BUDGET SUMMARY...

OVERVIEW

The Chancellor's final Budget seems something of an enigma. Incentives and reliefs for low income taxpayers and small businesses both seemed to have been discarded by the same Chancellor who had introduced them. In his Budget speech in 1999, the Chancellor accelerated the introduction of the 10% starting rate, as part of a Budget that "builds on a strong foundation of economic stability, and encourages a dynamic Britain of enterprise and fairness." In 2007 the objectives of a strong economy and fair society again form the foundation, but the architecture has changed. The cynical may feel that this is the price paid in order to allow the Chancellor to announce a reduction in the basic rate of tax, perhaps intended to coincide effectively with a General Election in 2008.

Indeed, small businesses seem to have suffered unduly in this Budget. Conversely, the middle income taxpayer – perhaps predominating in marginal seats – may feel relatively relieved. Nevertheless, underlying many of the announcements is a growth in the powers conferred on Her Majesty's Revenue & Customs (HMRC) to introduce regulatory rather than statutory provisions. Of special concern is the persistence with proposals to introduce a wide-ranging anti-avoidance rule for Capital Gains Tax, the scope for which appears to be left to be determined by HMRC guidance. The increased delegation of the power of the legislative to the executive arm ought to worry us all.

Additionally, increasing investigatory powers emphasise a predominant concern with the policing rather than the administration of revenue collection. This is perhaps exemplified in the announcement that businesses may be targeted for enquiry according to HMRC's own assessment of tax risk: extraordinarily, risk is identified as including situations where HMRC is unsure of its ability to understand the issues at stake – whether involving tax or commercial matters. Ignorance, while of no excuse for taxpayers, nevertheless seems to justify aggressive targeting for enquiry.

Such an atmosphere will make it increasingly onerous for taxpayers, who are vulnerable to the costs of enquiries and the threat of penalties, while required to Self-Assess against a background of broad legislation and complex (but changeable) regulation.

At its heart, this Budget threatens the ability of taxpayers to plan their affairs with reasonable certainty. In some ways, this is an unexciting Budget to stand as the Chancellor's final testimony, but its underlying message should give considerable cause for concern. Far from representing a sure and firm foundation for economic strength, it appears in many ways to strengthen the powers conferred upon an executive incapable of formulating precise and consistent fiscal legislation.

Briefing

March 2007

CONTENTS

Personal Taxes	1
Domicile	2
Trusts	3
Capital Gains Tax	4
Inheritance Tax	5
Charities	6
Business Tax	7
Anti-avoidance	8
Taxes Management	9
VAT	10
Stamp Duty Land Tax	11

MAIN POINTS OF INTEREST

Some relief in tax rates on overseas dividends 1.3
No relief for life assurance premiums paid in pensions 1.7
No accommodation benefit charge for overseas homes in companies 1.9
Anti-avoidance and some relief for offshore funds 1.11
Power to define "listed" stock exchanges 1.12
Domicile and Residence - the review continues 2.1
Ill-defined powers against "contrived" losses 4.2
POAT - late elections allowed 5.2
Incorporation less attractive 7.4
Capital Allowances more generous but the end of IBAs and ABAs 7.6
Company car regime more "green" 7.8
R&D Relief extended 7.10
Loss Relief for passive partners restricted 8.7
Incentives to file your Return earlier and online 9.1 and 9.2
Harmonised system for penalties 9.6
Criminal investigation powers for HMRC 9.7

1. PERSONAL TAXES

1.1 Modernising the Personal Tax System

In a surprise move the Chancellor announced that the basic rate of Income Tax will be reduced from 22% to 20% for 2008/09 onwards. However, in order to redress the balance, the Chancellor also announced the removal of the 10% starting rate of tax for earned income and pensions. The starting rate is retained for savings income and capital gains and there are no changes to the rates which apply to dividends. These moves, ascribed to a drive for simplification", do little to assist in this end, and (incongrously) penalise low earners and pensioners.

Whilst most tax allowances increase in line with inflation, the Chancellor continues his previous practice of increases above the rate of inflation in all age-related allowances. Indeed, the allowance for those aged 75 and over will increase to £10,000 in 2011/12.

For the purposes of National Insurance, the upper earnings limit for employee's Class 1 contributions for 2008/09 will be increased by £3,900. The Class 4 upper profits limit for the self-employed will be increased by the same amount. These increases are above the rate of inflation and are steps towards the alignment of both limits with the point at which the higher rate of Income Tax becomes payable.

Details of the rates and allowances are given in the Rate Card.

1.2 Increased Subscription Limits for Individual Savings Accounts (ISA)

As announced in the Pre-Budget Report, ISAs are to be amended to remove the distinction that currently exists between "mini" and "maxi" accounts. This change will take effect from April 2008 and after this date an individual will be able to subscribe to a cash ISA, a stocks and shares ISA or a combination of both.

The annual ISA subscription limits will be increased to £3,600 for a cash ISA and £7,200 for a stocks and shares ISA. This is subject to an overall limit of £7,200 for subscription to both in a tax year.

1.3 Taxation of Dividends received from Non-UK Resident Companies

Individuals who receive dividends from UK companies are entitled to a non-repayable tax credit equal to one-ninth of the amount paid. For lower- and basic-rate taxpayers this credit will be sufficient to settle the tax liability on the dividend income. Higher-rate taxpayers pay tax at 32.5% on dividend income but the tax credit effectively reduces the tax charge to 25% of the dividend received.

From 6 April 2008, individuals in receipt of dividends from non-UK resident companies will also be entitled to a non-repayable tax credit, provided they own fewer than 10% of the shares in the company concerned and they receive less than £5,000 of dividends a year from all non-UK resident companies.

Although this represents a welcome change in the existing legislation, the limit of £5,000 will restrict its application; although the Government has indicated that it is considering whether it is possible to extend the scheme more generally.

1.4 Private Sector Service Charges – Relief from the 40% Trust Rate of Income Tax

Most landlords are required to hold service-charge and sinking-fund payments made by tenants and leaseholders on trust. Where these funds are invested in interest-bearing accounts or other similar investments, the income arising is chargeable to tax at the special trust rate of 40%. This can affect individuals, partnerships and companies.

A provision in the Finance Act 2006 exempts the first £1,000 of trust income from the full rate of 40%. This was intended to benefit small trusts including service charges and sinking funds held on trust so that income not exceeding £1,000 is taxed at 20%. Income in excess of £1,000 is taxed at 40% in the normal way. A similar exemption applies to service charges and sinking funds held on trust in the social housing sector.

The Budget announcement means that the existing relief for social landlords will be extended to all landlords in the UK holding service charges and sinking funds on trust. Normally these funds will be held in deposit accounts with interest being taxed at 20%. As a result, there will be no further tax liability in many cases.

1.5 Alternative Secured Pension Schemes

The Alternatively Secured Pension was introduced as part of the new pension regime (pension simplification) which came into force on 6 April 2006 – 'A Day'. It allows a pension scheme member, who reaches age 75, to draw an income directly from the assets of the pension fund, as an alternative to purchasing an annuity.

There is at present no requirement to draw a minimum income, and HMRC had expressed concern that the alternatively secured pension may be used to pass on assets to the next generation without suffering an Inheritance Tax charge, rather than as a means of providing a pension for the scheme member.

Last year's Finance Act introduced, with effect from 6 April 2006, an Inheritance Tax charge on the pension fund assets where a person had an alternatively secured pension immediately prior to his death. This charge does not apply to assets used to provide a pension for the spouse, or a person financially dependent on the deceased, or which were paid to a charity, within six months of the death.

This year's Finance Act will now introduce, from 6 April 2007, a minimum income withdrawal requirement of 65% of the amount of a comparable annuity which could be purchased for a 75-year-old with the assets of the fund.

When the scheme member dies on or after 6 April 2007, there will be, in addition to the Inheritance Tax charge described above, an unauthorised payment charge of up to 70% where any remaining alternatively secured pension funds are transferred to pension funds of other members of the scheme. It was also announced on Budget Day that the Government will consult on measures to be introduced to prevent ways of inheriting tax-privileged pension savings.

1.6 Pension Schemes Anti-avoidance

Amendments will be made to pensions tax rules to exempt from tax certain minor benefits provided to retired employees, and to exempt from Inheritance Tax certain death benefits. At the same time, two anti-avoidance rules will be introduced.

A number of non-cash benefits provided by employers to former employees will cease to be taxable with effect from 6 April 2006. Broadly speaking, the exemptions will mirror certain exemptions which presently apply to active employees. They are to include the continued provision of accommodation and related removal expenses, welfare counselling, recreational benefits, annual parties and similar functions, and equipment for disabled former employees.

Often, a pension scheme member will assign to a trust the benefits which would become payable on his death before taking retirement. It has been the practice not to charge Inheritance Tax on such death benefits, provided they are paid out to beneficiaries of the trust within two years of the death. From 6 April 2006, distributions by the Trustees will not be subject to Inheritance Tax provided they are made within two years of the date in which the Trustees are notified of the death or, if earlier, the date on which they could have reasonably been aware of the member's death.

New anti-avoidance rules will prevent loss of tax revenue by manipulation of the way in which unauthorised payments are made, and will also counter artificial arrangements to reduce pension payments in cases of early retirement due to ill-health.

1.7 Term Life Assurance through Pension Schemes

Prior to pensions simplification, part of a member's contributions could be used to pay premiums on a term assurance policy which would provide a lump sum on the member's death. Subject to certain contribution limits, tax relief was given on both the life policy and pension contributions. From 6 April 2006, the contribution limits applying to the life policy element were removed.

The tax relief on life policy contributions is now to be withdrawn for new policies: with effect from 1 August 2007 for occupational pension schemes, and from 6 April 2007 in relation to other pension schemes.

Existing policies taken out in conjunction with occupational schemes can continue to qualify for relief if the insurer received the application before 29 March 2007, and the policy was taken out as part of the pension scheme by 1 August 2007. For other pension schemes, the relevant dates are 14 December 2006 and 6 April 2007, respectively. In both cases, entitlement to relief ceases if the policy is varied outside the original terms so as to increase the sum assured or length under the term, other than by exercise of an option provided for by the policy.

1.8 Venture Capital Schemes

A number of technical changes have been announced to Enterprise Investment (EIS), Corporate Venturing (CVS) and Venture Capital Trust (VCT) schemes.

For all three schemes the definition of a "qualifying company" will be refined. Currently there is no restriction on the number of employees of a company raising funds under these schemes, but in future it will be a requirement that the company (or group of companies of which it is a member) has fewer than 50 full-time employees or equivalents at the time when the relevant shares are issued.

In addition, a new investment limit will apply to a company raising money under any of the three schemes. For an investment to qualify for relief under the EIS or CVS, or to be treated as a qualifying holding of a VCT, the company (or, where appropriate, the group of companies) must have raised no more than £2m under any or all of the schemes during the 12 months ending on the date of the investment concerned. If the limit is breached, none of the shares forming part of the relevant issue will qualify for relief under the EIS or CVS, or rank as a qualifying holding of the VCT.

The new investment limits do not come into force immediately: for VCTs they apply to funds raised after 5 April 2007, whilst for EIS and CVS purposes the limit applies to shares issued after the date on which the Finance Act 2007 comes into force.

A further change will apply to trades carried on by subsidiaries of an EIS, VCT or CVS company. Currently it is a requirement that the company carrying on the trade is a direct 90% subsidiary of the parent. From 6 April 2007 the rules will be amended to allow 100% subsidiaries of direct 90% subsidiaries to qualify, and also 90% subsidiaries of direct 100% subsidiaries.

For VCTs, two relieving provisions are proposed. The first relates to the requirement that a VCT must at all times have at least 70% by value of its investments in "qualifying holdings", in order to retain approval. In some cases this could prevent a VCT from disposing of an investment. To deal with the anomaly, a new rule will be introduced for disposals after 5 April 2007. This will allow a disposal to be ignored for the purposes of the 70% test for a period of six months, provided the investment concerned has formed part of the VCT's qualifying holdings for at least six months prior to the sale.

A second provision will enable the Revenue to make regulations allowing for approval to be retained for a VCT in some circumstances which would otherwise occasion its withdrawal.

For EIS investment funds, the present requirement for monies raised to be invested within six months of the

closing date is to be extended to 12 months for approved funds with a closing date after 6 October 2006.

Finally, the restrictions on inter-group transfers of trades consisting of the exploitation of relevant intangible assets will be removed from 6 April 2007. This will benefit not only EIS, VCT and CVS companies, but also those issuing options under the Enterprise Management Incentive (EMI) scheme.

1.9 Foreign Homes owned through a Company

The Government has introduced a welcome provision giving clarity on the tax treatment where individuals purchase overseas homes through a company. Where, for example, an individual purchases a French holiday home using a "Société Civile Immobilière" to avoid local forced heirship rules, it has long been a matter of uncertainty as to whether a benefit-in-kind Income Tax charge could be imposed for his use of company-owned accommodation.

The new rules, which will apply with retrospective effect, suggest no such charge will arise. It should be borne in mind that other anti-avoidance rules may nonetheless apply to tax the accommodation,, and advice should be sought as the new relief provision appears to be limited to the benefit-in-kind charge. Taxes arising as a result of a company being regarded as managed and controlled (and thus resident) in the UK are not covered and would need to be considered (subject to any Tax Treaty provisions). Furthermore, the provisions would seem to apply only to companies owned by the occupants – and may not assist in other cases.

1.10 Sharia-Compliant Finance Arrangements

With effect from 5 April 2007, the Government will introduce new rules for the taxation of "Sukuks" which are investments broadly similar to debt securities. The Income Tax and CGT regime will be equivalent to that for existing conventional debt securities with provision for a "Sukuk" to be taxed in a manner similar to that for both qualifying corporate bonds and non-QCBs, whether held by individuals or companies.

1.11 Offshore Funds

A number of changes have been announced to the tax regime for "offshore funds". Very broadly, an offshore fund is a collective investment scheme established outside the UK. If it does not distribute substantially all of its income each year and obtain certification from the Revenue as a "distributing fund", any profit realised on a disposal of shares or units by a UK resident will be taxed as income rather than as a capital gain.

The first change affects multi-tiered funds, that is offshore funds which themselves hold investments in other offshore funds. Currently, these cannot be distributing funds if more than 5% (by value of their assets) consists of interests in other offshore funds. For the purposes of the 5% test, investee funds are ignored if they are distributing funds themselves (or could have been if certification had been obtained). However, the existing legislation is limited so that only the first layer (investing fund and investee fund) can be disregarded. This anomaly will be removed for account periods beginning after 31 December 2006.

The Chancellor also proposes to make an important change to the scope of the offshore funds regime. This affects the status of open-ended investment companies (OEIC), which currently falls outside the definition. For account periods beginning after 31 December 2006, an OEIC will be regarded as an offshore fund for tax purposes if investors can reasonably expect to realise their investments in the OEIC within seven years (rather than the current test of six months, which has been commonly avoided).

A second change will ensure that a loss on the disposal of an investment in an offshore fund can only be regarded as a capital loss.

The third and final change will exclude offshore income gains from the computation of an investment trust's income, when considering the requirement that this must derive "wholly or mainly" from shares or securities. Offshore income gains will remain taxable as income within the investment trust.

1.12 Recognition of Stock Exchanges and Definition of "Listed" for Tax Purposes

In a number of instances, several reliefs depend upon whether shares are listed on a recognised stock exchange - eg Business Property Relief, Business Asset Taper Relief, or in connection with the claims under the Enterprise Investment Scheme. Conversely, ISA rules require that shareholdings within an account be so listed.

The Government is introducing legislation to allow HMRC to designate as a recognised stock exchange for tax purposes any UK investment exchange so designated by the Financial Services Authority. A list of such exchanges can be found on the FSA website at http://www.fsa.gov.uk/register/exchanges.do. This list does not currently include the Alternative Investment Market but it is thought that it is only a matter of time before it does so. If that suspicion is confirmed, this may be another instance of tax being increased, or reliefs denied, by stealth.

These measures will come into effect with Royal Assent.

It will be important for clients to check whether their shareholdings are affected by these measures before entering into any transactions involving shares where reliance is placed on any of the above reliefs.

The power to designate overseas exchanges is not altered by these measures.

2. DOMICILE

2.1 Residence and Domicile

As we approach the fifth anniversary of the Government's first announcement of an intention to review the tax rules relating to residence and domicile, this Budget confirms that the review is still ongoing. The commitment to publish a Consultation Paper, which appeared in previous Budgets, is no longer mentioned. Increased disclosure requirements in the 2006/07 Tax Returns may, in light of recent cases such as Gaines-Cooper, indicate that HMRC is concentrating on information gathering, and litigation within the existing régime, where such cases have introduced elements of uncertainty.

3. TRUSTS

3.1 Amendments to Trust Tax Legislation

Two modifications have been made to Income Tax rules affecting trusts in receipt of certain capital sums.

Firstly, where a trust receives capital in the form of a company share buyback, the trustees will (with effect from 6 April 2006) be taxed only on the part of the payment in excess of the original subscription price. Without this change tax would have been due on the entire payment.

Secondly, with effect from 6 April 2007, where the trustees realise a "chargeable event" eg on the surrender or maturity of certain types of life assurance policy, the 20% notional tax credit will not form part of the trust "tax pool". The amendment removes an unintended anomaly since, as a matter of trust law, the surrender proceeds would normally be capital and not distributable as income.

4. CAPITAL GAINS TAX

4.1 Annual Exemption

Details of the annual exemption for 2007/08 are given in the attached card.

4.2 Contrived Losses

As we reported in our December 2006 Pre-Budget Briefing, the provisions introduced by FA 2006 to deprive companies of relief for contrived losses are to be extended to individuals, trustees and personal representatives, with respect to losses accruing on disposals made on or after 6 December 2006.

In light of the comments received since that announcement, HMRC's guidance has been revised but no changes are to be made to the draft legislation itself. The provisions will disallow a loss accruing to a person if:

- the loss accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and
- the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage, whether this is with respect to Capital Gains Tax, Corporation Tax or Income Tax.

This wording is so wide that a literal interpretation would catch transactions hitherto thought unobjectionable and reliance will have to be placed on guidance to limit its scope.

This point was raised by the professional bodies with detailed suggestions for revisions so as to target only contrived schemes. Unfortunately, the Government has dismissed such concerns, stating that the legislation should be read purposively in conjunction with the Statement of Principle (though this is not referred to in the legislation) and that clarification may be found in the revised guidance.

Consequently, it remains a matter of concern that the legislation could catch standard tax-planning strategies (commonly referred to as variations on the bed and breakfasting technique which was used before the share-matching rules changed). An example would be where a taxpayer crystallises a loss by disposing of shares and a similar quantity is bought back by the taxpayer's spouse, a family trust or his ISA. The revised guidance specifically deals with the situation where the taxpayer's spouse is concerned, but by way of extreme examples, leaving much cause for uncertainty.

As these provisions constitute something of a general anti-avoidance rule, the professional bodies requested a statutory clearance procedure to enable taxpayers to obtain certainty. The position of trustees wishing to wind up a settlement was raised as a case where certainty was particularly desirable. It has been announced that HMRC will operate a limited post-transaction clearance system for trustees wishing to do so.

5. INHERITANCE TAX

5.1 Nil-rate Band increases

The Government had already announced its plans gradually to increase the threshold for Inheritance Tax to £300,000 for 2007/08; £312,000 for 2008/09; £325,000 for 2009/10. They have announced that the nil-rate band for 2010/11 will be £350,000.

There are no changes to Inheritance Tax rates which is reassuring following the enormity of the Inheritance Tax changes made in Finance Act 2006.

5.2 Pre-Owned Assets - Late Election

Individuals who would otherwise be liable to pay the Pre-Owned Assets Tax (POA) charge can elect to have the relevant assets treated as part of their IHT estate so as to avoid the POA liability. However, such elections had to be made by 31 January 2007 by those otherwise liable to the charge in the 2005/06 tax year.

Legislation being introduced in the 2007 Finance Bill will permit HMRC to accept late elections for 2005/06 and subsequently.

6. CHARITIES

6.1 Increase in "Permissible" Benefits

Generally, where a donor receives a benefit from a charity as a result of making a donation, that donation does not qualify for Gift Aid relief. However, there are de minimis limits on the value of the benefit received.

From 6 April 2007, the value of benefits that can be received from a charity by a donor in relation to a donation without prejudicing the Gift Aid available has been increased. For qualifying Gift Aid donations in excess of £1,000 the limit on the value of benefits received is increased to 5% of the donation, subject to an overriding limit of £500.

6.2 Other Changes

Amendments are proposed to preserve the tax-exempt status of funds derived from lotteries operated by charities in consequence of the introduction of provisions in the Gambling Act 2005 and the repeal of Lotteries and Amusements Act 1976. In light of the Gambling Act provisions, larger lotteries run by charities will need to be registered to continue to qualify for the exemption.

A restriction on the deductibility of expenditure incurred in relation to an employee seconded to a charity or educational establishment (which was accidentally lifted when the relevant provisions were rewritten) has been reintroduced. Only expenditure incurred within nine months of the end of the relevant accounting period will be deductible.

7. BUSINESS TAX

7.1 Business Tax Reform Package

The Chancellor has used this year's Budget as a platform to announce some significant changes to the taxation of business.

Of these, the headline announcement is that the rate of Corporation Tax, for companies liable to the main rate, will decrease from 30% to 28%. This is a welcome development, although not surprising given concerns about the UK's competitiveness in the face of lower tax jurisdictions.

The other side to this is a graduated increase in the rate of tax payable by small companies (presently those with taxable profits of less than £300,000) from the current rate of 19% to 22% by 2009. Whether this increase in the tax burden will be offset by the aggregate effect of a series of specifically targeted initiatives to assist small business (both those in this year's Budget and in the Companies Act 2006), is yet to be seen. At this stage, all that can be said is that simplifying the regulatory burden can be a complicated process.

Changes will also be made to the existing capital allowances regime, as explained below. These will clawback much of the tax revenue foregone by the decrease in the headline rate.

In addition, there is good news for companies incurring qualifying expenditure on research and development as Gordon Brown announced increases in the levels of deductions available under the existing scheme.

7.2 Corporation Tax Main Rates

As noted, individual companies, or companies in groups, with profits above the upper relevant maximum amount (currently £1,500,000) will from 1 April 2008 have their profits taxed at 28%. [The exception to this is companies with profits from oil extraction and oil rights within the UK and UK Continental Shelf.]

7.3 Corporation Tax Small Companies' Rates

The small companies' rate, which applies to companies whose taxable profits are below the lower relevant maximum amount (currently £300,000) will rise from 19% to 20% from 1 April 2007. Further rises to 21% in 2008 and 22% in 2009 are set to follow.

It should be noted that the rules surrounding the taxation of the majority of investment companies (non-trading companies) remain unchanged, such that Corporation Tax at the main rate will be applied.

Companies with taxable profits between the lower relevant maximum amount (£300,000) and the upper relevant maximum amount (£1,500,000) will continue to be taxed under the existing mechanism, which applies the main rate of tax to profits less a deduction for 'marginal relief' in order to arrive at an effective rate of taxation between the main rate, and the small companies' rate.

7.4 So - What has the Chancellor achieved?

The nil-rate Corporation Tax band was introduced to assist small companies. The Treasury then became concerned that small businesses were incorporating to take advantage of this, so the nil-rate was abolished. Now, small companies are to pay more tax with the rate rising to 22% over the next couple of years. In the meantime, the basic rate of Income Tax is to reduce to 20%. This is likely, and appears to be intended; to discourage small businesses from incorporating. It seems to confirm the impression that the Chancellor has vacillated between encouragement and disapproval.

7.5 Film Tax Relief

Finance Act 2006 introduced new rules governing tax relief for film production expenditure, the effect of which was to provide a deduction for tax purposes directly to the film producer.

Under these provisions, each film is treated as a distinct trade of the production company, the trade commencing when pre-production work begins and the associated costs and revenues being accounted for separately for each film. In addition, where productions intended for cinema release satisfy the criteria for certification as "British" films, an additional tax deduction for qualifying UK production expenditure is available. This is at a rate of 100% for films with qualifying production expenditure of £20m or less and 80% in other cases. In certain cases the tax deduction can be surrendered in return for a payable tax credit.

It is proposed that film production companies should be allowed to opt out of the Finance Act 2006 provisions, and to be taxed instead in accordance with the rules applying to companies generally. They will be able to do so by making an election in their Corporation Tax Return. Once made, the election will apply to films whose principal photography starts in the period to which the return relates, as well as any later films. It will not be possible to revoke an election outside the time limit for amending the relevant Corporation Tax Returns.

The new provisions will provide an extra element of flexibility, but their overall impact on the British film industry is likely to be limited.

7.6 Capital Allowances

The temporary 50% rate of first-year capital allowances available for qualifying expenditure on plant and machinery by small businesses will be extended for a further period of one year. The first-year capital allowances rate for medium-sized businesses remains unchanged at 40%. There are various reforms to the capital allowances system proposed for 2008/09 including the replacement of first-year allowances for small- and medium-sized businesses by an annual investment allowance of up to £50,000 per annum, and a reduction in the writing down allowances from 25% to 20%.

Industrial Building Allowances (IBAs) and Agricultural Building Allowances (ABAs) will be phased out over four years. The first measure is the withdrawal of the balancing adjustment and recalculation of Writing Down Allowances (WDAs) in respect of events occurring on or after 21 March 2007. Normally, when an industrial or agricultural building is sold or a leasehold interest comes to an end, such an event gives rise to a balancing adjustment based on any difference between residue of qualifying expenditure and the proceeds from the event. At present, the new owner (on a purchase within 25 years of the first use of an industrial building) is entitled to a recalculated WDA, based on the Relevant Qualified Expenditure (RQE) after the sale. Under the proposed revisions, the new holder of the relevant interest will take over the WDAs based on the previous owner's RQE.

For qualifying expenditure incurred on or after 11 April 2007, Business Premises Renovation Allowance (BPRA) will provide a 100% initial allowance for capital expenditure on the renovation or conversion of business properties that have been vacant for a year or longer in designated disadvantaged areas of the UK. Disadvantaged areas are defined as Northern Ireland and the areas specified as development areas by the Assisted Areas Order 2007. There will be a number of types of business that will be excluded from the scheme, including fishery, ship building, coal and steel industries, synthetic fibres, production of agricultural products and manufacture of milk products.

7.7 Company cars

With effect from 6 April 2007 legislation will be brought in to remove an anomaly whereby an employee earning less than £8,500 could incur a double tax charge if provided with car and car fuel benefits through an employer's credit card or voucher. There has been concessionary treatment in place since July 2004, so there will be no effect in practice.

Employees who are provided with a company car available for their private use will receive a 2% discount on the taxable benefit percentage if the car has been manufactured to run on Bioethanol (E85 fuel). This will have effect from 6 April 2008.

For 2007/08 the multiplier figure for the company car fuel benefit charge will remain at £14,400.

7.8 Reform of company car taxation

In March 2006, the Government issued a consultation document on "modernising tax relief for business expenditure on cars". In brief, this indicated that they were considering abolishing the current rules for restrictions on capital allowances and lease payments for "expensive cars" and introducing new rules that would be simpler to administer and would also have a beneficial environmental focus. Following initial consultation, the Government has issued an update setting out their proposals.

It is proposed that both capital allowance restrictions and lease rental restrictions should be based on CO2 emissions. Cars with emissions of less than 120g/km will retain the existing 100% first-year allowance. Cars with emissions between 121 and 165g/km will be assigned to the general plant and machinery pool. Cars with emissions above 165g/km will be assigned to a new pool with lower writing down allowances.

The leasing restriction would be abolished for cars with emissions of up to 165g/km and a uniform fixed percentage disallowance would be applied on leasing payments for cars with emissions in excess of 165g/km.

The Government has invited further comments by 16 May 2007.

7.9 Hydrocarbon oils duty

From 1 October 2007, excise duty on main road fuels will increase by 2p per litre. The rates will be increased by a further 2p per litre on 1 April 2008 and 1.84p per litre on 1 April 2009. The duty rates for other road fuels will be increased by the same percentage as the main road fuels. The effective rates of duty for non-road fuels will be increased by 2p per litre from 1 October 2007. These rates will be increased by the same percentage as the main road fuels on 1 April 2008 and 1 April 2009. The current duty differential of 20p per litre for bio fuels will be extended to 2009/10.

7.10 Extension of the R&D Tax Relief Scheme

The R&D tax relief scheme, giving an enhanced tax deduction to companies spending money on scientific research and development, has been reasonably successful; nonetheless, the Gower Review of Intellectual Property in the UK last year identified a number of areas in which it could be improved.

The Chancellor has now provided a response to the Review, with an increase 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, these increases in the level of deduction will not apply until the introduction of the Finance Act 2008 and are subject to approval from the EU.

As announced in the Pre-Budget Report, the qualifying limits for small and medium enterprises are to be increased so that an SME, for R&D tax credit purposes, will be a company which has:

- fewer than 500 employees (presently 250);
- turnover of less than €100m (presently €50m); and/or
- balance sheet total of less than €86m (presently €43m)

Although this change will be included in the Finance Act 2007, it will not come into effect until it has been approved by the EU, as the SME employee limits are set by EU legislation. If the usual timetable applies, the change will become effective sometime in September 2007.

7.11 Statutory Clearances

In the Pre-Budget Report in November 2006, the Chancellor announced that HMRC would extend existing clearance procedures so that businesses would be able to obtain HMRC's view of the tax consequences – across all relevant taxes – on significant commercial issues.

Existing clearance procedures are to be extended in 2007 for Stamp Duty Land Tax (from Royal Assent) and Substantial Shareholdings' Exemption (from 1 June 2007).

HMRC has a form of clearance procedure for all new legislation, allowing clarification to be sought under Code of Practice 10. However, this procedure can only be used for queries in respect of legislation introduced in the last four Finance Acts. Stamp Duty Land Tax (SDLT) was introduced in 2003, and the Substantial Shareholder Exemptions (SSE) in 2002. Both sets of provisions would be outside the time limit for queries, as there were two Finance Acts in 2005.

This extension in respect of SDLT and SSE ensures that queries can continue to be raised for issues relating to these matters – there will be a general extension for other areas of tax in 2008, but the present move is an indication that SDLT and SSE are still causing difficulty for companies, several years after their introduction.

7.12 Securitisation Companies

Finance Act 2005 allows securitisation companies to be taxed on the basis of accounting standards in force before the introduction of International Accounting Standards, for periods of account ending before 1 January 2008. This measure allows that treatment to be extended by regulation, and will cover a wider range of securitisations. No further detail is yet available as to the extent of the extension time and range.

7.13 Remote Gaming Duty

Remote gaming is the playing of a game of chance via remote communication, such as the internet, telephone or television. Internet gaming in particular has been the focus of some attention recently, with the threat of US proceedings against executives of remote gaming companies.

The Gambling Act 2005 will finally come into effect on 1 September 2007 and will make it possible for the Government to license UK-based remote gaming operators. Unsurprisingly, the Government want to make sure that they are able to levy gambling excise duty on the profits of these operators, given that they already levy duty on traditional gaming operators such as casinos.

The Finance Bill will contain provisions that will levy a flat 15% excise duty on gaming profits, in comparison with the tiered gaming duty which was charged on the gross gaming yield (rather than profits) of UK casino operators. That tiered duty is to be amended with effect from 1 April 2007, so that the rates of duty for UK casinos will be between 15% and 40%, depending on the level of gross gaming yield.

7.14 Sale and Repurchase Agreements (“REPOS”)

This year’s Budget announces the Government’s intention to establish a new Corporation Tax regime for “REPOS” with the view to replacing and simplifying the existing rules, and in so doing close down certain tax avoidance schemes that took advantage of the current system.

The consultation process between the Government and business is not yet complete, and so the final detail of the changes is not yet known; however, it is clear that substantive measures will be incorporated into the 2007 Finance Bill.

The new rules will adopt an accounts-based approach intended to ensure that the tax treatment mirrors the accounting treatment, (which following the phasing in of International Accounting Standards will require reporting of the substance of transactions over legal form).

8. ANTI-AVOIDANCE

Aside from Capital Gains Tax measures, described in section 5 above, measures to combat corporate avoidance are continued, with the Chancellor outlining various provisions to stop schemes that have been identified through the disclosure regulations:

8.1 Corporate Capital Loss and Gain Buying

Finance Act 2006 introduced measures to prevent groups of companies obtaining a tax advantage where ownership changed and where one of the main purposes of the change was to provide the new owners with access to the capital losses or gains in that company.

Under certain circumstances, these measures could be side-stepped by purchasing a holding company to access the losses and gains in the subsidiaries – that loophole has now been blocked.

8.2 Loss-buying

A particularly specialised form of tax avoidance has involved purchasing tax losses from loss-making corporate members of Lloyd’s insurance market who are ceasing underwriting activities. The special accounting system at Lloyd’s delays the tax recognition of losses so that it has been possible for purchasers of Lloyd’s corporate members to have the use of losses that arose before acquisition by the purchaser – generally, where a company is purchased, losses arising before the purchase cannot be used by the purchaser.

The advantage, which is specific to purchases of Lloyd’s corporate members, has now been blocked so that the losses cannot be used by a purchaser unless there is an existing economic connection between the purchaser and the Lloyd’s member.

8.3 Sale of lessor companies

These provisions were introduced in the Pre-Budget Report and are now confirmed in the Budget: the anti-avoidance measures are intended to stop avoidance of the rules introduced in the Finance Act 2006 that attempt to deter tax-motivated sales of companies that carry on a trade of leasing plant and machinery.

8.4 Employee benefit trusts

A company providing benefits to employees can deduct the cost for tax purposes in an accounting period only if the benefit is actually made available to the employee, either in the accounting period or within nine months of its end. This includes contributions to an employee benefit trust, and a company cannot obtain a tax deduction for the contribution until the trust itself makes a taxable transfer or payment to the employee (extended to include transfers or payments that would be taxable if not covered by an incentive scheme such as Employee Management Incentives).

However, as the legislation refers only to “payments” and “transfers” to Employee Benefit Trusts, (EBTs) some companies have been avoiding such payments or transfers by creating trusts over assets which the company owns. As expected, the Chancellor has moved to block this particular

loophole and the Finance Bill will contain a clause that "confirms" that any action bringing property into an employee benefit trust will be covered by the restriction – the Treasury, as usual, is not prepared to admit that the original legislation was flawed and so describe the change as a "confirmation".

8.5 Managed Service Companies

In order to minimise employment liabilities, many companies using the services of self-employed contractors require them to provide their services through a company. A Managed Service Company (MSC) is used by several self-employed individuals who each provide their services to clients. MSCs have become more popular as the Government has made it more difficult for self-employed individuals to make their services available through personal service companies, which generally provided the services of a single individual.

The Government views these companies as enabling individuals to gain a tax advantage by taking dividends rather than salary to extract their income: the provisions introduced in the Budget are intended to restrict any tax advantage by requiring an MSC to account for PAYE and National Insurance on all income received by an individual through an MSC on or after 6 April 2007.

There will be exclusions for employment agencies – the changes are intended to target those companies where the individuals have some influence on the way in which payments are made to them.

The Government assumes that individuals enter into MSC and personal service company arrangements motivated by tax advantages, overlooking the fact that a number of industry sectors require a self-employed individual to operate through a company. The changes to Corporate Taxation – in this and previous Budgets – have in any event made it rather less attractive for a self-employed individual to operate through a company; individuals using MSCs are, therefore, likely to be doing so at the insistence of clients and not through a tax avoidance motive.

8.6 Life Assurance and Commission

FA 2007 will include specific legislation aimed at targeting perceived tax avoidance through the use of short-term life assurance policies and commission arrangements. Taking effect from 21 March 2007, this will ensure that if a relevant chargeable event occurs:

- where premiums exceeding £100,000 are paid in any year; and
- where the relevant chargeable event occurs in the relevant period

then, in calculating the gain on the policy or contract, the allowable deduction for the premium paid is reduced by the amount of commission passed on to the individual or reinvested on his behalf.

Relevant chargeable events are: the maturity of the policy, the surrender of whole of the rights conferred by the contract, and the assignment for money or money's worth of those rights. As such, the legislation does not cover the situation where death gives rise to benefits under the policy.

The relevant period is the period from the start of the tax year in which the chargeable event falls to the actual date of the chargeable event and any of the three preceding years of assessment.

The legislation contains an anti-fragmentation rule which prevents individuals avoiding the provisions by acquiring a number of policies at or below the £100,000 limit. There is also a provision giving the Treasury the power to make regulations to change the amount of the premium threshold and the definition of "relevant period".

8.7 Tackling Avoidance – Individuals in Partnership – Restriction of Loss Relief

A measure to counter the avoidance of tax through the use of relief for partnership losses was announced on 2 March 2007 (as Revenue & Customs Brief 18/07) and will have effect from that date. The new legislation is targeted at non-active partners - defined as either a limited partner, or any partner who spends less than ten hours a week personally engaged in carrying on the partnership's trading activities. It will also apply to partners in a limited liability partnership.

The general rule is that an individual is able to set losses from a trade against their other income and capital gains (commonly referred to as sideways loss relief) in the current or preceding tax year (with carry-back for three preceding years available for the first four years of trading). However, this relief is already restricted for a non-active partner, who can claim to set losses against his or her other income or capital gains, only to the extent (broadly) that capital has been contributed to the partnership.

The new legislation will introduce two further measures to restrict the availability of sideways loss relief to non-active partners.

When calculating the amount of capital the individual has contributed to the partnership, certain sums will be excluded. These will be amounts paid by the non-active partner on or after 2 March 2007 (apart from where there was a relevant irrevocable pre-existing obligation) where the main purpose, or one of the main purposes, of the capital contribution is to have access to losses for which sideways loss relief can be claimed. Draft legislation has yet to be published so it is not known whether this will be a subjective or objective test.

It is also proposed to introduce a cap on the amount of sideways loss relief a non-active partner can claim in any tax year. To be known as the annual limit, will be set at £25,000 and apply to trading losses sustained on or after 2 March 2007. The cap is to restrict the loss relief claim; where other provisions bring the amount of losses eligible for sideways relief to below this limit, the lower figure prevails. It is understood that this new limit will not apply to losses arising from carrying on a profession or a Lloyd's underwriting business.

The annual limit will apply to the aggregate of all trading losses sustained by a relevant partner on or after 2 March 2007. It is proposed that the Treasury will be given powers to amend the quantum of the annual limit.

There will be special rules where a partner's basis period (the period for which the accounts are prepared) straddles 2 March 2007. The losses affected by the legislation will be the trading losses for the basis period less pre-

announcement losses, and there will be transitional apportionment and provisions.

Following the publication of the brief, and as a result of lobbying from the film industry, it was announced that neither the proposed purpose test nor the £25,000 annual limit will apply to losses derived solely from relevant film-related expenditure. Relevant film-related expenditure is expenditure meeting approved conditions sets down in earlier legislation. The concessions are to preserve the position for individuals benefiting under previous legislation from specified film tax reliefs (currently being phased out).

Where losses of a non-active partner are ineligible for sideways relief, they are carried forward and can be set against future partnership profits from the same trade.

9. TAX MANAGEMENT

9.1 Self-Assessment Tax Return Filing Dates

The Government accepted Lord Carter's revised recommendations on the Tax Return filing dates for individuals, trustees and partnerships in July 2006. There is no change to the filing deadline for 2006/07 Tax Returns. However, there will be two separate filing dates for 2007/08 onwards. For paper returns, there will be a new deadline of 31 October following the end of the tax year (so that for 2007/08 the deadline will be 31 October 2008). For Returns filed online, the deadline remains unchanged, being 31 January following the end of the tax year.

Rawlinson & Hunter already has software with full capability for online filing and we successfully filed a number of clients' 2005/06 Tax Returns online. We are intending to increase that number for 2006/07 with the aim that, with effect from 2007/08, the vast majority of our clients' Tax Returns will be filed online.

The cut-off date for amending a Return will be the same irrespective of the manner in which the Return is filed, ie, it will still be one year and ten months after the end of the tax year to which the Return relates. Various related provisions, that have time limits linked to Return filing deadlines, will be amended to ensure that the existing dates referred to are retained.

9.2 The Enquiry Window

Lord Carter's recommendation for shortening the period during which the Revenue will accept paper Tax Returns is clearly designed to encourage taxpayers to use online filing. Changes to the enquiry window are now introduced to encourage taxpayers to file their Returns earlier. For Income Tax Self-Assessment Returns from 2007/08 onwards, the normal enquiry window will close one year after the delivery of the Return to HMRC, rather than one year from the 31 January filing deadline.

9.3 Companies filing Tax Returns

To encourage early filing of Corporation Tax Returns, the normal enquiry window for most companies will become one year after the Return is delivered to HMRC. This will be effective for company Tax Returns for accounting periods ending after 31 March 2008. This change will not apply to large groups of companies whose Returns need to be reviewed together, where the current enquiry window remains linked to the statutory filing deadline.

9.4 Regulations to require online filing and electronic payment for businesses

Provisions will be introduced which will confer powers on HMRC to make regulations requiring businesses to file various forms online and make payments to HMRC electronically.

9.5 Effective date of payment by cheque

HMRC will be empowered to make regulations providing that, where a business pays Corporation Tax or VAT by cheque, the effective date of payment will be when the funds have cleared HMRC's account, rather than when the cheque is received. Businesses will therefore need to be prepared for such payments in advance if they are to be paid by cheque, or have the facility in place to pay funds electronically.

Regulations for online filing and electronic payments by businesses, setting out the effective dates for these measures, will be published in draft alongside the Finance Bill 2007.

9.6 Significant Changes to Penalty Regime

HMRC's powers to charge penalties in the event of submission of incorrect Tax Returns are scattered across the statutes, with different codes applying to Income Tax Self Assessment, Corporation Tax, PAYE/NIC and VAT. These are to be rationalised so that a single penalty code is to apply to all of these taxes, and the Finance Bill will contain legislation to give effect to this proposal. The new regime will apply from an "appointed day" which has yet to be announced by the Treasury but which is likely to affect return periods starting after 31 March 2008.

It is intended that there be statutory provision to vary the level of penalty imposed by reference to the circumstances in each case. Where a taxpayer makes a single and honest mistake, the penalty is likely to be waived. If the taxpayer makes an error through lack of care in preparing the return, the penalty can be expected to be modest. Higher penalties would apply where a taxpayer deliberately defaults, increasing still further if he then attempts to conceal the situation. By contrast, co-operation and full disclosure will be recognised. This effectively confirms existing practice. It is also possible that a penalty may be "suspended" to encourage future accurate compliance. A taxpayer will have a right in law to appeal against a penalty.

A harmonised system for charging penalties will bring greater clarity of expectation for the many taxpayers who, at some stage in their fiscal lives, find themselves in the position of having made an error in the filing of a Return. On this level, the changes are to be welcomed. Practitioners experienced in this field will look carefully to see that the introduction of a new charging structure is not used as an

opportunity to impose higher overall statutory rates of penalty than those customarily applied on a discretionary basis under the predecessor regimes.

9.7 Criminal Investigation Powers

The proposed changes in the penalty-charging regime do not, of course, affect HMRC's ability to institute criminal investigations in the most serious cases. Indeed, their powers in pursuing such cases are to be extended in the 2007 Finance Bill, so as to apply the provisions of the Police and Criminal Evidence Act 1984 (PACE) to tax enquiries generally, rather than being confined to investigations which relate to ex-Customs & Excise matters. These provisions will cover in particular:

- applications for search warrants
- applications for orders to obtain evidence from third parties
- arresting, searching and questioning suspects

These measures will enable HMRC, in prosecuting such cases, to operate within a single legislative framework, and will enhance their investigative powers in the process.

10. VAT

The Chancellor's Budget this year did not provide any major surprises. Measures introduced include changes to combat technical loopholes and to tighten up existing anti-avoidance rules.

The predictable increase in VAT thresholds was announced. With effect from 1 April 2007, the VAT registration threshold will be increased to £64,000 and the de-registration threshold will be increased to £62,000.

There will be a change to how taxpayers calculate VAT on private use of fuel used in motorcars. From the first VAT accounting period beginning on or after 1 May 2007, the fuel-scale charge will be based on CO_2 emissions rather than engine size.

The Chancellor introduced a minor change to the record-keeping requirements for businesses sold as a going concern. As from 1 September 2007, where a business is transferred as a going concern, business records are to be retained by the vendor (in line with requirements for other taxes).

A further announcement by the Chancellor affects businesses or other organisations which use land or buildings for non-business purposes. Organisations that allocate the acquisition of land and property for business and non-business use, to wholly business use, recover all VAT charged upfront (subject to the normal partial exemption rules) and account for VAT on the non-business use on each VAT Return. This is calculated by spreading the capital cost of the asset over an "economic life", and is commonly known as "Lennartz accounting". Regulations will be introduced so that calculations under the Lennartz principle will be decreased from a 20-year period to a 10-year period. These measures will be introduced on 1 September 2007.

To combat European missing trader fraud, the Chancellor has announced an extension to the list of goods for which a VAT registered business will be jointly and severally liable for VAT with the supplier, in cases where the recipients had reasonable grounds to suspect that VAT would go unpaid elsewhere in the supply chain. At present the list covers telephones, computers, their parts and accessories. The measure will now include certain sorts of electronic equipment of a kind ordinarily owned by individuals and used by them for leisure, amusement or entertainment. SatNav systems are included as computer equipment.

11. STAMP DUTY LAND TAX

The measures announced in relation to Stamp Duty and Stamp Duty Land Tax ("SDLT") are largely concerned with tidying up old anomalies and the creation of a new relief for new "green" properties. Their impact on the taxpayer is generally favourable.

11.1 Stamp Duty Land Tax

a) Relief for new zero-carbon homes

For a period of five years from 1 October 2007, newly built homes or properties converted and occupied for residential purposes for the first time, which meet new "green criteria", will be eligible for relief from SDLT on their first sale. The aim of the relief will be to ensure that only "carbon-neutral" homes, as measured over a period of a year, will qualify for SDLT relief.

There will be no SDLT on such homes with a purchase price of £500,000 or less. Where the purchase price exceeds £500,000, the SDLT will be reduced by £15,000. The qualifying criteria will be set out during the summer and the certification will be linked into the Building Control process administered by the local authority.

b) Exchange of property between connected parties

From the date that the Finance Bill receives Royal Assent, there will be a removal of the rule aggregating the value of both properties where there is an exchange of land between "connected parties" for the purpose of calculating the SDLT rate.

The purpose of the proposal is to treat all exchanges of land in the same manner, regardless of whether the parties are connected in any way. The SDLT on the transfer of each property will still be calculated by reference to the market value, but the rate at which it is charged will now only depend on the individual property rather than the aggregate total of the properties being exchanged. This measure will reduce the SDLT payable where each parcel of land exchanged is valued at less than £500,000.

c) Anti-Avoidance Measures

The Chancellor has confirmed that the Treasury regulations announced in the Pre-Budget Report in December 2006 aimed at two specific ways of avoiding SDL, will be given statutory effect in the Finance Bill. The first target is where a number of transactions are used to reduce the rate of tax from that which would have been due had all the transactions been seen as one. The second relates to transfers in and out of partnerships and the transfer of partnership interests, and introduces a claw-back provision similar to those for group relief.

BUDGET SUMMARY...

d) Administrative Changes

Two minor administrative changes were announced, which will have little effect on all but those dealing with the conveyance of property. In future, the payment of the Stamp Duty Land Tax will not need to be included within the self-certificate, though will still be due within 30 days of completion. In addition, in limited cases, which have yet to be announced, the purchaser's agent will be able to sign the self-certificate.

11.2 Stamp Duty

While there are well-established provisions to give relief in certain company reconstructions which have been extended over the last two years, the Chancellor has recognised a further practical difficulty and will legislate to relieve the position.

In the past, it was a strict requirement that the reconstruction should not change the proportions held by each of the shareholders, so that a mirror image was required before and after the reconstruction. The Finance Act 2006 introduced provisions allowing for small changes, mainly for practical reasons. Where companies have purchased their own shares, measures will be introduced to remove the company from the overall ownership test. This means that companies will no longer need to cancel shares, or accept shares in the acquiring company in order to fulfil the criteria for relief.

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