



UK Tax Law Update - UK Budget Special, March 2008

Welcome to a special issue of the UK Tax Law Update produced by the London Office of Steptoe & Johnson. It covers the significant highlights of the March 2008 Budget. If you would like to discuss any particular issue in more detail please contact Kassim Meghjee (kmeghjee@steptoe.com) or your usual Steptoe & Johnson contact. We hope you enjoy reading this and welcome any feedback that you may have.

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International Aspects

As expected there is not to be any delay in implementing the changes announced relating to the individuals who are tax resident but not domiciled in the UK. A number of changes have been made to the proposals announced in the pre-Budget Report 2007 as well as the draft legislation issued on 18 January 2008. The main changes are as follows:

- the £30,000 payable will now be a tax charge on unremitted income and gains (or a combination of the two) rather than a stand alone charge. This means that the individuals should be able to claim credit for the that amount under an applicable double taxation treaty.
- the draft legislation did not have effect for remittance basis users who have unremitted foreign income and gains of less than £1,000 in the year of assessment. This has been raised to £2,000.
- the £30,000 charge will only apply to individuals who are over the age of 18.
- those who will be claiming arising basis of taxation will, in certain circumstances, be able to offset their foreign losses against their foreign income or capital gains otherwise taxable.
- an exemption to the days of accounting rules is to be wider and encompass both switching between airports or terminals as well as modes of transport. The exemption however will not be available to those who engage in activities that are, to a substantially extent, unrelated to their passage through the UK.
- the rules relating to non-resident trusts have been re-written and are different from those that appeared in the draft legislation published in January 2008. Non-domicile beneficiaries of a non-resident trust who claim the remittance basis of taxation will from 6 April 2008 be taxed on the remittance basis of taxation on all UK and offshore assets. The trustees will be able to make an irrevocable election to rebase the assets held as at 6 April 2008 for the purposes of excluding any part of a chargeable gain relating to the period before 6 April 2008 from being taxed on non-domiciled beneficiaries.
- the deemed remittance rules that applied, as per the draft legislation issued on 18 January 2008, to offshore mortgages will not apply to existing mortgages secured on residential properties situated in



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the UK. This carve-out will apply to repayments for the remaining period of the loan, or until 5 April 2028, whichever is shorter. However if the terms of the loan are varied or any further advances are made after 12 March 2008 then the repayments will be treated as remittance from that point.

- a new exemption from the deemed remittance will be created for works of art purchased overseas and brought into the UK for public display without it being treated as if it is deemed remittance.

Other changes having an international dimension are as follows:

- the rate at which remittance basis users will be liable to income tax on foreign dividends is being corrected to 40% for those individuals liable to higher rate of tax. This corrects an error which had changed the applicable rate to 32.5%. This change comes into effect for remittances on or after 6 April 2008.
- UK resident individuals and non-resident Commonwealth and European Economic Area nationals will be entitled to notional tax credit on dividend received from non-UK resident companies with effect from 6 April 2008. This will bring the taxation of these dividends in line with dividends received from UK companies. This is only available to individuals who hold less than 10% of the ordinary shares in the relevant company. There are proposals to extend this treatment to all investors and not only those who hold less than 10%.
- changes are to be made to the Controlled Foreign Companies rule to prevent perceived abuse of the rules by using partnerships and trusts. The rules as drafted only apply to profits that arise to low-taxed foreign companies. Legislation is to be introduced which will come into effect on 12 March 2008 to block the number of artificial avoidance schemes that rely on the use of a partnership or a trust to escape the Controlled Foreign Companies charge.
- legislation is to be introduced which will come into effect for income arising on or after 6 April 2008 and for foreign tax paid on or after 6 April 2008 which will ensure that the credit for any foreign tax paid on trade or professional earnings of an individual is no more than the UK income tax due in respect of the same earnings. This measure will give statutory footing to existing practice and is in keeping with the rules that apply to the corporation tax regime.
- legislation is to be introduced to clarify rules that UK residents pay UK tax on their profits from foreign partnerships notwithstanding the wording of any double taxation treaty and the prevention of tax avoidance through the misuse of double taxation treaties. The first measure will be treated as having retrospective effect to legislation enacted in 1987 (which itself had retrospective effect); the second will have effect for income arising on or after 12 March 2008.
- legislation is to be introduced to make changes to the legislation underpinning the investment manager exemption in two respects. First, it will simplify the approach to defining transactions that are within the scope of that exemption. Secondly, changes are to be made to achieve proportionality in the sense that if the conditions of the exemptions are not satisfied, the charge to the UK will be proportional and not on all transactions carried out through the investment manager.



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Corporate

The bulk of the changes announced related to encouraging research and development and environmentally friendly initiatives.

- enhanced relief for research and development as well as vaccine research is to be increased from 150% to 175% for small and medium companies and 125% to 130% for large companies. This provision remains subject to the EC State Aid rules and will come into effect once that approval is given.
- Enterprise Zone allowances are to be withdrawn with effect from April 2011. Enterprise Zones which normally provide 100% allowance will not be subject to phasing out rules which apply to industrial and agricultural building allowances announced last year. The withdrawal will come into effect on 1 April 2011 for businesses within the charge to corporation tax and 6 April 2011 for business within the charge to income tax.
- the 100% first year allowance for expenditure incurred on natural gas and hydrogen refuelling equipment due to end on 31 March 2008 will be extended for an additional 5 years to 31 March 2013. Its scope has also been extended to include refuelling equipment for biogas.
- the 100% first year allowance for expenditure on cars with CO2 emissions not exceeding 120g/km driven is due to end on 31 March 2008. Legislation is to be introduced to extend the scheme for another 5 year period which will end on 31 March 2013, reduce the qualifying emission threshold so that the only expenditure on cars with CO2 emissions not exceeding 110g/km driven will attract the 100% first year allowance, introduce a transitional rule to ensure that in a leasing contract entered into before 1 April 2008 involving cars which currently qualify are not affected by the new rules.
- legislation will introduce a new annual investment allowance for the first £50,000 of a businesses expenditure on most plant and machinery each year. This new allowance will be available to any individual carrying on qualifying activity (this includes trades, professions, vocations, ordinary property business and individuals having an employment or office) any partnership consisting only of individuals, and any company. This annual investment allowance is subject to detailed qualifying requirements.
- the list of technologies which are covered by the energy efficient and water saving enhanced capital allowance is also to be extended. The changes to the scheme will have effect on and after a date to be appointed by Treasury order to be made prior to the Summer 2008 parliamentary process.
- legislation changes are to be made to allow companies within the charge to corporation tax that make a loss in the period in which they invest in certain designated energy saving or environmentally beneficial plant and machinery to be able to surrender their losses to the government in exchange for a cash payment. This will apply for qualifying expenditure incurred on or after 1 April 2008.

Other corporate related changes that merit mentioning are:

- the rules relating to which companies are associated with each other are to be simplified for companies



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whose taxable profits are below £300,000. The rules currently treat two companies controlled by business partners as being associated. The amendment is to treat such companies as associated only where there are arrangements which involve a shareholder or director or the partner securing a tax advantage. This would mean that such companies controlled by business partners will not necessarily be associated companies.

- the limit on the amount invested on which an investor can claim Enterprise Investment Scheme income tax relief in any one year is to be increased from £400,000 to £500,000. The activities of ship building, coal and steel production is to be added to the excluded activities lists for qualifying trade for the purposes of the Enterprise Investment Scheme.
- changes are also to be made to the Enterprise Management Incentive (EMI) schemes. EMI schemes will only be limited to qualifying companies with fewer than 250 employees. Companies involving ship building, coal and steel production will not longer qualify for EMI schemes. Regulations will also be made to increase the individual employee limit on the grounds of EMI qualifying options from £100,000 to £120,000. The option grant limit will increase with effect from 6 April 2008 and the qualifying company changes will have effect in respect of option granted on or after the date the Finance Bill 2008 received Royal Assent.
- changes are to be made to provide for instruments transferring shares that were previously chargeable with £5 stamp duty (whether as a result of the applicability of 0.5% rate or fixed duty on instruments transferring shares otherwise than in sale) will no longer need to be presented to HM Revenue and Customs for stamping. This measure will have effect for instruments executed on or after 13 March 2008.
- exemptions to stamp duty that are available for the raising of capital will be extended to alternative finance products (Sharia compliant products). This change will ensure they are treated on a par with equivalent debt securities falling within the definition of loan capital. The changes will have effect for transfers of loan capital on or after the date the Finance Bill 2008 receives the Royal Assent. Powers are also to be enacted to allow similar changes to be made by secondary legislation in the future.

And finally rates and thresholds:

- the corporation tax rate that will apply is as has been previously announced. Companies with profits below £300,000 will pay tax at a rate of 21% in 2008/09. Companies with profits in excess of £1.5million will pay corporation tax at a rate of 28% in 2008/09. Companies with profits in between £300,000 and £1.5million will pay tax at an effective rate which is between 21% and 28%. The same thresholds but different rates will apply to companies with profits from oil extraction and oil rights which are 19% and 30% respectively - the rate for profits in between the thresholds will be an effective rate between these two rates.
- the VAT registration threshold will, from 1 April 2008, be £67,000. The de-registration threshold will be £65,000. The registration and de-registration thresholds for acquisitions from other European Member States will be £67,000.



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Real Estate

Not as much activity on the real estate front:

- new regulations are to be introduced to provide a more favourable tax regime for authorised investment funds that invest mainly in real estate, UK-REITs or similar foreign companies with effect from 6 April 2008.
- legislation that applies to zero carbon homes is to be extended to apply to zero carbon flats as well. This will mean that no SDLT will be payable for all new zero carbon flats up to the purchase price of £500,000. Where the purchase price of a flat is in excess of £500,000 then the SDLT liability will be reduced by £15,000. The balance of the SDLT will be due in the normal way.
- legislation is to be enacted to decrease compliance burden such that transactions involving leases of a term of 7 years or more will only have to be notified where any chargeable consideration other than rent is more than £40,000 or where the annual rent is more than £1,000. Further changes will also be made so that it will no longer be necessary to complete either an SDLT1 (stamp duty land tax return) or SDLT60 (certificate that no SDLT is due) if the transaction is below the notifiable threshold.
- a rectification is to be made to anti-avoidance legislation affecting partnerships to allow for a transfer of an interest in a property within an investment partnership to be exempt from SDLT. This will mean that if there is a transfer of an interest in property within an investment partnership there will be no SDLT charge. This measure will have retrospective effect for transactions on or after 19 July 2007 (the date on which the relevant anti-avoidance legislation which inadvertently caught this came into effect).
- the provisions which result in the claw back in group relief will be amended to prevent avoidance schemes which rely on the transferor to leave the group before the transferee and thus preventing the applicability of the claw back provisions. The amended provisions will enable HMRC to link the two events and treat the transferee as having left the group first thus ensuring the group relief being clawed back. This change comes into effect for transactions where the effective date is on or after 13 March 2008.
- perceived anti-avoidance SDLT schemes which utilise the alternative finance exemptions (Sharia compliant exemptions) together with group relief is closed with effect from 12 March 2008.
- amendments to be made to simplify the procedure relating to the election to waive exemption relating to VAT which is to come into effect on 1 June 2008.

Individuals

The main announcements that effect individuals are:

- there is no change in the timeline of the abolition of taper relief and the application of the new capital gains tax rate of 18% which comes into effect for disposals made on or after 6 April 2008.



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Legislation is to be enacted to allow the first £1million of gains to be charged to capital gains tax at an effective rate of 10%. Gains in excess of £1million will be charged to capital gains tax at a rate of 18%. The £1million limit will operate as a lifetime limit allowing multiple claims to be made up to that amount. Disposals made on or before 5 April 2008 will not effect this limit.

- the rules relating to Income Shifting (when individuals enter into arrangements to direct income from those who pay tax at a higher rate to those who pay tax at a lower rate) have been deferred to April 2009.
- legislation is to be introduced to rectify an unintended consequence of the trust modernisation legislation which was part of the Finance Act 2006. It changes the income ordering rules such that the income from a settlor interested trust is treated as if it is one of the highest slices of income and thus consistent with the original intention of the legislation.
- legislation that applied to partners restricting sideways loss relief is now to be extended to individuals carrying on a trade in a non-active capacity directly thus losses made out of such trades will no longer be capable of being offset against other income as part of tax and avoidance arrangements.

The allowances, exemptions and rates that apply are as follows:

- the income tax personal allowance of an individual for the next tax year is set at £5,435
- the capital gains tax annual exemption for the next tax year is set at £9,600.
- the basic rate of income tax will be 20% for income up to £36,000 and 40% for income above that amount in the next tax year.
- capital gains tax will be payable at a rate of 18% for disposals on or after 6 April 2008.

Anti-Avoidance and other administrative measures

There are numerous anti-avoidance legislation measures which have been announced as part of Budget 2008. The principal ones are as follows (unless otherwise stated these come into effect immediately):

- legislation is to be enacted to counter perceived avoidance by businesses which lease in and lease out the same plant and machinery to exploit differences in the tax treatment of rental paid and received in order to generate a tax loss where there is no commercial loss.
- legislation is also to be announced to counter avoidance involving disguised interest and transferring of rights to lease rentals.
- legislation is also to be enacted to prevent perceived avoidance of tax that stems from the corporate intangible asset regime by any administration, liquidation or other insolvency proceedings or equivalent arrangements at any company or partnership may be involved in.



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- legislation is also to be enacted to prevent the effective transfer of capital allowances from a loss making group to a profit making group before a balancing charge is triggered thus accelerating the allowance.
- the tax avoidance disclosure regime is also to be amended to require the details of all co-promoters to be given to the Revenue and the co-promoters to be required to issue the scheme reference number to all those it sells the schemes to. The effective date of these provisions is to be set out in a Treasury Order.
- legislation is to be introduced in the Finance Bill 2008 to extend the provisions enacted in last year's Finance Act to create a single penalty regime for incorrect returns across all the taxes, levies and duties administered by HMRC. The penalty will be determined by the amount of the tax understated, the nature of the behaviour giving rise to the understatement and the extent of the disclosure by the tax payer. The use of suspended penalties will also be extended.

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