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24 March 2010

# Budget 2010

## Foreword

The impending general election appears to have taken any real spice out of this year's Budget (although we can likely expect another one following the election, regardless of which party wins). The Chancellor has taken this opportunity to offer minor savings to some taxpayers, funded by increases on those earning higher incomes, but the main political message appears to be one of stability and is clearly aimed at the financial markets.

The Chancellor has forecast that the deficit will be more than halved over the next four years, by a combination of tax increases on "highly" paid individuals and efficiency savings. However, this is based on certain growth targets over the same time period and therefore we could yet see increases in VAT, capital gains tax and income tax rates following the election.

There are a number of measures designed to promote small businesses, including:

- the doubling of 100% deduction for capital expenditure to £100,000; and
- entrepreneurs selling their businesses will benefit from a doubling in the limit for the 10% capital gains tax rate (from £1m to £2m).

We continue to await further substantive updates on the patent box regime, despite a specific mention in the Chancellor's speech. There do not seem to be many new anti-avoidance measures for corporates over and above those previously announced.

The main disappointment for individuals is that all of the measures announced in the Pre-Budget Report 2009 continue to stand, including the 50% income tax rate and the increases in NICs. First time buyers will be pleased that stamp duty has been abolished for two years for house purchases of up to £250,000, but this will be funded by a new 5% stamp duty rate for property purchases worth more than £1m.

Those of you who are fans of video games will be encouraged to learn that the Government intends to introduce a new tax relief for video games (subject to consultation and state aid approval).

## Business

The Budget contains a series of targeted business tax measures, some of which had been announced previously. These include:

### Bank Payroll Tax

The Budget confirms the introduction of the Bank Payroll Tax (**"BPT"**), and also a number of amendments that have been proposed in relation to the BPT which in most cases narrow its scope (principally by excluding independent brokers and fund managers from the scope of the tax). It is comforting that the relevant Budget Note (BN02) states that the chargeable period for the BPT will end on 5 April 2010. Thus, for the moment at least, no extension to the BPT looks likely. It also sets out some detail as regards the collection and assessment of the BPT. It is interesting that all taxable companies will have to provide returns, so those that do not feel they have paid a bonus or otherwise provided relevant remuneration caught by the BPT will still have to provide a "nil return", apparently contradicting what HMRC have previously said in their FAQs on the BPT (in FAQ21).

### Systemic tax risk and financial institutions

The Government (together with other countries) is to consider the ways in which the financial services industry can contribute to the costs of government interventions in that sector. One proposed approach relates to what is described as systemic risk tax. Only brief details are available at this stage, but it is likely to be a national tax based on the characteristics of the organisation in question and would apply to all financial institutions that pose a substantial systemic risk. Reaching international agreement on such a tax will be exceptionally complex given jurisdictional interests, which suggests that this will take some time (and will have to complement any new regulatory measures).

### Capital Distributions

Following the recent decision in *First Nationwide v HMRC*, this measure repeats a well received announcement made by HM Treasury and HMRC in late February that Finance Bill 2010 would contain provisions designed to provide greater certainty as to how certain distributions received by UK companies will be taxed. This legislation will have retrospective effect and shall confirm the practice of HMRC that only dividends specifically excluded from income should be treated as capital.

### Worldwide Debt Cap

The worldwide debt cap rules were introduced to restrict relief for UK financing costs where these costs were excessive compared with the financing costs of the worldwide group.

A number of changes to this legislation have already been announced for inclusion in Finance Bill 2010, but some further changes were announced in the Budget. Firstly, where a group includes securitisation companies that are within the special corporation tax regime for securitisation companies, the financing costs of the group as a whole are computed without including the results of the securitisation company. This complements the previously announced measure to exclude securitisation companies from the computation of UK financing costs and income.

Other changes include a power to make regulations that will enable a company involved in capital market arrangements, and which incurs an additional corporation tax liability as a result of the worldwide debt cap rules, to transfer that liability to another group company. In addition, clarification will be provided to ensure that a limited liability partnership cannot be the ultimate parent of a group of companies for debt cap purposes and also to ensure that arrangements which have the economic effect of loans and which give rise to an interest-like return will be taken into account for debt cap purposes.

## Changes in Accounting Standards

Regulations are to be introduced to amend corporation tax rules on loan relationships and derivative contracts where such changes are necessary as a consequence of changes in accounting standards.

## The Annual Investment Allowance

The Annual Investment Allowance was introduced to give 100% first-year tax relief for up to £50,000 per annum to businesses incurring expenditure on plant or machinery. This limit has now been doubled to £100,000 from April 2010. The basic requirements for this allowance remain unaltered, although new income tax anti-avoidance rules have been introduced from 24 March 2010. Whilst welcome, this effectively replaces the 40% first year allowance, which will be withdrawn on 31 March 2010 for corporations and 5 April 2010 for other businesses, thus providing a benefit for smaller businesses at the expense of large businesses.

## Patents Box

The Pre-Budget Report 2009 announced the introduction of a "Patents Box" offering a 10% corporation tax rate for patent income from 2013. Whilst the details are currently vague, a consultation on the design of the patent box will be issued in time for legislation in Finance Bill 2011.

## Tax Transparent Funds

The Government announced that it intends to work with the fund industry to develop a tax transparent fund vehicle and will hold a formal consultation, with a view to legislating in Finance Bill 2011.

## Real Estates Investment Trusts ("REITs") - Stock Dividends

The Government intends to legislate, in a Finance Bill to be introduced as soon as possible in the next Parliament, to allow REITs to issue stock dividends in lieu of cash dividends in meeting the requirement to distribute 90% of the profits from the REIT's property rental business.

To date, the REIT legislation has required for each accounting period a REIT (itself exempt from corporation tax on its property rental business) to distribute at least 90% of its property rental income profits by way of a dividend. This is taxed in the shareholders' hands as property income (and not as dividend income).

The change will put REITs on a level playing field with other companies (property and other) which can issue stock dividends in lieu of cash and the REIT shareholder will be taxed in the same way as though they had received cash. The REIT will be able to maintain its status and to invest profits back into the business when it considers it appropriate to do so (rather than having to distribute profits to its shareholders).

## Life Insurance Companies - Apportionment of income and gains

Where a life insurance company writes more than one type of insurance business, apportionment rules are used to determine profits from each type. For non-profit funds, this apportionment is on the basis of the liabilities to policy-holders for each type of business in the fund. It has been recognised that the regulatory return (the starting point for determining life insurance company profits) offers a means to defer tax. HMRC has become aware of tax not merely being deferred but avoided altogether in non-profit businesses by means of a business transfer.

The Pre-Budget Report 2009 announced an intention to modify the rules for apportioning the income and gains of a non-profit fund between categories of insurance business. This is now forthcoming. The Government has announced its intention to modify the transfer of business rules as soon as is practicable, but with effect from 24 March 2010.

## Islamic Finance

The Government announced that it intends to introduce measures to clarify how the capital allowance regime interacts with the rules on Alternative Finance Arrangements, and will consider introducing measures to further align all alternative property finance arrangements with the tax treatment of loan relationships.

## Close Company

Legislation is to be introduced in Finance Bill 2010 to deny a close company a corporate tax deduction where it releases or waives a loan to a participator. This corrects a perceived mismatch given that where such debts are released or waived, it is treated as a dividend for tax purposes in the hands of a borrower.

### Consortium relief

Following the decision in *Philips Electronics UK Limited v HMRC*, Finance Bill 2010 will introduce changes to allow all EEA resident companies engaged in UK consortia to pass on losses to their UK resident subsidiaries.

There are of course going to be further changes to the anti-avoidance rules to ensure artificial arrangements cannot inflate the losses beyond the proportion of the consortia member's active involvement.

### Lessor companies

Changes will be made to draft legislation published as part of the Pre-Budget Report 2009 which will allow lessor companies to elect for alternative tax treatment when they are sold. Profits of the company after any sale can be isolated by such an election and thereby avoid an immediate tax charge.

## Individuals

### Venture Capital Scheme ("VCT")

With effect from Royal Assent, VCTs will be able to list on any EU regulated market rather than just in London. In terms of VCT investments, the widening of the definition of "eligible shares" to include certain preference shares will be welcomed by VCTs and investee companies alike, as will the fact that investee companies can have a permanent establishment in the UK rather than having to trade "wholly or mainly in the UK". The same change is made for the purposes of the Enterprise Investment Scheme.

### Entrepreneurs' Relief

Some commentators were concerned that the Chancellor would raise the capital gains tax (**"CGT"**) rate in the Budget. Thus, the big surprise of the Budget was the effective decrease in CGT for those that qualify for entrepreneurs' relief and have gains in excess of £1m. The net effect of entrepreneurs relief is that the gains that qualify have an effective rate of 10% (rather than the usual CGT rate of 18%). Currently, a maximum amount of £1m of taxable gain qualifies for entrepreneurs relief (so a maximum tax saving of £80,000). From 6 April 2010, the maximum amount that qualifies will be £2m (so a maximum tax saving of £160,000).

### Employee Incentives and Benefits

Possibly the most interesting announcements in the field of employee share incentives and benefits are two short paragraphs in the Press Notice on Protecting Tax Revenues.

The first states simply "The Government today announces that it intends to take action to tackle avoidance through the use of trusts and other vehicles to reward employees." This may be the start of the long expected crack down on the use of employee benefit trusts to provide benefits without paying income tax or NICs; however, we await further details.

The second states simply that the Government intends, during 2010, to "consult on the taxation of returns from geared growth arrangements connected with employment-related securities, to ensure that income from employment is taxed correctly". Again there is little to indicate what they have in mind, but this could cover many things from "sweet equity" arrangements in highly leveraged private equity structures, through to special classes of employee shares which have little value when issued but increase in value as the company approaches an exit (sometimes called "flowering shares"), to possibly more artificial arrangements using special classes of shares in subsidiaries. As the taxation of these arrangements was considered to be reasonably settled, it will be interesting to see which areas the Government thinks may benefit from change.

There are also a couple of specific anti-avoidance measure targeted at approved share schemes.

The first is primarily aimed at avoidance schemes which involve companies paying money to the trustees of Share Incentive Plans (**"SIPs"**), with the money being used to purchase shares from individuals. The companies get a corporation tax deduction for the money paid to the SIP, and the rights of the shares held in the SIP are subsequently varied so that value is stripped out of them. As a result, the companies obtained a deduction for money paid to the shareholder, even though no (or little) value is transferred to employees. No deduction will be available for such arrangements in future.

The second measure is targeted at schemes which use "geared growth" shares in subsidiaries of listed companies to deliver value to employees under HMRC approved Company Share Option Plans (**"CSOPs"**).

The use of shares in unlisted subsidiaries of a listed company for CSOPs is to be stopped.

Both of these measures are intended to be introduced in Finance Bill 2010.

Finally there is a welcome measure affecting enterprise management incentive (**"EMI"**) share options, although this has been previously announced. The requirement that a single company granting EMI options must be carrying on a trade wholly or mainly in the UK is replaced with a requirement that the company must have a permanent establishment in the UK. The requirement that a parent company granting EMI options must have one group company carrying on a qualifying trade in the UK is replaced with the requirement that at least one company in the group which is carrying on a qualifying trade must have a permanent establishment in the UK. These changes are being introduced to ensure that the EMI rules comply with EU State Aid guidelines. The intention is to legislate this measure "in a Finance Bill to be introduced as soon as possible in the next Parliament".

## Anti-avoidance

True to form, the Government has announced targeted rules to deal with perceived tax avoidance. The main anti-avoidance measures can be summarised as follows:

- legislation will be introduced to ensure that taxpayers may only deduct foreign tax from foreign income where the foreign tax has been included in the taxpayer's taxable income. Amendments will also be made to the manufactured overseas dividend rules to prevent financial traders effectively obtaining relief for foreign tax twice;
- the existing transactions in securities legislation is to be replaced by clearer, more targeted legislation and will extend to arrangements involving close companies;
- the Disclosure of Tax Avoidance Schemes legislation is to be revised to include increased penalties for non-compliance and a requirement for scheme promoters to provide the names of clients to whom they have issued scheme reference numbers. The Government has also announced that it is considering bringing inheritance tax within the scope of the legislation;
- stricter penalties are to be introduced for taxpayers who fail to provide details of offshore income and gains, with penalties of up to 200% of the tax due potentially being imposed; and
- a discussion document has been published on the possible introduction of a generic rule to counter "group mismatch schemes" involving loans or derivatives. These schemes have been notified to the Government under the tax avoidance disclosure regime.

## Indirect taxes

### VAT

#### VAT Registration Threshold

The VAT registration threshold is being increased from £68,000 to £70,000 with effect from 1 April 2010.

#### Reverse Charge for Emissions Allowances

Missing Trader Intra-Community Fraud (**"MTIC"**) has been very costly to the UK Exchequer. Taxpayers purchasing certain specified supplies of mobile phones and computer chips are now required to account for and pay the VAT on their purchases (instead of the supplier) to combat MTIC. This reverse charge approach is now being extended to supplies of services such as emissions allowances with effect from 1 November 2010.

#### VAT Recovery for Mixed Use Assets

To date, VAT on immovable property, boats and aircraft has been recoverable by UK VAT-registered persons upfront and in full on both the business and private use of the asset (subject to any partial exemption restriction). VAT is then accountable to HMRC over subsequent years in respect of the private use of the asset. This method has been known as *Lennartz accounting*. A recent decision of the European Court of Justice has necessitated changes because many UK taxpayers were (wrongly) permitted to use *Lennartz accounting*. The changes, effective from January 2011, will mean that upfront full VAT recovery is restricted only to the business use of the asset (so as to exclude any private use). In addition, revenue protection legislation is being introduced to ensure that existing *Lennartz accounting* users continue to account for the VAT due.

## STAMP TAXES

### Stamp Duty Land Tax ("SDLT")

A new relief from SDLT for first-time buyers will be available for purchases of residential property of a value up to £250,000. This will apply to buyers who have not previously purchased residential property anywhere in the world and who intend to occupy the purchased property as their only or main home. This new relief will be time-limited to two years. The relief is due to take effect for purchases having an 'effective date' (normally the date of completion) on or after 25 March 2010 and before 25 March 2012.

To finance the first-time buyer's relief, a new SDLT rate of 5% will be introduced for purchases of residential property where the consideration exceeds £1 million. The new 5% rate will apply to purchases having an effective date on or after 6 April 2011.

Anti-avoidance legislation will be included in Finance Bill 2010 to prevent what is seen as exploitation of the SDLT rules by the use of partnerships. The new anti-avoidance rules will be directed at transactions where a partnership transaction has been 'contrived' specifically to reduce the SDLT payable so that the usual SDLT calculation rules for partners will not apply. The new rules will apply (subject to transitional rules) where transactions have an effective date on or after 24 March 2010.

Measures will be introduced (to have effect from 1 April 2011) in relation to the procedure for reclaiming overpayments of SDLT. The time limit for reclaiming overpayments will be reduced from six to four years, but the requirement that the overpayment must be the result of a mistake in a land transaction return will be removed.

### Stamp Duty and Stamp Duty Reserve Tax ("SDRT")

Following the recent decision of the European Court of Justice in *HSBC Holdings Plc and Vidacos Nominees Ltd v HMRC*, where it was held that EU Member States are not permitted to charge stamp duty or SDRT on the issue of shares to, and the transfer of existing shares into, EU clearance services, enabling legislation will be introduced in Finance Bill 2010 to give HM Treasury the express power to make regulations to remove multiple charges to stamp duty or SDRT falling on members of clearing houses (or their nominees), where transactions in UK securities are cleared through clearing houses or other central counterparties.

Anti-avoidance measures will be included in Finance Bill 2010 to target securities intended for non-EU markets which are initially routed through an EU clearance service.

HMRC has stated that it will work with the investment management industry with a view to treating certain investments by a collective investment scheme in another collective investment scheme as 'exempt investments' for SDRT purposes.

## INSURANCE PREMIUM TAX

### Insurance Premium Tax ("IPT") and Premium Splitting

The Pre-Budget Report 2009 announced that legislation would be introduced in Finance Bill 2010 to prevent the avoidance of IPT involving fees and commissions charged under a separate contract and draft legislation was published for comment. Following further consultation with insurance industry representatives, revised legislation has been published to close this loophole, which takes effect from 24 March 2010. Such payments now form part of the premium from which the insurer will be required to account for IPT in accordance with normal IPT accounting procedures. This measure only applies where the insured is an individual who enters into the insurance contract in a personal capacity (and not for business purposes). This measure does not apply to insurance bought by businesses as HMRC say they have seen no avoidance in that sector.

## HMRC Powers and Deterrents

### Penalties for Late Filing of Returns and Late Payments of Tax

Finance Bill 2010 will include legislation introducing a harmonised regime for the late payments of tax and late filing of tax returns which relate to indirect tax. This follows a similar harmonisation of the direct tax penalty regimes which was announced in the Budget 2009 and introduced in Finance Act 2009. The new legislation will apply to indirect taxes (including VAT, insurance premium tax, landfill tax and other excise duties), and shall impose differing penalties depending on whether the delay relates to a late filing or a late payment of tax, and whether such filing or return is required on a monthly or quarterly basis.

### Tackling Offshore Evasion

Legislation will be introduced to provide for larger penalties for taxpayers who fail to disclose their income or capital gains tax liabilities which are linked to an offshore matter. At present, tax-geared penalties are imposed for such non-disclosure, with the level of such penalties depending on the behaviour of the taxpayer and the quality of the disclosure. Going forward, where non-compliance arises in a jurisdiction which has not agreed to exchange information with the UK, the penalty percentages will be double those currently imposed.

### Security for Payment of PAYE

Currently, legislation exists under which HMRC can require a business to provide financial security where HMRC believes VAT revenue is at risk because those running the business do not intend to meet their obligations. Regulations are now to be introduced under which HMRC may require financial security from employers where amounts due under PAYE or NICs are seriously at risk. Limited information is available in relation to the proposals – however, the requirement for security shall apply to employers who operate PAYE and have a history of serious non-compliance in terms of paying late or not paying at all; and the amount of security required shall depend on the potential tax liability. Failure by a person to give such security shall be a criminal offence, punishable by a fine of up to £5,000. Draft regulations will be published on HMRC's website and will be subject to consultation prior to implementation.

## Tax rates and allowances 2010/11

| | 2010/11<br>£ |
|---|---|
| Personal allowance (age under 65) | 6,475 |
| Personal allowance (age 65-74) | 9,490 |
| Personal allowance (age 75 and over) | 9,640 |
| Blind Person's Allowance | 1,890 |
| Married Couple's allowance<br>(age less than 75 and born before 6 April 1935) | 6,865 |
| Married Couple's allowance (age 75 and over) | 6,965 |
| Married Couple's allowance - minimum amount | 2,670 |
| Income limit for age-related allowances | 22,900 |

The personal allowance will be reduced where income is in excess of £100,000 by £1 for every £2 over £100,000 until the allowance is reduced to nil.

### Personal Pension Schemes

| | 2010/11<br>£ |
|---|---|
| Pension scheme annual allowance | 255,000 |
| Pension scheme lifetime allowance | 1,800,000 |

### National Insurance Contributions

| | 2010/11<br>£ |
|---|---|
| Primary Class 1 contributions | |
| Lower earnings limit (per week) | 97 |
| Upper earnings limit (per week) | 844 |
| Primary threshold (per week) | 110 |
| Secondary threshold (per week) | 110 |

| | |
|---|---|
| Class 2 annual small earnings exception | 5,075 |
| Class 2 rate (per week) | 2.40 |

| | |
|---|---|
| Class 3 rate (per week) | 12.05 |

| | |
|---|---|
| Class 4 contributions | |
| Lower annual earnings limit | 5,715 |
| Upper annual earnings limit | 43,875 |

From 6 April 2011 a 1% increase in employer, employee and self-employed rates of National Insurance Contributions (both main and additional rates) will be introduced, whilst the primary threshold and lower profits limit will be increased by £570.

### Capital gains tax annual exempt amount

| | 2010/11<br>£ |
|---|---|
| Individuals etc | 10,100 |
| Most Trustees | 5,050 |

### Inheritance Tax

| | 2010/11<br>£ |
|---|---|
| Individual allowance | 325,000 |

### Income tax: taxable bands (other than savings and dividend income)

| £ per year | 2010/11<br>£ |
|---|---|
| Basic rate: 20% | 0-37,400 |
| Higher rate: 40% | over 37,400 |
| Additional rate: 50% | over 150,000 |

### Corporation tax on profits

| | 2010/11<br>£ |
|---|---|
| Small companies' rate: 21% * | 0-300,000 |
| Marginal relief | 300,001-<br>1,500,000 |
| Main rate: 28% | 1,500,001 or more |

* the rise in the small companies' rate to 22% has been deferred for a further year, to 1 April 2011.

### Stamp taxes and duties

Transfers of land and buildings (considerations paid)

| Rate | Residential in disadvantaged areas | Residential outside disadvantaged areas | Non-residential |
|---|---|---|---|
| | Total value of consideration | | |
| Zero | £0 - £150,000 | £0 - £125,000 | £0 - £150,000 |
| 1%* | Over £150,000 - £250,000 | Over £125,000 - £250,000 | Over £150,000 - £250,000 |
| 3% | Over £250,000 - £500,000 | Over £250,000 - £500,000 | Over £250,000 - £500,000 |
| 4% | Over £500,000 | Over £500,000 | Over £500,000 |
| 5% | Over £1million | Over £1million | |

* From 25 March 2010 until 24 March 2012, no Stamp Duty Land Tax will be due on purchases of residential property where the consideration is less than or equal to £250,000 where the purchaser (or all of the purchasers, if applicable) is a first time buyer and intends to occupy the property as their only or main home.

## Contacts

The foregoing is a summary of the changes announced.
For further information please contact:

***Sandy Bhogal***
Partner
T +44 (0)20 3130 3645
E SBhogal@mayerbrown.com

***Michael Cashman***
Partner
T +44 (0)20 3130 3228
E MCashman@mayerbrown.com

***James Hill***
Partner
T +44 (0)20 3130 3227
E James.Hill@mayerbrown.com

***Andrew Stanger***
Partner
T +44 (0)20 3130 3934
E AStanger@mayerbrown.com

***Peter Steiner***
Partner
T +44 (0)20 3130 3811
E PSteiner@mayerbrown.com

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March 2010