

Global Rewards Update: United Kingdom

June 2009

BUDGET SPECIAL

Introduction

In the recent budget, the UK Chancellor has announced the introduction of measures which will significantly increase the tax burden for higher paid employees. A brief summary of the changes is as follows:

- An increase in income tax rates and phasing out of personal allowances for higher earners;
- Restrictions on tax relief for pension contributions for higher earners;
- New obligations for companies' Senior Accounting Officers; and
- A proposal for tougher penalties for late payment of income tax deducted through PAYE.

Tax Rate Changes

Currently, the top rate of income tax in the UK is 40%, payable by those earning more than £43,875 (approximately US\$72,130), with the income tax-free personal allowance generally available regardless of the level of the employee's income. However, with effect from April 6, 2010, a new 50% income tax rate is to be introduced for those earning more than £150,000 (approximately US\$246,476) per annum. In addition, the personal allowance will be phased out for those earning £100,000 (approximately US\$164,328) or more. The allowance will be reduced by £1 (approximately US\$1.64) for every £2 (approximately US\$3.28) of income above the threshold, with complete phase out occurring when income reaches £112,950 (approximately US\$185,603). The changes will introduce an effective rate of income tax of 60% on income between £100,000 and £112,950 (approximately US\$185,603).

The tax rate increase and phase out of the personal allowance will have a particularly significant impact on the cost of bringing expatriate employees to the UK on a tax equalized basis, as the top grossed-up income tax rate will rise from 67% to 100% (assuming UK social security is not also payable).

Furthermore, it has been announced that, with effect from April 6, 2011, both employer and employee social security contributions will increase by 0.5%. The rate for employers will become 13.3% (uncapped). The rate for employees will become 11.5% up to the upper earnings limit, and then 1.5% uncapped.

Tax relief for pension contributions to be restricted

Higher rate income tax relief is being restricted for contributions by or on behalf of individuals to UK registered pension plans (and potentially overseas pension plans). The proposal is that higher rate relief will be tapered away for those with taxable incomes of between £150,000 and £180,000 (approximately US\$295,433) from April 6, 2011 so that for those with incomes above £180,000 contributions will only benefit from basic rate tax relief. The exact mechanism for applying these rules has not yet been confirmed.

Provisions applying from April 22, 2009 (the date of the Budget) will also prevent the forestalling of the new rules. For the tax years 2009/10 and 2010/11, individuals with incomes of at least £150,000 in the year, or any of the preceding two tax years could be impacted. Steps taken to reduce income below £150,000, for example by entering into salary sacrifice arrangements set up after April 22, 2009, will be negated by adding back the amount sacrificed.

There will be a special annual allowance of £20,000 (approximately US\$32,808) applied to any pension savings that exceed the individual's normal established pattern of contributions. Contributions in excess of this level will be taxed at 20% for 2009/10 and will be collected via self-assessment. From 2010/11, when the 50% top income tax rate takes effect, indications are that this special allowance charge may increase to 30%.

The provisions are complex and specific advice should be sought as appropriate.

Senior Accounting Officer

The Budget introduced a new provision whereby the Senior Accounting Officer of large companies will be required to ensure that the company and/or group's accounting arrangements are such that the taxes and duties of the company or group can be calculated accurately.

The provisions will mean that it is necessary for an individual within the company to be named to HMRC as the Senior Accounting Officer. That individual will be responsible for tax reporting on behalf of the company and its subsidiaries—and the key provision is that the named individual will be *personally liable* if the tax liabilities of the company are incorrectly calculated or paid late to HMRC.

Tougher penalties for late payment of PAYE

Large employers in the UK are required to operate withholding and pay the amounts withheld to HMRC on a monthly basis. Finance Bill 2009 will introduce a stricter regime in relation to the penalties for late filing of tax returns and late payment of tax. Of particular significance for employers is that HMRC have confirmed their intention (as indicated in the 2008 Pre-Budget

report) to charge penalties where PAYE due to HMRC is paid late.

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ACTION

Companies should consider the following:

- With the increased rates of income tax and social security, employers should focus on compensation strategies that deliver gains which fall within the capital gains tax regime (CGT). This can include HMRC approved plans where possible and other tax efficient planning arrangements.
- In addition to the recognized tax-advantaged plans (EMI, CSOP, SAYE, SIP), the Approved Performance Share Plan ("APSP"), an idea developed by Deloitte, can also be taken into account for tax planning purpose. This plan replicates the commercial characteristics of a performance share plan (broadly a free share plan) but is more tax efficient. In particular, it allows employers to deliver free shares to employees with the growth in value of the first £30,000 (approximately US\$49,217) of shares awarded falling within the more beneficial CGT regime.
- The proposed higher income tax and social security rates will also have a significant impact on Deferred Bonus Plans—when any bonuses deferred are expected to vest after April 2010, when the increased rates are due to be in effect. We therefore expect employers to consider the possibility of accelerating the vesting of bonuses to before April 6, 2010 to avoid the increased rates. A more detailed note on these issues is available.
- In light of the proposed increase in PAYE penalties, employers will want to ensure that they have systems in place to correctly withhold tax and remit these sums to HMRC on a timely basis. This can be particularly challenging where employees have incentive plan gains and/or where mobile employees are involved.
- It is likely that existing pension arrangements for those earning above £150,000 will become significantly less attractive in the new environment. There will need to be a fundamental reassessment of the approach to pension funding and management.
- With the new obligations for a named Senior Accounting Officer combined with tougher penalties for late payment of PAYE, it is more critical than ever to ensure that compliance is correctly carried out.

People to Contact

For assistance in this matter or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services advisor or email us at: globalequity@deloitte.com and a global rewards consultant will contact you.

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