

2006 PRE-BUDGET REPORT SUMMARY

Chancellor Gordon Brown presented his Pre-Budget Report on Wednesday 6 December 2006.

PERSONAL TAX

Rates

The income tax rates and bands for 2007/08 were not announced in the Pre-Budget Report. Details of these are normally made available in the main spring Budget.

Allowances

The Chancellor confirmed the level of income tax allowances for 2007/08. The allowances will be increased in line with inflation and are summarised below together with the other proposed allowances announced in the Pre-Budget Report.

	2007/08 £	2006/07 £
Personal allowance		
- under 65	5,225	5,035
- 65 – 74**	7,550	7,280
- 75 and over**	7,690	7,420
Married couple's allowance*		
- aged less than 75 and born before 6.4.35**	6,285	6,065
- 75 and over**	6,365	6,135
- minimum amount	2,440	2,350
Age allowance income limit**	20,900	20,100
Blind person's allowance	1,730	1,660

Notes

* *Qualifies for relief at 10%*

** *Reduce age allowance by £1 for every £2 of excess income over the income limit*

Child Tax Credit

The Child Tax Credit which is means tested is potentially available to families who have responsibility for one or more children. The credit is paid direct to the main carer. There are several elements to the credit but broadly the maximum is an annual amount for 2007/08 of £1,845 per child together with a family element (one per family) of £545 per annum. The amount per child has been increased but the family element has been frozen since the introduction of the credit.

Some credit is likely to be payable for 2007/08 if a family's income is less than £58,175 a year, or £66,350 if there is a child under one year old.

Working Tax Credit

The Working Tax Credit (WTC) was introduced to reward the work of people on a low income. It also provides working families with assistance to meet the costs of childcare. The annual income threshold for 2007/08 is £5,220 (the same as 2006/07) with a reduction of 37p for every extra £1 of income. The basic maximum benefit is increased for 2007/08 to £1,730.

Childcare costs continue to form part of the WTC calculation at rate of 80% of eligible costs up to a maximum of £175 per week (£300 if two or more children). This element is paid with Child Tax Credit.

Child benefit

The government will introduce from April 2009 a new entitlement for all pregnant women to receive child benefit from the 29th week of their pregnancy. This measure is being introduced in recognition of the importance of a healthy diet during pregnancy. The additional entitlement will be worth up to £200.

Pensioners

The Chancellor has announced various measures for pensioners from April 2007:

- the basic state pension will rise to £87.30
- the Pensions Credit will be increased to £119.05 for single pensioners and £181.70 for couples
- the Savings Credit will be increased to a maximum of £19.05 for single pensioners and £25.26 for couples.

The government is also introducing free off-peak local area bus travel, and committing to extend this to off-peak nationwide bus travel from April 2008 for those over 60 and the disabled.

Individual Savings Accounts (ISA)

When ISAs were introduced in 1999 they were guaranteed to run for ten years to 2009. Currently the overall annual investment limit is £7,000 with a maximum of £3,000 in cash and this was guaranteed to run until the end of 2009/10.

Over 16 million people – more than one in three adults – now have an ISA.

The government are now making the ISA a permanent feature of the savings landscape and intends to introduce a number of reforms designed to simplify the ISA regime and increase its flexibility for providers and savers.

- The overall annual investment limit will be at least £7,000.
- The mini/maxi distinction within the ISA will be removed. The government will continue to allow individuals to hold these components with either the same or different providers.
- Individuals with funds saved in the cash component of ISAs from previous years will be able to transfer those funds into the stocks and shares component without affecting their annual investment limit.
- Personal Equity Plans will be brought within the ISA wrapper.
- Child Trust Fund accounts will be able to rollover into ISAs when they start to mature from 2020 onwards.

Saving Gateway

The government has piloted savings schemes which use a system of matching – a government contribution for each pound saved. The aim is to encourage saving among lower income households. Initial participant feedback has been encouraging and the government intend to publish the final evaluation of the scheme in spring 2007.

Pensions

The new taxation of pensions regime finally took effect from 6 April 2006, referred to as 'A' day. There is now a single set of tax rules for all registered pension schemes.

A number of technical improvements have been announced which are designed to ensure that:

- pension tax rules meet the original intentions of the simplified regime
- tax reliefs for pensions are used to encourage individuals to provide for their retirement income
- industry costs are reduced.

A number of anti-avoidance measures were introduced in Finance Act 2006 and the government has considered that further provisions are necessary.

Alternatively Secured Pensions (ASPs)

The pensions tax rules require an individual to secure an income before they reach the age of 75. Most people will have an annuity or scheme pension, but an ASP was provided as an alternative. ASPs were designed for those who have a principled religious objection to annuitisation.

The government is therefore trying to restrict the use of ASPs to their original limited purpose by:

- introducing a minimum income requirement of 65% of the annual amount of a comparable annuity
- setting a higher maximum income withdrawal of 90% of the annual amount of a comparable annuity
- imposing an unauthorised payments charge where ASP funds remaining on the death of a member are transferred to pension funds of other members in the scheme.

Finance Act 2006 introduced an inheritance tax charge on left over ASP funds on the death of the scheme member and the government is considering how this will work and interact correctly with the new unauthorised payment provisions.

CORPORATE AND BUSINESS TAX

Construction Industry Scheme

The government has confirmed that the new Construction Industry Scheme will be introduced on 6 April 2007. Subcontractors may be entitled to receive payments without deduction of tax if they have satisfied certain criteria. Otherwise there is a standard deduction rate (currently 18%) for registered subcontractors.

An increasing proportion of subcontractors in the current scheme do not have their full tax and NIC met by their deductions. To reduce the additional payments due after the end of the year, the new scheme will have a standard deduction rate of 20%.

A higher deduction rate is introduced in the new scheme which allows unregistered subcontractors to start work. The government has now confirmed this rate will be 30%. One of the purposes of the higher rate is to encourage subcontractors to register.

Tax motivated incorporation

The government remains concerned about the tax motivated incorporation of the self-employed, which involves businesses taking advantage of structural differences in the tax and NIC treatment that applies to companies. The government will therefore continue to review 'how the system could be modernised, made simpler, more efficient and more competitive'.

Tax relief for business cars

In March 2006 HMRC and HM Treasury issued jointly a discussion document about business expenditure on cars.

The proposals are:

- a new car pool would be introduced in which all cars would be pooled
- a range of first year allowances depending on a car's CO2 emissions, would be introduced
- the annual tax write off for other cars (the 'writing down allowance') would be set below the 25% rate available for other business assets.

As a consequence there would no longer need to be a specific distinction between cars costing more or less than £12,000.

The government will continue discussions with business and present more detailed proposals at Budget 2007.

UK Real Estate Investment Trusts (UK-REITs)

Legislation to establish UK-REITs was included in Finance Act 2006. The regime is open to UK resident companies that are listed on a recognised stock exchange. Companies that meet the UK-REIT eligibility criteria will not

pay corporation tax on qualifying property rental income or qualifying chargeable gains.

UK-REITs are required to distribute at least 90% of the tax exempt profits each year. The dividends paid out of the tax exempt profits will be treated as property income in the hands of the shareholders.

Two main changes are proposed to the regime:

- the conditions to be met by a company when giving notice and on joining the regime will be relaxed to make it easier for newly-established companies to become UK-REITs
- it is proposed to extend the exemption from tax on property income for charities to property income distributions received from a UK-REIT.

Corporate members of Lloyd's insurance market

Where a company has unrelieved trading losses and transfers its business to another company, the losses may, in certain scenarios, be transferred to the successor company. Proposals will adapt the rules which govern the transfer of trading losses by Lloyd's corporate members from one company to another company under the same control, typically as part of a group reconstruction.

The proposals will enable Lloyd's corporate members to benefit from the transfer of losses in the same way as other companies.

Controlled foreign companies (CFCs)

The CFC tax rules potentially apply to tax UK companies with subsidiary companies operating in low tax jurisdictions. A proportion of the profits may be subject to UK tax if the profits are not paid by the subsidiary to the UK company. Following the recent European Court of Justice judgment in the Cadbury Schweppes case, changes are being made to the CFC rules, effective from 6 December 2006, to change the law to reflect the decision.

The changes will relax UK CFC rules by enabling UK companies to apply to HMRC to disregard those profits of their CFCs that arise from genuine economic activity in business establishments in other European Union Member States or certain other states in the European Economic Area.

The government will consult with business in 2007 on a wider package of reform.

Other anti-avoidance measures

A disclosure regime for tax schemes was introduced in 2004 that has enabled HMRC to respond to avoidance schemes more swiftly. The government has announced measures, effective from 6 December 2006, to tackle artificial schemes, brought to light under the disclosure rules. These schemes which have exploited certain aspects of tax legislation include the rules on manufactured payments, exchange gains and losses, annual payments, double taxation relief and lease and leaseback.

EMPLOYMENT ISSUES

National Insurance Contributions (NICs)

The detailed NIC rates, earnings limits and thresholds proposed for 2007/08 are set out below. The thresholds have been increased but the rates of Class 1 and 4 contributions have been held at their existing levels.

National Insurance rates		
	2007/08	2006/07
Employees' threshold	£100 pw	£97 pw
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Upper earnings limit – employees only	£670 pw	£645 pw
Employees' Class 1 rate on earnings between threshold and upper earnings limit	11%	11%
Employees' Class 1 rate on earnings above upper earnings limit	1%	1%
Employers' Class 1 rate on earnings above threshold	12.8%	12.8%
Class 2 – self-employed flat rate	£2.20 pw	£2.10 pw
Class 2 – small earnings exception	£4,635 pa	£4,465 pa
Lower profits limit (for self-employed Class 4 contribution)	£5,225	£5,035
Upper profits limit	£34,840	£33,540
Class 4 rate on profits between lower and upper profits limit	8%	8%
Class 4 rate on profits above upper profits limit	1%	1%
Class 3 – voluntary	£7.80 pw	£7.55 pw

Although employees' NICs only become payable once earnings exceed £100 per week, any earnings between £87 and £100 per week in 2007/08 will protect an entitlement to basic state retirement benefits without incurring a liability to NIC.

Managed service companies (MSCs)

In 2000 the government introduced rules to tackle the provision of services through Personal Service Companies (PSCs). These rules have been referred to by the name of the press release of that time, IR35.

PSCs were designed to 'disguise employment' by interposing an intermediary, usually a company, between the payer and worker. This minimised the amount of tax and NIC due by paying that worker predominantly with dividends.

MSCs attempt to avoid the IR35 rules. The types of MSCs vary but are often referred to as 'composite companies' or 'managed PSCs'. HMRC have encountered increasing difficulty in applying the IR35 rules to MSCs because of the large number of workers involved and the labour-intensive nature of the work. Even when the IR35 rules have been successfully applied, an MSC can often escape payment of outstanding tax and NIC as they have no assets and can be wound up.

The government has therefore decided to remove MSCs from the IR35 rules and introduce new rules from April 2007. The intention of the new rules is to:

- ensure that those working in MSCs pay tax and NIC at the same level as other employees
- alter the travel and subsistence rules for workers of MSCs to ensure they are consistent with those for other employees
- allow the recovery of outstanding tax and NIC from 'appropriate third parties'.

Increasing employment opportunities

The government's long-term goal is to achieve full employment. This means that everyone should be given support and advice to help them to find and keep a job. Under this banner, the government is:

- improving enforcement of the National Minimum Wage (NMW), with a 50% increase in the resources allocated to tackle non-compliance, and by raising penalties for the seriously non-compliant
- bringing in measures to simplify and reduce errors in the benefits system.

CAPITAL TAXES

Planning Gain Supplement (PGS)

Following last year's Pre-Budget Report the government issued a consultation paper on the introduction of a PGS. Following that paper further consultation is now being undertaken on valuing and paying a PGS. Legislation may be introduced to tax some of the windfall gain accruing to landowners from the sale of their land for residential development to capture some of the uplift in value arising when full planning permission is granted.

The following are some of the principles that may be considered:

- a system for gathering information as to the value of land proposed for development
- the government would then set a tax rate on these values, to be paid by the developer
- the granting of residential planning permission would be contingent on the payment of the PGS
- there may be a lower rate for developments on brownfield sites
- consideration may be given to allowing developers to pay their contributions in instalments over a period of time.

The government recognises that the introduction of a PGS would need to be accompanied by transitional measures. These would help developers already engaged in land sales where contracts had been drawn up before the charge was introduced or those who held large amounts of land where planning permission had yet to be secured.

Stamp Duty Land Tax (SDLT) anti-avoidance

An anti-avoidance measure has been announced to tackle a number of SDLT schemes. The measure takes effect on or after 6 December 2006 but there are transitional provisions to protect those who entered into contractual commitments before 2pm on 6 December 2006.

The first change provides that where one person disposes of a chargeable interest and another person acquires that interest, or one derived from it, and:

- a number of transactions are involved in the disposal and acquisition, and
- the SDLT on all these transactions is less than that which would have been chargeable on a single land transaction

then the transactions are disregarded and there is a notional land transaction on which the chargeable consideration is the total consideration given or received.

The second change is to make a number of alterations to transfers into and out of partnerships and transfers of partnership interests.

Capital loss anti-avoidance measure

In Finance Act 2006, specific rules were introduced to target 'contrived' capital losses created by companies. A loss accruing to a company is not an allowable loss if it arises as part of arrangements which have a tax advantage as their main purpose or one of the main purposes.

HMRC have become concerned that persons other than companies were involved in the creation of 'contrived' capital losses to secure a tax advantage. Therefore for capital losses arising on disposals on or after 6 December 2006 the anti-avoidance rule for companies is extended to all persons liable to capital gains tax including individuals, trustees and personal representatives.

VAT

Transfer of going concern

If a business is transferred as a going concern, the transaction is not regarded as a transaction within the scope of VAT provided that certain conditions are satisfied.

VAT record keeping requirements for businesses transferred as a going concern will be brought into line with other tax and regulatory regimes so that the seller retains his records, except in the few cases where because the buyer retains the seller's VAT number it is essential for VAT compliance purposes that the records are passed over.

Partial exemption

A business that makes both taxable and exempt supplies (a partly exempt business) must operate a partial exemption method to calculate how much VAT it can recover on its costs. Many large partly exempt businesses operate a 'tailor-made' special method that must be approved by HMRC before use.

Following consultation, the government intends implementing two changes with effect from 1 April 2007:

- A business must declare 'to the best of its knowledge and belief' that its proposed special method is fair and reasonable. HMRC will have the power to set aside a method if the person signing the declaration knew or ought reasonably to have known that it is not fair and reasonable.
- Partly exempt businesses that make overseas supplies will have the right to apply for a 'combined method' that caters for the recovery of VAT on certain overseas supplies.

Proposed reverse charge for Missing Trader Intra-Community (MTIC) fraud

MTIC fraud is a sophisticated and organised criminal attack on the VAT system. The fraud arises through contrived transaction chains involving supplies of high value goods with the tax loss occurring when the VAT charged by the supplier is not paid to HMRC but can be reclaimed by the recipient.

A reverse charge procedure was introduced in Finance Act 2006 whereby the VAT registered customer, rather than the seller, accounts for and pays the VAT on the supply of certain goods of a kind used in MTIC fraud.

The planned implementation date of the reverse charge was 1 December 2006 but has been postponed because there have been difficulties in the negotiations with other member states on the derogation required by the UK to introduce the charge. The government has confirmed that the discussions are still continuing and still plans to introduce reverse charge VAT accounting for a range of goods including mobile phones and computer chips once the derogation has been agreed.

ENVIRONMENTAL MEASURES

Air Passenger Duty (APD)

APD rates will be increased from 1 February 2007. The new rates of duty will be:

- for passengers flying to destinations in the European Economic Area, the European Common Aviation Area, countries applying to join the European Union, and Switzerland, £10 in the lowest class of travel and £20 otherwise
- for passengers flying to other destinations, £40 in the lowest class of travel and £80 otherwise.

Landlords Energy Saving Allowance (LESA)

In 2004, the LESA was introduced, which provides an allowance of up to £1,500 for landlords who invest in cavity wall, loft, solid wall and hot water system insulation, as well as draught proofing insulation.

Following consultation, the government no longer intends to reform the wear and tear allowance by making it conditional on the energy efficiency of the property. However the government intends to extend the scope of the existing LESA to include:

- the expansion of LESA to corporate landlords
- an extension of the scheme from 2009 to 2015
- the application of the allowance per property rather than per building
- ensuring that even smaller properties have access to the full allowance
- the addition of the acquisition and installation of floor insulation as qualifying investment.

Landfill tax

The standard rate of landfill tax will be increased from £21 per tonne to £24 per tonne from 1 April 2007. The lower rate of tax will remain unchanged at £2 per tonne. The government will also consider the case for steeper increases from 2008.

Road fuel

From 7 December 2006 the effective excise duty rates for road fuels will be increased by 1.25 pence per litre.

Householders who generate their own power

Legislation will be introduced to put beyond doubt that where private householders install microgeneration technology in their home to generate

power for their personal use, any payments they receive from the sale of surplus power to an energy company is not subject to income tax.

Tackling climate change

The Pre-Budget Report sets out several elements in the government's strategy for tackling climate change both domestically and globally, including:

- promoting the development of a global carbon market
- taking further steps towards realising carbon capture and storage technology
- a package of measures to encourage the development of the biofuels market and innovative types of biofuel
- an ambition for all new homes to be zero-carbon within a decade, with a time-limited stamp duty exemption for most new zero-carbon homes.

OTHER MATTERS

Online filing

Lord Carter's review of HMRC online filing services was published earlier in 2006. Legislation will be brought forward during 2007 to implement the changes which will start in 2008.

The key proposals are to:

- require businesses to file their VAT returns, company tax returns and PAYE in-year forms online in phases from April 2008
- introduce new filing deadlines for income tax self assessment returns of 31 October for paper forms from 2008 but retain 31 January for online returns
- promote online filing by tax agents and better quality data by withdrawing computer generated paper 'substitute' self assessment returns from 2007/08.

Company filing dates

Following Lord Carter's recommendations and consultation by HMRC and Companies House, the government will work to provide a single online filing facility by 2010. To encourage earlier filing and give businesses certainty sooner, from 2008 the period during which an enquiry can be opened into a corporation tax return will be tied, for most companies, to the actual date HMRC receives the return rather than a fixed filing date.

Review of HMRC powers, deterrents and safeguards

The government launched a review of HMRC powers and taxpayer safeguards in March 2005 to provide tools for the newly integrated HMRC. In March 2006 HMRC launched its second consultation on the general principles of reform and in August more detailed consultation on modernising criminal investigation powers.

A summary of the responses to the March consultation has now been published. The comments are generally supportive of the broad approach proposed. A detailed consultation on penalties for incorrect returns and a further consultation on criminal powers will be published in the near future.

Varney Review – review of links with large businesses

The findings of the review carried out by Sir David Varney were published in November 2006 and the government has confirmed that it has accepted all its findings.

The review's proposals will provide:

- business with greater certainty about the tax treatment of transactions by providing a system of advance rulings for significant transactions

- more efficient resolution of tax issues
- a more cost effective approach to administering tax affairs based on an efficient risk-based audit approach.

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