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# EMERGENCY BUDGET JUNE 2010



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## Contents

Overview Budget 2010 .....	01
Capital gains tax increased to 28% - good news?.....	02
Capital allowances and careless whispers .....	03
20% VAT - proper planning more important than ever .....	03
Targeted anti-avoidance continues but is a GAAR now inevitable?.....	04
Driving UK innovation: bold claims about IP .....	04
Consortium relief - EU compliant but watch out for voting rights .....	05
Osbourne pre-empts G20 with bank levy .....	05
Corporation tax rate cut - "Britain open for business" .....	06
All change for pensions relief - again! .....	06
Contacts.....	07



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## Emergency Budget June 2010

On 22 June the Chancellor published the emergency Budget.

We think that the City will broadly welcome today's emergency Budget, in particular the phased reduction of corporation tax rates, which is a significant first step in making the UK a more competitive and attractive location for international business.

Whilst the increase the CGT rate will be disappointing for some, the top rate of 28% is lower than many were expecting, and the extension of Entrepreneurs' Relief to cover £5m of lifetime gains is good news for Britain's wealth generators, on whom growth depends.

However, the announcement that the Government is considering a GAAR will come as a disappointment to business, and seems at odds with the Government's welcome commitment to simplify our corporate tax system.

On the following pages are summaries of the key measures announced in the emergency Budget.

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### Capital gains tax increased to 28% – good news?

The much-feared alignment of CGT rates with income tax rates never happened. This may be seen by some as a “tactic” to make today’s increases more palatable.

From 23 June, individuals whose combined capital gains and income are higher than £37,400 (the upper limit of the income tax basic rate band) will pay 28% CGT. Gains that do not cause the basic rate income tax threshold to be crossed remain taxable at 18%.

Today’s announcement also means that:

- gains made before 23 June will still be taxable at 18% only, and will not “use up” any available basic rate band going forward;
- gains made by trustees and personal representatives will be increased from 18% to 28% (except in some circumstances where Entrepreneurs’ Relief may apply to business assets);
- non-domiciled “remittance basis users” who pay the £30,000 charge will pay 28% on chargeable (eg remitted) gains; and
- beneficiaries of offshore trusts who receive payments from the trust can be charged to capital gains tax at rates of up to 44.8%.

**Entrepreneurs’ Relief** – The lifetime allowance for Entrepreneurs’ Relief is extended from £2m to £5m for gains made after 23 June. This will be welcomed by those that expressed concerns about higher rates of taxation on business assets.

**Income to capital planning** – Given that there will still be a potential 22% differential between income and CGT rates, we anticipate that there is still scope for sensible and sound planning to maximise capital and minimise income returns.

**CGT-free roll up** – The absence of any form of taper relief or indexation does mean that where investment assets have been held for many years, a significant element of tax may arise on what are effectively “inflationary” gains. This pushes the real rate of long term CGT much closer to, if not higher than, income tax rates.

This penalises long term holders of assets (often real estate), which runs counter to the aims of the Government to encourage long-term investment. It may also mean that there is increasing investor preference to hold real estate or other investments through offshore life bonds, or certain types of collective investment schemes or funds (such as UK Real Estate Investment Funds (REITs) or Property Authorised Investment Funds (PAIFs)), where gains can be rolled up tax free and/or disposed of (and taxed) in tranches.

...and finally, given the pressure from the Liberal Democrats to align CGT rates with income tax rates of up to 50%, the 28% rate is likely to be perceived as a more acceptable outcome than many suggested alternatives. It is also interesting to note that in the Budget speech George Osborne indicated that he accepted advice from the Institute of Fiscal Studies that higher tax rates can result in lower tax collections. This advice has largely been ignored by previous governments and is perhaps an encouraging step by the new Government.

“... there is still scope for sensible and sound planning to maximise capital and minimise income returns.”

**Capital allowances and careless whispers**

Just like the much feared hike in CGT rates to 50%, talk of the scrapping of capital allowances has proved to be nothing more than “corridor gossip”.

The Government has however announced reductions in the capital allowances available to businesses investing in plant and machinery.

Writing-down allowances for new and unrelieved expenditure on plant and machinery will reduce from the current main rate of 20% to 18% for most assets, including short life assets. For items categorised as integral features, long life assets and thermal insulation, there will be a reduction in the special rate of allowances from the current rate of 10% to 8%.

For corporates, the changes apply to expenditure incurred on or after 1 April 2012. For businesses liable to income tax, the measures bite on expenditure incurred on or after 6 April 2012.

These changes in effect defer some relief to later years. The Government estimates that the measures will result in increased tax revenue, roughly comparable to the revenue decreases flowing from the corporation tax rate reductions announced today.

**20% VAT – proper planning more important than ever**

The standard rate of VAT will increase from 17.5% to 20% – this was widely expected and takes effect from 4 January 2011.

Partially exempt businesses, such as banks and insurance companies, will suffer the costs and efficient VAT-planning becomes increasingly critical in the current economic climate. Consideration should be given to accelerating capital expenditure projects, so that VAT is charged at the current 17.5%, subject to negotiating the anti-forestalling designed to prevent taxpayers from benefitting from the 17.5% rate. Looking at the longer term, where commercial objectives permit, it may still be possible to restructure operations in order to mitigate the impact of this VAT increase.

For fund managers that invest in tax exempt assets such as equities, bonds and student and residential accommodation, the increase in rate is likely to further stimulate interest in offshore and UK authorised structures, in order to minimise VAT leakage and enhance returns.

For those investing in real estate, the VAT increase will mean an increase in SDLT for some transactions, SDLT being charged on the VAT-inclusive consideration.

There was no reduction in the VAT rate for refurbishment in the private rented sector, nor was the VAT treatment of new build and repairs “equalised”, which had been proposed.

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... it may still be possible to restructure operations in order to mitigate the impact of this VAT increase.”

### Targeted anti-avoidance continues but is a GAAR now inevitable?

The new Government's approach to tax avoidance has been the subject of much anticipation. In addition to a number of targeted anti-avoidance rules announced in today's Budget (including one aimed at the derecognition of accounting profit from financial assets), the Coalition Government has published a document setting out its intended approach regarding tax policy, including avoidance.

The Government proposes to introduce reforms to make the tax system more simple, transparent and predictable, including by providing clarity and certainty to taxpayers on the legislative objectives and the future direction of the tax system, and by slowing down the rate of change. This will be welcome news to taxpayers, who have criticised the UK tax system for becoming progressively more complicated and piecemeal.

Against this backdrop, it is disappointing that the Government announced it is considering the introduction of a general anti-avoidance rule (GAAR), which would only create uncertainty by placing the onus on taxpayers to seek permission from HMRC every time they want to carry out a transaction. This seems to go against the wider policy objectives set out in the policy document, from which one can only assume that these policy objectives are not intended to apply to the GAAR.

It is interesting that GAARs have been unsuccessful in countries such as Australia and Canada, being both unpopular with taxpayers because of the uncertainty they created, and ineffective at combating the marketing of tax planning schemes.

We very much hope that the Government will conclude that the GAAR is unnecessary. Indeed the GAAR would be counterproductive if the Government carries through with its welcome commitment to simplify the corporate tax system.

### Driving UK innovation: bold claims about IP

We are heading for "the most competitive corporate tax system in the G20", according to the Government today.

As part of a package of measures aimed at reducing the overall corporate tax burden, the Government intends to consult with business on IP taxation reform.

This consultation follows the Dyson Review, which put forward proposals to drive innovation in the UK, principally:

- increasing EIS relief to 30% for investors in high-tech start-ups;
- refocusing the system of R&D tax credits to stimulate innovation in high tech companies, SMEs and start-ups; and
- streamlining the claim process of loss relief for small companies.

The consultation will take place in autumn 2010 – perhaps to coincide with the Government's intended reforms to the CFC rules, where IP and finance companies were particular focuses of attention. The Budget materials also suggest that introduction of the "patent box" (announced by the previous Government) is still on the cards.

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### Consortium relief – EU compliant but watch out for voting rights

Two changes affecting the application of consortium relief will come into effect for accounting periods commencing after the enactment of the next Finance Act.

Currently only a UK tax resident company can be a “link company” for the purposes of consortium relief. This definition will be extended to include companies established within the European Economic Area. The change follows the Tax Tribunal’s decision in the recent Philips Electronics case, that the requirement that a “link” company be resident in the UK (or trading in the UK through a UK permanent establishment) contravened EU law. The change may increase the usability of losses as a consortium company could potentially be “linked” to a greater number of companies.

Currently the maximum amount of losses that may be claimed from a consortium company is determined by the lowest percentage of:

1. the ordinary share capital held;
2. profits to which the company is entitled; or
3. assets to which the company would be entitled to on a winding up.

A further test will now be applied based upon the proportion of voting rights held by the consortium member. This change could potentially limit the amount of losses that may be claimed from a consortium company.

Intriguingly, the fiscal effect of these changes is not clear from the Budget 2010 materials.

### Corporation tax rate cut – “Britain open for business”

The corporation tax main rate is to be reduced from 28% to 27% from 1 April 2011. There will be further 1% cuts in the main rate each year for the following three years so that by 1 April 2014 the rate will be 24%. If other countries do not alter their rates, this would be one of the lowest rates of any of the major western economies.

The Chancellor stated that these reductions would signal that the British economy is “open for business”. The rate cuts are intended to boost the competitiveness of the UK’s corporation tax regime to stimulate investment and diversify the economy away from financial services on which the UK has relied heavily in the past.

The Government will announce in the autumn a more detailed programme for reform of the UK corporation tax regime, paying particular attention to the UK’s tax competitiveness for multi-national business. This will include changes to the controlled foreign company regime, a more territorial approach to taxation of branch profits and reform of the taxation of intellectual property.

The reduction in the main rate of corporation tax is to be welcomed, but more detail on the proposed reforms of the corporation tax regime will be needed before the full impact on business of this package of measures can be determined.

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### Osborne pre-empt G20 with bank levy

The pre-election Conservative party promise to push ahead with a “bank tax” proved not to be empty. The Chancellor today announced the introduction of a UK bank levy from 1 January 2011. The levy will be imposed on the total balance sheet liabilities of UK banks and UK branches of foreign banks, net of Tier 1 capital, insured retail deposits, sovereign debt repos and retail insurance policyholder liabilities – a methodology intended to push the banking system towards what the Government regards as “less risky funding profiles”.

The proposed rate is 0.07% (0.04% in 2011), with a reduced rate of 0.035% (0.02% in 2011) applying to longer-maturity wholesale funding (ie more than one year remaining). The levy is not intended to catch small banks: it will only apply where total prescribed liabilities are north of £20bn.

The levy will be non-deductible for corporation tax purposes and tightly drafted anti-avoidance provisions are expected.

The Budget brings perhaps mixed news for banks overall: like other businesses, they will welcome the phased reduction in the rate of corporation tax and the promised simplifications to the corporation tax regime. However, the concern is that the bank levy, together with other changes to the corporation tax landscape (including VAT), will make the UK less attractive as a financial centre. Also, like the bank payroll tax, the inference is that the policy underpinning bank taxation going forward will be as much “behavioural change” as the raising of revenue.

**Consultation will take place this summer, with detailed legislation to follow. We will be making representations on behalf of our banking clients. Please contact us if you wish us to make representations on your behalf.**

### All change for pensions relief – again!

The Government has recognised that the restrictions on pensions relief for high earners, introduced earlier this year, are not only complex but could adversely affect pensions and UK business.

The current legislation is to be repealed and replaced by an alternative approach, mainly involving a significant reduction in the annual allowance. Permitted contributions will obtain full tax relief, but the annual allowance could be as low as £30,000-£45,000. Contributions in excess of this will be subject to tax. The existing anti-forestalling provisions will remain in place.

Employer Financed Retirement Benefit Schemes (pension schemes which are not tax exempt) and other vehicles have been used to avoid the restrictions on pensions tax relief and to defer or avoid liability to income tax. Legislation is to be enacted in 2011 which will clamp down on these arrangements and on the use of trusts to avoid or defer employee taxation generally.

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## About BLP

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