These notes refer to the Finance Act 2009 (c.10) which received Royal Assent on 21 July 2009

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

Section 6Schedule 2: Additional Rate, Dividend Additional Rate, Trust Rates and Pension Tax Rates

Summary

1. Section 6 and Schedule 2 include the provisions for an additional rate of income tax and an additional rate for dividends and consequential amendments including increases to the trust rate and dividend trust rate. There are other consequential amendments including changes to the income tax charges applying to registered pension schemes. From tax year 2010–11 there will be a new additional rate of income tax that will apply to taxable income in excess of £150,000. A new 42.5 per cent dividend additional rate will alternatively apply where dividends form part of an individual's taxable income in excess of £150,000. This will provide three main rates of income tax: the basic rate, the higher rate and the additional rate. There will be three rates of tax applying to dividends: the dividend ordinary rate for dividends otherwise taxable at the basic rate, the dividend upper rate for dividends otherwise taxable at the higher rate and the dividend additional rate for dividends otherwise taxable at the additional rate.

Details of the Section

2. Subsections (1) and (2) amend section 6 of the Income Tax Act 2007 (ITA) (the basic and higher rate). They add the additional rate to the main rates at which income tax is charged.

3. Subsection (3) adds a reference to the dividend additional rate in section 6 of ITA.

4. Subsection (4) amends section 9 of ITA (the trust rate and dividend trust rate) which sets out the trust and dividend rates that apply to the income of certain trusts (see background note). The trust rate will be increased to 50 per cent from 40 per cent, and the dividend trust rate will be increased to 42.5 per cent from 32.5 per cent.

5. Subsection (5) introduces Schedule 2 to this Act.

6. Subsection (6) provides that the amendments made by this section are effective for 2010-11 and subsequent years.

Details of the Schedule

7. Paragraph 2 amends section 6 of ITA (the basic and higher rate) by adding the additional rate to the rates of income tax that are set by Parliament each year.

8. Paragraph 3 amends section 8 of ITA (the dividend ordinary rate and dividend upper rate). It adds the dividend additional rate to the rates of tax at which dividend income is charged.

9. Paragraph 4(2) amends section 10(3) of ITA, which provides that an individual's income is charged to tax at the higher rate where it exceeds the basic rate limit. The

amendment provides that an individual's income is charged to tax at the higher rate up to the higher rate limit.

10. Paragraph 4(3) inserts a new section 10(3A) into ITA which provides that an individual's income is charged to tax at the additional rate where it exceeds the higher rate limit.

11. Paragraph 4(4) inserts a new section 10(5A) into ITA which provides the amount of the higher rate limit. It is £150,000.

12. Paragraph 4(5) inserts a signpost to the provisions to increase the higher rate limit by gift aid donations and pension contributions where basic rate income tax relief is provided at source.

13. Paragraph 5(2) inserts a new section 13(2A) into ITA which provides that an individual's dividend income is charged to tax at the dividend additional rate where it would otherwise be charged at the additional rate and is not relevant foreign income charged in accordance with section 832 of the Income Tax (Trading and Other Income) Act 2005.

14. Paragraphs 5(3) to 5(5) make amendments to section 13 of ITA consequential to the insertion of new section 13(2A).

15. Paragraph 6 amends section 414(2)(b) of ITA (relief for gifts to charity) to provide that an individual's higher rate limit is increased by the grossed up amount of their gift aid donation.

16. Paragraph 7 provides for a consequential amendment to section 515 of ITA. Section 515 provides for the rate of tax where a charge arises on heritage maintenance settlements under section 512 of ITA. Tax is charged on the difference between the higher rate of income tax for a year and the trust rate. The amendment ensures that the rate of charge will reflect the introduction of the additional rate of tax.

17. Paragraph 8 amends section 989 of ITA (the definitions) consequential to the creation of the additional rate, the dividend additional rate and the higher rate limit.

18. Paragraph 9 amends Schedule 4 to ITA (index of defined expressions) consequential to the creation of the additional rate, the dividend additional rate and the higher rate limit and the move of the basic rate limit from section 20(2) to section 10 of ITA by Finance Act (FA) 2008.

19. Paragraph 11 amends section 192(4) of FA 2004 (relief for pension contributions at source) to provide that an individual's basic rate limit and higher rate limit are increased by the amount of their pension contributions where they receive tax relief at source by making a claim.

20. Paragraph 12 amends section 208 of FA 2004 (unauthorised payments charge) to provide that HM Treasury may by order vary the rate of the unauthorised payments charge, and that different rates can apply in different circumstances. This charge applies to the recipient where a registered pension scheme makes an unauthorised payment. Section 208(6) already provides for the rate of the unauthorised payments charge to be increased or decreased by Treasury Order, but not that different rates can be applied. Section 208(5) provides that the rate of the unauthorised payments charge is 40 per cent of the unauthorised payment.

21. Paragraph 13 amends section 209 of FA 2004 (unauthorised payments surcharge) to provide that HM Treasury may by order vary the rate of the unauthorised payments surcharge and that different rates can apply in different circumstances. This surcharge applies to the recipient where a registered pension scheme makes an unauthorised payment or payments worth more than 25 per cent of the value of the member's rights under the arrangement. Section 209(7) already provides for the rate of the unauthorised payments surcharge to be increased or decreased by Treasury Order. Section 209(6)

provides that the rate of the unauthorised payments surcharge is 15 per cent of the surchargable unauthorised payment.

22. Paragraph 14 amends section 215 of FA 2004 (amount of the lifetime allowance charge) to provide that HM Treasury may by order vary the rate of the lifetime allowance charge. This charge applies to the recipient of benefits from registered pension schemes that cause their lifetime allowance to be exceeded. Section 215(2) provides that the rate of the lifetime allowance charge is 55 per cent (in respect of lump sum benefits) or 25 per cent (in respect of pension benefits) of the chargeable amount above the lifetime allowance. The lifetime allowance for the 2009-10 tax year is £1.75 million.

23. Paragraph 15 amends section 227 of FA 2004 (annual allowance charge) to provide that HM Treasury may by order vary the rate of the annual allowance charge. This charge applies to an individual with annual contributions or benefit accruals under a registered pension scheme that exceed the annual allowance. Section 227(4) provides that the rate of the annual allowance charge is 40 per cent of the amount that exceeds the annual allowance. The annual allowance for the 2009-10 tax year is £245,000.

24. Paragraph 16 amends section 240 (amount of scheme sanction charge) to provide that HM Treasury may by order vary the rate and applicable percentage of the scheme sanction charge. This charge applies to the administrator of a registered pension scheme that makes unauthorised payments or transactions (these are known as "scheme chargeable payments"). Section 240(1) provides that the rate of scheme sanction charge is 40 per cent. Section 240(3) provides that there is a deduction from the scheme sanction charge, which is the lesser of 25 per cent of the scheme chargeable payments, or the amount of the unauthorised payment charge paid by the person liable to it under section 208 of FA 2004.

25. Paragraph 17 amends section 242 (de-registration charge) to provide that HM Treasury may by order vary the rate of the de-registration charge. This charge applies to a scheme administrator where the tax registration of a pension scheme is withdrawn. Section 242(4) provides that the rate of the de-registration charge is 40 per cent of the value of the sums and assets held by the pension scheme immediately before de-registration.

26. Paragraph 18 provides that the powers to make regulations varying rates etc in connection with the charges applying to registered pension schemes, which are provided in the amendments to FA 2004 made by paragraphs 12 to 17 of this Schedule, are to be exercised through affirmative resolution procedures before the House of Commons.

27. Paragraph 19 introduces amendments to the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) consequential to the creation of the additional rate, the dividend additional rate and the higher rate limit.

28. Paragraph 20 provides for a consequential amendment to section 640(6) of ITTOIA. Section 640 of ITTOIA sets out the amount of notional tax credit attached to certain capital payments, made by trustees to settlors, that are deemed for tax purposes to be income. A charge to tax on the settlor arises when the capital payment can be matched with undistributed income in the trust. A payment is matched first with the earlier income of the trust. The notional credit is linked to the rate of tax that the trustees have paid on the income with which the capital payment is matched. As the trust rate will increase to 50 per cent for 2010-11 onwards the amendment ensures that the notional tax credit for capital payments matched with undistributed income of 2010-11 onwards is also increased to 50 per cent.

29. Paragraph 21 provides for a consequential amendment to section 685A(3) of ITTOIA (settlor-interested settlements), which provides a notional tax credit at the higher rate for payments made to a non-settlor beneficiary of a settlor interested trust. As the trust rate will increase to 50 per cent for 2010–11 the amendment ensures that such income will in the hands of the beneficiary be treated as having paid tax at this rate.

30. Paragraph 22 amends section 669(3) of ITTOIA (reduction in residuary income: inheritance tax on accrued income) to provide that the reduction in the residuary income can be calculated by reference to the additional rate or dividend additional rate.

31. Paragraph 23 amends Part 2 of Schedule 4 to ITTOIA (index of defined expressions) consequential to the creation of the additional rate and the dividend additional rate.

32. Paragraph 24 amends section 7(5) of F(No.2)A 2005 (charge to income tax on social security pension lump sum) by adding the additional rate to the rates of tax which apply to social security pension lump sum payments. A social security lump sum is taxed at the highest rate of tax that applies on the individual's total income (excluding the lump sum). Presently these rates of tax are the basic rate and higher rate. From 2010-11, these rates of tax will include the additional rate.

33. Paragraph 25(1) provides that the powers conferred by amendments made by this Schedule can be exercised from Royal Assent for the 2010-11 and subsequent tax years. Subject to that, paragraph 25(2) provides that the amendments made by this Schedule have effect for 2010-11 and subsequent tax years.

Background Note

34. For 2009-10 there are two main rates of income tax: the basic rate and higher rate. The effect of this section and Schedule is to add a further main rate of income tax – the "additional rate". This will be introduced in 2010-11 at a rate of 50 per cent.

35. Separately section 1 to this Act introduces the charge to income tax for 2009-10 and sets the main rates of income tax at 20 per cent for the basic rate and 40 per cent for the higher rate. From 2010-11, the additional rate of income tax will be set along with the other main rates of income tax.

36. The rates of tax which apply to dividends are not set separately each year. Rather they are included in section 8 of ITA. From 2010-11 the new dividend additional rate introduced by the section will be 42.5 per cent and will apply where dividends form part of an individual's taxable income in excess of £150,000.

37. The trust rate of tax is the rate of tax paid by trustees that generally applies to the income of discretionary or accumulation trusts. Trustees are liable to tax on income received at the trust rate of tax, but dividends and other similar income are chargeable at the dividend trust rate.

38. All income paid to the beneficiaries of discretionary or accumulation trusts that are not settlor interested carries a credit at the trust rate, so the payment is treated as if it had been made after the deduction of tax at that rate. Beneficiaries will be able to reclaim tax where the trust rate exceeds the rate of tax at which their income is chargeable. Different rules apply where the trust is settlor interested. The payment is not grossed up but notional tax is provided to the beneficiary.