

ChantreyVellacottDFK

The Budget 2006

by Chantrey Vellacott DFK



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Russell Square House
10/12 Russell Square
London WC1B 5LF

Tel. +44(0)20 7509 9000

Fax. +44(0)20 7436 8884

Email. info@cvdffk.com

Web. www.cvdffk.com

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1 INTRODUCTION

On 22 March, unusually a Wednesday, Gordon Brown delivered an hour long speech that might be his last as the occupier of Number 11 Downing Street before the removal men come in to take the furniture next door.

He said that this year, he wanted to “strike the right balance between tax spending and borrowing”, but then which Chancellor does not?

By the end of his speech he had become somewhat boring in his promotion of packages to support education. Time and again, he returned to this subject and one can only conclude that this Government has decided that the future of our children is the most important priority for the rest of this Parliament.

Much of what the Chancellor announced was fairly predictable, with a great deal of emphasis on the freezing of taxes and duties, although cigarettes, wine (but not champagne) and beer will cost more.

This Chancellor has a reputation as a clever man and ably demonstrates this with his use of other people's money to fund public ventures. For example, as well as the application of the tax take, we will also benefit from his corralling of unclaimed bank accounts, The National Lottery and partnerships with business.

More controversially, Chancellor Brown has announced further significant sales of public assets that will bring in tens of billions of pounds. In the past, this was known as selling off the crown jewels

although perhaps a politer version is to express this as an opportunity to provide for further investment in education (and other essential services).

The Chancellor's other major thrust was towards supporting energy efficiency and the environment. There is to be a radical reform of vehicle excise rates with many drivers of cars with low emissions benefiting. Further, the climate change levy is to remain at current levels.

Gordon Brown described this as “a budget for Britain's future” and he might well have an eye to enjoying that future as the country's Prime Minister. If he does, he should get support from those young entrepreneurs who are now to be offered the enticement of scholarships to American universities. He may also have increasing numbers of fans from the gentler sex, having promised to address what he described as the unacceptable discrimination in women's pay.

One issue that many expected to see addressed was the inheritance tax threshold that has become increasingly inadequate for estates containing property, especially in London. However, the Chancellor has not only committed to an increase that is merely a little above inflation, but has additionally committed to similar levels for a four-year period.

This 2006 Budget might well not be remembered at all in future, although many would regard this as a good thing, since it is a natural and welcome consequence where headline rates of income tax, corporation tax and VAT have all remained at existing levels.

2 INCOME TAX

2.1 Income Tax Allowances and Rates

For 2006/2007, the 10% starting rate band has been extended to £2,150 of taxable income. The basic rate band covers income from £2,150 to £33,300.

The personal allowance for those aged under 65 has been increased to £5,035. The personal allowances for individuals aged between 65 and 74, and aged 75 and over have been increased to £7,280 and £7,420 respectively.

The married couples' allowance, which is only available in tax year 2006/2007 where at least one spouse was born before 6 April 1935, has increased to £6,065. Where one of the spouses is aged 75 or over the allowance has been increased to £6,135. The relief is only available at 10%.

Full details of allowance rates and thresholds applicable in 2005/2006 and 2006/2007 are set out in Tables A and B.

2.2 Changes to the Venture Capital Schemes

Venture Capital Trusts (VCT)

Several new measures have been brought into effect from 6 April 2006. The two year temporary increase in income tax relief on VCT investments to 40% from 6 April 2004 was due to revert to 20%. This will now be 30%.

The qualifying period for income tax relief will be increased from 3 to 5 years.

For a VCT to gain and retain its privileged status, several criteria with regard to investments must be fulfilled. These include the following:

- 70% of the value of its investments must be represented by shares or securities in qualifying holdings
- No more than 15% of the investments can be in a single holding company.

From 6 April 2007, money held by a VCT will be treated as a non-qualifying investment and will be taken into account on that basis when making the appropriate calculations.

Enterprise Investment Schemes (EIS)

With effect from 6 April 2006, the amount available for EIS income tax relief has been doubled to £400,000. Furthermore, the maximum amount that can be carried back during the first 6 months of any tax year to the previous tax year has also been doubled to £50,000.

Gross Asset Test

The size of companies that can raise money under 'Venture Capital Schemes' will change. The 'relevant assets' that a company may previously have held could be up to £15m before the investment and £16m thereafter. These limits are to be substantially reduced to £7m and £8m respectively.

The new limits will come into effect as follows:

- VCTs – for all funds raised after 6 April 2006
- EIS & Corporate Venturing Schemes – for shares issued on or after 6 April 2006, unless the shares were subscribed before 22 March 2006
- EIS investments made by Approved Investment Funds from 6 April 2006, unless the fund was raising money prior to this date and was approved before 22 March 2006.

2.3 Employment – Related Securities

Some extra anti-avoidance measures have been introduced in connection with employment-related securities.

It is to be noted that these retrospectively take effect from 2 December 2004.

The primary goal of this new legislation is to ensure that any reward of employment obtained by employees from avoidance schemes using options over shares and securities will be fully subject to tax through PAYE and National Insurance Contributions.

Following earlier Government statements that they would close down future schemes, where necessary with effect from 2 December 2004, this is the first move in what could well prove to be very controversial legislation.

They state that “evidence shows employers are continuing to use

complex and contrived schemes to avoid paying the proper amount of income tax and National Insurance Contributions, exploiting the tax rules relating to options over shares and securities”. It is now proposed that these will be stopped with effect from 2 December 2004.

In future, a targeted purposive test will be introduced and this will be applied where a securities option is used as part of an avoidance scheme.

The consequence is that the anti-avoidance measures for employment-related securities that were introduced in 2005 and earlier will apply to all such options with PAYE and NIC payable.

2.4 Company Car & Fuel Benefit Tax

Currently, the company car benefit is based on the list price of the car and a scale based on CO₂ emissions. For the tax year 2008/09, the lowest rate of 15% will be charged where CO₂ emissions do not exceed 135g/km, a reduction of 5g/km.

A new (even) lower rate of 10% will also be introduced for 2008/09 in respect of CO₂ emissions of 120g/km or less.

The company car fuel benefit multiplier has remained frozen at £14,400 for 2006/07.

2.5 Modernising the Tax System for Trusts

A package of changes is proposed as part of the Government's modernisation programme following on from their consultation exercise.

The main changes taking effect from 6 April 2006 include harmonising the definitions of "settlor", "settled property" and "settlement" for Income Tax and Capital Gains Tax purposes. There will also be a harmonised residence test for trustees, which will take effect from 6 April 2007.

2.6 Qualifying Life Insurance Policies

When qualifying life policies are significantly varied, this may result in a tax charge where the policy is later assigned or reaches maturity. A policy that is varied on or after 7 October 2005 will not be treated as being significantly varied if the only change is in the method of the calculation of the return to policyholders. This can often occur when insurance business is transferred from one company to another.

If the variation took place under a court approved business transfer scheme, the amendment also applies retrospectively.

2.7 Exemptions for Computers and Mobile Phones

Currently, where employees have the use of computers or mobile phones

loaned to them by their employers, the benefit in kind arising may be exempt from tax. With effect from 6 April 2006, these tax exemptions are to be amended.

The exemption for computers will be removed where these are made available to employees for private use. It remains to be seen exactly how this will be applied in practice.

In addition, there will be a restriction on the number of mobile phones that employers can lend to employees for private use to one per employee. Further, the exemption will no longer extend to phones loaned to members of an employee's family or household.

More positively, the legislation has been clarified to ensure that where an employee receives a mobile phone for private use through a salary sacrifice arrangement, no charge will arise to tax even if the employee has the right to surrender the phone for additional wages or salary.

Another beneficial change is the widening of the exemption relating to mobile phones to include vouchers provided to employees for their private use. However, it appears that this will only apply where the voucher is used on a mobile phone lent to the employee by the employer and where the benefit in kind on the loan of the mobile phone would have been exempt had a voucher not been used.

2.8 Simplification of the Taxation of Pensions

As previously announced, a new universal pension regime comes into existence on 6 April 2006, 'A Day', which replaces the many different existing sets of pension rules. The maximum that can be invested in the tax year 2006/07 is the lower of 100% of net relevant earnings and an annual allowance of £215,000.

There is a lifetime allowance of £1.5m. In addition, if enhanced protection has been taken out then there will be no tax charge.

Further key points of the new regime can be found in Table F.

2.9 Eye Tests and Glasses for VDU Users

With effect from 6 April 2006, a technical amendment has been made to the legislation which will ensure that where vouchers are used to provide eye tests or glasses for VDU users, there will no longer be a tax charge resulting from the benefit.

2.10 Landlord's Energy Saving Allowance

Currently, landlords that pay income tax can claim a Landlord's Energy Saving Allowance (LESA) in respect of let residential properties. The allowance has been extended from 6 April 2006 to include draught proofing and insulation of hot water systems. The maximum allowance is restricted to £1,500 per

building and is claimed as a deduction against rental income.

3 CAPITAL GAINS TAX

3.1 Capital Gains Tax Rates

The annual exemption for 2006/2007 will be increased to £8,800 for individuals and £4,400 for the majority of trusts.

For individuals, the amount chargeable to Capital Gains Tax is added to the income liable to Income Tax and treated as the top part of that total.

For 2006/2007, capital gains will be taxed at 10% if below the starting rate limit for Income Tax, at 20% if within the basic rate limit and at 40% if above the basic rate limit.

3.2 Capital Gains Tax: Bed & Breakfasting Rules

From 22 March 2006, the Capital Gains Tax identification rules relating to individuals and trustees making acquisitions within 30 days after a disposal will not apply where:

- At the date of acquisition the person is neither resident nor ordinarily resident in the UK
- They are resident or ordinarily resident but non-resident under a Double Taxation Treaty

In these circumstances, the shares deemed to be disposed of are those acquired before the disposal, rather than those acquired within 30 days thereafter.

4 CORPORATION AND BUSINESS TAX

4.1 Corporation Tax Rates

For the year to 31 March 2007, the main rate for Corporation Tax remains at 30% and the Small Companies Rate at 19%. The marginal rate remains at 32.75%.

As previously announced in the Pre Budget Report, the starting rate of 0% applying to those companies with profits up to £10,000 is abolished from 1 April 2006. A marginal rate of 23.75% that applied to profits between £10,000 and £50,000 is also abolished from that date.

An anti-avoidance provision that applied a minimum rate of 19% on distributed profits for small, incorporated businesses is also abolished from 1 April 2006.

The thresholds for the Small Companies Rate and the Main Rate remain at £300,000 and £1,500,000 respectively.

Full details of rates and thresholds applicable in 2005/06 and 2006/07 are set out in Table H.

4.2 Capital Allowances for Small Businesses

The First Year Allowance for capital expenditure on plant and machinery has been increased from 40% to 50%. The 50% First Year Allowance only applies to

capital expenditure by small businesses and will apply for one year only.

The increased allowance will apply to expenditure incurred on or after 1 April 2006 for companies and on or after 6 April 2006 for unincorporated businesses.

This increase will not be available to medium-sized companies and businesses, which will continue to be restricted to a First Year Allowance of 40%.

4.3 Research & Development Tax Relief

Changes are being made to the rules governing R&D tax relief and vaccine research relief.

They will align the claims process and time limits for claims to enhanced deductions with those for payable credits. All companies will be required to make, amend or withdraw their claims to enhanced deductions by the first anniversary of the filing date for the tax return. This will apply for accounting periods ending on or after 31 March 2006. Transitional rules will apply in the case of claims to enhanced deductions for accounting periods that end before 31 March 2006. Such claims will need to be made by the earlier of the current time limit for claims (six years after the end of the relevant accounting period) and 31 March 2008.

The 50% enhancement of qualifying expenditure which can lead, in some circumstances, to a payable tax credit for small and medium size

companies is to be extended to firms with between 250 and 500 employees

Vaccine research relief is extended to include payments made to clinical trial volunteers for taking part in the trials.

The operative date for the extension of R&D qualifying expenditure in the case of the "large company" scheme will be 1 April 2006 and will be a date to be appointed by Treasury Order for small and medium enterprises and vaccines research relief. The changes will take effect once state aids approval has been received from the European Commission.

4.4 Taxation of Leased Plant and Machinery

New legislation will align the tax treatment of leased plant and machinery with that of plant or machinery acquired using other forms of finance thus eliminating a distortion in the current rules.

This is likely to affect some lessees of plant or machinery where the lease is essentially a financing transaction.

Operating leases of 7 years or more will not be affected. By way of contrast, finance leases of under 5 years or in certain cases 5-7 years will also not be affected.

Subject to an option to elect otherwise, this legislation will only apply to longer leases that are essentially financing transactions.

In general, the legislation will apply to such leases finalised on or after 1 April 2006, although transitional arrangements will allow some leases finalised on or after this date to remain unaffected by the new rules.

4.5 UK Real Estate Investment Trusts (UK-REITs)

The measure to introduce UK-REITs follows two consultation papers (Budget 2004 and Budget 2005). It will affect companies and groups of companies whose main business is property investment, and individuals who invest in them. The regime will commence on 1 January 2007.

Companies or groups that meet the necessary conditions will be able to elect for special rules to apply to their property businesses and to their distributions. Their qualifying rental income and gains on disposals of investment properties will be exempt from Corporation Tax. Profits and gains on any other activities will be subject to Corporation Tax in the normal way.

Distributions paid out by a UK-REIT from exempt property income and gains will be treated as UK property income in the hands of the recipient and will be subject to deduction at source of 22% income tax. Dividends paid out of other profits will be treated as normal dividends for UK tax purposes. Details of the administrative arrangements regarding accounting for tax will be included in the regulations.

The conditions that have to be met to come within the UK-REIT regime are as follows:

- The company must be UK resident
- Its shares must be listed on a recognised stock exchange
- No single investor can be beneficially entitled to 10% or more of the distributions or control 10% or more of the capital or voting rights
- 75% or more of the assets must be investment property
- 75% or more of the income must be rental income
- The ratio of interest on loans that fund the tax-exempt business to rental income must be less than 1.25:1.

Companies wanting to become UK-REITs will have to pay an entry charge of 2% of the market value of the existing portfolio of their investment properties, although they will be able to pay this charge in instalments over 4 years.

The legislation relating to “housing investment trusts” will be repealed at the same time.

4.6 Extension of Group Relief

From 1 April 2006, UK companies will be able to claim tax losses from fellow subsidiaries that are not resident in the UK where those losses cannot be relieved elsewhere.

To qualify, a non-UK resident company must either be resident or have a permanent establishment in the European Economic Area.

A change in the legislation was required following the judgement in the case of Marks and Spencer plc v Halsey, held before the Court of Justice of the European Communities.

The tax loss incurred by the non-UK resident company can only be relieved in the UK where all possibilities of relief have been exhausted and future relief is unavailable in the company's own country or in any other country.

The amount available for relief in the UK must be calculated using UK tax principles. It will be the responsibility of the UK claimant company to demonstrate that the non-UK losses meet the relevant conditions.

4.7 Corporate Capital Losses

As announced in the Pre-Budget Report, the artificial creation and use of capital losses is to be curbed. With effect from 5 December 2005, legislation will be introduced to prevent:

- artificial creation of corporate capital losses
- the buying of capital gains and losses
- the conversion of income into capital gains, where the created capital gain is both matched by an income deduction and is covered by a capital loss.

4.8 Controlled Foreign Companies

An anti-avoidance measure was announced bringing the treatment of companies that became non-UK resident before 1 April 2002 into the Controlled Foreign Companies regime.

With effect from 22 March 2006, companies that became non-resident under a double tax treaty prior to 1 April 2002 will become subject to the CFC legislation on the occurrence of certain specified events, thus preventing them being used for tax avoidance.

4.9 Sale of Lessor Companies

Where a company is sold, and it carries on the business of leasing plant and machinery at the date of sale, it will be deemed to receive income equivalent to the difference between the book value of the leased assets and the tax written down value of those assets.

Immediately after the sale, a new accounting period begins for tax purposes and the company can claim an exactly matching expense. Where only a part of the company has been sold, the deemed income and the relief are reduced proportionately.

The new legislation is designed to stop the deferral of tax liabilities in the lessor company in cases where it could be sold to a group with substantial losses. It applies to leasing businesses carried on in a consortium structure and through a partnership.

It will also cover other methods by which deferred profits on a leasing transaction can be sheltered from tax e.g. through unusual partnership profit sharing arrangements and transfers between parties at other than market value.

The new legislation applies to sales of lessor companies occurring on or after 5 December 2005.

4.10 Anti - Avoidance

Measures are to be introduced to block a number of avoidance schemes that have been notified to HMRC under the disclosure rules introduced in Finance Act 2004. It is likely to affect companies that enter into certain types of arrangement that involve financial products designed to avoid tax.

A common feature of many of these schemes is that they use intra-group arrangements to avoid tax on income arising to the group, or create a tax loss when there is no economic loss to the group as a whole.

Although the operative date for much of this legislation is 22 March 2006, in certain instances it may catch arrangements entered into before that date.

4.11 Tax Incentives for British Films

A new tax incentive will be available for qualifying British films intended for cinema release where the principal photography starts after 1 April 2006.

An additional deduction is available for the qualifying expenditure on pre-production, principal photography and post-production activities taking place in the UK. The deduction is 100% where the costs are £20m or less and 80% for all other films. UK expenditure on all other activities is subject to normal tax rules.

If the additional deduction gives rise to a loss, the loss can be carried forward for offset against future income from the film or surrendered for a payable tax credit. The credit is calculated at a rate of 25% for films with qualifying expenditure of up to £20m and 20% for all others.

The existing tax relief continues for those films where filming commences before 31 March 2006, provided that the film is completed before 1 January 2007.

5 INDIRECT TAXES

5.1 VAT: Turnover Limits

The registration threshold will rise by £1,000 to £61,000 from 1 April 2006. The de-registration limit rises similarly to £59,000.

The registration and de-registration limits for acquisitions from other European Union member states will also be increased from £60,000 to £61,000.

5.2 VAT: Fuel Scale Charges

Whenever a business funds private motoring by subsidising fuel, it must account for VAT fuel scale charges, that is, output tax.

The scale charges have been revised and are shown at Table K.

Businesses must use the new scales from the start of their first accounting period beginning on or after 1 May 2006.

5.3 VAT: Special Method Rules

Two changes are being made to the application of VAT partial exemption special methods.

First, businesses wishing to use a special method must make a declaration that it is fair and reasonable to do so. This will enable HMRC to approve such methods more quickly and recoup VAT where a method is found to be overgenerous.

A second change will facilitate 'combined methods' that deal with recovery of VAT relating to overseas supplies. This will simplify the rules for partially exempt businesses that make overseas supplies. These changes are expected to take effect from April 2007, following consultation.

5.4 VAT: HMRC's Powers Relating to Inspection of Goods

New legislation provides clarification that the existing power for HMRC officers to enter premises and inspect goods in connection with VAT includes the right to mark any goods inspected (e.g. by applying an HMRC date stamp to the outer packaging) and to record details of the goods by any means (including electronic scanning of barcodes).

5.5 VAT: Power to Direct Additional Record-Keeping Requirements

HMRC will be able to direct individual businesses to keep specified records relating to goods that they have traded (e.g. unique identification numbers for mobile phones).

The measure will have effect when Finance Bill 2006 receives Royal Assent and will only be exercised where HMRC has reasonable grounds to believe that the additional records might assist in identifying supplies on which VAT might go unpaid.

5.6 VAT: Auctioneers' Fees

Commission charged by an auctioneer will be taxed at 17.5% irrespective of whether the auctioned goods are within temporary importation arrangements or are in free circulation within the EU.

The effective reduced rate of 5% will no longer apply in respect of commission on goods auctioned covered by the legislation relating to temporary importation. This change will take effect shortly after Royal Assent to the Finance Bill.

5.7 VAT: Reduced Rate for Contraceptives

With effect from 1 July 2006, contraceptive products will be taxed at the reduced rate of VAT of 5%. This includes sales by retailers, vending machines and via the Internet, regardless of whether purchased by an individual or organisation such as a sexual health charity or the NHS.

5.8 VAT: Supplies under Finance Agreements

The VAT rules that apply to finance agreements where title to the goods passes at the end of the contract (e.g. hire purchase) will be changed. Finance companies selling returned goods will no longer be able to treat the sale as outside the scope of VAT. This change will apply to finance agreements entered into on or after 13 April 2006 where the goods are delivered on or after 1 September 2006.

5.9 Possible Change to VAT Accounting for Electronic Items

In another attempt to tackle Carousel VAT fraud, it is proposed that a requirement be introduced requiring the purchasers of certain goods to account for the sales VAT. The goods include mobile phones, computer chips and other small electronic items. This would revise the normal VAT rules whereby the seller accounts for output VAT. This proposal will come into force only when all other EU member states have agreed it.

5.10 VAT: Phone Cards

Legislation is to be introduced with effect from Royal Assent to the Finance Bill which will enable the Government to make orders specifying additional circumstances in which VAT is to be charged on phone cards and other "credit vouchers".

5.11 Air Passenger Duty

There is no change to rates due to recent oil price uncertainty.

5.12 Landfill Tax

From 1 April 2006, the standard rate of landfill tax will be increased from £18 per tonne to £21 per tonne.

From the same date the maximum credit that landfill site operators may claim against their annual landfill tax liability, for contributions made to bodies with

objects concerned with the environment and which are enrolled under the Landfill Tax Credit Scheme, is to be changed from 6% to 6.7%.

5.13 Alcohol Duty Rates

From midnight on Sunday 26 March 2006, Alcohol Duty is increased by 1p on a pint of beer and 4p on a 75cl bottle of wine. The excise duty on spirits, cider and sparkling wine is frozen.

5.14 Tobacco Products: Changes in Duty Rates

From 6pm on 22 March 2006, the rates of duty on tobacco products imported into, or manufactured in, the United Kingdom will be increased.

The price of packets of 20 cigarettes will be increased by 9p and of five cigars by 3p.

Further measures attacking smuggling of tobacco products are also to be considered.

6 STAMP DUTIES

6.1 Residential Threshold

For any residential property transaction where the chargeable consideration is less than £125,000 no Stamp Duty Land Tax will be payable.

This represents an increase of £5,000 on the existing threshold and will apply to transactions where the effective date falls on or after 23 March 2006. The effective date is normally the date of completion.

6.2 Alternative Finance Reliefs

Where an individual uses alternative financing arrangements to purchase or lease land and buildings, Stamp Duty Land Tax is charged at no more than would be the case under traditional financing arrangements. This relief is now extended for all alternative finance purchases on or after Royal Assent to the Finance Bill so that all persons (including companies, clubs, trusts etc) can then benefit.

Alternative financing schemes are those that involve several taxable transfers of property such as where a financial institution buys a property for a purchaser, leases it to them and then transfers the freehold.

6.3 Simplification

A number of Stamp Duty Land Tax simplifications are proposed, some of which will take the transactions outside the scope of the tax.

Those that will be deemed to be not for chargeable consideration are:

- a gift of property where the recipient is liable to pay capital gains tax or inheritance tax
- the payment of a landlord's reasonable costs on the grant, variation or termination of a lease
- an agricultural tenant's covenant to assign entitlement to the Single Farm Payment to the landlord on termination of the tenancy.

These changes will have effect from Royal Assent to the Finance Bill.

Other changes, which will have effect from 12 April 2006, are:

- there will be no charge to Stamp Duty Land Tax on a transfer of an interest in a partnership where the partnership property includes land. This will apply to all partnerships carrying on a trade or profession, except where the trade is dealing in or developing land
- where the present legislation creates the possibility of a double charge to Stamp Duty Land Tax for partnerships, this possibility is now to be removed
- various minor matters where the present rules have resulted in uncertainty are now to be clarified or simplified.

6.4 Stamp Duty Land Tax – Withdrawal of Unit Trust Seeding Relief

Under current legislation, where property is transferred into a newly formed unit trust in exchange for the issue of units, no Stamp Duty Land Tax is payable. This relief is known as seeding relief.

With effect from 22 March 2006, this relief is withdrawn for all transfers, with transitional relief for contracts already entered into.

6.5 Stamp Duty – Reconstruction Reliefs

Minor changes to stamp duty reliefs on corporate reconstructions are proposed, with effect from Royal Assent to the 2006 Finance Bill.

Before relief from stamp duty becomes available, various conditions have to be fulfilled. In particular, the acquiring company must have a UK registered office. In July 2005, this was relaxed to include companies in the European Economic Area. In future, this condition will no longer apply to any company and thus the relief will apply to worldwide acquisitions.

Additionally, the reorganisation rules previously required that no change in the proportion owned by each shareholder should occur in a reconstruction. For practical reasons, this is to be slightly relaxed where the proportions change.

7 MISCELLANEOUS

7.1 Inheritance Tax Rates

The Inheritance Tax threshold (the nil rate band) is being increased, as previously announced, to £285,000 for 2006/07. The value of estates in excess of this figure will continue to be taxed at 40% on death and 20% on chargeable lifetime transfers.

The threshold will rise to £300,000 for 2007/08 and it was announced that it would then rise to £312,000 in 2008/09 and to £325,000 in 2009/10.

7.2 Aligning the Inheritance Tax Treatment for Trusts

Accumulation and Maintenance Trusts (A&Ms) and Interest in Possession Trusts (IIPs) have previously been looked on favourably from an Inheritance Tax (IHT) point of view, when compared with Discretionary Trusts.

New rules, applicable from 22 March 2006, aim to unify the rules by bringing both A&Ms and IIPs into the same regime as Discretionary Trusts.

Apart from some minor exceptions, any transfers into trust on or after 22 March 2006 will immediately be chargeable to IHT (20% on the value above the nil rate band). They will also be subject to periodic charges (up to 6% every 10 years) and exit charges when assets leave the settlement.

For existing A&Ms, there are transitional rules that allow changes to be made before 6 April 2008 to bring settlements within the new rules. If existing settlements do not comply with the new rules by that date, they will then come within the IHT regime described above.

For existing IIPs, as long as no new property is added to the trust they will not be affected by the new regime. However, if property is added or the life tenant changes, the settlement will then come within the new provisions.

7.3 Inheritance Tax & Pensions Simplification

New pension rules come into effect on 'A' Day, 6 April 2006. In consequence, provisions are being brought in with regard to Inheritance Tax (IHT). The provisions will be effective on the death of a scheme member on or after 6 April 2006.

Death of scheme member before 75

A measure will be introduced to legislate current IHT concessionary practice in relation to pension choices by scheme members in cases where the member dies before age 75. This will ensure that existing practice will continue to apply to registered pension schemes in much the same way as it does now. In addition, payments made to charity in these circumstances will be exempted from IHT.

Death of scheme member on or after age 75 – Alternatively Secured Pension

The new pension rules introduced the Alternatively Secured Pension (ASP), which is designed for those that have a principled religious objection to annuitisation. Following consultation by HMRC, legislation will be introduced in the Finance Bill to prevent ASPs being exploited to pass on retirement savings to dependants rather than using them to provide a pension in retirement.

7.4 Charities: Anti-avoidance provisions

Measures are introduced to attack those who misuse charitable reliefs. These will penalise arrangements that can reduce the amount of charitable funds that are used for good causes.

There are three measures that HMRC are taking.

The first will restrict the dealings that a charity can have with its substantial donors. These are donors giving more than £25,000 in a single 12-month period or £100,000 or more over a six-year period. The legislation will remove tax relief from the charity where restrictions are breached. This will apply to transactions that take place on or after 22 March 2006.

The second introduces a direct link between non-charitable expenditure incurred by a charity and loss of tax relief. This will mean that tax relief is restricted by £1 for every £1 of non-charitable expenditure incurred. This will

apply to such expenditure incurred in a chargeable period commencing on or after 22 March 2006.

Lastly, non-close companies will become subject to the same limits on benefits received as a result of a gift to charity as currently applies for individuals and close companies. They will also become subject to the same rules as close companies and individuals where gifts are potentially repayable or are associated with the acquisition of property by the charity from the donor or connected person. This will affect payments to charity made on or after 1 April 2006.

7.5 Relief for Charities' Trading Activities

New legislation will change the tax treatment of charities' trading income. This has become necessary following a series of recent legal decisions, which have had the unexpected effect of restricting tax.

The new rules will apply for chargeable periods commencing on or after 22 March 2006. They will legitimise the effect of the current HMRC approach in relation to charities that have both primary and non-primary purpose trading, or trading activities that are partly (but not mainly) carried on by beneficiaries of the charity.

It will split a trade into two separate parts:

- A trade which is exercised in the course of carrying out a primary purpose of the charity

- A non-primary purpose part.

Tax relief will be given on the primary purpose part and on the profits of any part carried out by the beneficiaries of the charity.

Relief will not be available for any non-primary purpose trade where the work is not carried out by the beneficiaries of the charity, although relief may still be available under the existing charitable exemption for small trades.

7.6 Relief From Special Trust Rates for Service Charges held by Social Landlords

Most landlords are required to hold service charges paid by tenants in trust. Many Registered Social Landlords (RSLs) and local authorities also hold service charges in trust.

This new measure will mean that the income produced by such funds held by RSLs and local authorities will now be charged at no more than the basic rate of tax, whereas they were previously chargeable at the special trust rates. This relief is also extended to charitable housing trusts and associations, housing action trusts and the Housing Corporation.

7.7 Changes to the Disclosure Regime

The disclosure regime introduced in 2004 whereby certain tax avoidance

schemes have to be notified to HMRC is to be extended to cover schemes within the whole of income tax, corporation tax and capital gains tax.

The schemes to be disclosed will be those within certain "hallmarks". The hallmarks will be in three groups covering those aimed at:

- New and innovative schemes
- Mass marketed tax products
- Areas of particular risk.

For new and innovative schemes, the hallmarks will be derived from the existing disclosure criteria of confidentiality, premium fees and off-market terms.

There will be two hallmarks aimed at specific schemes in the areas of creating losses to offset income tax or capital gains tax and certain leasing schemes.

There will be some modification to in-house schemes and a de minimis provision so that individuals and SMEs will not have to disclose in-house schemes.

The new regime will operate with effect from 1 July 2006.

7.8 International Tax Enforcement Arrangements

With effect from the date on which the Finance Bill 2006 receives Royal Assent, the exchange of information powers currently in the UK tax legislation will be

repealed. They will be replaced by a single power to make arrangements with another territory for the exchange of information, service of documents and assistance in tax collection in respect of both direct and indirect taxes.

There are consequential amendments to the existing rules allowing HMRC to disclose information to an overseas tax authority, to obtain information and take action on behalf of an overseas tax authority. From Royal Assent, HMRC will also be able to obtain information from all of the UK's treaty partners, whether or not the UK has a domestic interest in the information being sought.

7.9 Alternative Finance Arrangements

Legislation was introduced in 2005 to enable certain finance arrangements, which do not involve interest payments or receipts, to be taxed in a manner similar to those involving interest.

These changes are intended to facilitate the use of alternative financial products, for example those developed to be compliant with Shari'a law.

It is proposed to extend this to cover two further types of arrangement:

- Agency-style contracts, equivalent to a savings account
- Partnership-style arrangements, under which property or other assets are purchased.

Where certain conditions are met, amounts which equate economically to interest will be charged to tax on the same basis as interest. This will apply to arrangements entered into on or after 6 April 2006 for income tax purposes and 1 April 2006 for corporation tax purposes.

An additional change is proposed whereby low cost alternative finance arrangements provided to employees by employers will be treated as a benefit-in-kind in the same way as conventional low-interest loans to employees. This will apply to arrangements entered into on or after 22 March 2006.

7.10 London Olympic Games and Paralympic Games

Special measures are proposed which will exempt the following from UK tax:

- The London Organising Committee of the Olympic Games Limited
- The International Olympic Committee
- Non-UK resident competitors and support staff who will only temporarily come to the UK for the purpose of the Games in 2012.

There appears to be no equivalent exemption for UK competitors!

A INCOME TAX RATES

Individuals	2005/06	2006/07
Lower Rate on first (£2,090) £2,150 of taxable income	10%	10%
Basic Rate on next (£30,310) £31,150	22%	22%
Cumulative tax thereon	£6,877	£7,068
Higher Rate over (£32,400) £33,300	40%	40%
On Savings Income, excluding dividends		
taxable income up to lower rate limit	10%	10%
taxable income between lower and basic rate limit	20%	20%
taxable income above basic rate limit	40%	40%
On Dividend Income		
taxable income up to basic rate limit	10%	10%
taxable income above basic rate limit	32.5%	32.5%
Trusts		
Interest in Possession	10/20/22/40%	10/20/22/40%
Discretionary: Income used for expenses & next (£500) £1,000	10/20/22%	10/20/22%
Dividend Rate	32.5%	32.5%
Other Rate	40%	40%

B INCOME TAX ALLOWANCES

Effective at all rates of income tax	£	£
Personal Allowance	4,895	5,035
Age Allowance (65 - 74)	7,090	7,280
Age Allowance (75 & over)	7,220	7,420
Blind Person's Allowance	1,610	1,660
Effective at only 10%		
Age Allowance (Married, elder born before 6/4/35)	5,905	6,065
Age Allowance (Married, elder 75 & over)	5,975	6,135
Minimum Allowance (Married, elder born before 6/4/35)	2,280	2,350

All Age Allowances are reduced by £1 for every £2 of income over (£19,500) **£20,100**

C INDIVIDUAL SAVINGS ACCOUNTS (ISAS)

Annual Investment Limits	Mini ISAs (£)	Maxi ISA (£)
Overall Maximum Investment	7,000	7,000
Cash	3,000	3,000
Stocks & Shares	4,000	7,000

Individuals cannot have both a maxi ISA and one or more mini ISAs in the same year

D SCALE BENEFITS FOR VEHICLES

Company Cars: Employees provided with a company car available for private use are taxable according to a scale based on CO₂ emissions. The basic car benefits charge will be the car's list price multiplied by the percentage charge for the CO₂ emissions band in which the car falls, subject to the addition of any diesel supplement or a discount for cars using alternative fuels and technologies.

For the tax years 2005/06 to 2007/08

CO ₂ emissions in gms/km	% of car's list price	CO ₂ emissions in gms/km	% of car's list price	CO ₂ emissions in gms/km	% of car's list price
140	15 ¹	175	22 ¹	210	29 ¹
145	16 ¹	180	23 ¹	215	30 ¹
150	17 ¹	185	24 ¹	220	31 ¹
155	18 ¹	190	25 ¹	225	32 ¹
160	19 ¹	195	26 ¹	230	33 ²
165	20 ¹	200	27 ¹	235	34 ³
170	21 ¹	205	28 ¹	240	35 ⁴

Supplement if car runs solely on diesel ¹Add 3%. ²Add 2%. ³Add 1%. ⁴Maximum charge, therefore no diesel supplement. The diesel supplement does not apply for 2005/06 if the Euro IV emission limit is met. For the supplement not to apply for 2006/07 the car also needs to have been registered prior to 1 January 2006.

The benefit will be reduced for employee contributions up to £5,000 and/or where the car is unavailable for part of the year.

Fuel Benefit: The annual charge is linked to the car's CO₂ emissions using the same percentage figures as the company car benefit charge and multiplying them by **£14,400**.

Fuel Benefit: VAT Scales (Accounting Periods beginning on or after 1 May 2006)

Engine Size	3 Month Period VAT Scale		Annual VAT Scale	
	Petrol £	Diesel £	Petrol £	Diesel £
Up to 1400cc	273	260	1095	1040
1401cc to 2000cc	346	260	1385	1040
Over 2000cc	508	331	2035	1325

National Insurance Contributions: Employers' NICs (Class 1A) are chargeable on both company cars and fuel by reference to the above Income Tax scales. They are assessed annually together with other taxable benefits in kind and collected in arrears (**12.8% for 2005/06**).

Company Vans: With effect from the 6 April 2005 there will be no charge where an employee merely takes a company van home with no other private use. If there is unrestricted private use then vans up to 3.5 tonnes are taxed at a scale rate of £500 (£350 if 4 years old or over at next 5 April). This will increase from 6 April 2007 to £3,000 plus a fuel charge if applicable, irrespective of the age of the van.

E FIXED PROFIT CAR SCHEME

Business Mileage	per mile
Motor Cars and Vans	
Up to 10,000 miles	40p
Excess over 10,000 miles	25p
Motorcycles	24p
Cycles	20p

The rates are tax free allowances, which may be used to reimburse employees who use their own vehicle for business purposes.

Employers can use the following fuel only rates to reimburse employees for business travel in their company cars or require staff to repay the cost of fuel used for private travel, on or after 1 July 2005.

Engine size	Petrol Fuel Cost (per mile)	Diesel Fuel Cost (per mile)	LPG Fuel Cost (per mile)
1400cc or less	10p	9p	7p
1401cc – 2000cc	12p	9p	8p
Over 2000cc	16p	13p	10p

F PENSIONS

The new pension simplification legislation comes into force on the 6 April 2006, 'A day'.

Key Points

All individuals up to the age of 75 can invest up to £3,600 regardless of income.

The maximum that can be invested is the lower of 100% of net relevant earnings and the annual allowance of £215,000 for 2006/07, rising by £10,000 a year until 2010/11.

Employers may be able to contribute more than employees into a scheme.

All pension contributions paid by taxpayers are to be paid net of basic rate tax.

There is no provision to carry back premiums or to carry forward unused relief.

Lifetime allowance is £1.5m rising to £1.8m by 2010/11.

If taxpayers have elected or are considering electing for enhanced protection then no pension contributions can be made, otherwise the election becomes invalid.

If primary protection is being considered then a close eye needs to be kept on the growth of the fund.

G CAPITAL GAINS TAX

Rates	2005/06	2006/07
Individuals, as top slice of income		
on taxable gains up to lower rate limit	10%	10%
on taxable gains between lower and basic rate limit	20%	20%
on taxable gains above basic rate limit	40%	40%
Trusts generally/personal representatives	40%	40%
Annual Exemptions	£	£
Individuals & certain trusts	8,500	8,800
Trusts generally	4,250	4,400
Personal representatives for year of death & next two years	8,500	8,800

Indexation relief frozen at April 1998. Chargeable gains then reduced by reference to period of ownership post - April 1998. Abatement of 75% for business assets held for 2 years and 50% for 1 year. Abatement of 40% for non-business assets held 10 years tapering to 5% for 3 years ownership.

H CORPORATION TAX

YEAR TO 31 MARCH	2006	2007
Taxable Profits		
Starting Rate £0 - £10,000	0%	N/A
Marginal Rate £10,001 - £50,000	23.75%	N/A
Small Companies Rate: £0 - £300,000		19%
£50,001 - £300,000	19%	
Marginal Rate		
£300,001 - £1,500,000	32.75%	32.75%
Main Rate over £1,500,000	30%	30%
Non – corporate distribution rate	19%	N/A

Closely controlled investment-holding companies are always taxed at the Full Rate.

YEAR TO 5 APRIL	2006	2007
Rate of tax credit on dividends	$\frac{1}{9}$	$\frac{1}{9}$

I ENCOURAGING BUSINESS INVESTMENT

Investments qualifying under the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules will attract the benefits detailed below, if certain criteria are satisfied.

From 6 April 2006	EIS	VCT
Income Tax Credit (VCT: 40% from 6 April 2004 to 5 April 2006)	20%	30%
Limit for Income Tax Credit	£400,000	£200,000
Capital Gains Tax Deferral	Yes	No
Capital Gains Tax Exemption on Disposal	Yes	Yes

J INHERITANCE TAX

Rates

From the 6 April 2006 the first **£285,000** of cumulative chargeable transfers are taxed at NIL rate. Those in excess are taxed at 40% on death, 20% for lifetime transfers. Potentially exempt transfers within seven years before death are taxed at death rate with tapering relief as follows:

Years between gift & death	Percentage of death rate
Up to 3	100%
3 – 4	80%
4 – 5	60%
5 – 6	40%
6 – 7	20%
Over 7	NIL

Exemptions

		£
Annual exemption	per donor	3,000
Small gifts	per donee	250
Gifts in consideration of marriage by:	Parent	5,000
	Grandparent/Remoter ancestor	2,500
	Party to the marriage	2,500
	Other person	1,000

K VALUE ADDED TAX

Standard rate		17.5%
VAT fraction		7/47
Effective from	1 April 2005	1 April 2006
Registration Limits - Annual		
Future/past turnover	£60,000	£61,000
Deregistration Limit - Annual		
Future turnover	£58,000	£59,000
Cash Accounting Threshold		
Future turnover	£660,000	£660,000
Annual Accounting Threshold		
Future turnover	£660,000	£1,350,000

L STAMP DUTY LAND TAX

Transfer of land and buildings (consideration paid)

Residential Properties

0 - £125,000 (from 23 March 2006)	0%
£125,001 - £250,000	1%
£250,001 - £500,000	3%
£500,001+	4%

Non Residential Properties & Residential Properties in Disadvantaged Areas

0 - £150,000	0%
£150,001 - £250,000	1%
£250,001 - £500,000	3%
£500,001+	4%

M NATIONAL INSURANCE CONTRIBUTIONS FROM 6 APRIL 2006

Class 1 - Individuals in Employment

Lower Earnings Limit - £84 wkly, £364 mthly, £4,368 yrly.

There is no liability for either employees' or employers' contributions if earnings are below these limits.

Earnings Threshold (Employees & Employers) - £97 wkly, £420 mthly, £5,035 yrly.

For earnings between the lower earnings limit and the earnings threshold although no NIC's are actually paid they are treated as having been paid for the purposes of claiming benefits.

Upper Earnings Limit - £645 wkly, £2,795 mthly, £33,540 yrly. Applies to employees only.

Not Contracted-out rates on the following bands of weekly earnings	Employee		Employer	
£0.00 to £84.00		NIL		NIL
£84.01 to £97.00		0%		0%
£97.01 to £645.00		11%		12.8%
Over £645.00		1%		12.8%

Contracted-out rates on the following bands of weekly earnings	Employee		Employer	
			COSR	COMP
£0.00 to £84.00		NIL	NIL	NIL
£84.01 to £97.00		0%	0%	0%
£97.01 to £645.00		9.4%	9.3%	11.8%
Over £645.00		1%	12.8%	12.8%

Employer Contributions – COSR above relates to contracted-out salary-related schemes and COMP to contracted-out money purchase schemes.

Class 2 - Self Employed Individuals - £2.10 a week. Earnings under £4,465 per annum are exempt.

Class 3 - Voluntary Contributions - £7.55 a week, for protection of benefits by those not liable under Class 1 or 2.

Class 4 - Self Employed Individuals - 8% on assessable profits between £5,035 and £33,540 a year. 1% above £33,540.

London

Russell Square House
10/12 Russell Square
London
WC1B 5LF

Contact: Mark Lamb

Tel: + 44 (0)20 7509 9000

Email: mlamb@cvdffk.com

Brighton & Hove

First Floor
16-17 Boundary Road
Brighton & Hove, East Sussex
BN3 4AN

Contact: Ken Touhey

Tel: +44 (0)1273 421200

Email: ktouhey@cvdffk.com

Croydon

Corinthian House
17 Lansdowne Road
Croydon
CR0 2BX

Contact: Anton Syrocki

Tel: +44 (0)20 8686 3915

Email: asyrocki@cvdffk.com

Northampton

Derngate Mews
Derngate
Northampton
NN1 1UE

Contact: John Harris

Tel: +44 (0)1604 639257

Email: jharris@cvdffk.com

Reading

Prospect House
58 Queens Road
Reading, Berkshire
RG1 4RP

Contact: Ian B Johnson

Tel: +44 (0)118 952 4700

Email: ibjohnson@cvdffk.com

Watford

Gresham House
53 Clarendon Road
Watford, Hertfordshire
WD17 1LR

Contact: Mark Stevens

Tel: +44 (0)1923 255111

Email: mstevens@cvdffk.com

Leicester

Artisan House
6 Princess Road West
Leicester
LE1 6TP

Contact: Elliot Harris

Tel: +44 (0)116 2471393

Email: eharris@cvdffk.com

DFK International

Russell Square House
10/12 Russell Square
London
WC1B 5LF

Contact: Simon Fraser

Tel: +44 (0)20 7436 6722

Email: sfraser@dfk.com



Chantrey Vellacott DFK

Email - info@cvdffk.com Web - www.cvdffk.com