

The Budget 2008

The Chancellor, Alistair Darling, presented his Budget Speech yesterday (12 March 2008) and released detailed proposals for tax and economic changes which are expected to ultimately become the Finance Act for 2008.

Unlike his predecessor, the current incumbent seems to have taken a more open and honest approach and actually taken on board many of the criticisms levied at the now Prime Minister on how these proceedings take place. This time, at least apparently, significant and wide ranging changes were not hidden away in the detailed budget notices and press releases.

In fact this year the areas that concerned freelance workers the most have been delayed or have been introduced in a more diluted form.

We were expecting hard hitting legislation that would affect the distribution (dividends) of profit to non working spouses and partners to counter the taxpayer's success in the Arctic Systems case last year. In fact the Chancellor has decided to extend the period of consultation and has delayed introducing any legislation until 2009. We now have a further year to consider the proposals and means to limit the downside effects of such changes.

In addition whilst the expected removal of the taper relief provisions that could have seen a large increase in Capital Gains Tax for business sales and closures has been introduced, the effects of the withdrawal have largely been diluted by the introduction of the Entrepreneurs relief for the first £1,000,000 of gains.

Unexpected changes have been announced that will concern anyone using Isle of Man and other off shore trust solutions which look likely to halt their use to avoid taxation on income.

Combined with the MSC legislation last year means that these schemes are now potentially very risky for those providing their own services and in practice diverting their income offshore before bringing it back to the UK.

Equally freelance workers using Umbrella companies (or PAYE schemes) now seem to have been targeted and need to be concerned by the announcement of a review on the deduction from income of expenses currently allowed, particularly travel expenses.

Other changes that are of interest other than the traditional changes in allowances, tax rates and tax bands (all of which were expected or announced last year) include:

1. changes in taxation of non UK domiciled individuals who are residents in the UK;
2. new penalty and interest regimes, combined with increased powers of investigation, for the less honest taxpayer;
3. changes in IHT that could see savings on the estates of the deceased passing firstly to spouses and then onto the family after the second death;

Income Shifting

The government will not be enacting its proposed legislation to combat what it terms as "income shifting". Instead, new measures will be postponed until 2009, pending further consultation to ensure that any legislation will provide "clarity and certainty" for businesses and their advisors.

Small businesses should be celebrating the chancellor's change of heart, it follows a massive number of responses to the Treasury's income shifting consultation document issued in December. An Early Day Motion requesting postponement was given support by both the conservative and liberal democrat parties, and over 170 MPs had signed it online. Business groups also petitioned No.10 and overall, the efforts to stall the new tax seem to have had the desired effect.

The legislation was expected to have applied to:

- 1 profits of a partnership, and
- 2 company dividends

These measures were designed to catch married couples, civil partnerships, cohabitees and family members who share business profits that have been generated substantially by the efforts of only one individual in the relationship.

The period of consultation has been lengthened and its scope extended. The various government departments will now put their findings forward in time for the 2008 autumn pre-budget report with a view to introducing changes in the 2009 Budget.

Capital Gains Tax

The chancellor confirmed that the government's new Capital Gains Tax reforms will be implemented next month and as outlined in draft legislation recently released by HMRC, a flat 18% CGT rate will be introduced from 6 April, with a 10% entrepreneurs' relief applying for the first £1m of asset sales. These changes apply to individuals, trustees and personal representatives, but not for companies.

The Finance Act 2008 will introduce the following changes:

- 1 A main rate of CGT of 18% will apply to all gains other than those covered by the new entrepreneurs tax relief or the CGT annual exemption.
- 2 A lower rate of 10% for gains on certain business assets which are covered by the new Entrepreneur relief (see below).
- 3 Capital gains will no longer be taxed by reference to income tax rates and bands.
- 4 The following will be abolished: taper relief, indexation allowance (currently frozen at April 1998), and 'halving relief', however, in some cases, indexation will not be lost after 6 April 2008 and rebasing of cost to 31 March 1982 value will be compulsory for assets held at that date.
- 5 Simplification of the rules for matching certain assets (mostly shares) disposed of with assets acquired.

Entrepreneur's Relief is especially relevant to freelancers who are closing down their companies with substantial accrued and undistributed profits and who wish to extract those funds using the informal winding procedure known as ESC 16.

Although not dissimilar to CGT retirement relief which was phased out in 2002/03, entrepreneurs relief will not be based on any age or illness conditions and the qualifying holding period will only be one year. Under the proposals the first £1 million of lifetime gains on qualifying business assets will be charged to CGT at an effective rate of 10 per cent with gains in excess of £1 million charged at the normal 18 per cent rate. An individual will be able to make claims for relief on more than one occasion, up to a lifetime total of £1 million of gains qualifying for this type of relief.

The new relief will apply against capital gains made when an individual disposes of all or part of an unincorporated business or partnership; capital gains made when an individual disposes of assets following the cessation of a business; capital gains made by individuals on the disposal of shares in a trading company subject to qualifying conditions. A 'business', in terms

of this relief will be any trade, profession or vocation, excluding property letting business, but furnished holiday letting is treated as a trade for this relief.

Draft legislation confirms the small print of entrepreneurs' relief and confirms tax treatment for earn-outs which span 5th April and confirms the start date of the 'lifetime allowance.

New Penalty Regime

While HMRC has been simplifying many of its processes, this year's budget reveals a department that is slowly consolidating its authority and a substantial review of its powers, deterrents and safeguards.

Penalties for incorrect returns and failure to notify a taxable activity

There will now be a single penalty regime for incorrect returns across all taxes, levies and duties administered by HMRC. The penalty will be determined by the amount of tax understated, the nature of behaviour giving rise to the understatement, and the extent of the disclosure by taxpayer. The use of suspended penalties will be extended.

Provision will also be made to extend and adapt this penalty regime to cover failures to register or notify HMRC of any new taxable activity for any of the taxes, levies or duties it administers, including late VAT registration.

This measure repeals a miscellany of pre-existing, specific penalty provisions. Penalties for incorrect returns will be calculated using the established method, which takes into account the amount understated and the extent of the disclosure. Honest mistakes will go unpunished but there will be a penalty of up to 30% for failure to take reasonable care, 70% for a deliberate understatement, and 100% for a deliberate understatement with concealment.

If a taxpayer takes active steps to put right the problem, this will be taken into account. For an unprompted disclosure of a failure to take reasonable care the penalty could be reduced to nil.

Significantly for agents, if the return is wrong because of information wrongly supplied or withheld by a third party, the measure will allow the penalty to be charged to that third party.

For failure to notify a taxable activity there will be no penalty unless there is tax and/or NICs due, nor where the taxpayer has a reasonable excuse. Again penalties will be based on 30% of unpaid tax for non-deliberate failure to notify, 70% for deliberate failure, and 100% for deliberate failure with concealment.

Compliance checks

The Finance Bill 2008 will include new powers designed to align and modernise HMRC's access to records and information. The new package will introduce:

1. A power to inspect records required under the record-keeping legislation, restricting VAT and PAYE inspections to statutory records but introducing a new power of inspection for direct tax.
2. A power to require supplementary information relevant to establishing the correct tax position (thereby delimiting VAT and PAYE inspections from statutory records at the same time as it restricts them, one assumes).
3. A power to require third parties to provide information relevant to establishing the correct tax position.
4. A power to visit business premises and to inspect records and assets.
5. Removal of VAT and PAYE powers to undertake inspections at private homes without taxpayer consent...but penalties can be levied for failure to allow an inspection and failing to comply with an information notice, including a tax-geared penalty.
6. An updated criminal offence of destroying or concealing records requested under a notice authorised by a tribunal.

The normal assessment time limits by which the amount of tax due can be changed will (generally speaking) be reduced, severely so in most cases of failure to take reasonable care.

New recovery powers

HMRC is to gain new powers to pursue tax dodgers through the courts, under new measures introduced in the 2008 Budget.

Previous powers of enforcement, inherited from the Inland Revenue and HM Customs and Excise, were different across the two regimes, leading to confusion for taxpayers and unnecessary cost to the Exchequer.

The new power to take control of goods through the civil courts will allow debts to be recovered in a single action. Currently through the inherited system taxpayers can face two sets of costs and fees from recovery.

From autumn 2008 HMRC also plans to make it easier for tax payers to settle their debts by introducing a new credit card payment service.

Inheritance Tax (IHT)

Proposals announced some months ago to protect unused IHT exemptions on the first transfer of an estate to a surviving spouse were confirmed.

Non domiciled UK tax payers

Individuals who were not born in the UK and who are considered to be foreign nationals only pay UK tax on foreign income if it is remitted into the UK.

New proposals will limit the benefit of this remittance basis and introduce a new flat rate tax charge of £30,000 for those non domiciles who have lived in the UK for 7 years or more.

VAT Changes

Although registration and deregistration limits have been changed by far the most significant change announced related to how VAT errors are handled. Previously errors of less than £2,000 could be corrected by VAT Returns with no formal notification. New proposals extend this to the greater of £10,000 and 1% of turnover (subject to an overriding maximum of £50,000)

VAT scale charges have also been altered.

Capital Allowances

New rules have been confirmed that will extend the first year allowances on the purchase of equipment so that from April 100% relief will now be granted on actual capital expenditure up to £50,000 as an Annual Investment Allowance. Small “pools” of expenditure of £1000 or less can be written of in an accounting period.

Writing down allowances (the annual amount) is to be reduced from 25% to 20%.

Special rules on cars giving a 100% allowance where the vehicle has very low emissions have been extended by 5 years.

Rates, Allowances and Bands

Income tax, capital gains tax, and inheritance tax

£ per year (unless stated)	2007-08	Change	2008-09
Income tax personal and age-related allowances			
Personal allowance (age under 65)	£5,225	+£210	£5,435
Personal allowance (age 65-74)	£7,550	+£1,480	£9,030
Personal allowance (age 75 and over)	£7,690	+£1,490	£9,180
Married couple's allowance* (aged less than 75 and born before 6th April 1935)	£6,285	+£250	£6,535
Married couple's allowance* (age 75 and over)	£6,365	+£260	£6,625
Married couple's allowance* - minimum amount	£2,440	+£100	£2,540
Income limit for age-related allowances	£20,900	+£900	£21,800
Blind person's allowance	£1,730	+£70	£1,800
Capital gains tax annual exempt amount			
Individuals etc.	£9,200	+£400	£9,600
Most trustees	£4,600	+£200	£4,800
Individual inheritance tax allowance	£300,000	+£12,000	£312,000
Pension schemes allowances			
Annual Allowance	£225,000	+£10,000	£235,000
Lifetime Allowance	£1,600,000	+£50,000	£1,650,000

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

Income tax: Taxable bands

2007-08	£ per year	2008-09	£ per year
Starting rate: 10%	£0-£2,230	-	-
Basic rate: 22%	£2,231-£34,600	Basic rate: 20%*	£0-£36,000
Higher rate: 40%	Over £34,600	Higher rate: 40%*	Over £36,000

* There will be a new 10% starting rate for savings income only, with a limit of £2320. If an individual's taxable non-savings income is above this limit then the 10% savings rate will not be applicable. There are no changes to the 10% dividend ordinary rate or the 32.5% dividend upper rate.

Corporation tax on profits

£ per year (unless stated)	2007-08	2008-09
£0-£300,000	20%	21%
£300,001 - £1,500,000	Marginal relief	Marginal relief
£1,500,001 or more	30%	28%

National insurance contributions

£ per week (unless stated)	2007-08	Change	2008-09
Lower earnings limit, primary Class 1	£87	+£3	£90
Upper earnings limit, primary Class 1	£670	+£100	£770
Primary threshold	£100	+£5	£105
Secondary threshold	£100	+£5	£105
Employees' primary Class 1 rate between primary threshold and upper earnings limit	11%	-	11%
Employees' primary Class 1 rate above upper earnings limit	1%	-	1%
Employees' contracted-out rebate - salary-related schemes	1.6%	-	1.6%
Employees' contracted-out rebate - money-purchase schemes	1.6%	-	1.6%
Married women's reduced rate between primary threshold and upper earnings limit	4.85%	-	4.85%
Married women's rate above upper earnings limit	1%	-	1%
Employers' secondary Class 1 rate above secondary threshold	12.8%	-	12.8%
Employers' contracted-out rebate, salary-related schemes	3.7%	-	3.7%
Employers' contracted-out rebate, money-purchase schemes	1.4%	-	1.4%
Class 2 rate	£2.20	+£0.10	£2.30
Class 2 small earnings exception (per year)	£4,635	+£190	£4,825
• Special Class 2 rate for share fishermen	£2.85	+0.10	£2.95
Special Class 2 rate for volunteer development workers	£4.35	+£0.15	£4.50
Class 3 rate (per week)	£7.80	£0.30	£8.10
Class 4 lower profits limit (per year)	+£5,225	+£210	£5,435
Class 4 upper profits limit (per year)	£34,840	+£5,200	£40,040
Class 4 rate between lower profits limit and upper profits limit	8%	-	8%
Class 4 rate above upper profits limit	1%	-	1%

Working and child tax credits rates

£ per year (unless stated)	2007-08	Change	2008-09
Working Tax Credit			
Basic element	£1,730	+£70	£1,800
Couple and lone parent element	£1,700	+£70	£1,770
30 hour element	£705	+£30	£735
Disabled worker element	£2,310	+£95	£2,405
Severe disability element	£980	+£40	£1,020
50+ Return to work payment (16-29 hours)	£1,185	+£50	£1,235
50+ Return to work payment (30+ hours)	£1,770	+£70	£1,840
Childcare element of the Working Tax Credit			
Maximum eligible cost for one child	£175 per week	-	£175 per week
Maximum eligible cost for two or more children	£300 per week	-	£300 per week
Percentage of eligible costs covered	80%	-	80%
Child Tax Credit			
Family element	£545	-	£545
Family element, baby addition	£545	-	£545
Child element	£1,845	+£240	£2,085
Disabled child element	£2,440	+£100	£2,540
Severely disabled child element	£980	+£40	£1,020
Income thresholds and withdrawal rates			
First income threshold	£5,220	+£1,200	£6,420
First withdrawal rate	37%	+2%	39%
Second income threshold	£50,000	-	£50,000
Second withdrawal rate	6.67%	-	6.67%
First threshold for those entitled to Child Tax Credit only	£14,495	+£1,080	£15,575
Income disregard	£25,000	-	£25,000

Child benefit and guardian's allowance rates from 6 April 2008

£ per week	2007-08	Change	2008-09
Eldest/Only Child	£18.10	+£0.70	£18.80
Other Children	£12.10	+£0.45	£12.55
Guardian's Allowance	£12.95	+£0.50	£13.45

Stamp taxes and duties on transfers of land and buildings (consideration paid)

Rate	Residential disadvantaged areas in	Residential disadvantaged areas outside	Non-residential
	Total value of consideration		
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

Stamp duty on the transfer of shares has also been changed with the fixed rate minimum of £5 being abolished