MAYER • BROWN

Budget

Budget Summary
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Foreword

Given the backdrop of the global credit crisis, the slowing economy and the pressure on public finances, the Chancellor opted in this year's Budget to follow a middle course between tax cuts which would stimulate the economy and tax increases which will improve public finances.

Alistair Darling's first Budget as Chancellor emphasised two themes; stability and competitiveness. Some would argue with the Chancellor's claim today that the UK has "the most competitive corporation tax regime in the G7". The headline rate of corporation tax may now be dropping (to 28%) but the complexity of the UK tax code means that many companies still face large compliance costs and may be better able to manage their effective tax rate by relocating elsewhere.

This Budget is also unusual in that the pack of materials is one of the largest seen in recent years; at the same time it contains relatively little in the way of significant changes to the existing tax rules. A large amount of the materials produced relate to changes previously announced. This review includes follow up on some of these previously announced measures as well as a summary of new measures.

The Government has chosen to delay the issue of the Consultation Document on the Taxation of Foreign Profits. This suggests that more work is needed, which is not surprising given the amount of input from taxpayers generated by the original discussion document. As this is a complex area and the Government is keen to encourage UK-headquartered groups, one should welcome any indication that HM Treasury is taking its time to consider changes which will hopefully stimulate inward investment whilst also protecting the UK tax base.

In common with the recent trend of targeting perceived tax abuse, various new measures have been announced to counteract arrangements which have been brought to HM Revenue & Customs' attention under the UK disclosure regime. The arrangements targeted are primarily those used by a relatively small number of larger enterprises with complex tax affairs.

The much heralded transition to an 18% flat tax rate for capital gains following the abolition of business asset taper relief has, as previously announced, been somewhat diluted for many taxpayers by the introduction of the entrepreneurs' relief.

It also appears that HM Treasury has taken account of many of the representations made on behalf of non-domiciled individuals. There are measures announced on the removal of offshore trusts from the scope of the rules (unless the income or gains are brought into the UK) and consideration has been given to the concerns of US domiciles living in the UK and their ability to secure a US tax offset on the £30,000 charge.

The Government has also commenced a programme of tax measures aimed at encouraging environmental change. There have been several incremental measures announced today, although these are not covered here.

Business

Associated Companies Rules

The associated companies rules as they apply to the small companies rate (SCR) of corporation tax will be simplified and the simplified rules will have effect from 1 April 2008. The effect of these changes will be that the rights or powers held by business partners will be attributed only when "relevant tax planning arrangements have at any time had effect in respect of the taxpayer company". "Relevant tax planning arrangements" will be defined as arrangements which involve the shareholder or director and the partner and secure a tax advantage by virtue of greater relief under section 13 of ICTA.

North Sea Fiscal Regime

Management Expenses

Current tax rules ring fence the profits of a company's oil and gas production in the UK and on the UK Continental Shelf. Losses arising outside the ring fence cannot be used to shelter ring fence profits. Since 2004, the expenses of managing an investment business have been able to be used to shelter a company's total profits (from all activities). HM Revenue & Customs has become aware of some energy companies seeking "to undermine the integrity of the ring fence rules" by arranging their affairs to offset expenses of managing an investment business against their ring fence profits. With immediate effect, this loophole has been closed.

Decommissioning Costs

Decommissioning of North Sea infrastructure is becoming of increasing relevance to energy companies. HM Revenue & Customs has reacted to this by announcing that it is planning to include in the Finance Bill 2008 a number of measures to provide such companies with greater access to corporation tax and petroleum revenue tax (PRT) relief. These measures will include the following:

- the period in which corporation tax losses can be carried back will be extended to April 2002;
- companies will be able to claim post-cessation costs of decommissioning for tax purposes until such time as the decommissioning has been completed; and
- the scope for PRT relief where companies (ex-participators) are called upon to meet such costs as a result of a default by another company (current participator) will also be extended.

Insurance Premium Tax (IPT)

Overseas insurers who are liable to be registered for IPT in the UK, but who have no business establishment in the UK, have to appoint a UK tax representative. That tax representative is jointly and severally liable for the insurer's obligations and liabilities in respect of IPT. If an overseas insurer fails to have a tax representative in these circumstances, HM Revenue & Customs can assess the insured party for the tax due.

The Finance Bill 2008 will remove the requirement for an overseas insurer to appoint a tax representative in these circumstances and will restrict HM Revenue & Customs' ability to assess the insured party to very limited circumstances (where the insurer is located outside the EU and that country is not covered by a mutual assistance-type provision on exchanges of information and recovery of tax due). Even if a tax representative is appointed, it will no longer be jointly and severally liable.

Life Insurance Companies

Simplification

In May 2006, HM Revenue & Customs launched a consultation about the simplification of the tax law relating to life insurance companies. Out of that process has come a number of measures, most of which are to take effect from various dates in 2008. The measures will include the simplification of the tax law relating to financing arrangements (contingent loans and financial reinsurance) used by life insurance companies. These companies have requirements for capital which cannot normally be met by straightforward borrowing. Instead they have used a variety of more complex financing arrangements (including contingent loans and financial reinsurance contracts). Although HM Revenue & Customs acknowledges that such arrangements do not normally give rise to tax issues, it is aware that profits can be generated without tax necessarily being paid on them. The Finance Bill 2008 will include a tax charge only when the financing arrangements are used to generate a surplus which is transferred to shareholders and which would not have existed without the arrangements. It will not affect financing designed simply to provide working capital or improve solvency. At the same time as this new tax charge is introduced, relief will be given for loan repayments and the recapture of reinsured liabilities to the extent that the surplus has been taxed. This change will have effect for accounting periods beginning on or after 1 January 2008.

Interest Apportionment

It is common practice for life insurance companies to reinsure large blocks of pension annuities to specialist providers who are better able to manage the longevity risk. Because pension annuities are long-term contracts, such arrangements can result in a substantial credit risk for the insurer. To manage that credit risk, re-insurers normally deposit back all or a substantial portion of the premium paid with the original insurer and the insurer normally pays interest to the re-insurer on that deposit back.

The Finance Bill 2008 will introduce legislation to provide that interest paid on deposits back from re-insurers will be wholly allocated to the category (or categories) of business re-insured by the contract giving rise to the deposit back. This is to prevent life insurance companies obtaining an unintended tax advantage by setting off a significant amount of interest against basic life assurance and generally annuity business (even though the deposit back related to a company's gross roll-up business which includes pension business).

Changes to the capital allowances regime

Following the announcement in last year's Budget of a business tax reform package and the publication of two technical notes by HM Revenue & Customs in December 2007, the Chancellor has today announced a significant overhaul of the current capital allowances regime:

- The main rate of writing down allowances on plant and machinery will be reduced from 25% to 20% for chargeable periods ending on or after 1 April 2008 (for corporation tax) and 6 April 2008 (for income tax). The rate of writing down allowances on long-life assets will increase from 6% to 10% and any new expenditure on such assets will be included in a 10% special rate pool.
- Industrial buildings allowances, enterprise zone allowances and agricultural buildings allowances, generally claimed as a 4% writing down allowance, will be gradually phased out over the next four years. The allowances will be withdrawn from 1 April 2011 (for corporation tax) and 6 April 2011 (for income tax).
- A new classification of "integral features" of a building will be introduced with effect from 1 April 2008 (for corporation tax) and 6 April 2008 (for income tax) for which writing down allowances of 10% each year will be available. The items in respect of which the 10% allowance can be claimed are detailed on a list and will include (amongst other things) electrical, cold water and space or water heating systems as well as lifts, escalators and moving walkways. Expenditure on these items will be included in the 10% special rate pool. In addition, writing down allowances for expenditure on thermal insulation (currently available only on industrial buildings) will be extended to expenditure on thermal insulation of all buildings (except those used for residential property businesses), but will be restricted to 10% (again, in the 10% special rate pool).
- A new annual investment allowance (AIA) of 100% for the first £50,000 spent by any business on plant and machinery will be introduced from 1 April 2008 (for corporation tax) and 6 April 2008 (for income tax). The AIA can be claimed on expenditure on long-life assets and items stated to be "integral features" as well as general plant and machinery. It will replace the existing first year allowances of 50% and 40% available to small and medium-sized enterprises, respectively, which will be withdrawn.
- Loss-making companies will be able to surrender to HM Revenue & Customs losses which are attributable to 100% first year capital allowances claimed on energy-saving or environmentally-beneficial plant and machinery (where the expenditure is incurred on or after 1 April 2008) in return for a tax credit equal to 19% of the losses surrendered. The amount that can be claimed is subject to a limit of the greater of the company's total PAYE and NICs liabilities in the period in which the loss is surrendered and £250,000.
- Following comments made by businesses in the consultation on the AIA, new legislation will be introduced allowing businesses to claim a plant and machinery writing-down allowance of up to £1,000 where unrelieved expenditure in the main pool or the new 10% special rate pool is £1,000 or less. This change will take effect from 1 April 2008 (for corporation tax) and 6 April 2008 (for income tax). This is designed primarily to reduce the current administrative burden for small enterprises.

- The lists of energy efficient and water-saving technologies on which 100% capital allowances are currently available are to be extended to include certain new technologies.
- The 100% first year allowance currently available for expenditure on natural gas and hydrogen refuelling equipment will be extended until 31 March 2013 and will also cover biogas refuelling equipment.
- The 100% first year allowance for expenditure on cars with CO2 emissions not exceeding 120g/km will be extended until 31 March 2013 but the emissions threshold will be reduced to 110g/km.

Investment funds

Budget 2008 makes a number of significant changes in relation to investment funds. The changes have largely been announced before, but the Budget and associated documents provide more detail.

Investment Management Exemption (IME)

As expected, legislation will be introduced in the Finance Bill 2008 in relation to the definition of "investment transaction" for the purposes of the IME and also as regards the consequences in the event that an onshore investment manager carries out a transaction for a non-resident which is not an "investment transaction" as defined.

In broad terms, only investment transactions can fall within the IME (and thus escape UK tax). The types of transaction coming within that definition are currently listed in various parts of the tax code. The new legislation will ensure that there is a single list of what constitutes an investment transaction, and HM Revenue & Customs will have the power to designate transactions as investment transactions. Whilst not clear from the Budget, it is expected that HM Revenue & Customs will (if it exercises this power) only add to the current list of investment transactions, rather than reduce it. The legislation will take effect from the date of the first order issued by HM Revenue & Customs designating transactions as investment transactions, and this will be at some point after the Finance Bill receives Royal Assent. The current rules will apply in the meantime.

Furthermore, the consequences of carrying out transactions other than investment transactions will be made more proportionate. At present, the consequence can be that the IME is failed for all transactions carried out by the investment manager (including investment transactions) during the relevant tax year. However, from 2008-2009 onward, only those transactions which do not meet the qualifying conditions for the IME will be subject to UK tax – the investment transactions will still qualify for the IME (assuming all the other conditions for the IME are met) even if non-qualifying transactions are carried out by the same investment manager.

The New Offshore Funds Regime

The taxation of offshore funds has been the subject of a long consultation. HM Revenue & Customs has announced that the new offshore funds regime will not now be introduced until the Finance Bill 2009. However, in the meantime (although only with effect from a "date to be appointed"), changes will be made which enable funds to be "qualifying funds" for the purposes of the offshore funds regime without actually making distributions (as is currently required). The benefit of being a qualifying fund is that UK investors will generally be subject to capital gains tax on gains made on investments in the fund as opposed to income tax on such gains (which is the case with certain interests in non-qualifying funds). The change will mean that instead of actually distributing 85% of their income to be a qualifying fund, offshore funds will instead be able to report their income. The quid pro quo, however, is that investors will be subject to income tax on such "reported income" irrespective of whether they have actually received a distribution of such income. HM Revenue & Customs also states that "it is expected that" the test for obtaining the qualifying fund status will be determined from when a fund first applies for such status as opposed to an annual test. It also states that minor failures to meet the conditions will not result in the status of the fund being removed retrospectively. It will be necessary to review the draft regulations (to be published shortly after the Finance Bill 2008) carefully on this issue.

Unauthorised Unit Trusts

A change has been announced in relation to unauthorised unit trusts (UUTs). As a result of a mistake in the drafting of the Income Tax Act 2007 (ITA), UUTs are currently required to pay income tax deducted from distributions to unitholders on 31 January of the tax year following the tax year in which such distributions are made. This will be changed (with effect for 2008-2009 and subsequent years) so that payments on account of such income tax for a given tax year will be required from UUTs on 31 January in that year and 31 July following that year, with a balancing payment or claim by 31 January in the following tax year.

Authorised Investment Funds – OEICs, AUTs, PAIFs and FAIFs

Yet more acronyms are added to the tax lexicon – PAIFs (Property Authorised Investment Funds) and FAIFs (Funds of Alternative Investment Funds). There follows a summary of the changes, but with both PAIFs and FAIFs, as with other changes announced by recent Budgets, the devil will be in the detail.

The new tax regime for PAIFs was first mooted last year, but changes will now be introduced with effect from 6 April 2008, much to the relief of those in the property and fund management industries. The downside is that the new regime will only be available to open ended investment companies (OEICs) but not authorised unit trusts (AUTs). OEICs that meet certain conditions will be able to elect into the new PAIF regime. Draft regulations in relation to PAIFs have been published. In brief terms the conditions are:

- at least 60% of the OEIC's business will need to be "property investment business" (and it will need to be stated in the incorporation documents and prospectus that the OEIC's investment objective is to carry on property investment business) – the 60% will be measured by reference to assets and net income and "property investment business" will include property rental business and owning shares in REITs;
- the OEIC must have "genuinely diverse ownership" – the draft regulations contain much detail on this aspect but the overall effect is that any OEIC which is not held by numerous investors runs the risk of being found to be in breach of this condition, and furthermore that no body corporate can be a beneficial owner of more than 10% of the net assets of the fund; and

- any debt finance taken out by the OEIC must be on normal commercial terms – basically loans will need to give no more than market rates of return and must not be linked to the results of the business.

The main tax consequences for an OEIC electing to become a PAIF are that property related income coming into the PAIF will be exempt and that distributions of property related income and taxable income (i.e. income arising from investments other than property related investments) of the PAIF will be subject to withholding of tax (which can be reclaimed by exempt investors).

The tax rules relating to FAIFs relate to the proposed new FSA rules on the same, and will come into force at some point following the enactment of the new FSA rules. In broad terms the thrust of the new rules is that where FAIFs invest in non-qualifying offshore funds (cf. above, soon to be "non-reporting" offshore funds), the gains made by the FAIF in relation to its holding in the offshore fund will be exempt (at present they are taxed as offshore income gains), but that taxable investors in the FAIF will now be subject to income tax (or corporation tax on income) on gains in relation to their FAIF investment as opposed to capital gains tax (or corporation tax on chargeable gains) as at present. Exempt investors will remain exempt as regards gains arising in relation to the holding in the FAIF. Both AUTs and OEICs will be able to elect into the new regime.

Funding Bonds

As previously announced, a change will be made with respect to funding bonds which essentially puts on a statutory footing HM Revenue & Customs' practice. In short, where interest is paid using funding bonds and tax is deducted at source and paid to HM Revenue & Customs in the form of funding bonds, any claim for repayment of that tax deducted at source will now be satisfied by HM Revenue & Customs giving funding bonds to the claimant. It will have effect in relation to funding bonds issued on or after 12 March 2008.

HM Revenue & Customs Powers

Together with the various press releases and budget notices, today saw the publication of "The framework for a better relationship" which sets out HM Revenue & Customs' current progress on implementing the November 2006 Review of Links with Large Business. The document emphasises that whilst progress has been made, much still remains to be done.

The Varney review looked at proposals in four areas that business had told HM Revenue & Customs would ease the burden on taxpayers: certainty, risk management, speedy resolution of issues and effective consultation.

Since the Pre-Budget Report 2007, HM Revenue & Customs has piloted the extension of the non-statutory clearance process and provided detailed guidance on HM Revenue & Customs' approach to tax compliance risk management for the largest businesses. This includes a new system which classifies large businesses as low and high risk and a new approach to transfer pricing, effective from April 2008.

HM Revenue & Customs Powers - Concessions

As a result of the House of Lords decision in Wilkinson, HM Revenue & Customs has been reviewing its previously published concessions and it expects to complete this review in August 2008. To the extent that such concessions are deemed to not be within HM Revenue & Customs' statutory powers, the intention is to introduce measures in the Finance Bill 2008 so as to ensure that such concessions are made statutory

HM Revenue & Customs Powers - penalties for incorrect returns and failure to notify a taxable activity

Legislative changes will be made to create a single penalty regime for incorrect returns across all taxes, levies and duties administered by HM Revenue & Customs. The penalty will be determined by the amount of tax understated, the nature of behaviour giving rise to the understatement and the extent of the disclosure by the taxpayer. The use of suspended penalties will be extended. There will be no penalty where a taxpayer makes a mistake but there will be a penalty of up to:

- 30% of the tax understated for failure to take reasonable care;
- 70% of the tax understated for deliberate understatement; and
- 100% of the tax understated for a deliberate understatement with concealment.

Where the return is incorrect because a third party has deliberately provided false information or deliberately withheld information from the taxpayer, with the intention of causing an understatement of tax due, there will be a new provision allowing a penalty to be charged on the third party.

Provision will also be made to extend and adapt this penalty regime to cover failures to register or notify HM Revenue & Customs of any new taxable activity for any of the taxes, levies or duties it administers, including late VAT registration.

It is expected that for incorrect returns, the new provisions will have effect for return periods commencing on or after 1 April 2009 where the return is to be filed on or after 1 April 2010. New penalties for failure to notify taxable activities are expected to have effect for failure to meet notification obligations that arise on or after 1 April 2009.

HM Revenue & Customs Powers – Compliance Checks

The Finance Bill 2008 will include new powers designed to facilitate HM Revenue & Customs' access to records and information. The new powers are as follows:

- HM Revenue & Customs will be able to inspect records required under the record-keeping legislation, restricting VAT and PAYE inspections to statutory records but introducing a new power of inspection for direct tax.
- HM Revenue & Customs can require supplementary information relevant to establishing the correct tax position.
- HM Revenue & Customs can require third parties to provide information relevant to establishing the correct tax position.
- HM Revenue & Customs will have the power to visit business premises and to inspect records and assets.

- HM Revenue & Customs will be unable to to undertake VAT and PAYE inspections at private homes without taxpayer consent. However, in such cases, penalties can be levied for failure to allow an inspection and failing to comply with an information notice, including a tax-geared penalty.
- An updated criminal offence of destroying or concealing records requested under a notice authorised by a tribunal.

The normal assessment time limits by which the amount of tax due can be changed will be reduced.

HM Revenue & Customs Powers – Recovery of Tax

Taxpayers will be able to pay tax and duties by credit card from Autumn 2008.

HM Revenue & Customs is set to gain new debt enforcement powers to collect unpaid sums of tax by taking control of goods in England and Wales. HM Revenue & Customs' debt enforcement powers by taking action through the civil courts is also set to be modernised.

Customs officers are to be granted powers to search goods for import or export, should they deem it necessary. Previously officers had the power only to insist that the proprietor of the container do the unpacking.

Tribunal Reforms

Currently, the way HM Revenue & Customs deals with appeals reflects the different history of the two former departments (i.e. Customs and Excise and the Inland Revenue), the requirements of particular taxes or schemes and the four independent appeals bodies that hear tax appeals against HM Revenue & Customs' decisions.

The Tribunals, Courts and Enforcement Act, introduced by the Ministry of Justice, simplifies this into a two tier tribunal system. Most tribunal appeals will be heard under the first tier, with appeals against these decisions heard by the second tier.

Following the HM Revenue & Customs consultation *Tax Appeals against decisions made by HM Revenue & Customs* which ran from October to December 2007, legislation will be introduced in the Finance Bill 2008 to provide a power to introduce secondary legislation to change the way appeals against HM Revenue & Customs decisions are handled.

Individuals

Residence and Domicile

The Chancellor has announced that he will press ahead with the proposed changes to the rules on the taxation of non–domiciled individuals, albeit with a few "sweeteners" announced or confirmed today. In addition, there are a number of changes to the residence tests.

Changes to the Residence Tests

It was announced in the Pre-Budget Report that, in calculating the number of days spent in the UK for the purposes of determining tax residence, both the day of arrival and the day of departure would count as a day of presence in the UK.

However, this was relaxed slightly today, when it was confirmed that, on or after 6 April 2008, only a day where an individual is present in the UK at midnight will be counted as a day of presence in the UK for the purpose of determining tax residence.

There is an additional exemption for passengers who are in transit between two places outside the UK, provided that the individual does not engage in activities substantially unrelated to his passage through the UK, such as business meetings.

Taxation of Non-Domiciled Individuals

There has been much speculation in the press about the possible repeal or deferral of the proposed £30,000 charge for certain non-domiciled individuals who wish to retain the remittance basis of taxation after 5 April 2008. The Chancellor confirmed that there will be no deferral of the introduction of the £30,000 charge (which will apply from 6 April 2008), although a number of concessions have been made.

The £30,000 charge will apply to non-domiciled and/or not ordinarily resident adults who have been resident in the UK for more than seven of the past ten tax years, and who wish to retain the remittance basis of taxation. The £30,000 charge is in addition to any UK tax which is payable on UK income and gains or foreign income or gains which are remitted to the UK.

The main concessions announced in the Budget are as follows:

- The first, and potentially most significant concession, is that the charge is to be structured as a tax charge on unremitted income and gains, rather than a levy. This measure is clearly designed to assist the argument that the charge is a creditable tax for US purposes, although interestingly, there was no announcement that the US has agreed that a credit will be available (despite widespread media speculation that a deal had been done with the US Treasury on this point).
- Secondly, the charge will only apply to adults.
- Thirdly, under the original proposals, people with unremitted foreign income or gains of less than £1,000 per annum were exempt from the charge. This de minimis threshold has now been raised to £2,000.

The Chancellor has also clamped down on a number of "loopholes and anomalies" in the remittance system. The changes announced in the Budget include confirmation that any asset which was purchased out of untaxed foreign income and which was owned by an individual on 11 March 2008 will be exempt from a charge under the remittance basis of taxation. Similarly, any asset in the UK on 5 April 2008 will also be exempt from a charge under the remittance basis for so long as the current owner continues to own the asset. There is also a new exemption from a remittance basis tax charge for works of art which are brought into the UK for public display.

There are also changes proposed to the capital gains tax regime for non-resident trusts. Non-domiciled beneficiaries of non-resident trusts who claim the remittance basis of taxation will, from 6 April 2008, be taxed on the remittance basis on all UK and foreign assets – this should provide a significant boost to entrepreneurs based in the UK. In addition, trustees will be able to make an irrevocable election to rebase assets held as at 6 April 2008 to effectively exclude that part of any chargeable gain which relates to the period before 6 April 2008 from being taxed on non-domiciled individuals – although the sting in the tail is that this may create an obligation to supply information to HM Revenue & Customs.

One interesting announcement, in an area of great uncertainty, relates to offshore mortgages. These are mortgages taken out by non-domiciled individuals from a non-UK lender, which are frequently used to purchase property in the UK – but which permit the individual to repay interest on the loan without giving rise to a taxable remittance.

The original announcements on the changes to the taxation of non-domiciled individuals made it clear that such payments would give rise to a remittance from 6 April 2008.

The Chancellor announced today that "grandfathering" provisions would be introduced into the legislation which would exempt interest repayments on existing mortgages, secured on a UK residential property, from these new rules. The grandfathering will have effect for the remaining period of the loan or until 5 April 2028, whichever is sooner. However, if the terms of the loan are varied, or further advances made after 12 March 2008, then any interest payments after that time will be treated as a remittance. It will be interesting to see what will constitute a variation in the terms of the loan – for example, would a change in the rate of interest suffice?

Employment Related Securities

Employees who are resident in the UK (but not ordinarily resident) will now be within the scope of the employment related securities rules in Part 7 of the Income Tax (Earnings and Pensions) Act 2003 if they receive employment related securities on or after 6 April 2008. Where gains on employment related securities are within these rules, and the gains are derived partly from employment duties in the UK and partly from duties outside the UK, they will be apportioned, with individuals who are taxed on the remittance basis of taxation only subject to tax to the extent that the gains relating to the non-UK duties are remitted. A similar apportionment will be available to non-domiciled individuals in certain circumstances.

Remittance Basis of Taxation and Foreign Dividend Income

As part of the tax law rewrite programme, the rate of tax payable by higher rate taxpayers who are taxed on the remittance basis of taxation was mistakenly reduced to 32.5% for remittances of foreign dividend income. This will be corrected from 6 April 2008, with a 40% tax rate applicable from this time.

Venture Capital Schemes

Tinkering with the venture capital schemes, which comprise the Enterprise Investment Scheme (EIS), the Venture Capital Trust (VCT) regime and the less commonly encountered Corporate Venturing Scheme (CVS) is something of a Budget tradition. This year there is a further increase in the amount on which an investor can claim EIS relief, up from £400,000 to £500,000 per year (it doubled to £400,000 in 2006), but in an interesting twist, this is being made subject to obtaining European Commission approval that this does not amount to unlawful state aid.

In a similar vein, three new "excluded activities" will be added to the list of activities which can disqualify the investee company from benefiting from the reliefs: ship-building, coal production and steel production. The original list was prepared to exclude activities which were thought to be not risky enough to warrant tax incentives, such as dealing in land or operating hotels. These new additions have apparently been requested by the European Commission on state aid grounds.

The changes take place in respect of shares issued on or after 6 April 2008 for EIS and CVS. For VCTs the change will have effect for money raised on or after 6 April 2008, but not for money derived from money raised before that date.

Enterprise Management Incentives (EMI)

EMI options were hit by the announcement of the changes to the CGT regime in the Pre-Budget Report last year, which in many cases will increase the effective rate of tax for EMI option holders from 10% to 18%. The Budget offers some compensation, in that the maximum value of shares which can be put under option to any one option holder has been increased from £100,000 to £120,000. This change takes effect for options granted on or after 6 April 2008.

There are, however, some additional restrictions on the companies which are able to grant EMI options, which have been included to deal with EU state aid concerns. EMI companies will be limited to those with fewer than 250 full-time employees (part-time employees being taken into account as a "just and reasonable fraction" of full-time employees). A similar limit of 50 employees was introduced for EIS/VCT/CVS investee companies last year. Also, as for EIS/VCT/CVS this year, ship-building, coal production and steel production are being added to the list of excluded trades. Both these changes will take effect in relation to options granted after the Finance Bill 2008 receives Royal Assent, and will not affect options already granted.

Pensions

Various technical changes are being made to the pensions tax legislation. In summary these are:

- a measure to ensure that those sums in non-UK pension funds that have received UK tax relief are appropriately identified for the purposes of UK tax limits and charges on benefits equivalent to those for registered UK pension schemes having effect;
- the amendment of regulation making powers to allow certain payments from pension schemes to be taxed in the same way as other authorised payments made by pension schemes instead of as unauthorised payments, and to simplify the administration of certain trivial commutation payments;

- some technical improvements to the legislation published at the time of the Pre-Budget Report which set out changes to simplify the way the pension tax rules operate when testing pension increases against the lifetime allowance; and
- legislation to confirm that the amount a company was permitted to deduct in respect of pension costs between 1 April 2004 and 5 April 2006 was limited to the pension contributions paid in the year. This corrects an inadvertent omission by the Government, which it claims had no practical impact.

Capital gains tax – entrepreneurs' relief

The Chancellor gave further details of the recently announced entrepreneurs' relief which is being added on to the changes to CGT announced in the Pre-Budget Report. The relief may apply to gains made by individuals on the disposal of:

- all or part of a trading business the individual carries on alone or in partnership;
- assets of the individual's or partnership's trading business following the cessation of the business;
- shares in (and securities of) the individual's "personal" trading company (or holding company of a trading group); and
- assets owned by the individual and used by his/her "personal" trading company (or group) or trading partnership.

The first £1m of gains which qualify for the relief will be charged to CGT at an effective rate of 10%. Gains in excess of £1m will attract the new rate of 18%. Claims may be made on more than one occasion, but the £1m limit is a lifetime limit, applying to disposals on or after 6 April 2008. The mechanism for the new relief is to reduce the gains for which the relief is due by 4/9 (taper relief also worked by reducing the gain, rather than the tax rate, hence references to effective tax rates).

The relief will have effect for gains on disposals of shares in (and securities of) a trading company (or the holding company of a trading group) provided that throughout a one-year qualifying period the individual making the disposal:

- is an officer or employee of the company, or of a company in the same group of companies; and
- owns at least 5% of the ordinary share capital of the company and that holding enables the individual to exercise at least 5% of the voting rights in that company.

The qualifying period, for a company which does not cease to trade, is the period of one year ending on the date of disposal.

Provision is also to be made for the relief to apply where an individual disposing of shares makes an "associated disposal" of an asset used in the company's business. A similar rule will apply for an "associated disposal" of an asset used in a partnership business and owned separately by a member of the partnership who is entitled to relief on disposal of his interest in the assets of the partnership.

Rules have also been published dealing with instances where the gain is deferred on a sale of shares (such as on an exchange of shares for loan notes); generally the relief would be available if the sale of the shares would have qualified for the relief had it been a disposal for CGT purposes.

Also, where shares have been exchanged for loan notes prior to 6 April 2008, the relief will be available on a subsequent disposal of the loan notes if a disposal of the shares at the time of the exchange would have qualified for the relief, had the relief been in force at that time.

Foreign Dividends

With effect from 6 April 2008, dividends received by UK resident (and certain non-resident) individuals from non-UK companies will carry the tax credit of one-ninth of the dividend that is currently attached to dividends from UK companies, provided the individual owns less than 10% of the non-UK company. With effect from 6 April 2009, this will be extended to situations where the individual owns more than 10% of the non-UK company, but only if certain anti-avoidance rules are met.

Anti-avoidance

The Anti-Avoidance Simplification Review was launched in the Pre-Budget Report 2007 and a progress report was published today. The document outlines the ways in which HM Revenue & Customs and HM Treasury have been engaging with business and provides a summary of views.

The various ways in which anti-avoidance legislation can be drafted (from prescriptive to principle based) are outlined. Whilst HM Treasury reserves the right to "retain this range of approaches at its disposal", it advocates that a principle based approach appears "to provide scope for simplifying existing legislation". Various repeals of legislation have been announced, in relation to bond-washing and dividend buying, transactions in securities and employment related securities.

Disclosure

Legislation will be introduced in the Finance Bill 2008 to improve the Scheme Reference Number (SRN) system of identifying users of schemes disclosed to HM Revenue & Customs under the disclosure regime.

The measures include allowing more than one promoter to disclose an arrangement on the same form or allowing a promoter to provide a co-promoter with the SRN and thereby relieve that co-promoter of any obligation to disclose the arrangement. They also provide for the introduction of a standard form which a promoter must use to pass the SRN to a user of the arrangement. Perhaps the most welcome change is that there will be provision for HM Revenue & Customs to withdraw a SRN, presumably for structures which no longer exhibit characteristics that render them subject to disclosure.

Controlled Foreign Companies (CFC)

As we await HM Treasury's revised proposals on the controlled company regime, a number of anti-avoidance measures have been introduced, which are aimed at companies which have sought to retain income offshore by falling within CFC exemptions. These are:

- Exempt activities holding company structures: which treat income accruing to the company (for accounting purposes) through a partnership, which said company has a major interest in, as outside the scope of the gross income of that company for CFC purposes;
- Offshore trust structures: whereby a company which is more than 50% owned by an offshore trust is treated as outside the scope of the CFC rules as it is not "controlled" by the remaining UK resident shareholders (and such shareholders retain the right to all the company's income).
- Income structures: which seek to reclassify income using discretionary trusts or aim to allow companies to satisfy an acceptable distribution policy by excluding certain income from the 'chargeable profits' calculation.

The legislation is effective for income which accrues after 12 March 2008. The definition of control has been widened but may inadvertently catch commercial structures where shareholders have rights to income or capital without actual control.

Whilst some of these changes are understandable, it appears to be an unnecessary exercise to introduce measures to counter structures which will likely qualify for exemption under the proposed new controlled company rules e.g. partnership structures. However, this may be motivated by HM Revenue & Customs' desire to challenge exempt activities holding company structures under current law.

Intangible assets regime

The definition of related party in Schedule 29 of the Finance Act 2002 is to be amended to clarify that the companies remain related parties even when one of the parties is in administration, liquidation, insolvency or equivalent arrangements. HM Revenue & Customs is targeting tax planning arrangements which are believed to circumvent the provisions which provide that deductions relating to intangibles created prior to 1 April 2002 and then transferred between related parties are not allowed for corporation tax purposes.

Leased plant or machinery

Draft legislation was announced or published in 2007 to counter certain leasing arrangements which had come to HM Revenue & Customs’ attention through the disclosure regime. These changes (and certain others) were elaborated on in this Budget.

Measures were introduced to counter structured leasing transactions which allow intermediate lessors of plant or machinery to realise a loss for tax purposes where no commercial loss arises. For example, where an intermediate lessor treats the head lease as a non-long funding lease but the sub-lease as a long funding lease, then it would be entitled to a full deduction for the rentals payable under the headlease but would only be subject to tax on the finance element of the rentals it receives, thereby creating a tax loss. The intention of the new provisions is to ensure that rentals received by intermediate lessors are taxed on the same basis as rentals paid.

Draft legislation announced in December 2007 is intended to bring premiums and other “capital” receipts made on or after 13 December 2007 into the charge to tax as income in the hands of a lessor. These receipts may not be taxed if they are not brought in as disposal value for capital allowances purposes or are taxed under the chargeable gains regime with the majority of the base cost available to set against the disposal proceeds.

The scope of the new draft legislation is to be broadened from 12 March 2008 to include plant or machinery leased with land and buildings (which are not fixtures) and will seek to prevent a lessor from reducing its disposal value for capital allowance purposes by matching the lease receivables with a liability.

Draft legislation published on 9 October 2007 was intended to prevent taxpayers transferring the ability to claim capital allowances by entering into a sale and leaseback which was not a long funding lease. The new legislation will apply to sale and finance leaseback transactions entered into on or after 9 October 2007. Section 222 CAA 2001 will be repealed so that a full disposal value will be brought into account upon disposal (in accordance with the usual rules where a company sells and finance leases back plant or machinery). These rules have been extended so that on or after 12 March 2008 they will also apply to leasebacks where there is a lease and leaseback.

Financial products avoidance: disguised interest and transfers of lease receivables

The Pre-Budget Report in 2007 announced (as part of the tax simplification process) a "principles-based" approach to avoidance involving financial products. The first instance of the approach was legislation relating to "disguised" interest. There was also a provision relating to the sale of income streams. A consultation document that included draft clauses was published in December 2007 and concerns were raised with HM Treasury regarding the short timeframe in which the new approach was to be adopted. These concerns have registered and it is now proposed to introduce a principles-based approach in 2009. However, in the absence of a generic measure dealing with financial products avoidance, the Government will introduce legislation in the Finance Bill 2008 to block the following tax planning arrangements:

- Foreign tax credits allowable in respect of interest: a company that sells an overseas debt instrument may currently credit any attributable foreign tax on payment of interest under that instrument during its period of ownership against its corporation tax liability, in some cases even if the debt is sold before the interest is actually paid, and any tax is suffered. With effect for sales occurring on or after 12 March 2008, this rule is repealed in response to arrangements which exploit it to obtain a tax advantage.

- Intra-group convertible debt accounting arbitrage: an issuing company, under new UK GAAP or IFRS, will separate out the equity instrument that is "embedded" within convertible debt. The "host" debt would be reported as a financial liability, and such an issuer would recognise an additional cost of finance, for accounting purposes, that accretes the carrying value of the financial liability to the debt's par value at maturity. A connected holding company, on the other hand, may not separately identify the equity instrument, if it has not adopted new UK GAAP or IFRS. Therefore, it would not recognise income corresponding to the issuer's additional cost of finance. This accounting asymmetry is respected for corporation tax purposes. However, with effect for credits and debits arising on or after 12 March 2008, legislation in the Finance Bill 2008 will require the holding company to recognise additional credits, for corporation tax purposes, to match the issuer's additional debits.

- Interest in the form of non-taxable distributions: HM Revenue & Customs has become aware of arrangements under which interest payable is structured as a distribution in circumstances where the payer is able to deduct the interest for tax purposes (or is not concerned with obtaining corporation tax relief). The recipient, receives the interest as a non-taxable distribution. Legislation (with effect for income arising on or after 12 March 2008) is proposed under which a company receiving interest that is treated as a distribution is to be taxed on that interest, if it arises in connection with tax avoidance.

- Disguised interest: HM Treasury has also sought to block arrangements, with effect for returns arising on or after 12 March 2008, designed to produce interest-equivalent returns (which are tax free) through the use of partnerships. The first of these relates to the acquisition of a partnership interest for the present value of the partnership capital, where that capital is in fact to be contributed by the vendor at some point in the future and is structured so that the increase in the economic value of the partnership interest falls outside the scope of corporation tax. The second arrangement produces a return on money invested by way of partnership capital through amendments to the profit-sharing ratio of the partners. Such returns will be taxed as profits from loan relationships. A number of technical changes are also proposed which will prevent the use of the derivative contracts in transactions that are designed to produce returns in the nature of disguised interest.

- Shares as debt rules: legislation will be introduced to stop planning that falls outside, or seeks to exploit, the "shares as debt" rules. This includes depreciatory transactions that create artificial losses, transactions which fall outside the scope of the rules because the rate of interest can be said to be uncommercial, certain arrangements that fragment or conceal an underlying return that is in the nature of disguised interest and the use of exit strategies that do not constitute a redemption for the purposes of the shares as debt rules.

- Leases of plant and machinery: legislation will be included in the Finance Bill 2008 to counter arrangements which avoid the application of the rent factoring rules. These provide that lease receivables are taxed as income where a person disposes of such receivables and the consideration is not brought into account for tax purposes as income, or as a capital allowances disposal receipt.

Tax treaties

An arrangement whereby a UK resident individual uses a non-UK partnership to receive income and avoid UK tax by claiming relief under a double tax treaty will no longer be available from 12 March 2008. This arrangement sought to take advantage of the "business profits article" in a treaty between two countries which would give exclusive taxing rights to the country in which a business is located (which as a matter of domestic law did not tax the income) and thereby prevent the UK from taxing the profits of that business in the hands of the UK resident individual.

Avoidance of income tax using manufactured payments

Under current law, individuals who make manufactured payments can obtain relief for these payments against their income, which has given rise to a range of avoidance arrangements. The new legislation will introduce a targeted anti-avoidance rule that denies relief for any manufactured payment made as part of a scheme or arrangements where one of the main purposes is to secure a tax advantage.

Sideways loss relief for individuals

Under current partnership rules, sideways loss relief enables trading losses to be set against other income and gains and has underpinned many tax shelters. Anti-avoidance legislation seeks to prevent inactive partners from benefiting from this relief. To prevent sole traders exploiting these rules, with effect for all losses arising on or after 12 March 2008, the legislation will be extended so no sideways loss relief will be allowed where tax avoidance was the main reason for investing.

Capital allowances buying and acceleration

Legislation is to be included in the Finance Bill 2008 to stop the use of arrangements which generate balancing allowances where trades are sold and the market value of any plant and machinery is less than its tax written down value and where the acquirer does not intend to carry on the trade in the long term. Relevant transactions after 12 March 2008 will now be treated as falling within s343(2) ICTA and no balancing allowances will be available.

Indirect taxes

VAT

VAT Registration & Deregistration thresholds

There is an increase in the VAT registration threshold from £64,000 to £67,000 and the VAT deregistration threshold from £62,000 to £65,000 from 1 April 2008. The VAT registration and deregistration threshold for relevant acquisitions from other EU Member States will also increase from £64,000 to £67,000 from 1 April 2008.

VAT exemption for fund management

In response to the ECJ judgment in the *JP Morgan Claverhouse Investment Trust* case, Group 5 of Schedule 9 to the VAT Act 1994 will be amended to:

- add closed-ended investment entities, which invest in securities and whose shares are included in the UK Listing Authority Official List and funds established outside the UK, which are recognised overseas schemes under the Financial Services and Markets Act 2000; and
- remove trust based schemes.

It is expected that the amendments will have effect from 1 October 2008.

Indirect tax returns: correction of errors

Currently, the error correction regulations for VAT, IPT (insurance premium tax), APD (air passenger duty), LFT (landfill tax), CCL (climate change levy) and AGL (aggregates levy) permit inclusions of errors (in previous returns) below £2,000 to be corrected on the return submitted in the period in which the errors are discovered. From 1 July 2008, the £2,000 error correction limit will be increased to the greater of:

- £10,000, or
- 1% of turnover, subject to an upper limit of £50,000.

Whilst, on the face of it, this change seems to make VAT administration easier for taxpayers, the ability to make frequent corrections of sizeable errors could yet invite abuse by certain taxpayers and it is therefore likely that HM Revenue & Customs will be sensitive to frequent error corrections by the same taxpayer.

Transitional period for claims

Following the recent House of Lords judgments in *Michael Fleming (trading as Bodycraft)* and *Condé Nast Publications Ltd*, the Finance Bill 2008 will provide a transitional period to 31 March 2009, during which eligible businesses can make VAT claims for overpaid output VAT incurred by businesses before the introduction of the three year cap on 1 May 1997. This change affects businesses registered for VAT between 1 April 1973 and 1 May 1997 who either declared more output VAT than they were liable for, or claimed less input VAT than they were entitled to.

Assessments to recover amounts incorrectly paid by HM Revenue & Customs to businesses who claim under these provisions must be made within two years of HM Revenue & Customs having acquired evidence of facts sufficient to justify the making of the assessment. There will now be a new two-year time limit from the end of the accounting period in which an erroneous payment is made to ensure that HM Revenue & Customs is able to recover amounts paid out where it is later discovered that repayment was mistaken.

Option to tax

Following various consultations undertaken by HM Revenue & Customs on the UK VAT option to tax rules, these rules will be amended to improve practical administration of the option to tax. These changes primarily deal with:

- opted properties held in a VAT group;
- opted buildings acquired for use as dwellings or a relevant residential purpose and bare land acquired for construction of a building for such purposes;
- the introduction of a new option to simplify the option to tax process for taxpayers with a number of properties;
- early revocation of an option to tax within a "cooling-off" period;
- the automatic lapse of an option to tax six years after the taxpayer ceased to have any interest in a property that he had previously opted to tax;
- the ability, in certain circumstances, to exclude a new building from a previous option to tax; and
- late applications for permission to opt to tax.

Some minor changes to the rules have also been made to enable taxpayers to revoke an option to tax after 20 years from the date on which such an option was exercised. The earliest date an option to tax will be revocable will be 1 August 2009.

Reduced rate retained on smoking cessation products

The reduced VAT rate of 5% for “over the counter” sales of pharmaceutical smoking cessation products which was due to expire on 30 June 2008 will continue to have effect from 1 July 2008. Smoking cessation products that are dispensed on a prescription will remain zero-rated. If you ever needed encouragement to give up smoking, this is it.

Stamp Taxes

Stamp Duty – Changes to Loan Capital Exemption

Most forms of loan capital are exempt from stamp duty. However, where the right to interest on a loan capital instrument is determined to any extent by the results of a business or value of any property, the exemption does not apply and transfers of that loan capital are subject to ad valorem stamp duty.

Under the proposed changes, a loan capital instrument that does not meet the current exemption criteria will nevertheless qualify for exemption from stamp duty if it is part of a capital market arrangement and the right to interest is on limited recourse terms.

These changes will have effect for transfers of loan capital on or after the date that the Finance Bill 2008 receives Royal Assent.

Stamp Duty – Alternative Finance

Under the changes proposed by the Budget, legislation will be introduced in the Finance Bill 2008 to classify alternative finance investment bonds as loan capital for stamp duty purposes and the return as a right to interest. This will ensure that such bonds may benefit from the loan capital exemption. Legislation will also be introduced in the Finance Bill 2008 to amend the power to make provision relating to alternative finance arrangements by secondary legislation.

Stamp Duty – Fixed stamp duty charge £5 abolished

The minimum £5 stamp duty charge on instruments transferring stocks and shares will be abolished from 13 March 2008. From that date, there will be a consideration threshold of £1,000 below which instruments transferring stocks and securities will no longer need to be stamped. Such instruments may therefore in the future be sent directly to the company registrar without first being presented to HM Revenue & Customs.

Stamp Duty Land Tax – Notification thresholds for Land Transactions

HM Revenue & Customs must be notified about most transactions involving the acquisition of a major interest in land for consideration unless specifically exempted. The threshold for notifying HM Revenue & Customs of a land transaction will increase from £1,000 to £40,000. Transactions involving leases for a term of seven years or more will only have to be notified where any chargeable consideration other than rent is more than £40,000 or where the annual rent is more than £1,000.

It will no longer be necessary to complete either a stamp duty land tax return (HM Revenue & Customs form SDLT1) or certificate that no stamp duty land tax is due (HM Revenue & Customs form SDLT 60) if the transaction is below the notifiable threshold.

Stamp Duty Land Tax – changes to the £600 rule

Certain provisions in the Finance Act 2003 were introduced to prevent the manipulation of lease thresholds. These provisions apply to leases where payment is made by both rent and a premium when the lease is signed. Currently, where the annual rent on a lease is more than £600, then the normal 0% thresholds that would have effect, £125,000 for residential property and £150,000 for non-residential property, are withdrawn and SDLT is charged at 1%.

The Budget proposes amendments to these rules as follows:

- for non-residential properties where the annual rent on a lease is £1,000 or more then the normal 0% threshold that would have effect at £150,000 is withdrawn and SDLT is charged at 1%; and
- for residential properties the rule will no longer have effect and, regardless of what rent is paid, the normal thresholds will have effect to any premium paid. This amendment will also have effect in respect of disadvantaged areas relief.

These changes will have effect for transactions on and after 12 March 2008.

Stamp Duty Land Tax – Anti-Avoidance

The Finance Bill 2008 will amend provisions inserted in the Finance Act 2003 by the Finance Act 2007 to ensure that, where there is a transfer of an interest in a property within an investment partnership, there will be no charge to SDLT. This change will be retrospective and will be made effective from 19 July 2007.

Legislation will also be introduced in the Finance Bill 2008, effective from 13 March 2008, to amend provisions that enable groups to transfer assets within a group and then sell the purchasing company on to a third party without incurring SDLT.

Stamp Duty Land Tax – Anti-Avoidance : Alternative Finance

Provisions were made in the Finance Act 2003 to encourage the use of alternative finance structures that did not use conventional mortgage schemes to buy property. HM Revenue & Customs is of the view that some financial institutions have misused SDLT exemptions by colluding with vendors so that ownership of a property is placed in a subsidiary company of the financial institution. The subsidiary then claims that the transaction is intended for the purposes of allowing the equivalent of mortgaging on a mortgage free property or re-mortgaging. Once ownership of the property has passed from the vendor to the subsidiary, however, the financial institution can then sell the property without incurring any SDLT by selling shares in the subsidiary company. Legislation introduced in the Finance Bill 2008 will close this loophole.

Tax rates and allowances 2008/9

	2008/9 £
Personal allowance (age under 65)	5,435
Personal allowance (age 65-74)	9,030
Personal allowance (age 75 and over)	9,180
Blind Person's Allowance	1,800
Married Couple's allowance* (age less than 75 and born before 6 April 1935)	6,535
Married Couple's allowance* (age 75 and over)	6,625
Married Couple's allowance* - minimum amount	2,540
Income limit for age-related allowances	21,800

* Married Couple's allowance is given at a rate of 10%

Personal Pension Schemes

	2008/9 £
Pension scheme earnings cap (1989 cap)	N/A
Pension scheme annual allowance (from 6 April 2008)	235,000
Pension scheme lifetime allowance (from 6 April 2008)	1,650,000

National Insurance Contributions

	2008/9 £
Primary Class 1 contributions	
Lower earnings limit (per week)	90
Upper earnings limit (per week)	770
Primary threshold (per week)	105
Secondary threshold (per week)	105

Class 2 annual small earnings exception	4,825
Class 2 rate (per week)	2.30

Class 3 rate (per week)	8.10

Class 4 contributions	
Lower annual earnings limit	5,435
Upper annual earnings limit	40,040

Capital gains tax annual exempt amount

	2008/9 £
Individuals etc	9,600
Most Trustees	4,800

Inheritance Tax

	2008/9 £
Individual allowance	312,000

Income tax: taxable bands

£ per year	2008/9 £
Starting rate: N/A*	-
Basic rate: 20%	0 – 36,000
Higher rate: 40%	Over 36,000

* There will be a new 10% starting rate for savings income only, with a limit of £2,320. If an individual's taxable non-savings income is above this limit then the 10% savings rate will not be applicable. There are no changes to the 10% dividend ordinary rate or to the 32.5% dividend upper rate.

Corporation tax on profits

	2008/9 £
Small companies' rate: 21%	0 – 300,000
Marginal relief	300,001 – 1,500,000
Main rate: 28%	1,500,001 or more

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

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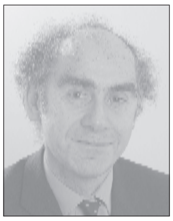

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