PRE-BUDGET REPORT 9 OCTOBER 2007
Summary of the Main Taxation Provisions

Alistair Darling's first Pre-Budget Report contained several major surprises, and as ever it was the supporting material issued by the Treasury and HM Revenue & Customs (HMRC) that revealed the full extent of the tax changes planned.

Inheritance tax

The nil rate band – currently £300,000 per individual – will become transferable. The estate of a surviving spouse or civil partner will be able to benefit from any unused inheritance tax nil rate band of their deceased spouse or partner. This will apply on the death of a surviving spouse or partner after 8 October 2007, regardless of when the first death occurred.

The amount of the nil rate band available for transfer will be based on the proportion of the nil rate band that was unused when the first spouse or partner died. The unused proportion will be applied to the amount of the nil rate band in force at the date of the surviving spouse or partner's death.

For example, Mr A dies today leaving his children £100,000 (ie one-third of the current nil rate band) with the rest of his estate passing to his wife. On Mrs A's subsequent death, her nil rate band will then be increased by two-thirds. So, if the nil rate band at the time of Mrs A's death is £360,000, she will be able to leave £600,000 free of inheritance tax, ie £360,000 plus £240,000 (two-thirds of £360,000).

If a person marries more than once, the nil rate band of the survivor can only be increased by a maximum of 100%.

Capital gains tax

There will be a single 18% rate of capital gains tax from 6 April 2008 for individuals, trustees and personal representatives. Taper relief and indexation relief (except for companies) will be withdrawn from the same date.

These changes will result in a simplification of the identification rules for matching disposals of part of a holding of shares acquired on more than one date. The annual exemption (currently £9,200) will remain and other capital gains tax reliefs (eg, for a main residence) will continue.

Residence and domicile

Several important changes will take effect from 6 April 2008:

- A non-domiciled individual who has been UK tax resident for seven or more years will only be able to use the remittance basis for taxation of their overseas income if they pay an additional tax charge of £30,000 a year. Years of residence before 6 April 2008 will be taken into account.

- Any individual who is UK tax resident, but not domiciled or not ordinarily resident, and who claims the remittance basis for taxing overseas income, will only be able to claim their personal allowances, married couple's allowance and blind person's allowance if their unremitted foreign income is below £1,000 a year.

- An individual's days of departure and arrival will be counted as days of residence in the UK for tax purposes. At present they are normally excluded.

- There will also be a number of technical changes to the remittance basis of taxation. The definition of remittance will be extended. The 'ceased source' rule will be removed, so that it will no longer be possible to close down a bank account or other income source in one tax year and remit the funds to the UK in the next year with no tax liability.

As a consequence of these changes, from 6 April 2008 the current restrictions will be removed on the remittance treatment of investment and employment income from the Republic of Ireland for individuals who are UK tax resident, but not domiciled or not ordinarily resident.

Income tax

Tax allowances, tax credits and national insurance contributions

The absence of the September RPI figure – because of the unusually early Pre-Budget Report – means that details of the tax allowances, the tax credits and the 2008/09 NIC thresholds could not be issued today and are not included in this summary.

Fuel benefit charge

The fuel benefit charge multiplier for employees' 'free fuel' will rise by £2,500 to £16,900 from 6 April 2008. This is the amount used as the basis for calculating the taxable value of fuel provided by an employer for private mileage in a company car.

Self-assessment

The threshold below which taxpayers do not need to make payments on account in January and July each year of their income tax liability will be increased from £500 to £1,000 from 2009/10.

The turnover limit for submission of 'three-line accounts' doubles to £30,000 beginning this year and shorter self-employment pages in their tax returns are introduced for businesses with a turnover below the VAT registration threshold.

There will be consultations on how best to collect tax on benefits in kind and expenses through the payroll, as well as on the removal of the £8,500 a year income threshold at which most benefits in kind become taxable.

Offshore funds

The Government issued a discussion paper about the tax treatment of offshore funds, proposing the revision of the categories of distributor and non-distributor funds, as well as a number of other changes.

Business taxation

Income shifting

The Government will be consulting on draft legislation to be published soon after the Pre-Budget Report that will address the issue of 'income shifting'. Income shifting is where one person arranges their affairs so that their income is diverted to a second person who is subject to a lower tax rate, in order to obtain a tax advantage. It is intended that the legislation will be introduced from 2008/09.

The provisions will work alongside the existing rules on settlements and business deductions and will only apply when the income is in the form of partnership profits or dividends and other distributions from companies. The new rules will not affect income from employment, interest on savings or income from other sources. Relevant factors in deciding whether or not there has been ‘income shifting’ in any particular case could include the work done by the individuals, the investment made and the risks to which the individuals are subject through the business.

The Government has been prompted to introduce these changes following the HMRC defeat in the *Arctic Systems* case.

Company owned life policies

For company accounting periods beginning on or after 1 April 2008, annuity contracts and life policies, other than protection-type policies, will be subject to the loan relationships regime. There will be a mechanism to give a credit for the tax treated as paid by the insurer. This complex set of rules could mean companies paying corporation tax each year based on the increase in the value of the policy.

Reviews of business tax

The Government will launch three reviews this autumn on:

- How to simplify VAT rules and administration in the UK and the EU.
- How anti-avoidance legislation can meet the aim of both simplicity and revenue protection.
- The simplification of the corporation tax rules for related companies.

VAT

VAT and housing

Currently, renovations and alterations to residential property that has been empty for at least three years is eligible for a reduced VAT rate of 5%. From 1 January 2008, the minimum period will be reduced to two years.

Stamp duties

Stamp duty

Transfers of shares or securities in UK companies that currently attract stamp duty not exceeding £5 (whether fixed or *ad valorem*) will be exempt from stamp duty from Budget Day 2008 and need not be presented for stamping.

Stamp duty land tax

Transactions involving residential and non-residential property where the chargeable consideration is less than £40,000, will not have to be notified to HMRC from Budget Day 2008.

Leases will have to be notified where the lease term is seven years or more, the chargeable consideration exceeds £40,000 and the annual rent is more than £1,000.

Pensions

Pension credit

The pension credit standard minimum guarantee will be uprated to £124 a week for single pensioners and £189 a week for couples in 2008/09.

Pension annuity reform
The Government has consulted with interested parties about the development of pension products that combine pension fund withdrawal with a guaranteed income. However, the Government has decided not to change the rules, because it says a change would increase the complexity and only affect a small number of people with large pension savings.

Pensions – spreading of contributions
The Finance Bill 2008 will contain legislation, effective from 9 October 2007, to prevent the ‘spreading rules’ for pension contribution tax relief being circumvented by routing payments through a new company.

Pensions – other changes
The inheritance of tax-relieved pension savings using scheme pensions or lifetime annuities will be subject to unauthorised payment tax charges and, where appropriate, inheritance tax . The measure is effective for surrenders of benefits after 9 October 2007 and for increases in pension rights attributable to the death of a member when the member dies after 5 April 2008.

Anti-avoidance

Holiday pay national insurance contribution exemption
The NIC exemption for holiday pay that is paid through third parties will be removed for all sectors outside the construction industry with effect from 30 October 2007. The exemption will remain for the construction industry for another five years to give it time to adjust.

Other anti-avoidance provisions
Legislation will be introduced to counter a range of different tax avoidance schemes, including individuals who pay all the interest in advance on certain business loans to accelerate their tax relief, the sale and leaseback of plant and machinery, and companies that in effect convert interest into non-taxable income.

The Government will also be consulting on principles-based responses to tax avoidance involving income stripping and disguised interest with the aim of improving clarity and certainty.

Links

http://www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_index.cfm
http://www.hmrc.gov.uk/pbr2007/index.htm

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at October 2007, which are subject to change. These proposals may be changed in the Spring 2008 Budget and subsequent legislation.