OVERVIEW

After the drama of George Osborne's first "Emergency" Budget as Chancellor in June and the announcement of swingeing cuts to the State sector and to benefits in the autumn, this Budget seemed a quiet affair. There was certainly disappointment from Labour that more was not done to boost growth given the unanticipated improvement in the deficit figures – although the sceptical would suspect that Mr Miliband would express disappointment no matter what was announced.

In fact it is unfair to ignore the attempts to boost growth and, clearly, Mr Osborne is keen to emphasise that Britain is "open for business". There were significant incentives to encourage inward investment including a reduction in Corporate Tax rates and a relaxation of the controlled foreign company rules. Entrepreneurs' Relief is doubled to encourage serial entrepreneurs. Interestingly, the non-domiciled are also included in these incentives by the announcement of measures to exempt remittances of foreign income and capital gains where they are used for commercial investment in UK businesses. They are also to be encouraged to remain in the UK by the removal and simplification of some of the more burdensome new rules introduced in the 2008 Finance Act. However, where they have been resident for 12 or more years and wish to opt for the remittance basis in any year, the charge is increased next year from £30,000 to £50,000 per annum. Finally, it is announced that there is to be a statutory residence test (needed to provide long overdue clarification of the rules). It is welcome news that the Government intends to consult widely before introducing legislation with effect from April 2012. The non-domiciled will be relieved to hear that the Government does not plan any other substantive changes to their tax regime in this Parliament.

For individual taxpayers generally, there was not much welcome news. While the 50% tax rate was confirmed as temporary for the wealthy and there was an increase in the personal allowance for the poor, the increases in National Insurance were retained. The proposal to amalgamate National Insurance with tax – also subject to a consultation period – seems far off, possibly because it might highlight the true fiscal burden. There were further squeezes on pensions and the promise of targeted anti-avoidance measures both legislative and operational, against high net worth individuals.

Indeed, there was a heavy emphasis on anti-avoidance and much made of a £42 billion "tax gap" of which one sixth was ascribed to tax evasion and one sixth to tax avoidance. While it is heartening to see the Government now making a distinction between the two, which the previous administration had carefully blurred over a number of years, both are clearly regarded as illegitimate, with no distinction for legitimate tax mitigation. Much was made of the sums purportedly lost to the Exchequer as a result. The basis of the Treasury figures is unclear, but there is a determination to brand avoidance as anti-social and

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unacceptable. There are to be further measures against dishonest tax agents and there will be a consultation paper on this and on the range of penalties H M Revenue & Customs ("HMRC") can impose for failure to comply with the regulations. The general undertaking to consult widely before new proposals are introduced is welcomed, but the wide-ranging growth of anti-avoidance measures, the identification of taxpayers and their advisors as dishonest, and further increases in the penalty regime, less so.

Anti-avoidance measures are also prominent in Corporation Tax provisions, but coupled with more positive initiatives. For large companies HMRC are to appoint "customer relationship managers". The upside for companies is an ability to obtain advance clearance for certain transactions and activities, (something needed for some time and increasingly difficult under the self-assessment regime).

In the Financial Services sector, the banks face an increased banking levy and both their profits and the bonuses awarded to their staff continue to be a cause of concern. For Life Assurance companies there are proposals to bring their favourable taxation regime more into line with that for companies generally, including the removal of tax protection for their claims equalisation reserves and changes in the way long term business is subject to tax.

For the charitable sector the news was rather better in a direct attempt to boost the "Big Society". There is to be welcome reform to the substantial donor rules, help for those wishing to make gifts of important works of art or historical objects, a relaxation in the record keeping for small donations under Gift Aid together with a streamlining of the Gift Aid system allowing charities to better manage their cash flow, and a reduced rate of Inheritance Tax where 10 percent or more of a deceased person's net estate is left to charity. These are helpful provisions for a sector facing particular financial problems in the current economic climate, and the loss of transitional relief on Gift Aid donations.

Taken as a package, the Budget appears to show a prudent, if unexciting, course. It is to be hoped that in future Budgets, the Chancellor will recognise the need for competitive rates of Income Tax, as well as Corporation Tax, move speedily to a reduction of the 50% rate, and recognise that National Insurance Contributions increase that headline rate to levels which disincentivises high earners, and their employers, both of whom need to be attracted to the UK. A last point for house owners to watch may be the Chancellor's comment about finding ways of ensuring that owners of high value property cannot avoid paying their full share. Could this presage a restriction of the exemption for Principal Private Residences?

A PERSONAL TAX AND CHARITIES

1. INCOME TAX ALLOWANCES AND RATES

The personal allowance will rise by £1,000 to £7,475 for 2011/12 as planned. A further increase of £630 to £8,105 was announced for 2012/13. These increases will over-ride the standard increment in line with the Retail Prices Index ("RPI").

As announced in December 2010 the basic rate limit for 2011/12 will be reduced by £2,400 to £35,000. For higher rate taxpayers this reduction more than counters the increase in the personal allowance. The basic rate will be further reduced by £630 to £34,370 for 2012/13, reflecting the increase in the personal allowance for that year, and meaning that the higher rate threshold for taxpayers benefitting from the full personal allowance has been frozen at £42,475.

Both the income limit, above which taxpayers start to lose the personal allowance, and the additional rate limit, above which taxpayers pay Income Tax at 50%, remain fixed at £100,000 and £150,000 respectively.

The Chancellor reiterated that the 50% rate of tax was a temporary measure but made no announcement as to when that rate might be reduced.

2. FOREIGN DOMICILIARIES

2.1 Overview

In a welcome move the uncertainty over the taxation of foreign domiciliaries, created by the announcement of further reviews in the Government's Coalition Agreement, has ended. While there will be no legislation until next year (providing sufficient time for consultation) it seems that there will be three areas where changes will be made, effective from 6 April 2012, and that there will then be no further substantive changes in this Parliament. A consultation document will be issued in June which will provide more details and we will produce a special briefing on this.

2.2 £50,000 Remittance Basis Charge ("RBC") after 12 tax years

Finance Act 2008 introduced a £30,000 charge (the RBC) which is payable by individuals who have been UK resident in at least seven of the preceding nine tax years if they elect to be taxed under the remittance basis (and are otherwise not exempt). This £30,000 charge will remain for those who qualify and have not been UK resident for 12 tax years. Those who have been resident for 12 tax years or more will have to pay an increased charge of £50,000 if they are to claim the remittance basis. Although the wording in the Budget documentation is ambiguous, it has been clarified that taxpayers will still be able to decide year by year whether to elect for the remittance basis, albeit at a higher cost.

2.3 Exemption for commercial investment in UK businesses

A significant concern with the current regime is the disincentive to inward investment. The announcement of an exemption where UK resident foreign domiciliaries remit income and gains for commercial investment in UK businesses is to be welcomed. We have no details of the conditions for any such exemption but hope they will be sufficiently wide as to attract inward investment without imposing additional administrative burdens.

2.4 Simplification

The remittance basis has never been a simple regime but there is widespread feeling that Finance Act 2008 raised the levels of complexity to such an extent that it is impossible for some taxpayers to be fully compliant. Simplification of the rules is required and so we welcome the commitment to introduce reforms to "simplify some aspects of the current tax rules for non-domiciles to remove undue administrative burdens".

3. STATUTORY RESIDENCE TEST

The current state of UK tax law on residence and ordinary residence leaves much to be desired. The statutory provisions are piecemeal with respect to residence (and non-existent for ordinary residence).

Recourse to case law is necessary to have any idea of the meaning of the terms and this has led to considerable uncertainty (as acknowledged in the Budget documentation). Recent Court decisions and changes to HMRC guidance have added to this and it is recognised that a legislative solution is required. The Chancellor has announced that there will be a consultation document issued in June, leading to

implementation of a statutory test from April 2012. The introduction of a clear, objective and sensible statutory residence test will be highly beneficial. The wrong test would, however, be hugely damaging. The Budget documentation recognizes that a statutory definition should "provide greater certainty for taxpayers". It is hoped this means that the test will be an objective one. We will issue a specific briefing when the consultative document is published.

4. PENSIONS

In the Emergency Budget in June 2010, the Coalition Government announced a number of measures which they intended, following a consultation process, to introduce with effect from 6 April 2011. Following consultation, draft legislation has been published which will take effect from 6 April 2011.

4.1 Restricting pensions tax relief

The previous Government had sought to restrict higher rate tax relief on pension contributions for those individuals earning more than £150,000 annually, with complete withdrawal for those earning in excess of £180,000. These proposals were repealed by the Coalition Government before they took effect. In their place, the two allowances which presently apply to registered pension schemes, the annual and the lifetime allowance, will be reduced from £255,000 to £50,000 and from £1.8 million to £1.5 million respectively. The reduction in the annual allowance will take effect from 6 April 2011 with the reduction in the lifetime allowance being deferred by a further year until 6 April 2012.

The annual allowance

The annual allowance represents the maximum value of contributions from all sources which may be paid into an individual's pension scheme annually. Any contributions in excess of this allowance are liable to a tax charge. The key points are as follows:-

i. Income Tax relief due on personal contributions within the annual allowance will be given at the individual's marginal rate of tax, including the 50% rate where applicable.

ii. Any tax charge on excess contributions will be levied at the individual's marginal rate of tax. This was previously set at a fixed rate of 40%. The individual may be able to elect for this charge to be borne by the pension scheme, although the provisions are complex and advice should be sought.

Iii. If annual pension contributions during the year are less than £50,000, the surplus, known as the unused annual allowance, can be carried forward for up to three years.

iv. For those individuals who contribute to a defined benefits pension scheme (broadly speaking, final salary schemes), the annual allowance is measured by multiplying the increase in the maximum pension payable by a factor of 16. This was previously set at a factor of 10.

v. Transitional rules apply where a pension input period ending in 2011/12 commenced before 14 October 2010. Such a period straddles the effective date on which the reduced allowance comes into effect and special rules apply to determine the value of the annual allowance for the period.

The lifetime allowance

The lifetime allowance represents the maximum value of benefits that may be drawn from a registered pension scheme. If the assets of the scheme are greater in value than the lifetime allowance at the date of withdrawal, a tax charge of 25% will be levied on the excess.

Transitional rules are in place to protect those individuals whose pension funds are already valued in excess of £1.5 million or who believe their funds will, through investment growth, increase in value beyond that amount. Anyone who is in this position can apply for a new personalised lifetime allowance of £1.8 million by giving notice to HMRC. The draft legislation provides for HMRC to make regulations specifying how this notice is to be given.

4.2 Withdrawal of compulsory annuitisation by age 75

Whilst it is has not been strictly compulsory to purchase an annuity before age 75 and there is provision for alternative methods of income withdrawal, the rules are so severe that in most cases they would prove disadvantageous.

In the Emergency Budget, the Government announced its intention to examine alternative forms of pension withdrawal. The previous requirement was to purchase an annuity or alternatively secured pension by age 75. As an interim measure, individual's who attained age 75 after 22 June 2010 were allowed to defer their decision on what to do with their pension savings until the new provisions are in place.

Draft legislation has been published and these changes will come into effect on 6 April 2011.

The key points are as follows:-

i. The compulsory requirement to enter into an alternatively secured pension at age 75, where an annuity has not been purchased, will be abolished. This measure will end the effective requirement to purchase an annuity by age 75.

ii. The alternatively secured pension rules will be replaced by a new method of withdrawal known as drawdown pension. The drawdown pension rules permit individuals to leave their funds invested and to make withdrawals throughout their retirement. Withdrawals from a drawdown pension will be taxed as pension income.

iii. Withdrawals from a drawdown pension will be restricted to an annual maximum of 100% of the annuity that could have been secured from the pension fund. This cap will be reviewed at least every three years until age 75 at which point it will be reviewed annually.

iv. If individuals are able to demonstrate that their annual income from certain other pension sources (excluding other drawdown arrangements) is at least £20,000 they will, on making a valid declaration, be able to apply for "flexible drawdown". Flexible drawdown permits an individual unlimited access to his pension fund which effectively enables him to withdraw funds without limit.

v. If an individual makes further contributions to an active registered pension scheme after claiming flexible drawdown, those contributions are subject to the annual allowance charge in full.

vi. If an individual makes a withdrawal from a drawdown pension fund whilst resident outside the UK for a period of less than five years, he will be liable to UK Income Tax on the amount withdrawn in the tax year in which he becomes UK resident again.

vii. Inheritance Tax will not ordinarily apply to drawdown pension funds remaining under a registered pension scheme on death. This will apply even if the individual has died after the age of 75. However, tax at 55% will be charged on lump sum death benefits paid out from 6 April 2011.

5. CAPITAL GAINS TAX ("CGT")

5.1 Annual Exempt Amount

Following the Government's decision to index the rates and allowances for direct taxes generally by reference to the Consumer Price Index ("the CPI") rather than the RPI, the annual exemption for Capital Gains Tax will also rise in line with the CPI from 6 April 2012.

The exempt amount will be calculated by applying the percentage increase in the CPI for the 12 months to the previous September, rounded up to the nearest £100. The Treasury will, however, reserve the right to override this. If the CPI decreases, the annual exemption will remain unchanged until the index once again shows an increase.

The annual exempt amount for 2011/12 has been set by the statutory RPI increase at £10,600, representing a £500 increase on the previous year.

5.2 Entrepreneurs' Relief

There is to be a further increase in the lifetime limit on gains qualifying for Entrepreneurs' Relief following that introduced in the Emergency Budget on 22 June 2010. The relief has doubled from £5 million to £10 million for disposals made on or after 6 April 2011, and increased tenfold since its introduction three years ago. This is a welcome move designed to encourage serial entrepreneurs and means that qualifying gains will be liable to CGT at only 10%. It also applies to Trustees where a beneficiary meets the conditions. The relief, applies, broadly, to gains made on disposals of businesses, business assets and shares in personal trading companies.

Where qualifying gains are made above the prevailing limit (£5 million for gains realised between 23 June 2010 and 5 April 2011, £2 million for gains made between 6 April and 22 June 2010, and £1 million between 6 April 2008 and 5 April 2010) no further relief is due in respect of those disposals. However, if more qualifying gains are made on or after 6 April 2011, the balance of relief up to the new limit of £10 million is available.

There are no other changes to the rules or conditions for Entrepreneurs' Relief.

6. ENTERPRISE INVESTMENT SCHEME ("EIS") AND VENTURE CAPITAL TRUSTS ("VCT")

EIS and VCT schemes are long established incentives to investment in smaller, unlisted companies.

Changes have been announced which will affect both investors and the qualifying conditions which companies must meet in order to issue qualifying EIS or VCT shares. All are subject to State Aid approval.

6.1 Investors

Two major changes have been made to increase incentives for investors. The first applies to shares issued on or after 6 April 2011. Income Tax relief, which is given as a reduction of the individual's tax liability, will be increased from 20% to 30% on qualifying investments.

The second change applies from 6 April 2012. From this date the amount on which an individual can claim EIS Income Tax relief will increase from £500,000 to £1 million.

No specific changes have been made to Capital Gains Tax ("CGT") deferral relief, or to the CGT exemption that applies to EIS shares where these have been held for at least three years and the Income Tax relief has not been withdrawn.

Increasing the amount upon which EIS Income Tax relief can be claimed has therefore increased the potential for avoiding CGT on the disposal of EIS shares at a profit. However, the Income Tax and CGT reliefs continue to reflect the risks associated with investing in unquoted companies.

6.2 Companies

There are various conditions which companies need to meet in order to issue qualifying EIS/VCT shares. Three of these conditions will change with effect from 6 April 2012:

- The size threshold for qualifying companies is to be amended. Before 6 April 2012 the company must not hold gross assets of more than £7 million before the share issue and £8 million after the investment. From 6 April 2012 the gross assets threshold will be £15 million before the share issue, with the upper limit after the investment being abolished completely.
- The limit on the number of employees will increase from 50 to 250.
- The maximum amount of investment which a company can obtain from both schemes will increase from £2 million to £10 million.

In addition renewable power generating businesses which receive their income wholly or substantially from Feed-In Tariffs ("FITs") will be placed on the non-qualifying trade list. This change takes effect where commercial electricity generation commences after 6 April 2012. If generation commences before this date, EIS and VCT relief can be claimed. Any shares issued before 23 March 2011 will not be affected by this change.

The Government has also announced that it intends to bring forward consultation on further changes to both schemes.

7. ISAs AND JUNIOR ISAs

7.1 Annual ISA Subscription limit

In line with the preference for applying the CPI (rather than the RPI) to allowances and thresholds, the annual ISA subscription limit will rise annually in line with the CPI from 6 April 2012.

The increase will be applied by reference to the CPI for September in the preceding year although the resulting threshold will be rounded to £120 so as to accommodate regular monthly payments more easily. If the CPI is negative, the limit will remain unchanged.

Also unchanged is the portion that may be invested into a cash ISA. This remains a maximum of half of the total annual limit, with any balance able to be invested in a stocks and shares ISA.

The limit for 2011/12, will be increased by £480 to £10,680 in line with the RPI under the current rules. The limit for investment in a cash ISA is therefore £5,340.

7.2 Junior ISAs

Stocks and shares ISAs have historically only been available to subscribers aged 18 or over, although 16 to 18 year olds have been permitted to invest in cash-only ISAs.

The Government is now proposing to extend the availability of tax efficient "investment plans for children" with the introduction of the Junior ISA. This will be made available to UK residents under the age of 18 who do not already have a Child Trust Fund. The product will be available as a cash or stocks and shares account and will have many of the features of the existing ISA, including the benefit of tax relief on income and capital gains earned within the product.

The precise details of the account features remain subject to consultation and development at the current time, although the Junior ISA is expected to be available from the autumn.

8. INTEREST ON TIME DEPOSITS

A qualifying time deposit is a loan for more than £50,000 (or equivalent) which is repayable at a specified time within five years.

While the interest on such deposits is subject to tax at normal rates, they were excluded from the requirement to deduct tax at source.

This will change for new accounts from 6 April 2012, and lower rate tax (currently 20%) will have to be deducted at source from interest payments.

9. FURNISHED LETTINGS

The Budget statement confirms that the changes previously announced to the rules for Furnished Holiday Lettings ("FHL") and the extension of the regime to the European Economic Area ("EEA") will be included in the Finance Bill. Generally, the rules will restrict the availability of Income Tax loss relief.

From April 2011 loss relief may only be claimed against income from the same FHL business but, importantly, the new rules will distinguish between UK and EEA FHL businesses. Losses arising on a UK FHL business can only be offset against UK FHL income and, likewise, EEA losses only against EEA income.

Currently, a property must be available for letting for at least 140 days and actually let for 70 days in a year to qualify as a holiday letting. However, from April 2012, the availability day count will increase to 210 and the "actually let" days to 105. A period of grace will allow for an election where a business fails to meet the actually let requirement for one or two years providing certain criteria are met. Such an election will first apply from 2010/11.

Whilst it seems that the availability of Income Tax loss relief will inevitably be restricted, certain valuable Capital Gains Tax reliefs including business asset roll-over relief, Entrepreneurs' Relief and relief for gifts of business assets will continue to apply.

10. CHARITIES

10.1 Replacement of substantial donor rules

The "substantial donor rules" were intended to prevent tax reliefs in circumstances where benefits were provided to donors who made charitable donations of at least £25,000 in a period of 12 months, or at least £150,000 during a period of six years. The objection to these rules has always been that they could apply even when a donation was genuine, thereby discouraging substantial but bona fide donations from donors who might have other dealings with the charity.

The rules are replaced from 1 April 2011 with a new regime applying a purpose test to donations. Under these rules, tax relief will be denied when the main purpose or one of the main purposes of the donor in being party to arrangements is to receive an advantage for himself or a connected person. There will be no thresholds on the size of the donation that must be exceeded before the new rules will apply, although they will not if the benefits received by the donor would be allowable under the Gift Aid scheme (see 10.3). A key benefit of the change for charities is that, where a donation is deemed tainted under the new rules, it is the donor who loses tax relief on the donation and suffers an Income Tax charge equal to the tax reclaimed by the charity. However, if HMRC believe that the charity knew the donation was tainted, then the charity will be held jointly and severally liable to the charge.

Although this change is intended to avoid disincentives to genuine donations, there remains concern that the new legislation will not discriminate sufficiently and careful consideration of transactions which are entirely innocent is still necessary.

10.2 Self-Assessment donate

Currently self-assessment taxpayers who are due a repayment of tax from HMRC may request that the repayment should instead be made to a charity of the taxpayer's choice. Uptake has been low and, because of this and the vulnerability of the scheme to fraud, it will be withdrawn for repayments of tax due for 2011/12 and subsequent years and for repayments of tax due in respect of earlier tax years made on or after 6 April 2012.

10.3 Gift Aid benefit limits

In a move designed to encourage charitable giving, the maximum value of benefits that a donor may receive from a charity will be increased from £500 to £2,500. The change will have effect for benefits received as a consequence of donations made on or after 6 April 2011 for individuals, and for donations made in accounting periods on or after 1 April 2011 for companies.

This increased maximum remains subject to the rule that the benefit must not exceed 5% of the gift.

10.4 Gift Aid administration

As a further encouragement to the charity sector, charities that receive small donations of £10 or less will, from April 2013, be able to apply for a Gift Aid style repayment without the need to obtain Gift Aid Declarations for those donations. The amount of small donations on which the repayment can be claimed by a charity will be capped at £5,000 per year. To qualify, charities will need to have been recognised by HMRC for Gift Aid purposes for at least three years and have a good compliance record.

In response to representations from charities, a new online system will be introduced in 2012/13 to allow charities to register their details for Gift Aid and to make Gift Aid claims. In addition to this HMRC will be working towards developing a supporting electronic Gift Aid database for Gift Aid declarations.

10.5 Gifts of Art

The Government is considering the introduction of a tax reduction for taxpayers who give a work of art or historical object of national importance to the State. Consultation on these proposals will take place during 2011.

10.6 Inheritance Tax - Reduced Rate

Where a death occurs on or after 6 April 2012 and 10% or more of the deceased's net estate (after various deductions) has been left to charity, the rate of Inheritance Tax will be reduced to 36%. The benefit of the reduction will accrue to the charities concerned.

11. INHERITANCE TAX ("IHT")

The IHT nil-rate band remains fixed at £325,000 for 2011/12 to 2014/15. From 2015/16 onwards it will increase in line with CPI.

12. OFFSHORE FUNDS

A number of proposed amendments to the (previously published) provisions governing offshore funds will be taken forward. These are predominantly administrative in nature, and address difficulties that have been identified with the regulations introduced in 2009.

12.1 Equalisation arrangements

The application of the reporting fund rules to offshore funds which operate equalisation arrangements is to be clarified. For funds that do not operate equalisation, provisions are to be introduced which achieve a similar effect by apportionment of the reported income.

12.2 Transparent funds

The application of the reporting fund rules to transparent funds is clarified and expanded to deal predominantly with the treatment of interests held in non-reporting funds.

12.3 Exemption of funds investing in unquoted trading companies

A fund which invests at least 90% of its assets in unquoted trading companies throughout an investor's period of ownership will be taken outside of the regime (and so any gain will be chargeable to Capital Gains Tax and not Income Tax) regardless of whether the fund complies with the reporting funds rules.

This is a welcome exemption in principle, although in practice it may be difficult to obtain sufficient information regarding the composition of a fund's investments to prove that the exemption will apply. Furthermore, such funds may realise substantial proceeds from disposals and therefore have substantial amounts of cash on hand from time to time. As currently drafted, where such cash balances exceed 10% of the fund assets by value, the exemption will not apply.

12.4 Other administrative changes

Further changes of an administrative nature are to be made to the regulations, correcting areas of uncertainty in the regulations as originally drafted, rectifying errors, and updating for changes in other provisions.

B TAXES FOR BUSINESS

13. BUSINESS TAX

13.1 Corporation Tax

Rates

In an effort to maintain competitive rates of Corporation Tax, the main rate will be reduced for the financial year commencing 1 April 2011 from 28% to 26%. This is a more generous reduction than the 1% announced in the Emergency Budget.

The main rate will be further cut by 1% in each of the following three years resulting in rates of 25% from April 2012, 24% from April 2013, and 23% from April 2014.

The small companies' rate of Corporation Tax will fall from 21% to 20% on 1 April 2011. This is in line with the announcement in the Emergency Budget.

Associated companies

The associated company rules for the small companies' rate of Corporation Tax will be reformed. From 1 April 2011, companies can only be associated through an attribution of rights between connected individuals, where there is substantial commercial interdependence between the companies concerned. The current rules do not require commercial interdependence, and these changes should result in fewer companies needing to be treated as associated companies.

13.2 Capital Allowances

Plant and Machinery

With effect from April 2012, the rates of Writing-Down Allowances ("WDAs") for new and unrelieved capital expenditure on plant and machinery will be reduced from 20% to 18% per annum for expenditure in the main rate pool; and from 10% to 8% per annum for expenditure in the special rate pool. These changes will be incorporated in the Finance Bill.

Reduction in Annual Investment Allowances ("AIA")

The AIA provides a 100% deduction for capital expenditure on most plant or machinery (except for cars) up to a maximum amount, which is currently £100,000. The Finance Bill will include legislation to reduce the maximum amount of the AIA to £25,000 per annum with effect from April 2012. Capital expenditure above this threshold will continue to be eligible for standard Capital Allowances against taxable profits.

Short life assets

Businesses can elect for expenditure on plant and machinery to be treated as Short Life Assets ("SLA"). Expenditure incurred on SLAs is allocated to a "single asset pool", and if the asset is disposed of before a cut-off period, Capital Allowances can be claimed such that the total allowances given over the period of ownership equate to the actual net cost of the asset to the business.

An election is beneficial if the asset depreciates faster than the rate at which Capital Allowances are given, and it is disposed of before the cut-off date.

Currently the cut-off point is four years from the end of the chargeable period when the expenditure on the asset is incurred. However, the Chancellor has announced that the cut-off period will be extended from 4 years to 8 years from April 2011. This will mean that a wider range of assets will benefit from an SLA election.

Anti-avoidance

The Government has announced that it will consult in May 2011 on bringing the existing test for the application of the Capital Allowance anti-avoidance rules into conformity with other anti-avoidance provisions.

Legislation will also be introduced to counter avoidance involving the leasing of plant and machinery where taxpayers claim Capital Allowances twice on one amount of expenditure.

13.3 Research and Development ("R&D")

Rate of R&D tax relief

In computing their taxable profits, Small or Medium sized Enterprises ("SMEs") can claim an enhanced deduction for qualifying R&D expenditure at a rate of 175%. With effect from 1 April 2011, the Chancellor has announced that this enhanced deduction will increase to 200%, and will further increase to 225% from April 2012.

Simplification of R&D tax relief

The Chancellor has also announced that, subject to further consultation, the following changes will be made to simplify R&D tax relief:-

- The rule limiting a small or medium company's R&D tax credit to the amount of PAYE/NIC it pays will be abolished.
- The £10,000 minimum R&D expenditure condition will be abolished for all companies.
- R&D relief will become available for large companies where they subcontract activity which forms part of a wider R&D project.

13.4 International Taxation

Exploitation of intellectual property by Controlled Foreign Companies ("CFCs")

The Budget has brought forward previously announced proposals for an exemption from the CFC rules to apply to certain companies engaged in the exploitation of Intellectual Property ("IP").

For accounting periods beginning on or after 1 January 2011 (and not from 1 April as proposed originally), the new exemption will apply to companies whose main business is IP exploitation, and where both the IP and the

company have “minimal connection” with the UK. “Minimal” in this context means:

- that the IP must not have been transferred from the UK in the last 10 years,
- or have been created or maintained in the UK by a group company, and
- the company must not have been substantially funded by equity investment from the UK, nor
- derive most of its income from the UK,
- nor outsource any part of the IP activity to the UK.

The rules are tough, perhaps unreasonably so.

This change, however, may only prove to be an interim measure, with further, and more fundamental, reforms to the CFC rules promised in 2012.

Extension to the “period of grace” from the CFC rules

With effect for accounting periods beginning on or after 1 January 2011, there is a relaxation to the so-called “period of grace” that allows companies which become CFCs for the first time to escape the CFC charge.

The current regime allows for newly acquired foreign subsidiaries, and for foreign businesses investing in the UK for the first time, to be exempted from charge for up to 24 months. The Government’s intention is to extend the period of grace to three years.

Other changes to the CFC rules

The current de minimis exemption is amended for accounting periods beginning on or after 1 January 2011, by increasing the annual profit limit from £50,000 to £200,000.

An exemption is introduced, also from 1 January 2011, for certain intra-group trading transactions where there is little connection with the UK.

There is also an extension to the transitional rules for superior and non-local holding companies until July 2012.

Group Finance Companies

The Budget confirms that, following several years of consultation, new rules will be introduced in 2012, with the publication of a consultation document in May 2011.

As part of the reform, group finance companies, typically set up by multinationals to manage a group’s overseas financing operations, have been identified as a case for partial CFC exemption. This will be achieved on the basis of a finance company’s debt to equity ratio, with the Government considering a minimum ratio of 1:3.

Therefore, if an overseas company is fully equity funded, 75% of its overseas finance income will be exempted from the CFC charge, equating to an effective rate of tax of 1/4 of the main UK rate; so reducing the rate to 5.75% by 2014.

Patent Box regime

The Budget has confirmed the Government’s intention to tax company profits from patents at a new Corporation Tax rate of 10%, with the aim of incentivising the creation and retention of IP in the UK.

The UK’s patent box regime will come on stream from April 2013 and only for patents “first commercialised” – an expression still to be defined – after 29 November 2010. A consultation document, due to be published in May 2011, will hopefully clarify this and other aspects of the new rules.

Foreign Branches of UK Companies

To avoid any distortion between the taxation of foreign branches and the taxation of foreign subsidiaries (whose dividends to the UK are now generally exempt from Corporation Tax), new rules are being introduced to allow for a tax exemption, on an opt-in basis, for trading profits arising from a UK company’s foreign branches.

The opt-in will apply for accounting periods beginning on or after Royal Assent to the 2011 Finance Bill, and the election to opt-in will be irrevocable. The election will also apply to all current and future branches of the company for all accounting periods following the period in which it is made.

However, a branch located in a country with which the UK has no tax treaty will be excluded from any opt-in if it is a branch of a “small” company (ie one with fewer than 50 employees and either turnover or assets below €10 million). Tax exemption will also be denied to certain branches in low-tax countries.

Companies opting-in must also recognise that any tax losses will not be relievable against other UK profits. Opting-in may therefore be inappropriate for companies with start-up losses. Furthermore, a company that elects to opt-in with respect to a foreign branch, which has moved from loss to profit-making, is not able to claim exemption until the losses of the preceding six years have been matched by profits.

OECD Transfer Pricing Guidelines

The Government will introduce legislation, effective from 1 April 2011, which will update the definition of "transfer pricing guidelines" to refer to the most recent version of the OECD Transfer Pricing Guidelines.

Amendments to the Debt Cap rules

The ongoing consultation on the debt cap rules has identified practical issues with their application that need to be addressed. Further consultation will take place in June 2011, after which the Government will introduce legislation to simplify these rules.

13.5 Employment Taxation

National Insurance Increases effective from 6 April 2011

Increases in the rates of NIC were announced by the previous Labour government in their March 2010 Budget, and confirmed in the Coalition's Emergency Budget.

The rates for NIC for both employees and employers have increased by 1% as planned. For employees the rates for 2011/12 are 12% on annual earnings between £7,228 and £42,484 and 2% on earnings in excess of £42,484. For employers the rate for 2011/12 is 13.8% for annual earnings in excess of £7,072. The upper earnings limit for 2011/12 has been aligned with the Income Tax higher rate threshold.

From 2012/13 onwards the various NIC thresholds will be increased in line with the CPI instead of the RPI, with the exceptions of the Upper Earnings Limit, which will continue to be aligned to the Income Tax higher rate threshold, and the Employers' NIC threshold, which will increase in line with the RPI.

In advance of the Budget there was much speculation that the Government would announce plans to merge Income Tax and NIC, recognising that the latter is a tax by another name and that the existence of parallel sets of rules unnecessarily complicates the tax system.

In the event, the Chancellor chose to announce a consultation on the options, stages, and timing of reforms to integrate the two systems. A consultation document will be published later in the year, setting out the differences between Income Tax and NIC and the options for addressing these. However, the contributory principle will be retained, and there will be no extension of NIC to individuals above the state pension age, or to forms of income to which they do not currently apply.

Disguised remuneration

Anti-avoidance provisions to block arrangements to "disguise remuneration" using Employee Benefit Trusts ("EBTs") and other vehicles had been previously announced and are confirmed.

The use of EBTs, in particular family benefit trusts and Employer-Financed Retirement Benefit Schemes ("EFRBS"), has long been favoured by employers to reward employees and to defer, if not avoid, the corresponding Income Tax and NIC liabilities.

The new rules, effective from 6 April 2011, have EBT arrangements clearly in their sights, but go much further. Where any "relevant third party" - and that appears to include anyone other than the employer – pays a sum, provides an asset, or merely earmarks an amount to provide "rewards, recognition or loans" to an employee (including former and prospective employees) in connection with their employment, that amount will count as employment income, subject to PAYE and NIC.

The Government has sensibly taken HMRC approved share plans outside the rules, and has made amendments to an earlier published draft of the legislation 'to limit impacts on employers and individuals where it is possible to identify arrangements that cannot be used for avoidance purposes'. However, the revised provisions will not be available before the 2011 Finance Bill is published on 31 March.

Reduced childcare relief for higher earners

From 6 April 2011, the Income Tax relief available from an Employer-Supported Childcare ("ESC") scheme will be restricted for higher and additional rate taxpayers. This is expected to impact some 180,000 families throughout the UK.

Company car and fuel benefits

The Chancellor announced changes to the legislation governing the calculation of the taxable benefit in kind arising on the provision of a company car and/or free fuel to an employee:

- The company car percentages used to calculate the cash equivalent arising on the benefit are to be reduced by 1% from April 2013. This reduction will apply to all vehicles with emissions between 95g and 220g/km.
- Zero emissions cars remain a tax-free benefit, and ultra low emissions cars (those with emissions up to 75g/km) will continue to give rise to a taxable benefit of 5% of the vehicle list price.

- With effect from 6 April 2011, the relevant set figure (currently £18,000) on which an employee's fuel benefit is calculated will increase to £18,800 per year.

Approved mileage allowance payments

The Chancellor announced that the approved mileage allowance payments rate, for employees who use private cars for business travel, would be increased from 40p to 45p per mile. For annual mileage in excess of 10,000 miles, the approved rate is to remain unchanged at 25p per mile.

13.6 Stamp Duty Land Tax ("SDLT")

Rate increase

Another tax increase previously announced in the March 2010 Budget is the new SDLT rate applying to all residential property purchases costing more than £1 million. From 6 April 2011, the rate will be 5% on the whole purchase price where this exceeds £1 million, an increase from 4%.

Bulk purchases

A form of SDLT relief is to be introduced for purchasers acquiring interests in more than one residential dwelling (such as a block of flats). Broadly, where the relief is claimed, the SDLT rate will be calculated based on the average price of the dwellings rather than the total price paid, subject to a minimum 1% charge.

Alternative finance arrangements

A well known SDLT saving scheme, relying on legislation introduced in 2007 to assist those whose religious beliefs meant they could not use traditional mortgage products, has been blocked. The scheme, which used "Alternative Finance" arrangements, relied on the use of sub-sale reliefs which removed the SDLT charge on the purchase of interests in land for those using these arrangements.

The new rules, which apply from 24 March 2011, seek to ensure that the relief is restricted to those with genuinely Sharia-compliant mortgages from recognised lenders.

13.7 Miscellaneous

Withdrawal of tax reliefs

The Office of Tax Simplification has reviewed the 1042 tax reliefs apparently available in the UK tax system, to identify those that are either no longer relevant, or are poorly targeted, or result in an administrative burden that far outweighs their benefit.

Following the review, the Chancellor has announced that seven reliefs are to be removed in the Finance Bill 2011, with another 36 reliefs to be abolished over the next few years. The reliefs to be abolished include:

- Tax-free late night taxis provided by employers. This relief is likely to be abolished next year.
- Tax-free luncheon vouchers of 15p per day provided by employers.

Degrouping charges anti-avoidance

If a company leaves a group holding an asset which has been transferred from another group member within the last six years, the gain which is deferred on the intra-group transfer is brought into charge. However, if both the transferor and transferee company leave the group at the same time, and they are both part of the same sub-group from the time of the transfer to the date they leave the group, there is an exception to the charge.

Certain groups of companies have sought to exploit this to avoid chargeable gains on the disposal of assets, and new measures to prevent this are introduced with effect from 23 March 2011.

Simplification of degrouping charge rules

A new rule is also to be introduced later in 2011 to ensure that where the sale of a target company is exempt from tax under the Substantial Shareholdings Exemption ("SSE"), any degrouping charge is also exempted from tax by being added to the exempt chargeable gain.

In addition, if a company has chosen to "hive down" a trade and assets to a new subsidiary, which is sold out of the trading group, the subsidiary will be treated as having been held in the group for 12 months prior to disposal so that the SSE would cover both the degrouping charge and any gain on the shares in the subsidiary.

Existing provisions to allow the reallocation of a degrouping charge, and to rollover a degrouping charge, will be repealed.

Group mismatches and derecognition

In certain corporate group situations, the tax treatment of loans and derivatives can result in asymmetry, for example because one company obtains a deduction whilst there is no corresponding charge in the other. HMRC are aware of a number of tax schemes which exploit this mismatch and are therefore introducing anti-avoidance legislation in the Finance Bill.

Draft legislation was published in December last

year, but, following consultation, some minor amendments will be made:

- to clarify that only transactions with the UK will be affected
- to introduce a de minimis threshold to one of the tests so that it does not apply unless there is a tax saving of at least £2 million
- to amend another test so that there is both a subjective and objective element. The objective element is that the scheme is one which is more likely to produce a tax advantage than a tax disadvantage.

In addition, the existing anti-avoidance rules on derecognition of loan relationships and derivative contracts will be amended to ensure that debits on creditor loan relationships are denied; that the rules will only apply where a company remains party to a loan relationship/derivative contract; and to require companies to account for differences between the accounts carrying value and the fair value in the period in which the tax avoidance scheme is implemented.

Sale of lessor companies

The Government has announced that it will introduce legislation with effect from 23 March 2011 to amend the anti-avoidance legislation on sales of lessor companies so as to withdraw the option to elect for alternative treatment.

Accounting standards on leases

The Government will introduce legislation in the Finance Bill to ensure that the rules governing the treatment of leases for tax purposes continue to apply as now in the event of the adoption of a new accounting standard.

14. VAT

There are no major changes in this year's Budget.

With effect from 1 April 2011 the VAT threshold is raised to £73,000 and the VAT deregistration threshold is raised to £71,000.

Anti-avoidance measures include:

- rules to prevent exploitation of the "Low Value Consignment Relief" threshold, below which goods imported from outside the EU are VAT free. The current threshold is £18. The relief has been exploited in ways that gives small and medium UK businesses a competitive disadvantage. With effect from 1 November 2011 the threshold will reduce to £15 but there will be immediate consultation with the European Commission to limit the scope of the relief.
- legislation to be introduced in the Finance Bill to withdraw the VAT zero-rating for ancillary printed matter where it is connected to a supply of a differently VAT rated service.

Recognising cash flow problems, HMRC will continue to offer time to pay agreements to viable businesses experiencing genuine short term difficulties.

15. FINANCIAL SERVICES SECTOR

The Chancellor has announced a number of consultation exercises relating to businesses operating in the financial services sector, with a view to legislating in due course.

15.1 Bank capital instruments

New capital instruments may be devised by banks in response to the Basel III proposals on capital adequacy requirements, but, recognising there may be uncertainty about their tax treatment, HMRC will hold informal consultations with interested parties in April.

15.2 Tax transparent funds

The Government will consult in June on proposals to introduce a tax transparent fund vehicle, so as to allow the UK fund industry to compete following recent European regulatory changes. Any legislation would be introduced in the 2012 Finance Bill.

15.3 Insurance companies

A new life insurance tax regime has been outlined in a Technical Note published on Budget Day, which is intended to come into effect in January 2013. The objective is to create a simpler system more closely aligned with the taxation of companies generally. A consultation document will be issued in April 2011, leading to legislation in the 2012 Finance Bill. Consultation (and legislation) over the same time scale is envisaged on the way in which certain long term business is taxed.

General insurers and Lloyd's insurers currently receive a tax deduction for amounts based on regulatory Claims Equalisation Reserves ("CERs"). CERs apply to certain lines of business recognised as being the most volatile. However, from January 2013 there will be no regulatory requirement for CERs, and built-up reserves will become taxable. The Government will therefore consult with the industry, in order to establish whether retaining the

tax relief is justifiable.

15.4 Islamic Finances

Subject again to consultation, the Government will make regulations to introduce direct tax rules for Sharia-compliant variable loan arrangements and derivatives.

15.5 Stop loss premiums

HMRC has altered its views on the timing of tax deductions in respect of stop loss premiums and now considers that they are deductible in accordance with the normal rules applying to the computation of trading profits. Amending legislation will be introduced in the Finance Bill 2012.

16. FUEL DUTY

The Fuel Duty Escalator is to be abolished and replaced with a Fair Fuel Stabiliser. Furthermore, the main Fuel Duty rate has been reduced by 1p per litre. Clearly, both measures are aimed at easing the burden on beleaguered motorists at a time of record pump prices.

However, there remains a general upward trend in the level of most fuel duties. The increase in Fuel Duty planned for 1 April 2011 is simply being deferred until 1 January 2012 when the main Fuel Duty rate will increase by 3.02p per litre. At the same time, the effective rate of duty for non-road fuels will rise in proportion to the main Fuel Duty rate, the duty increases on natural gas will maintain the differential with the main road fuels, and the differential for road fuel gas other than natural gas will be reduced by the equivalent of 1p per litre of petrol. Also on 1 January 2012 the duty rate for leaded petrol will increase by the same monetary amount as the main Fuel Duty and the duty rate for aviation gasoline will rise in proportion to the main Fuel Duty rate.

When oil prices are high, the Fair Fuel Stabiliser will restrict the increase in Fuel Duty by reference to the RPI. However, if the oil price falls below a set trigger price the Government will increase Fuel Duty by RPI plus 1p per litre. The Government believes that a trigger price, of $75 per barrel is appropriate and will set a final trigger price and mechanism after seeking the views of the main interested parties.

Also, further Fuel Duty increases have been announced for 1 August 2012 and, therefore, it seems likely that any hope for a sustained reduction in the level of energy costs will very much depend on the political climate in the Middle East and the consequential impact on the price of a barrel of oil.

Measures will be implemented to subject private jets to Air Passenger Duty.

C ANTI-AVOIDANCE AND ADMINISTRATION

17. ANTI-AVOIDANCE

HM Treasury and HMRC issued a separate paper following the Budget, setting out further details of the Government's strategy on anti-avoidance measures, after the launch of its new approach in June 2010.

The strategy is aimed at preventing avoidance at the outset, detecting it early where it persists, and counter-acting it effectively through legislative changes and litigation.

The June 2010 document identified two key elements. The first was to consider the case for a General Anti-Avoidance Rule, and the second to review areas of the tax system which have seen repeated avoidance.

The Budget announced reviews of two areas perceived to be vulnerable to marketed avoidance schemes. The first is where reliefs for Income Tax losses are exploited, and the review will examine ways in which reliefs can be targeted.

The second area is unauthorised unit trusts where such trusts are used by companies to create tax advantages.

Subsequent Budgets will announce further areas for review.

HMRC have observed that under certain schemes, an individual can benefit from deferring tax until the scheme is defeated. Under the new proposals, users of certain schemes will be encouraged to pay disputed tax earlier than is currently required, or face an additional charge for late payment of the tax should a further liability be found to be due. HMRC will publish lists of the schemes to which these provisions will apply.

Following an announcement in December 2010, a study group has been set up to explore the case for a General Anti-Avoidance Rule. The study group will complete its work by 31 October 2011.

The Government has committed to further consultation, if proposals are to be taken forward.

Specific anti-avoidance measures have been identified for consultation and potential legislation in Finance Bill 2012. These include arrangements where a claim is made under a Double Taxation Treaty in order to avoid UK tax, although the detail of the arrangements being targeted is not yet clear. The Government has explained that the approach would be in accordance with the generally accepted international principles as set out by the OECD. It has already been noted publicly that certain existing, specific UK anti-avoidance measures might be contrary to EU legislation, and it will be interesting to see how this new legislation might drafted.

A consultation document on employer asset backed pension contributions will be published later this Spring, with a view to introducing legislation in Finance Bill 2012. A consultation document on changes to the Capital Allowances anti-avoidance legislation, to prevent abuse of the rules on plant and machinery, will be published in May 2011, with a view to introducing legislation in the Finance Bill 2012. A further consultation document on mandatory pooling of fixtures will be published at the end of May.

The Government will also consult further on extending the definition of the hallmarks which identify avoidance schemes which need to be disclosed to HMRC. It is intended that the bank levy and Inheritance Tax (on transfers into trusts) should be brought within these provisions.

The document also highlights measures to enhance HMRC's detection capabilities, which include working with scheme promoters on the provision of lists of clients who have taken up avoidance schemes, with the first list being due by 30 April 2011.

The High Net Worth Units will also be better resourced, as wealthy individuals are identified as a group likely to engage in tax avoidance.

The publication "Spotlight" is available on the HMRC website. This highlights schemes which HMRC will challenge, and also identifies areas where taxpayers are already conceding that schemes have failed.

At the same time, the Government has amended its protocol on unscheduled announcements of changes in tax law. Ministers will undertake to observe the following criteria when considering pre-emptive changes to the legislation:

- without change there would be a significant risk to the Exchequer;
- significant new information has emerged to identify the risk or indicate its scale; and
- immediate action is expected to prevent significant losses to the Exchequer.

Legislative changes announced in this way will be confined to addressing the identified risk, with wider changes being introduced on a slower timetable. A change in HMRC's interpretation of the law (unless prompted by a Court ruling) will not be regarded as "significant new information".

The Protocol also recognises that retroactive change should be wholly exceptional, except where liabilities would otherwise be reduced.

18. TAX ADMINISTRATION

18.1 Matters for consultation

The Budget documentation contained announcements of consultations on a number of administrative issues, including the following:

i) the modernisation of some of the terminology in the tax legislation relating to incapacitated persons, which in some instances no longer meets appropriate standards

ii) the range of penalties which HMRC can charge for non-compliance with regulatory obligations across the tax regime

iii) further measures to be taken against dishonest tax agents

iv) the transparency generally of the administration of the personal tax system, and how it can be improved, including by the development of a new online tax calculator and other applications which can be downloaded for the taxpayer's use

v) mandatory online registration for the main business taxes (the Registration Wizard), the Government having already announced online VAT registration and deregistration and notification of changes from August 2012

vi) the rolling out of compulsory online VAT Return filing from April 2012 for businesses with turnovers of less than £100,000 (larger businesses and new businesses having already been required to do this since April 2010).

18.2 Office for Tax Simplification ("OTS")

The OTS, formed late last year by the present Government, has been busy, particularly in two areas:

i) it has been undertaking a review of the taxation of small businesses, and the Government's response to the first phase of this is awaited. It is now to move on to the second phase, which will focus on improving tax administration for small businesses. Any recommendations arising from this review will be delivered early enough for the Government to include in the 2012 Budget.

ii) As part of the small business review, the OTS considered the difficult issue of IR35, the term used to describe the anti-avoidance code designed to prevent individuals who would otherwise be classified as employees from providing their services via a personal company. Broadly, IR35 requires personal companies caught by the provisions to apply PAYE and NIC as though it were an employment. This has caused uncertainty in many cases and the legislation has been recognised as defective. Having taken account of the feedback from the OTS, the Government has elected to retain IR35 but will try to address its defects. It will do this by providing greater pre-transaction certainty (including a helpline), publish better guidance, restrict the number of case reviews (which will always now be conducted by specialists) and establish an IR35 Forum which will enable stakeholders to monitor the operation of the rules.

18.3 Tax Consultation Framework

The Government published a draft Consultation Framework in December 2010. The purpose of this document was to summarise how the Government would implement its intention to consult widely on many changes to tax law and policy, and to define the circumstances in which it did not consider prior consultation to be desirable. Having reviewed responses, the Government will shortly publish its final Consultation Framework.

This Briefing Note provides a commentary on those parts of the Budget which we think will be of specific interest to our clients and contacts.

The information contained in this briefing does not constitute advice and is intended solely to provide the reader with an outline of the provisions. It is not a substitute for specialist advice in respect of individual situations.

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