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UNITED KINGDOM BUDGET 2010

22 JUNE 2010

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LONDON

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This special issue of our *United Kingdom Tax Bulletin* includes a summary of the main Budget proposals announced by the Chancellor of the Exchequer on 22 June 2010.

HMRC and HM Treasury have issued a large number of press releases and other documents relating to the proposed Budget changes. Many of the matters considered are highly technical, and further details are available on request from our London office.

2010/11

Allowances

Personal allowance (reduced for incomes over £100,000)	£6,475
Capital gains tax exemption	£10,100
Trustees CGT exemption	£5,050
Inheritance tax threshold	£325,000
VAT threshold	£68,000

Income Tax Rates

Up to £37,400	20%
Over £37,400	40%
Over £150,000	50%

Trust Rates

Rate applicable to trusts	50%
Dividend Trust Rate	42.5%

Corporate Tax Rates

Up to £300,000 (going down to 20% on 1 April 2011)	21%
Over £1.5 million (going down by 1% p.a. from 1 April 2011)	28%

Capital Gains Tax

Flat rate for basic rate taxpayers	18%
Flat rate for higher rate taxpayers (after 22 June 2010)	28%

Value Added Tax

Flat rate up to 3 January 2011	17.5%
Flat rate from 4 January 2011	20%

Capital Gains Tax

For disposals on or after 23 June 2010 the rate of capital gains tax is increased from 18% to 28% to the extent that the gain (when added to the income for the year) exceeds the basic rate band. There are to be no indexation or tapering reliefs. The limit applicable to Entrepreneur Relief is increased to £5 million – see below.

The annual exemption of £10,100 remains unchanged.

Gains arising to trustees on or after 23 June will be taxed at the 28% rate.

Capital losses for the current year, and losses brought forward, are to be applied in the way most beneficial to the taxpayer.

A change to the rate during the tax year invites many questions, some of which are addressed in a short series of Q&As released by HMRC.

Deferred gains – for example, gains reinvested into Enterprise Investment Scheme Shares – which come back into charge after 22 June 2010 will be taxed at the new rate. The same will apply where the consideration for an earlier disposal was as loan notes – whether taken as qualifying corporate bonds (QCBs) or non-QCBs.

The situation for foreign domiciliaries who have elected for the remittance basis for their overseas gains is unclear. Such gains, whenever realised, are treated as taxable in the year in which they are remitted. Gains which were made prior to 23 June, but where the proceeds are remitted after 23 June, risk being taxed at 28%. The Q&As indicate that gains **arising** (or treated as arising) before 23 June are chargeable at 18%; however, the HMRC Technical Team suggests that the date of remittance and not the date of the disposal is the determining factor. Unpublished guidance suggests that this may be modified where the remittance has been made from a mixed fund, the suggestion being that all remittances falling within Section 809J ITA 2007 during 2010/11 will be treated as having been made prior to 23 June.

Similar concerns apply to the stockpiled gains of a non-resident trust which are treated as accruing to beneficiaries who receive capital distributions from the trust. The same applies to individuals who are liable to tax on the gains of non-resident trusts and companies and those who fall within the temporary non-resident provisions because their absence from the UK does not exceed five tax years. The legislation currently treats the gains as accruing "in the year" and not on any particular date.

Capital Gains Tax: Entrepreneur Relief

The Entrepreneur Relief for capital gains tax was increased in the March Budget to £2 million to provide an effective rate of 10% on disposals of business assets up to that limit. With effect from 23 June, the lifetime limit of Entrepreneur Relief is being increased to £5 million.

This coincides with the increase in the capital gains tax rate to 28% with effect from 23 June, and although the calculation will be different for gains before and after Budget Day, the result will be the same – gains on qualifying assets up to the threshold will be chargeable at only 10%. Any gains over that limit will be chargeable at the rate appropriate to the individual's income. All other rules relating to Entrepreneur Relief and, in particular, the definition of qualifying gains remain the same.

Pension Contributions

Last year, proposals were announced whereby tax relief for pension contributions for those earning more than £130,000 would be restricted to the basic rate.

This was to come into force on 5 April 2011, and to prevent people paying lots of contributions ahead of the game, there were forestalling provisions. Any contributions greater than £20,000 (or such higher amount which had habitually been paid each year) were subject to a high income excess relief charge which had the effect of denying higher rate relief.

This is all going out the window. It would appear that the new provisions are going to be repealed and there will instead be an annual allowance in the range £30,000 to £45,000.

Nevertheless, the forestalling provisions in force for 2009/10 and the current year will continue to apply and apparently will be amended to prevent abuse of this new proposal.

Pensions: Annuity Obligation

The obligation to purchase an annuity by age 75 is to be amended, as well; pending new rules to be proposed, this obligation is to be deferred to age 77 for those who have not yet reached age 75.

Value Added Tax

The rate of VAT is being increased on 4 January 2011 to 20%. As usual there will be forestalling provisions to catch arrangements designed to take advantage of the present rule by issuing a VAT invoice or causing payment to be made before the rate increase, where the goods or services are not supplied until after 3 January. These provisions will apply where:

- The parties are connected;
- The value of the supply exceeds £100,000 (except in cases where prepayment is normal commercial practice);
- The supplier or connected person funds a prepayment for the goods or services; or
- An advance VAT invoice is issued where the payment is not due within six months.

This is, of course, just a repeat of what happened last year when the rate increased from 15% to 17.5%. I expect December to be a good billing month.

The thresholds applicable to the flat rate scheme have been revised to reflect the increase in the VAT rate, and so have the appropriate percentages for those businesses which qualify for the scheme.

Income Tax

The allowances for 2010/11 remain the same – although there is an increase proposed for next year. The rate bands remain unchanged – and so do the rates of tax.

- Up to £37,400 – 20%
- Over £37,400 – 40%
- Over £150,000 – 50%

Non-Doms

There is comparatively little about non-doms in this Budget. All that is said is that the government will review the taxation of non-domiciled individuals. This will assess whether changes can be made to the current rules to ensure that non-doms make a fair contribution to reduce the deficit in return for greater certainty and stability for those bringing skills and investment to the UK.

Where a non-dom claims the remittance basis and pays the £30,000, the basic rate band is deemed to have been utilised and any gains are charged at 28%.

It is suggested by HMRC that remittances of overseas gains after 22 June will all be chargeable at 28%, but this depends upon what is meant by gains arising, and some clarification is required.

National Insurance Contributions (NICs)

The thresholds for NIC liability are being increased with effect from 5 April 2011. In an effort to assist in job creation outside the South East, there is to be an NIC holiday for new businesses of up to £5,000 for each of the first 10 employees employed after Budget Day. Detailed rules are yet to be published, but the commencement date for this NIC holiday is expected to be 6 September 2010.

Inheritance Tax

No changes are proposed to inheritance tax other than to freeze the nil rate band threshold at £325,000 until 2015. However, there are proposals to introduce a disclosure obligation in respect of schemes designed to avoid inheritance tax.

Corporation Tax

The rates of corporation tax are to remain unchanged until 1 April 2011.

However, on 1 April 2011 the small companies rate on profits up to £300,000 will be reduced to 20%.

The main rate of corporation tax on profits over £1.5 million will be reduced from 28% to 27% on 1 April 2011 and will go down a further 1% per annum to 24% by 1 April 2014.

The marginal rate between £300,000 and £1.5 million will remain at 29.75% for the current year and will go down next year to 28.75%.

Capital Allowances

The annual allowances for plants and machinery are to be reduced with effect from April 2012. There are two aspects to the changes.

The first is the rate of writing-down allowances on equipment pools. The main equipment pool for general plant and machinery currently benefits from a 20% allowance, and this is to be reduced to 18%. Special rate pools currently benefit from 10% writing-down allowances, and this will be reduced to 8%. The main items in special rate pools are a plant which is integral to a building and business cars with CO_2 emissions over a given limit.

Both these changes have effect for the calculation of writing-down allowances for chargeable periods on or after 6 April 2012 for income tax, and 1 April 2012 for corporation tax.

Where the accounting period spans the date of change there will be a hybrid rate of writing-down allowances. For example, for a company with an accounting date of 30 September, writing-down allowances for its general pool of machinery and plants will be at the rate of 19% for its accounting period ending on 30 September 2012, this being one half of the 20% rate plus one half of the 18% rate.

The second change relates to allowances on plants and machinery and is a reduction in the limit for annual investment allowances. The limit was increased from £50,000 to £100,000 from April 2010 in the March Budget, but this limit is going down to £25,000 with effect from April 2012.

There is a further allowance, a 100% first-year deduction for business expenditure on new and unused zero-emission goods vehicles. It appears that the delay in implementing this allowance, which appeared in the March Budget, was to comply with European State Aid rules.

Research and Development Tax Relief

Small and medium-sized companies benefit from effective 175% tax relief in respect of their research and development expenditure. This relief is not available to unincorporated businesses and is subject to detailed conditions in relation to the nature of the research and development and other aspects.

One of the conditions is that the company incurring the expenditure must own any intellectual property which derives from it. HMRC interpreted this test strictly, maintaining that the IP ownership must vest in a meaningful way, so that relief would be denied if the period of ownership by the company concerned was too short. Many practitioners regarded HMRC's interpretation of this test as being unjustified.

In the Pre-Budget Report, it was announced that the test would be abolished, but the relevant legislation did not appear in the Finance Act 2010. It has now been announced that the legislation will appear in a Finance Bill to be introduced in the autumn, and it will apply to any expenditure incurred by a small or medium-sized company in an accounting period ending on or after 9 December 2009.

Furnished Holiday Lettings

The outgoing government proposed to abolish all reliefs relating to furnished holiday lettings. However, owing to the inordinate haste with which the Finance Bill 2010 was enacted, it proved impossible to include this proposal, and the Conservatives announced that they would not proceed with the abolition.

The Budget papers now confirm that the repeal of the tax reliefs for furnished holiday lettings will not be implemented. Instead, it is proposed to change the eligibility thresholds and the use of loss relief. The relief requires actual letting to the public for 70 days in a 12-month period, and availability of letting for 140 days in that period. It is thought that the government plans to increase both these figures. Details of the restriction and loss relief have not been given; Section 25 FA 2010 introduced a denial of loss relief for property businesses where the loss arises from the annual investment allowance coupled with "tax avoidance arrangements", and presumably a wider withdrawal of loss reliefs is now being considered. Any changes are to have effect from April 2011.

Settlor Interested Trusts

Where a settlor or his or her spouse has any interest in a trust, the anti-avoidance legislation provides that the income is to be treated as that of the settlor for all tax purposes. HMRC take the view that the trustees are equally liable to tax on the income and, in the case of discretionary trusts, the higher trust rate of tax applies to the trustees.

To prevent a double liability, the settlor is given credit for the tax paid by the trustees. If the settlors' tax rate is lower than the trust rate, he or she will be able to secure a payment of some of the tax paid by the trustees. At present there is no requirement for the settlor to pay this back to the trust, but this is to be changed for payments relating to trust income that arises on or after 6 April 2010. Settlors will now be required to pay the tax recovered to the trustees. One wonders whether it would not be far simpler if the rule were to be that HMRC will pay the repayment to the trustees and not the settlor.

Employee Benefit Trusts (EBTs)

The March Budget proposed measures to bring into charge disguised remuneration through the use of EBTs – but did not specify any particular proposals. This Budget is no better. HMRC simply say that whatever measures are introduced will apply equally to employer-financed retirement schemes and will take effect from April 2011.

Proposals are also being developed to ensure that profits from Employment Related Securities are chargeable to income tax and NIC.

Banks

A bank levy is to be introduced on 1 January 2011. The levy will be set at a rate of 0.04% in 2011, rising to 0.07% in later years. The levy will apply to banks and building societies and to the UK operations of foreign banks. It will only apply to large banks whose relevant aggregate liabilities amount to at least £20 billion. The levy will not be deductible for tax purposes.

The German and French governments are proposing to introduce a similar levy and have issued a statement to that effect.

There is no information about any continuation of the bankers bonus charge. All that is said is that the government is taking action to tackle unacceptable bank bonuses – but we do not know what that action is going to be.

General Anti-Avoidance Rule

The government intends to examine whether a general anti-avoidance rule should form one element of strengthened defences.

This has been considered before (and rejected), and the experience in other countries has not been good. But that is no guide to what will happen this time.

Enterprise Management Incentive (EMI) Schemes

At the moment, companies offering share options to their employees under an EMI Scheme must operate wholly or mainly in the UK. However, it will now be possible for a company granting EMI options to merely have a permanent establishment in the UK.

This is apparently to ensure that the EMI Scheme complies with European State Aid guidelines. This is not a new announcement, being something which was foreshadowed in the previous Budget.

Venture Capital Funds

Similarly, Enterprise Investment Schemes (EISs) and Venture Capital Trusts (VCTs) presently require that there is a qualifying trade going on wholly or mainly in the UK, but the requirement is now that the company issuing the shares must have a permanent establishment in the UK.

New legislation will exclude shares from qualifying for the purposes of EIS or VCT if they are an enterprise in difficulty within the EC guidelines.

IR35

The government remains committed to a review of IR35.

UK-REIT Stock Dividends

Provisions will be included in the Finance Bill to permit UK-REITs to satisfy the requirement to distribute 90% of the profits from their property rental business annually in the future via stock dividends in lieu of cash dividends. This is a measure which might be particularly welcome to REIT managers anxious to preserve capital. It is likely, however, to be less attractive to investors who will be taxed on their stock dividends in the same way as on the equivalent cash dividend without the benefit of the cash flow.

Controlled Foreign Companies

There have been a number of announcements recently relating to controlled foreign companies, particularly having regard to the unhappy journey of these provisions through the Courts.

Pursuant to the Chancellor's wish to make the UK an attractive location for business, he is being very cautious about how the controlled foreign company legislation should be amended, and the government are now considering how to make improvements to be introduced into the Finance Bill next year.

World Wide Debt Cap

The world wide debt cap was introduced last year to prevent what was regarded as excessive debt funding of UK companies. These provisions restrict relief for UK financing costs where they exceed the financing costs of the world wide group.

This is a very controversial area, and wide ranging changes are now proposed which will find their way into the Finance Bill to be published in the autumn.

Capital Distributions

Some uncertainty has arisen recently about the corporation tax treatment of distributions. This has arisen from arguments by HMRC that the meaning of a dividend for tax purposes was different from its company law meaning and that dividends are income or capital depending upon the reserves from which they were paid. What HMRC had in mind is that if they could categorise dividends as capital receipts, they could be brought into charge to corporation tax and not be exempt which is the case of dividends generally.

It is now proposed that the Finance Bill will include provisions to ensure that dividends will not be excluded from the exemption, because they are capital distributions; this will have retrospective effect. This was foreshadowed by a ministerial statement (and a reference in the March Budget). This change will have effect for distributions made on or after 1 July 2009. However, the application of this clarification for income tax purposes will only have effect in respect of distributions made on or after 22 June 2010.

Stamp Duty Land Tax (SDLT)

The previous government's proposal to impose a 5% SDLT charge on residential property over £1 million from 6 April 2011 is being implemented. The government is going to examine whether further changes regarding high-value transactions are needed to prevent avoidance.

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22 June 2010

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