

# Your Firm's Details Printed Here

## Pre-Budget Report 2007

### The highlights of the Chancellor's Statement

Tuesday 9 October 2007

## Capital Taxes

### Capital gains tax (CGT) reform

The Chancellor surprised everyone with major changes to the CGT regime. Legislation will be introduced next year to give effect to a new single rate of charge to CGT at 18%. A number of changes will be made for disposals made on or after 6 April 2008 to simplify the capital gains tax regime, including:

- the withdrawal of taper relief
- the withdrawal of indexation allowance
- simplification of the share identification rules.

### CGT annual exemption

The annual exemption allows the first element of chargeable gains made in a given tax year to be exempt from CGT. An annual exemption will remain in place and for 2007/08 this is currently £9,200.

### CGT rates of tax

Individuals making capital gains currently treat those gains as the top slice of income. This means that, currently, tapered gains are charged at 10% where gains plus taxable income do not exceed £2,230; 20% between £2,231 and £34,600; and 40% on any balance. For trustees the rate of CGT is 40%.

For 2008/09 there will be a single rate of capital gains tax set at 18%, which will apply to individuals, trustees and personal representatives.

### CGT reliefs

Taper relief was introduced for disposals on or after 6 April 1998 and can reduce the amount of the gain chargeable to CGT. The amount of relief available depends on whether the asset is classed as a business or non-business asset and, also, on the length of time an asset has been held since 1998.

For disposals on or after 6 April 2008 and any held over gains coming into charge on or after that date, taper relief will no longer be available. The chargeable gain will be liable to tax at 18%, after deducting allowable losses, any other reliefs and the annual exemption.



Indexation allowance was, for individuals and trustees, the precursor to taper relief and gave relief for the effect of inflation on the costs incurred on assets. Indexation was frozen as at 5 April 1998. Currently, where an asset was held at 6 April 1998 and is disposed of after that date, any 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.

## Comment

The major changes announced will mean that CGT calculations will become a lot simpler. However although an 18% rate of CGT sounds low, there will be many losers.

Consider a higher rate taxpayer who makes a gain on £1m on a business asset. Business asset taper relief is available at 75%, so, in simple terms, only £250,000 is chargeable at 40%, a bill of £100,000.

Under the new rules, the whole of the £1m is chargeable at 18% a bill of, £180,000. Simplification may come at quite a price!

## Inheritance tax (IHT) threshold

The IHT nil rate band was increased to £300,000 with effect from 6 April 2007.

Transfers of property between spouses or civil partners are generally exempt from IHT. This means that if an individual dies and leaves some or all of their property to their spouse or civil partner, they may not have fully used their nil-rate band.

The new rules will allow any nil-rate band unused on the first death to be used when the surviving or civil partner dies. The transfer of the unused nil-rate band from a deceased spouse or civil partner, irrelevant of the date of death, may be made to the estate of their surviving spouse or civil partner who dies on or after 9 October 2007.

The amount of the nil-rate band available for transfer will be based on the proportion of the nil-rate band which was unused when the first spouse or civil partner died.

For example, on the first death none of the original nil-rate band was used because the whole of the estate was left to the surviving spouse. If the nil-rate band is £350,000 when the surviving spouse dies, it would be increased by 100% to £700,000.

## Comment

This is an interesting way of addressing a problem that has arisen over recent years, namely that house price increases have meant that many people have been dragged into the IHT net. Certainly the change will help address this issue.



# Corporate and Business Tax

## 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!

# Employment Issues

## Company cars and the fuel scale charge

Where a car is provided for an employee's private use, a taxable benefit arises which is based on the list price of the car and its CO2 emissions. The percentages range from 15% to 35% for most cars. There are currently discounts available for environmentally friendly cars and from 6 April 2008 there will be a 2% discount for cars that have been manufactured to run on E85 fuel.

If free fuel is provided for private motoring then a fuel benefit tax charge arises based on the percentage used for the car benefit and a 'multiplier', which is currently £14,400. For 2008/09 the figure will increase to £16,900.

## Comment

The fuel scale charge figure has not changed since it was introduced in 2003. This rise, combined with an increase in the car benefit percentages for 2008/09, means that many employees will see a substantial increase in their tax bills from next April.

Employers should seriously consider whether the fuel benefit is worth maintaining, as the associated Class 1A payable by employers on benefits in kind will also go up.

## National Insurance Contributions (NICs)

In the last Pre Budget Report, all of the NIC rates were announced for the forthcoming year but, this year, no rates at all were announced!

In this year's Budget, significant proposed changes to the limits between which NICs are payable were announced. For 2008/09 the upper earnings limits (UEL), above which employees continue to pay contributions of 1% on earnings, will be increased by £75 per week above indexation.

The upper profits limit for Class 4 national insurance for the self-employed will also be increased in 2008/09 by £75 per week above indexation.

In the following year the upper earnings limits will be aligned with the point at which the higher rate of income tax becomes payable.

## Comment

The government claims the increases in national insurance are aimed at simplifying the tax system but it comes at quite a cost to employees and the self-employed.



# Personal Tax

## Tax rates for 2008/09

As previously announced the government proposes to radically change the tax rates for 2008/09 onwards when the 10% starting rate will be abolished for earned and pensions income and the 22% basic rate of tax will be reduced to 20%. The higher rate of tax will continue at 40%.

The starting rate will continue to be available for savings and investment income. There are no changes to the tax rates applicable to dividends. However the rate of tax applicable to capital gains will change significantly to a flat rate of 18% for 2008/09 (see Capital Taxes section).

The income tax bands for 2008/09 were not announced in the Pre-Budget Report. Details of these are normally made available in the main spring Budget.

## Comment

Gordon Brown had previously announced the reduction of the basic rate of tax by 2% in the Budget earlier this year. He also announced that the point at which people start paying the higher rate of tax will be increased significantly to £43,000 from 2009/10.

There is, however, a significant sting in the tail for some of those with earned income. The changes in the upper earning limit for NIC (see Employment Issues) will largely negate the income tax savings for many.

## Allowances

The Chancellor did not announce the level of income tax allowances for 2008/09. The current personal allowance for those under the age of 65 is £5,225.

## Residence and domicile

The government has announced the completion of the residence and

domicile review with a package of reforms which will take effect from April 2008.

The main proposal is that UK residents who are non-domiciled, who wish to continue to be taxed on a 'remittance basis' rather than on their worldwide income and gains, will have to pay an annual charge of £30,000. This measure is being introduced to ensure that they contribute in respect of the foreign income and gains which they keep abroad and on which they do not pay UK tax. The charge will apply if they have been resident in the UK for more than seven years.

Other proposals include:

- users of the remittance basis will lose their automatic entitlement to the personal allowance, currently £5,225, subject to a de minimis
- to ensure that when determining if an individual is resident in the UK, days of arrival and departure are counted
- to amend the current rules to remove flaws and anomalies that allow individuals who are assessed only on a remittance basis to sidestep UK tax where it is due on income and gains.

The government will consult on the detail of these proposals and on a wider range of options, including an option to make those individuals who are resident in the UK for more than ten years contribute more.

