



# BUDGET 2008

Newsletter Issue 2

March 2008

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Welcome to our special Budget newsletter. This brings together all relevant announcements made by the Chancellor in the **Budget Report** on 12 March 2008 to provide comprehensive analysis in one document. The relevant paragraphs in your online Memo product will also shortly be updated.

Use the links on the left to navigate to the areas that you are most interested in. As normal there is a link for every chapter of the existing Tax Memo, but we have added 2 separate sections where significant changes have been made - firstly in the area of the taxation of non-domiciled individuals and secondly with regard to the changes to the penalties regime.

We believe you will 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](mailto:flm@flmemo.co.uk).

## Headlines

### Capital allowances

Confirmation of the introduction of the new system of allowances including the annual investment allowance, integral features and extensions to the "green" technology categories

### Capital gains

The introduction of the new regime coupled with the commencement of the entrepreneurs' relief

### Taxation of non-domiciles

Details of the radical changes to the taxation of non-domiciled individuals including a number of changes on previously announced areas

### HMRC powers and penalties

The latest news on HMRC's continuing powers review following the merger of the former departments of Inland Revenue and Customs and Excise

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## Corporation tax

### *Long funding leases*

See TM ¶171

As detailed in a previous update legislation is being put in place to counter avoidance schemes involving chains of leases and premiums.

The Budget announcement amends these slightly to limit the scope to the areas of avoidance by limiting the application of the rules so that it no longer applies to cases where the lessor is not entitled to capital allowances on the asset, where a contribution from the lessee reduces the lessor's expenditure for capital allowances purposes or where indemnity payments are made to compensate the lessor for loss arising due to damage of or by the asset.

### *Capital allowances Successions to trade*

See TM ¶272

The rules on a succession of trade for capital allowances purposes will be extended in order to combat avoidance schemes that seek to gain balancing allowances through a series of transactions. The scheme involves the transfer of a trade to a profitable group before it is sold on in a short period of time. If the market value was lower on the final onward sale a balancing allowance could then be obtained by the profitable group. To counteract this the final acquisition will be taken to have taken place at the tax written down value. This will only apply where the cessation of trade generates a balancing allowance and the arrangements were put in place solely to secure that allowance and will result in the final purchaser being entitled to the benefit of the remaining qualifying expenditure.

### *Integral features*

See TM ¶300

Following consultation the "new special rate pool" will be introduced alongside the annual investment allowance. This pool will attract an annual writing down allowance of 10%. The list of integral features is as follows:

- electrical systems (including lighting),
- cold water systems,
- space or water heating systems, powered systems of ventilation, air cooling or purification, and any ceiling or floor comprised in this,
- lifts, escalators and moving walkways,
- external solar shading, and
- active facades.

This will have a variety of results depending on the situation. In some cases where such items would have qualified previously there is a loss of 15%, while others who previously would not have qualified will make a substantial gain.

This pool will be extended to include thermal insulation of all existing buildings used for a purpose other than a residential property business. It will also include long life assets, effectively changing the rate from 6% to 10%.

According to the Budget Note the pool will encompass the original expenditure on acquisition of any of the above systems and also "replacement expenditure", which is considered to be any replacement in a 12 month period where the cost incurred exceeds 50% of the total replacement cost at that time. This alters the current position regarding part replacements of such items where it is considered that substantially the whole of the asset must be replaced before it is considered capital expenditure. If this is the test that is applied, in practice it may mean securing a quote for replacement of the whole system in order to secure a revenue deduction.

### *Plant and machinery pool*

See TM ¶342

With the reform of allowances the continuing plant and machinery pool will attract writing down allowances of 20% as opposed to the previous rate of 25%. As this comes into effect on a fixed date a "hybrid rate" must be used for accounting periods straddling the date.



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### Corporation tax ctd

#### Example

For a company with a year end of 31 December 2008, 91 days would fall before the introduction date of 1 April 2008, with 275 falling after. The calculation proceeds as follows:

$$91 / 366 \times 25\% = 6.22\%$$

$$275 / 366 \times 20\% = 15.03\%$$

Hybrid rate is the sum 21.25%

This percentage is then applied to the residue in the pool for that year only. In order to simplify this calculation HMRC are provide a ready reckoner.

Taxpayers with small plant pools or, under the new regime, special rate pools of less than £1,000 will be able to write off the entire pool at their own choice. This is a simplification method introduced to cut the administrative burden for smaller taxpayers.

#### Annual investment allowance

See *TM* ¶366

As part of the business reform package announced at the previous Budget the legislation to enact the new annual investment allowance (AIA) has been published, coming into affect 1 April 2008 for companies and 6 April 2008 for unincorporated traders. As opposed to the existing system of first year allowances, with the exception of the 100% allowances, a business will be able to claim 100% allowances on up to £50,000 of expenditure on plant and machinery in a year, with the exception of cars. Any amounts over this will fall to the new pools of expenditure to obtain relief at either the 10% or 20% rate, depending on the type of asset. Where an accounting period is not a year in length the limit will be proportionately varied. This will also apply where the period straddles the introduction of the new rules.

In some cases a single AIA will be attributed to more than one company or unincorporated business. In a group situation the AIA will be split between the group companies.

For other companies the situation will be less clear and will not follow the current "associated companies" test. As a starting point every company and unincorporated business will be entitled to an AIA. However, like the group situation, one AIA may be required to be split across more than one taxable person. For this to happen both companies or unincorporated businesses must be controlled by the same person or group of people. Unlike in relation to the associated companies definition for the small companies marginal relief provisions this does not include the business interests of connected persons. So it is possible under this situation that two companies may be associated in terms of the tax rates applying but still be able to claim a separate AIA by virtue of this exclusion. If the taxable persons are still associated in these terms then they must also share premises or be involved in "similar activities", this last test being based on the European Union's NACE classification system. These tests will be applied on an accounting year basis for companies and a tax year for unincorporated traders. If either of these are satisfied then the AIA will be allocated among the companies or businesses, but unlike the small companies band the taxpayer will be able to decide on the split. It should also be noted that a company and an unincorporated business will not be required to split an AIA, so it would be possible for a sole trader to have one AIA and for his personal company to have another.

The AIA will not be available where the main purpose of a transaction is to gain entitlement to an AIA that the business would not have otherwise been entitled to.

#### First year tax credits

See *TM* ¶388, ¶390

Again as part of the business tax reform package **companies** will be able to surrender losses generated due to capital allowances claimed on designated energy-saving or environmentally beneficial plant and machinery in return for a cash payment from government. This credit will be 19% of the amount surrendered subject to a maximum of the greater of the company's PAYE

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### Corporation tax ctd

and NIC liability for the period and £250,000. This will only be possible where the loss cannot first be utilised against other profits of the company or group relieved. Given that the lowest rate of corporation tax will be 21% it would appear that surrendering the loss by virtue of group relief where this is available would be advantageous.

To ensure that the credits are used as intended there is also a claw-back period of four years after the end of the accounting period to which it relates. If the asset is sold within this time the credits will be required to be repaid.

### Environmentally beneficial technologies

See TM ¶388

As highlighted in a previous update the definition of technologies covered by the enhanced capital allowances scheme will be extended to include waste water recovery and reuse systems.

### Low emission cars

See TM ¶391

The existing scheme allowing 100% first year allowances for expenditure on cars with a carbon dioxide emission level of less than 120g/km was intended to end on 31 March 2008. This will be extended for a further 5 years until 31 March 2013 but with the limit reduced to 110g/km. For those who have entered into leasing contracts for cars with an emission level between the two limits the leasing cost restriction will continue to be disapplied until the end of the existing contract.

### Gas refuelling stations

See TM ¶392

The 100% first year allowance for expenditure on natural gas and hydrogen refuelling equipment was due to end on 31 March 2008. Again this has been extended for a further 5 years and the scope has been widened to include refuelling equipment for biogas.

### Research and development relief

See TM ¶794+

The rates of relief given under these provisions will increase as was previously announced. For SMEs the rate will rise from 150% to 175%, with the large company scheme being uplifted from 125% to 130%. In order to ensure these pass European Commission guidelines, as they are notified State Aids, certain changes have to be made. Firstly it will only be available to companies where the last accounts were produced on a going concern basis. Secondly the maximum relief available will be restricted to €7.5 million per project. Finally the relief available under the vaccine research relief will be reduced from 50% to 40%. As this measure has to be approved by the European Commission the commencement date will be appointed by Treasury order.

### Corporate intangible assets regime

See TM ¶824

On the introduction of the new regime existing assets could only be brought into the scheme where they were purchased from "unrelated parties". The tests used to ascertain whether parties are related or not can be affected by one of the companies going into liquidation, administration or other insolvency proceedings. New legislation will tighten the definition to ensure that any such event will not affect the outcome of the test.

### Property authorised investment funds

See TM ¶979

New regulations are to be introduced which will allow certain authorised investment funds to elect for tax treatment which will move the point of tax from the funds to investors.

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### Corporation tax ctd

Under the new regulations an AIF, can be exempt from corporation tax if it:

- is an open-ended investment company (OEIC);
- carries on a property investment business, including investing in real estate investment trusts (REITs), and similar overseas alternative investment funds;
- is readily, and freely available to encourage a genuine diversity of ownership; and
- does not have corporate investors who, directly or indirectly, own more than 10%.

The distributions to investors will have tax deducted at the basic rate, and importantly non-taxpayers and exempt bodies such as pension funds can reclaim the tax incurred. This will be of benefit as under the existing regime exempt bodies and non-taxpayers could not reclaim the tax deducted at source as the distributions were dividends.

These changes, which will come into effect on 6 April 2008, are to compliment the existing UK-REIT regime, which are closed investments.

Within the supplementary documentation released by HMRC following the budget is a draft Statutory Instrument making provision for the exemption from SDLT for the transfer of property when an authorised unit trust (AUT) converts to an OEIC who wishes to join the new regime. The draft SI appears to be drawn widely enough to cover the conversion of any AUT to an OEIC. This change was not covered anywhere else in the budget documentation.

#### **Associated companies simplification**

See *TM ¶1360*

Following representations the Government will introduce legislation effective from 1 April 2008 to restrict the attribution of rights and powers of business partners as associates for the purposes of the small companies rate only. The new measure will ensure that business partners are only included where tax planning arrangements have at any time had effect in respect of the taxpayer company in order to secure greater relief under the small companies relief provision. In the absence of such arrangements the partner's rights will no longer be included in determining the associate status.

#### **Corporation tax rates**

See *TM ¶1342*

The rates of corporation tax for FY 2008 will be as previously announced at 28% and 21% for large and small companies respectively. The small companies' relief fraction will become 7/400. It has been confirmed that the mainstream rate of corporation tax will remain at 28% for FY 2009.

#### **Corporate venturing scheme**

See *TM ¶1896*

With effect from 6 April 2008 the qualifying activities for the corporate venturing scheme no longer include:

- Shipbuilding;
- Coal production; or
- Steel production.

The government have stated that they have removed the above on the advice of the European Commission to ensure that they are not deemed to be providing State aid.

#### **Controlled foreign companies**

See *TM ¶2145+*

A number of anti-avoidance provisions are being introduced to combat schemes that HMRC have become aware of through the tax avoidance disclosure regime. These involve the use of a partnership or trust to secure one of the exemptions from the charge or arranging for profits to be earned in a way that they may fall outside the scope of the existing rules. In order to close these the definition of "control" will be amended to take account of the right to receive income from or the proceeds of sale of the shares and a widening of the profits that should be included in the calculation of apportionment. While HMRC do not believe that the schemes work they are legislating to ensure that the matter is put beyond doubt.

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## Income tax

### **Loss relief restrictions**

See TM ¶2476

A similar restriction to that imposed on non-active partners is to be applied to individuals trading on their own account. This measure is being introduced to counteract avoidance schemes involving syndicates who are deemed to be trading in investments securing substantial tax losses to shelter other income. Where an individual secures a loss in a trade in which they are active less than 10 hours a week the loss will not be available to offset against other income where it is generated as a result of tax avoidance arrangements entered into on or after 12 March 2008. Where the loss arises under any other circumstance the loss available for relief for a non-active individual will be limited to £25,000 per annum. Neither of these restrictions will apply where the loss is attributable to qualifying film expenditure or a Lloyd's underwriting business. In order to align the provisions for partners and individuals the definition of non-active partner will also be amended.

### **Trading stock**

See TM ¶2670

It has been announced that the long standing rule established in *Sharkey v Wernher* will be added to statute.

### **Funds of alternative investment funds**

See TM ¶2817

To compliment the Financial Services Authority's (FSA) proposals on Funds of alternative investment funds (FAIF) draft tax legislation has been published. FAIFs will invest in mainly non-qualifying offshore funds, and the tax regime will move taxation on offshore income gains from the fund to the investors.

FAIFs will be exempt from tax on these income gains, and the investor will be chargeable solely to income tax on any gain made on the disposal of units in the fund. These regulations are to be implemented from a date to be announced and are currently in draft form, and may be subject to change.

### **Savings and investments**

See TM ¶2875, TM ¶2913, TM ¶3450

The amount of subscription qualifying for relief under the enterprise investment scheme will be increased to £500,000 with effect from 6 April 2008.

HMRC has also announced restrictions on the company activities qualifying under the EIS and Venture Capital Trust regulations. Companies carrying on the activities of shipbuilding, coal and steel production will be excluded from qualifying for EIS and VCT purposes from 6 April 2008 and the restriction will affect shares issued after this date or capital raised. For VCT purposes the changes to the qualifying activities will have no effect for money derived from the investment of money raised before that date.

Restrictions have been announced to the qualifying conditions for enterprise management incentive ("EMI") share options. Legislation will be introduced to make two changes regarding EMI qualifying companies. Only companies with fewer than 250 full time employees will be eligible to qualify for EMI status and the activities of shipbuilding, coal and steel production will be excluded from qualifying trades. The limit of qualifying options will be raised from £100,000 to £120,000. These measures will take effect from 6 April 2008.

### **Community investment tax relief**

See TM ¶2927

The existing legislation prohibits a return of value from the recipient of the investment to the investor in the year preceding the investment, or 5 years following the investment. Retrospective legislation is to be enacted to ensure that deposits from community development finance institution (CDFI) made in the ordinary course of their banking arrangements do not effect the availability of community investment tax relief for the bank holding the deposit.



## BUDGET 2008 NEWS

### Income tax ctd

#### **Company car benefit**

See TM ¶3298

The previously announced introduction of a lower cash equivalent percentage for low emission cars will be introduced from 6 April 2008. This new rate of 10% will apply to cars with emissions of 120g/km or less. The limit for the 15% rate, by which all other percentages are set, will remain at 135g/km until 2010-2011 when this will decrease to 130g/km.

#### **Child trust funds**

See TM ¶3695

While all parents will continue to receive a voucher in order to open an account from 6 April 2009 it will not be a requirement that the provider has to be in physical possession of the document in order to open an account. In order to allow paperless transactions the provider will only require the details from the voucher.

#### **Pension changes**

See TM ¶3830

A number of small changes have been made to the pension regime. Firstly there have been a three technical amendments in relation to increases in pension level in order to ease administration by the pension trustees. Secondly the rules on trivial commutation are being amended to allow pensioners to take "stranded pots" and sums below £2,000. However this will still be subject to the overriding limit of £16,000 in total.

#### **Foreign dividends**

See TM ¶4286+

Recipients of dividends from non-resident companies are entitled to a non-repayable tax credit provided they own less than 10% of the share capital and the total sums received from all such sources does not exceed £5,000 in the year.

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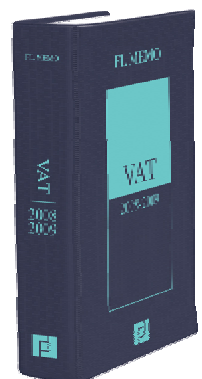
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## BUDGET 2008 NEWS

### Capital gains tax

#### ***Reform and entrepreneurs relief***

*See TM ¶15220*

The changes announced to the CGT regime at the Pre-Budget and earlier this year have been confirmed as being included in *Finance Bill 2008*. Further details were given on the treatment of deferred gains under the new relief. Where qualifying corporate bonds are received post 6 April 2008 in return for shares that would have qualified for the relief the relief will apply to reduce the postponed gain and can be claimed at any time up to the disposal of the bonds. These rules will apply equally to gains deferred under the Enterprise Investment Scheme. There will also be an option to disapply the usual rules on "paper for paper" transactions where the taxpayer can elect to be taxed at the time of the exchange and claim the relief.

For disposals prior to 5 April 2008 where gains have been deferred that become chargeable post 6 April 2008 the relief will be available if the original disposal would have qualified.

A number of examples have been published by HMRC to illustrate the method of applying the legislation. These show a series of straightforward cases including the provisions stated above.

While the new relief has placated the fears of many business owners the biggest losers will be those with options under the Enterprise Management Incentive scheme. Under the regulations as they stand it is unlikely that the employees concerned would have a sufficiently long period of ownership of the resulting shares or a sufficiently large stake in the company to qualify. The reduced rate of tax on such shares under the taper relief regime was one of the largest attractions of the scheme with the ownership period accruing at the date of grant of the option without any financial commitment by the employee.

#### ***Base cost of inherited assets***

*See TM ¶15592*

Where a legatee acquires an asset from a deceased's estate this is deemed to be acquired at market value. Where the estate was subject to inheritance tax this value will have been "ascertained" and it is this value that is to be used as the market value. With the ability to transfer the nil rate band for inheritance tax the asset's value may be ascertained at a later point in time. For instance upon the death of the husband all of his estate may pass to his wife and as such no value is ascertained. However on the wife's death the value of the asset will need to be agreed in order to work out the amount of nil rate band that is available for transfer. A change to the existing legislation will be introduced to ensure that this value will not require to be used for CGT purposes.

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## BUDGET 2008 NEWS

### Inheritance tax

#### ***Pension funds***

*See TM ¶16589*

While there are a number of rules to prevent individuals passing on savings that have received tax relief. These rules will now be extended to:

- impose unauthorised payment charges if a member surrenders rights to payments under a lifetime annuity or dependents annuity. This charge could be up to 70%, and
- impose unauthorised payment charges when a member with rights to a pension or annuity dies and a "connected person" becomes entitled to an increase in their own rights due to the death.

These will not apply where the scheme has 20 or more members and all members rights increase due to a death.

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## BUDGET 2008 NEWS

### Trusts and estates

#### ***Inheritance tax***

*See TM ¶7178*

HMRC has announced that there will be new legislation brought in concerning the changes introduced in Finance Act 2006 to interest in possession trusts set up prior to 22 March 2006. HMRC has said that the legislation will clarify the inheritance tax position where an interest in possession existing on 22 March 2006 comes to an end and is replaced with a new interest in possession trust, known as a transitional serial interest, ("TSI") for the same beneficiary. The transitional period will also be extended from 5 April 2008 to 5 October 2008.

#### ***Income tax***

*See TM ¶7335*

HMRC has announced that the income arising from a settlor interested trust can be treated as the highest amount of income received by a settlor. This removes an anomaly within the legislation which treated the income from a settlor interested trust as charged to tax before savings or dividend income. The new legislation amends Finance Act 2006 and is treated as taking effect from 6 April 2006. The re-ordering of income may generate a tax repayment for individuals.

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### VAT

See TM ¶17770 and VAT Memo

#### Registration thresholds

	Existing threshold (£)	New threshold from 1 April 2008 (£)
Registration	64,000	67,000
Deregistration	62,000	65,000
EU Acquisitions	64,000	67,000

#### Fund management services

Following the ECJ decision in the case of *J P Morgan Fleming Claverhouse*, and subsequent announcements, it has been confirmed that the existing legislation which defines the exemption for fund management services is to be extended. The exemption is to be extended to the provision of fund management services to all UK listed investments (including investment trust companies and venture capital trusts). The exempt will also apply to the management of certain overseas funds.

The notable exception from provision is pension funds. Pension funds have been lobbying to have their management charges included within the exemption, but the budget notes follow HMRC's brief on this issue and have construed the exemption narrowly. It is possible that a test case will be taken to the VAT tribunal in the coming year.

#### Fuel scale charges

New fuel scale charges will apply from 1 August 2008. This will affect traders next prescribed accounting period commencing on or after this date. The fuel scale charge has been brought into line with the direct tax car and fuel benefits table. The new table can be found at [www.hmrc.gov.uk](http://www.hmrc.gov.uk), and will be included in the new edition of VAT Memo, published in April, as well as on the online version of the existing edition.

#### Smoking cessation products

The reduced rate of VAT is to continue to apply to smoking cessation products after 30 June 2008. It is not clear whether this will be for a further 1 year period, or indefinitely.

#### Three year cap

As expected the government has announced that it intends to legislate for a transitional period for claims relating to rights accrued before December 1996 for output tax, and May 1997 for input tax following the House of Lords decisions in *Fleming* and *Conde Nast*. Readers of Tax Memo and VAT Memo updates will be aware that it was held that it was unlawful for the 3 year cap to be introduced without implementing a suitable transitional period. As a result it is possible to make claims until 31 March 2009 for:

- Output tax over-declared between 1 April 1973 and 4 December 1996; and
- Input tax under-claimed from 1 April 1973 to 1 May 1997.

Claimants should be aware that it is proposed that HMRC's powers of assessment will be amended to enable them to recover VAT which is subsequently found to have been repaid incorrectly within 2 years from the end of the accounting period in which erroneous payment is made. This change will be included in the Finance Bill.

This is a change from the existing legislation which states that HMRC can only assess within 2 years of being in full possession of the facts. Presumably, HMRC feels that as they have been in "full possession" of protective claims relating to *Fleming/Conde Nast* for some time, and have had to release taxpayers from the undertakings that they would repay should HMRC win at the

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### VAT ctd

House of Lords they require some additional power in case of any fraudulent claims. It appears from the information available that these powers will extend to any claim for output tax and input tax not just *Fleming/Conde Nast* related claims.

### Staff hire concession

It was announced that the staff hire concession for employment bureaux is to be removed from 1 April 2009. HMRC have stated that they feel that employment law now give fair treatment to employment bureaux as they are treated as employers and are therefore in the same position as an ordinary employer. This is not unexpected, and VAT will now apply on all consideration received for the hire of staff. Under the concession the bureau only needed to account for VAT on their margin, after taking into account wages paid to the "employee".

Many businesses in sectors where there is a restriction on input tax recovery, such as finance and charities, will be disappointed that the concession is being withdrawn. It was common practice in these industries for the staffing arrangements of subsidiaries, or connected parties who were not part of a VAT group, to be structured in this way.

The other interesting point on the removal of the concession is that in the technical note HMRC have stated that the concession "has no basis in UK or EU law". Following the announcement that government is going to legislation for concessions which have been deemed to be outside HMRC's powers (see *Codifying concessions in Powers, penalties and administration*) this may be an indication that some concessions will be withdrawn rather than codified.

### Option to tax reform

As expected, comment was made on the proposed reforms to the option to tax legislation (Schedule 10 VATA 1994).

Following previous consultations, as detailed in VAT Memo, a number of changes are proposed, including:

- Opted properties held in a VAT group;
- Opted buildings acquired for use as dwellings or relevant residential purpose and bare land acquired for construction of buildings for these purposes;
- The introduction of a new option to simplify the option to tax process for taxpayers with a number of properties;
- Early revocation of an option to tax within a "cooling-off" period;
- The automatic lapse of an option to tax six years after the taxpayer ceased to have any interest in a property that they had previously opted to tax;
- The ability, in certain circumstances, to exclude a new building from a previous option to tax; and
- Late applications for permission to opt to tax.

The legislation will have effect from 1 June 2008, at the earliest, and will include the provisions for revocation of options. The earliest an option can be revoked is 1 August 2009.



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## Stamp taxes

### Stamp duty De minimis charge

See TM ¶9546

Some welcome news was that stamp duty, on transactions where the minimum of £5 is payable, is to be removed. This means that any transactions valued at £1,000 or less will be exempt. This includes transferring shares otherwise than on sale. HMRC estimates that this will affect 68% of transactions.

### Changes to loan capital exemption

See TM ¶9549

The other changes to stamp duty both related to the loan capital exemption. Firstly, the exemption has been extended to include transfers of loan capital which are subject to capital market arrangements, and rights are limited on recourse terms. Currently the exemption does not apply where the right to interest on a loan capital instrument is determined by results of business or the value of a property.

Secondly, Sukuk, which is an Islamic finance investment bond, will now be treated as loan capital for the purposes of stamp duty, and will therefore be exempt.

### Stamp duty land tax Zero carbon flats

See TM ¶9410

As Tax Memo online users will be aware, the government announced last year that they were considering extending the zero-rating of new zero carbon houses to new flats. It has been announced in the budget that this will now occur, and will be back dated to 1 October 2007. It is intended that this relief will run until at least 30 September 2012, and will apply to the first sale of zero-carbon flats up to the value of £500,000. If a zero-carbon flat is sold for more than £500,000, the SDLT charge will be reduced by £15,000. The other conditions for zero-rating will be the same as for zero carbon houses.

It has also been announced that it is intended that legislation will be enacted that will allow a government department to make a "reasonable charge" to the vendor of the flat, and presumably for zero carbon houses as well, if they carry out an assessment to establish if the property is zero carbon.

### Land transaction return

See TM ¶9428

The Finance Bill 2008 will include new provisions, with effect from 12 March 2008, exempting the following transactions from the requirement to submit a land transaction form.

- Non-lease acquisitions where the chargeable consideration is less than £40,000;
- Transactions involving leases of 7 years or more where the chargeable consideration, other than rent is £40,000, or the annual rent is less than £1,000.

It will no longer be necessary to submit either stamp duty land tax returns, or certificates confirming no stamp duty is payable if the transaction value is below the land transaction return threshold.

Also included were provisions, effective from the 12 March 2008, for situations where both a premium and annual rent are payable:

- For non-residential properties, where the annual rent is £1,000 or more, the £150,000 0% threshold is withdrawn and SDLT is charged on the premium at 1%;
- For residential properties, regardless of what rent is paid, the normal thresholds will have effect on any premium paid. This includes properties in disadvantaged areas.

### Shared ownership

Changes to the SDLT rules are to be made to ensure that in the vast majority of cases, buyers of shared ownership properties will only pay SDLT on acquiring the final 20% of the property. No further details were provided.



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### Stamp taxes ctd

#### ***Anti-avoidance provisions***

##### **Disclosure rules for residential property**

The SDLT disclosure rules are to be extended to cover residential property worth at least £1 million. This will be enacted by secondary legislation later this year. HMRC want to monitor residential property transactions at the higher end of the market where special purposes vehicles (SPVs) are being used to take the transaction outside the scope of SDLT.

If an SPV is set up to hold a property for a beneficial owner, it is possible for the buyer to acquire the shares in the SPV that holds property, rather than directly acquiring the land. In this case the buyer will only incur stamp duty at 0.5%, rather than SDLT at 4%.

##### **Groups**

If a property is transferred to another company within an SDLT group, there is no SDLT charge. There are existing anti-avoidance provisions in place where SDLT relief is clawed back if the acquiring company leaves the group within 3 years of the date of transfer. Before the budget, it was possible for the vendor to leave the group, and for the shares in the acquiring company to subsequently be sold (along with the underlying property) meaning the property was effectively being sold SDLT free. For transactions entered into on, or after 13 March 2008, this will no longer be possible where the vendor company leaves the SDLT group and within 3 years from that date there is a change in control of the acquiring company. If this occurs there will be a claw back of the SDLT relief obtained on the initial transfer.

##### **Investment partnerships**

It was announced that the finance bill will include provisions to make the transfer of an interest in a property within an investment partnership exempt from SDLT. This change will be retrospective to 19 July 2007 (the date of Royal Assent for FA 2007) as the provisions of FA 2007 had the unintended affect that, when ownership interests were transferred by taxpayers selling their investment in a partnership which held a property, a SDLT charge arose.

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### Other indirect taxes

#### **Landfill tax**

*See TM ¶19830*

#### **Rates rise again**

The Chancellor has increased the standard rate of Landfill tax to £40/tonne with effect from 1 April 2009. The rate is set to rise to £32/tonne on 1 April 2008, therefore with the additional rise it represents a 66% increase in two years. The increase will be held out as another example of the government's green credentials, however this will put pressure on Council tax, and may be behind the decision by a number of councils to move to fortnightly rubbish collections.

#### **Exemption for waste from contaminated land**

The exemption for waste from cleaning contaminated land disposed of at landfill is to be removed. The deadline for submitting applications to gain approval for exemption is 30 November 2008. The waste which has been granted exemption has to be disposed of by 31 March 2012, otherwise it will be subject to Landfill tax at the appropriate rate.

#### **Environmental bodies credit scheme**

The maximum credit available to landfill site operators is to be reduced from 6.6% to 6%. There will also be a change of procedure with HMRC taking over the monitoring of the environmental bodies from ENTRUST. It is also proposed that the bodies will have 28 days to provide information to HMRC, rather than the 14 days they currently have.

#### **Insurance premium tax**

#### **Overseas insurers**

*See TM ¶19806*

It was announced that the compulsory requirement for an overseas insurer to appoint a tax representative is to be removed. The overseas insurer will still be required to register for IPT, and may still appoint an agent however the agent will no longer be held jointly and severally liable for the insurers IPT liability.

The budget proposals also provided for the restriction of HMRC's ability to assess the insured party for IPT due when the insurer is located outside the EU and covered by a mutual assistance directive or equivalent. HMRC will still be able to assess the insured party when the insurer is based outside the EU and not covered by a mutual assistance directive or equivalent.

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# Budget 2008

## Non-domiciles

### *Residence and domicile changes*

#### Days of residence

Further to the changes previously announced in the pre-budget report on 9 October 2007 and the draft legislation issued on 18 January 2008, there are modifications announced to the method of calculation of days of residency for UK tax purposes.

A day **will only count** towards UK residency if the individual is present in the UK at midnight. An additional **transit exemption** has been announced for passengers travelling through the UK. Where someone is in transit and travels from the point of arrival to the point of departure through the UK, that day will not count as a UK resident day, provided that the individual does not undertake activities which are to a substantial extent unrelated to their journey. The exemption is to protect travellers from generating a day of residency where their journey entails travelling between UK airports, train stations or ports. The restriction on activities means that the transit exemption would not apply for days when business meetings were held between arrival and departure; any such days would count as UK resident days.

#### New tax charge

As previously announced, the personal allowances for income tax and the annual exemption for capital gains tax will be withdrawn where a UK resident non-domiciled person chooses to claim the remittance basis. Where a non-domiciled individual has less than £2,000 of unremitted foreign income and gains, (increased from the initial announcement of £1,000), the allowances can be retained. Individuals can choose annually whether to claim the remittance basis or be taxed on their world-wide income and gains.

The charge to retain the remittance basis after 7 years of UK residency (out of the previous 10), is confirmed as £30,000 per annum, but a concession is announced for non-domiciled children under the age of 18. The charge will only apply to children in the year when they become 18.

Details of the payment of the remittance charge (£30,000) have been announced. Where the charge is paid by cheque or by electronic means from an off-shore source, the payment itself will not be taxed as remittance. If the £30,000 is repaid, however, it will be taxed as a remittance at that point. HMRC have announced that the charge will either be income or capital gains tax, rather than a stand-alone charge. This means that if the income or capital gains to which the charge relates are later remitted to the UK, they will not be taxed again. HMRC will publish rules determining the ordering of payments. The charge will therefore be eligible for relief under double taxation agreements and to cover gift aid donations.

#### Remittance basis and foreign dividend income

HMRC has announced that foreign dividend income taxed on the remittance basis in the UK will be liable at 40% for higher rate taxpayers from 6 April 2008. Currently foreign dividend income taxable on the remittance basis is taxable at 32.5% and the new legislation will reinstate the tax treatment previously applying.

#### Remittances of works of art

HMRC has announced the introduction of a new scheme for works of art brought into the UK for public display or educational purposes. The scheme will allow works of art which have been purchased overseas from unremitted untaxed employment income, capital gains or relevant foreign income to be brought into the UK for public display without giving rise to a tax charge under the remittance basis. Provided that the conditions are fulfilled, the importation may be temporary or indefinite.

#### Remittance basis charge

Aspects of the remittance basis have been tightened up. HMRC has confirmed that the previous announcements concerning the source ceasing rules will take effect from 6 April 2008. Where the remittance basis has been claimed in a year, income of that year will be liable to tax if it is **remitted** to the UK, even where the source of the income **ceased** in a previous year.



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The remittance basis is being extended so that the conversion of unremitted relevant foreign income into other property or services derived from that income, will give rise to a tax charge, as a remittance, if such property or services are brought into the UK. There will be exemptions for

- personal assets costing less than £1,000;
- assets brought into the UK for repair and restoration;
- assets in the UK for less than a total 9 month period and
- assets brought into the as works of art for public display.

Grandfathering provisions will apply to assets held on 11 March that were purchased out of untaxed relevant foreign income, even where such assets are currently outside the UK and are subsequently brought into the UK. In addition, any asset in the UK on 5 April 2008 will be exempt from a charge under the remittance basis so long as it remains in current ownership, even if it is exported and later re-imported. If such an asset is sold in the UK it will trigger a tax charge as a remittance. The changes will not apply to employment income and capital gains rules that already tax the remittance of non-cash assets.

HMRC has confirmed that foreign savings and investment income arising during a year when the remittance basis is claimed will be taxed whenever remitted to the UK, whether or not a claim to be taxed under the remittance basis is made in the year of the remittance. This blocks the ability to claim the arising basis of taxation and bring previously unremitted foreign savings and investment income to the UK without triggering a tax liability.

There will be new provisions introduced to determine the tax treatment of the remittance of a "mixed fund". The new provisions will establish how much of a transfer from a mixed fund is treated as the individual's income or gains. HMRC has said that the new rules will be more comprehensive than the draft legislation published on 18 January.

The draft legislation concerning the alienation of assets abroad will be amended. Where a non-domiciled or not ordinarily resident individual arranges for money or property to be brought into the UK following the alienation of such assets abroad, the transferor will be taxed on the remittance basis. The definitions applying to the transferees in the legislation will change. The rules will apply where

- an individual makes a transfer of assets to his "immediate family" (defined as spouse, civil partner, co-habitee living as spouse or civil partner, and their children or grandchildren under age 18, or
- a transfer to a close company or companies that would be close if they were resident in the UK, if the individual or a member of his family is a participant.

Consequently, the transferor will be taxed under the remittance basis. This prevents the alienation of assets abroad and subsequent remittance of funds to the UK tax-free by immediate family members.

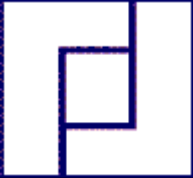
Where a non-domiciled individual elects to be taxed on their world-wide income and gains, it will be possible to claim relief for losses arising on the disposal of assets held outside the UK. Hitherto, the remittance basis applied automatically for capital gains tax purposes and it was not possible to remit a loss on the disposal of a foreign asset. The new provisions will give relief for world-wide losses where a non-domiciled individual is taxed on their world-wide gains and has not claimed the remittance basis from 2008-09. Individuals who claim the remittance basis will be able to **elect** into a separate regime for relief of foreign losses, but that election will be **irrevocable**. HMRC will require details of unremitted capital gains as part of the requirements of the election. Further legislation in this area is expected.

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### Non-domiciles ctd

#### Off-shore trusts

Amendments have been introduced to the tax treatment of non-domiciled beneficiaries of off-shore trusts. The new legislation will

- tax non-domiciled beneficiaries of non-UK trusts on the remittance basis for capital gains tax on UK and off-shore situated assets;
- allow trustees to make an irrevocable election to rebase assets held to their value at 6 April 2008; and
- no longer require disclosure to HMRC about trust assets or details of the trustees provided taxpayers have made a correct return of their tax liabilities. Note that additional information may be required where a re-basing election is made or if HMRC choose to enquire into a beneficiary's tax return.

These changes give effect to the re-assurances issued by the acting chairman of HMRC, Dave Harnett, in February, namely that the intention was not to tax historic trust gains, and have been made in response to lobbying by professional bodies and interested parties. HMRC has also issued a supplementary document detailing the changes to the taxation of beneficiaries of non-resident trusts.

#### Off-shore mortgages

Amendments have been made to the proposals regarding off-shore mortgages. The draft legislation issued in January proposes that repayments of loans borrowed from off-shore banks will be taxable as remittances where the property is situated in the UK. HMRC have announced that grandfathering provisions will be introduced to protect existing arrangements. Where interest payments are made on existing UK residential property mortgages, these will not be treated as remittances for the remaining lifetime of the mortgage or until 5 April 2028, whichever is the shorter. These provisions will prohibit the ability of non-domiciled individuals to re-arrange residential property mortgages without triggering a remittance charge.

#### Anti-avoidance changes

HMRC has confirmed that changes will be made to the draft legislation to tax non-domiciled participators of foreign companies on the gains accruing to the company. The draft legislation was announced on 18 January and HMRC have said that this will be subject to minor changes as a result of consultation.

HMRC has also confirmed that the accrued income scheme will now apply to non-domiciled individuals. The draft legislation in this area was published on 18 January.

HMRC has announced that legislation will be introduced to prevent the avoidance of income tax by non-domiciles transferring assets abroad. It is anticipated that the legislation will be similar to that already applying to UK domiciled individuals. If the remittance basis is claimed, it will apply to those using it.

HMRC has also announced the introduction of amendments to the legislation taxing employment related securities ("ERS") for resident but not ordinarily resident employees. There will be an apportionment of the ERS income where the employee is taxed on the remittance basis, to ensure that only the proportion relating to overseas duties will be subject to income tax when it is remitted to the UK. Securities acquired or options granted before 6 April 2008, will not be affected by the changes.



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## Penalties, powers and administration

### ***Penalties for incorrect returns***

Schedule 24 FA 2007 enacted a common system of penalties for income tax, capital gains tax, corporation tax, PAYE and VAT. It has been announced that Finance Bill 2008 will include provisions to extend the common system to:

- Environmental taxes (aggregates levy, climate change levy and landfill tax);
- Excise duties, including air passenger duty;
- Accounting for recovery of student loans by employers;
- Inheritance tax;
- Insurance premium tax;
- Pension schemes; and
- Petroleum revenue tax.

In summary, the penalties, which are based on the amount of tax understated, will be:

- 30% for failure to take reasonable care;
- 70% for deliberate understatement; or
- 100% for a deliberate understatement with concealment.

It will be possible to mitigate the penalty if a disclosure is made by the taxpayer, with greater mitigation for an unprompted disclosure.

The proposals also include provisions for penalties to be applied to third parties if they have deliberately provided false information, or withheld information from the taxpayer, leading to an under-declaration of tax. It is assumed that this provision will apply to taxes covered by Schedule 24 FA 2007 as well as the taxes which will be covered by Finance Bill 2008.

It is expected that the earliest the above will have effect is for returns for periods commencing on or after 1 April 2009, and which are due to be submitted after 1 April 2010.

### ***Penalties for failure to notify***

Further to the above, it is intended that Schedule 24 FA 2007 will be extended to cover penalties for failing to register, or failing to notify a new taxable activity. This will include VAT registration and late notification of self-employment. This is an important point to note as the new penalties could be significantly higher than the existing regime.

There is to be further consultation on this issue.

### ***Compliance checks***

Legislation will be introduced in Finance Bill 2008 to reform the rules for checking that taxpayers have paid the correct amount of income tax, corporate tax, CGT, VAT and PAYE.

It is proposed that the above regimes will be aligned as follows:

- a power to inspect records required under the record-keeping legislation – this restricts the existing VAT and PAYE inspections to statutory records and introduces a new power of inspection for direct tax;
- a power to require supplementary information which is relevant to establishing the correct tax position;
- a power to require third parties to provide information which is relevant to establishing a taxpayer's correct tax position;
- a power to visit business premises and to inspect records, assets and premises; removal of VAT and PAYE powers to undertake inspections at private homes without taxpayer consent;
- appeal rights against any penalty, and against information notices which have not been pre-authorised by an appeal tribunal;
- penalties for failure to allow an inspection and failing to comply with an information notice, including a tax-g geared penalty which can be imposed by the new upper tier tribunals; and
- an updated criminal offence of destroying or concealing records requested under a notice authorised by a tribunal.



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### Penalties, powers and administration ctd

The proposals also include a model of the aligned time limits for assessments, as follows:

Tax	Mistake	Discovery	Failure to take reasonable care	Deliberate understatement or failure to notify liability
VAT	4 years	N/A	4 years	20 years
IT & CGT	N/A	4 years	6 years	20 years
Corporation	N/A	4 years	6 years	20 years
PAYE	4 years	N/A	6 years	20 years

Taxpayers' time limits for making claims will also be aligned at 4 years.

#### **Payments and repayments**

From Autumn 2008 HMRC will accept payment of tax by credit card. Any transaction fee that HMRC incurs will also be charged to the taxpayer.

The *Finance Bill 2008* will formalise HMRC's ability to offset a repayment for one tax against another. This is already informally done for income tax and CGT and will be extended to cover other taxes.

#### **Indirect tax returns: correction of errors**

It has been announced that the limit for correcting errors on subsequent returns is to be increased for VAT, Insurance premium tax (IPT), Air passenger duty (APD), Landfill tax (LFT) and other indirect taxes.

The de minimis limit is to be increased to the greater of £10,000 or 1% of turnover up to £50,000.

For VAT and LFT "turnover" is defined as the net VAT turnover for the return period in which the amendment is made (the box 6 figure on the VAT return). For IPT it is the box 10 figure on the IPT return for the period in which the amendment is made.

If a business is not VAT registered, the maximum amendment for early returns is £10,000.

There is an interesting comment in the response to consultation document which states that HMRC find it "difficult to see that corrections on a later return would meet full unprompted disclosure [*requirement of the new penalties for errors system*]". It remains to be seen whether this point is taken further but would seem to remove certainly from the process.

#### **Codifying concessions**

Following the decision in the case of *R (oao John Wilkinson) v HMRC*, HMRC can only apply discretion on collection and management issues. It has been announced that HMRC has reviewed its extra-statutory concessions and is considering whether it needs to draft legislation for any concessions that may be outside their discretion.

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