

2007 Pre-Budget Report and Comprehensive Spending Review

PRE-BUDGET REPORT NOTES

9 October 2007

Pre-Budget Report Notes contain technical information additional to the press notices issued by HM Treasury with the Pre-Budget Report. They are not the same as press notices, which are primarily used as brief explanations of new policy for the media, but rather contain additional, more detailed information on the finer points and application of taxation changes announced in the Pre-Budget Report. As such they are designed to assist businesses that may be immediately affected by the changes, and to provide more technical information to those with a specialist interest such as tax consultants and advisers, City financial institutions and local HM Revenue and Customs offices. This information is also published on the Treasury and HM Revenue and Customs internet sites.

CONTENTS:

PBRN	PBR Note	Page
1	Changes to State Second Pension (S2P) and Contracting Out	3
2	Exploitation of National Insurance Contributions Exemption	7
3	Tackling Avoidance: Individuals paying interest in advance: Restriction of Loss Relief	9
4	Fire Safety Capital Allowances	11
5	Sale of Lessors: Companies in Partnership	13
6	Leased Plant and Machinery: Anti-Avoidance	15
7	Investment Manager Exemption	17
8	Tax and Accountancy: Hedging Foreign Exchange Risks	19
9	Tackling Avoidance: Corporation Tax: Disguised Interest	21
10	Company Gains on Life Policies	23
11	Life Insurance Companies: Consultation Outcomes and Simplification	25
12	Life Insurance Companies: Expenses relating to Reinsurance Arrangements	27
13	Spreading of Tax Relief for Employer Pension Contributions	29
14	Pensions: Technical Improvements	31
15	Inheriting Tax-Relieved Pension Savings	33
16	Inheritance Tax: Nil-Rate Band	35
17	Capital Gains Tax Reform	37
18	Residence & Domicile Review	41
19	Remittance Basis: Irish Investment and Employment Income	45
20	Reduction of Stamp Duty Administrative Burden	47

21	Stamp Duty Land Tax (SDLT): Change in Notification Thresholds for Land Transactions	49
22	Stamp Duty Land Tax (SDLT): Change to Anti-Avoidance Legislation Affecting Partnerships	51
23	Fuel Benefit Charge	53
24	Air Passenger Duty (APD)	55
25	VAT and Housing	57
26	Landfill Tax: Exemption for Waste Arising from Dredging and Treated with Additives	59
27	Facilitating Use of Biobutanol	61
28	Income Tax Self Assessment (ITSA): Increase in Payment on Account (POA) Threshold	63

HM REVENUE AND CUSTOMS PRESS OFFICE

Press enquiries: 020 7147 0798 / 2324 / 2328 (Business Tax Desk)
020 7147 2318 / 2333 / 2319 (Personal Tax Desk)
020 7147 2314 / 2331 / 0052 (Law Enforcement Desk)
07860 359544 (Out of hours)

GOVERNMENT DEPARTMENT INTERNET SITES

Further information and all published documents relating to the Pre-Budget Report may be found on the Internet at the following addresses:

HM Treasury: www.hm-treasury.gov.uk

HM Revenue and Customs: www.hmrc.gov.uk

CHANGES TO STATE SECOND PENSION (S2P) AND CONTRACTING OUT

Who is likely to be affected?

1. All employers.

General description of the measure

2. Following the announcement at Budget 2007 of the harmonisation of the National Insurance Contributions (NICs) Upper Earnings Limit (UEL) with the threshold at which higher rate income tax becomes payable from 6 April 2009, legislation will be introduced to bring forward the introduction of the Upper Accrual Point (UAP) prescribed in the Pensions Act 2007 to 6 April 2009.
3. This will ensure that the reforms to the State Second Pension (S2P) announced in the May 2006 White Paper ("Security in retirement: towards a new pension system") take place as originally intended. In the absence of this action there would have been a small increase in the S2P payable to those earning above the UEL for the tax year 2007-08 (assuming indexation for prices from 6 April 2008) and in the rebates received by those same earners and their employers who are contracted out.

Operative date

4. This measure will have effect on and after 6 April 2009. New P11/P14s will need to be used from that date.

Current law and proposed revisions

5. Amongst other changes, the Pensions Act 2007 made provision for the Secretary of State for DWP to prescribe a date to:
 - Abolish the option to contract out for members of defined contribution schemes (Money Purchase Schemes and Appropriate Personal Pension Schemes);
 - Introduce the UAP to achieve a simpler, flat rate S2P by around 2030.

At the time of the May 2006 White Paper the intended date for these changes was 2012, or the date at which the basic State Pension is first linked to earnings.

6. This measure will bring forward one of these changes. On 6 April 2009 the UAP will be introduced and set at a level that is consistent with the level the UAP would have been under White Paper pension reforms from 2012 onwards. This level will be cash fixed from the point it is introduced, and

will be below the level of the UEL from 6 April 2009 to 6 April 2012, but above the level the UEL would have been prior to the announcements on personal tax made at Budget 2007. Therefore there is still a small gain in S2P accruals or the contracted out rebates for affected employees and employers until 6 April 2012, compared to the pre Budget 07 position.

7. This will mean that from 6 April 2009 employers and employees with occupational pension schemes contracted out of S2P will receive contracted-out rebates on earnings between the Lower Earnings Limit (LEL) and UAP. Employers and employees will pay NICs at 12.8% and 11% respectively on earnings between the UAP and UEL.
8. An additional column will need to be included on the P11/P14 or their equivalents used by employers to show this band of earnings. Under pension reforms, these changes would have been required anyway from 2012 for employers and employees with defined benefit occupational pension schemes.
9. Employers who do not have occupational pension schemes will also have to record the earnings between the Primary Threshold and UAP and UAP to UEL. This is because until 2012, or the date at which the option to contract out is abolished for members of defined contribution pension schemes, they may have employees in pension schemes into which HM Revenue & Customs make minimum payments which will also be limited to the UAP on and after 6 April 2009.
10. Only earnings up to the UAP will be used to calculate S2P rights and so this information needs to be provided by employers in their annual return for the 2009/10 tax year onwards.
11. This will require legislation within the National Insurance Contributions Bill. The legislation to enact the advancement of the UAP will be included in the National Insurance Contributions Bill 2007 and in secondary legislation.
12. The NICs Bill is likely to be introduced in the next session of Parliament, and the draft regulations announcing the level of the UAP and describing the changes to recording and reporting requirements for employers from 6 April 2009 will be published in January 2008 to assist Employers and Payroll Software developers. HMRC encourages employers to use payroll software and works actively with payroll software industry to ensure that software accurately reflects changes. HMRC will issue a free employer CD-ROM to assist employers.
13. Definitions of terms used:
 - **Lower earnings limit (LEL)** is currently £87 per week and is the point at which the earnings count for benefit purposes. Those who earn below the LEL do not build up any entitlement to contributory benefits.
 - **Primary threshold (PT)** is currently £100 per week and is the point above which employees begin to pay Class 1 primary NICs. Although no primary Class 1 NICs are payable at or below the PT, those who earn between the LEL and PT are deemed to have paid Class 1 NICs

for contributory benefit purposes.

- **Upper Earnings Limit (UEL)** is currently £670 per week and is the point at which primary Class 1 NICs cease to count for benefit purposes.
- **Upper Accrual Point (UAP)** prior to the introduction of the UAP, the upper earnings limit was the end point for state pension accruals. The UAP will now be the new upper limit of accruals.

Further advice

14. If you have any questions about this change, please contact Kevin Rice on 020 7147 2514 (email: kevin.rice@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

EXPLOITATION OF NATIONAL INSURANCE CONTRIBUTIONS EXEMPTION

Who is likely to be affected?

1. Construction sector employers, employees and their holiday pay scheme operators. Other employers, employees and their holiday pay scheme operators that use the holiday pay National Insurance Contributions (NICs) exemption, intended for the construction industry, will also be affected.

General description of the measure

2. The NICs exemption for holiday pay will be withdrawn. However, there will be a transitional period for the construction sector of five years. For this period, the sector will continue to benefit from the exemption.

Operative date

3. Secondary legislation will be laid on 9 October 2007 to have effect on and after 30 October 2007.

Current law and proposed revisions

4. A longstanding NICs exemption in secondary legislation (currently in Paragraph 12 of Part 10 of Schedule 3 to the Social Security (Contributions) Regulations 2001) allows employers to provide holiday pay to employees without paying NICs. The exemption, originally envisaged for use by the construction sector, was introduced in the 1960s to take account of the high mobility and turnover of the labour force in the sector and to avoid situations where one employer would have to pay a benefit which they had not actually funded or had only partially funded. This exemption is now being used by employers outside this sector, with large impacts on Exchequer yield.
5. The legislation will amend the exemption so that it will be removed immediately for all but the construction sector. A five year transitional period will be introduced for the construction sector, before the exemption is withdrawn completely on 30 October 2012.

Further advice

6. If you have any questions about this measure please contact Raj Nayyar on 020 7147 2521 (email: raj.nayyar@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

TACKLING AVOIDANCE: INDIVIDUALS PAYING INTEREST IN ADVANCE: RESTRICTION OF LOSS RELIEF

Who is likely to be affected?

1. Individuals who enter into arrangements designed to avoid income and capital gains tax.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to block a scheme notified under the avoidance disclosure rules whereby individuals seek to accelerate relief for interest payments made on certain qualifying loans.

Operative date

3. The measure will have effect in relation to interest that is paid on qualifying loans on or after 9 October 2007.

Current law and proposed revisions

4. Where an individual borrows money that is invested in a partnership or in certain types of small company, interest paid on the loan may be eligible for relief against the individual's income or gains. The amount of interest eligible for relief is the amount of interest paid in the tax year, regardless of the period to which the interest relates.
5. In the avoidance scheme, all interest on the loan is paid in advance, with the aim of accelerating tax relief. The loan may then be repaid, with the amount of the loan repayment being substantially reduced to reflect the fact that at the point of repayment the loan is no longer interest-bearing.
6. This measure denies tax relief for interest that relates to a later tax year than the year in which the interest is paid.
7. Draft legislation has been published today on the HM Revenue & Customs website.

Further advice

8. If you have any questions about this measure, please contact Richard Rogers on 020 7147 2625 (e-mail richard.rogers@hmrc.gsi.gov.uk). Information about Pre Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

FIRE SAFETY CAPITAL ALLOWANCES

Who is likely to be affected?

1. Businesses undertaking fire safety alterations in response to notices issued by Fire Authorities.

General description of the measure

2. Legislation extending capital allowances to expenditure on building alterations, made in response to a notice from a Fire Authority, is to be repealed as it no longer serves its purpose.

Operative date

3. There will be no relief available for expenditure incurred on or after 1 April 2008 for businesses within the charge to corporation tax and on or after 6 April 2008 for businesses within the charge to income tax.

Current law and proposed revisions

4. The rules giving relief for fire safety alterations were introduced in 1974 to encourage businesses to ensure that existing buildings met fire safety standards that have had to be met since 1976 for new buildings.
5. Since the original tax legislation was introduced, fire safety legislation has been reformed and now operates on a self-assessment basis. Section 29 of Capital Allowances Act (CAA) 2001 was amended to reflect that change. As a consequence, in Great Britain, the provision applies only to those who have not complied with fire safety requirements and, as a result, are issued with a prohibition notice by a Fire Authority. To ensure that this does not encourage businesses to delay vital safety improvement work, legislation will be introduced in Finance Bill 2008 to repeal section 29 of CAA 2001 and remove this relief. This will provide consistent treatment across the United Kingdom.
6. Relief for expenditure on fire safety equipment such as fire alarms and sprinkler systems will continue to be available for all businesses.

Further advice

7. If you have any questions about this measure, please contact Ann Sterenberg on 020 7147 2710 (email: ann.sterenberg@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

SALE OF LESSORS: COMPANIES IN PARTNERSHIP

Who is likely to be affected?

1. Companies carrying on the business of leasing plant or machinery in partnership.

General description of the measure

2. This measure amends Schedule 10 to Finance Act (FA) 2006 to avoid an unintended and unfair tax liability where a single company acquires all of the business of leasing plant or machinery carried out by a partnership.

Operative date

3. This measure will have effect on and after 5 December 2005, the date from which Schedule 10 has effect.

Current law and proposed revisions

4. Schedule 10 to FA 2006 counters avoidance involving the sale of companies leasing plant or machinery. In broad terms it does this by bringing into charge an amount of income that is taxed on the seller's group and giving an equal amount of relief to the purchaser's group. Where the business is carried on by companies in partnership and there is a change in a partner's interest in the business the legislation brings into charge an amount of income for the selling partner and a relief for the acquiring partner.
5. When a leasing business carried on by companies in partnership is sold to a single company, Schedule 10 brings an amount of income into charge for the partners. However, it does not give matching relief to the purchaser.
6. Legislation will be introduced in Finance Bill 2008 to ensure that relief is available to the purchasing company.
7. Draft legislation has been published today on the HM Revenue and Customs website.

Further advice

8. If you have any questions about this measure, please contact Jo Brindley on 020 7147 2571 (email: jo.brindley@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

LEASED PLANT AND MACHINERY: ANTI-AVOIDANCE

Who is likely to be affected?

1. Businesses leasing plant or machinery.

General description of the measure

2. This measure will counter avoidance involving the sale and finance leaseback of existing plant or machinery by removing a rule that allows businesses to dispose of plant or machinery free of tax and by bringing the finance leaseback within the scope of the rules for taxing long funding leases.
3. It will also counter attempts to exploit the rules for taxing long funding leases to create a tax loss where there is little or no commercial loss by bringing the measure of taxable profits into line with commercial profits.

Operative date

4. The measure will have effect for transactions entered into on or after 9 October 2007.

Current law and proposed revisions

Sale and finance leaseback

5. Rules were introduced in 1997 to counter tax avoidance involving the sale and finance leaseback of plant or machinery by entities that were not liable to tax. These arrangements relied on the purchaser being able to claim capital allowances on the plant or machinery it leased back to the original owner.
6. These rules allow most of the sales proceeds to be received untaxed but restricted the capital allowances that could be claimed by the purchaser. Abuse of these rules was partially countered in 2004 but new arrangements continue to exploit the 1997 rules.
7. Legislation will be introduced in Finance Bill 2008 to remove the 1997 legislation that is being exploited. As a consequence, most of the rules introduced in 2004 will be removed as well.

8. In order to ensure that the avoidance countered in 1997 does not return, leases in sale and finance leaseback arrangements will be brought within the scope of the long funding lease rules. This aspect of the measure will not have effect if the plant or machinery is less than four months old when sold.

Long funding leases

9. A lessor under a long funding lease is not entitled to claim capital allowances on the cost of the leased asset but, to compensate, it is only taxed on a small proportion of the lease rental income. Avoidance schemes have been developed that purport to establish an alternative deduction for the cost of the leased asset. If these arrangements are effective they will generate a tax loss approximately equivalent to the cost of the leased asset, even though there is no commercial loss.
10. Legislation will be introduced in Finance Bill 2008 to put beyond doubt that where a deduction is available for the cost of the leased asset the rules restricting the amount of taxable income do not apply. This will prevent the lessor generating artificial losses.
11. Legislation will also be introduced in Finance Bill 2008 to counter alternative attempts to avoid tax by using the long funding lease rules to create a substantial tax loss where there is little or no commercial loss.

Draft legislation

12. Further details of this measure, including draft legislation and draft explanatory notes, are contained in a Technical Note published today on the HM Revenue & Customs website.

Further advice

13. If you have any questions about this measure, please contact Paul Lane on 020 7147 2637 (email: paul.lane@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

INVESTMENT MANAGER EXEMPTION

Who is likely to be affected?

1. UK investment managers and non-residents trading in the UK through investment managers.

General description of the measure

2. On 20 July 2007, HM Revenue & Customs revised its guidance on the Investment Manager Exemption (IME) in an updated version of Statement of Practice 1/01. This followed a period of public consultation for which the Summary of Responses was published on 29 March 2007.
3. Certain changes required amendments to the legislation and could not be introduced through guidance. This measure will amend the IME legislation to clarify and simplify the scope of transactions to which the IME applies and ensure a proportionate outcome where one of the conditions for exemption is not met. These changes arise from ongoing consultation with representative bodies for the asset management sector.

Operative date

4. This measure will have effect on and after the date that Finance Bill 2008 receives Royal Assent.

Current law and proposed revisions

5. The IME enables non-residents (funds and individuals) to appoint UK-based investment managers without the risk of exposing themselves to UK taxation provided certain conditions are met. The current legislation is at section 127 of and Schedule 23 to Finance Act (FA) 1995, section 152 of and Schedule 26 to FA 2003 and sections 818 to 828 Income Tax Act 2007.
6. To clarify and simplify the scope of transactions to which the IME applies, the list of transactions to which the IME applies will be more closely aligned to activities regulated by the Financial Services Authority with certain exclusions.
7. The changes will also provide a more proportionate tax effect for non-qualifying transactions or arrangements by removing the rule which may cause the whole of a non-resident's UK profits to be brought into UK tax if the investment manager carries out any transactions in the capacity of a permanent establishment.

Further advice

8. If you have any questions about this measure, please contact Andrew Martyn on 020 7147 3342 (email: andrew.martyn@hmrc.gsi.gov.uk) or Mike Hogan on 020 7147 2655 (email: mike.hogan@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

TAX AND ACCOUNTANCY: HEDGING FOREIGN EXCHANGE RISKS

Who is likely to be affected?

1. Large and medium-sized companies who are exposed to foreign exchange risk because they have investments in overseas subsidiaries.

General description of the measure

2. This measure makes changes to the tax treatment of exchange gains and losses on loans and derivatives that are used to hedge foreign exchange risk arising from a company's investment in non-sterling trading or business operations. This follows consultation with industry.
3. Regulations will be laid before the end of the year to make a short-term change. HM Revenue & Customs (HMRC) will issue a technical note in the first quarter of 2008, together with draft regulations to consult on more extensive changes that are to be introduced on or after 1 January 2009.

Operative date

4. The regulations to be laid this year will have effect for company accounting periods beginning on or after 1 January 2008. It is intended that the longer-term changes will apply to periods beginning on or after 1 January 2009, to give companies time to make any necessary adjustments to their hedging arrangements.

Current law and proposed revisions

5. Companies holding shares or similar investments in non-sterling businesses frequently hedge the foreign exchange risk that arises by borrowing in the same currency, or using currency derivatives. Tax rules allow exchange gains or losses on these loans or derivatives to be disregarded where they hedge (or "match") shares in this way, so that only the net economic position is taxed.
6. These tax rules are currently split between secondary legislation (in Statutory Instrument 2004/3256, the so-called "Disregard Regulations"), which caters for companies that have adopted International Financial Reporting Standards or the UK equivalent, and primary legislation which deals with companies still using "old UK Generally Accepted Accounting Practice". The relevant primary legislation was repealed by Finance (No 2) Act 2005, from a day to be appointed. The Government intends to make the appointed day 1 January 2009, and to introduce from that date regulations providing a comprehensive code for all "forex matching".

7. Following on-going consultation with industry and the professions about forex matching, two measures are announced today. The first will allow companies to elect to value “matched” shares at the value of the net foreign currency assets underlying the shareholding, rather than at book value as at present. Amendments to the Disregard Regulations to allow such “net asset value matching” will be made later this year.
8. The second measure will replace the present rules for identifying which loans and derivatives are matched with shares, which rely on the company’s intentions, with a more straightforward and objective approach. Draft regulations, to be published for consultation early in 2008, will embody this measure. They will also refine the “net asset value matching” approach and will include a targeted anti-avoidance rule to prevent companies disregarding exchange gains in circumstances where exchange losses would be claimed for tax.

Further advice

9. If you have any questions about this measure, please contact Sue Davies on 020 7147 2565 (email: sue.davies2@hmrc.gsi.gov.uk) or Aidan Reilly on 020 7147 2575 (email: aidan.reilly@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

TACKLING AVOIDANCE: CORPORATION TAX: DISGUISED INTEREST

Who is likely to be affected?

1. Companies that enter into certain arrangements designed to avoid corporation tax.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to block a scheme that aims to convert what in substance is interest into a non-taxable income.

Operative date

3. This measure will have effect in relation to affected distributions paid on or after 9 October 2007.

Current law and proposed revisions

4. Distributions of profits paid by UK companies to other UK companies are generally exempt from corporation tax.
5. Anti-avoidance legislation introduced in Finance (No. 2) Act 2005 (the "shares as debt" rules) provides for certain shares that mimic debt to be treated as loans. The result of this is that distributions paid in respect of these shares are charged to corporation tax as income, rather than being exempt.
6. Only straightforward distributions, such as dividends, can be charged to corporation tax under the "shares as debt" rules. A scheme has been notified to HM Revenue & Customs (HMRC) indicating that attempts have been made to get around these rules and avoid the corporation tax charge. This has been done by structuring such shares so that they pay other types of distribution that are not charged to corporation tax under the current rules. The legislation introduced by this measure ensures that, where the relevant conditions are met, all distributions paid in respect of the shares fall within the rules, regardless of the type.
7. Draft legislation to achieve this has been published today on the HMRC website.

Further advice

8. If you have any questions about this measure, please contact Richard Rogers on 020 7147 2625 (e-mail: richard.rogers@hmrc.gsi.gov.uk).

Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

COMPANY GAINS ON LIFE POLICIES

Who is likely to be affected?

1. Companies who own life insurance policies with a large investment element or life annuity contracts.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to bring all life insurance policies and life annuity contracts to which a company is a party, other than protection-type policies, within the loan relationships legislation that is used to tax debt and debt-like instruments.
3. There will be a mechanism to give credit to the company for tax treated as suffered by the insurer where the UK 'I minus E' basis of taxation or an EEA equivalent has applied to the insurer.
4. The chargeable events rules that apply to companies will be repealed.

Operative date

5. The measure will apply to accounting periods of companies beginning on or after 1 April 2008.

Current law and proposed revisions

6. Gains on life policies and life annuity contracts owned by companies are taxed currently under the chargeable event rules in Chapter 2 Part 13 of the Income and Corporation Taxes Act 1988.
7. In practice, very few companies own life policies and annuity contracts. Where such policies and contracts are used for investment, economically they resemble debt-like instruments. Under this measure they will be taxed as such under the loan relationships legislation. This brings them into line with the treatment of capital redemption policies owned by companies, which ceased to be excluded from the loan relationships legislation on and after 10 February 2005. But protection policies – those that do not have, or are not capable of acquiring, a surrender value – will not be included. Where the policy or contract forms part of the basic life assurance and general annuity business of an insurer taxed in the UK under the I minus E system, or has been subject to an equivalent regime elsewhere in the EEA, there will now be a mechanism to give credit to the company for tax suffered by the insurer.

8. Where a company is a party to a life insurance policy which is not a protection policy or a life annuity contract on the first day of the first accounting period of the company to begin on or after 1 April 2008, that policy or contract will be brought within the loan relationship rules. The policy or contract will be treated as surrendered in full on that date. Any chargeable event gain arising on the company on this deemed surrender, will be brought into account as a non-trading credit in the accounting period in which the company actually disposes of its interest in the policy or contract.
9. Following these changes, the chargeable event gain rules applying to companies will no longer be required and so will be repealed.
10. Draft clauses have been published today on the HM Revenue & Customs website.

Further advice

11. If you have any questions about this measure, please contact Richard Thomas on 020 7147 2558 (email: richard.thomas@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

LIFE INSURANCE COMPANIES: CONSULTATION OUTCOMES AND SIMPLIFICATION

Who is likely to be affected?

1. Companies carrying on life insurance business.

General description of the measure

2. In May 2006, HM Revenue & Customs (HMRC) published "Life Assurance Company Taxation: A Technical Consultative Document" to solicit views on how to simplify certain aspects of the tax law relating to life insurance companies. The consultation was divided into five strands and for each of them a working group was established consisting of HMRC officials and representatives from the insurance industry and its advisers. This work has already resulted in measures announced at 2006 Pre-Budget Report and Budget 2007, which were enacted in Finance Act 2007. The two changes announced today are further products of this work.
3. The first change repeals the rules which apply to apportioning the investment return where a life insurance company has reattributed its inherited estate.
4. The second change updates and simplifies the law which applies to transfers of long-term insurance business.

Operative date

5. The repeal of the inherited estates legislation will have effect for accounting periods beginning on or after 1 January 2008. The changes to the transfers of business legislation will have effect for transfers taking place on or after a date in 2008 to be determined.

Current law and proposed revisions

6. Where a life insurance company has reattributed its inherited estate to shareholders, complex rules, introduced by Statutory Instrument (SI) 2005/3465 and SI 2006/1358, provide for apportionment of the entire investment return arising from the inherited estate to basic life assurance and general annuity business. The regulations also provide for corresponding adjustments to the investment return attributed to other categories of business, most importantly pension business. This is to ensure that the benefit of exemptions available for the investment return on pension business are not granted to the return on inherited estates assets which are not backing pension business liabilities. Post-

implementation work on the inherited estates rules has indicated that they are not working as intended, and that the Exchequer yield from the rules does not justify their legislative complexity. Draft legislation repealing the inherited estates rules is published today on the HMRC website. The issue of the taxation of the inherited estate following reattribution will remain under consideration.

7. Mergers and acquisitions within the insurance industry are an important commercial activity, but they can also be high tax risk events. Over the years a number of rules have been enacted to block a wide range of tax planning schemes associated with transfers of insurance business. This led to very complex anti-avoidance legislation which could inhibit commercially driven transfers. Reform of this area has been a major priority both for HMRC and the insurance industry as part of the ongoing consultation process. Work has centred on simplifying the law associated with transfers in tandem with the development of a targeted anti-avoidance rule to protect the Exchequer. The measure was partially enacted in Finance Act 2007, but with the addition of a time-limited power to make secondary legislation in order to allow for amendment of primary legislation by 1 April 2008. Draft regulations are published today on the HMRC website.
8. Other issues arising from the May 2006 consultation are still being discussed with the industry. Discussion of most of the outstanding issues including, for example, the tax consequences of financing arrangements adopted by insurers, and the tax treatment of structural assets, should be completed in the next six months. But there are one or two issues – such as apportionment – which are likely to take longer to resolve.

Further advice

9. If you have any questions about this measure, or about the draft legislation, please contact Richard Thomas on 020 7147 2558 (email: richard.thomas@hmrc.gsi.gov.uk) or Colin McHardy on 020 7147 2614 (email: colin.mchardy@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

LIFE INSURANCE COMPANIES: EXPENSES RELATING TO REINSURANCE ARRANGEMENTS

Who is likely to be affected?

1. Companies carrying on life insurance business and entering into reinsurance arrangements in respect of some or all of their life insurance business.

General description of the measure

2. This measure will prevent life insurance companies getting corporation tax relief for expenses relating to reinsured life insurance business where they have not borne the economic cost of those expenses.

Operative date

3. This measure will have effect for expenses incurred on or after 9 October 2007, and on or after 1 January 2008 for expenses incurred before then which are spread forward. It will not affect deductions for earlier periods.

Current law and proposed revisions

4. Normally where an insurance company reinsures life insurance business it receives a payment from the reinsurance company which is designed to cover the life insurance company's costs incurred in selling the business which has been reinsured. Under current law, the payment received from the reinsurance company is offset against the expenses which the life insurance company has incurred in selling the business which has been reinsured, so that that the life insurance company obtains a tax deduction only for the expenses of which it has borne the economic cost.
5. HM Revenue & Customs (HMRC) has seen examples of two ways in which companies reinsuring their business have sought to claim a deduction for the full amount of the expenses they have incurred in selling that business without recognising any reimbursement of those expenses by the reinsurer.
6. One scheme involves the reinsurance company making a payment to the life insurance company which is described as a loan or a rebate of premium but which acts, in part at least, as reimbursement for the selling expenses of the life insurance company.

7. In another variant, instead of the insurance company paying a premium to the reinsurance company and the reinsurance company making a payment on account of expenses back to the life insurance company, the life insurance company simply pays a net premium.
8. HMRC does not accept that these methods are effective in all cases, and will litigate these issues where appropriate. However to clarify the law and to protect the Exchequer's position, legislation will be introduced in Finance Bill 2008, with effect from today, to ensure that where expenses are incurred relating to life insurance business which is subsequently reinsured, a tax deduction is available only for those expenses relating to the reinsured business of which the life insurance company has borne the economic cost. Draft legislation to achieve this has been published today on the HMRC website.

Further advice

9. If you have any questions about this measure, please contact Richard Thomas on 020 7147 2558 (e-mail: richard.thomas@hmrc.gsi.gov.uk) or Colin McHardy on 020 7147 2614 (e-mail: colin.mchardy@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

SPREADING OF TAX RELIEF FOR PENSION CONTRIBUTIONS

Who is likely to be affected?

1. Employers making large payments that transfer their obligations to meet registered pension scheme liabilities to another person.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to ensure that the rules that spread tax relief for large employer pension contributions relative to their contribution in the previous year cannot be circumvented.

Operative date

3. This measure will have effect for payments made on or after 10 October 2007 under binding obligations entered into on or after 9 October 2007.

Current law and proposed revisions

4. Employers generally get relief against their taxable profits for contributions paid to a registered pension scheme. Relief is given for the chargeable period in which the contributions are paid.
5. Some large contributions are spread over a period of up to 4 years. This spreading applies where the contribution:
 - is more than 210 per cent of the contribution paid in the previous chargeable period; and
 - exceeds 110 per cent of the contribution paid in that previous period by at least £500,000.
6. The measure will ensure that the spreading of contributions cannot be avoided by routing them through a new company. Draft legislation to achieve this has been published today on the HM Revenue & Customs website.

Further advice

7. If you have any questions about this measure, please contact the Pensions Helpline on 0115 974 1600. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

PENSIONS: TECHNICAL IMPROVEMENTS

Who is likely to be affected?

1. Pension scheme providers, pension scheme administrators, members of registered pension schemes and their dependants, and financial advisers.

General description of the measure

2. Technical improvements to the pension tax rules.

Operative date

3. Operative dates are outlined with each measure below.

Current law and proposed revisions

4. The tax rules for pension saving are set out in Part 4 of Finance Act (FA) 2004, with further measures enacted in FA 2005, 2006 and 2007. The technical improvements will introduce easements to the rules.

Lifetime allowance test (benefit crystallisation event 3) BCE3

5. Following consultation announced at 2006 Pre-Budget Report, legislation will be introduced in Finance Bill 2008 to make three small changes to the rules for how the lifetime allowance operates for pension increases:
 - The circumstances in which schemes are exempt from the BCE3 test will be widened;
 - Increases in pensions will be exempt as long as they don't exceed a normal rate of increase in a pension in a 12 month period; and
 - A small change will be made so that schemes use the Retail Price Index (RPI) figure published two months before the pension increase occurs.
6. In addition, a technical change will be made to the current legislation which includes indexation of previous crystallisation events.
7. The changes will be backdated to have effect on and after 6 April 2006 (A Day), apart from the change in calculation of RPI which will have effect on and after 6 April 2008 and the technical change which will have effect on 10 October 2007.
8. Draft legislation to achieve this has been published today on the HMRC website.

Protection of lump sums exceeding 25 per cent of pension rights

9. The calculation of protected lump sum rights will be changed where additional amounts are put into the scheme or additional benefit accrues after A Day. Schemes will no longer have to calculate whether relevant benefit accrual has taken place and this will simplify the administration of the protected rights. This measure will be backdated to have effect on and after 6 April 2006.

Taxable property provisions

10. The definition of investment-regulated pension schemes will be changed to ensure that it does not include schemes where individual members could not realistically be expected to influence scheme decisions to invest in taxable property, in particular large occupational schemes.
11. This change will be backdated to have effect on and after 6 April 2006.

Inheritance tax on overseas pension schemes

12. Legislation will be introduced in Finance Bill 2008 to restore inheritance tax (IHT) protection to UK tax-relieved pension savings held in overseas pension schemes. These savings will be provided with the IHT protection that is available to funds held in UK registered pension schemes.
13. The change will be backdated to have effect on and after 6 April 2006.

Further advice

14. If you have any questions about these measures, please contact Pensions Helpline on 0115 974 1600. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

INHERITING TAX-RELIEVED PENSION SAVINGS

Who is likely to be affected?

1. Members of registered pension schemes, their dependants and beneficiaries, scheme administrators, insurance companies and financial advisers.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to ensure that tax-relieved pension savings diverted into inheritance using scheme pensions and lifetime annuities are subject to unauthorised payment tax charges and, where appropriate, inheritance tax (IHT).

Operative date

3. This measure will have effect for surrenders made on or after 10 October 2007 and for increases in pension rights attributable to the death of a member when the member dies on or after 6 April 2008. The IHT provisions will also have effect when the member dies on or after 6 April 2008.

Current law and proposed revisions

4. There are existing rules to prevent the abuse of pension tax reliefs through members surrendering rights under registered pension schemes during their lifetime or through the reallocation of assets after a member's death in certain circumstances.
5. The proposed legislation extends the existing anti-avoidance rules:
 - to impose unauthorised payment charges when the member surrenders rights to payments under a lifetime annuity or dependant's annuity;
 - to impose unauthorised payments charges when a member who has rights to a scheme pension, a lifetime annuity, a dependant's scheme pension or a dependant's annuity, dies; and a connected person becomes entitled to an increase in their pension rights under the scheme that is attributable to that death;
 - to impose an IHT charge where a member with a scheme pension, a lifetime annuity, a dependant's scheme pension or a dependant's annuity dies aged 75 or over and there is an increase in pension rights attributable to the death of a member or an unauthorised lump sum payment in respect of the deceased's pension scheme arrangement.

6. Unauthorised payments are subject to income tax charges of up to 70 per cent.
7. The income tax and IHT charges on re-allocations of rights after a member has died do not apply where the scheme has 20 or more members and the increases in rights are applied at the same rate for each member.
8. HM Revenue & Customs (HMRC) published a Consultation paper at Budget 2007 entitled "Tax relief for pensions: inheriting Tax-relieved Pension Savings".
9. Draft legislation has been published today on the HMRC website.

Further advice

10. If you have any questions about this measure, please contact Pensions Helpline on 0115 974 1600. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

INHERITANCE TAX (IHT) NIL-RATE BAND

Who is likely to be affected?

1. Individuals and personal representatives of estates.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to allow a claim to be made to transfer any unused IHT nil-rate band on a person's death to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007. This will apply where the IHT nil-rate band of the first deceased spouse or civil partner was not fully used in calculating the IHT liability of their estate. When the surviving spouse or civil partner dies, the unused amount may be added to their own nil-rate band.
3. The IHT provisions for alternatively secured pensions (ASP) will also be changed. Currently, a charge arises on left-over ASP funds once a relevant dependant's pension benefits cease and the rates of tax are those applying at the date of that event rather than as at the date of death of the scheme member. This rule will be modified so that, if the IHT nil-rate band was not fully used when the original 'owner' of the ASP died, the same proportion that was unused will be applied to the amount of the nil-rate band in force at the date of the later event and be available against the ASP.

Operative date

4. A transfer of unused nil-rate band from a deceased spouse or civil partner (no matter what the date of their death) may be made to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007.

Current law and proposed revisions

5. Under current law, the estate left by someone who dies is entitled to an amount known as the IHT nil-rate band which is chargeable to IHT at 0 per cent. Any value above the nil-rate band is charged at 40 per cent. The nil-rate band in 2007/08 is £300,000.
6. Transfers of property between spouses or civil partners are generally exempt from IHT. This means that someone who dies leaving some or all of their property to their spouse or civil partner may not have fully used up their nil-rate band. The new rules will allow any nil-rate band unused on the first death to be used when the surviving spouse or civil partner dies.

7. The amount of the nil-rate band potentially available for transfer will be based on the proportion of the nil-rate band that was unused when the first spouse or civil partner died.
8. For example:
 - On the first death none of the original nil-rate band was used because the entire estate was left to a surviving spouse. Then if the nil-rate band when the surviving spouse dies is £350,000 that would be increased by 100 per cent to £700,000.
 - If on the first death the chargeable estate is £150,000 and the nil-rate band is £300,000, then 50 per cent of the original nil-rate band would be unused. If the nil-rate band when the surviving spouse dies is £350,000, then that would be increased by 50 per cent to £525,000.
9. The amount of additional nil-rate band that can be accumulated by any one surviving spouse or civil partner will be limited to the value of the nil-rate band in force at the time of their death. This may be relevant where a person dies having survived more than one spouse or civil partner. This may also be relevant where a person dies having been married to, or the registered civil partner of, someone who had themselves survived one or more spouses or civil partners.
10. Where the new rules have effect, personal representatives will not have to claim for unused nil-rate band to be transferred at the time of the first death. Any claims for transfer of unused nil-rate band amounts will be made by the personal representatives of the estate of the second spouse or civil partner to die when they make an IHT return.
11. Draft legislation and guidance for the transfer of the nil-rate band have been published today and are available on the HM Revenue & Customs website.

Further advice

12. If you have any questions about this change, please contact the Inheritance Tax & Probate Helpline on 0845 3020900. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

CAPITAL GAINS TAX REFORM

Who is likely to be affected?

1. Individuals, trustees and personal representatives with a gain which is chargeable to capital gains tax (CGT). Companies that are liable to corporation tax in respect of their chargeable gains are not affected by any of these changes.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to give effect to a new single rate of charge to CGT at 18 per cent. A number of changes to simplify the capital gains tax regime will be made, including:
 - The withdrawal of taper relief;
 - The withdrawal of indexation allowance;
 - The abolition of the 'kink test' for assets held at 31 March 1982;
 - Abolition of halving relief; and
 - Simplification of the share identification rules.
3. The Annual Exempt Amount (AEA) will remain. The current level for 2007-08 is £9,200 for individuals and £4,600 for some trustees. The AEA for 2008-09 will be announced at Budget 2008. Other CGT reliefs, as explained below, continue to have effect.

Operative date

4. The measure will have effect for disposals made on or after 6 April 2008. The current CGT rules continue to apply for disposals made up to 5 April 2008.

Current law and proposed revisions

5. Section 4 of Taxation of Chargeable Gains Act 1992 (TCGA) provides that an individual is currently chargeable to CGT at the rates for income tax on savings income (10 per cent, 20 per cent or 40 per cent in the tax year 2007-08), treating his or her net chargeable gains (after deduction of allowable losses, taper relief, any other relevant reliefs, and the AEA) as the top slice of his or her income. Most trustees and personal representatives are chargeable at the rate applicable to trusts (40 per cent for 2007-08).
6. For the tax year 2008-09 there will be a single rate of capital gains tax set at 18 per cent. The rate will apply to individuals, trustees and personal representatives. The 18 per cent rate of CGT does not affect the income tax rates.

7. The main **taper relief** provisions are in section 2A of and Schedule A1 to TCGA. Taper relief came into effect for disposals on or after 6 April 1998. The relief may reduce the amount of the gain chargeable to capital gains tax (and hence reduce the effective rate of tax payable on the gain). The amount of relief available depends on the length of time an asset has been held since that date, and whether the asset is classified as a business or non-business asset for taper relief purposes. Currently maximum business assets taper relief is available if the business asset has been held for 2 years, and the maximum non-business asset taper relief is available if the non-business asset is held for 10 years.
8. For disposals on or after 6 April 2008 and held over gains coming into charge on or after 6 April 2008 taper relief will no longer be available (even if assets were held before this date) and the chargeable gain will be liable to tax at the new rate of 18 per cent (subject to the deduction of allowable losses, any other reliefs and the AEA).
9. The **indexation allowance** rules are in sections 53 to 57 of TCGA. Indexation was introduced as a mandatory relief with effect from 31 March 1982. It was frozen for CGT purposes at 6 April 1998 for assets held at that time. Currently where an asset was held at 6 April 1998 and is disposed of after that date the gain on the disposal may be eligible for indexation and taper relief. For disposals on or after 6 April 2008 indexation allowance will no longer be available in computing the gain arising. This change will only affect assets that were acquired before 6 April 1998.
10. The **'kink test'** rules are in section 35 of TCGA and only affect assets that were held on 31 March 1982. This has the effect that the gain (or loss) on the disposal of an asset held on 31 March 1982 is the lower of two amounts: the gain (or loss) calculated by reference to the original acquisition cost of the asset (and any other allowable expenditure on it), and the gain (or loss) based on treating the value of the asset on 31 March 1982 as the total allowable expenditure up to that date. It is possible to elect for the actual 31 March 1982 market value to be used without considering the kink test. The abolition of the kink test will mean all assets held on 31 March 1982 will be deemed to have had a cost equivalent to their market value on that date.
11. **Halving relief** will also be abolished. This relief, the rules for which are in Schedule 4 to TCGA, reduces the amount of a chargeable gain which, because of the previous operation of certain reliefs, effectively includes a deferred gain that relates to a period before 31 March 1982. The abolition of taper relief, indexation allowance, the kink test and halving relief will apply to disposals on or after 6 April 2008.

Examples

12. As a result of these changes individuals disposing of assets on or after 6 April 2008 will work out the tax due as follows (please note that these examples use the 2007-08 AEA for illustrative purposes; the AEA for

2008-09 will be announced at Budget 2008):

- In 1995 Mr E purchased a holiday home in Devon for £100,000. He sells it in July 2008 for £250,000. The CGT due is calculated by deducting the purchase cost of £100,000 from the sale proceeds of £250,000 to give a gain of £150,000. Assuming he has no other capital gains in the tax year 2008-09 he can deduct from this the full AEA of £9,200 giving a chargeable gain of £140,800. That gain is taxed at 18 per cent giving tax payable of £25,344.
 - In 1960 Miss S purchased some shares costing £500. In March 1982 they were worth £450. In August 2008 she sells the shares for £25,000. To calculate her CGT liability Miss S will need to deduct from the disposal proceeds of £25,000 the March 1982 valuation of £450 giving £24,550. (She cannot deduct the cost of the shares of £500 as abolition of the kink test means she has to use the March 1982 valuation.) Assuming she has the full AEA for 2008-09 available she then deducts the £9,200 giving a chargeable gain of £15,350. That gain is taxed at 18 per cent giving tax payable of £2,763.
 - In 2006 Mr D had a loss of £30,000 on disposal of an asset. He had no other gains against which he could set off the loss. In June 2008 he sold his holiday home at a gain of £80,000. To calculate his liability to CGT Mr D can still bring forward his loss of £30,000 and set it off to reduce the gain to £50,000. Assuming the full AEA for 2008-09 is available he then deducts £9,200 giving a chargeable gain of £40,800. That gain is taxed at 18 per cent giving tax payable of £7,344.
 - In November 2007 Miss E enters into an unconditional contract to sell assets to Mr Y in May 2008. Because the contract is unconditional the disposal takes place for CGT purposes in November 2007 and the existing rules for indexation (if appropriate), taper and rates of tax will apply. The gain is chargeable for 2007-08, and the tax is payable in January 2009 under the normal Self-Assessment rules.
 - Also in November 2007 Ms F enters into a conditional contract to sell assets to Mr Q in May 2008. Because the contract is conditional the disposal date is when the conditions are satisfied. If the conditions are satisfied in May 2008 then the new rules will apply, the gain will be chargeable in the year 2008-09 at the new rate of 18 per cent, and the tax will be payable in January 2010.
 - Mr G owns a fish and chip shop in Brighton. On 1 June 2008 he sells the shop and reinvests the gain into buying a larger shop on the seafront. Mr G claims business asset roll-over relief so there is no tax payable when he disposes of the shop. CGT liability will be deferred until a point in the future (this may be on the disposal of the replacement shop if it is not replaced with another qualifying business asset).
13. These changes to the CGT rules will allow certain provisions to be simplified. For example the current rules for the identification for CGT purposes of shares and securities (and other assets which cannot be distinguished from one another) can be found at sections 104 to 106A and 109 of TCGA. These prescribe a complex order of identification, dependent upon the dates when the assets were acquired. Currently shares disposed of on any given day are identified with shares acquired on

that day (the “same day rules”) and within the next 30 days (the “bed and breakfasting rules”), then with shares acquired from April 1998 (on a LIFO – “last in first out” – basis), and then with shares in up to three separate pools. As a result of the changes described above, it will be possible to replace the LIFO rules with a simpler system under which from 6 April 2008 all shares of the same class in the same company will be treated as forming a single asset (a “share pool”), regardless of when they were originally acquired. The same day rules and bed and breakfasting rules remain unchanged, and shares will be identified under those rules before they are identified with shares in the share pool.

14. Other CGT reliefs will continue to be available. For example:

- Private Residence Relief will continue to be available for principal private residences.
- Business asset roll-over relief continues to be available. Roll-over relief enables the CGT payable on the gain on a chargeable asset to be deferred until a point in the future. Taper relief is not given on the rolled-over gain under the current rules.
- The Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) attract a number of CGT reliefs. These include CGT exemption where Income Tax relief has been claimed; loss relief on unquoted shares; deferral relief; and extended taper relief (all subject to certain conditions). For disposals on or after 6 April 2008 there will be no taper relief available. All other CGT EIS and VCT reliefs continue to apply.
- Business asset gift hold-over relief also continues to apply. This relief allows CGT on business assets that are given away to be held over until the assets are disposed of by the donee.
- As in the example above, any unused allowable losses from past years will continue to be allowed to be brought forward in order to reduce any gains.

15. Detail of any consequential changes and draft legislation will be published later this year. In the interim HMRC will be discussing the detail of these proposals with interested parties.

Further advice

16. If you have any questions about these changes or if you would like to take part in discussions, please contact Rachel Salisbury on 020 7147 2743 (email: Rachel.Salisbury@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

RESIDENCE & DOMICILE REVIEW

Who is likely to be affected?

1. UK residents paying tax on the remittance basis and non-resident individuals who spend a significant amount of time in the UK.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to:
 - Introduce an additional tax charge for individuals using the remittance basis of taxation;
 - End the automatic entitlement to certain personal allowances for individuals resident in the UK who are using the remittance basis;
 - Ensure that when determining if an individual is resident in the UK in any year, days of arrival and departure are counted; and
 - Address a range of anomalies in the remittance basis.
3. The remittance basis of taxation can apply to those UK residents who are not domiciled in the UK or who are not ordinarily resident in the UK. The remittance basis provides that such residents will be taxed on foreign income and gains only when they are remitted to the UK.

Operative date

4. All these changes will apply on or after 6 April 2008.

Current law and proposed revisions

An additional tax charge for the remittance basis

5. UK residents who are not domiciled or not ordinarily resident within the UK can currently use the remittance basis of taxation. This means that any income and capital gains arising overseas are only taxed here when that income or gain is remitted into the UK.
6. After a non-domiciled individual has been resident in the UK for seven years they will only be able to use the remittance basis of taxation if they pay an additional tax charge of £30,000 a year. Where an individual then decides not to use the remittance basis (and not pay the additional tax charge) they will be taxed on all their worldwide income and gains whether or not they are remitted to the UK.
7. The new rules will come into force on and after 6 April 2008 and all previous years of residence will count from that day. So, for example, an individual not domiciled within the UK who has been resident in the UK for

five years in April 2008 will only be able to claim the remittance basis of taxation for two more years before they have to pay either the £30,000 annual tax charge or account for tax under the arising basis.

Residence

8. When deciding if an individual is resident in the UK for tax purposes HMRC does not currently count the days they arrive in or depart from the UK. On and after 6 April 2008, days of arrival and departure will be counted as days of presence in the UK for residence test purposes.

Personal allowances

9. Everyone who is resident in the UK is entitled to an income tax personal allowance and, in some circumstances, a blind person's allowance. These are the amounts of income someone can receive without paying tax. Certain individuals are also entitled to the married couple's allowance. These allowances reduce the amount of tax they have to pay.
10. On or after 6 April 2008, subject to a *de minimis* limit, individuals who are resident but not UK domiciled or not ordinarily resident will not be able to use both the remittance basis and any of the personal income tax allowances. The change will apply to personal allowances, married couple's allowance and the blind person's allowance. A *de minimis* limit will apply such that remittance basis users who have unremitted foreign income of less than £1,000 a year will be able to retain their personal, married couple's and blind person's allowances as appropriate.
11. A person who has triggered the additional tax charge detailed above will still have no entitlement to UK personal allowances in the following year if they decide to continue using the remittance basis and pay the additional charge. If, at any future point, that person no longer uses the remittance basis, they will again be entitled to UK personal allowances.

Anomalies

12. Anomalies in the current rules mean that individuals using the remittance basis of taxation can avoid paying UK tax on their foreign income and gains effectively brought into the UK. A number of changes are being made to ensure that where foreign income and gains are remitted to the UK then tax is charged on those remittances. The changes include:
 - Correcting a flaw in the current claims mechanism which allows income arising in one year to be remitted tax free the following year by claiming the remittance basis in the first year but not in the second;
 - Reducing the scope for the alienation of income and gains through the use of offshore structures, such as companies and trusts, which convert taxable income and gains into non-taxable payments;
 - Extending those existing anti-avoidance measures which currently do not apply to remittance basis users so that in future they do;
 - Removing the 'ceased source' rule; and
 - Extending the definition of remittance in relevant foreign income.

Consultation

13. There will be consultation on the detail of the changes, based round draft legislation that will be published towards the end of the year.
14. The Government will be consulting on whether people who have been resident in the UK for longer than ten years should make a greater contribution.

Further advice

15. If you have any questions about the changes please telephone 020 7147 2762 or email andrew.hayward@hmrc.gsi.gov.uk. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

REMITTANCE BASIS: IRISH INVESTMENT AND EMPLOYMENT INCOME

Who is likely to be affected?

1. Individuals who are resident but not domiciled or not ordinarily resident in the UK, and have investment income arising in the Republic of Ireland or work for an employer resident in the Republic of Ireland.

General description of the measure

2. Restrictions in the way the remittance basis of taxation applies to investment and employment income from the Republic of Ireland are to be removed.

Operative date

3. The restrictions will cease to apply from 6 April 2008.

Current law and proposed revisions

4. Individuals who qualify for the remittance basis of taxation are normally liable to tax on foreign source income only if it is remitted to the UK. But the remittance basis does not apply to investment income arising in the Republic of Ireland, and this is currently charged to tax on an arising basis. This restriction is to be removed from 2008-09, so that the same rules apply to all foreign investment income, regardless of the country of origin.
5. Individuals who are resident and ordinarily resident but not domiciled in the UK face a similar restriction in relation to earnings from employment with an employer resident in the Republic of Ireland. This is currently taxed on an arising basis and the remittance basis is not available. This restriction is also to be removed from 2008-09.

Further advice

6. If you have any questions on the investment income measure, please contact Andrew Ellis on 020 7147 2658 (email: andrew.ellis1@hmrc.gsi.gov.uk). If you have any questions on the employment income measure, please contact Peter Seedhouse on 020 7147 2529 (email: peter.seedhouse@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

REDUCTION OF STAMP DUTY ADMINISTRATIVE BURDEN

Who is likely to be affected?

1. Taxpayers who acquire shares or securities in UK companies where a stock transfer form or other instrument is used to complete the transfer.

General description of the measure

2. Transfers that currently attract stamp duty not exceeding £5 (whether fixed or *ad valorem*) will be exempt and not have to be presented for stamping.
3. This measure will reduce the number of stock transfer forms that need to be presented to HM Revenue & Customs (HMRC) for physical stamping.

Operative date

4. This measure will have effect on and after Budget Day 2008.

Current law and proposed revisions

5. Under Part III of Schedule 13 to Finance Act 1999, certain transfers of shares and securities attract a fixed stamp duty charge of £5. Amongst other things these include: instruments transferring shares otherwise than on sale (such as transfers between nominees); declarations of trust (provided they do not constitute a sale); and replacement or second copies of instruments. Legislation will be introduced in Finance Bill 2008 to add such instruments to the categories of instruments that may be certified as exempt, as set out in the Stamp Duty (Exempt Instruments) Regulations 1987 (Statutory Instrument 1987/516). The instruments will therefore no longer attract stamp duty and will in future not need to be presented to HMRC for stamping.
6. Legislation will be introduced in Finance Bill 2008 to add such instruments to the categories of instruments that may be certified as exempt, as set out in the Stamp Duty (Exempt Instruments) Regulations 1987 (Statutory Instrument 1987/516). The instruments will therefore no longer attract stamp duty and will in future not need to be presented to HMRC for stamping.
7. Also, Part I of Schedule 13 currently charges *ad valorem* stamp duty on instruments that transfer shares and securities on sale. The duty is calculated at the rate of 0.5 per cent of the consideration given for the transfer, rounded up to the nearest £5. This means that any transaction where the consideration is £1,000 or less attracts £5 stamp duty and must

be presented to HMRC. A threshold will be introduced so that instruments where the transfer consideration does not exceed £1,000 will no longer attract any stamp duty and will not need to be seen by the Stamp Office.

8. These changes will result in approximately 220,000 low value instruments being removed from the stamping process.

Further advice

9. If you have any questions about this change, please contact Miles Harwood on 020 7147 2801 (email: miles.harwood@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

STAMP DUTY LAND TAX (SDLT): CHANGE IN NOTIFICATION THRESHOLDS FOR LAND TRANSACTIONS

Who is likely to be affected?

1. Taxpayers entering into a land transaction relating to residential or non-residential property where the chargeable consideration is less than £40,000.
2. Taxpayers entering into linked land transaction relating to either residential or non-residential property where the chargeable consideration of the linked transactions is less than £40,000.
3. Taxpayers who have had the grant of a lease for a period of 7 years or more where the grant is made for a chargeable consideration of less than £40,000.

General description of the measure

4. Legislation will be introduced in Finance Bill 2008 to change the rules for individuals notifying HM Revenue and Customs (HMRC) about a land transaction. For transactions involving residential and non-residential property where the chargeable consideration is less than £40,000, there will no longer be any need to notify HMRC about the transaction. Leases will have to be notified when the lease is for a term of seven years or more and where any chargeable consideration is more than £40,000 and the annual rent is more than £1,000.

Operative date

5. This measure will have effect for transactions on and after the date of Budget 2008.

Current law and proposed revisions

6. Stamp duty land tax is charged, at varying rates, on the consideration given for a land transaction. At present, no tax is payable on transactions in residential property if the consideration does not exceed £125,000 (and on transactions in non-residential property if the consideration does not exceed £150,000). Tax is payable at 1 per cent if the consideration exceeds £125,000 for residential properties (or £150,000 for residential properties which can claim disadvantaged area relief, and non-residential properties) but does not exceed £250,000. Tax is payable at 3 per cent if the consideration exceeds £250,000 but does not exceed £500,000, and at 4 per cent for consideration above £500,000.

7. The measure will raise the threshold for when a person has to notify HMRC of a land transaction. Currently, purchasers have to notify HMRC of most transactions involving the acquisition of a major interest in land for consideration using form SDLT1 unless specifically exempted. There are, for example, exemptions for:
 - Transactions where there is no chargeable consideration;
 - The acquisition of property by a person in or towards satisfaction of his entitlement under or in relation to the will of a deceased person, or on the intestacy of a deceased person. This is provided that there is no chargeable consideration other than the assumption of secured debt;
 - The grant of a lease by a registered social landlord in certain specific situations;
 - Certain transactions on the ending of a marriage or a civil partnership formed under the Civil Partnership Act 2004;
 - Certain transactions following a person's death.
8. Leases currently must be notified if the lease is for a period of seven years or more and the grant is made for a chargeable consideration. Leases should also be notified when they are granted for periods of less than seven years but tax is chargeable at a rate of 1 per cent or higher on either or both any premium or rent paid. This also applied in circumstances where there would have been tax chargeable at a rate of 1 per cent or higher but for the availability of a relief.
9. Since most transactions currently have to be notified to HMRC purchasers have to submit returns to HMRC even in cases where there is no stamp duty land tax payable.
10. This measure aims to reduce the administrative burden of SDLT by introducing a threshold for notifying HMRC of non-residential land transactions. It also raises the current threshold for notification of residential property transactions from the current £1,000 to £40,000.

Further advice

11. If you have any questions about this measure, please contact the Stamp Taxes Help Line on 0845 603 0135. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

STAMP DUTY LAND TAX (SDLT): CHANGE TO ANTI-AVOIDANCE LEGISLATION AFFECTING PARTNERSHIPS

Who is likely to be affected?

1. Property investment partnerships that purchase interests in property in the United Kingdom.

General description of the measure

2. Legislation will be introduced in Finance Bill 2008 to amend Finance Act (FA) 2007 to ensure that, where there is a transfer of an interest in a property within an investment partnership, there will be no charge to SDLT.

Operative date

3. This measure will have effect on and after the date of Budget 2008. The measure will be retrospective and apply to such transactions that occurred on and after 19 July 2007 (the date FA 2007 received Royal Assent).

Current law and proposed revisions

4. SDLT is charged, at varying rates, on the consideration given for a land transaction. At present, no tax is payable on transactions in residential property if the consideration does not exceed £125,000 (and on transactions in non-residential property if the consideration does not exceed £150,000). Tax is payable at 1 per cent if the consideration exceeds £125,000 for residential properties (or £150,000 for residential properties which can claim disadvantaged area relief, and non-residential properties) but does not exceed £250,000. Tax is payable at 3 per cent if the consideration exceeds £250,000 but does not exceed £500,000, and at 4 per cent for a consideration above £500,000.
5. FA 2007 introduced changes that tackled schemes which allowed payment of SDLT to be avoided by using provisions in previous SDLT legislation intended to help the transfer of property between different partners within an investment partnership. The changes amended the following parts of stamp duty land tax legislation within the Finance Act 2003:
 - the charge on transfers into partnerships set out in paragraphs 10-12 of Schedule 15;
 - the charge on transfers out of partnerships set out in paragraphs 18-20 of Schedule 15;
 - the charge on transfers of an interest in a property-investment partnership set out in paragraph 14 of Schedule 15.

6. The changes made in FA 2007 were made because HM Revenue and Customs (HMRC) had been made aware of a number of sophisticated and highly artificial tax avoidance schemes that were being used in high value commercial property transactions to avoid payment of SDLT.
7. After FA 2007 received Royal Assent, however, some property investment partnerships raised concerns in discussions with HM Treasury about the effects that this legislation has had on them. The legislation has affected the trusts by ensuring that each time there is a change in the size of share held within the property investment partnership there is a charge for SDLT regardless of whether there was any consideration paid for the change and regardless of whether the parties involved in the transaction were connected to each other in any way. Previously, provisions in SDLT legislation to help ease the movement of property between partners had been used to relieve these transactions of the charge to SDLT that would have been due on transactions involving transfers between partners.
8. The legislation in Finance Bill 2008 will amend FA 2007 in order to ensure that where there is a transfer of an interest in a property within an investment partnership, there will be no charge to SDLT.

Further advice

9. If you have any questions about this measure, please contact Michael Lyttle on 020 7147 2792, (email: michael.lyttle@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

FUEL BENEFIT CHARGE

Who is likely to be affected?

1. Employees who drive company cars and receive free fuel for private use from their employer, and employers who bear Class 1A National Insurance Contributions (NICs) on the taxable benefit of providing free fuel for private use.

General description of the measure

2. The fuel benefit charge (FBC) multiplier will be increased from £14,400 to £16,900 on and after 6 April 2008.

Operative date

3. The measure will have effect on and after 6 April 2008.

Current law and proposed revisions

4. If an employee receives free fuel for their company car for private use then a benefit that is subject to tax and NICs arises from section 149 of Income Tax (Earnings and Pensions) Act (ITEPA) 2003. Since April 2003 the fuel benefit charge has been calculated by applying the appropriate company car tax percentage to a set figure known as the multiplier. Since April 2003, the multiplier has been set at £14,400. The percentage is calculated by reference to the CO₂ of the company car. Tax and Class 1A NICs are then charged on the FBC.
5. From 6 April 2008 the fixed multiplier will increase from £14,400 to £16,900.
6. The change will be made by regulations which will be laid in time to have effect on and after 6 April 2008.

Further advice

7. If you have any questions about this change, please contact Employer Helpline on 0845 7143 143. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

AIR PASSENGER DUTY (APD)

Who is likely to be affected?

1. Airlines, travel agents and air passengers.

General description of the measure

2. Current definitions to determine class of travel for air passenger duty (APD) purposes will be amended so that single class flights offering only a business class service will attract the standard rate of APD.

Operative date

3. This measure will have effect in relation to any carriage of a passenger which begins on or after 1 November 2008.

Current law and proposed revisions

4. There are currently two rates of APD for classes of travel. Travel in the lowest class of travel available on a flight qualifies for a reduced rate of APD, while travel in all other classes attracts the standard rate of APD.
5. Under the current definition of class of travel, carriers offering business class only flights account for APD at the reduced rate. These flights are configured to seat significantly fewer passengers than they are capable of carrying and offer a business class level of service for all passengers. A comparable business class service offered on flights where more than one class of travel is available is liable to APD at the standard rate.
6. The class of travel definition will be amended so that business class only flights attract the standard rate of APD. We propose using seat pitch, more commonly referred to as leg room, as one of the criteria by which we will do this.
7. For aircraft where only one class of travel is available then where the seat pitch exceeds 40" the standard rate of APD will apply.
8. Legislation will be introduced in Finance Bill 2008 to amend section 30 of Finance Act 1994 to implement the changes to classes of travel.
9. The Government also intends from 1 November 2009 to replace APD with a tax payable per plane rather than per passenger. A consultation on this will follow in due course and one aim will be to introduce this tax in a way which raises around £520 million in a full year (2010/2011). This revenue could also

be achieved by increases to APD rate from the same date.

Further advice

10. If you have any questions about this measure, please contact National Advice Service on 0845 010 9000. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

VAT AND HOUSING

Who is likely to be affected?

1. Construction contractors and property owners

General description of the measure

2. Secondary legislation will be introduced to ensure that renovations and alterations to residential properties that have been empty for at least two years will be eligible for a reduced VAT rate of 5 per cent. Currently, such properties must have been empty for at least three years to qualify for the reduced VAT rate.

Operative date

3. This measure will have effect on and after 1 January 2008.

Current law and proposed revisions

4. The current law is set out in Note 3 to Group 7 of Schedule 7A to the Value Added Tax Act 1994.
5. This provides that VAT is chargeable at a 5 per cent reduced rate on works of renovation or alteration to residential properties that have been empty for at least three years.
6. This measure will extend eligibility for this reduced VAT rate, so that it will apply to works of alteration or renovation carried out to residential properties that have been empty for at least two years.

Further advice

7. If you have any questions about this measure, please contact Steve Lumby on 020 7147 0409 (email: steve.lumby@hmrc.gsi.gov.uk). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

LANDFILL TAX: EXEMPTION FOR WASTE ARISING FROM DREDGING AND TREATED WITH ADDITIVES

Who is likely to be affected?

1. Waterways authorities, dredging contractors and landfill site operators.

General description of the measure

2. Secondary legislation was laid before Parliament on 8 October which will extend the scope of the exemption from landfill tax for waste arising from dredging activities.
3. A ban on the landfilling of waste containing free-draining liquid is being phased in throughout the UK, necessitating the treatment of waste arising from dredging operations before it is sent to landfill. The ban comes into effect on 30 October 2007 in England, Wales and Northern Ireland and is already in place in Scotland.
4. Where treatment of waste involves adding other materials to immobilise the liquid content permanently, the waste will then fall outside the scope of the original exemption. The landfill tax exemption is therefore being extended to ensure that all waste from dredging that is disposed of by landfill will continue to benefit from exemption.

Operative date

5. The extension to the exemption will have effect for relevant disposals of waste made, or treated as made, on or after 30 October 2007.

Current law and proposed revisions

6. Material removed from waterways by dredging and disposed of at authorised landfill sites is exempt from landfill tax by section 43 of Finance Act 1996. The exemption stipulates that all material discarded must have been removed from the bed of a waterway.
7. A Treasury Order, laid before Parliament on 8 October 2007, will add a new subsection (5) to section 43, extending the exemption to disposals of material all of which HM Revenue & Customs is satisfied comprises material removed from the bed of a waterway and other material which has been added to it in order to ensure compliance with waste acceptance criteria.

Further advice

8. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

FACILITATING USE OF BIOBUTANOL

Who is likely to be affected?

1. Businesses producing and importing biobutanol.

General description of the measure

2. Biobutanol is an alcohol derived from the fermentation of biomass, and a lower carbon emitting substitute for petrol.
3. Biobutanol used as a road fuel in specific pilot projects to test the use of biofuels will be eligible to duty at 30.35 pence per litre. Eligible pilot projects that offer potential environmental benefits will be approved individually by HM Revenue & Customs, subject to appropriate anti-fraud safeguards.

Operative date

4. A statutory instrument will be laid before Parliament shortly, and will come into effect 21 days after being laid.

Current law and proposed revisions

5. Biobutanol is currently treated as a fuel substitute to petrol, and under section 6A of the Hydrocarbon Oil Duties Act 1979, it is subject to duty at 50.35 pence per litre.
6. A statutory instrument will be made under section 20AB of Hydrocarbon Oil Duties Act 1979.

Further advice

7. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

INCOME TAX SELF ASSESSMENT (ITSA): INCREASE IN PAYMENT ON ACCOUNT (POA) THRESHOLD

Who is likely to be affected?

1. Taxpayers making payments on account (POA) of their annual income tax liability under the income tax self assessment (ITSA) system, with annual income tax liabilities between £500 and £1000 from 2009/10 and beyond. This will remove 367,000 taxpayers from the POA regime, 319,000 of whom have business income.

General description of the measure

2. This measure doubles, from £500 to £1000, the threshold below which taxpayers do not need to make in-year payments on account of their annual income tax liability under the ITSA system.

Operative date

3. This measure will have effect on and after 6 April 2009 for income tax due for 2009-10. The first POAs affected will therefore be those due in January 2010 and July 2010.

Current law and proposed revisions

4. Currently, taxpayers within the ITSA regime are required to make two POAs towards their income tax liability for any year, unless:
 - their income tax bill for the previous year was less than £500, or
 - 80 per cent or more of the tax due was deducted at source.
5. The £500 threshold was set after consultation in 1996 at a level designed to ensure that most employees and pensioners, and others who have relatively small outstanding tax liabilities, would not have to make POAs, but rather one payment by 31 January following the end of the tax year.
6. The current threshold figure of £500 is set out in secondary legislation (Statutory Instrument 1996/1654 - Income Tax (Payments on Account) Regulations 1996). These regulations will be amended by the making of a new regulation to raise the figure at regulation 3 from £500 to £1000.
7. Draft legislation has been published today on the HM Revenue & Customs website.

Further advice

8. If you have any questions about this measure, please contact Brian Major on 020 7438 8494 (email: brian.major@hmrc.gsi.gov.uk) or Stephanie Allistone on 020 7147 2394 (email: stephanie.allistone@hmrc.gsi.gov.uk). For advice on how this will affect your individual tax affairs, please contact the SA Helpline on 0845 900 0444 or your local tax office. Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

