



TAX
FACULTY

TAXline

TAXline supplement for members of the Tax Faculty, edited by Jane Moore

June 2010

BUDGET REPORT JUNE 2010

The Tax Faculty's summary of
the Budget Report, produced
by the Tax Faculty technical team.



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BUDGET REPORT JUNE 2010

The Emergency Budget – the second UK Budget in 2010 and the first under the new Government – was delivered on 22 June 2010.

This summary of the Budget measures has been produced by the Tax Faculty's technical team and edited by Jane Moore.

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Editor: Jane Moore
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1. BUDGET OVERVIEW

In the run up to the general election, the Conservative party manifesto stated that if elected that they would hold an Emergency Budget within 50 days of taking office and that a credible plan for deficit reduction would be top of their list.

Although they failed to win an outright majority, this centrepiece of policy survived the horse-trading that followed after 6 May 2010. The very first item on the coalition agreement was a restatement of this aim and a confirmation that there would be a move to accelerated debt reduction with spending cuts taking priority. To underline this point, it was agreed that £6bn of cuts would be found in the current financial year, 2010/11.

Tough talk? Yes, but against a background of the credit crisis engulfing sovereign states and the UK's financial credibility under pressure, it was important to send out a strong message that the coalition's priority was to bring the nation's finances under control. The more tricky task would be to exercise tough love: namely achieving fiscal consolidation without tipping the UK back into recession, possible deflation and rising unemployment.

True to the Government's word, the Emergency Budget (as the Chancellor chose to call it) was held only 41 days after signing the coalition agreement. In the meantime, the Chancellor had also made a number of announcements on tax and budget policy, including the establishment of the Office for Budget Responsibility (OBR) charged with independent vetting of the forecasts and assumptions, for example GDP growth, that underpin the Budget figures.

In advance of the Emergency Budget, the first report from the OBR was published on 14 June 2010. Its conclusions on the fiscal and economic forecast made for interesting reading. In summary, as compared to the Budget in March 2010, the OBR downgraded future growth estimates, reduced the expected current year budget deficit but revised upwards the underlying structural deficit.

The more tricky task would be to exercise tough love: namely achieving fiscal consolidation without tipping the UK back into recession, possible deflation and rising unemployment.

The Chancellor was at pains to support business and offer a clear roadmap for business tax over the life of this Parliament.

The OBR set the scene for an austerity budget the like of which most of us have not seen before. The tough talk has now been translated into concrete action, with a range of public spending cuts and tax increases that will impact on everyone.

The Chancellor was at pains to support business and offer a clear roadmap for business tax over the life of this Parliament. Corporation tax rates for both large and small companies will be reduced: the main rate from 28% to 24% over four years and the small companies' rate to 20%. To compensate for these reductions in headline rates, capital allowances will be reduced slightly and the annual investment allowance cut back from £100,000 to £25,000.

Attention beforehand was focused on areas where taxes would be increased, with hot favourites being an increase in the VAT rate to 20% and an increase in the CGT rate. VAT was indeed increased to 20% but only from 4 January 2011, thereby giving consumers six months to make purchases at the old rate of 17.5%. In addition, anti-forestalling arrangements will seek to stop businesses entering into arrangements to avoid the effect of the increase in the VAT rate.

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The scale of the proposals was unprecedented, but the Chancellor was anxious to demonstrate support for the disadvantaged and for the UK's regions

It came as no surprise that the rate of CGT was increased, given that the difference between the CGT rate (18%) and the top rate of income tax (50%) would be 32% this year. In the event, a new CGT rate was introduced of 28%. However, the new rate only applies where total taxable gains and income are more than the upper limit of the income tax basic rate band; gains below that limit will be taxed at the 18% rate. This will add complexity to the CGT system. Further complications to the 2010/11 tax calculations will arise because the new rate applies from part-way through the year, to disposals on or after 23 June 2010. However, there was probably a need to act quickly to shore up leakage as taxpayers sought to convert income into capital.

Turning to spending cuts, the Chancellor said that the consolidation will be achieved through 77% spending cuts and 23% tax increases, in other words about £3 of savings would be found for every £1 of tax raised. He made a number of far-reaching announcements that will impact on welfare benefits, with tax credits for the higher paid, housing benefit and disability living allowance being in the firing line. In addition, at the next spending round it looks like departmental budgets will be cut by up to 25% rather than the 20% that had been pencilled in. And the Chancellor made it clear that public sector pensions are unaffordable and up for review. The scale of the proposals was unprecedented, but the Chancellor was anxious to demonstrate support for the disadvantaged and for the UK's regions.

On tax policy, the Government published a consultation document on formulating a new approach to tax policy-making. This is a welcome development and reflects many of the points that we have been making over the years to improve tax law. The Government proposes that there will be early and better consultation, that there will be improved analysis of the impact of changes, that legislation will be published in draft before it is included in a Finance Bill and that there will be greater Parliamentary scrutiny of tax legislation. We look forward to working with government and HMRC to embed these proposals into tax policy-making.

The danger is that if he has gone too far, the UK could be plunged back into recession and the jobless total could soar. The stakes are high, and it remains to be seen if the UK will be resilient enough to take such treatment.

We may have had a change of government but any thoughts that the coalition would be softer on tax avoidance are misplaced: the coalition agreement made it clear that the drive to root out tax evasion and counter tax avoidance would continue. It has. A number of new anti-avoidance measures were announced and in addition further detailed consideration will be given to a general anti-avoidance rule (GAAR). A GAAR was proposed in 1998 but following consultation the idea was rejected, never to resurface. There must be a good chance that the time is right for a GAAR.

In conclusion, if this Budget starts to address the problem of reducing the UK's debt mountain and restoring our fiscal credibility while fostering a return to growth, then the Chancellor will be remembered as someone who, like an anxious parent, administered some pretty tough love when it was most needed. The danger is that if he has gone too far, the UK could be plunged back into recession and the jobless total could soar. The stakes are high, and it remains to be seen if the UK will be resilient enough to take such treatment.

2. FINANCE ACTS AND TAX POLICY-MAKING

TIMETABLE FOR THE FINANCE ACT(S)

The usual practice for an incoming government is to introduce its own Finance Bill which is then passed before Parliament's summer recess as the Finance (No 2) Act. Such Bills will usually comprise measures that have already been announced and may include measures announced by a previous government of a different political persuasion.

In keeping with its proposals to ensure that there is proper scrutiny of Finance Bills, the Government will depart from this model. The intention, as set out in paragraph 2.118 of the Red Book, is that the Government will publish a Finance Bill shortly which will legislate its key priorities, presumably such matters as the proposed changes to the corporation tax rates, capital allowances and CGT rates. This Bill will then be enacted before the summer recess at the end of July and will therefore become the Finance (No 2) Act 2010.

In addition, the Government proposes to publish a further Bill in the autumn which will include measures 'inherited' (to quote the words used in the Red Book) from the previous government that had been announced but not included in the first Finance Act 2010. It is proposed that this Bill will be published in draft for comment in July.

Depending upon when this final Bill is passed, we may therefore have a Finance (No 3) Act 2010. Our internet search suggests that we may have had only one of these before, in 1915, and presumably that was due to the necessity to raise money in wartime. If we are right, a third Finance Act in one year looks to have been as extinct, in the UK at least, as that huge bird the Great Bustard! Could the latter's successful reintroduction to the UK in 2009 have been a harbinger for the return of a third Finance Act, the rarest phenomenon in the history of UK tax? It's worth remembering that, while the Great Bustard may be big, it can fly!

TAX POLICY-MAKING – A NEW APPROACH

We said in our submission ahead of the Emergency Budget (TAXREP 27/10) that we were concerned that the UK tax system was suffering a crisis of confidence. We recommended that government should concentrate on a small number of key priorities which should include setting a clear framework for tax simplification and associated improvements to the formulation of tax policy.

Our recommendations look to have fallen on fertile ground. The Government has published a consultation paper *Tax policy making: a new approach*, which commits it to improving tax policy-making based on better and earlier consultation, fewer policy changes, greater Parliamentary scrutiny and a tax simplification programme.

Paragraph 1.3 of the document sets out five key problem areas:

- a lack of a clear strategy for the tax system;
- consulting too late in the policy development cycle;
- length and complexity of the tax code;
- uncertainty due to volume and timing of tax changes; and
- inadequate Parliamentary scrutiny of tax legislation.

We could not have summarised it better! That covers pretty much everything we have been saying for the last five years or more.

So, the problems have been identified. Now comes the hard bit. What exactly needs to be done about them?

Tax strategy: The Government has set out a fairly clear strategy for business tax, although much detail still needs to be decided including a clear direction for small business tax policy.

Consultation: The Government will publish a statement on its approach to tax consultation later this year. It is proposed that consultation will occur at each identifiable stage, that policy objectives will be clearly set out together with impact analyses, and that a clear stakeholder engagement strategy will be identified with respondents in no doubt as to what they are being asked to do. Changes will be confirmed no later than three months before the start of the tax year and will be accompanied by draft legislation and any significant secondary legislation.

Tax simplification: The Government will proceed with an independent Office of Tax Simplification, and further details will be announced shortly.

The pace of change: The Government will slow down the pace of change and focus on fewer and better developed proposals.

Better scrutiny: The proposals for better consultation and earlier publication of draft legislation should help to improve scrutiny. In a recognition that many substantive proposals are now dealt with through secondary legislation, the same principles and disciplines will be applied. The Government also recognises that Parliament should have a stronger and more effective role in scrutinising tax legislation, and has suggested that the Treasury Select Committee should consider how this could be done.

Comments are requested on the proposals in the consultation document by 22 September 2010, and by 12 July for those who wish to be involved in the discussions. We have already expressed our interest in being involved, and we would welcome members' comments on the proposals (please send comments to Frank Haskew).

If these statements of intent are introduced they will amount to the most fundamental reform of tax policy-making in decades. Taken as a whole they should help to restore confidence, stability and certainty into the tax system. The new approach will require much greater discipline and a more considered approach from tax policy-makers. That will be very welcome. The commitment to much earlier and more detailed consultation has also thrown down a challenge to the tax profession. If we want a better tax system we need to put time and effort into effective engagement with tax policy-makers. This is our chance: we have only ourselves to blame if we do not seize it with both hands.

3. RATES AND ALLOWANCES

The main rates and allowances for 2010/11 are summarised in the table on pages 8–9. Most of these are unchanged from the table published with our March 2010 Budget supplement. There have been changes to CGT and VAT.

The 2010/11 changes and the information we have so far about rates and allowances for 2011/12 and subsequent years are summarised below.

INCOME TAX

The 2010/11 rates and allowances remain as previously announced.

From 6 April 2011, the personal allowance for those aged under 65 will be increased by £1,000 to £7,475.

So that higher rate taxpayers do not benefit from this increase, the band of income chargeable at basic rate will be reduced. Press Notice PN01 says that the basic rate limit will be reduced by £2,500 based on current estimates of the RPI, though the exact figures for the basic rate limit and higher rate threshold will be confirmed in the autumn.

CAPITAL GAINS TAX

From 23 June 2010 there will in effect be three rates of capital gains tax (CGT) – 10%, 18% and 28%.

The 10% rate applies to gains qualifying for entrepreneur's relief. The new 28% rate applies to gains of individuals above the higher rate income tax threshold, and to gains of trusts and estates.

The lifetime limit applying to gains qualifying for entrepreneurs' relief will increase from £2m to £5m with effect from 23 June 2010.

The annual exempt amount remains unchanged at £10,100 for 2010/11 (for most trustees it is £5,500).

NATIONAL INSURANCE

For 2010/11, NIC rates and thresholds were previously announced and there are no changes.

NIC from 6 April 2011 (BN01)

The secondary (employer) threshold will rise by £21 a week above the level that indexation would reach.

The alignment of the upper earnings limit (UEL) for Class 1 NIC and the upper profits limit (UPL) for Class 4 NIC with the higher rate income threshold (the total of the personal allowance for those aged under 65 and the basic rate limit) will be maintained. As the income tax basic rate limit will be reduced (so that higher rate taxpayers do not benefit from the increase in the personal allowance), the UEL and UPL will be reduced. The exact figure will be confirmed when September's RPI is known but PN02 indicates that the UEL and UPL will be reduced by £1,650.

In summary therefore for 2011/12:

- Classes 1 and 4 NIC main rates will increase to 12% and 9% respectively.
- Class 1 secondary (ie employer) rate and Classes 1A and 1B will increase to 13.8%.
- The additional rates of Classes 1 and 4 will increase to 2%.
- The primary (ie employee) threshold for Class 1 and lower profits limit for Class 4 will be increased by £570 (as announced in the 2009 PBR).
- The UEL and UPL for 2011/12 will not be known until publication of the RPI for September 2010.

TAX CREDITS AND CHILD BENEFIT

The 2010/11 rates and thresholds for Working Tax Credit (WTC) and Child Tax Credit (CTC), Child Benefit and Guardian's Allowance were previously announced and have not changed.

There will be a range of changes for 2011/12 and subsequent years which are detailed in section 6 below on tax credits.

VAT

VAT turnover thresholds for 2010/11 were previously announced and have not changed.

The standard rate of VAT will increase from 17.5% to 20% from 4 January 2011.

There will be consequential changes to the thresholds and percentages for the VAT flat rate scheme.

4. PERSONAL AND EMPLOYMENT TAXES

SHARED LIVES CARERS (BN27)

As previously announced at PBR 2009, income tax relief for shared lives carers will be put on a statutory footing, in a similar way to the existing relief for foster carers. Legislation will be in a Finance Bill after the summer recess.

A shared lives carer is someone who, in their own home, cares for up to three individuals who have been placed with them under a local authority Shared Lives placement scheme. The category includes adult placement carers.

The income from providing shared lives care is taxable (generally as the income of a trade, profession or vocation). HMRC currently allows various non-statutory deductions and exemptions for adult placement carers, known as the 'simplified arrangements'. These will be replaced by new rules will apply from 6 April 2010.

Under the new rules, shared lives carers will have a tax-free allowance per household, comprising a fixed £10,000 per tax year and weekly amounts of either £200 or £250 for each adult placed with them. If the carer's total receipts from caring are less than the total allowance for the year, the income will be tax-free. If the total receipts exceed the allowance the carer can choose either to be taxed on the excess or to work out their profits based on the usual rules for businesses.

For 2010/11 only, shared lives carers will be able to choose between the current non-statutory simplified arrangements or the new rules. The simplified arrangements will be withdrawn from 2011/12.

TAX RELIEFS AND EXEMPTIONS FOR CARERS OF CHILDREN (BN26)

A new income tax exemption will apply on and after 6 April 2010 for certain payments to carers looking after children under a special guardianship order or under a residence order where the carer is not the child's parent or step-parent. This exemption will be similar to the current tax exemption for payments to adopters and will be distinct from the new income tax regime for shared lives carers.

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SUMMARY OF THE MAIN RATES AND ALLOWANCES FOR 2010/11

Income tax rates		National Insurance	
Basic rate	20%	<i>Rates are per week unless stated</i>	
On income up to	£37,400	Lower earnings limit, primary Class 1	£97
Higher rate	40%	Upper earnings limit, primary Class 1	£844
On income between	£37,400–£150,000	Upper Accruals Point	£770
Additional rate	50%	Primary threshold	£110
On income over	£150,000	Secondary threshold	£110
Starting rate for savings income	10%	Employees' primary Class 1 rate	
On income within first	£2,440	Between PT and UEL	11%
Lower dividend rate	10%	Above UEL	1%
Higher dividend rate	32.5%	Employees' contracted-out rebate	
Additional dividend rate	42.5%	Salary-related schemes	1.6%
Trust rate	40%	Money-purchase schemes	1.6%
Trust rate on dividends	42.5%	Married women's reduced rate	4.85%
		Employers' secondary Class 1 rate	12.8%
		Employers' contracted-out rebate	
		Salary-related schemes	3.7%
		Money-purchase schemes	1.4%
		Class 2 rate	£2.40
		Class 2 small earnings exception (year)	£5,075
		Special Class 2 rate for share fishermen	£3.05
		Special Class 2 rate for volunteer development workers	£4.85
		Class 3 rate	£12.05
		Class 4 lower profits limit (year)	£5,715
		Class 4 upper profits limit (year)	£43,875
		Class 4 rate between lower and upper profits limit	8%
		Class 4 rate above upper profits limit	1%
Income tax allowances			
	£		
Personal allowance (age under 65)	6,475		
Personal allowance (age 65–74)	9,490		
Personal allowance (age 75+)	9,640		
Married couple's allowance (age 75+)	6,965		
Married couple's allowance minimum amount	2,670		
Income limit for age-related allowances	22,900		
Blind person's allowance	1,890		
Pensions			
Annual allowance	£255,000		
Lifetime allowance	£1.8m		

Tax credits

Working tax credit	£
Basic element	1,920
Couple and lone parent element	1,890
30 hour element	£790
Disabled worker element	2,570
Severe disability element	1,095
50+ Return to work payment (16–29 hours)	1,320
50+ Return to work payment (30+ hours)	1,965

Childcare element of the WTC

Maximum eligible cost	
For one child	£175 per week
For two or more children	£300 per week
Eligible costs covered	80%

Child tax credit	£
Family element	545
Family element, baby addition	545
Child element	2,300
Disabled child element	2,715
Severely disabled child element	1,095

Income thresholds and withdrawal rates

First income threshold	£6,420
First withdrawal rate	39%
Second income threshold	£50,000
Second withdrawal rate	6.67%
First threshold for those entitled to CTC only	£16,190
Income disregard	£25,000

Corporation tax

For financial year to 31 March 2011

Main rate	28%
Small companies' rate	21%
Upper profits limit	£1.5m
Lower profits limit	£300,000
Effective marginal rate	29.75%
Marginal rate fraction	7/400

Capital gains tax

Standard rate	18%
Higher rate*	28%
Annual exemption	
For individuals, PRs and some trustees	£10,100
For most trustees	£5,050
Entrepreneurs' relief rate	10%
Entrepreneurs' relief lifetime limit of gains	
To 22 June 2010	£2m
From 23 June 2010	£5m

*The higher rate applies from 23 June 2010 to gains of individuals above the higher rate income tax threshold and to gains of trusts and estates.

Inheritance tax

Rate	40%
Nil rate band	£325,000

VAT

Standard rate of VAT	
To 3 January 2011	17.5%
From 4 January 2011	20%
Reduced rate	5%
Registration threshold	£70,000
Deregistration limit	£68,000

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This was announced at the March 2010 Budget and the legislation will be included in a Finance Bill after the summer recess.

EXPENSES PAID TO MPs (BN30)

Since 6 May 2010 MPs' expenses have been paid under a new scheme developed by the Independent Parliamentary Standards Authority (IPSA). Legislation is to be introduced to address the tax and NI consequences of the new scheme.

The proposed changes are mainly to include references in the legislation to IPSA being the administering body rather than the House Authorities and to include in legislation certain easements which previously existed. The following will be covered:

- The exemption in s 292, Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) for 'personal additional accommodation' expenditure: payments made by IPSA for additional expenses necessarily incurred in staying away overnight for the purposes of performing Parliamentary duties will be tax-free in the same way as payments formerly made under the previous rules.
- The s 294, ITEPA 2003 exemption for EU visits: payments made by IPSA to cover costs of certain visits to EU institutions or EU member state parliaments will be tax-free in the same way as payments formerly made under the previous rules. The exemption will be extended to cover travel to Council of Europe parliaments as well.
- Tax relief is to be extended to all travel expenses reimbursed by IPSA relating Parliamentary business, whether in a constituency or Westminster or between the two. Previously this was by concession only.
- Travel by spouses that is reimbursed by IPSA in new, more restricted circumstances will be exempted from tax. Previously the rules were more generous and the exemption was by concession.
- Previously the cost of evening meals eaten 'on the Parliamentary estate' when Parliament was sitting late was covered by the s 292, ITEPA 2003 exemption for 'personal additional accommodation' expenditure. Such meals are now dealt with separately by IPSA and new legislation is needed to maintain the previous tax treatment.

Regulations will also be made to ensure that the NI treatment mirrors the tax position.

SEAFARERS' EARNINGS DEDUCTION (BN31)

The seafarers' earnings deduction is available to individuals who work on ships and are ordinarily resident in the UK. It can give 100% UK tax relief for earnings from carrying out duties as a seafarer wholly or partly outside the UK during an eligible period.

Legislation is to be introduced in the Finance Bill after the summer recess to extend the availability of this deduction to seafarers who are EU or EEA residents, with effect from 6 April 2011.

This change had previously been announced in the 2009 PBR.

TAXATION OF INDIVIDUALS NOT DOMICILED IN UK (Red Book para 1.98)

In its coalition agreement the Government announced that it would review the taxation of individuals who are not domiciled in the UK. The accompanying documents to the Emergency Budget indicate that the Government will:

'assess whether changes can be made to the current rules to ensure that non domiciled individuals make a fair contribution to reducing the deficit, in return for greater certainty and stability for those bringing skills and investment to the UK'.

EMPLOYER NIC HOLIDAY FOR NEW BUSINESSES

Qualifying new businesses set up on or after 22 June 2010 will be able to benefit from a three-year scheme to exempt new businesses outside London, the South East and East England from up to £5,000 of Class 1 employer NIC for each of their first 10 employees hired in the first year of business. Each holiday will last for the first 52 weeks of each employee's employment, providing these fall within the three-year holiday scheme period.

Most kinds of business activity (including investment and property businesses) will be eligible for the holiday provided they employ staff and meet other criteria, but businesses in the coal sector and individuals employing staff for personal services will be excluded, and there will be restrictions for the agriculture and fisheries sectors.

Most staff will be included but there will be some specific exclusions, for example employees operating under companies caught by the IR35 rules and employees engaged through managed service companies.



HMRC has published a set of questions and answers Regional employer NICs holiday for new businesses. It is intended that the detailed criteria will be published shortly with a view to the scheme being up and running by early September 2010.

Businesses which meet the criteria and which start up between 22 June and the time the holiday scheme starts will have to pay employer's NIC in the period before the start of the scheme but will receive a holiday of equal duration once the scheme starts.

REVIEW OF THE PAYE SYSTEM (Red Book para 2.25)

The Pay As You Earn (PAYE) system is a fundamental part of the UK tax system. The Government wishes to explore how it could be improved in order to reduce costs and make the system easier for employers and HMRC to administer. As an initial step, the Government says it intends 'to consult with employers and payroll providers in the summer on mechanisms that could support more frequent or real time PAYE data.'

5. PENSIONS AND SAVINGS

BUDGET ANNOUNCEMENT ON PENSIONS TAX RELIEF PLANS

We are very pleased that the Government, having listened to the considerable concerns of representative bodies including the ICAEW, has announced that it intends to repeal the provisions introduced in Finance Bill 2010 for the restriction of pensions tax relief. This does not however mean that high earners will continue to receive full tax relief on pension contributions. The Government will be consulting on an alternative approach to achieve the same objectives, to be in place from April 2011.

The Government agrees that the high income excess relief charge, which was due to come into force on 6 April 2011, could have had unwelcome consequences for pensions saving, bringing significant complexity to the tax system and damaging UK business and competitiveness. However, the cost of pensions tax relief is unsustainably high so the alternative approach will need to be structured to achieve the same level of reduction in the cost of pensions tax relief.

The proposal is to reduce the annual allowance from its current level of £255,000 to an amount between £30,000 and £45,000. The annual allowance is the

maximum amount of contribution made to a qualifying pension scheme on which full tax relief will be given. There is also a lifetime maximum allowance which is currently £1.8m.

There will be no changes to the existing anti-forestalling provisions in Finance Act 2009 which restrict pensions tax relief for 2009/10 and 2010/11 in advance of the proposed April 2011 changes.

What is not specifically mentioned is the extent to which the employer contributions will be taken into account. However, the £130,000 and £150,000 thresholds and the varying definitions of 'income' will be disappearing.

Consultations on the revised proposals will be starting shortly with interested parties. There are many issues to be considered including:

- valuation of defined benefit scheme contributions;
- dealing with one-off spikes in pension accruals;
- flexibility in paying any charges arising;
- operational matters;
- minimising administrative burdens.

The stated aim is to achieve a fair and simple pensions tax regime which is sustainable in the long term. The Tax Faculty will be involved in the consultations and discussions so please let us have your views.

Further details are in *Restricting Pensions Tax Relief*, published by HM Treasury on 22 June 2010.

REQUIREMENT TO BUY AN ANNUITY INCREASED TO AGE 77 (BN22)

Pension savers will no longer be required to purchase an annuity with their pension fund by age 75.

This new measure will be introduced from 2011/12. Until then there will be transitional arrangements so that the age at which the annuity must be purchased will increase to 77 with effect from 22 June 2010. This is so that those reaching age 75 can defer decisions relating to pension savings until the new rules are finalised.

Currently strict maximum and minimum withdrawal limits apply to pension scheme members with money purchase arrangements who have not bought an annuity by age 75. There can also be tax charges of up to 70% on death plus IHT charges which could be as high as 82%.

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With effect from 22 June 2010, where a scheme member with a money purchase arrangement has not yet bought an annuity and reaches age 75 on or after 22 June 2010:

- The strict maximum and minimum income withdrawal limits will apply from age 77 rather than age 75.
- Immediately before their 75th birthday they will become entitled to income withdrawal and a tax-free pension commencement lump sum in respect of those funds not previously made available for income withdrawal.
- Before the main changes have effect from April 2011, the tax charge will be 35% on lump sum death benefits paid by the scheme on or after 22 June 2010, aged 75 or over.
- The IHT death charges on scheme members who are in drawdown and aged 75 or over will also not apply.

There will be a consultation on the proposals.

CHANGES TO PENSIONS TAXATION FOR 'NEST' (BN23)

Some of the changes notified in the March 2010 Budget have reappeared in the Emergency Budget in Budget Note BN23.

In November 2008 the Pensions Act 2008 introduced measures aimed at encouraging greater private saving for retirement. Most of the measures in the Act will come into effect from 2012, including a duty on employers to automatically enrol all eligible workers into a good quality workplace pension scheme (provided they are not already in such a scheme) and to make a minimum contribution.

The Act also allows for the establishment of a new scheme, formerly known as personal accounts but recently rebranded as NEST – National Employment Savings Trust. This is intended to be a simple, low-cost pensions savings vehicle aimed at those currently without access to a workplace pension scheme.

With effect from Royal Assent following a Finance Bill after the Parliamentary summer recess, NEST can be registered with HMRC in the same way as other registered pension schemes

The following provisions included in the March Budget note have not been included in this one:

- There will be no tax liability on interest charges on late pension contributions made by employers to qualifying pension schemes.
- Regulations may be made to correct unintended tax consequences arising from implementation of NEST.
- There is no tax charge on the borrowing associated with establishing and operating NEST.

REITS AND STOCK DIVIDENDS (BN18)

This measure will allow UK Real Estate Investment Trusts (REITs) to issue stock dividends in lieu of cash dividends in meeting the requirement to distribute 90% of the profits from the property rental business of the REIT.

INDEXING ISA LIMITS FROM 2011 (BN21)

As announced in the March 2010 Budget, the individual savings account (ISA) regulations will be amended so that from 6 April 2011 the annual ISA limits will be increased each year by the RPI of the previous September. The increased limit will be rounded to the nearest multiple of £120. If RPI is negative, the limits will remain unchanged. The cash ISA limit will continue to be half of the stocks and shares ISA limit. The limits for 2010/11 are £5,100 for cash and £10,200 in total for all savers.

SAVING GATEWAY (Red Book para 2.61)

The Government will not now introduce the Saving Gateway in July 2010. The Saving Gateway was a government-sponsored savings plan for (mainly) low income people. Savings of up to £25 a month could be made over a two-year period and the Government was going to contribute 50p for every £1 saved.

CHILD TRUST FUND

The Government announced on 24 May 2010 that it intends to reduce and then stop all government contributions to Child Trust Funds (CTFs). Once legislation has been passed, it is planned that from August 2010, government contributions will reduce at birth and stop at age 7. New CTF vouchers will cease from 1 January 2011.

There will be no immediate effect on existing CTFs. CTF accounts already in existence will continue to operate as currently. This will mean that:

- no withdrawals will be allowed until the child's 18th birthday;



- tax-free investment growth will continue;
- friends and family can still contribute up to a total of £1,200 a year;
- vouchers will still be valid until their expiry date; and
- HMRC will open accounts for children where the voucher has not been used by the expiry date.

Subject to the relevant legislation being enacted, the proposals are to:

- reduce government contributions for children born from August 2010 from £250 to £50 to children in better off families, and from £500 to £100 to children in lower income families;
- stop all government contributions at age 7 for children that reach that age from August 2010 onwards; and
- stop issuing new CTF vouchers from January 2011.

6. TAX CREDITS

The Government has announced a complicated package of measures designed to reduce spending on tax credits (working tax credit (WTC) and child tax credit (CTC)). The main thrust of these is to reduce entitlement to tax credits for households with income of £40,000 or more. However, for those who qualify there will also be an extra increase in the child element of child tax credit, by £150 above indexation in April 2011 and £60 above indexation in April 2012.

Full details of the changes are:

Withdrawal rate: From 6 April 2011, the withdrawal rate will increase from 39% to 41%. Households have their tax credits withdrawn when their income exceeds the first income threshold which is currently £6420 for those in receipt of WTC and CTC, and £16,190 for those in receipt of CTC only. The change means that households will lose 41p for every £1 of income above the relevant threshold.

Upper income limit: From 6 April 2011 families with household income above £40,000 will start to have their family element tapered away. Currently the upper income limit is £50,000. The family element is currently £545 per year (£1090 if there is a child aged under one).

Withdrawal of family element of CTC: From 6 April 2011, the family element will be reduced by 41p for every £1 of income above the new £40,000 threshold. Currently it is withdrawn at 6.67%, ie £1 for every £15 of income over the (current) £50,000 threshold.

Also, from 6 April 2012 the family element will start to be withdrawn immediately after the child element. Currently, the family element (and baby element) is protected from withdrawal until income reaches £50,000, even if all other elements of tax credits are withdrawn much further down the income scale.

Baby element of CTC: This will be removed from 6 April 2011. Currently families who have a child aged under one get an additional £545 added to the basic family element.

Extra CTC for children aged one to two: The previous government announced that from 6 April 2012, an additional amount of CTC would be introduced for those with children under one to two. This will no longer happen.

The 50+ element of WTC: This will be removed from 6 April 2012. The 50+ element means that people aged 50 or more can qualify for WTC by working at least 16 hours for the first year when they return to work after receiving certain benefits. Otherwise, those without children and who do not qualify for the disability element will have to work at least 30 hours to qualify for WTC.

WTC for those aged 60+: Those aged 60 and over qualify for WTC by working at least 16 hours (rather than 30 as currently required) from April 2011. This was announced by the previous government and is still going ahead.

Backdating: From April 2012, backdating of a new claim or of an increased award following a change of circumstances will be limited to one month. Currently the maximum period of backdating is three months.

Income disregard: From 6 April 2011 the income disregard will reduce from £25,000 to £10,000 for 2011/12 and 2012/13 and then to £5,000 from 6 April 2013. The disregard is the amount by which income can rise in one tax year compared to the previous year before a tax credit award must be revised.

Disregard for falls in income: From 6 April 2012, there will be a new feature in the system – an income

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disregard of £2,500 for falls in income. Currently, if income falls by any amount as compared to the previous year, tax credits are adjusted so that the claimant receives an amount based on their new (lower) income. The new disregard means that tax credits will not be adjusted until income falls by more than £2,500 compared to the previous year

Increases in rates from April 2011: The Consumer Price Index (CPI) will be used to uprate all of those elements of tax credits were previously uprated by the RPI from April 2011.

The child element of the Child Tax Credit will increase by £150 above CPI in 2011/12 and £60 above CPI in 2012/13.

BENEFITS UPDATING

The Government has decided to use the CPI rather than the RPI to uprate all benefits, tax credits and public service pensions. This will apply from April 2011.

CHILD BENEFIT

Child benefit will continue as a universal benefit, and the Chancellor did not (at least for now) grasp the nettle of making it either means-tested or taxable.

However, the rates of benefit will be frozen for three years from April 2011.

STATE PENSION

From April 2011 the state pension will be uprated by what the Chancellor called a 'triple guarantee', ie by reference to earnings, prices or 2.5%, whichever gives the highest figure.

7. CAPITAL GAINS TAX

CGT RATES (BN20)

From 23 June 2010 there will be two rates of capital gains tax (CGT) – 18% and 28%. A rate of 10% will continue to apply to gains qualifying for entrepreneurs' relief. The annual exempt amount remains unchanged at £10,100 for 2010/11.

The existing rate of CGT of 18% will apply where taxable income and gains do not exceed the income tax higher rate threshold (£37,400 in 2010/11). The higher rate of 28% will apply to those whose income and gains exceed this figure.

The higher rate will also apply to gains of trusts and of estates. It is disappointing that estates will not be able to benefit from the 18% rate and perhaps the Government might be persuaded to reconsider this.

Where an individual's taxable income is lower than the income tax higher rate threshold, only that part of a taxable gain which (when added to taxable income) exceeds that threshold will be taxed at the higher rate. It should be noted that all gains realised in 2010/11 before 23 June 2010 will be taxed at 18% and will not be aggregated with taxable income to determine the rate applicable to taxable gains realised on or after that date. Taxpayers will also be able to deduct losses and allocate the annual exempt amount in the way which minimises the tax due.

It appears that the higher rate of 28% was chosen because 'dynamic analysis' by HM Treasury showed that an increase beyond a rate of 28% would have resulted in lower total revenues (discussed further below).

Furthermore the Chancellor has decided not to reintroduce tapers or relief for inflationary gains on the grounds that this would add to complexity and administrative burdens.

The rate applying to gains deferred, for example under the Enterprise Investment Scheme, will be the rate applying when the gain becomes liable to tax.

ENTREPRENEURS' RELIEF (BN20)

The lifetime limit applying to gains qualifying for entrepreneurs' relief will increase from £2m to £5m. This applies to qualifying gains made on or after 23 June 2010.

Those realising taxable gains qualifying for entrepreneurs' relief of up to £7.4m in total will be better off as a result of the changes. It is only above this level that the increase in the rate of CGT outweighs the benefit of the increased entrepreneurs' relief.

The 4/9ths deduction which previously applied to gains qualifying for entrepreneurs' relief so as to give an effective rate of 10% will cease on 22 June 2010. In its place, there will simply be a rate of 10% on gains qualifying for the relief.

CGT – DYNAMIC ANALYSIS

For the first time HM Treasury has published how it calculates its Budget policy costings, including the CGT ones.

If the rate of CGT goes up then taxpayers are discouraged from realising capital gains and so fewer gains become taxable at the higher rate. But at the same time if the difference between the rate of CGT and income tax is reduced then the incentive to 'convert' income into capital gains, or to invest for a capital gain, is reduced and more income tax becomes payable.

On the basis of econometric studies, principally in the United States, HM Treasury concluded that an increase in the rate of CGT by 10%, to 28% for higher rate taxpayers, would produce a reduction in CGT in 2011/12 of £800m from the tax that would have been payable if the level of gains had been unaffected by the increase in the level of CGT. However, this would be partially offset by an increase in income tax of £600m. Although it is not immediately clear from the costings, HM Treasury obviously also concluded that any increase beyond the 10% announced would have had an overall negative impact on total tax receipts.

PRIVATE RESIDENCE RELIEF FOR ADULT PLACEMENT CARERS (BN28)

An adult placement carer is a person who looks after an adult under a placement scheme with a local authority. The carer does the work in their own home and is paid by the local authority, and the earnings are taxable under the usual rules for a trade, profession or vocation (though subject to certain exemptions).

One or more rooms in the carer's home may be used exclusively for the caring activity – in fact the local authority contract may require this. As a result, the CGT exemption for an only or main residence may not apply to that part of the house when the carer comes to sell it. This is because private residence relief (PRR) is not available for any part of a property used exclusively for business.

This restriction on PRR is removed for disposals on or after 9 December 2009. The fact that part of the home is occupied by an adult in care will not make it ineligible for PRR.

This will be a very welcome relief for carers. It was first announced in the 2009 PBR (which is why it applies from 9 December 2009). Legislation will be included in a Finance Bill after the summer recess.

8. BUSINESS TAX

TAXES FOR BUSINESS – AN OVERVIEW

The Chancellor outlined a range of measures which will be introduced over the life of the current Parliament and which are intended to ensure that business will have the opportunity to prosper despite the dire state of the public finances.

The main corporation tax rate which is currently 28% will be reduced progressively by 1% each year, starting from April 2011, so that by 2014/15 the rate will be 24%. At the same time the small companies' rate, which applies to companies with profits up to £300,000, will be reduced from 21% to 20% from April 2011.

There are to be some reductions in capital allowances but less than had been predicted. The main plant and machinery capital allowance will come down from 20 to 18% and the special rate for long life and other assets, including motor cars with other than very low emissions, will be reduced from 10 to 8%. The Annual Investment Allowance (AIA) which allows the full write-off of expenditure up to the AIA threshold has been reduced so that in future only £25,000 rather than £100,000 of expenditure can be written off in any one year. All these changes are not going to be introduced until April 2012.

The reform of international tax is going to continue following the exemption for foreign company dividends that was introduced in 2009 at the same time as the worldwide debt cap. The controlled foreign company rules are to be consulted on over the summer and there will be some interim changes from April 2011 with a fully-fledged new regime from April 2012. The intention is likely to be to target profits which are diverted from the UK.

A more territorial approach to the taxation of foreign branches is also going to be the subject of consultation over the summer. This will be coupled with the consideration of the options for retaining foreign branch loss relief.

There will also be a number of further consultations and reviews covering:

- IR35 and small business tax.
- The taxation of intellectual property.
- The role R&D tax credits play in supporting innovation.

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- CGT rules for groups of companies.
- Introduction of a General Anti-Avoidance Rule (GAAR).

CAPITAL ALLOWANCES – RATES (BN04)

The rates of writing down allowance will be reduced:

- From 20% to 18% for the main plant and machinery pool.
- From 10% to 8% for the special rate pool for integral features, cars bought after 31 March 2009 emitting more than 160g/km CO₂, and long-life assets.

This will apply for chargeable periods ending on or after 1 April 2012 for corporation tax, and ending on or after 6 April 2012 for income tax. A hybrid rate must be calculated and used where the chargeable period spans 1 or 6 April 2012.

ANNUAL INVESTMENT ALLOWANCE (BN04)

The 100% annual investment allowance introduced in April 2008 for the first £50,000 of expenditure incurred each year on most types of plant, was increased to £100,000 in Finance Act 2010. The increase has effect for expenditure incurred on or after 1 April 2010 for businesses within the charge to corporation tax and on or after 6 April 2010, for businesses within the charge to income tax.

The current Budget proposes to reduce this annual limit to £25,000 from April 2012.

ZERO EMISSION GOODS VEHICLES – 100% FYAS (BN05)

A 100% first year allowance (FYA) will be available for expenditure on new and unused (not second hand) electric vans purchased in the five years from 1 (or 6) April 2010. This confirms the announcement made in PBR 2009.

CAPITAL ALLOWANCES FOR QUALIFYING CARERS (BN29)

There will be changes to remove some anomalies in the capital allowances legislation which affect foster carers and shared lives carers.

These carers can take advantage of special simplified rules which provide exemption for their earnings up to certain limits. Alternatively they can choose to calculate their taxable profits under normal business rules. They

can opt for one treatment or the other year-by-year. This raises the question of how to deal with their capital allowances claims, and existing legislation is intended to ensure that they do not have balancing adjustments when moving from claiming capital allowances to the simplified rules. However, the legislation does not currently work as it should, and so will be amended to apply as intended.

In addition, where a carer moves from the simplified scheme to normal business rules and can claim capital allowances, they will be treated as acquiring the assets they already own for the lesser of the market value of the assets at that time and the unrelieved expenditure.

VENTURE CAPITAL SCHEMES AND EMI (BN10 AND BN11)

Four further changes are required before the European Commission will give its approval to the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) schemes as State aids. Draft legislation for these changes was published with the 2009 Pre-Budget Report and we were advised that Government would legislate for these as soon as possible in the next Parliament.

In summary these will:

- apply an additional requirement that to qualify under either scheme, a company must not be in difficulty;
- replace the requirement for a company to carry on its qualifying trade wholly or mainly in the UK, with a new requirement that the company must have a permanent establishment in the UK;
- replace the requirement that a VCT's shares must be included in the official UK List, with a requirement that their shares must be traded on an EU regulated market; and
- change the rules governing the amount of a VCT's investment which must be held as equity.

A similar territorial change is announced for companies offering share options to their employees under Enterprise Management Incentives (EMI). The requirement for a company to carry on its qualifying trade wholly or mainly in the UK, is replaced with a new requirement that the company must have a permanent establishment in the UK.



FILM TAX RELIEF – MULTI-YEAR CLAIMS (BN12)

Measures will be introduced to correct an anomaly restricting the amount of tax credit claimable where films are produced over more than one accounting period and spending increases in the second or later periods. The changes will adjust the way the amount surrenderable for tax credit is calculated and will be applied for accounting periods ending on or after 9 December 2009.

FURNISHED HOLIDAY LETTINGS

On 22 June HMRC published a series of question and answers which continue the saga of the future tax treatment of income from furnished holiday lettings (FHL) (see www.hmrc.gov.uk/budget2010/fhl-qa-3755.pdf).

The current position is that the FHL rules, extended to properties let elsewhere in the EEA, will continue to apply during 2010/11. The Government will consult over the summer about plans to change the tax treatment from 6 April 2011 (1 April 2011 for companies).

The proposed changes would:

- ensure the FHL rules apply equally to properties in the EEA;
- increase the number of days that qualifying properties have to be available for, and actually let as, commercial holiday letting; and
- change the way in which FHL loss relief is given.

Full details about the proposed changes will be published over the summer for consultation.

This all began in the 2009 Budget when the then Chancellor announced his intention to abolish the FHL regime. HM Treasury explained the reasons for this as follows:

- The current system which applied only to properties fulfilling certain criteria, required property to be in the UK. They believed this to be in contravention of EU law. The scheme, if retained, would need to be extended to include properties located elsewhere in the European Economic Area.
- Using the UK tax regime to encourage investment in specific types of let property abroad while not extending the tax relief to other types of UK

letting, would not be in the best interests of the UK economy.

- The current scheme discriminates unfairly between furnished holiday letting businesses and other property letting businesses within the UK.

Consequently the existing rules were accepted as applying to properties throughout the EU with immediate and also retrospective effect. At the same time it was announced that the existing rules would be withdrawn from April 2010. After an informal period of consultation, draft legislation was published at the time of the PBR in December 2009.

Due to the impending election, the anticipated withdrawal was dropped from Finance Bill 2010. Consequently, the FHL scheme remains and applies to all let property within the EU.

9. COMPANY TAX

CORPORATION TAX RATES (BN02 and BN03)

The main corporation tax rate which is currently 28% will be reduced progressively by 1% each year, starting from April 2011, so that by 2014/15 the rate will be 24%.

At the same time the small companies' rate, which applies to companies with profits up to £300,000, will be reduced from 21% to 20% from April 2011. This is instead of the previous government's intention to increase the rate to 22%.

BANK LEVY

As part of the Government's efforts to rebalance the economy, move away from reliance on the banking sector and ensuring that banks make a fair contribution to the risks they pose to the financial system, the Chancellor announced that a levy will be introduced on bank balance sheets from 1 January 2011. The Government also hopes that the proposed levy will encourage banks to adopt less risky funding profiles, although quite how this will be achieved remains to be seen. However, the levy is not insurance against failure nor a fund for future resolution.

A banking levy had been widely touted, but it was thought that the UK would not act unilaterally on this measure. However, the Chancellor was one step ahead of the doubting Thomases: he announced that Germany and France had also agreed to introduce such a levy.

Information on the levy is a bit scanty at present. There is no detailed Budget Note although there is a page and a half on the levy on HM Treasury's website. The levy will apply to:

- the consolidated balance sheet of UK banking groups and building societies;
- the aggregated subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK; and
- the balance sheets of UK banks in non-banking groups.

It will be based on total liabilities (ie both short and long term liabilities) excluding:

- Tier 1 capital;
- insured retail deposits;
- repos secured on sovereign debt; and
- policy-holder liabilities of retail insurance businesses within banking groups.

The Government will consider the technical details of this and other aspects of the levy design in consultation with industry over the summer, and then issue further details in the autumn ready for the start date of 1 January 2011.

It is proposed that the levy will be set at 0.07% which is expected to raise over £2bn annually. However, there will be a lower rate of 0.04% for 2011, the first year of operation.

CAPITAL DISTRIBUTIONS (BN06)

Clarification will be included in the Finance Bill to be published in draft in July so that the interpretation of the tax treatment of capital distributions that applied before 2005 will be restored. Under this interpretation capital distributions were regarded as of an income nature unless a specific rule said otherwise (such as for example distributions in a winding up). It will be applied retrospectively subject to an opt-out to ensure the new legislation does not give rise to increased tax liabilities in respect of those earlier transactions.

The new legislation should also clarify the tax treatment of capital reductions effected under the new provisions in Companies Act 2006.

AMENDMENTS TO THE 'WORLDWIDE DEBT CAP' LEGISLATION (BN07)

The debt cap rules were introduced for accounting periods beginning on or after 1 January 2010 as a safeguard to ensure that while dividends from overseas subsidiaries are now exempt from UK tax a limit may be imposed on the amount of interest that is deductible from UK profits. This is designed to prevent groups of companies 'over loading' the UK with debt.

The provisions restrict the deductibility of interest in the UK where the UK financing costs exceed the financing costs of the worldwide group.

During the course of the consultations on these measures the Government accepted that if the legislation in Finance Act 2009 could be improved then this would be done in a subsequent Finance Act.

The majority of these changes were announced in BN06 published at the time of the March 2010 Budget but the current version of the Budget Note, BN07, is said to supersede that earlier version.

The changes currently envisaged are set out below and will be included in the draft Finance Bill to be published in July 2010 for enactment in the autumn.

The changes are to:

- eliminate mismatches in the application of the 'gateway test' caused by different accounting treatments of the same debt in single entity accounts and consolidated accounts;
- eliminate mismatches between the computation of UK financing costs and worldwide financing costs where borrowing is undertaken by a partnership, including a limited liability partnership;
- exclude securitisation companies from the debt cap rules;
- include in the assets and liabilities of companies that are taken into account for the 'gateway test' long term arrangements that have the economic effect of loans and which give rise to an interest-like return, even where these do not have the legal form of loans;
- expand the definition of 'financial instrument' when determining whether a financial services group is excluded from the debt cap;



- prevent the allocation of a debt cap disallowances to group companies which are dual resident investment companies;
- include guarantee fees received from other group companies in a company's financing income;
- correct a drafting error relating to group treasury companies;
- exclude distributions made by industrial and provident societies, which are normally treated as interest for tax purposes, from the financing expenses of such companies;
- exclude interest paid to non-departmental public body;
- clarify the meaning of 'ancillary expenses' in the definition of available amount; and
- introduce two restrictions on entities that can be the 'ultimate parent' of a group of companies.

RESEARCH AND DEVELOPMENT TAX RELIEF (BN08)

Until now, it has been necessary for a SME company which has claimed research and development (R&D) tax relief to itself hold any intellectual property arising from that R&D.

It was announced in the 2009 PBR that this condition will not apply to any expenditure incurred in accounting periods ending on or after 9 December 2009 but the measure was not included in Finance Act 2010. The provision will now be included in the draft Finance Bill to be published in July.

OIL AND GAS FISCAL REGIME (BN09)

FA 2009 introduced a package of measures to provide support for investment in the UK and the UK Continental Shelf (UKCS).

The FA 2009 reinvestment relief regime is to be extended to include reinvestment in exploration and development expenditure, including drilling costs. This measure will have retrospective application to disposals made on or after 24 March 2010.

In addition the reinvestment relief legislation is to be corrected for a previous drafting oversight such that it can apply in a group context. This change will have retrospective application to disposals on or after 22 April 2009.

Finance Bill 2011 will extend the application of the chargeable gain exemption on swaps of UK/UKCS to, for example, situations where non-licence consideration is involved.

The field allowance legislation is to be extended to include fields that have previously been decommissioned. This is to have retrospective application to fields with development consent authorised on or after 22 April 2009.

The field allowance qualifying criteria for ultra high pressure/high temperature are to be reduced and the allowance is to be tapered. This change will be effected by way of an Order to be issued before 29 July 2010.

CONSORTIUM RELIEF (BN14)

Consortium relief rules allow, in certain circumstances, a member of a consortium to transfer its share of the consortium's unused losses to another member of its group. This is commonly known as the 'link company rule' and the member that makes the transfer is known as the 'link company'. Under current UK law the link company must be UK resident. It was held in the case of Philips Electronics UK Ltd v HMRC (2009) UKFTT 226 that the restriction to UK resident companies breached the EU freedom of establishment.

The law is now to be changed to allow any company established within the EEA to be a link company.

The amount of the losses that can be claimed is determined by the lowest result from three tests – the percentage entitlement of ordinary share capital, the percentage entitlement of profits and the percentage entitlement of assets on a winding up. The proposed revision adds an additional test based on the proportion of voting rights. All the changes will have effect for accounting periods commencing on or after the date that the legislation is published which presumably will be some time in July when the draft autumn Finance Bill is to be published as per para 2.118 of the Red Book.

LIFE INSURANCE COMPANIES: CHANGES TO TAX RULES (BN15)

The Government will consult with the industry to ensure that when a UK life insurance company transfers long term insurance business to a non-EEA overseas company there is not an unintended tax charge.

The second change will ensure a consistent basis of taxation when life insurance business ceases to be carried on in the UK through a UK company and starts to be carried on through a UK branch of a company resident elsewhere in the EEA.

The third change is in relation to an anti-avoidance provision in FA 2010 to prevent manipulation to avoid tax on previously unrecognised profits. An anti-avoidance rule will be introduced in Finance Bill 2010 to ensure that the new measure is effective in cases where life insurance business is transferred to another company.

10. IHT AND TRUSTS

INCOME TAX ADJUSTMENTS BETWEEN SETTLORS AND TRUSTEES (BN25)

As announced in March 2010, the income tax adjustment mechanism for those who are taxed on the income arising to a trust that they have set up (settlor-interested trusts) will be amended to require settlors to pay repayments of tax they receive on trust income to the trustees. It will have effect for repayments relating to income tax chargeable on or after 6 April 2010.

The adjustment mechanism ensures that the same income is not taxed twice and that the settlor neither gains nor suffers a loss. In relation to the trust income, under s 646, ITTOIA 2005 the settlor is entitled to recover from the trustees the amount of any extra tax he needs to pay and must pay over to them any repayment received in respect of offsetting an allowance or relief against such income so that he receives a bigger repayment than he could otherwise have obtained.

Section 646 will be extended to all repayments of tax obtained by a settlor in relation to trust income; for example, where he is liable to income tax at a lower rate (say 40%) than the trustees (50% from 2010/11). These payments to trustees will be disregarded for IHT.

The last Paymaster General made clear in Finance Bill debates the then government's low opinion of trusts and we understand that the trust tax rate was set at 50% to discourage additional rate (ie 50%) taxpayers from arbitraging between taking income personally and via a trust. The above proposal introduces an interesting twist.

TRUSTS COMPENSATING ASBESTOS VICTIMS (BN24)

As announced at Budget 2010, trusts that have been specifically set up set up on or before 23 March 2010 as part of an arrangement made by a company with its creditors to pay compensation to, or in respect of, individuals with asbestos-related conditions will be exempt from CGT, IHT and income tax. This measure will have effect from 6 April 2006.

11. VAT AND DUTIES

VAT RATE INCREASE (BN43)

As widely expected, the Chancellor announced that the standard rate of VAT is to increase from 17.5% to 20%. The effective date for the change will be 4 January 2011, which was perhaps somewhat less predictable.

HMRC has produced detailed guidance about this rate increase: *VAT: Increase in the standard rate and anti-avoidance – Draft Legislation and Explanatory Note*. The issues are similar to those when the rate increased from 15% to 17.5% on 1 January 2010. The standard rate of VAT will go up to 20% for any supplies made on or after 4 January 2011.

Zero-rated supplies (such as basic foodstuffs, children's clothing and books), exempt supplies (such as education and health) and supplies subject to VAT at the 5% reduced rate (such as domestic fuel and power) are not affected by this change.

There were no changes to the categories of exempt or zero-rated goods and services.

CHANGE OF STANDARD RATE – ANTI-FORESTALLING LEGISLATION (BN44)

To stop businesses manipulating the rules to avoid the rate increase, HMRC has published draft anti-forestalling legislation and an explanatory note. Again, this is very similar to the supplementary charge legislation issued last year for the increase from 15% to 17.5%.

The anti-forestalling legislation is targeted on artificial arrangements and is unlikely to affect suppliers conducting their business as they normally do when no VAT rate increase is anticipated. It provides that, in certain circumstances, a supplementary charge to VAT of 2.5% will be due on supplies of goods or



services on which VAT of 17.5% has been declared. The legislation will have effect for transactions on and after 22 June 2010.

Forestalling occurs when arrangements are put in place for a VAT invoice to be issued by a supplier, or payment received by a supplier, before the rate increase; but the goods are not due to be delivered or services to be performed until on or after the date that the rate increases to 20%. The grant of a right or similar option may also be used for forestalling. Full details of how the anti-forestalling rules will apply are in *VAT: Increase in the standard rate and anti-avoidance – Draft Legislation and Explanatory Note*.

The supplementary charge does not apply to prepaid or invoiced rentals of land, buildings or other assets, if the period concerned is a year or less, and the prepayment or the issuing of an advance invoice is normal commercial practice.

Suppliers may adjust the amount payable under contracts with customers for any supplementary charges, unless the contracts say otherwise.

FLAT RATE SCHEME – THRESHOLDS AND PERCENTAGES (BN45)

Another consequence of the increase of the standard rate of VAT from 17.5% to 20% is the percentages used in the flat rate scheme and the VAT inclusive thresholds have been recalculated. The recalculated flat rate percentages and thresholds will have effect on and after 4 January 2011 until further notice.

The VAT flat rate scheme was introduced in 2002 with the objective of simplifying VAT for businesses with an annual turnover up to £150,000 excluding VAT. That threshold remains unchanged.

Full details of the new percentages are in Budget Note 45.

The exit thresholds whereby a business has to leave the scheme if either its tax inclusive annual flat rate turnover exceeds £225,000 or, on a forward look, its tax inclusive turnover in the next 30 days can reasonably be expected to exceed £225,000 are to be increased to £230,000 to maintain the same effect.

If a business using the flat rate scheme exceeds the annual exit threshold as a result of a one-off transaction but, in the subsequent year, expects its tax inclusive annual flat rate turnover to be less than

£187,500, it may remain in the scheme with the agreement of HMRC. This threshold will be increased to £191,500.

Membership of the flat rate scheme is optional and businesses wishing to leave it may do so at any time. HMRC also has the discretion to agree a retrospective leaving date and intends to apply this discretion sympathetically where a business takes the view that, as a result of these changes, it no longer wants to use the scheme.

ZERO-RATING OF 'QUALIFYING' AIRCRAFT (BN39)

The definition of aircraft that can be supplied at the zero rate is to be changed from one based on weight and usage to one based on the status of the customer. With effect from 1 January 2011, supplies of aircraft will be zero-rated only where used by airlines operating for reward chiefly on international routes.

The current law at Sch 8, VAT Act 1994 provides that supplies may be zero-rated where the aircraft is of a weight of not less than 8,000kg and is not designed or adapted for recreation or pleasure use. The change is being made to align the domestic definition of qualifying aircraft with that in Article 148 of the Principal VAT Directive.

There is no change to the treatment of supplies of aircraft to State institutions.

PLACE OF SUPPLY OF GAS, HEAT AND COOLING (BN40)

As previously announced, the place of supply rules for supplies of natural gas and of heat and cooling is to be changed with effect from 1 January 2011.

Under existing arrangements, gas supplied via the natural gas distribution system is treated as supplied where either a wholesale customer is established or the natural gas is consumed. UK customers who are registered for VAT have to account for VAT on the supplies of natural gas they receive from suppliers established abroad as a reverse charge. There are currently no rules which specifically govern the application of VAT to supplies of heat and cooling.

The existing rules, which also include electricity, are to be amended so as to:

- extend their scope to cover supplies in all categories of natural gas pipeline;

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- limit their scope to supplies involving natural gas pipelines located in the EU or linked to such pipelines; and
- extend the relief from VAT at importation to all natural gas imported via a network (including liquefied natural gas by tanker).

The amended rules will also be extended to apply to heat and cooling supplied through networks.

Affected businesses are likely to be suppliers, importers and VAT-registered recipients of natural gas, heat and cooling, and also providers and VAT-registered recipients of services comprising access to, and use of, natural gas and heat and cooling distribution networks.

POSTAL SERVICES (BN41)

As previously announced, with effect from 31 January 2011 certain postal services provided by Royal Mail are to become subject to VAT at the standard rate.

The zero-rating for passenger transport services will also be updated to reflect the status of the provider of a passenger transport service made in conjunction with its postal services.

Some customers of Royal Mail purchasing the relevant services will be affected, as they will now have to pay VAT. However, social mail, including stamped mail, remains exempt from VAT, so private individuals should largely be unaffected.

Currently, a VAT exemption applies to the conveyance of postal packets and services connected to the conveyance of postal packets by Royal Mail (including Parcelforce). The VAT exemption under Group 3, Sch 9, VAT Act 1994 will be amended to restrict the scope of the exemption to supplies of public postal services under a licence duty and incidental goods made by Royal Mail. This will include services where, pursuant to a licence duty, Royal Mail allows private postal operators access to its postal facilities.

Supplies of services that Royal Mail is not required to make under a licence duty (those not subject to any price and regulatory control, such as those made by Parcelforce), and services provided on terms and conditions that have been individually negotiated, will in future be subject to the standard rate of VAT. The Budget Note includes a list of services affected.

Zero-rating applies to the transport of passengers by the Post Office, including any wholly owned subsidiary of the Post Office. The provision has historically only been used for rural bus services, known as the 'Postbus,' that Royal Mail provides in conjunction with its postal delivery services, although it also applies to other modes of transport, such as aircraft and ships. Item 4(b) of Group 8, Sch 8, VAT Act 1994 will be amended to zero rate passenger transport provided by Royal Mail. There is no change to the scope of the zero-rating.

A detailed Technical Note VAT – Postal Services can be found at www.hmrc.gov.uk/budget2010/vat-post-tech-note-5260.pdf. This sets out all the services which will be affected by the change.

LENNARTZ ACCOUNTING (BN42)

As previously announced, legalisation is being introduced to remove the application of the 'Lennartz' accounting mechanism for the recovery of VAT from 1 January 2011.

Under existing arrangements, VAT on immovable property, boats and aircraft is recoverable upfront and in full on both the business and private use of the asset (subject to any partial exemption restriction). VAT is then payable over subsequent years in respect of the private use of the asset. This is known as 'Lennartz' accounting.

The changes will ensure that VAT recovery is restricted only to the business use of the asset, excluding any private use by the taxpayer or the taxpayer's staff. Changes to the capital goods scheme will also be made so that it will take account of changes in private use over subsequent years.

TOBACCO PRODUCTS DUTY – LONG CIGARETTES (BN34)

The basis of tobacco products duty calculation in the case of long cigarettes will change with effect from 1 January 2011.

In the case of cigarettes longer than 8cm (excluding any filter), each additional 3cm (or part thereof) will be treated as an additional cigarette for the purposes of specific duty calculation. For example a cigarette of 12 cm would be treated as three cigarettes.

This change is being made to ensure that UK legislation remains aligned with European Directive

95/59 which has been amended to prevent tax avoidance.

LANDLINE DUTY (Red Book para 2.98)

The March 2010 Budget proposed a landline duty of 50p per line per month, to be introduced from 1 October 2010. This will not be implemented.

12. ENVIRONMENTAL TAXES

LANDFILL TAX – CRITERIA FOR THE LOWER RATE (BN32)

New primary legislation (to be included in the Finance Bill after the summer recess) will specify that HMRC must publish the criteria to be used in determining what material qualifies for the lower rate of landfill tax.

HM Treasury must take account of these published criteria when it makes Orders specifying what material qualifies for the lower rate. Any changes required to the existing Landfill Tax (Qualifying Material) Order 1996, SI 1996/1528 – which lists qualifying wastes – will apply to disposals made on or after 1 April 2011.

AGGREGATES LEVY – NORTHERN IRELAND CREDIT SCHEME (BN33)

The Northern Ireland aggregates levy credit scheme is to be extended for a further 10 years. The scheme grants an 80% tax credit to aggregate producers in Northern Ireland who meet certain conditions.

Under s 30A, HMRC may make regulations providing for a tax credit where a charge to aggregates levy has arisen on a quantity of aggregate which has been subject to commercial exploitation in Northern Ireland up to 31 March 2011. Section 30A(2)(b) will be amended so that the period to which such regulations may apply ends on 31 March 2021.

Under regulation 3(1) of the Aggregates Levy (Northern Ireland Tax Credit) Regulations 2004, a tax credit may only be granted on aggregate commercially exploited before 1 April 2011. Subject to EU Commission State aid approval, new regulations will be laid amending regulation 3(1) to extend this date to 1 April 2021.

13. ANTI-AVOIDANCE

A GAAR FOR THE UK?

As noted in the Budget Overview, we may have had a change of government but any thoughts that the coalition would be softer on tax avoidance are misplaced. The drive to root out tax evasion and counter tax avoidance continues and a number of new anti-avoidance measures were announced.

More importantly, there will be consideration given to the introduction of a general anti-avoidance rule (GAAR). The idea of a GAAR has been kicking around for a long time. A GAAR was proposed in the early years of the last government (1998) but following consultation the idea was rejected. It did not reappear although various suggestions were made that it might.

There must be a good chance that this time around a GAAR may see the light of day. Why has the mood changed? For a start, there have been many examples in recent years of the introduction of wide ranging anti-avoidance provisions, including a number of 'mini GAARs'. Second, the volume of tax legislation has almost doubled since the 1998 proposals were made. With a commitment to simplify the tax system, a GAAR may be one way of simplifying the tax system, provided of course that where anti-avoidance legislation duplicates the GAAR it should be repealed.

One problem with the 1998 GAAR was that no clearance mechanism would be proposed – it would therefore not have provided the degree of certainty that is required. More recently, it has been suggested that there would be a GAAR but taxpayers would have to pay to obtain a clearance – that might be a price worth paying if it achieved a high level of certainty.

At the moment the Government has merely flagged up that it will examine the case for developing a GAAR as part of wider work on improvements to tax policy-making. No timescales for given for making a decision not when a GAAR might be introduced. We would welcome views on the proposal to introduce a GAAR and, if so, what form it should take. It remains to be seen if a GAAR was introduced whether it would in effect mirror the current judicial approach to tax avoidance or whether it would seek to go further and strengthen existing tests further.

AUTHORISED INVESTMENT FUNDS (BN16)

Legislation will be introduced, to have effect on or after 22 June 2010, to prevent corporate members of authorised investment funds (AIFs) making use of tax credits on distributions from AIFs where the AIF has not paid UK tax.

LOAN RELATIONSHIPS (BN17)

Under generally accepted accounting practice, where a company is party to a loan relationship or derivative contract, but passes on the risks and rewards associated with it to another party, the loan or derivative may be derecognised. This means that profits and losses arising from the transaction do not appear on the company's profit and loss account. Since the taxation of loan relationships and derivative contracts usually follows the accounts, this meant that it was possible to avoid tax on income arising from certain loan relationships and derivative contracts.

The measures to be introduced in Finance Bill 2010 will affect credits or debits arising on or after 22 June 2010 and will supplement existing legislation which already targeted this area of potential anti-avoidance, most recently in Finance Act 2009.

A Technical Note is to be issued in early July 2010 setting out proposals for generic legislation to tackle avoidance schemes involving derecognition of loan relationships and derivative contracts. Any further changes to the legislation in this area will be introduced in Finance Bill 2011, with effect from a date to be announced.

14. HMRC POWERS AND COMPLIANCE

OVERPAYMENTS OF SDLT AND PRT (BN35)

The March 2010 Budget set out proposals (in BN65) for amending the error or mistake relief claim rules for stamp duty land tax (SDLT) and petroleum revenue tax (PRT) to harmonise them with similar changes to the rules for income tax, CGT and corporation tax that were introduced in FA 2009. These proposals will now be taken forward by the new Government.

The proposed changes will provide a means of reclaiming overpayments of SDLT and PRT where there is no other statutory route available. The requirement that the overpayment must be made as the result of a

mistake in the return will be removed, and the current restrictions on the right of appeal will be removed so that any appeal will follow the usual procedures. The current time limit for claiming repayments of SDLT and PRT is six years: this will be reduced to four years.

The measure will be included in a Finance Bill that will be introduced after the summer recess. The measure will have effect on or after 1 April 2011 (including the reduction in the time limit referred to above).

HARMONISATION OF INTEREST RULES FOR CT AND PRT (BN36)

The March 2010 Budget set out proposals (in BN66) for the inclusion of corporation tax and PRT in the new harmonised interest regime introduced in FA 2009. These proposals will now be taken forward by the new Government.

By way of background, FA 2009 introduced a new harmonised interest regime for late payments and repayments of taxes and duties. The intention was that that the FA 2009 rules would apply to all taxes and duties, but corporation tax and PRT were excluded from the FA 2009 provisions pending further consultation. A further consultation and draft legislation were then published in the 2009 PBR, to which the Tax Faculty responded as TAXREP 14/10.

It is now proposed to implement the integration of these two taxes within the new FA 2009 rules except for the interest rules for quarterly instalments of corporation tax: these will remain excluded due to the particular nature of those payments. Interest will be charged from the date the tax was due to be paid to HMRC until the date it is paid. HMRC will pay interest on repayments from the date the tax was due to be paid or, if later, the date the payment was actually received, to the date the repayment is made.

The measures will be included in a Finance Bill that will be introduced after the summer recess. However, the changes to the rules will require some changes to HMRC's systems, so they will be phased in over a number of years by way of Treasury Orders.

PENALTIES FOR LATE FILING AND PAYMENT OF TAX (BN37)

The March 2010 Budget set out proposals (in BN67) for the inclusion of VAT, IPT and a number of other levies and duties under the control of HMRC within the FA 2009 reform of the penalty regimes for late filing of tax returns and late payment of tax. These



proposals will now be taken forward by the new Government.

Following consultation as part of the review of HMRC's powers, the FA 2009 measures were the first part of a two-stage reform with the new rules first being introduced for income tax, corporation tax, IHT and other direct taxes. In the 2009 PBR, HMRC published a further consultation document and draft legislation to extend these provisions to the remaining taxes and duties under HMRC's control. The extended rules create penalty models designed to reflect the more frequent filing and paying obligations for these taxes and duties compared to the direct tax penalty models enacted in FA 2009. Set out below is an example of how the late filing penalty model would work for VAT.

Example

Where a return is late, the penalty will be £100 and a 12 month penalty period is created. If there is a further late filing in the penalty period, the penalty will be £200 and the penalty period is extended to a further 12 months. Two further late filings in the penalty period will see the penalty increase to £300 and £400. If a return is not made within six months, there will be a penalty of the greater of £300 and 5% of any VAT shown on the return and a similar penalty if the return is not made within 12 months.

In our response to the earlier consultation (published as TAXREP 15/10), we expressed concern that, although the new penalty models for VAT are not that different from the existing rules, the new structure may result in unreasonable or disproportionate penalties. Penalties could mount up very quickly where businesses are submitting monthly VAT returns, for example in VAT repayment cases. It would be easy for deadlines to be missed and for the business to struggle to escape out of the penalty cycle.

The measures will be included in a Finance Bill that will be introduced after the summer recess. In a similar manner to the proposals set out above to extend the harmonisation of the interest rules, the changes to the rules will require some changes to HMRC's systems so some changes will be phased in over a number of years by way of Treasury Orders.

EXCISE MODERNISATION AND COMPLIANCE CHECKS (BN38)

The March 2010 Budget set out proposals (in BN69) arising out of the powers review for updating the compliance checking framework for excise duties on alcohol, tobacco, energy products, gambling duties and air passenger duty. These proposals will now be taken forward by the new Government.

The measures include modernising the information and inspection powers and aligning the record-keeping rules and time limits for assessments and claims with changes made to other taxes and duties as a result of the powers review.

The measures will be included in a Finance Bill that will be introduced after the summer recess. The changes to the rules and implementation dates will be made by way of Treasury Orders. The record-keeping changes are expected to apply from 1 April 2011 and the time limit changes from 1 April 2012.

EQUITABLE LIABILITY

In the 2009 PBR, it was announced that the practice of equitable liability would be incorporated in legislation. The original intention, announced in Budget 2009, had been to abolish it. But both HMRC and the then government had been swayed by representations (from the Tax Faculty and others) that the practice should be retained as there was a need for it in the tax system.

Under the practice of equitable liability, where a taxpayer has not submitted tax returns and has missed all deadlines to displace HMRC's assessments or determinations of his or her liability, HMRC will still forego any tax that is legally due but which the taxpayer can show is excessive.

So far we have not seen any legislation concerning equitable liability, nor is the topic included in any of the June 2010 Budget Notes that bring forward the measures inherited from the previous government. We hope that this has not been overlooked or the decision reversed, and will be following this up with Government.



15. OTHER ISSUES

DEDUCTION OF TAX AT SOURCE FROM INTEREST AND OTHER PAYMENTS (BN13)

When a person other than a company makes a payments of the type set out in s 963, Income Taxes Act 2007, that person must deduct income tax from the payment and must notify HMRC 'without delay'. The types of payment covered include interest, patent royalties and other annual payments.

Regulations are to be made to amend how and when a person should report the income tax deducted from the payments. It is expected that the new provisions will apply from Royal Assent to a Finance Bill introduced after the Parliamentary summer recess.

INSURANCE PREMIUM TAX – INCREASE IN RATES (BN19)

The standard rate of IPT applies to most general insurance, including property, motor and medical insurance. Life assurance and other long term insurance products are exempt from IPT.

The higher rate of IPT applies to travel insurance and to certain insurance (eg extended warranties) sold alongside motor vehicles and some consumer goods. It was introduced at 17.5% in 1997 to stop VAT avoidance through 'value-shifting' between goods (subject to VAT at 17.5%) and related insurance.

The standard rate of IPT is to rise from 5% to 6% and the higher rate of IPT from 17.5% to 20%, in line with the increase in the standard rate of VAT, for premiums received or written by an insurer on or after 4 January 2011.

For insurers using the cash receipt method to account for IPT, the new rates will have effect for premiums received under taxable insurance contracts on or after 4 January 2011. For insurers who account for IPT using the special accounting scheme the new rates will have effect for premiums that are written into their records as due to them on or after 4 January 2011.

SDLT RELIEF FOR FIRST-TIME BUYERS (Red Book para 2.66)

The Government will review the effectiveness of the stamp duty land tax (SDLT) relief for first time buyers.

MANAGED PAYMENT PLANS (Red Book para 2.26)

The Government has decided to defer implementation of managed payment plans.

Managed payment plans are an optional scheme which would allow companies and taxpayers within self assessment to pay their tax in a series of monthly instalments either side of the statutory due date. The legislation is in FA 2009.

We understand that the decision has been taken because of the cost of implementing the scheme. HMRC intends to revisit the managed payment plan idea when resources allow.