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Pre-Budget Report 2006

The highlights of the Chancellor's Statement

Wednesday 6 December 2006

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'.



PERSONAL TAX

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 government is 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 (ISAs)

Comment

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. Changes include:

- The overall annual investment limit will be at least £7,000.
- The mini/maxi distinction within the ISA will be removed.
- 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.

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.



EMPLOYMENT ISSUES

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'.

Comment

The proposals are a recognition by HMRC that they do not have the resources to enforce the IR35 rules across the country. It will be interesting to see if the government takes further steps to tackle the tax and NIC savings that can be made by using dividends.

CAPITAL TAXES

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.

Comment

It appears that the disclosure rules have brought to HMRC's attention schemes which they are unhappy with and so HMRC have acted, in a very broad-brush way, to address them. Where a person has made arrangements, and a main purpose of those arrangements is to gain a tax advantage by creating a 'contrived' capital loss, that loss will not be an allowable loss for the purposes of capital gains tax, income tax or corporation tax.

VAT

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.

The planned implementation date of legislation to tackle this 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 the legislation 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.

Road fuel

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



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.

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.