

Deloitte.



Clarity
Pre-Budget Report
– Deloitte's full
commentary

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1 Introduction

The Chancellor sat down after an hour, when he delivered a road map for tax reductions now, followed by tax increases in 2010 and 2011.

Business will be pleased to see the Foreign Profits announcements, although there isn't yet much detail available. There will be a dividend exemption in 2009, together with a worldwide debt cap on interest deductions, which finances it. However, the most important announcement is contained in letters to the CBI and the Hundred Group, where the move to a territorial tax base (taxing only UK source profits) and the reduction in the scope of the CFC rules will be welcomed. The Treasury has costed the CFC reduction at £275 million, in two years' time.

Small business gets a wide ranging package of extra finance, including a scheme to spread tax payments and a new 3 year loss carry-back rule for losses up to £50,000. In addition, the increase in small companies rate to 22% is deferred a year, to 2010.

We shall all start paying for the tax reductions in 2011, assuming the Government is re-elected. National Insurance contributions will rise by 0.5% for both employers and employees, although the lower rate threshold will be increased to match the new personal allowance. Higher rate taxpayers will see personal allowances cut (for those earning over £100,000) and eliminated (for those earning over £140,000). In addition, there will be a new 45% rate for those earning over £150,000.

In the meantime, the Government's message is 'spend, spend spend' at least for the next 13 months, to benefit from the reduced 15% VAT rate.

Bill Dodwell is Head of the Tax Policy Group at Deloitte

2 Key topics

2.1 Taxation of foreign profits of companies

Today's announcement on foreign profits reform brings a welcome resolution to over two years of debate on the introduction of an exemption from UK corporation tax for overseas dividends. The announcement of reforms which are to be introduced into law in Finance Bill 2009 represent significant changes to how the UK taxes international activity. However, it also opens a further round of consultation on the future of the UK's Controlled Foreign Company (CFC) rules which, for some businesses, have been the most controversial part of the consultation process to date.



Summary of the announcement

At a very high level, the reform package announced today will introduce an exemption for foreign dividends (subject to certain restrictions) received by large and medium businesses. It is not clear yet from what date this will apply. This will be accompanied by the abolition of the outdated Treasury Consent requirements and their replacement with a post-transaction reporting requirement for high-risk transactions with a value of more than £100m. These two reforms are intended as the 'good news' parts of the package. The 'bad news' parts of the package are;

- the introduction of a worldwide cap on the amount of interest which can be deducted for tax purposes in the UK,
- an extension to the current anti-avoidance rules for loan relationships and
- the restriction of some of the current exemptions which take overseas subsidiaries outside the scope of the current CFC rules.

The cost of reform

HM Treasury's estimated cost of the foreign profits reform (published in the Pre-Budget Report) is zero in 2008/09, +£75m (ie income to HMT) in 2009/10, +£25m (ie income to HMT) in 2010/11 and a cost to HMT in 2011/12 of £275m. The declining cost profile of the overall package is interesting, although there is no detail as to how this breaks down between the various elements of the reform package. However, this profile does indicate that over time HM Treasury expect this package to represent a cost to the Exchequer.

Future reform: CFC

A wider reform of the CFC rules (which was originally suggested as part of this reform package) has been deferred. This will still be taken forward but will follow its own timetable, although it is not expected this will be concluded in time for Finance Bill 2010. In an open letter from the Financial Secretary to the Treasury to the CBI and Hundred Group, it is stated that the intention of this reform will be to modernise the rules, which will aim to protect against artificial diversion of profit from the UK. This letter also indicates that a new CFC system should not tax profits genuinely earned in overseas subsidiaries. This is stated to be consistent with a "move towards a more territorial system of taxing foreign subsidiaries".

In terms of process for future CFC reform there is no indication of what we can expect, but a consultation or discussion document on options for reform is likely to be the next step. This announcement suggests that the Treasury have listened to the concerns of business and representative bodies over the proposals put forward for CFC reform in the 2007 Discussion Document (the income based controlled companies rules) along with the calls which have been made not to rush this critical piece of reform. Therefore, separating CFC reform from the wider package seems sensible in terms of process as this allows dividend exemption to be introduced without further delay, whilst further work on policy options for the future of CFC are worked through.

A territorial system?

Whilst the statement of the expected future intention of CFC is reassuring, the continued uncertainty over timetable and the outcome of this reform may be unsettling for some businesses. The outline of the income based controlled companies rules, suggested in the 2007 Discussion Document, was regarded by many as an attempt to broaden the scope of the current CFC rules, bringing more offshore activities within the UK tax net. In today's open letter to the CBI and Hundred Group, the Financial Secretary to the Treasury acknowledges that there has been speculation the Government is seeking to increase the scope of the CFC rules and goes on to say that this is not the case.

Of course, full consultation on CFC reform will take time so this leaves us with the question of whether there will be tensions in how the current CFC regime is operated by HMRC during the period between now and the introduction of future reform. The current system does tax situations where profits are genuinely earned in overseas subsidiaries where there has been no diversion of profit from the UK, and the motive test, which many may expect would apply in such situations, is often denied by HMRC. This tension could very easily be managed if HMRC were to revise their position on the motive test to provide clear and public guidance that under current rules, profits that are genuinely earned in overseas subsidiaries will be CFC exempt. This would be a very positive move in demonstrating the Treasury is serious about its stated intention and would help relieve the pressure on the CFC position of UK groups who are competing with companies located in more favourable tax jurisdictions.

Shorter term CFC issues

Today's announcement includes the abolition of some of the current avenues available for offshore subsidiaries to qualify as exempt CFCs. These changes may, depending on their detail, adversely impact some very common commercial arrangements.

The first, the Acceptable Distribution Policy (ADP) exemption, allows a CFC to be exempt if it distributes at least 90% of its profits back to the UK via a taxable dividend within 18 months of the end of the accounting period. The introduction of dividend exemption means this CFC exemption no longer makes sense and in fact, even if it were not abolished it simply would not be effective any more as the requirement for the dividend to be subject to UK tax would not be met under a dividend exemption system.

The second change is the proposed abolition of the holding company tests contained within the exempt activities CFC exemption, subject to a 24 month transition period (the full details of which are yet to be published) which is announced to allow groups time to unwind holding company structures. This is more controversial. By proposing

to abolish the holding company tests, the Government is ignoring the fact that many groups have holding companies which are used for normal commercial purposes. For example, a holding company may be used to provide services to other companies within the same territory which, under the current rules, could be exempt from a CFC apportionment. Holding companies are also used for cash pooling and financing within the same territory. In many normal acquisition scenarios a holding company may be used as a bid vehicle and may provide finance. All of these situations which may escape the ambit of the current CFC rules in a straightforward manner are likely to be impacted by the proposed abolition of these tests. This means that affected companies will need to consider whether any of the alternative CFC exemptions may be available to them or suffer a CFC apportionment which, even if it does not increase the total tax cost (because of relief for overseas taxes already suffered) it will increase their compliance burdens.

Who is likely to be affected?

The different elements of the reform package announced are likely to impact different sectors in different ways. The impact on specific taxpayers will of course depend on the circumstances of each group but we would broadly expect the impact to be as follows:

- UK outbound groups – should benefit from dividend exemption. The interest cap proposals are likely to negatively impact groups with upstream loans where external debt is borrowed wholly in the UK.
- Inbound groups – many will not benefit from exemption but could be adversely impacted by the interest cap proposals. Even if this does not result in additional tax cost it is likely to be a compliance cost, depending on the detail of the rules.
- Cash rich groups/groups required to hold liquid assets in their business are likely to be adversely impacted by the debt cap depending on how the net consolidated interest position of the group is calculated and how much of their external debt is located in the UK (if interest on UK debt remains deductible in spite of the cap).
- Private Equity & Fund structures – it is unclear whether the typical sorts of investment structures used by these groups are likely to be impacted by the interest proposals. This is likely to depend on how the consolidated group accounts for shareholder investment and whether this is regarded as external debt.

Whether groups will benefit from the overall package of reform will depend on how significant a benefit they believe dividend exemption offers them and whether the impact of the interest cap is a price they are willing to pay.

Next Steps

Today's announcement states that draft legislation containing the detailed proposals will be published in the coming weeks for consultation. The intention is for the final form of the legislation to be introduced in Finance Bill 2009. No timetable has been suggested for wider CFC reform, but as this is unlikely to be complete before 2010, which is widely expected to be an election year, it is unclear how this will impact the prospects for CFC reform.

Bill Dodwell is Head of the Tax Policy Group at Deloitte

2.2 Personal tax rates, allowances and NIC

The PBR was a mix of the widely expected and the enormously surprising from a personal tax perspective this year.

We already knew (because the Treasury started briefing journalists last night, in a complete break with tradition) that the temporary uplift to personal allowances, designed to compensate lower and middle earners for the withdrawal of the 10% tax rate, would be made permanent. It's also been uplifted to £145 (from £120) from 1 April 2009.



We also knew that the highest 1% of earners - those earning more than £150,000 - will find themselves subject to a new 45% tax rate from 2011.

We weren't expecting the changes to NIC. From 2011, the rate for both employer's and employees' NIC will increase by ½%. As a sweetener, the lower earnings limit for NIC will be brought into line with the income tax personal allowance threshold. Our back of the envelope calculation shows that someone earning £40k will be £100 per year worse off.

But a bitter pill is the alignment of the upper earnings limit and the higher rate tax band with effect from April 2009. People earning around £44k will find themselves £32 per month worse off.

As an aside, the cost to employers will be c.£2 billion per annum.

Most surprising of all was the news that from April 2010 people earning between £100k-£140k per annum will lose part of the benefit of the income tax personal allowance, an allowance previously enshrined as sacrosanct for all taxpayers. 649,000 people fell into that bracket in 2008-09. The Chancellor announced that such earners will only receive the same net benefit from their personal allowance as basic rate taxpayers - which will take around £100 per month out of their pockets. And it's worse news for people earning more than £140k per annum will get no personal allowance at all - at a cost to them of £200 per month.

One additional twist is that the personal allowance tapers off at £100k and £140k - you lose £1 of personal allowance for every £2 you earn. That means that the effective tax rate for people within the two taper regions is a whopping 60%.

By the way, that means that by 2011 we'll have 6 different income tax rates to juggle with, plus tapering allowances. That's quite an increase in complexity for anyone who operates a payroll.

Overall, it's clear that higher earners will see an increased tax burden due to the new upper tax rate and decreased personal allowances, but so too will middle earners owing to the NIC changes.

Patricia Mock is a PCS Director at Deloitte

2.3 VAT rate change

The headline grabbing VAT rate reduction announced in the PBR is in fact likely to have little impact. In our opinion, for the average consumer, a 2.5% reduction in VAT is unlikely to convince them to spend where previously they may have saved.

For business too the change is likely to create a number of commercial headaches rather than be a significant stimulus to the economy. This is particularly the case for retailers who now have to deal with some major systems changes to account for the new VAT rate at one of their busiest times of the year. Many retailers are already offering significant discounts to attract shoppers and they will now need to consider how quickly they are able to implement the required changes.



Dan Lyons is a VAT partner at Deloitte

3 Budget measures

3.1 Business

3.1.1 Changes to the trading loss carry back rules

Companies and unincorporated businesses making trading losses will have an additional way to relieve these losses.

Current rules allow trading losses to be relieved in a number of ways, including against income in the current year or carried back to the preceding year and the Government is now introducing a further mechanism for relief. It will now be possible to carry back trading losses for three years, where they have not been fully utilised by a single-year carry back claim.

For companies the new rules will apply for accounting periods ending between 24 November 2008 and 23 November 2009, while for unincorporated businesses the new rules will apply for the tax year 2008-09.

Losses must be set against profits from the most recent accounting period first. The amount of losses that can be carried back to the preceding year remains unlimited. After carry back to the preceding year, a maximum of £50,000 of the balance can be claimed by carrying back to the earlier two periods.

Our view

The additional means of obtaining relief is welcome but the £50,000 limit and temporary nature of the relief will in practice restrict its benefit.

3.1.2 Compliance checks: the next stage

Background

As part of its wider review of 'Modernising Powers, Deterrents and Safeguards' HMRC has published a further consultation document covering the next stage of its information powers and compliance checks for:

- insurance premium tax
- environmental taxes
- stamp duty reserve tax
- inheritance tax
- petroleum revenue tax

Aim

FA 2008 aligned information powers, inspection powers, assessment time limits and record-keeping requirements, for income tax, capital gains tax, corporation tax, VAT and PAYE which it is anticipated will have effect from 1 April 2009.

Subject to this further consultation, the aim is to extend these new powers to the taxes listed above.

Previous consultations

The consultation document follows a number of previous consultations covering compliance checking:

- March 2005: 'HM Revenue & Customs and the Taxpayer: Modernising Powers, Deterrents and Safeguards
- March 2006: 'HM Revenue & Customs and the Taxpayer: Modernising Powers, Deterrents and Safeguards: The Developing Programme of Work' (this sought initial views on HMRC's compliance checking activities)
- May 2007: 'HM Revenue & Customs and the Taxpayer: Modernising Powers, deterrents and Safeguards: A new approach to compliance checks
- January 2008: 'HM Revenue & Customs and the Taxpayer: Modernising Powers, Deterrents and safeguards: A new approach to compliance checks: responses to consultation and proposals' together with draft legislation and guidance.

Key features

Schedule 36 FA 2008 provides the legislative framework for aligned information powers and compliance checks the key features of which are:

- HMRC officers to be able to issue 'taxpayer notice' to obtain information and documents for the purposes of 'checking the taxpayer's tax position' Replacement of ITSA, CTSA, VATA, & Section 20 TMA 1970 information powers.
- The concept of checking a taxpayer's 'tax position' includes past, present and future liability to pay any tax.
- 'Third party notice': Power to obtain information and documents from a third party, such as a bank, possibly an employer, subject to certain safeguards.
- An officer may make an 'informal notification' that a document is (or is likely to be) subject to an information notice. There will be monetary penalties for non-compliance.
- Criminal sanction for concealing, destroying or disposal of documents after receiving an information notice (or following an informal notification).
- Power to inspect business premises for the purpose of checking the tax position of any person.
- Inspection on either written notice or by/with agreement of 'authorised officer of Revenue & Customs'.
- Power for HMRC to specify when and where documents are produced for inspection.
- Power for HMRC to carry out in-year inspections during an accounting period and before tax return is filed.
- Power to remove documents.
- Alignment of time limits for the assessment of the taxes across CT, IT, PAYE, NIC and VAT.

Impact

Only those businesses which are already within the regime for these taxes will be impacted.

Timeline

Subject to the consultation the new information powers and compliance checks would be extended to these other taxes through Finance Bill 2009 and are anticipated to take effect from 1 April 2010.

HMRC has invited comments by 13 February 2009 and will be inviting taxpayer representatives for these taxes to meet with the Review team. Responses should be sent to HMRC Review of Powers: compliance checks, Room 1/72, 100 Parliament Street, London SW1A 2BQ.

Our view

We welcome the consultation and the overall objective of aligning the administration and management of all taxes. We have responded at all stages of the consultation process concerned with 'Modernising Powers, Deterrents and Safeguards' and will be responding to this document. It is important to remember that these are 'powers' and much will therefore depend on how HMRC apply them in practice.

3.1.3 Connected party loan relationships

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

Debts owed to connected party creditors

Although the timeframe for introduction of this change has been confirmed, no details as to how the change will take effect have been released.

The change relates to the tax deductions available for interest on a loan relationship, where the creditor party does not bring the credits into account for loan relationship purposes (commonly because they are not tax resident in the UK). Under the current rules deductions are granted on a paid basis rather than an accruals basis, where the interest is not paid within twelve months of the end of the accounting period in which it is accrued.

This issue is currently subject to an HMRC consultation process and HMRC have stated that they are considering the responses received as part of the consultation process.

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

This change will address the asymmetric tax treatment on the release of a connected party debt, where that debt is treated for tax purposes as a trade debt. Under current rules the creditor does not receive relief for such a release, but the debtor may be

taxed on the credit. Under the new rules the debtor will not be taxed on the credit. It is not yet clear how the legislation will be altered to achieve this result.

Our view

We are looking forward to receiving clarity on how the law will be amended in relation to these rules.

In relation to the correction of asymmetric tax treatment of connected party trade debts, companies have frequently been forced in the past to undertake specific planning to ensure that they do not suffer adverse tax consequences from a commercial intragroup situation and this is therefore a welcome change.

3.1.4 Consultations: payments, repayments and debt: the next stage

Background

Following legislation introduced in FA 2008, HMRC has issued a further consultation document entitled 'Payments, Repayment and Debt: The Next Stage'. The objective is to deliver more efficient systems for payment, repayment and debt management through a more taxpayer focused approach, making it easier for taxpayers to pay and enabling HMRC to tackle debt more effectively.

Aim

The intention is to produce a fairer, modernised payment, repayment and debt collection system that:

- fully supports those who wish to pay what they owe on time;
- helps those who may have difficulty paying;
- takes more effective action against those who seek to gain an advantage through not meeting their liabilities or delaying payment.

Key features

The consultation focuses on the following areas:

- a voluntary and flexible monthly instalment payment scheme on a single tax basis for income taxpayers corporation taxpayers not within the Quarterly Instalment Payment (QIP) regime;
- award of costs in successful court actions in relation to late payment;
- extension of HMRC's ability to collect small debts collected through the PAYE system;
- tracing missing debtors through third parties;
- encouraging compliance through the greater use of financial securities for seriously non-compliant businesses and the introduction of tax clearance certificates confirming to businesses that they are fully compliant with their tax obligations.

Timeline

Subject to consultation, these proposed changes may be introduced in Finance Bill 2009, to take effect from an appointed date thereafter.

The consultation is open until 13 February 2009 and HMRC propose to publish responses around Budget 2009 with any changes introduced through the 2009 Finance Bill.

Our view

The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future. The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future.

3.1.5 Contaminated land relief

The Chancellor today confirmed an extension to Contaminated Land Relief to include remediating long term derelict land, land contaminated by Japanese Knotweed and extending the list of qualifying expenditure where works are carried out by sub-contractors. These measures are in line with those initially proposed in December 2007 in the Government's response to the consultation "Tax incentives for development of brown-field land" and will apply to expenditure incurred on or after 1 April 2009. Draft guidance will also be published setting out the alignment of the tests for Land Remediation Relief with remediation undertaken specifically in relation to planning permissions.

The key aspects of the changes and extensions to the relief are as follows.

- Contaminated Land Relief (CLR) will be expanded to be available on clearing long term derelict sites. It should be noted that there is a limited amount of expenditure that will qualify and furthermore the site needs to have been empty from 1 April 1998.
- HMRC are to legislate that clearance of Japanese Knotweed will be allowable, however it will be subject to restrictions.
- The definition as to what relief constitutes CLR has been tightened, with the definition of harm being restricted to increase the threshold at which a claim can be made (for example harm to the 'health of living organisms' has changed to 'death of living organisms or significant injury').
- Furthermore the new legislation will only allow relief of harm caused as a result of an industrial activity and natural issues have been specifically excluded (however Treasury Orders will be introduced to expand the relief, for example to Radon).
- The interest in the land has been increased from almost any interest or right to be either a freehold or leasehold (or option to acquire).
- The relief will not be available on expenditure incurred on landfill tax or expenditure required to be incurred by law (for example because the site is dangerous or causing nuisance).

Our view

Whilst not being much of a surprise, given the previous announcement of these measures, they are nevertheless welcome and fit the profile of green incentives extended by the Government. Overall, the relief is being expanded in terms of potential areas, however the measures include some tightening as to the relief that could potentially qualify.

3.1.6 Corporation tax simplification for smaller companies

Budget 2008 announced a review to consider the benefits of simplifying corporation tax calculations and statutory return obligations for smaller companies, (i.e. those with a turnover of less than £750,000 and with fewer than 10 employees). The review has involved HM Treasury and HM Revenue & Customs (HMRC) listening to business views of where complexity creates burdens and how these might be addressed. The Department for Business, Enterprise and Regulatory Reform (BERR) are also involved.

A discussion document issued today provides an update of the work of the review, and seeks further views. The document also notes a proposal being considered at EU level to allow Member States to vary accounting requirements for micro companies.

The document agrees that simplification of corporation tax calculations for smaller companies is a good idea in principle. However, there is no agreement on the form any simplification should take. There was no consensus on aligning tax and accounting requirements. Similarly, there was no consensus on the relative complexity of tax calculations for companies versus self-employed businesses, nor any particular support for integrating the two to arrive at a common set of rules.

The review will not take forward the following ideas:

- Statutory accounts profits to be used as taxable profits;
- Flat rate expense allowances, i.e. the expenses to be allowed against business income being set at a flat rate for all similar businesses.

Two other ideas will be taken forward:

- A possible new accounting standard which aligns current statutory accounting and tax calculation obligations; and
- a new tax regime based on cash flow.

The discussion document seeks responses to both these ideas.

Our view

This is a very different approach to the taxation of small companies. Clearly both the proposed ideas have a number of difficult issues to consider, especially since tax and accounting measures differ significantly in a number of areas, eg depreciation of fixed assets.

3.1.7 Disclosure of tax avoidance schemes

HMRC have announced changes to the rules governing the disclosure of tax avoidance schemes. For accounting periods starting on or after 1 April 2009 companies must report a Scheme Reference Number (SRN) in their tax return for the year in which the scheme is implemented rather than the year in which the SRN is received. Rules have also been introduced concerning the limited conditions under which taxpayers need to report an SRN outside a tax return.

Our view

This is a minor amendment to the timing rules for SRNs and is unlikely to have any significant impact on users of SRNs.

3.1.8 Disguised interest

Revised draft legislation and associated commentary has been released with intended effect for arrangements entered into on or after 1 April 2009. This takes into account the comments received by HMRC at the various workshops that have been held since the last consultation document. Further comments on the revised consultation need to be made by 11 February 2009.

The aim of the rules is to tackle tax avoidance involving disguised interest for corporation tax purposes. The purpose of the provisions is to tax any amount or return which is economically equivalent to interest as if it were a profit arising to the company from a loan relationship. This will generally capture disguised interest in non-loan transactions.

This type of return has been clarified in the draft legislation as one that is referable to the time value of money, at a rate reasonably comparable to a commercial rate of interest and where there is no practical likelihood that it will cease to arise.

Contingent returns should therefore fall outside this definition. Any exchange gains or losses on retranslating a non-sterling interest return are specifically included. However, the rules appear to exclude any exchange differences relating to retranslation of principal amounts.

Where the disguised interest return is split between two or more persons then the provisions seek to allocate the return on a 'just and reasonable' basis between those persons.

The proposal to specifically include arrangements which seek to capitalise companies with tax losses in order to utilise the losses has been dropped following strong opposition on consultation.

Any return falling within these provisions is taxed as a profit arising to the company from a loan relationship. The loan relationship debits and credits to be brought into account in respect of the return must be determined on an amortised cost basis of accounting, whether or not this is reflected in the company's accounts. This contrasts

with the existing shares-as-debt regime which seeks to tax the return on a fair value basis.

Exclusions

The provisions do not apply to any arrangements which produce such a return if and to the extent that the return is brought into account for corporation tax purposes as trading income or under the loan relationships, derivative contracts, or intangible fixed asset regimes. HMRC commentary suggests that this clause confirms the exclusivity of the loan relationships regime, for example, in the context of the specific provisions dealing with index-linked gilts. However, the drafting does not appear to put this beyond doubt. HMRC also comment that Section 37 TCGA 1992 should prevent any double charge as a capital gain but would welcome views.

In any event, the rules do not apply to any arrangements which produce such a return unless the main purpose, or one of the main purposes, of the arrangement is to secure that the return is not brought into account as income for corporation tax purposes. This purpose-based exclusion is much more consistent with other 'unallowable purpose' provisions within existing statute.

The main positive development is the general exclusion for intra-group shareholdings and non-group shareholdings which are subject to CFC apportionment (or would be but for a CFC exemption). A group company for these purposes is defined as a company within a capital gains group. This should make it clear that the target area for these proposals is corporation tax avoidance on disguised interest income from third party 'deposit'-type arrangements.

The intra-group and CFC shareholding exclusions only apply where the arrangement is such that it is the share alone that produces the disguised interest return. There are also requirements that the shares are fully-paid up with no unpaid amounts or contingent obligations outstanding.

Shares accounted for as liabilities

The introduction of the disguised interest rules should permit the repeal of various other anti-avoidance provisions including the shares-as-debt rules, quasi-stock lending arrangements and repo anti-avoidance. The shares-as-debt rules targeted at redeemable preference shares are to be replaced with a wider definition of any share that is accounted for as a liability.

As with the current rules, the shares still need to be designed to produce a return which equates, in substance, to the return on the investment of money at a commercial rate of interest. The investing company also needs to have an unallowable purpose in acquiring/holding the shares for the rules to apply in line with the existing Section 91D provisions.

A major positive development is an exclusion where the issuing company and investing company are 'connected' companies. For these purposes 'connected' should follow the loan relationships connection test.

Any shares falling within these provisions are taxed under the loan relationship provisions, and accordingly any return, including distributions, should be taxable

under the core charging provisions of the loan relationships code. This contrasts with the current shares-as-debt rules which tax on a fair value basis.

Similarly, transitional arrangements for shares becoming subject to these rules deem a disposal and acquisition at a 'notional carrying value', i.e. the carrying value in the accounts at that time. Again, this contrasts with the existing regime where transition is on a fair-value basis.

Our view

The disguised interest rules have caused widespread discussion as to the effectiveness and appropriateness of a principle based approach to legislation. The draft legislation and consultation period have given rise to a moving landscape both as to the scope and detail of the rules and their interaction with many related areas of corporate tax. We are pleased that much of the feedback has been taken on board by the draftsman, especially in relation to clarifying the scope of the rules (and its applicability within groups). This has given rise to a much clearer and more targeted approach which should set the platform for workable legislation. There still remain some areas of uncertainty but we hope that the forthcoming open days will be useful in ironing these out.

3.1.9 Environmental measures

Despite the current economic climate environmental goals remain a high priority for the Government, as evidenced by the recent announcement that it has increased the UK's emissions reduction target to 80% of 1990 levels by 2050.

With a view to introducing a green stimulus and supporting low-carbon growth, the following have been announced:

- Accelerating £535 million of capital spending on energy efficiency, rail transport and adaptation measures;
- Inclusion of aviation in the EU Emissions Trading Scheme from 2012;
- The Renewables Obligation will be retained to provide financial support and greater certainty for large-scale renewable electricity and will be extended by at least 10 years;
- The previously postponed 2p per litre fuel increase will come into effect from 1 December 2008;
- Installing 600,000 insulation measures this winter, through the £6.8bn Home Energy Saving Programme;
- Reform to vehicle excise duty with effect from April 2009, although the maximum increase will be £5 in 2009 and no more than £30 in 2010;
- Reform of air passenger duty from 1 November 2009 to introduce four bands based on distance travelled. Proposals to introduce an aviation duty which would have been levied per plane have been scrapped;
- From April 2009 the tax relief for business expenditure on cars will be based on emissions;
- From 1 April 2009 land remediation relief will be extended to specified expenditure and also amended to provide greater clarity. This relief is intended to incentivise bringing long term derelict land back into use. The relief will give bodies liable to corporation tax a deduction of 150% for qualifying expenditure on removing or mitigating the effect of contamination.

Our view

The Government has had to balance its environmental objectives with the current economic climate, but it is clear that the environment remains a clear area of priority. This is most clearly exemplified with the shelving of the proposed aviation duty after listening to the concerns of the industry in the consultation process. However, the Government has not abandoned its environmental objectives in this area as aviation will be included in the EU Emissions Trading Scheme from 2012 and air passenger duty will be amended from 2009 to more closely align the tax with distance travelled.

3.1.10 Change of accounting practice regulations

An anomaly has been identified in the regulations that deal with the taxation consequences of a change of accounting practice with regard to financial instruments.

The Loan Relationships and Derivative Contracts (Change of Accounting Practice) Regulations 2004 SI2004/3271 (COAP Regulations) were introduced to ensure that most changes to the measurement or recognition of financial instruments as a result of a change of accounting policy, in particular on the adoption of International Financial Reporting Standards (IFRS) or their UK equivalents, would be taxed or relieved for corporation tax purposes. Most such transitional adjustments were to be taxed or relieved on a spreading basis over ten years.

The anomaly relates to exchange gains and losses on certain foreign denominated financial instruments, which were not taxed before the change of accounting practice due to the tax rules relating to foreign exchange hedging transactions (the tax matching provisions).

Where these instruments were being treated for accounting purposes as a hedge of a company's economic risk from holding foreign investments (net investment hedge) prior to the change of accounting practice, the exchange movements were not taxed under the tax matching provisions.

However the COAP Regulations, as presently worded, will tax or relieve the reversal of these exchange movements on change of accounting practice even where the amounts in question were not previously taxed or relieved due to the tax matching provisions. This can result in double taxation (where there is a transitional credit to reverse forex losses not previously relieved) or double relief (where there is a transitional debit reversing forex gains not previously taxed).

Regulations are to be laid, to take effect on and after 1 January 2009, to prevent further double taxation or double relief with regard to foreign exchange gains and losses under the COAP Regulations as a result of a change of accounting practice, to the extent that an amount would otherwise be brought into account under the COAP Regulations during the proportion of the ten year spreading period arising after 31 December 2008.

Draft regulations will be published shortly to allow taxpayers a brief period to comment on the detail of these changes before the regulations are laid.

Our view

This measure is welcome as it will eliminate an unintended effect of the transitional

regulations on a change in accounting policy. Unfortunately, no comment has been made relating to relieving the potential double taxation that some taxpayers may have suffered in 2008 or prior periods.

3.1.11 Foreign profits of companies – UK taxation

The following changes in relation to the taxation of foreign profits will be introduced in Finance Bill 2009. The date from which these will take effect is yet to be announced. Detailed draft clauses will be released for consultation in the coming weeks.

Foreign profits reform - foreign dividends received by UK companies

- Any foreign dividend received on an ordinary share will be exempt from UK corporation tax;
- Exemption will only be available to large and medium businesses. Small businesses which receive foreign dividends will still be subject to UK tax with credit;
- The above exemptions will be subject to a Targeted Anti-Avoidance Rule (TAAR) which will apply where there is a scheme which is tax motivated and carries certain characteristics. No detail has yet been provided on this;
- Any other dividends will still be subject to UK tax, with credit given for overseas tax suffered.

Our view

This brings a welcome resolution to over two years of debate on the introduction of an exemption from UK corporation tax for overseas dividends.

Tax accounting view

Subject to clarification of the detail, the exemption for foreign dividends may result in the partial release of deferred tax liabilities for large and medium groups reporting under International Financial Reporting Standards currently provided on:

- unremitted earnings of foreign investments where there is no control over the repatriation policy; and
- unremitted earnings of foreign subsidiaries where there is an intention to remit profits.

Any release would be relevant for balance sheet dates following substantive enactment of the legislation.

Foreign profits reform - tax deductions for interest

- Extension of the current unallowable purpose test (which applies to deny tax deductions for loan relationships which have an unallowable purpose) to apply to a scheme or arrangement. Currently this test is applied on an entity by entity basis to the party entering into a loan relationship or derivative. As this test applies to each accounting period where an entity is party to such a relationship this change will affect existing arrangements as well as future ones;

- The introduction of the worldwide debt cap. This will limit the amount of UK deductible interest available by reference to the group's consolidated net external finance costs;
- The definitions used and the precise mechanics of how this cap would operate have not yet been published, so a number of significant uncertainties remain;
- The comparison with group consolidated interest is on a net basis and therefore interest income would be expected to be netted against interest expense. It is therefore expected that cash rich groups who currently have debt in the UK will be caught by the cap. However, the open letter published by the Financial Secretary to the Treasury in July of this year did suggest there would be a set-aside provision whereby the cap will not apply in circumstances where the group is in a temporary cash surplus position.

Our view

The interest cap proposals are likely to negatively impact UK outbound groups with upstream loans where external debt is borrowed wholly in the UK. Inbound groups could also be adversely impacted by the interest cap proposals as, even if this does not result in additional tax cost, it is likely to be a compliance cost, depending on the detail of the rules.

Cash rich groups, or groups required to hold liquid assets in their business, are likely to be adversely impacted by the debt cap depending on how the net consolidated interest position of the group is calculated and how much of their external debt is located in the UK (if interest on UK debt remains deductible in spite of the cap).

Foreign profits reform - treasury consents

- Today's announcement includes the abolition of the treasury consent rules in s765 and 765A ICTA 1988, which require advance consent to be obtained from HM Treasury for particular types of cross-border transactions, and require notification of these transactions where they take place within the EU.
- In place of these rules, a new post-transaction quarterly reporting requirement is introduced for high risk transactions with a market value of £100m. No report is required for transactions with a value below this threshold.

Our view

It is currently not clear what level of information will be required to be reported. If this is a light touch requirement, then this reform is likely to be a positive move for business, especially in relation to removing the requirement to obtain advance consent for some transactions and the custodial penalty. If the information requirement is burdensome this may not be much of an improvement.

Foreign profits reform - changes to treatment of controlled foreign companies

- The current CFC exemption for companies which pay at least 90% of their chargeable profits back to the UK via a taxable dividend (the Acceptable Distribution Policy Exemption or ADP) is being abolished in the light of the introduction of a dividend exemption;

- In addition, today's announcement suggests that the current exemption from CFC status provided under the Exempt Activities test for holding companies will also be abolished. This is subject to a 24 month transitional period to allow existing holding company structures to be unwound.

In addition, the Government stated it will continue to examine options for reform of the UK CFC rules, and the letter published today by the Financial Secretary to the Treasury to the CBI and Hundred Group commits to consultation on the modernisation of the CFC regime.

Our view

Whilst the statement of the expected future intention of the CFC rule is reassuring, the continued uncertainty over timetable and the outcome of this reform may be unsettling for some businesses.

3.1.12 Interest – alignment of treatment across different taxes

A consultation document has been issued which examines proposals for the harmonisation of interest charged and paid on late paid and overpaid tax, respectively.

Background

This is part of HMRC's programme of legislative changes which aims, amongst other things, to look at how alignment between the interest rules for the various taxes could bring benefits to taxpayers, their advisers and HMRC.

The document follows on from an earlier consultation document published on 19 June 2008, 'Interest ' Working towards a harmonised regime'. The responses to and discussions on the earlier consultation document have been used to develop the key proposals set out in this consultation document.

HMRC propose that an effective interest regime should be based on the principle of recompense, removing the benefit of delaying payment for people who pay late and providing reasonable recompense for those who overpay.

Key issues

- The existing rules have evolved specific to each tax over time and are inconsistent between different taxes, with interest being calculated at different rates, with different formulae, different reference dates, having different names and not always being tax deductible.

Consultation document proposals

The proposals in this document suggest that:

- A single interest rate is applied to late payments of all taxes, with the exception of Quarterly Instalment Payments (QIP).
- The rate should track the Bank of England base rate as this is easily accessible to taxpayers.
- A single rate should also apply to all overpayments of taxes, except for QIPs. This rate should remain lower than the late payment rate.

- Interest should be paid and charged as simple interest.
- The rates under the QIP scheme should be different.

Responses are requested to this consultation document by 13 February 2009. The responses will be published as part of Budget 2009.

Responses to June consultation document

The proposals take into account the key views expressed in the responses to the June consultation document, which were that:

- The Bank of England base rate offered the best realistic recompense to taxpayers.
- There is a rationale for maintaining a differential between interest rates on late payment and overpayments.
- Interest should be charged during the year on late paid PAYE.
- Interest should represent recompense and not a penalty.
- Interest should be calculated on a simple, rather than a compound method, to keep things understandable for taxpayers.
- The current QIP system should remain as it is.

Impact

The main administrative benefits of the new proposed regime would be greater simplicity, greater certainty and greater fairness.

Our view

The proposed changes would simplify matters for clients and tax advisors and would reduce the administrative burden on HMRC in having to be aware of several different methods of interest calculation. Basing the interest regime on the concept of recompense would also seem fairer than the current regime, under which interest on some taxes is calculated on this basis, whereas the interest rules on other taxes appears punitive in comparison.

3.1.13 Investment funds taxation

There are minor updates to the Qualified Investor Scheme, Property Authorised Investment Fund and Real Estate Investment Trust regimes which were broadly expected. There is also commitment to ongoing discussions on the reform of investment trust companies, the offshore funds rules and the Schedule 19 stamp duty reserve tax regime for Authorised Investment Funds, plus clarifying the trading vs investment question, and introducing a Tax Exempt Fund regime, but no further progress.

One potential issue is a possible side-wind of the exemption for foreign dividends for large and medium sized companies. If AIFs were to qualify for that exemption, it may lead to loss of access to double tax treaties and increase the tax cost in the fund, reducing the attractiveness of the UK as a fund location. It would however be a step closer to the exempt model some in the industry have sought. If AIFs are carved out then there would be no impact.

In more detail:

QIS

The draconian tax treatment for certain investors holding >10% of a QIS is being replaced by a genuine diversity of ownership rule along the lines of that already implemented for PAIFs. Generally this should make QIS easy to manage though pension funds and life companies will no longer be able to use QIS as captive funds.

PAIFs

There were 3 minor clarificatory amendments to the PAIF regime

(1) Where a 'feeder fund' is used to comply with the '10% rule' it will be exempt from Sch 19 SDRT on unit transactions to ensure a double charge does not apply, (though the feeder fund will have to 'satisfy certain conditions' which are not stipulated).

(2) Flexibility for PAIFs to make net payments to other AIFs is granted which may be administratively simpler if all other investors obtain such payments net.

(3) Distributions will be subject to the manufactured dividends rules so they are treated in the same way as comparable payments on other securities normally paid net of WHT.

REITs

Anti-avoidance measures will be introduced to prevent a group splitting itself into 2 groups for REIT purposes and obtaining the benefits of the regime by circumventing the group wide balance of business tests

Our view

In the harshest economic environment most of us have witnessed it is not surprising that the Government's focus in this PBR is not on tax measures for the esoteric legislation that impacts pooled funds. Given that the once relatively simple regime for UK funds now has separate regimes for QIS & PAIFs with further regimes such as TEFs in the pipeline, and that the offshore funds rules and investment management exemption rules have been substantially amended in recent times, that may be just as well.

3.1.14 Increase in VAT turnover threshold for bespoke retail schemes

The turnover threshold above which retailers must agree a bespoke retail scheme to calculate their VAT (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 and existing schemes will continue to be used unless and until the agreement ends.

Our view

This is part of the wider VAT simplification review and simply indexes the threshold which has been set at £100 million since 2000. This is part of the wider VAT simplification review and simply indexes the threshold which has been set at £100 million since 2000.

3.1.15 Insurance tax summaries and measures

Introduction

The big headlines from the PBR were largely leaked in advance - a temporary cut in VAT to 15%, a new higher rate of tax of 45% and reduced personal allowances for higher rate taxpayers alongside an increase in NIC for employers and employees of 0.5%.

Other announcements of wider interest to insurers relate to the taxation of foreign profits.

Insurance specific changes announced are that tax deductible claims equalisation reserves are to be introduced for Lloyd's corporate members, and a review is to be carried out to look at maintaining a form of claims equalisation reserve for other general insurers following the introduction of Solvency II.

Our view

The announcement on claims equalisation reserves is to be welcomed.

Insurers looking for certainty on the taxation of foreign profits will be disappointed. Although a dividend exemption has been announced, there are a great many unanswered questions.

The new rate of 45% and the reduction of personal tax allowances for high earners, when introduced, will further complicate the comparison between insurance-wrapped and other savings products.

Foreign profits

A key area of interest for insurers and corporates generally is the taxation of foreign profits. The intention to exempt dividends was trailed in the press at the weekend and this has now been announced with limited supporting detail.

In summary, for Finance Bill 2009:

1. Large and medium sized businesses (not defined) will have most foreign dividends exempted
2. A targeted anti-avoidance rule will be introduced to prevent abuse of the exemption
3. A worldwide debt interest rate cap will be introduced
4. The unallowable purpose test will be extended
5. Consequential changes are to be made to the CFC rules

No details are available on the interest cap, the treatment of portfolio dividends and the consequential changes. A fuller review of the CFC rules will be carried out but any changes are to be subject to further consultation and are not likely to be finalised before 2011.

Our view

There are a number of unanswered questions that will be of particular interest to insurers.

Worldwide debt interest cap: it is not clear how the calculation will deal with financial traders, or treat preference shares which have been issued to raise funds.

Dividend exemption: insurers will be particularly interested in the practicalities and compliance costs of identifying and operating an exemption for 'most' shares. In addition, Lloyd's members that are currently taxed on UK portfolio dividends will hope that reform will bring them into line with other UK insurers.

CFC changes: the longer-term reform will take some years to come into effect, and in the meantime there will continue to be debate over what the treatment should be of group reinsurers that carry on genuine economic activity.

Branches: the proposed dividend exemption will risk distorting the tax comparison between branches and subsidiaries at a time when regulatory and capital developments are leading insurers to consider actively moving to more branch structures.

General insurance measures**Claims equalisation reserves: Lloyd's**

General insurers outside Lloyd's are required by regulatory rules to maintain claims equalisation reserves against certain types of loss. Amounts put into the reserve are tax deductible. The Government has announced that it will bring in a form of tax deductible claims equalisation reserve relief for Lloyd's corporate members, where there is no regulatory requirement to maintain one. The new rules will apply to profits treated as arising in year ended 31 December 2008 onwards, that is to the 2005 year of account and earlier run-off years, for which syndicate returns will already have been made by 1 July 2008.

Our view

This new relief is welcome and follows sustained lobbying by Lloyd's. There is no further detail at present and it is unclear whether, and if so how, the relief will apply to SLPs and LLPs. We anticipate that corporate members will need information from managing agents to enable them to calculate and claim the relief in their tax returns for year ended 31 December 2008.

Claims equalisation reserves: other general insurers

General insurers outside Lloyd's are required by regulatory rules to maintain claims equalisation reserves against certain types of loss. Amounts put into the reserve are tax deductible. The Government has announced that it will bring in a form of tax deductible claims equalisation reserve relief for Lloyd's corporate members, where there is no regulatory requirement to maintain one. The new rules will apply to profits treated as arising in year ended 31 December 2008 onwards, that is to the 2005 year of account and earlier run-off years, for which syndicate returns will already have been made by 1 July 2008.

Our view

This is also a positive development as some insurers have significant amounts in tax deductible claims equalisation reserves.

General insurance reserves

There was no announcement today on the tax treatment of general insurers' technical provisions. Consultation continues on Regulations to define the 'appropriate amount' which will limit the tax deductible amount of technical provisions for the purposes of Schedule 11 FA 2007. We understand that new Regulations will not apply to 31 December 2008 year ends and that HMRC is now aiming to finalise the Regulations by 31 March 2009.

HMRC is currently considering the form of the Regulations and the definition of the "appropriate amount". We understand that draft Regulations may be available for consultation before the end of the year.

Life insurance measures

There were no significant provisions specific to life insurance companies announced in the Pre-Budget Report but a number of general measures are also relevant to life companies.

Qualified Investor Schemes

Specific tax charges on investors with holdings of 10% or more in a Qualified Investor Scheme (QIS) will be removed from 1 January 2009 in order to allow those investors to benefit from the regime applied to investors with smaller holdings and investors in other Authorised Investment Funds. Previously life insurance companies were exempted from the QIS rules, allowing them to hold more than 10% in a QIS without incurring the additional tax charges. Going forward the tax charge will only be applicable to schemes which restrict investment to certain individuals or companies.

Other PBR changes impacting life companies

The new tax rates for individuals give rise to some complexities with top slicing relief for individuals earning over £100,000. The changes will further complicate assessment of the difference in tax treatment between capital gains and income tax on chargeable events.

Changes will be introduced to prevent a debtor company being taxed on the profit arising on release of a connected party debt. We will need to see the legislation to identify whether there are any particular issues for life companies.

Other potential changes in legislation

There are expected to be changes to deal with some areas where the legislation has been found not to be working in practice. There are several areas subject to ongoing discussion with the industry: additions to long term funds: transfer schemes and s.30 TCGA 1992 (application of value shifting to the transferor); and venture capital funds where multiple tiers of funds can cause particular problems. We understand that HMRC is also considering the position of mutual surplus.

There may also be minor corrections to defective legislation. We hope that this includes removing the reference in s.85A FA 1989 (Excess Adjusted Case I Profits calculation) to the now repealed paragraph 21 of schedule 11 of FA 1996: whilst it was intended that the changes in FA 2008 should not change the treatment of loan

relationship deficits it is not clear that the legislation as drafted achieves this.

AIF Dividends

An additional measure will prevent the corporate streaming provisions in the AIF regulations from applying at all to investors for whom an AIF dividend is to be treated as a trading receipt. General insurance companies are not expected to be included in this legislation and the current anti avoidance contained within regulation 52 SI 2006/964 will still apply to them. We are not expecting the position for life companies to change as a result of this proposal.

Unit pricing

Although we expect the exemption of tax on foreign dividends will apply to dividends received by life assurance companies this is still to be specifically confirmed. There will be unit pricing implications if it is confirmed that the exemption will apply, in particular:

- The dividends should be treated as exempt in the hands of BLAGAB policyholders and the corresponding double tax relief on the withholding tax will have to be written off.
- If the underlying funds are in an AIF, and the underlying funds are treated as receiving exempt portfolio dividends, there may be no tax credit arising from streamlined dividends, effectively reducing returns for GRB funds.

Indirect taxes

Standard rate of VAT

The rate of VAT is to be temporarily reduced from 17.5% to 15% from 1 December 2008 until 31 December 2009.

Our view

This is also a positive development as some insurers have significant amounts in tax deductible claims equalisation reserves.

Insurance premium tax

The rate of VAT is to be temporarily reduced from 17.5% to 15% from 1 December 2008 until 31 December 2009.

Other corporate measures

The main points of interest to insurers are likely to be the following.

Principles based approach to financial avoidance products

A further consultation document has been published with a view to introducing legislation in Finance Bill 2009.

British offshore financial centres

The Government has announced a review of British offshore financial centres, their role in the global economy and their long-term business strategies. This is in the context of growing international pressure to line up standards of financial regulation and to meet international norms with regard to taxation. The independent review will be wider than tax and will consider, among other things, financial supervision and

transparency, fiscal arrangements, financial crisis management and international cooperation.

3.1.16 Late filing and late payment consultation

HMRC has been engaged for some years in an extensive programme called 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. Workshops were conducted in September, shortly after the end of the consultation period. As is customary for Modernising Powers, Deterrents and Safeguards, the same consultation document considers many taxes, in this case including income tax, corporation tax, PAYE and VAT.

A new consultation document has been published today. It covers a great deal of ground, but the key proposals are:

1. For annual and one-off returns, e.g. CTSA or ITSA
2. For quarterly obligations, e.g. most VAT traders
3. For monthly obligations, e.g. most PAYE

For annual and one-off returns, e.g. CTSA or ITSA

Late filing

- An initial fixed penalty, which HMRC see as unlikely to be significantly increased from £100, its current level for self assessment.
- A fixed but modest daily penalty running for up to three months starting from three months after the return's due date. The document suggests the daily amount will be fixed in the statute. At present daily penalties can be charged at up to £60 per day and the document suggests that going forward the daily fixed amount will be very significantly less than this £60 per day. Under current law daily penalties require authorisation by the General or Special Commissioners. Under the new proposals authorisation will not be required, but there will be a right of appeal.
- Tax-geared penalties will arise seven and 12 months after the filing deadline. Under current CTSA rules tax-geared penalties arise six and 12 months after the filing deadline. An even more important difference is the base for tax-geared penalties. Under the proposals, they would be based on the tax shown on the return, whether or not it has been paid by the time the penalty arises. Under current legislation they are based on tax unpaid six months after the normal filing deadline. 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

In addition to interest charged on tax paid late, it is proposed to have tax-geared penalties one month (three months for corporation tax), six months and 12 months after the due date. For corporation tax, there are currently no such penalties, though for ITSA the surcharges (at 28 days late and six months late) are similar to the proposals.

For quarterly obligations, e.g. most VAT traders

Current VAT legislation wraps up late filing and late payment together. The new legislation treats the two separately.

Late filing

As with current VAT legislation a rolling default window starts to run from the first failure to submit a return by the filing date. The default window expires a year after the default. Further defaults extend the default window until a year after the latest default. The penalties would be fixed sums which increase as the number of defaults increase, though for the third and subsequent default the penalty per default would be the same.

It is also proposed that the tax geared penalties for very late filing at six and 12 months (including those for deliberate non-filing) should also apply to any quarterly return that is this late

Late payment

As for late filing the suggestion is for a rolling default window (but separate from the filing window). The first time the taxpayer defaults, they enter a default window which expires a year after the default. Further defaults extend the default window until a year after the latest default. The taxpayer can therefore only leave a default window by paying on time for 12 months.

The penalty would be calculated by reference to the number of defaults in the default window. The first default would not trigger a penalty at all and instead HMRC would issue a default notice. The penalties would be percentages of the tax unpaid which increase as the number of defaults increase, though for the fourth and subsequent default the percentage penalty per default would be the same.

As for annual or one off payment obligations, if the payment is more than six or 12 months late then further penalties are charged, calculated as a percentage of the tax unpaid at those points in time.

For monthly obligations, e.g. most PAYE

The June consultation document considered late payments of in-year PAYE separately. Many respondents to the consultation expressed disquiet at the three possible options outlined in the June consultation, (i.e. monthly statements, monthly estimates or extending the large employers' surcharge). A fourth, and in HMRC's view, better option is now being considered in more detail in this consultation. This involves requiring employers to report some additional information either on or alongside the end of year P35 return, which would be the amount due to be remitted to HMRC for each month of the year. The monthly figures would be an aggregate for each month and not split into the various elements, e.g. PAYE, NIC and CIS payments.

The objective of making employers report the amounts to be paid, with the knowledge that interest and penalties will be applied, is to deter employers from paying PAYE late.

HMRC will be able to reconcile this expanded end of year return with the in-year

payment and identify any discrepancies. The focus of this reconciliation was whether the payments had been made on time and if HMRC consider that these entries are not accurate, they could be the subject of an audit. Employers would be liable to interest on late paid in-year PAYE from the date it is due to the date it is paid. If payments are repeatedly made late or the delay in payment was prolonged, employers will be subject to late payment penalties in the same way as other taxes.

If there is only one late payment in the year, there will be no penalty. If there is more than one default, the penalty will be calculated by first calculating the total amount of tax paid late in the year (excluding the first default) and multiplying the amount by a percentage which would be determined by reference to the number of defaults. For very late payment, amounts remaining unpaid six months after the due date, an additional penalty would be payable, calculated as a percentage of the unpaid tax. After 12 months, a further penalty is payable. This is in line with the approach taken across all taxes.

This would potentially apply to all employers and would replace the current large employer's surcharge.

The consultation document suggests the CIS scheme could be dealt with in the same way as PAYE. Further work continues on other monthly regimes.

Our view

HMRC have responded to some comments on the June proposals and September workshops. However we still think that requiring penalties for late payment as well as interest at a commercial rate is excessive. Also it appears that tax-gear penalties geared to the amount of tax shown on the return (rather than the amount unpaid as is currently the case for CTSA) are excessive. Overall we do not think the current, generally law-abiding approach, of UK taxpayers justifies such increases in penalties.

As regards in-year PAYE our concern is that excessive burdens should not be placed on all employers, especially large employers, who generally do pay PAYE on time.

3.1.17 Penalties for late payment of PAYE

HMRC proposes a tougher penalty regime for employers who pay over PAYE deductions after the monthly due date. Currently, large employers with more than 250 staff are subject to a small penalty charge after more than two late payments. This is calculated on their total PAYE remittances. HMRC proposes instead that all employers who miss more than one monthly payment due date would be subject to what looks like a much more significant penalty on late-paid PAYE. It would be geared initially to the number of defaults, but become tax-gear where payment is more than 6 months late. Employers would notify total payments for each month in their end of year returns. These penalties would be in addition to interest on PAYE not paid over by the due date on the 19th of the month.

Our view

Although HMRC is consulting at this stage it is clearly aiming at introducing legislation to this effect in the 2009 Finance Bill. This may affect not just cash-strapped employers who deliberately defer payment, but employers who fail to pick

up in sufficient time remuneration paid on their behalf by third parties, including on an overseas payroll.

3.1.18 Lloyds Corporates – claims equalisation relief

Corporate members of the Lloyds insurance market will in future benefit from an alignment with other general insurers, by being able to claim tax relief on claims equalisation reserves (or provisions) in respect of profits treated as arising in the year ended 31 December 2008 onwards.

Our view

We believe that this is a sensible and welcome alignment of the relief.

3.1.19 National Insurance Contributions proposals

Several rumours were circulating prior to the Chancellor's speech for reduced National Insurance Contributions (NICs) to help the economy, SMEs and for those who employ the recently unemployed. In fact none of these or any other reductions in NICs were announced.

What was announced was a major rise in NICs from April 2011. Employer, employee and self-employed rates increase by 0.5 per cent from that date. That means the employer rate will go up from 12.8% to 13.3% before tax relief. More particularly the employee rates will go up from 11% (being the not contracted-out rate) to 11.5% up to the upper earnings limit and from 1% to 1.5% above that limit. Likewise the self employed rate will increase from 8% to 8.5% and from 1% to 1.5% above the upper profits limit.

For 2009/10 the rates remain unchanged and most of the limits increase in line with inflation. However the upper earnings limit for the employed and the upper profits limit for the self employed will be aligned with the point at which higher rate income tax becomes payable. From April 2011 the threshold at which people start to pay NICs will also be aligned with the income tax personal allowance.

Our view

This is a significant cost increase from April 2011, not just to employers, but for all earners. The increase in the employee rate on unlimited income from 1% to 1.5% will make it more expensive for employers to payroll benefits in kind. It is perhaps not surprising that there is no further news on the current proposal for payrolling of benefits in kind.

3.1.20 North Sea fiscal regime

The Government has today published its proposals for further reform of the North Sea fiscal regime. This 66 page paper follows on from a previous consultation document published in December 2007 and builds on changes announced in the March 2008 Budget. This is the latest instalment in a long running discussion between the Government and industry, which first began with the 2005 Pre-Budget Report. The next steps are a period for industry to respond followed by a package of reforms to be introduced at Budget 2009.

Fiscal Incentives

The Government has outlined its views on the need for fiscal incentives to stimulate new activity in the North Sea. It has concluded that targeted incentives could lead to an increase in investment and production, but noted that such incentives would need to balance the needs of the taxpayer and industry.

In this respect, the Government has rejected both a broad reduction in the supplementary charge (SCT) and a capital expenditure uplift. Instead, the Government's favoured approach is the introduction of a 'Value Allowance' where a specified amount of upstream profits arising in fields that meet certain criteria would be taxed at a reduced rate.

The Government is seeking further input from industry regarding the best method to deliver the allowance and the types of fields on which the allowance should be targeted.

Chargeable Gains

In order to reduce distortions created by the current fiscal regime and to facilitate trading assets, the Government is proposing two changes to the existing legislation:

- Where North Sea licences are swapped, no gain will arise to the extent that the value of the licence acquired equals the value of the licence disposed of; and
- Gains on the disposal of North Sea licence interests will be exempt from tax to the extent that disposal proceeds are reinvested in other North Sea licences. Under current rules, gains can only be deferred for a maximum of 10 years.

Change of use

The following summarises the Government's proposals in connection with the change of use of the North Sea from predominantly oil & gas exploration and production, to other uses such as carbon sequestration (CCS), renewable energy (offshore wind) and gas storage. These new activities will need to be defined in law (as this will be required for Petroleum Revenue Tax (PRT) purposes) and are referred to as being for a 'change of use' purpose below.

Decommissioning

The Government has proposed that relief for decommissioning costs for ex-ring fence assets which are used for a 'change of use' purpose will be given on the same basis as if the assets had remained within the ring fence. The comments in the consultation document imply that this would mean that relief would be given against ring fence corporation tax, SCT and PRT where appropriate. No detail has been given on the mechanics.

Proposed removal of a disposal for PRT purposes

The Government has proposed that there will be no disposal for PRT purposes where a PRT 'qualifying asset' ceases to be used in connection with a PRT taxable field, and is then used for a 'change of use'. This is conditional on there being no disposal receipts within 2 years of the last use of the asset in connection with a PRT field. This measure will remove any PRT charge where a qualifying asset is no longer used for PRT purposes.

Taxation of income and expenditure

Proposals have been announced to ensure that PRT will not be charged in relation to assets used for a 'change of use' purpose.

Capital allowances

No changes have been proposed to levels of capital allowances on 'change of use' activities and deemed disposals arising on 'change of use'. However HM Revenue and Customs (HMRC) will endeavour to give advance clearance for the values used.

No changes have been proposed to the '5 year clawback' rule for ring fence first year allowances which requires that assets are used for this period in a ring trade to qualify for the allowances.

Petroleum Revenue Tax

The Government is proposing changes to the existing PRT legislation to ensure that companies can obtain PRT relief for decommissioning costs where licences are terminated before decommissioning is completed. This is particularly relevant due to the forthcoming expiry of the 1st round of licences in 2010.

In addition, the Government has sought to simplify the PRT regime by identifying a number of areas where legislation can be improved or removed altogether. These include - provisional expenditure allowance, commingling agreements, spreading of supplement, pre-PRT expenditure and tariff receipts allowance.

On the question of the future of PRT more generally, whilst the Government continues to believe that the abolition of PRT could have benefits for the North Sea and is willing to continue to engage with industry on this question, it has concluded that the abolition of PRT by way of a PRT 'buy out' should not be considered further at this time.

Other aspects

The Government is inviting comments from industry on the following areas:

- Impact of changes proposed by industry to remove inheritance tax charges on decommissioning trusts;
- Further discussion regarding the proposals to remove some or all of Coal Bed Methane from the North Sea fiscal regime.

Our view

The proposed changes are more far reaching than anticipated, with the proposed Value Allowance and chargeable gains changes potentially very welcome to maximise the value of the North Sea in a period of declining oil prices.

3.1.21 Plant and machinery leasing changes

The Government have introduced changes to the way certain leases of plant or machinery and films are taxed. The changes have effect from 13 November 2008, the date of the release of three technical notes relating to leasing ('Plant and machinery leasing: anti-avoidance'; 'Sale of lessor companies - intermediate lessors' and 'Leasing avoidance by film partnerships').

The first set of measures tackles perceived avoidance using the rules relating to how leases of plant or machinery are taxed. The changes may affect any company entering into a lease of plant or machinery whether or not for a commercial purpose.

The second set of measures are in response to perceived avoidance relating to the "Sale of Lessor" rules which can apply upon the change in ownership of a company which is a lessor of plant or machinery. The changes are likely to affect those who seek to avoid a charge arising under the Sale of Lessor rules, whether or not the underlying transaction is commercially motivated.

Finally, the Government have introduced changes to counter perceived avoidance relating to film leasing. These changes are likely to affect mainly those seeking to shelter rental income arising from leases of films.

Changes to plant or machinery leasing rules

The changes impact certain arrangements whereby a company which owned plant or machinery could refinance these assets and obtain additional capital allowances in addition to their original expenditure on the plant or machinery.

The first change inserts a market value "floor" or minimum on the capital allowance disposal value taken to the capital allowance pool on the grant of a long funding finance lease. This seeks to counter avoidance arrangements whereby the disposal value to be brought into account before these changes on the occasion of a grant of a long funding finance lease was negligible. In a typical arrangement, the long funding finance lessor would then lease back the plant or machinery under a long funding operating lease to obtain an entitlement to capital allowances under the lease back on the market value of the plant or machinery.

Now that there is a disposal value of at least a market value whenever a long funding lease is granted the Technical note also brings changes to ensure that where there is an initial payment under a lease it is not deemed taxable under s785B ICTA 1988 (which taxes capital sums due under leases as if they were income attributable to the lease).

The second change tackles arrangements whereby owners of plant or machinery with a market value in excess of original cost could sell (or lease) and leaseback the plant or machinery and achieve additional capital allowances on the excess of market value above original cost. The changes limit the amount of qualifying expenditure for capital allowances on the leaseback to the disposal proceeds brought into the capital allowance pool on the outward sale (or lease) or, if there is no such disposal value the lower of market value and original cost to the seller (or head lessor) group.

A further aspect of these changes is that they remove the choice that a long funding

lessee generally has as to whether to claim capital allowances or instead claim rental deductions under the lease, if the lease is a leaseback arrangement.

There are also changes to the availability of first year allowances or annual investment allowances in certain arrangements involving the leasing of plant or machinery. A lessee under a long funding leaseback or a hire purchase contract which would confer capital allowances on the lessee is denied a first year allowance or annual investment allowance if he would otherwise have been entitled to one.

Finally, changes have been made to the rules governing the termination of a long funding lease. If a lessee has been entitled to a deemed addition for capital allowance purposes under the long funding lease rules then upon the termination of the lease a comparison should be made between the amount of that addition and the amount of net expenditure under the lease, with the difference being brought into account as a disposal value.

Our view

The changes to the disposal value rules should ensure that the economic effect of the grant of a long funding lease is brought into account for tax purposes.

The limit on the qualifying expenditure under leasebacks prevents businesses from converting indexation allowances or capital losses into additional capital allowances.

The changes to the disposal value rules on termination of leases tighten the computational rule so that the appropriate disposal value is brought into account in all instances.

Changes to the Sale of Lessor rules

Anti-avoidance legislation introduced in Schedule 10 Finance Act 2006 removed the tax advantage arising from the sale of certain lessor companies. Such companies typically show a period of tax losses, during which the tax allowances arising from the plant and machinery in question exceed taxable rentals, followed by a period of predictable taxable profits as the tax allowances become insignificant although the rentals continue as before. By selling the company to a loss-making group before the period of taxable profits begins, the tax liabilities otherwise arising during the tax profitable period could be avoided. The Finance Act 2006 changes removed this opportunity by imposing a deemed tax charge on the company being disposed of equivalent to the excess tax allowances received prior to the sale: although there is a mirror tax deduction to the same company following the purchase such deduction cannot be offset against the deemed income. There is no commercial purposes test in the Sale of Lessor rules and we are aware that the charge has potentially applied to commercially motivated disposals of leasing businesses.

HMRC is currently undertaking a consultation exercise to identify whether certain relieving provisions could be introduced to Schedule 10.

In the meantime, the changes announced on 13 November seek to counter arrangements to avoid Schedule 10 whereby a leasing company with an inherent Schedule 10 charge sold plant or machinery assets subject to leases and leased the assets back under a long funding lease. The long funding leaseback means that the leasing company continues to be entitled to claim capital allowances in respect of the plant or machinery. One of the requirements for the Schedule 10 charge to trigger is

that at least half of the accounting value of plant or machinery owned by the leasing company relates to leased plant or machinery. By selling the plant or machinery prior to selling the leasing company the Schedule 10 charge which would otherwise have arisen was avoided because when the leasing company was sold it did not own the plant or machinery assets.

The changes to Schedule 10 apply to remove the requirement that a leasing company should own the plant or machinery subject to leases for Schedule 10 to apply. There are also changes to the definition of the amounts from which any Schedule 10 charge is computed to tackle the manipulation of balance sheet values by leasing companies to reduce or avoid a charge arising under Schedule 10. Instead of the Schedule 10 charge being calculated on the difference between the tax written down value of plant or machinery and the net book value of plant or machinery per the accounts, the net book value has been replaced with the unencumbered market value of the asset in certain situations. HMRC have also made an amendment to remove an exclusion from Schedule 10 applicable when assets are sold at the same time under terms whereby the lessor retains an entitlement to the rentals associated with the assets.

The Government have asked for comments, in particular if businesses feel that the changes would have an adverse affect on commercial transactions.

Our view

The application of Schedule 10 can be inequitable and can impede genuine commercial transactions-hence the consultation. The tightening of the rules does nothing to deal with these problems and it is to be hoped that the consultation will comprehensively deal with this.

Changes to the Film leasing rules

The Government have today published draft legislation to counter film lessors who previously took advantage of accelerated capital allowances in respect of investment in certain films now seeking to shelter the rental income in respect of the films by terminating the original lease and entering into a long funding lease of the film. A lessor under a long funding lease is only taxed on the interest element of rentals received. The proposed changes deny relief where a long funding lease of a film is entered into on or after 13 November 2008.

Our view

The changes appear to mean that a lessor entering into long funding lease of a film after 13 November 2008 could be taxed on the gross income under the lease with no tax relief for the cost of the film.

3.1.22 Small companies rate

The planned increase in the small companies' rate (SCR) from 21% to 22% from 1 April 2009 has been deferred for one year. This will apply to all profits other than ring fence profits, which will continue to be taxed at 19%.

Small companies are broadly those with profits of less than £300,000.

Our view

This is a welcome but limited change which will delay the increased tax burden on small companies. This will now come into force on 1 April 2010.

3.1.23 Stock lending arrangements

Legislation will be introduced next year to relieve the tax charges that might otherwise arise on persons who have entered into stock lending arrangements with a financial institution which subsequently becomes insolvent.

The changes apply where the borrower becomes insolvent, or to sale and repurchase arrangements ('repos') where the purchaser becomes insolvent, from 1 September 2008. Consequently, and importantly, they will cover stock lending arrangements entered into with Lehman Brothers.

Legislation will be introduced in Finance Bill 2009 to disapply the rule that treats the non-return of borrowed securities as a disposal by the lender for the purposes of tax on chargeable gains (both for individuals and companies), provided that the lender uses collateral provided by the borrower to acquire replacement securities of the same kind in the market.

The Finance Bill will also contain a provision removing, retrospectively, the stamp duty or Stamp Duty Reserve Tax charge where the lender in a stock lending arrangement, or repo counterparty, uses collateral provided by the borrower (who has since become insolvent) to buy replacement securities of the same kind.

Our view

The proposed exemptions represent a welcome clarification in relation to the non-return of stock and collateral, and are a sensible and proportionate response to the issues faced by those required to re-align their portfolios, as highlighted in particular by the collapse of Lehman Brothers in mid September this year.

3.1.24 Taxpayers' charter

HMRC has now responded to the comments of participants in the consultation on a proposed new charter between HMRC, individuals, businesses and tax agents. Both the Inland Revenue and HM Customs & Excise had charters before their merger in 2005, but they had fallen into disuse and HMRC had therefore proposed a new charter.

The responses supported the idea of the charter and in particular that a single charter is appropriate and it must be short and simple to understand. The consultation document had contemplated no statutory framework for the charter, but most respondents argued that a legal foundation was preferable. The Government has therefore announced that a statutory framework will be included in next year's Finance Bill.

The charter will include a number of high-level principles and should apply to all those who deal with HMRC. The title 'Taxpayers' Charter' will be used as a working title until a more suitable name is determined.

The next stage of consultation will focus on content. As a start, HMRC has organised an event to involve customers, staff and others to start to design the draft charter, and a more formal consultation will be announced early in the New Year.

Our view

Deloitte supports the statutory framework, and more widely supports the principle of safeguards for taxpayers being part of the law.

3.1.25 Tax relief on company cars

New rules have been introduced for expenditure incurred on cars on or after 1 April 2009 for businesses in the charge to corporation tax and 6 April 2009 for businesses in the charge to income tax. From these dates, expenditure on cars will be allocated to one of the two general plant and machinery pools, depending on the cars' CO2 emissions. Expenditure on cars with CO2 emissions over 160g/km will be dealt with in the special rate pool and will attract WDAs at 10 per cent.

Cars that have an element of non-business use will continue to be dealt with in a single asset pool to enable the private use adjustment to be made, but for expenditure incurred from April 2009 onwards the rate of WDA will be determined by the cars CO2 emissions.

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 with a flat rate disallowance of 15% for cars with CO2 emissions of 160g/km or more. This disallowance will only apply to one lease rather than all links in a chain of leases.

Our view

These new rules reflect the government's stated intention of encouraging use of more environmentally friendly modes of transport through fiscal means.

3.1.26 Transfers of income

Today's consultation document for a 'Principles Based Approach to Financial Products Avoidance' provides updated draft legislation on the transfers of income proposals. The anticipated commencement date is 1 April 2009 and will apply to transfers that take place 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 that 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' to include sale, exchange, gift and assignment and any other arrangement that

equates in substance to a transfer (for example, issuing a financial instrument).

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 receipts would have been chargeable but for the transfer. The income is treated as arising in line with the recognition of the transfer consideration in the accounts of the transferor. If the consideration is not recognised in the accounts (to any extent), it is treated as arising at the time of the transfer. The same treatment applies to any income representing the extent to which the market value exceeds the consideration for the transfer.

Equipment lessors will note that the proposed rules also 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'.

Exclusions

These provisions do not apply if the transfer is a consequence of a transfer of shares where the rights over the shares extend beyond the 'relevant receipts', or if the transfer is 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 brought into account under the capital allowances regime.

The charging provision does not apply if and to the extent that the consideration for the transfer (or the market value if greater) is brought into account as income of the transferor, in calculating the profits of the transferor, or is brought into account under the capital allowances regime.

There are also provisions to treat the transferee as party to a loan relationship in respect of the consideration for the transfer, to the extent that it is recognised as a financial asset in its GAAP accounts.

There are also provisions dealing with transfers of income for individuals.

Our view

Similar to the disguised interest rules, we welcome the approach of the transfer of income streams draft legislation in that it attempts to simplify anti-avoidance legislation to a principled approach - which allows various piecemeal sections to be repealed. We are looking forward to further clarification on some uncertain areas through further consultation.

3.1.27 VAT flat rate scheme

The VAT flat rate scheme is available to small businesses with a turnover of up to £150,000. Businesses using the scheme pay VAT as a flat percentage of turnover which varies according to the nature of the business.

These rates will be changed to reflect the new lower rate of 15% VAT. In addition, the requirement that anticipated total annual income is less than £187,000 before joining the scheme will be removed. However, if annual income exceeds £225,000, a business

must leave the scheme. The method of determining income has not been defined in the legislation, but HMRC has announced that taxpayers must use the same method as they use to determine VAT payable whilst on the scheme. Accordingly, if a business calculates its VAT liability on cash received the leaving test will also be based on cash received. If the VAT liability is calculated on the basis of invoices issued then the leaving test will also be based on this method.

The changes will take effect from 1 April 2009.

Our view

These simplifications will be welcomed by small businesses.

3.1.28 VAT rate reduction

The standard rate of UK VAT will be reduced from 17.5% to 15%, with effect from 1 December 2008 until 31 December 2009. The rate will revert back to 17.5% on 1 January 2010.

The reduced rate will neither impact zero-rated goods (such as basic foodstuffs and children's clothing) nor supplies subject to the 5% reduced rate (such as domestic fuel and power).

Anti-forestalling measures are to be introduced in the Finance Bill 2009 to prevent businesses from taking advantage of the VAT rate increase on 1 January 2010 by making prepayments.

Our view

As a consequence of the change, businesses will face systems issues to implement the new rate, including dealing with payments already received for goods and services to be delivered after 1 December (and vice versa) as well as credit notes.

Retailers will have the substantial task of repricing their goods if they are able to pass on the rate change to consumers, alongside discounting measures that many will be taking already to stimulate trade in the face of the economic downturn.

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 the VAT on the cost will not be fully recoverable.

The impact on ordinary consumers is not likely to be significant as we calculate that (even if the VAT saving is passed on in full) the average family will only save around £200 per year.

3.2 Individuals

3.2.1 Air passenger duty

The proposal to replace air passenger duty (APD) with aviation duty has been scrapped. Instead, in order to ensure greater stability and to protect competitiveness at a time of economic uncertainty, the existing APD framework will be amended with four new geographical bands being introduced. The changes will have effect for any travel which commences on or after 1 November 2009, irrespective of when the ticket for travel was booked or purchased:-

Band and approximate distance in miles from London	In the lowest class of travel (reduced rate)		In other than the lowest class of travel (standard rate)	
	2009-10	2010-11	2009-10	2010-11
Band A (0-2000)	£11	£12	£22	£24
Band B (2001-4000)	£45	£60	£90	£120
Band C (4001-6000)	£50	£75	£100	£150
Band D (over 6000)	£55	£85	£110	£170

Existing rates of APD range from £10 to £80 per passenger.

APD is calculated on a per passenger basis, whereas aviation duty would have been based on a per plane basis. The original proposals would have impacted the whole of the aviation sector, particularly the freight industry. The actual changes will only affect passenger travel.

The aviation industry is to be included within the EU Emissions Trading Scheme with effect from 2012.

Our view

Impact on freight industry

This is good news for the freight industry which would otherwise have been caught by the previously proposed aviation duty.

Impact on consumers

Unlike the proposed aviation duty, airlines should find it simpler to pass APD straight through to the passenger at point of sale. Whilst airlines can choose whether or not they pass this tax cost on, it is likely that passengers will bear the additional cost.

For example, a passenger travelling economy from London to Tokyo today would pay £40 whereas this time next year this will rise to £50. In 2010 it will be £75.

Similarly, anyone travelling in any class other than standard economy will pay £80 today, £100 this time next year and £150 the year after.

Environmental impact

Whether or not this will have a positive impact on the environment remains to be seen. It is possible that some passengers will connect to long-haul flights via alternative European hubs, thus minimising their APD rather than reducing their long-haul travel.

3.2.2 Alcohol – excise duty increases

Excise duty on alcohol will increase by 8% as of 1 December 2008. This change follows the 6% increase which took effect from 17 March 2008. The impact of the latest changes on retail prices is equivalent to:

- 52 pence on a 70cl bottle of spirits (37.5% abv);
- 3 pence on a pint of beer;
- 13 pence on a bottle of wine
- 2 pence on a litre of cider.

The smallest brewers will continue to receive 50% duty relief from the Small Brewers Relief Scheme.

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products.

3.2.3 Changes to the trading loss carry back rules

Companies and unincorporated businesses making trading losses will have an additional way to relieve these losses.

Current rules allow trading losses to be relieved in a number of ways, including against income in the current year or carried back to the preceding year and the Government is now introducing a further mechanism for relief. It will now be possible to carry back trading losses for three years, where they have not been fully utilised by a single-year carry back claim.

For companies the new rules will apply for accounting periods ending between 24 November 2008 and 23 November 2009, while for unincorporated businesses the new rules will apply for the tax year 2008-09.

Losses must be set against profits from the most recent accounting period first. The amount of losses that can be carried back to the preceding year remains unlimited. After carry back to the preceding year, a maximum of £50,000 of the balance can be claimed by carrying back to the earlier two periods.

Our view

The additional means of obtaining relief is welcome but the £50,000 limit and temporary nature of the relief will in practice restrict its benefit.

3.2.4 Consultation: Payments, repayments and debt: the next stage

Background

Following legislation introduced in FA 2008, HMRC has issued a further consultation document entitled 'Payments, Repayment and Debt: The Next Stage'. The objective is to deliver more efficient systems for payment, repayment and debt management through a more taxpayer focused approach, making it easier for taxpayers to pay and enabling HMRC to tackle debt more effectively.

Aim

The intention is to produce a fairer, modernised payment, repayment and debt collection system that:

- fully supports those who wish to pay what they owe on time;
- helps those who may have difficulty paying;
- takes more effective action against those who seek to gain an advantage through not meeting their liabilities or delaying payment.

Key features

The consultation focuses on the following areas:

- a voluntary and flexible monthly instalment payment scheme on a single tax basis for income taxpayers corporation taxpayers not within the Quarterly Instalment Payment (QIP) regime;
- award of costs in successful court actions in relation to late payment;
- extension of HMRC's ability to collect small debts collected through the PAYE system;
- tracing missing debtors through third parties;
- encouraging compliance through the greater use of financial securities for seriously non-compliant businesses and the introduction of tax clearance certificates confirming to businesses that they are fully compliant with their tax obligations.

Timeline

Subject to consultation, these proposed changes may be introduced in Finance Bill 2009, to take effect from an appointed date thereafter.

The consultation is open until 13 February 2009 and HMRC propose to publish responses around Budget 2009 with any changes introduced through the 2009 Finance Bill.

Our view

The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future.

The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future

3.2.5 Disabled company car drivers

Company car tax is calculated by multiplying the list price with the appropriate percentage based on the CO₂ emissions of the car. The employee pays income tax on this figure and the company pay Class 1A National Insurance on it. Often automatic cars have a higher list price and CO₂ emissions than equivalent manual cars.

Currently disabled company car drivers of automatic cars who hold a blue badge are able to use the CO₂ emissions figure of an equivalent manual car when calculating their company car benefit charge. From 6th April 2009 they can also use the list price of an equivalent manual car.

Our view

This is a technical change to treat disabled drivers of manual company cars in line with disabled drivers of automatic company cars.

3.2.6 Disclosure of offshore accounts

The Government has announced that HMRC will be giving offshore account holders a new opportunity in 2009 to disclose, of their own accord, if they have unpaid tax or duties and to settle debts. A further announcement will be made in early 2009.

Our view

This follows on from last year's initiative apparently recovered around £400 million in unpaid taxes at a cost to the Exchequer of just £6.5 million.

3.2.7 Employee share schemes – nil paid 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 subsequently paid up the full market value of the shares out of the sale proceeds or if they sold the shares to a purchaser who assumed the responsibility to pay up further instalments.

Additionally, where an employee holds nil or partly paid shares and receives further shares in proportion to their existing holding as a result of a rights or bonus issue, previously an income tax charge could arise in relation to the additional shares notwithstanding that no additional value was received.

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

Our view

In practice the current provisions do not affect many employee share arrangements. However the proposed changes which remove legislative anomalies are welcome

3.2.8 Film partnership leasing avoidance

As announced on 13 November 2008, the Government has outlined details of the action taken to counter avoidance of taxation by film leasing partnerships.

Under standard arrangements, films are acquired or produced and leased over a period of up to 15 years to a company which would commercially exploit the film. The partners claim accelerated allowances and are taxed on the lease rentals, so the effect is to permit partners to defer their tax liability.

The new anti avoidance rules are aimed at arrangements under which the existing leases are replaced with new leases designed to qualify as long funding finance leases of plant and machinery. The effect was to replace taxable income with income that was largely tax free.

The new rules provide that rentals are taxable in full to the extent that they are payable after 13 November 2008 and relate to periods after that date.

These provisions should not affect the current scheme.

Our view

The new rules are a not unexpected response to a tax avoidance arrangement.

3.2.9 Fuel – excise duty increase

On 16 July 2008 the Chancellor announced that the fuel duty increases planned for 1 October 2008 would be postponed.

These increases will now take place from 1 December 2008, to offset the recent reduction in prices and VAT rate.

Excise duty on unleaded petrol and diesel will rise by 2p per litre, which is an increase of just over 4% on current rates. This will be followed by further increases of 1.84p per litre on 1 April 2009 and by 0.5p per litre above indexation on 1 April 2010. Excise duty on leaded petrol will also rise by 2p per litre. The same increase of 2p per litre will apply to biofuels (biodiesel and bioethanol) as a result of the Chancellor's decision to maintain the existing duty differential of 20p per litre between main road fuels and biofuels.

However, from 2010 the 20p per litre differential will be abolished and thereafter duty will be charged at the same rate as main road fuels.

The effective rate of duty for non-road fuels subject to rebated rates of excise duty will

also increase in line with the duty on main road fuels.

When used as a road fuel the rate of excise duty on liquefied petroleum gas (LPG) and natural gas (including biogas) will increase by 4.28p per kg and 2.9p per kg respectively on 1 December 2008. Further increases are scheduled on 1 April 2009, of 4.05p per kg and 2.66p per kg respectively.

The existing duty differential applicable to biogas (equivalent to 40.88p per litre) will remain at present levels at least until the Budget of 2012.

Finally, on and after 1 November 2008 a new fiscal definition was introduced for aviation gasoline (Avgas). The duty rate will be 0.3103p per litre from 1 December 2008 (a 1p per litre increase from the current rate).

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products.

3.2.10 Investment funds taxation

There are minor updates to the Qualified Investor Scheme, Property Authorised Investment Fund and Real Estate Investment Trust regimes which were broadly expected. There is also commitment to ongoing discussions on the reform of investment trust companies, the offshore funds rules and the Schedule 19 stamp duty reserve tax regime for Authorised Investment Funds, plus clarifying the trading vs investment question, and introducing a Tax Exempt Fund regime, but no further progress.

One potential issue is a possible side-wind of the exemption for foreign dividends for large and medium sized companies. If AIFs were to qualify for that exemption, it may lead to loss of access to double tax treaties and increase the tax cost in the fund, reducing the attractiveness of the UK as a fund location. It would however be a step closer to the exempt model some in the industry have sought. If AIFs are carved out then there would be no impact.

In more detail:

QIS

The draconian tax treatment for certain investors holding >10% of a QIS is being replaced by a genuine diversity of ownership rule along the lines of that already implemented for PAIFs. Generally this should make QIS easy to manage though pension funds and life companies will no longer be able to use QIS as captive funds.

PAIFs

There were 3 minor clarificatory amendments to the PAIF regime

(1) Where a 'feeder fund' is used to comply with the '10% rule' it will be exempt from Sch 19 SDRT on unit transactions to ensure a double charge does not apply, (though the feeder fund will have to 'satisfy certain conditions' which are not stipulated).

(2) Flexibility for PAIFs to make net payments to other AIFs is granted which may be administratively simpler if all other investors obtain such payments net.

(3) Distributions will be subject to the manufactured dividends rules so they are treated in the same way as comparable payments on other securities normally paid net of WHT.

REITs

Anti-avoidance measures will be introduced to prevent a group splitting itself into 2 groups for REIT purposes and obtaining the benefits of the regime by circumventing the group wide balance of business tests

Our view

In the harshest economic environment most of us have witnessed it is not surprising that the Government's focus in this PBR is not on tax measures for the esoteric legislation that impacts pooled funds. Given that the once relatively simple regime for UK funds now has separate regimes for QIS & PAIFs with further regimes such as TEFs in the pipeline, and that the offshore funds rules and investment management exemption rules have been substantially amended in recent times, that may be just as well.

3.2.11 Individual savings accounts and multilateral institutions

An extension has been announced to the ISA regulations to enable investors to hold bonds issued by Multilateral Institutions within a stocks and shares ISA.

Multilateral Institutions are institutions that provide financial support and professional advice for economic and social development activities in developing countries, as defined by the OECD.

The new extension will have effect from 16 December 2008.

Our view

The extension to the type of investments that may be made under an ISA plan is a welcome change which provides investors with greater choice.

3.2.12 Interest – alignment of treatment across different taxes

A consultation document has been issued which examines proposals for the harmonisation of interest charged and paid on late paid and overpaid tax, respectively.

Background

This is part of HMRC's programme of legislative changes which aims, amongst other things, to look at how alignment between the interest rules for the various taxes could bring benefits to taxpayers, their advisers and HMRC.

The document follows on from an earlier consultation document published on 19 June 2008, 'Interest ' Working towards a harmonised regime'. The responses to and discussions on the earlier consultation document have been used to develop the key proposals set out in this consultation document.

HMRC propose that an effective interest regime should be based on the principle of recompense, removing the benefit of delaying payment for people who pay late and

providing reasonable recompense for those who overpay.

Key issues

- The existing rules have evolved specific to each tax over time and are inconsistent between different taxes, with interest being calculated at different rates, with different formulae, different reference dates, having different names and not always being tax deductible.

Consultation document proposals

The proposals in this document suggest that:

- A single interest rate is applied to late payments of all taxes, with the exception of Quarterly Instalment Payments (QIP).
- The rate should track the Bank of England base rate as this is easily accessible to taxpayers.
- A single rate should also apply to all overpayments of taxes, except for QIPs. This rate should remain lower than the late payment rate.
- Interest should be paid and charged as simple interest.
- The rates under the QIP scheme should be different.

Responses are requested to this consultation document by 13 February 2009. The responses will be published as part of Budget 2009.

Responses to June consultation document

The proposals take into account the key views expressed in the responses to the June consultation document, which were that:

- The Bank of England base rate offered the best realistic recompense to taxpayers.
- There is a rationale for maintaining a differential between interest rates on late payment and overpayments.
- Interest should be charged during the year on late paid PAYE.
- Interest should represent recompense and not a penalty.
- Interest should be calculated on a simple, rather than a compound method, to keep things understandable for taxpayers.
- The current QIP system should remain as it is.

Impact

The main administrative benefits of the new proposed regime would be greater simplicity, greater certainty and greater fairness.

Our view

The proposed changes would simplify matters for clients and tax advisors and would reduce the administrative burden on HMRC in having to be aware of several different methods of interest calculation. Basing the interest regime on the concept of recompense would also seem fairer than the current regime, under which interest on some taxes is calculated on this basis, whereas the interest rules on other taxes appears punitive in comparison.

3.2.13 Late filing and late payment consultation

HMRC has been engaged for some years in an extensive programme called 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. Workshops were conducted in September, shortly after the end of the consultation period. As is customary for Modernising Powers, Deterrents and Safeguards, the same consultation document considers many taxes, in this case including income tax, corporation tax, PAYE and VAT.

A new consultation document has been published today. It covers a great deal of ground, but the key proposals are:

1. For annual and one-off returns, e.g. CTSA or ITSA
2. For quarterly obligations, e.g. most VAT traders
3. For monthly obligations, e.g. most PAYE

For annual and one-off returns, e.g. CTSA or ITSA

Late filing

- An initial fixed penalty, which HMRC see as unlikely to be significantly increased from £100, its current level for self assessment.
- A fixed but modest daily penalty running for up to three months starting from three months after the return's due date. The document suggests the daily amount will be fixed in the statute. At present daily penalties can be charged at up to £60 per day and the document suggests that going forward the daily fixed amount will be very significantly less than this £60 per day. Under current law daily penalties require authorisation by the General or Special Commissioners. Under the new proposals authorisation will not be required, but there will be a right of appeal.
- Tax-geared penalties will arise seven and 12 months after the filing deadline. Under current CTSA rules tax-geared penalties arise six and 12 months after the filing deadline. An even more important difference is the base for tax-geared penalties. Under the proposals, they would be based on the tax shown on the return, whether or not it has been paid by the time the penalty arises. Under current legislation they are based on tax unpaid six months after the normal filing deadline. 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

In addition to interest charged on tax paid late, it is proposed to have tax-geared penalties one month (three months for corporation tax), six months and 12 months after the due date. For corporation tax, there are currently no such penalties, though for ITSA the surcharges (at 28 days late and six months late) are similar to the proposals.

For quarterly obligations, e.g. most VAT traders

Current VAT legislation wraps up late filing and late payment together. The new legislation treats the two separately.

Late filing

As with current VAT legislation a rolling default window starts to run from the first failure to submit a return by the filing date. The default window expires a year after the default. Further defaults extend the default window until a year after the latest default. The penalties would be fixed sums which increase as the number of defaults increase, though for the third and subsequent default the penalty per default would be the same.

It is also proposed that the tax geared penalties for very late filing at six and 12 months (including those for deliberate non-filing) should also apply to any quarterly return that is this late

Late payment

As for late filing the suggestion is for a rolling default window (but separate from the filing window). The first time the taxpayer defaults, they enter a default window which expires a year after the default. Further defaults extend the default window until a year after the latest default. The taxpayer can therefore only leave a default window by paying on time for 12 months.

The penalty would be calculated by reference to the number of defaults in the default window. The first default would not trigger a penalty at all and instead HMRC would issue a default notice. The penalties would be percentages of the tax unpaid which increase as the number of defaults increase, though for the fourth and subsequent default the percentage penalty per default would be the same.

As for annual or one off payment obligations, if the payment is more than six or 12 months late then further penalties are charged, calculated as a percentage of the tax unpaid at those points in time.

For monthly obligations, e.g. most PAYE

The June consultation document considered late payments of in-year PAYE separately. Many respondents to the consultation expressed disquiet at the three possible options outlined in the June consultation, (i.e. monthly statements, monthly estimates or extending the large employers' surcharge). A fourth, and in HMRC's view, better option is now being considered in more detail in this consultation. This involves requiring employers to report some additional information either on or alongside the end of year P35 return, which would be the amount due to be remitted to HMRC for each month of the year. The monthly figures would be an aggregate for each month and not split into the various elements, e.g. PAYE, NIC and CIS payments.

The objective of making employers report the amounts to be paid, with the knowledge that interest and penalties will be applied, is to deter employers from paying PAYE late.

HMRC will be able to reconcile this expanded end of year return with the in-year payment and identify any discrepancies. The focus of this reconciliation was whether

the payments had been made on time and if HMRC consider that these entries are not accurate, they could be the subject of an audit. Employers would be liable to interest on late paid in-year PAYE from the date it is due to the date it is paid. If payments are repeatedly made late or the delay in payment was prolonged, employers will be subject to late payment penalties in the same way as other taxes.

If there is only one late payment in the year, there will be no penalty. If there is more than one default, the penalty will be calculated by first calculating the total amount of tax paid late in the year (excluding the first default) and multiplying the amount by a percentage which would be determined by reference to the number of defaults. For very late payment, amounts remaining unpaid six months after the due date, an additional penalty would be payable, calculated as a percentage of the unpaid tax. After 12 months, a further penalty is payable. This is in line with the approach taken across all taxes.

This would potentially apply to all employers and would replace the current large employer's surcharge.

The consultation document suggests the CIS scheme could be dealt with in the same way as PAYE. Further work continues on other monthly regimes.

Our view

HMRC have responded to some comments on the June proposals and September workshops. However we still think that requiring penalties for late payment as well as interest at a commercial rate is excessive. Also it appears that tax-gear penalties geared to the amount of tax shown on the return (rather than the amount unpaid as is currently the case for CTSA) are excessive. Overall we do not think the current, generally law-abiding approach, of UK taxpayers justifies such increases in penalties.

As regards in-year PAYE our concern is that excessive burdens should not be placed on all employers, especially large employers, who generally do pay PAYE on time.

3.2.14 National insurance contributions proposals

Several rumours were circulating prior to the Chancellor's speech for reduced National Insurance Contributions (NICs) to help the economy, SMEs and for those who employ the recently unemployed. In fact none of these or any other reductions in NICs were announced.

What was announced was a major rise in NICs from April 2011. Employer, employee and self-employed rates increase by 0.5 per cent from that date. That means the employer rate will go up from 12.8% to 13.3% before tax relief. More particularly the employee rates will go up from 11% (being the not contracted-out rate) to 11.5% up to the upper earnings limit and from 1% to 1.5% above that limit. Likewise the self employed rate will increase from 8% to 8.5% and from 1% to 1.5% above the upper profits limit.

For 2009/10 the rates remain unchanged and most of the limits increase in line with inflation. However the upper earnings limit for the employed and the upper profits limit for the self employed will be aligned with the point at which higher rate income

tax becomes payable. From April 2011 the threshold at which people start to pay NICs will also be aligned with the income tax personal allowance.

Our view

This is a significant cost increase from April 2011, not just to employers, but for all earners. The increase in the employee rate on unlimited income from 1% to 1.5% will make it more expensive for employers to payroll benefits in kind. It is perhaps not surprising that there is no further news on the current proposal for payrolling of benefits in kind.

3.2.15 Pension savings

Lifetime allowance

Individuals who are members of registered pension schemes are subject to a lifetime allowance on the total cumulative value of the pension benefits they draw from those schemes, whether they receive them in the form of a lump sum or a pension. The value of the benefits is measured at the time they commence. If an individual breaches this limit they are subject to a lifetime allowance charge. The rate of charge is 25% if the excess benefits are taken as pension income and 55% if taken as a lump sum.

The lifetime allowance for the current tax year is £1.65m and is due to grow to £1.75m for 2009/10 and £1.8m for 2010/11. The Chancellor today announced that the allowance will then be frozen at £1.8m for 2011/12 through to 2015/16 inclusive.

For example, an individual who, in 2008/9 takes a lump sum of £250,000, and an associated pension with a capital value of £750,000, would have 'crystallised' total benefits of £1m. Provided he/she had not previously crystallised benefits from any other pension arrangement, no lifetime allowance charge would arise, because the total cumulative benefits of £1m are less than the 2008/9 lifetime allowance.

Annual allowance

The annual allowance is also being frozen for the tax years 2011/12 to 2015/16 inclusive, at £255,000. The annual allowance provides a cap on the total annual amount of tax-relieved contributions, or benefit accrual, that may be made into one or more registered pension schemes by or on behalf of an individual. Savings above this amount are subject to an annual allowance charge of 40%, payable by the individual. The rate for the current tax year is £235,000, rising to £245,000 in 2009/10 and £255,000 in 2010/11.

Potential effect of income tax rate increase to 45% from 2011/12

The top rate of income tax for individuals earning in excess of £150,000 will be 45% from 2011/12. This appears to mean that these individuals will be able to obtain tax relief at 45% on contributions to registered pension schemes out of the top slice of their taxable income.

Our view

The freezing of the lifetime allowance means that it will be even more important for those individuals with pension rights built up in approved schemes before 6 April 2006 to protect them, where appropriate, from the lifetime allowance charge. The deadline for doing so is 5 April 2009.

Those individuals for whom transitional protection (as above) is not appropriate, and who are aiming to save up to the lifetime allowance, will need to carefully assess their future contributions bearing in mind that the growth of their pension funds will count towards the lifetime allowance.

With pressure on annuity rates due to increasing longevity, anticipated low inflation and interest rates, retirees will potentially need to look for other savings vehicles to fund their retirement.

The potential increase in tax relief on pension contributions for those within the new 45% tax bracket from 2011/12 will mean that those individuals will have an extra 5% tax rebate to either spend or invest. This may explain in part why the pension allowances have been frozen.

3.2.16 Qualified investor schemes

These are a form of Authorised Investment Fund (AIF) which can only be marketed to sophisticated investors. They have wider investment powers than other forms of AIF.

Currently a less favourable tax regime applies to investors who hold more than 10% of a Qualified Investor Scheme (QIS). From 1 January 2009 all investors in QISs will be taxed in the same way as investors in other AIFs, such as unit trusts or open ended investment companies. This is subject to a condition that the scheme does not limit its investors to specific individuals or companies.

Our view

These changes offer an improved and simplified tax regime for these funds.

3.2.17 Stock lending arrangements

Legislation will be introduced next year to relieve the tax charges that might otherwise arise on persons who have entered into stock lending arrangements with a financial institution which subsequently becomes insolvent.

The changes apply where the borrower becomes insolvent, or to sale and repurchase arrangements ('repos') where the purchaser becomes insolvent, from 1 September 2008. Consequently, and importantly, they will cover stock lending arrangements entered into with Lehman Brothers.

Legislation will be introduced in Finance Bill 2009 to disapply the rule that treats the non-return of borrowed securities as a disposal by the lender for the purposes of tax on chargeable gains (both for individuals and companies), provided that the lender uses collateral provided by the borrower to acquire replacement securities of the same kind in the market.

The Finance Bill will also contain a provision removing, retrospectively, the stamp duty or Stamp Duty Reserve Tax charge where the lender in a stock lending arrangement, or repo counterparty, uses collateral provided by the borrower (who has since become insolvent) to buy replacement securities of the same kind.

Our view

The proposed exemptions represent a welcome clarification in relation to the non-return of stock and collateral, and are a sensible and proportionate response to the issues faced by those required to re-align their portfolios, as highlighted in particular by the collapse of Lehman Brothers in mid September this year.

3.2.18 Taxpayers' charter

HMRC has now responded to the comments of participants in the consultation on a proposed new charter between HMRC, individuals, businesses and tax agents. Both the Inland Revenue and HM Customs & Excise had charters before their merger in 2005, but they had fallen into disuse and HMRC had therefore proposed a new charter.

The responses supported the idea of the charter and in particular that a single charter is appropriate and it must be short and simple to understand. The consultation document had contemplated no statutory framework for the charter, but most respondents argued that a legal foundation was preferable. The Government has therefore announced that a statutory framework will be included in next year's Finance Bill.

The charter will include a number of high-level principles and should apply to all those who deal with HMRC. The title 'Taxpayers' Charter' will be used as a working title until a more suitable name is determined.

The next stage of consultation will focus on content. As a start, HMRC has organised an event to involve customers, staff and others to start to design the draft charter, and a more formal consultation will be announced early in the New Year.

Our view

Deloitte supports the statutory framework, and more widely supports the principle of safeguards for taxpayers being part of the law.

3.2.19 Tobacco – excise duty increase

With effect from 6pm on 24 November 2008, the excise duty on cigarettes is increased to 24% of retail price (up from 22%), plus £112.07 per thousand cigarettes.

The duty on all other tobacco products is increased by 4%. As from 6pm on 24 November 2008, the effective rates will be:

- Hand-rolling tobacco: £122.01 per kilogram;
- Cigars: £169.74 per kilogram;
- Other smoking tobacco and chewing tobacco: £74.63 per kilogram.

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products.

3.2.20 Travel expenses tax relief

In July 2008, HMRC published a consultation document relating to the use of 'overarching' contracts of employment for workers engaged by employment agencies

and umbrella companies. In the consultation document HMRC expressed concern that the workers, by virtue of being employees, were obtaining the benefit of tax relief on their home to work travel costs to which employees are not normally entitled. This tax relief is available because in most cases agency or umbrella workers are working at a succession of temporary workplaces, rather than at a permanent workplace.

Following the consultation, the Government has decided to retain the current rules, although the consultation confirmed that there were poor levels of compliance which could be improved if HMRC were able to enforce these more strictly. HMRC will refocus their efforts to make sure that the regime is properly applied. However, if compliance does not improve, then the Government may return to this issue.

Our view

This announcement is very welcome as it makes clear that the current regime will continue, at least for the time being. This benefits not only temporary workers, but changes to the rules may have had an adverse impact on other employees with a succession of temporary workplaces, e.g. in the construction industry.

3.3 Indirect

3.3.1 Air passenger duty

The proposal to replace air passenger duty (APD) with aviation duty has been scrapped. Instead, in order to ensure greater stability and to protect competitiveness at a time of economic uncertainty, the existing APD framework will be amended with four new geographical bands being introduced. The changes will have effect for any travel which commences on or after 1 November 2009, irrespective of when the ticket for travel was booked or purchased:-

Band and approximate distance in miles from London	In the lowest class of travel (reduced rate)		In other than the lowest class of travel (standard rate)	
	2009-10	2010-11	2009-10	2010-11
Band A (0-2000)	£11	£12	£22	£24
Band B (2001-4000)	£45	£60	£90	£120
Band C (4001-6000)	£50	£75	£100	£150
Band D (over 6000)	£55	£85	£110	£170

Existing rates of APD range from £10 to £80 per passenger.

APD is calculated on a per passenger basis, whereas aviation duty would have been based on a per plane basis. The original proposals would have impacted the whole of the aviation sector, particularly the freight industry. The actual changes will only affect passenger travel.

The aviation industry is to be included within the EU Emissions Trading Scheme with effect from 2012.

Our view

Impact on freight industry

This is good news for the freight industry which would otherwise have been caught by the previously proposed aviation duty.

Impact on consumers

Unlike the proposed aviation duty, airlines should find it simpler to pass APD straight through to the passenger at point of sale. Whilst airlines can choose whether or not they pass this tax cost on, it is likely that passengers will bear the additional cost.

For example, a passenger travelling economy from London to Tokyo today would pay £40 whereas this time next year this will rise to £50. In 2010 it will be £75.

Similarly, anyone travelling in any class other than standard economy will pay £80 today, £100 this time next year and £150 the year after.

Environmental impact

Whether or not this will have a positive impact on the environment remains to be seen. It is possible that some passengers will connect to long-haul flights via alternative European hubs, thus minimising their APD rather than reducing their long-haul travel.

3.3.2 Alcohol – excise duty increases

Excise duty on alcohol will increase by 8% as of 1 December 2008. This change follows the 6% increase which took effect from 17 March 2008. The impact of the latest changes on retail prices is equivalent to:

- 52 pence on a 70cl bottle of spirits (37.5% abv);
- 3 pence on a pint of beer;
- 13 pence on a bottle of wine
- 2 pence on a litre of cider.

The smallest brewers will continue to receive 50% duty relief from the Small Brewers Relief Scheme.

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products.

3.3.3 Consultation: payments, repayments and debt: the next stage

Background

Following legislation introduced in FA 2008, HMRC has issued a further consultation document entitled 'Payments, Repayment and Debt: The Next Stage'. The objective is to deliver more efficient systems for payment, repayment and debt management through a more taxpayer focused approach, making it easier for taxpayers to pay and enabling HMRC to tackle debt more effectively.

Aim

The intention is to produce a fairer, modernised payment, repayment and debt collection system that:

- fully supports those who wish to pay what they owe on time;
- helps those who may have difficulty paying;
- takes more effective action against those who seek to gain an advantage through not meeting their liabilities or delaying payment.

Key features

The consultation focuses on the following areas:

- a voluntary and flexible monthly instalment payment scheme on a single tax basis for income taxpayers corporation taxpayers not within the Quarterly Instalment Payment (QIP) regime;
- award of costs in successful court actions in relation to late payment;
- extension of HMRC's ability to collect small debts collected through the PAYE system;
- tracing missing debtors through third parties;

- encouraging compliance through the greater use of financial securities for seriously non-compliant businesses and the introduction of tax clearance certificates confirming to businesses that they are fully compliant with their tax obligations.

Timeline

Subject to consultation, these proposed changes may be introduced in Finance Bill 2009, to take effect from an appointed date thereafter.

The consultation is open until 13 February 2009 and HMRC propose to publish responses around Budget 2009 with any changes introduced through the 2009 Finance Bill.

Our view

The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future. The proposed voluntary scheme for instalment payments will be attractive to taxpayers in helping to manage cash flow. It should also help taxpayers in arrears and enable them to manage their tax payment obligations more easily in the future.

3.3.4 Environmental measures

Despite the current economic climate environmental goals remain a high priority for the Government, as evidenced by the recent announcement that it has increased the UK's emissions reduction target to 80% of 1990 levels by 2050.

With a view to introducing a green stimulus and supporting low-carbon growth, the following have been announced:

- Accelerating £535 million of capital spending on energy efficiency, rail transport and adaptation measures;
- Inclusion of aviation in the EU Emissions Trading Scheme from 2012;
- The Renewables Obligation will be retained to provide financial support and greater certainty for large-scale renewable electricity and will be extended by at least 10 years;
- The previously postponed 2p per litre fuel increase will come into effect from 1 December 2008;
- Installing 600,000 insulation measures this winter, through the £6.8bn Home Energy Saving Programme;
- Reform to vehicle excise duty with effect from April 2009, although the maximum increase will be £5 in 2009 and no more than £30 in 2010;
- Reform of air passenger duty from 1 November 2009 to introduce four bands based on distance travelled. Proposals to introduce an aviation duty which would have been levied per plane have been scrapped;
- From April 2009 the tax relief for business expenditure on cars will be based on emissions;

- From 1 April 2009 land remediation relief will be extended to specified expenditure and also amended to provide greater clarity. This relief is intended to incentivise bringing long term derelict land back into use. The relief will give bodies liable to corporation tax a deduction of 150% for qualifying expenditure on removing or mitigating the effect of contamination.

Our view

The Government has had to balance its environmental objectives with the current economic climate, but it is clear that the environment remains a clear area of priority. This is most clearly exemplified with the shelving of the proposed aviation duty after listening to the concerns of the industry in the consultation process. However, the Government has not abandoned its environmental objectives in this area as aviation will be included in the EU Emissions Trading Scheme from 2012 and air passenger duty will be amended from 2009 to more closely align the tax with distance travelled.

3.3.5 Fuel – excise duty increase

On 16 July 2008 the Chancellor announced that the fuel duty increases planned for 1 October 2008 would be postponed.

These increases will now take place from 1 December 2008, to offset the recent reduction in prices and VAT rate.

Excise duty on unleaded petrol and diesel will rise by 2p per litre, which is an increase of just over 4% on current rates. This will be followed by further increases of 1.84p per litre on 1 April 2009 and by 0.5p per litre above indexation on 1 April 2010. Excise duty on leaded petrol will also rise by 2p per litre. The same increase of 2p per litre will apply to biofuels (biodiesel and bioethanol) as a result of the Chancellor's decision to maintain the existing duty differential of 20p per litre between main road fuels and biofuels.

However, from 2010 the 20p per litre differential will be abolished and thereafter duty will be charged at the same rate as main road fuels.

The effective rate of duty for non-road fuels subject to rebated rates of excise duty will also increase in line with the duty on main road fuels.

When used as a road fuel the rate of excise duty on liquefied petroleum gas (LPG) and natural gas (including biogas) will increase by 4.28p per kg and 2.9p per kg respectively on 1 December 2008. Further increases are scheduled on 1 April 2009, of 4.05p per kg and 2.66p per kg respectively.

The existing duty differential applicable to biogas (equivalent to 40.88p per litre) will remain at present levels at least until the Budget of 2012.

Finally, on and after 1 November 2008 a new fiscal definition was introduced for

aviation gasoline (Avgas). The duty rate will be 0.3103p per litre from 1 December 2008 (a 1p per litre increase from the current rate).

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products.

3.3.6 Increase in VAT turnover threshold for bespoke retail schemes

The turnover threshold above which retailers must agree a bespoke retail scheme to calculate their VAT (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 and existing schemes will continue to be used unless and until the agreement ends.

Our view

This is part of the wider VAT simplification review and simply indexes the threshold which has been set at £100 million since 2000. This is part of the wider VAT simplification review and simply indexes the threshold which has been set at £100 million since 2000.

3.3.7 Interest – alignment of treatment across different taxes

A consultation document has been issued which examines proposals for the harmonisation of interest charged and paid on late paid and overpaid tax, respectively.

Background

This is part of HMRC's programme of legislative changes which aims, amongst other things, to look at how alignment between the interest rules for the various taxes could bring benefits to taxpayers, their advisers and HMRC.

The document follows on from an earlier consultation document published on 19 June 2008, 'Interest ' Working towards a harmonised regime'. The responses to and discussions on the earlier consultation document have been used to develop the key proposals set out in this consultation document.

HMRC propose that an effective interest regime should be based on the principle of recompense, removing the benefit of delaying payment for people who pay late and providing reasonable recompense for those who overpay.

Key issues

- The existing rules have evolved specific to each tax over time and are inconsistent between different taxes, with interest being calculated at different rates, with different formulae, different reference dates, having different names and not always being tax deductible.

Consultation document proposals

The proposals in this document suggest that:

- A single interest rate is applied to late payments of all taxes, with the exception of Quarterly Instalment Payments (QIP).
- The rate should track the Bank of England base rate as this is easily accessible to taxpayers.
- A single rate should also apply to all overpayments of taxes, except for QIPs. This rate should remain lower than the late payment rate.
- Interest should be paid and charged as simple interest.
- The rates under the QIP scheme should be different.

Responses are requested to this consultation document by 13 February 2009. The responses will be published as part of Budget 2009.

Responses to June consultation document

The proposals take into account the key views expressed in the responses to the June consultation document, which were that:

- The Bank of England base rate offered the best realistic recompense to taxpayers.
- There is a rationale for maintaining a differential between interest rates on late payment and overpayments.
- Interest should be charged during the year on late paid PAYE.
- Interest should represent recompense and not a penalty.
- Interest should be calculated on a simple, rather than a compound method, to keep things understandable for taxpayers.
- The current QIP system should remain as it is.

Impact

The main administrative benefits of the new proposed regime would be greater simplicity, greater certainty and greater fairness.

Our view

The proposed changes would simplify matters for clients and tax advisors and would reduce the administrative burden on HMRC in having to be aware of several different methods of interest calculation. Basing the interest regime on the concept of recompense would also seem fairer than the current regime, under which interest on some taxes is calculated on this basis, whereas the interest rules on other taxes appears punitive in comparison.

3.3.8 Late filing and late payment consultation

HMRC has been engaged for some years in an extensive programme called 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. Workshops were conducted in September, shortly after the end of the

consultation period. As is customary for Modernising Powers, Deterrents and Safeguards, the same consultation document considers many taxes, in this case including income tax, corporation tax, PAYE and VAT.

A new consultation document has been published today. It covers a great deal of ground, but the key proposals are:

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For annual and one-off returns, e.g. CTSA or ITSA

Late filing

- An initial fixed penalty, which HMRC see as unlikely to be significantly increased from £100, its current level for self assessment.
- A fixed but modest daily penalty running for up to three months starting from three months after the return's due date. The document suggests the daily amount will be fixed in the statute. At present daily penalties can be charged at up to £60 per day and the document suggests that going forward the daily fixed amount will be very significantly less than this £60 per day. Under current law daily penalties require authorisation by the General or Special Commissioners. Under the new proposals authorisation will not be required, but there will be a right of appeal.
- Tax-geared penalties will arise seven and 12 months after the filing deadline. Under current CTSA rules tax-geared penalties arise six and 12 months after the filing deadline. An even more important difference is the base for tax-geared penalties. Under the proposals, they would be based on the tax shown on the return, whether or not it has been paid by the time the penalty arises. Under current legislation they are based on tax unpaid six months after the normal filing deadline. 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

In addition to interest charged on tax paid late, it is proposed to have tax-geared penalties one month (three months for corporation tax), six months and 12 months after the due date. For corporation tax, there are currently no such penalties, though for ITSA the surcharges (at 28 days late and six months late) are similar to the proposals.

For quarterly obligations, e.g. most VAT traders

Current VAT legislation wraps up late filing and late payment together. The new legislation treats the two separately.

Late filing

As with current VAT legislation a rolling default window starts to run from the first failure to submit a return by the filing date. The default window expires a year after the default. Further defaults extend the default window until a year after the latest default. The penalties would be fixed sums which increase as the number of defaults

increase, though for the third and subsequent default the penalty per default would be the same.

It is also proposed that the tax geared penalties for very late filing at six and 12 months (including those for deliberate non-filing) should also apply to any quarterly return that is this late

Late payment

As for late filing the suggestion is for a rolling default window (but separate from the filing window). The first time the taxpayer defaults, they enter a default window which expires a year after the default. Further defaults extend the default window until a year after the latest default. The taxpayer can therefore only leave a default window by paying on time for 12 months.

The penalty would be calculated by reference to the number of defaults in the default window. The first default would not trigger a penalty at all and instead HMRC would issue a default notice. The penalties would be percentages of the tax unpaid which increase as the number of defaults increase, though for the fourth and subsequent default the percentage penalty per default would be the same.

As for annual or one off payment obligations, if the payment is more than six or 12 months late then further penalties are charged, calculated as a percentage of the tax unpaid at those points in time.

For monthly obligations, e.g. most PAYE

The June consultation document considered late payments of in-year PAYE separately. Many respondents to the consultation expressed disquiet at the three possible options outlined in the June consultation, (i.e. monthly statements, monthly estimates or extending the large employers' surcharge). A fourth, and in HMRC's view, better option is now being considered in more detail in this consultation. This involves requiring employers to report some additional information either on or alongside the end of year P35 return, which would be the amount due to be remitted to HMRC for each month of the year. The monthly figures would be an aggregate for each month and not split into the various elements, e.g. PAYE, NIC and CIS payments.

The objective of making employers report the amounts to be paid, with the knowledge that interest and penalties will be applied, is to deter employers from paying PAYE late.

HMRC will be able to reconcile this expanded end of year return with the in-year payment and identify any discrepancies. The focus of this reconciliation was whether the payments had been made on time and if HMRC consider that these entries are not accurate, they could be the subject of an audit. Employers would be liable to interest on late paid in-year PAYE from the date it is due to the date it is paid. If payments are repeatedly made late or the delay in payment was prolonged, employers will be subject to late payment penalties in the same way as other taxes.

If there is only one late payment in the year, there will be no penalty. If there is more than one default, the penalty will be calculated by first calculating the total amount of tax paid late in the year (excluding the first default) and multiplying the amount by a percentage which would be determined by reference to the number of defaults. For

very late payment, amounts remaining unpaid six months after the due date, an additional penalty would be payable, calculated as a percentage of the unpaid tax. After 12 months, a further penalty is payable. This is in line with the approach taken across all taxes.

This would potentially apply to all employers and would replace the current large employer's surcharge.

The consultation document suggests the CIS scheme could be dealt with in the same way as PAYE. Further work continues on other monthly regimes.

Our view

HMRC have responded to some comments on the June proposals and September workshops. However we still think that requiring penalties for late payment as well as interest at a commercial rate is excessive. Also it appears that tax-gear penalties geared to the amount of tax shown on the return (rather than the amount unpaid as is currently the case for CTSA) are excessive. Overall we do not think the current, generally law-abiding approach, of UK taxpayers justifies such increases in penalties.

As regards in-year PAYE our concern is that excessive burdens should not be placed on all employers, especially large employers, who generally do pay PAYE on time.

3.3.9 Tobacco – excise duty increase

With effect from 6pm on 24 November 2008, the excise duty on cigarettes is increased to 24% of retail price (up from 22%), plus £112.07 per thousand cigarettes.

The duty on all other tobacco products is increased by 4%. As from 6pm on 24 November 2008, the effective rates will be:

- Hand-rolling tobacco: £122.01 per kilogram;
- Cigars: £169.74 per kilogram;
- Other smoking tobacco and chewing tobacco: £74.63 per kilogram.

Our view

These changes are intended to negate the 2.5% reduction in VAT from 17.5% to 15% on these products

3.3.10 VAT flat rate scheme available to small businesses

The VAT flat rate scheme is available to small businesses with a turnover of up to £150,000. Businesses using the scheme pay VAT as a flat percentage of turnover which varies according to the nature of the business.

These rates will be changed to reflect the new lower rate of 15% VAT. In addition, the requirement that anticipated total annual income is less than £187,000 before joining the scheme will be removed. However, if annual income exceeds £225,000, a business must leave the scheme. The method of determining income has not been defined in the legislation, but HMRC has announced that taxpayers must use the same method

as they use to determine VAT payable whilst on the scheme. Accordingly, if a business calculates its VAT liability on cash received the leaving test will also be based on cash received. If the VAT liability is calculated on the basis of invoices issued then the leaving test will also be based on this method.

The changes will take effect from 1 April 2009.

Our view

These simplifications will be welcomed by small businesses.

3.3.11 VAT rate reduction

The standard rate of UK VAT will be reduced from 17.5% to 15%, with effect from 1 December 2008 until 31 December 2009. The rate will revert back to 17.5% on 1 January 2010.

The reduced rate will neither impact zero-rated goods (such as basic foodstuffs and children's clothing) nor supplies subject to the 5% reduced rate (such as domestic fuel and power).

Anti-forestalling measures are to be introduced in the Finance Bill 2009 to prevent businesses from taking advantage of the VAT rate increase on 1 January 2010 by making prepayments.

Our view

As a consequence of the change, businesses will face systems issues to implement the new rate, including dealing with payments already received for goods and services to be delivered after 1 December (and vice versa) as well as credit notes.

Retailers will have the substantial task of repricing their goods if they are able to pass on the rate change to consumers, alongside discounting measures that many will be taking already to stimulate trade in the face of the economic downturn.

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 the VAT on the cost will not be fully recoverable.

The impact on ordinary consumers is not likely to be significant as we calculate that (even if the VAT saving is passed on in full) the average family will only save around £200 per year.