



TAX MEMO 2007-2008

Newsletter Issue 1

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Welcome to the first newsletter for the 2007/08 edition of *Tax Memo*. This pulls together all relevant announcements made by the Chancellor in the **Pre-Budget Report** on 9 October 2007 to provide a comprehensive analysis in one document. The relevant paragraphs in your Memo product will also be updated individually online.

We hope you find this particular newsletter useful and informative 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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Disclaimer

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Whilst every care has been taken to ensure the accuracy of the contents, the editors and the publishers cannot accept responsibility for any loss occasioned to any person acting or refraining to act as a result of any statement in it.



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Corporation tax

Long funding lease income

See TM ¶138

For expenditure incurred on or after 9 October 2007, a lessor **cannot rely** on the long funding lease rules to restrict taxable rental income if the:

- lessor is claiming a revenue deduction for the cost of the asset; or
- main purpose is to secure a "substantial difference" between the company's GAAP profit or loss and the taxable profit or loss.

Employer pension contributions

See TM ¶159

Provisions will be introduced (effective from 10 October 2007) to ensure that the **spreading** of large pension contributions cannot be avoided by routing payments through a new company.

Capital allowances

Fire safety assets

See TM ¶309

Expenditure on **building alterations** made in response to a notice from a fire authority will, from 6 April 2008 (1 April 2008 for individuals), no longer qualify for capital allowances.

Memo points Relief for expenditure on fire safety equipment (such as fire alarms and sprinkler systems) will continue to be available to all businesses in the usual manner (¶318).

Sale and finance leaseback arrangements

See TM ¶336

The sale and finance leaseback arrangements are to be **amended** for transactions taking place on or after 9 October 2007, as follows:

- a UK seller will no longer be able to rely on the sale and finance leaseback limit to restrict his disposal value when the lessee is outside the charge to UK tax (and therefore not affected by the restriction to the revenue deduction (¶166)); and
- a sale under a sale and finance leaseback will be treated as a long funding lease (¶483).

Loan relationships

Income from shares

See TM ¶876

From 9 October 2007 all **distribution income** (not just dividend income) from shares that fall within the loan relationship regime will be taxable.

Memo points Prior to 9 October 2007, only straightforward dividend income from such shares was taxed as income. Certain schemes have been **disclosed** to HMRC that exploit these rules by structuring such shares so that they pay out other types of distributions that are not taxed under the current rules. These changes are intended to stop this avoidance.

Hedging exchange movements

See TM ¶892

Companies holding shares in non-sterling businesses frequently hedge the exchange risk by borrowing in the same currency. Currently **exchange gains or losses** are disregarded where they hedge (or "match") shares in this way.

For company accounting periods commencing on or after 1 January 2008, the following changes are to be made to the existing matching regulations:

- companies will be allowed to elect to **value matched shares** at the value of the net foreign currency assets underlying the shareholding, rather than at book value as at present; and
- the current **rules for identifying** which loans are matched with which shares are to be replaced with a more straightforward method.

Memo points 1. Exact details of these provisions are to be published for **consultation** early in 2008, together with a targeted anti-avoidance rule to prevent abuse.

2. It is intended that **more extensive changes** are also to be introduced for accounting periods commencing on or after 1 January 2009. Consultation on these changes will start in the first quarter of 2008.

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Corporation tax

Sale of lessor companies

See TM ¶1830

Currently, when a leasing business carried on by companies in partnership is sold to a single company, there is **no relief available** to the purchaser (in the form of a deduction (¶1825)). This was never the intention of the original legislation and the **oversight is to be corrected** in the 2008 Finance Bill and will be backdated to apply from 5 December 2005 (the date the original provisions came into force).

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Income tax

Fuel benefit charge

See TM ¶3304

When private fuel is provided for a company car, the benefit in kind is calculated by multiplying a fixed sum by a percentage which is based on the car's carbon dioxide emissions. From 6 April 2008, this fixed sum will **increase** to £16,900.

State second pensions and NIC

See TM ¶3662, ¶5035

From 6 April 2009, an **Upper Accrual Point** (UAP) will be introduced. This will be the maximum amount of earnings which qualify for state pension benefits, and will be lower than the current limit (the upper earnings threshold).

The **practical effect** of this will be to:

- increase the NIC burden on contracted out occupational pension schemes. (Currently, lower levels of NIC are payable up to the upper earnings limit. However, from 2009, the normal limits of NIC will commence once the UAP is reached); and
- complicate year end reporting of earnings (¶4704).

Pensions

Minor technical improvements

See TM ¶3792+

The following changes are being made as part of the **continuing refinement** to the registered pension rules.

The **effective date** for all of these changes is 6 April 2006.

Area of pension rules	Change	¶¶
Lifetime allowance test	No test will apply where a pension is increased within certain bounds (i.e. a normal rate of increase measured over a 12 month period)	¶3792
Member-directed schemes	Definition changed so that larger schemes, where members have no realistic prospect of influencing the scheme's investment decisions, are no longer treated as member-directed	¶3818
Protection for excessive lump sums	Schemes no longer have to calculate whether relevant benefit accrual has taken place	¶3840

Anti-avoidance - inheriting pensions

See TM ¶3869, ¶6589

Following the anti-avoidance rules introduced in Budget 2007 relating to alternatively secured pensions, the Government has now gone further to **prohibit the passing on** of a person's pension savings free of tax.

The rules combat this avoidance through the use of both income tax and inheritance tax charges.

A **surrender**, on or after 10 October 2007, by the member of his rights to payments from a lifetime annuity or dependant's annuity will be subject to an unauthorised payment income charge.

Secondly, any **increase** (from 6 April 2008) to a member's **pension rights** (under a scheme pension or lifetime annuity), resulting from the death of another member who is connected with him, will be taxable **unless** the scheme has at least 20 members and every member gains at the same rate. All such increases will be treated as an unauthorised payment, with a further liability to inheritance tax where the deceased member died on or after 6 April 2008 aged at least 75 (with an offset for the income tax charge).

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Income tax

Residence and domicile review

See TM ¶4156+

From 6 April 2008, the following changes which **target foreign individuals** are due to take place.

Area	Change	¶¶
Days of arrival and departure	These will be counted as days of residence	¶4156
Remittance basis of taxation	Persons who have been resident in the UK for at least 7 years will only be able to claim the remittance basis if they pay an annual £30,000 charge Otherwise the arising basis will apply to all of their income	¶4200
	UK residents who are either non-domiciled or not ordinarily resident, and have unremitted foreign income in excess of £1,000 a year, will no longer be able to claim the personal allowance, married couples allowance or blind person's allowance The payment of the annual charge (see above) has no effect on the availability of the allowances	¶4390
	It will no longer be possible to remit income tax-free by claiming the remittance basis in one year and not in the next	¶4204
	The source ceasing rule will be abolished so that if a source of income ceases in one year, it cannot be remitted to the UK free of tax in a following year	¶4208
	Future action (subject to consultation) will target the use of certain offshore trust and company structures by non-domiciles Current anti-avoidance legislation will also be extended to include non-domiciles	

Irish income and the remittance basis

See TM ¶4202, ¶4252

Taxpayers who claim the remittance basis are only liable to tax on foreign income when it is remitted to the UK.

From 6 April 2008, the exclusion of Irish **investment income** from the remittance basis is to be removed.

In addition, the restriction on non-domiciled persons who earn income from an **Irish employer** will also be lifted, so that they too can also enjoy the remittance basis.

Interest relief on qualifying loans

See TM ¶4368

Tax relief is available when a loan is taken out in order to fund the acquisition of a business interest e.g. a partnership interest or close company shares. A tax saving scheme has been promoted which accelerates tax relief when **interest** on such a loan is **paid in advance**.

From 9 October 2007, no tax relief will be available on interest payments which **relate to** a later tax year than that in which they are paid.

Legislation will be included in Finance Bill 2008.

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Income tax

Payments on account

See TM ¶4504

From 2009/10, interim payments on account will not be required where the net tax liability for the previous year was less than £1,000 (currently this threshold is £500).

The first payment to be affected will be that due in January 2010.

Memo points The **net tax liability** is the total amount of income tax and Class 4 NIC as reduced by amounts deducted at source.

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PAYE and NIC

NIC exemption and holiday pay

See TM 14980

From 30 October 2007, the current exemption from NIC which applies to holiday pay will be **withdrawn**.

However, for the **construction industry** (the original intended beneficiaries of this exemption) there will be a 5 year transitional period during which the exemption will remain.

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Capital gains tax

Capital gains tax reform

See TM ¶5220+, ¶7376

Legislation is to be introduced in the 2008 Finance Bill which will **radically alter** the existing capital gains tax regime. The new rules will **apply to** all disposals made on or after 6 April 2008 (and held-over gains coming into charge on or after this date).

In outline, the **changes to be introduced are:**

- a new single flat rate of 18% for all chargeable gains This rate will apply to individuals, trustees and personal representatives. (It does not affect companies, which will continue to be taxed to at the corporation tax rate on their chargeable gains);
- the withdrawal of indexation allowance (for assets that were acquired before 6 April 1998);
- the withdrawal of taper relief;
- simplification of the share identification rules whereby, from 6 April 2008, all shares of the same class in the same company will be treated as forming a single asset (a "share pool") irrespective of when they were originally acquired;
- all assets held on 31 March 1982 will be deemed to have a base cost equal to their March 1982 value; and
- abolition of halving relief (¶5371, ¶6077, ¶6126).

The following **examples** are provided to illustrate the new regime (using, for illustrative purposes, the 2007/08 rates).

Example

1. In 1995, Mr E purchased a holiday home in Devon for £100,000. He sells it in July 2008 for £250,000. The CGT due is:

	£
Proceeds	250,000
Less: Cost price	<u>(100,000)</u>
	150,000
Annual exemption	<u>(9,200)</u>
	<u>140,800</u>
Tax due @ 18%	<u>25,344</u>

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Capital gains tax

Capital gains tax reform (cont)

Example (cont)

2. In 1960, Mrs S purchased some shares costing £500. In March 1982, they were worth £450. In August 2008 she sells the shares for £25,000. The CGT due is:

	£
Proceeds	25,000
Less: Cost price	<u>(450)</u>
	24,550
Annual exemption	<u>(9,200)</u>
	<u>15,350</u>
Tax due @ 18%	<u>2,763</u>

3. In 2006, Mr D had a loss of £30,000 on the disposal of an asset. He had no other gains on which to set that loss against. In June 2008, he sold his holiday home at a gain of £80,000. The CGT due is:

	£
Gain on holiday house	80,000
Less: Brought forward losses	<u>(30,000)</u>
	50,000
Annual exemption	<u>(9,200)</u>
	<u>40,800</u>
Tax due @ 18%	<u>7,344</u>

4 In November 2007, Miss E enters into an unconditional contract to sell assets to Mr Y in May 2008. Because the contract is unconditional the disposal takes place for CGT purposes in November 2007 and the existing rules for indexation allowance, taper relief and tax rates apply. (If the contract had been conditional, the disposal would have taken place when the conditions were satisfied in May 2008. Consequently the new rules would apply).

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Inheritance tax

Nil rate band and couples

See TM ¶6580

Transfers to spouses are exempt from inheritance tax. So where the estate of one spouse is transferred to the other **on death**, this can result in a wasted nil rate band.

A change is being made which means that on the death **of the surviving spouse** on or after 9 October 2007, his estate can claim any unused nil rate band arising on the first death. This has retrospective effect so unutilised nil rate bands arising on deaths before 9 October can be added to those of widows and widowers.

Example 1. Mr A died and left everything to his wife, so that none of his nil rate band was used. If the nil rate band is £350,000 when Mrs A dies, the nil rate band available to her personal representatives will be £700,000.

2. If Mr A had made chargeable transfers of £150,000 when the nil rate band was £300,000, this would result in 50% of the nil rate band being unused. So if Mrs A dies when the nil rate band is £350,000, this is increased by 50% to £525,000.

Alternatively secured pensions

See TM ¶6610

When the estate of a pension member includes a residual pension fund which is liable to inheritance tax, a further tax charge occurs on the death of the dependant who received the benefit of the fund.

In a move which mirrors the changes to couples outline above, any **unused nil rate band** on the first death will be available on the second death.

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Trusts

Family run businesses

See *TM* ¶17355

It has been announced that legislation to **prevent income splitting** will take effect from 2008/09. The perceived abuse only **affects** company dividends and partnership profits. HMRC will publish practical guidance once a consultation is complete.

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VAT

Refurbishment of empty premises

See TM ¶8882

The reduced rate of VAT currently applies to the renovation of residential buildings which have been empty for at least 3 years prior to the construction work commencing.

From 1 January 2008, the **period of non-occupation** is reduced to just 2 years.

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Stamp taxes

Planning gain supplement

See TM ¶9340

It has been announced that the planning gain supplement will not be introduced in the next Parliamentary session (although it has not been taken off the agenda altogether).

SDLT notifiable transactions

See TM ¶9430

From Budget Day 2008, persons involved in either residential or non-residential property transactions where the **chargeable consideration** is below £40,000 will no longer need to complete a land transaction return.

Leases which satisfy all of the following criteria must still notified:

- a term in excess of 7 years;
- rent in excess of £1,000 per annum; and
- chargeable consideration in excess of £40,000.

Small value transactions and stamp duty

See TM ¶9546, ¶9575

From Budget Day 2008, transfers of shares and securities that currently only attract a **stamp duty charge of up to £5** will be exempt, and so no submission of the instrument to HMRC will be necessary. This will affect instruments liable to either fixed rate or ad valorem duty.

SDLT and partnerships

See TM ¶9769

Finance Bill 2008 will introduce rules (with retrospective effect back to 19 July 2007), which will ensure that no SDLT charge arises on the **transfer of a property interest within** an investment partnership.

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Other indirect taxes

Landfill tax

See TM ¶9841

Waste from **dredging** will be exempt from landfill tax even if materials have been added to it (prior to sending it to landfill) to immobilise any liquid content.

Memo points This **provision is necessary because** from 30 October 2007, it becomes illegal to landfill waste containing free draining liquid. Consequently it is necessary to treat waste from dredging prior to disposal.

Air passenger duty

See TM ¶9891

For any flights beginning on or after 1 November 2008 **business class only** flights will attract the standard rates of duty. (Currently the precise definition of class of travel means that carriers offering business class only flights pay the reduced rate of APD).

Memo points It is also intended that, from 1 November 2009, APD will be replaced with a **tax payable per plane** (as opposed to per passenger).

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