PRE-BUDGET STATEMENT 2006

IT'S ALL ABOUT **ANTI-AVOIDANCE**

EDITORIAL

A Pre-Budget Statement gives an opportunity to present an interim report on the economy and the fiscal regime, while allowing an opportunity for ad hoc measures designed to repair specific deficiencies within the system. During Gordon Brown's tenure, it has come to be used increasingly to announce anti-avoidance measures, both specific and general. This Statement is no exception: the bulk of the initiatives announced involve more complex and targeted anti-avoidance legislation; and it appears that the next Finance Act will once again be long and add to the complexity of the tax system. It is notable that the Chancellor does not recognise the impact of such complexity on his touchstone of promoting fairness for all tax payers.

In some ways the Statement is notable for what it omits or ignores. There is, in particular, no reference to the review of the residence and domicile rules, although past references to this review, ongoing since 2003, have placed it in the context of the quest for a fair and balanced system. It may be that, following recent decisions of the Courts or Special Commissioners (particularly the case of Gaines-Cooper v Revenue and Customs Commissioners), HMRC have concluded that it may be advantageous to retain the current, and sometimes ill defined, rules (particularly on residence), and so be able to apply these with an element of discretion, leaving a degree of uncertainty to discourage the more borderline claims.

Other predictions, so far unrealised, include further changes to the Inheritance Tax regime, measures to implement the Carter Report on filing deadlines and penalties (although some elements of this have been announced), or the alignment of PAYE and NIC. However, provisions have been announced to deal with PAYE/NIC avoidance through managed service companies.

Some anti-avoidance measures are to be expected. Those targeted at capital loss schemes and Stamp Duty avoidance schemes are justified, although the draft legislation will need careful consideration, and would appear to leave much to be determined by HMRC guidance, adding to the extra-statutory rules. However, opportunities for consultation afforded by the publication of provisions on this and other areas is to be welcomed, as are the examples given by HMRC of the situations against which such provisions are targeted.

It is hoped, on the wider economic front, that the buoyancy of the economy will continue to match the Chancellor's optimism, and enable his spending requirements to be financed. Measures to raise revenue through 'ecologically correct' taxation - the rise in air passenger duty rates, for example - will reflect in inflation and may prove too dependent upon international political and economic changes.

Turning now to the provisions themselves:

- **CAPITAL GAINS TAX:**

The FA 2006 legislation depriving companies of relief for synthetic losses has been extended to cover individuals, trustees and personal representatives. The change affects capital losses arising on disposals on or after 6 December 2006, by denying relief (whether for Capital Gains Tax, Income Tax or Corporation Tax purposes) where the loss has arisen as a result of artificial arrangements. HMRC have published draft legislation and guidance notes on their website on which comments are invited. The guidance notes state that the rules are intended to deny relief to a person who deliberately or knowingly enters into arrangements to avoid tax. However, the "purpose" test is a hybrid mixture of subjective and objective criteria and it could have a wider effect than that stated.

Briefing

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Rawlinson & Hunter
Chartered Accountants

Eagle House, 110 Jermyn Street
London SW1Y 6RH

and at

Lower Mill, Kingston Road
Ewell, Surrey KT17 2AE

T +44 (0)20 7451 9000
F +44 (0)20 7451 9090
E firstname.lastname@rawlinson-hunter.com
W www.rawlinson-hunter.com

- ## ALTERNATIVELY SECURED PENSIONS (ASP):

As expected, the Chancellor has announced that the ASP provisions will be tightened with effect from 6 April 2007.

As it stands, an individual is not required to purchase an annuity if he enters into an ASP. If he does, he is able to draw income without any minimum requirement. This allowed an otherwise financially secure individual to restrict the amount of pension taken, leaving the fund to continue to roll up tax free. On death, the funds remaining in the ASP could be used to provide pensions for his dependants, the only potential tax charge being to Inheritance Tax. It was possible to create schemes where the individual's children or grandchildren were members so that assets could be passed to future generations.

The proposals work in two ways:

1. A minimum income requirement of 65% is introduced, and the maximum income draw down is increased from 70% to 90% of the annual income which would arise from a comparable annuity bought by the fund for a 75 year old.
2. Where on the death of the individual (or of a dependant who has inherited the benefit of the fund from him) there remain funds which are not given to charity, an additional tax charge is introduced at penal rates. Referred to as an "unauthorised payment charge", this is assessed on the pension scheme administrator and can be at a rate of up to 70% of transfers to pension funds of other members of the scheme. It is not clear how this will interact with any Inheritance Tax charges and HMRC have said they will consult with interested parties on the issue.

- ## DISCLOSURE REGIME:

FA 2004 introduced requirements for disclosure of marketed anti-avoidance schemes. These rules oblige the promoter of a tax scheme to provide HMRC with a description, transaction details and a summary of the tax consequences within days of the scheme being marketed. HMRC register the scheme, allocating a number (which taxpayers adopting the scheme must quote when filing Tax Returns). There has been discussion in the professional press as to whether these rules are wider than first thought in application and apply to bespoke tax planning exercises. This uncertainty will not be allayed by the announcement that a consultation document on new powers to investigate undisclosed schemes is to be published.

- ## DIRECT TAX CLAIMS:

Where claims for repayment of tax paid by mistake are made (generally as a result of a re-interpretation or judicial decision), these are subject to a six year limitation period if made on or after 6 September 2003. This six year limit is to be extended to older claims, and restores symmetry between the right of taxpayers to claim repayment of tax and the right of HMRC to recover outstanding tax.

- ## STAMP DUTY LAND TAX (SDLT):

The Chancellor announced Treasury regulations taking effect as at 2.00pm on 6 December 2006 to prevent two ways of avoiding SDLT. The first is where a number of transactions are used to reduce the rate of tax from that which would have applied had all the transactions between the buyer and the seller been taken as one. The second change relates to transfers in and out of partnerships and transfers of partnership interests, introducing claw-back provisions similar to those for group relief for companies.

- ## PLANNING GAIN SUPPLEMENT:

In the 2005 PBR, the Chancellor announced that there would be consideration given to a windfall tax on planning gains (being the difference between the value of the land when put to its current use and its value with full planning permission). The tax would be levied at the time development commenced. There is to be further consultation to establish whether the proposals will be workable, and it is not intended to introduce the provisions until 2009. At present, tax is only levied when the developed land is sold, and the proposed supplement would impose an additional charge, and impact on cash flow. Owners may be forced to sell once planning permission is obtained, rather than develop the land themselves.

- ## MANAGED SERVICE COMPANIES

FA 2000 introduced what are known generally as the IR35 rules, to prevent the avoidance of PAYE and NICs through the use of personal service companies. These rules operate where the "employee" has a beneficial interest in the personal service company invoicing the "employer" for his services. A managed service company operates by ensuring that no worker has a large enough beneficial interest in its share capital to trigger the IR 35 rules. Specifically targeted legislation to counter-act the use of such companies is to be introduced and is expected to apply from April 2007.

- ## TAX – MOTIVATED INCORPORATION:

In an unexpectedly generous measure in 2002, a zero rate of Corporation Tax was introduced for profits of £10,000 or less. This resulted in large numbers of sole traders deciding to transfer their businesses to companies. The Government responded in FA 2006 by withdrawing this nil-rate, a move seen as a disappointing volte face. The Government is apparently still concerned that there is a tax incentive for the self-employed to incorporate, and is continuing to give thought to how the system can be "modernised". The 2007 Budget may be too early for clear proposals on this to materialise. It is nevertheless worrying that the Government is still not satisfied with the significant anti-avoidance measures which it has already taken in this area.

- ## CONTROLLED FOREIGN COMPANIES (CFCS):

The CFC legislation stops UK companies from accumulating profits in subsidiary companies situated in low tax jurisdictions, by apportioning certain profits to the UK company. There has been an exemption from the CFC provisions where the shares of the subsidiary are publicly quoted. In some jurisdictions, it has become relatively easy to secure a public quotation and HMRC believe that this exemption has been used artificially to avoid profit apportionment under the CFC legislation. This exemption for publicly quoted companies has therefore been withdrawn entirely as from 6 December 2006.

- ## OTHER SPECIFIC ANTI-AVOIDANCE PROVISIONS:

There are six other Corporation Tax anti-avoidance measures against artificial schemes which have been notified to HMRC under the disclosure rules. Many of these arrangements involved the creation of artificial tax losses linked to a non-taxable receipt. These provisions demonstrate the success of the FA 2004 disclosure rules, which are themselves being further strengthened.