Isle of Man

Financial Services Briefing - UK Budget Special

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Prepared by Isle of Man Finance and Lansons Communications

Headlines

- **New 50% top tax rate on incomes over £150k and reduced personal allowances for incomes over £100k**
- **Economy expected to shrink by 3.5% in 2009**
- **Government borrowing of £173bn next year**
- **An increase in the ISA annual limit to £10, 200 (£5,100 in cash) for over 50s this year and for all next year**
- **Tax relief on pensions savings cut for those on incomes over £150k**
- **Draft code of practice on taxation for the banking sector**
- **Tax on trusts will increase to 50% from April 2010**
- **VAT rate, currently 15% will return to 17.5% on 1 January 2010**

The Ability to Choose

It is difficult to imagine the scale of decisions that Mr Darling was faced with never mind the answers. The sheer size of the financial challenge that the UK (and Rest of the World) faces was brought into stark contrast by the size of the UK's forecast budget deficit. Before the subdued applause from Labour backbenchers had subsided, the IMF saw fit to correct(?) some of Mr Darling's homework which I doubt he welcomed.

However, quickly forgotten are the bold moves and decisive moves that the UK made in Q4 last year when faced with the systemic failure of the banking sector. Though we suffered some subsequent collateral damage, I have to admit very few alternatives have been subsequently suggested. The phrase "a weeks a long time in politics" never resonated so poignantly.

Whether the ambitious growth estimates or measures to generate tax revenue will work only time will tell. The coming years will no doubt be in stark contrast to consumer boom we have all enjoyed in the last 60 years, but any Government must not forget that, as adults, we all enjoy freedom of choice.

Now is not the time to compare the Isle of Man fiscal policy to that of the UK as we remain a committed economic partner to them, but with every loss, there is inevitably winners. I cannot help but think we, in the Isle of Man, are currently very well placed to support Hign Net-worth Individuals and entrepreneurs in a market which requires innovation which rewards those who generate wealth. Again time will tell.

John Spellman

Economic Forecast

In November in his Pre-Budget Report the Chancellor told the House of Commons that the economy would contract by approximately 1% this year and public borrowing would rise to £118bn this year. The Chancellor has recently made the following revisions:

- **In 2009 a contraction in the economy of 3.5%**
- **Expected economic growth of 1.25% in 2010**
- **Expected economic growth of 3.5% in 2011**
- **CPI Inflation to reduce to 1% by the end of the year and remain below target in 2010 and increase to 2.25% in 2011**
- **MPC's inflation target to remain unchanged**
- **Budget deficit to halve in 4 years**

These downward revisions put Britain in the depths of its worst recession since 1945. The effects of these figures will hit tax receipts hard and in turn put further pressure on the Government's spending plans. The commitment to increase current spending growth, in real terms, at an average of 0.7 per cent a year from 2011-12 onwards is a politically important dividing line for Labour.

Over recent months we have seen a fiscal stimulus, a loosening of monetary policy and the advent of quantitative easing, however there have been some glimpses of a recovery on the horizon - as the Chancellor said he expects growth to return this year.

UK Public Finances

The first part of the Budget setting out the balance sheet of public finances is hugely significant. These figures will hang spectre like defining what is politically possible in the short term.

- **Government borrowing will be £175bn this year and fall to £173bn in 2010-2011; £140bn in 2010-2011, then £118bn 2011-2012, then £97bn in 2012-2013.**
- **Public sector net debt will rise to 59% of GDP this year, increasing to 68%, 74% and 79% in the subsequent consecutive years. It will start to fall in 2016.**
- **The Budget projections expect the current Budget to remain in deficit throughout the forecast period, peaking at 9.4 per cent of GDP in 2010-11, and then falling to 4.3 per cent by 2013-14.**
- **A fiscal easing of 0.5% of GDP this year followed by a fiscal tightening of 0.85% from next year and each year until 2013-2014**
- **Public spending growth to reduce to 0.7% from 1.1% in 2011-2012**
- **Provisional estimated cost of the bank bailout stands at 3.5% of GDP**

The Budget shows public borrowing at unprecedented levels next year of £173 bn. The key test in this Budget will be whether it sends a credible signal to the market that this debt can be repaid. Giving confidence to investors will be all the more important given the amendments to the Government's expected gilt sales. Gilt sales of nearly £200bn are expected to be needed this year.

Financial Services Regulation

The Chancellor announced the publication of Treasury paper on financial services regulation - this is expected to partially respond to the FSA's Turner review of financial services regulation. The paper is likely to focus on the following areas:
- **Reform of corporate governance**
- **Capital and liquidity requirements**
- **Increasing transparency in operations**
- **Regulation of hedge funds**
- **A single set of accountancy rules**
- **Actions to reduce the impact of the failure of financial firms.**

The Budget also announced the Government will bring forward proposals regarding the governance and accountability of the FSCS and the Financial Ombudsman Service to ensure that they are best able to respond to these challenges.

The Government has also announced a consultation document will be published in summer 2009 on the Walker review of corporate governance. Conclusions on the issue are planned for autumn 2009.

Perhaps as a result of George Osborne's comments about making the banking sector more competitive the Budget announces plans to consider, building on the OFT financial services strategy on how best to encourage new entrants to the financial services markets and putting forward proposals to encourage a diversity of ownership structures in financial institutions. In particular encouraging mutuals, to this end a Government will put forward further proposals in its forthcoming paper to strengthen the mutual sector.

As the debate turns to the long term shape of the financial services sector the Government will, before the summer, set out its approach to renewing financial markets for the long term, exploring these issues in greater detail and updating on progress on the G20 work and an outline programme for the implementation of the Banking Act 2009.

Savings and Pensions

Pensions

In a politically fashionable move, the Chancellor took the opportunity to reclaim some of the lost revenues due to pensions tax relief, whilst also send a political message about fairness. In his terms, the changes "will ensure that those individuals with the highest incomes make the largest contribution to fiscal consolidation."

- **From April 2011, tax relief on pensions contributions will be restricted for those with incomes of £150,000 and over, and tapered down until it is 20 per cent**
- **Legislation in this year's Finance Bill will prevent people front loading their pension contributions now in order to avoid the change, whilst permitting individuals to continue to receive tax relief at the higher rate on the higher of £20,000 or their normal pattern of contributions.**
- **The Government will raise the capital disregard in Pension Credit, and pensioner-related Housing and Council Tax Benefit, from £6,000 to £10,000 in November 2009.**

The changes mean a substantial £3.1 billion boost to public finances in 2012-13, with the Government calculating on the basis of a lagged effect to due to self-assessment. Industry are likely to be grateful for the process of consultation announced to ensure that defined benefit pension schemes are treated fairly in relation to defined contribution pension schemes and personal pensions. There will need to be agreement over the appropriate method of valuing pension benefits of those with over £150,000 in defined benefit pension schemes and of valuing the related employer contributions.

ISAs

ISA savings limits have been an annual predictive and campaigning sport. With interest rates so low and the political pressure on to support savers, the Chancellor announced that:
- **For the tax year 2009-10, the annual ISA investment limit will increase for everyone aged 50 and over.**
- **Individuals will be able to save £10,200 in their ISA, up to £5,100 of which can be saved in cash.**
- **To allow ISA providers time to adjust their systems, deposits above the current ISA allowance can only be made from October 2009.**
- **The Government will extend these increases in the ISA limits to everyone from 6 April 2010.**

The revenue loss to the Treasury stands at - £60m in 2011/12, so a comparatively low sum that the *government can afford to give away while being seen to do something for savers.*

Personal Taxation

Following the shock pre-Budget report decision to raise the top rate of tax, the Chancellor announced two further measures today:

- **From April 2010, an additional rate of income tax of 50 per cent will apply to income over £150,000**
- **The income tax personal allowance will be restricted for those with incomes over £100,000.**

The Chancellor delivered a political bombshell by backtracking on Labour's manifesto pledge not to increase the top rate of tax - twice. The revenue effects are significant bringing in nearly £2bn in 2011-12.The Government will also consult on a new Charter that will provide a clear statement of the principles governing HMRC's relationship with citizens and businesses this is to be launched by autumn 2009

Anti-avoidance measures

The Budget has unveiled a number of measures that it is taking action to tackle tax avoidance schemes, these include:

- **Legislation to stop abuse of the manufactured overseas dividend rules**
- **Clarification of the double tax relief rules to counter abusive schemes**
- **Legislation to target avoidance schemes involving financial products**
- **HMRC will seek to issue notices requiring financial institutions to provide information about offshore account holders. The Government announces that a New Disclosure Opportunity will run until March 2010. This will give holders of offshore accounts an opportunity to disclose, of their own accord, if they have unpaid tax or duties and to settle debts.**
- **Plans to legislate for the publication by HMRC of the names of both corporate and individual taxpayers who incur a penalty because they have deliberately understated more than £25,000 of tax**
- **Plans to establish a statutory requirement for senior accounting officers of major corporates to certify personally that adequate controls to prepare accurate tax computations are in place**
- **HMRC will require those who have incurred a penalty for deliberate understatement of over £5,000 of tax to provide more information about their tax affairs for up to five years to ensure they have proper systems to be able to make a correct tax return; and**
- **HMRC will shortly issue a draft code of practice on taxation for the banking sector, along with a consultation document.**

The Budget has unveiled some quite robust policies to tackle tax avoidance which it says "undermine fiscal sustainability, damage the delivery of policy objectives, impose significant costs on society and shift a greater tax burden on to ordinary taxpayers."

As had been widely trailed there are plans to name and shame individuals involved in tax avoidance schemes. We can expect a legislation to target financial tax avoidance scheme, new information requirements on firms about offshore account holders and a code of practice on taxation for the banking sector.

Jobs and employment

On the same day as unemployment figures were announced as having risen to the highest level since Labour came to power, the Chancellor announced that he will provide targeted help to assist people gain new jobs and skills. He announced:

- **Shorter working week and flexi working hours will increase**
- **Tax credits to compensate for loss of income for the unemployed**
- **Government support to protect 500,000 jobs (as announced in the January Employment Summit)**
- **Those under 25 out of work for over a year will be offered a job or a place in training**
- **An additional £1.7 billion of funding for Job Centre Plus and New Deal (in addition to £1.3bn announced in 2008)**
- **£250 million funding to help people get work experience in growth industries**
- **£260 million of new money for training and subsidies to help young people gain skills and work experience**
- **Funding for local authorities and partners to take forward the creation of 100,000 new jobs in socially useful activity**
- **Creation of an extra 54,000 student places in sixth form education**

The Treasury has been under pressure by trade and business groups to tackle the rise in unemployment - the Federation of Small Businesses has estimated that 120 small businesses are going bust every day. However, it remains to be seen if these measures will really have any significant impact as they filter down to communities.

VAT

The Budget announced that legislation will be introduced in the Finance Bill 2009 to ensure that VAT is paid at the correct rate on supplies made on or after that date. As announced at the 2008 Pre-Budget Report, on 1 December 2008 the standard rate of VAT was reduced temporarily to 15 per cent. The rate will return to 17.5 per cent on 1 January 2010

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