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BUDGET SUMMARY...

KEY POINTS

- The non-domiciled - further modification
- UK tax residence - counting nights
- Offshore Trusts - charge on capital payments
- Entrepreneurs Relief for CGT - further details
- Inheritance Tax - confirmation of transferable nil-rate band
- Inheritance Tax - clarification on Transitional Serial Interests
- Anti-avoidance - income-shifting provisions deferred
- Tax losses for sole traders - restrictions
- Changes to HMRC powers
- Restrictions on use of Tax Treaties
- Offshore Funds - helpful relaxation

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 first nine sections are of particular relevance to private clients and their family trusts while the next three cover Business Tax, VAT and Stamp Duty Land Tax, and final section is of general relevance.

1. OVERVIEW

The Chancellor's first Budget performance was eclipsed by the somewhat under-rehearsed previews given in the Pre-Budget Statement and through the publication and revisions of draft legislation over the new year. His air of confidence on the day could not eradicate awareness that he had to conceal some embarrassing u-turns - particularly on aspects of the taxation of foreign domiciliaries. Although one of the most eagerly awaited aspects, that issue merited only seconds of his speech, as if a brief reference would diminish its potential for embarrassment, but the accompanying Budget releases are copious, and significantly modify the draft legislation published in January.

However tempting it may be to dwell on this, it is important to recognise that both HM Treasury and HM Revenue & Customs ("HMRC") have been responsive to representations, and have been prepared to devote considerable resources to consultation. The modifications announced are a direct result of the process of consultation as is the provision made in the reformed Capital Gains Tax ("CGT") regime for a relief for entrepreneurs, effectively restoring the 10% rate of tax for gains up to £1,000,000 on business assets, when the flat rate of 18% is introduced from 6 April.

The new regime for foreign domiciliaries will still prove problematic and there remain difficulties, illogicalities and traps in the provisions now announced. It is to be hoped that both the Treasury and HMRC will remain open to representations to ensure that the law will be considered, fair and effective. The Government wishes it to be clear that this issue will be closed for the remainder of this Parliament (and the next!); hence the opportunity to ensure fair and workable legislation must now be taken, and the Government should remain prepared to consider a statutory residence test, a reform of the CGT provisions relating to gains in foreign companies, and a continuing consultation on proposals for the reform of the taxation of offshore income gains.

Otherwise, the proposals demonstrate the effectiveness of the scheme disclosure provisions. Targeted anti-avoidance rules are announced - further general rules are threatened. The tendency of the Government to over-ride international tax treaties continues, and while some reforms are apparently held up by EU considerations, others which seem discriminatory are pursued.

The Budget Notes run to 270 pages, supplemented by additional releases on specific issues. It would seem likely that the Finance Bill will be of epic proportions.

2. UK TAX RESIDENCE

2. The Residence Test and Day Count

Under the current practice described in HMRC's booklet, IR20, days of arrival and departure are generally ignored in determining whether the individual is resident in the UK for tax purposes. The Pre-Budget Report in October

proposed that all days and part days spent in the UK, including those of arrival and departure, should be counted. A limited exception was to apply to transit passengers remaining airside. This would have provided one of the strictest tests for residence anywhere in the world.

As a compromise, the Government has announced that days will only be counted where the individual is present in the UK at midnight. Therefore, an individual arriving in the UK on Monday and leaving on Thursday morning will have spent three days in the UK for residence purposes under the new rules. This would have counted as two days under the current rules, but as four under the Pre-Budget proposals and January draft legislation.

The conditions for qualifying as a transit passenger are also relaxed. Originally, such passengers would have had to remain in the restricted area of a port or airport. This would have been of no help to people who were required to change airport (or in some cases terminals). Under the Budget proposals, passengers changing airports, airport terminals or switching between different modes of transport, will not be regarded as present, even if in the UK at midnight. This is dependent upon their not engaging in activities "to a substantial extent unrelated to their passage through the UK", such as holding business meetings. In these circumstances, the transit exemption will be denied

Statutory legislation on residence is sparse and the only statutory "day count" relates to the "183 day test" through which these changes will be enacted. The test, under which a visitor is not treated as resident unless his visits over a four year period exceed 90 days per year on average, derives from HMRC's practice and case law; much of that case law is old and some contradictory. HMRC will update IR20 to incorporate the new basis for the day count to the 90 day test. This approach is of questionable validity, and it is disappointing that the opportunity to produce a comprehensive statutory test for residence providing much needed clarity has been missed.

3. TAXATION OF UK RESIDENT FOREIGN DOMICILIARIES

The principal elements of the new regime for the taxation of foreign domiciled residents of the UK follow the policy announced in the Pre-Budget Report, but with significant modifications.

3.1 £30,000 charge for long-term residents claiming the remittance basis

The headline proposal in the Pre-Budget report was the introduction of a £30,000 charge, if the taxpayer has been resident for seven out of the previous nine years in order to continue to benefit from the remittance basis. It is confirmed that this charge will apply from 6 April 2008. A de minimis level of £1,000 was originally proposed. This is to be increased to £2,000.

Although the £30,000 charge is in addition to tax due on remitted foreign income and gains, it has already been announced that so long as it is paid from a foreign source direct to HMRC by cheque or electronic transfer, the payment will not itself be taxed as a remittance.

As a result of intense lobbying, the Government will further amend the draft legislation so that:

- i) The £30,000 charge will only apply to adults. Therefore, children under the age of 18 will not be liable to the charge until the year they turn 18. However, it will otherwise remain a per capita charge, and spouses will have to consider independently whether to pay.
- ii) The nature of the charge has been altered from a stand alone charge to a tax charge on unremitted income and gains.

The change from a stand-alone charge to a charge on unremitted income and gains (or a combination of both) is an attempt to ensure that the payment can be regarded as income tax or capital gains tax. The Government therefore expects the charge to be eligible for relief under Double Taxation Agreements, subject to the terms of individual treaties. It has not, however, yet obtained confirmation from the United States Treasury or the IRS that it will be eligible for credit against US tax. A legal opinion has been posted on the HM Treasury website arguing that credit in the US should generally be available but this is not definitive.

It has been confirmed that the £30,000 payment will be available to cover Gift Aid donations.

A taxpayer paying the £30,000 charge can choose the unremitted foreign income or gains to which the £30,000 payment should relate. Those unremitted income or gains will not then be taxed if subsequently remitted to the UK. However, as yet unknown ordering rules will be introduced, so that untaxed foreign income and gains are treated as remitted in priority to foreign income or gains on which the £30,000 charge is paid. Consequently, it may be necessary for an individual to remit all foreign income and gains to get full credit.

Where an individual can claim the remittance basis, the taxpayer can choose each year whether to do so, or instead to pay tax on worldwide income and gains. The £30,000 charge need not therefore be paid for a year where the cost would not be worthwhile in comparison with a liability based on worldwide income or gains.

3.2 Personal allowances and the remittance basis

Under current legislation all UK residents, including foreign domiciliaries liable to tax on the remittance basis, are entitled to a personal allowance against income and an annual exemption for capital gains.

With effect from 6 April 2008, entitlement to the personal allowance (and smaller allowances such as blind person's allowance and married couple's/civil partner's allowance), and to the annual CGT exemption, will be lost for any tax year where the remittance basis is claimed. There will be an exception for those whose

unremitted income and gains in the year are less than the (revised) de minimis level of £2,000.

Personal allowances and the annual exemption will continue to be available for any year in which a taxpayer chooses not to claim the remittance basis for offshore income and gains.

3. Alienation

It has been confirmed that provisions will be enacted to tax as remittances of income or gains amounts which have been given away, either to connected entities such as an offshore company or trust, or to an immediate family member, and then remitted to the UK.

The definition of an "immediate family" member is less widely drawn than in the original proposal, although it will still include spouses, civil partners, individuals living together as spouses or civil partners and their children or grandchildren under 18. Any close company (or company that would be close if it were UK resident) of which any of the above immediate family members is a participator, or any trust of which an immediate family member is a beneficiary or settlor, will be caught by these provisions.

Whilst this is a welcome improvement on the original draft, and gifts to adults other than spouses will in general not be caught, deficiencies remain. In particular, the inclusion of companies and trusts may cause many traps, whereby remittances may occur without the knowledge, and without benefit to the taxpayer. In particular, concern was expressed that foreign trusts may have to remit to pay UK expenses, including professional fees for the advice they need to take. It is still to be hoped that HMRC will seek ways of ensuring that UK services can be provided to trustees without the settlor being treated as having remitted funds as a result.

3.4 Definition of Remittance

Under the current rules, relevant foreign income (broadly income ("RFI")) can only be taxed if brought into the UK as cash. Where assets purchased out of RFI were brought to the UK, no UK tax is currently charged unless and until the asset is sold or otherwise turned into cash in the UK. From 6 April 2008, money, property and services derived from RFI brought into the UK will be treated as remittance of that income. It is considered that this aligns the rules with those existing for assets purchased out of overseas employment income and capital gains.

The original proposals covered any assets brought to the UK, including personal items such as expensive watches or jewellery. There were doubts as to how this would be policed! The Budget proposals are more sensible and allow exemptions for personal effects such as clothes, shoes, jewellery and watches, and any assets costing less than £1,000. Assets brought to the UK for repair and restoration, or assets in the UK for less than nine months in total, are ignored.

The new rules do not apply to an asset owned by an individual on 11 March 2008 for so long as he continues to own it even if it is subsequently brought to the UK. Similarly, where an asset is in the UK on 5 April 2008 the rules do not apply if the asset is exported and then later re-imported to the UK. However, where such assets are converted into cash in the UK, the current rules providing for a tax charge on the income used to acquire it remain in force.

Following substantial lobbying from the major galleries, there has been a significant concession where works of art are brought to the UK for public display. Where a work of art was purchased from unremitted employment income or gains its import under the current rules was felt to give rise to a taxable remittance of that employment income or gains in the UK. The original proposals in the Pre-Budget Report confirmed this treatment and extended it to works of art purchased from RFI.

The Government now propose to exempt works of art brought to the UK for public display where they are purchased out of any type of foreign income or gain. This relaxes existing rules for assets purchased out of overseas employment income and gains.

It will cover works of art on public display in an approved establishment, and works held by such establishments for either educational purposes or for the public to see on application. The scheme mirrors the rules covering VAT and import duty on such works.

3.5 Offshore Mortgages

Considerable numbers of non-domiciled residents of the UK have purchased UK property funded by mortgages with foreign lenders. While repayment of the principal is treated as a remittance of the funds so applied, where the completion of the purchase took place outside the UK, the loan was generally not regarded as a "UK linked debt". In such a case repayments of principal from RFI could be made without giving rise to a taxable remittance to the UK. In any event, it was possible to meet the interest arising on overseas loans from unremitted foreign income and gains without attracting a tax charge. The draft legislation published on 18 January made it clear that repayments of the principal on such loans will be treated as a remittance on or after 6 April 2008 if made out of unremitted income or gains of all types. It was not clear whether the servicing costs – the interest payments – would also be caught, although HMRC subsequently stated that it was their intention that they should be. There was considerable concern about the likely impact this would have, particularly on the London property market where there is a concentration of non-domiciliaries owning highly geared properties and paying consequentially high interest charges.

HMRC has announced that interest payments made on existing offshore mortgages secured on residential property in the UK will not be treated as a remittance after 6 April 2008 for the remaining period of the loan or until 5 April 2028, whichever is earlier, provided they are

paid out of RFI. Furthermore, where existing loans are varied, further advances are made, or new loans taken out after 12 March 2008, interest payments will be treated as remittances from that point. Repayments of principal made out of offshore income and gains will be treated as remittances for new and existing mortgages.

While this looks to be a generous compromise from the earlier announcements, it is restricted. It only covers loans for residential property in the UK, not those taken out to invest in shares, commercial property or UK businesses. Furthermore, it only covers payments made out of RFI. Overseas employment income and gains used to fund such payments would be taxed as a remittance. This is illogical given the Government's earlier stated intention to apply the same rules to all types of income and gains. It is unclear whether it would apply to mortgages in settlor interested trusts.

The legislation will need careful scrutiny to establish whether a change from a fixed to a variable interest rate would constitute a variation in the terms of the loan. Where further funds are required, a separate facility may be necessary if the tax status of the interest payments on existing arrangements is not to be compromised.

3.6 Remittances from mixed accounts

There are currently no statutory rules to identify the nature of remittances made from accounts holding a mixture of untaxed RFI, employment income, capital gains, taxed income or gains and capital. The draft legislation published on 18 January 2008 provided an order of priority for determining the types of taxable and non-taxable funds to which transfers made from that account should be matched. These rules were complex, involving as they did an order of priority for matching funds credited to the account in a tax year, and where the credits for that tax year were extinguished, going back in time with the same order of priority in each year. The Budget Report does not confirm these rules, but, somewhat unhelpfully, merely states that the rules to be published in the Finance Bill will be more comprehensive than those in the draft legislation.

3.7 Ceased Source

Until now, RFI income has only been taxed on remittance to the UK if its source still exists in the year of remittance. This gave rise to an established planning technique whereby once a source of income had ceased, (for example when a rental property is sold), the income that has accumulated from that source could be remitted to the UK tax-free in the following tax years. When counter-measures were announced in the Pre-Budget Statement in October, there was little surprise, and the draft legislation published on 18 January to bring source-ceased income into charge has merely been endorsed in the Budget Statement.

From 6 April 2008, therefore, income that has arisen from a source that has ceased will be taxable as a remittance of that income. This (despite representations and some indications of sympathy from the authorities) appears to be the case even where the source ceased

some years ago and the income may long have been assumed to have been capitalised. Where individuals may require these funds in the UK at some point in the future, consideration should be made to remitting the funds prior to 5 April 2008.

3.8 Claim Mechanism - Remittance in a year in which the remittance basis is not claimed

It has been confirmed that foreign savings and investment income which are subject to the remittance basis and arise to an individual resident in the UK will remain taxable if remitted in any subsequent year in which the individual is resident, regardless of whether the remittance basis is claimed by the individual for that year.

3.9 Accrued Income Scheme

It is confirmed that the provisions of the Accrued Income Scheme, which deem a proportion of the sale proceeds of certain bonds to be income for tax purposes, will apply to foreign domiciliaries with respect to non-UK bonds from 6 April 2008, such deemed income being RFI and taxable on the remittance basis (if claimed).

This change will also result in these provisions applying to settlor-interested overseas trusts so that the deemed income treated as income of the trust will be treated for UK tax purposes as income of the settlor, again subject to the remittance basis. A remittance by the trustees in such cases (for example by UK investment or payment of UK expenses) would cause a liability to arise on the settlor.

3.10 Transfer of Assets abroad

The extended definition of a remittance will also apply in respect of income deemed to be that of a foreign domiciled individual under the transfer of assets abroad provisions.

Again, payment for UK services by foreign trustees or companies may then cause a settlor to be taxed as having made a remittance.

3.11 Capital Gains Tax Losses

The draft legislation published in January would have denied relief for losses to foreign domiciliaries even if they did not claim the remittance basis. This has happily been reconsidered, and if the remittance basis is not claimed from 2008/2009 onwards, loss relief will be available.

It will also be open to foreign domiciliaries who claim the remittance basis irrevocably to elect to be allowed to claim relief for overseas capital losses in future years in which they do not claim the remittance basis. However, such an election will require the disclosure of unremitted gains in years for which the remittance basis is claimed, and this may prove a powerful disincentive to making such an election, not least in terms of additional compliance, for many such individuals.

3.12 Residence, Domicile and Employment related securities

Gains realised on certain employment related securities (for example on the exercise of unapproved options) are subject to Income Tax. Currently where an employee is resident but not ordinarily resident, and performs duties of an employment in the UK and overseas, HMRC will usually only tax the element attributable to UK duties as it arises, with the non-UK element subject to the remittance basis. Such arrangements commonly benefit investment bank employees where options relate to shares in foreign parent companies.

Legislation is to be introduced which will codify this treatment where on or after 6 April 2008 employment-related securities are acquired by or options are granted to employees who are not ordinarily resident, in respect of both UK and non-UK work duties. The legislation will confirm that income gains from employment-related securities relating to duties outside the UK, will only be subject to tax to the extent they are remitted.

A similar basis should be available to non-domiciled individuals where the income gain is not remitted, and relates to a foreign employment where the duties of employment are performed wholly outside the UK.

3.13 Remittance basis and foreign dividend income

Resident but non-domiciled individuals are liable to UK tax on remittances of dividends from foreign companies. Although not accepted by HMRC, there is good reason to conclude that the original legislation (ICTA 1988) provided, on a proper reading, that the rate of tax applicable to dividends for higher rate taxpayers was 32.5% (with allowances, where, applicable, for any foreign tax credits). HMRC deny this reading, maintaining that the statutory rate (for higher rate taxpayers) was 40%.

The Tax Law Rewrite Committee was established to update and clarify certain parts of the law. The Committee reviewed the section dealing with remitted foreign dividends and this resulted in unambiguous legislation (ITTOIA 2005) confirming the appropriate rate of tax as 32.5%. HMRC accepted that this would apply from 6 April 2005. There are a number of taxpayers in the UK for whom the amounts are material, who are contesting HMRC's assertions that the 40% rate had previously applied.

HMRC contend that the 32.5% rate included in the revised Act was an error which resulted in an unintentional change in the law, which the Rewrite Committee did not have the power to introduce. The Budget announces an amendment to ensure that the 40% rate will apply to remittance basis users who remit foreign dividends.

It is questionable whether any attempt to apply a different rate of tax for foreign domiciliaries claiming the remittance basis to that for other UK residents would not be considered discriminatory under European Law.

4. OFFSHORE TRUSTS AND COMPANIES

4.1 Non-Resident Trusts - Capital Gains

The draft legislation published in January contained changes to the taxation of income and gains arising to non-resident trusts. These have been the subject of intensive lobbying, as much of what was proposed was draconian, and retroactive in effect, and would have constituted a significant disincentive to investment in the UK.

The current rules exempt non-domiciled settlors and beneficiaries of overseas trusts from CGT in respect of capital gains arising to overseas trustees and capital distributions made to them, whether brought to the UK or not. This will change on 6 April 2008.

The draft legislation would have imposed a CGT charge in different ways, depending upon whether the trust was "settlor interested" or not. Where it was "settlor interested" (and the settlor a UK resident claiming the remittance basis) the legislation would have taxed the settlor on any UK gains as realised, and any foreign gains remitted. However, the settlor would also have been taxable on any gains attributed to capital payments made, whether remitted to the UK or not. Non-settlor beneficiaries would have been subject to the attribution charge on capital payments made, again whether remitted to the UK or not. It would thus have been impossible to avoid UK CGT if benefits were derived from a trust even if conferred and retained outside the UK. In February, HMRC announced significant concessions. A proper remittance basis would apply and unremitted gains would not be taxed on those claiming the remittance basis. Furthermore, it was announced that gains realised or accrued before 5 April 2008 and capital payments made before that date would not be taxed.

The Budget proposals involve further significant modifications.

They may be summarised as follows:

- i) Foreign domiciled settlors (whether or not the remittance basis is claimed from 6 April) will not be subject to the settlor charge.
- ii) all beneficiaries (including the settlor) will be subject to the attribution charge, which allocates trust gains to capital payments made or benefits received on or after 6 April.
- iii) foreign domiciled beneficiaries (who claim the remittance basis) will be taxable only if a capital payment is remitted to, or a benefit received in, the UK.
- iv) capital payments made to foreign domiciliaries before 6 April 2008 will not be taxed even if attributed with post-April gains and regardless of whether the remittance basis is claimed in the year concerned.
- v) foreign domiciled beneficiaries (whether or not claiming the remittance basis) will not be taxed on capital

payments made after 5 April 2008 to the extent that these are matched with pre-6 April gains.

- vi) trustees will be given an option to rebase assets within trusts and certain underlying companies as at 5 April 2008.
- vii) matching rules for capital payments made after 5 April are revised, and transitional rules apply to payments made between 12 March and 5 April (to discourage distributions in excess of realised or rebased gains).

While the original proposals have been greatly modified, non-domiciled beneficiaries of offshore trusts will no longer enjoy an exemption from Capital Gains Tax where they receive capital payments which can be matched to trust gains after April. The Government's decision to drop the settlor charge for non-domiciliaries is a welcome sign of their willingness to listen to the concerns expressed about the possible impact of their proposal, particularly on long established UK property holding structures. It was difficult to see how coherent provisions for the remittance basis could be drafted, and it was recognised that to charge settlors on UK gains arising would be a disincentive to inward investment and cause many trusts to dispose of UK assets before 5 April.

The provisions which operate to allocate gains made within foreign trusts to capital payments made to beneficiaries will in future apply to non-domiciliaries, (as will the supplemental charge where there is a delay between the realisation of a gain and a capital payment being made). Capital distributions to which post-5 April gains are matched will be taxable on either an arising or remittance basis depending on the claim made by the recipient beneficiary in the year of receipt. The remittance basis will apply, where claimed, to the capital payment itself, even if the gain made by the trustees is on the disposal of a UK situated asset. The test is whether the property comprised in the capital distribution has been received in or brought to the UK, or if a benefit in kind has been enjoyed or used here.

4.2 Gains realised and payments made before 6 April 2008

There are provisions to prevent this charge from having a retroactive effect. Capital payments received and gains realised before 5 April 2008 will not give rise to a tax charge for a non-domiciled beneficiary, (whether the remittance basis is claimed after 5 April 2008 or not). The position is more complex where capital payments are received after 5 April 2008. These will be first matched against post-5 April 2008 gains on a Last in First Out ("LIFO") basis; only where the post-5 April 2008 capital payment exceeds the post-5 April 2008 gains, will it be matched against pre-5 April 2008 gains (and as a result not be taxable).

4.3 Rebasing election

A rebasing election will be available which will allow Trustees to elect to identify unrealised gains accrued in the trust fund as at 5 April 2008 and allocate these to the pre-April pool, thus taking them out of charge when allocated to capital payments to foreign domiciliaries.

The facility will allow the trustees of any non-UK resident trust - regardless of the domicile position of the settlor - to make an irrevocable election to deem that all assets owned by the trust on 6 April 2008 including those held by an underlying company, whose gains are apportionable to the trustees, are revalued to their market value as at that date. The election, if made, will apply to all of the assets of the trust and its underlying companies: the trustees cannot pick and choose which assets to rebase. It must be made on or before 31 January following a tax year in which either a capital payment is made to a UK resident beneficiary, or a transfer of part – but not the whole – of the trust fund is made to a new settlement where gains are attributable to the transfer.

The election does not trigger a deemed disposal and re-acquisition of the assets, but simply enables future gains realised to be allocated between those accruing in the period prior to 6 April 2008 and those thereafter. The gains attributable to the earlier period are only added to the pre-5 April 2008 pool when the assets are sold after 5 April 2008 and the gains are realised. (The consequences of a fall in value between 5 April 2008 and sale is not clear). Where a non-UK domiciled beneficiary receives a capital payment after 5 April 2008, and there are gains realised after 5 April 2008, the gain accruing before 6 April will not give rise to a tax charge in the hands of the non-domiciled recipient. UK domiciliaries in receipt of capital payments will continue to be taxed on the entirety of the gain.

Where any reliefs are available against the gain, these will be given on the basis of the rules applying at the date of the disposal, and the impact of any such relief will be apportioned between the pre and post 5 April 2008 gain.

The election does not disturb the date on which the gain is made and thus does not affect the date on which a gain may be attributed to a UK resident and domiciled settlor or the point from which the supplementary charge applies.

4.4 Matching payments to gains

Capital payments made after 5 April 2008 will be matched first to gains made after 5 April 2008 on a LIFO basis. Only when the gains arising after 5 April 2008 are exhausted will the payment be matched against gains realised before 5 April 2008 or pre-5 April 2008 gains arising as a result of a rebasing election, neither of which would give rise to a tax charge provided the beneficiary remained non-UK domiciled when the payment was received.

As noted above, capital payments made before 5 April 2008 do not give rise to a tax charge provided the beneficiary remains non-UK domiciled when post-5 April 2008 gains are made by the Trustees. If they were made before 12 March 2008, they can be used to absorb gains arising after 5 April 2008 (and take them out of tax in respect of future capital payments) but only to the extent that in the year the gains arise there are no capital payments, which would have priority, and no pre-5 April 2008 gains on a rebasing election. Surplus capital payments made between 12 March and 5 April 2008 will not be matched against post-5 April 2008 trust gains.

4.5 Trustee Borrowing

In certain situations it may make sense to make capital distributions prior to 5 April 2008 on the basis that these will not be taxable on foreign domiciled individuals. Where the trustees wish to make capital distributions prior to 5 April 2008 but do not have significant liquidity they may wish to borrow funds to fund the payment. Although there are anti-avoidance provisions that can trigger a deemed disposal and re-acquisition of trust assets in such situations, these gains would crystallise prior to 5 April 2008 and they would not be taxed on a foreign domiciliary (although they could be taxed on a UK resident and domiciled beneficiary receiving a distribution).

4.6 Supplementary Charge

Capital payments which attract gains realised in earlier years are liable to a supplementary charge. The effect of this is to increase the rate of CGT to a maximum of 28.8% (after six years). The supplementary charge will apply in respect of gains attributed to foreign domiciliaries after 5 April, but those who claim the remittance basis will have the charge calculated by reference to the date of the capital payment, rather than the remittance, and so will suffer no additional penalty by retaining the payment offshore.

The proposal to match capital payments to gains on a LIFO basis will also affect UK domiciled beneficiaries of offshore trusts and the calculation of the supplemental charge. The impact of the LIFO basis on the supplemental charge will be beneficial for them.

4.7 Non-Resident Trusts - Offshore Income Gains

When draft legislation was first published, it appeared that Offshore Income Gains ("OIG"s) arising to non-resident settlor-interested trusts would be taxable on the settlor as they arose. It is now confirmed that the remittance basis will apply, but with more onerous results both in terms of the rate applicable (the income tax rate) and the criteria for remittance (which could include remittance by the trustees in the case of a settlor-interested trust) than for capital gains.

In the case of settlor-interested trusts, if the settlor is UK resident and domiciled, the provisions will result, as they do now, in a charge to income tax on the full amount of the OIG in the year in which it arises, although this may be achieved through the interaction of two separate charging provisions.

In the case of settlor-interested trusts with a non-domiciled settlor claiming the remittance basis, the OIG will be taxable only if remitted to the UK, whether by the individual or in certain circumstances by the trust. Again, there are two separate provisions that achieve this result, and tracing the OIG to the point it is remitted may well be far from easy in most common circumstances.

The rebasing election described above will apply to OIGs as to other gains.

4.8 Disclosure

The draft legislation would have required disclosure of all trusts settled by a UK resident but foreign domiciled settlor after 1991. It has been recognised that these provisions were inappropriate and they are not to be implemented. There will be no automatic disclosure requirements although HMRC's enquiry powers will remain, and offshore trustees who elect for rebasing will effectively have to disclose.

4.9 Non-Resident Companies

As previously announced, the provisions which attribute gains realised within non-resident companies (which would be close companies if resident in the UK) to participators will be extended to foreign domiciliaries, but with the benefit of the remittance basis if this is claimed by the participator. Minor amendments to the draft provisions have been promised, but no details as to the nature of these amendments has been provided.

Most seriously, there are no proposals for the rebasing of assets held by a non-resident company in individual, rather than trust ownership. This would seem to be a retraction of statements previously made and it is hoped that it will be reconsidered. It is also disappointing that the opportunity has not been taken to revise thoroughly these provisions, whose penal effect has partly been concealed up to now by the exemption previously provided to foreign domiciled participators. The code is devoid of any motive defence and can easily lead to double taxation as gains apportioned are eventually realised. Again, it is hoped that the desire to finalise these proposals will not prevent consultation or necessary reforms.

5. ENTREPRENEURS' RELIEF FOR CGT

5.1 Entrepreneurs' Relief

The Chancellor has confirmed that a unified rate of Capital Gains Tax ("CGT") of 18% will apply from 6 April 2008, and that taper relief, differentiating between business and non-business assets, and indexation allowance will be abolished. However, in a press release issued on 24 January, he confirmed that a new CGT relief will be introduced for certain disposals of business-related assets, called "Entrepreneurs' Relief" which will apply to transactions on or after 6 April 2008.

The relief will operate on a cumulative basis, with a lifetime limit of £1m on eligible gains. However, any gains on disposals prior to 6 April 2008 will be ignored when calculating the relief available.

The effective tax rate on eligible gains will be 10% (achieved by applying an abatement to the actual gain and taxing the residue at the flat rate of 18%). To the extent that cumulative qualifying gains exceed the £1m limit, they will be taxed at 18%.

Entrepreneurs' Relief will also apply to certain disposals by trustees who own an interest in a business or

partnership with which a qualifying beneficiary is involved, or shares in a company of which such a beneficiary is an employee or director. For these purposes a qualifying beneficiary, broadly, is one with a fixed interest in the trust.

For disposals of a business or an interest in a business, gains will be eligible for the 10% effective rate if they derive from a trade, profession or vocation, including the commercial letting of furnished holiday accommodation in the UK. The individual (or the trustees) must have owned the business, or been a member of a partnership which owns the business, throughout a period of at least one year ending with the disposal.

Where the business is not disposed of but simply ceases, relief will be available in respect of gains on assets in use at the date of cessation of trade, provided that these are disposed of within three years.

Relief will also be available in respect of gains on the disposal of shares and securities in a trading company or the holding company of a trading group. In order to qualify, the individual making the disposal must have been an officer or employee of the company concerned, or of a company within the same group for at least one year immediately preceding the disposal. He must also have owned at least 5% of the shares in the company or held at least 5% of the voting rights, for at least a year.

In cases where the relief is claimed in respect of shares or securities and the company has ceased to trade, the one year minimum holding period ends on the date of cessation of trade and the actual disposal (for example on a liquidation of the company) must be made within a further three years.

Relief is extended to cover not only gains on the disposal of shares or securities but also certain "associated disposals", for example where a director sells both qualifying shares and a commercial property from which the company concerned carries on its trade.

Finally, Entrepreneurs' Relief will be available in respect of certain deferred capital gains where, for example, shares or securities are exchanged for other shares and securities and no tax charge arises at the date of the exchange because of the "paper for paper" CGT roll-over. In such cases it will be possible to claim Entrepreneurs' Relief at the time of the initial transaction, either by disapplying the normal roll-over provisions, or by reducing the amount of the deferred gains to reflect the relief.

These provisions are by no means as broad as Business Asset Taper Relief and those holding assets which currently qualify for full taper should still consider action before 5 April.

6. OFFSHORE AND UK FUNDS

The Budget contains provisions which affect the UK tax treatment of offshore funds. There are two measures, both intended (according to the Press Releases) to be helpful.

6.1 Investment Manager Exemption (IME)

The IME permits offshore funds to engage independent investment managers in the UK without the fund being treated as having a UK branch. The primary legislation and rules are scattered across three Acts and four Statutory Instruments and have been amended on several occasions. On this occasion, the amendments are:-

- A consolidation, in a single list, of the types of transaction which fall within the IME. It is to be hoped that the list, when published, will include all those presently permitted.
- A relaxation of the implications if a transaction is undertaken which falls outside the Exemption. The current legislation can imply that a single transgression is sufficient to taint all transactions by the investment manager on behalf of that particular fund. The draft legislation will make it clear that the fund will only be exposed to UK tax in relation to non-qualifying transactions.

6.2 Offshore funds

Under current law, an offshore fund wishing to secure CGT rather than income tax treatment for its investors is required, in addition to meeting certain investment criteria, to distribute at least 85% of its income within six months of each accounting period and be certified by HMRC as a distributing fund. The Finance Bill will contain provisions which make three changes to the current regime:-

- The requirement to make annual distributions is to end. Instead, a fund may undertake to be a "reporting fund" by reporting the income to its investors who then pay tax annually on their share. It is hoped that there will be provisions for a deduction for reported income from the eventual gain.
- There are likely to be further relaxations in the conditions necessary for an offshore fund to qualify for reporting fund status, a test which will be applied initially but not repeated annually.
- It is intended that minor breaches of the conditions will be treated more sympathetically and need not result, as now, in the fund losing its more favourable status.

While certain aspects are welcomed, there may well be considerable disappointment that alternative reliefs have not been announced to enable investors in foreign funds which are unwilling to comply with UK requirements either to initiate the reporting process or to elect for a regime which taxes a deemed level of distributions while retaining the CGT rate for capital growth. The reduction of the CGT rate introduces the potential for a significant imbalance in the taxation of foreign collective investment schemes, which may be essential ingredients of a modern portfolio. It is hoped that the regulations will recognise this.

It is not clear how the position of a foreign domiciliary claiming the remittance basis, and who invests in a reporting fund which does not actually distribute but re-invests its income, would be dealt with. It is to be hoped that the CGT rate would not be entirely denied if the proceeds were eventually remitted.

6.3 Tax Treatment of certain UK authorised funds

The range of investment activity permitted by FSA authorised funds has expanded to accommodate an appetite for innovative asset classes. However, while a Corporation Tax exemption has long been in place for UK authorised funds with traditional investment strategies, this has not covered funds pursuing investment in alternative asset classes such as hedge funds or real estate. Two provisions have been announced, designed to improve the tax treatment of certain types of new UK authorised funds:

1. The FSA has made provision for UK funds to be designated Funds of Alternative Investment Funds ('FAIFs'). These regulations cater for UK funds seeking to invest primarily in offshore non-qualifying funds such as hedge funds. UK authorised funds having FAIF status will be able to elect into the 'Tax FAIF regime', which will mean that the fund itself will be exempt from tax on the offshore income gains it realises. Instead, the investor will pay income tax when he disposes of units in the FAIF, rather than Capital Gains Tax. In effect, this moves the charge to tax from the fund to the investor, and would encourage foreign resident investors.
2. Authorised Investment Funds which invest principally in real estate, UK REITs or foreign equivalents will also be able to elect into a new tax regime similar to that described above. Rental profits and related income in the fund would be exempt from tax at fund level, but would instead be distributed to investors under deduction of basic rate tax. The investor may then have higher rate tax to pay or may be entitled to a tax refund. Such a regime would be preferable to the current system whereby the UK fund pays Corporation Tax on the profit and then distributes the net amount to the investor as dividend, with the prospect of further income tax on the distribution.

Both measures will assist in making UK authorised funds more attractive to the foreign investor, whilst reducing the overall tax leakage on the investment for a UK investor.

7. PERSONAL TAXES

7.1 Changes to Personal Tax Rates and Allowances

From 2008/09 the basic rate of tax will be reduced from 22% to 20%. The 10% starting rate will be abolished except for individuals whose savings income (excluding dividends) is less than £2,320. The 20% basic rate of tax will apply to income up to £36,000 and the 40% higher rate of tax will apply to income over £36,000, but dividend income will continue to be taxed at 10% for basic rate taxpayers, and 32.5% for higher rate tax payers (except for foreign dividends taxed on the remittance basis).

The personal tax allowance will be increased to £5,435, and the age allowances for those over 65 and 75 will be increased to £9,030 and £9,180 respectively. The income limit for the age related allowances is increased to £21,800.

Full details of the rates and allowances are given in the Rate Card.

7.2 Anti-avoidance: Loss Relief For Individuals

Finance Act 2007 introduced new anti-avoidance rules to limit the “sideways” loss relief which could be claimed by certain partners in trading partnerships. The partners in question were “non-active” spending an average of less than 10 hours per week on the trading activities of the partnership. The rule limited the sideways loss relief which they could claim to an aggregate maximum of £25,000 per tax year. The principal targets were investors in film partnership structures marketed as retail tax shelters.

These provisions are now to be extended to cover individuals carrying on sole trades on a non-active basis, thereby frustrating certain tax schemes which aim to circumvent the 2007 legislation. The same £25,000 aggregate trading loss limit will apply and all arrangements made on or after Budget Day are affected. Transitional rules will apply to the computation of losses where a sole trader’s basis period straddles 12 March 2008.

There is concern about the scope of these provisions, and it remains to be seen whether they could affect, say, those engaged in share, or managed farming arrangements.

7.3 Taxation of Foreign Dividends - further provision

As noted in paragraph 3.11, foreign domiciliaries electing for the remittance basis of taxation will not benefit from the dividend rate on foreign dividends when remitted.

For other UK individuals (UK domiciliaries and those not electing for the remittance basis) changes to the tax on dividends received from foreign companies are being introduced with effect from 6 April 2008. The proposals were originally announced in the 2007 Budget in response to a European Law ruling, and will ensure consistency in the taxation of foreign and UK dividends. This will mean that an individual will be entitled to a tax credit so that the rate of tax would be the same whether the company is UK resident or not, giving an effective rate of zero for basic rate taxpayers and 25% for higher rate taxpayers. Between 6 April 2008 and 6 April 2009 this will only apply to individuals with a shareholding of less than 10% in the non-resident company.

This tax credit will not be available if the source country does not levy a tax on corporate profits similar to Corporation Tax and there will be anti-avoidance provisions to ensure the new rules are not abused.

It is not yet clear how the new rules will interact with the existing rates of foreign tax credit as determined by countries with which the UK has an existing Double Taxation Agreement. However, it would be logical to assume that there would be no additional advantage given by the new provisions over and above existing foreign tax credit relief.

7.4 Venture Capital Schemes

The Enterprise Investments Scheme (“EIS”) gives 20% Income Tax relief on investments in certain unlisted trading companies. The maximum amount on which this relief can be claimed is being increased from £400,000 to £500,000 per year from 6 April 2008, although this is subject to obtaining approval from the European Commission. EIS investments will continue to benefit from exemption from CGT if the shares are held for three years or more, and in certain situations it may be possible to defer CGT arising on other disposals when making an EIS investment.

For Venture Capital Trusts (VCTs) the Income Tax relief will remain at 30% of the amount invested up to a maximum of £200,000 per tax year. Subject to certain conditions, dividends will continue to be payable tax-free and gains exempt from CGT.

In order to qualify for both EIS and VCT relief, there are certain restrictions on the activities of the companies concerned. With effect from 6 April 2008, shipbuilding and coal and steel production will be added to the list of excluded activities and new investments will not qualify for the relief.

7.5 Enterprise Management Incentives

Enterprise Management Incentive (EMI) share options are a highly tax efficient form of share options. In particular, the employee will not suffer an Income Tax charge when the option is exercised and will ultimately pay Capital Gains Tax on the entire growth in value, which for disposals after 6 April 2008 will be at the 18% rate. Furthermore, the employer may be able to claim a Corporation Tax deduction when the option is exercised.

From 6 April 2008 the limit on grants of EMI qualifying options for individual employees will be increased from £100,000 to £120,000.

There are a number of conditions to be met if share options are to qualify for EMI treatment. Most notably, the company must not have gross assets exceeding £30,000,000, nor be carrying on one of the excluded trading activities. These conditions are to be extended so that:

- EMIs will be limited to qualifying companies with fewer than 250 employees; and
- Companies involved in shipbuilding, coal and steel production will no longer qualify for EMI.

These restrictions are being introduced in order to comply with EU State Aid guidelines and will come into force for options granted after Royal Assent.

7.6 Income of beneficiaries under settlor-interested trusts

Legislation will be introduced to rectify an unintended consequence of the provisions of Finance Act 2006. This will affect individuals who receive discretionary income payments from a settlor-interested trust and who also receive savings or dividend income.

The income of a 'settlor-interested' trust is deemed to be that of the settlor and tax paid by the trustees of such trusts is treated as paid on his or her behalf. Although poorly drafted, in practice this adequately covers the situation where income payments are made to the settlor alone. However, to avoid the double taxation which would otherwise result where income is paid to another beneficiary, Finance Act 2006 provided that such income should carry a non-repayable 'notional' tax credit equal to the higher rate of tax, currently 40%. The purpose of the tax credit is to cover all of the tax liability on the trust income so that no further tax is due on the discretionary income payment.

However, under the current statutory ordering rules, income from a trust is charged to tax before both savings and dividend income and this can result in a beneficiary who also has savings and/or dividend income losing the benefit of the tax credit, and having to pay higher rate tax on the non-trust income.

Finance Act 2008 will treat income from a settlor-interested trust as one of the highest slices of income and the effect of this measure is backdated so that it applies from 6 April 2006, when the original problem arose.

7.7 Double Tax Relief

New legislation will be introduced to ensure that any credit given for foreign tax suffered on income from a trade or profession cannot exceed the UK Income Tax due on that same income. The rules will apply to income arising or foreign tax paid on or after 6 April 2008 and are in response to recent case law.

7.8 Manufactured Payments

The Government have confirmed the announcement made on 31 January 2008 to introduce rules designed to counter tax avoidance by individuals using "repo" or stocklending transactions to generate Income Tax losses on manufactured payments representing interest or dividends. The losses would be relieved against the individual's other income even though no economic loss was suffered.

The new rules, which take effect on or after 31 January 2008, will disallow loss relief where the transactions formed part of a scheme or arrangement designed to gain a tax advantage.

7.9 Pensions

The IHT protection already available to UK registered pension schemes will be extended to UK tax relieved pension savings held in overseas pension schemes.

The October 2007 Pre-Budget Report introduced an extension to existing anti-avoidance rules which prevent individuals from using their taxed relieved pensions savings to provide inheritances for others. The rules can apply unauthorised payment tax charges where:-

- a scheme member surrenders annuity (or dependant annuity) rights;
- a connected person (other than a dependant)

becomes entitled to an increase in his pension rights under the scheme which is attributable to the member's death. (This rule will not apply to schemes with over 20 members all of whom have their rights increased at the same rate because of member's death).

An IHT charge may also be imposed where a member with a pension scheme or annuity (or a dependant's scheme or annuity) dies aged 75 or over and there is an increase in pension rights attributable to the death of the member or an unauthorised lump sum payment in respect of the deceased's pension scheme arrangement. New provisions introduced in the Budget will prevent any remaining parts of a deceased's nil-rate band from being used more than once against the IHT charge.

There will also be new measures introduced with effect from 6 April 2008 in respect of overseas pension schemes to ensure that the UK tax limits on benefits are appropriately matched to contributions which have received UK tax relief.

8. INHERITANCE TAX (IHT)

8.1 Transitional Serial Interests (TSI)

The Finance Act 2006 changed the IHT treatment of interests in possession arising after 22 March 2006. Provision was made for a transitional period, originally expiring on 5 April 2008. During the transitional period, trustees of interest in possession trusts are able to create Transitional Serial Interests ("TSIs"). These are new life interests replacing those in place on 22 March 2006, which will continue to be taxed under the old rules. This is useful where, for example, there is a life tenant in poor health, or there is a wish to move the life interests down to the next generation.

In a welcome move, the transitional period is to be extended until 3 October 2008.

However, there were cases where trustees wished to replace the existing life interest with a new interest in possession in favour of the same beneficiary. This might be done in order to create more flexibility in a relatively inflexible trust interest. While it was not clear from the legislation, HMRC took the view that there would be an immediate charge to IHT on the creation of the new interest, a view not universally shared.

Amendments are to be introduced to make it clear that a replacement interest in possession in favour of the same beneficiary, within the now extended transitional period, will qualify as a TSI, and as a result there will be no immediate Inheritance Tax charge. This treatment will also apply to replacement interests created before Budget day, 12 March 2008. This is a welcome clarification in a highly complex area, as is the extension of the transitional period.

8.2 Transferable Nil-rate Band

In the Pre-Budget Report last October the Chancellor announced proposals to allow any unused nil-rate band on death to be transferred to the estate of a surviving spouse or civil partner, where he or she dies on or after 9 October 2007. The unused nil-rate band of the first spouse to die will then be offset in calculating the IHT due on the death of the survivor. The nil-rate band is presently £300,000, set to increase to £312,000 from 6 April 2008. Draft legislation to effect this has already been published.

The Budget proposals set out a consequential amendment to prevent a possible CGT complication.

Existing legislation provides that where an asset value is ascertained for IHT purposes, that value is also to have effect for CGT. In normal circumstances, the IHT valuation is secured first and is used for both taxes. Where the transferable nil-rate band is to be applied on the second death, it is therefore necessary to ascertain the value of assets which passed on the first death. These may not have been valued for IHT purposes. However, if an asset had been sold in the period between the two deaths, a valuation would have been made for CGT purposes. This amendment will ensure that (even if a different value for IHT is determined on the first death) the CGT calculation will not be re-opened.

9. CHARITIES

9.1 Gift Aid - Transitional Relief

It has been announced that a transitional rate of Gift Aid, made up of 20% basic rate and a 2% transitional relief, will run until 5 April 2011. This will affect only UK Charities and Community Amateur Sports Clubs in receipt of donations and not the individual donor.

Owing to the reduction in the basic rate of Income Tax, the amount of tax that UK charities can reclaim is reduced, and concerns were expressed about the potential impact on their funding, at least in the short term. This move is an attempt to redress the balance.

10. ANTI-AVOIDANCE

10.1 Restrictions on the use of Double Taxation Treaties

Two measures were announced to restrict the application of Double Tax Treaties entered into by the UK in order to frustrate perceived abuse.

The first measure is intended to address specific schemes involving business partnerships resident in a treaty jurisdiction where the partners are trustees of trusts established by a UK resident individual. Such structures are currently considered effective in preventing profits arising to the partnership from being taxed in the hands of the UK resident individual by virtue of the appropriate article in the relevant Double Tax Treaty. (In particular Isle of Man partnerships have been used to avoid tax on property development projects).

HMRC state that this measure will ensure that such structures are not and never have been effective in ensuring that the partnership profits are free of tax in the UK. It is not clear however that the measure as currently drafted is sufficiently widely drawn to catch all previous arrangements, but future structures of this type will be caught by the second measure below.

The second measure announced in this area is a more widespread attack on the use of the "Business Profits Article" contained in many Double Tax Treaties. The Business Profits Article in, for example, the UK/Guernsey tax treaty can be used in certain circumstances to ensure that the profits arising to a Guernsey company owned by a UK resident individual from a land development trading activity were sheltered from UK tax at the time they arose. Such business profits arising after 12 March 2008 will not benefit from treaty protection in this way.

Although understandable, it is a cause for concern that Double Tax Treaties are again being amended or over-riden by domestic legislation rather than international negotiation.

10.2 Income - Shifting

HMRC's previous attempt to clamp down on so-called "income shifting" failed when it was defeated in the House of Lords in the Arctic Systems tax case. This case involved a limited company director's right to distribute part of his company's profits to his wife.

In a highly controversial proposal, the Government announced new tax legislation that would require all small businesses paying out dividends or partnership profits to calculate whether the recipients received a market rate for their contributions to the success of the business.

The Government now intends to delay legislation until 2009, but has reiterated its view that it "is unfair that some individuals can arrange their affairs to gain a tax advantage by shifting part of their income to another person who is subject to a lower rate of tax."

10.3 Anti-avoidance Simplification Review

A progress report has been issued on the Government's Anti-avoidance Simplification Review, which recommends greater tax simplification whilst maintaining or enhancing the protection of tax revenue. It is intended that a more targeted approach will be adopted in future anti-avoidance legislation. HMRC have also identified a number of existing anti-avoidance measures to be reviewed, where the existing law is considered confusing or compliance with the law too burdensome. While these aims are commendable, the experience of recent years does not encourage one to expect their realisation.

11. BUSINESS TAX

11.1 Corporation Tax - Reduction in Main Rate

Individual companies or companies in groups, with profits above the upper relevant maximum amount (currently £1,500,000) will have their profits taxed at 28% from 1 April 2008 unless their profits are from oil extraction and oil rights within the UK and the UK continental shelf.

11.2 Corporation Tax - Increase in Small Companies' Rates

The small companies' rate, (which applies to companies whose tax profits are below currently £300,000), will rise from 20% to 21% from 1 April 2008. A further rise to 22% is set to follow in 2009.

The small companies' rate does not apply to most investment companies.

Companies with taxable profits between £300,000 and £1,500,000 will continue to be taxed at an effective rate of between the main rate and the small companies' rate.

Full details of tax rates are given in the Rate Card.

11.3 Simplification of Associated Companies Rules

The profits qualifying for the small companies' rate of tax is reduced if the taxpayer company has one or more associated companies. This can include a company controlled by a business partner of the shareholder or the taxpayer company.

The Government is now proposing to remove business partners from these rules except where tax avoidance is in point.

11.4 Changes To Rates Of Capital Allowances

A number of changes to the rates of capital allowances will take effect on 1 April 2008:-

- General plant & machinery writing down allowances will be decreased from 25% to 20% on a reducing balance basis;
- Long life asset allowances will increase from 6% to 10% on a reducing balance basis;
- Capital allowances on the "integral features" of a building and on thermal insulation will decrease from 25% to 10% on a reducing balance basis;
- First year allowances for small and medium sized businesses will be replaced by an annual investment allowance of up to £50,000 per annum; and
- Industrial Building Allowances (IBAs) and Agricultural Building Allowances (ABAs) will reduce from 4% to 3% on a straight line basis.

Finally, small businesses whose future expenditure on plant and machinery may be fully relieved by the annual investment allowance but which have small historic pools of unrelieved expenditure will, for periods after 1 April 2008, be able to claim a writing down allowance of up to £1,000 without having to calculate writing down allowances on very small balances.

11.5 Extension Of The R&D Tax Relief Scheme

The R&D tax relief scheme provides an enhanced tax deduction to companies incurring expenditure on scientific research and development. In the 2007 Budget, the Chancellor announced increases in the relief given under the scheme:

- the enhanced deduction for Small and Medium Enterprises (SMEs) will rise to 175% from 150%; and
- the large company enhanced deduction will rise from 125% to 130%.

However, the Government has now announced that these changes will not take effect until "a date to be appointed by Treasury order" as the agreement of the European Commission is required under State Aid approval rules.

11.6 The Taxation of Foreign Profits

The Government will put forward proposals on this matter in a consultation document to be published before the summer.

11.7 Controlled Foreign Companies - Anti-avoidance

Legislation will be introduced to block a number of tax avoidance schemes that rely on the use of a partnership or a trust to escape a Controlled Foreign Companies ("CFC") tax charge.

In one avoidance scheme, an offshore trust would own more than a 50% of the shares in an overseas company, so that the company might not be controlled by UK residents even though the remaining shares give the right to receive all of the company's profits. The definition of "control" for CFC purposes is to be amended so that rights to income and assets will be taken into account in determining whether UK residents control a foreign company.

To counter a further avoidance scheme, the Government proposes to ensure that the gross income of a CFC includes any partnership income to which it is entitled, and any trust income in respect of which the CFC is either settlor or beneficiary.

11.8 Corporate Intangible Assets - "Related Party" Rules

It appears that it was possible to avoid the "related party" rules in the corporate intangible assets regime if the related party was in administration or liquidation or involved in another insolvency procedure. The Government proposes to counter such avoidance.

11.9 Capital Allowances Buying and Acceleration

Again, to counter a scheme, a claim for a balancing allowance will be denied if a trade ceases to be carried on by one company and begins to be carried on by another company under arrangements designed to give rise to such an allowance.

11.10 Trading Stock

A trading profit or loss for tax purposes is, in the first instance, calculated in accordance with Generally Accepted Accounting Practice ("GAAP"). Such an accounting profit or loss is then adjusted to reflect specific tax rules that over-ride accounting practice.

Once the cost of an item has been taken into account as

part of the trading stock of a business, if it is subsequently removed from trading stock otherwise than in the ordinary course of the trade, (for example, appropriated for the proprietors' personal consumption), a disposal needs to be recognised. The value, in accordance with GAAP, will usually be the original cost of that item to the business. However, for tax purposes, case law establishes that the disposal value is the full market value of the item.

HMRC considers that this principle over-rides GAAP. However, there has recently been a trend in the Courts to emphasise the importance of GAAP for the purposes of calculating the results of a business for tax purposes, and questioning the extent to which historical case law precedent over-rides the commercial accounts. HMRC has now decided to remove any possible doubt about the market value principle applying to trading stock, and with effect from 12 March 2008 a new statutory rule will be introduced requiring a business to recognise the market value of an item that is appropriated into or out of trading stock other than in the normal course of business.

11.11 Leased Plant Or Machinery

The leasing industry has generally been successful at identifying tax saving opportunities that can arise through the interaction of the complex rules that govern the tax treatment of equipment lessors and lessees. The scheme disclosure rules have, again, enabled HMRC to identify arrangements which they consider offensive. In the Pre-Budget Report in October 2007, it was proposed that anti-avoidance rules be introduced in relation to sale and finance leaseback and long funding lease arrangements and in December 2007 further anti-avoidance measures were proposed to address a mismatched tax treatment that arose in certain transactions conducted through intermediate lessors, involving leases granted at a premium. The Finance Bill 2008 will include these measures generally with effect from the date when the proposals were originally announced, although there are a limited number of refinements that will apply only from 12 March 2008.

11.12 Financial Products Avoidance

The disclosure regulations have also drawn attention to arrangements intended to enable companies to receive what in substance is interest, but in a form that is potentially outside the scope of tax. For instance, if the investing company receives a return in the form of distributions from another UK resident company, rather than interest, the distributions are exempt from Corporation Tax. HMRC is developing legislation that will apply generally to all arrangements involving disguised interest, but this will not be introduced until 2009. In the meantime, the Finance Bill will target a number of specific avoidance schemes.

Arrangements involving the disposal of the right to receive future rental receipts from equipment leases for a value that is contended to be outside the scope of tax will also be blocked.

11.13 Company Cars

It is proposed to change the way that businesses claim relief for the cost of providing company cars, and to revise thresholds for employees.

Currently businesses obtain tax relief for the cost of company cars either by way of capital allowances on the acquisition costs or by way of relief for rental payments. With effect from 1 April 2009, expenditure on cars with CO₂ emissions above 160g/km will give rise to annual capital allowances at the rate of only 10% per annum. Expenditure on cars with lower CO₂ emissions will attract capital allowances at the rate of 20% per annum.

For those businesses which lease rather than buy cars, tax relief for rental payments will be restricted by a 15% disallowance for cars with CO₂ emissions above 160g/km. Where the car is leased through an intermediary lessor, it is likely that only the final business user will suffer the disallowance.

Cars with lower CO₂ emissions, currently not more than 120g/km, will continue to qualify for 100% capital allowances up to 31 March 2013, although the qualifying threshold will be reduced to 110g/km from April 2008.

The 100% allowance will also continue to be available for electrically propelled cars and for the cost of infrastructure equipment for gas re-fuelling, the scope of which will be extended to bio-gas infrastructure.

The benefit taxable on an employee is based on a percentage of the list price of the car. The percentage ranges from 15% to 35% depending upon the CO₂ emissions of the car. Presently the lowest percentage of 15% applies to cars emitting no more than 140g/km and the taxable benefit percentage increases by 1% for each additional 5g/km. For 2008/09 and 2009/10, the starting threshold will be reduced to 135g/km and for 2010/11 this will be further reduced to 130g/km.

A new lower percentage of 10% for cars with CO₂ emissions of no more than 120g/km will be introduced with effect from 6 April 2008.

12. VAT

Measures introduced in this year's Budget include the predictable increase in VAT thresholds and efforts to simplify the VAT regime, but no surprising changes.

With effect from 1 April 2008, the VAT registration threshold is raised to £67,000 and that for de-registration to £65,000.

Provisions will be introduced to simplify the legislation governing the Election to Waive Exemption (Option to Tax) on supplies of land and buildings. These are an attempt to improve the practical administration of the option to tax and will include simplifications to the process, and provisions for revocation and late application.

There will be an increase in the level below which previous errors may be corrected on the VAT return for the period

in which the errors are discovered. For accounting periods commencing on or after 1 July 2008, the limit will increase from £2,000 to the greater of

- £10,000, or
- 1% of turnover,

subject to an upper limit of £50,000.

To comply with court decisions, repayment claims for rights that accrued before the introduction of the three year cap in 1996 and 1997 can be made up to 31 March 2009.

Following a ruling by the European Court of Justice, with effect from 1 October 2008, the VAT exemption for fund management services will be extended to cover not only the management of authorised unit trusts, trust based schemes and open-ended investment companies but also investment trusts and venture capital trusts.

There are to be consultations on how best to simplify the operation of the partial exemption and capital goods regimes, and on the need for business to seek permission from HMRC before taxing otherwise VAT exempt supplies of land and buildings.

Further to the recent announcement of a reduction in VAT on refurbishment costs of empty domestic properties, the Government has agreed to consider the case for further reductions where expenditure is incurred in renovating other decrepit buildings.

13. STAMP DUTY AND SDLT

Legislation was introduced in 2007 to prevent Stamp Duty Land Tax ("SDLT") avoidance using schemes which took advantage of relieving provisions for certain transfers of property between members of an investment partnership. This was done by ensuring that whenever there was a change in the size of a partner's share in such a partnership, a charge to SDLT arose whether any consideration was paid for the change or the parties to the transaction were connected.

The 2007 provisions will be amended to ensure that where there is a transfer of an interest in a property within an investment partnership, no charge to SDLT will arise. Since the amendment operates as a relieving measure, it will apply retrospectively to transactions occurring on or after 19 July 2007.

14. HMRC POWERS AND PROCEDURES

14.1 Penalties for Incorrect Returns & Failure to Notify a Taxable Activity

It is the Government's intention to extend the existing penalty provisions so that a single penalty regime applies for incorrect returns across all taxes, levies and duties administered by HMRC. This will include environmental taxes, excise duties, stamp duties, accounting for recovery of student loans by employers, income, capital

gains and inheritance taxes, insurance premium tax, pension schemes and petroleum revenue tax. The penalty will be determined by the amount of tax understated, the behaviour giving rise to the understatement and the extent of disclosure by the taxpayer.

The new provisions will have effect from a date to be appointed by Treasury Order and, in the meantime, the Revenue will consult on guidance regarding their operation and implementation.

In addition, the rules allowing HMRC to enquire into whether the correct amount of tax has been paid are being amended to ensure that record keeping requirements for taxpayers, HMRC powers to obtain further information, and time limits for assessments and claims are more consistent across the taxes.

Information powers and penalties for failure to comply with these obligations will have effect on and after 1 April 2009. Time limits for making assessments and claims will require a transitional period and so will become fully operative on and after 1 April 2010.

Time limits for changing the amount of tax due by assessment vary across the taxes. New measures will align the time limits for assessments depending on whether the charge arises as a result of a taxpayer mistake, discovery, negligence or a deliberate understatement/ failure to notify liability regardless of the type of tax at stake.

14.2 Payments, Repayments & Debt

Although taxpayers can use a range of payment methods, credit card payments are not generally permitted. Such means of payment will in future be allowed provided the taxpayer bears the transaction fee. The facility is due to be available by the Autumn. It may (or may not) be thought odd that the Government should encourage borrowing to finance tax revenue.

BUDGET SUMMARY...

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