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2008 Pre-Budget Report Summary

Chancellor Alistair Darling presented his second Pre-Budget Report on Monday 24 November 2008.

As expected Mr Darling concentrated on measures to protect and support businesses and individuals in these 'extraordinary, challenging times for the global economy'.

This summary concentrates on the tax measures which are being introduced. The main tax proposals are:

- **reduction in standard rate of VAT from 1 December 2008**
- **changes to personal allowances including prospective reduction in the basic personal allowances for individuals with income above £100,000**
- **a prospective new income tax rate of 45%**
- **deferral of the planned increase in small company corporation tax rate**
- **new loss carry back provisions**
- **details of changes to capital allowances for cars.**

You will find more detail in the following summary. Please do get in touch if you have any questions.

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The government has announced significant changes to the system of personal allowances and tax rates for the next few years. These mainly impact on those with higher levels of income. These changes are set out below.

Allowances and rates

The 2009/10 personal allowance will be £6,475. The basic rate limit will be £37,400. Therefore an individual will pay 40% tax rather than the basic rate of 20% when their total income exceeds £43,875.

The 10% starting rate for savings income band (increased to £2,440) is only available where an individual's non savings income (broadly earnings, pensions, trading profits and property income) does not exceed the starting rate limit.

Changes for 2010/11

From 2010/11 the personal allowance will be subject to an income limit of £100,000. An individual's personal allowance will be reduced by £1 for every £2 of gross income they have above the income limit up to a maximum reduction of half of the personal allowance.

For those with income of above a second income limit of £140,000, the amount of their allowance will be further reduced by £1 for every £2 above this income limit up to a maximum of the full amount of the personal allowance.

Gross income for these purposes is broadly all income after adjustment for pension payments, charitable giving and relief for losses.

Changes for 2011/12

A new rate of income tax will be introduced of 45%. This will apply to taxable non savings income and savings income above £150,000.

Dividend income is currently taxed at 10% where it falls within the basic rate band and 32.5% where liable at the higher rate of tax. A new rate of 37.5% will be introduced for dividends which fall into the income band of above £150,000.

Trust rate

The trust rate will be increased from the 40% to 45% and the trust dividend rate from 32.5% to 37.5%. These changes will take effect from 2011/12.

Allowances	2009/10 £	2008/09 £
Personal allowance		
– under 65	6,475	6,035
– 65 – 74**	9,490	9,030
– 75 and over**	9,640	9,180
Married couple's allowance*		
– aged less than 75 and born before 6.4.35**	6,865	6,535
– 75 and over**	6,965	6,625
– minimum amount	2,670	2,540
Age allowance income limit**	22,900	21,800
Blind person's allowance	1,890	1,800

*Qualifies for relief at 10%
**Reduce age allowance by £1 for every £2 of excess income over the income limit

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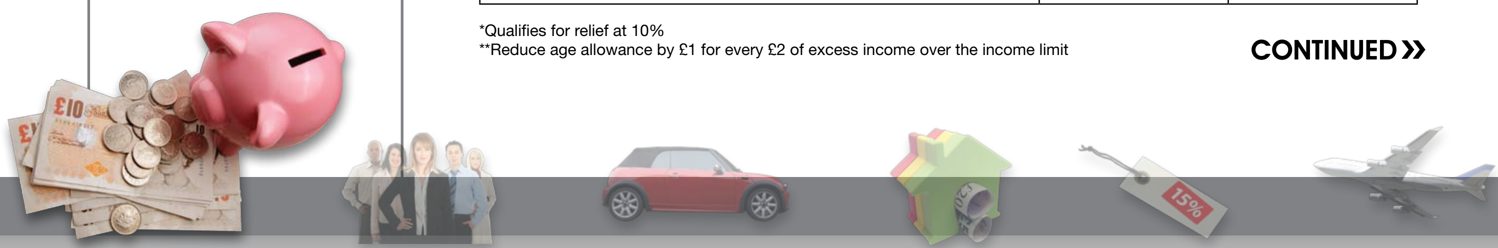

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National Insurance Contributions (NICs)

The detailed NIC rates, earnings limits and thresholds proposed for 2009/10 are set out below. The thresholds have been increased but the rates of Class 1 and 4 contributions have been held at their 2008/09 levels.

An increase in the rates of national insurance is proposed from April 2011. The increase of 0.5% applies to the rates applicable to employers', employees' and the self employed.

National insurance rates	2011/12 rates	2009/10	2008/09
Lower earnings limit threshold		£95pw	£90pw
Earnings threshold		£110pw	£105pw
Upper earnings limit – employees only		£844pw	£770pw
Employees' Class 1 rate on earnings between threshold and upper earnings limit	11.5%	11%	11%
Employees' Class 1 rate on earnings above upper earnings limit	1.5%	1%	1%
Employers' Class 1 rate on earnings above threshold	13.3%	12.8%	12.8%
Employers' Class 1a rate on benefits	13.3%	12.8%	12.8%
Class 2 – self-employed flat rate		£2.40pw	£2.30pw
Class 2 – small earnings exception		£5,075pa	£4,825pa
Lower profit limit (for self-employed Class 4 contribution)		£5,715	£5,435
Upper profits limit		£43,875	£40,040
Class 4 rate on profits between lower and upper profits limit	8.5%	8%	8%
Class 4 rate on profits above upper profits limit	1.5%	1%	1%
Class 3 – voluntary		£12.05pw	£8.10pw

Note

Although employees' NICs only become payable once earnings exceed £110 per week in 2009/10, any earnings between £95 and £110 per week will protect an entitlement to basic state retirement benefits without incurring a liability to NIC.

Tax Credits

There are two types of Tax Credits; Working Tax Credit and Child Tax Credit (CTC). The CTC is potentially available to families who have responsibility for one or more child. There are several elements to the credit but broadly the maximum is an annual amount for 2009/10 of £2,235 per child together with a family element (generally 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.

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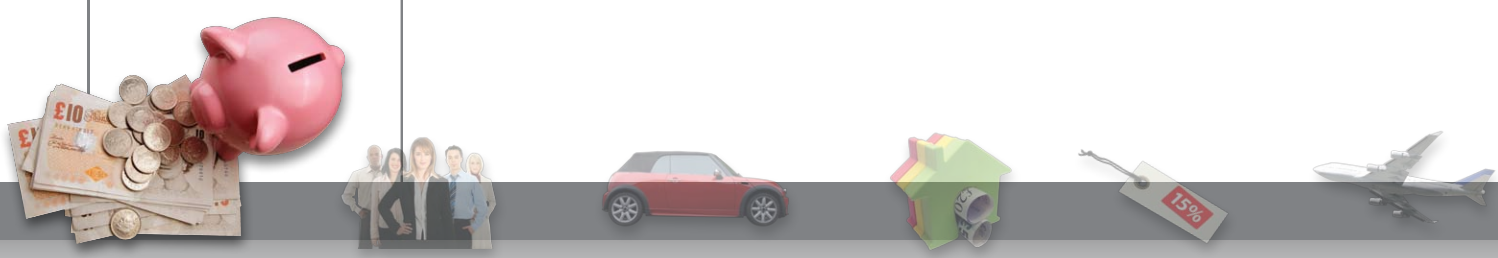

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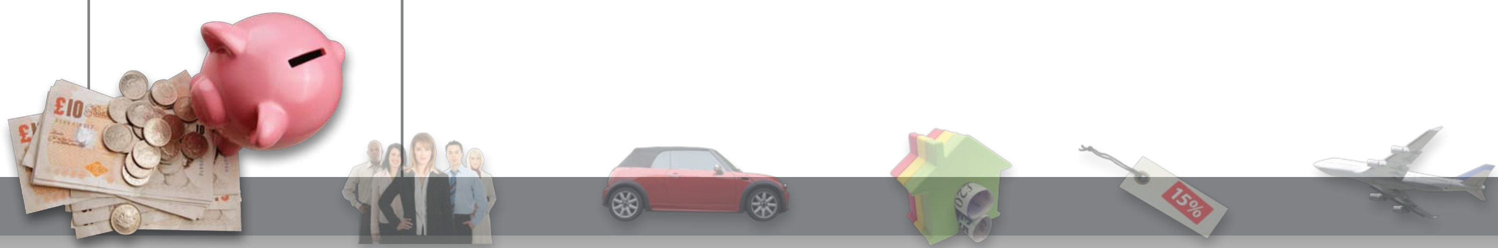
Child benefit

The amount of child benefit is usually increased from April each year. The Chancellor has announced that the annual increase expected in April 2009 will take effect from January 2009. The rate for the first child will be increased to £20 a week and for further children will be £13.20.

Pensions

The annual amount (AA) of pension contributions on which an individual is entitled to tax relief had previously been set for all tax years up until 2010/11, with the amount for 2010/11 being £255,000. The AA will be frozen from 2011/12 to 2015/16 at £255,000 pa.

Pension scheme members, not having existing transitional protection, who take pension and lump sum benefits are subject to a lifetime allowance (LA). The amount of the LA had previously been set for tax years to 2010/11, with the amount for 2010/11 being £1.8 million. The LA will be frozen from 2011/12 to 2015/16 at £1.8 million.



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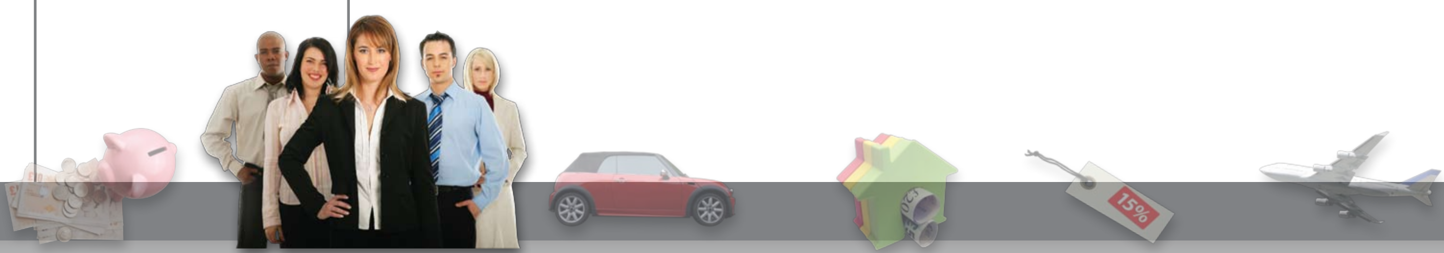
Disabled company car drivers

Disabled drivers who are provided with automatic cars by their employers can currently use the equivalent manual car rate of emissions to calculate their car benefit charge. From 6 April 2009 they will also be able to use the lower list price of an equivalent manual car to calculate the charge.

Share schemes

Three changes will be made from the date of Royal Assent to Finance Act 2009 to the rules for taxing shares issued to employees:

- shares acquired under an instalment arrangement but sold before all instalments have been paid will not incur a tax charge if no overall profit is made
- sale of shares which are nil or partly paid by the employee and which do not generate a profit will not incur a tax charge
- an anomaly in the rules relating to bonus issues which can result in a tax charge even though the value of existing shares falls will be corrected.



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Corporation tax rates

The main rate of corporation tax which applies to companies with profits of more than £1.5 million fell to 28% from 30% from 1 April 2008.

The small companies corporation tax rate which applies to companies with up to £300,000 of profits increased from 20% to 21% from 1 April 2008. The intention was to increase this rate to 22% in 2009 but this has been deferred until 1 April 2010.

The effective marginal corporation tax rate for profits between £300,000 and £1.5 million is 29.75% from 1 April 2008 and will remain the same for 2009.

'Income shifting'

The government intended that legislation would take effect from 6 April 2008 to address 'income shifting' ie shifting part of an individual's income to someone else who is subject to a lower rate of tax.

The government has consulted on this issue but, given the current economic challenges, is deferring action and will not bring forward legislation in Finance Bill 2009. The issue will be kept under review.

Trading loss carry back

Under current rules businesses already have a number of mechanisms to relieve trading losses against other income including past trading profits.

For example unincorporated businesses can offset unlimited trading losses against income in the preceding year. In the early years of operation an unincorporated businesses can carry trading losses back for three years.

The main relief for companies is a carry back of unlimited trading losses against profits made in the previous accounting period.

A proposed revision will apply for one year and will extend the period that current trading losses from businesses can be carried back against previous profits to a period of three years with losses being carried back against later years first.

The amount of losses that can be carried back to the preceding year remains unlimited. After carry back to the preceding year, a maximum of £50,000 of the balance of unused losses is then available for carry back to the earlier two years.

The measure will have effect for company accounting periods ending in the period 24 November 2008 to 23 November 2009. For unincorporated businesses, the measure will have effect in relation to trading losses for tax year 2008/09.

HMRC will make repayments arising from loss relief claims received under the new rules on or after Budget Day 2009.

Comment

A technical note provides further details of this provision but not draft legislation. For unincorporated businesses the carry back to the earlier two years will be restricted to profits from the same trade. It would appear that corporate losses can be carried back against all profits of the earlier two years.

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Further details have been provided on the changes to the capital allowance treatment of cars. The changes will have effect from 1 April 2009 for corporation tax purposes and 6 April 2009 for income tax. The special rules that restrict the amount of capital allowances for cars costing more than £12,000 will be abolished.

- Expenditure on cars with CO_2 emissions of 160gm/km or below will be allocated to the plant and machinery 'pool' (ie will obtain 20% writing down allowances (WDA)).
- Expenditure on cars with CO_2 emissions above 160gm/km will be allocated to the 'special rate pool' (ie will obtain 10% WDA).
- Cars that have an element of non-business use will continue to be dealt with in a single asset pool to enable the private use adjustment to be made, but for expenditure incurred from April 2009 onwards the rate of WDA will be determined by the car's CO_2 emissions.

Expenditure incurred before April 2009 will in general continue to be subject to the existing 'expensive' car rules for a transitional period of around five years. Any expenditure remaining in a single asset pool (unless there is any non-business use of the car) will be transferred to the main capital allowances pool.

From April 2009 the special rules that restrict the amount of lease rental payments that can be deducted for tax purposes for a car costing more than £12,000 will be reformed. The restriction will be changed to a flat rate disallowance of 15% of relevant payments and apply only in respect of cars with CO_2 emissions above 160gm/km.

Expenditure under leases that commenced prior to 1 or 6 April (that is where the car is made available before April 2009) will continue to be subject to the existing rules.

Motorcycles are to be excluded from the definition of cars and will not therefore be subject to these rules. Expenditure incurred on motorcycles on or after 1 or 6 April 2009 will qualify for the Annual Investment Allowance.

Comment

The changes announced have had a long gestation period and full details have not been provided with the Pre-Budget Report. A technical note will be published shortly.

The 100% first year allowance regime for low emission cars was extended to 31 March 2013 in Budget 2008 and therefore will still apply. The current threshold for CO_2 emissions is 110gm/km (so not many cars qualify).

Land Remediation Relief

Land Remediation Relief gives bodies liable to corporation tax a deduction of 150% for qualifying expenditure on removing or mitigating the effect of contamination.

Legislation will be introduced in Finance Bill 2009 to extend Land Remediation Relief to expenditure on remediating long term derelict land. Expenditure will qualify for relief if the remediated land had been derelict since 1 April 1998. The relief will only be available where the land was already derelict when it was acquired by the claimant.

The relief will be available on specified expenditure, for example the removal of foundations of buildings and underground pipes.

Finance Bill 2009 will also include powers to allow relief in respect of specified naturally occurring contaminants. This will include relief for the costs of treating land contaminated by Japanese Knotweed, radon and arsenic. However not all circumstances will qualify. In particular, it is the government's intention to exclude from relief expenditure on the removal of Japanese Knotweed from landfill sites.

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The measure will allow relief for the removal of Japanese Knotweed where infestation has occurred whilst the land has been in the ownership of the claimant.

Taxation of foreign profits

The government will bring forward reforms to the taxation of foreign profits in Finance Bill 2009 that exempt from tax most foreign dividends received by large and medium-sized groups, regardless of the level of shareholding.

A Targeted Anti-Avoidance Rule will apply to protect against any avoidance activity seeking to exploit these dividend exemptions. The exemption will be supported by a worldwide debt cap on interest, extension of the unallowable purpose rules and consequential changes to the Controlled Foreign Company (CFC) rules. In addition the existing Treasury consent rules will be reformed. Draft clauses will be issued in December for consultation.

The government will also continue to examine options for reform of the CFC rules. Any reform will aim to improve the way the CFC rules achieve their objective of taxing profits diverted from the UK.

Comment

The government is attempting to enhance the competitiveness of the corporate tax system to make the UK a more attractive location for multinational business. There have been a number of high profile plans by some UK businesses to relocate outside the UK.

Corporation tax: loan relationships

Legislation will be introduced in Finance Bill 2009 to amend the loan relationships rules affecting connected companies. Two companies are 'connected' under the loan relationships rules if one controls the other, or they are both under common control – so companies in the same group are connected.

The amendments cover:

- the release of trade debts between connected companies
- the late payment of interest between connected companies.

A creditor that formally releases a connected debtor from a trade debt is denied a deduction for the loss on the debt, but currently the debtor may be taxed on its 'profit' in certain circumstances. Under the first change proposed, the debtor company would not be taxable on the release.

Interest payable is normally allowed on the accruals basis. However a deduction for interest payable to a connected creditor that is outside the loan relationships rules is only allowed on a paid basis if paid more than 12 months from the accounting period in which it accrued. A consultation has taken place on how the rule should be amended. The options for change are being considered in the light of responses received to that consultation.

The changes will have effect for company accounting periods beginning on or after 1 April 2009.

Anti-avoidance measures

The government announced on 13 November that it would take action, effective from that date, to prevent a loss of tax:

- on transactions involving the leasing of plant or machinery under long funding leases
- on the sale of a company that is an intermediate lessor of plant or machinery
- on rents payable on long funding leases of films.

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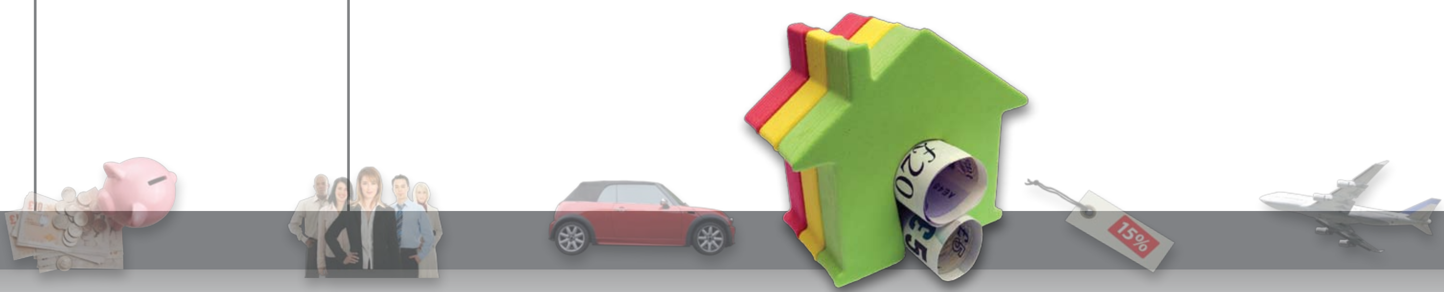
In addition to the tax measures introduced, there are a range of other proposals designed to help businesses through the current economic difficulties as follows:

- access to £1bn of funding from the European Investment Bank available to SMEs by the end of 2008
- the launch in early 2009 of a Small Business Finance Scheme with up to £1bn of lending by banks backed by government guarantee
- a temporary boost to export credits aimed at giving small exporters better access to working capital
- a capital fund of £50m providing help to SMEs who are overleveraged
- funding of up to £25m over the next six months via Regional Development Agencies
- a new Business Payment Support Service from HMRC to enable businesses to negotiate more flexible payment arrangements to meet business tax liabilities including PAYE
- the threshold for rate relief for empty business properties will rise to a rateable value of up to £15,000 for 2009/10
- more time will be available to pay backdated business rate bills that arise when a property is first rated as a business property.



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Rates

The standard rate of VAT will be reduced from 17.5% to 15% for the period 1 December 2008 to 31 December 2009. The rate will then revert to 17.5%. No changes have been made to the 5% reduced or the 0% rate.

The 15% rate will apply to:

- supplies of goods and services
- imports
- acquisitions of goods from other EC member states

made on or after 1 December 2008.

The government will introduce 'anti-forestalling legislation' to prevent abuse of the reduction in the standard rate of VAT.

Flat rate

The flat rate scheme is available to small businesses and is designed to reduce the administrative burden imposed when operating VAT.

Under the scheme a set percentage is applied to the VAT inclusive turnover of the business as a one-off calculation instead of having to identify and record the VAT on each sale and purchase made. Businesses pay a flat rate percentage on their VAT inclusive turnover and do not reclaim input VAT on purchases.

The percentages applicable to the scheme will be reduced with effect from 1 December 2008 to reflect the reduction in the standard rate of VAT.

Businesses are currently eligible to join the flat rate scheme where their:

- taxable turnover is less than £150,000 and
- total income is less than £187,500.

Legislation will be introduced to remove the total income test.

Businesses must check the value of their income annually to determine if they are eligible to remain in the scheme. If annual income exceeds £225,000, a business must leave the scheme. 'Income' for this purpose is not defined in VAT legislation.

In order to simplify the scheme in the future, the leaving test will be calculated based on the method used by the business to calculate its VAT while on the scheme. Therefore if a business calculates its VAT liability on cash received, the leaving test will also be based on cash received; if liability is calculated on the basis of invoices issued, the leaving test will be based on the same method.

These changes will be introduced from 1 April 2009.

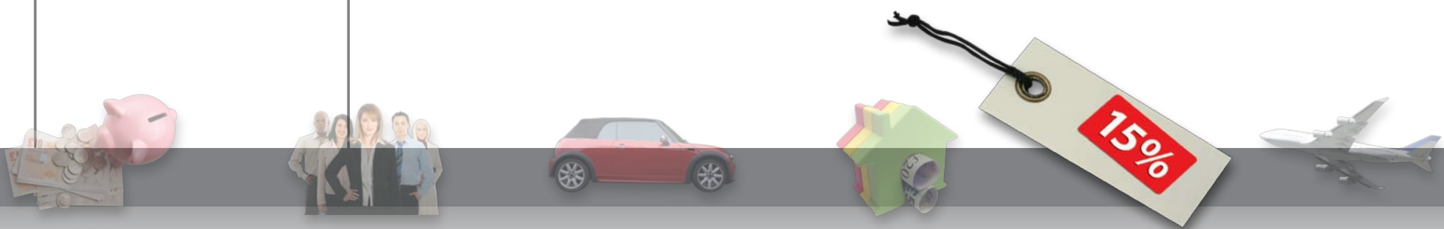
Credit notes for the change in VAT rate

Where payment is received or a VAT invoice issued before 1 December 2008 VAT will have been charged at 17.5%. Where these goods or services are provided on or after 1 December 2008 legislation allows the supplier to apply the new rate of VAT. Where this is applied the supplier is required to issue a credit note to their customer to show the reduction in VAT due.

Legislation will be introduced to extend the time limit for issuing these credit notes to 45 days.

Guidance

HMRC have produced a detailed guide for VAT registered businesses on the reduction in the standard rate of VAT.



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Air Passenger Duty

The proposed replacement of Air Passenger Duty (APD) by an aircraft based tax is scrapped. Instead APD will be revised to cover four bands based on distance from London. Within each band there will be one rate for standard class of travel and one rate for other classes. The new rates will apply for travel on or after 1 November 2009 irrespective of when the ticket was purchased.

Rates

	Standard class of travel (reduced rate)		Other than standard class of travel (standard rate)	
Band	**2009-10 £**	**2010-11 £**	**2009-10 £**	**2010-11 £**
A	11	12	22	24
B	45	60	90	120
C	50	75	100	150
D	55	85	110	170

Comment

Band A now covers some countries which were not previously in the lower band and passengers travelling to these countries will see a reduction in the rate from the current £40/£80 – these include Russia (west of Urals), Algeria, Morocco and Tunisia.

The current rates for the other bands are £40/£80 and all countries in these bands will see an increase. USA and Canada fall within Band B as does Pakistan. India falls in Band C. Australia and New Zealand are in Band D.

Disclosure of tax schemes

Legislation requires those promoting tax avoidance schemes to disclose them to HMRC, which issues a scheme reference number (SRN). New rules will require the SRN to be included on the tax return of a scheme user for the first year in which the scheme is implemented (and any subsequent years) and not the year in which the SRN is received.

HMRC compliance powers – further consultation

Further consultation documents have been issued as part of the review of the compliance powers of HMRC. These focus on:

- extending the record keeping and information powers introduced in Finance Act 2008 for the main direct taxes and VAT across all of the taxes administered by HMRC
- amending the penalties for late payment of tax
- interest rates on tax charged and tax repaid
- schemes to improve the payment of tax.