

# Pre-Budget Report briefing

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## INTRODUCTION

With UK GDP forecast to contract by between ¾% and 1¼% in 2009 the focus of this year's Pre-Budget Report (PBR) is to 'support the economy through these difficult times'. Probably the two key measures are:

- a temporary reduction in the VAT rate to 15% with effect from 1 December 2008 to 31 December 2009 (which is expected to cost £12.4bn); and
- the acceleration of £3bn of public spending.

Although the temporary reduction in VAT is to be welcomed, it cannot be assumed that all of the headline figure of £12.4bn will be passed onto consumers.

Other measures include the deferring, for one year, of the proposed 1% increase in the small companies rate of corporation tax and an increase in the carry-back period for trade losses from one year to three years.

In the longer term there will be a need to balance the books by generating significant additional revenues. As part of the Government's plans the following measures have been announced:

- from April 2010 individuals earning in excess of £100,000 will suffer restrictions on personal allowances;
- from April 2011 there will be a general increase in NIC for most earners;
- from April 2011 the top rate of income tax will rise to 45% for individuals earning in excess of £150,000 a year.

These changes are likely to be preceded by the next General Election which must be held on or before June 2010.

## BUSINESS TAX

### Foreign profits reforms

Today's announcement on foreign profits reforms brings a welcome resolution to over two years of debate on the introduction of an exemption for foreign dividends. It is now expected that Finance Bill 2009 will include an exemption for such dividends received by large and medium sized businesses (subject to certain restrictions).

As part of the accompanying package of reforms a worldwide interest cap has been announced which is expected to restrict UK interest deductions by reference to a group's consolidated external finance costs. An extension to the current anti-avoidance rules for loan relationships is also expected, and is intended to catch 'schemes or arrangements' which have an avoidance purpose.

The reforms also include the withdrawal of the 'acceptable distribution policy' and 'holding company' exemptions from the current UK controlled foreign companies (CFC) regulations. A 24 month transitional period to allow groups to unwind holding company structures is proposed.

A wider reform of the CFC rules has been deferred and will be subject to further consultation. It is intended that the new regime will represent a 'further move towards a territorial approach to taxing foreign subsidiaries'. It is stated that the new CFC system should not tax profits that are genuinely earned in overseas subsidiaries. Additional details are expected to be published during December.

The abolition of the Treasury Consent rules and notification requirements has also been announced and the existing rules are expected to be replaced by a reporting requirement for certain transactions with a value of more than £100m.

### **Principles-based approach to financial products avoidance**

A consultation document addressing a principles-based approach to counter financial products avoidance was published after PBR 2007. This dealt with two main areas: 'disguised interest' and transfers of income streams (or usufructs). The consultation process has continued and revised proposals have now been published for further consultation.

#### *Disguised interest*

The disguised interest proposals aim to charge to corporation tax as income any returns that are, in substance, debt returns. Returns in the nature of disguised interest are to be charged as profits under the corporation tax regime for corporate debt (loan relationships) where they are not already taxable as income.

The rules have been extended to include returns that represent the time value of money, at a rate reasonably comparable to a commercial rate of interest, where there is no practical likelihood that the return will not arise in accordance with the arrangement.

There is an important exclusion relating to returns from arrangements where there is no tax avoidance purpose. Further, returns from shares in group companies and CFCs are also generally excluded.

The disguised interest rules are intended to replace existing specific anti-avoidance rules relating to disguised interest such as the shares-as-debt rules in sections 91A-G FA 1996. The latter rules will thus be repealed in due course. However, it is proposed to retain the existing rules in so far as they relate to redeemable shares.

The new rules will apply to arrangements entered into on or after 1 April 2009 subject to transitional arrangements.

#### *Transfers of income*

The consultation document also provides updated draft legislation on the 'transfers of income streams' proposals. Again, the anticipated commencement date is 1 April 2009, but only in relation to transfers on or after that date.

The broad principle of these proposals is to ensure that an existing income stream continues to be taxed as income in the hands of the transferor and the character of the return for tax purposes cannot be changed by transferring the income stream to another person.

The draft provisions have been updated to include a much wider definition of 'transfer' so as to include sale, exchange, gift and assignment and any other arrangement that equates in substance to a transfer.

The provisions ensure that the market value of the right to the income stream (referred to as 'relevant receipts') is brought into account as income of the transferor chargeable to corporation tax in the same way as the relevant receipts would have been chargeable but for the transfer.

Equipment lessors will note that the proposed rules apply to the transfer of equipment rentals. Indeed the rules apply even when an equipment asset already out on lease is itself transferred, except to the extent that the sale proceeds are otherwise taxed as a capital allowance disposal receipt or as income. It is not clear how these rules will interact with the existing 'trade succession' rules.

These provisions do not apply if the transfer is a consequence of a transfer of shares where the rights extend beyond the rights to 'relevant receipts', or the transfer of a freehold interest in land or the grant of a long (50 years) lease over land, or where the consideration for transfer is already taxed as income, profits or under the capital allowance regime. The rules appear to be wider than originally proposed and may catch income arising following the transfer of assets such as intellectual property subject to licence arrangements.

### **Plant and machinery leasing changes**

As first announced on 13 November, the Government has included changes to the way certain leases of plant and machinery, leasing companies and film leases are taxed. The changes have effect from the date of the announcement.

The new rules tackle perceived avoidance based on the plant and machinery long funding leasing regime. The changes may affect any company entering into a lease of plant and machinery whether or not commercially motivated.

Changes have also been made to tighten rules which can affect lessors on any change in ownership. These deem taxable income to arise to the lessor in such circumstances.

There are also changes to counter perceived avoidance relating to film leasing. These are likely to affect mainly those seeking to shelter rental income arising from leases of films but may also affect commercially driven transactions.

### **Corporation tax: connected party loan relationships**

Two changes are being considered in respect of connected party loan relationships and both, if enacted, are expected to apply to companies with accounting periods beginning on or after 1 April 2009.

#### *Tax deductions for debts owed to connected party creditors outside of the loan relationships rules*

In July 2008 HMRC announced a consultation into the rules for late paid interest between connected companies (and, for the meantime, an HMRC Brief states that the late paid interest rules need not be applied in certain circumstances).

HMRC have stated that they are still considering the responses received to the consultation document.

#### *Asymmetry of treatment for the release of certain connected party trade debts*

This change is intended to address the asymmetrical tax treatment for the waiving of a trade debt by a connected party. Under the current rules, the debtor may be taxed on the credit although the creditor does not obtain corresponding relief. Under the proposed rules, the debtor will no longer be taxed on the credit. This is a welcome change to a situation commonly faced by companies. However, the draft legislation has not yet been published.

### **Change of accounting practice regulations: foreign exchange**

Amendments will be made to the Change of Accounting Practice (COAP) regulations 2004 to correct an anomaly which may lead to double taxation or double relief in relation to certain foreign exchange movements on foreign denominated financial instruments.

The change being announced to the COAP rules will disregard transitional adjustments arising on the change from old UK GAAP to new UK GAAP or International Accounting Standards as far as they relate to reversals of (previously untaxed) foreign exchange movements.

This change will apply to such reversals that would otherwise be brought into account after 31 December 2008. The draft amended regulations have not yet been published.

### **Carry back of trading losses**

Companies and unincorporated businesses making trading losses will generally be able to carry back these losses for up to three years rather than the current one year. For companies the new rules will apply for accounting periods ending between 24 November 2008 and 23 December 2009, while for unincorporated businesses the new rules will apply to the basis period for the tax year 2008-09. The one year loss carry back remains unlimited, whereas the carry back to earlier periods is capped at £50,000.

## **EMPLOYMENT AND PERSONAL TAXES**

### **Tax relief on company cars**

Expenditure on cars incurred on or after the beginning of April 2009 will be allocated to one of the two general plant and machinery pools, depending on the cars' CO<sub>2</sub> emissions. Expenditure on cars with CO<sub>2</sub> emissions over 160g/km will be dealt with in the special rate pool and will attract writing down allowances at 10%.

Expenditure incurred before April 2009 will, in general, continue to be subject to the old 'expensive' car rules for a transitional period of up to five years. After this transitional period, any expenditure remaining in a single asset pool will be transferred to the main capital allowances pool.

The lease rental rules will also be replaced for leases commencing on or after April 2009 by a flat rate disallowance of 15% for cars with CO<sub>2</sub> emissions of 160g/km or more. This disallowance will only apply to one lease rather than all links in a chain of leases.

### **Company cars 'ECOS' and 'AMAP'**

A report published today sets out the findings and conclusions from the review and consultation process in 2006 into employee car ownership schemes (ECOS) and their interaction with tax free approved mileage allowance payments (AMAPs). Following the review, and as announced in the 2007 Pre-Budget Report, the Government has confirmed it will not introduce a new tax regime for ECOS nor revise AMAPs but will keep a 'watching brief' on developments.

### **Disabled company car drivers - updated legislation**

Company car tax is calculated by multiplying the list price by the appropriate percentage based on the CO<sub>2</sub> emissions of the car. The employee pays income tax on this figure and the company pays Class 1A NIC. Often, automatic cars have higher list prices and CO<sub>2</sub> emissions than equivalent manual cars.

Currently, disabled company car drivers of automatic cars who hold a blue badge are able to use the CO<sub>2</sub> emissions figure of an equivalent manual car when calculating their company car benefit charge. From 6 April 2009 they can also use the list price of an equivalent manual car.

### **Employee share schemes - nil and partly paid shares**

Following the review announced in the 2007 Budget, HMRC have proposed changes to the anti-avoidance provisions applying to nil and partly paid shares.

Previously, where nil or partly paid shares were disposed of, employees were subject to income tax on the amount of a 'notional loan' equal to the amount of the outstanding unpaid amount at the time of disposal. This meant that employees could suffer income tax even if they sold the shares to a purchaser at a reduced price where the purchaser assumed the responsibility to pay up further instalments.

HMRC have confirmed that these potential charges will be removed for transactions taking place on or after Royal Assent to Finance Act 2009.

## **Pension limits**

The personal lifetime and annual allowances for tax-relieved pension savings are being frozen for five tax years from 2011/12 to 2015/16 at £1.8m and £255,000 respectively.

## **COMPLIANCE**

### **Late filing and late payment consultation**

HMRC have been engaged for some years in an extensive programme 'Modernising Powers, Deterrents and Safeguards'. As part of this programme, HMRC consulted in June 2008 on penalties for late filing of returns and late payment of taxes. The consultation considered many taxes, including income tax, corporation tax, PAYE and VAT.

A new consultation document has today been published. The key proposals for annual returns (eg CTSA or ITSA) are:

#### *Late filing:*

- An initial fixed penalty.
- A fixed but modest daily penalty running for up to three months starting from three months after the return's due date.
- Tax-gear penalties arising 7 and 12 months after the filing deadline, based on the tax shown on the return, whether or not it has been paid by the time the penalty arises. Under the proposals, the penalty could be up to 70% of the tax shown on the return if HMRC can demonstrate the late filing was deliberate, and up to 100% if the liability was also concealed.

#### *Late payment penalties:*

In addition to interest, it is proposed that tax-gear penalties will also apply where corporation tax is more than three months late or personal taxes are more than one month late.

Changes are also proposed to the VAT and PAYE penalty regimes, again covering both late filing and late payment.

### **Payment support**

From 24 November 2008 a business payment support line intended to help businesses that are having difficulty meeting their tax liabilities will be made available, to help these businesses agree a payment strategy. Where difficulties are caused by HMRC delays in processing repayments, taxpayers are encouraged to contact the office dealing with their claim.

## **VAT**

### **VAT rate cut to 15% from 1 December 2008**

The standard rate of VAT is to be cut to 15% with effect from 1 December 2008, and will run until 31 December 2009. As a consequence of the change, businesses will be facing systems issues arising from the implementation of the new rate, including dealing with payments already received for goods and services to be delivered after 1 December (and vice versa), credit notes, and so forth. Retailers will have the task of repricing their goods if they are to pass on the rate change. Larger businesses may wish to consider the level of the payments-on-account that they have to make, since these should be reduced to reflect the new, lower VAT rate. Businesses may also wish to consider the timing of purchases, particularly capital purchases, especially where VAT will not be fully recoverable.

### **Retailers – increase in the threshold for bespoke retail schemes**

As part of the wider simplification review, the turnover threshold above which retailers have to agree a 'bespoke' retail scheme (instead of using one of the standard schemes) will increase from £100 million to £130 million. The new threshold takes effect from 1 April 2009. Retailers with turnover above £100m but below £130m and with agreed bespoke schemes will continue to operate these schemes until the agreement ends.

### **Alcohol, tobacco and fuel duty**

The rates of duty on alcohol, tobacco and fuel are being increased with effect from 1 December 2008 by amounts calculated to reverse the effect of the reduction in the VAT rate. Accordingly, the price of fuel, alcoholic drinks and tobacco should not change materially as a result of the VAT rate change.

### **Air Passenger Duty**

The proposal to replace air passenger duty (APD) with aviation duty has been scrapped. Instead, the existing APD framework will be amended, with four new geographical bands being introduced for any travel which commences on or after 1 November 2009, irrespective of when the ticket for travel was booked or purchased. The new rates of APD will range from £11 to £170 per passenger, in place of the current rates which range from £10 to £80 per passenger.

# Tax rates and allowances 2009/10

## Allowances 2009/10

	2009/10 £	Change £	2008/09 £
Personal allowance (age under 65)	6,475	440	6,035
Personal allowance (age 65-74)	9,490	460	9,030
Personal allowance (age 75 and over)	9,640	460	9,180
Married Couple's allowance* (age less than 75 and born before 6 April 1935)	6,865	330	6,535
Married Couple's allowance* (age 75 and over)	6,965	340	6,625
Married Couple's allowance* - minimum amount	2,670	130	2,540
Income limit for age-related allowances	22,900	1,100	21,800

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

The basic and higher income tax rates remain at 20% and 40% for 2009/10 and 2010/2011. From 2010 the personal allowance will be tapered to half its value for those with incomes over £100,000 and to zero for those with incomes over £140,000. From 2011 incomes above £150,000 will be subject to a new 45% income tax rate.

## Pensions

	2009/10 £	Change £	2008/09 £
Annual allowance	245,000	10,000	235,000
Lifetime allowance	1,750,000	100,000	1,650,000

## National Insurance Contributions

	2009/10 £	Change £	2008/09 £
Primary Class 1 contributions			
Lower earnings limit (per week)	95	5	90
Upper earnings limit (per week)	844	74	770
Primary threshold (per week)	110	5	105
Secondary threshold (per week)	110	5	105
Class 2 annual small earnings exception	5,075	250	4,825
Class 2 rate (per week)	2.40	0.10	2.30
Class 3 voluntary contribution rate (per week)	12.05	3.95	8.10
Class 4 contributions			
Lower annual earnings limit	5,715	280	5,435
Upper annual earnings limit	43,875	3,835	40,040

From 6 April 2011 a 0.5% increase in employer, employee and self-employed rates of National Insurance Contributions (both main and additional rates) will be introduced. At the same time the point at which individuals start to pay National Insurance will be aligned with the personal allowance.