



CORPORATE AND BUSINESS TAX

Hugh Davies & Co.
CHARTERED ACCOUNTANTS

Income shifting

In July 2007 Mr and Mrs Jones won their case in the House of Lords. The profits of Arctic Systems (their company) which were paid equally to them by means of dividends would be taxed on each of them rather than solely on Mr Jones. The government believes it is unfair for one person to arrange their affairs so that their income is diverted to a second person, subject to a lower tax rate, to obtain a tax advantage.

The government has announced that draft legislation to take effect from 2008/09 to address income shifting will shortly be issued for consultation. The legislation will work alongside the existing rules on businesses deductions and settlements, and will seek to remove the tax advantage obtained from income shifting. It would only apply when the income is in the form of distributions from a company (dividends) or partnership profits.

HMRC will provide 'practical guidance' on the legislation as to the circumstances which may not be caught by the legislation. Relevant factors to consider when establishing whether or not income shifting has taken place could include the work done by the individuals in the business, the investments made and the risks to which they are subject through the business.

Income from employment, interest on savings and any other source will not be affected.

Comment

Legislation was widely expected following the Arctic Systems case. We await the publication of the draft legislation with interest!

Tax simplification reviews

The government has announced the start of a 'significant programme of tax simplification'. Three reviews will be started in the autumn where HM Treasury and HMRC will work in partnership with business to evaluate how a range of tax policies could be simplified. These initial reviews will cover:

- how to simplify VAT rules and administration in the UK and the EU
- how anti avoidance legislation can best meet the aims of simplicity and revenue protection
- how to simplify the corporation tax rules for related companies.



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VAT rules and administration

Areas where simplification will be of most significance to all VAT registered business include:

- Partial Exemption and the Capital Goods Scheme
- the frequency with which businesses submit returns
- VAT retail schemes.

Comment

There are 1.9 million VAT registered organisations in the UK. The VAT system already contains a wide range of schemes and methods, many targeted at smaller businesses, designed to simplify administrative requirements. However business has told the government that it would like to see further simplification.

Corporation tax rules for related companies

Areas where simplification will be of most significance to UK companies include:

- associated company rules for small companies corporation tax rate
- group aspects of corporation tax on chargeable gains
- corporation tax self assessment filing and payment for groups
- the burden of the transfer pricing rules.

Comment

There are over one million active companies in the UK, many of which have related companies, either as part of a wider company group, or because of association through common ownership. These relationships may complicate their tax affairs, and simplifying the corporation tax treatment of related companies could help reduce administrative and compliance burdens.



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Spreading of tax relief for pension contributions

Employers generally get tax relief against their taxable profits for contributions paid to a registered pension scheme. Relief is given for the accounting period in which the contributions are paid. Tax relief for some large contributions above £500,000 maybe spread over a period of up to four years.

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. 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.

The measure will ensure that the spreading of contributions cannot be avoided by routing them through a new company.

Other anti-avoidance measures

Action is being taken to counter various avoidance schemes:

- financial products - disguised interest (and thus taxable) as dividends (which are exempt from tax for companies)
- abusing the availability of interest relief through the payment of interest in advance
- avoidance involving the sale and finance leaseback of plant or machinery and attempts to exploit long funding leases to create a tax loss where there is little or no commercial loss.

Company gains on life policies

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 debts and debt-like instruments.

The special legislation that currently applies to such policies held by companies ('the chargeable events' rules) will therefore be repealed.

Comment

In practice very few companies own life policies and annuity contracts partly because of the archaic chargeable event rules. 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 which is a far more sensible taxation system.



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Tax relief for business cars

In March 2007 the government issued a second discussion document about business expenditure on cars.

The proposals are that:

- the existing 100% first year allowances for cars with CO2 emissions up to 120g/km be retained
- the general plant and machinery capital allowances pool will be used for cars with CO2 emissions between 121 and 165g/km
- a new car pool would be introduced with a lower writing down allowance than the general plant and machinery pool for other cars.

As a consequence there would no longer need to be a specific distinction between cars costing more or less than £12,000.

The government has issued a summary of the responses to the proposals. The majority of the respondents supported reform of the current system but views were divided as to what would be a preferable system. In the light of this, the government has not indicated its next steps to modernise the tax relief system.

Fire safety capital allowances

Legislation extending capital allowances to expenditure on building alterations, made in response to a notice from a Fire Authority, is to be repealed for expenditure from April 2008. Relief for expenditure on fire safety equipment such as fire alarms and sprinkler systems will continue to be available for all businesses.

Comment

The repeal sounds more severe than it actually is. The rules giving relief for fire safety alterations were introduced in 1974 to encourage businesses to ensure that existing buildings met fire safety standards. But since that date fire safety legislation has been reformed and now operates on a self-assessment basis. The tax relief 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, the relief is being removed.



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VAT and housing

Currently VAT is chargeable at 5% on renovations or alterations to residential properties that have been empty for at least three years.

Eligibility for this reduced VAT rate will, on and after 1 January 2008, apply to renovations or alterations carried out to residential properties that have been empty for at least two years.

For more information, contact Hugh Davies on 01722 336647.

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