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Tax

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Client Alert 10-149

June 2010

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EMERGENCY BUDGET 2010 - NEWSFLASH

The following is a summary of key measures of the Emergency Budget announced by the Chancellor of the Exchequer on 22nd June 2010, with particular emphasis on those proposals affecting business taxation.

1. PERSONAL TAXATION

Income Tax and National Insurance

The following measures will be introduced with effect from 6 April 2011:

- The personal allowance for those aged under 65 will be increased by £1,000 to £7,475.
- However, the basic rate income tax limit will be reduced to prevent higher rate taxpayers benefiting from the increased personal allowance. The exact figure will be confirmed when the Retail Price Index for September 2010 is known.
- The alignment of the higher rate income tax threshold (total of the personal allowance and basic rate limit) with the upper earnings/profits limit applicable to national insurance contributions (‘**NIC**’s) will be maintained by a corresponding reduction to the upper earnings/profits limit.
- The secondary threshold (i.e. the point at which employers start to pay Class 1 NICs) will be increased by an extra £21 per week above indexation. This is in addition to the previously announced increase in the primary (employee) threshold already planned for 2011-12 and the 1% increase in the NICs rate.

The Government is to announce a three-year scheme to exempt new businesses in various target regions from up to £5000 of employers’ NICs for each of their first ten employees hired in the first year of business. The scheme should be in operation by September 2010.

Individual Savings Account (‘ISA’) Subscription Limits

From 6 April 2011, the ISA limits will increase in line with the Retail Price Index each year.

Pensions

- The Government is considering restricting pensions tax relief from 6 April 2011 by reducing the annual allowance (currently £255,000) to £30,000-£45,000, subject to consultation. This measure would replace the higher earners pension tax regime which is due to come into effect in April 2011. There will be no changes to the anti-forestalling regime currently in force in relation to pension contributions.
- The requirement that members of registered pension schemes must use a pension fund to buy an annuity or otherwise secure a pension income by the age of 75 will be abolished from the tax year 2011-12. Pending implementation of the necessary changes, the age limit for individuals who have not attained age 75 before 22 June 2010 will be increased to 77 from that date and is due to be abolished the following year.

Capital Gains Tax

From 23 June 2010, the rate of UK capital gains tax rate (‘**CGT**’) will increase from 18% to 28% for higher and additional rate taxpayers. Any gains (and any parts of gains) above the upper limit of the basic income tax band (£37,400 for 2010-11) will be subject to 28% CGT. Gains of trustees or personal representatives of deceased persons will be subject to 28% CGT. Where entrepreneurs’ relief applies (see below) for individual and trustees, the 10% CGT rate remains.

The annual exempt amount for 2010-11 remains unchanged at £10,100. Gains arising in 2010-11 but before 23 June 2010 will continue to be subject to 18% CGT and will not be taken into account in determining the rate at which gains of individuals arising on or after 23 June 2010 should be charged.

Where gains on the disposal of an asset are deferred until some time after the disposal, e.g. through reinvestment in shares under an Enterprise Investment Scheme, the applicable CGT rate will be the rate at the time the deferral ends and the gain becomes liable to tax. Accordingly, gains on disposals before 23 June 2010 which are deferred until 23 June 2010 or later will incur CGT at the same rates as gains on disposals taking place on or after 23 June 2010.

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Entrepreneurs' relief

This relief provides for certain qualifying gains to be taxed at an effective CGT rate of 10%. From 23 June 2010, in order to assist businesses, the lifetime limit on gains qualifying for entrepreneurs' relief is increased from £2 million (£1 million before 6 April 2010) to £5 million. Where qualifying gains above the previous £2 million limit arise before 23 June 2010 (or above the £1 million limit before 6 April 2010) no additional relief will be allowed for the excess above the old limit. However, if qualifying gains are made on or after 23 June 2010, it will be possible to claim relief on up to a further £3 million of those additional gains (or up to £4 million where the earlier £1 million limit applied) so that relief is given on accumulated qualifying gains up to the new limit of £5 million.

Enterprise Management Incentives ('EMI') and Venture Capital Trusts ('VCT's)

The previously announced changes to the EMI and VCT rules to ensure compliance with EU State Aid guidelines will be introduced after the date of Royal Assent. The current requirement that a company granting EMI options must carry on a trade 'wholly or mainly' in the UK will be replaced with a requirement that it has a UK 'permanent establishment'. For VCTs, the current requirement that the VCT must be listed in the UK will be replaced with a requirement that the VCT's shares instead be admitted for trading on any EU regulated market.

2. BUSINESS TAXATION

Corporation Tax Rates

- The main rate (profits of more than £1.5m) will be reduced from 28% to 27% from 1 April 2011 with successive annual reductions until a final target of 24% by April 2014.
- The small companies' rate (profits of less than £300,000) will be reduced from 21% to 20% from 1 April 2011.
- The main rate for 'ring-fenced' profits from UK oil extraction and oil rights will remain at 30% and the oil industry small companies' rate will remain at 19%.

Capital Allowances

With effect from April 2012, the rates at which the capital cost of plant and machinery can be written down for tax purposes will fall:

- from 20% to 18% per annum for most assets; and
- from 10% to 8% for long life assets and special rate plant and machinery.

Transitional rates will apply for periods which span the above dates. The annual investment allowance which gives 100% tax relief for investment in plant and machinery, will be reduced from £100,000 to £25,000.

As announced in the March 2010 Budget, a 100% first year allowance will be introduced for new zero-emission goods vehicles acquired on or after 1 April 2010 for businesses within the charge to corporation tax and on or after 6 April 2010 for businesses within the charge to income tax. This will apply for a five year period.

Worldwide Debt Cap Legislation

The 'worldwide debt cap' was introduced last year to guard against excessive debt funding of UK companies. It achieves this by restricting relief for UK financing costs where these exceed the financing costs of the worldwide group. A number of changes will be made to the debt cap legislation to take into account the feedback from UK businesses and to ensure the rules work as originally intended.

Research and development ('R&D') tax relief

Companies that are small or medium-sized enterprises ('**SME**'s) are currently entitled to claim enhanced tax relief for expenditure on research and development, subject to fulfilling a number of conditions. These conditions include the requirement that any intellectual property created as a result of the expenditure to which the R&D is attributable is, or will be, vested in the company claiming the R&D relief.

As previously announced, this requirement relating to the ownership of intellectual property will be abolished for any expenditure incurred by a SME company on R&D in an accounting period ending on or after 9 December 2009.

Consortium Relief

The consortium relief rules allow a member of a consortium to transfer its share of the consortium company's unused losses to another member of its group provided certain conditions are satisfied. The member that makes the transfer is known as the 'link company' and must currently be UK resident. Rules will be introduced to allow any company established within the European Economic Area to be a 'link company' for consortium relief purposes.

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Additional rules will be introduced to limit the amount of losses that can be claimed from a consortium company to ensure that consortium relief is given in proportion to the member company's active involvement in the consortium. An additional test will be included to limit the maximum amount of losses that can be claimed based on voting rights and the extent of control the member company holds in the consortium.

Bank Levy

Subject to consultation with industry, the Government will introduce a bank levy from 1 January 2011. This will be based on the balance sheets of UK banking groups and building societies and foreign banks and banking groups operating in the UK. These institutions and groups will only be liable for the bank levy where their relevant aggregate liabilities amount to £20 billion or more.

The levy will be based on total liabilities (i.e. both short and long-term liabilities) excluding:

- Tier 1 capital;
- insured retail deposits;
- repos secured on sovereign debt; and
- policyholder liabilities of retail insurance businesses within banking groups.

It is proposed that derivative liabilities will only be taken into account where they are net derivative positions.

It is proposed that the levy will be set at 0.07% with a lower rate of 0.04% applicable in 2011. There will also be a reduced rate for longer maturity wholesale funding (i.e. greater than one year remaining to maturity), to be set at 0.02% in 2011 and then rising to 0.035%. The levy will not be deductible for the purposes of corporation tax and there will be anti-avoidance provisions.

Film Tax Relief

Changes previously announced in the 2009 Pre-Budget Report will take effect for accounting periods ending on or after 9 December 2009 to correct an unintended anomaly affecting the amount of tax credit available where films are produced over more than one accounting period.

3. ANTI-AVOIDANCE RULES

Corporation Tax Avoidance – Authorised Investment Funds ('AIF')

With the objective of closing a specific tax avoidance scheme, corporate investors will no longer be able to make use of an AIF to create a credit for UK tax where no UK tax has been paid. The amendments are designed to prevent the artificial creation, inflation or repayment of the deemed tax credit attached to a dividend distribution made by an AIF and paid to a corporate investor.

Loan Relationships

Specific measures have been introduced to take effect from 22 June 2010 to close down avoidance schemes where the profits arising to a company from a financial asset are said to fall out of account for tax purposes as a result of the 'derecognition' of a loan or derivative. In certain circumstances where accounting practice allows or requires a loan or derivative to be 'derecognised', the tax rules treat the profits and losses to be computed as if the particular asset had been fully recognised. The new measure will extend the circumstances in which such 'derecognised' amounts are to be fully recognised for tax purposes.

General Anti-Avoidance Rule and Disclosure

The Coalition Government has stated its intention to consider a General Anti-Avoidance Rule as a means of countering tax avoidance. At the same time, the Government announced that it will look into the rules relating to stamp duty land tax on high value property transactions to counter avoidance in this area.

The Government will also consult over the summer on bringing inheritance tax on trusts within the Disclosure of Tax Avoidance Schemes regime.

Employer Financed Retirement Benefit Schemes

Employer Financed Retirement Benefit Schemes will fall within the scope of legislation designed to tackle income tax and NIC avoidance schemes utilising trusts with effect from April 2011. No details of the proposed measures are available.

4. REAL ESTATE

UK Real Estate Investment Trusts ('REIT's)

The distribution requirement for REITs requires it to distribute, for each accounting period, 90% of the profits from its property rental business by way of a cash dividend. From the date of Royal Assent, REITs will be allowed to issue stock dividends in lieu of cash dividends for the purposes of this distribution requirement.

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5. VAT

Increase of VAT rate to 20%

The standard rate of VAT will be increased from 17.5% to 20% with effect from 4 January 2011. This change will not affect zero-rated supplies (i.e. basic foodstuffs, children's clothing and books), exempt supplies (i.e. education and health) or supplies subject to 5% VAT (i.e. domestic fuel and power.)

Anti-forestalling legislation will be introduced to counter arrangements which seek to apply the current 17.5% VAT rate to goods delivered or services performed on or after 4 January 2011, e.g. through issuing a VAT invoice before the rate increase in relation to goods which are not due to be delivered until after the increase. The legislation will provide for a 2.5% supplementary charge to VAT to be imposed on relevant transactions taking place on or after 22 June 2010.

Insurance Premium Tax ('IPT')

With effect from 4 January 2011, in line with the increase in VAT rates, the higher IPT rate is to increase from 17.5% to 20% and the standard rate will increase from 5% to 6%.

Further changes relating to VAT

- From 1 January 2011 there will be a change to the definition of aircraft that can be supplied at the zero rate of VAT from one based on weight and usage to one based on the status of the customer. Supplies of aircraft will be zero-rated only where such aircraft are used by airlines operating for reward primarily on international routes.
- There will be changes to the place of supply rules applicable to supplies of gas, heat and cooling, with effect from 1 January 2011.
- With effect from 31 January 2011, certain postal services provided by Royal Mail, being the 'universal service provider (USP), will cease to be exempt, but instead be subject to the standard rate of VAT. Specifically, supplies of services that a USP is not required to make under a licence duty (such as those made by Parcelforce), and services provided on terms and conditions that have been freely negotiated will be standard-rated. Private individuals should largely be unaffected as social mail, including stamped mail, will remain exempt from VAT.
- From 1 January 2011, the recovery of VAT incurred on immovable property, boats and aircraft which are to be used for both business and private purposes will be restricted to the business use of the relevant asset, excluding any private use by the taxpayer or the taxpayer's staff. Changes to the capital goods scheme will also be introduced so that it will take account of changes in private use over subsequent years. Under existing "Lennartz" accounting arrangements, VAT is recoverable upfront and in full on both the business and private use of the asset (subject to any partial exemption restriction) and VAT is then payable over subsequent years in respect of the private use of the asset. Taxpayers who choose not to unravel existing Lennartz accounting arrangements will be placed under a statutory obligation to continue to account for the VAT due under the arrangements.

6. HMRC – POWERS, DETERRENTS AND SAFEGUARDS AND TAX ADMINISTRATION

Relief for Overpayments of Stamp Duty Land Tax ('SDLT') and Petroleum Revenue Tax ('PRT')

Measures will be introduced to amend the SDLT and PRT error or mistake relief rules to ensure that there is a comprehensive statutory scheme of remedies for reclaiming overpayments where there is no other statutory route. This follows similar changes to the income tax, CGT and corporation rules in the Finance Act 2009.

Interest Harmonisation for Corporation Tax and Petroleum Revenue Tax

Tax payers who make late payments to HM Revenue & Customs ('**HMRC**') or who receive repayments from HMRC of tax are currently subject to a harmonised scheme of interest rates. To date, corporation tax and PRT have not been subject to this regime but this will be remedied in the Finance Bill to be enacted following this Budget.

Penalties for Late Filing of Returns and Payment of Tax

This measure will complete the reform of the penalty regime for late filing of tax returns and late payment of tax which began with certain taxes such as income tax, corporation tax and inheritance tax in the Finance Act 2009. It is now intended that the penalty regime will be extended to include VAT, IPT and various other excise duties in the Finance Bill to be enacted following this Budget.

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Client Alert 10-149

June 2010

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