BUDGET SUMMARY...

KEY POINTS

- Penal IHT changes for Trusts
- Filing Deadlines to be significantly advanced
- Charities: more restrictions to reliefs
- More Anti-avoidance for Pensions
- Real Estate Investment Trusts - new investment opportunities
- Venture Capital - more investment, fewer companies
- Extension to Rules on Disclosure of Tax Schemes
- Domicile still under review
- Some SDLT relaxation
- Loss Relief Anti-avoidance
- New Corporate Tax Regime for Film Producers
- Plant and Machinery - leasing changes
- R&D - better credit for the medium-sized company

Briefing

March 2006

CONTENTS

Overview	2
Personal Taxes	2
Domicile	4
Trusts	4
Capital Gains Tax	5
Inheritance Tax	5
Charities	7
Business Tax	7
Anti-avoidance	9
VAT	10
Stamp Duty Land Tax	11
International Mutual Assistance	12

RAWLINSON & HUNTER

1. OVERVIEW

The Chancellor presented his tenth Budget on 22 March, exceeding the record of any predecessor since 1822. Whatever the claim to economic stability and consistency, this Budget maintains the tendency to add to the legislative burden by continuing concentration on anti-avoidance, both real and perceived.

The most disturbing change, and one which targets responsible long-term estate planning, is the unexpected penalisation of trusts under the Inheritance Tax regime. Whatever the faults and inconsistencies of the Previously Owned Asset Tax introduced in 2004, it was widely supposed that this dealt with the perceived abuses of Inheritance Tax planning. However, it has apparently been decided that most planning through trusts is inherently objectionable and - except in very limited circumstances - trusts represent a means whereby controlled influence is improperly retained by settlors, even those who are wholly excluded from benefit.

Until now, the Inheritance Tax, and before this Capital Transfer Tax, regimes have recognised that trusts can have useful and proper purposes, and ones to be encouraged by public policy, particular examples being for the provision of minor beneficiaries, and for the long-term protection of assets against the uncertainties of life and the capacity of those for whom property is to be held. Accordingly, a rational and fair regime has been applied, whereby fixed interest trusts are broadly equated to property owned by the beneficiary, and trusts established to provide minor beneficiaries with fixed interests in the future have been given equally favourable treatment.

All this is now to change, and - except for certain exceptions in favour of trusts for the disabled and vulnerable - an Inheritance Tax charge of 20% will apply to settlements in excess of the nil-rate band available.

Thereafter, property held in trust will be subject to the same regime as has been applied to discretionary settlements - namely a charge of up to 6% on each ten-year anniversary and a proportionate exit charge on interim distributions.

These changes seem to have no reasonable basis in Fiscal policy, and sit ill with the modernisation proposed for the Income and Capital Gains Tax treatment of trusts, which is being implemented in large part in this Budget, following a lengthy consultation period. In the course of that consultation process, the Government expressed a recognition of the proper role trusts could play in family and estate planning, with stated aim that the fiscal treatment should not provide artificial incentives for the use of trusts, but equally should avoid creating artificial obstacles to their proper function. It seems remarkable that one set of provisions should be introduced with the aim of establishing, broadly, a level playing field, and be implemented following significant discussion and refinement, whilst another set should appear to penalise, without any warning or consultation, the use of settlements in general.

Other Budget provisions have also focused on increasing anti-avoidance. The tax scheme disclosure rules are to be extended to have general application, which may give cause for concern particularly given the broad and somewhat ambiguous tests originally introduced to identify reportable schemes. Provisions to restrict or prevent the claims to loss relief on lessor companies and pre-acquisition in losses in purchase companies are not unexpected, nor are provisions to deal with certain employee benefit schemes. All these however add to the perception of increasingly complex and detailed legislation, adding to the regulatory and administrative burden which the Budget itself boasts of attempting to reduce for businesses. It is particularly to be regretted that even where consultation takes place in these complex areas, the results of informed discussions are negated by other provisions introduced without warning or a properly informed consideration of their impact.

2. PERSONAL TAXES

Tax Return filing dates

HMRC have accepted the proposals of the Carter review of online filing and have said they will ensure that a robust efficient online filing facility is in place. They estimate that online filing will produce savings of £175m a year by streamlining the process. HMRC will require businesses to file their VAT, Corporate Tax and PAYE forms online from April 2008. There are however no proposals to shorten the periods available to businesses to prepare these, but for personal tax payers and trusts this is not the case, although a positive point is that the enquiry window will be linked to the actual date Returns are filed rather than the deadline itself. New filing deadlines will be introduced in 2008 requiring Tax Returns for individuals and trusts to be filed by 30 September, four clear months before the present deadline with an extension to 30 November for online filing. At the same time, computer-generated paper substitute Returns currently used by most advisers, including this Firm, will be withdrawn, so that Returns will either have to be filed online or prepared manually using the forms issued by the Revenue. Unless the system is dramatically improved and its reliability significantly enhanced, tax payers with complex affairs will be forced to use old fashioned manual Returns or risk failing to make a full disclosure, a point made by this Firm in its submission to HMRC on this point. This will significantly increase pressures on both tax payers and their advisers who will have a drastically shorter period in which to collect the information and prepare the Returns. A side effect is likely to be that a higher proportion of errors will be found in Returns which is likely to increase the number of Revenue enquiries.

Employee Issues

There are a couple of surprising announcements relating to the taxation of employee benefits.

The benefit-in-kind rules on computers provided to an employee for private use are to be changed from 6 April 2006 so as to remove the exemption for the first £500 of annual benefit. This will mean that employees will be taxed on 20% of the cost of the computer annually and the employer will pay Class 1A National Insurance on this benefit.

In addition, employees will now only be able to receive one mobile phone for private use from their employers tax-free and this benefit will no longer extend to members of the employees' family or household. From 6 April 2006, the choice of a mobile phone or additional salary can be given without attracting a tax charge.

The anomaly relating to the provision of vouchers by employers for eye tests and glasses, where the employee operates a VDU, has been abolished. From 6 April 2006, no tax charge will be levied where an employer pays for an eye test or corrective glasses directly to the supplier, reimburses the employee or provides a voucher.

Pensions

The new "simplified" pensions rules, under which the existing eight tax regimes will be merged into one, come into force on 5 April 2006 - 'A' Day. The changes have been the subject of widespread consultation and most of the relevant legislation is already on the statute book. A detailed explanation of the new rules and commentary on the issues which they raise were included in the November 2005 Personal Tax Update, which may be downloaded from our website.

As foreshadowed in the Chancellor's Pre-Budget Report, the investment criteria for self-directed pension arrangements after 'A' Day' will be tightened, so as to remove any tax advantages from investing in residential property and certain other assets such as fine wines, classic cars, works of art and antiques. Furthermore, the Chancellor has also announced that the 'recycling' of tax-free cash sums from pension funds, so as to create further tax relief, will be curtailed. Such recycling will not be subject to an outright prohibition, but a new anti-avoidance rule will apply if the amount recycled is more than 30% of the tax-free lump sum. Lump sums of less than £15,000 will be disregarded.

VC Schemes

Changes to the Enterprise Investment Scheme (EIS), the Corporate Venturing Scheme (CVS) and the Venture Capital Trust Scheme (VCT) have been announced. The rate of income tax relief for investors in VCTs will be decreased from 40% to 30% (a reduction less than expected) and the minimum holding period that investors must hold their shares for to qualify for income tax relief has increased from three to five years. These changes are effective for VCT shares issued on or after 6 April 2006.

The annual investment limit for EIS income tax relief has doubled to £400,000. Similarly, the maximum amount available to carry back to the previous tax year has doubled to £50,000. Both changes are effective for shares issued on or after 6 April 2006.

For all three schemes the limit in the maximum size of companies able to raise money under the schemes ("the gross asset test") has significantly reduced to £7m before the shares are issued and £8m afterwards. The new "gross asset test" will not apply in relation to funds raised by VCTs prior to 6 April 2006 or EIS or CVS shares subscribed for before 22 March 2006.

Real Estate Trusts

A new regime comes into force for which qualifying companies, and groups of companies whose main business is that of property investment, can elect to join from 1 January 2007. Those who elect to join the regime will be known as UK-REITs. The new regime will exempt income from property, and gains arising on property from tax, provided the company or group meets certain conditions. Dividends paid by companies that join the regime, to the extent that they relate to tax-exempted profits, will be treated as income from UK property for UK tax purposes and paid under the deduction of the basic rate of Income Tax. To be eligible to join the regime, the company or parent company of a group must be UK resident, listed and no one investor may have a beneficial interest of 10% or more in the company. Furthermore, three quarters of the company's or group's business must relate to property investment defined by certain income and asset criteria and there is a restriction regarding the amount of loan finance that can be used to fund the tax-exempt business.

On joining the regime, a one-off entry charge of 2% of the market value of the company or group investment properties will be levied and it will be possible to spread this entry charge over four years.

Qualifying Life Insurance Policies

This measure ensures that unexpected tax effects do not arise for holders of qualifying life assurance policies in circumstances where there is a variation in the method for calculating the investment return to holders of the policies.

Holocaust Victims

On 6 April 1996 (that is for tax years 1996/97 onwards) compensation payments, pertaining to dormant accounts where the original holder was a victim of Nationalist Socialist persecution, made by foreign banks and building societies will be exempt from tax. In particular this relates to payments made under the Claims Resolution Tribunal arrangements for dormant accounts in Switzerland.

In July 2005 a tax-exemption on all such payments was announced but consultation indicated that this could create significant complexities due to the possibility of re-opening tax liabilities going back many years. It is felt that no-one who should benefit from the exemption will be disadvantaged by the introduction of a commencement date.

There will be no liability to either Income or Capital Gains Tax in respect of payments received. There is also an exemption covering any Inheritance Tax which may have been paid in respect of the value of rights to original bank accounts immediately prior to the inception of the scheme concerned. It should be noted that there is no Inheritance Tax exemption with respect to actual payments from a scheme, these will form part of the individual's estate and be subject to Inheritance Tax on death in the usual manner.

At the same time as these changes are made, the existing concession, which exempts from tax similar payments made by UK banks and building societies under the Restore UK initiative, will be written into primary legislation.

3. DOMICILE

Ever since April 2002, when the Government announced that it was reviewing the tax regime for UK-resident non-domiciliaries, there has been the expectation that radical changes will be announced at the time of each Budget. To date, no proposals have emerged, but the issue remains under review. It is anticipated that a Consultation Paper will be produced in advance of any reforms, so substantive changes appear still to be some way off.

4. TRUSTS

New Regime

The Government commenced a process of consultation regarding the modernisation of the tax system for trusts in 2003. Draft legislation was published in January 2006. The Chancellor confirmed the issues, and the principles addressed will be included in the Finance Bill, although it is not clear whether amendments will reflect representations made. He proposes the following changes to the existing basis of taxation of the income and capital gains of trusts. These changes will apply from 6 April 2006, save the provisions concerning the residence of trustees, which will take effect from 6 April 2007.

Settlor

There will be a common meaning of settlor. This will include any person who provides property for the purposes of a settlement directly, indirectly or by reciprocal arrangement. Where assets are transferred from one settlement to another the original settlor will, in most cases, be regarded as the settlor of those assets in the transferee settlement.

Settled Property

The existing definition for Capital Gains Tax purposes will be common for both taxes, leading to a common meaning of "settlement". This will include all property held in trust other than held by a person as a nominee or a bare trustee.

Trustees as a Continuing Body of Persons

The concept of the trustees as a continuing body of persons contained in Capital Gains Tax legislation will be extended to Income Tax.

Residence of Trustees

The existing Income Tax rules for the determination of residence of trustees will be applied for both taxes, with some modification. Broadly, trustees shall be resident in the UK if they are all resident in the UK or, if the settlor is resident and UK domiciled, at least one trustee is UK resident.

The draft legislation contained provisions whereby, in certain circumstances, professional trustees could elect to be treated as non-resident in the UK. This proposal has been dropped due to concern that it may infringe EU State Aid rules. This will be of considerable disappointment to the UK professional community as it will, in practice, preclude UK resident professionals acting as trustees of overseas trusts from 6 April 2007.

Settlor Interested Trusts

The proposed legislation brings the Capital Gains Tax provisions closer to the existing Income Tax statute. The principal change is to extend the definition to include any settlement in which a dependant, unmarried child of the settlor has, or may enjoy, an interest in the settled property. This will apply to all settlements and will bring the settlors of many existing settlements within the scope of charge in future.

One effect in such instances will be the loss of the trustees' annual exemption of £4,400 (for 2006/07). In addition, the settlement of assets that would have otherwise enjoyed Capital Gains Tax 'hold-over' relief (on the transfer of business assets or a transfer that gives rise to an immediate IHT charge) will no longer enjoy the relief if minor, unmarried children of the settlor may enjoy the benefit.

Given that the settlement of assets, will, in the future, give rise to a charge to Inheritance Tax in almost all circumstances (see section 6) the combined charges to Capital Gains and Inheritance Taxes will make the settlement of new trusts for minor children extremely unattractive.

The income of a settlor-interested trust will be treated in future as though it had arisen directly to the settlor. However, perhaps, it is not surprising that losses arising in such trusts will not be deductible from the settlor's taxable income.

Sub-funds

One matter that has plagued many present or past overseas settlements which are held for the benefit of a number of family members has been the manner in which capital gains are attributed to recipient beneficiaries who are UK resident. This could result in beneficiaries suffering significantly different proportionate liabilities to tax on distributions they may receive.

To overcome this (and other circumstances) the proposed legislation includes welcome provisions to elect for sub-funds to be treated as a separate settlement for Income and Capital Gains Tax purposes. However, the election itself triggers a deemed disposal of the assets held in trust. This may prove prohibitive. Following any election, the trustees' annual Capital Gains Tax exemption is apportioned between the separate funds created.

Discretionary Beneficiaries of Settlor-interested Trusts

The existing practice of not taxing beneficiaries of discretionary trusts who receive income distributions, when the income is taxed on the settlor, is to be given statutory effect.

Lost Opportunities

The original consultative document included proposals for the streaming of trust income and gains through to beneficiaries, and the rationalisation of the application of Capital Gains Tax to estates. These proposals have been dropped. Overall, little has been done to modernise the taxation of trusts as the Government suggests. Rather, the legislation makes trusts less attractive, particularly when used for the genuine purpose of the administration of family assets.

Inheritance Tax Treatment of Trusts

Fundamental changes are to be made to the Inheritance Tax Treatment of trusts. These are described in section 6 below. The changes also include a number of consequential Capital Tax amendments, which are described in that section.

Service Charges held by Social Landlords

From 6 April 2006 Social Landlords who hold sinking funds or service charge payments, made by tenants and lease holders, in trust will not be subject to tax at the special trust rate (40%/32.5%) on the income arising from these sources. Instead, income will be taxed at lower, basic or divided ordinary rates (20%/22%/10%) as appropriate.

The term Social Landlord covers Registered Social Landlords, Local Authorities, Housing Associations in Northern Ireland, Charitable Housing Trusts, Charitable Housing Associations, Housing Action Trusts and the Housing Corporation.

5. CAPITAL GAINS TAX

Bed & Breakfast Rules

Certain changes were announced with regard to the Capital Gains Tax matching rules for the identification of shares. The existing rules were designed to prevent individuals and others within the charge to Capital Gains Tax from disposing of securities and then re-acquiring them so as either to use their annual exemption or to realise a capital loss, when in effect still holding on to the investments. Since the existing rules were introduced, certain tax avoidance schemes have been devised which took advantage of these matching rules on the appointment of non-resident trustees. The changes that were announced today will prevent the 30-day matching rules applying when the relevant person acquiring an asset is neither resident nor ordinarily resident in the United Kingdom or is resident in the UK but treated as non-resident under an International Tax Treaty.

6. INHERITANCE TAX

Trusts

In a surprise move, the Chancellor announced that the current Inheritance Tax regime for discretionary trusts will be extended to "accumulation and maintenance" and "interest in possession" trusts. This change is to be implemented from Budget Day, 22 March 2006, subject to limited exemptions and a transitional period for existing trusts affected by the new rules.

Interest in possession trusts give one or more beneficiaries the right to the use, or enjoyment of, trust capital, including the right to receive trust income. Under the present rules, transfers of property under such trusts are treated as potentially exempt and the trusts themselves suffer no charge to tax until the termination of the life interest. In many cases that event can also enjoy potential exemption or spouse exemption.

Accumulation and maintenance trusts are typically used to benefit children and other beneficiaries under the age of 25. They permit a degree of discretion, in particular, the trustees have powers to pay out income or add it to the trust capital, at their discretion. Provided certain conditions are met, accumulation and maintenance trusts are not subject to Inheritance Tax if the identified beneficiaries take life interests on or before the age of 25. The rules for interest in possession trusts then come into force.

Discretionary trusts pay Inheritance Tax at a rate of up to 6% on their asset value at each ten-year anniversary of their creation. There is also an exit charge when capital is distributed, based on the charge at the previous ten-year anniversary. Inheritance Tax is charged on creation of a discretionary trust, at 20% on lifetime transfers of assets in excess of the tax-free amount or nil-rate band, currently £275,000.

Under the new rules, the treatment previously enjoyed by interest in possession and accumulation and maintenance trusts will only apply in three situations. The three favoured categories are firstly, those created on death by a parent for a minor child who will be entitled to the assets in the trust at age 18; secondly, trusts created on death for the benefit of a life tenant whose interest cannot be replaced; and thirdly, trusts created in the settlor's lifetime, or on death, for a disabled person. All other trusts created on or after 22 March 2006 will fall within the discretionary trust regime.

The transitional period will last until 5 April 2008. Existing accumulation and maintenance trusts will be treated as discretionary trusts from 6 April 2008, unless the terms of the trust then provide that the assets are to pass to a beneficiary absolutely at age 18.

The present rules for existing interest in possession trusts will continue until the interest existing at 22 March 2006 comes to an end. If an individual then takes absolute ownership, there will be no change to the present treatment for Inheritance Tax. If the interest comes to an end and property remains in trust, the discretionary trust charges will then apply. To enable existing arrangements to be modified, a new interest in possession created before 6 April 2008, which replaces one in existence on 22 March 2006, will be treated as a pre-22 March 2006 interest for this purpose.

In a related amendment, a termination of an interest in possession on or after 22 March 2006 will be treated as a gift by the beneficiary, potentially bringing it within the "gift with reservation of benefit" anti-avoidance rules. This will restrict the scope for Inheritance Tax planning with interest in possession trusts.

Previously, the assets of an interest in possession trust would be revalued without charge for Capital Gains Tax purposes on the death of the life tenant. The same uplift applies on death to assets which an individual owns absolutely. This tax-free revaluation is now to be restricted to interest in possession trusts which qualify under the new rules ie those created on death for a life tenant whose interest cannot be replaced. It is not clear whether interests in possession which qualify for grandfathering relief (interests pre-existing 22 March, or replacing ones in existence on that date before 6 April 2008) will continue to benefit from the revaluation on death provisions. Since these will continue to be subject to Inheritance Tax as part of the life tenant’s estate, it would be reasonable that that should be so.

Capital Gains Tax ‘hold-over’ is presently available on most transfers to a discretionary trust. The exception is where the settlor or his spouse or civil partner or, from 6 April 2006 (if the trust modernisation proposals proceed as drafted) his minor children, have an interest in the trust. This ‘hold-over’ defers the Capital Gains Tax charge which would otherwise be payable, so that the trustees take the asset at the settlor's base cost. They pay Capital Gains Tax if they make a subsequent disposal in circumstances such that a further ‘hold-over’ claim cannot be made. A similar ‘hold-over’ claim can be made on a transfer of assets to a beneficiary of the trust. ‘Hold-over’ claims will be extended to trusts now coming within the discretionary trust regime. However,. this relief is of limited encouragement, since the extended definition of settlor for Capital Gains Tax purposes will serve to tax a settlement in wide-ranging circumstances.

All wills which include provision for interest in possession of accumulation and maintenance trusts should now be reviewed to ensure that they do not give rise to tax liabilities that are not anticipated. The use of flexible powers which are frequently used to terminate a life interest may create problems. Existing interest in possession trusts which provide for successive life interests, and all accumulation and maintenance trusts, are particular problem areas.

It may be beneficial to arrange that, on the termination of a life interest post 5 April 2008, trust assets pass to a beneficiary absolutely. Otherwise, there will be a chargeable transfer on the creation of a new life interest. The trustees may wish to consider creating new interests in possession in favour of younger beneficiaries before 6 April 2008.

Paradoxically, accumulation and maintenance trusts, which receive favoured tax status under the old rules, and were typically used to protect the younger generation from the risks of excessive wealth, appear to be penalised more heavily than interest in possession trusts. Conversion to interest in possession status would crystallise a chargeable transfer, and the alternative of leaving the trust in accumulation and maintenance form will bring it within the discretionary trust regime on 6 April 2008, unless the beneficiaries receive capital absolutely at 18.

Surprisingly, the Budget notes give no indication that the spouse exemption will be available if an interest in possession terminates in favour of a new life interest for the husband or wife, widow or widower. We hope that this is an unintended result which will be corrected in the passage of the Finance Bill through Parliament.

These changes are likely to have a far-reaching effect on estate planning, and in our view the use of trusts may prove to be severely restricted. There will be only limited scope for creating trusts for minor children given the withdrawal of Capital Gains Tax ‘hold-over’. Parents may be faced with a choice of making absolute gifts to their children, at an age when this would not be appropriate, or waiting to create a trust in their favour when they are all 18. It is fair to say that many existing discretionary trusts pay little or no Inheritance Tax, either because they fall within the nil-rate band exemption or they contain business or agricultural property which qualifies for the generous 100% Inheritance Tax Relief. Trustees of existing interest in possession and accumulation and maintenance trusts should however seek specialist advice before jeopardising their current status by accepting any additions to the trust funds.

Inheritance Tax and Pensions Simplification

It is now confirmed that legislation will be introduced to charge Inheritance Tax on the value of a pension fund on the death of the scheme member in certain circumstances. This change is introduced in conjunction with the new post 'A' Day regime commencing on 6 April 2006, and was suggested as a consultation paper issued by HMRC on 21 July 2005. The new legislation will apply in respect of the death of a pension scheme member on or after 6 April 2006.

Under the present pension rules, a scheme member must use the value of his fund to purchase an annuity no later than age 75. In principle, an Inheritance Tax charge can

arise if the individual delays taking his pension and thereby increases the value of the tax-free benefit payable on his subsequent death before age 75. In practice, HMRC do not generally impose a charge provided the decision is made when the member is in good health. This is on the basis that the individual can normally expect to survive to age 75, at which point an increased annuity will be payable to him. This current HMRC practice will be included in the new legislation, but may lead in practice to more enquiries into the pensioner's state of health when such a decision was made.

The new post 'A' Day rules allow members to defer taking an annuity indefinitely. One option is for the member to draw income by way of an alternatively secured pension instead of taking an annuity. The alternatively secured pension was specifically devised for those who have a principled religious objection to annuitisation, but its flexibility has been welcomed generally. There would clearly be the possibility of passing tax-privileged retirement savings to the members' dependents, rather than using them to provide a pension in retirement, by taking a lower alternatively secured pension.

The Government now proposes that alternatively secured pension funds remaining on the death of the scheme member will now be subject to Inheritance Tax, unless they have been used for the benefit of the members' spouse, civil partner or financial dependents, or paid to charity.

There is also the suggestion that the Government feels that the flexibility offered by alternatively secured pensions is too generous. The Budget notes indicate that the Government will now consider how best to restrict alternatively secured pensions to their original limited purpose.

7. CHARITIES

The Budget introduces two measures affecting charities. The first concerns anti-avoidance provisions, and the second makes provision for Income and Corporation Tax relief where a charity undertakes trading activities:

Anti-avoidance Provisions

The new rules are aimed at individuals and companies who misuse charitable reliefs through the use of companies they control. They will affect charities with substantial donors and certain companies who make cash donations to charity and receive large benefits in return for the gift. There are three aspects to the additional rules:

- The dealings that a charity can have with its "substantial donors" will be restricted and tax relief will be denied to the charity where such restrictions are breached. "Substantial donors" are defined as those giving £25,000 or more in a single 12-month period or £100,000 or more over a six-year period. The guidance issued by HMRC lists those transactions to which the new rules will apply, which include property transactions, loan arrangements, the payment of remuneration in certain cases, together with the investment by the charity in the donor's business, unless listed. Certain transactions (broadly those on commercial arm's-length terms) will be exempt. Any transactions which take place on or after 22 March 2006 will be affected.
- Until now, non-qualifying expenditure has resulted in a restriction of tax relief on income and gains received by the charity only to the extent to which its income and gains exceed £10,000, and are not exceeded by qualifying (or charitable) expenditure. From now on, non-qualifying expenditure will restrict relief regardless of the level of income or charitable expenditure; this will restrict the income and gains eligible for tax relief by £1 for every £1 of non-charitable expenditure incurred, and will have effect in relation to non-charitable expenditure incurred in any chargeable period commencing on or after 22 March 2006. An excess of non-qualifying expenditure over income or gains may be carried back to an earlier period.
- "Non-close" companies will be subject to the same limits on benefits received as a result of a gift to charity as currently apply for individuals and "close" companies (broadly those under the control of five or fewer persons). Similar rules will apply for non-close companies when gifts are potentially repayable or are associated with the acquisition of property by the charity from the donor or connected persons. This will affect payments to charities made on or after 1 April 2006.

Income and Corporation Tax Relief for Trading Activities Undertaken by a Charity

These rules will provide tax relief to those charities that undertake a trade that is only partly carried on for a charitable purpose, or which is partly (but not mainly) carried out by the beneficiaries of the charity. The new measures will apply to chargeable periods commencing on or after 22 March 2006, and relief will be given on profits reasonably attributable to that part of the trade which is carried on for the primary purpose, or carried out by the charity's beneficiaries. To an extent, it provides statutory form to the existing practice.

8. BUSINESS TAX

Corporation Tax Rates

As announced in the Pre-Budget Report, changes to revert back to the corporation tax position for small companies prior to the introduction of starting rate band and the non-corporate distributions rate have been introduced. From 1 April 2006 profits will be charged at either the small companies' rate of 19% or the main rate of 30%, with

marginal relief for companies with profits between the limits. The small companies' limits remain unchanged at £300,000 and £1.5m per annum for a single company with no associated companies.

Capital Allowances

The rate of first year capital allowances available for qualifying expenditure on plant and machinery by small businesses will increase from 40% to 50% from 1 April 2006. The first-year capital allowances rate for medium-sized businesses remains unchanged at 40%.

Group Loss Relief

Following the well-publicised outcome of the Marks & Spencer's case, in which the European Court of Justice ruled that the UK's group relief rules were in principle not compatible with European Law, new measures have been announced, with effect from 20 February 2006, to allow group loss relief in limited circumstances for foreign subsidiary losses or losses arising from permanent establishments. Foreign losses will only be relievable in the UK where all possibilities of relief have been exhausted and future loss relief is unavailable in the relevant local country. The foreign loss will need to be recalculated under UK tax principles. These new measures only apply to foreign subsidiaries or permanent establishments resident in the EEA and there will be anti-avoidance legislation introduced to prevent abuse.

R & D

Minor changes have been announced to the Research and Development tax relief and vaccines research relief. The time limit for the claim for the enhanced expenditure has been reduced from six to two years following the end of the relevant accounting period to align the time limit with that of the current time limit for the payable tax credits. The new time limit changes will be effective for accounting periods ending on or after 31 March 2006 and there will be transitional rules in the case of accounting periods ending before that date. The categories of qualifying expenditure have been extended to include payments made to clinical trial volunteers. This will be effective from 1 April 2006 for large companies. In the case of small- and medium-sized enterprises, the effective date will be announced by the Treasury subject to approval by the European Commission.

Securitisation and International Accounting Standards

The temporary tax regime that allowed a securitisation company to remain as a "UK GAAP" company rather than an "IAS" company has been extended for a further year to 31 December 2007 to allow for time to develop a more permanent tax regime.

Taxation of Leased Plant and Machinery

Currently, lessors are entitled to claim capital allowances on the cost of the plant and machinery and are taxed on the rentals received from the lessees. Lessees are not entitled to capital allowances but are entitled to a deduction for their rental payments. Longer-term leases function in a very similar way to loans and the new legislation intends to align the tax treatment of leased plant and machinery with that of plant and machinery acquired with other forms of finance. The new regime will apply to leases of longer than five years (and in some cases longer than seven years) and will prevent lessors claiming capital allowances on the cost of the leased asset, but tax them only on the proportion of the rental income that reflects the financing charges. Lessees will be entitled to claim capital allowances on much the same amount as they would had they bought the assets, and receive a deduction for that part of the rentals on which capital allowances are not available.

The legislation will apply to leases finalised on or after 1 April 2006. Also, it will be possible to elect to treat a pre 1 April 2006 lease, other than leases of cars to be taxed under the new regime.

Life Insurance Companies

The revisions address the basis for taxing income and gains attributable to assets not needed to pay for policyholder benefits, such that for accounting periods beginning on or after 1 January 2005 and ending before 1 October 2006, such income and gains will be taxed at normal corporation tax rates.

Film Tax Relief

Tax incentives for the British film industry were first introduced by the then Conservative Government in 1992 and provided for qualifying production expenditure to be written off for tax purposes over a period of 36 months. In 1997 the incoming Labour Government made further changes to the rules, introducing an enhanced 100% write-off for qualifying British films with production budgets not exceeding £15m. The two sets of rules have since operated side by side and they have undoubtedly increased substantially the funding available to British film producers.

The special tax reliefs have mostly financed the industry indirectly, by enabling producers to sell the benefit of their tax losses to individuals with substantial income tax liabilities at the 40% marginal rate. This has mostly been done through the medium of film leasing partnerships, which have purchased completed films and then leased them back to producers under arrangements underwritten by banking institutions. Not all film partnerships have been 'vanilla' structures of this type and over the years the rules have been progressively tightened in order to curtail perceived abuses of the reliefs. Concerns over such abuses, together with a desire to make the tax breaks more focused, has now prompted the Government to introduce an entirely new system.

The new regime applies to films intended for theatrical release which commence principal photography after 31 March 2006 and gives the benefit of tax reliefs and allowances directly to companies engaged in the production of 'British films'. A British film is defined as one which meets the conditions of a test to be introduced by means of

revisions to the Films Act 1985. Qualifying UK expenditure will be that which is directly incurred in relation to pre-production, principal photography and post-production activities which take place in the UK.

Under the revised rules, an additional tax deduction for qualifying UK production expenditure will be provided. This will be at a rate of 100% for films with total qualifying production expenditure of £20m or less and 80% for all other films. Where this additional deduction gives rise to a loss, the producer will be entitled to surrender it, up to the amount of its qualifying expenditure, in return for a payable tax credit. The credit will be calculated at a rate of 25% for films with qualifying production expenditure of up to £20m and 20% for all other films.

Transitional rules which preserve the existing tax reliefs will operate in relation to films commencing principal photography before 1 April 2006, provided that they are completed before 1 January 2007 and acquired (for example by a sale and leaseback film partnership) before 1 October 2007.

9. ANTI-AVOIDANCE

Disclosure of Tax Avoidance Schemes

The disclosure regime was first introduced by the Finance Act 2004 and requires promoters of certain tax avoidance schemes to provide details of the arrangements to HMRC within five days of making them available for use. In this way, HMRC are able to counter such schemes by the introduction of new legislation as soon as the schemes are marketed.

The existing regime is restricted to schemes that concern employment arrangements, certain financial products and Stamp Duty Land Tax. It will now be extended to cover the whole of Income Tax, Corporation Tax and Capital Gains Tax with effect from 1 July 2006. The full extent of the new regime will however only become clear when new tests to determine what constitutes a scheme are announced in April. HMRC have announced that the new tests will target certain specific types of schemes which will refine the existing criteria to identify schemes marketed with a high degree of confidentiality, or premium charges, those which by contrast are mass marketed, and areas defined as being of particular risk.

In certain situations where schemes are designed in-house and there is no promoter involved, the individual or company is required to disclose the scheme. At present it is only necessary to make such disclosures when the relevant Tax Return is filed. From 1 July 2006 large businesses (ie those that do not qualify as SMEs) will be required to disclose in-house schemes within 30 days of implementation.

Rawlinson & Hunter provides tailored tax planning for its clients and has not been required to make disclosures under the existing regime to date. We are concerned that the filters designed to ensure that disclosure only applied to "schemes" will not be sufficiently clear, and disclosure of a wider tax planning advice may be required.

Protecting Revenues: Finance Products

These measures block a number of avoidance schemes that have been notified to HRC under the disclosure rules introduced in 2004. A common feature of a number of these schemes is that they use intra-group arrangements to avoid tax on income arising in the group, or create a tax loss when there is no economic loss to the group as a whole.

Controlled Foreign Companies and Residence

Currently, companies that became non-UK resident as a result of a double taxation treaty before 1 April 2002 are not caught by the Controlled Foreign Companies ("CFC") legislation. From 22 March 2006 these companies will be subject to the CFC legislation and treated the same as companies that became non-resident after 1 April 2002.

The UK CFC legislation aims to limit the avoidance of UK tax that occurs when profits that might otherwise be taxed in the UK are for that reason diverted to a low-tax territory.

Remuneration

New anti-avoidance provisions are being introduced to counter schemes involving the award of certain types of share options to employees. The new provisions are designed to ensure that the full value of the benefit received by the employee is subject to tax and national insurance. The rules will apply where there is a tax avoidance motive and should not therefore affect genuine employee incentive schemes involving share options.

Sale of Lessors

Changes have been announced to the way that lessor companies are taxed when they change ownership. Groups have benefited from capital allowances in the early years of a lease, before selling lessor companies to loss-making groups to avoid paying tax on the subsequent profits.

Lessor companies are able to claim capital allowances on the plant and machinery that they lease. This normally results in tax profits being lower than accounting profits in the early years; effectively the tax charge is deferred. The timing benefits are increased where the lessor company is within a wider group through the surrender of early losses as group relief. Companies have been deferring the tax charge further (or indefinitely) by selling the company to a group that has substantial losses that can be surrendered to the lessor company by way of group relief.

The measures will recover the benefit the lessor company has derived from capital allowances where it is sold by way of a charge equivalent to the capital allowances claimed. The company will be entitled to an equal and opposite relief

in the next accounting period and therefore the new measures should not discourage sales of a lessor company which are not tax motivated.

Also includes measures to prevent groups manipulating the effect of the charge by transferring assets that are subject to leases from other group companies to the lessor companies.

Corporation Capital Losses

It is confirmed that the three anti-avoidance rules announced in the Pre-Budget Report will be effective from 5 December 2005. The measures are aimed at deterring:

- The contrived creation of corporate capital losses;
- The buying of capital gains and losses; and
- The conversion of income streams into capital gains, and the creation of a capital gain matched by an income deduction, where the gains are then relieved by capital losses.

Alternative Finance Arrangements

New measures have been announced to broaden the current legislation on alternative finance arrangements. The current legislation, introduced in the Finance Act 2005, provides for alternative finance arrangements which do not give rise to the payment or receipt of interest (such as "Shari'ah" financing compatible with Islamic principles) to be taxed in a manner similar to those involving interest. The new measures provide for low-cost finance arrangements provided by employers to employees to be treated in the same manner as conventional low-interest loans to employees, such as potentially giving rise to a taxable benefit on the employee. In addition, finance arrangement which equate in substance to a loan or deposit, but again do not give rise to the receipt or payment of interest, are also brought within the rules.

10. VAT

Changes announced in the Chancellor's Budget this year are rather low key with no major changes or surprises. Measures included in this year's Budget tighten up existing anti-avoidance rules and proposals to stem avoidance in particular areas.

The predictable increase in VAT thresholds was announced. With effect from 1 April 2006 the VAT threshold is raised to £61,000 and the VAT deregistration threshold is raised to £59,000.

There has been an increase in the turnover limit for businesses wishing to adopt the VAT "Annual Accounting Scheme". The limit will be raised to £1,350,000 with effect from 1 April 2006.

The Chancellor announced a change to the VAT treatment of auctioneers' commission relating to works of art, antiques, collector's items and second-hand goods at public auction, when the goods are subject to the Temporary Importation (TI) regime. VAT at the standard rate (17.5%) will be accountable on auctioneer's commission when goods are sold under the TI regime and imported into the EU. This measure will take effect soon after Royal Assent to the Finance Bill.

Measures are to be introduced to merely strengthen HMRC's fight against VAT avoidance. Areas of immediate interest are:

- Measures are to be introduced to clarify the existing powers for HMRC officers to enter premises and inspect goods. These measures will have effect when the Finance Bill 2006 receives Royal Assent.
- Measures will be introduced for businesses selling and purchasing "specified goods" such as mobile phones, computer chips and other similar electronic items. Normally, the seller accounts for and pays VAT chargeable on the sale, but the proposed change will require a VAT-registered business purchasing "specified goods" to account for the VAT instead of the seller. This proposal is to combat Missing Trader Intra Community Fraud in "specified goods". This is where a seller collects the VAT on the sale but goes missing without paying the VAT over to HMRC - the purchaser being entitled to recover the VAT charged by the seller. These measures will be introduced at a later date once the Government has agreed the proposal with other EU member states.
- New measures will allow HMRC to direct individual businesses to keep specified records relating to goods that may be the subject of a fraud in which VAT charged on the supply of the goods is at risk of not being paid to HMRC. Such frauds commonly arise from supplies of mobile phones and computer chips, although the scope of the new measures is not limited to goods of this type. The new measures for record keeping will have effect when the Finance Bill 2006 receives Royal Assent.

To deal with a technical loophole relating to Finance Companies and returned goods, measures will be introduced for all finance agreements entered into on or after 13 April 2006. The effect of the new measure is that the subsequent sale by a Finance Company of returned goods will be subject to VAT in the normal way.

The Chancellor announced measures to make particular VAT regimes easier and simpler to understand:

- Businesses that make both taxable and exempt supplies operate a Partial Exemption method for calculating recoverable VAT. HMRC will be conducting an informal

consultation exercise to simplify the Partial Exemption "special method" regime. HMRC intend to introduce any changes from April 2007.

- The Government accept that VAT legislation relating to land and property is extremely complex, in particular, the provisions relating to the option to tax. The provisions will be rewritten to make the language clear and easier to understand . This is an attempt to eradicate many of the problems experienced to date.

11. STAMP DUTY LAND TAX

The measures announced today in relation to Stamp Duty and Stamp Duty Land Tax ("SDLT") are largely concerned with the clarification of certain areas and the extension of various reliefs, and their impact on the taxpayer is generally favourable. The main changes are set out below.

Stamp Duty Land Tax

a) Increase in the nil-rate band for SDLT for residential property.

Where the effective date of the transaction is 23 March 2006 or later the 1% charge will start at £125,000, an increase of £5,000 on the current level. All other rates and bands remain unchanged.

b) Extension of alternative finance reliefs to all persons.

It is not uncommon for the purchase of land and buildings to be financed by alternative financing arrangements, structured to preclude the payment of interest, and characteristically, these arrangements involved several taxable transfers of property. Current reliefs ensure that, where these arrangements are carried out by an individual, the amount of SDLT chargeable is no more than it would be under a more traditional loan finance arrangement. The reliefs operate to allow later transactions in the chain to obtain relief if tax has been paid on an earlier transaction in the same chain.

Measures announced today will extend these reliefs to all persons thereby allowing parity of SDLT treatment to companies, clubs, trustees, etc, who wish to use alternative financing products and will take effect for transactions on or after Royal Assent to the Finance Bill 2006.

c) Clarification and simplification of existing SDLT legislation.

As is common when a new tax is introduced, the SDLT legislation has included a number of anomalies. Representations have led to the announcement of various clarification measures which have the effect of taking a number of common transactions outside the scope of SLDT. Three such transactions will be identified in Treasury regulations which will take effect from 12 April 2006. The most common type of transaction involves a gift of property where the donee or beneficiary agrees or is required to pay Capital Gains Tax or Inheritance Tax arising on the gift. The other changes will be included in the Finance Bill 2006 and will take effect from the date the Bill receives Royal Assent. Proposed changes include:

- Removal of the SLDT charge arising on the transfer of an interest in a partnership where the partnership property includes land. This will apply for all partnerships whose main activity is the carrying on of a trade or profession provided that this is not dealing in or developing land.

- The rules on the variation of rent will be simplified so as to restrict the current charge to rent increases (not provided for in the lease) to those within the first five years. After the end of the fifth year, all rent increases will be subject to the 'abnormal increase' rules, the formula for calculating which will be simplified.

- Measures to ensure that transfers of assets between sub-funds of a settlement do not attract a charge to SDLT.

d) Withdrawal of Unit Trust "Seeding relief" with effect from 22 March 2006

Seeding relief gives relief from SDLT where property is transferred into a newly formed unit trust in return for the issue of units. This relief is no longer available and SDLT will be charged by reference to the market value of the land and buildings transferred.

Stamp Duty

Whilst there are well-established provisions to give relief in certain company reconstructions, (broadly where a company acquires the whole or part of a business of another company or the entire share capital of another company), these only applied where the acquiring company was registered in the UK. On 22 July 2005 HMRC announced that from that date, the reliefs would be available to an acquiring company anywhere in the European Economic Area provided that all the other conditions were met. This measure will be extended further to include acquiring companies worldwide.

In addition, in the past it was a strict requirement that the reconstruction should not change the proportion of the company or its business owned by each shareholder. This means that a strict mirror image of shareholders and their interest was required before and after the reconstruction and this was applied rigorously by HMRC. Measures announced in the Budget will allow a slight change in proportions where this has to occur for practical reasons.

BUDGET SUMMARY...

12. INTERNATIONAL - MUTUAL ASSISTANCE

The Government announced an extension to its international agreements on mutual assistance in the enforcement of taxes.

Currently the Government has in place arrangements for the exchange of information with regard to Income Tax, Capital Gains Tax and Inheritance Tax. The new powers will be extended to include indirect taxes and also mutual assistance on recovery action.

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

Partners

Philip Prettejohn FCA
Bob Drennan FCA
Simon Jennings FCA
Chris Bliss FCA
James Kelly FCA
Mark Harris FCA
Frances Stephens ACA
David Barker CTA
Kulwarn Nagra FCA
Ben Melling FCA
Paul Baker ACA

Directors

Mike Cunningham ACA
Colin Giles FCCA
Nigel Medhurst AIIT
Sally Ousley CTA
Derek Rawlings ACA

Consultants

Ken Dent FCA
Ralph Stockwell FCA

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

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.