Hobsons : Pre Budget Report October 2007

Tax News

Alistair Darling has now presented his first Pre-Budget report. Pundits were speculating that he would be easing the impact of inheritance tax - we have not been disappointed! Although we cannot present all the tax ramifications of the Pre-Budget Report yesterday we have summarised below the significant changes to inheritance tax and capital gains tax. We also point out the Revenue's intention to deal with income splitting and covered a number of other tax changes.

Inheritance Tax

Inheritance Tax Threshold doubled as from 9 October 2007.

The nil rate band is increased from £300,000 to £600,000 from 9 October 2007. This will take many estates out of inheritance tax completely. The threshold will be increased to £700,000 from 2010.

Transfer of unused nil-rate band allowance.

The second surprising relaxation in the impact of IHT on the estates of married couples and civil partners came in the form of a transfer of unused nil-rate band on the first death. This provision combined with the announced increase mentioned above will likely have a very beneficial effect on assets passing on the second death to surviving children or other beneficiaries.

Please note this change will only apply to married couples and civil partners.

Prior to 9 October 2007 if a spouse or civil partner died with chargeable assets lower than the nil rate band any balance of allowance was lost. As from 9 October 2007 this unused allowance can be transferred to the surviving spouse/partner. The operative date of 9 October 2007 applies to the second death. (The date of death of the first partner before this date is irrelevant.)

As usual there are a number of provisions to combat misuse of this new facility - particularly the amount of any uplift on the second death will be restricted to the amount of the nil-rate band at that time.

The amount of the nil-rate band transferable will be based on the proportion unused when the first partner died. If on the first death all assets were left to the surviving spouse/partner all of the deceased partners nil-rate band would be unused. On the death of the surviving spouse the nil-rate band applied at the later death will be increased by 100%.

Claims for the transfer will be made by the personal representatives on the second death when they submit an IHT return.

This transfer of unused nil-rate band will also be applied to any inheritance tax charge which may arise once a dependent's interest in an alternately secured pension ceases.

Capital Gains Tax

Companies are not affected by the changes outlined below. They will apply to individuals, trustees and personal representatives chargeable to Capital Gains Tax.

The Pre-Budget Report is quoted below:

The Government will take steps to introduce "a major reform of capital gains tax, introducing a single rate of 18 per cent from April 2008, ensuring a more sustainable system that is straightforward for taxpayers, and internationally competitive;"

What this statement does not reveal is set out in more detail below:

Reliefs to be withdrawn:

- Taper Relief is to be withdrawn.
- Indexation Relief is to be withdrawn.
- The so-called "kink test" for assets held at 31 March 1982 is to be abolished. What this means in plain English is that all assets held at 31 March 1982 will be deemed to have a base cost at 31 March 1982 valuation - whether or not the actual cost was higher or lower.
- The Revenue are also abolishing halving relief and simplifying the share identification rules.

Reliefs that will still be available post 6 April 2008 include:

- Principal private residence exemption.
- Business asset roll-over relief.
- Enterprise Investment Schemes and Venture Capital Trusts will no longer qualify for taper relief, all other CGT advantages are retained.
- Business asset gift hold-over relief.
- Unused CGT losses brought forward from previous years.
- The Annual Exempt amount will still apply, presently £9,200 for individuals.

It has to be said that the ramifications of these changes to CGT planning are far reaching. The legislation enacting these reforms will not be available until the March Budget 2008 is published. However HMRC will be publishing more detail of any consequential changes later in the year.

The calculation of capital gains tax due will no longer be linked to your income tax calculation. At present you pay CGT at your marginal rate for income tax purposes, as if the gain was added to your other taxable income. From 6 April 2008 gains will be taxed at a flat rate of 18%. This rate will not affect your income tax rates.

We will be studying this information as and when made public and will advise clients of the likely planning implications - watch this space!

Income Shifting

Hidden away in the Press Releases published by HMRC yesterday is a document entitled "Protecting Tax Revenues". The first section deals with Income Shifting. The press commentary says:

"The Government will be consulting, shortly after the Pre-Budget Report, on draft legislation to take effect from 2008-09 to address income shifting. The legislation will work alongside the existing rules on businesses deductions and settlements, and will seek to remove the tax advantage obtained from income shifting. It would only apply when the income is in the form of distributions from a company (dividends) or partnership profits. Income from employment, interest on savings and any other source will not be affected."

It would appear that the Government have decided to legislate in this area following their defeat in the Arctic Systems case.

In the same document HMRC have acknowledged that they will take into account work done by individuals in the business, investments they have made and the risks to which they are exposed through their involvement in the business.

Readers should note the words "The Government will be consulting..". We will need to await the outcome of these consultations and the legislation that follows. However you should note that this seems to indicate a commitment to legislate for the tax year 2008-2009 and subsequent years.

Again we will advise clients of the likely impact on their current business structures as soon as the detail is made available.

Other taxes

Corporation Tax - The main rate of corporation tax is to be reduced from 30% to 28% from April 2008.

Capital Allowances - Fire Safety expenditure - Relief for expenditure on fire safety equipment will continue to be available to all businesses. However expenditure made in response to a notice from a Fire Authority will no longer qualify for a capital allowance. This will apply as from 1 April 2008 for companies and 6 April 2008 for sole traders and partnerships.

Taxation of Non-Domiciled tax payers in the UK

Changes are proposed regarding the taxation of UK residents who are paying tax on a remittance basis and non-residents who spend a significant time in the UK.

After 6 April 2008 non-domiciled persons using the remittance basis for more than 7 years will have to pay an annual charge of £30,000 per year if they wish to continue using the remittance basis. If they do not pay the £30,000 they will need to declare all their world-wide income for UK tax purposes, rather than restrict their disclosure to income remitted to the UK.

All residence in the UK prior to 6 April 2008 will count towards the 7 year period.

There are also a number of other proposed changes that will tend to increase the annual tax bill of non-domiciled tax payers in the UK.

Increase in Fuel Benefit Charge - If you still receive fuel for private purposes from your employer the amount of taxable benefit you will be charged is set to increase from 6 April 2008.

The current fuel benefit charge multiplier of £14,400 is to be increased to £16,900. A percentage rate is applied to this multiplier dependent on the CO2 rating of your company vehicle.

Air Passenger Duty - For passenger travel after 1 November 2008 single class flights offering business class travel will attract air passenger duty at the standard rate. Up to 1 November 2008 this class of service qualifies for the reduced rate APD.

There is also an intention to replace APD with a tax payable by each plane rather than per passenger - this change is proposed from 1 November 2009.

VAT and housing - From 1 January 2008 renovations and alterations to residential properties that have been empty for at least two years will be eligible for a reduced VAT rate of 5%. Currently such properties must have been empty for three years.

DISCLAIMER - PLEASE NOTE: The ideas shared with you in this document are intended to inform rather than advise. Taxpayers circumstances do vary and if you feel that tax strategies we have outlined may be beneficial it is important that you contact us before implementation. If you do or do not take action as a result of reading this newsletter, before receiving our written endorsement, we will accept no responsibility for any financial loss incurred.

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