Spring Budget 2006

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SUMMARY OF THE TAXATION PROVISIONS

In his tenth and possibly his last Budget, Gordon Brown focused on his spending plans but the accompanying notes revealed a range of important tax announcements. The tax regime for real estate investment trusts – REITs – was finalised. Small companies will benefit from an increased first year allowance for plant and machinery. There will also be an extension to research and development tax credits.

The Chancellor also revealed that accumulation and maintenance trusts and many interest in possession trusts would be treated in the same way as discretionary trusts for inheritance tax – with immediate effect. There are very few exemptions. Investments in venture capital trusts will qualify for income tax relief of 30% for 2006/07 (down from 40%), and investors will need to hold their shares for at least five years. Funds left over on death in 'alternatively secured pensions' for people over 75 will normally be subject to inheritance tax.

PERSONAL AND TRUST TAXATION

Income tax allowances, reliefs and credits	2006/07 £	2005/06 £
Personal (basic)	5,035	4,895
Personal (age 65 – 74)	7,280	7,090
Personal (age 75 and over)	7,420	7,220
Married couple's/civil partnership's (minimum) at 10%*	2,350	2,280
Married couple's/civil partnership's (age under 75) at 10%*	6,065	5,905
Married couple's/civil partnership's (age 75 and over) at 10%	6,135	5,975
Age related relief reduced by 50% of income over	20,100	19,500
Child tax credit (CTC) – family element	545	545
– family element baby addition	545	545
CTC usually reduced by 6.67% of joint income over	50,000	50,000
Childcare and childcare vouchers (weekly tax-free limit)	55	50
Blind person's allowance	1,660	1,610
Rent-a-room tax-free income	4,250	4,250
Venture capital trust (VCT) up to £200,000	30%	40%
Enterprise investment scheme (EIS) at 20% up to	400,000	200,000
EIS eligible for capital gains tax re-investment relief	No limit	No limit
Pension scheme – annual allowance	215,000	–
– lifetime allowance	1,500,000	–
– earnings cap	–	105,600

*Where at least one spouse/civil partner was born before 6 April 1935

Income tax rates	2006/07 £	2005/06 £
Starting rate 10% on first	2,150	2,090
Basic rate (20% for savings income) 22% on next	31,150	30,310
Higher rate 40% on income over	33,300	32,400
Dividends – basic rate taxpayers	10%	10%
– higher rate taxpayers	32.5%	32.5%
Pre-owned assets tax (charge as income) minimum taxable	5,000	5,000
Trusts – standard rate band generally	1,000	500
– dividends (rate applicable to trusts – RAT)	32.5%	32.5%
– other income (rate applicable to trusts – RAT)	40%	40%

Venture capital schemes

For investments in venture capital trusts (VCTs) made after 5 April 2006, the rate of relief will be reduced to 30% and the minimum qualifying holding period will increase from three years to five years. From the same date, the annual investment limit for income tax relief for enterprise investment schemes (EIS) will double to £400,000. From 6 April 2007, money held by a VCT will be treated as an investment in qualifying holdings.

The limit to the maximum size of companies able to raise money under the VCT, EIS and corporate venturing scheme (CVS) is reduced to £7m before investment and £8m afterwards. This will not apply to funds raised before 6 April 2006 for VCTs or for subscriptions to EIS or CVS shares made before 22 March 2006.

Taxation of trusts

From 6 April 2006, there will be a package of changes to the tax treatment of trusts. These will provide common definitions for income tax and capital gains tax, as well as increasing the standard rate band to £1,000. A parent will be regarded as having an interest in a settlement for capital gains tax purposes (as well as income tax) if their dependent minor child is a beneficiary. As a result, gains may be taxable on the parent. From 6 April 2007, the test for trustee residence will be the same for both income tax and capital gains tax.

Child trust fund

The Government will pay £250 (£500 for lower-income families) into each child trust fund account when the child reaches the age of seven. This will be in addition to the payment at birth.

PENSIONS AND EMPLOYMENT TAXATION

Inheritance tax and pensions

Statutory backing will be given to the current concessionary inheritance tax (IHT) treatment for pension scheme members who die before age 75. There will be no IHT charge where the recipient of any death benefits is a spouse, civil partner or someone financially dependent on the scheme member. An IHT charge will also not arise in other cases where the member, while in good health, chooses not to buy a scheme pension or annuity, even if their health subsequently deteriorates.

Where death occurs at age 75 or later and the individual is drawing an 'alternatively secured pension' (ASP), any 'transfer lump sum payment' (ie transfer to another scheme member) will be subject to IHT, unless the recipient is a spouse, civil partner or someone financially dependent on the scheme member. Death benefits paid to charity will be IHT free.

Similar provisions apply where an ASP death benefit becomes payable on the subsequent death of a surviving spouse, civil partner or financial dependant. The lump sum will normally be treated as an addition to the deceased member's estate. The scheme administrator will be responsible for accounting for and paying any IHT due.

Pension lump sum recycling

Amendments have been made to the draft legislation to prevent the recycling of tax-free lump sums as further tax-relieved pension contributions. The anti-avoidance measures will not apply where no more than 30% of a lump sum is recycled or where the lump sums are less than £15,000. This threshold will be increased in line with the standard lifetime allowance.

Exemptions for computers and mobile phones

The value of benefit in kind of computers loaned to employees will no longer be exempt from tax from 6 April 2006. From the same date, the tax exemption for mobile phones loaned to employees will be restricted to one phone per employee and will not extend to members of the employee's family or household.

Computer screen and other VDU users – eye tests and glasses

From 6 April 2006, there will be no tax charge where an employer pays for an eye test and/or corrective glasses by providing a voucher to employees who use VDUs – eg computer screens. This brings the treatment of vouchers into line with other methods of reimbursement.

Company cars

The figure for the company car fuel benefit charge will remain at £14,400 for 2006/07. The CO_2 emissions level for the minimum petrol percentage charge of 15% will stay at 140g/km for 2006/07 and 2007/08, but will fall to 135g/km from 2008/09. From 2008/09, there will also be a new 10% rate for cars with emissions of 120g/km or less.

BUSINESS TAXES

Corporation tax rates

The 0% starting rate is abolished from 1 April 2006, as announced in the Pre-Budget Report. Companies with profits up to £50,000 will therefore pay 19% tax. All other rates and bands remain the same. The removal of the starting rate means an end to the complex non-corporate distribution rate calculations.

UK real estate investment trusts (REITs)

From 1 January 2007, a new tax regime that gives tax exemption for income and gains from property will be available for companies or groups that meet certain conditions.

Qualifying companies and groups must be UK resident, listed on a recognised stock exchange and distribute at least 90% of their tax-exempt profits. No single shareholder may control 10% or more of share capital or voting rights. The ratio of interest on loans to fund the tax-exempt business in relation to rental income must be less than 1.25:1. Existing companies that switch to the REITs regime will be subject to an entry charge of 2% of the market value of their investment properties. The tax payment can be spread over four years in instalments of 0.50%, 0.53%, 0.56% and 0.60%.

Distributions from the exempt property element will be paid net of 22% tax. Other distributions will be taxed as normal dividends.

REITs will be qualifying investments for ISAs, PEPs and child trust funds.

Reform of film tax relief

A new tax relief will apply to film production companies which start principal photography on qualifying films after 31 March 2006. The relief will give a deduction for UK production expenditure of 100% for films with total qualifying expenditure of £20m or less and 80% for all other films. Where the deduction results in a tax loss, the company may surrender that loss, up to the amount of its qualifying UK expenditure, for a payable tax credit at a rate of 25% of the loss where the 100% deduction applies or 20% otherwise.

Alternative finance arrangements

Certain finance arrangements, including Shari'a compliant arrangements and the alternative finance version of low cost employee loans will be taxed no less favourably than equivalent arrangements that give rise to interest. The changes take effect between 22 March 2006 and 6 April 2006.

Capital allowances

The rate of first year allowance for small businesses will be 50% instead of 40%. The increase will apply for one year for spending incurred from 1 April 2006 for companies and from 6 April 2006 for self-employed people and partnerships. The rate for medium-size businesses remains 40%.

A consultation document on tax relief for business expenditure on cars considers modernising the capital allowances regime, with emphasis on providing further incentives for businesses to buy cleaner cars.

Research and development tax relief

Companies with between 250 and 500 employees will benefit from the 50% enhancement of qualifying expenditure instead of the current 25%. The change will take effect if the European Commission grants state aid approval. Further details of the proposal will be published later this year.

Companies will have to make, amend or withdraw claims to the enhanced deduction by the first anniversary of the filing date for the tax return instead of within the present six-year time limit.

Group relief

Group relief is extended, from 1 April 2006, to the losses of foreign subsidiaries that cannot be relieved elsewhere, where the subsidiaries are resident in the European Economic Area (EEA) or have incurred the losses in a permanent establishment in the EEA. Relief is restricted to losses for which there is no possibility of relief in any other country. Provisions to prevent abuse are effective from 20 February 2006. The change follows a decision in the European Court of Justice involving Marks and Spencer PLC.

Corporate capital losses

Three anti-avoidance measures, effective from 5 December 2005, will tackle schemes that enable companies to gain a tax advantage from capital losses. They deter the artificial creation of capital losses, the purchase of capital gains and losses and the conversion of income streams into capital gains.

Taxation of leased plant and machinery

New legislation will align the tax treatment of leased plant and machinery with that of plant and machinery acquired with other forms of finance. The change will generally only apply to longer leases that are essentially financing transactions finalised after 31 March 2006.

Trading by charities

The tax exemption for trades carried on by charities is extended to where only part of the trade is carried on for a primary purpose of the charity or carried out by beneficiaries. For periods starting after 21 March 2006, relief will be available on the profits that can reasonably be attributed to that part.

Landlord's energy saving allowance

The landlord's energy saving allowance will be extended from 6 April 2006 to include draught-proofing and insulation for hot water systems. The qualifying expenditure is deductible from letting profits that are subject to income tax.

Landfill tax

The standard rate of landfill tax will be increased from £18 to £21 per tonne from 1 April 2006. The lower rate remains at £2.

CAPITAL TAXES

Inheritance tax nil rate band

The inheritance tax nil rate band will increase to £285,000 from 6 April 2006. The nil rate bands have been set for the following three years, at £300,000 for 2007/08, £312,000 for 2008/09 and £325,000 for 2009/10.

Inheritance tax (IHT) treatment of trusts

From 22 March 2006, interest in possession (IIP) trusts and accumulation and maintenance (A&M) trusts will be subject to the same IHT rules as discretionary trusts, although there will be a few exceptions. This means:

- Payments into the trust will be chargeable transfers, with a possible immediate 20% IHT charge;
- A periodic charge will apply every ten years at a rate of up to 6%; and
- There will be an 'exit charge' proportionate to the periodic charge when funds are removed between ten-year anniversaries.

The current, more favourable IHT treatment will continue for A&M trusts created before 22 March 2006 which provide for assets to go to a beneficiary absolutely at age 18 – or where the terms of trusts are modified to do so before 6 April 2008.

The current IHT rules will also continue for IIP trusts created before 22 March 2006, until the interest in the trust property comes to an end. If, at that point, the property remains in trust, this will be treated as a creation of new settled property. If the termination occurs during the lifetime of the person beneficially entitled, this will be a chargeable transfer. If the interest ends on death, the settled property will form part of the beneficiary's estate (as now) and the trust property will become subject to the new regime. There are exceptions for charities. In both cases, periodic and exit charges will apply.

The new rules will not apply to certain trusts, eg those created for a disabled person or set up by a parent on death for a minor child who becomes fully entitled to the trust assets at age 18.

As a consequence of these revisions, transfers into and out of trusts will potentially be eligible for capital gains tax holdover relief.

Stamp duty land tax threshold

The threshold for stamp duty land tax (SDLT) on residential property transactions is increased to £125,000 from 23 March 2006. The rates and other thresholds are unchanged.

SDLT simplification and clarification

Certain forms of consideration will be treated as not chargeable from 12 April 2006. They include payment by a donee or beneficiary of capital gains tax or inheritance tax on a gift, as well as payment of a landlord's costs on a grant, variation or termination of a lease.

There will no longer be a charge to SDLT on the transfer of an interest in a trading partnership where the partnership property includes land, except where the partnership trade consists of developing or dealing in land. This and several other simplifications will take effect from the date of Royal Assent.

Alternative finance arrangements

The existing SDLT reliefs for alternative finance arrangements (eg those used by Muslims) available to individuals, will be extended to companies, trusts and clubs from the date of Royal Assent. The reliefs ensure that the SDLT payable is no more than would be due under standard loan finance arrangements.

SDLT – unit trusts

SDLT relief is withdrawn on the transfer of property into a newly formed unit trust for the issue of units. The change affects transfers from 22 March 2006, with transitional provisions to protect contracts entered into before 2pm on 22 March 2006.

Stamp duty reconstruction relief

Two extensions will be made to the relief from stamp duty for certain company reconstructions and acquisitions. The acquiring company will no longer have to be registered in the UK. The strict rules concerning the proportion of shares held by any shareholder will be relaxed so that relief will be given provided that, as near as practical, there is no change in overall ownership of the reconstructed business.

VALUE ADDED TAX (VAT)

Registration and deregistration

The VAT registration turnover limit rises to £61,000 from 1 April 2006. The deregistration limit increases to £59,000. The turnover limit for businesses to join the VAT annual accounting scheme rises to £1,350,000 from the same date. The cash accounting limit remains at £660,000 but may be increased to £1,350,000 subject to approval by the European Commission.

Reduced rate for contraceptives

The rate of VAT on contraceptive products will be reduced to 5%. The change is expected to take effect on 1 July 2006. Contraceptives that are currently zero-rated or exempt will remain so.

Missing trader intra-community VAT fraud – 'carousel fraud'

A new provision will change the person who is liable to account for and pay the VAT on the sale of mobile phones, computer chips and some other electronic items. This new rule is subject to the agreement of the European Commission.

HMRC's power to enter premises and inspect goods in connection with VAT will explicitly include the right to mark any goods inspected. HMRC will also be able to require businesses to keep specified records relating to certain goods that they have traded, for example IMEI numbers for mobile phones. The measure is directed at goods that may be subject to VAT fraud but not limited to them. These measures take effect from Royal Assent.

Partial exemption

HMRC will 'consult informally' on two proposed changes to the VAT partial exemption regime. One would require businesses to declare whether a proposed special method is 'fair and reasonable' before HMRC gives approval for its use. The change would enable HMRC to recoup VAT that has been incorrectly claimed where the business should have known that the method was not fair and reasonable. The other would facilitate 'combined methods' that cater for the recovery of VAT relating to overseas supplies.

VAT fuel scale charges

New scales apply from the start of the first accounting period beginning after 30 April 2006.

	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	260	38.72	273	40.66	86	12.81	91	13.55
1,401 – 2,000cc	260	38.72	346	51.53	86	12.81	115	17.13
Over 2,000cc	331	49.30	508	75.66	110	16.38	169	25.17

TAX AVOIDANCE

Changes to the disclosure regime

The rules requiring disclosure of the creation, marketing and use of tax avoidance schemes will be extended to include the whole of income tax, corporation tax and capital gains tax. The existing criteria for schemes to be disclosed will be replaced by a requirement based on hallmarks, on similar lines to the VAT disclosure rules. The time limit for disclosure of schemes devised in-house will be reduced to 30 days from the implementation of the scheme, but individuals and SMEs will no longer have to disclose in-house schemes. The changes take effect from 1 July 2006.

Financial products – anti-avoidance

A range of measures have been introduced to counter corporate tax avoidance. These include schemes based on stock lending on non-commercial terms, schemes involving the purchase and sale of distribution rights on shares and schemes using intra-group arrangements. The measures take effect from various dates between 5 December 2005 and 22 March 2006.

Charities

Measures effective from 22 March 2006 will restrict the scope for large donors to receive benefits from a charity after tax relief has been granted on a donation. They also strengthen the provisions that withdraw tax relief where charitable funds are used for non-charitable purposes. A further change from 1 April 2006 will extend to non-close companies the rules that restrict the benefits they can receive in return for a donation to charity.

International tax enforcement

The UK will have the power to enter into international agreements for mutual assistance in the enforcement of indirect taxes, from the date of Royal Assent. There are already such powers for direct taxes.

NATIONAL INSURANCE CONTRIBUTIONS (NICs)

Class 1 (Employees)

Not contracted out of state second pension (S2P)

	2006/07	2005/06
Employee	No NICs where earnings are up to £97 a week 11% NICs on £97.01 – £645 a week 1% NICs over £645 a week	No NICs where earnings are up to £94 a week 11% NICs on £94.01 – £630 a week 1% NICs over £630 a week
Employer	No NICs on the first £97 a week 12.8% NICs over £97 a week	No NICs on the first £94 a week 12.8% NICs over £94 a week

	2006/07			2005/06		
Earnings limit or threshold	Weekly £	Monthly £	Annual £	Weekly £	Monthly £	Annual £
Lower limit	84	364	4,368	82	356	4,264
NICs start	97	420	5,035	94	408	4,895
Upper limit	645	2,795	33,540	630	2,730	32,760

Contracted-out S2P rebate	2006/07	2005/06
Reduction on band earnings	£84.01-£645pw	£82.01-£630pw
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)	2006/07	2005/06
Flat rate	£2.10 pw £109.20 pa	£2.10 pw £109.20 pa
If earnings are over	£4,465 pa	£4,345 pa

Class 4 (Self-employed)	2006/07		2005/06	
On profits	£5,035 – £33,540 pa	8%	£4,895 – £32,760 pa	8%
	Over £33,540 pa	1%	Over £32,760 pa	1%

Class 3 (Voluntary)	2006/07	2005/06
Flat rate	£7.55 pw £392.60 pa	£7.35 pw £382.20 pa

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