



TAX
FACULTY

TAXline

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

March 2010

BUDGET REPORT 2010

The Tax Faculty's summary.



CONTENTS

www.icaew.com/taxfac

The Tax Faculty team

Chris Sanger

Chairman
+44 (0)20 7951 0150
CSanger@UK.EY.com

David Heaton

Deputy Chairman
+44 (0)113 285 5202
david.heaton@bakertilly.co.uk

Francesca Lagerberg

Chairman Technical Committee
+44 (0)20 7728 3454
Francesca.Lagerberg@gtuk.com

Frank Haskew

Head of Tax Faculty
+44 (0)20 7920 8618
Frank.Haskew@icaew.com

Peter Bickley

+44 (0)20 7920 8430
Peter.Bickley@icaew.com

Neil Gaskell

+44 (0)1908 248131
Neil.Gaskell@icaew.com

Anita Monteith

+44 (0)20 7920 8743
Anita.Monteith@icaew.com

Jane Moore

+44 (0)20 7920 8722
Jane.Moore@icaew.com

Philippa Stedman

+44 (0)20 7920 8765
Philippa.Stedman@icaew.com

Angela Williams

+44 (0)20 7920 8995
Angela.Williams@icaew.com

Ian Young

+44 (0)20 7920 8652
Ian.Young@icaew.com

Chrissie O'Connor

Manager
+44 (0)20 7920 8593
Chrissie.O'Connor@icaew.com

Katerina Nicholas

Services Manager
+44 (0)20 7920 3511
Katerina.Nicholas@icaew.com

Nina Turner

PA/Administrator
+44 (0)20 7920 8471
Nina.Turner@icaew.com

BUDGET REPORT 2010

The 2010 Budget was delivered on 24 March 2010.

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

CONTENTS

1. Overview	3
2. Rates and allowances	5
3. Personal and employment taxes	8
4. Pensions and savings	9
5. Tax credits and state benefits	11
6. Business tax	11
7. Company tax	13
8. IHT and trusts	15
9. VAT and duties	16
10. Stamp duty land tax	19
11. Environmental taxes	19
12. Anti-avoidance	20
13. HMRC powers and compliance	22
14. Other issues	25

The Tax Faculty

ICAEW

Chartered Accountants' Hall

PO Box 433

Moorgate Place, London EC2P 2BJ

Tel: +44 (0)20 7920 8646

Fax: +44 (0)20 7920 8780

email: taxfac@icaew.com

www.icaew.com/taxfac

All rights reserved. No part of this work which is covered by copyright, may be reproduced or copied in any form or by any means (including graphic, electronic or mechanical, photocopying, recording, recorded taping or retrieval information systems) without permission of the copyright holder.

The views expressed herein are not necessarily shared by the Council of the Institute. Articles and other material are published without responsibility on the part of the publisher or authors for loss occasioned by any person acting or refraining from action as a result of any view expressed therein.

Editor: Jane Moore
© 2010 Tax Faculty

The Tax Faculty produces a range of technical information. All items published since January 2000 and selected items prior to that date, can be viewed on the website at www.icaew.com/taxfac where the information can be found under the heading 'Faculty Publications'.

1. OVERVIEW

No shocks but no hand-outs – the Chancellor has set out his stall for the forthcoming general election

We said in our overview of the 2009 Pre-Budget Report that the outlook appeared to have stabilised and that there were some tentative signs that the worst of the recession may have past, although the fallout would continue for years to come.

With at least one eye on the forthcoming election, the picture the Chancellor set out in the 2010 Budget was very much 'steady as she goes', with few new announcements. The Chancellor sought to assure the markets that the Government was on top of the commitment to halve the budget deficit in four years, although precise details of how this will be achieved are somewhat sketchy.

The 2009 PBR forecast that 'growth' in 2009 would be -4.75%. In the 2010 Budget, the Chancellor revised this estimate down slightly to -5%. The forecast growth for 2010 remains at 1–1.5%, the same as predicted in the 2009 Budget and 2010 PBR. Nevertheless, the Chancellor recognised that the recovery looks like being a slow business. He revised his growth estimate for 2011 down slightly, to 3–3.5%, but this still appears to be a challenging target.

There was a clear need in this Budget for the Chancellor to deliver a credible plan for addressing the UK's budget deficit without in the process killing the green shoots of recovery. With the general election almost upon us, he resisted the temptation to provide pre-election handouts, which was a wise decision given the budget deficit. He described this Budget as fiscally neutral, although the Budget 'Red Book' shows that the effect of the changes he has announced will increase government borrowing by a further £1.4bn, before a fiscal tightening starting from 2011/12 onwards.

For businesses the Chancellor was keen to send out a positive message, although some of the initiatives had already been announced. He confirmed the extension of the 'time to pay' arrangements for businesses struggling to meet their tax liabilities, although a business wishing to defer tax of £1m or more will now need to provide an independent business review of its financial position. The increase in the annual investment allowance limit from £50,000 to £100,000 was unexpected and will be welcomed, although it will probably not make much difference to smaller businesses as they are unlikely to spend more than the current £50,000 on eligible plant and machinery. The one-year reductions in business rates will also be welcome, as will the commitments to increase the supply of loans and credit.

Turning to income tax, the Chancellor had no new announcement to make. However, as he has said previously, from 6 April 2010 there will be a new 50% rate which will apply to income over £150,000 and also personal allowances will be progressively withdrawn for incomes over £100,000.

The drive to root out tax evasion and counter tax avoidance continues. In a masterful pre-emptive strike on the tax status of a well-known figure in the Opposition party, the Chancellor announced the imminent signing of a tax information exchange agreement with Belize. He also

BUDGET REPORT 2010

www.icaew.com/taxfac

announced further measures to turn up the heat on taxpayers involved in offshore evasion, with increased penalties where the evasion involves a country with which the UK does not have an automatic tax information exchange agreement. Once again a raft of anti-avoidance measures were announced or re-announced, together with confirmation of further changes to the disclosure of tax avoidance scheme rules.

As for the UK's finances, it was important that the Chancellor sent out a clear message that the UK has a credible plan to address the UK's debt. The Chancellor certainly worked hard to put some flesh on the commitment to halve the deficit in four years. One welcome development was that net borrowing for 2009/10 is now projected to rise to 'only' £167bn as against £178bn in the 2009 PBR, although on the face of it this appeared strange given a further deterioration in GDP growth from -4.75% to -5%.

The Chancellor proposes that the deficit will be reduced by a combination of spending cuts, tax rises and growth. He announced that there will be further substantial reductions in public spending and that the Government is on track to achieve the £11bn efficiency savings target, although the precise details about how this will be achieved are less clear. However, no major new tax rises were proposed other than those announced previously. The Chancellor must clearly think that the tax and NIC rises he has announced so far will be sufficient to plug the gap. This still looks optimistic: if the forecast growth does not materialise it seems inevitable that there will have to be more broadly-based tax increases at some stage in the near future.

With an election in the offing, the Chancellor played his hand well with no further tax shocks and a clear commitment to support businesses while the recovery gathers pace. There was some solid progress reported on reducing the deficit and his wise decision to resist pre-election goodies was to his credit. The Chancellor has certainly set out his stall for the forthcoming general election.

For businesses the Chancellor was keen to send out a positive message, although some of the initiatives had already been announced. He confirmed the extension of the 'time to pay' arrangements for businesses struggling to meet their tax liabilities, although a business wishing to defer tax of £1m or more will now need to provide an independent business review of its financial position.

2. RATES AND ALLOWANCES

The main rates and allowances for 2010/11 are summarised in the table on pages 6–7.

INCOME TAX (BN02)

As previously announced, the income tax rates and thresholds will be the same in 2010/11 as in 2009/10, with the addition of the 50% rate which will apply to income in excess of £150,000. The trust rate also goes up to 50%.

The 2010/11 income tax allowances are the same as for 2009/10. The new restriction of the personal allowance of £1 for every £2 of income in excess of £100,000 begins on 6 April 2010.

CAPITAL GAINS TAX (BN02 AND BN27)

The CGT rate remains at 18%. The annual exemptions for 2010/11 is the same as for 2009/10, £10,100.

With effect from 6 April 2010, the lifetime limit on gains qualifying for entrepreneurs' relief will increase from £1m to £2m.

NATIONAL INSURANCE (PN02)

The rates and thresholds for NIC in the next two years will be as follows:

2010/11

NIC rates and thresholds were announced at the PBR and there are no changes.

2011/12

As a result of the 0.5% increase announced in PBR 2008 and the further 0.5% increase just announced:

- Classes 1 and 4 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 so that those paying the standard employee rate and earning under £20,000 will pay less NICs overall as a result of these changes.

TAX CREDITS AND CHILD BENEFIT (PN02)

The 2010/11 rates and thresholds for Working Tax Credit (WTC) and Child Tax Credit (CTC), Child Benefit and Guardian's Allowance were announced at the PBTR and there are no changes.

VAT TURNOVER THRESHOLDS (BN45)

With effect from 1 April 2010:

- The annual taxable turnover threshold, which determines whether a person must be registered for VAT, will be raised from £68,000 to £70,000.
- The taxable turnover threshold which determines whether a person may apply for deregistration will be increased from £66,000 to £68,000. The existing conditions for determining entitlement or liability to cancellation remain unchanged.
- The registration and deregistration limits for relevant acquisitions from other EU member states will also be increased from £68,000 to £70,000.

The increase in the annual taxable turnover threshold means that a person will have to apply for registration if:

- at the end of any month, the value of the taxable supplies made in the past 12 months or less has exceeded £70,000; or
- at any time there are reasonable grounds for believing that the value of the taxable supplies to be made in the next 30 days alone will exceed £70,000.

If at the end of any month, a person's taxable turnover in the past 12 months or less exceeds £70,000 but HMRC is satisfied that it will not exceed £68,000 in the next 12 months, that person will not have to be registered.

BUDGET REPORT 2010

www.icaew.com/taxfac

SUMMARY OF THE MAIN RATES AND ALLOWANCES FOR 2010/11

Income tax rates

Basic rate	20%
on income up to	£37,400
Higher rate	40%
on income between	£37,400–£150,000
Additional rate	50%
on income over	£150,000
Starting rate for savings income	10%
on income within first	£2,440
Lower dividend rate	10%
Higher dividend rate	32.5%
Additional dividend rate	42.5%
Trust rate	50%
Trust rate on dividends	42.5%

Income tax allowances

	£
Personal allowance (age under 65)	6,475
Personal allowance (age 65–74)	9,490
Income limit for withdrawing personal allowance	100,000
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

National Insurance

Rates are per week unless stated

Lower earnings limit, primary Class 1	£97
Upper earnings limit, primary Class 1	£844
Upper Accruals Point	£770
Primary threshold	£110
Secondary threshold	£110
Employees' primary Class 1 rate	
between PT and UEL	11%
above UEL	1%
Employees' contracted-out rebate	
Salary-related schemes	1.6%
Money-purchase schemes	1.6%
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%

SUMMARY OF THE MAIN RATES AND ALLOWANCES FOR 2010/11

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

Rate	18%
Annual exemption	
For individuals, PRs and some trustees	£10,100
For most trustees	£5,050
Entrepreneurs' relief effective rate	10%
Entrepreneurs' relief lifetime limit of gains	£2m

Inheritance tax

Rate	£40%
Nil rate band	£325,000

VAT

Standard rate of VAT	17.5%
Registration threshold	£70,000
Deregistration limit	£68,000

Pensions

Annual allowance	£255,000
Lifetime allowance	£1.8m

3. PERSONAL AND EMPLOYMENT TAXES

REMITTANCE BASIS: RELEVANT PERSON (BN38)

Finance Act 2008 introduced significant changes to the remittance basis of taxation which is an option available to individuals who are resident but either not domiciled or not ordinarily resident in the UK. This legislation introduced in s 809M, ITA 2007 the term 'relevant person'. This term included close companies in which the individual was a participator, and subsidiaries of such close companies.

Finance Bill 2010 will introduce a change effective from 6 April 2010 to make it clear that references to a relevant person include subsidiaries of non-resident close companies which would be close companies if they were resident in the UK.

BANK PAYROLL TAX (BN02)

A tax at 50% will be levied on bonuses in excess of £25,000 paid in the period from 9 December 2009, the date of the 2009 PBR, and 5 April 2010.

Following the announcement of the bank payroll tax at the time of 2009 PBR there have been considerable amendments to the initial proposals. The main changes are to define more precisely what companies and UK activities are caught by the tax and which individuals will be covered. In particular individuals will have to be in the UK for a minimum of 60 days during 2009/10.

In his Budget speech the Chancellor stated that this tax will raise £2bn, twice as much as was estimated at the time of the 2009 PBR. The original assumption was that bank bonuses themselves would be just £2bn, so to have raised this much in tax implies bonuses of £4bn. It appears on the face of it that the bank payroll tax has had absolutely no effect on the level of bonus payments, but has just made them more expensive for the banks and will bring in an additional £2bn to the public finances.

PAYE: SECURITY FOR PAYMENT (BN70)

HMRC will be given power to require by notice a financial security from employers who have a history of serious non compliance, paying their PAYE income tax late or not at all. There will be a right of appeal against the imposition of the security and the amount. It will

be a new criminal offence where a person required to give a security fails to do so. Those found guilty of the offence may be fined up to level £5,000. The intended implementation date is 6 April 2011. The measure is intended to affect those who are determined not to pay and not those who need time to pay and who make payment arrangements with HMRC.

Following consultation, s 684, ITEPA 2003 will be amended to include these provisions.

Similar provisions will be made for NICs through regulations using existing powers.

There are similar provisions requiring businesses to provide financial security where HMRC believes that VAT revenue is at risk, but currently no similar power for HMRC to require a security within PAYE or NICs legislation.

HMRC have consulted twice before on the greater use of securities: in June 2007: *Payments, Repayments and Debt: the developing programme of work* and in November 2008 a further consultation was issued: *Payments, Repayments and Debt: The Next Stage*.

WORKPLACE CANTEENS EXEMPTION AND SALARY SACRIFICE

As announced at PBR 2009, the tax exemption for workplace canteens will be restricted from 6 April 2011. The exemption in s 317, ITEPA 2003 will not apply when used in conjunction with salary sacrifice or flexible benefit arrangements. The exemption will continue to apply for subsidised canteens that are available to all employees.

HMRC published an impact assessment on Budget Day and draft legislation with explanatory notes on 2 February 2010.

LOW EMISSION COMPANY CARS AND VANS (BN43)

We were always concerned that linking the benefit in kind charge to emission levels could prove to be an administrative burden in the making. This was even before the Government began changing the % rates which apply to cars emitting different levels of CO₂ year on year.

Budget 2010 makes a further announcement in relation to the benefit in kind for using company cars and vans which do not emit CO₂ at all (electric cars



and vans) and cars which emit 75g/Km or less. For the five years from 6 April 2010, there will be a 0% benefit for electric cars and a new 5% percentage rate for calculating the benefit for using a car emit 75g/Km or less.

This is in addition to the change we were told about in the PBR 2009. From 6 April 2012, a new lower 10% band will be introduced for company cars with CO₂ emissions of up to 99g/km. From this date the taxable benefit on employees and the Class 1A NIC charge on employers for cars with these emissions will be calculated at 10% of the list price.

This will extend the system of bands so that they increase by 1% point with every 5g/km CO₂ from 10%.

EMPLOYER-SUPPORTED CHILDCARE (BN36)

The conditions for exemption from the chargeable benefit of employer-supported childcare will be relaxed in situations involving salary sacrifice. The reason for this is that apparently some employers have been excluding employees at or near the National Minimum Wage level from participating in such childcare schemes. This will have retrospective effect for 2005/06 onwards.

TAX RELIEFS AND EXEMPTIONS FOR CARERS OF CHILDREN (BN37)

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.

Kinship carers who are providing care to a child who has not been placed with them under a residence order will be entitled to claim the new relief for shared lives carers.

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. New rules, announced in the PBR, will apply from 6 April 2010 which give shared lives carers a statutory tax-free allowance per household to set against income from caring.

4. PENSIONS AND SAVINGS

IMPLEMENTING THE RESTRICTION OF PENSIONS TAX RELIEF (BN33)

The Government has confirmed its intention, announced at Budget 2009, to reduce the rate of tax relief on pension contributions made by, or on behalf of, those with high incomes. The reduced relief will apply to contributions made on or after 6 April 2011 by those with incomes (as defined) of £150,000 or more. Those with incomes of £130,000 or more whose employer makes pension contributions on their behalf may also be affected.

'Anti-forestalling' provisions, including a 'special annual allowance charge' were introduced in the Finance Bill 2009 so that high income individuals would not obtain a tax advantage by making increased pension contributions before 6 April 2011. However, provided that contributions remained at the same level as previously, or did not increase by more than £20,000 pa (£30,000 pa in certain circumstances), tax relief would continue to be given at the individual's marginal rate.

From 6 April 2011, the reduction of tax relief on pension contributions will apply to all high earners, whether or not they increase the amount of their contributions. Furthermore, contributions made by employers will also be taken into account where total annual income is more than £130,000.

The new provisions will apply to those whose total annual income before the deduction of, or relief for, pension contributions and charitable donations is both:

- £130,000 or over; and
- including the value of employer contributions, is £150,000 or over.

Where income (before the deduction of, or relief for, pension contributions and charitable donations) is over £130,000 and, including employer contributions, is between £150,000 and £180,000, the amount of relief available will taper from marginal tax rate down to basic tax rate as income increases.

The relief will be restricted by means of a 'high income excess relief charge' which will apply to contributions made by the individual and in the case of employees, also to contributions made by their employer. The charge will be collected via self assessment.

The provisions are complex and have already been subject to consultation. In particular, the basis for computing the value of the deemed contribution for employees in defined benefit schemes needs defining and there are numerous practical issues to be addressed. Further consultation will be undertaken on various aspects of the proposals.

PENSIONS LIFETIME AND ANNUAL ALLOWANCES FROM 6 APRIL 2011 (BN34)

As announced in the 2008 PBR, the rates for the pensions Lifetime Allowance (LTA) and the Annual Allowance (AA) will remain at £1.8m and £255,000 respectively for tax years 2010/11 to 2015/16 inclusive. Other limits which are set by reference to the LTA, including the commutation limit for small amounts of pension rights, will therefore also remain unchanged.

If the value of pension benefits and lump sums exceeds the LTA at the time they are paid, a recovery charge applies to the excess. This is 25% of the excess if a pension is taken and 55% of the excess if a lump sum is paid. Individuals who have 'transitional protection' are not affected by these rules.

There is no limit to the contributions which can be made to a pension scheme but if the annual allowance is exceeded in a tax year, the excess is liable to an annual allowance charge of 40% of the excess. In money purchase schemes the contribution is the amount paid into the scheme. In defined benefit and cash balance schemes the contribution is the increase for the year in the amount of accrued rights to benefits.

The freezing of the LTA and AA will mean that more individuals are likely to be affected by the limits in the future.

CHANGES TO PENSIONS TAXATION FOR 'NEST' (BN35)

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.

Measures will be introduced in the next Parliament so that, with effect from Royal Assent:

- NEST can be registered with HMRC in the same way as other registered pension schemes
- 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

INDEXING ISA LIMITS FROM 2011 (BN28)

The individual savings account (ISA) regulations will be amended by statutory instrument 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. As announced in Budget 2009, the limits for 2010/11 are £5,100 and £10,200 respectively for all savers, not just those aged 50 and over.

LIFE ASSURANCE POLICIES: DEFICIENCY RELIEF (BN20)

When a life insurance policy, life annuity contract or capital redemption policy comes to an end, individuals may be entitled to a tax reduction called 'deficiency relief'. This occurs when the individual is liable to tax at the higher rate or dividend upper rate and taxable gains (called chargeable event gains) have arisen earlier in the life of the policy or contract but when it ends the result is negative.

The Government intends to introduce legislation in the next Parliament:

- to extend the relief from 6 April 2010 so that a tax reduction may also be due if the individual has income subject to the additional and dividend additional rates of tax.; and



- to restrict the relief where the policy is surrendered on or after 6 April 2010 and arrangements are made on or after 22 April 2009 to secure a tax reduction greater than the income tax due on earlier chargeable event gains

SAVING GATEWAY

The Saving Gateway has been known about for the last two years. It is a government-sponsored savings plan for (mainly) low income people. Savings of up to £25 a month will be permitted over a two-year period where the government contribute 50p for every £1 saved.

The scheme will now be launched in July 2010

5. TAX CREDITS AND STATE BENEFITS

TAX CREDITS: WTC FOR THOSE AGED 60-PLUS

The working hours requirement for Working Tax Credit (WTC) is either at least 30 hours a week, or at least 16 hours a week in certain circumstances. Older people currently have to meet the 30 hours rather than the 16 hours requirement unless they have dependent children or qualify for a disability element or for the 'return to work' element (for those aged 50-plus who have been on benefits).

From 6 April 2011 people aged 60 and over will qualify for WTC if they work at least 16 hours a week. This is more generous than the PBR announcement which said this change would apply at age 65.

OTHER TAX CREDITS CHANGES

From April 2010, HMRC will aim to simplify the childcare element of Working Tax Credit for those parents who use childcare only for short fixed periods such as the summer holidays.

The WTC disability element for those who have been claiming the Employment and Support Allowance (ESA) may change from 6 April 2011. ESA claimants who have a limited capability for work and leave ESA to move into work for at least 16 hours a week with the help of WTC will automatically qualify for the disability element of WTC. HMRC will consult on this difficult area and also on the disadvantage test of WTC.

The child element of CTC will rise by £4 per week from April 2012 for children aged one or two.

STATE PENSION (PN02)

As announced at the PBR, the state pension will be increased by 2.5% from April 2010, giving a full basic state pension of £97.65 per week. Pension credit will be increased to £132.60 a week for single pensioners and £202.40 for couples from April 2010.

Winter fuel payments will remain continue at the 2009/10 level for the winter of 2010/11.

6. BUSINESS TAX

CAPITAL ALLOWANCES (BN09)

The annual investment allowance (AIA) will be increased from the current limit of £50,000 to a new limit of £100,000. The increase will have effect for expenditure incurred on or after 1 April 2010 for businesses within the charge to corporation tax (CT) and on or after 6 April 2010, for businesses within the charge to income tax.

The capital allowances system for plant and machinery was given a thorough overhaul in 2008. Since April 2008, most businesses, regardless of size, have been able to claim the Annual Investment Allowance (AIA) on up to £50,000 of their expenditure each year on plant and machinery (not cars). The balance of expenditure qualifies for a writing down allowance of either 20% for general plant and machinery or 10% for 'special rate' integral features and other plant. There was no extension of the 40% allowance which reappeared in Budget 2009 for a one year period from 1 (or 6) April 2009.

Where a business has a chargeable period that spans 1 or 6 April, the maximum allowance available for the period as a whole will be calculated pro rata for the periods before and after the increase. This is subject to the additional caveat that not more than £50,000 of the expenditure can be relieved in the period before 1 or 6 April 2010.

BUDGET REPORT 2010

Illustration

A company prepares its accounts for the year ended 31 December 2010. The maximum AIA available for the period overall would be

$$3/12 \times £50,000 (£12,500) + 9/12 \times £100,000 (£75,000) = £87,500$$

However, in the part of the chargeable period falling before 1 April 2010, only a maximum of £50,000 of that expenditure could be covered.

It would appear that avoidance schemes have been developed which generate property losses from claiming the AIA to be relieved against general income. New anti-avoidance legislation will apply to losses arising as a result of arrangements entered into on or after 24 March 2010.

ELECTRIC VANS: 100% FYA (BN42)

Confirming the announcement made in PBR 2009, a 100% first year allowance for the purchase of new, unused (not second-hand) electric vans applies to expenditure in the five years from 1 April 2010 for companies and 6 April 2010 for other businesses subject to income tax.

VENTURE CAPITAL SCHEMES AND EMI (BN12 AND BN13)

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 PBR. The Budget says that Government will 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;
- replaces 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;
- replaces 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

- changes 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.

CGT ENTREPRENEURS' RELIEF (BN27)

With effect from 6 April 2010, the lifetime limit on gains qualifying for entrepreneurs' relief will increase from £1m to £2m.

SMALL BUSINESS RATE RELIEF (BUDGET BOOK PARA 4.19)

The level of small business rate relief in England will be increased temporarily for one year from 1 October 2010. This will give full relief for eligible businesses occupying premises with a rateable value of up to £6,000 and tapering relief for rateable values up to £12,000.

ENHANCED ONLINE SERVICES FOR SMES (BUDGET BOOK PARA 4.20)

In its paper *Delivering a new relationship with business: Reducing burdens and helping businesses get it right* HMRC reports on the steps which have been taken to reduce the administrative burden of the tax system. By the end of 2011, we are promised better online help for SMEs and their agents from Businesslink and HMRC. These will provide:

From Businesslink:

- A personalised web service for those starting up in business giving better access to relevant tax guidance for all SMEs and flexible tax payment plans to help businesses manage their cash flow.

From HMRC:

- A single interactive form to enable new businesses and new employers to register for multiple taxes online and to authorise tax agents.
- An online facility that reduces the need for businesses, or their agents, to provide the same information to HMRC multiple times and allows them a single online view of current tax liabilities or repayments due.



7. COMPANY TAX

CORPORATION TAX RATE (BN03)

The full rate of corporation tax remains at 28% for company profits in excess of £1.5m. The small company rate of 21% applies to profits up to £300,000 and a marginal rate of 29.75% is then applied to profits within the two limits.

The limits are split where there are associated companies so if there are two associated companies the limits are £150,000 and £750,000.

SMALL COMPANIES' RATE (BN04)

The small companies' rate of corporation tax will continue at the current rate, 21%, for the year beginning on 1 April 2010. It had been planned to increase the rate to 22% but as announced in the 2009 PBR the increase has been deferred for a year until 2011/12.

A FUTURE TAX ON BANKS (BUDGET BOOK PARA 3.8)

The IMF has been tasked by the G20 to prepare a report on possible ways to ensure that the financial sector makes a fair and substantial contribution to the wider costs associated with government interventions to repair the banking sector. All the UK political parties are keeping in close touch with the IMF to make sure that whatever proposals they put forward, in the Budget and/or their election manifestos, are not diametrically different from what the IMF is likely to recommend.

The Budget Book then puts forward the idea of a 'banking' systemic risk tax as part of a package of regulatory measures to reduce the risks and impact of systemic failure in the banking sector. At this stage the Government has only put forward some general principles which it believes should underpin such a systemic risk tax.

- it should be coordinated internationally to minimise competitive distortions and potential double taxation and the risk of arbitrage;
- it should be complementary to existing G20 initiatives aimed at addressing systemic risk;
- the proceeds of such a tax should go to national governments and be part of general taxation and not be hypothecated to the banking sector;

- the tax base should be as simple as possible and take account of characteristics of a firm's business which give rise to systemic risk; and
- it should cover all financial institutions that might contribute significantly to systemic risk.

CAPITAL DISTRIBUTIONS (BN05)

Clarification will be included in a future Finance Bill to the effect 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 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.

FOREIGN COMPANY PROFITS: THE DEBT CAP RULES (BN06)

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 will now be exempt from UK tax there may be a limit on the amount of interest that will be 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 Financial Secretary to the Treasury announced various changes in a statement in the House on 9 November 2009 and the detailed legislation and explanatory were published at the time of the PBR.

The PBR changes include:

- eliminating mismatches in the application of the 'gateway test' caused by different accounting treatments of the same debt in single entity accounts and consolidated accounts;

BUDGET REPORT 2010

www.icaew.com/taxfac

- excluding securitisation companies from the debt cap rules;
- eliminating mismatches between the computation of UK financing costs and worldwide financing costs where borrowing is undertaken by a partnership, including a limited liability partnership;
- restricting the allocation of disallowances under the debt cap to group companies which are dual resident investment companies;
- allowing other companies to elect that no disallowance shall be allocated to them;
- amending the definition of a group treasury company to prevent an anomalous result where other companies in the group have income from treasury activities;
- including guarantee fees received from other group companies in a company's financing income; and
- widening the definition of a collective investment scheme to prevent the automatic exclusion of overseas partnerships which are, legally, bodies corporate.

Further changes have now been announced in the Budget:

- the assets and liabilities of companies that are taken into account for the 'gateway test' will include 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;
- it will be made clear that a limited liability partnership cannot be the ultimate parent of a group of companies for debt cap purposes; and
- distributions made by industrial and provident societies, which are normally treated as interest for tax purposes, will be excluded from the financing expenses of such companies.

CONTROLLED FOREIGN COMPANIES (BUDGET BOOK PARA 4.61)

The Budget Book (para 4.61) confirms the time-table for introducing legislation in Finance Bill 2011 to put in place a new CFC regime. The Government published its principles in July 2009 and a Consultation Document in January 2010 on which comments are

required by 20 April 2010. Tax Faculty has put in an initial response, TAXREP 8/10 and is currently finalising a more detailed response.

TAXATION OF FOREIGN BRANCH PROFITS (BUDGET BOOK PARA 4.62)

The taxation of foreign branches was left out of the review of foreign profits which began in 2007 and led to dividends from overseas subsidiaries being exempted from tax in Finance Act 2009. Paragraph 4.62 of the Budget Book indicates that consultation is now to begin on the taxation of foreign branches.

PATENT BOX REGIME (BUDGET BOOK PARA 4.32)

The Government has confirmed that it will consult during 2010 with a view to enacting legislation in 2011 to introduce a 'patent box' regime under which income from patents will be taxed at a rate of 10% from April 2013.

The reduced rate will apply to patents granted after the legislation is passed in 2011 and the consultation will consider how to include patents not yet commercialised at that point and how the legislation can apply to equivalent overseas patents held by UK companies. In addition, the consultation will consider how to identify and value embedded patents and how to give relief for acquired patents.

ACCOUNTING STANDARDS ON FINANCIAL INSTRUMENTS (BN07)

The International Accounting Standards Board (IASB) is proposing a number of changes to IAS 39 Financial Instruments: measurement and recognition, due to take effect in 2010. These changes will affect the way in which financial instruments such as loans, securities and derivatives are treated for accounts which are prepared under IFRS. The UK's Accounting Standards Board will make corresponding changes to the equivalent UK accounting standard FRS 26 Financial Instruments.

The IASB has issued, or is proposing to issue, Exposure Drafts proposing changes in four main areas of IFRS 39, as follows:

- the way that financial instruments are classified and measured for accounting purposes;
- when they are recognised on the balance sheet;
- how impairment losses are quantified; and



- how hedging arrangements should be accounted for.

Because the tax treatment of such instruments is based on the accounting treatment, changes to the accounting rules will have implications for the tax rules on loans, derivatives and repos (sale and repurchase agreements).

Legislation will be introduced in Finance Bill 2010 to respond to these changes by inserting a power to amend the loan relationships and derivative contracts rules by way of secondary legislation. The amendments will be limited to those necessary to ensure the rules continue to operate fairly and efficiently where companies adopt the modified accounting standards. The regulations will have effect for company accounting periods ending on or after 1 January 2010. However, the IASB has also proposed that companies should be able to adopt certain of the accounting changes retrospectively, in which case any tax changes will also be applied retrospectively.

NORTH SEA FISCAL REGIME: REINVESTMENT RELIEF (BN08)

FA 2009 introduced reinvestment relief when disposal proceeds are reinvested in new old trade assets. It was intended that this relief would also apply within a group of companies when the group company making the reinvestment is not the same group company that made the disposal. Unfortunately the 2009 legislation failed to achieve this objective and corrective legislation is to be introduced.

REITS AND STOCK DIVIDENDS (BN22)

The UK legislation requires a UK real estate investment trust (REIT) to distribute 90% of the profits from its property rental business by way of dividend for each accounting period. The legislation will be changed so that stock dividends will be treated in the same way as other distributions and will count towards the 90% distribution test.

8. IHT AND TRUSTS

IHT NIL RATE BAND (BN31)

The IHT nil rate band will be frozen at £325,000 for 2010/11 and until 5 April 2015.

This means that the maximum total nil rate band for an estate where the personal representatives can claim a transfer of unused nil rate band from the dead person's previously-deceased spouse or civil partner will remain at £650,000.

INCOME TAX ADJUSTMENTS BETWEEN SETTLORS AND TRUSTEES (BN30)

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 s646, 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 that which 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 inheritance tax purposes.

The last Paymaster General made clear in Finance Bill debates the 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 (BN29)

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 capital gains tax (CGT), inheritance tax (IHT) and income tax. This measure will have effect from 6 April 2006.

9. VAT AND DUTIES

RATES AND THRESHOLDS

See the Rates and Allowances section.

FUEL SCALE CHARGES (BN44)

The VAT scale charges for taxing private use of road fuel are to be increased with effect from the start of the first VAT period beginning on or after 1 May 2010, to reflect the increase in fuel prices since the 2009 Budget. The table of CO₂ bands is also being amended to maintain alignment with those used for direct tax purposes.

BN44 shows the revised scale charges and output tax payable in each accounting period, depending whether it is a 12-month, 3-month or 1-month accounting period for each CO₂ band. In a 12-month period the VAT fuel scale charge ranges from £570 for the 120 or lower CO₂ band to £1,985 for the 230 CO₂ or higher band.

VAT is payable on these scale charges at the rate applicable at the time the charge is due. To calculate standard rate VAT from the VAT inclusive amount, multiply the VAT inclusive scale charge by the appropriate VAT fraction. At 17.5%, the VAT fraction is 7/47.

The scale charge for a particular vehicle is determined by its CO₂ emissions figure. Where the CO₂ emissions figure of a vehicle is not a multiple of five, the figure is rounded down to the next multiple of five to determine the level of charge. For a bi-fuel vehicle which has two CO₂ emissions figures, the lower of the two figures should be used. For cars which are too old to have a CO₂ emissions figure, HMRC has prescribed a level of emissions by reference to the vehicle's engine capacity.

ZERO-RATING OF 'QUALIFYING' AIRCRAFT (BN46)

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 September 2010, 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 (VATA 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 (BN47)

The application of VAT to 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 are required 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;
- 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.

Amendments will be made to the following provisions of the VATA 1994:

- section 9A(5) – to amend the definition of ‘relevant goods’ for the purposes of applying the reverse charge mechanism through which VAT is accounted for under the place of supply arrangements; and
- para 3, Sch 4 – to add ‘other cooling’ as a category of goods.

Affected businesses are likely to be suppliers, importers and VAT-registered recipients of natural gas, heat and cooling. Also providers and VAT-registered recipients of

services comprising access to, and use of, natural gas and heat and cooling distribution networks.

POSTAL SERVICES (BN48)

With effect from 31 January 2011, certain postal services provided by Royal Mail Holdings PLC 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, VATA 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. There is a list of affected services in the BN48.

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, VATA 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* was published on Budget Day.

REVERSE CHARGE FOR EMISSIONS ALLOWANCES (BN49)

Emissions allowances are to be subject to the reverse charge with effect from 1 November 2010. At the same time the zero rate for supplies of emissions allowances, that was introduced on 31 July 2009 as an interim measure to combat Missing Trader Intra-Community (MTIC) fraud, will be withdrawn.

Any VAT-registered business purchasing emissions allowances will therefore be required to account for and pay the VAT chargeable, instead of the supplier.

The new legislation will also provide for an option of introducing reporting requirements to deal with fraud in the services sector. However, there will be no additional reporting requirements in respect of emissions allowances and so suppliers will not be required to submit reverse charge sales lists for these supplies.

LENNARTZ ACCOUNTING (BN50)

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.

Changes are being introduced to 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 introduced so that it will take account of changes in private use over subsequent years.

Until a recent change in policy arising from an ECJ decision, many taxpayers were incorrectly permitted to use Lennartz accounting (see *Revenue and Customs Brief 02/10*). The revenue protection legislation introduced by this measure ensures that where such taxpayers choose not to unravel these arrangements, they have a statutory obligation to continue to account for the VAT due under the arrangements. The legislation will ensure that this position is treated as having always had effect.

Amendments will be made to the VATA 1994 to:

- provide a distinction between business input tax and non-business VAT;

- ensure that VAT is not recoverable on a taxable person's private use (or the private use of his staff) of a relevant asset;
- provide a power to make regulations to treat non-business VAT as input tax;
- provide enabling powers to introduce further regulations; and
- ensure that for certain assets specified in the new legislation, VAT cannot be recovered in respect of private use or purposes other than those of a business from 1 January 2011.

There will be a measure to ensure output tax continues to be paid where a credit was allowed in respect of a supply falling under para 5(4), Sch 4, VATA 1994 and to provide the detailed circumstances where this will apply as well as definitions. This will be treated as having always had effect.

TOBACCO SMUGGLING IN THE POST (BN71)

Section 106, Postal Services Act 2000 gives postal operators the power to stop packets which they suspect contain smuggled goods and pass these to customs.

HMRC is currently required to notify the addressee and invite them to attend before such packets can be opened. With effect from the date of Royal Assent of the Finance Bill 2010, HMRC will no longer be required to do this.

LANDLINE DUTY (BN51)

A new duty charge of 50p per line per month is to be introduced from 1 October 2010 on owners of local loops which are the physical circuit which connects a network termination point to a public electronic communications network.

10. STAMP DUTY LAND TAX

TWO YEAR SDLT HOLIDAY FOR FIRST TIME BUYERS (BN25)

Legislation will be introduced in Finance Bill 2010 to provide a stamp duty land tax (SDLT) relief where:

- an individual or individuals jointly purchase a major interest in land which is wholly residential;
- the consideration is more than £125,000 but not more than £250,000;
- that individual (or all of them) intends to occupy the property as his/her or their only or main residence;
- the Individual(s) has or have not previously purchased such an interest or its equivalent anywhere in the world;
- the effective date of the transaction is on or after 25 March 2010 and before 25 March 2012

Individuals who can take advantage of this relief will only pay SDLT where the consideration is over £250,000.

While the first time buyer requirement will probably be self-certified in the first instance, we do wonder how it can effectively be policed.

SDLT FOR EXPENSIVE PROPERTIES (BN24)

A new rate of 5% will be introduced for transactions (normally the date of completion) in residential property on or after 6 April 2011 where the consideration for the transaction exceeds £1m. At present the highest SDLT rate of 4% applies to purchases where the consideration exceeds £500,000.

ANTI-AVOIDANCE: CONTRIVED PARTNERSHIPS (BN26)

Legislation will be introduced in Finance Bill 2010 to ensure that existing SDLT anti-avoidance rules apply to transactions which exploit the SDLT partnerships rules by contriving a partnership. Transactions which fall within the anti-avoidance rules will not benefit from the special partnerships rules for calculating chargeable consideration.

The measure will apply where a 'notional land transaction' created by the anti-avoidance rules has an effective date on or after 24 March 2010, subject to transitional rules.

SDLT AND PETROLEUM REVENUE TAX: RELIEF FOR OVERPAYMENTS (BN65)

Changes are proposed to the SDLT and PRT error or mistake legislation. These follow similar changes to the income tax, CGT and corporation tax rules in FA 2009. The proposed changes are modelled on the legislation contained in Sch 52, FA 2009. They will prevent alternative claims for repayment, eg common law claims, and will have a four-year time limit. Draft legislation on the SDLT measures was published on 6 January 2010.

The new rules will come into effect on 1 April 2011 to allow a transitional period during which claims will be possible under the current rules.

11. ENVIRONMENTAL TAXES

LANDFILL TAX (BN52)

The standard rate of landfill tax increases by £8 to £48 per tonne for disposals of waste made, or treated as made, on or after 1 April 2010. There will be a further £8 increase to £56 from 1 April 2011 and the Chancellor has also announced further £8 per year increases up to and including April 2014 by which time the rate will be £80 per tonne.

CLIMATE CHANGE LEVY (BN55)

The rates of climate change levy will increase in line with inflation with effect from 1 April 2011.

AGGREGATES LEVY (BN56)

The rate of aggregates levy is to increase from £2 to £2.10 per tonne for any aggregate commercially exploited on or after 1 April 2011.

12. ANTI-AVOIDANCE

The Government listed a range of anti-avoidance measures many of which have been announced already and some of which, for instance the revision to the disclosure regime and offshore evasion measures, have been the subject of consultation exercises in which the Tax Faculty has been involved.

In his speech the Chancellor estimated that the measures he was taking would raise £1.5bn in tax and protect a further £4bn of tax receipts, both figures being in respect of 2012/13.

These numbers should be compared with the estimates published at the time of the 2009 PBR in December which were that the size of the UK net tax gap was £40bn in 2007/08 covering both indirect and direct taxes.

DISCLOSURE OF TAX AVOIDANCE SCHEMES (BN64)

The Disclosure regime was introduced in 2004 and the Government estimates (Budget Book para 5.59) that since then it has led to the closure of £12bn of avoidance opportunities. At the time of the 2009 PBR HMRC published a consultation document with various changes to the existing regime. The Tax Faculty submitted its comments, TAXREP 12/10, and the Government has now published Disclosure of Tax Avoidance Schemes (DOTAS) – Consultation Response Document summarising the comments it received as well as an Impact Assessment. In the light of the comments made on the original proposals there will be some modification to the original proposals but the five areas in which changes are to be made will include:

- bring forward the time when disclosure of a scheme is required;
- increase penalties to tackle those who do not comply with the disclosure rules;
- introduce a requirement for third party introducers to identify scheme promoters;
- introduce a requirement for promoters to provide lists of clients to whom they have provided schemes; and

- extend and enhance the hallmarks that require the disclosure of avoidance schemes, including schemes involving employee remuneration and those designed to convert income into capital.

HIDDEN ECONOMY ADVISORY GROUP (BUDGET BOOK PARA 5.74)

This new group was announced at the time of the 2009 PBR to consider what actions HMRC could take to increase the number of people that make the transition from the hidden to the formal economy. As a result of its initial work HMRC will lay down a clearer route whereby those with undeclared tax can establish their position and disclose their liabilities to HMRC.

The Hidden Economy Advisory Group has highlighted several key areas for further work and detailed analysis (paragraph 5.74 of the Budget Book):

- to build on the success of HMRC's current and past disclosure opportunities in offering mechanisms for leaving the hidden economy;
- to consider how HMRC can improve the link between access to work opportunities and operating in the formal economy; and
- to educate people about the unacceptability of evading tax and the dangers of working informally.

SALE OF LESSOR COMPANIES: OPTION TO ELECT (BN14)

PBR 2009 announced that lessor companies would be given the option to elect that the immediate charge that would otherwise arise under Sch 10 FA 2006 (now Chapter 3 Part 9 of CTA 2010) is collected on the profits of the leasing business following the sale. There are now to be changes to these proposals and more draft legislation has been published following discussions with industry.

RELEASE OF LOANS TO PARTICIPATORS IN CLOSE COMPANIES (BN15)

Close companies (which are those companies owned by five or fewer shareholders) will not be able to get a deduction from their profits when a loan to one of those shareholders is either released or written off on or after 24 March 2010. The effect of releasing or writing off the debt is to trigger an income receipt, akin to a dividend payment, in the hands of the shareholder which will continue to be the case but there will no longer be a corporation tax deduction.

RISK TRANSFER SCHEMES (BN16)

PBR 2009 announced measures to be introduced with effect from 1 April 2010 to restrict loss relief on certain group hedging transactions such that losses are limited to the real economic losses suffered by the group concerned, the losses are ring fenced, and they can only be offset against profits from the same arrangements. The new powers will be extended in the case of banks and other financial traders to instruments other than loans and derivatives.

COUNTERING DOUBLE TAX RELIEF AVOIDANCE (BN17)

Three anti-avoidance measures are to be introduced to counteract certain complex schemes used by banks and financial institutions which are designed to increase double tax relief for foreign tax suffered. The three measures are:

- ensuring that a person may only deduct foreign tax where that person has included the foreign tax in their taxable income (ie they are being taxed on their gross income and not the net income with the foreign tax deducted once already);
- amendments to the double tax relief anti-avoidance rules to tighten the definitions of certain prescribed schemes in Sch 28AB ICTA 1988; and
- clarification that relief for foreign tax is available only if the gross amount (rather than the net amount) of a dividend or manufactured overseas dividend is included in taxable income prior to the relief for foreign tax being given.

INSURANCE PREMIUM TAX: PREMIUM SPLITTING (BN18)

Measures were announced in the 2009 PBR to prevent the avoidance of insurance premium tax (IPT) on insurance provided to individuals by splitting the premium between two contracts, one being predominantly for the administrative charges (which would not attract IPT). Following discussions with industry, revised draft legislation has now been published in relation to fee payments received on or after 24 March 2010.

SHARE INCENTIVE PLANS (BN39)

Two pieces of anti-avoidance legislation are to be introduced effective from 24 March 2010 in relation to HMRC approved share incentive plans (SIP). Where a company makes a contribution to the trustees of the SIP, the normal corporate tax deduction will be denied if it is not genuinely intended that the shares acquired by the contribution will be passed to employees. Secondly there will be minor amendments to the rules whereby SIP approval can be withdrawn when companies enter into transactions that manipulate the value of SIP shares.

COMPANY SHARE OPTION PLANS (BN40)

HMRC approved Company Share Option Plans (CSOP) allow tax-advantaged options to be granted to UK employees. The legislation will be amended so that approved CSOP options may no longer be granted over shares in a company that is under the control of a listed company. It will, however, still be possible to implement a CSOP over shares in a listed company or a company that is not under the control of another company.

TRANSACTIONS IN SECURITIES (BN41)

The aim of the legislation in this area is to prevent the extraction of profits from companies which result in shareholders obtaining an 'income tax advantage' where the transaction is, in broad terms, tax-motivated rather than commercially driven.

Following consultation, the existing legislation is to be replaced by measures which will:

- apply to securities in close companies (including overseas companies) which is a wide definition than previously;
- clarify how the tax advantage is to be quantified;
- introduce a new exemption covering fundamental changes in ownership; and
- remove obsolete tests covering transactions where avoidance opportunities no longer arise.

FINANCIAL PRODUCTS AVOIDANCE: GROUP MISMATCHES

HMRC has issued a discussion document proposing a principles based anti-avoidance approach to transactions that involve loan relationships and derivatives that give rise to 'group mismatches'

ie where a transaction gives rise to asymmetry (tax deductible losses versus non-taxable profits) between companies in the same group.

A number of schemes have been notified to HMRC in the past under the tax disclosure regime and when appropriate HMRC has taken action against such schemes on a one by one basis. The current proposal is to introduce a principles based solution.

The discussion document identifies a number of solutions that could address the problem (eg the exclusion of debits and credits, imposition of further debits and credits, or otherwise cancelling the UK tax advantage).

A key question is whether the proposed legislation should impact only UK-UK transactions or be extended to cover cross border arrangements. It will also be expected to cover the possibility of repealing various targeted anti-avoidance rules including, potentially, the arbitrage rules (or part of them).

13. HMRC POWERS AND COMPLIANCE

HARMONISATION OF INTEREST RULES FOR CT AND PRT (BN66)

Following consultation as part of the review of HMRC's powers, 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 petroleum revenue tax were excluded from the FA 2009 provisions pending further consultation on how the integration of these taxes could be achieved.

A further consultation and draft legislation were then published at the 2009 PBR to integrate these taxes within the FA 2009 rules, to which the Tax Faculty responded in TAXREP 14/10. It was proposed to integrate these taxes within the new FA 2009 rules except for the interest rules for quarterly instalments of corporation tax: these would remain excluded due to the particular nature of those payments.

It is now proposed to implement the integration of these two taxes in line with the proposals in the December 2009 consultation document. 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 provisions will not be included in any Finance Bill laid before the current Parliament is dissolved but instead will be included in a Finance Bill to be introduced as soon as possible in the next Parliament. The actual implementation of these rules requires a number of changes to HMRC's systems which will be phased in over a number of years by way of Treasury Order. As noted above, the interest rules for quarterly instalments of corporation tax will remain unchanged.

PENALTIES FOR LATE FILING AND PAYMENT OF TAX (BN67)

Following consultation as part of the review of HMRC's powers, FA 2009 introduced a reform of the penalty regimes for late filing of tax returns and late payment of tax. The FA 2009 measures were the first part of a two-stage reform, with the new rules being introduced for income tax, corporation tax, inheritance tax and other direct taxes.

In the 2009 PBR, HMRC published a further consultation document and draft legislation on the second part of the reform, namely to extend these provisions to the remaining taxes and duties under HMRC's control. These include VAT, insurance premium tax, aggregates levy, climate change levy and landfill tax as well as the wide range of duties administered by HMRC. The extended rules will create penalty models which reflect the more frequent filing and paying obligations for these taxes and duties compared to the direct tax penalty models enacted in FA 2009.

It appears that the proposed penalty structure to be adopted will be as set out in the 2009 PBR draft legislation.

As an example, here is how the late filing penalty model would work for VAT. 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.

These provisions will not be included in any Finance Bill laid before the current Parliament is dissolved. They will be included in a Finance Bill to be introduced as soon as possible in the next Parliament. In a similar manner to the proposals set out above to extend the harmonisation of the interest rules, the actual implementation of these rules requires a number of changes to HMRC's systems which will be phased in over a number of years by way of Treasury Order.

TACKLING OFFSHORE TAX EVASION (BN68)

HMRC has published revised proposals for tackling offshore tax evasion, and a summary of responses to the December consultation on this topic.

There will be a new scale of penalties for under-declared tax which relates to overseas income or gains. This is intended to apply for tax periods beginning on or after 1 April 2011.

The new framework will build on the existing regime for penalties for inaccuracies – ie stepped percentages depending on the taxpayer's behaviour. But the level of penalties will depend on what sort of information exchange agreement the UK has with the country where the overseas income or gains arise. If there is no provision at all for exchange of information, the penalties could be as much as 200% of the tax underpaid in the worst cases (ie where there has been deliberate and concealed understatement).

There will be no penalties where the taxpayer has taken 'reasonable care', and it will still be possible to get a nil penalty for careless non-compliance where the taxpayer makes an unprompted disclosure and cooperates fully.

HMRC launched the consultation on offshore tax evasion at the 2009 PBR. It contained two main proposals:

- Penalties: A tougher penalty regime for non-compliance with an offshore element. In effect, all offshore non-compliance would be treated as though it were deliberate.
- Notification of offshore accounts: A new requirement for people to tell HMRC when they open offshore bank accounts, except where the account is in a country which has automatic information exchange arrangements with the UK. There would be penalties for failing to notify HMRC within 60 days.

The Tax Faculty responded in TAXREP 16/10. In a nutshell, we did not support the proposals. While we agreed that HMRC needs to tackle tax evasion (whether offshore or otherwise) and that it needs effective tools to do the job, we thought that these proposals would place an unnecessary burden on the compliant majority while not necessarily catching the evaders. We also thought it unfair to treat all offshore non-compliance – whether careless or fraudulent – as deliberate, which would mean the minimum penalty would be 20%.

HMRC has decided not to proceed with the December proposal for a notification requirement for offshore bank accounts, though it is still looking into the whole area of disclosure requirements for offshore assets.

The new penalty proposals are summarised above, but to give a bit more detail:

- Penalties for under-declaration of tax are determined by Schedule 24, FA 2007 (penalties for inaccuracies in returns), Schedule 41, FA 2008 (penalties for failure to notify) and Schedule 55, FA 2009 (penalties for failure to make a return).
- Each of these Schedules provides for tax-gear penalties. The level of the penalty is determined by the behaviour of the taxpayer and the quality of disclosure.
- The mechanics of the penalty frameworks for offshore non-compliance will remain the same, but the absolute level of the percentage used to determine the tax-gear penalty will be determined by the jurisdiction in which the non-compliance arises.
- Where the non-compliance occurs in a jurisdiction

BUDGET REPORT 2010

which has provision to exchange information on savings income automatically with the UK, the penalty percentages will be the same as those in the current Schedules (ie the same as for non-compliance arising in the UK).

- Where the non-compliance arises in a jurisdiction which has agreed to exchange information with the UK, but does not automatically share that information, the penalty percentages will be 1.5 times those set out in the existing Schedules.
- Where the non-compliance arises in a jurisdiction which has not agreed to exchange information with the UK, the penalty percentages will be double those set out in the existing Schedules.
- These new rules will apply to income tax and capital gains tax.

The new penalty proposals are an improvement on the December ones, in that they do not treat all offshore non-compliance as deliberate, no penalty will apply where the taxpayer has taken reasonable care, and there is a possibility of a nil penalty for careless (not deliberate) non-compliance.

However, for careless mistakes (as opposed to fraud) it seems to us unfair that the level of penalty should depend on what sort of information exchange agreement the UK happens to have with the country where the offshore income or gains arise. And given the huge complexity of the rules for taxing overseas income and gains, we are concerned that those who simply do not understand or know about the rules might end up with a penalty, unless HMRC accepts that they have not been careless.

EXCISE MODERNISATION AND COMPLIANCE CHECKS (BN69)

The compliance checking framework for excise duties on alcohol, tobacco, energy products, gambling duties and air passenger duty is to be updated, including:

- modernising information and inspection powers; and
- aligning the record-keeping rules and the time limits for assessments and claims with changes made to other taxes and duties.

Time limits for making assessments and claims need a transitional period and are not expected to become

fully operative before 1 April 2012. The record-keeping changes and amendments to information and inspection powers are expected to have effect from 1 April 2011.

The existing information and inspection powers will be updated, as in the table below:

As time limits across other taxes and duties have been aligned in recent years, excise is now out of step. The standard time limit for making claims and assessments will be increased from three to four years. The extended 20 year time limit for deliberate underpayment of excise duty will be retained but the terminology used to describe the behaviours subject to it will be aligned with recent penalties legislation.

Existing Power	Elements of proposal that are new, aligned or unchanged
To enter premises of revenue traders	A new element that would permit inspection of documents.
To enter premises of those thought to be acting as revenue traders	A new power to inspect documents is included.
to enter premises used by a revenue trader	Clarification that the existing powers include the power even if those premises are owned by another.
To make unannounced visits	No change.
Prohibition of inspection of wholly private premises	This is current practice but is now made explicit
Application for a warrant to search	The power exists but would be extended to search for documents required to accompany the goods.
Information from those who may hold relevant information	This is new and would allow HMRC to seek information from other parties such as banks. Safeguards would be a formal notice requirement, pre-authorised by a tribunal.

14. OTHER ISSUES

BASIC BANK ACCOUNTS

Banks are to be forced to make available free basic bank accounts to those on the lowest incomes and it is estimated that a further 1m people will be able to open such accounts. This will, of course, be a cost-saving measure for government as dealing with individuals without bank accounts is an expensive business for such bodies as HMRC.

UK CHARITY TAX RELIEFS (BN32)

Currently UK charitable tax exemptions and reliefs are only available to UK charities. Non-UK charities are therefore unable to benefit from these exemptions and reliefs. In addition, UK taxpayers are unable to obtain tax relief on donations to non-UK charities.

Legislation is to be introduced to extend UK charitable tax exemptions and reliefs to certain organisations which are equivalent to UK charities and community amateur sports clubs (CASCs) in the EU, Norway and Iceland. This will require a new definition of charity for UK tax purposes. The new definition will include a requirement for UK charities and EU organisations to demonstrate that their trustees, directors and managers are 'fit and proper'.

HMRC will also introduce a number of other reforms relating to the existing rules and the Gift Aid regime, in particular:

- Rules regarding payments by UK charities to bodies outside the UK will be strengthened.
- Charities will have to apply donations received under Payroll Giving for charitable purposes only to claim a tax exemption.
- Changes will be made to current Gift Aid reclaim procedures and there will be new notification procedures for new charities wishing to claim tax on Gift Aid donations.

In addition there are to be anti-avoidance provisions to prevent exploitation of the rules for tax relief on gifts of certain qualifying investments to charities: these provisions were announced in a Parliamentary Written Statement on 15 December 2009 and these measures will be effective from the date of that Statement.

The changes will in most cases apply from 24 March 2010. The new definition of a charity which will apply to Gift Aid donations by individuals on or after 6 April 2010. Claims for donations to EU and EEA charities will apply to donations from 1 April 2010 onwards but it will be open to donors to make a case for the period after 27 January 2010 when the ECJ decided that the UK regime had to be changed (see the ECJ judgment on the *Persche* case).