

Pre-Budget Report 2005

The highlights of the Chancellor's Statement

Monday 5 December 2005

CORPORATE AND BUSINESS TAX

Better working with business

The newly integrated HM Revenue and Customs (HMRC) has published its report following consultation with SMEs and announced:

- a consultation on companies providing information only once to HMRC and Companies House including consideration of the alignment of filing dates for accounts and returns
- a reduction in the reporting requirements for Form 42 (the form on which employers report their transactions in employment-related securities, mainly shares and share options) by no longer requiring a form for the first issue of shares in the majority of cases.

Income recognition and accounting standards

UITF 40 'Revenue recognition and service contracts' was issued in March 2005 to give guidance on income recognition for contracts for services such as those rendered by accountants and solicitors. In brief, it requires income to be recognised as a contract for services progresses

This will mean that many businesses will be recognising income before an invoice has been issued to a customer and therefore before payment has been received.

The government will legislate in Finance Bill 2006 to enable most businesses affected by the March 2005 changes in the income recognition rules to spread any extra tax charge over three years. Those businesses most severely affected will be able to spread the charge over six years.

Comment

This is a most welcome response to lobbying by the professional bodies.



CORPORATE AND BUSINESS TAX

Taxation of small companies

A starting rate of corporation tax of 0% was introduced in 2002 and applies to companies with taxable profits of £10,000 or less. Companies with profits between £10,000 and £50,000 enjoy a marginal relief from the small companies' rate of 19%. The zero rate was introduced to encourage the creation of small businesses and to allow them to grow.

In 2004, the government thought the system was being 'abused' and introduced a 'non-corporate distribution rate' of 19% on companies to the extent that profits were distributed.

The result has been a complex system and the government has concluded that many self-employed and employed people are still being advised to incorporate simply to reduce their tax and national insurance liabilities.

The government has therefore decided to replace the non-corporate distribution and zero rates with a new single banding set at the current small companies' rate of 19%.

Comment

Many will welcome the abolition of a complex system but it does mean that all small companies will pay corporation tax at 19% whether their profits are retained or distributed.

Capital allowances

To ensure that small businesses are provided with incentives to invest for growth, the government will extend the first-year capital allowances to 50% in the year from April 2006.

Film Tax Relief

In Budget 2005 the Chancellor announced an extension to the current tax reliefs for low budget films until 31 March 2006. Following a period of consultation, the government has now given details of the proposed new tax incentives for British films. The key features are:

- the regime will apply to 'film production companies'
- partnerships can no longer become involved in film production to shelter their members' income from tax.

UK Real Estate Investment Trusts (UK-REITs)

UK-REITs have been considered as a means to improve the efficiency of both the commercial and residential property investment markets by providing liquid and publicly available investment vehicles. The proposals include the following key features:

- the regime will be open to companies, resident in the UK, that are publicly listed on a Recognised Stock Exchange
- companies or groups that meet the UK-REIT eligibility criteria as set out in legislation will not pay corporation tax on qualifying property rental income or qualifying chargeable gains
- a requirement to distribute at least 95% of net taxable profits on rental income to investors, who will then pay tax at their marginal rate.

Leased plant and machinery

Currently a lease of plant and machinery is treated as the hire of an asset.

Provisions are being introduced, effective from 1 April 2006, to align the tax treatment of leased plant and machinery with that of other forms of finance.



PERSONAL TAX

Tax Credits

As previously announced childcare costs continue to form part of the Working Tax Credit calculation at an increased rate of 80% of eligible costs up to a maximum of £175 per week (£300 if two or more children). The rate was previously 70%.

More surprising was the announcement that the disregard in tax credits for increases in income between one tax year and the next rises from £2,500 to £25,000 from April 2006.

Comment

This should ensure that almost all families with increasing incomes will not have their tax credit entitlement reduced in the first year of the increase.

To improve compliance in the operation of tax credits, the Revenue will more than double the number of prepayment checks carried out on new claims and introduce new training and procedures so that staff can recognise potential fraud.

Unclaimed assets

The government proposes that unclaimed assets in the banking system should be reinvested in society while they remain unclaimed. Where the owners can be traced, they can be reunited with their assets. The government has agreed that any unclaimed assets should include accounts where there has been no customer activity for a period of 15 years.



VAT

Annual accounting scheme

The annual taxable turnover limit for joining the scheme is to increase from £660,000 to £1,350,000 with effect from April 2006.

Cash accounting scheme

The government has written to the European Commission with a view to increasing the turnover limit for joining the cash accounting scheme from £660,000 to £1,350,000 with effect from April 2006.

Comment

This is an increase of more than 100% and may benefit up to one million small businesses.

Car fuel scale charges

The Chancellor announced in Budget 2005

the government's intention to align the VAT car fuel scale charges with the income tax benefit in kind provisions. This new system is to come into force on 1 May 2007.

VAT and property

The government is introducing a package of measures to modernise, simplify and provide greater certainty for businesses dealing with some VAT and land and property matters. These will include:

- a new consultation on supplies where the legal and beneficial ownership in land has been separated
- guidance on the revocation of the option to tax after 20 years.

ANTI-AVOIDANCE MEASURES

Pensions

April 2006 ('A' day) will see the introduction of the long awaited new taxation regime for pensions. The government is concerned about potential abuse of the new regime and the Pre-Budget Report contained details of two new measures.



From 'A' day the government will remove the tax advantages for investing in residential property or certain other assets such as fine wines, classic cars and art and antiques from pension schemes which are 'self-directed'. This will include Self Invested Personal Pension Schemes (SIPPS) and Small Self Administered Schemes (SSAS).

The government is also introducing an anti-avoidance provision to prevent a device known

Comment

The effect will be to remove all tax advantages from holding prohibited assets directly or indirectly in such schemes and will broadly mean that it is at least no more advantageous to hold such assets in a pension scheme than it is to hold them personally.

as 'recycling'. The device works by taking a tax-free lump sum from a scheme which is reinvested back into another scheme giving further tax relief on the amount invested. This in turn allows a further tax-free lump sum to be paid out.

Comment

The new rules will remove tax advantages in relation to lump sums which are artificially recycled in this way.

Tax schemes

In 2004 new disclosure rules were introduced in relation to certain tax schemes. Broadly the rules require 'promoters' to provide details of their schemes to the Revenue shortly after the scheme is sold. The government now intends to:

- improve the effectiveness of the 'filters' for direct tax to ensure they reflect recent developments in avoidance behaviour
- extend the regime to all of income tax, capital gains tax and corporation tax
- require businesses to provide information on direct tax schemes and arrangements devised 'in-house' within 30 days, bringing them more in line with the rules for scheme promoters.

CAPITAL TAXES

Planning gain supplement

The government has issued a consultation paper on the introduction of a planning gain supplement (PGS). Legislation would be introduced to extract some of the windfall gain accruing to landowners from the sale of their land for residential development.

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
- the granting of residential planning permission would be contingent on the payment of the PGS
- there may be a lower rate for development on brownfield sites.