

# CHANCERY MANAGEMENT NEWS UPDATE

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## On This Day In Previous Years

In 1918 the Royal Air Force replaced the Royal Flying Corps

In 1891 The Wrigley Company was founded in Chicago, Illinois

In 1924 the first gramophone that could change records automatically went on sale.

## The Variable Interest Rates

Interest rates may be at an all time low for savers and some borrowers but that is not the case for employees receiving beneficial loans. For the whole of the tax year 2008-2009 HM Revenue & Customs (HMRC) interest rates have remained at 6.25% up to 1<sup>st</sup> March 2009 at which time they were reduced to 4.75%. The choice of the date change is a break from tradition. The change of rates used to be effective from the 6<sup>th</sup> of the month being the start of a tax month. This is known as the official rate of interest.

The latest CD Rom issued by HMRC is incorrect because it was issued before the official rate of interest was reduced. Therefore some P11D software which has already been released will be incorrect. The latest version can be downloaded from [www.hmrc.gov.uk/forms/p11dint.pdf](http://www.hmrc.gov.uk/forms/p11dint.pdf)

For employers that have to calculate beneficial loans manually the calculation for this year can be worked out on the latest issue of the P11D working sheet 4 form P11D(INR) which should show the correct official interest rate for the whole of the 2008-2009 as 6.1%. This is the first time since 2001-2002 that the official interest rate has changed before the end of a tax year. In that year the official interest rate changed in January.

When the official rate of interest changes within a tax year the rate that applies for a particular loan is the average rate over the number of days in the period the loan was owed. In this tax year it has been calculated by HMRC as 6.1%

The number of days from the start of the tax year to February 28<sup>th</sup> 2009 is 329 which leaves 36 days from the 1<sup>st</sup> March to 5<sup>th</sup> April, being the end of the tax year. Therefore, the average is calculated by taking 329 days @ 6.25% and 36 days @ 4.75% as shown in the example below.

$329 @ 6.25\% + 36 @ 4.75\%$  divided by 365 = 6.102%. Therefore the official rate of interest for the whole of the tax year 2008-2009 equates to 6.1%. *Please note: In a leap year 366 days are used in the calculation.*

However if the loan is only outstanding for part of the year the calculation is different. If the loan was first made available on 1<sup>st</sup> December 2008 and is still outstanding at the end of the tax year, there are 126 days between 1<sup>st</sup> December and the 5<sup>th</sup> April being the end of the tax year.

Therefore the calculation for that will be  $90 \text{ days} @ 6.25\% + 36 \text{ days} @ 4.75\%$  divided by 126 days = 5.82%.

If the loan was from April to 31<sup>st</sup> July the rate was 6.25% for the whole of that period and therefore 6.25% is the rate applicable.

If a loan commences on 7<sup>th</sup> March 2009 and is still outstanding on 5<sup>th</sup> April there is no tax liability in this tax year because a loan has to be outstanding for a complete tax month before a liability arises. There is a special rule in place to prevent such a situation being used by design for tax avoidance purposes. For example, if an employee or director took out a loan on 7<sup>th</sup> March and repaid it on 5<sup>th</sup> April and then took a loan out on 8<sup>th</sup> April etc. that would not be interest free.

Loans in foreign currencies are treated as being made in GBP, the exceptions being Swiss Francs and Japanese Yen. The official interest rate for these currencies are 5.5% and 3.9% respectively. These rates of interest have been applicable since the 1994 tax year.

These rates only apply to employees who are liable for income tax in the UK but normally live in Switzerland or Japan and who have lived there at some time during the six year period to the end of the tax year 2008-2009. For example, it would apply to a Japanese resident working for an extended period in the UK.

The cash equivalent to living accommodation that costs more than £75,000 per annum to provide is made up of two charges. The charges are:

1. A basic benefit charge
2. The additional annual rent charge.

The additional annual rent is calculated by multiplying the amount by which the cost of providing the property exceeds £75,000 by the official rate of interest.

The calculation differs from the calculation used for beneficial loans as to the rate. In the case of living accommodation the official rate of interest that should be used is the rate of interest as at 6<sup>th</sup> April 2008, (the first date of the tax year). Therefore for this tax year 2008-2009 the rate will be 6.25%. For the tax year 2009-2010 the rate will be 4.75%, unless legislation changes.

## **National Insurance Contributions Act 2008**

The National Insurance Contributions Act (NICA2008) contains two main measures.

1. The Upper Earnings Limit (UEL) is to be aligned with the higher rate threshold for income tax from tax year 2009-2010.
2. Bring forward to April 2009 the introduction of the UAP for the additional State pension (known as the State second pension), (S2P).

In the 2007 the Chancellor announced that from April 2009 the UEL would be aligned with the threshold at which income tax at the higher rate of tax becomes payable. This alignment is being introduced in two stages.

- a) In April 2008 the weekly UEL was increased by £75, equating to an annual increase of £3,900.
- b) In April 2009 the UEL will equate to the higher rate income tax threshold plus the income tax personal allowance of £6,475.

Although the change in 2008-2009 was achieved by secondary legislation, the change in 2009-2010 required primary legislation, (being NICA 2008). This is due to the fact that the previous primary legislation stated that the UEL could not be more than 7.5 times higher than the Lower Earnings Limit (LEL) and NICA 2008 removes that rule with effect from 6 April 2008.

The main changes are:

For tax years up to 2009-2010 the S2P accrues on the part of employee earnings between the LEL and the UEL. This element which is known as the surplus earnings factor(s) is revalued in line with the growth in average earnings up to the last full tax year of a contributor's working life since 1978 to produce a lifetime average which is then multiplied by the accrual rate that is relevant at the time. The figure is then divided by 52 to produce a weekly rate of additional pension.

For S2P calculations the earnings are split into three different levels being the earnings bands.

Entitlement accrues at a different rate in each earnings band.

Up to the tax year ending 2008-2009 these bands were:

1. The LEL and the low earnings threshold (LET)
2. The LET and the upper earnings threshold (UET)
3. The UET and the UEL

In 2008-2009 the LET level is £13,500 and the UET level is £31,500.

People earning at or above the LEL accrue S2P on a cumulative basis depending on the level of their earnings. People earning between LEL and the LET are treated for S2P purposes as having earnings at the LET.

The pensions Act 2007 was introduced to provide rules to allow the S2P to be restructured for a simpler flat rate system to be introduced. This Act allows the UAP to replace the UEL for the purpose of capping the entitlement to the S2P.

The UAP will be frozen in cash terms for now, but it will result in the gradual erosion of earnings related accruals. The effect over a period of time will be that the UET will reach the level of the UAP and many years later the LET will also reach the level of the UAP.

The intention of the UAP was that it would be introduced at the same time as a flat rate accrual amount of about £1.50 per week that would replace accruals on earnings between the LEL and the LET

These changes were expected when the Pensions Bill was introduced in 2007 to deliver entitlement to the S2P on a completely flat rate basis by about 2030.

However, following the changes to align the UEL with the higher rate tax threshold, NICA 2008 introduces the UAP from 6<sup>th</sup> April 2009, before the introduction of the flat rate accrual amount.

The effect of the 2007 Budget announcements would have meant that without this intervention, the level of the UAP upon introduction in 2012 as originally planned would have been considerably higher than that forecast in the Regulatory Impact Assessment provided for the Pensions Act 2007. As a consequence the S2P would have accrued on a greater amount of earnings than intended.

Bringing forward the UAP to April 2009 and fixing it at an amount about the equivalent to the level the UEL was projected to be in 2012 prior to the 2007 Budget announcement realigns with the proposal to achieve flat rate accruals by about 2030 as set out in the Government white paper "Security In Retirement" towards a new pension scheme.

The UAP will replace the UEL as the weekly upper cap on earnings when determining entitlement to the S2P. It is set at £770 per week the level of the UEL for 2008-2009. It will be frozen in cash terms and together with the flat rate accrual amount in the Pensions Act 2007 will remove earnings related accruals within the original time span.

From the 6 April 2009 employers and employees with occupational pension schemes contracted out of the S2P scheme will only receive contracted out rebates on earnings from the LEL up to the ET.

The result of these changes will mean that employers and employees will pay National Insurance at 12.8% and at 11% respectively under current rates on all earnings between the UAP and UEL.

An additional field is required from 6 April 2009 to record this band of earnings.

Employers who do not have occupational pension schemes will also have to record the earnings between the primary earnings threshold and UAP and between the UAP and UEL.

This is because until 2012 or the date at which time the option to contract out is abolished for members of defined contribution pension schemes, employers may have employees in pension schemes that HMRC makes minimum payments to. Those will also be limited to the UAP from 6<sup>th</sup> April 2009.

This information is necessary for S2P calculation purposes and to enable HMRC to calculate and

pay over age related rebates up to the UAP for those employees in contracted out money purchase schemes and to calculate and pay over the minimum contributions up to the UAP in respect of those employees who hold appropriate personal pensions. It is also necessary for HMRC to ensure that the correct amount of contributions has been paid.

## State Pension Increase Is Above Inflation

April is not a bad month this year for our pensioners. It will increase by 5% on 6<sup>th</sup> April 2009 which is in line with the Retail Price Index as it was back in September 2008. This will mean a real boost in income at last.

In addition every pensioner should have received a one off tax free payment of £60 in January. This tax free payment was on top of the £10 Christmas bonus. If you or a relative have not received it by the end of this tax year call: 0845 606 0265.

Pensioners should make the most of it because if inflation continues to fall this year, and then starts to rise as we come out of recession the situation could reverse next year.

## The Budget Is On Hold

The budget will be on Wednesday 22<sup>nd</sup> April 2009. That is the latest the regular spring Budget has been since the Second World War and more than a fortnight after the new tax year begins on 6<sup>th</sup> April 2009. Normally the Budget is in March but this year the Treasury were busy preparing for the G20 conference of the world's leading economies held on 2<sup>nd</sup> April in London.

### Quotations of the Month

Know the true value of time; snatch, seize and enjoy every minute of it.

Never let the other fellow set the agenda.

For fast acting relief try slowing down.

Imagination is the eye of the soul.

The best time for parents to put their children to bed is while they still have the strength.

In skating over thin ice safety is our speed

The four stages of man are infancy, childhood, adolescence and obsolescence.

Source: The CML collection

### Statistics of the Month

More than a quarter of adults in Britain struggle to add up prices in their heads when shopping. 47% of adults wish they had learnt more maths at school. Women appear to be less numerate or more honest than men. 34% of women say they have trouble working out sums in their heads as opposed to 18% of men. Source: You Gov / The Times.

More than half of British parents consider childhood over at the age of 11. Almost three quarters allow children alcohol at home before they are aged 18 years. More than half of children aged between 11 and 16 are allowed out after 11pm. Three quarters of parents say their children have scant regard for authority and have frequently defied them. Source: The Daily Telegraph

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