SUMMARY OF THE TAXATION PROVISIONS

In his pre-election Budget, the Chancellor Gordon Brown announced a range of new measures and confirmed a number of changes announced in recent months. As usual, there were many more announcements in the various Budget papers and press releases than in the speech itself.

The individual savings account (ISA) limits will be extended to April 2010. The capital gains tax annual exemption for 2005/06 will be £8,500. The inheritance tax nil rate band will be £275,000 for 2005/06 and will rise to £285,000 in 2006/07 and to £300,000 in 2007/08. From 17 March 2005, the zero rate threshold for stamp duty land tax will increase to £120,000 for residential property transactions and the relief for commercial property in disadvantaged areas will cease. Various measures were announced to tackle tax avoidance, with particular focus on stamp duty land tax.

PERSONAL TAX

Income tax allowances, reliefs and credits	2005/06 £	2004/05 £
Personal (minimum)	**4,895**	4,745
Personal (age 65-74)	**7,090**	6,830
Personal (age 75 and over)	**7,220**	6,950
Married couple's/civil partnership's (minimum) at 10%*	**2,280**	2,210
Married couple's/civil partnership's (age under 75) at 10%*	**5,905**	5,725
Married couple's/civil partnership's (age 75 and over) at 10%	**5,975**	5,795
Age related relief reduced by 50% of income over	**19,500**	18,900
Child tax credit (CTC) – family element:	**545**	545
CTC – family element baby addition	**545**	545
CTC usually reduced by 6.67% of joint income over	**50,000**	50,000
Childcare and childcare tax vouchers (weekly entitlement)	**50**	–
Blind person's allowance	**1,610**	1,560
Rent-a-room tax-free income	**4,250**	4,250
Pensions earnings cap	**105,600**	102,000
Venture capital trust (VCT) at 40%	**200,000**	200,000
Enterprise investment scheme (EIS) at 20%	**200,000**	200,000
EIS eligible for capital gains tax re-investment relief	**No limit**	No limit

*Where either claimant was born before 6 April 1935

Income tax rates	2005/06 £	2004/05 £
Starting rate 10% on first	**2,090**	2,020
Basic rate (20% for savings income) 22% on next	**30,310**	29,380
Higher rate 40% on income over	**32,400**	31,400
Dividends: basic rate taxpayers	**10%**	10%
higher rate taxpayers	**32.5%**	32.5%
Pre-owned assets tax (£5,000 minimum taxable)	**As income**	N/A
Trusts: basic rate band	**500**	–
dividends (rate applicable to trusts – RAT)	**32.5%**	32.5%
other income (rate applicable to trusts – RAT)	**40%**	40%

Individual savings accounts and child trust funds

The current individual savings account (ISA) limits of £7,000 for the overall maximum and £3,000 for the cash component will continue until 5 April 2010.

From 6 April 2006 at the latest, the ISA and child trust fund investment rules will be extended to permit investment in all retail collective investment schemes authorised by the FSA, provided the schemes do not restrict investors' access to their funds. For ISAs, any collective investment scheme that promises 'cash-like' returns will be limited to the cash component. One of the main effects of the change will be to allow ISAs to hold collective funds that invest in property.

Reform of taxation of collective investment schemes

Investors in authorised unit trusts and open-ended investment companies (OEICs) and providers of these funds will be affected by changes in the rules relating to their taxation from dates to be announced. Powers to change the regulations will be included in the Finance Act 2005.

- **Distributions** Unit trusts and OEICs can invest in a mix of assets including equities and bonds, but the 'bond fund' rules prevent them from making distributions fully reflecting that mix. The '60% test' will therefore be removed and funds will be able to make interest and dividend distributions in the same period in proportion to the interest and other income received. Funds will be able to elect to distribute income only as dividends.
- **Substantial ownership rule** To counter tax avoidance the Finance Act will include a power to make regulations to tax unitholders and shareholders in qualifying investor schemes (QIS) differently if they own a substantial portion of a QIS. Where an investor owns a substantial portion of a QIS, any annual increase in the value of their units and shares will be chargeable as income under self-assessment. Certain kinds of investor such as pension funds, charities and life insurance companies will be excluded from this rule.

Real estate investment trusts

The government has published 'UK real estate investment trusts: a discussion paper'.

Shari'a compliant finance arrangements

Shari'a compliant investment or borrowing arrangements by individuals and companies that do not involve the receipt or payment of interest will generally be taxed no more or less favourably than equivalent banking arrangements that do give rise to interest. The measure takes effect for transactions entered into from 6 April 2005.

Modernising trust taxation

A new tax regime for certain trusts with vulnerable beneficiaries will retrospectively have effect from 6 April 2004. Trustees will be taxed at the beneficiary's tax rate(s). For trusts subject to the rate applicable to trusts (RAT – currently 40%), a £500 standard rate band will apply from 6 April 2005. Further amendments to trust taxation, including revised definitions and streaming of income, will be made in next year's Finance Bill.

Gift aid

From 6 April 2006, any charity that grants the public the right to view property that it preserves or maintains may accept a donation that qualifies for gift aid instead of an admission charge. The donation must either allow unrestricted visits for at least one year or, for shorter periods it should be at least 10% more than the corresponding admission charges.

Tax and same sex civil partners

Civil partnerships formed under the Civil Partnership Act 2004 will be treated in the same way as married couples for all tax purposes, including inheritance tax and capital gains tax. The changes will take effect from 5 December 2005, when the Act comes into force.

PENSIONS AND EMPLOYMENT TAX

Simplification of pensions

Technical changes will be made to the simplified pension regime that will operate from 6 April 2006. There is also to be fresh consultation on the anomalies arising from the different treatment of scheme pensions and lifetime annuities in the calculation of pension commencement lump sums.

Outplacement counselling

The current income tax exemption for outplacement counselling and re-training expenses for full-time employees who lose their jobs will be extended to part-time employees with effect from 6 April 2005.

Company car and fuel benefit

The figure for the company car and fuel benefit charge will remain unchanged at £14,400 for 2005/06. The CO_2 emissions level qualifying for the minimum petrol percentage charge (15%) will be 140g/km for 2005/06, 2006/07 and 2007/08.

Computer and bicycle exemptions

From 6 April 2005, there will be no income tax charge if an employee pays the market value to buy computers or bicycles previously loaned to them by their employer. The change reverses existing legislation that can give rise to a tax charge where assets are transferred to an employee and have previously been provided as benefits in kind.

Payments to employees at universities and technical colleges

From 1 September 2005, payments of up to £15,000 (previously £7,000) for an academic year can be made free of tax to employees for periods of attendance on full-time educational courses at recognised educational establishments. From the same date, such payments will also be free of Class 1 national insurance contributions regardless of whether they have been made under a training contract or an employment contract. The changes relate to the 2005/06 and subsequent academic years.

BUSINESS TAXES

Research institute spinout companies

If an employee of a research institution (RI) acquires shares in a spinout company to which the RI has transferred intellectual property, an income tax and national insurance charge could arise under the employment-related securities provisions. This has contributed to a significant reduction in the number of new spinouts. The value of intellectual property on transfer to the spinout company will be disregarded from 2 December 2004, thereby avoiding an immediate tax and NIC charge. For spinout companies set up before 2 December 2004, there will be an opportunity to elect before 15 October 2005 that income tax and NIC liabilities will not be payable unless and until the company is successful.

International accounting standards

Technical amendments will be made to the Finance Act 2004 legislation and to regulations made in December 2004. These reflect recent developments in both IAS and UK Generally Accepted Accounting Practice and correct some errors and omissions in the previous legislation. The changes will generally have effect for periods beginning on or after 1 January 2005, the earliest date from which companies are permitted to use IAS to draw up their accounts. An anti-avoidance measure will also be introduced to prevent companies taking advantage of the announcement made in the Pre-Budget Report that transitional adjustments would be deferred until 2006 at the earliest. This will apply from 14 December 2004.

Film tax relief

Tax relief for low budget qualifying British films (s48 relief), which was due to expire on 1 July 2005, will be extended until 31 March 2006. This extension will enable films to qualify for current tax relief, where the first day of principal photography is before 1 April 2006 and the film is completed before 1 January 2007. Acquisition relief will continue to be available for films that meet these conditions and are acquired before 1 October 2007.

The Pre-Budget Report announced measures to counter tax avoidance schemes based on film production and acquisition. These included schemes which allowed relief to be claimed more than once on a single film, used arrangements to defer tax for over 15 years and enabled partnerships to obtain loss relief for money that was not fully at risk. The relevant legislation will generally be effective from 2 December 2004.

Renovation of business premises

A new Business Premises Renovation Allowance scheme will provide 100% first-year allowances for capital expenditure on renovating or converting vacant business properties in designated disadvantaged areas. The scheme will apply if the EU grants state aid approval.

CAPITAL TAXES

Inheritance tax nil rate band

The inheritance tax nil rate band will increase to £275,000 from 6 April 2005. The nil rate bands have been set for the following two years, at £285,000 for 2006/07 and £300,000 for 2007/08.

Capital gains tax annual exemption

The annual capital gains tax exemption for individuals will rise to £8,500 from 6 April 2005. The maximum annual exemption for most trusts will be £4,250.

Chargeable gains – temporary non-residents

Individuals who leave the UK temporarily will no longer be able to use the terms of any double taxation agreement to escape tax on capital gains arising while they are abroad. The change will affect individuals who leave the UK after 5 April 2005 and some who leave between 16 March and 5 April 2005.

Under current law, the chargeable gains of individuals are normally subject to tax if they are not resident and not ordinarily resident in the UK for fewer than five tax years. This is charged in the tax year of their return to the UK. It has been argued that the terms of the tax treaties of certain countries prevented the Inland Revenue from taxing the gains of individuals resident in those countries. The Inland Revenue disputes this view, but the new measure is intended to put the matter beyond doubt. It also covers the position where individuals are simultaneously resident in two countries.

Chargeable gains – trustees' change of residence

An anti-avoidance measure will prevent trustees of settlements from exploiting the terms of certain double taxation agreements to avoid UK tax on chargeable gains. With effect from 16 March 2005, it will prevent the terms of any tax treaty overriding UK capital gains tax law, where the disposal is made in a tax year in which the trustees are at some time resident or ordinarily resident in the UK.

Chargeable gains – location of assets

From 16 March 2005, changes are made to the rules for determining where certain assets are located for the purposes of tax on chargeable gains. In particular, bearer shares in companies incorporated in the UK will be treated as situated in the UK, regardless of where the shares are actually located. An intangible asset, such as a contract or a right to sue, will be treated as situated in the UK if it is subject to UK law, unless its location is covered by existing legislation.

The change will bring such assets within the scope of capital gains tax for individuals who are resident but not domiciled in the UK, and who are therefore not generally taxable on gains on assets located outside the UK. It will also affect non-residents trading in the UK through a branch, agency or permanent establishment.

Stamp duty land tax – residential

The threshold for stamp duty land tax on residential transactions is raised from £60,000 to £120,000 with effect from 17 March 2005. Tax will be payable at 1% on the whole of the consideration if it is more than £120,000 but not more than £250,000. There is no change to the higher threshold of £150,000 for residential transactions in designated disadvantaged areas. The other rates and bands are unchanged.

Stamp duty land tax – commercial

Disadvantaged areas relief ends for non-residential land transactions from 17 March 2005, unless the contract was entered into before that date. For relief to be preserved, there must be no variation or assignment of the contract or sub-sale, and the transaction must not be the exercise of an option or pre-emption right.

Stamp duty land tax disclosure rules

Rules have been introduced requiring the disclosure to the Inland Revenue of information about schemes and arrangements intended to avoid stamp duty land tax on commercial property transactions in the UK with a market value of at least £5 million. They are similar to the existing disclosure rules for tax avoidance schemes involving employment or certain financial products and will take effect from 1 July 2005.

Stamp duty land tax avoidance

New provisions block several stamp duty land tax avoidance schemes. There will now be a charge where land is transferred into a partnership and the transferor takes money out of the partnership within three years. Other changes affect the claw-back of group relief, acquisition relief, the grant of new leases where one party is a bare trustee, certain variations of leases to remove restrictive covenants, the withdrawal of sub-sale relief where the second transaction is also relieved from tax, the contingent consideration rules and sale and leaseback transactions.

All the changes take effect from 17 March 2005, except for transactions in pursuance of contracts entered into before that date, which are unaffected, subject to certain conditions.

Stamp duty land tax returns

The Inland Revenue valuation agencies will obtain access to information on stamp duty land tax returns with effect from Royal Assent.

VALUE ADDED TAX (VAT)

Turnover limits

The VAT registration turnover limit rises to £60,000 from 1 April 2005. The deregistration limit increases to £58,000. There are no changes to the turnover limits for the cash accounting, annual accounting and flat rate schemes.

Disclosure rules

The disclosure rules are extended to schemes that give a tax advantage that does not appear on a VAT return. For example, the advantage might involve VAT that cannot be deducted because it relates to exempt supplies or non-business activity. Currently, businesses need only disclose use of a scheme when it has made a difference to the figures on their VAT return.

Two new schemes will join the list of specific schemes that businesses must disclose if their turnover is £600,000 or more. One scheme exploits differences between the UK and another EU member state's treatment of vouchers. The other scheme attempts to remove the effect of an election to waive exemption on supplies of land and property. A new 'hallmark' of avoidance is introduced to require a disclosure of schemes that make use of face value vouchers with low redemption rates. The changes will come into effect after Royal Assent on dates to be announced.

Partial exemption

Some changes are made to the partial exemption rules from 1 April 2005 to address weaknesses in the calculation methods. In future, approval or direction of a special method will have to be in writing. Customs will be able to override special methods more often. Another change removes the benefit of rounding-up in the standard method for businesses with 'residual' input tax of £400,000 a month or more.

Unjust enrichment

Customs will be able to refuse VAT repayment in a wider range of circumstances, where businesses have accounted for VAT incorrectly charged to customers. At present, Customs can refuse a VAT repayment on the grounds of 'unjust enrichment' only to the extent that a business has overpaid VAT. The measure extends the defence of unjust enrichment to all claims for refunds of overcharged and over-accounted for VAT, regardless of whether they are in a payment or repayment position on individual VAT returns. The measure will apply to all claims for a credit of VAT made after 22 March 2005.

Place of supply

Some UK businesses registered for VAT have to account for VAT on natural gas and electricity received from suppliers established outside the UK, following changes introduced from 1 January 2005. A new rule effective from 17 March 2005 establishes that the value on which VAT is to be accounted for is the consideration payable to the supplier.

Local authorities

Local authority provision of certain services, such as childcare and welfare, will be reclassified as non-business activities rather than exempt activities for VAT purposes from 1 April 2005.

This will remove the present restriction on VAT refunded to local authorities when they provide these services.

Charities and communities

From a date to be announced, the 5% reduced rate of VAT will be extended to certain supplies of advice or information connected with or intended to promote the welfare of elderly or disabled people or children, except where the goods and services are exempt from VAT.

An interim grant scheme to cover VAT costs incurred by charities in the construction, renovation and maintenance of memorials will be introduced while the government negotiates at the European level for a permanent reduced rate.

The government will make special donations equivalent to the VAT collected from fund-raising activities for Tsunami relief, and the VAT collected on the Band Aid single and Live Aid DVD.

VAT fuel scale charges

New scales apply from the start of the first accounting period beginning after 30 April 2005.

	3 month period				1 month period			
Cylinder capacity	Scale charge diesel £	VAT due per car £	Scale charge petrol £	VAT due per car £	Scale charge diesel £	VAT due per car £	Scale charge petrol £	VAT due per car £
Up to 1,400cc	236	35.15	246	36.64	78	11.62	82	12.21
1,401-2,000cc	236	35.15	311	46.32	78	11.62	103	15.34
Over 2,000cc	300	44.68	457	68.06	100	14.89	152	22.64

TAX AVOIDANCE

Double taxation relief for trade receipts

Legislation will clarify the amount of double taxation relief that will be given when foreign tax is paid on income that is a trade receipt for UK tax purposes or on other income that is computed in a similar way for UK tax purposes. The changes will generally take effect from 16 March 2005 for companies and from 6 April 2005 for individuals.

Avoidance through arbitrage

From 16 March 2005, legislation will counter tax avoidance using arbitrage schemes that involve hybrid entities or hybrid instruments.

Double taxation relief anti-avoidance

With effect from 16 March 2005, legislation will counter arrangements designed to give rise to excessive double taxation relief claims.

Corporate intangible assets

Changes to the legislation covering corporate intangible assets, such as goodwill, will amend the related party rules and market value rules from 16 March 2005. Payment entitlements under the single payment scheme for farmers will not count as eligible replacement assets for the purposes of capital gains rollover relief (or hold-over relief in the case of depreciating assets) when acquired by companies. This provision will apply to acquisitions of payment entitlement from 22 March 2005.

Financial avoidance

Eight avoidance schemes that have been disclosed to the Inland Revenue under the disclosure rules introduced in Finance Act 2004 will be blocked by legislation. They include schemes based on stripped corporate bonds and corporately owned capital redemption bonds.

NATIONAL INSURANCE CONTRIBUTIONS (NICs)

Class 1 (Employees)

Not Contracted out of State Second Pension (S2P)

	2005/06	2004/05
Employee	No NICs where earnings are up to £94 a week 11% NICs on £94.01-£630 a week 1% NICs over £630 a week	No NICs where earnings are up to £91 a week 11% NICs on £91.01-£610 a week 1% NICs over £610 a week
Employer	No NICs on the first £94 a week 12.8% NICs over £94 a week	No NICs on the first £91 a week 12.8% NICs over £91 a week

	2005/06			2004/05		
Earnings limit or threshold	Weekly £	Monthly £	Annual £	Weekly £	Monthly £	Annual £
Lower limit	82	356	4,264	79	342	4,108
NICs start	94	408	4,895	91	395	4,745
Upper limit	630	2,730	32,760	610	2,644	31,720

Contracted-out S2P rebate	2005/06	2004/05
Reduction on band earnings	£82.01-£630pw	£79.01-£610pw
Employer rate reduction		
• Salary-related scheme	3.5%	3.5%
• Money-purchase scheme	1.0%	1.0%
Employee rate reduction	1.6%	1.6%
Class 1A (Employers)		
Most taxable employee benefits	12.8%	12.8%

Class 2 (Self-employed)	2005/06	2004/05
Flat rate	£2.10 pw £109.20 pa	£2.05 pw £106.60 pa
If earnings are over	£4,345 pa	£4,215 pa

Class 4 (Self-employed)	2005/06		2004/05	
On profits	£4,895-£32,760 pa	8%	£4,745-£31,720 pa	8%
	Over £32,760 pa	1%	Over £31,720 pa	1%

Class 3 (Voluntary)	2005/06	2004/05
Flat rate	£7.35 pw £382.20 pa	£7.15 pw £371.80 pa