

PRE-BUDGET REPORT 5 DECEMBER 2005

Summary of the Main Taxation Provisions

This year's Pre-Budget Report was generally seen as posing major difficulties for the Chancellor. The predictions in his March 2005 Budget for growth and borrowing have proved seriously wrong, as many commentators predicted would be the case. In typical style, Gordon Brown swept aside such issues and announced a wide range of measures, including a major U-turn on the treatment of residential property in pension plans.

The Pre-Budget Report includes a further raft of measures against tax avoidance, broadening the scope of the rules introduced by the Finance Act 2004 that require the disclosure of schemes.

Tax allowances and national insurance contributions (NICs)

The basic personal allowance and starting point for national insurance contributions will rise in 2006/07 to £5,035. The rates of employers', employees' and class 4 NICs will stay unchanged. The flat rate of NIC for the self-employed will remain at £2.10 a week for 2006/07. A full list of the 2006/07 income tax allowances and NIC rates and thresholds is set out at the end of this summary.

Pension simplification

The government will remove the tax advantages for self-invested personal pensions (SIPPs), small self-administered schemes (SSASs) and all other forms of self-invested pensions that invest directly in residential property and certain other 'prohibited assets', such as fine wine, art and antiques. Indirect investments, eg unauthorised unit trusts, that are a close proxy for direct investment in prohibited assets will be treated in the same way as direct investments.

Any attempt to invest in prohibited assets will attract tax penalties on the member (at 40%) and on the pension scheme. If the value of the prohibited asset(s) exceeds 25% of the scheme value, the scheme may be de-registered and suffer a 40% tax charge on its total value.

The government 'is minded' to allow investment in such assets through 'genuine diverse commercial vehicles', such as REITs, but will monitor their use to ensure that the funds are not used to circumvent the new rules on prohibited assets.

The rules will generally take effect from 6 December 2005, subject to transitional reliefs.

From 6 April 2006, new legislation will remove the tax advantages of recycling lump sums drawn from pension schemes to make further pension contributions. This change will not affect lump sums drawn in the normal course of taking pension benefits.

A number of other minor technical changes were also announced.

Tax credits

As previously announced, the childcare element of working tax credit will rise in 2006/07 to 80% of costs up to £175 a week for a single child (ie a payment of up to £140 a week) and £300 a week for two or more children (ie a payment of up to £240 a week). The level of childcare costs covered will remain unchanged, but the other elements of working tax credit will rise in line with inflation. The first income threshold for working tax credit will be frozen at £5,220.

The child element of child tax credit will increase by 4.4% to £1,765 in 2006/07. However, the family element of child tax credit and baby addition will remain unchanged at £545 for a third year. For those claimants not entitled to working tax credit, the first income threshold (at which child tax credits other than the baby and family element start to be withdrawn) will rise to £14,155. The second threshold (at which the baby and family elements start to be withdrawn) is again unchanged at £50,000.

From 6 April 2006, virtually no families will suffer a tax credit clawback in the first year in which their income increases. This is because the disregard for increases in income between successive tax years will rise from £2,500 to £25,000 in 2006/07. However, from April 2007 the time allowed to report a change that reduces entitlement to tax credits will be cut from three months to one month.

Residence and domicile

The government says that it is continuing to review the residence and domicile rules as they affect individuals.

Corporation tax

The rate of corporation tax for small companies will be a single band of 19% from 1 April 2006. The 0% rate for the first £10,000 of undistributed profits will be abolished following the large number of self-employed people who decided to incorporate to reduce their liability to tax and national insurance contributions.

First year allowances

First year capital allowances for small businesses will be extended to 50% in the year from 1 April for companies and 6 April 2006 for unincorporated businesses.

The government intends to introduce at some point a new range of first year allowances for cars that will depend on their carbon dioxide (CO₂) emissions. This would build on the existing 100% first year allowances for cars with very low emissions.

Work in progress – the impact of accounting standards

A welcome change will impact on businesses – mainly in the service sector – that will have to pay more tax on work in progress as a result of guidance by the Accounting Standards Board in a circular known as UITF Abstract 40. The Finance Bill 2006 will contain measures enabling most businesses to spread any extra tax charge over three years. Those businesses that are most severely affected will be able to spread the charge over six years.

VAT annual accounting

The turnover threshold at which companies can qualify for the VAT annual accounting scheme will be increased to £1,350,000 from April 2006. The government will also raise the Cash Accounting Scheme turnover threshold to the same level, subject to the agreement of the European Commission.

Real Estate Investment Trusts (REITs)

Draft legislation on REITs will be in the Finance Bill 2006. HMRC will publish initial details of the proposals before the end of this year, which will include three key features:

- The regime will be restricted to UK resident companies publicly listed on a Recognised Stock Exchange;
- Companies that qualify will not pay corporation tax on qualifying property rental income or qualifying property chargeable gains; and
- There will be a requirement for REITs to distribute at least 95% of their net taxable profits on rental income.

Film taxation

New incentives for culturally British films will replace the existing reliefs from 1 April 2006. Films costing £20 million or less will be allowed an enhanced deduction of 100% of allowable production costs with a payable cash element of 25%. Films costing over £20 million will be allowed an enhanced deduction of 80% with cash payable of 20%.

Tax avoidance measures

There will be changes to the 2004 disclosure regime for tax avoidance which are aimed at helping HMRC to detect and respond to tax avoidance quickly. This regime will be extended to all income tax, corporation tax and capital gains tax. Businesses that devise their own tax schemes will be required to disclose them within 30 days of their implementation, bringing them into line with commercial tax scheme promoters.

Various measures were announced to counter tax avoidance through companies creating artificial capital losses, stock lending, relief for corporate intangible assets and capital losses on disposals of rights conferred by certain insurance policies. Measures will also counter inheritance tax avoidance by the use of second-hand interests in foreign trusts, as well as the avoidance of tax on pre-owned assets. HMRC has said that it will monitor schemes for avoiding income tax and national insurance contributions on remuneration, especially during the bonus-paying season. Any ensuing legislation may be backdated to 2 December 2004.

Income tax – personal and age-related allowances 2006/07

| | 2006/07 |
|--|---------|
| | £ |
| Personal allowance (age under 65) | 5,035 |
| Personal allowance (age 65-74) | 7,280 |
| Personal allowance (age 75 and over) | 7,420 |
| Married couple's allowance* (aged less than 75 and born before 6 April 1935) | 6,065 |
| Married couple's allowance* (age 75 and over) | 6,135 |
| Married couple's allowance* – minimum amount | 2,350 |
| Age allowances income limit | 20,100 |

* Tax relief for the married couple's allowance is given at the rate of 10%, and is only available where at least one spouse was born before 6 April 1935. The same allowances and conditions apply for civil partners.

National insurance contributions

| | 2006/07 |
|--|---|
| Lower earnings limit, primary class 1 | £84 a week |
| Upper earnings limit, primary class 1 | £645 a week |
| Primary threshold | £97 a week |
| Secondary threshold | £97 a week |
| Employees' primary class 1 rate | 11% of £97.01 to £645 a week 1% above £645 a week |
| Employees' contracted-out rebate | 1.6% |
| Married women's reduced rate | 4.85% |
| Employers' secondary class 1 rate | 12.8% on earnings above £97 a week |
| Employers' contracted-out rebate, salary-related schemes | 3.5% |
| Employers' contracted-out rebate, money-purchase schemes | 1.0% |
| Class 2 rate | £2.10 a week |
| Class 2 small earnings exception | £4,465 a year |
| Special class 2 rate for share fishermen | £2.75 a week |
| Special class 2 rate for volunteer development workers | £4.20 a week |
| Class 3 rate | £7.55 a week |
| Class 4 rates | 8% of £5,035 to £33,540 a year 1% above £33,540 a year |
| Class 4 lower profits limit | £5,035 a year |
| Class 4 upper profits limit | £33,540 a year |

Links

http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/prebud_pbr05_index.cfm

<http://www.hmrc.gov.uk/pbr2005/index.htm>

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