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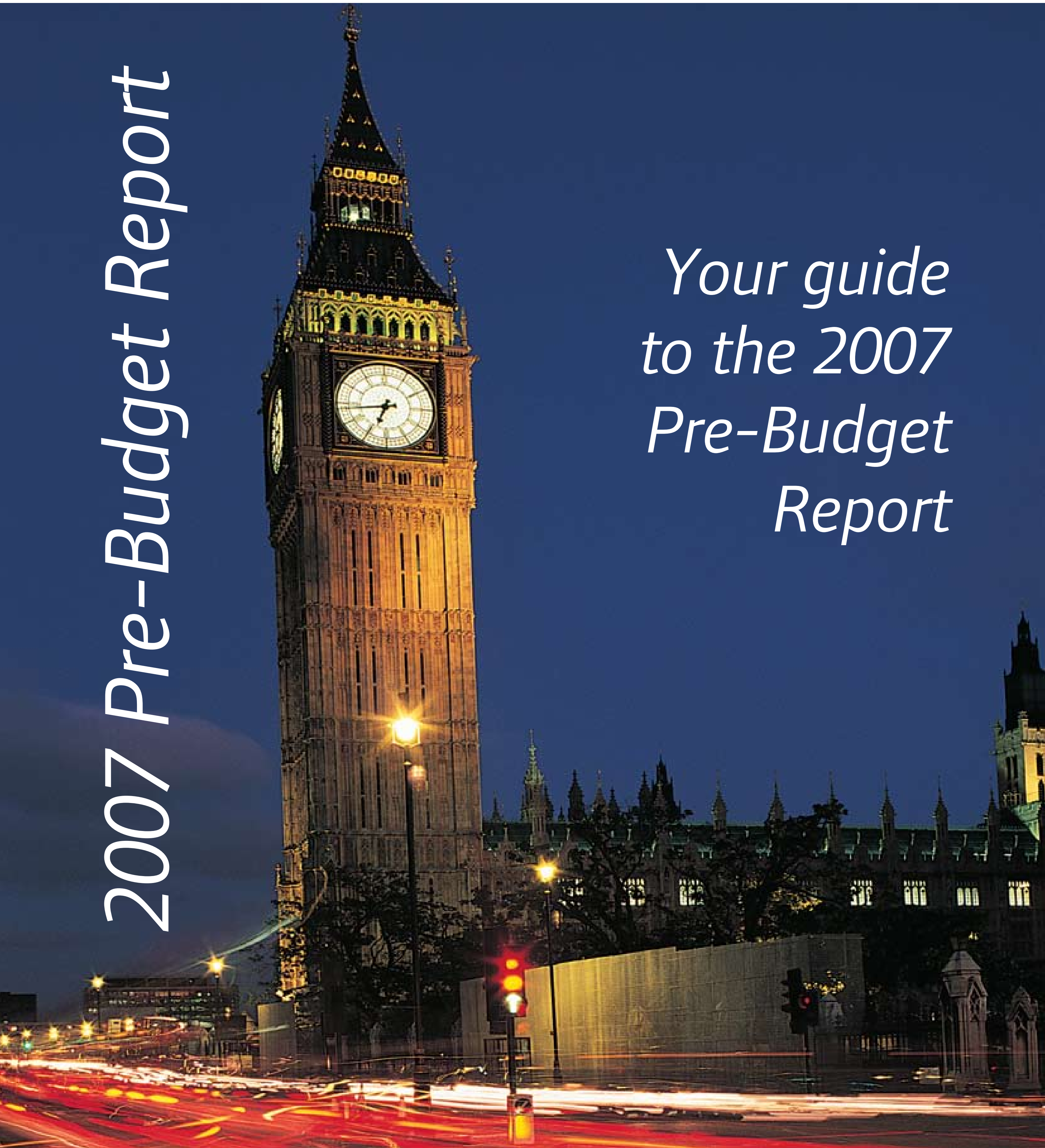
2007 Pre-Budget Report



Your guide to the 2007 Pre-Budget Report

2007 Pre-Budget Report

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Following a politically turbulent week, Chancellor Alistair Darling has presented his first Pre-Budget Report to the House of Commons.

While acknowledging recent uncertainty in the global markets, Mr Darling emphasised that the UK economy remained strong, and that the Government had met all of its fiscal rules. Notwithstanding this, the Chancellor revised economic growth forecasts for 2008 downwards, from 3% to 2-2.5%.

Key measures of interest to business owners included a series of reviews of the business taxation regime, aimed at simplifying the tax system for businesses and the self-employed, and proposals to allow local authorities in England to set a business rate supplement. The Chancellor also confirmed that the main rate of corporation tax will fall by 2%, to 28%, from next year.

The capital gains tax system will also be subject to reforms, with the introduction of a single rate of 18%, with the stated aim of ensuring that private equity bosses pay a ‘fair share’; while a number of ‘loopholes’ for non-domiciled taxpayers will also be examined.

The Chancellor made a much-anticipated announcement on inheritance tax, revealing that the potential threshold for married couples, civil partners, widows and widowers will increase to £600,000, rising to £700,000 by 2010.

Other significant announcements include the introduction of a new aviation tax in 2009, which will tax individual flights rather than passengers, and increased investment in health and education, transport, and science and technology.

Do please contact us for specific advice about how these announcements might affect you or your business.

Tuesday 9th October 2007

Business matters

Business tax simplification

The Chancellor announced a number of measures aimed at tax simplification, including:

- Beginning this year, doubling the three line account threshold to £30,000 and introducing shorter self-employment pages for businesses with turnovers below the VAT registration threshold
- For those self assessment payments on account due in January 2010 and July 2010 (ie for 2009/10), the threshold below which taxpayers do not need to make payments on account will be doubled from £500 to £1,000
- Consulting this Autumn on how best to collect tax on benefits in kind and expenses through the payroll, removing the need for a separate end of year process for many employers
- Consulting on removing the £8,500 a year threshold at which most benefits in kind become taxable, making it simpler for employers when reporting benefits
- Consulting on how to improve the present separate systems for collecting Class 2 and Class 4 national insurance contributions (NICs)
- Repealing 'outdated' legislation relating to expenditure on fire safety equipment from April 2008, making the tax code easier to understand.

Corporation tax

The Chancellor confirmed that the main rate of corporation tax will be cut by 2% to 28% from next year.

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Personal Tax

The 2008/09 rates and allowances for income tax, national insurance contributions, the Working and Child Tax Credits and Child Benefit/Guardian's Allowance will be published after the September Retail Prices Index becomes available.

Capital gains tax reform

For the tax year 2008/09 there will be a single rate of capital gains tax (CGT) set at 18%. The rate will apply to individuals, trustees and personal representatives. The 18% rate of CGT does not affect the income tax rates.

A number of changes to simplify the capital gains tax regime will be made, effective for disposals on or after 6 April 2008, including:

- The withdrawal of taper relief (even if assets were held before 6 April 2008)
- The withdrawal of indexation allowance (this change will only affect assets that were acquired before 6 April 1998)
- The abolition of the 'kink test' (this means that all assets held on 31 March 1982 will be deemed to have had a cost equivalent to their market value on that date)
- Simplification of the share identification rules. From 6 April 2008 all shares of the same class in the same company will be treated as forming a single asset (a 'share pool'), regardless of when they were originally acquired. However, the same day rules and bed and breakfasting rules remain unchanged, and shares will be identified under those rules before they are identified with shares in the share pool.

The Annual Exempt Amount (AEA) will remain. The current level for 2007/08 is £9,200 for individuals and £4,600 for some trustees. The AEA for 2008/09 will be announced at Budget 2008. Other CGT reliefs, as explained below, continue to have effect.

These measures will have effect for disposals made on or after 6 April 2008 and for held over gains coming into charge on or after 6 April 2008. The current CGT rules continue to apply for disposals made up to 5 April 2008.

Examples

As a result of these changes, individuals disposing of assets on or after 6 April 2008 will work out the tax due as follows (please note that these examples use the 2007/08 AEA for illustrative purposes; the AEA for 2008/09 will be announced at Budget 2008):

In 1995 Andrew purchased a holiday home in Devon for £100,000. He sells it in July 2008 for £250,000. The CGT due is calculated by deducting the purchase cost of £100,000 from the sale proceeds of £250,000 to give a gain of £150,000. Assuming he has no other capital gains in the tax year 2008/09 he can deduct from this the full AEA of £9,200 giving a chargeable gain of £140,800. That gain is taxed at 18% giving tax payable on 31 January 2010 of £25,344.

In 1960 Sam purchased some shares costing £500. In March 1982 they were worth £450. In August 2008 she sells the shares for £25,000. To calculate her CGT liability Sam will need to deduct from the disposal proceeds of £25,000 the March 1982 valuation of £450, giving £24,550. (She cannot deduct the cost of the shares of £500 as abolition of the kink test means she has to use the March 1982 valuation.) Assuming she has the full AEA for 2008/09 available she then deducts the £9,200 giving a chargeable gain of £15,350. That gain is taxed at 18% giving tax payable of £2,763.

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Personal Tax

Other CGT reliefs will continue to be available. For example:

- Private Residence Relief will continue to be available for principal private residences
- Business asset roll-over relief continues to be available. Roll-over relief enables the CGT payable on the gain on a chargeable asset to be deferred until a point in the future. Taper relief is not given on the rolled-over gain under the current rules
- The Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) attract a number of CGT reliefs. These include: CGT exemption where income tax relief has been claimed; loss relief on unquoted shares; deferral relief; and extended taper relief (all subject to certain conditions). For disposals on or after 6 April 2008 there will be no taper relief available. All other CGT EIS and VCT reliefs continue to apply
- Business asset gift hold-over relief also continues to apply. This relief allows CGT on business assets that are given away to be held over until the assets are disposed of by the donee
- Unused allowable losses from past years will continue to be allowed to be brought forward in order to reduce any gains.

Note: companies that are liable to corporation tax in respect of their chargeable gains are not affected by any of these changes.

Inheritance tax (IHT)

The IHT nil-rate band – effectively the 'exemption' – on the death of one spouse or civil partner was specific to that individual death estate and could not be carried forward. In many cases, this resulted in a large IHT liability on the death of the surviving spouse or civil partner.

With effect from second deaths on or after 9 October 2007 the unused percentage of the nil-rate band from the first death estate can be carried forward and added to the nil-rate band available to the second.

For example:

- *On the first death none of the original nil-rate band was used because the entire estate was left to a surviving spouse. Then if the nil-rate band when the surviving spouse dies is £350,000 that would be increased by 100% to £700,000*
- *If on the first death the chargeable estate is £150,000 and the nil-rate band is £300,000, then 50% of the original nil-rate band would be unused. If the nil-rate band when the surviving spouse dies is £350,000, then that would be increased by 50% to £525,000.*

A similar provision will apply to alternatively secured pensions (ASPs). This will make the same proportion of the original owner's nil-rate band that was not used by their death estate available against the ASP charge on the cessation of the relevant dependant's pension benefits.

Inheriting pensions

Rules which will take effect from surrenders made after 9 October 2007 and deaths after 5 April 2008 will introduce taxing provisions affecting:

- Surrender of rights to payments under a lifetime or dependant's annuity
- A connected person becoming entitled to an increase in their scheme pension rights following, and in consequence of, the death of a member
- A scheme member whose scheme rights are increased by virtue of the death of another scheme member at age 75 or more, or who becomes entitled to an unauthorised lump sum in consequence of that death.

Full details will be included in Finance Bill 2008.

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Green taxes and the environment

Car Fuel Benefit

Since its introduction in 2003, the 'fuel benefit multiplier' has remained at £14,400. The multiplier is the amount by which the car's emissions based benefit rate is multiplied to arrive at the amount liable to tax and (employer) national insurance contributions.

From 6 April 2008 the multiplier will be increased to £16,900, taking the maximum income tax payable when an employer pays for the fuel an employee or director uses for private travel, from £168 to just over £197 per month.

Air Passenger Duty

Two intended measures have been announced which affect Air Passenger Duty (APD):

- From 1 November 2008 duty will be payable at the standard rate on all 'business class only' flights (thus rising from £40 to £80 for non-EEA flights)

- From 1 November 2009 duty will be payable per flight, not per passenger, under a new aviation tax.

APD rates will remain frozen at their current rates for 2008/09. For EEA flights these are £20 (standard) and £10 (reduced). For non-EEA flights these are £80 (standard) and £40 (reduced).

Other green measures

Other environmental measures announced included:

- Confirmation of a rise in line with inflation for the climate change levy from April 2008, with agreements extended to 2017

- Exemption for investment in microgeneration from reassessment between rates valuations

- A draft Order on the measures to support biofuels from April 2008 has been laid in Parliament.

The Government also hopes to be able to include policy recommendations based on the King Review of low-carbon cars in Budget 2008.

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Benefits

The amount of **child maintenance** a family can receive without an impact on their family benefits will rise from £10 to £20 per week in 2008, and to £40 per week in 2010.

In Budget 2007 an increase in **child tax credit** of £150 a year in addition to the indexation increase was announced, effective April 2008. The Chancellor announced that the increase in 2008 will in fact be £175 a year over indexation, with a further increase in 2010.

The **pension credit** will be increased by £5 per week from April 2008, for single pensioners, and by £7.65 per week for couples.

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Compliance and anti-avoidance

Changes to the remittance basis

Individuals not domiciled or not ordinarily resident in the UK are currently taxed on overseas income and capital gains only at the time of remittance to the UK.

From April 2008:

- After being resident in the UK for seven years, individuals will have the choice of paying tax on their worldwide income and gains or an annual £30,000 of tax over and above that payable on the remittance basis
- Days of arrival in and departure from the UK will be included as days 'in' the UK in establishing whether or not an individual is resident in the UK for tax purposes
- Unless unremitted foreign income is less than £1,000 a year, those claiming the remittance basis will lose their entitlement to UK personal income tax allowances.

Further technical measures will reduce opportunities for those taxable on the remittance basis to, for example, alienate income or gains, or convert income and gains into non-taxable funds.

Remittance basis for income from Irish investments and employers

Historically the income arising to UK resident non-domiciliaries from investment in the Republic and from employers resident there has been taxable as it arises.

From 6 April 2008 the general remittance basis (as outlined above) will apply to such income.

Spreading of tax relief for pension contributions

Legislation will be introduced in the Finance Bill 2008 to ensure that the rules that spread tax relief for large employer pension contributions relative to their contribution in the previous year cannot be circumvented by routing them through a new company. The measure will have effect for payments made on or after 10 October 2007 under binding obligations entered into on or after 9 October 2007.

Income shifting

Following the widely publicised decision in the Arctic Systems husband-and-wife business tax case, the Government has confirmed that it believes it is unfair for one person to arrange their affairs so that their income is diverted to a second person, subject to a lower tax rate, to obtain a tax advantage (income shifting). The vast majority of individuals cannot shift their income and income shifting is considered to run counter to the principle of independent taxation.

The Government will be consulting, shortly after the Pre-Budget Report, on draft legislation to take effect from 2008/09 to address income shifting. The legislation will work alongside the existing rules on businesses deductions and settlements, and will seek to remove the tax advantage obtained from income shifting. It would only apply when the income is in the form of distributions from a company (dividends) or partnership profits. Income from employment, interest on savings and any other source will not be affected.

HM Revenue and Customs will draw on the wide range of commercial experience available across the advisory community in framing practical guidance that minimises burdens, and makes it as easy as possible for individuals to understand their position. Relevant factors to consider when establishing whether or not income shifting has taken place could include the work done by the individuals in the business, the investments made and the risks to which they are subject through the business.

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Compliance and anti-avoidance

National insurance contributions exemption for holiday pay

The exemption from national insurance contributions (NICs) of holiday pay paid via a third party is to be removed for all sectors outside the construction industry. The exemption was aimed at addressing problems of high mobility and turnover of the labour force in the construction industry, but working time regulations now ensure holiday entitlement is preserved in all sectors and therefore an ongoing exemption for construction is no longer appropriate. However, given the longstanding nature and wide range of benefits typically provided by schemes, the exemption will be maintained for the construction industry for five years to give it sufficient time to adjust.

Employers outside this sector are increasingly using the exemption solely to reduce their and their employees' NICs liability, and therefore secondary legislation now laid before Parliament will remove the exemption for these employers from 30 October 2007.

Other anti-avoidance measures

Disclosure Regime
Budget 2004 introduced a disclosure regime that has enabled the Government to respond to tax avoidance more swiftly and in a more targeted fashion.

In order to better identify and tackle those who make use of marketed avoidance schemes, the Government will consult on options to improve the operation of Scheme Reference Numbers.

Following on from action in 2006/07 on stamp duty land tax avoidance, the Government will consult with interested parties later this year on how to extend the disclosure regime to high value residential property transactions.

The Government will also consult with interested parties later this year on the practicalities of addressing the use of special purpose vehicles to reduce stamp duty land tax liability on high value residential property.

Financial Products - disguised interest
Action is being taken, effective immediately, to counter attempts by some companies to get around the shares as debt rules, which apply to interest income disguised as a capital gain or 'tax nothing'.

Interest relief exploitation
Action is being taken, effective immediately, to tackle avoidance schemes seen as abusing the availability of interest relief through the payment of interest in advance.

Leasing avoidance
Action is being taken, with immediate effect, to prevent two types of arrangement that seek to avoid tax through the leasing of plant and machinery. The measures will counter avoidance involving the sale and finance leaseback of plant or machinery and attempts to exploit long funding leases to create a tax loss where there is little or no commercial loss.

Life Insurance Companies
Legislation will be introduced to prevent life insurance companies from benefiting from tax relief for expenses in respect of reinsured business which have been met by the reinsurer of that business.

This will apply to transactions entered into on or after 9 October 2007 (and from 2008 to amounts spread forward in respect of earlier transactions).

Tackling Vehicle Excise Duty (VED) Evasion
To assist in the fight against VED evasion, the Government has now strengthened VED enforcement powers to include motorists driving unlicensed vehicles and parking in areas where enforcement is not currently permitted.

Therefore in addition to public roads, from 1 September 2008 VED enforcement will also cover vehicles parked in public places that are not intrinsically part of a private dwelling, where a Statutory Off Road Notification has not been made.

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Other measures

Fixed-rate mortgages

The Housing Finance Review, launched in July, has already held discussions with a variety of mortgage lenders, investment banks, regulators, consumer groups and academics with a view to 'improving the efficiency' of mortgage finance markets.

A key aim is to make it possible for lenders to offer affordable long-term fixed rate mortgages of ten years or more. One proposal is for the Debt Management Office (DMO) to issue specific derivatives which may help mortgage lenders to hedge longer-term fixed rate mortgages more cost effectively, and in turn pass on the benefit to households.

The Housing Finance Review is due to report at Budget 2008.

Pensions: Technical improvements

Several changes will be made to introduce easements to the pension scheme rules. These relate to the lifetime allowance test, protection of lump sums exceeding 25% of pension rights, taxable property provisions and inheritance tax protection on overseas pension schemes. All the changes will be backdated and take effect on and after 6 April 2006 ('A' Day).

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Consultations and Proposals

A significant number of consultations and studies of interest to businesses were commissioned to coincide with the Pre-Budget Report.

Supplementary business rates

Alongside the Pre-Budget Report and Comprehensive Spending Review, the Government has published a White Paper relating to business rate supplements. The document announces the introduction of a new power for local authorities in England to raise and retain local supplements on the national business rate, in order to fund projects that will promote economic development.

The proposal, which builds on the review of sub-national economic development and regeneration, is being promoted as a substantial devolution of power to local communities, allowing them to make investment decisions that more closely reflect local economic need.

The announcement follows extensive public debate on reform to business rates in England and the recommendations of the Lyons Inquiry into local government.

The Government's proposed model for business rate supplements involves four levels of protection for business:

- Revenue from supplements will only be available for spending on economic development in addition to existing plans. Proposals will be subject to detailed statutory consultation
- A national upper limit of 2p in the pound will be set on the level on supplements that can be levied
- To protect smaller businesses from disproportionate burdens, properties liable for business rates with a rateable value of £50,000 or less will be exempted from paying supplements
- Where the supplement will support more than a third of the total cost of the project there will be a full 'double-lock' vote of businesses affected.

By April 2010 the Government will legislate to enable local authorities to levy the first supplements.

The PDF document is available here:
http://www.hm-treasury.gov.uk/media/B/9/pbr_csr07_businessrate266.pdf

Modernising tax relief for business expenditure on cars

In the 2006 Budget, the Government launched a consultation on modernising tax relief for business expenditure on cars. This proposed replacing the existing capital allowance rules that apply to cars costing over £12,000, with a range of first-year capital allowances based on CO2 emissions, with the balance of unrelieved expenditure being taken to a new car pool with lower writing down allowances than the general pool.

An update was published in March 2007 in which views were sought on a refined proposal that utilised two pools, the general plant and machinery pool and a lower rate pool, and introduced a threshold for emissions. The pool to which expenditure would be allocated would depend on whether or not the CO2 emission levels were above or below the threshold.

The update document also sought views on proposals to reform the lease rental restriction utilising the same emissions threshold and applying a uniform fixed percentage disallowance on relevant payments on cars with emissions above the threshold.

The summary of responses is available here:

http://www.hm-treasury.gov.uk/media/5/2/pbr_csr07_cars248.pdf

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Consultations and Proposals

Aligning income tax and national insurance

In the 2006 Budget, the Government announced that it would review the case for aligning income tax and national insurance contributions (NICs), with the aim of reducing administrative burdens on employers and improving outcomes for those on lower incomes. The report published today sets out the conclusions of the review, and includes detailed analysis of the costs and benefits of moving to an annual and cumulative NIC system. It also sets out action that HM Revenue & Customs will take to further reduce administrative burdens.

The PDF document can be accessed here:
http://www.hm-treasury.gov.uk/media/B/B/pbr_csr07_incometax713.pdf

Moving to a global low carbon economy

One year after the publication of the Stern Review of the economics of climate change, the Government has published a document which draws together the key aspects of its response and its future priorities, both in the context of international negotiations and of the UK's efforts at home and abroad to reduce greenhouse gas emissions.

The PDF document is available here:
http://www.hm-treasury.gov.uk/media/A/B/pbr_csr07_stern770.pdf

Offshore funds: a discussion paper

The Government has published a discussion paper setting out how it intends to modernise the offshore funds tax regime, and is seeking comments on these proposals.

The discussion paper covers changes to the definition of offshore funds for UK tax purposes, a proposed framework for offshore funds, and the tax treatment of UK investors into those funds.

A consultation stage impact assessment is included in the Annex, on which the Government is inviting comments from interest parties, by a deadline of Wednesday 9 January 2008.

The PDF document can be viewed here:
http://www.hm-treasury.gov.uk/media/2/E/pbr_csr07_offshore402.pdf

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