Making sense of the Budget*

The Chancellor's Budget 2009

22 April 2009

This is an analysis of the UK Chancellor of the Exchequer's main proposals as outlined in his Budget Report to Parliament on 22 April 2009 and in press releases and other documents published by the Government. Legislative proposals are subject to detailed legislation in Finance Bills which may be altered during their passage through Parliament. You should neither act nor refrain from acting on the basis of this analysis without first obtaining appropriate professional advice.

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Economic analysis

Economic analysis

The Chancellor, Alistair Darling, faced a huge challenge in designing a Budget package that was both effective in boosting the economy in the short term and affordable in the medium term. In the event, he announced a package involving a further net fiscal stimulus of around £5 billion in 2009/10, but despite this he predicted that the economy will shrink by around 3.5% in 2009.

The budget deficit is therefore set to balloon to a projected peak of around £175 billion (12.4% of GDP) in 2009/10 before falling back in later years on the assumption of a robust economic recovery, public spending constraint and tax and national insurance rises in 2011 and beyond. But the public finances are not projected to return to a sustainable state (defined as current budget balance) until 2017/18.

How credible are these new Treasury forecasts of growth and borrowing? Will the fiscal stimulus measures announced in the Budget be effective? And what other tax and spending measures may be needed in later years to bring public sector borrowing back under control?

Treasury forecasts suggest economy will recover from 2010 onwards

The UK economy stalled in the second quarter and fell into a deep recession in the second half of last year that appears to have continued during the first quarter of 2009. All the evidence points to this being the most severe UK recession since at least the early 1980s and possibly even since the 1930s.

The downturn in the UK mirrors that in the US, the euro area and Japan in the wake of the global financial crisis. Emerging markets have also been hit severely since last September, with eastern Europe suffering particularly badly and even China and India seeing sharp slowdowns in their previous rapid growth rates. Indeed the world economy as a whole now looks set to shrink in 2009 for the first time since the Second World War.

The downturn has spread to all parts of the UK economy (except for government services), with manufacturing and construction output showing particularly sharp falls in activity over the past six months. Retailers have also suffered, particularly in non-food discretionary spending, while the previously buoyant business and financial services sector has been hit by the fall-out from the crisis in the City.

Jobs are being lost across the economy, with the unemployment rate increasing to 6.7% in March, back above two million and on a sharply rising trend. This is feeding back into lower consumer confidence and spending. While some indicators such as purchasing managers indices suggest that the rate of decline in activity may have begun to slow, there is little doubt that the economy is still on a downward trajectory in the short term.

The new Treasury forecasts reflect this bleak reality in the short term, projecting that:

- UK GDP will fall by around 3.5% in 2009;
- consumer spending will contract by around 3% in 2009 and investment by around 11%; even with public spending rising by around 4.75%, this implies a fall of around 3.75% in UK domestic demand in 2009;

- exports will fall by around 8.75% in 2009 due to the weakness of the world economy, although net trade will still give some positive impetus to GDP growth due to an even larger projected fall in imports of around 9.25%; and
- inflation will fall very sharply later this year, with CPI inflation projected to be down to just 1% by Q4 2009 and RPI inflation moving further into negative territory later in the year.

Beyond 2009, however, the Treasury remains much more upbeat, projecting that:

- UK GDP growth will rebound to around 1-1.5% in 2010 and an average of 3.5% in 2011-13; and
- this will be led by a strong revival in exports and investment, with consumer spending growth also picking up later in the period.

While the Treasury view for 2009 seems reasonable enough, the risks around its medium term growth projections appear to be weighted to the downside at present given the severity of the global financial crisis. There is no guarantee that the world economy will bounce back promptly in 2010 in such circumstances. Even when it does eventually recover, this could trigger some further rises in oil and other commodity prices, pushing global inflation back up again and forcing interest rate rises that could retard the speed of the recovery in the major advanced economies in the medium term.

In the UK, it is likely that the major banks will take several years to restore their balance sheets to full health, while households will be understandably reluctant to borrow and spend as they have done during the past decade. In these circumstances, businesses are also likely to be reluctant to recruit or invest significantly until there is hard evidence that the future demand for their products will be robust.

We therefore suspect that the pace of recovery may be slower than the Treasury is projecting for 2010 and beyond. Specifically, we project UK GDP growth to be around zero on average in 2010 in our main scenario, as compared to the Treasury's 1-1.5% projection, although we do expect some gradual recovery to emerge during the course of next year.

Will the fiscal stimulus package in the Budget boost the economy significantly?

The Chancellor announced a fiscal stimulus package in the Budget with a net value of around £5 billion in 2009/10. The main elements of this package and their estimated cost are as follows:

- doubling of the main business capital allowance rate to 40% (£1.6 billion);
- deferral of business rates payments (£0.7 billion);
- increase in basic rate of state pension next year by 2.5% rather than by RPI as usual (£0.6 billion);
- additional employment funding to protect jobs and provide training (£0.6 billion); and
- extra financial support for housing (£0.4 billion)

This Budget package is in addition to around £20 billion of fiscal stimulus already announced in the Pre-Budget Report (PBR). Even with a combined value of around £25 billion including the PBR measures, however, we doubt that this fiscal stimulus will do more than take the edge off what will still be a very deep recession. In particular, much of any temporary tax cuts will either by saved or spent on imports, so a significant proportion (perhaps half or more) of the fiscal stimulus will leak away rather than adding to UK GDP.

This is not to say the Chancellor was wrong to have taken some such action to boost the economy, but it would be unrealistic to expect miracles from this package alone. For the moment, continued efforts by the Government and the Bank of England to support the banking sector and inject additional money and credit into the economy are more important for combating the recession than anything announced in the Budget.

Public borrowing reduction relies on economic recovery, tight public spending control and tax rises in the medium term

Public sector net borrowing (PSNB) is now estimated at around £90 billion (6.3% of GDP) in 2008/09, up from £34.6 billion in 2007/08. The latest Treasury forecasts show a further surge in public borrowing to around £175 billion (a record 12.4% of GDP) in 2009/10. This reflects both the effects of the recession and, to a lesser degree, the costs of the fiscal stimulus packages announced over the past year. Borrowing is then expected to start declining steadily from 2010/11 onwards as a result of:

- an economic recovery starting in 2010 and accelerating in later years;
- tight public spending control from 2011/12 onwards (averaging 0.7% per annum real growth in current spending over the three years to 2013/14); and
- tax increases, with the key revenue generating measures proposed in the Budget including the income tax rate rise to 50p on incomes above £150,000 and a hike in fuel duty; these are in addition to the measures announced in the PBR such as national insurance contribution rate increases from 2011.

For the reasons discussed above, we consider that the Treasury's growth projections for 2010 onwards may prove to be somewhat optimistic. As a result, public borrowing could well turn out to be even greater than projected by the Treasury, although of course there is huge uncertainty about the extent of any such borrowing overshoot at this stage. If this risk does materialise, however, then it seems likely that further tax rises and even greater spending restraint will be needed.

Indeed we have recommended that there should be a real freeze on current public spending in the three years to 2013/14 in order to return the public finances to a sustainable position (defined as current budget balance or surplus) by that year, rather than waiting until 2017/18 as the Treasury projections suggest. We are concerned as to whether the projected net public sector debt level (including potential losses from financial sector interventions) of close to 80% of GDP in 2013/14 will be considered acceptable by the government bond markets in the medium term.

For the moment, however, the Chancellor has probably done the most that he could have to boost the economy in the short term and he has also at least begun to outline how he plans to restore the public finances to health in the medium term. But more action on this is likely to be needed in due course, both in terms of additional tax increases after the economy has recovered and even tougher public spending control from 2011 onwards. The process of restoring the public finances to health will be a long and painful one: the Budget is just the first step down that road.

Business taxation

Corporation tax rates unchanged

The current rates of corporation tax are to remain unchanged for the foreseeable future.

The rate of corporation tax for companies with taxable profits of up to £300,000 will remain at 21%. For companies with taxable profits exceeding £300,000 but not more than £1.5milion, the fraction used to calculate the marginal small companies' relief remains at 7/400.

Companies with taxable profits in excess of £1.5million will continue to pay corporation tax at 28%.

Companies with 'ring fence profits' from oil extraction and oil rights in the UK and the UK continental shelf also remain unaffected. The rates are 19% for companies with profits of up to £300,000 and 30% for profits in excess of £1.5million. The fraction for ring fence profits remains unchanged at 11/400.

Taxation of foreign profits

Draft legislation relating to the taxation of foreign profits was released on 9 December 2008. This reform, together with the ongoing review of the UK's controlled foreign companies (CFC) regime, is intended to ensure that the UK tax system remains internationally competitive and represents a move towards a more territorial approach to the taxation of foreign subsidiaries. However, it should be noted that many of the changes will also apply to wholly UK groups.

The original proposals included an extension of the existing 'unallowable purpose' rule for loan relationships and derivative contracts. However, it has now been confirmed that this measure will not form part of the current package but will be kept under review. The package now comprises four key elements:

- introduction of a dividend exemption for the majority of both UK and foreign dividends;
- introduction of a 'debt cap' restricting UK tax deductions for finance costs to the level of a group's external finance expense;
- repeal of the Treasury Consent legislation and replacement with a new quarterly reporting requirement; and
- abolition of the CFC acceptable distribution policy (ADP) exemption and exempt activities non-local holding company exemptions (subject to a two year transitional period for the latter).

Commencement dates

Revised draft legislation will be included in Finance Bill 2009.

- The dividend exemption will apply to dividends and other distributions received on or after 1 July 2009.

- There is a welcome delay to the commencement of the debt cap rules and the legislation will now only apply to finance expenses payable in accounting periods beginning on or after 1 January 2010.
- The changes to the CFC regime have effect for accounting periods starting on or after 1 July 2009 with transitional provisions for accounting periods straddling this date.
- The repeal of the Treasury Consent rules and the replacement reporting regime will apply to transactions undertaken on or after 1 July 2009.

Dividend exemption

All distributions (both UK and foreign) will be taxable unless they fall within one of five specified exemptions. The exemptions are subject to anti-avoidance provisions. The consultation process highlighted a number of technical issues concerning the draft legislation, but overall the introduction of a dividend exemption was broadly welcomed by taxpayers. However, the related issue of branch taxation has not yet been addressed.

Originally, it was proposed that the exemptions would not be available to small companies in respect of foreign dividends received in respect of shareholdings of 10% or more. However, it has now been confirmed that an exemption for dividends or other distributions arising from holdings of 10% or more will be extended to all companies, subject to anti-avoidance provisions.

Debt cap

On 7 April 2009, following extensive consultation with business and advisers, the Government announced changes to the proposed legislation regarding the calculation of the debt cap. Although the basic principles remain similar to those originally proposed, the mechanics of the calculations have changed substantially.

UK resident group companies (or non-UK resident group companies with a UK permanent establishment) with net finance expense will be required to compare their combined net finance deductions (‘tested amount’) with the worldwide group's gross external finance expense (‘available amount’) taken from consolidated accounts prepared either under International Accounting Standards (IAS) or other acceptable standards (including UK and US GAAP). UK group companies with net finance income or no finance income or expense are excluded when calculating the tested amount.

Impairment losses, profits or losses on the disposal of a loan (capital gain/ loss), foreign exchange, external debt factoring, external hedging arrangements and certain short-term debt are specifically excluded from the definition of finance expense, whilst all finance leases are included.

To the extent the tested amount exceeds the available amount, the UK group must restrict its finance deductions for tax purposes. Corresponding adjustments may be made to reduce UK group finance income up to the amount of the disallowance.

A ‘gateway test’ will be introduced and, if met, a group will not have to take any further action in respect of the debt cap measure. The gateway test will operate by comparing the net debt of UK group companies with the worldwide group’s gross debt based on consolidated accounts. If the total net debt of all relevant companies with net debt is less than 75% of gross debt from the worldwide consolidated accounts then the group passes the test. The applicability of this gateway test is not as wide as originally anticipated following HMRC’s initial proposals during the consultation process. Instead, this gateway test is likely mainly to benefit inbound groups.

If the group cannot meet the gateway test, it may still avoid the detailed application of the rules if a certifying statement is made confirming that the available amount exceeds the tested amount. However, given the complexities of the rules, significant work is likely to be required to obtain the sufficient level of comfort to self assess that this is the case.

Other key points to note are set out below.

- Financial services groups may now be exempt based on a new test where debt forms an intrinsic part of the way in which that business is conducted.
- The debt cap now applies in principle to all companies. However, it appears that there will be an exemption from the rules for companies that are part of a group which consists entirely of small and medium sized companies. There will also be a de minimis exemption, but it is not yet known what the de minimis amount will be.
- A targeted anti-avoidance rule will be introduced to counter arrangements whose main purpose is to increase the available amount, decrease the tested amount or affect the debt in the gateway test.
- It will be possible to elect to disregard certain UK to UK loans if non-trading loan relationship deficits or management expenses are unable to be relieved following a disallowance under these rules.

Overall HMRC appears to have listened to the specific objections raised by taxpayers at a detailed level and attempted to address the issues with bespoke fixes. However, the rules remain complex and we anticipate that a significant proportion of companies, including nearly all entirely UK based and UK headquartered groups, will still fall within the debt cap rules.

HMRC has assessed the administration burden of the debt cap at £8.7 million per annum.

Treasury Consent

The repeal of the existing rules has generally been well received. However, the exclusions from the new reporting requirement as per the 9 December 2008 draft legislation are narrower than the existing General Consents so that certain transactions which do not currently require consent may have to be reported under the new regime.

It has now been confirmed that companies are required to make their report within 6 months of the transaction. This is a welcome change from the 9 December draft legislation which was to require reporting within 14 days of the end of the quarter in which the transaction took place.

Controlled foreign companies

The Government announced in Pre-Budget Report 2008 that it will continue to examine options to reform the UK's CFC rules, recognising that the rules have not kept pace with the changing nature of global business, and that a radical overhaul of the regime is required to improve UK competitiveness. CFC reform is intended to modernise the UK CFC rules as part of the Government's move towards a territorial approach in taxing foreign subsidiaries of UK companies.

A liaison committee of business representatives has been set up to assist with the policy process and facilitate effective consultation. The review is intended to take a case study approach and HM Treasury and HMRC have also been consulting with both business and advisers to gather examples of situations where businesses are currently constrained by the CFC rules. Initial workshops are expected in May/ June 2009.

PwC is encouraging HM Treasury to fully evaluate the need for any CFC legislation and to consider instead the tightening of other anti-avoidance legislation with a view to preventing artificial diversion of profits from the UK. Where a CFC regime is retained we would recommend HM Treasury considers reform as part of a balanced package, rather than view the regime in isolation, and to include a foreign income exemption in order for the rules to be competitive.

Consultation is expected to continue through 2009 and beyond, with legislation not anticipated before Finance Bill 2011. However, in the interim, the ADP and exempt activity holding company exemptions (for superior and non-local holding companies only) are to be abolished, subject to transitional provisions. The exemption for local holding companies is now to be retained following representations from business and is a welcome change to the 9 December draft legislation.

Temporary first year allowances on plant or machinery

The Chancellor announced a temporary 40% first year allowance, to promote investment in certain types of plant and machinery. This will be available to individuals, partnerships and companies, regardless of size, that incur qualifying expenditure in the 12-month period beginning 1 April 2009 (corporation tax) or 6 April 2009 (income tax).

The first £50,000 spent on plant or machinery by each business qualifies (subject to conditions) for the 100% annual investment allowance. The new temporary first year allowance will apply to expenditure in excess of this amount on general plant or machinery, including short-life assets, which would otherwise have attracted a writing-down rate of 20% per annum (reducing balance basis). There will be no cap on the amount of expenditure eligible for this enhanced relief. The relief will apply equally to the acquisition of new and second-hand assets. However, under prevailing anti-avoidance provisions, it is unlikely that assets acquired from connected parties will qualify.

Unfortunately the new enhanced allowance will not be available for special rate expenditure, which typically includes the majority of fixed plant and machinery integral to a building or structure. Other exclusions are for expenditure on long-life assets (defined as assets with an expected life, when new, in excess of 25 years) and motor cars.

Assets provided for leasing will also be excluded from the enhanced relief, although it is not yet clear whether this will apply to relevant plant and machinery installed in leased real property.

Changes to assets eligible for 100% capital allowances

The lists of energy and water efficient technologies eligible for enhanced 100% capital allowances are to be amended.

The following will be added to the lists:

- uninterruptible power supplies;
- air to water heat pumps; and
- close control air conditioning systems.

The following will be removed from the lists:

- air source: single duct and packaged double duct heat pumps;

- ground source: brine to air heat pumps; and
- water source: packaged heat pumps.

Some additional minor changes will also be made to the existing criteria.

All changes will be effective from a date to be specified before the summer Parliamentary recess.

Tax relief for expenditure on company cars

Budget 2009 confirmed the amendments announced on 1 April 2009 in relation to tax relief for expenditure incurred on ‘expensive cars’. The existing capital allowances rules for cars costing over £12,000 have been abolished. Instead, writing down allowances (WDAs) will be available according to the car’s carbon dioxide (CO_2) emissions. The changes took effect for corporation tax from 1 April 2009 and for income tax from 6 April 2009. There are related changes for car leasing. The draft legislation comprises the following:

- Cars with CO_2 emissions of over 160g/km will attract WDAs at 10% whilst others will attract WDAs at 20%. Expenditure incurred before April 2009 will, in general, continue to be subject to the pre-existing ‘expensive cars’ rules for a transitional period of five years.
- Cars with a non-business use element will continue to be dealt with in a separate pool so that the private use adjustment can still be made. However, the available WDAs will be determined by the car’s CO_2 emissions.
- The leasing restriction that applies to leases of ‘expensive cars’ has also been amended. Expenditure under new leases on any cars with CO_2 emissions above 160g/km will be subject to a flat rate disallowance of 15% (but limited to expenditure on only one lease in a chain of leases). Expenditure under leases made prior to 1 or 6 April 2009 will continue to be subject to the old rules.

The draft legislation issued on 1 April 2009 contained specific anti avoidance rules. Broadly, the anti-avoidance rules will prevent the generation of balancing allowances from either selling cars at less than market value or ceasing a qualifying activity which is then taken on by another group company.

Extension of trading loss carry back for businesses

Companies and unincorporated businesses making losses from carrying on trades, professions or vocations (collectively referred to as trading losses) are able to offset those losses against profits made in subsequent periods in order to reduce their future tax liability. In addition, there is also a limited ability to offset such losses against profits made in prior periods in order to generate a repayment of tax previously paid. However, until 22 April 2009, it has generally only been possible to carry back losses to the preceding year (except for start-up unincorporated businesses and businesses ceasing to trade, both of which having long been permitted to carry their trading losses back for three years).

An extension to the right to carry back trading losses was announced in the 2008 Pre-Budget Report. At that time it was stated that the extension would apply to trading losses generated by companies in accounting periods ending in the period 24 November 2008 to 23 November 2009 and by unincorporated businesses in the tax year 2008/09. On 22 April 2009 it was announced that the extension would now apply to trading losses made over a longer period; for companies, those

generated in accounting periods ending in the period 24 November 2008 to 23 November 2010 and for unincorporated businesses those generated for tax years 2008/09 and 2009/10.

Such losses may now be carried back up to three years. The amount that can be carried back to the preceding year remains unlimited but this extension now allows any additional unused trading losses, up to a maximum of £50,000 per 12 month period or tax year, to be carried back for offset against the profits arising in the earlier two years, with losses being carried back against later years first.

Reallocation of chargeable gains between group companies

The legislation which enables groups of companies to offset gains and losses on chargeable assets is to be simplified so that it applies to a wider class of disposals and assets including deemed disposals.

Currently, a group company can arrange, by joint election, for a deemed transfer of an asset to another group company prior to its disposal. The chargeable gain or loss on the disposal of the asset then accrues in that other group company so that, for example, it can be matched with losses. However, this treatment is only available if there is a disposal of an asset to a third party outside the group.

The new legislation will permit, by election, the transfer of a gain or loss arising on a disposal of an asset to another group company. The former restrictions on the type of asset disposed and the circumstances under which the gain or loss arose will no longer apply.

This is a welcome amendment as it should enable groups of companies to match gains and losses on assets which where not previously eligible, for example, an asset which is subject to a negligible value claim or shares in a subsidiary company which has been placed into liquidation.

The new legislation is expected to apply to gains or losses arising on or after Royal Assent.

Group companies issuing preference shares to third parties

The Government has confirmed previously-announced changes to the rules in ICTA 1988 Schedule 18, which will mean that fewer subsidiary companies issuing preference shares to external investors will be excluded from a group relief, stamp duty or capital gains group. This change is said to be most relevant to regulated financial institutions which issue preference shares qualifying as Tier 1 regulatory capital. However other groups may also have deliberately issued shares to prevent companies from being members of a group, for some reason; these groups will need to check the position and if necessary make the election for the old treatment to continue.

Broadly, under the existing rules, if more than 25% of the income or capital of a subsidiary company could become payable to an ‘equity holder’ which is not a member of a group, the subsidiary will not be treated as a member of the group for group relief, stamp duty or stamp duty land tax purposes. A similar rule applies for determining membership of a capital gains group, although in that case the percentage is 50% or more. In determining what is an equity holder, ‘fixed-rate preference shares’ are ignored, but other preference shares are included.

The term ‘fixed-rate preference shares’ will now be amended to ‘relevant preference shares’, which will be defined to include, in addition to fixed-rate preference shares:

- shares whose dividend may not be paid, or may be reduced, if the issuing company is in severe financial difficulties;
- shares whose dividend might be restricted by regulatory capital considerations; or
- shares whose dividend is linked to a variable published market rate (such as LIBOR) or to an official index of consumer prices (such as the Retail Price Index).

This change will be backdated to accounting periods which commenced on or after 1 January 2008, but there will be an election to preserve the existing treatment of shares issued before 18 December 2008, when this proposal was first announced.

Double tax relief: effective rate on dividends

Foreign-source dividends are subject to corporation tax at the effective rate applicable for the accounting period in which they are received. Companies with accounting periods straddling 1 April 2008 have an effective corporation tax rate between 30% and 28% (29.5%, for example). However, the double tax relief (DTR) mixer cap formula, which limits the amount of credit relief available on foreign dividends, operates by reference to the statutory rate of corporation tax in force on the payment date (i.e. 30% or 28%). This has potentially resulted in an unintended restriction on the amount of DTR available.

HMRC first acknowledged this mismatch in September 2007 and confirmed in July 2008 that the rules would be amended with retrospective effect from 1 April 2008. Legislation will be introduced in Finance Bill 2009. The impact of the discrepancy is to be eliminated by calculating the mixer cap by reference to the blended effective rate for the period, rather than the statutory rate on the date of payment.

Release of business debts between connected companies

Finance Bill 2009 will include legislation to ensure that, where a trade or property business debt is formally released, the tax treatment in the debtor company will be under the loan relationship rules. This will mean that the debtor is not taxed on any credit arising, where the debtor is connected with the creditor company. The tax treatment of such debts had previously been brought within the loan relationship rules for the creditor company only - with the result that, in a connected party situation, the creditor company was denied a tax deduction on a release whereas the debtor company might be taxed. The change should make the tax treatment symmetrical within groups, such that a release of a debt which is treated as a trade or property business debt in both companies will be ignored in both companies for tax purposes.

The change will apply to releases made on or after 22 April 2009. This differs from the commencement as previously announced: the change was originally intended to apply to releases made in accounting periods beginning on or after 1 April 2009.

Companies are connected for this purpose where, at any time in the relevant period, they are under common control or one company controls the other. Note that the change will apply only to formal releases, which are usually written under deed. It would not protect a simple informal waiver of a trade debt, which may create taxable income for the debtor company.

Structured foreign exchange arrangements

The Government has announced that it will publish a technical note in the summer. The note will set out the issues and potential approaches to structured financial arrangements which involve the overhedging or underhedging of certain economic risks. Although such arrangements are not motivated by tax avoidance they pass on to the Exchequer, through tax relief, commercial risks that would otherwise be borne by the business on such transactions. The Government believes that the economic risks should be shared between the Exchequer and the business as Parliament intended.

Tax losses computed in foreign currency

HMRC has confirmed that Finance Bill 2009 will contain new rules covering corporation tax losses carried forward or back in a currency other than sterling. This confirmation follows a ministerial statement in December 2008 and the publication of draft legislation in March 2009.

The rules will provide that, where a company computes its profits or losses for corporation tax purposes in a currency other than sterling, any losses carried forward to future accounting periods or back to a previous accounting period will be translated into sterling at the same exchange rate as the profits they are offsetting. This rule change is welcome, as it should prevent situations where tax losses match the profits they are offsetting in the relevant foreign currency but there is a mismatch after translation to sterling due to foreign exchange movements.

The rules will apply to all profits and losses arising in accounting periods beginning on or after 29 December 2007 - hence including those companies with 52-week accounting periods beginning on the last Saturday of 2007. However, companies may elect that the new rules are only to apply to accounting periods beginning on or after the date of Royal Assent to FB 2009. There are special transitional rules, and also rules covering the situation where a company changes the currency in which it computes its taxable profits.

Real estate investment trusts

Disappointingly, the Government has not offered any concession to real estate investment trusts (REITs) to assist with their cashflow constraints. The requirement for REITs to distribute 90% of property rental business income is putting a considerable strain on many of the REITs and there have been calls for a relaxation of the rules over recent months. Currently, REITs are required to make this distribution within 12 months of their accounting period end; it was hoped that a deferral mechanism would be introduced in this Budget but no such measure, or indeed alternative alleviating measure, has appeared.

However, the Government has offered some flexibility to enable REITs to raise cash in the market. REITs can now offer convertible non-voting preference shares as well as the current suite of permitted securities (ordinary shares, non-voting preference shares and convertible loan stock).

The Government announced last year that it would stop property rich groups such as operators of hotels, pubs and retail businesses from converting to REITs and the legislation will apply from 22 April 2009. However, the Government is clearly not seeking to prevent the conversion of landlords which let properties to pubs rather than operate them. A technical change has been introduced to treat rent from pubs as rental income and not trading income (which is currently the case) to permit such landlords to convert to REITs.

There were some other technical amendments introduced, mainly for consistency and clarification.

A level playing field for Islamic financial instruments

Alternative finance investment bonds are defined in Finance Act 2005 and correspond to Islamic financial instruments known as sukuk.

For religious reasons, many Islamic investors will not invest in interest paying bonds, or allow their companies to borrow by issuing bonds. Over the last decade, sukuk have been approved by Islamic religious scholars as a way for companies to issue tradeable certificates (sukuk) which give investors a steady payment stream. One common way to structure a sukuk is for the sponsoring company to sell one or more assets to a special purpose vehicle company (SPV), which pays for the assets by issuing sukuk to investors. The SPV then generates income by renting the assets back to the sponsoring company, and pays that income to the investors. After a specified period, the sponsor repurchases the assets from the SPV, which passes the sale proceeds to the investors to redeem the sukuk.

The transfer of real estate assets to an SPV can trigger charges to stamp duty land tax. The sale can also crystallise capital gains and a claw-back of capital allowances. None of these tax penalties would arise if a company simply issued conventional interest bearing debt secured on the assets. The tax changes will eliminate these tax penalties, provided that various detailed requirements which will be specified in the Finance Bill 2009 are met.

Manufactured interest

As announced on 27 January 2009 by the Financial Secretary to the Treasury, legislation will be introduced to ensure that the tax treatment of manufactured interest payments is consistent with the treatment of such payments in company accounts prepared in accordance with UK GAAP. The announcement followed a decision in the High Court relating to the treatment of deemed manufactured payments. It was felt that this decision could result in payers of real manufactured interest obtaining excessive deductions and recipients being taxed on amounts greater than those they actually received.

The legislation will apply to real manufactured interest payments made both before and after 27 January, and to manufactured interest payments deemed to be made on or after 27 January. HMRC has indicated that the legislation is not intended to apply to the type of deemed manufactured payments which were the subject of the High Court case.

Agreements to waive tax reliefs

The Government recently introduced an asset protection scheme aimed at supporting some taxpayers (primarily financial institutions) by effectively insuring certain losses. In return for this support, the taxpayer is required to enter into a legally binding agreement setting out certain terms including, for example, minimum disclosure levels, payment of a fee and waiver of rights to certain tax reliefs such as the carry forward of losses against future profits. Although such agreements are legally binding, they are not currently supported by tax legislation, as certain tax reliefs are automatic and could therefore override the agreement.

Relevant tax legislation is therefore to be amended to ensure that agreements entered into under the asset protection scheme or other similar schemes are not overridden. The impact of these changes

should be minimal, as they are intended to simply bring the mechanics of the legislation in line with commitments that taxpayers have already made.

Stock lending reliefs

As announced in Pre-Budget Report 2008, Finance Bill 2009 will introduce capital gains reliefs and stamp duty reliefs where stock loans have defaulted following the entry into insolvency of one of the parties to the stock loan.

The termination of a stock loan with no return of shares (including shares provided as collateral) results in a deemed capital gains disposal of the shares on the date of termination and, in the case of UK shares, a potential charge to stamp duty or stamp duty reserve tax (SDRT). In addition, lenders purchasing UK shares following the default of stock loans (and borrowers purchasing UK shares to replace lost collateral) are required to pay stamp duty or SDRT on those purchases. Any tax liabilities arising in these ways would be unexpected, given that transfers of shares under stock loans typically qualify for exemption from tax on capital gains and, in the case of UK shares, exemption from stamp duty and SDRT.

FB 2009 capital gains and stamp duty/ SDRT changes, effective from 1 September 2008, will address these concerns:

- For capital gains, the termination of a stock loan with no return of shares to the lender due to insolvency will not be considered a deemed disposal of those shares by the lender, provided that the lender uses collateral to fund the purchase of equivalent replacement shares. Such a purchase in these circumstances will be treated as if it were the return of the borrowed shares by the borrower. Although consideration was given to extending these changes to apply to sale and repurchase (repo) transactions, this will not happen.
- Changes to the stamp duty/ SDRT rules will mean that transfers of UK shares under defaulted stock loans and repos (including shares provided as collateral) are not subject to stamp duty or SDRT. In addition, following default, purchases by lenders of equivalent replacement UK shares, funded by use of collateral (and purchases by borrowers of equivalent replacement UK shares as collateral) will not be subject to stamp duty or SDRT.

Elective regime for UK authorised investment funds

The initial consultation on the tax elected fund (TEF) regime was issued in July 2008 and was followed by a summary of responses issued by HM Treasury (HMT) in December 2008. It was announced in the Budget that this elective regime will come into effect from 1 September 2009. The final details of the regime are yet to be published, but HMT has confirmed that draft regulations for the regime will be issued for consultation shortly.

Broadly, the regime will act to exempt certain streams of income from tax within a fund where the fund elects into the regime. Only those TEFs that satisfy a genuine diversity of ownership condition will be able to elect into the regime. Capital gains in a TEF will continue to be exempt from tax, as is currently the case for authorised investment funds (AIFs). Distributions made by TEFs to investors will need to be streamed into two distributions – a dividend distribution and an interest distribution – and taxed accordingly.

It is fair to say that the proposed TEF regime failed to arouse much in the way of enthusiasm within the industry on its launch in July 2008 and it remains to be seen whether it will meet the main aim set out

by HMT to improve the competitiveness of the UK funds industry compared to its foreign counterparts (primarily Luxembourg and Dublin). The lack of competitiveness of the UK fund industry stems in part from investor perception that UK funds are taxable, and it is difficult to see a change occurring in this perception where TEFs are still potentially subject to tax on some of their income. Another concern with the proposed regime is the treatment of offshore income gains in the fund which remain taxable. Perhaps most questions were asked on the administrative complexities of handling the new regime and the associated costs. Given that the vast majority of UK funds currently pay no tax, it is difficult to see the cost/ benefit analyses stacking up for many fund providers as things currently stand.

Certainty on trading versus investment for Authorised Investment Funds

The Budget confirmed that legislation will be introduced from 1 September 2009 to provide that specified transactions undertaken by Authorised Investment Funds (AIFs) will be treated as investing rather than trading for tax purposes. A 'white list' of such transactions will be published. This is in line with the consultation document issued by HM Treasury in December 2008. The Budget also announced that the legislation will also extend to UK-resident investors in equivalent offshore funds.

The 'white list' will, broadly, replicate the updated list of investment transactions used for the UK investment manager exemption, and will apply to AIFs that meet a genuine diversity of ownership condition. This list is broadly drafted and includes transactions in shares, loans, debt instruments, derivative contracts, money deposits, units in collective investment schemes and carbon emission credits.

The issue of trading is of key importance when looking at the UK taxation of AIFs, as gains made on investments are normally exempt from tax in the fund. However, where the fund is found to be trading, profits are potentially taxed at 20%. For many years, this has resulted in significant uncertainty for UK funds, due to the lack of any statutory definition of trading or investing, particularly in the context of asset management.

The proposed changes were therefore warmly welcomed by the industry and should act to boost the international competitiveness of UK funds. However, the 'white list' does not currently apply to transactions undertaken by pension funds, investment trust companies and insurance groups. This legislation may therefore distort investment decisions and undermine the Government's aim that investors should choose investments for commercial reasons and not for tax reasons. The asset management industry will need to continue its lobbying to obtain this natural extension.

New tax rules for investment trust companies investing in interest bearing assets

The taxation of investment trust companies (ITCs) was the subject of a report published in October 2007 by the Association of Investment Companies (AIC) in which it was suggested that UK tax rules were acting as a barrier to the promotion of ITCs in the UK. A key factor was the absence of a tax efficient manner in which to invest in bonds and similar interest bearing securities.

Under the current rules, ITCs are, in broad terms, subject to corporation tax on income arising from bonds and other forms of debt. Such treatment potentially puts ITCs at a disadvantage in comparison to other investment vehicles, which can pay out interest type returns in a gross form without suffering intermediate tax leakage (e.g. AIFs, offshore funds, or direct investment).

Draft legislation was published for comment and consultation on 16 December 2008. This set out a new elective tax framework that would allow ITCs to invest in interest bearing assets in a tax efficient way. The proposed rules move the point of taxation from the ITC to the shareholder by means of a tax deductible interest distribution with the result that shareholders would face broadly the same tax treatment as they would have had, had they owned the interest bearing asset directly. This would place ITCs investing in such assets in a comparable position vis a vis other investment vehicles.

Following the consultation period it has been confirmed that the new rules will be introduced by secondary legislation and will have effect for any interest distributions made on or after 1 September 2009. Where an ITC makes an interest distribution under the new rules this income will be treated in the hands of the shareholder as if it was a payment of yearly interest.

The new elective regime has been welcomed by the ITC community as a positive move although it is unlikely that the new regime will be of interest to all, given that many ITCs invest predominantly in equities and pay little tax. However, there will be clear benefits for ITCs that have or want to have investment strategies based on significant amounts of debt.

ITCs wishing to take advantage of the new rules will need to consider the cost benefit analysis carefully, taking into account the administrative requirements in relation to reporting two forms of distribution together with the circumstances of their different investor populations, only some of whom stand to benefit from the new regime.

Offshore funds definition and new rules

New definition

Finance Bill 2009 will bring in a new tax definition of 'offshore fund' from 1 December 2009, subject to transitional arrangements. The two-month postponement of implementation will allow further consideration of the impact of changes from the December 2008 proposals.

As expected, specific exemptions from the new definition will include fixed share capital arrangements which "do not mimic open-ended arrangements", partnerships and capital-only arrangements. However the position for certain fully transparent arrangements has moved on.

Specific provisions for fully transparent funds

From 1 December 2009, a UK investor subject to capital gains tax (CGT) who invests into a fully transparent or 'contract-based' offshore fund will be deemed to have a chargeable asset. This amends the previously complex position whereby the UK investor was required to compute and pay CGT by reference to gains arising from the fund's underlying investments - which created a significant reporting burden. Elections into the new treatment can be made on and after 22 April 2009 and can be retrospective to 2003/04. Where an election is made, it will be assumed that prior to 1 December 2009 the investor had an interest in a fund certified by HMRC as a distributing fund.

The amended position for a fully transparent arrangement will only apply where it is deemed to fall within the new 'offshore fund' definition. These provisions will not apply to partnerships, as it is intended that comparability of treatment between UK and offshore partnerships should continue. Neither will they apply currently to UK investors subject to UK corporation tax, as their tax treatment is yet to be decided.

We believe that these proposed changes will be helpful for a significant number of UK investors, but further consideration is needed as to whether or not they will affect a UK investor's ability to access

worldwide double taxation treaties. Offshore contractual arrangements in many cases rely on full tax transparency to maintain tax efficiency for investors, and it will be important to consider how wide-ranging the impact of these changes will be.

Proposed reporting regime

The proposed reporting regime is to be introduced by regulations, intended to be released shortly. The effective date is to be 1 December 2009. Details of the mechanics of the regime are awaited, but the calculation of reportable income for trading transactions has been clarified. The stipulation that the calculation would include all profits of a 'trade' raised industry concerns that offshore funds marketed into the UK would be significantly disadvantaged over UK funds. It has now been confirmed that the proposed 'white list' of transactions which can be considered non-trading in a UK authorised investment fund will be extended to 'equivalent' offshore funds from 1 December 2009.

There is no specific guidance on the meaning of 'equivalent offshore funds'. It would also appear that the offshore fund will be required to meet a 'genuine diversity of ownership' test to access the benefits of the white list - this is to avoid bespoke private vehicles benefiting. We expect that the test will be based around the existing 'genuine diversity of ownership' provisions within the UK Property Authorised Investment Funds and Qualified Investor Schemes regimes.

Updating the North Sea fiscal regime

The Budget sets out a number of changes to the tax rules for oil and gas companies operating in the UK and on the UK Continental Shelf (UKCS). These include measures intended to encourage the development of certain challenging fields, remove barriers to the change of use of North Sea assets and infrastructure, simplify some elements of the North Sea Fiscal Regime and stop avoidance.

These measures are generally as expected and arise from a series of consultations between the Government and industry, which culminated in a consultation document, Supporting Investment, published in November 2008.

New field allowance

In order to encourage the development of certain challenging fields in the UK and UKCS, the Government has announced a new 'field allowance'. This applies to oil and gas fields given development consent on or after 22 April 2009 and takes the form of a fixed cash allowance that can be set against the profit subject to the 20% supplementary charge payable by the companies involved in such fields. Such an amount will hence only be taxable at the ring fence corporation tax (RFCT) rate of 30%, or 19% for small companies. Once the allowance for a field has been fully utilised, the field will then pay the full North Sea rate of tax.

There are different types of field that attract relief at different rates.

The allowance is on a per field basis and the allowance will be divided between field partners on the basis of their equity in the field. In the event that a company has more than one field, the allowances will be pooled for use against the company's profits subject to supplementary charge. Unused relief can be carried forward.

Definition of a consortium within the ring fence

The definition of a consortium for the purpose of RFCT, specifically whether or not companies are associated for this purpose, will be brought into line with the general corporation tax definition.

Changes to chargeable gains in the ring fence

Companies that transfer UK or UKCS licences between themselves by swapping them can potentially be subject to chargeable gains. The Budget announcement has stated that, for disposals made on or after 22 April 2009, no chargeable gain will arise on such swaps provided that the licences being swapped are of equal value. This previously only applied to pre-development licences and will now also apply to licences that have been given development consent.

It was also announced that, for disposals made on or after 22 April 2009, if proceeds arising from a disposal of a chargeable asset in the ring fence are reinvested in another chargeable ring fence asset, no chargeable gain will arise. Previously the chargeable gain arising from the disposal could have been held over for up to 10 years before coming into charge, reducing the base cost of the new asset by the reinvested proceeds, rather than being entirely exempted.

Changes to the PRT regime

There have been a number of minor changes introduced to the petroleum revenue tax (PRT) in order to simplify the regime and ensure equitable treatment for decommissioning.

Under current legislation, PRT relief for decommissioning expenditure is not available to a company if those costs have been incurred more than 12 months after it has ceased to be a licence holder in respect of that taxable field. The new rules will allow relief for such expenditure but will also ensure that any income that may arise in respect of the assets in question will also be chargeable to PRT.

The method of allocation where oil from various fields is blended in transportation (‘commingled oil’) will be on a just and reasonable basis for PRT periods beginning after 30 June 2009.

Provisional expenditure allowance, which was generated when PRT expenditure claims were deferred and then clawed back in the following year, will be repealed for PRT periods beginning after 30 June 2009. Provisional expenditure already granted will be clawed back in the following 12 months.

Change of use rules

Assets acquired for hydrocarbon recovery in the North Sea can potentially be reused for other activities. Some of these alternative uses, so called ‘change of use’ activities, including gas storage, carbon capture and storage and wind power, could contribute to the Government’s wider objectives around providing a secure supply of sustainable energy.

Consultation between Government and Industry has taken place over a number of years and, as a result, Government has announced the following package of changes:

- removal of the PRT charge when a qualifying asset is no longer used for a taxable field purpose;
- ensuring that PRT is not levied on income relating to change of use activities; and
- ensuring that abandonment costs are relievable for RFCT and PRT purposes on the same basis as would have been the case had the assets remained within the ring fence trade.

A question arising from the consultation process has been whether it is desirable to create a special tax regime for activities such as carbon capture and storage and wind power. No conclusions have been reached in this respect to date, but is was interesting to hear Mr Darling comment in his speech that he intended the low carbon sector to follow the success of the North Sea … so maybe a specific tax regime will follow.

In addition, following calls for clarification on the tax treatment of cushion gas in gas storage facilities, Government today confirms that cushion gas is eligible for plant and machinery allowances.

Anti-avoidance measures for decommissioning

Companies producing oil and gas in the UK and UKCS have a statutory requirement to decommission oil and gas fields at the end of their life. They are able to obtain relief for such decommissioning costs, in the form of 100% capital allowances against ring fence profits, once they have been incurred. However, the Government has stated that it has become aware that some companies have entered into intra-group arrangements designed to enable a claim for tax relief to be made before the actual decommissioning work is carried out.

The proposed amendment to the legislation applies to decommissioning expenditure incurred on or after 22 April 2009. It provides that expenditure must be incurred and paid out in respect of an approved abandonment programme and it will only be allowable in the accounting period in which the decommissioning is actually carried out or undertaken. If the expenditure in respect of which a claim is made is 'disproportionate' to the decommissioning carried out, the claim can be reduced proportionately.

Transfers of business between mutual societies

Currently different tax consequences arise where a transfer is made to a company as opposed to a mutual society. Different tax consequences also arise on transfers between different types of mutual society.

Legislation will be introduced to allow an equivalent taxation basis to transferred business pre and post transfer. This may benefit certain friendly society transfers. In addition, certainty of tax treatment will be provided where it is currently unclear.

The changes will apply to transfers of business on or after 22 April 2009.

UK dividend exemption for Lloyd's corporate members

Lloyd's corporate members will no longer pay UK corporation tax on dividends and other distributions received from UK companies. This change is welcomed. It will bring the tax treatment of dividends and other distributions received by Lloyd's corporate members into line with those of general insurance companies.

The change will apply to dividends and other distributions received on or after 1 July 2009.

Life insurance companies: simplification

Finance Bill 2009 will introduce further measures to simplify and modernise the taxation of life insurance companies, following the consultation launched in May 2006.

Additions to the long-term fund, losses and capital bonuses

Legislation in FB 2009 will replace the guidance previously in HMRC's Life Assurance Manual (LAM) at paragraph 6.57. There are three strands to this measure.

- It will be explicit in law that additions to a long-term insurance fund are not taxable in the trading profit computations.
- Capital bonuses paid to policyholders out of additions to a long-term fund will not be tax-deductible.
- Life assurance trading losses are restricted where there is an addition to the long-term fund and Condition A or B is met.

Condition A is where a loss arises in a with-profit company which has a non-profit investment reserve, where the non-profit fund is not supporting a with-profit fund. Condition B is where a non-profit fund chooses to invest in assets (other than structural assets) that result in an admissibility write-down. The thinking in both cases is that the company has chosen to generate a loss and so loss relief should be restricted. Only the amount of loss created as a result of the addition and Condition A or B being met is restricted. Double-counting is avoided by ensuring that, where an amount restricts a loss in one year, it cannot restrict another loss later on. It is only sideways, carryback and group relief that is restricted, so any restricted loss may still be carried forward.

As insurers already argue that additions to the long-term fund are non-taxable, the measure will be seen only as a useful restatement of existing law, replacing the current LAM guidance.

The changes to the tax treatment of amounts added to the long-term insurance fund have effect for accounting periods ending on or after 22 April 2009 in respect of additions made on or after 22 April 2009. Restrictions in relief for amounts allocated to policyholders have effect for accounting periods ending on or after 22 April 2009 in respect of allocations made on or after 22 April 2009.

The circumstances in which bonuses are not tax deductible or loss relief is restricted will, hopefully, be rare, and so these measures will be of little concern to most companies. Nevertheless companies will need to take care to ensure that they do not inadvertently fall within them. For instance, Condition B will be in point if a company has deliberately invested in inadmissible assets in the past and then makes an addition to the long-term fund on or after 22 April 2009.

Foreign business assets and the floor

Foreign business assets are being fully removed from the calculation of the with-profits floor. This measure will have effect for accounting periods beginning on or after 1 January 2009 (and ending on or after 22 April 2009), but the industry hopes that this can be moved to 1 January 2008.

Value shifting and transfers of life assurance business

There will be a change to the value shifting provisions to ensure that there is no value shift as a result of a transfer of long term business between companies in the same group. This is a welcome amendment and will allow a number of dormant companies to be liquidated that have hitherto been kept in existence because of worries that the value shifting provisions might apply. The change applies to disposals of assets on or after 22 April 2009.

Contingent loans transitional provisions

There will be changes to the transitional provisions dealing with 'old' contingent rules under FA 1989 section 83ZA to ensure that they have the result of giving the relief that would have been received under section 83ZA. This is a welcome amendment and will remove a potential anomaly.

Extension to Business Payment Support Service

The Business Payment Support Service introduced in November 2008 allows HMRC to agree extended payment terms for businesses unable to meet their corporation tax or income tax liabilities when they would normally fall due. Payment terms can now be extended further in circumstances where the business expects to make current year losses sufficient to carry back and eliminate any prior year liability. The extended service is available immediately and an agreement will usually be reached within four working days.

Personal and employment taxation

Increased income tax rates

In a bid to generate increased tax revenues the Chancellor has escalated measures announced in Pre-Budget Report 2008 to increase income tax levied on higher earners, and most trusts. The new tax rates will be both higher than previously indicated and commence one year earlier from 6 April 2010.

New 50% rate of income tax

From 6 April 2010, there will be three main rates of income tax, with a higher rate of 50% being introduced for individuals with taxable income over £150,000. This has been increased from 45% as indicated in the PBR 2008. Dividend income in excess of this new limit will be taxed at 42.5%.

Elimination of the personal allowance

From 6 April 2010 the personal allowance for individuals with adjusted net income over £100,000 will be limited by £1 for every £2 above this limit. Based on 2009/10 personal allowances, this will mean that individuals with adjusted net income of £112,950 or more will not benefit from a tax free personal allowance.

An individual's adjusted net income is, broadly, taxable income less trading losses, pension contributions and Gift Aid, but before deduction for contributions to trade unions or police organisations.

Trusts income

The majority of trusts pay tax at a special rate applicable to trusts whenever income exceeds £1,000. Income received by trusts which was previously taxed at the rate applicable to trusts of 40% will now be taxed at 50%. Likewise dividends will be taxed at 42.5% rather than the previous rate of 32.5%.

Registered pension scheme charges

HMRC notes 'exit charges' in relation to registered pension schemes may be impacted by the increase in the highest rate of income tax.

Tax planning and comment

The measures introduced will increase the differential between capital gains tax at 18% and income tax at 50%, fuelling interest in structuring investments to fall within the capital gains tax legislation. Interest in sheltering income streams in privately held companies to take advantage of the lower corporation tax rate of 28% is also likely to increase.

In relation to a possible increase to charges imposed on unauthorised pension payments, it would seem unjust in the extreme for charges to be calculated with reference to the higher 50% rate, in scenarios where relief has been given at 40% or 20% under the new restricted pension contribution rules or, in the case of employer contributions, 28%. It would be inequitable to tax unauthorised employer or employee payments by registered schemes at a rate considerably higher than the maximum relief which could have been claimed on the contributions giving rise to the payment.

Limitations to pension tax relief for high income individuals

The Chancellor has announced measures to limit tax relief on pension contributions by individuals with annual incomes of £150,000 or more. The restrictions will be introduced with effect from 6 April 2011, but legislation will be introduced with effect from 22 April 2009 aimed at preventing individuals from making additional contributions prior to the new rules taking effect.

While higher rate taxpayers currently receive tax relief at 40%, the changes which will come into effect from 6 April 2011 will restrict higher rate tax relief for individuals with an annual income of £150,000 or more. Relief for individuals with an annual income of £180,000 or more will be restricted to a maximum of the basic rate.

This could make pension savings unattractive for these individuals unless they expect to be basic rate taxpayers in retirement. The benefit of gross roll-up on investments may not overcome this additional taxation compared to simply taking cash.

The Bill will also introduce an anti-forestalling measure - the ‘special annual allowance charge’ - with effect from 22 April 2009. This aims to remove the potential advantage to individuals of increasing their pension contributions ahead of the new regime starting. Further details are set out below.

The existing limitations by reference to 100% of annual earnings or the annual allowance if less (£245,000 for 2009/10) will continue to apply.

Special annual allowance charge

The special annual allowance is an allowance for 2009/10 and 2010/11 applicable to individuals with relevant income of £150,000 or more. However, the HMRC guidance is contradictory or ambiguous in this respect, so it is unclear whether this means relevant income of over £150,000 in any tax year after 2006/07, or over £150,000 in the year in question and either of the two previous tax years. In other words, it is unclear whether 2007/08 earnings are relevant when considering contributions paid in 2010/11.

The allowance sets an upper limit on the amount of non-regular pension contributions which can attract higher rate tax relief. The maximum annual allowance will be £20,000 which includes the amount of regular normal ongoing pension savings. The allowance operates in conjunction with ‘protected pension inputs’ to determine which contributions qualify for higher rate tax relief.

The associated tax charge is applied where the allowance is exceeded, and will bring tax relief on contributions which are not ‘protected pension inputs’ down to the basic rate.

Application of tax relief restrictions

Where regular savings exceed £20,000 per annum, those savings will be ‘protected pension inputs’, and the new tax charge will only apply to any increases to regular savings after 22 April 2009. However, where regular savings are below £20,000, the tax charge will only apply to excess payments over £20,000. The £20,000 limit includes amounts paid by the individual or their employer or by a third party.

Who is affected by the changes?

The changes are designed to catch those who have a high level of income and seek to increase their pension savings in excess of their normal pattern of contributions. The changes will therefore not impact those who:

- have income of less than £150,000 in a tax year and the previous two tax years (taking into account the ambiguity in HMRC's guidelines noted above);
- have income of £150,000 or more, but who continue as normal with their existing pattern of pension contributions and do not make any additional pension payments;
- have income of £150,000 or more and do increase their pension savings on or after 22 April 2009 over and above their normal pattern of regular contributions, but whose total pension savings in the year are less than £20,000.

The new tax charge will not apply to any normal, regular ongoing pension savings that are in place before 22 April 2009, whatever the value. However, individuals who fall outside the above conditions will be subject to the new rules introduced from 22 April 2009.

What is relevant income?

The special annual pensions allowance only relates to 'relevant income' which, broadly, comprises:

- total income before the pension contributions, personal allowance and other reliefs and deductions;
- less any normal deductions for reliefs (such as trading losses) including deductions for pension contributions to a maximum of £20,000; and
- less Gift Aid deductions.

Relevant income includes any amounts foregone by salary sacrifice in return for pension contributions or increased benefits implemented on or after 22 April 2009.

What are normal and regular ongoing savings?

For money purchase schemes where monthly, quarterly or yearly contributions are set, 'normal, regular, ongoing savings' mean the continuation of these contributions under agreements signed prior to 22 April 2009 and paid at least quarterly. For final salary schemes, 'normal, regular, ongoing savings' are maintained if there is no change to the way final benefits are calculated after 22 April 2009.

Individuals earning over £150,000 who used their annual bonus to finance retirement savings will not be able to claim that these are regular contributions (and hence claim protection from the new tax) because the payments were not made at least quarterly.

Additional benefits under defined benefit schemes such as the civil service or MPs' schemes, that arise from extra years of service or from pay rises, are not expected to attract the special annual allowance charge however large the increase, provided that the formula for calculating the benefits and the benefit structure remain the same. However, new arrangements to purchase 'added years' in such schemes could be caught.

Enforcement of the new rules

If pension savings have exceeded the special annual allowance, any tax relief that has been over-claimed will be recaptured through the special annual allowance tax charge. The tax charge will be applied through an individual's self-assessment tax return on the Pensions Savings Tax Charges pages. Broadly, this means that where an excessive amount has obtained tax relief at 40%, that excess is clawed back by a 20% tax charge which needs to be self-assessed.

Pensions advice and tax planning

Depending on the nature of the pension arrangements, it may be possible for individuals affected by these changes to claim a refund of contributions paid after 6 April 2009 which would cancel the associated tax charge.

Company car tax changes

The tax charge on individuals using cars provided by their employers for private use has historically encouraged the use of greener, lower emission cars. From 6 April 2011, amendments will be made to simplify the system and further encourage the use of more energy efficient vehicles.

The key changes from 2011/2012 will be:

- the lower threshold for CO2 emissions will be reduced from 130g/km to 125 g/km, increasing the number of cars taxed at more than 15%;
- the current £80,000 list price cap will be abolished, leading to higher tax charges for individuals using more expensive cars;
- rules relating to electronically propelled cars first registered from 1998 onwards will be simplified to directly apply a 9% rate, rather than the current system of achieving this rate by applying 15% with a 6% discount;
- rules relating to electronically propelled cars registered before 1998 will be repealed, as no such cars now exist; and
- rules relating to electric/ petrol hybrid cars, cars propelled by bi-fuels, road fuel gas and bioethanol, and Euro IV standard diesel cars registered before 1 January 1996 will all be abolished, so that the taxable figure will depend on the actual level of CO2 emissions, rather than the method by which emissions are reduced.

The changes will also increase the national insurance payable by individuals' employers in relation to the benefit.

Increased allowances for tax free ISA savings

In an aim to encourage a culture of saving, and to coincide with the 10th anniversary of their introduction, the Government has increased the amounts able to be saved tax free in Individual Savings Accounts (ISAs). This move will be implemented in two stages and will be introduced firstly for the over 50s, presumably with the aim of focusing on those who are more reliant on income generated from their savings which has been severely hit over the last 12 months.

The total amount that can be saved each year will be increased from £7,200 to £10,200. This will first take effect on 6 October 2009 from which point individuals aged over 50 will be able to deposit £10,200 into their 2009/10 ISA, up to £5,100 of which can be in cash. As previously, the amount invested in stocks and shares can be made with one or more ISA providers.

The limits will be raised for all ISA savers from 6 April 2010.

Individuals’ foreign dividend income

As previously proposed, Finance Bill 2009 will extend the provision of non-payable tax credits for individuals who receive dividends from non-UK resident companies. From 22 April 2009, individuals who own 10% or more of the shares in such a company will be eligible for such credits - like those who own less than 10% (rule introduced by FA 2008) and like individuals receiving dividends from shares in UK resident companies. This cuts the effective tax rate, at a personal level, to nil for basic-rate taxpayers and 25% for higher-rate taxpayers.

Draft legislation issued for consultation in January 2009 is likely to form the basis for the Bill provisions. There will be a requirement that the dividend source country is a ‘qualifying territory’, i.e. one with which the UK has a double taxation agreement which includes a non-discrimination article. HM Treasury will have power to vary the list of qualifying and non-qualifying territories.

There will be anti-avoidance provisions, including a targeted anti-avoidance rule to counter schemes which seek eligibility for dividends which do not originate in a qualifying territory. Further details are awaited.

Distributions to individuals from offshore funds

FA 2008 provided for certain individuals who receive dividends from non-UK resident companies (other than companies which are offshore funds) to be eligible for non-payable tax credits, and Finance Bill 2009 broadens the range of eligible shareholders, as noted separately. In general, individuals will be in the same personal income tax position as those who receive dividend income from UK or other non-UK companies, i.e. basic-rate taxpayers will have an effective rate of tax of nil and higher-rate taxpayers 25%.

With effect from 22 April 2009, FB 2009 will also allow non-payable tax credits in respect of most dividends from offshore funds - but not those funds which hold more than 60% of their assets in the form of interest-bearing securities (or their economic equivalent). Distributions from the latter will be taxed on the individual as yearly interest.

The new provisions will not apply where individuals invest in offshore funds which are transparent for tax purposes, such as partnerships.

Relaxation of venture capital scheme tax rules

Last year’s enterprise investment scheme (EIS) consultation has led to four helpful amendments to the venture capital tax relief schemes.

For all three schemes, there is a relaxation of the requirement regarding the employment of money raised. Investee companies raising money under the EIS, venture capital trust (VCT) and corporate venturing scheme (CVS) regimes will now have two years from the issue of shares (or commencement of trade if later) in which to employ the funds raised for qualifying purposes - rather than at least 80% in the first 12 months and the remainder in the following 12 months.

This simplification is welcome and applies to EIS and CVS investments made on or after 22 April 2009 and to funds raised by VCTs on or after 22 April 2009.

For investments made after 5 April 2009, the EIS income tax relief that can be carried back to the previous tax year is derestricted, subject to the normal £500,000 per annum investment cap. This is helpful for those raising funds as well as for investors. EIS income tax relief can only be obtained up to an amount which reduces the investor's income tax liability to nil.

Additionally a correction is made, effective from 22 April 2009, to an anomaly in the capital gains deferral relief rules which produced an inequitable result where an EIS company was taken over in a share for share exchange.

A final relaxation applies where a company raises EIS and non-EIS monies on the same day. Previously, where a company raised EIS monies and on the same day also raised funds from an issue of shares of the same class to non-EIS investors, all those funds were required to be employed within the EIS time limits. This requirement will be removed for the non-EIS shares issued on or after 22 April 2009.

Financial services compensation scheme measures

Changes are proposed in relation to certain forms of assistance offered by the Financial services compensation scheme (FSCS).

The interest element

Customers of defaulting financial institutions may be entitled to receive a compensation payment by the FSCS. The compensation may include an amount which represents interest which would have accrued from the date that the last interest was paid to the customer to the date the institution defaulted. This interest is calculated as if the tax deduction rules applied.

Legislation will be introduced to ensure that compensation payments made on or after 6 October 2008 will be treated as interest, so an individual will be in the same tax position as if it were actual interest received from the financial institution itself. This will enable the notional tax deducted to be available for repayment to a non-taxpayer or to be treated it if it were basic rate tax when calculating any liability to higher rate tax.

This clarifies the position and includes an element favourable to HMRC in that the amount is definitely taxable, and favourable to the taxpayer by ensuring it carries a tax credit.

Pensions

Individuals who have pensions savings with an insurance company which qualifies for assistance from the FSCS could have their rights transferred to another insurer or could be paid compensation. Because the FSCS is not a registered pension scheme the action could disadvantage the individual, primarily because lump sum commutation payments are only tax free if paid by registered pension schemes.

Measures are to be introduced to ensure that broadly the same tax treatment will apply to the individual's payments as if the FSCS had not taken any action.

Pensions: taxation of Financial Assistance Scheme payments

Where a defined benefit occupational pension scheme was wound up with insufficient assets between 1 January 1997 and 5 April 2005, the Financial Assistance Scheme (FAS) may provide financial help to members. (Since then this role has been filled by the Pension Protection Fund.) The FAS is a Government-funded scheme, not a pension scheme. It makes payments to members of qualifying pension schemes to supplement pension payments (if any) made by those schemes. The aim is to bring the total paid up to 90% of a member's pension entitlement, subject to a cap.

Going forward, the FAS will be responsible for making all of the payments due to members, including lump sum payments. Finance Bill 2009 will allow payments by the FAS to be taxed in broadly the same way as payments made by registered pension schemes. This will prevent members from being tax-disadvantaged because payments are not received from a registered pension scheme. For example, certain lump sums paid by a registered pension scheme are tax-free.

The measure will have effect for all payments made by the FAS, whenever made.

Personal allowances for Commonwealth citizens to be withdrawn

Under current domestic law, personal allowances are made available to certain taxpayers even if they are not resident in the UK.

From 6 April 2010, the law will be amended so that taxpayers will only be eligible to claim personal allowances as Commonwealth citizens if they are resident in the UK, or if they are resident in a country with which the UK has a double taxation agreement and they are able to claim personal allowances under that treaty.

The change will not affect UK nationals, as they can continue to claim personal allowances as EEA nationals, but other Commonwealth citizens, such as taxpayers from Tonga or the Maldives who have UK investments generating income are likely to be adversely affected.

Changes to the remittance basis regime

Various changes to the FA 2008 remittance basis regime have been announced, most of which are to be introduced in Finance Bill 2009.

Legislation will replace the Statement of Practice that currently allows resident but not ordinarily resident employees to apply the 'mixed fund' rules to their earnings on an annualised basis - but this will be deferred to Finance Bill 2010 to allow time for consultation.

The exemption for remittances of certain property for personal use such as jewellery, clothing, footwear and watches applied only where such items were purchased using offshore investment income. This exemption is to be extended to all remittances of personal property, as defined, and will be retrospective to 6 April 2008.

Two situations are addressed in which the remittance basis can apply without the taxpayer actively claiming it, so losing entitlement to personal allowance and capital gains tax annual exemption.

- The first concerned taxpayers who have less than £2,000 of unremitted offshore income and gains for the fiscal year. The law is to be amended to make it clear that they can claim the arising basis if they so wish.
- The second allowed the remittance basis for individuals who, as well as meeting certain other conditions, made no remittances of offshore income and gains and had no UK source income in the tax year. This was aimed principally at 'trailing spouses'. Under the new rules, the exemption will apply even if UK investment income is paid to the non-working spouse, provided that it is less than £100 per tax year. This should allow many more trailing spouses to benefit. Here also, the law is to be amended to allow taxpayers to 'opt out' of the remittance basis and into the arising basis if they so wish.

A further exemption is to be introduced for low-income workers with foreign earnings of less than £10,000 and overseas investment income of less than £100, so that they will not be required to file a UK tax return unless a return is issued to them. The exemption only applies if all of the foreign income is subject to foreign tax.

The interaction between the settlements legislation and the remittance basis is to be clarified. Further changes to the transitional provisions are also to be made to ensure that the law in ITA 2007 Part 14, Chapter A1 does not apply to income arising before 6 April 2008 that is taxable under the settlements legislation in ITTOIA 2005 Part 5, Chapter 5.

Additional changes are to be made to the Gift Aid provisions to ensure that any amounts paid by way of the £30,000 remittance basis charge will be regarded for Gift Aid purposes as tax paid.

Two anti-avoidance provisions have been announced. The definition of 'participator' and 'close company' are to be clarified in the law, and provisions will also be introduced to confirm when the rules on the valuation of sets of property remitted to the UK apply.

Furnished holiday lettings relief to be extended then abolished

Individual and corporate landlords with income from furnished holiday properties situated in the UK can be treated as if they were trading for certain tax purposes. To benefit from this treatment certain qualifying tests must be satisfied. However, properties which are situated outside the UK will not benefit from this treatment even though all the other qualifying tests are met.

The Government considers that restricting this treatment to UK situated properties may be in breach of European law and so has decided that the furnished holiday lettings provisions will be repealed with effect from 6 April 2010. Meanwhile the treatment will be extended to qualifying furnished holiday letting (FHL) properties situated in the European Economic Area (EEA). The EEA comprises the 27 EU member states plus Norway, Iceland and Liechtenstein.

Requests for FHL treatment or claims for reliefs arising as a consequence of being treated this way will be accepted by HMRC within the normal time limits for amending a self assessment tax return or the normal time limit for the relevant claim. HMRC has announced that until 31 July 2009, it will accept late amendments to personal tax returns for the year ended 5 April 2007 and corporation tax returns for accounting periods ending on or after 31 December 2006.

Landlords with EEA situated FHLs have a window of opportunity to benefit from a range of potentially significant reliefs as a consequence of the extension of these provisions, even if they will be short lived.

Welcome IHT and CGT relief for farmers

In January 2009 the European Commission (EC) requested that the UK ended discriminatory provisions whereby inheritance tax (IHT) agricultural property relief (APR) and woodlands relief (WR) are only available in respect of property situated in the UK, Channel Islands or Isle of Man.

HMRC announced that with effect from 22 April 2009, relief will be extended to agricultural property and woodland in the European Economic Area (EEA). The EEA states are comprised of the 27 EU member states plus Norway, Iceland and Liechtenstein.

In addition, where IHT was due or paid on or after 23 April 2003 in relation to property situated in an EEA state at the time the charge arose, relief can be claimed. Such claims will not be time barred until 21 April 2010 at the earliest.

Relief from IHT is available for transfers of certain assets that qualify as agricultural property. The relief operates so as to reduce the value of the asset that is chargeable (or potentially chargeable) to IHT. Relief will be either 100% or 50% and there is no monetary limit to the amount of relief available. One of the main aims of APR is to prevent a forced sale of qualifying assets on death in order to pay the IHT. APR may be available on a lifetime transfer or on a death, whereas WR applies on death only and enables the deferral of IHT in respect of the value of trees and underwood, until they are sold. A claim for WR must usually be made within two years of the date of death. The earliest deadline for reclaiming overpayments will be 21 April 2010. Budget Note BN50 does not specifically state from what date a retrospective claim can be made but it is implied that this would also be from 23 April 2003.

Capital gains tax holdover relief will also be extended to agricultural property in EEA states which has been farmed by a person other than the owner. Claims for 2003/04 under the extended provisions can be made until 31 January 2010.

The EC request for the ending of the discriminatory provisions gave rise to concern that the reliefs might be abolished totally, rather than extended, so the extension of the relief will be welcomed by individuals and executors alike.

Save As You Earn (SAYE) process simplification

The responsibility for some administrative functions will be transferred from HM Treasury to HMRC. HMRC will be able to specify that certain SAYE savings contracts will be subject to interest rates in force before the contracts were entered into. In addition, electronic communications will be allowed between scheme administrators and HMRC, and the minimum period between the issue of certain certifications and the date when they come into effect is reduced from 28 days to 15 days.

Charities substantial donor threshold increased

Legislation was introduced in 2006 which restricted a charity's tax exemption where a substantial donor receives value back from the charity. Where a charity enters into specified transactions with a substantial donor, that expenditure is treated as non-charitable and will attract a tax charge for the charity.

Until 22 April 2009, individuals or companies qualify as substantial donors if they give £25,000 or more in a twelve-month period or £100,000 in a six-year period. The Government has issued a regulation to increase the six-year donation threshold to £150,000 with effect from 23 April 2009.

The Government has also announced further consultation on the substantial donor legislation, which will take place during summer 2009, with a view to producing legislation in 2010.

Anti-avoidance

Disguised interest rules become effective 22 April 2009

In December 2007 HMRC issued a consultation document containing its proposals to deal with tax avoidance using financial products. The document dealt with two types of avoidance: disguised interest (dealt with here) and transfers of income streams (considered separately). Following a period of consultation, HMRC issued a revised consultation document, with amended draft legislation and explanatory notes, at the time of the November 2008 Pre-Budget Report. HMRC has now confirmed that legislation will be included in Finance Bill 2009.

The original consultation document set out a new approach for taxing company transactions which are loans in substance but, due to their legal form, are taxed more favourably than loans or not taxed at all. HMRC's previous approach to such avoidance has been to enact legislation on a piecemeal basis to target particular schemes, including legislation such as the 'shares treated as debt' rules in Finance Act 1996. The aim of the disguised interest rules is to replace these piecemeal responses with a comprehensive set of rules which ensure that an interest-like return is charged to corporation tax in all circumstances where an arrangement is structured with the intention that the return is not taxed as income.

The original draft legislation contained an over-arching principle that the rules should tax a return which is 'economically equivalent to interest', and deliberately contained relatively few detailed rules as to how the law should operate in practice. This led to concerns that HMRC would have significant discretion over how the law would operate in practice.

It is assumed that the legislation to be included in FB 2009 will be broadly in line with the draft published at the time of the November 2008 PBR. The draft legislation retained the original concept of taxing a return which is 'economically equivalent to interest'; but set out a series of criteria to determine whether the rules apply. These criteria are:

- the return must be by reference to a time value of an amount of money;
- the return must be at a rate reasonably comparable to a commercial rate of interest; and
- there must be no practical likelihood of the return not arising as expected.

The revised rules attempt to deal with some of the concerns and uncertainties raised during the consultation process. The key points are summarised below.

- The revised rules stated that they will not apply to an arrangement unless the main purpose, or one of the main purposes, of the arrangement is tax avoidance. However, Budget Note BN37 states that the rules will not apply where it is reasonable to assume that tax avoidance is not a main purpose of the arrangements. This may indicate a change in the approach.
- The rules are intended to catch returns denominated in a foreign currency, including the foreign exchange movements.
- Straightforward intra-group share investments are excluded. In straightforward situations this should prevent double taxation in a chain of companies and should also remove controlled foreign companies from the scope of the rules.

- The rules catch an overall interest-like return which is split between different companies. However, doubts remain over the extent to which the rules will disaggregate an interest-like return which forms part of a larger (non interest-like) return.

There is also a specific rule for preference shares which are accounted for as a financial liability rather than equity. It is proposed that such shares will be dealt with by what is effectively a revised version of the 'shares treated as debt' rules in Finance Act 1996. Broadly, if such shares (whether redeemable or not) give rise to an interest-like return and are held for an 'unallowable purpose', the shares are taxed on all accounting debits or credits in the same way that a loan receivable would be. Again, shareholdings in group companies are outside the scope of the rules.

The new rules are to be in force from 22 April 2009, not 1 April 2009 as previously announced. Arrangements entered into before 22 April 2009 may be outside the scope of the rules.

Transfer of income streams

In December 2007 HMRC issued a consultation document containing its proposals to deal with tax avoidance using financial products. The document dealt with two types of avoidance: transfers of income streams (dealt with here) and disguised interest (considered separately). Following a long period of consultation, HMRC has now confirmed that legislation will be included in Finance Bill 2009.

The legislation aims to catch situations where a person (including a company or an individual) disposes of a right to receive income without selling the underlying asset from which the income derives. In many cases, existing tax law provides that the seller is taxed on the receipt as income rather than a capital gain. However, existing tax law does not cover all situations, so the new rules introduce a comprehensive, principles-based code to ensure that receipts of this type are taxed as income.

The last draft of the proposed legislation was issued by HMRC at an open day on 6 March 2009. The rules in FB 2009 are expected to be substantially the same as that draft, subject to some minor amendments. The following comments are based on that last draft.

The rules normally bite only where the transfer of an income stream does not arise as a result of a transfer of the underlying asset. The exception to this rule is an annuity, which is considered to be indistinguishable from its income. Existing law already taxes the sale of an annuity as income.

In addition, the rules generally only apply to a transaction where it is motivated by tax avoidance. However, this motive test will not exclude from the rules transactions where the underlying asset is an annuity, a share or a lease of plant and machinery.

There are also specific exclusions from the rules for the grant of a lease of land and the disposal of an oil licence, as well as a provision to prevent double taxation.

The rules provide that the consideration received for the transfer is treated as taxable income when it is recognised in a transferor company's accounts; and is treated as arising in the chargeable period in which the transfer takes place for an individual. Market value is substituted for actual consideration where the latter is substantially less than the former.

The new rules will have effect for transfers of income taking place on or after 22 April 2009.

It should be noted that previous drafts of these provisions have received less comment than those on disguised interest and are therefore more likely, perhaps, to unintentionally affect commercial or

otherwise benign arrangements. Potentially affected persons should therefore scrutinise carefully the next set of draft legislation, when it is published.

Late paid interest and deeply discounted securities

It has been confirmed that Finance Bill 2009 will contain changes to the anti avoidance rules for companies in respect of late paid interest and deeply discounted securities (DDSs). HMRC first announced in July 2008 that it intended to make changes in order to make the rules compliant with EU law. Interested parties were given the opportunity to comment on the proposals, including draft legislation, and the rules to be included in FB 2009 are the end result of that consultation process.

HMRC also announced in July 2008 that a concession to the current rules would be available to companies. This is described in more detail below.

Current version of the rules

The current version of the late paid interest rules applies where a UK company pays interest more that 12 months after the end of an accounting period, and the creditor is not a company taxed on the interest under the UK rules for loan relationships. Where applicable, the paying company gets tax relief only when the interest is paid, not when it accrues.

There are similar anti-avoidance rules which apply where a company issues a DDS to a connected company or to a participator. The rules apply where the investor in the DDS is not taxed on the discount income in the same period as that in which the issuer obtains tax relief on that discount. Where applicable relief for the discount is deferred until the DDS is redeemed.

Changes for accounting periods beginning on or after 1 April 2009

Subject to an option to elect to extend the current rules for an extra accounting period, the changes will apply for accounting periods beginning on or after 1 April 2009. Based on draft legislation released by HMRC in March 2009, the revised late paid interest rules for companies will apply only where:

- the interest is paid more than 12 months after the end of the accounting period;
- the lender is not taxed on the interest under the UK corporation tax rules for loan relationships; and
- at least one of the following five conditions applies.

The five conditions are set out below.

- The UK company is connected to the lending company, and the lending company is resident or effectively managed in a ‘non-qualifying territory’. Broadly, a non-qualifying territory is one without a ‘good’ tax treaty with the UK. A good tax treaty is one with a non-discrimination provision. Most non tax haven territories will be good.
- The UK company is a close company, the lending company is a participator (or associate, etc), and the lending company is resident/ managed in a ‘non-qualifying territory’. Note that there are additional rules for collective investment scheme (CIS) based close companies and CIS limited partnerships.
- The UK company is a close company, and the lender is a non-corporate participator (or associate, etc). Note that there are additional CIS rules again.

- The UK company has a ‘major interest’ in the lending company (or vice versa), and the lending company is resident/ managed in a ‘non-qualifying territory’. A first company has a major interest in a second company where the first company and another person each control at least 40% of the second company.
- The loan is from a pension scheme.

A company may elect for the current basis to continue to apply for the first accounting period beginning on or after 1 April 2009. This may be helpful for companies that would benefit from a deferral of tax deductions for the interest. However, no election may be made for an accounting period ending after 31 March 2011. This will prevent the election being made by a newly incorporated company for its first accounting period, where the period ends after that date.

There is no specific anti-avoidance rule, but HMRC has stated that such a rule will be introduced if the relaxation of the rules is abused.

The amended rules for DDSs will operate under similar principles.

Concession for accounting periods beginning before 1 April 2009

At the same time as the announcement of the consultation, in July 2008, HMRC also published a concession to the current rules on late paid interest. The concession stated that HMRC would not seek to apply the late interest rule in situations where the lender is a non-UK resident company, hence enabling UK companies to claim a tax deduction for interest on an accruals basis in such situations.

HMRC subsequently confirmed that the concession would apply in situations where the lender is not only a non-UK corporate lender but is also a participator (or similar) in a close UK borrowing company. Without this extension to the concession, it would be of no help in situations where the UK company is also caught by the rule for participator lenders.

The concession can be applied where the tax return is submitted on or after 28 July 2008, or where the return is open due to enquiries on any issue. Companies have the option to take advantage of the concession, but are not obliged to do so.

Financial arrangements avoidance

Legislation will be included in Finance Bill 2009 to counter two schemes notified to HMRC under the tax avoidance disclosure rules.

The first scheme involves an intra group convertible loan which is highly likely to convert into shares of the issuing company. The debtor company accrues and obtains a tax deduction for more than the corresponding taxable amount in the creditor company. The new legislation will impute additional taxable credits into the creditor company to make the tax treatment symmetrical.

In the second, a company derecognises in its accounts a derivative that is carried at fair value, with the result that profits arising to the company on that derivative fall out of account for tax purposes. The new legislation will require the profits and losses on the derivative to be fully brought into account for tax purposes, even if they are not recognised in the accounts.

The new legislation will apply to debits and credits arising on or after 22 April 2009.

Hedging proceeds from future rights issues of shares

Where a company announces that it intends to raise funds from a rights issue of shares denominated in a currency other than its functional currency, the company might enter into a derivative contract to hedge the foreign exchange exposure arising between the announcement and receipt of the proceeds.

Currently, any exchange gain or loss on the derivative is taxable when the derivative is closed out. However, a new rule - announced on 10 March 2009 and to be implemented by amending Regulations - will permanently exclude any such gain or loss from tax, unless there is a gain on the derivative which is distributed to shareholders in any subsequent period.

The new rule will apply to all currency derivative contracts entered into on or after 1 January 2009, although there will be a special rule for hedges entered into before 10 March 2009.

Forex losses: targeted anti-avoidance rule

Finance Bill 2009 will introduce legislation amending the foreign exchange tax matching rules for companies. The aim is to deal with certain schemes notified to HMRC under the tax avoidance disclosure rules.

The forex tax matching rules typically apply where a company enters into a foreign currency loan or derivative contract to hedge the forex risks arising from its investment in foreign currency denominated shares. They ensure that the forex movements arising on the loan or derivative are deferred and brought into tax at the same time and in the same manner as any forex movements on the shares (typically on disposal).

The legislation is intended to counter two types of scheme:

- A “one way bet”, which gives a group a tax-deductible forex loss if a currency moves in one direction, but no taxable forex gain if the currency moves the other way. The new legislation will provide that forex gains and losses are not eligible to be tax-matched where there is a ‘one-way exchange effect’. Such an effect exists where the total taxable forex gains and losses arising to a company and all companies connected with it would differ from the equal and opposite forex loss or gain which should arise if the currency moved the same amount the other way. The rule is not intended to apply if the asymmetry does not create a tax advantage, or if it does not result from tax matching.
- A scheme which aims for a tax deduction for the interest element (‘forward points’) of a loss on a currency contract, without the counterparty being taxed on the corresponding profit. To counter this type of scheme, ‘forward points’ are to be excluded from the amounts eligible to be tax-matched.

Whilst it is understood that HMRC wishes to counter such schemes, there is concern that the impact of the rules may be more complex and far-reaching than might have been envisaged, particularly given the apparent inclusion of all connected companies in the test.

The new rules will apply to forex gains and losses arising on or after 22 April 2009.

Changes to prevent deductions for amortisation of goodwill

There are still different tax regimes applying to the taxation of intangible fixed assets for companies, depending, broadly, on whether the intangible fixed asset was acquired or created on or after 1 April 2002. The regime applying to assets acquired or created on or after 1 April 2002 ('the new rules') is generally more favourable, with, inter-alia, tax relief due in respect of amortisation charges, as per the accounts.

Goodwill and certain other internally generated intangible fixed assets are excluded from the new regime if the business of the company was carried on before 1 April 2002, or the asset was held on this date. If such goodwill or other asset is subsequently acquired from a related party this does not, generally, bring the asset into the new regime. In some intra-group reorganisations deductions have been claimed for amortisation relief in respect of the goodwill arising and in respect of certain other internally generated assets. Legislation will be introduced in Finance Bill 2009 which appears to be aimed at preventing such deductions although without the draft legislation it is not possible to assess the full extent of the changes.

The new rules will have effect from 22 April 2009 and will be treated as always having had effect. Therefore, no further relief will be due in respect of amortisation of goodwill where the goodwill arose on a related party acquisition prior to 22 April 2009.

Sale of lessor companies

Anti-avoidance legislation was introduced by FA 2006 Schedule 10 in relation to changes of ownership of companies carrying on a leasing business. Prior to the introduction of this legislation, a tax advantage could arise where a lessor company was sold to a group which expected to have tax losses available for surrender by way of group relief.

The tax advantage arose because the tax relief (available via capital allowances) normally exceeds the commercial depreciation at the outset of a lease. This timing advantage reverses later in the lease period. The effect of these accelerated capital allowances is that often a lessor company will realise tax losses to begin with (available for surrender by way of group relief). The sale of 'lease-tails', when a lessor company is sold to a group with tax losses, had the effect that no tax was payable on the profits arising in later periods on the reversal of the capital allowances.

The 2006 legislation countered this by ensuring that an accounting period ends on the sale of a lessor company, and the company is treated as receiving income (in the accounting period ending on the change of ownership) to the extent that the tax written down value of the assets is less that the accounts value. A deduction of the same amount then arises in the next accounting period of the lessee company.

Some changes are now proposed to the 2006 legislation. Most of these ensure that the legislation should work as intended in all circumstances, including more complex transactions involving partnerships or consortia.

Additionally where the tax deduction which arises in the accounting period starting on the change of ownership gives rise to a tax loss, this loss (to the extent it arises because of the deduction) may now be surrendered by way of group relief over an extended period of five years, with the value of the loss being preserved by reference to commercial interest rates. This more generous relief reflects the fact that sales of lessor companies also happen in commercial circumstances with no tax-avoidance

purpose, and the purchasing group will not always have the tax capacity immediately to use any tax losses which arise from the tax deduction.

The changes apply to all accounting periods which end on or after 22 April 2009.

Anti-avoidance: Plant and machinery leasing

A press release was issued on 13 November 2008, together with draft legislation. This legislation, to be included in Finance Act 2009, is designed to ensure that a business will not gain more tax relief than it would have done if it had obtained loan finance.

The legislation is aimed at a number of structures where a business owning plant and machinery on which capital allowances had been claimed entered into sale and leaseback or lease and leaseback transactions, and will have effect from 13 November 2008.

Additionally, a defect in the Capital Allowances Act 2001 is corrected as from 13 November 2008. This defect resulted in a loss of tax in some circumstances when a long funding lease comes to an end. The rules for long funding leases were introduced in 2006, and broadly have the effect that the tax treatment of long funding leases (as defined) is the same as for loan finance.

Two other changes are announced which will have effect for sales on or after 22 April 2009. These changes amend the definitions of 'sale and leaseback' in Capital Allowances Act 2001 sections 216 and 221. Without these amendments, the definitions did not cover all the ways in which sale and leaseback arrangements could be structured, resulting in opportunities for what HMRC sees as tax avoidance when there was a refinancing of existing assets.

Double tax relief: Repayment of foreign tax

Currently, a UK company which has claimed double tax relief (DTR) in respect of foreign tax paid must notify HMRC and amend its claim if there is a subsequent change in the amount of the foreign tax, for example, as a result of a repayment. However, if the tax is repaid to a person other than the claimant it is arguable that there is no obligation to amend the DTR claim. This can arise, for example, because some foreign territories provide that when a company resident in that territory pays a dividend, a refund of tax paid by that company is made to the recipient of the dividend, rather than to the company itself.

Legislation is to be introduced in Finance Bill 2009 to ensure that a DTR claim will have to be withdrawn or amended where there is a repayment of the foreign tax to a person other than the company which made the claim.

Double taxation relief avoidance using manufactured overseas dividends

HMRC has become aware of an intra-group sale and repurchase (repo) transaction undertaken by bank groups which is intended to produce a perceived tax advantage. As a result of the structure of the transaction and the prescriptive nature of the UK rules relating to manufactured overseas dividends (MODs), one party to the transaction is deemed for UK tax purposes to receive a MOD. In addition, this deemed MOD is treated as having been subject to deduction of foreign withholding tax and the recipient of the MOD is entitled to relief for that foreign tax. However, since the receipt is a

deemed MOD rather than an actual payment, there is no deduction of foreign tax from any amount actually received by the recipient. Therefore, HMRC's view is that the recipient does not actually bear the economic cost of the foreign tax, despite the fact that it is entitled to relief for that tax.

HMRC intends to introduce legislation to counter this type of transaction by preventing relief for foreign tax where the recipient of a MOD does not bear the economic cost of the foreign tax. Although the legislation is to be introduced in Finance Bill 2009, it takes effect on and after 22 April 2009.

Double taxation relief for bank trading receipts

Following the decision in *Legal & General Assurance Society Limited v Thomas* [2005] SpC 461, Finance Act 2005 introduced legislation restricting the availability of double taxation relief (DTR) for foreign taxes paid on Schedule D Case I income (now, of course, just 'trading income' under CTA 2009), or income computed on a similar basis for UK tax purposes. The rules intend to ensure that the DTR claimed cannot exceed the equivalent corporation tax on the net profits attributable to that source of income, after deducting an appropriate allocation of expenses, and are often referred to as a "mini-DI computation".

HMRC believes that certain banks have sought to avoid the impact of this legislation, either by routing loans through subsidiaries which are taxed differently or by financing in such a way that funding costs are not directly attributable to the income and are therefore not deducted in calculating the DTR restriction. Although HMRC considers that the existing legislation should already have the desired effect, changes are to be introduced to put the matter beyond doubt.

Removal of tax advantages of lease premium arrangements

Living accommodation is a significant cost when bringing internationally mobile employees to the UK, as is the tax cost on it. Where a property is rented for an employee, the rent paid is normally taxed on the employee as a benefit in kind, but any amounts paid instead as a capital lease premium have not been included in the principal taxing provision for living accommodation (although they could be taken into account as part of the extra charge for expensive accommodation).

Until 21 April 2009, companies could reduce the tax cost of providing accommodation by paying a lease premium and a lower rent on properties provided for their employees assigned to the UK. Premiums paid on any leases entered into on or after 22 April 2009 will instead be taxed as additional rent spread over the life of the lease, unless the leases are for a period of 10 years or more, or unless the leases are on business properties used by the employer which also include part of a property for an employee's domestic use.

This will effectively end their usefulness as a tax-planning tool for internationally mobile employees.

Interest on loans to invest in a partnership or close company

As announced on 19 March 2009, legislation is to be introduced in Finance Bill 2009 to deny individuals relief for loan interest on investments in partnerships or close companies, where the interest is paid as part of an arrangement and the deductibility of the interest means that the investor is guaranteed to make a profit. Draft legislation was released on 19 March and will be retrospective to that date.

It is understood that this anti-avoidance measure is principally aimed at a number of arrangements which were being offered to partners in 'old' sale and leaseback film partnerships. They purported to produce an interest deduction for borrowings to participate in the new arrangement, which could then be used to offset the reversing film sale and leaseback income.

Avoidance using offshore life insurance policies

Following an HM Treasury announcement and the issue of draft legislation on 1 April, the Budget confirms the introduction of legislation to counter planning whereby income tax losses were said to arise on investments in offshore life insurance policies. In fact, HMRC considers that such schemes have never worked but have decided to legislate in order to put the matter beyond doubt for contracts made on or after 1 April.

Prior to these changes, some analysts considered that an income tax loss could arise on an offshore life insurance policy by virtue of legislation dealing with losses on miscellaneous transactions. HMRC considered that the interaction with the specific legislation for the taxation of life insurance policies was always such that a loss cannot arise. Presumably HMRC considers there to be sufficient grounds for argument to necessitate the specific exclusion of life insurance contracts from the miscellaneous losses provisions.

These anti-avoidance provisions will apply to all new life insurance policies and to any existing policies which are altered in such a way as to otherwise generate a loss.

Avoidance using employment income legislation

Legislation will be introduced in Finance Bill 2009 to close down tax avoidance schemes which abuse reliefs available for employment-related liabilities and losses incurred by employees during the course of employments established for the purpose of the schemes.

The schemes concerned rely on the creation of highly artificial liabilities and losses through a series of arrangements established for the purposes of the schemes. The schemes connect individuals with companies or trusts, some of which may be offshore. A common feature is that liabilities and losses are created through intentional acts of default in the context of contrived employments.

The legislation will affect the tax liabilities of affected persons who have claimed the relevant reliefs on or after 12 January 2009.

Spotlight on selected tax avoidance schemes

The Government has announced that HMRC will shortly publish a "Spotlight" giving notice of selected avoidance schemes that are thought to be ineffective, in order to discourage potential users.

However, this could prove to be a double-edged sword and it will be interesting to see how it develops. Some potential users clearly will be dissuaded; others may become interested in planning they would not otherwise have heard of, and others again may seek to refine the schemes to make them more viable. It will also be interesting to see how much detail is given of the perceived weaknesses in the schemes; too little will be unpersuasive and weaken any deterrent effect, while too much will give taxpayers ammunition with which to patch any holes.

Stamp duty and SDLT

SDLT: extension of tax avoidance disclosure to residential property and introduction of SRNs

For some time, the Government has been proposing that stamp duty land tax (SDLT) on transactions of residential property with a value of at least £1 million be brought within the tax avoidance disclosure (TAD) regime. The Government has also been suggesting a mechanism to identify users of disclosed SDLT arrangements, both residential and non-residential. Further details have now been provided via a consultation document.

Currently certain SDLT arrangements are excluded from being notified, and the proposal is that the same exclusions will apply for residential property as they have to date for non-residential property. These exclusions are highly prescriptive, with the effect that, in some cases, arrangements need to be disclosed even though they are likely to be considered routine SDLT planning. The proposals also include a 'grandfathering' rule exempting from disclosure arrangements of the same, or substantially the same, description as arrangements that were first made available by any person before the date the changes come into effect. However, other ways to extend the TAD rules to residential property will also be considered.

Scheme reference numbers (SRNs) have now been part of the TAD rules for income tax, corporation tax and capital gains tax for some time. The Government proposes extending their use to SDLT in order to identify users of disclosed SDLT arrangements. This will mean that:

- a person disclosing an SDLT arrangement to HMRC will normally be issued with a SRN by HMRC within 30 days of HMRC receiving the disclosure;
- a scheme promoter issued with a SRN will be required to pass the SRN onto its client; and
- the user of the arrangement will be required to report the SRN and other information to HMRC.

The Government intends to introduce these changes towards the end of 2009. Comments on the consultation should be sent to HMRC before 16 July 2009.

SDLT: further temporary increase in 0% threshold for residential property

Late last year the Government decided that urgent action was needed to support the residential property market and so introduced a 'holiday' (short-term exemption) from stamp duty land tax. This applied to purchases of residential property for not more than £175,000 other than grants of leases for less than 21 years, or the assignment of leases with less than 21 years to run. The holiday applied to transactions with an effective date of 3 September 2008 to 2 September 2009 inclusive. Prior to that time, purchases for £125,000 or less had been exempt.

The Government has now announced that the holiday will continue until 31 December 2009. The threshold will then revert to £125,000.

The effective date is usually the date of completion, not the date of exchange of contracts. However, the effective date will be earlier than the date of completion if the contract is substantially performed at an earlier date. This would be the case if the purchaser took possession, or paid a substantial amount of the purchase price, prior to completion.

Favourable SDLT treatment extended to new shared ownership arrangements

Special stamp duty land tax (SDLT) rules deal with shared ownership leases granted by certain public sector housing bodies. The purchaser pays a proportion of the market value up front, and rent reflecting the value of the remainder. The purchaser has the right to purchase additional shares in the property ('staircasing').

Purchasers have the option of paying SDLT on either:

- the initial price paid, the rent, and subsequent staircasing payments; or
- the market value of the property, with exemption for the rent and the staircasing payments.

These provisions are to be extended to shared ownership leases granted by certain profit-making registered providers of social housing from Royal Assent.

The Government will also simplify the SDLT treatment for 'Rent to HomeBuy' schemes from 22 April 2009. These schemes enable purchasers to occupy their homes under a short tenancy, enabling them to save for a deposit.

Finally, registered social landlords enjoy SDLT exemption for their purchases and this exemption is to be extended from Royal Assent to registered providers of social housing, funded by public subsidies.

SDLT leasehold enfranchisement

To date, relief from stamp duty land tax (SDLT) has been available on leasehold enfranchisement where the transaction is entered into by an 'RTE company' as defined in the Leasehold Reform, Housing and Urban Development Act 1993. However, that definition has never come into force and so it has never been possible to benefit from the relief.

SDLT relief is now to be available to any nominee or appointee who acquires the freehold of a block of flats on behalf of leaseholders under a statutory right of collective enfranchisement. The relief will then operate as originally intended. This change is effective from 22 April 2009.

VAT and other indirect taxes

The VAT Package

Legislation will be published as part of the Finance Bill and in secondary legislation, implementing the 1 January 2010 'VAT Package' changes to the place of supply of services and introducing the new EC Sales List for services, which businesses will have to complete for supplies of services made to VAT registered customers. Legislation will also be introduced to implement the simplified 8th Directive VAT refund procedure (also effective 1 January 2010) under which EU businesses can reclaim VAT incurred in Member States in which they are not established for VAT purposes.

New place of supply rules for services

From 1 January 2010, the rules for determining the place of supply (i.e. taxation) of supplies of services will be re-written, extending the reverse charge on business to business (B2B) transactions and ensuring that most types of service will be taxed in the Member State of consumption.

Supplies of services - new reporting obligations

As a result of the changes to the place of supply of services, and to reduce the risk of VAT fraud, the current EC Sales List (ESL) system, which requires suppliers of goods to complete periodic listings of intra-EC transactions, will be extended to include intra-EC supplies of services in respect of which the recipient is required to account for VAT under the reverse charge procedure.

Simplified 8th Directive refund procedure

The simplified 8th Directive VAT refund procedure, under which businesses can obtain a refund of VAT incurred in other Member States, includes a simplified electronic procedure for the submission and processing of refund applications, and a detailed timetable for processing and paying refund applications.

Time of supply for reverse charge services

In addition to changes to the place of supply of services, the time of supply of reverse charge services will change from the time of payment to the earlier of when the service is completed, or when payment is made. In respect of continuous supplies of services, the time of supply will be the end of each billing or payment period. For continuous supplies not subject to billing or payment periods, the time of supply will be 31 December each year unless a payment has previously been made (in which case the time of supply will be the date of payment).

VAT rate returns to 17.5% on 1 January 2010

HMRC confirmed that the standard VAT rate will revert to 17.5% on 1 January 2010. This will require some changes to the current legislation which only enables HMRC to alter the rate temporarily for a period of one year, as the current rate reduction is for a period of 13 months.

It was also announced that ‘anti-forestalling’ legislation will be enacted to counter ‘schemes’ relying on the creation of VAT tax points by the issue of an invoice or receipt of payment when the rate is 15% if the actual supply of goods or services is not to take place or be completed until after the rate has

reverted to 17.5%. This anti-forestalling legislation will, in summary, apply where the recipient is unable to recover VAT charged on a supply (or the grant of the right to receive a supply at a discount or for free) and:

- the supplier and customer are connected parties; or
- the supplier assists the purchaser to fund the acquisition of the goods or services (or grant of the right); or
- a VAT invoice is issued by the supplier but payment is not due for at least six months; or
- the value of a prepayment is £100,000 or more, unless such prepayments are 'normal commercial practice' (HMRC has indicated that property supplies and asset leasing will not be affected, but further detail is expected from HMRC, e.g. as to whether longer-term supplies such as construction could be affected).

The first three conditions are effective from 25 November 2008, the fourth from 31 March 2009.

VAT: increased turnover thresholds for registration and deregistration

Budget Note 70 announces that the taxable turnover threshold, which determines whether a person must be registered for VAT, will be increased from £67,000 to £68,000.

The taxable turnover threshold which determines whether a person may apply for deregistration will be increased from £65,000 to £66,000. The existing conditions for determining entitlement or liability to deregistration remain unchanged.

The registration and deregistration threshold for relevant acquisitions from other EU Member States will also be increased from £67,000 to £68,000.

These changes, which seek to maintain the value of the thresholds in real terms, will have effect on and after 1 May 2009.

VAT: changes in fuel scale charges

Budget Note 69 announces that a statutory instrument has been laid to replace the current Table A in section 57(3) of the VAT Act 1994, which sets out the applicable fuel scale charges for taxing private use of road fuel, with a new table. The changes are being made to reflect changes to fuel prices. Businesses must use the new charges from the start of their next prescribed accounting period beginning on or after 1 May 2009.

Other VAT changes

The following changes were also announced.

Simplification of the option to tax

When a business has made exempt supplies of land or a building and decides that it wishes to tax future supplies, it must obtain HMRC's permission to opt unless it satisfies one of four conditions for

“automatic permission” which are set out in tertiary legislation published in Notice 742A “Opting to tax land and buildings”.

HMRC announced that the third of the four conditions, i.e.

- the building or relevant part of the building has been unoccupied between the date of the surrender and the date the option to tax is to take effect; and
- there will be no further exempt supplies of the land or building; and
- you do not intend or expect that you will occupy the land or building other than for taxable purposes

is to be amended to reduce the number of businesses which are required to seek HMRC’s permission. This simplification will come into effect on 1 May 2009, but some of the current informal concessionary relaxations of the requirement to seek permission will continue to have effect until 30 April 2010.

The revised third condition is to be published shortly in an Information Sheet.

Reduced rate on children’s car seat bases

The 5% reduced rate of VAT is to be applied, with effect from 1 July 2009, to supplies of bases for children’s car seats. To date, the reduced rate has only applied to supplies of the children’s car seats themselves.

Agricultural land

Legislation will be introduced to clarify that a change in VAT liability or rate will not affect the rental of agricultural land for the purposes of the Agricultural Holdings Act 1986.

Environmental tax changes

Landfill tax

HMRC confirmed the expected increase in the rate of landfill tax from £40 per tonne to £48 per tonne with effect from 1 April 2010.

HMRC also announced changes to landfill tax legislation, effective from 1 September 2009. These changes originate from the Court of Appeal’s judgment in *Waste Recycling Group Limited* [2008] EWCA Civ 849 that, where certain materials are re-used by the site operator for daily cover requirements or to maintain access roads etc. on a landfill site, they are not subject to the tax. The legislative changes are intended to clarify the law in this respect and the record-keeping requirements to support non-taxation.

In support of the proposed legislative changes, HMRC also announced a consultation exercise seeking views on the preferred and alternative options for change, which are aimed at modernising the definition of a taxable disposal of waste at a landfill site and also the definition of wastes that should qualify for the lower rate of tax.

Climate change levy (CCL)

A restricted relief from CCL will be introduced applying to supplies of electricity and liquefied petroleum gas used in manufacturing certain plastic products.

With effect from 1 April 2009, a new mechanism will enable HMRC to recover a proportion of CCL relief if a facility fails to meet its agreed climate change reduction target and the sector in which it operates also fails to meet its aggregate target for the same period.

CCL will be extended from 1 January 2010 to supplies of low value solid fuel valued at no more than £15 per tonne.

Excise duties

The Chancellor announced a number of changes to excise duties.

Alcohol and cigarettes

The Chancellor announced that duty rates on alcohol will increase by 2% with effect from midnight on 22 April 2009.

The increases translate to 13 pence on a normal size bottle of spirits; 1 pence on a pint of beer or cider; 3 pence on a litre of cider; 4 pence on a bottle of wine; and 5 pence on a bottle of sparkling wine.

The Government also announced a renewal of its strategy to tackle alcohol fraud, part of which involves consulting the drinks industry on the use of financial securities. In particular, the consultation will monitor the cost of, and provide options for, changes in relation to movements of excise goods (particularly alcoholic beverages) to other Member States under duty suspension arrangements. The Government will also legislate to withdraw the facility under which businesses can claim duty drawback on goods warehoused for export. Duty paid goods that are exported under other conditions will still be eligible for the drawback.

Excise duty on cigarettes and other tobacco products will increase by 2% with effect from 6.00pm on 22 April 2009. In addition, the ad valorem rate has also been increased by 2%, to 24% of the retail selling price. These increases represent an increase of 14 pence on the price of an average packet of cigarettes.

Oils

On 1 April 2009, the duty rates for unleaded petrol and diesel were increased by 1.84 pence per litre, and the Chancellor announced that these rates will increase on 1 September 2009 by a further 2 pence per litre, and from 1 April 2010 to 1 April 2013, by 1 pence per litre above indexation in each year.

The duty rates for biodiesel and bioethanol were increased by 1.84 pence per litre from 1 April 2009, and will be further increased from 1 September to maintain the current 20 pence per litre price differential. However, the duty differential will cease from 2010, and thereafter, duty will be charged at the same rate as petrol and diesel.

Other excise duty measures

The Chancellor announced that legislation will be introduced requiring HMRC to introduce, by 31 December 2009, a Charter, which will set out standards of behaviour and values to which HMRC will be expected to adhere in respect of dealings with taxpayers.

Excise duty will be brought into line with the interest treatment applied to other taxes, and under or over paid excise duty will be subject to a harmonised interest rate in line with other taxes.

Betting and gaming

There have been several changes to betting and gaming from a VAT and duty perspective.

Bingo

VAT on participation fees for bingo and other games of chance will be removed from 27 April 2009 whilst the bingo duty rate has been increased from the current 15% of gross profits to 22% for accounting periods beginning on or after that date. The money prize limit for bingo duty exemption for small scale amusements has been increased from £50 to £70 for bingo played on or after 1 June 2009. These changes will impact the partial exemption position of bingo operators.

Gaming duty

Gaming duty will be applied to casino games generally rather than to the statutory listed games from Royal Assent of the Finance Act 2009. The gaming duty bandings have been increased in line with inflation.

Gaming and amusement machines

A consultation on the reform of amusement machine licence duty such that the duty will be calculated by reference to gross profits rather than a licence charge has been announced. Amusement machine licence duty (AMLD) has been increased with effect for licence applications received after 4pm on 22 April 2009. Changes have also been announced to the classes of machines which are exempt from AMLD.

The definition of gaming machines in the Betting Gaming and Duties Act 1981 is to be amended so that it does not need any cross reference to the definition in the VAT legislation.

HMRC and the taxpayer

Personal penalties for senior accounting officers in respect of inadequate tax reporting systems

One Budget surprise which will be of considerable interest to senior accounting officers of large companies (those companies not defined as medium or small) is the publication of BN62 "Corporate Transparency: Personal Tax Accountability of Senior Accounting Officers of Large Companies".

This note says that legislation will be introduced in Finance Bill 2009 to require 'senior accounting officers' of large companies to:

- take reasonable steps to establish and monitor accounting systems so that they are 'adequate' for 'accurate' tax reporting purposes (tax reporting in this context being the preparation and submission of returns to HMRC and not accounting for tax figures in the financial statements); and
- certify annually that these systems are adequate or alternatively specify to HMRC any inadequacies (and additionally confirm that they are notified to the company auditors).

In addition to these obligations imposed on the senior accounting officer, large companies will also be obliged to notify HMRC of the identity of the senior accounting officer responsible.

These new and, for the UK tax system, revolutionary requirements will be backed up by new penalty provisions providing for up to £5,000 penalties chargeable personally on the senior accounting officer for careless or deliberate failure to comply with these obligations. Similarly there will be company penalties for careless or deliberate failure to comply with the notification obligation.

The new obligations will apply to accounting periods beginning on or after the date at which the Finance Bill receives Royal Assent.

Obviously, the draft legislation will be scrutinised very keenly and many issues will need to be clarified such as those below.

- Who is a senior accounting officer? (For example, does it include a group or company CFO?)
- How will 'adequate' and 'accurate' be defined? (Will HMRC publish benchmarks?)
- How wide will the obligations extend? (For example, are CFCs and transfer pricing covered?)

It is also very easy to see businesses making representations about the additional burden imposed especially in the current climate.

Wider background

Since the merger of HM Customs and Excise and the Inland Revenue there have been a number of initiatives by the merged HMRC with regard to large corporates. The HMRC office responsible for dealing with the 1,000 or so very largest corporates is the Large Business Service (LBS) and, since the implementation of the Varney reforms, there has been a significant emphasis on a risk-based

approach to examining the tax returns of large businesses. The initiatives and the risk-based approach are also being run out to the remainder of the approximately 15,000 large corporates administered outside the LBS.

An essential part of the risk assessment process involves HMRC understanding a large corporate's approach to governance and to the delivery of returns and information to HMRC. Over the last year there has been a very significant increase in focus on the systems that a corporate has in place for delivering correct and complete returns to HMRC. There is currently a pilot initiative ongoing within HMRC whereby approximately 10 large corporates are being identified for thorough 'systems reviews' by HMRC. The HMRC project is entitled Relying on Customers' Governance and Delivery and it is expected that over the next year to 18 months the product of these reviews will be used to inform systems work on other large corporates. In addition to the work under this pilot, many large corporates are also having their systems described or analysed by HMRC systems auditors so that HMRC can better understand whether to rely on the returns as submitted and how to assess the risks in the relevant tax returns more efficiently.

Various measures have been introduced to support HMRC's increasing focus on tax systems including:

- the absolute right of HMRC to see statutory records;
- the obligation on a corporate to provide reasonable assistance to HMRC's IT auditors;
- provisions which allow HMRC to suspend a penalty and stipulate conditions such as systems improvement which must be met before penalties are avoided; and
- operationally, the allocation of HMRC systems auditors to the large corporate population.

However, the new provision significantly increases HMRC's armoury in this area and its personal impact will undoubtedly have a mind-concentrating effect on the CFOs and others in large companies who will want to ensure that adequate systems are in place to report tax liabilities correctly. CFOs and chief accountants will undoubtedly want to consider the implications sooner rather than later and certainly won't be waiting for the legislation to take effect.

Next steps

Companies will want to decide how they respond to these changes and in particular, what they need to do to underpin the new certification requirement.

Those who provide the certification imply the existence of a clear understanding of the processes, systems and controls in place in respect of submitted computations. Notably, this would include finance as well as tax systems and processes. Therefore, companies that do not currently have these mapped out should consider doing so. HMRC use 'Business Tax Flow Overviews', spreadsheet audit technology and systems testing in their tax process reviews and, accordingly, approaching a certification exercise now with these in mind would seem sensible.

This also presents an opportunity for companies to both improve the robustness of their systems and deliver efficiency savings. Automation, tax sensitisation of existing systems and improved interaction between the tax and finance functions represent key improvements which could be achieved. In addition, tools are available to provide assurance on data coding into finance systems, to identify tax sensitive items and to aid the analysis and manipulation of information.

Late filing and late payment penalties and interest

Penalties for late filing and late payment

Currently, a number of different provisions deal with late payment of taxes and late filing across a range of taxes and duties administered by HMRC. A new set of measures will be introduced to reform the penalty regime for those who pay taxes late or fail to file returns on time for:

- income tax, corporation tax, PAYE, NICs and the construction industry scheme (CIS);
- stamp duty land tax and stamp duty reserve tax; and
- IHT, pension schemes and petroleum revenue tax.

These changes form part of HMRC's ongoing review of Powers, Deterrents and Safeguards and Tax Administration. Penalties will be charged for late filing of annual returns - these will be stepped from an initial fixed penalty due immediately a return becomes late; through daily penalties; and moving to tax-geared penalties of up 5% of the tax due where a delay has continued for six months, and a further 5% due where the delay continues for 12 months. Where a delay continues for longer than 12 months and a taxpayer deliberately withholds information necessary to assess the tax due, a penalty of 70% of the tax due may be charged.

Late payment penalties are intended to operate on broadly the same stepped basis, though this time with an initial tax-geared 5% penalty followed by penalties of 5% and a further 5% of tax unpaid due at six and 12 months. Amendments will be made so that the provisions will broadly apply for CIS returns and payments due under the PAYE system as well as for annual obligations. The regime enables HMRC to apply penalties for the first time where employers are late in making monthly PAYE and NICs payments and where companies make late payments of corporation tax.

The new regime also provides a statutory protection from penalties for taxpayers who have agreed 'time to pay' arrangements with HMRC. However, in the event that taxpayers default on agreed arrangements, the provisions will enable HMRC to re-impose penalties in some circumstances.

The regime will be introduced over a number of years, starting with penalties for late payment of in-year PAYE from April 2010. Additional returns will be brought into the regime over time. It is intended that legislation to extend the regime to other taxes administered by HMRC will be introduced in Finance Bill 2010.

Interest on tax paid late and tax overpaid

Measures are also to be introduced to harmonise rates of interest across all taxes administered by HMRC. Interest rates will be set and implemented automatically.

It is intended that interest rates will be charged by reference to Bank of England base rate, with the rate of interest updated automatically within 13 days of any change thereto. A differential between interest charged on tax paid late and interest paid on tax overpaid will remain, with a single rate of interest for late payment interest and single rate for repayment interest applicable to all taxes.

These new rates will be implemented across the various liabilities on a gradual basis, with late payments of in-year PAYE to be the first liability subject to the new regime from April 2010.

Action on tax evasion

Taxpayers who have evaded tax are to be faced with various new procedures.

Naming and shaming

HMRC has announced that Finance Bill 2009 will contain legislation allowing the public naming of taxpayers – individuals, businesses and companies – who are penalised for understating or failing to notify their tax liabilities.

The legislation will apply to taxpayers who deliberately suppress their reportable income leading to a loss of tax of more than £25,000. HMRC will publish on a quarterly basis details which are sufficient to identify the taxpayers including the name and address and the amount of tax evaded and the period in question.

There will be important exemptions for those making unprompted disclosures to HMRC or who make prompted disclosures within certain time limits. Also, there will be no publication in respect of matters which are under appeal.

This is a completely new departure for HMRC. The question of taxpayer confidentiality is a cornerstone of the UK tax system. However, HMRC is understood to be influenced by the perceived success of similar regimes in other countries, including in particular, Ireland.

The draft legislation will, no doubt, be the subject of close examination to ensure appropriate safeguards are in place, but the continued strengthening of HMRC's weaponry in its drive against the seriously non-compliant will be welcomed by many. Others may be understandably cautious until satisfied that the system is operating properly and that naming and shaming does not take place inappropriately.

New disclosure opportunity

HMRC has announced a further opportunity for offshore bank account holders to make voluntary disclosures of any unpaid liabilities. The facility will be open until March 2010 and details are expected to be announced later this year. It is likely that the penalty levied on those who take part in the scheme will be less than that which would ordinarily be chargeable, and in particular less than that chargeable under HMRC's new penalty regime.

New information powers

HMRC has also indicated that they intend to introduce additional record keeping requirements for those who have deliberately understated their taxable income by £5,000 or more. These requirements will give HMRC the opportunity to check that such taxpayers have proper systems in place to ensure tax returns are complete and correct, and are intended to make it easier for HMRC to monitor future compliance.

Limitations to right to reclaim tax paid in error

There will be new legislation regulating repayments of corporation tax, income tax or capital gains tax which do not fall within the scope of any other statutory procedure. The new rules will come into force on 1 April 2010 and these claims will need to be made within four years.

It seems that the Government has introduced this measure because in recent years there have been a number of claims under common law to recover tax paid under a mistake; the common law is more generous than the statutory procedure, both by allowing longer time limits during which the case can be brought, and by awarding interest on successful claims at a higher (and compound) rate. However, from 1 April 2010 these common law remedies will not be available to recover overpaid tax.

At the same time some changes are being made to the 'error or mistake' procedure which allows taxpayers to recover tax overpaid under an assessment. The changes remove the need for an assessment and for a mistake to have arisen in a return. Additionally, complexity will be removed by introducing a self-assessment system under which the claimant determines the amount of claim subject to HMRC's right to enquire. However, any restrictions on the ability to make a claim are not clear, and the draft legislation will need careful consideration in order to understand whether the scope of what can be reclaimed has been increased or restricted.

Compliance checking regime to be extended

As part of its ongoing review and modernisation of Powers, Deterrents and Safeguards, HMRC introduced in Finance Act 2008 a new regime for checking that taxpayers were complying with their obligations in respect of the major taxes administered by the department. The regime is now to be extended to include a number of other taxes administered by HMRC including inheritance tax, petroleum revenue tax, stamp duty land tax, stamp duty reserve tax, insurance premium tax and a number of environmental taxes.

As a result of the new regime, record keeping, inspection and information powers, and time limits for assessments and claims will be brought into line with the other taxes administered by HMRC. The regime will include:

- an inspection power enabling HMRC to inspect statutory records;
- an information disclosure power enabling information to obtained from taxpayers and third parties;
- a power enabling HMRC to visit business premises to inspect records and business assets;
- penalties for failing to comply with information notices or failing to allow an inspection; and
- an alignment of time limits for assessments and claims with other areas of the tax system (broadly, claims and assessments will only be possible within four years of the end of the relevant period subject to extended assessing time limits where taxpayers have failed to tax reasonable care or made deliberate errors).

It is expected that the new information and record keeping requirements will be operative from 1 April 2010 while the provisions in respect of time limits will require a transitional period and will therefore be operative from 1 April 2011.

The role of tax agents

As part of its ongoing review of Powers, Deterrents and Safeguards, HMRC has announced a consultation on the role played by tax agents in the tax system, and in particular how tax agents' role impacts on HMRC's efforts to address risks to the tax base.

The consultation document emphasises HMRC's view that the work of tax agents is essential in ensuring the smooth operation of the UK tax system and that the majority of tax agents provide a valuable service both to their clients and within the context of the wider tax system. However, the consultation document indicates that HMRC also regards the activities of some tax agents as presenting additional risks to the Exchequer, listing a number of instances of behaviour which it considers to be either negligent or, in some instances, fraudulent.

The consultation document indicates that HMRC considers its current powers to investigate and penalise tax agents who are considered to present risks, at s20A and s99 Taxes Management Act 1970, to be inadequate. HMRC poses a series of questions around the most effective mechanisms to deal with actual or potential non-compliance by tax agents and the risks presented by inadequate work. The questions concern:

- the nature of any penalties and investigation powers which might be appropriate;
- the extent to which professional bodies should be involved; and
- the extent to which standards of behaviour could be laid down by HMRC and to which adherence with these standards would impact HMRC's assessment of risk.

Although HMRC's efforts to improve compliance and work with tax agents and professional bodies to address the risks presented by agents' failures to take reasonable care or deliberate non-compliance are to be welcomed, the additional administrative burden and costs of compliance with any new regime will need to be considered carefully.

At present, the consultation is at a very early stage and no firm proposals have been made. However, it is clear that HMRC intends to move towards a more sophisticated regulatory approach.

Unpaid tax and MPPs, the PAYE system and lost contacts

A number of provisions are to be introduced to assist taxpayers in managing their tax debts, and to enable HMRC to deal with tax debts. These provisions have been introduced following consultation and form part of HMRC's ongoing review of Powers, Deterrents, Safeguards and Tax Administration.

The provisions will enable taxpayers to enter voluntary managed payment plans (MPPs) under which income tax or corporation tax debts can be paid in instalments straddling the due date. Taxpayers who enter an MPP will be protected from the normal interest and penalty provisions which apply to tax paid late. It is not anticipated that MPPs will be available until April 2011 at the earliest as HMRC will need to make a number of amendments to computer systems in order to process payments in this way.

Additionally, provisions will be introduced enabling HMRC to collect tax debts through the PAYE system. Taxpayers with small tax debts who receive income paid under the PAYE system will be able to spread their payments using the PAYE system. Safeguards protecting the level of taxpayers' income and limiting the amount which can be collected through this mechanism will be retained. Introduction of this measure is expected to be delayed until April 2012 as a result of the need to make amendments to HMRC's accounting and computer systems.

Finally, a measure will be introduced enabling HMRC to obtain contact details from third parties, including companies and businesses, for taxpayers who have outstanding tax debts but with whom HMRC have lost contact.

The HMRC Charter

A measure is to be introduced which will require HMRC to publish and maintain an 'HMRC Charter'. The HMRC Charter will be launched in autumn 2009 and will be in place by 31 December at the latest. The board of HMRC will be required to report on its performance against the Charter on an annual basis.

This is the first time that HMRC or its predecessor organisations has had a charter which is established on a statutory basis. Consultation on the nature and scope of a charter or similar public commitment has been ongoing since 2008 and the second and final round is due to be complete by 12 May 2009.

The HMRC Charter and its incorporation into statute is potentially an important safeguard for taxpayers. It is important to note that the Charter will also set out expectations on the part of taxpayers. Although the Charter is intended to supplement other statutory safeguards, such as appeals procedures, it will undoubtedly be useful for taxpayers to have access to a formal statement of HMRC's intended standards of behaviour.

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