

Emergency Budget 2010 Headlines

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“The Budget highlighted what was already well anticipated – cuts and tough times ahead for the public sector.”

Stephen Gifford
Chief Economist, Grant Thornton

“Capital Gains Tax increases packed an immediate punch.”

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The UK Economy

The 2010 Emergency Budget was the Chancellor’s big debut and it was a serious but upbeat occasion with George Osborne highlighting how he believes the economy has been managed irresponsibly by the previous administration and now needs unavoidable change around benefits, taxation, pensions and Government spending.

Tax rises and spending cuts

With the Chancellor relinquishing his responsibility for economic forecasting, he set out the economic and fiscal projections from the Office of Budget Responsibility (OBR) and then focused on his plans for tax and spending over the coming years.

The Chancellor announced the equivalent of £8 billion in annual tax rises by 2013/14 through increases in VAT, Capital Gains Tax and the new banking levy. Current receipts are 37.2% of GDP this year and predicted to increase to 38.0% in 2011/12 and to 38.4% in 2012/13.

But it will be around public expenditure where the challenges reside. Spending reductions of £32 billion per annum by 2013/14 are much worse than the drastic cuts of the early 1980s. Given commitments around health spending, unprotected departments are likely to have a mountain to climb over the course of this Parliament.

Public Sector Impact on the public sector

Today’s announcement highlighted what was already well anticipated - cuts and tough times ahead for the public sector. While many may argue that cuts in public sector pay and pensions should mirror what has already happened in the private sector, the reality of implementing such plans might be a lot harder than anticipated.

More detail will be revealed on where these cuts and efficiency savings will be made in the Comprehensive Spending Review in October, but at this point, public sector organisations will do well to continue making plans to reduce spending,

an action they've been anticipating well before today's Budget.

While the impact will fall on both the public and private sectors, opportunities have also been created. Better procurement in the public sector will sharpen the commerciality of transactions and service agreements. In addition, new partnering opportunities will emerge and those most adept at adjusting to new arrangements will benefit albeit in the medium term. On a positive front, the Chancellor announced his commitment to the importance of infrastructure with no further cuts to capital expenditure.

Commitment to capital investment

Today's announcement confirmed that the currently planned reduction of 25% in gross annual public sector investment that will take place by 2015/16 will not change. The current capital programmes will nevertheless be subject to a fundamental review to direct resources to where they will achieve the greatest economic return, so there may be winners and losers by sector and region when the spending review is announced in October.

There is, however, also commitment to maintaining existing capital expenditure plans, which overall promote capital projects in the regions, including some major transport projects and a Regional Growth Fund. The establishment of the Green Investment Bank also confirms the importance placed on the sustainability agenda.

There were no specific announcements on the use of PFI and how the commitment to the protection of capital budgets will in practice be applied to local government PPP projects, and there are no specific restrictions proposed on local government prudential borrowing, allowing local financing of investment to continue. However this will be reviewed so there still remains uncertainty as to the methods of financing for capital projects.

The overall assessment of the sector will be completed for the Spending Review announcement on 20 October, but we expect to see interim decisions on aspects of capital programmes such as Building Schools for the Future in the meantime.

Both the public and private sectors will be reassured overall but still need greater clarity on specific projects in order to continue to commit resources and avoid abortive costs.

Increased pressures on Local Government spend

Local government spending has already been cut by £1.2 billion as part of the £6.2 billion spending cuts previously announced for the current year. Today, the Chancellor confirmed unprotected Whitehall departments will have budgets cut on average by 25% in real terms over the current parliament.

The final settlements will be confirmed in the autumn Spending Review. The ability to mitigate service cuts through Council Tax rises will be constrained next year due to the proposed freeze but the statement suggests that some compensation for this may be made available by central government.

Local government staff will be affected through the proposed two year public sector pay freeze, along with the public sector pensions review and the proposal that top salaries are capped.

There was little specifically on the Coalition's aim of greater third sector involvement in delivery of local services but proposals to ease the burden of VAT charges on charities benefiting from shared services may facilitate this.

The proposal to abolish Regional Development Agencies (RDAs) was confirmed today, although they will, in some cases, transform into local enterprise partnerships where Local Authorities will have greater influence to facilitate greater coordination of investment in



transport, housing, regeneration and other aspects of economic development. As part of this reform, proposals will be developed for local authorities to support growth, including options for business rates and Council Tax incentives to allow reinvestment locally. Planning is intended to be driven more by local decisions through the use of Local Development Orders.

Overall there are likely to be significant challenges in prioritisation and in securing efficiencies which will require careful financial planning. Effective coordination across borders, across sectoral boundaries and with the private and voluntary sectors will also be critical to successfully navigating these challenges over the months and years ahead.

Tax

High and middle income earners will continue to weep as the Capital Gains Tax packs an immediate punch

Capital Gains Tax (CGT) will increase from 18% to 28% for high and middle income earners from midnight which is an unprecedented move to impose the CGT change with immediate effect. This will hit high net worth individuals and middle income earners on incomes over £43,875 who had not planned to crystallise gains prior to today at the lower available rates. CGT was always going to be a source of political debate in this Budget, with conflicting views on the rate, the timing of the introduction and how to support entrepreneurs who had made business decisions around existing rules.

Balancing the competing demands of raising money and keeping tax simple - or at least simpler - the Chancellor has opted not to significantly differentiate between long-term and short-term held investments by reintroducing taper relief on assets, but has kept entrepreneurs' relief and significantly raised the lifetime limit. This will be £5 million from midnight tonight which means the relief which began as an £80,000 benefit (£1 million at the difference between 18% and 10%) and is now potentially worth £900,000. This does highlight a commitment to those who own their own business or are significant shareholders.

VAT rise is the necessary evil to fill the spending deficit

The standard rate of VAT will rise from 17.5% to 20% on 4 January 2011.

It was an expected move and, providing an additional £13 billion a year, was an obvious revenue raiser for the Treasury which will go some way to filling the vast spending deficit. Compared to the EU we have enjoyed a relatively low rate of VAT but this rise could add further pressure to an inflation rate that is already higher than the Government would like. The rate change will of course create administrative

burdens for businesses as this will be the third VAT change in just over two years, although the Chancellor has helped retailers by keeping the rate down for six months, encouraging spending in the run up to Christmas and the first days of the January sales.

Chancellor's bank levy to coincide with French and German measures

Chancellor Osborne has demonstrated his tough stance towards the financial services industry by introducing a banking levy on bank balance sheets from January 2011. The rates will initially be 0.04%, rising to 0.07%, which is eventually estimated to raise over £2 billion a year. It should be relatively easy to implement this levy, which makes banks bear the burden of potential systemic risk.

The Government perceives Britain as being uniquely exposed to the risk of bank failure, as the ratio between bank assets and GDP is far higher in Britain than in other Western countries. It is good news that France and Germany will join Britain in implementing a bank levy as this should mean a level playing field between the UK and its major European counterparts.

Although the banking industry rejects levies in principle, this measure is probably less punitive and less disruptive to markets than a foreign currency transaction tax could have been.

Osborne's attempt to lure corporates needs to go further

Today's announcement that the corporation tax rate will reduce from 28% to 24% over a four year period will be welcomed by British industry. A reduction to 25% had been expected, going below this to 24% by 2014 is therefore good news. There is a proposal to introduce a possible General Anti-Avoidance Rule to capture aggressive tax planning. There is also an unwelcome delay in introducing the final controlled foreign company provisions, which will not now be introduced until 2012.

We have known for a long while that the mainstream Corporation Tax rate was scheduled to come down but it is disappointing that this cut will now be introduced in phases. Companies of all sizes need assistance and a cut is welcome but it's frustrating that any positive change will come in so slowly.

Controlled foreign companies rules act as the main deterrent for most companies to headquarter themselves in the UK. The previous Government had set up a consultation on how to simplify the existing rules but today's decision not to introduce final legislation until 2012 is a great disappointment especially considering that coalition Government's main message to the business community was on simplification.

Small businesses to benefit as IR35 abolishment is on the cards

Chancellor George Osborne provided small businesses with some encouraging news, including a reduction in the small profits rate and a national insurance contribution holiday for small start-ups in certain regions. But the big news is that IR35 may be abolished soon.

The review of small business taxation has been debated for nearly a decade and the hoped-for abolition of IR35 looks very much on the cards.



The IR35 rules have created problems for over ten years for entrepreneurs using personal service companies and have led to hundreds of tax cases, many of which have been lost by HM Revenue & Customs (HMRC).

More good news is the reduction in the small companies rate of tax which falls 1% to 20% from next April. This reverses the recent trend of increasing taxation.

Anti-avoidance measures back in the spotlight to help plug the deficit

Today's Emergency Budget has outlined various anti-avoidance measures which aim to collect much needed revenue by bringing back into the spotlight the discussion on introducing a General Anti-Avoidance Rule (GAAR), to clamp down on tax planning arrangements. Additionally, the Disclosure of Tax Schemes arrangements (where promoters of tax schemes must notify HMRC when a new planning arrangement is developed) will be beefed up in 2011/12 to catch more tax avoidance arrangements, including Inheritance Tax planning.

Areas which will be first in the firing line for review are likely to be planning relating to General Growth and Employment Related Securities, schemes exploiting large gifts to charities for tax reasons, and avoidance involving the use of trusts and other vehicles to shelter pension income.

Business as usual for the Government as UK companies are hit by the 'tax on jobs' after all

Next April the increase in earnings threshold of £21 a week will reduce employment costs but the 1% increase already announced by the Labour Government is not being reversed.

Although the 1% National Insurance Contribution (NIC) hike for employees will be offset by higher personal allowances for those earning less than

£100,000 the increase will directly impact on people's pay slips making moderate and high earners worse off.

At first sight the newly announced NIC concessions for all of the UK outside London and the South East look good, however care will need to be taken to ensure that the relevant conditions are met to take advantage of this new relief. Although we can expect all manner of restrictions to be applied, in essence, the Government seems to be prepared to pay £5,000 for each 'new job' created for up to ten new jobs per qualifying business.

Tax – the sector view

Distressed property market escapes expected hit in budget announcement

Today's Emergency Budget announcement did not hit the property and construction industry as hard as anticipated. The CGT increase was the main area of concern ahead of the Budget but was not as bad as anticipated and as the change will take place at midnight tonight, it avoids the market being flooded with properties as sellers try to take advantage of the 18% rate.

There is no surprise that VAT increases have been announced and this change will hit some in the property sector hard. Both landlords and tenants will be hit by an additional VAT cost at a time when the sector is trying to recover.

The increase in Entrepreneurs' relief is welcome despite the fact it only applies to the disposal of shares in trading businesses (including property developer-traders, fund management, contractors and housebuilders) but not property investment of up to £5 million. This means that qualifying disposals will be eligible for an effective 10% Capital Gains Tax rate.

UK construction companies hit hard by Budget announcement

The tax and VAT hike announced today will add to the distress of an already fragile recovery in the construction sector. As consumers now face an increase to their tax bill and a rise in VAT, this will undoubtedly lead to a fall in the confidence they need to make larger scale purchases. Many will question if now is the right time to buy, if they have the funds to do so and if their jobs are secure.

Another fear of a VAT rise is that it will lead to more cash strapped consumers resorting to cash-in-hand payments to builders for home improvements to avoid paying a higher rate of VAT. This is a practice that can only lead to the unfortunate promotion of a 'cowboy culture', which we certainly don't want to see increase.



Blow to technology sector investment Research and Development (R&D)

The Chancellor mentioned that the Dyson Report recommendations will be considered as part of the overall review of the corporation tax regime. Dyson suggested refocusing reliefs on smaller and hi-tech companies through a simplified system of claims. We have seen a first step towards this with the simplification of the intellectual property ownership requirements for SMEs claiming R&D tax credits. This Budget announced a consultation which will end in the autumn.

R&D tax credits are worth in excess of £500 million to British business and we hope the Government seizes the opportunity to revitalise what has been an important stimulus to investment in the sector.

Video games tax relief

The scrapping of proposals to introduce a video games relief is a huge blow for the sector that has been lobbying for a tax break for the majority of the last parliament. The games sector is an important part of the technology sector in the UK and we share the industry's concern that more generous tax breaks in other countries will have an adverse impact on attracting investment in the sector to the UK.

Swings and roundabouts for the media sector

Overall, today's Emergency Budget announcements were not particularly helpful for the media sector but could have been much worse.

The CGT increase for higher rate investors will be an unwelcome announcement as transactional activity in the media sector is just beginning to recover. However this is balanced by an increase to the 10% rate band for those selling their trading companies where the first £5 million of gains can benefit from entrepreneur's relief; it is just a shame this relief was not extended to employee share schemes.

Today's announcement that the proposed video games relief has been scrapped is a real blow to a sector which makes a significant contribution to the UK economy. It also makes the prospect of a future tax relief for the animation industry much more remote. At least the Government has taken note of the recent Oxford Economics Report and Film Tax Relief remains in force. There is also a correction to the anomaly which restricted businesses from claiming full relief as was promised by the previous Government in the Pre-Budget Report.



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