



BUDGET 2010

TAX MEMO 2009-2010

Newsletter Issue 3

June 2010

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Welcome to the third newsletter for the 2009/10 edition of *Tax Memo*. This pulls together all relevant announcements made by the Chancellor in the Budget on 22 June 2010 to provide a comprehensive analysis in one document. The relevant paragraphs in your Memo product will also be updated individually online.

The first Budget of the new coalition Government was expected to concentrate on public spending more than tax rises and this was certainly the case. However, a number of new measures, along with previous announcements that hadn't made it into the statute book, will keep tax advisers busy for a number of months.

As well as the substantive announcements a number of consultations are due to be undertaken, in such areas as the reform of the corporation tax system, the taxation of non-domiciled individuals and an examination of how to make the PAYE system simpler, perhaps introducing more regular or real time filing.

We believe that you will find this newsletter useful and informative in advising you about the changes and welcome any comments you may have as to how we can improve our service. We look forward to receiving your emails at flm@flmemo.co.uk.

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CORPORATION TAX

Capital allowances: rates and allowances

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See ¶369, ¶413

Two significant changes are to be implemented.

▶ Corporation tax

Firstly, for periods ending on or after 1 April 2012 (6 April 2012 for income tax purposes) the **rates of allowances on plant and machinery** are to be reduced. The allowance that is currently applicable to most qualifying plant of 20% will become 18%, with the special rate dropping from 10% to 8%. As these changes happen on a fixed date it will be necessary to calculate a hybrid rate for any period straddling the change.

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Example

A company has an accounting period ending on 31 December 2012. 91 days would fall under the old rate and 277 under the new.

$91/366 \times 20\%$	4.97%
$277/366 \times 18\%$	13.52%
Hybrid rate	18.49%

Secondly, from April 2012 the **annual investment allowance** will be reduced to £25,000. The method for allocating expenditure against this in any period straddling this date will be detailed in legislation nearer the time.

Rates

See ¶1342, ¶9962

Both the main rate and the small companies' rates have been announced for financial year 2011. The **main rate** is set to drop by 1% to 27%. It is the current intention that this will continue to drop by 1% each financial year until it reaches 24% for financial year 2014.

The **small companies' rate** will similarly be reduced by 1% to 20% for financial year 2011.

Consortium relief

See TM ¶1580, ¶1587

The **link company** rules are to be amended by the next Finance Bill and these changes will come into force for accounting periods beginning on or after the date of publication of the legislation. In order to comply with its EU obligations the Government will replace the condition that the link company has to be UK resident with one that ensures the company is EEA resident.

The **general rules** will also be amended to introduce a further potential restriction to the amount of losses a consortium company can claim. Presently the percentage that can be claimed is limited to the lower of the company's holding of ordinary share capital, entitlement to assets on a winding up or entitlement to profits on distribution. The **further limit** will be the proportion of voting rights and control the company holds in the consortium.





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Zero-emission goods vehicles

See TM ¶298, ¶327

For expenditure incurred on zero-emission goods vehicles on or after 1 April 2010 (6 April 2010 for income tax purposes), and for the following 5 years, a first year allowance is to be introduced. Where a business **purchases a new, unused vehicle** that is designed primarily for the carriage of goods and it cannot under any circumstances produce CO₂ emissions, it will be able to claim 100% capital allowances on the item in the period it is purchased. This expenditure will then be excluded from the annual investment allowance.

In order to comply with State Aid rules the following businesses will **not qualify**:

- » those that are considered to be in **difficulty**;
- » those who are **yet to repay State Aid** that has been deemed illegal;
- » those engaged in the **fisheries or aquaculture sectors**; and
- » those **managing waste** for others.

Further, there will be an **overall cap** on the amount of expenditure that a business (along with associated businesses) can claim over the life of the relief which will be set at €85 million.

Changes to research and development criteria

See TM ¶798

The next Finance Bill after the summer recess will introduce legislation to remove the necessity for a **small or medium-sized enterprise** to own any intellectual property arising from its research in order to secure additional relief for qualifying expenditure. This will apply for expenditure incurred in an accounting period ending on or after 9 December 2009.

Further changes to worldwide debt cap rules

See TM ¶877

Previously announced changes that were not included in Finance Act 2010 are to be enacted as follows.

Firstly, in looking at the **assets and liabilities** in the net debt calculation, long-term arrangements that, while not being in the legal form of a loan, have similarities to a loan, including an interest-like return, will be included.

Secondly, the rules will be clarified to put beyond doubt that a **limited liability partnership** cannot be the ultimate parent of a group for these purposes.

Finally, **distributions** made by **industrial and provident societies** will not be included as finance expenses, even though they are normally treated as interest payments for tax purposes.

Changes to dividend exemption rules

See TM ¶953

The exemption that previously only applied to distributions of an income nature is to be extended for companies receiving **dividends of a capital nature**. This will be coupled with a



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widening of the definition of distribution to include a return of a reserve arising from a reduction in share capital.

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Real Estate Investment Trusts

See *TM* ¶985

The rules on the **distribution level** that a REIT must make in order to retain its status are to be changed in the first Finance Bill of the next Parliament. From the date the Bill receives Royal Assent a REIT will be able to count any **stock dividends** it makes towards the 90% requirement. The recipients of such dividends will still be taxed in the same way as if they had received a cash dividend from the REIT.

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INCOME TAX

Guardians and kinship carers

See TM ¶2408

An **income tax exemption**, similar to that for adopters, will be made available to individuals caring for children placed with them under:

- » a **special guardianship order** (“special guardians”); or
- » a **residence order**, where the individual is not the child’s parent or step-parent (certain “kinship carers”).

The exemption will apply to payments made to the carer on or after 6 April 2010.

This measure was previously announced in the March 2010 Budget. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

Shared lives carers

See TM ¶2408

A tax-free allowance, similar to that for foster carers, will be made available to individuals who:

- » provide **care for up to three people** under a local authority shared lives placement scheme; and
- » **share their home** and family life with those people.

Foster children do not count towards the three-person limit, and siblings count together as one person (for this purpose only).

The **annual exemption** will be:

- » £10,000 for each tax year; plus
- » £200 a week for each person cared for who is under 11 years old; plus
- » £250 a week for each person who is older.

If the **total receipts** from providing care do not **exceed the annual limit**, they are tax free. Otherwise, the carer can opt to be taxed on a simplified basis instead of having the receipts taxed as trading income.

These changes apply from 6 April 2010. For 2010/11, the existing simplified tax arrangements for adult placement carers can be used instead if the carer so chooses. Those arrangements will be abolished from 2011/12 onwards.

This measure was previously announced in the 2009 Pre-Budget report. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

Furnished holiday lettings

See TM ¶2777+

The favoured tax treatment for furnished holiday lettings **will not now be withdrawn** from 6 April 2010 as announced by the previous Government.

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Individual Savings Accounts (ISAs)

See *TM* ¶2797

An individual may make subscriptions to an ISA up to an **annual limit**. For 2010/11 the limit is £10,200, of which £5,100 may be saved in cash.

From 6 April 2011 the limits will be **increased** in line with the annual percentage increase in the Retail Prices Index (RPI), rounded off to a figure which allows for the easy calculation of monthly payments. The maximum cash element will be 50% of the overall limit.

The limits will not be reduced if the RPI decreases.

This measure was previously announced in the March 2010 Budget.

Deduction of tax at source

See *TM* ¶2846

An **individual or other non-corporate person** who makes a payment under deduction of income tax is required to **report it to HMRC** "without delay". HMRC are to be given powers to specify when and how such a report must be made. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

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

See *TM* ¶2873, 2913

A number of changes will be made to these schemes, so that they continue to receive approval from the European Commission. These measures were previously announced in the March 2010 Budget. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess, and the changes will apply from a date to be announced.

VCTs only

The requirement that shares in the VCT must be **listed in the UK** will be **extended** such that the shares will qualify if they are **listed on any EEA market**.

The **minimum proportion** of the VCT's holdings that must be **eligible shares** will rise from 30% to 70%. The **definition** of eligible shares will be amended to include shares that may carry certain preferential rights to dividends.

EIS and VCTs

Relief will be **denied** in cases where it is reasonable to assume that the company raising the funds is in difficulty.

At present the company must carry on a **trade wholly or mainly in the UK**. This condition will be replaced by a requirement that the company must have a **permanent establishment in the UK**.

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Enterprise Management Incentive (EMI) schemes

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See TM ¶3467

At present a company wishing to operate an EMI scheme must **carry on a trade wholly or mainly in the UK**. To comply with EU state aid guidelines, this condition will be **replaced** by a requirement that the company must have a **permanent establishment in the UK**.

► Corporation tax

► Income tax

This measure was previously announced in the March 2010 Budget. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess, and the new requirement will apply to options granted on or after the date of Royal Assent.

► PAYE and NIC

Tax credits

See TM ¶3705+

► Capital gains tax

From April 2011, tax credits will be **index-linked to the Consumer Prices Index (CPI)**, rather than the Retail Prices Index (RPI) as at present. This is considered to be a better measure of inflation for the purpose, because it excludes most housing costs.

► Trusts, settlements and estates

The **child element** of the Child Tax Credit will increase by £150 more than CPI in April 2011, and by £60 more than CPI in April 2012, but the baby element will be removed from April 2011.

► Value added tax

Other rate changes are summarised below:

Child and Working Tax credits rates	2010/11	2011/12
Income thresholds and withdrawal rates:		
First withdrawal rate	39%	41%
Second income threshold	£50,000	£40,000
Second withdrawal rate	6.67%	41%
Income disregard	£25,000	£10,000

There will be **further changes** in 2012/13, of which the following were announced:

- » the family element of Child Tax Credit will be withdrawn immediately after the child element;
- » the 50-plus element will be withdrawn from Working Tax Credit;
- » the previously announced £4 supplementary Child Tax Credit for children aged up to 2 will not now be introduced;
- » the back-dating period for claims will be reduced from 3 months to 1 month; and
- » a disregard of £2,500 will be introduced for reductions of income during the year.

► Stamp taxes

Pension contributions – high earners

See TM ¶3777

The Finance Act 2010 restricts tax relief on pension contributions from 6 April 2011 for individuals with annual earnings of £150,000.

This complex legislation is **likely to be repealed**, and replaced by a system of reduced annual allowances with a broadly similar effect. A consultation process will take place with a view to making this change in time for 6 April 2011.





INCOME TAX cont...

Pension income – annualisation by age 75

See TM ¶3858

On retirement, an individual who is a member of a registered pension scheme may take part of the pension fund in the form of a tax-free lump sum at any time before his 75th birthday. Under **existing rules**, the balance of the fund must be used to secure an annuity before the individual reaches 75. If this is not done:

- » strict maximum and minimum limits apply to the annual income that can be withdrawn from the fund;
- » if the individual dies, tax is charged (at up to 70%) on any part of the fund which is not used to provide benefits to dependents or to charity; and
- » inheritance tax charges may apply on death.

From 20 June 2010 these rules are amended for any individual who:

- » is a member of a **money purchase scheme**;
- » has not yet secured an annuity; and
- » did not reach his 75th birthday before that date.

For such an individual:

- » the maximum and minimum withdrawal limits will not apply until his 77th birthday; and
- » a tax-free lump sum can still be withdrawn immediately before his 75th birthday.

The amended rules will be finalised for 2011/12 following further consultation. In the meantime, for **individuals who die at an age greater than 75, the:**

- » maximum tax charge on death will be capped at 35%; and
- » existing inheritance tax charge will no longer apply.

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Personal allowance

See TM ¶4392

The basic personal allowance for 2011/12 will be **£7,475** (2010/11: £6,475).

Pensioners' personal allowance

See TM ¶4395

Legislation requires that the personal allowance for over 65s be increased each year by the annual percentage increase in the Retail Prices Index (RPI). This legislation will be overridden for 2011/12, but the exact allowance will not be announced until after the publication of the RPI for September 2010.

Overseas issues: seafarers

See TM ¶4395

A **UK seafarer** who performs his duties wholly or partly overseas can claim a 100% income tax deduction for the attributable earnings. From 6 April 2011 this deduction will be **extended to EU and European Economic Area residents** who pay UK tax on their earnings as seafarers.

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INCOME TAX cont...

This measure was previously announced in the 2009 pre-Budget report. Details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

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Rates of tax

See *TM ¶4408*

Legislation requires that the **basic rate limit** be increased each year by the annual percentage increase in the Retail Prices Index (RPI). This legislation will be overridden for **2011/12**, **reducing** the limit such that higher-rate and additional-rate taxpayers will not benefit from the increase in the personal allowance (¶4392). The exact limit will not be announced until after the publication of the RPI for September 2010.

In **2012/13** the basic rate limit will be **frozen** at its 2011/12 level.

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PAYE and NIC

NIC standard rate threshold

See TM ¶5004

Legislation requires that the threshold at which Class 1A (employer's) national insurance contributions become payable be increased each year by the annual percentage increase in the Retail Prices Index (RPI). The **weekly threshold for 2011/12** will increase by £21 more than this, but the exact threshold will not be announced until after the publication of the RPI for September 2010.

NIC standard rate

See TM ¶5004

As previously announced, from 6 April 2011:

- » all Class 1 and Class 1A contribution **rates will rise by 1%**; and
- » the **threshold** at which Class 1 (employee's) national insurance contributions become payable will increase by £570 for the year as a whole.

The upper earnings limit will be reduced, such that most higher-rate and additional-rate taxpayers will pay a similar amount of NIC as in 2010/11.

The rates for 2011/12 as presently known are summarised below:

Weekly threshold	Employee's NIC rate	Employer's NIC rate
Up to the upper earnings limit (2010/11: £844)	12%	13.8%
Above the limit	2%	13.8%

NIC reduction for new regional businesses

See TM ¶5048

Businesses which start up in certain regions of the UK: will be exempt from up to £50,000 of employer's NIC in their first year of operation.

The maximum exemption will be £5,000 for each of the first 10 employees hired in the first year of business.

The scheme is intended to start no later than September 2010 and will run for 3 years. Any new business which starts up on or after 22 June 2010 will be eligible, subject to meeting various criteria which will be announced in the near future.

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PAYE and NIC cont...

NIC Class 4 rate

See *TM ¶5093*

As previously announced, from 6 April 2011:

- » all Class 4 contribution rates **will rise by 1%**; and
- » the **lower profits limit** (threshold at which Class 4 national insurance contributions become payable) will increase by **£570**.

The **upper profits limit** will not be announced until after the publication of the RPI for September 2010. The rates for 2011/12 as presently known are summarised below:

Profits assessed in 2011/12	Class 4 NIC rate
£6,285 to the upper profits limit (2010/11: £43,875)	9%
Above the upper profits limit	2%

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CAPITAL GAINS TAX

Rates

See ¶6043, ¶ 6331

Two major changes are to be implemented, effective from 23 June 2010.

Firstly, a new capital gains tax rate of 28% will apply to the higher rate gains. In essence, where the total of an individual's gains, after the annual exemption and any losses, and income, after the personal allowance, would take them above the upper limit of the basic rate band for the year, the gain will be taken as the top slice and the amount falling above this limit will be taxed at the new rate. The existing rate will apply for all gains below this limit. The new rate will also apply for **trustees and personal representatives** regardless of the level of income or gains.

Gains that have already occurred this tax year will remain to be taxed at 18% and will not be accounted for in ascertaining if the basic rate threshold has been exceeded.

Secondly, **entrepreneurs' relief** will be further extended to cover lifetime gains of £5 million. This will not affect gains made in the current tax year arising prior to 23 June 2010. The legislation will also be amended so that a flat rate of 10% is charged on eligible gains rather than reducing the gain by a fractional amount as is currently the case.

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Adult placement carers

See TM ¶6170

On the disposal of a taxpayer's **principal private residence** (PPR) any area set aside exclusively for the purposes of a trade or similar will not attract PPR relief, leaving part of any gain made left to charge. Under a government scheme, Shared Lives, carers may be required to set aside a room for an adult to stay with them. Where this is the case, for disposals after 9 December 2009 the relief will be not be restricted for that room

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TRUSTS, SETTLEMENTS AND ESTATES

Repayment of tax to settlor

See *TM* ¶7348

A settlor who is taxable on the trust's income may receive a repayment of tax if he is taxable at a lower rate than the trustees. If this situation arises because of an **allowance or relief** available to him, he must pass the tax repayment on to the trustees.

From 6 April 2010 this requirement is **extended**, such that **any** repayment received by the settlor in relation to trust income must be paid over to the trustees, irrespective of how it arose.

This measure was previously announced in the March 2010 Budget. Further details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

Charitable trusts for asbestos victims

See *TM* ¶7510+, ¶7395, ¶7326

Certain trusts for asbestos victims will be **exempt from taxation** with effect from 6 April 2006.

Such a trust will be exempt from:

- » the 10-year inheritance tax (IHT) charge on assets, and from IHT on certain payments out of the trust;
- » capital gains tax on disposals of trust assets; and
- » income tax on trust income.

To **qualify**, a trust must have been set up:

- » on or before 23 March 2010;
- » as part of an arrangement between a company and its creditors; and
- » specifically for the purpose of paying compensation to (or in respect of) victims of asbestos-related conditions.

This measure was previously announced in the March 2010 Budget. Further details will be in the Finance Bill to be introduced after the Parliamentary summer recess.

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VALUE ADDED TAX

Time of supply

See TM ¶7900

The **standard rate** of VAT will increase to 20% from 17.5% with effect from 4 January 2011. Special measures will be introduced to prevent the 17.5% rate applying to supplies made on or after 4 January 2011 where the **recipient of the supply is unable to recover** all the VAT on the supply and either:

- » the parties are connected; and/or
- » the value of the supply exceeds £100,000 (unless prepayments or advance VAT invoices are usual commercial practice); and/or
- » the supplier (or someone connected with the supplier) funds a prepayment; and/or
- » an advance invoice is issued and payment is not due for at least 6 months.

Flat rate scheme percentages

See TM ¶8636

When the standard rate of VAT goes up to 20% on 4 January 2011 the following percentages will apply under the flat rate scheme:

Category of business	Appropriate percentage
Accountancy or book-keeping	14.5
Advertising	11
Agricultural services	11
Any other activity not listed elsewhere	12
Architect, civil and structural engineer or surveyor	14.5
Boarding or care of animals	12
Business services that are not listed elsewhere	12
Catering services including restaurants and takeaways	12.5
Computer and IT consultancy or data processing	14.5
Computer repair services	10.5
Dealing in waste or scrap	10.5
Entertainment or journalism	12.5
Estate agency or property management services	12
Farming or agriculture that is not listed elsewhere	6.5
Film, radio, television or video production	13
Financial services	13.5
Forestry or fishing	10.5
General building or construction services*	9.5
Hairdressing or other beauty treatment services	13
Hiring or renting goods	9.5
Hotel or accommodation	10.5
Investigation or security	12
Labour-only building or construction services*	14.5

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Category of business	Appropriate percentage
Laundry or dry-cleaning services	12
Lawyer or legal services	14.5
Library, archive, museum or other cultural activity	9.5
Management consultancy	14
Manufacturing fabricated metal products	10.5
Manufacturing food	9
Manufacturing that is not listed elsewhere	9.5
Manufacturing yarn, textiles or clothing	9
Membership organisation	8
Mining or quarrying	10
Packaging	9
Photography	11
Post offices	5
Printing	8.5
Publishing	11
Pubs	6.5
Real estate activity not listed elsewhere	14
Repairing personal or household goods	10
Repairing vehicles	8.5
Retailing food, confectionary, tobacco, newspapers or children's clothing	4
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	8
Retailing that is not listed elsewhere	7.5
Retailing vehicles or fuel	6.5
Secretarial services	13
Social work	11
Sport or recreation	8.5
Transport or storage, including couriers, freight, removals and taxis	10
Travel agency	10.5
Veterinary medicine	11
Wholesaling agricultural products	8
Wholesaling food	7.5
Wholesaling that is not listed elsewhere	8.5

* 'Labour-only building or construction services' means building or construction services where the value of materials supplied is less than 10% of relevant turnover from such services; any other building or construction services are 'General building or construction services'.





VALUE ADDED TAX cont...

Flat rate scheme thresholds

See TM ¶8650

The increase in the standard rate of VAT to 20% on 4 January 2011 will affect the flat rate scheme thresholds. Businesses with a total taxable annual turnover of up to £150,000 will be eligible to join the scheme as now. However, the threshold beyond which businesses will have to **leave the scheme** is a VAT-inclusive figure and so will go up, from £225,000 to £230,000. If a business exceeds that threshold as a result of a one-off transaction, it will be allowed to remain in the scheme if its tax-inclusive turnover in the following year is not expected to exceed £191,500 (£187,500 until 4 January 2011).

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Late filing of returns and payment of VAT

See TM ¶9858

From a date to be announced a new, largely flat-rate penalty regime will apply where a VAT return is submitted after the due date and a new tax-geared penalty regime will apply where payment is made after the due date.

The **maximum late filing penalty** will be £400, unless failure to file extends beyond 6 months, in which case a penalty of 5% of the relevant tax is proposed, with another 5% levy after 12 months.

The tax-geared penalties for **late payment** will go up to 4%, unless failure to pay extends beyond 6 months, in which case a penalty of 5% of the relevant tax will be payable. Another 5% levy will become due after 12 months.

Rate of VAT

See TM ¶9986

The standard rate of VAT will increase to 20% from 17.5% with effect from 4 January 2011. No change will be made to the list of zero-rated items and the reduced rate will remain at 5%.

AS PREVIOUSLY ANNOUNCED

Postal services exemption

See TM ¶8042

From 31 January 2011 the exemption for postal services will be restricted to supplies of public postal services (and incidental goods) by the **universal service provider** (currently Royal Mail). Postal services supplied on terms which are individually negotiated, and services not made under a licence duty, will become standard-rated from that date.

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Zero-rating of aircraft

See TM ¶8052

For zero-rating purposes, a qualifying aircraft will no longer be determined by its weight or commercial design. From 1 January 2011 zero-rating will depend on the **recipient of the supply** being an airline operating for reward chiefly on international routes. When previously announced the implementation date was 1 September 2010.





VALUE ADDED TAX cont...

Lennartz mechanism

TM ¶8142, ¶8145

The Lennartz mechanism is to be made unavailable in respect of purchases of land, property, boats and aircraft. The Lennartz mechanism applies where an asset is purchased for both business and private purposes. Under this mechanism full input tax recovery is permitted on purchase and output tax is accounted for in respect of private use over the asset's economic life. From **1 January 2011** full input tax recovery will not be available on purchase; instead input tax will be restricted to the business use proportion. The Capital Goods Scheme will be amended to take account of this change.

HMRC has also recently announced an amended policy under which Lennartz is not available **unless non-business use is private use** (as opposed to, for example, use by a charity for non-commercial purposes). Legislation will be introduced to ensure that those affected by this change of policy do not gain an advantage by, for example, ceasing to account for output tax on non-business use.

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STAMP TAXES

Overpayments of SDLT

See TM ¶9463

Overpaid SDLT can currently be reclaimed where there has been an excessive assessment caused by a mistake in a land transaction return. Legislation effective from 1 April 2011 will **remove the requirement** that the overpayment was caused by a mistake in a return and that it must have been subject to an assessment. Currently the reclaim can be made within 6 years. That will be reduced to 4 years. The new rules will also confirm that HMRC is not liable to repay any amount except as provided for in legislation. Current restrictions on rights of appeal are also to be removed.

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