BUDGET TAX CHANGES FROM 6TH APRIL 2008

The core changes will be:

- New tax return filing deadline for paper tax returns.
- New penalty regime for errors & non disclosure resulting in an understatement of tax.
- New basis of calculating capital gains and associated reliefs.
- Non-domiciled persons but resident in the UK.
- New rules for trusts.

Contact:
Stephen Hopwood
Director
020 7825 7255
stephen.hopwood@argentaplc.com

Simon Braidley
Tax Manager
020 7825 7265
simon.braidley@argentaplc.com
**New Tax Return Filing Deadline**

From 6 April 2008, if your annual Self Assessment Tax Return is not filed online it will have to be submitted to HM Revenue and Customs (HMRC) by 31 October 2008. This is three months earlier than the previous deadline.

Filing a paper Return after 31 October will result in a late filing penalty of £100.

Tax Returns filed online will retain the usual filing deadline of 31 January.

**New HMRC Penalty Regime for Errors & Non-Disclosure**

There will be 12 months from the date HMRC receives your Tax Return for HMRC to raise an enquiry into that Return.

If a Tax Return is filed late the enquiry window is extended to 15 months from the date the Return is received.

Legislation will be introduced to create a single penalties regime covering all taxes. This is expected to apply for return periods commencing on or after 1 April 2009, where the Return is due to be filed on or after 1 April 2010.

The penalty will be determined by:

a) Amount of tax understated.

b) Nature of behaviour that resulted in the understatement of tax.

c) Extent of disclosure.

Not only will the understated tax have to be paid but interest will be added from the date the tax was originally due. The new penalty regime can impose penalties up to 100% of the tax understated.

**Capital Gains**

From 6 April 2008 there will be:

A flat capital gains tax rate of 18% for individuals, personal representatives and trustees.

No taper, indexation or halving reliefs.

Matching of shares sold on or after 6 April 2008 will be:

a) A disposal on the same day as an acquisition.

b) Shares reacquired within 30 days of disposal. (To counter Bed & Breakfast transactions, this is an existing matching rule).

c) Shares acquired from 5 April 1982 up to the day before a disposal will now form a single pool.

d) Shares held at 5 April 1982 will be deemed to have the 31 March 1982 market value as the deemed cost. The original cost of the asset is no longer applicable.
e) Entrepreneurs’ relief will give an effective tax rate of 10%, but will be limited to the first £1 million of lifetime disposals. Thereafter gains will be taxed at 18%. Specific conditions apply in order to benefit from the relief:

The conditions have to be met for at least one year.

On disposal of all, or part of a trading business, (including assets formerly used in such business) either alone or in partnership. (Furnished holiday lettings are eligible for this relief, but not letting businesses).

On disposal of shares in a trading company, or a company in the same group of companies, but the investor has to be:

a) either an officer or employee of the company, or a company in the same group of companies, and

b) has to own at least 5% of the shares in the company and is able to exercise at least 5% of the voting rights.

As a general rule of thumb, a higher rate taxpayer selling non-business assets under the proposed new rules will benefit from a lower capital gains tax liability for assets that were acquired after 5 April 1998 (when indexation allowance was replaced by taper relief).

**Lloyd’s Syndicate Capacity and Entrepreneurs’ Relief**

It would appear that on cessation of an underwriting business, the disposal of ALL the Lloyd’s syndicate capacity would qualify for Entrepreneurs’ relief.

Where an underwriting business continues, the yearly rearrangement of syndicate capacity at the auctions, would appear NOT to qualify for Entrepreneur’s relief, because there has not been a ‘material’ disposal of the business.

It may be possible to argue that the disposal of an entire syndicate’s capacity is a material disposal, therefore eligible for relief.

Argenta Taxation along with Lloyd’s Taxation department are seeking clarification from HM Revenue & Customs.

**Winners and Losers**

An example of how the new rules affect the sale of non-business assets by a higher rate taxpayer is attached at Appendix A.

To preserve an element of indexation relief, it is possible to transfer an asset that attracts indexation relief to your spouse or civil partner (see Appendix B). Action must be taken before 5 April 2008.

**Business Asset Taper (relief withdrawn from 6 April 2008)**

Previously if a business asset had been held for at least 2 years, the maximum taper relief of 75% could be obtained. This would give a higher rate taxpayer an effective rate of tax of 10%.
Examples of previous business assets that will not benefit from the new Entrepreneurs’ relief are:

- AIM Shares.
- Unquoted shares.
- Shares in your employer’s company.

Consequently you may want to consider selling business assets prior to 5 April 2008.

Business Asset shareholders will need to remember the ‘Last One In, First One Out’ (LIFO) matching rules before making any disposals, as those held under one year do not qualify for business asset taper relief. For those assets held for one year 50% relief is given, but that is still equivalent to a 20% rate of tax for a higher rate taxpayer. The main advantage falls to those who have owned a business asset for at least 2 years where 75% business asset taper relief would apply, thus giving an effective tax rate of 10%.

**Residence & Domicile**

Who is affected:

UK residents who are not domiciled in the UK and only paying tax on their offshore income on a remittance basis.

Non-resident individuals who spend a significant amount of time in the UK.

The changes from 6 April 2008 are:

- Any day that an individual is present in the UK at midnight will now be treated as a day resident in the UK. The only exception is for days spent in transit, so long as during the transit the individual does not engage in activities inconsistent with being in transit.

- For individuals making frequent visits to the UK, care should be taken to ensure that visits to the UK remain at or below the average of 90 days per year in the UK in any four year period.

- If an individual is not UK domiciled or not ordinarily resident in the UK but wishes to continue to use the remittance basis and has been UK resident for at least 7 of the previous 10 years, an annual flat rate charge of £30,000 will be payable.

- You will not be eligible for personal allowances and capital gains annual exemption if you choose the remittance basis.

- If you do not wish to pay the £30,000 flat rate charge, then you will be taxed on your worldwide income and gains whether they are remitted into the UK or not.

- If the offshore income or gains not remitted to the UK is below £2,000, you will be exempt from the £30,000 charge and still qualify for personal allowances and capital gains annual exemption.
Accumulation & Maintenance trusts are broadly trusts for the benefit of children under the age of 25, where the income is accumulated or, at the trustees' discretion distributed for the maintenance, education, or benefit of the beneficiaries.

In order to continue to benefit from the current favourable Inheritance Tax exemption of not imposing a 10 yearly charge or an exit charge, the trustees will need to amend the trust deed before 5 April 2008 so that the beneficiaries:

a) Have a right to the income (an interest in possession) AND capital at aged 18. So at aged 18 the income and capital belongs to the child and the trustees can no longer make any direction, or

b) Have the right to the income at aged 18, but the capital doesn’t vest to the beneficiaries until some point between their 18th and 25th birthday. In which case, the maximum period that the capital can be outside the beneficiaries’ hands is seven years (25-18). The price the trustees pay for having this extra control over the capital is that when the capital eventually vests to the beneficiary, an exit charge up to a maximum 4.2% (6% ÷10 yrs x 7years max) will arise.

If the trust deed is not altered to meet the conditions mentioned above, then both a 10 yearly and an exit charge will apply. The first 10 yearly charge of 6% will apply on every 10th anniversary following the creation of the settlement. The Trustees will need to provide the following details:

a) Date the trust was created.

b) The seven year chargeable gifts history of the settlor up to the date of commencement.

c) Existence of any related settlements on that day.

d) Any additional ‘property’ added since creation.

An interest in possession (IIP) trust applies where the beneficiary has the right to their share of the trust income (also known as the life tenant). The beneficiary does not need to have any right to the capital.

If the beneficiary does not have the automatic right to the income, because it is the trustees that decide how much income the beneficiary receives, the trust is a discretionary trust. In which case the following changes do not apply, because the trust is already subject to the 6% ten yearly charge and exit charge.

An IIP trust usually has one beneficiary absolutely entitled to the income (the life tenant), but the capital may pass onto another beneficiary when the life tenant’s interest comes to an end. On the death of the life tenant, the value of the settled property is brought into the deceased life tenant’s estate for Inheritance Tax purposes and full 40% IHT would be payable.

IIP trusts that were created before 22 March 2006 will, from 6 April 2008, be subject to the following change:
If the beneficiary’s (the life tenant) interest comes to an end during their lifetime, and the trust property remains in the settlement, they are treated as making a gift of settled property, which will be treated as creating a new settlement and subject to a 20% entry charge. They will also be subject to the ten yearly 6% charge and the exit charge.

If the beneficiary doesn’t need the income from the trust, they may wish to make changes to the trust so that another beneficiary becomes entitled to the income before the 5 April 2008.

The trustees should seek full professional advice before making any changes.

**Income Splitting**

Income splitting occurs when an individual has the power to shift their income to another, in order to gain a tax advantage by making use of the other party's personal allowances or lower tax bands.

The new legislation intended for implementation on 6 April 2008 has been deferred to allow for greater consultation. It is expected to be included in Finance Bill 2009.

**Restrictions on Trade**

**Losses**

Anti-avoidance legislation applicable from 12 March 2008 will prevent an individual claiming losses sustained in a trade against income other than from the trade, where the individual works less than 10 hours a week on the activity of the trade. By concession this will not apply to Lloyd’s underwriting losses.
### Appendix A - Capital Gains Examples

<table>
<thead>
<tr>
<th></th>
<th>Current Rules up to 5/4/08</th>
<th>Proposed New Rules from 6/4/08</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Non Business Assets</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Business Asset</td>
<td>(1,000)</td>
<td>(1,000)</td>
</tr>
<tr>
<td>Indexation – For (B) April 1985 to April 1998 rate 0.716</td>
<td>(716)</td>
<td>n/a</td>
</tr>
<tr>
<td>Indexation – For (C) April 1982 to April 1998 rate 1.047</td>
<td>(1,047)</td>
<td>(1,047)</td>
</tr>
<tr>
<td>Gain</td>
<td>4,000</td>
<td>3,284</td>
</tr>
</tbody>
</table>

**Non business asset taper**

- **B)** taper period May 1998 to date of sale say 5/4/08 = 9 years: 65% of gain chargeable = 2,600
- **C)** taper period April 1998 to date of sale say 5/4/08 + 1 yr bonus = 10 years: 60% of gain chargeable = 1,970, effective rate = 1,772
- **D)** taper period for a business asset greater than 2 years: 25% of gain chargeable = 738

**Capital gains tax rates**

- **(for A to D based on higher rate 40%)**: 40% of gain chargeable = 2,953, 18% of gain chargeable = 295

**Capital gains tax payable**

- **A to D**: 1040, 788, 709, 295, 720
- **E**: 26%, 19.7%, 17.7%, 7.4%, 18% #

---

**Notes**

- **#** - For a disposal from 6 April 2008, if the asset sold is a qualifying asset that is eligible for entrepreneurs’ relief, then the fixed rate of 18% would be reduced to an effective rate of 10% capped to a lifetime limit of £1 million.
- **D** – if the business asset was acquired after 6 April 1998, it would not have had the benefit of indexation relief and the effective tax rate would have been 10%
- **E** – there is no indexation relief or taper relief for disposals from 6 April 2008 onwards.
Appendix B

Indexation Relief (to be withdrawn from 6 April 2008).

Under the current rules assets acquired between 6 April 1982 and 5 April 1998 attract indexation relief which enhances the original acquisition (base) cost of an asset, thus effectively reducing a capital gain on sale.

For example, an asset acquired at the following dates would have its base cost increased under current rules by:

<table>
<thead>
<tr>
<th>Asset Acquired</th>
<th>Indexation Rate</th>
<th>Cost of a £1,000 asset with Indexation</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1982</td>
<td>1.047</td>
<td>£2,047</td>
</tr>
<tr>
<td>April 1985</td>
<td>0.716</td>
<td>£1,716</td>
</tr>
<tr>
<td>April 1990</td>
<td>0.300</td>
<td>£1,300</td>
</tr>
<tr>
<td>April 1995</td>
<td>0.091</td>
<td>£1,091</td>
</tr>
<tr>
<td>April 1998</td>
<td>0.000</td>
<td>£1,000</td>
</tr>
</tbody>
</table>

The proposed Budget changes mean that after 6 April 2008 the disposal of an asset acquired before 5 April 1998 will no longer have the benefit of indexation relief and only the original cost or 31 March 1982 market value (if acquired before that date) will be used.

It is possible before 5 April 2008 to transfer an asset that attracts indexation relief to your spouse in order to preserve the indexation allowance. The spouse’s deemed cost would be your original cost plus indexation.