

PRE-BUDGET STATEMENT 2007

BUSINESS TAX BRIEFING

EDITORIAL COMMENT

While much of the drama of Mr Darling's first Pre-Budget Statement as Chancellor was reserved for individuals and trustees, there are a number of measures affecting businesses. These fall into three main categories:

- Anti-avoidance measures introduced as a result of information gleaned under the tax scheme disclosure provisions.
- Attempts made to simplify the taxation regime affecting businesses.
- Generally helpful relieving provisions for specific categories of business.

The impact of the rules obliging promoters to disclose the detail of tax avoidance schemes is not to be underestimated. It has provided HMRC with a torrent of detailed current information. Before these rules were introduced, HMRC would only have had access to this information either when disclosed on a Tax Return or as a result of an enquiry. In either case, there would have been a significant delay between the implementation of the scheme and their becoming aware of it. These rules allow them to act quickly and effectively to shut down perceived abuses. We can expect to see many more such measures reacting to specific schemes.

The Chancellor also announced that the Government is to launch three reviews covering VAT, anti-avoidance and the Corporation Tax rules for related companies. The intention is that the Treasury and HMRC will work in partnership with businesses to consider how rules in these three areas could be simplified. While aiming to simplify the tax system is laudable, the results of previous efforts have met with mixed success. In some cases, attempts to simplify legislation have resulted in an even greater lack of clarity and on more than one occasion in unforeseen results. Nevertheless, the Government's wish to engage in a wide consultation is to be welcomed, and businesses should take the opportunity to put their point of view not only to ensure that genuine anomalies and difficulties are addressed but also to encourage the Government to engage in further consultation when future policies are introduced.

There are also useful relaxations to the rules concerning the Investment Manager Exemption, clarification on corporate gains on life assurance policies, and simplification and relieving provisions for Stamp Duty Land Tax.

• SIMPLIFICATION IN BUSINESS TAX

This autumn the Government will launch three reviews where the Treasury and HMRC will work in partnership with the business community to evaluate how a range of tax policies could be simplified.

These initial reviews will cover:

- how to simplify VAT rules and administration in the UK and the EU;
- how anti-avoidance legislation can best meet the aims of simplicity and revenue protection; and
- how to simplify the Corporation Tax rules for related companies.

VAT rules and administration

The following areas may have scope for simplification, subject to the interaction of UK rules with EU law and processes:

- procedures associated with the election to waive exemption (option to tax) on land and buildings;
- the standard Partial Exemption method;
- the procedure for calculating and adjusting VAT recovery under the Capital Goods Scheme;
- the frequency with which businesses submit Returns, and in particular whether annual Returns may be more appropriate for some businesses;
- the design of approved VAT Retail Schemes; and
- complexities requiring simplification at EU level.

Anti-avoidance legislation

The priority areas that the Treasury and HMRC believe will best achieve simplification in anti-avoidance legislation are:

- ensuring that new anti-avoidance legislation is clear, effective and well targeted; and
- simplifying areas of existing anti-avoidance legislation.

The Treasury and HMRC want to agree with the business community which particular legislative methods minimise business burdens. The review could also look at whether all anti-avoidance provisions should be in primary legislation or in a more flexible combination of primary and secondary legislation, and whether anti-avoidance legislation should be integrated into the tax code or should occupy its own dedicated section.

Corporation Tax rules for related companies

There are about two million active companies in the UK, many of which have related companies, either as part of a wider company group, or because of association through common ownership. These

relationships may complicate their tax affairs, and simplifying the Corporation Tax treatment of related companies could help reduce administrative and compliance burdens. The Treasury and HMRC believe that the areas where simplification will be of most significance to UK companies are:

- group aspects of Corporation Tax on chargeable gains;
- associated company rules for the small companies Corporation Tax rate, particularly where association is through an unrelated partnership;
- Corporation Tax Self-Assessment filing and payment arrangements for groups; and
- further reductions in the administrative burden of transfer pricing rules.

• UK INVESTMENT MANAGERS

The Investment Manager Exemption allows non-resident funds and individuals to appoint UK-based investment managers without exposure to UK tax, provided certain conditions are met. In particular, the Exemption applies to a list of transactions. These are to be more closely aligned to FSA regulated activities.

If the conditions are not met and the activities of the investment manager result in a UK taxable presence for a non-resident, the present rules would bring all of the non-resident's profits into the UK tax net. This is to be amended so that the tax consequences are proportionate to the non-qualifying activities, rather than the present all-or-nothing effect.

• FUEL BENEFIT

The "multiplier" used to calculate the benefit of private fuel provided by an employer is increased from £14,400 to £16,900. The benefit is calculated by applying the company car tax percentage (which is based on the car's CO₂ emissions) to the multiplier. This gives a maximum increase in tax payable of £350 per annum.

• CORPORATE PENSIONS CONTRIBUTIONS - 'SPREADING' ANTI-AVOIDANCE

The changes to the pensions regime have resulted in some large contributions being paid by companies. Significant contributions have to be spread for tax purposes over four years, to prevent a single large deduction. As companies often would prefer the single deduction, attempts have been made to avoid these spreading rules. Although not described as anti-avoidance, HMRC is introducing measures to ensure that at least one such attempt to circumvent the spreading rules is blocked.

• LEASING

Unusually, the Government has introduced a retrospective relief for an unintended tax liability that could be imposed where a company acquires the leasing business of a partnership.

An anti-avoidance measure introduced in the 2006 Finance Act imposed a tax charge on the vendors of a leasing business and balanced this with relief for the purchasers on the same amount. However, the legislation was flawed, and where the purchaser is a single company, acquiring a leasing business from a partnership of companies, the vendors would be charged to tax with no relief for the company acquiring the business.

The 2008 Finance Bill will contain measures to correct this, so that the purchasing company obtains relief. The availability of this relief will be back-dated to 5 December 2005, when the original anti-avoidance measure came into force.

This is a helpful gesture to correct flawed legislation but at the same time HMRC is keen to attack perceived abuses, and an anti-avoidance measure is to be introduced to eliminate the use of schemes that take advantage of certain weaknesses in the taxation of sale and leaseback arrangements. These arrangements will be taxed as though they are long funding leases.

The 2008 Finance Bill will include changes to ensure that, where a tax deduction is available for the cost of a leased asset, the lessor will be unable to generate artificial losses. There will also be changes intended to ensure that a substantial tax loss cannot be created using the long funding lease rules where there is no equivalent commercial loss.

• CORPORATE INTEREST - ANTI-AVOIDANCE

A UK company which receives dividends from another UK company is exempt from Corporation Tax on those dividends. This has led to a number of schemes intended to structure debt as equity, so that payments are categorised as non-taxable dividends rather than taxable interest.

As details of such schemes generally need to be returned to HMRC under the disclosure rules, they usually have a short shelf-life. Another such scheme has been closed in the Pre-Budget Report with immediate effect.

• CAPITAL ALLOWANCES - FIRE SAFETY

One of the anomalies in the capital allowances regime is to be repealed from April 2008 – capital allowances on expenditure on building alterations required to comply with notices from a Fire Authority. As fire safety compliance is now on a self-assessment basis, such allowances are only available to businesses that have failed to comply

with the law and so have been issued with a notice. Giving tax relief to those who have failed to comply with legislation is, unsurprisingly, not encouraged by the Government and so such allowances will be abolished from April 2008.

This does not affect capital allowances on expenditure on fire safety equipment such as alarms and sprinkler systems for businesses complying with the law.

• REINSURANCE - ANTI-AVOIDANCE

Various schemes have been disclosed to HMRC which attempt to obtain a tax deduction for certain reinsured life insurance business expenses where the economic cost of the expenses has not been suffered by the claimant. These schemes are blocked with effect from 9 October, although HMRC remains adamant that they were ineffective in any event and intends to pursue such claimants in court where appropriate.

• HEDGING FOREIGN EXCHANGE

At present, any exchange gains and losses that arise from using loans or derivatives to hedge against the foreign exchange (“forex”) risk involved in a company owning non-sterling investments are disregarded where the loans or derivatives match shares. Only the net economic position is taxed.

This is to change with effect from 1 January 2009 and a comprehensive code on forex matching will be introduced. Details have yet to be published but HMRC has already announced that the rules will include anti-avoidance provisions.

• CORPORATE GAINS ON LIFE INSURANCE POLICIES

These rules are unlikely to affect many companies, since few own life policies and annuity contracts. Where such policies are held for investment purposes, they tend to be held via debt-like instruments. As such, HMRC has announced plans to tax these policies and contracts under the loan relationships rules.

To achieve this, any qualifying policies or contracts held by companies on 1 April 2008 will be deemed to have been surrendered in full on that date. Any gain arising on the deemed surrender will be brought into account as a non-trading credit when the company actually disposes of the policy or contract.

This only affects policies and contracts held for investment purposes, not those taken out by the company for its own purposes.

• LIFE INSURANCE COMPANIES - SIMPLIFICATION OF TAX

HMRC has been in the process of simplifying taxation of life insurance companies for a few years and the next step is to simplify the rules applying to transfers of long-term insurance business. The process is not going entirely smoothly, and a previous step has had to be reversed. Complex rules relating to certain esoteric pension business exemptions have been found not to work as intended and so have been repealed, pending further consideration.

• STAMP DUTY AND STAMP DUTY LAND TAX

Stamp Duty

A new exemption is to be introduced with effect from Budget Day 2008 for instruments transferring shares or securities where the fixed or ad valorem Stamp Duty liability would be £5 or less.

Stamp Duty Land Tax

Transactions (or linked transactions), whether in commercial or residential property will no longer need to be reported for Stamp Duty Land Tax (SDLT) purposes where the consideration received is no greater than £40,000. This applies to transactions occurring on or after Budget Day 2008.

Anti-avoidance measures, introduced by Finance Act 2007, imposing a SDLT charge on certain changes in shares in property investment partnerships are to be specifically disapplied with retrospective effect. This is to ensure that such partnerships are not caught by the broad scope of these measures.

• VAT AND HOUSING

With effect from 1 January 2008, renovations and alterations to residential properties that have been empty for at least two years will qualify for a reduced rate of 5%. Currently such properties have to have been empty for three or more years to qualify.

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