

# Pre-Budget Report

9 December 2009



# Smith & Williamson

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# Introduction

Unusually there was little tax content in the Chancellor's speech, but the Pre-Budget Report (PBR) itself comprised 212 pages of detail. In addition, there were 35 Pre-Budget Notes issued by HMRC to wade through.

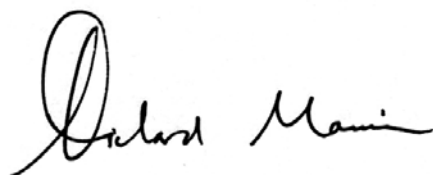
The backdrop to this year's PBR was particularly intriguing. It was obvious that at some point the Government would need to raise more tax to start repaying the exceptional borrowings resulting from the economic crisis. In this connection we were already on notice that a new 50% top rate of income tax would apply to taxable income exceeding £150,000 per annum from 6 April 2010, and personal allowances would be withdrawn from individuals whose taxable income exceeded £100,000 per annum. But those increases alone were clearly not going to bridge the gap. So the question was how the difference was to be tackled – more tax increases, less spending, or both.

And of course this question has a political as well as an economic dimension as we move towards the next election. In more normal times the Chancellor of the Exchequer would surely want to reduce the headline taxes just before an election and he certainly would prefer not to announce tax increases.

In the end, the Chancellor decided not to go for large tax rises for 2010/11, but warned that National Insurance contributions (NIC) would rise by 1% across the board with effect from 6 April 2011. However there may be a government of a different hue in power in 2011. So it remains to be seen whether this warning actually comes to fruition.

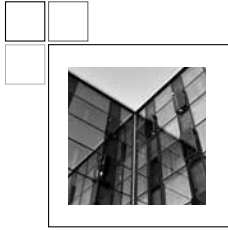
The press had been full of dire predictions for a windfall tax on bankers' bonuses with bankers lining up to take the Government to the European Court over a potential breach of their human rights. In the event, we ended up with a targeted levy on the banks' bonus pools between now and 5 April 2010 and it will be interesting to see how effective this is.

The Financial Secretary of the Treasury, Mr Stephen Timms, had warned that the Government's patience with contrived tax avoidance was wearing very thin and that we should expect to see yet more anti-avoidance legislation in the PBR. We were not disappointed. We have a raft of new targeted rules covering a wide range of schemes designed to avoid various taxes, and yet more threats for those who have offshore bank accounts that have not been disclosed. This is all part of a concerted attack on avoidance and evasion by the UK authorities and other leading economies which will undoubtedly continue to be a mainstream activity for HMRC, irrespective of the possible change in Government in 2010.



Richard Mannion  
National Tax director

9 December 2009



# 1 Personal tax and trust

## 1.1 Income tax and National Insurance rates, thresholds and limits

Several significant changes to take effect from 2010/11 were announced in April's Budget, including:

- taxpayers with 'adjusted net income' exceeding £100,000 per annum will suffer a reduction to their personal allowance of £1 for every £2 in excess of £100,000. The maximum reduction is the full amount of the personal allowance;
- a new higher rate of tax of 50% will apply to taxpayers with income over £150,000 per annum (42.5% for dividend income);
- the rate applicable to trusts will increase to 50% (42.5% for dividend income).

'Adjusted net income' takes into account specific deductions including payments made to pension schemes, gift aid donations and trading losses.

In the PBR speech the Chancellor announced that there would be no further changes to 2010/11 income tax rates or thresholds, except for some changes in what can be tax deductible. He also proposed a freeze in April 2012, for one year, for the point at which people start paying income tax at 40%. This will affect those with incomes over £43,000.

For NIC, with effect from 6 April 2010, the lower earnings limit which is linked to the basic state pension will increase by £2 to £97 per week. All other rates and thresholds for 2010/11 will remain unchanged with the exception of Class 2 for Volunteer Development Workers, which will increase by 10p to £4.85 per week.

The 2008 PBR announced that with effect from 2011/12 the main rate of Class 1 employees' contributions and Class 4 NICs would be increased by 0.5% to 11.5% and 8.5% respectively, the Class 1 employer rate would be increased by 0.5% to 13.3% and the increased rates would also apply to Class 1A and Class 1B contributions. The additional rate of Class 1 and 4 NICs would also be increased by 0.5% to 1.5%.

It is now proposed that, from 2011/12, all rates will be increased by 1%, not 0.5%, giving the following totals:

Main rates:

Class 1 employees	12.0%
Class 4	9.0%
Class 1 employers, Class 1A and Class 1B	13.8%

Additional rates:

Class 1 employees	2.0%
Class 4 NIC	2.0%

In order to compensate the lowest earners, the primary threshold and the lower profits limit will be increased by £570 for 2011/12 so that the increase only affects those earning over £20,000.

The proposed changes to personal tax rates, allowances and limits and NIC rates and thresholds are set out in Appendix 1.

**Comment:** The further increase in NICs from April 2011 will affect all employers, employees and the self-employed alike. The increase in the primary threshold and lower profit limits will provide a small measure of relief for the lowest earners, and the real impact of the measure will be felt by the higher earners, particularly when coupled with the 50% tax rate for income in excess of £150,000.

## 1.2 Furnished holiday lettings

The Government has published draft legislation and guidance on the withdrawal of the special rules which apply to the taxation of furnished holiday lettings (FHLs) anywhere in the European Economic Area (EEA) not just in the UK.

The existing rules will cease to apply from the commencement date which will generally be 6 April 2010 for individuals and 1 April 2010 for companies. Specifically, this will mean that:

- losses will only be off-settable against profits from property businesses rather than being off-settable against other income or gains;
- FHL income will not count as relevant earnings for the purpose of calculating the size of tax deductible pension premiums;
- capital allowances will not be available on expenditure on plant and machinery or fixtures and fittings in the property, but can continue to be claimed on capital allowance pools that exist at the commencement date and will continue to be available on items not used within the property, e.g mower and computer;
- the normal wear and tear allowance for furnished residential property of 10% of rents will be available;
- no roll-over of chargeable gains will be available after the commencement date where either the asset disposed of or acquired is a FHL, although gains rolled into FHL acquisitions pre-commencement will not come into charge until the property is disposed of;
- no hold-over of chargeable gains will be available on gifts which are FHLs;
- entrepreneurs' relief, (which reduces the rate of CGT from 18% to 10% on £1m of lifetime gains) will not apply to the disposal of a FHL business;
- no capital loss can be claimed on irrecoverable loans to FHL businesses, where the loan was made after the commencement date;
- the substantial shareholding exemption will not apply to companies which have FHL businesses;
- FHLs will continue to be subject to business rates;
- FHL income will still be subject to VAT if the registration limit is reached; and
- no changes are proposed to the inheritance tax (IHT) treatment of FHLs.

**Comment:** The draft legislation and guidance has been published despite vocal opposition from the accountancy profession, the tourism industry and trade organisations. The guidance confirms worst fears and the examples show that almost any FHL business will be caught, however large and however many extra services are provided. The argument that the holiday let business is labour intensive and more akin to the hotel business has fallen on deaf ears, as has the argument that the tourism industry will be irretrievably damaged since FHL owners will take the easy option and sell up or let on a longer-term basis. The loss of capital allowances is particularly unfortunate since the high standards demanded by the modern tourist require a high level of investment. The significant reduction in tax relief could well tip the balance.

The comment that the IHT rules have not changed is small comfort since last year HMRC changed its view as to whether FHLs would qualify for business property relief and now considers that they are property investment businesses and therefore unlikely to qualify.

The guidance fails to consider apart-hotels nor does it cover what happens when a FHL commences in 2009/10 so that the 12-month qualifying period runs into 2010/11.

At this stage, we do not know whether the draft legislation will become law; it will be included in the 2010 Finance Bill but that will necessarily be abbreviated so that it can be enacted before Parliament is dissolved prior to the 2010 election.

### 1.3 Film tax relief

Film production companies which incur qualifying expenditure on producing British films can potentially obtain additional tax deductions (up to 100% of the original expenditure) and, if the company has a tax loss, it may be surrendered for a cash repayment in the form of a tax credit (up to 25% of the surrenderable loss). The rates applicable depend on whether it is a limited budget film or not.

The Government announced that legislation will be introduced to reword the way in which the loss surrenderable by a film production company for a film tax credit is calculated. There was an unintended restriction to the available tax credit in cases where there was increased UK expenditure in the second and subsequent periods. The proposed new rules will calculate the amount surrenderable for a film tax credit to be the lower of:

- the available qualifying expenditure; and
- the loss for the period, plus any unsurrendered brought forward loss.

The new rules will have effect for accounting periods ending on or after 9 December 2009.

**Comment:** This amendment corrects an unintended anomaly arising from the wording of the original legislation and so now allows a company to obtain film tax credits based on the total qualifying expenditure in the correct period. The correction is an understandable change and will be welcomed by those film production companies claiming film tax credits who previously have had it restricted.

### 1.4 Income tax treatment of shared lives carers

Legislation will be introduced in Finance Bill 2010 to establish a new income tax relief for qualifying shared lives carers, similar to the current foster care relief, with effect from 6 April 2010.

The shared lives carers affected are those who:

- provide accommodation, care and support for up to three individuals who have been placed with them under a local authority shared lives placement scheme; and
- share their home and family life with the individuals placed with them under the shared lives scheme.

The relief will consist of a tax free allowance, and carers whose shared lives earnings are less than the tax free allowance will not be taxed on their income from providing shared lives care. Those carers whose shared lives earnings are more than the tax free allowances have the option to choose a simplified method for calculating their profits based on:

- their total receipts from providing care less the tax free allowance; or
- their actual profits computed using the normal tax rules for businesses.

The relief will replace the existing simplified arrangements which can be continued to be used in the meantime.

The tax free allowance will be available per household, and consist of:

- £10,000 fixed amount per annum;
- £200 per week (or part week), per placement aged under 11; and
- £250 per week (or part week), per placement aged 11 or over.

Where there is more than one carer in the household, the household may still only provide care to a maximum of three shared lives placements, and the allowance will be shared equally between the carers. If the carer is entitled to both foster care relief and shared lives carers, only one £10,000 fixed amount per year may be claimed.

**Comment:** This new relief, while welcome, is unlikely to affect many taxpayers.

### 1.5 Seafarers' earnings deduction

Seafarers' earnings deduction, which can provide 100% relief from tax for the earnings of a UK resident seafarer carrying out duties wholly or partly outside the UK, provided the individual is ordinarily resident in the UK, is to be extended from 6 April 2011 so that it is also available to seafarers who are residents of an EU or EEA state.

**Comment:** This measure is being introduced to ensure that the provisions are compatible with the EU Treaty as the current regime is likely to discriminate against seafarers who are foreign nationals who are unlikely to be ordinarily resident here.

### 1.6 Capital gains tax: Private residence relief and adult placement carers

Property, including the family home, is a chargeable asset for capital gains tax (CGT) purposes. There is, however, a specific CGT relief to exempt from tax gains on the only or main residence of an individual. The rules can be complex and there are potential restrictions on the amount of relief available.

Prior to the changes announced in the 2009 PBR, main residence relief could be restricted purely as a result of an individual providing accommodation in their only or main residence for adults in need of care under an adult placement scheme. The changes announced provide that for disposals on or after 9 December 2009 the individual's entitlement to the CGT exemption on his/her only or main residence will not be restricted as a result of part of the dwelling house being used by a person pursuant to an adult placement scheme.

The problems stemmed from the fact that the contract entered into with the local authority might provide that one or more rooms in the dwelling house have to be set aside exclusively for the use of the adult in care. Having to set aside part of the dwelling house such that it could not be occupied by the individual is an issue for main residence relief purposes because:

- the CGT exemption only applies to parts of the dwelling house occupied as the individual's only or main residence; and
- the legislation specifies that the exemption is not available where part of a property is used exclusively for a trade, business profession or vocation.

In both cases the CGT exemption would only be available with respect to the appropriate part of the gain relating to the property occupied as the individual's only or main residence.

The changes provide that for the purposes of the main residence relief qualifying conditions the occupation by the person pursuant to an adult placement scheme is:

- disregarded when considering the individual's occupation of the dwelling house; and
- does not amount to the use of that part of the dwelling house exclusively for the purposes of a trade, business profession or vocation.

**Comment:** The changes to the legislation are welcome and will be good news for adult placement carers. We would, however, say that it is likely that many such individuals would not have realised that the contracts they were entering into with the local authorities could result in a restriction in their main residence relief entitlement. We would like to see the changes being given retrospective effect rather than, as in the draft legislation, only having effect in relation to disposals occurring on or after 9 December 2009. Backdating these favourable changes would seem equitable as it appears clear that there was no intention that adult placement carers should suffer a restriction in their entitlement to main residence relief.

### 1.7 Inheritance tax: Nil rate band

Finance Bill 2010 will maintain the limit of the IHT nil rate band (the amount that can be left through an individual's estate free of IHT) for 2010/11 at the 2009/10 rate of £325,000.

Finance Act 2007 had originally provided for a rise to £350,000 for the 2010/11 tax year.

**Comment:** The promise to increase the threshold was originally made in 2007 and with the benefit of hindsight it seems this may have been premature. However since then the Government has introduced legislation that will enable the unused exemption of one spouse/civil partner to be transferred to the other and that will have removed a large number of estates from the tax net. The Chancellor clearly thought that the proposed increase could be deferred for the time being, particularly bearing in mind that the values of many assets will have been depressed by the economic crisis.

## 1.8 Inheritance tax avoidance

The Government has announced that legislation will be introduced to counter, with immediate effect, two tax schemes which were designed to avoid the charge to IHT on transfers into a relevant property trust. Draft legislation and explanatory notes have been published.

The first scheme avoided the IHT charge on property transferred into trust through the individual purchasing the interest in the trust rather than transferring assets into the trust. Broadly, the draft legislation provides that where an interest has been purchased at full value that interest will be treated as part of the purchaser's estate. This means that on their death the value of the trust interest will be aggregated with their death estate and IHT payable. The legislation also provided that there will be a chargeable transfer if the interest comes to an end during the individual's lifetime. The amendments have effect in relation to an interest in possession to which a person becomes entitled on or after 9 December 2009.

The second scheme reduced the IHT charge by arranging for the transactions to fall within the rules relating to reversionary interests in trusts. Broadly, the scheme made use of the fact that certain reversionary interests are part of a person's estate in order to reduce the value of the transfer into the trust and, therefore, the amount on which the initial IHT charge could bite. The draft legislation refers to the following individuals as "relevant reversioners":

- a person acquired the beneficial entitlement to the reversionary interest for a consideration in money or money's worth; or
- the settlor or the spouse/civil partner of the settlor is beneficially entitled to the reversionary interest.

There is a deemed chargeable transfer of value where the entitlement to the reversionary interest comes to an end by virtue of a relevant reversioner becoming entitled to an actual interest in possession in the relevant property.

In addition there will be a chargeable transfer should there be a transfer of a reversionary interest in relevant property to which a relevant reversioner is beneficially entitled.

The amendments have effect in relation to reversionary interests to which a relevant reversioner becomes beneficially entitled on or after 9 December 2009.

**Comment:** The specific measures announced are targeted at blocking specific IHT avoidance planning of which HMRC has become aware.

There was, however, a short paragraph in the press notices stating that the Government "is also examining wider solutions to the problem of trusts being used to avoid IHT charges." As HMRC's own commissioned research (HMRC Research Report 25) has shown for the majority of individuals who establish trusts tax is not the driving factor. It is more about having the ability to control assets for example:

- passing them on to children or grandchildren;
- providing for a beneficiary in a particular way;
- withholding assets until children reach a certain age; and
- ensuring money stays within the 'bloodline'.

At the time of the trust modernisation consultation in 2005 and early 2006 it seemed to be accepted that there should be a level playing field, such that from a tax perspective it was neither advantageous nor disadvantageous to hold property within a trust as opposed to personally. However, legislative changes since then have in a number of ways tilted the balance against trusts. Given the importance of trusts for non-tax purposes there should be a return to the idea of there being a level playing field. This initiative by the Government to counter what it perceives as unacceptable IHT tax avoidance by a minority should not result in the majority suffering. It is, therefore, to be hoped that there will be substantive consultation before any measures are decided upon.

### 1.9 Modernising powers, deterrents and safeguards: Tackling offshore tax evasion

HMRC has issued a consultation document which sets out details of two proposed measures to tackle offshore evasion.

The first proposal is for robust penalties for offshore non-compliance. The Government announced at the 2009 PBR that it will legislate to ensure that, subject to a reasonable excuse provision, all offshore non-compliance will attract penalties at the same scale as domestic penalties for deliberate non-compliance. This would mean the non-compliant would be liable for minimum tax-geared penalties of:

- 20% where there is an unprompted disclosure;
- 35% where there is a prompted disclosure;
- 70% where there is no disclosure;
- up to 100% where the non-compliance was not disclosed and had been concealed.

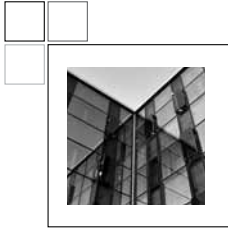
The second proposal is for a new notification requirement for overseas bank accounts. The proposal would require all new offshore bank accounts in certain high-risk jurisdictions without information exchange with the UK to be notified to HMRC. Accounts in some other jurisdictions would be notifiable if the balance in the account was over £25,000. Accounts in jurisdictions which have adequate arrangements for exchange of information would be entirely exempt from the notification requirement. Jurisdictions with provision to exchange information automatically with the UK would fall into this exempt group.

There are no firm proposals with respect to the information HMRC receives on offshore structures such as trusts. It is, however, apparent that HMRC is concerned that those seeking to conceal their assets might use other offshore vehicles to do so. The consultation document discusses the existing framework within which HMRC can obtain information on non-resident trusts, perceived weaknesses in the current rules and potential areas where HMRC's information powers could be strengthened. In particular comments are sought on:

- the possibility of requiring UK resident settlors to notify HMRC every time they transfer value into a non-resident trust or a subsidiary company of such a trust; and
- whether barristers should continue to be excluded from the existing information requirements that apply to professional advisers.

It is stated that any additional information requirements (whether with respect to personal accounts or transfers to non-resident trusts) will not apply to remittance basis users.

**Comment:** HMRC is carrying on a concerted attack against avoidance of tax related to the use of offshore bank accounts and is seeking more powers to bolster this work.



## 2 Banking sector

### 2.1 Bank payroll tax

With effect from 9 December 2009, a new wide-ranging payroll tax will apply where bonuses are paid or similar arrangements are entered into for 'banking employees'. The legislation is expressed to be effective for relevant arrangements until 5 April 2010, although there is an indication in the details released that it may be continued thereafter until a proposed Financial Services Bill comes into force. The rate of tax is 50% and this tax is not deductible when computing the bank's taxable profit.

Broadly, a taxable company will be one that is a bank, a building society, a UK resident investment company or financial trading company within a banking or building society group, or an equivalent UK branch. In addition, a company wholly or mainly carrying out 'relevant regulated activities', which is widely drawn and includes dealing in investments as principal or agent, is caught.

A financial trading company is one whose trade consists wholly or partly in dealing in securities. There are detailed provisions for members of groups.

The term 'relevant banking employee' does not only cover bankers but similarly extends to those who wholly or mainly carry out 'relevant regulated activities'. These include dealing in investments both as principal and agent and safeguarding and administering investments. These activities are defined and regulated under the Financial Services and Markets Act 2000 (FSMA). These provisions have no effect on the taxability or otherwise of any award as far as the employee is concerned.

Amounts of relevant remuneration over £25,000 (whether paid in one go or in several instalments) will be caught. For the purposes of calculating the amount of charge, the value of the remuneration will be, broadly, the greater of market value and the cost of its provision. Tax will be payable on 31 August 2010.

Detailed anti-avoidance provisions have been published. The starting point is that the employee does not himself have to be liable to income tax on any relevant amount in order for the charge to arise. The tax is not intended to be similar to NIC but rather much broader.

The relevant remuneration that is caught is much broader than 'earnings' which is simply money or money's worth. It extends to other benefits whether provided by the employer or a third party such as an employee benefit trust (EBT). There are particularly severe provisions concerning loans which can be treated as remuneration for this purpose even though the individual may have to repay the amount in question.

Similarly, it is not possible to make current arrangements for future payment after 5 April 2010 without being immediately liable. This will mean that payments into vehicles such as EBTs may well be caught.

The provisions extend to most forms of reward and certainly include company shares. Where assets are restricted in value, their full unrestricted value is the basis of charge.

Some remuneration is excluded from these provisions. This includes payments under approved all-employee share plans (share incentive plans and Save As You Earn schemes) but not discretionary approved company share option plan arrangements, unapproved options or other long term incentive plan awards. Awards contractually promised before 9 December 2009 are also excluded as is ordinary contractual pay.

**Comment:** The tax does not attempt to target what might be thought to have been the reward for activities considered objectionable but rather it assumes that any bonus in the sector is necessarily offensive. All employees are tarred with the same brush regardless of any genuine merit whatever, or indeed regardless of the commercial, as opposed to contractual, needs of the employer to incentivise and retain employees in any given case.

This, together with the very severe threshold level at which this tax is set (£25,000), does suggest that it is intended to be a one-off arrangement and not to be continued indefinitely.

It has to be said that the volume of highly developed material immediately available on the matter, including draft legislation, and the very comprehensive anti-avoidance proposals suggests that this has not been a recent decision but has been thought about by someone for some time.

Even so, the tax is almost of necessity highly arbitrary in its application and effect. It is highly likely that blameless employees carrying out worthy, risk-free or risk-reducing activities will be caught. Similarly, it is possible that some employees who might have been expected to have been covered will not be caught, perhaps because their employer's trade is sufficiently broad that it is not wholly or mainly carrying on regulated activity.

Given the draconian and arbitrary nature of the legislation it is to be expected that close scrutiny will be given to these provisions by employers to see whether or not any individual bonus can be paid in any particular case.

## 2.2 Code of Practice on Taxation for Banks

The Government has announced a package of measures for banks and published in a consultation response document an updated version of The Code of Practice on Taxation for banks. The code has several components:

- it describes what the Government believes to be good practice for governance and decision-making in banks, including tax planning, and asks banks to have tax governance integrated into business decision-making;
- following the 'spirit of the law' will mean banks should undertake tax planning to support their business operations, rather than use them to achieve tax results that are contrary to the 'intentions of Parliament' and for HMRC to commit to comment on plans where the bank wishes to discuss them; and
- the code encourages banks to work with HMRC to build mutually open and transparent relationships.

A bank's decision on adoption of the code, and its success in implementing it, will not affect the bank's relationship with HMRC; HMRC's objective is to establish open and transparent relationships with all large business customers. But HMRC will wish to discuss with banks that adopt the code how they are complying with it and will evaluate this as part of the normal risk-assessment process, seeking to understand both the bank's overall implementation of the code, and the reasons behind particular decisions.

**Comment:** There has been a consultation process with the banking sector and there are specific concerns around:

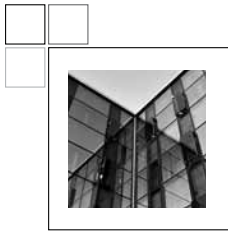
- the potential for conflict for compliance with the code against responsibilities to shareholders;
- who is the arbiter of "the intentions of parliament"; and
- what does "spirit of the law" mean.

Many commentators have pointed out that identifying the intention of Parliament is a function of the courts and not of HMRC. Indeed HMRC acknowledges that the code can have no legal effect.

A well known instance illustrating the principal concerns with HMRC's attempt to influence taxpayer's behaviour can be derived from the Arctic Systems case, (*Jones v Garnett* [2007] STC 1536). The decision of the courts was contrary to the views of HMRC and ministers, but in line with the opinion of other tax commentators.

An open question is, therefore, whether the code of conduct for banks, when conscientiously applied by HMRC in the context of the Arctic Systems case, would have produced the correct outcome as found by the House of Lords. If it might not have done, there must be a concern that the Code could have the unfortunate effect of denying banks or their customers a just outcome in any given case.

We shall have to wait and see whether the code is seen as a matter for the banking sector only, or simply as a stepping stone for rolling the principle out to other sectors, law firms, accountancy practices, etc.



## 3 Business

### 3.1 Corporation tax rates

The main rate of corporation tax applicable to taxable profits above £1.5m for the financial year commencing 1 April 2010 is to be kept at 28%.

The PBR also announced that the small companies' rate of corporation tax would remain at 21% for the financial year commencing on 1 April 2010, and that the proposed rate increase to 22% has been deferred for one year. The lower and upper limits for marginal relief calculations remain unchanged at £300,000 and £1.5m respectively, which means that the fraction used for calculating marginal relief will remain at 7/400.

**Comment:** The deferral of the increase in small companies' corporation tax rate to 21% looks sensible, although plans to increase to 22% as from April 2011 still remain.

### 3.2 Intellectual property reform

There is planned legislation in time for the Finance Bill 2011 to be operational from April 2013 for a 10% rate of corporation tax for income from patents. There is no actual detail so far, however, the Chancellor's speech suggested that it is targeted at the pharmaceutical and biotech industries so that the UK remains an attractive location for innovation given reduced corporation tax rates for intellectual property (IP) income in Netherlands, Belgium and Luxembourg.

**Comment:** The so called 'patent box' approach certainly looks attractive on paper but there remain a number of questions, not least whether related research and development (R&D) spend is somehow ring-fenced and in so doing the present enhanced and generous R&D reliefs are restricted. It is not difficult to envisage the position where, as is often the case in the pharmaceutical and biotech sectors investment, is front loaded with the result that what is initially presented as a 'tax break' turns out to be a revenue raising measure.

It should be noted that the Netherlands 'Patent box' rate reduces from 10% to 5% from 1 January 2010 and tax relief on research expenditure is not restricted to the patent tax rate. It remains to be seen whether the UK draft rules are couched such that they genuinely compete with the IP regimes in other European countries.

### 3.3 Business Payment Support Service

The 2008 PBR announced the launch of the Business Payment Support Service (BPSS). This was introduced in response to the worsening economic position and recognised the impact of the recession on business profitability and, more seriously, the problems faced by many businesses regarding cash flow.

This service was designed to assist all businesses that were unable to pay their tax by providing a fast track response for time to pay applications. Time to pay arrangements have been available for years, but their availability was not previously well known. The BPSS brought the existing facility into the open and made it more accessible.

Statistics indicate that over 160,000 businesses have been helped in the period to date involving tax liabilities of over £4bn. The Chancellor confirmed that the service is to continue for as long as necessary.

From a date to be announced HMRC, will require businesses seeking time to pay arrangements worth £1m or more to provide an independent business review in support of their request.

**Comment:** The BPSS has been very successful in providing a sympathetic hearing for businesses whose cash flow suffered as a result of the recession.

However there have been difficulties over time to pay arrangements for partnerships because of the way in which they are structured. Taxable profits from a partnership are allocated to individual partners and the resulting tax liabilities are charged to the individual and the way that the BPSS operated meant that HMRC expected each of the partners to make individual time to pay applications, notwithstanding that none of them may have had a detailed knowledge of the firm's financial position. We understand that new guidance will be issued shortly making it clear that partnerships are covered by the BPSS.

The forthcoming requirement for an independent business review indicates that the bar is being raised for larger applications.

### 3.4 Electric vans: 100% first-year allowances

It has been announced that, subject to confirming the state aid position, businesses purchasing new (unused) electric vans will be able to take advantage of 100% first-year allowances (electric cars already qualify for first-year allowances). The new rules are proposed to come into effect for expenditure incurred on or after 1 April 2010.

By way of background, capital allowances are generally available for businesses to obtain tax deductions for the cost of acquiring capital assets (as opposed to the accounting depreciation charge). Capital assets qualifying for the main pool should qualify for capital allowances at the current rate of 20%. First-year allowances are available for certain assets which provide accelerated tax deductions.

**Comment:** The new rules to allow 100% first-year allowances will be welcomed by businesses intending to purchase new electric vans after the effective date on the basis that a full tax deduction is accelerated and obtained in the year of acquisition. However, it is not clear how many businesses this measure will assist and therefore may only be of limited benefit in the near future, but as technology and the whole infrastructure improves this may prove much more popular.

### 3.5 Research and development tax relief

Prior to the PBR, small or medium-sized enterprise companies (SMEs) could only claim enhanced tax reliefs for expenditure on R&D or, if expenditure was subsidised, large company relief (no cash credit but enhanced losses at a lower rate than for SME relief) if they owned any IP attributable to the R&D expenditure.

Legislation will be introduced in Finance Bill 2010 to abolish the IP ownership condition which means an SME company will not need to own the IP in respect of R&D expenditure incurred in an accounting period ending on or after 9 December 2009.

It should be noted that for the purposes of R&D relief, the SME thresholds are higher than those set out by the European Commission (EC) and the SME must have fewer than 500 employees and satisfy one out of the following two tests:

- turnover  $\leq$  €100m or;
- balance sheet total  $\leq$  €86m

**Comment:** This is a welcome simplification that removes one of the most problematic bars to claiming relief. Accordingly, more SME companies should be able to benefit from R&D reliefs. It is notable that the time period from which relief can be claimed using the new rules extends to expenditure incurred before the PBR announcement.

### 3.6 Tax and accountancy: Changes to accounting standards on financial instruments

Financial Reporting Standard (FRS26), and its International Accounting Standard equivalent (IAS39), deals with the recognition and measurement of financial instruments. The International Accounting Standards Board is proposing changes to IAS39 which are expected to flow through into FRS26. The plan is to introduce enabling legislation in the Finance Bill 2010 to allow any associated tax changes thought appropriate to be enacted through secondary legislation. This would be by way of statutory instrument which allows such changes to be made outside a Finance Bill timetable. There are planned changes on the accounting side under four main areas. They are:

- the way the financial instruments are classified and measured for accounting purposes;
- timing of balance sheet recognition;
- how impairment losses are quantified; and
- how hedging arrangements should be accounted for.

The Government is consulting informally with businesses and their advisers about the implications of these changes for tax law.

**Comment:** The tax treatment, subject to exceptions of course, is based on the accounting. It is good that the Government is consulting but while its pre-occupation with secondary legislation in favour of primary legislation may be expedient, and notwithstanding the consultation process, the lack of Parliamentary scrutiny can be of concern particularly in highly technical areas such as this.

### 3.7 Sale of lessor companies

A permanent tax deduction from leasing could be achieved prior to Finance Act 2006 by group relieving the tax losses normally achieved in the start-up phase of a leasing business, and then selling that business as it becomes profitable, but prior to the generation of taxable profits. Finance Act 2006 reduced this possibility by requiring a tax charge on the vendor based on the tax timing difference at the point of sale. Tax relief for the value of this charge could then be obtained by the purchaser in its own group. The tax charge was triggered when there was a change in economic ownership.

However, the Finance Act 2006 changes made certain commercial non-tax motivated transactions difficult to complete, particularly where the buyer was loss making or not part of a group (and so unable to use group relief). They also provided a situation where a leasing business owned by a consortium could avoid the charge imposed by Finance Act 2006.

Changes made in Finance Act 2009 partially relieved the adverse impact of the 2006 anti-avoidance by permitting a longer period over which the relief could be surrendered, but did not resolve the position for a buyer that was not part of a group, or was unable to use the relief over the permitted extended period.

To reduce impediments to commercial transactions, the PBR introduces an election to compute the tax charges on a sale of a lessor business on a different basis to that in Finance Act 2006. The alternative basis treats the leasing business as ring fenced and collects tax on the deferred profits of the business as they arise. It includes provisions to prevent manipulation of the results of the ring fenced business. The draft legislation has effect for transactions made on or after 9 December 2009.

New draft legislation also tightens up the application of the tax charge imposed by Finance Act 2006 legislation in the case of consortia. This is achieved by broadening the definition of a company owned by a consortium for group relief for the purpose of assessing whether the Finance Act 2006 charge applies, from one which is a 90% subsidiary of a company owned by the consortium to one which is a 75% subsidiary.

**Comment:** The design of anti-avoidance legislation for one set of circumstances does not always make sense in different economic circumstances. The Government has responded after consultation with the leasing industry by introducing new provisions to facilitate commercial transactions subject to its desired policy aims of not using losses generated from leasing capital allowances to offset profits from unrelated businesses to an excessive extent. It has also acted to close down a weakness in the original anti-avoidance legislation with respect to leasing companies owned by consortia.

### 3.8 Relief for interest: Amendments to 'Worldwide Debt Cap' legislation

Finance Act 2009 introduced debt cap legislation as part of the measures to reform the taxation of foreign profits, although it can affect large groups which only have UK operations. Refinements to the way the debt cap rules operate in practice were announced on 9 November 2009 and draft legislation for these amendments was published with the PBR.

The debt cap acts as a potential restriction on the net finance costs of certain UK members of a large group if those costs exceed the group worldwide gross accounting finance cost. The rules are effective for accounting periods commencing on or after 1 January 2010, and apply after all other tax adjustments such as transfer pricing, thin capitalisation, tax arbitrage and loans for unallowable purposes.

Certain entities are excluded from the application of the debt cap rules. The excluded groups are (i) qualifying financial service groups and (ii) groups which meet a 'gateway test'. The gateway test excludes large groups from the debt cap where the net debt of all 'relevant group companies' (those UK resident entities that are group members to the extent of at least 75%) is 75% or less of gross group worldwide debt.

Group definition points:

- the draft legislation excludes securitisation companies from the definition of relevant group companies, but they are still included for the purpose of assessing the gateway test;
- international entities (for example non-UK LLPs) that would otherwise meet the requirements for definition of a collective investment scheme are excluded from being ultimate parent companies for determining what is a group and a relevant group company for the purpose of the debt cap; and
- the definition of financial instrument is clarified for the purposes of assessing whether a group meets the qualifying financial service exclusion.

Gateway test points:

- for the purpose of the gateway test where liabilities of relevant group companies would be different in amount to the same liability of the worldwide group, the amount will be determined for both using the accounting standard applicable to the worldwide group; and
- liabilities for the purpose of the gateway test do not include liabilities representing preference shares.

Calculation and allocation points:

- for the purpose of calculating interest costs where the loan is from a partnership, the interest costs for the purpose of the available amount of the worldwide group will be assessed on a similar basis to the costs for the tested amount of relevant group companies;
- there is a relaxation for the election to exclude group treasury companies from the calculation of the tested amount. The requirement to have 90% income from group treasury activities will be assessed on a company by company basis, rather than for all companies undertaking group treasury activities;
- guarantee fees will be included in the assessment of finance income; and
- where a disallowance has to be allocated it will be possible to elect to exclude specific companies from that allocation. This exclusion will apply whether the allocation is performed by taxpayer return, or by statutory allocation. To protect existing anti-avoidance rules dual resident investment companies will automatically be excluded companies for this purpose.

**Comment:** These amendments help the practical application of the debt cap rules. These rules are nevertheless complex, and there may well be further refinements as practical problems emerge. All large groups should be reviewing their financing arrangements to see if the debt cap rules apply. Finance Act 2009 included anti-avoidance to exclude certain arrangements undertaken specifically to avoid the debt cap rules, but indicated certain arrangements specified in regulations would not be treated as 'excluded'. While these regulations had not been issued by 9 December, HMRC's website does now have draft guidance indicating those arrangements that would be regarded as acceptable.

### 3.9 Risk-transfer schemes

New legislation is to be introduced in Finance Bill 2010 to restrict the utilisation of losses arising from certain hedging transactions.

Under normal tax rules a deduction is available for accounting losses arising under generally accepted accounting principles, and is available to offset against all taxable profits earned by the group. New legislation will be introduced whereby, in certain circumstances, losses arising from the hedging of loan relationships and derivative contracts will only be available to offset against future profits arising from that same transaction. Broadly the new legislation aims to target those instances where the accounting loss recognised for tax in each individual group entity exceeds the economic loss suffered by the worldwide group in respect of these transactions.

This new legislation will be effective for all accounting periods beginning on or after 1 April 2010. Where the accounting period straddles this date, the accounting period will be treated as consisting of two accounting periods with the first period ending on the day before the commencement date, and the second period beginning on the commencement date. The new rules will apply to the deemed accounting period beginning on or after the commencement date.

**Comment:** The application of these anti-avoidance provisions should only apply to large multinational groups of companies which have entered into hedging transactions that meet the specific criteria as set out in the draft legislation. Therefore we would not expect these provisions to have a wide application outside this category of companies.

### 3.10 Capital allowances: Anti-avoidance

When a company is sold, its inherent tax attributes, tax written down values and tax losses normally transfer with the company for the benefit of the purchaser and its group. There are existing anti-avoidance rules in relation to tax losses where a company changes ownership but these do not specifically cover unclaimed capital allowances. New anti-avoidance legislation is to be introduced in the Finance Bill 2010 aimed at restricting the purchaser's ability to use those allowances. The law is to be targeted at tax motivated transactions where parties have entered into arrangements where the main purpose or one of the main purposes is to acquire an interest in those allowances.

By way of background, anti-avoidance rules in relation to tax losses either disqualify tax losses entirely as at the date of change of ownership, but if not disqualified are allowed to be offset against profits arising from the same trade.

The new rules in relation to capital allowances, however are as follows:

- they only apply to a tax motivated transaction where one of the main purposes was to acquire 'latent capital allowances';
- where the anti-avoidance rules apply, the allowances are restricted in the way they can be used so that they can only be set against profits that would have arisen had the company sale not taken place – in other words, continuing profits, arising from the same trade; and

This means any excess allowances will not be available by way of group relief or offset against other profits within any new group and these new rules effectively mirror the general principle that tax losses can only be used against profits of the same trade, by ring-fencing and denying the ability to pass the relief on to other companies within the purchaser group.

**Comment:** This broadly brings the anti-avoidance rules for capital allowances into line with those for the trading losses. The fertile ground for disagreement is around determining whether the anti-avoidance rules apply in the first place, namely the purpose of any particular transaction.

### 3.11 Plant and machinery leasing: Anti-avoidance

The 2009 PBR announced additional anti-avoidance rules introduced in relation to two relatively specific areas of abuse concerned with the leasing of plant and machinery.

The first scheme at which the new rules are targeted is one where lessor companies are potentially able to sell the right to lease rental income without being subject to tax on the full amount of income, whilst retaining the right to claim capital allowances on the full cost of the asset being leased, thus generating UK tax losses without a corresponding economic loss. A variation of the scheme purports to achieve a similar result but with losses being generated from rental rebates. The new rules apply to restrict the amount on which capital allowances may be claimed to the present value of income in connection with the lease brought into account for tax. In addition, the amount of tax deduction allowed for rental rebates will be restricted to the taxable income received in connection with these leases.

The second type of scheme targeted by the anti-avoidance is one broadly intended to turn an initial tax free sum received from the sale of lease rental income (which should be taxed at a later date) into permanent tax free amount by ceasing to be within the charge to tax before that income has been taxed. The new rules will ensure that where a leasing business ceases to be within the charge to tax using scheme arrangements, a capital allowance disposal amount is brought within the charge to tax as if the scheme arrangements had not been entered into.

These measures will have effect for expenditure incurred on plant and machinery on or after 9 December 2009, or for businesses ceasing to be within the charge to tax on or after this date.

**Comment:** The tightening up of the UK tax regime by introducing this anti-avoidance is understandable, though it does again demonstrate the Government's lack of success in introducing fair and effective legislation from the outset.

### 3.12 Index linked gilt edged securities

The Government has acted with immediate effect to restrict those companies or groups entering into transactions involving Index Linked Gilt Edged Securities (ILGs) from benefitting from the tax exemption where the inflationary increase in the ILG value is not taxed where the group benefits economically.

This is a specific measure aimed to counter situations where companies undertake artificial structured finance transactions that take advantage of legislative provisions enabling a tax free valuation uplift in ILGs which are hedged to reduce the inflationary exposure.

**Comment:** The Government has acted quickly to target specific transactions that seek to abuse legislative provisions in this area by implementing measures that seek to tax the economic gain.

### 3.13 Use of partnership structures for EIS fund-raising

HMRC has announced a change in its interpretation of the Enterprise Investment Scheme (EIS) legislation in relation to the use of partnership structures for EIS fund-raising. A typical structure involved companies becoming corporate members of an LLP, where the qualifying trade was carried on by one entity, the LLP, with EIS funds of £2m raised in each company (the annual limit per company) and contributed as capital to the LLP. HMRC viewed this as a way of getting round the funding limits and other restrictions (e.g. the gross assets test) using one entity to carry on the trade, and has published a technical explanation of why the legislation does not allow such partnership structures.

HMRC has announced how it intends to implement this change of interpretation. Where the relevant shares have been issued on or before 9 December 2009, and HMRC has issued a compliance certificate having received an EIS 1 form, it will not apply this new interpretation and investors' ability to claim relief will not be affected. Where the relevant shares are issued after 9 December 2009, or the shares have been issued on or before this date (without receiving a compliance certificate) and provisional EIS approval had not been obtained, then HMRC will apply its new interpretation and investors will not be able to claim EIS relief.

**Comment:** This is a blow to encouraging private investment in unquoted trading companies, at a time when many individuals are keen to reduce their income tax liabilities with the 50% top rate of tax applying for high earners from 6 April 2010.

There is likely to be some resentment to this change of HMRC interpretation in the venture capital and private equity industries. There is likely to be some consternation that partnership structures will not be allowed for EIS fund-raising even though such structures are allowed for Venture Capital Trusts (VCTs) investing in qualifying companies. A call may come from these industries for the EIS legislation to be brought into line with the VCT legislation in relation to qualifying companies, to enable partnership structures to be used once again for EIS fund-raising.

HMRC has decided that it will not apply its new interpretation retrospectively. If the relevant shares have been issued on or before 9 December 2009, investors' EIS relief will not be withdrawn where partnership structures have been used as long as either HMRC has issued compliance certificates or HMRC granted provisional approval for that share issue.

### 3.14 Draft legislation on specific changes to the Venture Capital Schemes

HMRC has published draft legislation to implement changes to the EIS and VCT rules, and has asked for comment by 1 February 2010.

There are four specific changes which are required to maintain state aid approval from the EC for the schemes:

- a new requirement that to qualify under either scheme, a company must not be in difficulty;
- the current requirement that to qualify under either scheme a company must carry on its qualifying trade wholly or mainly in the UK, to be replaced with a requirement that the company must have a permanent establishment in the UK;
- the current requirement for a VCT's shares to be included in the Official UK list, to be replaced with one that their shares must be traded on an EU regulated market; and
- the current requirement that a VCT must hold at least 30% of its qualifying holdings by value in qualifying ordinary shares to be increased to 70%.

HMRC has also proposed a new definition of the size of a company that can benefit under the schemes, to be aligned more closely with the EC definition.

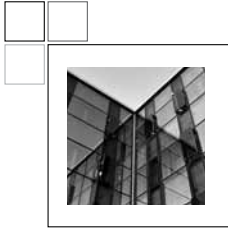
**Comment:** Apart from the proposed new definition of size for qualifying companies, all of these proposed changes were expected, having been first announced when the schemes obtained formal state aid approval from the EC in April this year.

The most significant proposal is for companies to be able to raise funds under the EIS and from VCTs where the majority of their trading activities are not carried on in the UK, which is not the case at present. The only requirement in this respect will be that the company has a permanent establishment in the UK, based on the OECD Model Tax Convention. A permanent establishment is essentially a fixed place of business and could include a branch, office or factory for example. This change should lead to a far greater number of companies qualifying for investment under the venture capital schemes.

The proposal to disallow investment in companies in difficulty (defined by reference to the EC Guidelines on 'State Aid for Restructuring Firms in Difficulty') is a response to individuals investing in companies in order to generate a capital loss that can be set off against income.

### 3.15 Consultation on harmonised interest regime for all taxes

Harmonised late payment interest and repayment interest provisions were introduced in Finance Act 2009 for all taxes administered by HMRC, except corporation tax and petroleum revenue tax. A consultation has been issued for comment by 3 March 2010 setting out draft legislation to bring corporation tax and petroleum revenue tax into the new harmonised interest regime. This will be implemented in a phased way over several years and the provisions will be brought into effect by Treasury Orders.



## 4 Employers' tax

### 4.1 Salary sacrifice: Workplace canteens

The tax exempt status of free or subsidised meals provided at the workplace that are available to all is to be removed from 6 April 2011 in circumstances where the benefit is obtained by the employer's employees through the sacrifice of salary or other benefits.

**Comment:** This is a targeted measure to tackle an abuse that is perceived by HMRC. Employers who provide free or subsidised meals to all their staff at the workplace as a standard benefit will not be affected by the change. But those who offer the facility under either a salary sacrifice arrangement or flexible benefits package, such that employees must give up taxable pay or another benefit in kind in order to take it up, are to be penalised so that the tax and Class 1 NIC advantages that accrue from the arrangements are eliminated.

It is difficult to see why HMRC has stopped at subsidised workplace meals as these sorts of salary sacrifice/flexible benefit arrangements create similar tax and NIC savings where a variety of other tax advantaged benefits are used. Possibly there is more to come.

### 4.2 Changes to company car tax

From 6 April 2012 the graduated table of company car tax bands used to determine the appropriate percentage to be applied to the car's list price will be amended so that it starts at 10% (for cars with CO<sub>2</sub> emissions of 99 g/km or less) and all the other CO<sub>2</sub> emissions thresholds will move down by 5g/km.

**Comment:** These changes are being flagged well in advance as has been the Government's practice in this regard over recent years. The reduction in the emissions thresholds is the sixth such move since the current regime for taxing company cars was introduced in 2003/04. The change to introduce the 10% band will mean that qualifying low emissions cars will no longer exist as a separate category.

### 4.3 Company car tax and van benefit charge: Electric cars

From 6 April 2010 for five years employees and directors who are provided with a company car for their private use that is propelled solely by electricity will have no taxable benefit. Those provided with company vans available for unlimited private use that are propelled solely by electricity will have their taxable benefit reduced from the current £3,000 to zero, again from 6 April 2010 for five years.

**Comment:** It is difficult to imagine that many employees and directors will be able to benefit immediately from this measure, but possibly towards the end of the five years technology and availability of such cars and vans will have improved sufficiently to make this more than a mere gesture. It is worth noting that both the employee and the employer will benefit from this measure as there will be no Class 1A NIC liability arising from these benefits either.

#### 4.4 Cars and vans: Changes to fuel benefit tax

The amount of the taxable benefit of private fuel provided for a company car is to be increased from 6 April 2010. The taxable benefit is derived by applying the appropriate percentage according to the car's CO<sub>2</sub> emissions rating to a fixed amount. That amount is currently £16,900 and it will increase to £18,000.

The taxable benefit for private fuel provided to a company van user will also increase from £500 to £550 from 6 April 2010.

**Comment:** The current values for these two benefits have been in place since 6 April 2007 for vans and 2008 for cars. These increases should therefore come as no surprise.

#### 4.5 PAYE pooling

Draft Pay As You Earn (PAYE) regulations can be expected for consultation in early 2010 with the aim to allow large connected employers to combine PAYE references, thereby potentially creating opportunities to reduce administration costs.

**Comment:** Likely to be welcomed by large employers as it should reduce employer payroll compliance.

#### 4.6 Travel schemes

There is a concern the National Minimum Wage Regulations are being exploited at the expense of employees who give up salary for tax and NIC free travel costs available for travel to temporary workplace. Changes are proposed to National Minimum Wage Regulations aimed at stopping this with a consultation in the New Year.

**Comment:** Such arrangements are used for other employees in addition to employees at or close to minimum wage. It will be interesting to see if the proposed changes will be extended to include such employees.

#### 4.7 Enterprise Management Incentives: Compliance with EC state aid requirements

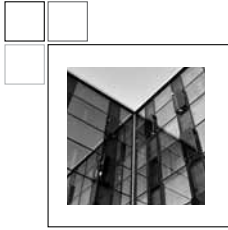
HMRC has released draft legislation designed to relax the requirements to qualify for Enterprise Management Incentives (EMI) status for options granted after 6 April 2010.

Currently, in order to qualify for EMI, a company, or at least one company in the group must carry on a qualifying trade wholly or mainly in the UK.

This rule is to be abolished and replaced by a new, much wider rule. In future, in order to be a qualifying company for an EMI purposes, the company only has to have a permanent establishment in the UK. This will permit such a company to trade mainly abroad. Many more companies will therefore qualify for EMI.

**Comment:** First, it should be noted that the terms on which the EC has agreed to the continuation of State Aid through EMI schemes is that it will come to an end in April 2018. It is not clear from the Release whether this will mean that all outstanding EMI options will cease to attract tax relief from that time or whether only options granted after that date would lose relief. It is to be hoped that it is the second possibility.

Second, it would appear that, for existing options, rather anomalously, if a company does not continue to meet the current requirement of trading wholly or mainly in the UK then the option will be disqualified, even though a new option granted after 6 April 2010 would not be. It is to be hoped that this odd result will be addressed.



## 5 VAT and other indirect taxes

### 5.1 Temporary change in rate

As previously announced the Chancellor has confirmed the end of the temporary reduction in the standard rate of VAT of 15% on 31 December 2009. As of 1 January 2010 the standard rate of VAT will return to 17.5%.

The return to the standard rate of 17.5% will include some transitional rules allowing businesses trading across the midnight deadline to continue with the lower 15% rate until they close (or until 6am, whichever is earlier). There are also plans to let shops add the extra VAT to prices at the tills for up to 28 days, giving them extra time to complete the re-pricing of their stock.

There are complicated anti-forestalling rules, also previously announced, to stop businesses taking prolonged advantage of the 15% rate after 1 January 2010. These rules add a supplementary charge of 2.5% VAT in certain circumstances.

**Comment:** The Chancellor believes the temporary VAT rate reduction has delivered stimulus of about £11.5bn into the economy. However whether this is accurate or not and how this could have been measured is unclear.

The change in the VAT rate is again likely to cause many businesses some administrative issues.

There are special rules dealing with tax points for supplies that cross the VAT rate change. These rules should be reviewed by all businesses to ensure the correct rate of VAT is applied to purchases and sales.

### 5.2 Flat rate scheme

The VAT rates under the flat rate scheme are amended to reflect the end of the temporary reduction of the standard rate of VAT and the latest data on VAT payments by the various sectors.

The percentages were re-calculated in December 2008 to reflect the temporary reduction in the standard rate of VAT. The flat rate percentages have now been re-calculated to reflect the reversion of the standard rate of VAT to 17.5% and the new rates will be implemented on 1 January 2010.

Virtually all sectors are facing an increase (as a result of the increase in the standard rate) but some sector increases will be greater than others.

**Comment:** This is to be expected following the rise in the standard rate of VAT, but what is unclear is how much the flat rate percentages have been increased as a result of the rate rise and how much of it is just a general increase.

### 5.3 Cross-border VAT changes in 2010

As previously announced, the place of supply of services is to change and secondary legislation is to be introduced. A single statutory instrument has been prepared for all changes which amend the VAT Regulations and will come into effect on 1 January 2010. The VAT Regulations are in respect of the following:

- changes to the time of supply for cross-border supplies of services where VAT is accounted for by the business customer;
- new requirements to record intra-EU supplies of services that are taxable in another EU country on an EC Sales List;
- changes to the requirements for recording the intra-EU movement of goods on EC Sales Lists; and
- a new method for reclaiming VAT incurred in another EU country (EC 8th Directive claims).

**Comment:** This is the final stage of the UK implementation of what has been widely referred to as the 'VAT package'. It is the most fundamental change in EU VAT since it was adopted and will no doubt lead to a number of practical problems on or after 1 January 2010. Until businesses become more aware of the new rules and the EU member states become more co-ordinated there may be some confusion in relation to these measures, especially the requirement to submit EC Sales Lists for services.

### 5.4 Insurance premium tax: Premium splitting

Insurance premium tax (IPT) is paid by an insurer on the gross premium charged under a taxable insurance contract, which includes any commissions or fees unless they are charged to the insured under a separate contract. Legislation will be introduced to close an avoidance scheme involving so called 'administration fees' charged under a separate contract.

The legislation brings certain fees charged under a separate contract in connection with personal lines insurance into the scope of IPT. The legislation will have effect for payments made on or after 9 December 2009.

The legislation will be changed under primary legislation to specify that for insurance contracts with private individuals, the provision defining a 'separate contract' excludes contracts that are entered into at or about the same time as the insurance contract and are:

- contracts for services that would usually form part of the insurance contract; or
- where the insured is required to enter into both contracts together, or would be unlikely not to.

Separate charges for amendments to the insurance contract or for paying for insurance by credit/debit card or by instalments are specifically excluded from this measure. Charges made for services provided in connection with insurance contracts with businesses and other organisations are not covered by the new legislation.

**Comment:** This measure was widely anticipated following a recent High Court case, *Homeserve Membership Limited v The Commissioners* [2009] EWHC 1311 (Ch), in which the taxpayer successfully argued that they supplied private individuals with separate insurance and administration services with the administration services not subject to IPT. This is also another example of the Government cracking down on perceived tax avoidance.

### 5.5 Climate change levy: Reduced rate

Gas and electricity utilities, and other suppliers involved with the climate change agreements scheme are currently able to claim the 20% reduced rate of climate change levy for facilities in energy intensive sectors. All claimants must certify to their energy suppliers the extent of their entitlement to the levy relief.

The reduced rate of the climate change levy of 20% is to be increased to 35% through the introduction of secondary legislation in 2010. The new reduced rate will have effect for supplies of taxable commodities treated as taking place on and after 1 April 2011, with the requirement to give new certificates having effect on and after 1 April 2011. Any new certificates required must be given by the completion of the claimant's first annual review after that date.

**Comment:** This measure appears to be revenue raising to help fund their environmental initiatives. Although businesses that have entered a Climate Change Agreement still benefit from a lower climate change levy, it is not as favourable as before.

#### 5.6 Stamp duty and stamp duty reserve tax anti-avoidance: Transfers of shares to depository receipt systems and clearance services

The recent European Court of Justice (ECJ) ruling in *HSBC Holdings Plc and Vidacos Nominees Ltd v Commissioners for HMRC* upheld the exemption from 1.5% stamp duty or stamp duty reserve tax (SDRT) charge when new shares are issued to an EU clearance service or depository receipt system.

Legislation will be introduced in the Finance Bill 2010 to reduce the scope of this exemption for shares intended for a non-EU clearance service or depository receipt system that are routed through an EU clearance service.

This anti-avoidance measure will have effect for transfers made on or after 1 October 2009.

**Comment:** While we await the draft legislation, the exemption from stamp duty and SDRT arising from the recent ECJ ruling has created the potential for shares to be issued to a non-EU depository system or clearance service avoiding stamp taxes altogether, which was obviously not the intention. These anti-avoidance measures will close down this possibility retrospectively.

#### 5.7 Disclosure of tax avoidance schemes: Stamp duty land tax

The Government proposes to extend the Disclosure of Tax Avoidance Schemes (DOTAS) regime to include disclosure by users of certain stamp duty land tax (SDLT) avoidance schemes that concern residential property with a value of at least £1m. These new rules will also apply to schemes that concern a mixture of residential and non-residential property where either:

- the value of the residential property is at least £1m; or
- the value of all the property is at least £5m.

The rules will include a 'grandfathering' provision that will exempt from disclosure any scheme which was first made available for implementation before the date the new rules come into force.

In addition, disclosure will be required by users of SDLT schemes for non-residential property exceeding a value of £5m. Previously it was only the promoter that was required to disclose.

It is proposed that this extension to the DOTAS regime will be in force by 1 April 2010.

**Comment:** The extension of the DOTAS regime to include notification of transactions relating to residential property is not surprising in light of the Government's continued aim to target tax avoidance schemes. Requiring users to disclose the use of SDLT schemes should be a useful aid to identifying the extent to which SDLT schemes are used, whether residential or non residential. The threshold of £1m for residential property is interesting but should certainly not be taken as HMRC approving of or turning a blind eye to SDLT planning that yields less than £40,000 of tax. DOTAS is a disclosure obligation only – it does not deal with the SDLT legislation.

### **5.8 Consultation on obligations to file returns and pay tax on time**

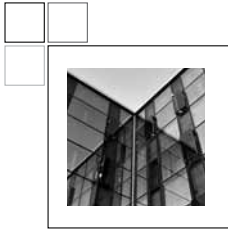
Provisions were included in Finance Act 2009 to create an aligned penalty regime for those who do not meet their obligations to submit returns and pay the tax they owe on time. The new penalty models in the legislation covered a broad range of taxes (income tax, corporation tax, PAYE, Construction Industry Scheme, IHT, petroleum revenue tax, stamp duties). This consultation introduces draft legislation to apply the same late filing and late payment penalty regime to the following indirect taxes: VAT, IPT, aggregates duty, climate change levy, landfill tax and excise duties.

### **5.9 Modernising powers, deterrents and safeguards: Excise tax administration**

This consultation covers civil powers and safeguards needed to check that people have registered, are operating within the controls of the regimes and have paid excise duty accurately and on time. Compliance checks in this consultation comprise three broad elements: information and inspection powers, record keeping and time limits for assessments and claims.

An update to existing powers in the Customs and Excise Management Act 1979 (CEMA) is proposed. There is also a proposal to modernise and align excise legislation on record keeping with the updated VAT rules. The proposal is to increase the normal time limit for assessment and claims from three to four years which would modernise and bring VAT and excise time limits back into line. The 20-year time limit for deliberate understatements of duty would be retained. The new time limits would not affect the period for which records would need to be retained.

Streamlining of warehousing is proposed so that businesses would no longer need to segregate different activities and types of alcohol. This will be taken forward outside the formal consultation as it does not require legislation. HMRC has also commenced a review of UK Customs law.



## 6 Pensions and investment

### 6.1 Pensions: Restructuring tax relief for high-income individuals (anti-forestalling)

The Budget in April 2009 announced a substantial overhaul effective from 6 April 2011 of the tax relief on pension contributions/benefits accrued for individuals with an income of £150,000 or more. To stop individuals pre-empting the changes by making large pension contributions in 2009/10 and 2010/11 anti-forestalling legislation was introduced in respect of contributions from 22 April 2009 which impacted individuals:

- with relevant income of £150,000 or more in the year in question or preceding two years; and
- who pay or benefit from pension contributions in that year in excess of £20,000, or in some circumstances £30,000, unless those contributions were regular (paid at least quarterly) and contracted for by noon on 22 April 2009.

For those individuals caught the tax relief on excess contributions is, effectively, restricted to basic rate tax.

A further change to the above was announced in the PBR. With effect, from 9 December the relevant income threshold is reduced to £130,000 and those affected will be hit by the anti-forestalling changes described above in respect of excess pension contributions made on or after 9 December unless already contracted for.

**Comment:** Bearing in mind that pensions had been attacked in April it was not widely thought that another change would follow so quickly however, HMRC appear to be correcting what may have been an earlier mistake in that they wanted to target anybody earning £150,000 or more including employer pension contributions. When calculating income for these purposes salary sacrifice arrangements put in place on or after the 9th December will have to be included.

Needless to say these changes have further complicated an individual's tax affairs and a large number of people will now fall into the special annual allowance charge net and will need advice on how best to plan their pension contributions going forward.

### 6.2 Restriction of pension tax relief from April 2011

In the 2009 Budget it was announced that as of 2011/2012 tax relief on pension contributions for those with total income of £150,000 or more would be limited. It was, however, also stated that pension benefits derived from an employer's contributions would not be included when calculating whether the £150,000 limit had been breached.

This consultation paper describes how the Revenue would like to change the rules and there is a consultation period of 12 weeks ending on the 3rd March 2010 during which time interested parties can make their views known on the proposed changes.

The thrust of the proposals is that individuals with income of less than £130,000, including their own pension contributions and charitable donations but excluding employer pension contributions, need not be concerned. However those with income of £130,000 or more are caught if, when any pension contributions funded (or eventually funded) by their employer are added, their 'gross' income increases to £150,000 or more. The latter reflects a change to the original proposals.

If this is the case tax relief for pension contributions is tapered where 'gross' income falls between £150,000 and £180,000, at which point it is restricted to the basic rate.

**Comment:** The upshot of these proposed changes is that anyone with total income of less than £130,000 or 'gross' income of less than £150,000 will still be entitled to tax relief at their highest marginal rate. Those with 'gross' income of more than £180,000 will have tax relief limited to the basic rate of tax, 20%. Individuals with 'gross' income between £150,000 and £180,000 will have to apply a special taper rate to determine what their relief is.

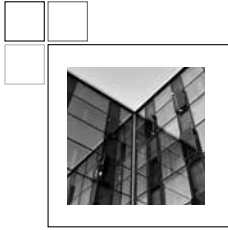
### 6.3 State pensions

It was announced that while state pensions normally increase at the rate of inflation, recent deflation would mean no increase in the current year but there will be an increase of 2.5% as of April 2010.

### 6.4 Personal accounts

These pension plans which have been designed to encourage low earners to make pension provision by matching individual contributions with NIC rebates and tax relief were scheduled to go ahead in September 2012. However, they have been delayed a year until 2013, which will result in a tax saving in 2012/13 of approximately £100m.

**Comment:** Many commentators believe that these personal accounts will not be implemented at all and this delaying tactic, whilst helping to raise revenue, may suggest that the Government thinks likewise.



## 7 Miscellaneous

### 7.1 Extra-statutory concessions

The House of Lords decision in *R (on the application of Wilkinson) v Inland Revenue Commissioners* [2005] UKHL 30 made it clear that the scope of HMRC's discretion to make concessions that depart from the strict statutory position was limited and that a significant proportion of the extra-statutory concessions that had been made were ultra vires. This led to a review of existing concessions. There were powers which would enable some of the concessions to be enacted. These powers were, however, insufficient to enact all the concessions it was felt needed to be given legislative effect.

The enabling provision at s160 of Finance Act 2008 gave the Treasury the power to enact existing HMRC concessions. Legislation to enact 19 extra-statutory concessions came into effect in April 2009. Budget 2009 announced that 10 concessions could be withdrawn as HMRC felt the concessions were obsolete, no longer applied or unnecessary (as little used).

As discussed later in this booklet, following discussions with interested parties the equitable liability concession which was to be withdrawn will now be legislated as soon as possible.

A further eight concessions were enacted in November 2009. It was announced at 2009 PBR that a further seven extra statutory concessions will be enacted in 2010. Draft legislation has been released for consultation with a view to ensuring that the legislation gives effect to the existing concessionary treatment. The deadline for comments is 3 March 2010. The concessions to be enacted are as follows.

Concession	Tax
Lump sums paid under overseas pension schemes	Income tax
Life assurance premium relief by deduction: pre-marriage policies: premium relief after divorce	Income tax
Repayment supplement: life assurance premium relief	Income tax
Termination payment and legal costs	Income tax
Trading activities for charitable purposes	Income and corporation tax
Qualifying life assurance policies – reinstatement within 13 months	Income tax
Insurance premium tax: arrangements for discounted insurance	Insurance premium tax

**Comment:** It is expected that further extra statutory concessions will be enacted. HMRC is committed to releasing draft legislation for consultation.

### 7.2 Equitable liability

An individual in the Self Assessment system is required to file an annual return. If they fail to do so HMRC is able to issue a determination (effectively an estimated assessment) and the tax shown on the determination is due for payment unless the taxpayer files a return within a set period of time. However, in some cases, if this deadline is missed, HMRC may still allow a late return to be made by concession. Legislation will be introduced to permit HMRC to continue to apply this treatment provided the taxpayer can show the figure of tax due is excessive compared to the correct amount payable and that he/she brings his/her tax affairs completely up-to-date.

**Comment:** HMRC has been reviewing all extra-statutory concessions following a case which cast doubt on their legality. Some concessions have been enshrined in legislation and others have been scrapped on the basis they have become obsolete.

HMRC originally planned to scrap this particular concession, but this caused a backlash from the professional bodies. This was because the concession had proved of fundamental value in cases where an individual's tax affairs had got into a muddle perhaps because of illness or just an inability to cope with paperwork. In such cases HMRC may have been contemplating bankruptcy proceedings and the concession gave the opportunity for a last minute reprieve to be sorted out.

### 7.3 Disclosure of tax avoidance schemes

DOTAS was introduced in 2004 and required promoters of tax avoidance schemes to notify HMRC of new schemes within strict deadlines. DOTAS now applies to income tax, corporation tax, CGT, SDLT, VAT and NIC. The Government has used information from DOTAS to introduce a range of anti-avoidance measures every year since 2004 – a total of 49 measures, closing off over £12bn in avoidance opportunities.

A consultation document has been issued setting out the following five proposals to improve the disclosure regime:

- a change to the time when a promoter must disclose a marketed scheme to HMRC;
- a power to require persons who introduce potential clients to a promoter to provide information about the promoter;
- increased penalties for failure to disclose a scheme;
- promoters to provide HMRC with periodic information about clients to whom they have issued a scheme reference number; and
- revisions and extensions to the extensions to the Hallmarks.

**Comment:** DOTAS has become an important weapon in HMRC's armoury and therefore we can expect the rules to be kept under constant review so that it is responsive to changes in market trends.

### 7.4 Tax administration and debt management: Enforcement of judgements and litigation

HMRC has announced that for decisions from courts and tribunals after 1 April 2010 it will take a tougher stance on the collection of debts in litigation.

Hitherto, HMRC has been prepared to forgo collection of tax where there is a further continuing appeal, notwithstanding that it has the power to proceed with collection.

It intends now to take a consistently tough approach and will normally require payment of the tax due in all cases where they win whether or not there is a pending appeal.

**Comment:** As a result of this change, because interest in these circumstances will be on a simple basis, it may well be that the taxpayer will not be put back in the overall position that he should have been in if HMRC had not erroneously claimed the tax.

### 7.5 Charities

It was announced at 2009 Budget that:

- the Government had commissioned research into how best to support the third sector through the Gift Aid system and the effect of redirecting higher rate relief from donors to charities; and
- there would be further informal consultation with charities based around amending the current substantial donors anti-avoidance legislation so as to introduce in Finance Bill 2010 an effective anti-avoidance purpose test.

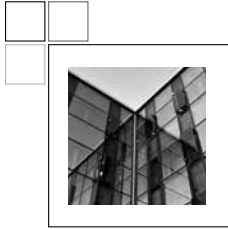
The 2009 PBR provides a brief update on both of these issues.

The Gift Aid research report is being considered by the Government and will be published on the HM Treasury website on 15 December 2009. Further discussions on the options for reforming gift aid will be held in the wake of the report's publication.

With respect to the substantial donor rules the Government proposes to replace the current anti-avoidance rules with a new purpose test which would deny tax relief on donations to charities where the donor is party to an arrangement, the purpose or one of the main purposes of which is to extract value from the charity.

**Comment:** The Gift Aid system is of vital importance to charities and we await with interest the publication of the research report.

The current substantial donor rules are complex, insufficiently targeted (catching innocent transactions) and place a significant administrative burden on charities. The repeal of these rules is to be welcomed. We hope that there will be substantive consultation on the proposed new legislation so that it is a positive improvement meeting the Government's anti-avoidance purpose without catching innocent transactions or placing an undue burden on charities.



# Appendix 1

## VAT

	%
Standard rate – current rate	17.5
Standard rate – on or after 1 December 2008	15
Standard rate – on or after 1 January 2010	17.5

## Income tax personal and age-related allowances 2010/11 (£ per year)

	2009/10	Change	2010/11
Personal allowance (age under 65)**	6,475	(+0)	6,475
Personal allowance (age 65-74)**	9,490	(+0)	9,490
Personal allowance (age 75 and over)**	9,640	(+0)	9,640
Income limit for age-related allowances	22,900	(+0)	22,900
Married couple's allowance* (aged 75 and over)	6,965	(+0)	6,965
Married couple's allowance* – minimum amount	2,670	(+0)	2,670
Blind person's allowance	1,890	(+0)	1,890

\*Married couple's allowance given at the rate of 10%

\*\*From 2010/11 the basic personal allowance will be gradually reduced to nil by £1 for every £2 of 'adjusted net income' above £100,000.

## Income tax rates (£)

	2009/10	Change	2010/11
Starting savings rate 10%	0 – 2,440	(+0)	0 – 2,440
Basic rate 20%*	0 – 37,400	(+0)	0 – 37,400
Higher rate 40%**	37,400+	(+0)	37,400 – 150,000
Additional higher rate 50%***	n/a	(+150,000)	150,000+

\*10% starting rate for savings only where other income does not exceed the band

\*\*32.5% for dividend income

\*\*\*42.5% for dividend income

## National Insurance contributions 2010/11

Item	2010/11
Lower earnings limit, primary Class 1	£97 per week
Upper earnings limit, primary Class 1	£844 per week
Upper accruals point	£770 per week
Primary threshold	£110 per week
Secondary threshold	£110 per week
Employees' primary Class 1 rate	11% of £110.01 to £844 per week 1% above £844 per week
Employees' contracted-out rebate	1.6%
Married women's reduced rate	4.85% of £110.01 to £844 per week 1% above £844 per week
Employers' secondary Class 1 rate	12.8% above £110 per week
Employers' contracted-out rebate, salary-related schemes	3.7%
Employers' contracted-out rebate, money-purchase schemes	1.4%
Class 2 rate	£2.40 per week
Class 2 small earnings exception	£5,075 per year
Special Class 2 rate for share fishermen	£3.05 per week
Special Class 2 rate for volunteer development workers	£4.85 per week
Class 3 rate	£12.05 per week
Class 4 lower profits limit	£5,715 per annum
Class 4 upper profits limit	£43,875 per annum
Class 4 rate	8% of £5,715 to £43,875 per annum 1% above £43,875 per annum

## Capital gains tax annual exempt amount (£)

	2009/10	Change	2010/11
Individuals, etc.:	10,100	(+0)	10,100*
Most trustees:	5,050	(+0)	5,050*

\*These allowances and limits have not been pre-announced. Instead, they assume they are the same as in the previous year as indexation rules do not apply under negative inflation.

## Pension scheme allowances (£)

	2009/10	Change	2010/11
Pension scheme annual allowance	245,000	(+10,000)	255,000
Pension scheme lifetime allowance	1,750,000	(+50,000)	1,800,000

Working and child tax credits 2010/11 £ per year (unless stated)

	2009/10	Change	2010/11
<b>Working tax credit</b>			
Basic element	1,890	(+30)	1,920
Couple and lone parent element	1,860	(+30)	1,890
30-hour element	775	(+15)	790
Disabled worker element	2,530	(+40)	2,570
Severe disability element	1,075	(+20)	1,095
50+ return to work payment (16-29 hours)	1,300	(+20)	1,320
50+ return to work payment (30+ hours)	1,935	(+30)	1,965
<b>Childcare element of the working tax credit</b>			
Maximum eligible cost for one child (per week)	175	(+0)	175
Maximum eligible cost for two or more children (per week)	300	(+0)	300
Percent of eligible costs covered	80	(+0)	80
<b>Child tax credit</b>			
Family element	545	(+0)	545
Family element, baby addition	545	(+0)	545
Child element	2,235	(+65)	2,300
Disabled child element	2,670	(+45)	2,715
Severely disabled child element	1,075	(+20)	1,095
<b>Income thresholds and withdrawal rates</b>			
First income threshold	6,420	(+0)	6,420
First withdrawal rate (%)	39	(+0)	39
Second income threshold	50,000	(+0)	50,000
Second withdrawal rate (%)	6.67	(+0)	6.67
First threshold for those entitled to child tax credit only	16,040	(+150)	16,190
Income disregard	25,000	(+0)	25,000

Child benefit/guardian allowance rates 2010/11 £ per week (unless stated)

	2009/10	Change	2010/11
Eldest/only child	20.00	(+30p)	20.30
Other children	13.20	(+20p)	13.40
Guardian's allowance	14.10	(+20p)	14.30

Stamp taxes and duties

Transfers of land and buildings (consideration paid)

<b>Rate</b>	<b>Residential in disadvantaged areas</b>	<b>Residential outside disadvantaged areas</b>	<b>Non-residential</b>
<b>Value of total consideration</b>			
Zero	£0 – £150,000*	£0 – £125,000*	£0 – £150,000
1%	Over £150,000* – £250,000	Over £125,000* – £250,000	Over £150,000 – £250,000
3%	Over £250,000 – £500,000	Over £250,000 – £500,000	Over £250,000 – £500,000
4%	Over £500,000	Over £500,000	Over £500,000

\*£175,000 threshold applies until 31 December 2009

Vehicle excise duty for motorbikes: 2010/11 rates

<b>VED band</b>	<b>Change 2009/10 to 2010/11</b>	<b>2010/11 rate</b>
Up to 150cc	(+£0)	£15
151-400cc	(+£0)	£33
401-600cc	(+£2)	£50
Over 600cc	(+£4)	£70

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# Notes

