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The Budget 2007

Gordon Brown presented his eleventh Budget on Wednesday 21 March 2007. This is expected to be his last before he makes a bid to become Prime Minister.

He was upbeat about the state of the UK economy and reported a budget surplus of £11 billion over the economic cycle. This surplus, together with proposed asset sales and civil service cuts, allows him to invest further in public infrastructure projects as well as in security and defence.

The speech included the usual quick fire announcements covering tax years up to 2012. A highlight for many was the reduction in the basic rate of income tax to 20%, but this is countered by an expansion in the amount of income that is subject to national insurance. Sweeping changes are also to be made to the capital allowance and corporation tax systems.

Our summary focuses on the issues likely to affect you, your family and your business. To help you decipher what was said we have included our own comments.

If you have any questions please do not hesitate to contact us for advice.

## Main Budget proposals

- Corporation tax for small companies increased from 19% to 22% over three years
- Cut in corporation tax from 30% to 28% for large companies from 2008
- Reduction in basic rate income tax to 20% from 2008
- Significant increases in national insurance on earned income from 2008
- Capital allowance system reform
- Landfill tax to increase by £8 per tonne each year to 2011
- Increased Vehicle Excise Duty for all cars except the very cleanest.

## Previous announcements

Some of the changes detailed in this summary have been the subject of earlier announcements. Here is a reminder of some of the more important ones.

- Increased investment limits for Individual Savings Accounts
- Restriction of the use of Alternatively Secured Pensions
- A new tax system for workers using managed service companies.

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The Budget proposals may be subject to amendment in the Finance Act. You are therefore advised to contact us before taking any action as a result of the contents of this summary.

# PERSONAL TAX

## Tax rates for 2007/08

For the eighth consecutive tax year, income tax rates remain at 10%, 22% and 40%. The special rules for savings income and dividends continue to apply.

## Tax rates for 2008/09

The government proposes to radically change the tax rates for 2008/09 onwards when the 10% starting rate will be abolished for earned and pensions income and the 22% basic rate of tax will be reduced to 20%. The higher rate of tax will continue at 40%.

The starting rate will continue to be available for savings and investment income and capital gains. There are no changes to the tax rates applicable to dividends.

### Comment

The Chancellor is obviously keen to hit the headlines with his last Budget by announcing the reduction of the basic rate of tax by 2%. He also announced that the point at which people start paying the higher rate of tax will be increased significantly to £43,000 from 2009/10.

There is, however, a significant sting in the tail for those with earned income. The changes in the upper earning limit for NIC (see Employment issues) will largely negate the income tax savings.

## Allowances

The 2007/08 personal allowances were announced in last December's Pre-Budget Report. The personal allowance for those under 65 is £5,225.

## Tax Credits

There are two types of Tax Credits; Working Tax Credit (WTC) and Child Tax Credit (CTC). The CTC is potentially available to families who have responsibility for one or more children. There are several elements to the credit but broadly the maximum is an annual amount for 2007/08 of £1,845 per child together with a family element (one per family) of £545 per annum. The amount per child has been increased but the family element has been frozen since the introduction of the credit.

Some credit is likely to be payable for 2007/08 if a family's income is less than £58,175 a year, or £66,350 if there is a child under one year old.

In order to finalise a Tax Credits award given for the previous tax year, claimants may have to complete an annual declaration. The declaration will also renew any claim for the current year. The date for renewals of Tax Credits for 2007/08 will be 31 July 2007.

### Comment

Last year the renewal deadline was brought forward to 31 August from 30 September. The 31 July deadline is very tight but it is possible to renew using estimated figures and then provide final figures by the following 31 January.

## Individual Savings Accounts (ISAs)

When ISAs were introduced in 1999 they were guaranteed to run for ten years to 2009. Currently the overall annual investment limit is £7,000 with a maximum of £3,000 in cash and this was guaranteed to run until the end of 2009/10.

The government is now making the ISA a permanent feature of the savings landscape. A number of reforms will be introduced from 6 April 2008:

- The mini/maxi distinction within ISAs will be removed. The government will continue to allow individuals to hold these components with either the same or different providers.
- The maximum amount which can be invested into a cash ISA will be increased to £3,600.
- The maximum amount which can be invested into a stocks and shares ISA will be £7,200, subject to an overall limit of £7,200 subscribed into both ISAs in a tax year.

Further reforms are also expected:

- Individuals with funds saved in the cash component of ISAs from previous years will be able to transfer those funds into the stocks and shares component without affecting their annual investment limit.
- Personal Equity Plans will be brought within the ISA wrapper.
- Child Trust Fund accounts will be able to rollover into ISAs when they start to mature from 2020 onwards.

## Comment

Over 16 million people - more than one in three adults - now have an ISA.

## Foreign dividends

The government proposes to introduce in Finance Act 2008 amendments to the system of taxation for individuals who own foreign shares. From 6 April 2008 individuals in receipt of foreign dividends will be entitled to a non-repayable tax credit of one ninth of the distribution. The legislation will apply to individuals who own less than a 10% shareholding in the company and in total they receive less than £5,000 of dividends a year from non UK-resident companies.

## Pensions

The new pension regime took effect from 6 April 2006, referred to as 'A' day. There is now a single set of tax rules for all registered pension schemes.

A number of anti-avoidance measures were introduced in 2006 and the government has considered that further provisions are necessary.

## Alternatively Secured Pensions (ASPs)

### Comment

The tax rules for pensions require an individual to secure an income before they reach the age of 75. Most people will have an annuity or scheme pension but the ASP has been provided as an alternative. ASPs were designed for those who have a principled religious objection to annuitisation. The government is therefore trying to restrict the use of ASPs to their original limited purpose.

As previously announced, the 2007 Finance Bill will introduce further restrictions to funds invested as an ASP by:

- introducing a minimum income requirement of 55% of the annual amount of a comparable annuity
- setting a higher maximum income withdrawal of 90% of the annual amount of a comparable annuity
- imposing an unauthorised payments charge where ASP funds remaining on the death of a member are transferred to pension funds of other members in the scheme
- introducing legislation to deal with the situation where a provider has been unable to trace a scheme member by age 75.

Previous legislation introduced an inheritance tax (IHT) charge on left over ASP funds on the death of the scheme member. The Finance Bill will introduce changes to the IHT rules so that the IHT nil rate band will be set in priority against the estate of the deceased excluding ASP funds. Special provisions will be introduced to cover the situation where there is an amount of the nil rate band remaining available.

The new provisions will apply from 6 April 2007.

## Pensions term assurance

The government has become aware that life insurance policies that provide lump sum death benefits alone are being offered as personal pension arrangements and thus eligible for tax relief.

The Finance Bill will introduce a measure to remove an individual's entitlement to tax relief on any pension contributions they pay that are used to fund personal term assurance policies. The measure will not affect the relief available for contributions paid by employers.

For contributions under occupational registered pension schemes the measures will take effect for payments made on or after 1 August 2007 in respect of personal term assurance policies unless the insurer receives the application for the policy before 29 March 2007.

For contributions under other registered pension schemes it will take effect for all contributions made on or after 6 April 2007, unless the insurer received the application before 14 December 2006 and the policy taken out before 6 April 2007.

### Comment

A number of pension providers have been marketing pensions term assurance with the expectation of the purchaser obtaining full tax relief on the costs of term life cover. It would seem the number of policies sold has been far greater than the government had predicted.

## Service charges and sinking funds held on trust by landlords

Many leases provide for the landlord to collect service charges from tenants to create reserves or 'sinking funds' to cover the cost of irregular and expensive repair works on the property. These reserves are held on trust and currently taxable at the special trust rate of 40%.

Legislation will be introduced in the Finance Bill to extend an existing exemption from the special trust rate which currently applies to Registered Social Landlords and other social landlords to private sector landlords.

### Comment

The funds are generally held on bank deposit which will mean that income will be taxed at the savings rate of 20%.

## Gift Aid

For donations to charities to be eligible for Gift Aid tax relief there are limits on the value of benefits that individuals and companies can receive as a result of making those donations. For donations made on or after 6 April 2007, which are in excess of £1,000, the limit on the value of benefits received will be doubled from the current 2.5% to 5% of the donation. The overall limit on the value of benefits received will be doubled from £250 to £500.

## Anti-avoidance: life insurance policies

Legislation will target policies that are used in schemes to avoid income tax on investment income. It will only apply where premiums exceed £100,000 in any year into short to medium term life insurance policies and commissions are passed on or reinvested in the policy by an intermediary. In such circumstances the amount of the premium allowed in calculating the gain is restricted to the true cost to the policyholder, taking into account the benefit to the policy holder of any commission rebate.

# CORPORATE AND BUSINESS TAX

## Tax motivated incorporation

The government has moved to discourage small businesses from incorporating for tax reasons by increasing the tax they will pay on profits up to £300,000, from 19% to 20% with effect from 1 April 2007. The small companies' corporation tax rate will further increase to 21% in 2008 and to 22% in 2009.

In contrast the corporation tax paid by large companies with profits of £1.5 million or more will be cut from 30% to 28% from 1 April 2008. However companies with ring fenced North Sea oil and gas activities retain the current corporation tax rates of 19% and 30%.

The effective marginal corporation tax rate for profits between £300,000 and £1.5 million is 32.5% from 1 April 2007.

### Comment

These corporation tax changes for small companies mean the tax due on profits made within a company will exceed the income tax payable on the same amount of profits made by a sole trader or partner, as the basic rate of income tax will drop to 20% from 6 April 2008. However, an individual will also have to pay Class 4 national insurance on his self-employed profits. The overall effect of the measures will be to reduce considerably the tax advantages of incorporation.

## Capital allowances

The system of capital allowances is to be significantly revised from 2008/09. The proposals are:

- Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) will be phased out, with final withdrawal of both regimes by 2011

- most balancing allowances and balancing charges for IBAs and ABAs cease to apply for changes in ownership on or after 21 March 2007
- writing down allowances for plant and machinery will be cut from 25% to 20%
- writing down allowances for certain fixtures in a building will be cut from 25% to 10%
- writing down allowances for long life assets will be increased from 6% to 10%.

In addition the following changes will be subject to consultation:

- a new investment allowance for the first £50,000 spent on plant and machinery
- where businesses have a loss after claiming 100% capital allowances on green technologies they will be able to reclaim a tax credit from HMRC.

The current 50% first year allowance for plant and machinery which can be claimed by small businesses, which was due to expire in April 2007, will be extended to April 2008. The capital allowances that can be claimed on business cars have not altered but proposed changes to the rules are being consulted on further.

### Comment

These changes to capital allowances remove many complicated calculations that must be performed on the sale of a building. The annual investment allowance may encourage smaller businesses to invest but in practice it will not affect the purchasing decisions of larger companies.

## Tax relief for business cars

In March 2006 the government issued a discussion document about business expenditure on cars. As a result of consultation, revised proposals have been issued.

The proposals are that:

- the existing 100% first year allowances for cars with CO<sub>2</sub> emissions up to 120g/km be retained
- the general plant and machinery capital allowances pool will be used for cars with CO<sub>2</sub> emissions between 121 and 165g/km
- a new car pool would be introduced with a lower writing down allowance than the general plant and machinery pool for other cars.

As a consequence there would no longer need to be a specific distinction between cars costing more or less than £12,000.

## Business premises renovation allowance

In 2005 legislation was enacted to provide a 100% capital allowance to businesses or individuals who renovate business premises which have been empty for at least one year. This tax relief is to be brought into effect from 11 April 2007 with the following limitations:

- it will only apply to premises in Northern Ireland and in designated disadvantaged areas in the rest of the UK
- it will not apply to premises used by certain business sectors such as coal, steel, shipbuilding and fisheries.

## Landlords energy saving allowance

In 2004 the landlords energy saving allowance was introduced to provide tax relief for the cost of insulation installed in let residential properties, up to maximum of £1,500 per building. The following changes are proposed:

- the types of insulation materials that qualify will be extended to include floor insulation

- the expenditure cap will apply per property rather than per building to allow each flat in a block to benefit in the same way as a single house
- the scheme will apply to costs incurred until 2015, extended from 2009
- the tax relief will be extended to corporate landlords, subject to state aid approval.

## Research and development tax relief

Research and development (R&D) tax relief gives enhanced tax relief to companies who undertake qualifying R&D projects. The company must spend at least £10,000 on qualifying items in one year. The proposed changes, subject to state aid approval, are:

- large companies will be able to claim 130% relief, increased from 125%
- small and medium sized companies will be able to claim 175% relief, increased from 150%
- the definition of a medium sized company will be changed to increase the number of permitted employees from 250 to 500.

## Comment

The increased R&D tax relief may make the tax relief more attractive to companies who had not previously claimed this relief but in practice it will still be difficult to ensure the project falls into the tight definition of R&D to qualify.

## Construction Industry Scheme

The new Construction Industry Scheme will be introduced on 6 April 2007. Subcontractors may be entitled to receive payments without deduction of tax if they have satisfied certain criteria. Otherwise a standard deduction rate of 20% will apply for registered subcontractors.

A higher deduction rate of 30% is introduced to allow unregistered subcontractors to start work. One of the purposes of the higher rate is to encourage subcontractors to register with HMRC for the scheme.

## Companies qualifying for venture capital reliefs

From 6 April 2007 companies that raise additional funds under the Enterprise Investment Scheme (EIS), Venture Capital Trust (VCT), or the Corporate Venturing Scheme (CVS) will have the following restrictions imposed:

- the company or group must have fewer than 50 full-time employees
- it must have raised no more than £2 million under any of these schemes in the previous 12 months.

The definition of a qualifying subsidiary is relaxed to include direct 100% subsidiaries of 90% subsidiaries.

Currently, a VCT must have at least 70% of its investments in qualifying holdings. This means that a VCT may not be able to sell a holding without breaching this test. The rules are relaxed to allow a six month period to reinvest cash received from the disposal of a qualifying investment.

Also for EIS 90% of funds raised must be used in the trade within 12 months, an extension from the current six month period, for approved funds with a closing date on or after 7 October 2006.

### Comment

The restrictions on the amount of funds that can be raised and the number of employees may reduce the size of company that can qualify for venture capital relief and as such may make investments under these schemes more risky. However the lengthening of the period during which funds can be held before being invested in a qualifying trade may allow managers to make more considered investment decisions.

## Loss relief restrictions for partners

Where a partner makes a tax loss that individual can normally off-set the loss against their other income or capital gains (sideways loss relief). Currently, the amount of sideways loss relief a non-active partner can claim in one tax year is restricted broadly to the amount of capital that the partner has contributed to the partnership. A non-active partner is one who spends less than 10 hours a week involved in the partnership business, or has limited liability.

New legislation will exclude capital contributions paid by non-active partners on or after 2 March 2007, where the main purpose for contributing the capital to the partnership is for the partner to have access to losses sustained after that date for which sideways loss relief could be claimed. In its place there will be an annual cap of £25,000 on the amount of trading losses for which a non-active partner can claim sideways loss relief.

These provisions will not apply to losses derived from 'relevant film related expenditure'.

## Controlled foreign companies (CFCs)

The CFC tax rules potentially apply to tax UK companies with subsidiary companies operating in low tax jurisdictions. A proportion of the profits may be subject to UK tax if the profits are not paid by the subsidiary to the UK company. Following the recent European Court of Justice (ECJ) judgment in the Cadbury Schweppes case, changes have been made to the CFC rules, effective from 6 December 2006, to change the law to reflect the decision.

The changes will relax UK CFC rules by enabling UK companies to apply to HMRC to disregard those profits of their CFCs that arise from genuine economic activity in business establishments in other European Union Member States or certain other states in the European Economic Area.

The government will consult with business in 2007 on a wider package of reform.

## Six year limitation period for direct tax claims

In October 2006, in the Deutsche Morgan Grenfell case, the House of Lords determined that a company had paid tax earlier than it need have done under a 'mistake of law'. The mistake could be held to have been discovered only when the ECJ gave its judgment in a similar case in March 2001.

The effect of this is to potentially allow similar claims for overpayment of tax back to 1973 and overrides the normal limitation period of bringing claims within six years of the event giving rise to the claim.

Legislation in 2004 has already removed the ability to make a claim on or after 8 September 2003 for events outside the six year limitation period. New provisions will be introduced in the Finance Bill which will remove the ability to continue with tax claims involving a mistake of law which were started before 8 September 2003 (except where the Courts have given final judgment before 6 December 2006).

## Other anti-avoidance measures

A disclosure regime for tax schemes was introduced in 2004 that has enabled HMRC to respond to avoidance schemes more swiftly. The government has announced a number of measures to tackle artificial schemes brought to light under the disclosure rules.

HMRC will be given powers to investigate schemes where there are reasonable grounds to believe that a promoter has failed to comply with the statutory disclosure obligations.

# EMPLOYMENT ISSUES

## National Insurance Contributions (NICs)

There is no change in the rates of NIC but there are significant proposed changes to the limits between which NICs are payable. For 2007/08 the lower and upper earnings limits (UEL) increase by inflation so that employees will pay 11% NIC on earnings between £100 and £670 per week. Employees continue to pay contributions of 1% on earnings above the UEL. For 2008/09 the UEL will be increased by £75 per week above indexation.

The upper profits limit for Class 4 national insurance for the self-employed will also be increased in 2008/09 by £75 per week above indexation.

In the following year the upper earnings limits will be aligned with the point at which the higher rate of income tax becomes payable.

### Comment

The government claims the increases in national insurance are aimed at simplifying the tax system but it comes at quite a cost to employees and the self-employed.

## Managed service companies (MSCs)

In 2000 the government introduced rules to tackle the provision of services through many personal service companies (PSCs). These rules have been referred to by the name of the press release of that time, IR35.

Many PSCs were designed to 'disguise employment' by interposing a company between the payer and worker. If the IR35 rules apply most of the income received by the company is deemed to be paid to the worker as employment income and PAYE and NICs are due accordingly.

MSCs attempt to avoid the IR35 rules. The types of MSCs vary but are often referred to as 'composite companies' or 'managed PSCs'. HMRC have encountered increasing difficulty in applying the IR35 rules to MSCs because of the large number of workers involved and the labour intensive nature of the work. Even when the IR35 rules have been successfully applied, an MSC can often escape payment of outstanding PAYE and NIC as they have no assets and can be wound up.

The government has confirmed that new rules will apply to MSCs. The intention of the new rules is to:

- ensure that those working in MSCs pay PAYE and NIC at the same level as other employees
- alter the travel and subsistence rules for workers of MSCs to ensure they are consistent with those for other employees
- allow the recovery of outstanding PAYE and NIC from 'specified persons' if the amounts cannot be recovered from the company.

MSCs will be required to account for PAYE on all payments received by individuals on or after 6 April 2007. NICs will be due shortly after the Finance Bill receives Royal Assent.

The 'specified persons' who may be called upon to pay PAYE and NIC will primarily be the MSC's director and the person who provided the company to the individual. The provision

is likely to have effect for debts incurred from August 2007. In certain cases the debt can also be transferred to persons who encourage or are actively involved in individuals' provision of their services through MSCs. This provision will take effect for debts incurred on or after 6 January 2008.

### Comment

The new rules for MSCs do not affect anyone working through their own PSC. Some people working via an MSC may be better off if they can set up their own PSC (provided the company will not be caught by IR35). The type of work the individual performs for their clients will need to be considered in detail to determine whether the setting up of an individual PSC is appropriate.

## Company cars and the fuel scale charge

Where a car is provided for an employee's private use, a taxable benefit arises which is based on the list price of the car and its CO<sub>2</sub> emissions. The percentages range from 15% to 35% for most cars. There are currently discounts available for environmentally friendly cars and from 6 April 2008 there will be a 2% discount for cars that have been manufactured to run on E85 fuel.

If free fuel is provided for private motoring then a fuel benefit tax charge arises based on the percentage used for the car benefit which is applied to £14,400. For 2007/08 the figure will remain at £14,400.

### Comment

E85 is the term for motor fuel blends of 85% ethanol and 15% petrol and is referred to as bioethanol E85 in the UK. Currently it seems you can only buy E85 fuel from a few Morrisons supermarket forecourts. Hopefully supplies will be improved before the introduction of the new 2% discount.

# CAPITAL TAXES

## Capital gains tax (CGT) annual exemption

The annual exemption for 2007/08 is £9,200. For most trusts the exempt limit is increased to £4,600.

## CGT rates of tax

For individuals capital gains continue to be treated as the top slice of income. For 2007/08 rates continue to be aligned with those applying to savings income. Tapered gains are charged at 10% where gains plus taxable income do not exceed £2,230; 20% between £2,231 and £34,600; and 40% on any balance.

For trustees the rate of CGT is 40%.

## Inheritance tax (IHT) threshold

The IHT nil rate band is increased to £300,000 with effect from 6 April 2007. The Chancellor previously announced that the band will rise to £312,000 in 2008 and £325,000 in 2009.

### Comment

Once again it is disappointing that little attempt was made to increase the nil rate band to reflect the steady rise in the housing market. The family home remains the main asset in many estates and some IHT planning should be considered if the value of the estate exceeds the nil rate band.

## Planning Gain Supplement (PGS)

The PGS has been the subject of consultation since 2004 and is now expected to be introduced where planning permission is granted after 31 March 2009. The following principles have been established:

- the PGS will be levied at a flat rate on the difference in the value of land without

planning permission and the freehold value with full planning permission

- both residential and commercial developments will be included
- there is unlikely to be any exemption for small scale developments such as building a single house in a back garden
- the developer will pay the PGS within 60 days of the date the development commences
- the developer will have to self assess the PGS and obtain the necessary valuations.

### Comment

The PGS is designed to encourage landowners to release land for development, although how a tax on this action will achieve this aim remains to be seen. Landowners and developers need to consider the impact of the PGS on proposed developments that may not commence until after 31 March 2009.

## Capital loss anti-avoidance measure

In 2006 specific rules were introduced to target 'contrived' capital losses created by companies. A loss accruing to a company is not an allowable loss if it arises as part of arrangements which have a tax advantage as their main purpose or one of the main purposes.

HMRC have become concerned that persons other than companies were involved in the creation of 'contrived' capital losses to secure a tax advantage. Therefore for capital losses arising on disposals on or after 6 December 2006 the anti-avoidance rule for companies is extended to all persons liable to CGT including individuals, trustees and personal representatives.

A capital loss will still be available if it arises from 'genuine commercial transactions'.

## Comment

The draft legislation is wide ranging and there is concern as to how HMRC are going to apply the legislation in practice.

## Homes abroad owned through a company

Individuals often purchase a property abroad by setting up a company to own the property. This is done for a variety of reasons related to the tax or inheritance laws of the country in which the asset is situated. Where the individuals direct the company's affairs (whether through an agent or not) they could be assessed on an employment income benefit in kind charge as a director of the company. Legislation will remove that tax charge where certain qualifying conditions are satisfied:

- the company is owned by individuals
- the sole activity of the company is holding the property for occupation and/or letting
- the property is the company's only or main asset
- the property is not funded directly or indirectly by a connected company.

The legislation will not be enacted until 2008 but HMRC will not seek to tax anyone in the intervening period provided the qualifying conditions are satisfied.

## Pre-owned assets: late elections

Where an individual benefits from assets that are subject to the pre-owned assets income tax charge, they can elect for those assets to be treated as forming part of their estate for IHT purposes. For individuals who are liable from 2005/06 (the first year of charge), the deadline was 31 January 2007. The Finance Bill will include legislation to allow HMRC to accept late elections. This may apply to any late elections for the 2005/06 tax year.

## Stamp Duty Land Tax (SDLT): exchanges of property

If individuals exchange property SDLT is charged by reference to the market value of the property acquired by each party. However if the parties are 'connected persons', for example husband and wife or brother and sister, the market values are aggregated and the rate of SDLT is that applicable to the aggregate value. This may mean that a higher rate of tax applies.

The Finance Bill will provide that the two legs of an exchange will not be linked and will apply to exchanges on or after the date of Royal Assent.

## SDLT: new zero carbon homes

A new relief will be introduced for buyers of new zero carbon homes from 1 October 2007. Relief will not be available on existing homes. The relief will be:

- purchase price of £500,000 or less - no SDLT
- purchase price above £500,000 - SDLT liability reduced by £15,000.

A property will qualify if there are zero carbon emissions from all energy use in the home over a year. To achieve this, the fabric of the home will be required to reach a very high energy efficient standard and to be able to provide onsite renewable heat and power.

The relief will not be available beyond 30 September 2012.

## Comment

Homes will not be required to be zero carbon at all times but the import of grid power and export of renewable power should at least balance over the course of a year.

# VAT

## VAT thresholds

The VAT registration limits increase with effect from 1 April 2007 as follows:

- the threshold for compulsory registration is £64,000
- the threshold for voluntary deregistration is £62,000.

## Cash accounting scheme

The government has already increased the turnover limit for joining the cash accounting scheme from £660,000 to £1,350,000 from 1 April 2007.

## Reverse charge for Missing Trader Intra Community (MTIC) fraud

MTIC fraud is a criminal attack on the VAT system. The fraud arises through contrived transaction chains involving supplies of high value goods with the tax loss occurring when the VAT charged by the seller is not paid to HMRC but can be reclaimed by the purchaser.

A reverse charge procedure was introduced in Finance Act 2006 whereby the VAT registered purchaser, rather than the seller, accounts for and pays the VAT on the supply of certain goods of a kind used in MTIC fraud. Provided that purchasers have correctly accounted for the reverse charge, they can recover this VAT in the normal way.

The planned implementation date of the reverse charge has now been announced as 1 June 2007. There are two categories of goods covered:

- mobile phones
- integrated circuit devices such as microprocessors and central processing units.

A seller will account for VAT in the normal way for goods supplied within the UK to a VAT registered business where the total value of the goods supplied together and detailed on a single invoice is less than £5,000 (excluding VAT).

## Car fuel scale charges

Where an employee is provided with free fuel along with a company car, an income tax benefit in kind arises based on the CO<sub>2</sub> emissions of the car. In addition the employer has to pay a VAT car fuel scale charge. A new system is to come into force from the start the next VAT accounting period beginning on or after on 1 May 2007. The existing VAT fuel scale charge, which is based on the engine size and fuel type of a car, will be replaced by a fuel scale charge based solely on the CO<sub>2</sub> rating of a car.

## Reduced rate for smoking cessation products

Smoking cessation products dispensed on prescription are already zero rated. A reduced 5% VAT rate for 'over the counter' sales of smoking cessation products will be introduced for one year and will take effect alongside the introduction of the ban on smoking in public places in England.

## Joint and several liability

HMRC may direct that a business that purchases particular goods from another VAT registered business can be jointly and severally liable for VAT that remains unpaid in the supply chain. These rules can apply if HMRC presume the business had reasonable grounds to suspect that VAT would go unpaid. The list of specific goods will be extended from 1 May 2007 to include electronic equipment of a type ordinarily owned by individuals and used by them for leisure or entertainment.

# ENVIRONMENTAL MEASURES

## Air Passenger Duty (APD)

In the Pre-Budget Report APD rates were increased from 1 February 2007. The new rates of duty are:

- for passengers flying to destinations in the European Economic Area, the European Common Aviation Area, countries applying to join the European Union, and Switzerland, £10 in the lowest class of travel and £20 otherwise
- for passengers flying to other destinations, £40 in the lowest class of travel and £80 otherwise.

## Landfill tax

The standard rate of landfill tax will be increased from £21 per tonne to £24 per tonne from 1 April 2007. The lower rate of tax will remain at £2 per tonne.

Legislation will be included in the Finance Bill to further increase the standard rate from £24 to £32 per tonne and increase the lower rate from £2 to £2.50 per tonne. These increases will apply from 1 April 2008.

## Comment

The government has announced its commitment to increase the standard rate of the landfill tax by £8 a tonne per year until at least 2010/11.

## Aggregates Levy

Legislation will be included in the Finance Bill to increase the rate of Aggregates Levy from 1 April 2008. The current rate of £1.60 per tonne will rise to £1.95 per tonne.

## Climate Change Levy

As announced in 2006 the rates will increase in line with inflation from 1 April 2007 and the Finance Bill will include further inflationary increases in the rates from 1 April 2008.

## Road fuel

From 1 October 2007 the effective excise duty rates for road fuels will be increased by 2 pence per litre. Further announcements were made that the next two years' increases will be 2 pence and 1.84 pence per litre.

The government has announced that the current 20 pence per litre duty differential on biofuels will be extended to 2009/10.

## Vehicle Excise Duty (VED)

The government has announced the VED rates for this year and the following two years.

The major change will be increasing the rate for the most polluting band G cars to £300 in 2007/08 and to £400 in 2008/09. There will be a reduction in the rate of duty on band B cars to £35.

## Microgeneration

Legislation will be introduced in the Finance Bill to clarify the tax treatment of private householders who have installed microgeneration technology in their homes primarily for the purpose of generating electricity for their personal use. The receipt of a Renewables Obligation Certificate (ROC) will not be subject to income tax and gains made on the disposal of a ROC will not be subject to capital gains tax.

# OTHER MATTERS

## Online filing

Lord Carter's review of HMRC online filing services was published in 2006. Legislation will be brought forward during 2007 to implement the changes which will start in 2008.

The key proposals are to:

- require businesses to file their PAYE in-year forms, VAT returns and company tax returns online in phases from April 2009
- introduce new filing deadlines for income tax self assessment returns of 31 October for paper forms from 2008 but retain 31 January for online returns
- relate the time limit for HMRC to commence enquiries into an income tax self assessment return to the actual filing date of the return and not the statutory filing date.

## Company filing dates

Following Lord Carter's recommendations and consultation by HMRC and Companies House, the government will work to provide a single online filing facility by 2010. From 2008 the period during which an enquiry can be opened into a corporation tax return will, for most companies, be tied to the actual date HMRC receives the return rather than a fixed filing date. The aim of this is to encourage earlier filing and give businesses certainty sooner.

## Review of HMRC powers, deterrents and safeguards

The government launched a review of HMRC powers and taxpayer safeguards in March 2005 as a result of the creation of the newly formed HMRC. The general consultation on the approach to investigation work is continuing and will focus on areas such as safeguards for taxpayers, making it easier to pay, tackling late payment and compliance assurance checks.

## Criminal investigation powers

Currently the powers in the Police and Criminal Evidence Act 1984 (PACE) apply only to the former Customs & Excise part of HMRC. These powers are to be extended right across HMRC and will apply to criminal investigations into direct as well as indirect taxes. Specifically Revenue officers will be able to:

- apply to magistrates and judges for search warrants
- apply to judges for a court order to obtain evidence from a third party
- arrest suspects, search upon arrest and question.

## Penalties for incorrect returns

There are currently a wide range of penalty powers within the different tax regimes administered by HMRC. These will be removed and replaced by a single regime that will apply for income tax, corporation tax, PAYE, NIC and VAT where taxpayers understate their liability to tax.

The new penalty regime will be largely determined by the behaviour of the taxpayer leading up to the understatement. The extent of any disclosure made will be taken into account, but it is anticipated that there will be much less scope for negotiation on the level of penalties than under the current regime.

The new rules will also provide for penalties to be suspended to allow taxpayers to demonstrate that they have mended their ways.

The provisions are likely to apply to returns for periods commencing after 31 March 2008 where the return is filed after 31 March 2009.

# RATES AND ALLOWANCES 2007/08

## INCOME TAX RATES

2007/08		2006/07	
Band	Rate	Band	Rate
£	%	£	%
0 - 2,230	10	0 - 2,150	10
2,231 - 34,600	22*	2,151 - 33,300	22*
Over 34,600	40**	Over 33,300	40**

\* Except dividends (10%) and savings income (20%).

\*\* Except dividends (32.5%).

Other income taxed first, then savings income and finally dividends.

## INCOME TAX RELIEFS

		2007/08	2006/07
		£	£
Personal allowance	- under 65	5,225	5,035
	- 65 - 74*	7,550	7,280
	- 75 and over*	7,690	7,420
	- aged less than 75 and born before 6.4.35*	6,285	6,065
Married couple's allowance (relief at 10%)	- aged less than 75 and born before 6.4.35*	6,365	6,135
	- 75 and over*	2,440	2,350
*Age allowance income limit (Reduce age allowance by £1 for every £2 of excess income over £20,900.)		20,900	20,100
Blind person's allowance		1,730	1,660

## TAX CREDITS

	2007/08	2006/07
	£	£
<b>Working Tax Credit</b>		
Basic element - max. 1,730		1,665
Childcare element		
80% of eligible costs up to £175 per week (£300 if two or more children).		
<b>Child Tax Credit (CTC)</b>		
Child element		
per child - max. 1,845		1,765
Family element	545	545
Baby addition	545	545

### Reductions in maximum rates

37% of income above £5,220\* p.a.

\*If only CTC is claimed, the threshold is £14,495 p.a. (£14,155). The family element of CTC is not reduced unless income is more than £50,000 p.a. when it is reduced by £1 for every £15 of additional income.

## PENSION PREMIUMS

- Tax relief available for personal contributions: higher of £3,600 (gross) or 100% of relevant earnings.
- Employers will obtain tax relief on employer contributions if they are paid and made 'wholly and exclusively'. Tax relief for large contributions may be spread over several years.
- Any contributions in excess of £225,000 (£215,000), whether personal or by the employer, may be subject to income tax on the individual at 40%.
- No carry back of pension contributions.

## INDIVIDUAL SAVINGS ACCOUNTS (ISAs)

	2007/08 and 2006/07	£
Overall investment limit	- maxi ISA	7,000
	- mini ISA	4,000
	- stocks, shares and life insurance	
	- cash	3,000

## CAR, VAN AND FUEL BENEFITS

### 2007/08 and 2006/07

CO <sub>2</sub> emissions (gm/km) (round down to nearest 5gm/km)	% of car's list price taxed	Fuel benefit (£14,400 x %)
up to 140	15	2,160
145	16	2,304
150	17	2,448
155	18	2,592
160	19	2,736
165	20	2,880
170	21	3,024
175	22	3,168
180	23	3,312
185	24	3,456
190	25	3,600
195	26	3,744
200	27	3,888
205	28	4,032
210	29	4,176
215	30	4,320
220	31	4,464
225	32	4,608
230	33	4,752
235	34	4,896
240 and above	35	5,040

### Company cars

- For diesel cars add a 3% supplement but maximum still 35%. This was waived for Euro IV diesels. From 2006/07, no waiver for diesels registered on/after 1 January 2006.
- Discounts apply to certain environmentally friendly cars.
- For cars registered before 1 January 1998 the charge is based on engine size.
- The list price includes accessories and is subject to an upper limit of £80,000.
- The list price is reduced for capital contributions made by the employee up to £5,000.

### Fuel benefit

- The fuel benefit charge is proportionately reduced if provision of private fuel ceases part way through the year.
- The fuel benefit is reduced to nil only if the employee pays for all private fuel.

### Van benefit per vehicle

2007/08	2006/07
Van benefit £3,000	Under 4 years old £500*
Fuel benefit £500	Over 4 years old £350*

The charges will not apply if a 'restricted private use condition' is met throughout the tax year.  
\*Van benefits include fuel for private use.

## MILEAGE ALLOWANCE PAYMENTS

### 2007/08 and 2006/07

Cars and vans	Rate per mile
Up to 10,000 miles	40p
Over 10,000 miles	25p
<b>Bicycles</b>	20p
<b>Motorcycles</b>	24p

These rates represent the maximum tax free mileage allowances for employees using their own vehicles for business. Any excess is taxable. If the employee receives less than the statutory rate, tax relief can be claimed on the difference.

## CAPITAL ALLOWANCES

### Writing Down Allowance

Plant and Machinery*	25%# (reducing balance)
Motor Cars**	25% (reducing balance) - £3,000 max.
Industrial and Agricultural Buildings and Hotels	4% (straight line)

\* For small businesses: first year allowances (FYAs) of 50% for 24 months from 6.4.06 (1.4.06 for companies). 40% otherwise.

For medium-sized businesses: FYAs of 40%.

For all businesses: 100% FYAs on expenditure on energy saving plant and machinery.

\*\* 100% FYAs on new cars with CO<sub>2</sub> emissions not exceeding 120 gm/km until 31.3.08.

# 6% on certain long life assets.

## STAMP DUTY & STAMP DUTY LAND TAX

Land and buildings (on full consideration paid)			
Rate	Residential property		Non-residential
	Disadvantaged areas	Other	
	£	£	
Nil	0 - 150,000	0 - 125,000	0 - 150,000
1%	150,001 - 250,000	125,001 - 250,000	150,001 - 250,000
3%	250,001 - 500,000	250,001 - 500,000	250,001 - 500,000
4%	Over 500,000	Over 500,000	Over 500,000

Shares and securities - rate 0.5%.

## INHERITANCE TAX

Death rate %	Lifetime rate	Chargeable transfers	
		2007/08 £'000	2006/07 £'000
Nil	Nil	0 - 300	0 - 285
40	20	Over 300	Over 285

### Reliefs

Annual exemption	£3,000	Marriage - parent	£5,000
Small gifts	£250	- grandparent	£2,500
		- bride/groom	£2,500
		- other	£1,000

### Reduced charge on gifts within seven years of death

Years before death	0-3	3-4	4-5	5-6	6-7
% of death charge	100	80	60	40	20

## NATIONAL INSURANCE

Class 1 (employed) contracted in	2007/08 Rates	
	Employer	Employee
Weekly earnings Up to £100	Nil*	Nil*
£100.01 - £670	12.8%**	11%**
Over £670	12.8%**	£62.70 + 1%*

\* Entitlement to contribution-based benefits retained for earnings between £87.01 and £100 per week.

\*\* On earnings above £100. \* On earnings above £670.

<b>Class 1A (employers)</b>	12.8% on employee taxable benefits
<b>Class 1B (employers)</b>	12.8% on PAYE Settlement Agreements
<b>Class 2 (self-employed)</b>	flat rate per week £2.20 small earnings exception p.a. £4,635 flat rate per week £7.80
<b>Class 3 (voluntary)</b>	flat rate per week £7.80
<b>Class 4 (self-employed)</b>	8% on profits between £5,225 and £34,840 plus 1% on profits over £34,840

## CAPITAL GAINS TAX

Individuals	2007/08	2006/07
	£	£
Exemption	9,200	8,800
Balance of gains (reduced by taper relief) charged as top slice of income (at savings rates - ie 10%, 20% or 40%)		
<b>Trusts</b>		
Exemption	4,600	4,400
Balance of gains (reduced by taper relief)	40%	40%

### Taper relief 2007/08 and 2006/07 disposals

Percentage relief depends on number of complete years asset owned after 5.4.98.

Years of ownership	1	2	3	4	5	6	7	8	9	10
Business assets (% relief)	50	75	75	75	75	75	75	75	75	75
Non-business assets (% relief)	0	0	5	10	15	20	25	30	35	40

\* Add one extra year if asset owned before 17.3.98 (subject to overriding max. of 40%).

This summary is published for the information of clients. It provides only an overview of the main proposals announced by the Chancellor of the Exchequer in his Budget Statement, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this summary can be accepted by the authors or the firm.

## MAIN SOCIAL SECURITY BENEFITS

Weekly benefit	2007/08	2006/07
<b>Basic retirement pension</b> - single person	£87.30	£84.25
- married couple	£139.60	£134.75

<b>Statutory pay rates</b> - average weekly earnings £87 (£84) or over	
Statutory Sick Pay	£72.55 £70.05
Statutory Maternity Pay	
First six weeks	90% of weekly earnings
Next 33 weeks**	£112.75* £108.85*
Statutory Paternity Pay - two weeks	£112.75* £108.85*
Statutory Adoption Pay - 39 weeks**	£112.75* £108.85*

\* Or 90% of weekly earnings if lower.

\*\* For children due/placed from 1 April 2007.

## CORPORATION TAX

	Year to 31.3.08		Year to 31.3.07	
	Profits band £	Rate %	Profits band £	Rate %
Small companies rate	0-300,000	20	0-300,000	19
Marginal (small companies) rate	300,001-1,500,000	32.50	300,001-1,500,000	32.75
Full rate	Over 1,500,000	30	Over 1,500,000	30
Small companies fraction		1/40		11/400

The profits limits are reduced for accounting periods of less than 12 months and for a company with associated companies.

## VALUE ADDED TAX

Standard rate	17.5%
Reduced rate	5%
Annual Registration Limit - from 1.4.07 (1.4.06 - 31.3.07)	£61,000 £64,000
Annual Deregistration Limit - from 1.4.07 (1.4.06 - 31.3.07)	£59,000 £62,000

**Flat Rate Scheme** - allows businesses to calculate their VAT payment as a percentage of their VAT inclusive turnover.

Limits - annual VAT exclusive taxable turnover does not exceed £150,000 and total VAT exclusive annual turnover does not exceed £187,500. Leave on anniversary of scheme where total VAT inclusive annual turnover exceeds £225,000.

**Cash Accounting** - allows businesses to account for input and output VAT on a paid and received basis.

Limits from 1 April 2007 - where annual VAT exclusive taxable turnover does not exceed £1,350,000. Leave at end of a VAT period where annual VAT exclusive taxable turnover exceeds £1,600,000.

**Annual Accounting** - allows businesses to smooth out cash flow by paying a set amount, either monthly or quarterly. Only one VAT return due a year.

Limits - where annual VAT exclusive taxable turnover does not exceed £1,350,000. Leave on anniversary of scheme where annual VAT exclusive taxable turnover exceeds £1,600,000.

## SELF ASSESSMENT KEY DATES: 2007/08

**31 July 2007** - Second payment on account for 2006/07.

**30 September 2007** - Deadline for submission of 2006/07 paper tax returns for HMRC calculation; and where the taxpayer wants a balancing payment (below £2,000) collected through their 2008/09 PAYE code.

**5 October 2007** - Deadline for notifying HMRC of new sources of income if no tax return has been issued for 2006/07.

**30 December 2007** - Deadline for submission of 2006/07 tax returns over the internet; and where the taxpayer wants a balancing payment (below £2,000) collected through their 2008/09 PAYE code.

**31 January 2008** - Deadline for filing tax returns for 2006/07.

Balancing payment due for 2006/07. First payment due for 2007/08.



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