



Emergency Budget Alert June 2010

**Message from Richard Brooks
Head of Tax
RBC Regent Tax Consultants Limited**

Prior to the Budget today there was much speculation about what spending cuts and tax increases would be brought in by the new UK Coalition Government. After all they needed to tackle an enormous budget deficit they inherited from the outgoing Labour Government.

After analysing the Chancellor's speech and reading the associated press releases there is nothing hidden away in the small print, no crafty stealth taxes and no over complex anti-avoidance provisions. The Budget is harsh but clearly designed to tackle the financial mess that the UK is in by imposing strong spending cuts in the state and welfare areas. The Budget does contain tax increases but again these are clearly stated and basically take the form of an increase in VAT, a new Bank tax and a rise in the rate of capital gains tax.

As a tax practitioner, this Budget clearly gets my approval as it seems to indicate we are moving to a new era which will, hopefully, see open and honest tax legislation designed to encourage enterprise and an end to the over complex and red tape creating Budgets of the last thirteen years. That said, the changes proposed clearly indicate where tax will be paid and when.

The only cloud on the horizon is a mention of a consultation possibly on the introduction of a Tax General Anti-Avoidance Rule (GAAR) which was last raised in 1997 and considered totally unworkable.

Richard Brooks
Head of Tax British Isles

Index

Personal Tax	3
Individual Savings Accounts (ISAs)	3
Registered Pension Schemes	3
Income tax adjustments between settlors and trustees.....	4
Capital Gains Tax: rates and entrepreneur's relief	4
Corporation Tax	4
Consortium relief	5
Corporation Tax avoidance: Authorised Investment Funds	5
Loan relationships: anti-avoidance	5
VAT.....	6
Capital allowances: Rate and annual investment allowance changes	7
Research and development tax relief	7
Enterprise Management Incentives	7
Venture Capital Schemes	8
Income Tax deducted at source.....	8
UK Real Estate Investment Trusts (REITs) and stock dividends	8
Stamp Duty Land Tax	9
Review of HMRC powers, deterrents and safeguards	9
The Banking Levy.....	9

Personal Tax

The personal allowance, basic rate limit and National Insurance thresholds for 2011-12

The following income tax and National Insurance Contributions (NICs) changes will have effect for 2011-12:

- The personal allowance for those aged under 65 will be increased by £1,000 to £7,475
- The basic rate limit will be reduced so that higher rate taxpayers do not benefit from the increase in the personal allowance. The exact figure will be confirmed when September's Retail Prices Index (RPI) is known
- The alignment of the Upper Earnings/Profits Limit (UEL/UPL) with the higher rate threshold (the total of the personal allowance for those aged under 65 and the basic rate limit) will be maintained by reducing the UEL/UPL
- The secondary threshold, which is the point at which employers start to pay Class 1 NICs, is to be increased by an extra £21 per week above indexation

Individual Savings Accounts (ISAs)

Indexing Individual Savings Account Limits from 2011

From April 2011 the ISA limits will be increased in line with the Retail Prices Index (RPI) on an annual basis.

The ISA annual subscription limits were increased for all savers from April 6, 2010, to £10,200 of which £5,100 can be saved in cash. Indexation of the limits for the tax year 2011-12 will take effect on and after April 6, 2011 and for subsequent tax years on and after April 6 of each year.

The new annual limits will be rounded to the nearest multiple of 120 so that individuals who save monthly will be able to calculate their monthly savings more easily. The new limits will be calculated by reference to the RPI for the September before the start of the following tax year and HM Revenue &

Customs will announce the new limits each year in advance of the start of the new tax year in which they will apply.

If the RPI is negative, the ISA limits would be unchanged. As is the case now the cash ISA limit will be half the value of the stocks and shares ISA limit.

Registered Pension Schemes

Transitional Measure Deferring the Effective Requirement to Buy an Annuity to Age 77

The Government has announced that it will end the effective requirement to use a pension fund to buy an annuity by age 75 with effect from 2011-12.

Under current law, members of registered pension schemes with money purchase arrangements have the option before age 75 of taking a pension from the scheme, buying an annuity or drawing income directly from the pension fund as an unsecured pension. After age 75, income can be drawn from the fund but there are strict minimum and maximum limits. Also, if such a member dies after reaching age 75 and any of the fund is not used to pay either pensions to dependants or a charitable donation, it is subject to tax charges up to 70 per cent. Specific Inheritance Tax (IHT) charges also apply to certain pension scheme members who die on or after their 75th birthday.

Pending implementation of the necessary changes, transitional measures will be introduced in the Finance Bill 2010 to increase to 77 the age by which members of registered pension schemes have to buy an annuity or otherwise secure a pension income. This change will also apply for the purposes of the IHT charges for members age 75 and over. The transitional measures will affect those members who reach age 75 on and after June 22, 2010 and will enable them to defer their decision on what to do

with their pension savings until the new rules are finalised next year. The Government has announced that it will consult shortly on the detail of the changes being introduced in 2011-12.

Income tax adjustments between settlors and trustees

Where a settlor has retained an interest in a discretionary trust, the trustees still pay tax at the highest rate, and the settlor is taxable on the income with relief for the tax paid by the trustees. Where the settlor's personal tax liability is less than that of the trustees, he is entitled to a repayment. It was announced in the March Budget that a repayment in respect of any trust income, must be paid back to trustees by the settlor but this would be ignored for Inheritance Tax purposes.

This same measure has been announced in today's Budget, but there does not appear to be any significant change to the original proposal. The effective date is still April 6, 2010.

Capital Gains Tax: rates and entrepreneur's relief

Rate of Capital Gains Tax

The Coalition Government had already announced that the rate of Capital Gains Tax (CGT) would increase broadly in line with income tax rates. What wasn't known until today was what the rate would be, when it would be effective from and whether there would be any reliefs.

Today it was announced that the rate of CGT would remain at 18% for basic rate taxpayers, providing their total income and gains did not exceed the basic rate limit of £37,400. For higher rate taxpayers, the rate will increase to 28% from June 23, 2010 for gains or part of gains exceeding the basic rate limit. For beneficiaries of offshore trusts, this means that the maximum rate of tax they will pay on trust gains will be 44.8%. There is no detail at present regarding how the rate

change will interact with the attribution of gains before and after June 23.

Higher rate taxpayers will be able to use their capital losses and annual exemption in the most beneficial way, where their capital gains straddle the basic rate and higher rate bands. The annual exemption remains at £10,100.

Entrepreneurs' relief

This relief was previously available on the first £1 million of qualifying gains on disposals of businesses by individuals, and in some cases trustees, resulting in an effective rate of 10% on gains up to the limit. This lifetime limit was increased to £2 million from April 6 and it has now been announced that it will further be increased to £5 million from June 23, 2010. Any disposals prior to the date of change will benefit from the limit in place at that time, but future disposals will benefit from the additional allowance.

The method of computation was previously complicated as it reduced the gain and then applied the full rate of tax to the reduced gain. The method will now be to charge 10% CGT on the whole gain (within the lifetime limit) and therefore the relief will be equally available to higher rate taxpayers.

Corporation Tax

Main rate

For the financial year commencing April 1, 2011 the main rate of Corporation Tax on profits of more than £1.5 million will be reduced to 27%. There are further decreases proposed to reduce the rate by 1% each year until the financial year commencing April 1, 2014 when the rate will be 24%.

The main rate of Corporation Tax for "ring fence" profits, in respect of profits from oil and gas production in the UK and the UK Continental Shelf, will remain at 30%.

Small profits rate

For the financial year commencing April 1, 2011 the small profits rate on profits below £300,000 will be reduced to 20%.

The small profits rate on “ring fence” profits will remain at 19%.

Capital distributions

As announced in the March 2010 Budget this measure will clarify the Corporation Tax treatment of certain distributions received by UK companies.

The new legislation will mean that distributions will not be prevented from falling within the distribution exemption by virtue of being capital in nature.

The Government intends to legislate this measure in a Finance Bill to be introduced after the summer recess.

Consortium relief

Consortium relief rules allow a member of a consortium to transfer its share of the consortium’s unused losses to another member of its group in certain circumstances. Under current rules the member making the transfer must be a UK resident company. A measure will be introduced to extend the rules to allow any company established within the European Economic Area to make such a transfer.

The maximum amount of losses that may be claimed from a consortium company is currently determined by the lowest result from three tests:

1. the percentage of ordinary share capital held;
2. the percentage of profits to which the company is entitled; and
3. the percentage of assets to which the company would be entitled on a winding up.

An additional test is going to be added based on the proportion of voting rights and the extent of control the member holds in the consortium.

These measures will be introduced in the Finance Bill and the changes to the legislation will have effect for accounting

periods commencing on or after the date that the legislation is published.

Corporation Tax avoidance: Authorised Investment Funds

The tax regulations applicable to Authorised Investment Funds (AIFs) “stream” any dividend distribution made by an AIF and paid to a corporate investor. This means that any part of the distribution derived from taxable income of the AIF is treated as an annual payment with an associated deemed tax credit. This normally ensures that the correct rate of corporation tax is paid by the investor after taking into account tax in the AIF. Two amendments to the AIF regulations will prevent the artificial creation, inflation or repayment of the deemed tax attached to an annual payment.

The first amendment restricts the corporation tax deduction given for interest distributions so that the deduction is reduced to the extent that the distribution is derived from dividends exempt from corporation tax.

The second amendment ensures that where foreign tax is suffered by an AIF then the deemed tax credit in the hands of the corporate investor (including another AIF) is treated as a foreign tax credit for all tax purposes and that a proportionate part of the income is treated as foreign income.

These measures have effect on and after June 22, 2010.

Loan relationships: anti-avoidance

A company’s taxable profits and losses from its loan relationships and derivative contracts are normally based on the amounts shown in accounts prepared in accordance with generally accepted accounting practice. In certain circumstances, where accounting practice allows a loan or derivative or its associated cash flows to be “derecognised”, the tax rules override the accounting practice and require profits and losses to be computed as if the asset had been fully recognised.

A measure to be introduced will extend the circumstances in which amounts are to be fully recognised for tax purposes to cases where derecognition arises as a result of the acquisition or variation of a capital interest in a company, partnership or trust, or where derecognition is triggered by an event that occurs in a later accounting period to that in which the derecognition takes place.

The legislation will have effect for credits and debits arising on or after June 22, 2010.

A technical note is to be issued in early July 2010 setting out proposals for generic legislation to tackle avoidance schemes involving derecognition of loan relationships and derivative contracts. Any further changes to the legislation on derecognition will be made in Finance Bill 2011, with effect from a date to be announced.

VAT

Change of standard rate

The standard rate of VAT will be increased from 17.5% to 20%. The 20% rate will have effect for any supply made on or after January 4, 2011.

Zero rated supplies, such as basic foodstuffs, children's clothing and books; exempt supplies such as education and health; and supplies subject to VAT at the 5% reduced rate are not affected by this change.

VAT flat rate scheme

The VAT inclusive thresholds used in the VAT flat rate scheme have been recalculated to reflect the increase in the standard rate of VAT to 20%. These changes come into force on January 4, 2011.

The VAT flat rate scheme was introduced to simplify VAT for business with an annual turnover up to £150,000. This threshold remains unchanged.

A business has to leave the scheme if either its tax inclusive flat rate turnover exceeds

£225,000 or on a forward look, its tax inclusive turnover in the next 30 days can reasonably be expected to exceed £225,000. As a result of the increase in the standard rate of VAT to 20%, both of these exit thresholds will be increased to £230,000.

Also, if a business using the flat rate scheme exceeds the annual exit threshold as a result of a one off transaction but, in the subsequent tax year, expects its tax inclusive annual flat rate turnover to be less than £187,500, it may remain in the scheme with the agreement of HMRC. As a result in the increase in the standard rate of VAT to 20% this threshold will be increased to £191,500.

Anti-forestalling legislation

Anti-forestalling legislation will be introduced to counter arrangements designed to apply the 17.5% VAT rate to goods and services to be delivered or performed on or after January 4, 2011.

This measure provides that in certain circumstances a supplementary charge to VAT of 2.5% will be due on supplies of goods and services on which VAT of 17.5% has been declared.

The legislation has been targeted on artificial arrangements and is unlikely to affect suppliers conducting their business as they normally do when no VAT increase is anticipated.

Postal services

This measure will apply VAT at the standard rate to certain postal services provided by Royal Mail Holdings PLC, the Universal Service Provider (USP) of public postal services in the UK.

Social mail, including stamped mail, remains exempt from VAT so private individuals should largely be unaffected.

Lennartz accounting

Under existing arrangements, VAT on immovable property, boats and aircraft is recoverable upfront and in full on both the business and private use of the asset. VAT is then payable over subsequent years in respect of the private use of the asset. This is known as “Lennartz” accounting.

The changes introduced by this measure will ensure that VAT recovery is restricted only to the business use of the asset, excluding any private use by the taxpayer or the taxpayer’s staff.

Capital allowances: Rate and annual investment allowance changes

Writing-down allowances (WDAs)

Capital allowances allow a business to write off the costs of capital assets, such as plant and machinery, against their taxable income. They take the place of commercial depreciation, which is not allowed for tax. The general rate of plant and machinery WDA is currently 20% per annum on a reducing balance basis. For special rate expenditure the rate of plant and machinery WDA is currently 10% per annum on a reducing balance basis. Special rate expenditure includes expenditure on long-life assets, thermal insulation, integral features and expenditure incurred on or after April 1, 2009 on cars with CO₂ emissions of more than 160g/km.

The WDAs will be reduced from 20% to 18% for expenditure allocated to the general rate pool and from 10% to 8% for expenditure allocated to the special rate pool. This will take effect for the calculation of WDAs for chargeable periods ending on or after April 1, 2012 for businesses within the charge to Corporation Tax (CT) and on or after April 6, 2012 for businesses within the charge to income tax.

For businesses whose chargeable period spans April 1 (CT) or April 6 (Income Tax) a hybrid rate will need to be calculated.

Annual investment allowance

For businesses investing in plant and machinery the maximum amount of their annual investment allowance will be reduced from £100,000 to £25,000 with effect from April 2012.

Research and development tax relief

The change will affect Small or Medium Enterprises (SMEs) claiming enhanced tax relief for expenditure on research and development.

The Government will legislate to abolish the condition which requires that any intellectual property deriving from the research and development to which expenditure is attributable be owned by the SME making the claim for enhanced tax relief.

This condition also applies where a company which is a SME applies for research and development tax relief under the rules for large companies, because the expenditure is excluded from the SME relief by virtue of being subsidised.

This is due to be legislated for in a Finance Bill to be introduced as soon as possible after the summer recess and will have effect for any expenditure incurred by a SME company on research and development in an accounting period ending on or after December 9, 2009.

Enterprise Management Incentives

Under current legislation, a single company granting Enterprise Management Incentive options to its employees must carry on a trade ‘wholly or mainly’ in the UK. In the case of a parent company, at least one company in the group must be carrying on a ‘qualifying trade wholly or mainly in the UK’.

In order to ensure compliance with EU State Aid guidelines, in future, a single company must have a ‘permanent establishment’ in the UK. In the case of a parent company, at least one company in the group that is

carrying on a 'qualifying trade' must have a 'permanent establishment' in the UK. This change will apply from the date that the legislation receives Royal Assent.

Venture Capital Schemes

Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EIS)

The current legislation requires the shares making up a VCT's ordinary share capital to be included in the official UK list throughout the relevant accounting period. In future, the requirement will be that the shares be admitted for trading on any EU regulated market. This will mean that VCTs will be able to be listed on markets throughout the EU/European Economic Area.

In addition, the current legislation also requires that at least 30% of the VCT's qualifying holdings is represented throughout the relevant accounting period by holdings of eligible shares, as defined. The new legislation will increase the eligible share holdings requirements to 70% and will also change the definition of eligible shares, to allow VCTs to include shares which may carry certain preferential rights to dividends.

The new legislation will exclude shares in a company from qualifying for the purposes of the legislation if it is reasonable to assume that the company would be treated as an 'enterprise in difficulty' for the purposes of the European Commission's Rescue and Restructuring Guidelines. This change will apply to both VCTs and the EIS.

The current legislation also requires that there is a trade carried on wholly or mainly in the UK. For shares issued on or after the commencement of the new legislation, the requirement will be that the company must have a permanent establishment in the UK. Permanent establishment will be defined based on Article 5 of the OECD Model Tax Convention on Income and Capital. This change will also apply to both VCTs and the EIS.

These changes are the final changes to VCTs and EIS agreed with the European Commission as a condition for their approval by the Commission as approved State Aids.

The date of the changes has still to be agreed and the Government will legislate for the changes in a Finance Bill to be introduced as soon as possible after the summer recess.

Income Tax deducted at source

Changes to the rules on income tax deducted at source will affect individuals and other non-corporates that make payments of interest, patent royalties or other annual payments which require tax to be deducted at source. Companies will not be affected.

Where a person, other than a company, makes a payment from which income tax is required to be deducted, they are required to deliver an account of that payment to HMRC without delay.

The changes provide HMRC with a power to make regulations to amend when and how a person should report income tax deducted from certain payments.

UK Real Estate Investment Trusts (REITs) and stock dividends

The UK REIT legislation was first introduced in the Finance Act 2006 and has been rewritten in the Corporation Tax Act 2010. It requires a UK REIT to distribute, for each accounting period, 90% of the profits from its property rental business by way of a dividend.

The distribution itself is known as a property income distribution and in the hands of the shareholder is taxed as though it was income from property.

New legislation will allow UK REITs to issue stock dividends in lieu of cash dividends to meet the 90% test. It will have effect for property income distributions made on or after the date of Royal Assent.

These stock dividends will be taxed in the same way as the property income distributions paid in cash.

Stamp Duty Land Tax

Relief for overpayments

This measure will amend the SDLT error or mistake relief rules. This will align SDLT with Income Tax, Capital Gains Tax and Corporation Tax rules which were amended in the Finance Act 2009. The changes will provide a means of reclaiming repayments when there is no other statutory route.

A repayment of SDLT was only issued if the overpayment was a result of a mistake in a return and that it was made under an assessment.

The new measure will remove this requirement. To allow for a transitional period in which claims can be made under the old rules, the measure will have effect on and after April 1, 2011.

The time limit for claiming repayments will be amended to four years from April 1, 2011

Review of HMRC powers, deterrents and safeguards

Penalties for late filing of returns and payment of tax

As previously announced in the Budget earlier this year, the Coalition Government still plans to introduce legislation to reform the penalty regimes for late filing of tax returns and late payment of tax for the following indirect taxes:

- VAT and insurance premium tax
- Aggregates levy, climate change levy and landfill tax
- Air passenger duty, alcoholic liquor duties, tobacco products duty, hydrocarbon oil duties, general betting duty, pool betting duty, bingo duty, lottery duty, gaming duty and remote gaming duty; and
- Other excise duties

The legislation will replace the current variety of penalties and will treat late payment of tax and late filed tax returns separately. This follows on from legislation enacted in Finance Act 2009 for certain taxes including income tax, corporation tax, inheritance tax and other direct taxes.

The late filing and late payment penalty models are broadly similar and are designed to encourage filing and payment by the correct dates by introducing an escalating series of penalties depending upon the number of failures within a set penalty period. Further penalties will arise if there is a prolonged delay in filing returns or paying the tax due.

Implementation of the new penalty regimes requires changes to HMRC internal systems and is to be staged over a number of years. The new provisions will be brought into effect by Treasury orders which will specify the dates from which they have effect.

Excise modernisation and compliance checks

This measure will update the compliance checking framework for excise duties including:

- Modernising information and inspection powers; and
- Aligning the record keeping rules and the time limits for assessments and claims

This is to bring excise into line with other taxes and duties which have been aligned in recent years. These changes will be subject to a transitional period and are not expected to become fully operative before April 1, 2012.

The Banking Levy

As predicted the Chancellor today announced a new Banking Levy and indicated that both France & Germany are set to announce similar taxes.

The levy will not be connected to bank bonuses but instead be a balance sheet levy on UK banks and building societies, and the UK subsidiaries of foreign banks, which the

Chancellor anticipates will raise more than £2 billion annually.

The levy will come into force in January 2011.

Smaller banks will be exempt from the move and Tier 1 capital exempt, essentially meaning the levy is a tax on banks' risk assets. The idea being that the bank should make a contribution proportional to their level of risk.

The British Bankers Association commenting on the Budget speech said it understands the part banks must play in the economic recovery, but warned the Chancellor must be careful the tax does not hit commerce too severely.

Bank levies need to be co-ordinated internationally and must not prevent the industry in the UK from being able to compete. We will have to watch this space and see how the levy develops internationally over time; given the UK, France & Germany have now taken the lead.

Contact Us

We have a number of specialist directors and senior managers dealing with taxation who would be happy to assist you. In the first instance, please contact:

RBC Regent Tax Consultants Limited

La Motte Chambers, St Helier, Jersey
Channel Islands, JE1 1PB

Richard Brooks

+44 (0) 1534 501 520

richard.brooks@rbc.com

Ann Wylie

+44 (0) 1534 501 309

ann.wylie@rbc.com

Mark Power

+44 (0) 1534 501 308

mark.power@rbc.com

RBC International Wealth Planning

71 Queen Victoria Street, London
EC4V 4DE

RBC International Wealth Planning

4th Floor, The Quadrangle, Imperial Square
Cheltenham, Glos, GL50 1PZ

Louise Somerset

+44 (0)1242 548 448

louise.somerset@rbc.com

Andrew Robins

+44 (0) 1242 548 403

andrew.s.robins@rbc.com

Rachel de Souza

+44 (0) 20 7029 7756

rachel.desouza@rbc.com

rbcicwp@rbc.com

www.rbcwminternational.com



This publication has been issued by RBC International Wealth Planning and RBC Regent Tax Consultants Limited.

RBC International Wealth Planning is the trading name of RBC Wealth Planning International Limited. Registered Office: La Motte Chambers, St Helier, Jersey, Channel Islands, JE1 1PB, registered company number FC023283

RBC Regent Tax Consultants Limited, registered office: La Motte Chambers, St Helier, Jersey, Channel Islands, JE1 1PB. Registered company number 70896

The summary contained herein has been carefully prepared based upon information that is believed to be accurate at the time of writing and is intended for general guidance only. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the authors. On any specific matter you are advised to take professional advice.

Telephone calls to RBC may be recorded for training and evaluation purposes.

© Trademark of Royal Bank of Canada. ™ Trademark of Royal Bank of Canada. Used under licence.

Tax 220610-18