

## UK Budget Briefing

### If it counts, it's covered

22<sup>nd</sup> June 2010

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#### Introduction

The Chancellor, George Osborne, presented his first Budget statement today, and as expected, significant public sector spending cuts were announced. The main tax changes are an immediate increase in the rate of capital gains tax to 28% and an increase in the standard rate of VAT to 20% from January 2011.

Other measures include a plan to systematically reduce the main corporation tax rates down to 24% by 2014.

VAT increase to 20% will raise around £54 billion in the next five years

#### 1. Business Tax

##### 1.1 Corporation tax rates

The main rate of corporation tax will be reduced from 28% to 27% from 1 April 2011. There will be further 1% reductions in the main corporation tax rate in each of the next three years to bring the rate down to 24% by 1 April 2014.

The small profits rate of corporation tax will be reduced from 21% to 20% from 1 April 2011. The previous Government had planned for the rate to rise to 22%.

The Chancellor also announced that the Government will produce a paper on rebalancing the Northern Ireland economy, and examine potential mechanisms for changing the corporation tax rate in Northern Ireland.

## **1.2 Capital allowances: reduction in writing down rates**

The main rate of writing down allowances for expenditure on plant and machinery is to be reduced from 20% to 18% per annum and from 10% to 8% per annum for expenditure allocated to the special rate pool (e.g. long life assets).

The reduced rates will apply from 1 April 2012 for businesses within the charge to corporation tax and from 6 April 2012 for businesses within the charge to income tax.

The Annual Investment Allowance allows businesses to set the full amount of their annual capital expenditure on most plant and machinery (apart from cars) against their taxable profits, subject to an annual maximum amount. The current maximum amount of £100,000 is to be reduced to a new limit of £25,000 from April 2012. Details of the transitional arrangements are yet to be published.

## **1.3 Bank levy**

In a joint statement, the UK, France and Germany have confirmed their intention to introduce a levy on banks. The UK measure, which will be based on the bank's adjusted balance sheet, will take effect from 1 January 2011. The levy will apply to UK banks and building societies as well as foreign banks operating in the UK and is expected that the levy will raise over £2 billion annually.

## **1.4 Capital distributions**

Draft legislation has been released to address a problem which, in HMRC's view, can arise when a company pays certain dividends to another company. Near the end of 2009 HMRC started to take the view that amounts lawfully paid by companies as dividends, which arose from an earlier reduction of capital, might for corporate shareholders be taxable as a chargeable gain, rather than as an exempt dividend, as had previously been their view. The proposals should ensure that such dividends are not to be taxed as a chargeable gain. They will have full retrospective effect for payments from UK resident companies. For payments from non-UK resident companies, the changes only apply from 1 July 2009.

## **1.5 Loan relationships anti-avoidance**

HMRC have announced extensions to the existing anti-avoidance rules regarding the 'derecognition' of loan relationships or derivative contracts, applicable to debits and credits arising on or after 22 June 2010.

The Government also intends to publish a Technical Note early in July 2010 containing proposals for generic anti-avoidance legislation in respect of schemes involving derecognition, with a view to legislating in Finance Bill 2011.

## **1.6 R&D tax relief**

Later this year, the Government will consult on a long term approach to the taxation of R&D, based on the proposals contained in Sir James Dyson's March 2010 report, 'Ingenious Britain'. The report suggests that R&D tax credits should be refocused on high tech companies, small businesses and new start-ups in order to stimulate a new wave of technology. It was also announced that the proposed tax relief for UK video games will not now go ahead.

## **1.7 Consortium relief**

Companies that are in the same group as a 'link company', which holds an interest in a consortium, may claim relief for a share of any consortium company losses. Under current rules, the link company must be UK-resident. In 2009, the First-tier Tribunal found that the 'link company' requirements constituted a restriction to the EU Freedom of Establishment principle. Legislation is to be introduced, as soon as possible, which will extend the rules to allow EEA companies to be link companies.

Unrelated to this change, an additional test is to be introduced into the consortium relief rules which will limit the maximum losses available based on the proportion of voting rights and the extent of control the member holds in the consortium.

## **1.8 Corporate capital gains simplification**

Following the consultation earlier this year on changes to capital gains taxation for companies on depreciable transactions, pre-entry losses and degrouping charges, draft legislation will be published later this year to be included in Finance Act 2011. It is not known what the extent of the reforms are to be.

## **1.9 Controlled Foreign Companies (CFC) and foreign branch reform**

The expected date for the full reform of the CFC rules has been deferred to 2012. However, it is intended that interim improvements will be made in 2011 'to make the current rules easier to operate and where possible increase competitiveness'.

There will be a move towards a more territorial basis for taxing foreign branches of UK companies which we would expect to involve a system of exemption for certain branch profits. There will be consultation this summer on options for retaining foreign branch loss relief as part of any new regime. Legislation is expected in 2011.

## **1.10 Tackling tax avoidance**

The Government announced its intention to consult on several anti-avoidance measures. This includes arrangements using trusts and other vehicles to reward employees as announced in March 2010. Legislation will take effect from April 2011. It will also review whether the introduction of a general anti-avoidance rule (GAAR) would be appropriate.

## **2. Personal and Employment Taxes**

### **2.1 Capital Gains Tax (CGT): rates and Entrepreneurs' relief**

A new rate of CGT of 28% (currently 18%) is introduced from 23 June 2010. This higher rate will apply to individuals with total taxable income and gains above the upper limit of the basic rate income tax band (£37,400 for 2010/11), trustees and personal representatives of deceased persons. Otherwise, for individuals, the rate of CGT will remain at 18%. The rate change will apply to all gains arising on or after 23 June 2010.

The Annual Exempt Amount will remain unchanged at £10,100 for 2010/11.

The rate of CGT on gains qualifying for entrepreneurs' relief remains unchanged at 10% but the lifetime limit on gains will increase from £2 million to £5 million.

## **2.2 Regional employer NIC holiday for new businesses**

The Chancellor announced a regional employer NIC holiday for new businesses. New businesses setting up in certain regions (most notably excluding London, the South East and East Anglia) during a three year qualifying period will not have to pay the first £5,000 of employer's Class 1 NICs due in the first 12 months of employment for each of the first ten employees hired in the first year of business.

The exact criteria for qualifying for the scheme will be published shortly.

The NIC holiday will start as soon as is practicable, probably from 6 September 2010, but with some relief for those businesses setting up between 22 June 2010 and commencement.

## **3. Indirect Tax**

### **3.1 VAT rate to rise to 20% with effect from 4 January 2011**

As had been widely expected, the Chancellor announced an increase in the standard rate of VAT to 20%. The change will take effect on 4 January 2011 and there will be anti-forestalling provisions. The reduced (5%) rate remains unchanged. The Chancellor confirmed that there is to be no change to the VAT base, so goods and services that currently qualify for zero-rating and exemption will remain zero-rated or exempt.

### **3.2 Adjustments to the VAT 'payments on account' scheme**

In order to maintain the overall effect of the scheme, the 'payments on account' scheme, under which larger businesses (currently those paying £2 million or more in VAT a year) is to be amended 'to maintain the status quo of the scheme'. This suggests that the threshold for entry to the scheme will be changed to reflect the higher VAT rate.

### **3.3 Insurance premium tax (IPT) increases from 4 January 2011**

The higher rate of IPT, which is charged on certain insurance contracts relating to electrical appliances, motor vehicles and travel, will be increased to 20%, in line with the increased VAT rate, with effect from 4 January 2011. The standard rate of IPT (currently 5%), will also increase on 4 January, to 6%. The IPT law contains provisions that will largely prevent the current rates from applying to policies coming into force after 4 January 2011.

### **3.4 Landline duty – the tax that never was!**

The Chancellor announced that the 50p per month landline duty, which was to be imposed on all fixed telephone lines to finance high speed broadband access, is to be abolished – before it came into force!

### **3.5 Stamp Duty Land Tax (SDLT)**

The Government announced that it will examine whether further changes to the SDLT rules on 'high value' property transactions are needed to prevent avoidance.

As announced in the March 2010 Budget, the rules for correcting mistakes in SDLT returns to claim a repayment of tax are to be amended. The proposed changes will align the rules with the income tax, CGT and corporation tax legislation contained in the Finance Act 2009.

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