

Pre-Budget Report 2008 - A Summary of the Taxation Proposals

Introduction

Alistair Darling's second Pre-Budget Report was introduced as being a response to global recession and contains a range of measures intended to support the economy through recession.

Some of these have been widely heralded in the media, in particular the reduction in the rate of VAT, the postponement of the increase in the small companies' corporation tax rate and the corporation tax exemption for foreign dividends received by large and medium sized groups; also, the future increase in the top rate of tax for "the rich".

The principal taxation proposals are summarised below.

Income Tax

Income Tax Rates, Allowances and Limits and National Insurance Contributions Rates and Thresholds

The personal allowance, currently £6,035 will be increased to £6,475 for 2009/10, with increases for individuals aged between 65 and 74 and aged 75 and over increased to £9,490 and £9,640 respectively.

The basic rate band for 2009/10 will increase to £37,400 which means the point at which people start to pay higher rate tax becomes £43,875 (£37,400 + £6,475) and this will also be the upper earnings limit for primary Class 1 National Insurance.

For 2010/11 it is proposed that there will be two separate income limits for the basic personal allowance. The personal allowance will be reduced for individuals with gross incomes above £100,000 by £1 for every £2 above the income limit up to a maximum of one half. However, if your gross income is above £140,000 the personal allowance will be further reduced by £1 for every £2 to a maximum of the full amount of the basic personal allowance.

For 2011/12 a new 45% tax rate will apply to taxable non savings and savings income above £150,000 from 6 April 2011. In addition, there will be a new dividend rate of 37.5% which will apply to taxable dividend income above £150,000. The current rates of 10% and 32.5% will continue to apply up to the new limit.

Also for 2011/12 the dividend trust rate will be increased to 37.5% and the trust rate of tax will be increased from 40% to 45%.

From 2011/12 there will also be changes to the main rate of Class 1 and Class 4 National Insurance, it will increase by 0.5% to 11.5% and 8.5% respectively. In addition, the Class 1 Employer rate will be increased by a similar amount to 13.3%, this rate will also apply to Class 1A and Class 1B contributions.

In addition, for 2011/12 the additional rate of Class 1 and 4 NIC's which applies above the upper threshold limit will be increased by 0.5% to 1.5%. The changes in National Insurance apply on and after 6 April 2011.

Income Shifting

In the current economic climate, the Government has decided to defer taking any action and will not bring forward legislation in the Finance Bill 2009. It will, however, keep the issue "under review".

Leasing Avoidance by Film Partnerships

Legislation is to be introduced to counter aggressive tax avoidance involving the leasing of films to others under a long funding lease by making rentals fully taxable.

The proposals will apply to long funding leases entered into on or after 13 November 2008 and rents payable under long funding leases entered into prior to that date to the extent that payments refer to periods after 13 November 2008.

The proposals counter attempts to turn taxable income into non-taxable income through the replacement of existing leases with leases that qualify as long funding leases of plant and machinery.

Pension Schemes

Tax relieved saving in a registered pension scheme is subject to an overall "lifetime allowance" which will rise to £1.8m by 2010-11 and annual contributions limited to the "annual allowance" which will be £255,000 by 2010-11.

The 2010-11 lifetime allowance and annual allowance will be held constant for a further five tax years to 2015-16. This measure has effect from 6 April 2011.

A number of other limits are linked to the lifetime allowance and these will also remain constant between 2010-11 and 2015-16.

Individual Savings Accounts and Multilateral Institutions

From 16 December 2008 the list of investments that qualify for the ISA regime will include bonds issued by Multilateral Institutions.

Anti-avoidance Simplification in Regard to Shares

Legislation is to be introduced in the Finance Bill 2009 to simplify certain tax rules relating to employment-related securities. Three changes are proposed:

- If employment-related securities are acquired with payments due in instalments and the employee disposes of the securities before all payments have been made, a charge can arise even though no gain has been made. A change should remove this tax charge, although a charge may still arise if the requirement to pay the remaining instalments is removed.
- A tax charge can arise on the sale of nil or partly paid shares even though no gain has been made by the employee and this will be removed.
- Where an employee receives a scrip or bonus issue of shares to ensure that the employee's holding is not diluted, a tax charge can arise even though no extra value has passed to the employee. The charge may arise because the value of the existing shares falls due to the bonus issue.
In addition, there will be a repeal of redundant anti-avoidance legislation relating to the exploitation of mismatches of tax treatment between dealing and non-dealing companies.

Corporation and Business Tax

Corporation Tax Small Companies Rate

The increase in Corporation Tax for small companies from 21% to 22% that had previously been planned to take effect from 1 April 2009 has been deferred to 1 April 2010. The present profit limit of £300,000 and £1.5 million marginal rate band for a single company will continue in effect with the marginal rate remaining at 29.75%

Ring fence profits, that is those relating to oil extraction and oil rights, will remain at 19% for 2009/10.

Taxation of Foreign Profits

The Government is bringing forward a package of reforms to the taxation of companies' foreign profits. These are to be included in Finance Bill 2009 and will deliver an exemption from tax for most foreign dividends received by large and medium sized groups. The exemption will be supported by a worldwide debt cap on interest, extension of the unallowable purpose rules and consequential changes to the Controlled Foreign Company rules. The existing Treasury consent rules will also be reformed.

Trading Loss Carry Back for Businesses

For one year only, companies and unincorporated businesses will be able to carry back losses to earlier accounting periods than presently permitted. This will apply to companies that have accounting periods that end in the period from 24 November 2008 to 23 November 2009 and to unincorporated businesses that have trading losses in the tax year 2008/09.

Presently, businesses and companies can carry back unlimited amounts of losses into the preceding year and obtain a repayment of tax. Also where unincorporated businesses commence business, they can carry back losses three years and any businesses ceasing to trade can carry back losses for three years. Unused losses can be carried forward for offset against future profits.

Under the proposals, losses will be capable of being carried back three years with the offset being against later profits before earlier profits. However, the amount that can be carried back beyond the current one year will be restricted to £50,000.

Loan Relationships – Connected Companies

Under current legislation, where connected companies (generally companies under common control) release trade debts that exist between them, the company that has a debt is denied relief for the amount written off, but the company that is relieved of its obligation may be taxed on the "profit" it has made.

It is proposed that the company that makes a profit will not be taxed on that profit.

It is also proposed to review the question of interest which arises on loans between connected companies that are outside loan relationship rules and which is currently only allowed as a deduction on a paid basis rather than on an accruals basis. A consultation process has been undertaken and action will now be taken in regard to the responses received.

HMRC Business Payment Support Service

HMRC will provide a new service for businesses in temporary financial difficulty and unable to pay their tax bills to enable them to spread payment of their bills over a timetable they can afford. The service will cover all business taxes, including corporation tax, VAT, PAYE, income tax and NICs.

Business Expenditure on Cars

In the 2008 Budget it was announced that the current rules for expensive cars would be replaced by a more environmentally based system with the writing down allowance based upon CO2 emissions. Similarly, allowable lease rentals would be based upon CO2 emissions.

The new rules will now come into effect from 1 April 2009 for companies within the charge to corporation tax and 6 April 2009 for businesses within the charge to income tax.

From April 2009, the rules relating to cars costing over £12,000 will be abolished. After the appropriate date, qualifying expenditure will be allocated to one of the two general plant and machinery pools for capital allowances. Cars with CO2 emissions over 160 g/km will be dealt with through the special rate pool with writing down allowances at 10%. Others will be in the main pool attracting allowances at 20%.

Expenditure incurred before April 2009 will continue to be dealt with on the current basis for a period of around 5 years after which any expenditure will be transferred to the main capital allowance pool.

For leased vehicles, from April 2009 there will be a disallowance of 15% of the rental payments where the car has CO2 emissions above 160 g/km

A technical note is shortly to be published by HM Revenue and Customs providing more details.

Claims Equalisation Relief for Lloyd's Corporates

Corporate members of Lloyd's insurance market will be able to claim tax relief on amounts set aside to cover claims for future volatile and uncertain risks (e.g. storm damage). Corporate members of Lloyds do not currently qualify for this type of relief. The legislation will apply to profits treated as arising in the year ended 31 December 2008.

Tax on Chargeable Gains, Stamp Duty and Stamp Duty Reserve Tax: Stock Lending Arrangements

Changes will be made to the tax treatment of stock lending arrangements entered into by market makers, securities dealers and financial institutions where the borrower subsequently becomes insolvent and is unable to return securities borrowed under the arrangement.

The rule that currently treats the non-return of borrowed securities as a disposal by the lender at market rate for capital gains purposes, will no longer apply. In addition stamp duty and stamp duty reserve tax charges will also be disapplied.

The changes to the capital gains rules will have effect for stock lending arrangements where the borrower becomes insolvent on or after 24 November 2008. It will also be possible to elect for the changes to have effect from 1 September 2008 up to 24 November 2008.

The stamp duty and stamp duty reserve tax changes will have effect for stock lending arrangements where the borrower becomes insolvent, or to repos where the purchaser becomes insolvent, on or after 1 September 2008.

Qualified Investor Schemes

With effect from 1 January 2009 (subject to transitional periods applying to existing qualified investor schemes), qualified investor schemes (QIS) and their investors will have the existing measure that effectively limits investors to a 10 per cent share of any one fund replaced by a genuine diversity of ownership rule.

The current regulations will be amended to remove the specific tax charge on substantial investors. This is subject to a condition that the investment will not be limited to specific individuals or companies ('the genuine diversity of ownership rule').

Property Authorised Investment Funds

With effect from 1 January 2009, property authorised investment funds (Property AIFs) and their investors will be able to obtain exemption from stamp duty reserve tax (SDRT) for feeder funds to property AIFs.

The new measures also provide for simpler distributions to Property AIFs and clarification of the tax treatment of manufactured payments representing Property AIF distributions.

Avoidance Using Authorised Investment Funds

A technical provision will be introduced applying to banks and other financial business who participate in Authorised Unit Trusts, Open-Ended Investment Companies and other authorised collective investment schemes.

Where the investor's return from the scheme includes non-UK source income, the rules currently provide for credit in respect of tax withheld from that income to be limited in the same way as other foreign income. Schemes to evade the limitation of credit have been notified to HM Revenue & Customs who now advise that these will be blocked with effect from 1 January 2009.

Change of Accounting Practice - Forex

The law of Unintended Consequences continues to bedevil the implementation of International Accounting Standards. Some 2½ years after implementation, a further anomaly now needs correction: large organisations who hedged their currency exposures under UK GAAP were allowed to match the hedge with the underlying asset, thus recognising neither exchange gain nor loss for either accounting or tax purposes.

International Accounting Standards generally require such hedges to be marked to market. Transitional rules were meant to ensure the resulting gains or losses were to be recognised for tax purposes over ten years. Unfortunately, the wording of the relevant regulations allowed some of the differences arising on implementation of the change of accounting policy to be recognised in full immediately, thus potentially leading to double taxation, or double relief. This will be corrected with effect from 1 January 2009.

Plant & Machinery

There are a number of detailed technical changes to the tax treatment of leased plant and machinery, all of which are made retrospective to 13 November 2008.

Some changes potentially apply to all businesses that lease machinery but, in practice, are only likely to apply to businesses leasing items of major equipment:

- A typical refinancing strategy for a business is to sell an asset it already owns in order to lease it back. Where this happens, the vendor business suffers a recapture of capital allowances already claimed but, if the lease is a "long-funding lease", the vendor in its capacity as lessee, will usually be entitled to capital allowances on the leased-back asset. It has been possible to structure these arrangements so that the allowances the lessee claims are greater than the amount brought into account as the disposal value on the sale to the lessor. This is to be prevented, as is a similar arrangement where the leaseback is transacted at an artificially depressed price.
- At the end of a "long funding lease", a disposal value is brought into account by the lessee to allow any residue of expenditure or recapture any excess amount that has been allowed. It has been found that the rules do not always work as intended, particularly where there is a guaranteed disposal value at the end of the lease. A new rule will overcome this difficulty.
- Another change is likely to apply only to leasing companies. Generally, where a leasing company is sold, the accelerated capital allowances it has been able to claim are taxed but are then available for a fresh claim by the company in the hands of its new owners. Thus the tax benefit of the accelerated allowances accrues to the owner of the leasing company, not the person who owned it at the time the leases were written. A way of avoiding this allowance recapture was to arrange for the leasing company itself to sell and lease back its plant so that it no longer had title to the equipment, then the allowance recapture could not arise. This also is now prevented.

UK Real Estate Investment Trusts

For accounting periods beginning on or after 1 April 2009 a company or group of companies will need to meet revised requirements in order to fall within the REIT regime. The regime exempts from tax both income and gains made on property, provided certain conditions are met. The proposed changes will mean that the conditions and tests are applied to the whole economic group and so will exclude all owner occupied property from the tax exempt business.

Draft legislation is to be published in the New Year for consultation.

Land Remediation Relief

From 1 April 2009 the relief is extended to specified expenditure on bringing long term derelict land back into productive use. Long term is defined as derelict since 1 April 1998, although there will be power within the legislation to amend this date. The land must have been derelict at the time it was acquired by the claimant. The categories of expenditure that qualify for relief are clarified to give companies greater certainty about qualifying expenditure. Relief will not be available where it is considered that the method of remediation is inappropriate e.g. the use of landfill sites for Japanese Knotweed. It will also not be available to the direct or indirect polluters of the land.

Draft legislation has been published today and will be included in the 2009 Finance Bill.

Indirect Taxes

Changes to the Standard Rate of VAT

The standard rate of VAT is to be reduced from 17.5% to 15% from 1 December 2008. It will remain at 15% until 1 January 2010, when it will revert to 17.5%.

Zero rated, exempt and reduced rated supplies will not be affected.

The percentages used in the Flat Rate Scheme for small businesses will be amended to reflect the reduction in the standard rate of VAT.

Legislation will be introduced in Finance Bill 2009 to ensure that businesses are not able to use artificial arrangements to reduce the VAT rate on goods or services to be provided after the VAT rate reverts to 17.5%.

Where suppliers issued VAT invoices prior to 1 December 2008 in respect of supplies that are to be made after 1 December 2008 they may choose to apply the new VAT rate of 15% to the earlier invoice. In this case they will be required to issue credit notes to their customers to evidence the credit for the reduction in VAT that is now due. The time limit for issuing such credit notes is to be extended from 14 to 45 days after the change of rate.

Simplifying the Entry and Leaving Rules for the VAT Flat Rate Scheme

With effect from 1 April 2009, eligibility to join the VAT Flat Rate Scheme will be determined solely by whether a business's taxable turnover is less than £150,000. The additional test that is based on total business income will be removed.

The method of calculating income for the purposes of the leaving test (i.e. if income exceeds £225,000) will be based on the method used by the business to calculate its VAT while on the scheme.

VAT: Bespoke Retail Schemes Threshold

With effect from 1 April 2009 the threshold above which a business may not use a published retail scheme to account for VAT on its retail supplies will increase from £100 million to £130 million.

Adjustments to Amounts of Tobacco Duty Payable

From 6pm on 24 November 2008, the rate of ad valorem duty on cigarettes imported into, or manufactured in, the United Kingdom will be increased to 24%. The specific duty will be unchanged at £112.07 per thousand cigarettes.

The rates of duty on other tobacco products imported into, or manufactured in, the United Kingdom will be increased by 4%.

Adjustments to Amounts of Alcohol Duty Payable

From 1 December 2008, Alcohol Duty is increased by 8%. This equates to an additional 3p on a pint of beer, 13p on a bottle of wine and 53p on a bottle of spirits.

The Small Brewers Relief scheme will continue to provide 50% duty relief to the smallest brewers.

Miscellaneous

Disclosure of Schemes

Since 2004, promoters of tax avoidance schemes have been required to disclose details of the scheme to HM Revenue & Customs, normally receiving in response a "scheme reference number" (SRN). The promoters are required to pass the SRN on to those expected to benefit from the scheme who, in turn, should notify HM Revenue & Customs they are involved in it.

Until now, taxpayers have been required to report a SRN when they are first advised of it; after 1 April 2009, they should report it in the tax year or accounting period when they first benefit from it.

Additionally, taxpayers who make a free-standing loss-claim which involves such a scheme – and taxpayers who participate in so many such schemes that there is not enough room to record them all on their regular tax return, will need to complete a special form, AAG4.

Taxpayer's Charter

The Government has announced that it will begin consultation in January 2009 on the wording of a Charter for HMRC.

Disclaimer

This summary is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this summary. The summary represents our understanding of the law and HM Revenue & Customs' practice as at November 2008, which are subject to change in the Spring 2009 Budget and subsequent legislation.