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Direct taxes: rates and allowances 2009/10

This paper sets out the main changes to direct tax rates and allowances announced in the Budget on 22 April 2009. It lists the principal personal allowances which will be available against income tax in the tax year 2009/10, and it outlines the conditions necessary for eligibility for these allowances.

The paper provides a summary of the general tax position in straightforward cases only. It should be noted that it deals with tax allowances only. No reference is made to cash benefits provided under the social security system, or to child tax credit and working tax credit.

Antony Seely

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Summary

- Income tax on earned income is charged at two rates: the basic rate and the higher rate. For 2009/10 both rates are unchanged: the basic rate is set at 20%, and the higher rate at 40%. Tax is charged at the basic rate up to the basic rate limit, set at £37,400.

- The personal allowance is increased by £130 in real terms, to £6,475 for 2009/10. The two age-related personal allowances for older people are increased in line with inflation: to £9,490 for people aged 65-74 years, and to £9,640 for people aged 75 years and over. The income limit for the age-related allowances is also increased in line with statutory indexation to £22,900.

- Elderly taxpayers may be entitled to the married couple's allowance. This allowance has been withdrawn from all couples who were aged under 65 on 6 April 2000, so that only couples in which one partner was born on or before 5 April 1935 may still claim it. For 2009/10 this allowance is set at £6,965, restricted to 10 per cent.

- The rates of National Insurance contributions (NICs) for employees and employers are unchanged for 2009/10. For employees the rate of NICs is set at 11% on all earnings between the primary threshold and the upper earnings limit, and at 1% on earnings *above* the upper earnings limit. For employers the rate of NICs is set at 12.8% on earnings above the secondary threshold. Both the primary and secondary thresholds (which are set equal to each other) are increased in line with inflation to £110. The upper earnings limit is increased from £770 to £844.

- In the 2009 Budget a series of important changes to income tax and NICs were announced, to be introduced, in two stages, in April 2010 and April 2011. These include the introduction of a new higher rate of income tax of 50% on incomes over £150,000 from April 2010, and increasing the rates of NICs for employees, employers and the self-employed by 0.5 percentage points. A short appendix to this paper gives details.

- This paper does not provide details of the cash benefits provided under the social security system. In addition, it deals only with tax allowances and 'wasteable' tax credits: those which are limited to the amount of the tax liability and therefore cannot give rise to a payment by the authorities to the taxpayer. 'Non-wasteable' tax credits – such as the child tax credit and the working tax credit – are not so limited, so that the excess of the credit over the tax liability can be paid to the taxpayer. Further details on these credits are published on HM Revenue & Customs internet site.[1]

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[1] http://www.hmrc.gov.uk/taxcredits/

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I Rates and thresholds

A. Income tax

1. Earned income

For 2009/10 income tax on earned income is charged at two rates: these are the basic rate of 20%, and the higher rate of 40%.

The 20% basic rate applies to taxable income up to £37,400. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax. Taxable income in excess of this threshold is charged at the higher rate of 40%.

2008/09		2009/10	
Taxable income	**Tax rate**	**Taxable income**	**Tax rate**
£0 - £34,800	**20%**	**£0 - £37,400**	**20%**
Over £34,800	**40%**	**Over £37,400**	**40%**

This two-rate structure covers all non-savings income: earnings, pensions, taxable social security benefits, trading profits and income from property. It dates from April 2008, when a starting rate of income tax set at 10% was withdrawn. When this was done, the 10% starting rate was *retained* for savings income: that is, bank and building society interest. This remains in place.

2. Savings and dividend income

For 2009/10 savings income is charged at 10% for income up to £2,440. Above this limit savings income is charged tax at the basic rate of 20%, up to the basic rate limit of £37,400. Savings income above this limit is charged at the 40% higher rate.

Generally savings income is taxed at source at 20%. Individuals with too little income to pay tax, or those paying only the starting rate, can claim a repayment of tax from HM Revenue & Customs. Alternatively individuals may apply to have their savings income paid gross of tax.[2]

For 2009/10 the rates of tax on dividend income are unchanged: 10% for income below the basic rate limit, and 32.5% above that.

In calculating tax liability, dividend and savings income are regarded as the 'top slice' of income, with dividends the highest. As a consequence, if an individual's non-savings income exceeds the starting rate limit for savings, then the 10% starting rate will not be available for their savings income.

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[2] HM Revenue & Customs provide an online calculator to help individuals assess if they should do this - http://www.hmrc.gov.uk/calcs/r85.htm - and a helpline providing advice on this issue (0845 980 0645).

B. National Insurance contributions

Employees pay National Insurance contributions (NICs) on their earnings if they exceed the lower earnings limit (LEL), which is set at £95 per week for 2009/10. A zero rate of NICs is charged on earnings between the LEL and the primary threshold (PT), which is set at £110 per week.[3] Earnings above the PT are charged NICs at a rate of 11%, subject to a cap at the upper earnings limit (UEL), which is set at £844 per week. Earnings above the UEL are charged NICs at a rate of 1%.

Employees contracted out of the state second pension (S2P) pay a reduced rate of NICs. Employers pay NICs on employee earnings at a rate of 12.8% on earnings above the secondary threshold (ST), also set at £110 a week for 2009/10.

The LEL, PT and ST are all increased in line with inflation. The UEL is increased by an additional £35 in real terms, aligning it with the point at which taxpayers start to pay the higher rate of income tax.[4]

The rates of NICs for employees and employers for 2009/10 are set out below:[5]

Earnings[1] **£ per week**	**Employee (primary) NIC rate (per cent)[2]**	**Employer (secondary) NIC rate (per cent)[3]**
Below £95 (LEL)	0%	0%
£95 to £110 (PT/ST)	0%[4]	0%
£110 to £844 (UEL)	11%	12.8%
Above £844	1%	12.8%

[1] *The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.*
[2] *The contracted-out rebate for primary contributions in 2009/10 is 1.6 per cent of earnings between the LEL and the upper accrual point (UAP) of £770 for contracted-out salary-related schemes (CORS) and contracted-out money purchase schemes (COMPS).*
[3] *The contracted-out rebate for secondary contributions is 3.7 per cent of earnings between the LEL and UAP for CORS and 1.4 per cent for COMPS. For COMPS, an additional age-related rebate is paid direct to the scheme following the end of the tax year. For appropriate personal pensions, the employee and employer pay NICs at the standard, not contracted-out, rate. An age and earnings related rebate is paid direct to the personal pension provider following the end of the tax year.*
[4] *No NICs are actually payable but a notional Class 1 NIC will be deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.*

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3 A notional primary Class 1 NIC is deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.
4 This reform is discussed in, *National Insurance Contributions Bill*, Library Research paper 07/88, 11 December 2007.
5 HM Treasury, *Budget 2009*, HC 407 April 2008 p156

II Personal allowances

All individuals irrespective of sex or marital status receive a personal allowance which they can set against income tax. Two age-related additions are made to the allowance: the first, if someone is 65 or over, the second if they are 75 or over. Those born before 6 April 1935 may be eligible for two other allowances: the married couple's allowance and tax relief on maintenance payments. An allowance is also given to individuals who are blind.

Income tax legislation requires the main allowances and thresholds to be increased in line with the Retail Prices Index (RPI) unless Parliament determines otherwise. This statutory requirement - the so-called "Rooker-Wise" amendment - was introduced under section 22 of the *Finance Act 1977*.[6] The amendment was successfully made through the cross-party co-operation of Jeff Rooker, Audrey Wise and Nigel Lawson. All three argued that without indexation, inflation acted as an unauthorised, unintended and unknown increase in taxation. By ensuring that any real changes in allowances would have to be voted on, the amendment ensured changes in the income tax structure would be 'out in the open'.

When allowances and thresholds are increased in line with the RPI, they are rounded up to the nearest £10 or £100. For personal allowances this income limit is £10; for age allowances and the higher rate threshold the limit is £100. When uprating the main allowances and thresholds, the relevant inflation rate is the increase in the RPI in the year to September. For the year to September 2008 the rate of inflation was 5.0%.[7]

The statutory requirement to increase allowances and thresholds refers to increases in the RPI *only*; there is no requirement to cut allowances, should prices fall. RPI inflation is expected to be negative in 2008/09, but the Government has confirmed that in these circumstances it will "maintain the cash value of tax allowances and thresholds … consistent with statute."[8]

A. Personal allowance

Every taxpayer resident in the United Kingdom is entitled to a personal allowance that can be set against any type of income for tax purposes. Two additional levels of the allowance are provided for the elderly. The allowance is not transferable between spouses.

These three allowances for 2009/10 are:

Under 65	**£6,475**
65 – 74	**£9,490**
75 and over	**£9,640**

6 The statutory requirement to uprate allowances and thresholds, is consolidated in ss 57 & 21 of the *Income Tax Act 2007*.

7 Office for National Statistics press notice, *Consumer price indices - September 2008*, 14 October 2008. Uprating is calculated using the values of the RPI; for details see, HM Treasury, *Tax Benefit Reference Manual* 2008/09 edition paras 1.16-19. House of Commons Deposited paper 2008-1972 – available at: http://www.parliament.uk/deposits/depositedpapers/2008/DEP2008-1972.zip

8 *Pre-Budget Report* Cm 7484 November 2008 p86

The personal allowance is increased by £440, which represents an increase of £130 in real terms. The two age-related personal allowances for older people are increased by £460 in line with inflation. The additional age allowances are reduced above a certain income limit by £1 for every £2 by which income exceeds the limit (this is explained in more detail below). In such cases only the extra allowance is withdrawn. No-one over the age of 65 receives less than the basic personal allowance.

B. Income limit for age-related allowances

Taxpayers claiming an age-related allowance whose income exceeds £22,900 for 2009/10 will have their allowance reduced by £1 for every £2 that their income exceeds this limit. This progressive reduction continues until the allowance is equal in value to the ordinary personal allowance, or, in the case of those taxpayers still entitled to the married couple's allowance (MCA), a 'minimum' allowance. The income limit is increased by £1,100 in line with statutory indexation.

For individual taxpayers qualifying for an age-related personal allowance, the benefit of the additional allowance will not be completely withdrawn until their total income reaches the following limits:

65 – 74	**£28,930**
75 and over	**£29,230**

C. Blind person's allowance

Any person registered as blind is entitled to the blind person's allowance. The allowance is increased in line with inflation by £90 to £1,890 for 2009/10. The allowance is not restricted in value. If someone has insufficient income to make use of the allowance it can be transferred to a spouse.

D. Two transitional allowances for the elderly

Four allowances were withdrawn from April 2000: the married couple's allowance (MCA) for couples aged under 65 at that time; the additional personal allowance; the maintenance allowance for separated or divorced couples under 65; and the widow's bereavement allowance.[9] The MCA and tax relief on maintenance payments were retained for individuals where either they, or their spouse/one-time spouse, had reached the age of 65 by the start of the tax year 2000/01; ie, they were born on or before 5 April 1935.

[9] The abolition of these allowances was announced in the March 1999 Budget; for further details see *Direct taxes: rates & allowances 2000/01*, Library Research paper 00/38, 29 March 2000 pp 11-12.

1. Married couple's allowance

Married couples in which at least one partner reached 65 by 6 April 2000 are still entitled to claim a **married couple's allowance**.[10] For 2009/10, this age-related allowance is £6,965. The allowance is increased by £340, in line with statutory indexation. Tax relief for the allowances is 'restricted' to 10%. In effect taxpayers receive a credit worth 10% of the MCA to set against their final tax bill: ie, £697.

The value of the MCA is gradually reduced for taxpayers earning above the income limit, in the same way as the age-related personal allowances (see p10 of this paper). The withdrawal of the MCA from elderly couples is subject to a minimum allowance set at £2,670 for 2009/10, restricted to 10%.[11] No couple entitled to the allowance will receive less than this. Where a couple marry during the tax year the allowance is reduced by one twelfth for each complete tax month pre-marriage. In the first instance the MCA is given to the husband, though if couples elect, the minimum MCA can be transferred to the wife or split equally between spouses. In previous years, in line with the personal allowance, an age-related MCA was given to couples between 65 and 74, and a second, higher MCA to those 75 or over. Given that anyone born before 6 April 1935 will be 75 or over this tax year, it is only the second of these allowances that remains applicable.

On 5 December 2005 the *Civil Partnership Act 2004* came into force, creating a new legal status for same-sex couples wishing to have their relationships recognised in law. In March 2005 the Government announced that civil partners would be treated the same as married couples for tax purposes. As a consequence, civil partners may claim the MCA, *provided* – as with married couples – one or more partner was born before 6 April 1935.[12]

2. Tax relief for maintenance payments

Generally maintenance payments are made outside the tax system: those who make payments cannot claim them against tax, and those who receive them are not taxed on them. Separated or divorced individuals who pay maintenance direct to their ex-spouse under a legally binding agreement may qualify for a limited form of tax relief – often referred to as a '**maintenance allowance**' – provided that one or more of the parties reached 65 prior to 6 April 2000. This relief is set equal to the 'minimum' MCA that couples 75 or over can receive (which is £2,670 restricted to 10 per cent for 2009/10). Individuals who make maintenance payments to a child, or to someone to whom they have not been married, do not qualify for this relief. Tax relief is withdrawn if the ex-spouse who receives maintenance remarries.[13]

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10 When a person born on or before 5 April 1935 newly gets married, that person or their spouse is entitled to claim the MCA.

11 The minimum amount of the MCA is also increased in line with statutory indexation for 2009/10.

12 The rules regarding the MCA for civil partners, and marriages after 5 December 2005, are slightly different regarding the initial right of claim. For details see HM Revenue & Customs, *Independent Taxation Manual* paras IN511A-IN518C.

13 This relief is also given to those paying maintenance under arrangements set up before 15 March 1988, who benefited from transitional relief withdrawn in April 2000. Again, relief is only given if one or more of the parties reached 65 prior to 6 April 2000.

III Main personal income tax rates and allowances since 1990/91

Table 1

Main income tax rates and allowances: 1990/91-2009/10

	Allowances/Limits (£ per annum)			Rates		
	Personal Allowance	Lower/ Starting Rate Limit	Basic Rate Limit	Lower/ Starting	Basic	Higher
1990/91	3,005	n/a	20,700	n/a	25%	40%
1991/92	3,295	n/a	23,700	n/a	25%	40%
1992/93	3,445	2,000	23,700	20%	25%	40%
1993/94	3,445	2,500	23,700	20%	25%	40%
1994/95	3,445	3,000	23,700	20%	25%	40%
1995/96	3,525	3,200	24,300	20%	25%	40%
1996/97	3,765	3,900	25,500	20%	24%	40%
1997/98	4,045	4,100	26,100	20%	23%	40%
1998/99	4,195	4,300	27,100	20%	23%	40%
1999/00	4,335	1,500	28,000	10%	23%	40%
2000/01	4,385	1,520	28,400	10%	22%	40%
2001/02	4,535	1,880	29,400	10%	22%	40%
2002/03	4,615	1,920	29,900	10%	22%	40%
2003/04	4,615	1,960	30,500	10%	22%	40%
2004/05	4,745	2,020	31,400	10%	22%	40%
2005/06	4,895	2,090	32,400	10%	22%	40%
2006/07	5,035	2,150	33,300	10%	22%	40%
2007/08	5,225	2,230	34,600	10%	22%	40%
2008/09	6,035	n/a	34,800	n/a	20%	40%
2009/10	6,475	n/a	37,400	n/a	20%	40%

Notes: (a) From 2008/09, a 10% starting rate of income tax is retained for savings income. See text for further details.

Sources: Budget 2009, HM Treasury, HC 407 2008-09
Tax Benefit Reference Manual: 2008-09, HM Treasury, 2008

Table 2

Age-related allowances: 1990/91-2009/10
£ per annum

	Personal		Married couple's (a)	
	65-74	75+	65-74	75+
1990/91	3,670	3,820	2,145	2,185
1991/92	4,020	4,180	2,355	2,395
1992/93	4,200	4,370	2,465	2,505
1993/94	4,200	4,370	2,465	2,505
1994/95	4,200	4,370	2,665	2,705
1995/96	4,630	4,800	2,995	3,035
1996/97	4,910	5,090	3,115	3,155
1997/98	5,220	5,400	3,185	3,225
1998/99	5,410	5,600	3,305	3,345
1999/00	5,720	5,980	5,125	5,195
2000/01	5,790	6,050	5,185	5,255
2001/02	5,990	6,260	5,365	5,435
2002/03	6,100	6,370	5,465	5,535
2003/04	6,610	6,720	5,565	5,635
2004/05	6,830	6,950	5,725	5,795
2005/06	7,090	7,220	5,905	5,975
2006/07	7,280	7,420	6,065	6,135
2007/08	7,550	7,690	6,285	6,365
2008/09	9,030	9,180	6,535	6,625
2009/10	9,490	9,640	..	6,965

Notes: (a) Relief restricted to 20 per cent in 1994/95, 15 per cent from 1995/96 to 1998/99, and to 10 per cent from 1999/00. Since 2000/01 the MCA has only been given to couples in which at least one partner was born before 6 April 1935. All those currently eligible for the 65-74 allowance will be at least 75 years old at some point during the 2009/10 tax year.

Sources: Budget 2009, HM Treasury, HC 407 2008-09
Tax Benefit Reference Manual: 2008-09, HM Treasury, 2008

IV Fringe benefits: company cars & free fuel

Generally individuals are taxed on the cash value of any fringe benefit they enjoy by virtue of their employment.[14] Special rules apply in evaluating the cash value of a company car: in brief, a normal minimum charge of 15% of the car's price applies to cars emitting CO_2 at or below a specified qualifying level – set at 135g/km for 2009/10. The percentage charge builds up in 1% steps for every additional full 5g/km over that level up to a maximum charge of 35% of the car's price. A lower 10% rate applies to cars with CO_2 emissions of 120g/km or less.

The system for taxing company cars was reformed in April 2002. The qualifying level of CO_2 emissions was set initially at 165g/km, and has been reduced gradually each year, reflecting improvements in the fuel efficiency of new cars.[15] There are certain supplements and reductions to the tax charge to take account of different fuels.[16]

In April 2003 the rules for determining the taxable benefit of free fuel provided for private motoring in a company car were also changed so that the benefit charge was related to the level of CO_2 emissions. The same percentage charge is used as for company cars – starting at 15% and rising to 35%. To calculate the benefit charge the percentage figure is multiplied against a set figure for the year; for 2009/10 this is £16,900.

V Pensions

In the 2004 Budget the Government announced a simplification in the tax treatment of pensions to come into effect from 6 April 2006 ('A-day'). This reform in the tax rules sets two limits for an individual's tax-privileged pension saving: an annual allowance for the amount of contributions that may be made over a year, and a lifetime allowance setting an overall ceiling on the amount of tax-privileged pension savings that someone may accrue. For 2009/10 these allowances are set at £245,000 per year and £1.75 million respectively. Full details are published on HMRC's internet site.[17] Prior to this, an annual limit – the pension scheme earnings cap – was set on the maximum earnings from which contributions to a personal, occupational or stakeholder pension scheme could attract tax relief.

In the 2009 Budget the Government proposed that from April 2011 tax relief on pension contributions will be restricted for those with incomes of £150,000 and over; it is to consult on the best way to implement this reform, to ensure that the different categories of pension schemes used by individuals are treated fairly.[18]

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14 The cash value is added to their taxable income, and taxed accordingly; ie, taxed at the same rate as the rest of their income (20% or 40% depending on their circumstances). Benefits in kind are taxed if the person receiving them is a director, or an employee who earns £8,500 or more per year.

15 The qualifying level of emissions is to be cut to 130g/km from 2010/11. A number of further reforms are to be made from 2011/12 (for details see, *Budget 2009*, HC 407 April 2009 pp146-7).

16 Guidance on these rules is given on HMRC's site at: http://www.hmrc.gov.uk/cars/index.htm

17 http://www.hmrc.gov.uk/pensionschemes/pts.htm

18 HC 407 April 2009 p107

VI Charities

There is no general tax exemption or relief granted to taxpayers who make gifts to charities. Tax relief is provided through two schemes which cover regular donations made out of one's salary (Payroll Giving) and one-off cash gifts (Gift Aid).

Under the Payroll Giving scheme charitable donations are wholly deductible for income tax purposes, the relief being given through the PAYE system. The employer deducts the appropriate sum from a participating employee's pay, and passes it to an agency which distributes it to the charity or charities of the employee's choice. There are no minimum or maximum limits for donations under the scheme.[19]

Gift Aid allows income tax relief for single donations by individuals. When this relief was introduced in 1990, a minimum limit on donations was set at £600. Tax relief applies to a donation of any size, following the abolition of the minimum limit – then £250 – from 6 April 2000.[20] Under the scheme charities claim repayment of basic rate tax on donations. Higher rate taxpayers claim higher rate tax relief on their gifts. The basic rate of income tax was cut from 22% to 20% from 6 April 2008, and charities are entitled to a transitional relief for three years which preserves the value of tax relief at 22%.[21]

VII Capital gains tax

Capital gains tax (CGT) is charged on gains in excess of the annual exempt amount, which is increased in line with statutory indexation to £10,100 for 2009/10. Individuals may realise gains up to this threshold free of tax.

The tax is charged at the single headline rate of 18%. A series of reforms were made to the tax in April 2008; prior to this capital gains were treated as the top slice of income, and the tax was charged at the same rates of tax as savings income.[22]

VIII Inheritance tax

Inheritance tax is levied on the value of a person's estate at the time of their death.[23] Most large gifts made out of someone's estate within seven years of their death are treated as part of their estate for tax. The tax is charged at 40% above the tax-free allowance. This allowance is increased by £13,000 to £325,000 for 2009/10.

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[19] A maximum limit of £1,200 a year applied prior to 6 April 2000. Further information is on HMRC's site at: http://www.hmrc.gov.uk/individuals/giving/payroll.htm

[20] Further information is on HMRC's site at: http://www.hmrc.gov.uk/individuals/giving/gift-aid.htm

[21] Details are on HMRC's site at: http://www.hmrc.gov.uk/charities/transitional-relief.htm

[22] Details on the tax are collated on HMRC's site at: http://www.hmrc.gov.uk/cgt/index.htm

[23] Details on the tax are collated on HMRC's site at: http://www.hmrc.gov.uk/inheritancetax/

Gifts made to one's spouse or civil partner are exempt from tax irrespective of their size, and irrespective of whether they are made during one's life, or made under the terms of one's will. In addition, widows, widowers and civil partners are entitled to use the share, if any, of their partner's tax-free allowance which was unused when they died, to set against tax on their own estate. This transferable allowance is available to all survivors of a marriage or civil partnership who die on or after 9th October 2007 – whenever their first partner died.[24]

[24] Further information is provided on HMRC's site at: http://www.hmrc.gov.uk/inheritancetax/intro/transfer-threshold.htm

Appendix: Changes announced in Budget 2009 for 2010/12

In his Budget speech on 22nd April 2009 the Chancellor, Alistair Darling, announced a number of changes to income tax and National Insurance contributions, which would take effect in the future tax years.

- From April 2010 a new higher rate of income tax of 50% will be introduced on income over £150,000.

- From April 2010 the income tax personal allowance will be gradually withdrawn, for individuals with incomes above £100,000. The allowance will be reduced by £1 for every £2 above this income limit, until completely withdrawn.

- From April 2011 the rates of National Insurance contributions (NICs) will be increased by 0.5 percentage points, for employees, employers and the self-employed.

- From April 2011 the primary threshold for NICs will be re-aligned with the personal allowance. Both the primary and secondary NICs thresholds were aligned with the personal allowance in April 2001. This was reversed by the Government's decision in May 2008 to increase the personal allowance by an extra £600, as compensation for the withdrawal of the 10p starting rate that year.