates of corporation tax or VAT. Changes to the income tax treatment of high earners, which had already been announced in 2009, were confirmed. The increase of the top marginal rate of income tax to 50% from April 2010, coupled with a reduction of personal allowances and reliefs (such as the restriction on relief for pension contributions) for individuals earning over £150,000, will undoubtedly have an impact on London’s ability to attract and retain the best employees. On top of this is the previously announced bank payroll tax, which will impose a 50% tax on banks on bonus awards in excess of £25,000 from 9 December 2009 until 5 April 2010. There may be some relief that the bank payroll tax has not been extended beyond April 2010.

Otherwise, the budget does not contain any radical thinking for taxation of businesses in the UK. No attempt is made to address the UK’s competitiveness in international taxation, which many commentators feel has been decreasing. In January 2010 HM Revenue and Customs (HMRC) launched a consultation process on the controlled foreign company (CFC) rules. The outcome of this consultation is eagerly awaited.

The budget did contain a package of measures designed to support and encourage small and medium-size enterprises. These include some reliefs from business rates, some “time to pay” arrangements, and increasing the annual investment allowance (broadly, a first-year 100% depreciation on certain plant and machinery) from £50,000 to £100,000. In addition, an expansion to entrepreneurs’ relief has been announced. The entrepreneurs’ relief provides for certain capital gains to be taxed at a reduced rate of 10%, in contrast to the normal rate of 18%, for the first £1 million of lifetime capital gains. This reduced rate will now apply to the first £2 million of those lifetime capital gains.

Anti-avoidance

As has become customary since the introduction of tax disclosure rules in 2004, the budget does contain a number of specific anti-avoidance provisions. This year, they include measures to limit double tax relief to situations where the taxpayer has genuinely borne the cost of the foreign taxes, a clamp down on "group mismatch schemes" which enable a group to take advantage of differing accounting treatment for financial instruments or transactions between different companies, prevention of abuse of the Share Incentive Plan rules under which companies have been obtaining an accelerated corporation tax deduction for benefits notionally to be provided to employees, and extensions to the regime for the disclosure of tax avoidance schemes.

Impact on employee remuneration

In addition to the new 50% rate of income tax for those earning over £150,000, which takes effect from April 2010, the national insurance contribution (NIC) rates on earnings will increase by 1% from April 2011. The top rate of employers' NICs will become 13.8% and the top rate of employees' NICs will become 2%.

The budget also announces a change to the approved company share option plan (CSOP) rules. This is stated to be as a result of some tax avoidance schemes that are designed to deliver greater value to employees than the rules intended; under the CSOP rules, options over shares with a maximum value of £30,000 at the time of grant can be issued. It appears that rather than introducing a targeted anti-avoidance rule, the CSOP rules will be changed so that it is no longer possible to have a CSOP in respect of shares in a subsidiary of a listed company; rather, the shares must be in the listed company (or another company not controlled by any other company) itself. While this is likely to affect only a relatively small number of taxpayers, it appears that non-abusive plans would also be caught by the new restrictions. Existing schemes should not be affected.

The budget also announces reviews into the use of employee benefit trusts (EBTs) and geared growth shares, with a view to closing down tax avoidance structures. The attention on EBTs is not a surprise, since HMRC announced in January 2010 that EBTs were an area of focus for them. Many of the benefits of EBTs have been eroded over recent years; they were historically used to deliver a mismatch between the time at which the employer was able to obtain a deduction for corporation tax purposes and the time at which the employee was taxed on the benefit, and also to avoid payment of NICs. Consequently, the use of EBTs is now much restricted, although they can be used to defer the imposition of income tax for employees. The consultation process will need to be watched, to ascertain whether any changes are targeted at specific abuse or are wide enough to cover more commonplace deferral techniques.

With respect to geared growth shares, very little detail has been given. The use of employment related securities that aim to deliver as much as possible by way of capital growth outside the employment income tax regime has become increasingly popular, particularly given the large discrepancy between the top rate of income tax (50%) and the rate of capital gains tax (18%). Such techniques include the use of "growth shares" or "profits interests". Potentially, other common means of rewarding employees may be caught, perhaps even including carried interests awarded to private equity executives. The tax treatment of carried interests, which is generally accepted to constitute largely capital gains tax treatment, has received particular attention in the last few years as many jurisdictions consider whether carried interests are properly treated as employment income or capital gains. The government's implicit approval of capital gains tax treatment—shown by its not having introduced targeted legislation in

recent years to address carried interest—was welcome, but this review process raises the possibility of changes in the near future.

On the positive side, it is announced that the Enterprise Management Incentive (EMI) plans (which permit tax advantaged options to be granted in respect of certain smaller companies) is to be extended. In response to concern over compatibility with EU law, the range of companies in respect of which EMI treatment may be available is to be extended, such that it is no longer necessary for the group to contain a company with a qualifying trade that is wholly or mainly in the UK, but rather that a member of the group must have a permanent establishment in the UK.

For more information about the issues discussed in this Tax LawFlash, please contact your Morgan Lewis attorney or the contact listed below:

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