

The Budget – 12 March 2008

Key points

1) Income tax

The basic rate of income tax reduced to 20% on 6 April 2008 (previously 22%). The higher rate of income remains at 40%.

2) Corporation tax

The rates of corporation tax from 1 April 2008 are as outlined in previous Budgets and have been confirmed as 28% for companies with profits in excess of £1.5 million and 21% for companies with profits up to and including £300,000. The marginal rate (between £300,000 and £1.5 million) is 29.75%

If the company has associated companies these thresholds are divided by the number of associated companies e.g. if one associated company these thresholds are halved, if two associated companies these thresholds are divided into three etc. The effect of associated companies may therefore be an increase in the corporation tax payable by each company.

3) Associated companies

HMRC has sought to simplify the rules regarding associated companies.

From 1 April 2008 business partners will no longer be treated as associates providing they have not at any time undertaken tax planning to disassociate the parties. Therefore companies that are controlled by business partners will not be treated as associated companies.

The effect of having associated companies is that the thresholds of profits at which companies pay tax is reduced and therefore the tax payable by companies is often increased. This is therefore good news for such companies.

This also affects film partnership arrangements. A film partnership is a tax deferral arrangement typically entered into by individuals who otherwise had no dealings with each other. HMRC treated partners of film partnerships as business partners – the effect being that all of the partners of the film partnership would be associates and therefore any companies controlled by the partners would be associated – affecting the tax payable by those companies.

In recent years HMRC has raised a number of enquiries into the tax returns of affected companies but they had put the enquiries on hold pending a decision on this matter. HMRC has confirmed that the rules only affect the status from 1 April 2008 and therefore they intend re-opening the enquiries for earlier years.

4) Capital allowances – integral features

As announced previously a new capital allowances pool is being created for expenditure on integral features. Such expenditure will attract a writing-down allowance of 10% a year. This relates to new or replacement integral features acquired on or after 6 April 2008 (1 April 2008 for companies).

Many of the features currently qualify for 25% writing-down allowance rather than the 10% rate that has been proposed - although such expenditure may also qualify for the £50,000 annual investment allowance in the new regime. All businesses should therefore review whether to accelerate or defer capital expenditure.

Following the 'green' initiative, one or two features that have environmental qualities such as expenditure on electrical and cold water systems are now to qualify for capital allowances.

5) 'Green' measures

The Chancellor previously announced that this would be a green-focused Budget and this was evident in his speech. With the promise of increased road fuel duty up to £950 for the biggest gas-guzzlers and an exemption from the duty in year one for the most efficient new cars the question is whether this action will really affect the spending decisions made by taxpayers.

He also announced an extension to the 100% tax write off for the acquisition of cars with CO₂ emissions not exceeding 120g/km. However note that this has a subtle but significant change – from 1 April 2008 (for all businesses) this will only apply to cars with CO₂ emissions not exceeding 110g/km. Anyone considering acquiring a car with CO₂ emission between 110g/km and 120g/km may wish to ensure such expenditure is incurred before the end of March 2008.

There was also an extension until 31 March 2013 for the 100% tax write off for expenditure on natural gas and hydrogen refuelling systems. From 1 April 2008 this also applies to expenditure on refuelling equipment for biogas.

6) Annual Investment Allowance

Following previous consultations and announcements the annual investment allowance ('AIA') has been introduced. This allowance enables businesses to claim tax relief on up to £50,000 per year of capital expenditure incurred on assets used in their business. This is not available for expenditure on cars.

A key tip for all businesses is that any expenditure that otherwise qualifies for a 100% first year capital allowance (such as expenditure on energy-efficient equipment) can be excluded in calculating the claim for the AIA. Care should therefore be taken with any refurbishment or significant capital expenditure to ascertain whether such expenditure includes energy-efficient expenditure.

The £50,000 AIA is available for a singleton company; if a company is in a group, it has one £50,000 AIA but this can be allocated between the group companies on any basis. Where a company or unincorporated business is under common control the AIA will be available to each entity unless they have shared premises or similar activities. Where a company and unincorporated business are under common control each of them is able to claim the full AIA.

7) Tax credit for expenditure on enhanced capital allowances

Companies that incur expenditure on or after 1 April 2008 on certain environmentally-friendly or energy-efficient assets may be able to receive a tax repayment.

Where such companies claim a 100% tax write down in the year of expenditure and this creates or enhances a trading loss. This loss can be surrendered for a tax repayment. The loss surrendered is the lower of the actual loss and the 100% write down of the asset.

The tax repayment is 19% of the loss surrendered with a maximum repayment of £250,000 or the company's PAYE/NIC liabilities for the year if that is greater.

Many companies are unaware of the relief and may welcome receiving news of the tax repayment.

8) Capital allowances – small pools

From 6 April 2008 (1 April 2008 for companies), where businesses have a main capital allowance pool or new special rate pool with balances of less than £1,000 they can claim immediate tax relief for those balances. Under current rules they are unable to do this unless the business ceases to trade and therefore they can currently only claim relief by writing down the pool each year.

These measures do not apply to single-asset pools such as that applying for cars costing at least £12,000.

This provision will therefore be good news to those businesses that have such small balances.

9) Research and Development (R&D)

The rate of relief under the R&D tax credit scheme for small and medium sized companies (SMEs) will increase from 150% to 175%. The rate for large companies will be increased from 125% to 130%. SMEs will not be able to claim relief where their most recent accounts have not been prepared on a going concern basis, and will be subject to a cap of €7.5 million on the amount of relief available per R&D project.

10) Venture Capital Schemes

Investors can invest up to £500,000 on or after 6 April 2008 under the Enterprise Investment Scheme. This is an increase of £100,000. This provision does not take effect until EU approval has been obtained but once obtained it is effective for all investments made on or after 6 April 2008.

The definition of a qualifying company for the purpose of the Enterprise Investment Scheme, Corporate Venturing Scheme and Venture Capital Trusts will change from 6 April 2008. From that date shipbuilding and coal and steel production will be excluded.

11) Enterprise Management Incentives

Qualifying companies will be able to grant EMI share options of up to £120,000 from 6 April 2008, currently the limit is £100,000.

The definition of a qualifying company will include a limit on the number of qualifying employees. From date of Royal Assent of the Finance Bill 2008 companies with fewer than 250 employees will qualify providing they also satisfy other conditions. Similarly the qualifying activities will exclude shipbuilding and coal and steel production from Royal Assent.

This is good news because companies are able to provide more incentives to key employees. It also presents a window of opportunity for companies that have 250 or more employees to consider granting EMI options to their employees before the Finance Bill 2008 receives Royal Assent.

12) Trading stock

HMRC has announced that appropriations to and from stock which don't occur as part of the trade of the business concerned will be at market value. This is contrary to UK GAAP, however according to HMRC in these circumstances tax law should be followed.

This would apply where an owner takes stock for their own purposes or where a business acquires property originally as stock to develop and sell but then subsequently decides to hold it as an investment or transfer it to a group company.

HMRC has said that this merely puts into statute a rule long-established by case law.

13) Taxation of personal dividends

UK residents and non-resident Commonwealth and EEA nationals currently receive a non-payable tax credit in respect of dividends received from UK companies. However they do not receive such a tax credit in respect of dividends from non-UK resident companies. A higher rate taxpayer therefore pays tax at 32.5% rather than the effective 25% rate for UK dividends.

From 6 April 2008 UK resident individuals and UK and EEA nationals will be able to claim a tax credit on dividends received from non-UK resident companies providing they hold less than 10% of the shares in those companies.

From 6 April 2009 it is proposed that the tax credit will be available for such individuals who receive dividends from non-UK resident companies in which they hold at least 10% of the shares, provided the source country levies a tax on corporate profits similar to corporation tax.

This will be welcome news for such individuals as they should see their income tax rate fall in respect of dividends from overseas companies.

14) Entrepreneurs' Relief

This relief was introduced following intense lobbying from business groups unhappy at the changes being made to the capital gains tax system.

The draft legislation was issued a few weeks ago and based on the budget note the proposals announced at the Budget seem in line with expectations. Broadly, those owning trading businesses or employees or directors owning at least 5% of the ordinary shares and voting rights in their trading company for at least a year prior to disposal, can each realise cumulative gains (on or after 6 April 2008) of up to £1 million which will be taxable at 10% (rather than the new 18% rate). The relief can also extend to businesses and shares held by trustees, and to assets used by the business or company which is being sold.

15) Income shifting

The government has decided to postpone the implementation of anti-income shifting rules, (to prevent taxpayers arranging their affairs to gain a tax advantage by shifting part of their income to another person who is subject to a lower rate of tax). The ideas expressed in the much criticised consultation document issued on 6 December 2007 were considered to be largely unworkable. The postponement will be welcomed as it will allow for a further period of consultation and ensure that the legislation will provide clarity and certainty for businesses and their advisers

16) Individual Savings Accounts (ISAs)

ISA holders who withdrew monies from their ISA from Northern Rock between 13 and 19 September 2007 are permitted to reinvest them in a new ISA. The deadline for reinvestment is 5 April 2008.

17) Charities and Gift Aid

From 6 April 2008 the basic rate of income tax reduces from 22% to 20%. Charities recover income tax at the basic rate for donations made by taxpayers under Gift Aid. Charities will therefore lose out under these proposals.

The Chancellor has announced that he will permit charities to continue to recover income tax at 22% rather than the basic rate of income tax for donations made between 6 April 2008 and 5 April 2011 inclusive.

Charities will no doubt be extremely happy with this transitional relief. It was also announced that the government would consult with charities on simplifying the rules on 'substantial donors' so that innocent transactions are no longer caught.

18) Stamp Duty administration relief

Currently stamp duty is payable on transfer of shares on sale at 0.5% of the amount on consideration with a minimum of £5 – i.e. equates to consideration of £1,000.

In addition a fixed £5 stamp duty is payable on certain transactions that are not sales.

The Chancellor has announced that in future where all such transfers incur a stamp duty liability of £5 they will be exempt and the instrument affecting the transfer does not need to be stamped.

19) No sideways loss relief

Individuals are able to claim relief against other income and capital gains for losses arising from their trade. HMRC has become aware of tax planning that enable business owners to generate trading losses without them necessarily being active in the trade.

Legislation was introduced to tackle this for partnerships but HMRC has become aware of tax planning mechanisms that generate such trading losses for sole traders.

From Budget day, 12 March 2008, individuals who carry on a sole trade will not be able to claim 'sideways' loss relief if they are only involved in the commercial activities of the trade for less than 10 hours per week.

Such commercial activities would presumably include both active involvement with customers of the business as well as the accounting and administration which must be actively managed and controlled.

Sole traders will need to manage their activities and affairs properly to ensure that they have sufficient involvement in their business to enable them to claim loss relief.

20) Company car rates

Employees who have company cars have for a few years had the benefit in kind calculated based on the CO₂ emissions of the car. The benefit in kind range between 15% and 35% of the list price of the car, although to encourage investment in green technologies a 10% benefit in kind was introduced for cars with CO₂ emissions up to and including 120gms/km.

As previously announced the 15% rate for 2008/09 and 2009/10 applies for cars with CO₂ emissions of 135gms/km. For the tax year 2010/11 this will apply for cars with CO₂ emission of 130gms/km.

In addition, as previously announced the deemed benefit for employer-provided private fuel increases from £14,400 to £16,900 from April 2008. The benefit in kind on which the employee pays tax is then calculated on the rate applicable to the car benefit using the CO₂ emissions.

So for a higher rate taxpayer with a non-environmentally friendly car attracting a 35% benefit their fuel benefit is £5,916 (35% x £16,900) and income tax of £2,366 – a rise in income tax of £350 per year.

The additional benefit in kind also costs the employer more. Employers should therefore review their expenses policies and determine whether they can be improved to reduce costs to employer and employee and help in fight to reduce carbon emissions.

21) Residence and domicile

There has been much press coverage about the changes to the non-domicile rules and these are contained in the budget notes. Two changes from the original rules are:

UK residents who are not UK domiciled can continue to use the remittance basis and claim personal allowances and annual exemptions for income and gains respectively without paying the £30,000 annual charge where their unremitted foreign income and gains do not exceed £2,000. This is instead of the £1,000 outlined in earlier proposals.

These rules only apply to adults and not children. No doubt opportunities will be investigated to ascertain whether adults can exploit this exemption for their children.

22) Remittance basis – trusts

As previously announced trustees of off-shore trusts will be able to make an election to rebase the value of assets held in the trust so that any gains arising to non-domiciled beneficiaries on those assets will only relate to the proceeds less revalued amount at 6 April 2008.

This will be welcome news for trustees that had been facing the potential of capital gains arising in the future and taxable in the UK based on historic cost.

This concession does not appear to have been extended to individuals (i.e. on assets held directly).

23) Resident

In the build up to the Budget another key discussion point was how you treat days of arrival into and departure from the UK when considering whether an individual is resident in the UK and liable to UK income tax.

From 6 April 2008 days of arrival into and departure from the UK will only count in this assessment if the individual is in the UK at midnight. So if they arrive on Monday morning and leave on Tuesday afternoon they will have one day counting towards residence.

There was concern about how people travelling through the UK between two foreign countries would be treated if they had to change airport or mode of transport. HMRC has confirmed that such an individual can change airport or mode of transport and even if they are in transit across midnight this will not count as a day in the UK. However during transit the individual must not engage in activities that are to a substantial effect unrelated to their passage through the UK. So if they have a meeting during this time of transit, the exemption will not apply and the period will count as a day in the UK.

This may present an opportunity for an individual to come to the UK for a day that does not include midnight and for that day not to count as a day of residence in the UK. This may occur for example if they caught the first flight into the UK on a day and the last flight home on the same day – they would have spent a number of hours in the UK but that would not appear to count as a day in the UK for residence purposes. Clearly it will be important to read the legislation to clarify this point.

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