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CHARTERED ACCOUNTANTS AND CHARTERED TAX ADVISERS

# Chancellor's Budget 2009

April 2009

## The Budget - issues for businesses

### Corporation tax

The main rate of corporation tax for companies with profits above £1.5 million (divided by the number of associated companies) will be 28% for financial years commencing 1 April 2009 and 2010.

As announced at the November 2008 Pre-Budget Report the corporation tax rate for companies with profits up to £300,000 (divided by the number of associated companies) will remain at 21% for the financial year commencing on 1 April 2009.

### Income tax

From April 2010 taxable income above £150,000 will be subject to income tax at 50%. Dividend income received above this threshold is taxable at 42.5% with a 10% tax credit. This means that the effective rate of tax on net dividends received above this threshold is 36.11%.

A rise in income tax rates for higher incomes was expected. The Chancellor announced in the November 2008 Pre-Budget Report that income tax rates would rise but this was due to be introduced from April 2011. In addition the rate was originally intended to be 45% (an effective rate of 30.6% for dividends) and so this higher and earlier tax liability will mean that tax planning will need to be accelerated.

From April 2010 the basic personal allowance for income tax will gradually be reduced to nil for individuals with adjusted net incomes above £100,000. This allowance will reduce by £1 for every £2 of income above £100,000. The adjusted net income is calculated after deducting trading losses, gross and grossed up payments to pension schemes and grossed-up Gift Aid contributions.

This change means that there is a new effective rate of income tax of 60% for those earning just in excess of £100,000.

The removal of the personal allowance had been announced in November 2008 but was originally intended to be withdrawn in two stages, a 50% withdrawal for income above £100,000 and the remaining 50% withdrawn for income above £140,000.

***Tip***

Taxpayers on higher incomes should consider bringing forward income to be taxable at lower rates. Careful consideration should be given to profit extraction and whether it is more tax efficient to pay dividends or bonuses at these new levels of income or consider alternative way to extract profits. Where companies have insufficient financial resources to pay out profits, the additional dividends and bonuses can be loaned back to the company. The company can then pay interest to the lender at a commercial rate (there is a requirement to deduct 20% income tax before making such payments).



Although the increase in income tax rates initially suggests that partnerships and sole traders should incorporate, there are ways of continuing to operate as an unincorporated business whilst still avoiding the need to pay 50% income tax on undrawn profits, and retaining the benefit of reduced National Insurance costs.

For those earning just in excess of £100,000 a year from 2010, a Gift Aid donation which reduces income to £100,000 will attract tax relief at an effective rate of 60%.

**Capital allowances**

Enhanced Capital Allowance (ECA) schemes - the energy efficient scheme list will be revised to include one new technology (uninterruptible power supplies) and two new sub-technologies (air to water heat pumps and close control air conditioning systems). Businesses can write off 100% of the cost (of plant and equipment within these schemes) against the taxable profits of the period in which the expenditure is incurred.
Business expenditure on cars - where cars are acquired after 31 March 2009 (companies) and 5 April 2009 (unincorporated businesses), capital allowances (tax relief for depreciation) will be:

- $CO_2$ emissions exceed 160 g/km: 10% a year
- $CO_2$ emissions 160 g/km or less: 20% a year
- Cars purchased new with $CO_2$ emissions 110 g/km or less: 100% a year

For cars (with $CO_2$ emissions exceeding 160 g/km) leased from April 2009, only 85% of the leasing costs are tax deductible. For cars with lower emissions leasing costs are 100% tax deductible.

A temporary first year capital allowance of 40% has been introduced for expenditure on plant and machinery incurred in the 12 months from 1 April 2009 for companies and 6 April 2009 for other businesses.

This allowance does not apply to expenditure on assets qualifying for the lower writing down allowance of 10% (for example long-life assets and integral features) and exclusions also apply for expenditure on cars and assets for leasing.

This allowance will be of most interest to businesses that incur expenditure on assets in excess of the Annual Investment Allowance and where such expenditure does not qualify for other 100% first year allowances that apply to expenditure on certain energy-efficient and environmentally-friendly assets.

***Tip***

Businesses that require significant capital investment (where total capital expenditure will not be covered by the annual investment allowance (AIA)) will welcome this change, but they should not ignore the more accelerated reliefs available for expenditure on 'green' assets. Businesses affect should consider accelerating post April 2010 capital expenditure.

**Losses**

It was announced in the Pre-Budget Report, that businesses would be able to carry back up to £50,000 of trading losses against profits for the previous three years instead of only the last 12 months. This has now been extended to losses arising in the accounting periods ending in the period from 24 November 2008 to 23 November 2010 for companies, or the two tax years 2008/09 and 2009/10 for unincorporated businesses. Losses can be carried back one year without limit. The extended carry back is restricted to £50,000 for each of the two years. For example, £50,000 of losses can be carried back three years from a company's accounting period ending 31 December 2008, and £50,000 can be carried back three years from the accounting period ending 31 December 2009.

**Foreign profits**

Dividends and other distributions received by UK companies from foreign companies on or after 1 July 2009 will be exempt from UK corporation tax providing they do not fall foul of anti-avoidance provisions. Contrary to previous announcements this applies to dividends from all such foreign companies regardless of the shareholding.

Tax relief for interest payable by UK members of groups of companies is going to be restricted based on the level of consolidated gross finance expense for that group. Certain exclusions will apply for example in respect of financial services and short term finance debt.

As announced previously, changes are also being made to the UK's Controlled Foreign Company regime. For accounting periods commencing on or after 1 July 2009 (plus transitional provisions where the period straddles that date) there will no longer be an exemption from the CFC rules where the foreign subsidiary has an acceptable distribution policy (ADP). Similarly the exemption that related to certain holdings companies is being removed.

Legislation currently exists requiring certain consents from HM Treasury where transactions take place with overseas subsidiaries. From 1 July 2009 this system is being repealed and is being replaced with a system of post-transaction reporting where the transactions has a value of £100 million or more.

***Tip***

Companies that receive foreign dividends should review the changes to ascertain whether they qualify for this exemption particularly where the rates of foreign tax are significantly different from the rates in the UK and particularly where double tax relief could not previously be claimed in full for foreign tax paid on those dividends.




## Loan relationships and trade debts

Changes are being made to the rules regarding the release of trade debt where the creditor and debtor companies are connected so that the treatment of the debtor and creditor companies is matched i.e. where the loan is released the creditor company does not incur a corporation tax charge but similarly the debtor company does not obtain corporation tax relief.

This change relates to debts that are released on or after 22 April 2009.

As announced previously changes are being introduced to the provisions which allow a company to claim corporation tax relief for interest payable to connected parties. In such cases where the interest was paid more than 12 months after the end of the accounting period interest was only allowable against corporation tax when it was paid.

This provision which applies for accounting periods beginning on or after 1 April 2009 will now only apply if the recipient company is tax resident in a non-qualifying territory (i.e. a tax haven).

Anti-avoidance provisions maybe introduced if this is abused.

## Groups of companies

Legislation will be introduced to ensure that companies issuing particular types of new preference share capital to external investors do not cease to be a 'group' for purposes of claiming/surrendering losses etc. The changes apply to all accounting periods commencing on or after 1 January 2008.
Where deemed gains or losses arise to group companies on or after the date that Finance Bill 2009 receives Royal Assent, it will now be possible to transfer these to other companies in the same group (eg a loss arising from a 'negligible value' claim will be surrenderable to a group company which can use that loss against a chargeable gain which it has realised). Similar arrangements already exist for gains or losses arising on disposals to third parties.

## Venture Capital

A number of changes have been made to venture capital schemes. Starting in 2009/10 investors in the Enterprise Investment Scheme (EIS) companies will be able to treat any amount of investment (subject to the £500,000 annual limit), as being made in the previous tax year. Where an EIS company is taken over, and the original shares are exchanged for shares in the acquiring company, the capital gain arising in the exchange will not be taxed, regardless of when the share exchange takes place.
For EIS, the Corporate Venturing Scheme and Venture Capital Trusts there are relaxations in the time limits for spending the money raised from share issues. It is now merely necessary for the whole of the money to be spent within two years (previously the company had to use 80% of the money raised within one year of the share issue and the remainder within two years).

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## Compliance

For accounting period beginning on or after the date the Finance Bill receives Royal Assent, 'senior accounting officers' (whose identity must be notified to HMRC) of 'large companies' (these are companies which fail to meet at least two of these criteria: not more than 250 employees; turnover and balance sheet total no more than £22.8 million and £11.4 million, respectively) must take reasonable steps to establish and monitor accounting systems within their companies that are adequate for the purposes of accurate tax reporting. The 'senior accounting officer' will be required to certify annually that the accounting systems in operation are adequate for the purposes of accurate tax reporting; or to specify the nature of any inadequacies and confirm that those inadequacies have been notified to the company auditors.

## Business owners and shareholders

The annual exempt amount for capital gains tax (CGT) is increased to £10,100 (£9,600 2008/09). The rate of CGT remains unchanged at 18% on net gains after reliefs, losses and the annual exemption. Entrepreneurs' Relief reduces the rate to 10% on the first £1 million of lifetime gains on disposals of qualifying business assets.

## Pensions

Although it was announced that from 6 April 2011 tax relief for pension contributions will be restricted for individuals with an annual income of £150,000 or more, the restrictions actually commence on 22 April 2009. From 6 April 2011 relief will be tapered away so that for those earning over £180,000 relief will be worth only 20%. But to avoid high earning individuals paying increased contributions prior to 6 April 2011, anyone with an annual income in excess of £150,000 and paying contributions in excess of £20,000 a year before 6 April 2011 may suffer the 'special annual allowance tax charge' (a 20% tax charge on excess contributions including those paid by employers). These measures are likely to make pensions far less attractive for high earners. The draft legislation is subject to consultation and it is hoped that some changes will be made before the Finance Bill receives Royal assent.

***Tip***

The draft rules are extremely complex, but for taxpayers with income only marginally in excess of £150,000, comparatively small 'Gift Aid' donations may remove them from the prospect of this additional tax charge. The loss of full income tax relief on contributions made by high earners will make investments outside 'pension wrappers' more attractive. Where investments are in capital growth assets, although there is no initial tax relief, the rate of capital gains tax is only 18% and the whole of the investment is accessible (compared to a pension where 75% of the fund must be taken as income and is unlikely to be paid out in full during the pensioner's lifetime).



**Employment issues**

There are no changes to the taxation of company cars and fuel for 2009/10. Changes to taxable benefits for company cars from 6 April 2011:

- the 15% scale rate will apply to $CO_2$ emissions of 125 g/km (currently 135 g/km falling to 130 g/km in 2010/11)
- the 'list price' cap of £80,000 will be abolished
- the reductions currently available for electric/petrol hybrid cars and cars propelled by bi-fuels, road fuel gas and bioethanol will be abolished.

**VAT**

A new package of measures is being introduced that will seek to provide a uniform approach to cross border transactions.

The place of supply rules determine the country in which a supply of services is made and therefore where any VAT is payable. From 1 January 2010 these rules are changing for certain categories of expenditure. The new rules will focus on the place that the customer is established rather than the location of the supplier.

The new rules will apply to valuations and works carried out on goods. The new rules will also apply to the long term hire of vehicles (long term is more than 30 days (90 days for vessels)). This will only relate to supplies made to VAT registered customers.

The impact of this provision is that such supplies will be made free of VAT, but the customer will be responsible for reporting the VAT under the reverse charge provisions. As a result such customers will not have to register for VAT in the country in which the supplier is based but will have to report the VAT on the returns made to their own tax authorities.

The administrative requirements relating to EC Sales List is also changing with effect from 1 January 2010.

From that date the supply of services with the EC which operate under the reverse charge provisions will need to be included on the quarterly EC Sales Lists. This will enable the tax authorities of the country where the supplier is based to cross refer these records with the returns that are made by each supplier.

***Tip***

For businesses that previously had to consider registering for VAT in the country in which their supplier was based these changes will be good news, albeit that the result is an increase in the administration in their home country.


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## Miscellaneous reliefs

All tax reliefs for furnished holiday lettings (FHL) are to be abolished from 6 April 2010. This change is happening because the existing rules (FHL property must be located in the UK) are thought not comply with European law. Until 6 April 2010, HMRC will regard the FHL rules as applying to furnished holiday accommodation elsewhere in the EEA.

***Tip***

This provides an opportunity to bring 'qualifying' properties located in EEA countries within the FHL regime for past years. This could provide losses to set against other income, deferral of capital gains, relevant earnings for pension contributions, etc. The timing of claims will depend on the particular relief sought.

Agricultural property relief (APR) and woodlands relief (WR) - both inheritance tax (IHT) reliefs - are extended to property in the European Economic Area (EEA). Such property will also qualify for CGT hold over relief.

- APR can now be claimed in respect of IHT due or paid on or after 23 April 2003 in relation to agricultural property located in an EEA
- For deaths before 22 April 2009, property located within an EEA state will become eligible for WR. The time limit for obtaining WR is usually within two years of the date of death. It is proposed that the earliest deadline for reclaiming overpayments on property qualifying for WR will be 21 April 2010.

***Tip***

Review the estates of those who have died since 1 October 2002, who may have owned agricultural property located in an EEA country; and for more recent deaths where woodlands may have formed part of the deceased's estate.


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