

Budget 2006

BUDGET NOTES

22 March 2006

Budget Notes contain technical information additional to the press notices issued by HM Revenue and Customs at the Budget. They are not the same as press notices, which are primarily used as brief explanations of new policy for the media, but rather contain additional, more detailed information on the finer points and application of taxation changes announced in the Budget. As such they are designed to assist businesses that may be immediately affected by the changes, and to provide more technical information to those with a specialist interest such as tax consultants and advisers, City financial institutions and local HM Revenue and Customs offices. This information is also published on the Treasury and HM Revenue and Customs internet sites.

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GOVERNMENT DEPARTMENT INTERNET SITES

Further information and all published documents relating to the Budget may be found on the Internet at the following addresses:

HM Treasury: www.hm-treasury.gov.uk

HM Revenue and Customs: www.hmrc.gov.uk

CORPORATION TAX RATES

Who is likely to be affected?

1. Most companies with profits chargeable to corporation tax of less than £50,000.

General description of the measure

2. The reduction of the starting rate of corporation tax to 0% in April 2002 has resulted in a significant number of small businesses incorporating solely or mainly for tax and NIC reasons rather than as a step to growth.
3. This measure will simplify the corporation tax position for small companies with a single CT rate replacing the starting and non-corporate distribution rates.
4. There will be no changes to the current small companies and main rates, nor to the profit limits and fraction used in smoothing the differences between these rates (marginal small companies' relief).

Operative date

5. The new rates will apply from 1 April 2006.

Current law and proposed revisions

6. The various corporation tax rates are to be found in the Income and Corporation Taxes Act 1988. The provisions in respect of the starting rate are at Section 13AA and those for the non-corporate distribution rate at Section 13AB and Schedule A2.
7. The rate at which corporation tax is payable depends on the amount of a company's profits for the financial year in question. Corporation tax is charged at the starting rate (currently 0%) where profits are £10,000 or less, the small companies' rate (currently 19%) where profits are between £50,001 - £300,000, and the main rate (currently 30%) where profits exceed £1,500,000. Marginal relief is given to smooth the transition from one rate to another.
8. In addition, where a company makes a distribution on or after 1 April 2004 to a non-corporate person (a recipient who is not a company) a minimum rate of 19% is applied to the profits distributed.
9. This measure will remove the starting and non-corporate distribution rates from 1 April 2006. This will result in a much simpler regime with

profits charged at either the small companies' rate or the main rate, with marginal relief for companies with profits between the limits.

Further advice

10. If you have any questions about this change, please contact your local HMRC office. Information about Budget measures and on how to contact local offices is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

INCREASE IN RATE OF FIRST-YEAR CAPITAL ALLOWANCES FOR SMALL BUSINESSES

Who is likely to be affected?

1. Small businesses investing in plant and machinery.

General description of the measure

2. The rate of first-year capital allowances for small businesses spending on most plant and machinery will be increased from 40% to 50% for a period of one year.

Operative date

3. The increased allowance will apply to spending incurred on or after 1 April 2006 for businesses in the charge to corporation tax, and on or after 6 April 2006 for businesses in the charge to income tax.

Current law and proposed revisions

4. Capital allowances allow the cost of capital assets to be written off against a business's taxable profits. They take the place of commercial depreciation charged in commercial accounts. The main rate of capital allowances for general spending on plant and machinery is 25% a year on the reducing balance basis. First-year allowances (FYAs) bring forward the time that tax relief is available for capital spending and allow a greater proportion of the cost of an investment to qualify for tax relief against a business's profits of the period during which the investment is made.
5. The amounts of FYAs are set out in section 52 of the Capital Allowances Act 2001. Small and medium-sized enterprises can claim 40% FYAs on their investments in most plant and machinery. There are some exceptions, including spending on long-life assets, cars and assets for leasing.

6. This measure will increase the rate of FYAs for small businesses only, from 40% to 50% for a period of one year, providing an increased cash-flow benefit for small business's investments in plant and machinery. The rate of FYAs for medium-sized enterprises remains unchanged at 40%.

Further advice

7. If you have any questions about this change, please contact your local HM Revenue and Customs office. Information about Budget measures and on how to contact local offices is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

UK REAL ESTATE INVESTMENT TRUSTS

Who is likely to be affected?

1. Companies and groups of companies whose main business is property investment, and people who invest in them.

General description of the measure

2. The measure puts in place a regime that exempts income from and gains made on property from tax, provided the company or group meets certain conditions.
3. The measure also changes the character of dividends paid by companies that join the regime, to the extent that they relate to tax-exempt profits. These dividends are treated as income from UK property for UK tax purposes and are paid under deduction of basic rate income tax.

Operative date

4. Companies and groups can elect to join the regime with effect from 1 January 2007.

Current law and proposed revisions

5. Where a company owns property, it is chargeable to corporation tax at 30%, on the net rents received (section 15 Income and Corporation Tax Act 1988 (ICTA)) and under section 1 Taxation of Capital Gains Act 1992 on any gains made when property is sold. When a company distributes these profits to investors, they are treated as normal dividends for tax purposes, as set out in Part VI of ICTA and Chapter 3 Part 4 Income Tax (Trading and Other Income) Act 2005 (ITTOIA).
6. For many investors, there is no further tax to pay on the dividends. This is because UK companies are in general exempt from tax on UK dividends (section 208 ICTA), and for individuals, the tax credit attached to the dividend meets the liability to tax for all but higher rate taxpayers (section 397 ITTOIA). Higher rate taxpayers pay additional tax of 25% on the dividend. The tax credit cannot be paid to investors whose liability to UK tax is less than the tax credit.
7. For companies or groups that meet the necessary conditions for the regime, the measure will allow them to elect for special rules to apply to their property business and to their distributions. Those that elect will be known as UK-REITs (Real Estate Investment Trusts).

8. For UK-REITs, their qualifying rental income and gains on disposals of investment properties will be exempt from corporation tax. Profits and gains on any other activities carried on by the UK-REIT will be subject to corporation tax in the normal way.
9. Distributions paid out by a UK-REIT, so far as they are paid out of tax-exempt property income or gains, will be treated as UK property income. They will be chargeable to tax under Schedule A (section 15 ICTA) (for corporation tax) or section 268 ITTOIA (for income tax) and paid out to investors under deduction of basic rate income tax (22%). Dividends paid out of other profits will be treated as normal dividends for UK tax purposes. The detail of the administrative arrangements for accounting for tax deducted from payments will be included in regulations.
10. The conditions that have to be met to come within the UK-REIT regime cover:
 - the company (or the parent company in the case of a group),
 - the business carried on, and
 - a requirement to distribute at least 90% of the tax-exempt profits each year.
11. The conditions the company must meet include the following:
 - it must be UK resident for tax purposes,
 - its shares must be listed on a recognised stock exchange, and
 - no one investor may be beneficially entitled to 10% or more of distributions or control directly or indirectly 10% or more of the share capital or voting rights.
12. The conditions that relate to the business are that:
 - 75% or more of its assets must be investment property,
 - 75% or more of its income must be rental income, and
 - the ratio of taxable rental profits before interest and capital allowances to interest on loans to fund the tax-exempt business must be more than 1.25:1.
13. Companies or groups wanting to become UK-REITs will pay an entry charge of 2% of the market value of their investment properties at the date the company or group joins the regime. This charge will be collected at the same time as any corporation tax that is due for the first accounting period the regime applies to them. Companies or groups will be able to spread the charge over four years, in instalments of 0.5%, 0.53%, 0.56% and 0.6% if they prefer.
14. The legislation relating to "housing investment trusts" (sections 508A and 508B ICTA) is being repealed at the same time.

Further advice

15. The measure to permit UK-REITs follows two consultation papers (Budget 2004 and Budget 2005). Draft clauses and explanatory notes setting out the framework for the regime have been published on the HMRC website in several stages, starting 14 December 2005. An updated version of

these explanatory notes is published today on the HMRC website, alongside this Budget Note.

16. If you have any questions about this change, please contact Nicola Westbrooke on 020 7147 2588 or Claire Gough on 020 7147 2548. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

REFORM OF FILM TAX RELIEF

Who is likely to be affected?

1. Companies within the charge to UK taxation incurring expenditure on the production of British films intended for cinema exhibition.

General description of the measure

2. The measure introduces a new tax relief for the production of British films.

Operative date

3. The new relief will be available to films intended for theatrical release which commence principal photography on or after 1 April 2006.
4. The existing tax relief will continue to apply to the production of films commencing principal photography on or before 31 March 2006, provided the film is completed before 1 January 2007 and to the acquisition of films where acquisition takes place before 1 October 2007.

Current law and proposed revisions

5. The basic tax treatment of expenditure on the production and acquisition of films is governed by sections 40A and 40B of the Finance (No 2) Act 1992 and, for individuals, section 134 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).
6. Tax relief is provided by section 42 of the Finance (No 2) Act 1992 and sections 138 to 144 of ITTOIA 2005 which allow expenditure on the production or acquisition of British films to be matched against income from the film or written off over three years. Section 48 of the Finance (No 2) Act 1997 allows such expenditure on low budget British films to be written off immediately. Such relief is only available to films intended for cinema exhibition.
7. A British film is one certified as such under the Films Act 1985. These provisions allow the expenditure on producing or buying a film to be treated as revenue, rather than capital, expenditure. The same basic treatment also applies to expenditure on British films intended for broadcast on television.
8. The new film tax relief will be underpinned by a new treatment for film production companies (FPCs) that ensures that, for tax purposes a FPC will be defined as a company responsible for principal photography, post-production and for delivering the completed film. Each film will be treated

as a separate trade for tax purposes.

9. The current tax reliefs will be replaced with a new regime available to the production of British films by a FPC and will be provided on a maximum of 80% of total qualifying UK expenditure. To be eligible for the new relief, qualifying UK expenditure must be at least 25% of total production expenditure on the film.
10. A British film will be defined as one which meets the conditions of a test to be introduced by revisions to the Films Act 1985. Qualifying UK expenditure will be defined as that directly incurred in relation to pre-production, principal photography and post production activities which take place within the UK. Expenditure on other film-related activities, such as development, distribution and marketing, will be subject to normal tax rules.
11. The new incentive will provide an additional tax deduction for UK production expenditure. The rate of the deduction will be 100 per cent for films with total qualifying production expenditure of £20m or less and 80 per cent for all other films. Where this additional deduction gives rise to a tax loss, the FPC will be entitled to surrender that loss, up to the amount of its qualifying UK expenditure, for a payable tax credit. This tax credit will be calculated at a rate of 25 per cent of the loss surrendered for films with qualifying production expenditure of £20m or less and 20 per cent for all other qualifying films.
12. Alternatively, a FPC will be able to carry forward the additional deduction and set it against future income from the film in the same way as other losses. When the trade ceases, for example when the film is sold or ceases to be exploited, the FPC will be able to transfer its unused additional deduction to another trade of producing a British film carried on either within the same FPC or in another FPC within the group.

Further advice

13. If you have any questions about this change, please contact Craig Mason (020 7147 2599), David Harris (020 7147 2562) or George Rowing (020 7147 2550). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

AMENDMENTS TO THE RESEARCH & DEVELOPMENT TAX RELIEF SCHEMES

Who is likely to be affected?

1. Companies making claims to relief under the Research and Development (R&D) relief schemes.

General description of the measure

2. In line with a key recommendation of the Cox Review, the Government intends to provide additional support to firms with between 250 and 500 employees through R&D tax credits, subject to the outcome of state aid discussions with the European Commission. Further details of the proposals will be published later this year.
3. Two minor changes are being made to the rules governing R&D tax relief and vaccines research relief in Finance Bill 06. These changes:
 - align the claims process and time limits for claims to enhanced deductions with those for payable credits; and
 - extend the categories of qualifying expenditure to include payments made to clinical trial volunteers.
4. Both these changes were announced in *Supporting growth and innovation: next steps for the R&D tax credit*, published in December 2005.

Operative date

5. The changes to the claims process will apply, for all three schemes, for accounting periods ending on or after 31 March 2006. Transitional rules will apply in the case of accounting periods ending before that date.
6. The operative date for the extension of qualifying expenditure will be as follows:
 - in the case of the 'large company' R&D scheme (Schedule 12 FA 2002), 1 April 2006; and
 - in the case of the R&D scheme for small and medium enterprises and vaccines research relief, a date to be appointed by Treasury Order. This will allow the extension to take effect once state aids approval has been received.

Current law and proposed revisions

7. Schedule 20 Finance Act 2000 provides for tax relief for small and medium sized companies undertaking qualifying R&D activities. A 50% enhancement of qualifying expenditure can be claimed under the scheme and in some circumstances this can lead to a payable tax credit. Schedule 12 Finance Act 2002 provides for tax relief for large companies undertaking qualifying R&D activities. Large companies can claim a 25% enhancement of their qualifying expenditure under this scheme. Schedule 13 Finance Act 2002 provides for tax relief for companies of all sizes carrying vaccine research. The relief is in the form of a 50% enhancement of qualifying expenditure and in the case of small and medium companies can result in a payable tax credit.
8. Under Schedule 20 Finance Act 2000 and Schedule 13 Finance Act 2002 companies must make, amend or withdraw claims to payable tax credits in their tax returns and the time limit for doing this is the first anniversary of the filing date for the return. There are no specific rules for claims to enhanced deductions. The normal rules for claims therefore apply and such claims can currently be made up to six years from the end of the accounting period to which they relate.
9. The new rules align the process and time limits for making tax credit claims and for making claims for the enhanced deduction. All companies will be required to make, amend or withdraw their claim to the enhanced deduction by the first anniversary of the filing date for the tax return. Transitional rules will apply in the case of claims to the enhanced deduction for accounting periods ended before 31 March 2006. Such claims will need to be made by the earlier of the current time limit for claims (six years after the end of the relevant accounting period) and 31 March 2008.
10. The amendment extends the categories of qualifying expenditure to include payments made to clinical trial volunteers for taking part in the trials. In the case of the SME R&D scheme and vaccines research relief, which are notified state aids, this extension is subject to approval by the European Commission.

Further advice

11. If you have any questions about these changes, please contact Grusheka Lowton on 020 7147 2573 or Lynn Carroll on 020 7147 2636. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

ALTERNATIVE FINANCE ARRANGEMENTS

Who is likely to be affected?

1. Individuals and companies wishing to invest or borrow under alternative finance arrangements that do not involve the receipt or payment of interest.
2. Banks, building societies and similar financial institutions offering alternative finance products.

General description of the measure

3. The measure;
 - provides for two additional financial arrangements that replicate the effect of investments or loans at interest, ensuring that they are taxed no more or less favourably than equivalent arrangements that do give rise to interest;
 - provides for low-cost alternative finance arrangements by employers to employees to be taxed in the same way as equivalent loans that give rise to interest, and
 - allows other similar arrangements, which equate in substance to a loan or deposit but do not give rise to the payment or receipt of interest, to be brought into the existing legislation by Treasury Order.
4. These changes further facilitate the use of alternative financial products including, for example, those developed to be Shari'a compliant.

Operative date

5. The provision relating to alternative finance arrangements made available to employees will apply to arrangements entered into on or after 22 March 2006. The remaining provisions apply to arrangements entered into on or after 6 April 2006 for income tax purposes and 1 April 2006 for corporation tax purposes.

Current law and proposed revisions

6. Finance Act 2005 (FA 2005) introduced legislation to deal with finance arrangements that are structured so that they do not involve the payment or receipt of interest. It enabled certain financial arrangements to be taxed in a manner similar to those involving interest. It also ensured that other rules relating to interest, such as deduction of tax at source, apply in the same way.

7. The new provisions build on FA 2005 by providing for two additional alternative finance arrangements to be taxed on a level playing field to products involving interest. These relate to an agency-style contract, which is equivalent to a saving account, and a partnership-style arrangement used to finance the purchase of property or other assets.
8. This is achieved by providing that, where certain conditions are met, amounts equating economically to interest that are paid by the financial institution to the investor or received by the financial institution are to be charged to tax on the same basis as interest.
9. The proposed revision also amends FA 2005 to provide that low cost alternative finance arrangements provided by employers to employees are treated in the same way as conventional low-interest loans to employees. Existing legislation provides that a taxable benefit-in-kind arises from a 'taxable cheap loan' made to an employee. The difference between the amount of interest actually payable, and the amount of interest that would be payable at the official rate, represents the taxable benefit.
10. It is unclear whether the existing legislation includes alternative finance arrangements. The proposed revision puts it beyond doubt that benefits under such arrangements will be taxed on a par with conventional loans.

Further advice

11. A draft of the clauses that are proposed to be included in the Finance Bill is today published on the Revenue & Customs website. Comments on the draft are welcome, and should be submitted by e-mail to Sue Davies (sue.davies2@hmrc.gsi.gov.uk) or Lesley Hamilton (lesley.hamilton@hmrc.gsi.gov.uk) by Tuesday 28 March 2006.
12. If you have any questions about this change, please contact Sue Davies on 020 7147 2565 or Lesley Hamilton on 020 7147 2564. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CHANGES TO THE VENTURE CAPITAL SCHEMES

Who is likely to be affected?

1. Investors under the Enterprise Investment Scheme (EIS), the Corporate Venturing Scheme (CVS), and the Venture Capital Trust (VCT) scheme.
2. Companies attracting investment under those schemes.
3. VCTs.

General description of the measure

4. For VCTs:
 - The new rate of income tax relief for investors in VCTs will be 30%.
 - The minimum period for which VCT investors must hold their shares will rise to 5 years.
 - A change to the meaning of "investment".
5. Regarding the EIS:
 - The annual investment limit for income tax relief is doubled to £400,000.
6. Regarding EIS, VCTs and CVS
 - The limit in the maximum size of companies able to raise money under the schemes ("the gross assets test") is reduced to £7million before investment and £8 million afterwards.

Operative dates

7. The new measures take effect from 6 April 2006, apart from the change to the 70% qualifying holdings condition for VCTs, which has effect from 6 April 2007.
8. The change to the "gross assets test" will not apply in relation to funds raised by VCTs prior to 6 April 2006, nor to EIS or CVS shares subscribed for before 22 March 2006.
9. For EIS investments made by Approved Investment Funds (AIFs) raising funds the new gross assets test limits will not apply to investments made by AIFs which were approved before 22 March and which have started raising money before 6 April 2006.

Current law and proposed revisions

Income tax relief for investment in VCTs

10. Section 94 Finance Act 2004 introduced a two-year temporary increase in the rate of income tax relief available to VCT investors. That temporary rate of 40% applies to investments made before 6 April 2006, with the rate scheduled to revert to 20% thereafter. The new rate of income tax relief that will now apply to VCT shares issued on or after 6 April 2006 will be the increased rate of 30%.

VCTs: Qualifying holding period

11. Under Schedule 15B, Income and Corporation Taxes Act 1988 (ICTA), individuals must hold VCT shares for a minimum period of three years to qualify for income tax relief. This period will rise to five years for shares issued on or after 6 April 2006.

VCTs: The meaning of "investment"

12. Under Section 842AA ICTA a VCT must have 70% by value of its investments represented by shares or securities in qualifying holdings to gain and retain approval. It must also have no more than 15% of its total investments in a single holding in any company. The new rules will mean that any money that a VCT holds (or is held on its behalf) after 6 April 2007 will be treated as an investment for the purpose of these tests.

Annual EIS investment limit

13. Individuals can qualify for EIS income tax relief to obtain a reduction in their income tax liabilities of an amount up to 20% of the amount they invest in new full-risk ordinary shares in qualifying companies under Section 290 ICTA. This is subject to an investment limit of £200,000 per tax year. With effect for shares issued on or after 6 April 2006 this limit is doubled to £400,000.

14. Under Section 289A ICTA, individuals who invest in eligible shares under the EIS scheme during the first six months of any tax year can choose to treat up to half of them as if they had been issued in the previous year, and claim relief accordingly, subject to a maximum carry-back figure of £25,000. This figure is doubled from £25,000 to £50,000, with effect from 6 April 2006.

EIS, VCTs and CVS: The "gross assets test"

15. Under current rules the relevant assets of the company (or group of companies) raising money under the venture capital schemes may not exceed £15 million immediately before the investment and £16 million immediately afterwards. These limits will be reduced to £7 million and £8 million.

16. For VCTs the new limits apply to investment of funds raised after 6 April 2006 – for investment of funds raised before 6 April 2006, and money derived from such investments, the existing limits continue to apply.
17. For EIS and CVS the new limits apply to shares issued on or after 6 April 2006. But the old rules continue to apply in relation to shares issued after that date providing they were subscribed for before 22 March 2006.
18. EIS investments made by Approved Investment Funds (AIFs) will similarly be subject to the new limits from 6 April 2006. But where an AIF was approved before 22 March 2006 and was raising money before 6 April 2006, investments can be made in companies which meet the old gross assets limits.

Further advice

19. If you have any questions about these changes, please call Malcolm White 020 7147 3175. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

EXTENSION TO GROUP RELIEF

Who is likely to be affected?

1. The new relief will be available to UK groups with foreign subsidiaries that have incurred foreign tax losses that cannot be relieved elsewhere where those subsidiaries are either resident in the European Economic Area (EEA) or have incurred the relevant losses in a permanent establishment in the EEA.

General description of the measure

2. This measure introduces a small extension to the group loss relief rules to reflect European Community law. It will include provisions to prevent abuse.

Operative date

3. The legislation preventing abuse will be effective from 20 February 2006. All other legislation will be effective from 1 April 2006.

Current law and proposed revisions

4. Under Section 402 Income and Corporation Taxes Act 1988, a group company can claim to set the losses of another group company against its profits, thereby reducing the amount of corporation tax it pays. However, this applies only if both the claimant company and the surrendering company are UK resident or carrying on a trade in the UK through a permanent establishment.
5. On 13 December 2005 the Court of Justice of the European Communities (CJEC) handed down its decision in the case of Marks & Spencer plc v. Halsey. This case concerned the UK's group loss relief rules for companies.
6. In summary, the Court ruled that the UK's group loss relief rules are in principle compatible with European law, but go too far in denying loss relief to a parent company for the losses of a foreign subsidiary where the parent company has demonstrated that the non-resident subsidiary has exhausted all possibilities of relief in its state of residence.
7. Primary legislation is being introduced to ensure compatibility with European Community law. The legislation will not affect the existing group loss relief rules as they apply between UK companies or UK permanent establishments. The new relief will apply only where a UK parent

company has a foreign subsidiary (including an indirectly held subsidiary) which has incurred a foreign tax loss that is unrelievable in the home state (or elsewhere), and where that subsidiary is either resident in the EEA or has incurred the relevant losses in a permanent establishment in the EEA.

8. The foreign losses will be 'relievable in the UK' only where all possibilities of relief have been exhausted and future relief is unavailable in the country where they were incurred or in any other country. Where there is a foreign company in the ownership chain between the surrendering company and a UK parent, precedence rules will be used to determine whether relief will be available in the UK.
9. In order to obtain relief against UK profits the foreign tax loss will need to be recomputed under UK tax principles. This means that relief will only be available for losses or other amounts that may be surrendered under the existing UK rules. In addition, when calculating the amount of the relief, regard will be had to the overall amount of the unrelieved foreign loss. That is, relief will not be given for an amount that does not represent an unrelieved foreign tax loss.
10. All appropriate compliance obligations will be placed on the UK claimant company. Therefore, the claimant company will be responsible for demonstrating that the losses meet the relevant conditions.
11. Legislation will also be introduced, effective from 20 February 2006, to deny loss relief where there are arrangements which either result in losses becoming unrelievable outside the UK that might otherwise be relievable, or give rise to unrelievable losses which would not have arisen but for the availability of relief in the UK, if the main purpose or one of the main purposes of those arrangements is to obtain UK relief.

Further advice

12. If you have any questions about this change, please contact Robert Jordan on 020 7147 2622. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

SECURITISATION AND INTERNATIONAL ACCOUNTING STANDARDS (IAS)

Who is likely to be affected?

1. Large companies involved in securitisations or issuance of debt.

General description of the measure

2. Changes to the temporary regime for securitisation companies under which they remain on old UK generally accepted accounting practice (GAAP) for tax purposes.

Operative date

3. The regime is extended by one year. The changes to the regime have effect from the original start date of 1 January 2005.

Current law and proposed revisions

4. A temporary tax regime for securitisation companies was introduced in Section 83 Finance Act 2005, to enable such companies to be taxed on the basis of accounting standards in force before the introduction of IAS. This regime was due to end on 31 December 2006.
5. In order to allow time to develop a more permanent tax regime for securitisation companies, the temporary regime is being extended by one year to 31 December 2007.
6. Amendments are also being made to the definitions of securitisation companies for the purpose of the temporary regime to ensure it works as intended.
7. The first change is to exclude companies that issue debt in circumstances other than a securitisation.
8. Companies that were within the regime on 22 March 2006, or were legally committed to entering into arrangements on 22 March 2006 that would have brought them within the regime, can elect to retain the original rule.
9. The other changes allow the inclusion of chains of intermediate borrowing companies, and extend the range of permitted activities that a note issuing company can carry on to include the activity of acting as a guarantor.

Further advice

10.If you have any questions about this change, please contact Sarah Weston on 020 7147 2575 or sarah.weston@hmrc.gsi.gov.uk. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

SALE OF LESSORS

Who is likely to be affected?

1. Companies carrying on a business of leasing plant or machinery.

General description of the measure

2. The measure affects arrangements that can lead to a loss of tax when a company carrying on a business of leasing plant or machinery is sold or otherwise changes hands or enters into transactions with a similar effect.
3. The measure brings into charge an amount which recovers the benefit that the company has derived from capital allowances and gives the company an equal and opposite relief.

Operative date

4. The measure will apply where changes in the economic ownership of lessor companies occur on or after 5 December 2005.

Current law and proposed revisions

5. Lessor companies take advantage of the benefit of capital allowances to defer tax on the profits on long leasing transactions. The effect of this early relief is unwound as the lease progresses so that profits are brought into tax in the later period of the lease. These timing benefits are accessed where the lessor company is within a wider group through the surrender of early losses as group relief. This is a normal consequence of the availability of capital allowances and group relief. The tax profit profile is not matched in the commercial accounts of the company, which will typically report profits throughout.
6. The Government has become aware of increased activity designed to shelter the deferred profits from taxation. Typically this will take the form of a sale of the company to a group that has substantial losses that can be surrendered to the lessor company. When this happens the tax on the profits is further deferred, sometimes indefinitely.
7. The sale of lessors measure affects all sales of companies carrying on a leasing business and acts by bringing into charge an amount of income which is calculated by reference to the difference between the commercial position of the company and the tax position. The accounting period of the company is brought to a close and a relief is given in the next accounting period in the form of an exactly matching expense. The availability of the

relief means that a sale of a lessor company that is not tax motivated will not be discouraged because the profit-making purchaser is likely to be willing to compensate the seller for the effect of the charge because the lessor company brings with it a valuable relief.

8. The charge and the relief are triggered by changes in the economic ownership of the lessor company and there are provisions to ensure that where there is only a partial sale the charge is reduced proportionately.
9. The measure covers leasing businesses carried on in a consortium structure and through a partnership. It also addresses other methods by which deferred profits on a leasing transaction can be sheltered from tax through unusual partnership profit sharing arrangements, the transfer of assets between parties at a value other than market value and transactions whereby the leased asset is sold and part or all of the income stream is retained.
10. The measure as published on 5 December 2005 will be amended to take account of developments in the reform of the taxation of leasing and in response to comments made following publication of the draft legislation. Where these changes have the effect of reducing the scope or effect of the measure these beneficial changes will have effect from 5 December. Other changes will have effect from 22 March.
11. The following changes reduce the scope of the measure and have retrospective effect:
 - The definition of a plant or machinery lease will be aligned with that in leasing reform. This means that, for example, companies that enter into leasing transactions that are primarily leases of real property will not have 'qualifying leased plant or machinery' and so may be outside the scope of the charge.
 - Where a 'qualifying change of ownership' occurs as a consequence of an internal reorganisation of a group of companies no charge will be triggered as long as all companies involved remain 75% subsidiaries of the principal company.
 - Provisions which restricted access to losses derived from the relief will be changed to ensure that groups are now able to surrender losses derived from the relief as group relief over a period of at least twelve months after the change in ownership.
12. Provisions dealing with the disposal of a leased asset where income is retained will be changed to ensure that no amounts are taken into consideration twice nor fall out of tax.
 - The draft legislation as published on 5 December treated as disposal value the amount of the consideration received plus, in the case of a finance lease, the net investment in the lease amount. The net investment in the lease amount is calculated by reference to the future income stream together with the expected residual value of the asset subject to the lease. It is likely that the amount of consideration received will also reflect the expected residual value of the asset and as a consequence this amount could be taken into account twice. The

provisions setting out how the disposal value is calculated will be changed so that the disposal value for capital allowances purposes is the amount of consideration received plus the net present value of the future rentals retained by the seller. In cases where the consideration received equals or exceeds the original cost of the asset the whole of this amount will be the disposal value but no further amount in respect of the net present value of future rentals retained by the seller will be included in the disposal value. This change will have effect from 5 December 2005

- The 5 December draft legislation also excluded from taxation any future rentals, which had been taken into account in calculating the disposal value. As a consequence of this, in almost all cases all future rentals would fall out of account. The draft legislation will be changed so that future rentals will be brought into charge over the remaining term of the lease, to the extent that their value has not been treated as disposal value for capital allowances purposes. This change will have effect for rentals receivable on or after 22 March 2006. Rentals receivable before this date are therefore unlikely to be brought into charge.

13. A change will be made to prevent groups of companies manipulating the effect of the charge by transferring assets that are subject to leases from other group members to the lessor company at values other than market value. To prevent this, the value of any leased assets acquired directly or indirectly from connected parties will be taken to be market value for the purposes of determining whether the company is carrying on a business of leasing plant or machinery and for the purposes of calculating the charge. This change will apply to transactions occurring on or after 22 March 2006.

14. Draft legislation will be published before the end of March.

Further advice

15. If you have any questions about these changes, please contact Jo Brindley on 020 7147 2571 or Malcolm Smith on 020 7147 2555. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CORPORATE CAPITAL LOSSES

Who is likely to be affected?

1. Those companies that take part in schemes or arrangements in order to gain a tax advantage from capital losses.

General description of the measure

2. As announced in the Pre-Budget Report 2005, three targeted anti-avoidance rules will be introduced to ensure that the creation and use of capital losses is restricted to genuine commercial transactions. Following consultation, minor amendments have been made to the legislation dealing with tax-motivated loss and gain buying so that it operates as intended. Changes have also been made to the guidance issued in the Pre-Budget Report in order to provide further clarity for business.

Operative date

3. All three anti-avoidance rules will be effective from 5 December 2005.

Current law and proposed revisions

4. The clauses, announced in the Pre-Budget Report, repeal Section 106 and Schedule 7AA of the Taxation of Chargeable Gains Act 1992 (TCGA). They insert new Section 184A to 184I, and amend Section 8 TCGA 1992.
5. The clauses are aimed at deterring:
 - the contrived creation of corporate capital losses.
 - the buying of capital gains and losses; and
 - the conversion of income streams into capital gains, and the creation of a capital gain matched by an income deduction, where the gains are then wholly or partly franked by capital losses.

6. Since the publication of draft clauses on 5 December 2005, changes have been made to ensure that new sections 184A and 184B do not adversely affect some cases where companies realised a capital loss before 5 December 2005, and to address interactions between these sections and other rules providing for the roll-over or deferral of capital gains. The guidance notes have been expanded and refined following comments received during the consultation with business that concluded on 6 February 2006.

Further advice

7. If you have any questions about this change, please contact Robert Jordan on 0207 147 2622. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

LONDON OLYMPIC GAMES AND PARALYMPIC GAMES

Who is likely to be affected?

1. The London Organising Committee of the Olympic Games Ltd (“LOCOG”, the company set up to organise the Games), the International Olympic Committee (“IOC”), and non-UK resident competitors and support staff temporarily in the UK for the Games.

General description of the measure

2. These measures will exempt LOCOG from corporation tax and will provide powers for regulations to be made in relation to the IOC and non-resident athletes and other persons temporarily in the UK to carry out Olympic-related business. The powers will allow provision to be made to ensure that the IOC's revenues generated from the Games, income of non-UK resident athletes from their performance at the Games, and income of other persons temporarily in the UK to carry out Olympic-related business will not be chargeable to corporation tax, income tax or capital gains tax.

Operative date

3. LOCOG will be exempt from corporation tax from 22 October 2004 (the date the company was incorporated). The regulations made under the powers are unlikely to be needed until nearer the time of the Games.

Current law and proposed revisions

4. A UK resident company is within the charge to corporation tax under section 6 Income and Corporation Taxes Act (ICTA) 1988. LOCOG will be taken out of that charge by specific exemption. Powers will be put in place to allow regulations to be made to provide exemption for a wholly-owned subsidiary of LOCOG, where appropriate. Powers will also be taken to allow regulations to be made relating to LOCOG, or a person acting in concert with LOCOG, to ensure that the benefit of exemption does not extend beyond LOCOG's functions under the Host City contract.

5. A non-resident company is only within the charge to corporation tax if it carries on a trade in the UK through a permanent establishment as defined in section 148 Finance Act 2003. Powers will be put in place for regulations to ensure that the IOC and, if applicable, any non-UK resident person owned or controlled by it, will not have a permanent establishment in the UK and so will not be chargeable to corporation tax. The powers will also allow regulations to be made to prevent the IOC, and any non-UK resident person owned or controlled by it, from being chargeable to income tax or capital gains tax on revenues generated in relation to the Games.
6. Sections 13 and 14 of Income Tax (Trading and Other Income) Act (ITTOIA) 2005 and sections 555-558 ICTA 1988 bring payments made to non-UK resident visiting performers within the charge to income tax and provide for tax to be withheld. General earnings from duties performed in the UK by non-UK resident employees are liable to income tax under section 27 Income Tax (Earnings and Pensions) Act 2003. Profits of a trade of a non-UK resident, to the extent that it is carried on in the UK, are liable to income tax under section 6 ITTOIA 2005, or in the case of a non-UK resident company to corporation tax under section 11 ICTA 1988. Powers will be taken for regulations to be made later. These regulations will ensure that non-UK resident competitors will not be charged to tax on income arising from their performance at the Games, and that non-UK residents who are only temporarily in the UK for the purpose of the Games will not be charged to income tax on their earnings from the work they perform in relation to the Games.
7. In certain circumstances section 349 ICTA 1988 requires tax to be withheld from royalties, interest and other annual payments. Section 349(1) will not apply to royalties and annual payments made to LOCOG. Powers will be taken that will enable regulations to be made to prevent section 349(1) from applying to royalties and annual payments made to visiting performers and support staff, and to prevent section 349 from applying to the IOC and any non-UK resident owned or controlled by it.

Further advice

8. If you have any questions about this change, please contact Mark Anderson on 020 7147 2621. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CONTROLLED FOREIGN COMPANIES AND RESIDENCE

Who is likely to be affected?

1. Companies which became non-resident in the UK for tax purposes before 1 April 2002.

General description of the measure

2. This measure is designed to ensure that some companies which became non-resident in the UK as a result of the operation of a double taxation treaty before 1 April 2002 are brought within the controlled foreign companies (CFC) legislation.

Operative date

3. This change will have effect from 22 March 2006.

Current law and proposed revisions

4. Section 747 of the Income and Corporation Taxes Act 1988 brings some subsidiaries of UK companies within the controlled foreign companies legislation.
5. Subsection 1B of section 747 provides that Section 249 of the Finance Act 1994 is disregarded for the purposes of the CFC legislation.
6. This means that companies which became non-resident for other tax purposes as the result of the operation of a double taxation treaty are still regarded as resident for the purposes of the CFC legislation.
7. When subsection 1B of Section 747 was introduced by Finance Act 2002, companies which became non-resident before 1 April 2002 were excluded.
8. This measure will remove that difference with effect from 22 March 2006, so that companies which became non-resident as a result of a double taxation treaty before 1 April 2002 will become subject to the CFC legislation on the occurrence of certain specified events. This will ensure that companies which became non-resident as a result of a double taxation treaty before 1 April 2002 cannot be used for tax avoidance.

Further advice

9. If you have any questions about this change, please contact Chris Murrricane on 020 7147 2684 or Andrew Hoar on 020 7147 2719. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

TAXATION OF LEASED PLANT AND MACHINERY

Who is likely to be affected?

1. Lessors and some lessees of plant or machinery where the lease is essentially a financing transaction. Leases of less than 5 years, and in some cases 7 years or more, will not be affected.

General description of the measure

2. This legislation aligns the tax treatment of leased plant and machinery with that of plant and machinery acquired with other forms of finance. As a consequence it reduces a distortion in the current system caused by the differing tax treatment of finance from different sources.
3. Subject to an option to elect otherwise, this legislation will only apply to longer leases that are essentially financing transactions. These leases will be known as “long funding leases”.

Operative date

4. In general, the legislation will apply to long funding leases finalised on or after 1 April 2006. Transitional arrangements will allow some leases finalised on or after this date to remain unaffected by the new rules.

Current law and proposed revisions

5. Under the current law:
 - lessors of plant and machinery are entitled to claim capital allowances on its cost and they are taxed on all the rentals received from the lessees; and
 - lessees are not entitled to capital allowances and are entitled to a deduction for all their rentals.
6. Some leases function in a very similar way to a loan. Where this is the case, the new regime will:
 - prevent lessors claiming capital allowances on the cost of the leased asset and tax them only on the proportion of the rental income that reflects the financing charges; and
 - allow lessees to claim capital allowances on much the same amount as they would have been able to had they bought the asset, and receive a deduction for that part of the rentals on which capital allowances are not available.
7. Subject to anti-avoidance rules, the new regime will not apply to:
 - leases of less than 5 years; or

- leases of between 5 and 7 years where certain conditions are met.

Tonnage tax

8. The new regime will not apply to leases that would otherwise be long funding leases of ships to companies within tonnage tax as long as the lease is directly to the tonnage tax company or indirectly via one member of the tonnage tax company's group.
9. In order to meet this condition, where the lease contract is finalised on or after 1 April 2006, the tonnage tax company will also be required:
 - to operate and manage the ship; and
 - not to lease the ship out for more than 7 years at a time.
10. A company will be regarded as operating and managing the ship where it is responsible for operating the ship throughout the period of the charter and for defraying all or substantially all expenses in connection with the ship during that period.

Transitional rules

11. Details of the transitional arrangements were contained in the draft legislation published on 5 December 2005. The principle conditions that must be met before the transitional rules apply are that there was an agreement to lease the plant or machinery (referred to as "pre-existing heads of agreement" in that draft legislation) in place before 21 July 2005 and that the asset is under construction before 1 April 2006.
12. Amendments will be made to the draft legislation to ensure that:
 - all leases of plant or machinery finalised (made unconditional with no terms to be agreed) before 21 July 2005 remain taxed on the basis of the current law, i.e. they will remain within the existing regime; and
 - where a lease does not remain within the existing regime, expenditure incurred before Royal Assent to Finance Bill 2006 will be subject to the existing regime only where there was an agreement to lease the plant or machinery in place before 21 July 2005.
13. In those cases where a lease does not remain within the existing regime, our view is that if a contract for the provision of the leased plant or machinery is varied so that expenditure to be incurred by a lessor is brought forward so that additional sums are payable before Royal Assent, those additional payments fall within the new regime. However, to avoid doubt, an explicit provision to this effect will be included in the final legislation. This specific provision will not apply where the variation took place, or the lease was finalised, before 22 March.

Election

14. The legislation will give HM Treasury the power to make regulations that will allow lessors to elect for leases, other than leases of cars, to be taxed under the new regime providing that the value of the leased assets does not exceed £10m. The election will not need to be made on a group basis and will be available to any lessor.
15. The election will be available for leases finalised on or after 1 April 2006, but only where the asset has not been leased before or has been previously leased only under a long funding lease.
16. An election should allow lessors to be taxed on the leasing profits shown in their accounts providing those accounts reflect the profits that would be taxed on the statutory basis.

Other changes

First year allowances

17. To ensure stability of the new regime, the legislation will make amendments that will allow first year allowances to remain available to lessors only where:
 - they lease cars with low carbon dioxide emissions; or
 - the plant or machinery is leased with a building and functions as background plant or machinery.

Hire purchase

18. The legislation will amend the hire purchase rules in section 67 Capital Allowances Act 2001 so that:
 - hire purchase transactions with overseas lessees are treated in the same way as transaction with UK lessees;
 - they only apply to a lessee if the lease should be accounted for as a finance lease under generally accepted accounting principles; and
 - the hire purchase rules will apply equally to alternative hire purchase arrangements, for example those developed to be Shari'a compliant.
19. The changes to the hire purchase rules will apply to contracts finalised on or after 1 April 2006.

Finance costs

20. The legislation will make two changes that apply to companies carrying on oil extraction activities etc. in the UK or on the UK continental shelf. It will:
 - expand the scope of s.494AA ICTA, which deals with the finance costs arising on sale and leaseback transactions, to cover sale and leaseback transactions where the leaseback is what the legislation refers to as a "long funding operating lease" of plant or machinery; and
 - amend the definition of "finance costs" in s.501A ICTA which is used in calculating the adjusted ring fence profits on which the supplementary

charge is payable.

21. A similar change will be made to the definition of finance costs in paragraph 63 of Schedule 22 Finance Act 2000, which governs the way that finance costs are to be allocated between tonnage tax and non-tonnage tax activities.

Further advice

22. Further draft legislation and a Technical Note will be published before the end of March 2006.

23. A final Regulatory Impact Assessment is available on the HM Revenue & Customs website.

24. If you have any questions about this change, please contact Paul Lane on 020 7147 2637 (email: paul.lane@hmrc.gsi.gov.uk) or Malcolm Smith on 020 7147 2555. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

NORTH SEA OIL PRICING

Who is likely to be affected?

1. Oil and gas companies that operate in the UK or on the UK continental shelf.

General description of the measure

2. Certain companies can exploit the current oil tax pricing rules to ensure a lower tax price for sales of North Sea production. This can lead to behaviour that is not tax neutral. The changes to be introduced will change the current North Sea oil valuation and pricing rules to achieve a fairer and less distortive tax pricing system.
3. The measure will impact on;
 - pricing for tax purposes of non-arm's length disposals of oil,
 - the scope of the Nominations Scheme, and
 - the rules for determining which field blended oil is deemed to be lifted from.

Operative date

4. The new rules will apply on and after 1 July 2006.

Current law and proposed revisions

5. Legislation for determining the monthly market value of oil for non-arms' length disposals is at Section 2 and Schedule 3 Oil Taxation Act 1975. Changes will be made to arrive at a value for tax purposes that reflects the ways in which that kind of oil is sold at arm's length.
6. From 1 July 2006, oil disposed not at arm's length will be split into two categories;
 - Category 1 oils will be those that are specified by HM Revenue & Customs (HMRC) where a published price is readily available. Initially this will include sales of Brent, Forties, Ekofisk, Statfjord and Flotta. The oil will be priced based on a five day period using an arithmetic mean of published prices from price reporting agencies on the date of delivery of the oil and two days either side, known as the 2-1-2 method.
 - Category 2 oils will be all other types of oil for which there are no published or quoted prices. Here HMRC will agree valuations based on actual arm's length disposals which reflect market practice more closely than current rules.
7. Legislation on the Nominations Scheme is at Section 61 and Schedule 10

Finance Act 1987 and SI 1338/1987. Changes to be made by Finance Bill 2006 mean that from 1 July 2006;

- the scheme will be limited to arm's length sales made through forward contracts,
 - the time limit for nominating a sale will be reduced from 5pm on the day after the transaction was agreed to within 2 hours from the time the transaction is agreed,
 - the process of reconciling nominations will be amended to take account of limiting the scope of the scheme to forward contracts and to take account of the 2-1-2 pricing changes referred to above, and
 - any nominations excess will be liable to ring fence corporation tax and supplementary charge in addition to petroleum revenue tax (PRT).
8. Current rules for allocating oil which is mingled from more than one oil field can be used to arbitrage between fields which pay and those which do not pay PRT leading to significant tax loss. The arbitrage opportunity can be extended by buying in non-equity oil. Legislation dealing with disposals of blended oil is at Regulation 20 SI 1338/1987 and Section 2(5) Oil Taxation Act 1975. The changes to be made in Finance Bill 2006 will ensure that a sale of blended oil is allocated proportionately across a company's various interests for tax purposes. The rules in Regulation 20(8) will be repealed. Section 2(5) will be amended to provide for the use of a formula for determining the allocation. The changes will cover both a company's equity oil (from its own field interests) and also any non-equity oil under its control.

Further advice

9. Draft legislation and a Regulatory Impact Assessment for determining the tax pricing of non-arm's length disposals of oil were published on the HMRC website on 2 December 2005. A Regulatory Impact Assessment of the changes to the Nomination Scheme and allocation of blended oil is published today.
10. If you have any questions about this change, please contact Mike Crabtree, HMRC Oil and Gas on 020 7438 6576. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

QUALIFYING LIFE INSURANCE POLICIES

Who is likely to be affected?

1. Some holders of qualifying life insurance policies whose terms are varied.

General description of the measure

2. This measure ensures that unexpected tax effects do not arise for holders of qualifying life assurance policies in certain circumstances. These circumstances are where there is a variation in the method for calculating the investment return to holders of the policies, for instance from with-profits to non profit unit-linked. In the past these variations have often been linked with transfers of insurance business from one insurance company to another.

Operative date

3. The amendment applies to the type of variation described above taking place on or after 7 October 2005. It also applies retrospectively to similar variations that took place under court-approved insurance business transfer schemes.

Current law and proposed revisions

4. Under the complex qualifying policy rules appearing at Schedule 15 to the Income and Corporation Taxes Act 1988 a policy needs to be re-tested if its terms are varied significantly. The result of this may be an unexpected tax charge when the policy is later assigned or comes to an end. Older policies still attracting life assurance premium relief may also lose this relief.
5. The proposed amendment will mean that variations that merely alter the method for calculating the investment returns allocated by the insurer to policyholders are disregarded, and will preserve the position for variations that formed part of an insurance business transfer scheme.

Further advice

6. If you have any questions about this change, please contact Victor Baker (020 7147 2606). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

LIFE INSURANCE COMPANIES

Who is likely to be affected?

1. Life insurance companies.

General description of the measures

2. Two measures relating to life insurance companies (measures A and B) were announced on 29 September 2005 (with a further announcement on measure B on 3 November 2005). As a result of consultation undertaken since the announcements, the proposed legislation to implement them has been revised.
3. The Insurance Companies (Corporation Tax Acts) (Amendment) Order 2005 (SI2005/3465) sets out a revised basis for taxing the income and gains attributable to assets not needed to pay policyholder benefits (the "inherited estate") to ensure that, for accounting periods beginning on or after 1 January 2005 and ending before 1 October 2006, such income and gains will be taxed at normal corporation tax rates. As a result of consultation undertaken since the laying of the instrument, a further amending instrument will be laid shortly. In addition, the Finance Bill will contain a provision extending the effect of the instrument. (Measure C).
4. A further measure will make some technical changes to the corporation tax and stamp duty land tax (SDLT) rules that apply where there is a transfer of business in connection with a scheme of demutualisation. (Measure D).
5. There will also be a consultation exercise looking at a number of issues which have been identified by practitioners in the insurance industry and within Government as ones which could simplify the current I minus E system and remove unnecessary barriers to commercial transactions, especially business transfers. A consultation document will be issued later this spring.

Operative date

6. Measures A and B will apply for periods ending on or after 29 September 2005, as announced. Measure C will come into force at Royal Assent and will apply for periods ending after 30 September 2006. Measure D will apply in relation to transfers of business on or after today (but with one aspect backdated to 2 December 2004).

Current law and proposed revisions

7. The measures to be included in the Finance Bill will:

- A Provide that any increase in a non-profit life assurance company's "Form 14 Line 51" entry (the entry in that line of that Form in a company's periodical return to the FSA) will be brought into account as additional receipts in computing profits, and any decrease as an additional expense.
- B Contain provisions which ensure that where there is a reduction of surplus which represents previously untaxed amounts earned by a mutual company which has demutualised, an amount equal to the reduction will be brought into account as income in computing profits. That amount will not however exceed the amount that is necessary to ensure that the company's taxable profit from with-profits business is not less than the transfer of surplus to shareholders, and in the case of a 100:0 fund (where all current surplus is allocated to policy holders) that there is no loss.
- C Provide that the amendments made to the apportionment rules by SI 2005/3465 and any subsequent Orders will apply for periods of account ending after 30 September 2006. Further changes to the apportionment rules will be discussed in the consultation document referred to at paragraph 5 above.
- D Make a number of changes to the rules applying to transfers of business. This includes a relaxation of the rules governing clawback of group relief for SDLT purposes in connection with a demutualisation, and the removal of a charge to tax if assets are transferred from a company's long-term insurance fund in consideration of the transferee assuming concomitant liabilities under a loan. Provisions applying where there is a transfer of liabilities which exceed the assets transferred will also be amended to prevent an unintended tax charge arising where the business transferred includes long-term business which is not life assurance business and where the transferee is the reinsurer of the transferor.

Revisions to previously announced measures

8. A full explanatory note was published on 29 September 2005 describing the proposed changes in measures A and B. In the light of representations received from the industry, changes have been made to measure B as follows:
- the changes announced on 3 November 2005 are included;
 - where a company has received certain injections of capital which increase the "Form 14 Line 51" entry, the amount of that entry will be reduced by the amount of the capital injection represented in that line;
 - where a company had a resilience capital amount at the end of 2005, the amount to be brought into account in 2005 will be reduced by that amount, but two thirds of it will be brought into account in 2007 and a further third in 2008; and
 - the rules will also cater for transfers of business.
9. In relation to measure A,
- the definition of unappropriated surplus will also include a case where there is an addition to the surplus of the transferee in a demutualisation that was received in connection with the demutualisation. In any such case, the measure will only have effect for periods ending on or after today;
 - changes have also been made to clarify the position where unappropriated surplus is held in a non-profit fund.

"Inherited Estate" – measure C

10. Finance (No. 2) Act 2005 contained an amendment to existing regulation-making powers taking the form of a time-limited power ("sunset clause"). SI2005/3465 was accordingly laid on 16 December 2005 and applies to accounting periods beginning on or after 1 January 2005 and ending before 1 October 2006. The measure in the Finance Bill will simply provide that the amendments made by the Order will continue to apply in the future. A further Order will provide a comprehensive set of rules dealing with corresponding adjustments.

Further advice

11. If you have any questions about this change, please contact Richard Thomas (020 7147 2558) or Colin McHardy (020 7147 2614). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

PROTECTING REVENUES: FINANCIAL PRODUCTS

Who is likely to be affected?

1. Companies who enter into certain types of arrangement that involve financial products designed to avoid tax.

General description of the measure

2. These measures block a number of avoidance schemes that have been notified to HM Revenue and Customs under the disclosure rules introduced in Finance Act 2004. A common feature of a number of these schemes ((d) to (g) below) is that they use intra-group arrangements to avoid tax on income arising to the group, or create a tax loss when there is no economic loss to the group as whole. Work will continue to examine the extent to which these and other similar themes are common to this type of avoidance scheme, and the scope for identifying a common approach to addressing them.
3. In order to tackle immediate issues, legislation will be introduced in the 2006 Finance Bill to block the following schemes:
 - a. avoidance of tax on interest on cash using stock lending arrangements on non-commercial terms;
 - b. arrangements involving purchase and sale of rights to distributions on shares used by financial traders to create tax losses;
 - c. avoidance of tax through use of instruments which are economically loans but which are claimed not to be loan relationships because they cannot be settled in cash (so called "mandatory convertibles") but by the issue of shares;
 - d. exploitation of the group continuity rules for loan relationships and derivative contracts to take advantage of different accounting methods used by group companies, or to avoid tax on discount arising on transfers;
 - e. exploitation of accounting rules which result in profits on loan relationships being de-recognised, and thus falling out of tax;
 - f. avoidance of tax in respect of loan relationships under arrangements where the investor receives less than a full commercial lending return (which would be taxable), but another connected party receives the value of that return in a non-taxable form; and

- g. regulations coming into force today will prevent arrangements to hedge currency exposures resulting in tax relief where there is a loss on the hedge but no tax charge where there is a profit.
4. In addition, minor changes will be made to the 'shares as debt rules' introduced in Finance (No 2) Act 2005, to clarify the wording and ensure they work as intended, and in one instance to provide a relaxation asked for by business.

Operative date

5. The changes apply to scheme (a) in respect of arrangements entered into on or after 5 December 2005, with transitional provisions where arrangements in force on that date are amended. The extension of the stock lending anti-avoidance rules to other arrangements which are similar to stock lending arrangements will apply to arrangements entered into on or after 22nd March 2006.
6. The changes apply to scheme (b) where sales of rights to distributions are made on or after 20 January 2006.
7. The changes apply to schemes (c), (e) and (f) in respect of profits accruing from 22nd March 2006, and to scheme (g) to exchange losses brought into account from 22nd March 2006.
8. The changes apply to scheme (d) in respect of transfers of loan relationships or derivative contracts on or after 22nd March 2006.
9. The changes to the 'shares as debt rules' will apply to profits accruing on or after today, and the relaxation of the time limit for issues of mirror shares will apply where the public issue is on or after 22nd March 2006.

Current law and proposed revisions

10. In outline, the proposed changes will block the schemes as follows:
 - a. a lender who provides cash collateral under a stock lending arrangement with no provision for manufactured payments will be treated as receiving interest on that cash at a commercial rate. In addition, this treatment along with existing anti-avoidance legislation in section 736B Income and Corporation Taxes Act 1988 ("ICTA") will be extended to non-commercial arrangements which are economically similar to stock lending arrangements;
 - b. the exemption from tax in section 730 ICTA on proceeds of sale or other realisation of the right to receive a distribution on shares will be removed;
 - c. arrangements involving the lending of money but which are not loan relationships solely because they cannot be settled in cash but by the issue of shares will be brought within the loan relationships regime in

Chapter 2 Part 4 Finance Act 1996 (“FA 1996”);

- d. the group continuity rules (paragraph 12 Schedule 9 FA 1996 and paragraph 28 Schedule 26 Finance Act 2002) will be amended to ensure that no profits fall out of account where assets are transferred under contrived arrangements designed to take advantage of the tax definition of ‘fair value’. And where discount arises on transfer of a loan relationship or derivative contract, that discount will not be prevented from being brought into account by the group continuity rules;
- e. the loan relationship rules in Chapter 2 Part 4 FA 1996 will be amended in two ways. First, to ensure that in cases where the accounting treatment wholly or partly de-recognises profits or losses on loan relationships so that some or all of those profits or losses fall out of tax, the full amounts of those profits or losses must be brought into account for tax purposes;
- f. second, where a company is party to a creditor loan relationship and does not receive interest, but a connected party receives the value of that interest in non-taxable form, then the creditor company is treated as receiving loan relationship profits equal to that non-taxable value;
- g. regulations are being made that will disregard for tax purposes an exchange loss on a contrived hedging arrangement in circumstances where, had there been an exchange profit, that profit would have escaped tax; and
- h. the wording of the ‘shares as debt rules’ will be amended to clarify the times when the sections apply, and to ensure the interaction of sections 91A and 91B FA 1996 works properly. The definition of ‘outstanding third party obligations’ in section 91A FA 1996 will be amended to prevent attempts to get around it. The meaning of ‘redeemable’ shares in section 91D FA 1996 will be extended to include guaranteed exit arrangements. The time limit for the issue of shares which mirror qualifying publicly-issued shares will be extended from 24 hours to seven days.

Further advice

11. If you have any questions about these changes, please contact Chris Kerr on 020 7147 2619 or Richard Thomas on 020 7147 2558. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

SIMPLIFICATION OF THE TAXATION OF PENSIONS

Who is likely to be affected?

1. Pension scheme savers, employers, insurance companies, occupational and personal pension schemes and their advisers, and financial advisers.

General description of the measure

2. The simplified tax regime for pensions comes into effect on 6 April 2006 (A-Day). From that date, there will be a single set of tax rules for all tax-advantaged pension schemes. The relevant legislation is contained in Finance Acts 2004 and 2005, and accompanying regulations.
3. These new measures build on those in Finance Act 2004, providing additional flexibility and protection for schemes and individuals, clarifying aspects of the new regime and introducing further necessary anti-avoidance and compliance rules.

Operative date

4. Will have effect from 6 April 2006.

Current law and proposed revisions

5. Pension savings are currently governed by various different tax regimes limiting the amount that an individual can contribute to a tax-advantaged pension scheme and the consequent benefits that a scheme can pay out. Pensions simplification will replace the existing tax regimes with a single universal regime for tax-privileged pension savings. The numerous controls in the current regimes will be replaced by two key controls in the new regime:
 - the lifetime allowance of £1.5m on tax privileged savings, rising to £1.8m by 2010; and
 - The annual allowance of £215,000 for savings in a tax privileged pension scheme, rising to £255,000 by 2010.

6. New measures were announced on the HMRC website at <http://www.hmrc.gov.uk/pensionschemes/pts.htm> and in the HMRC Technical Note published alongside the Chancellor's Pre-Budget Report on 5 December 2005. These include measures to stop the potential abuse of the pension tax simplification rules in Finance Act 2004. The anti-abuse measures include:

- tightening the rules for self-directed pension schemes to remove the tax advantages for investing in residential property and certain other assets such as fine wines, classic cars, art and antiques; and
- preventing individuals from artificially boosting their pension funds by recycling tax-free lump sums with the removal of tax advantages. Following comments received on the draft legislation a revised version can now be found on the HMRC website. The rule will not be triggered where no more than 30% of the lump sum is recycled, and the threshold under which lump sums of less than £15,000 will not trigger the rule will be linked to the standard lifetime allowance. HMRC has also made numerous changes to the draft guidance on the legislation, which is also now available on their website.

Further advice

7. An updated full regulatory impact assessment "Simplifying the taxation of pensions" is also published today.
8. If you have any questions about these measures, please contact the pensions helpline on 0115 974 1600. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

STAMP DUTY LAND TAX: RAISING THE THRESHOLD FOR RESIDENTIAL TRANSACTIONS

Who is likely to be affected?

1. Anyone who enters into a land transaction relating to residential property where the chargeable consideration exceeds £120,000 but does not exceed £125,000.

General description of the measure

2. The measure raises the threshold for stamp duty land tax on residential transactions from £120,000 to £125,000.

Operative date

3. Any land transaction the 'effective date' of which (see below) is on or after 23 March 2006.

Current law and proposed revisions

4. Stamp duty land tax is charged, at varying rates, on the consideration given for a land transaction. At present no tax is payable on transactions in residential property if the consideration does not exceed £120,000. Tax is payable at 1% if the consideration exceeds £120,000 but does not exceed £250,000.
5. This measure raises the threshold to £125,000. No tax will be payable on transactions in residential property if the consideration does not exceed £125,000. Tax will be payable at 1% if the consideration exceeds £125,000 but does not exceed £250,000.
6. This change takes effect for transactions the 'effective date' of which is on or after 23 March 2006. The effective date is normally the date of completion, not the date of exchange of contracts. However the effective date may be earlier than the date of completion if the contract is 'substantially performed', for example if the purchaser takes possession or pays the purchase price in advance of completion. Most residential contracts will not be 'substantially performed' in advance of completion.

Further advice

7. If you have any questions about this change, please contact the Stamp Taxes Help Line on 0845 603 0135. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

STAMP DUTY LAND TAX: EXTENSION OF ALTERNATIVE FINANCE RELIEFS

Who is likely to be affected?

1. Anyone wishing to use alternative financing arrangements for the purchase or lease of land and buildings.

General description of the measure

2. Current reliefs allow individuals to purchase land and buildings using alternative financing arrangements which are structured to preclude the payment of interest. The reliefs ensure that the stamp duty land tax due is no more than would be due under more traditional loan finance arrangements.
3. These reliefs will be extended so that all persons such as companies, clubs and trusts can take advantage of this form of financing.

Operative date

4. This measure has effect for all alternative finance purchases on or after Royal Assent to Finance Bill 2006.

Current law and proposed revisions

5. Sections 71A, 72, 72A and 73 Finance Act 2003 give equality of stamp duty land tax treatment to certain alternative finance purchases. These purchases characteristically involve several taxable transfers of property. The reliefs give parity of stamp duty land tax treatment by allowing later transactions in the chain to obtain relief if tax has been paid on an earlier transaction in the chain. Currently, these reliefs are restricted to purchases by individuals.
6. The schemes covered are those where;
 - a financial institution purchases a property for a buyer, leases it to them and finally transfers the freehold to the buyer;
 - a financial institution purchases a property for a buyer, leases it to them and transfers the freehold to them in small, regular tranches;
 - a financial institution purchases a property for a buyer and re-sells it to the buyer at a higher price with an interest free mortgage.
7. From Royal Assent to Finance Bill 2006, these reliefs will be extended to all persons, allowing parity of stamp duty land tax treatment to companies, clubs, trustees etc. who wish to avail themselves of these alternative financing products.

Further advice

8. If you have any questions about this change, please contact John Neale, 020 7147 2792, john.neale@hmrc.gsi.gov.uk. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

STAMP DUTY LAND TAX: SIMPLIFICATION AND CLARIFICATION OF THE LAW

Who is likely to be affected?

1. Anyone involved in land transactions.

General description of the measure

2. A number of measures will be included in the Finance Bill to simplify and clarify the law relating to stamp duty land tax. In addition Treasury regulations have been made under existing powers to take a number of transactions outside the scope of stamp duty land tax.

Operative date

3. At Royal Assent to Finance Bill 2006, for measures contained in the Finance Bill.
4. 12 April 2006 for measures contained in Treasury regulations.

Current law and proposed revisions

5. The law on stamp duty land tax is contained in Part 4 Finance Act 2003, as amended, and regulations made thereunder. We have received a number of representations on areas where the application of the law is complex or unclear.
6. Treasury regulations will provide that a number of features of common transactions will be taken out of the scope of stamp duty land tax. This will be done by deeming these features not to be 'chargeable consideration'. These are:
 - a gift of property where the donee or beneficiary agrees or is required to pay capital gains tax or inheritance tax arising on the gift;
 - the payment of landlord's reasonable costs on the grant, variation or termination of a lease; and
 - a covenant by an agricultural tenant to assign entitlement to the Single Farm Payment to the landlord on termination of the tenancy.
7. The remaining provisions will be included in the Finance Bill.
8. At present there is a charge to stamp duty land tax where there is a transfer of an interest in a partnership, if the partnership property includes land. That charge will be removed for all partnerships whose main activity is the carrying on of a trade (other than a trade of dealing in or developing land) or a profession.

9. There are also two places in the stamp duty land tax legislation on partnerships where there is the possibility of a double charge (the charge on 'actual consideration' in paragraph 10 of Schedule 15 and the interaction between paragraphs 14, 17 and 17A of Schedule 15). This potential double charge will be removed.
10. There is uncertainty as to how the rules on 'successive linked leases' apply where an agreement for lease is followed by the grant of a lease. The measure will provide that the rules on 'successive linked leases' do not apply in these circumstances.
11. The rules on variations in rent will be simplified. The current charge on rent increases not provided for in the lease (paragraph 13 of Schedule 17A) will be restricted to increases in the first five years of the lease. All rent increases after the end of year five, whether provided for in the lease or not, will be subject to the 'abnormal increase' rules in paragraphs 14 and 15. The formula for what is an 'abnormal increase' will also be simplified.
12. The treatment of rent reviews under the legislation governing agricultural tenancies, and of 'interim rents' under the legislation governing business tenancies, will be clarified.
13. The treatment of leases which are 'backdated' and expressed to commence immediately after the expiry of a former lease, will be simplified and clarified.
14. The rules for notifying assignments of leases will be clarified to make it clear that where a lease was originally granted for less than seven years its assignment need be notified only if there is stamp duty land tax to pay, or if there is a relief to be claimed.
15. The measure will ensure that transfers of assets between sub-funds of a settlement do not attract a charge to stamp duty land tax.

Further advice

16. If you have any questions about this change, please contact Crispin Taylor, 020 7147 2793, crispin.taylor@hmrc.gsi.gov.uk. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

STAMP DUTY LAND TAX: WITHDRAWAL OF UNIT TRUST 'SEEDING RELIEF'

Who is likely to be affected?

1. Promoters, investors and potential investors in unit trust schemes which invest in property.

General description of the measure

2. 'Seeding relief' gives relief from stamp duty land tax when property is transferred into a newly formed unit trust in consideration of the issue of units. This measure withdraws seeding relief. There will now be a stamp duty land tax charge on the transfer of property into a unit trust in consideration of the issue of units, by reference to the market value of the land and buildings transferred.

Operative date

3. This measure has effect for all transfers into unit trusts on or after 22 March 2006. There are transitional provisions to protect contracts entered into before 2 pm on 22 March.

Current law and proposed revisions

4. Section 64A Finance Act 2003 currently gives relief where property is transferred to the trustees of a unit trust scheme in consideration of the issue of units, provided that after that transfer the transferor is the only unit-holder.
5. Section 64A will be repealed as regards land transactions the effective date of which is on or after 22 March 2006.
6. On general principles the chargeable consideration for a transfer of property into a unit trust in consideration of the issue of units will normally be the market value of the property. Section 53 Finance Act 2003 provides explicitly that the chargeable consideration on a transfer of property to a company 'connected' with the transferor, or in consideration of the issue of shares of a company 'connected' with the transferor, should be not less than the market value of the chargeable interest transferred. Section 53 will be extended to apply to transfers to trustees of a unit trust scheme.
7. The measure will not apply where the transfer to the trustees is effected:
 - In pursuance of a contract entered into and substantially performed before 2 p.m. on 22 March 2006 ('the relevant time'), or

- In pursuance of any other contract entered into before the relevant time, provided that the transfer to the trustees is not an 'excluded transaction'.
8. A transaction is an 'excluded transaction' where:
- The unit trust scheme was not established at the relevant time, or contained no assets, or almost no assets, at the effective time.
 - At or after the effective time the contract is varied in a way that 'significantly affects' the transaction (see below).
 - The subject-matter of the land transaction is not identified in the contract in a way that would have enabled its acquisition before the relevant time.
 - Rights under the contract are assigned at or after the relevant time.
 - The land transaction is effected in consequence of the exercise, at or after the relevant time, of an option, right of pre-emption or similar transaction.
 - At or after the relevant time there is an assignment, sub-sale or other transaction (relating to the whole or part of the subject-matter of the contract) under which a person other than the contracting purchaser becomes entitled to call for a conveyance.
9. A variation 'significantly affects' the transaction only if;
- it substitutes a different purchaser, or
 - the subject-matter of the land transaction is varied, or
 - the consideration for the land transaction is varied.

Further advice

10. If you have any questions about this change, please contact Crispin Taylor, 020 7147 2793, crispin.taylor@hmrc.gsi.gov.uk. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

STAMP DUTY RECONSTRUCTION RELIEFS

Who is likely to be affected?

1. Companies acquiring either;
 - the whole or part of a business of another company, or
 - the entire share capital of another company.

General description of the measure

2. The measure will amend the rules under which certain company reconstructions and acquisitions may qualify for relief from stamp duty. The requirement that the acquiring company must be registered in the UK will be removed.
3. The strict rules concerning the proportion of shares held by any shareholder will also be changed so that relief may be given provided that, as nearly as is practical, there is no change in overall ownership of the reconstructed business.

Operative date

4. From Royal Assent to Finance Bill 2006.

Current law and proposed revisions

5. Sections 75 to 77 Finance Act 1986 relieve from stamp duty certain company reconstructions and acquisitions that result in no overall change of ownership of the company or its business. One requirement is that the registered office of the acquiring company is in the UK. On 22 July 2005 HM Revenue and Customs announced that it would, from then on, accept claims to relief when shares are acquired by a company anywhere in the European Economic Area, provided that all other conditions for the relief were met. This measure will extend the scope of the relief further, so that it will be available to acquiring companies world-wide.
6. Sections 75 and 77 also require that the reconstruction shall not change the proportion of the company or its business that is owned by each shareholder. A minor change is being made to this rule so that relief is not denied because the proportion of shares in the new structure held by each shareholder has to change slightly for practical reasons.

Further advice

7. If you have any questions about this change, please contact Ian Burton on 020 7147 2788. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

ALIGNING THE INHERITANCE TAX TREATMENT FOR TRUSTS

Who is likely to be affected?

1. People who have set up, or have an interest in, “accumulation & maintenance” trusts (A&Ms) and/or “interest in possession” trusts (IIPs) that do not meet new inheritance tax (IHT) rules about their terms and the circumstances in which they are created.

General description of the measure

2. This measure refines the current IHT rules for A&Ms and IIPs. Trusts of this type that currently receive special treatment but do not qualify under the new rules will come within the mainstream IHT regime for “relevant property” trusts. This change will apply also to existing A&Ms and IIPs, subject to the transitional rules described below.

Operative date

3. The new rules will apply on and after 22 March 2006 to new trusts, additions of new assets to existing trusts and, subject to transitional provisions, to other IHT-relevant events in relation to existing trusts. Transitional rules will provide for a period of adjustment for certain existing trusts up to 6 April 2008, and for continuing exclusion from the “relevant property” charges if they satisfy conditions for ongoing protection.

Current law and proposed revisions

4. Part III, Chapter III Inheritance Tax Act 1984 (IHTA) provides a specific regime for “relevant property” trusts – broadly, those trusts in which no person has an interest in possession. It combines:
 - an immediate “entry” tax charge of 20% on lifetime transfers that exceed the IHT threshold into “relevant property” trusts;
 - a “periodic” tax charge of 6% on the value of trust assets over the IHT threshold once every ten years; and
 - an “exit” charge proportionate to the periodic charge when funds are taken out of a trust between ten-year anniversaries.
5. There are special rules for A&M trusts (section 71 IHTA) and IIP trusts (Part III, Chapter II IHTA). Lifetime transfers into these trusts are exempt from IHT if the settlor survives seven years, and the trusts are not subject to the periodic or exit charges.
6. Legislation in the Finance Bill will limit these special rules to trusts that:
 - are created on death by a parent for a minor child who will be fully

- entitled to the assets in the trust at age 18; or
 - are created on death for the benefit of one life tenant in order of time whose interest cannot be replaced (more than one such trust may be created on death as long as the trust capital vests absolutely when the life interest comes to an end); or
 - are created either in the settlor's lifetime or on death for a disabled person (see section 89(4) IHTA).
- Any other trusts will fall into the mainstream IHT rules for "relevant property" trusts.

New trusts

7. In the case of trusts created on and after 22 March 2006, this means that lifetime transfers into trusts are no longer eligible for special treatment unless they are set up for a disabled person. All other transfers will be immediately chargeable. Trusts that do not qualify for special treatment – whether they are created in life or on death – will be liable to the periodic and exit charges applying to "relevant property" trusts.

Existing A&M trusts

8. Where existing A&M trusts provide that the assets in trust will go to a beneficiary absolutely at 18 – or where the terms on which they are held are modified before 6 April 2008 to provide this – their current IHT treatment will continue.
9. Where they do not, the trust assets will become "relevant property" from 6 April 2008 and the periodic and exit charges will apply. Ten-yearly anniversaries will arise by reference to the original date of settlement. For the first ten years after 6 April 2008, the rate of charge will reflect the fact that the property has not been "relevant property" throughout a full ten-year period. For example, if the first ten-yearly anniversary falls in November 2008, it will be one twentieth of the normal charge.

Existing IIP trusts

10. The current rules for existing IIP trusts will run on until the interest in the trust property at 22 March 2006 comes to an end. If someone then takes absolute ownership, this will be a transfer by the person with the interest in the property – either a transfer on death or a "potentially exempt transfer" if they are still living – and will receive the same IHT treatment as now. The trust will have no further IHT consequences.
11. If the interest comes to an end so that the property remains on trust, this will be treated as the creation of new settled property;
 - if it comes to an end during the lifetime of the person beneficially entitled to it, this will be a transfer creating "relevant property" (unless the new trusts are for charitable purposes) and will therefore be immediately chargeable; and
 - if the interest comes to an end on death, it will form part of the person's IHT estate as now and the settled property will then become "relevant

property” (unless the charity exemption applies).
In both cases, the periodic and exit charges will apply.

12. However, any new IIP that arises when an IIP created before 22 March 2006 comes to an end before 6 April 2008 – whether on death or otherwise – will be treated as an IIP that was in place on 22 March 2006.

Gifts with reservation

13. Where an individual is beneficially entitled to an interest in settled property, and continues to be treated for IHT purposes as owning the property, a termination of the interest in the individual’s lifetime on or after 22 March 2006 will be treated as a gift for purposes of the IHT “gift with reservation” rules. So if they retain the use of the settled property after their interest in it ends, it will remain chargeable in their hands in the same way as if they had formerly owned it outright.

Capital gains tax consequentialia

14. Changes to the IHT treatment of trusts will have a number of implications for CGT:
- transfers into and out of trusts that will now come within the “relevant property” rules will automatically be eligible for hold-over relief under Section 260(2)(a) Taxation of Chargeable Gains Act 1992 (TCGA);
 - hold-over relief under Section 260(2)(d) TCGA will be restricted to trusts that meet the new IHT rules for trusts for minor children;
 - the special rules in Section 72 and Section 73 TCGA relating to the death of a person entitled to an IIP will be restricted to assets that are subject to an IIP which meets the new IHT rules.

Further advice

15. If you have any questions about the changes, please contact the Probate/IHT Helpline on 0845 3020 900. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

INHERITANCE TAX & PENSIONS SIMPLIFICATION

Who is likely to be affected?

1. The beneficiaries of members of registered pension schemes.

General description of the measure

2. This measure clarifies how inheritance tax (IHT) will apply to choices made under the new pension scheme rules, which come into effect on 6 April 2006. It legislates an existing IHT concessionary practice for scheme members who die under the age of 75 and sets out how IHT is to be charged on death on or after age 75 where funds are held in an alternatively secured pension.

Operative date

3. Effective on the death of a scheme member on and after 6 April 2006.

Current law and proposed revisions

Death of scheme member before age 75

4. The present IHT rules will continue to apply to registered pension schemes in much the same way as they do currently. This measure will legislate the IHT concessionary practice dating from 1992 in relation to pension choices by scheme members. The practice was first published in Inland Revenue Tax Bulletin 2 (February 1992) and was subsequently updated in 1999 to take account of the introduction of income withdrawal under pension schemes.
5. An IHT charge can arise in a scheme member's lifetime under section 3(3) Inheritance Tax Act 1984 if they do not exercise their right to take pension benefits. The charge applies at the latest time when the right could be exercised i.e. immediately before death. For example, if a scheme member did not take their pension when their life expectancy was seriously impaired, and this resulted in an enhanced death benefit being paid to their beneficiaries, then IHT could apply. Currently, by concession, IHT is not charged in respect of these enhanced death benefits where the beneficiary is a spouse, civil partner or person who is financially dependant on the scheme member. Nor is IHT applied where a scheme member chooses not to exercise a right at a time when this choice does not trigger a charge (for example, choosing not to take a pension when they are in good health) and does not subsequently vary that choice, even when a reduction in their life expectancy would in strictness trigger an IHT charge.

6. This concessionary treatment will be legislated in the Finance Bill. In addition, payments arising in these circumstances which are made to charity will also be exempted from IHT.

Death of scheme member on or after age 75 – Alternatively Secured Pension

7. The Government provides generous tax relief on pensions on the basis that pension funds are used to secure an income in retirement. The pensions tax simplification rules provide that an individual must secure an income before they reach the age of 75. For most people an annuity or scheme pension is the best means by which they can do this. The new pensions tax regime introduces an additional option for securing their retirement income – an Alternatively Secured Pension (ASP).
8. The Government made clear throughout the development of the new pensions tax regime that ASPs are specifically designed for those who have a principled religious objection to annuitisation. It has become clear that some individuals and their advisors are intending instead to use the ASP provisions for a much wider purpose to enable individuals to pass on tax-privileged retirement savings to their dependants rather than to provide a pension in retirement. In order to prevent this the Government is examining how best to restrict ASPs to their original limited purpose.
9. Following a consultation by HMRC, legislation will be introduced in the Finance Bill to ensure that appropriate IHT charges will apply on left-over ASP funds. The Government will apply an IHT charge on left-over ASP funds on death (or later) as follows:
 - any funds paid as a “transfer lump sum death benefit” (i.e. where the funds remain within the scheme for the benefit of other scheme members) **or** refunded to an employer **or** used to provide benefits for a dependant in the pension scheme context who is not a spouse, civil partner or person who is financially dependant will be subject to an IHT charge on the death of the original scheme member as if the funds were part of the scheme member’s own taxable estate on death;
 - any funds paid on the death of the scheme member to charity will be exempt from IHT, as will funds expended for the scheme member’s spouse, civil partner or person who is financially dependant on the scheme member;
 - any left-over funds, once use by the spouse, civil partner or person who is financially dependant (the beneficiary) has come to an end, will be chargeable to IHT on the earlier of the cessation of those benefits and the death of the beneficiary. These remaining funds will be treated as if they were an addition to the original scheme member’s estate. However, any left-over funds that are paid to charity will be exempt from IHT;

- in certain circumstances, an IHT charge on ASP funds will fall on the estate of a dependant (rather than that of the original scheme member). This will apply where a dependant – within the meaning of the pension scheme rules – opts for an ASP derived from “benefits” inherited from a scheme member who died before age 75. Here, any left-over funds on the dependant’s death will be charged to IHT as if they were part of the dependant’s taxable estate on death.

The IHT charge

10. IHT will be payable on the value of the taxable property at the time the charge arises, and calculated by reference to the tax-free threshold and rate of tax in place at that time. The pension scheme administrator will be responsible for accounting for and paying any IHT due on the ASP funds.
11. There are two instances where the tax charges on ASP funds overlap. One is where the funds are paid to an employer and the other is where on the death of a dependant under age 75 any remaining funds are paid out as a lump sum other than to a charity. The IHT charge takes priority over the pension scheme tax charge which is then applied to the net fund after deduction of IHT.

Impact

12. HMRC will work closely with the pensions industry on the necessary processes to help minimise any regulatory impact on pension schemes. Personal representatives of estates will be required to provide information in the estate account about the ASP. This will include an estimate of the value of the left-over ASP funds at the date of death together with details of the name and address of the scheme administrator (who will be liable for any IHT payable).

Further advice

13. These IHT aspects are reflected in the updated full regulatory impact assessment “Simplifying the taxation of pensions” which is also published today.
14. If you have any questions about this change, please contact the IHT Pensions Helpline on 0131 777 4296. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CAPITAL GAINS TAX: “BED AND BREAKFASTING RULES”

Who is likely to be affected?

1. Individuals and trustees.

General description of the measure

2. This measure amends the capital gains tax (CGT) “bed and breakfasting” rules to counter tax avoidance schemes, which exploit the bed and breakfasting rules in certain circumstances to ensure that no CGT is chargeable on substantial gains. One such scheme was used in the case of *Davies v Hicks*, in which it was held in the High Court that no such tax was payable in respect of a disposal of shares made by the trustees of a settlement. The trustees had ceased to be resident in the United Kingdom after making the disposal but before acquiring identical shares (within 30 days after the disposal). There has also been a disclosure to HM Revenue and Customs of a different scheme, which purports to exploit these rules.

Operative date

3. The amendment will apply in relation to acquisitions made on or after 22 March 2006, as explained in paragraphs 7 to 9 below.

Current law and proposed revisions

4. The CGT bed and breakfasting rules are contained in section 106A(5) of the Taxation of Chargeable Gains Act 1992. They form part of the rules that apply in certain circumstances where there is a disposal of “securities”. In section 106A, “securities” means assets which may not be separately identifiable, such as securities and shares.
5. These rules are needed for cases where a person who has acquired securities in a number of transactions at different times disposes of some of them. Identifying the securities disposed of determines what amounts of cost are allowed in calculating the capital gain or loss arising on the disposal, and, in the case of a gain, what taper relief is due.
6. The bed and breakfasting rules are designed to prevent individuals and others within the charge to CGT disposing of shares or securities and acquiring identical ones shortly afterwards for the purpose of realising a capital gain free of tax (because it is covered by the annual exempt amount) or a capital loss (which can be set off against chargeable gains to reduce a tax liability) while still, in effect, holding on to the investment.

7. Section 106A(5) applies where, within 30 days after the disposal, the person who made the disposal acquires securities which are identical to those disposed of. Its effect is that the capital gain or loss is calculated as though the securities disposed of were, as far as that is possible, those acquired in the 30 day period. If there is more than one acquisition of securities in the 30 day period, the securities disposed of are identified as far as possible with those acquired earlier in that period rather than those acquired later. In most circumstances the price received on the disposal is likely to be very similar to the price paid shortly afterwards to acquire identical assets. As a result any gain or loss arising on the disposal is likely to be small.
8. This amendment will prevent section 106A(5) applying in relation to acquisitions made at times when the person referred to in paragraph 7 above is neither resident nor ordinarily resident in the United Kingdom. It will also prevent section 106A(5) applying in relation to acquisitions made at times when that person is resident or ordinarily resident in the United Kingdom but is "Treaty non-resident". (A person who is regarded as resident in a territory outside the United Kingdom for tax treaty purposes is "Treaty non-resident".) Where the amendment has effect, the gain or loss on the disposal will be calculated on the basis that the securities disposed of were acquired before the disposal rather than being those acquired within 30 days after the disposal.
9. The amendment will apply in relation to acquisitions made on or after today, irrespective of when the disposal was made.

Further advice

10. If you have any questions about this change, please contact Colin Weston on 020 7147 2764. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CHARITIES: ANTI – AVOIDANCE PROVISIONS

Who is likely to be affected?

1. Individuals and companies who misuse charitable reliefs through the use of charities they control. Charities with substantial donors. Non-close companies making cash donations to charity and receiving large benefits in return for the gift.

General description of the measure

2. These additional rules will act to protect charitable reliefs from misuse. They will penalise certain behaviours that can reduce the amount of charitable funds that are used for good causes. There are three strands to the action HM Revenue and Customs (HMRC) are taking:
 - the first strand will restrict the dealings that a charity can have with its substantial donors those giving £25,000 or more in a single 12-month period, or £100,000 or more over a 6 year period and remove tax relief from the charity where the restrictions are breached;
 - the second strand will provide a direct link between non-charitable expenditure incurred by a charity and loss of tax relief, restricting the income and gains eligible for tax relief by £1 for every £1 of non-charitable expenditure incurred; and
 - the final strand will make non-close companies subject to the same limits on benefits received as a result of a gift to charity as currently apply for individuals and close companies. Non-close companies will also become subject to the same rules as close companies and individuals that apply when gifts are potentially repayable or are associated with the acquisition of property by the charity from the donor or connected persons.

Operative date

3. The first strand will affect transactions that take place on or after 22 March 2006. The second will have effect in relation to non-charitable expenditure incurred in a chargeable period commencing on or after 22 March 2006. The final strand will affect payments to charity made on or after 1 April 2006.

Current law and proposed revisions

4. Section 505 of the Income and Corporation Taxes Act 1988 ("ICTA") contains a mechanism that reverses tax relief granted to a charity where it incurs (or is treated as incurring) non-qualifying expenditure. The restriction of relief applies when a charity has relevant income and gains (broadly those on which tax relief is granted) of more than £10,000, the charity incurs non-qualifying (non-charitable) expenditure and the charity's qualifying (charitable) expenditure does not equal or exceed its relevant income and gains. Where this is the case relief is restricted on the relevant income and gains that exceed the charity's qualifying expenditure to the extent that non-qualifying expenditure is incurred. The remaining balance of non-qualifying expenditure can be carried back to the preceding 5 years.
5. These changes will remove the £10,000 de minimis limit and reverse the order in which charitable and non-charitable expenditure is set against the charity's tax relieved income and gains. This will mean that for every £1 of non-charitable expenditure incurred by the charity, there will be a corresponding restriction of the income and gains that attract tax exemption. Where there is an excess of non-charitable expenditure over total income in the current year the excess can be carried back to an earlier period.
6. The new rules will place additional restrictions on transactions that can take place between a charity and its substantial donors without the charity's tax relief being restricted. An individual or a company will be a substantial donor if they give to a charity £25,000 or more in any 12-month period or £100,000 over a 6-year period. The donor will be a substantial donor for the chargeable period in which they exceed these limits and the following 5 chargeable periods. The limits will apply only to amounts on which tax relief has been claimed.
7. The new rules will apply to the following transactions unless the transaction is otherwise exempt:
 - the sale or letting of property, or provision of services by a charity to a substantial donor, or by a substantial donor to a charity;
 - an exchange of property between a charity and a substantial donor;
 - the provision of financial assistance (such as the provision of a loan, guarantee, indemnity or financial arrangements compliant with Islamic law) to a charity by a substantial donor, or to a substantial donor by a charity;
 - payment by a charity of remuneration to a substantial donor apart from a payment for services as a trustee approved by the appropriate charity regulator or the courts; and
 - investment by a charity in the business of a substantial donor as long as the business is not listed on a recognised stock exchange.
8. Certain transactions by a substantial donor to a charity will be exempt from the new rules. These are transactions that HMRC is satisfied that a charity engages in for genuine commercial reasons, on terms that are no

less beneficial to the charity than those that might be expected of an identical arm's length transaction, so long as the transaction is not part of an arrangement for the avoidance of tax. The exemption will apply to:

- financial assistance given to a charity by a substantial donor; or
- the sale or letting of property, or the provision of services, where the transaction forms part of the business of the substantial donor; or
- transactions that are provided by a charity to a substantial donor in furtherance of the charitable purpose of the charity and which are no more beneficial to the substantial donor than could be obtained on arm's length terms.

9. The new rules will not apply to a disposal at less than market value by a substantial donor to a charity to which section 587B ICTA (gifts of shares security and real property to charity etc) or section 257 Taxation of Chargeable Gains Act 1992 (gifts to charities etc) applies.

10. The new rules will not apply to transactions that occur after the commencement date where the transaction is the result of a contract entered into by the charity and substantial donor before the commencement of the new rules.

11. Where a charity takes part in any of the transactions that are not otherwise exempt, any payments made by the charity in connection with the transaction will be treated as non-charitable expenditure. Where the transaction is not on arm's length terms any difference between the actual terms and arm's length terms, so far as it favours the substantial donor, shall be treated as non-charitable expenditure and the charity will have its tax relief restricted.

12. Section 339 ICTA provides tax relief for companies making a cash donation to charity. No relief is available for close companies (broadly those under the control of five or fewer persons) where the company receives benefits in consequence of making the gift that exceed the limits below:

- for donations not exceeding £100, 25 per cent of the gift;
- for donations exceeding £100 but not exceeding £1000, £25; and
- for donations exceeding £1000, 2.5 per cent of the gift up to a maximum of £250.

Relief is also not available if a gift is made subject to a condition as to repayment or is made as part of an arrangement for the acquisition of property, otherwise than as a gift, from the company or connected persons.

13. The new rules will extend these restrictions and this limit on benefits received in consequence of a gift to charity - which also apply to gifts by individuals - to companies that are not close companies.

Further advice

14. If you have any questions about this change, please contact Adrian Cooper on 020 7147 2782 or John Kington on 0151 472 6019. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CHARITIES: INCOME AND CORPORATION TAX RELIEF FOR TRADING ACTIVITIES UNDERTAKEN BY A CHARITY

Who is likely to be affected?

1. Charities that undertake a trade that is only partly carried on for a primary (charitable) purpose, or which is partly (but not mainly) carried out by the beneficiaries of the charity.

General description of the measure

2. This measure will provide tax relief for charities where only part of a trade is carried on for a primary purpose, or where a trade is partly (but not mainly) carried out by the beneficiaries of a charity. Relief will be available on the profits that can reasonably be attributed to the part of the trade that is carried on for a primary purpose, or that is carried out by the beneficiaries of the charity.

Operative date

3. Chargeable periods commencing on or after 22 March 2006.

Current law and proposed revisions

4. Section 505 of the Income and Corporation Taxes Act 1988 (ICTA) provides charities with an exemption from income tax or corporation tax on profits attributable to a trade, carried on in the UK or abroad, so long as the profits are applied solely to charitable purposes. The relief applies in two situations:
 - where the trade is exercised in the course of carrying out a primary purpose, such as the provision of residential care for the elderly; or
 - where the work of the trade is mainly carried out by the beneficiaries of the charity.
5. In some cases a trade may amount, in part, to a primary purpose trade but may not be wholly a primary purpose trade. For instance, the trade might deal in a range of goods or services some of which are within a primary purpose and some of which are not. Where this is the case, there is a risk that the trade as a whole will become tainted, resulting in the loss of tax relief on the primary purpose part of the trade. Tainting occurs where the non-primary purpose element of the trade is substantial - typically more than 10% of the turnover of the trade, or more than £50,000.

6. Alternatively the trade may be partly (but not mainly) carried on by beneficiaries of the charity. Where this is the case the trade could also be tainted, leading to a loss of tax relief on the whole of the trade.
7. HM Revenue and Customs (HMRC) have traditionally mitigated the risk of tainting a charity's trade by taking the view that a charity may have more than one trade. Where we could identify distinct activities, we would treat those activities as separate trades. However, case law does not support such an approach and it is likely that for most charities they will have only a single trade (control and management of activities being conducted by the same persons).
8. The new rules will legitimise the effect of the current HMRC approach in relation to charities with primary and non-primary purpose trading activities, or with trading activities that are partly (but not mainly) carried on by the beneficiaries of the charity. It will split a trade into two separate parts, a primary purpose part and a non-primary purpose part, with tax relief under section 505 ICTA given on the profits of the primary purpose part, or on the profits of the part carried out by the beneficiaries of the charity.
9. Where tax relief is not available under section 505 ICTA it is still possible that a charity may be granted tax relief by virtue of Section 46 Finance Act 2000 (the "exemption for small trades").
10. The exemption for small trades provides relief from income or corporation tax for charities where they conduct a small non-primary purpose trade within the charity.

Further advice

11. If you have any questions about this change, please contact Adrian Cooper on 020 7147 2782 or John Kington on 0151 472 6019. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

EXEMPTIONS FOR COMPUTERS & MOBILE PHONES

Who is likely to be affected?

11. Employees who are loaned a computer and/or mobile phone for private use by their employer. Employers (and third party facilitators) who loan computers and/or mobile phones to their employees for private use.

General description of the measure

12. This measure will change the tax exemption that applies to the benefit in kind that arises when employers loan mobile phones to their employees and members of the employee's family or household for private use. It will also remove the tax exemption that applies to computers loaned to employees for private use.

Operative date

13. Will have effect from 6 April 2006.

Current law and proposed revisions

14. Computers and mobile phones loaned to employees by their employer may be exempt from the tax charge on the benefit in kind arising. For computers (section 320 Income Tax (Earnings and Pensions) Act 2003 (ITEPA)) the exemption currently applies to the first £500 of annual benefit in kind. There is currently no limit to the number of mobile phones that can be loaned and no financial limit (section 319 ITEPA).
15. This measure will remove the exemption for computers made available by employers to their employees for private use. It will also restrict the number of mobile phones employers can loan to employees for private use tax-free to one per employee, and will not extend to members of the employees' family or household.
6. The measure will also amend section 319 ITEPA to ensure that where an employee has been provided with a mobile phone for private use through a salary sacrifice arrangement no charge will arise under the general earnings charge of section 62 (3) ITEPA, even if the employee has the right to surrender the phone for additional wages or salary.
7. Some employers have chosen to use vouchers as the mechanism for making available mobile phones to their employees for private use. In these circumstances a charge to tax and Class 1 National Insurance contributions (NICs) arises on the provision of the voucher. This measure will exempt the provision of a voucher from tax and NICs where it is used

to facilitate the loan of a mobile phone to an employee for private use, but only where the benefit in kind arising on the loan of the mobile phone would have been exempt if a voucher had not been used. This will mean that from 6 April 2006 the method used by employers to loan mobile phones to employees will have no effect on the outcome for tax and NICs purposes.

Further advice

8. If you have any questions about this change, please contact your local HMRC office (see telephone directory for details) or call the Employer Helpline on 0845 7143 143. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VDU USERS: EYE TESTS AND GLASSES

Who is likely to be affected?

1. Employees and employers who obtain or provide eyetests and corrective spectacles for Visual Display Unit (VDU) use.

General description of the measure

2. Employers are required by law to provide, or meet the cost of, eyecare tests and/or corrective glasses for VDU use for their employees. HMRC would not normally expect a tax charge on the benefit in kind. However, this would not be the case if eyetests and/or glasses were provided by means of a voucher.
3. The purpose of this measure is to ensure that there is no tax charge however an employer pays for an eye test and/or corrective glasses, whether direct to the provider, by reimbursing the cost to the employee or by providing a voucher.
4. It also provides a regulation-making power that will allow HMRC to exempt similar benefits in kind from a tax charge when provided by vouchers.

Operative date

5. Will have effect from 6 April 2006.

Current law and proposed revisions

6. Chapter 4 of Part 3 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) covers the tax treatment of vouchers and credit tokens. Sections 82-89 cover non-cash vouchers and Section 82 provides the circumstances when non-cash vouchers are taxable.
7. Sections 95 and 96 contain general supplementary provisions relating to the tax treatment of vouchers and credit tokens. Additional regulation-making powers will be added to section 96 to exempt from a tax charge vouchers used to provide a benefit by an employer that would otherwise be exempt from a tax charge.
8. Section 266 lists the benefits in kind exempt from a tax charge when a non-cash voucher is used to provide it. Eyetests and glasses for VDU users will be added to the list at subsection (3) of section 266 ITEPA thus removing a tax charge where an employer pays for their provision by means of a voucher.

9. Chapter 11 of Part 4 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) lists miscellaneous employer-provided benefits that are exempt from an Income Tax charge. A new section will be added as section 320A that will exempt from tax the provision of eye tests and special corrective glasses.

Further advice

10. If you have any questions about this change, please contact your local HMRC office (see the Telephone Directory for details), or call the Employer helpline on 0845 7143 143. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

DORMANT ACCOUNTS OF HOLOCAUST VICTIMS

Who is likely to be affected?

1. Holocaust victims, or their heirs, receiving certain compensation payments made in relation to dormant accounts. In particular those receiving payments made under the Restore UK initiative or the Claims Resolution Tribunal arrangements for dormant accounts in Switzerland.

General description of the measure

2. This measure, which was first announced in July 2005, will exempt payments made by foreign banks and building societies from tax. It also takes the opportunity to legislate an existing Extra Statutory Concession, A 100, which already exempts payments made by UK banks and building societies under the Restore UK initiative.

Operative date

3. The exemption will apply to payments made in the tax year 1996-97 or any later year of assessment.

Current law and proposed revisions

4. The July 2005 announcement stated that the exemption would apply whenever such payments were made. However, the commencement date for the exemption has been changed to 1996-97 because extensive research and discussions with interested parties indicate that this revised date should cover those who should benefit from the exemption, whilst avoiding the significant complexity associated with the possibility of reopening tax liabilities from earlier years.
5. Primary legislation will provide that in order to qualify for the exemption the original account holder must be a "victim of National-Socialist persecution". This means those persecuted on the basis of race, religion, physical or mental disability or sexual orientation. The exemption will cover payments, which represent both interest that should have been credited to the account and also revaluation of the original balance to take account of inflation during that period.

6. The legislation will add an additional provision to the Income Tax (Trading and Other Income) Act 2005 to exempt the payments from income tax. Similarly, a provision will be added to the Taxation of Chargeable Gains Act 1992 to exempt any gain arising on the disposal of a right to receive the payments. The legislation will also include an exemption for any additional inheritance tax (IHT) (or earlier taxes) that may have arisen to an estate from rights to an original bank account immediately prior to inception of the scheme concerned. By contrast, actual payments from a scheme will form part of the IHT estate of those who receive them in the normal way.

Further advice

7. If you have any questions about this change, please contact Elspeth Fearn on 020 7147 2849. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

PROTECTING REVENUES: EMPLOYMENT-RELATED SECURITIES

Who is likely to be affected?

1. Employers and employees who participate in avoidance schemes and arrangements that use options over shares and securities.

General description of the measure

2. Legislation will ensure that any reward of employment obtained by employees from avoidance schemes using options over shares and securities will be fully subject to tax through PAYE and National Insurance Contributions.

Operative date

3. This will take effect from 2 December 2004.

Current law and proposed revisions

4. Part 7 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), provides the income tax rules in cases where securities, interests in securities or securities options are acquired in connection with employment to ensure that all of the value received by way of remuneration in the form of shares or other securities is taxed at the time it is accessed by the employee.
5. On 2 December 2004, after closing down successive schemes which sought to avoid tax and National Insurance Contributions, the Government made a statement that it would close down future schemes, where necessary from that date.
6. Despite this statement, evidence shows employers are continuing to use complex and contrived schemes to avoid paying the proper amount of income tax and National Insurance contributions, exploiting the tax rules relating to options over shares and securities. These avoidance schemes, which seek to sidestep the rules in Part 7 of ITEPA, will be stopped with effect from 2 December 2004.
7. Finance Bill 2006 will introduce a targeted purpose test to be applied where a securities option is used as part of an avoidance scheme. The option itself will remain within the definition of a security as provided in Chapter 1 of Part 7 of ITEPA. Consequently the anti-avoidance measures for employment-related securities that were introduced in the Finance (No. 2) Act 2005 and earlier legislation will all apply to such options.

Further advice

8. Draft clauses and explanatory notes are published today. Draft National Insurance Contributions regulations corresponding to this tax legislation will be published in May 2006.
8. If you have any questions about this change, please contact Steve Lig on 020 7147 2827. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

RELIEF FROM SPECIAL TRUST RATES FOR SERVICE CHARGES HELD BY SOCIAL LANDLORDS

Who is likely to be affected?

1. Registered Social Landlords and other social landlords.

General description of the measure

2. This is a new relief for income arising on service charges/sinking funds held in trust by Registered Social Landlords (RSLs) and local authorities. Instead of being taxed at the special trust rates such income will be taxed at lower, basic or dividend ordinary rate as appropriate. The relief will also apply to service charges held in trust by the Housing Corporation, housing action trusts and charitable housing trusts.

Operative date

3. The changes will take effect for income arising from 6 April 2006.

Current law and proposed revisions

4. Most landlords, be they individuals, partnerships or companies, are required to hold service charge payments made by tenants and leaseholders in trust. RSLs and local authorities are not required to hold service charge payments in trust but in practice they often do so. If they do hold funds on trust and the income can accumulate then the income will be taxed at the special trust rates (40%/32.5%). The measure will exempt the income arising from service charges held on trust by RSLs and local authorities from the special trust rates. The income will instead be chargeable at no more than the basic rate of tax. As well as RSLs and local authorities, relief will be available for housing associations in Northern Ireland, charitable housing trusts, charitable housing associations, housing action trusts, and the Housing Corporation.
5. Section 686 of the Income and Corporation Taxes Act 1988 (ICTA) will be amended so that any income arising to any of those social landlords from service charges held in trust is exempt from the special trust rates.
6. The relief will apply to all of the UK.

Further advice

7. If you have any questions about this change, please contact Rachel Salisbury on 020 7147 2761. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

MODERNISING THE TAX SYSTEM FOR TRUSTS

Who is likely to be affected?

1. Trustees, beneficiaries and settlers of settlements.

General description of the measure

2. A package of changes to modernise the tax system for trusts, in particular by increasing the standard rate band for trustees who pay tax at the special rates applicable to trusts, and bringing the main trust-related definitions and tests for tax on income and chargeable gains into line with each other. These measures follow the introduction in Budget 2005 of the standard rate band and a new tax regime for certain trusts with vulnerable beneficiaries.

Operative date

3. The changes will take effect from 6 April 2006, with the exception of the harmonised residence test for trustees, which will take effect from 6 April 2007.

Current law and proposed revisions

4. At present, the approaches to taxing trustees for the purposes of the Income Tax Acts and the Taxation of Chargeable Gains Act 1992 (TCGA) are quite different. For example, unlike the TCGA, the Income Tax Acts contain no definition of “settled property”. And the differences between the rules for tax on income and chargeable gains can result in trustees being non-UK resident for income tax purposes but the trustees of the settlement being UK resident for the purposes of the TCGA, and vice versa. The new definitions and tests will end these unhelpful differences in treatment.
5. The main changes introduced by the new measures are:
 - an increase of the standard rate band from £500 to £1,000;
 - a common meaning of “settled property”, leading to a common meaning of “settlement”;
 - a common meaning of “settlor”;
 - provision for the trustees of a settlement to be treated as a single person;
 - a common test to determine whether the trustees of a settlement are resident in the United Kingdom;
 - provision for the trustees of a settlement to elect that a sub-fund of the settlement be treated as a separate settlement in certain circumstances.

6. All the above changes, with the exception of the increase in the standard rate band, are to apply for the purposes of the Income Tax Acts and the TCGA, subject to separate provision being made in certain circumstances (such as in provisions designed to counter tax avoidance).
7. In addition, the following changes are being introduced;
- the income of settlor-interested settlements is to be treated as though it had arisen directly to the settlor;
 - a measure to legislate the existing practice of not taxing beneficiaries who receive discretionary income payments from the trustees of settlor-interested trusts; and
 - modifications to some of the provisions in the TCGA which determine whether a person who is a settlor in relation to a settlement has an interest in the settlement, so that account is taken of dependent minor children.

Some of the proposed changes included in the consultation exercise, such as income streaming and changes to the way estates in administration are charged to capital gains tax, are not being taken forward at this time.

Further advice

8. If you have any questions about these changes, please contact Roger Willoughby on 0131 777 4143 or Rachel Salisbury on 020 7147 2761. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

COMPANY CAR AND FUEL BENEFIT TAX

Who is likely to be affected?

1. Employees provided with a car that is available for their private use and free private fuel where provided; and employers who bear Class 1A National Insurance contributions on the taxable benefit of a provided car and fuel.

General description of the measure

2. The measure:
 - sets the company car fuel figure for 2006/07;
 - sets the company car tax charge for 2008/09; and
 - introduces, from 2008/09, a new 10% appropriate percentage rate for company cars with CO₂ emissions of 120g/km or below.

Operative date

3. 6 April 2006 – company car fuel multiplier.
6 April 2008 – company car tax.

Current law and proposed revisions

Company car fuel benefit tax

4. An additional taxable benefit arises from section 149 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 if the employee receives free fuel for the company car for their private use. The company car fuel benefit tax charge was reformed in April 2003 to align with the environmental principles of the company car tax system. Since April 2003, the fuel benefit charge has been calculated by applying the company car tax appropriate percentage to a set figure known as the multiplier. In 2005/06 the multiplier was £14,400.
5. For 2006/07, the multiplier figure for the company car fuel benefit tax charge will be frozen at £14,400.

Company car tax

6. Where a car is made available for an employee's private use, a taxable benefit arises from sections 114 and 120 ITEPA 2003. Company car tax was reformed in April 2002 and is now calculated by applying a percentage to the list price of the car. The percentage is related to the CO₂ emissions of the car and ranges from 15% - 35% (in 1% increments) for a petrol car. Diesel cars attract a 3% supplement on petrol percentages (capped at 35%). The 2004 Pre-Budget Report announced that from April 2006, the waiver of the 3% supplement for diesel cars meeting Euro IV standards will be withdrawn for all registered cars from 1 January 2006.
7. The CO₂ emissions qualifying for the minimum petrol percentage change have been set as follows:
 - 2006/07-140grams per kilometre of CO₂; and
 - 2007/08-140grams per kilometre of CO₂.
8. From 2008/09, the level of CO₂ emissions qualifying for the lower rate of 15% will be reduced by 5g/km to 135g/km.
9. From 2008/09 there will be an additional appropriate percentage rate of 10% for company cars with CO₂ emissions of 120grams per kilometre or below.

Company car evaluation report: second stage

10. The results of the second stage of the evaluation of the reform of the company car tax system were published today. The results show the reform to be successful with significant reductions in CO₂ emissions, a reduction of private miles in company cars and generally a high level of awareness and understanding of the reform by employers and company car drivers.

Further advice

11. If you have any questions about this change, please contact the Employer Helpline on 0845 7143 143 or your Local Enquiry Office (see telephone directory for details). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

AIR PASSENGER DUTY (APD)

Who is likely to be affected?

1. Airlines, travel agents and air passengers.

General description of the measure

2. Air Passenger Duty rates are frozen.
3. Croatia will be added to the destinations for which the lower rates of APD apply, in recognition of its status as an EU applicant country.

Operative date

4. Will take effect from 1 November 2006.

Current law and proposed revisions

5. Section 30 of the Finance Act 1994 will be amended to implement the changes.

Further advice

6. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

HYDROCARBON OILS: DUTY RATES

Who is likely to be affected?

1. Businesses producing and importing hydrocarbon oils products.

General description of the measure

2. From 1 September 2006, excise duty rates on main road fuels will be increased by 1.25 pence per litre (ppl), in line with inflation. All other hydrocarbon oils used for road fuel will also increase in line with inflation. Effective rates of duty (that is, the relevant duty minus the relevant rebate) for non-road fuels will also be increased by 1.25 ppl, to maintain the differential to main rates. In order to maintain the current differentials with main road fuels, the duty rates for biodiesel / bioethanol will also be increased by 1.25 ppl. The duty rate for natural gas will increase by 1.25ppl (1.81 p/kg) to maintain the differential with main road fuels. The duty rate for Liquefied Petroleum Gas will increase by 2.25ppl (3.21 p/kg) to reduce the differential with main road fuels by 1ppl.

Operative date

3. These changes will take effect from 1 September 2006.

Current law and proposed revisions

4. The Hydrocarbon Oil Duties Act 1979, will be amended by the Finance Bill whilst the Excise Duties (Surcharges or Rebates) (Hydrocarbon Oils etc.) Order 2005, the Excise Duties (Road Fuel Gas) (Reliefs) Regulations 2005, and the Excise Duties (Surcharges Or Rebates) (Hydrocarbon Oils etc.) (Amendment) Order 2005 will be revoked. Note that these statutory instruments are revoked with effect from the date when the Finance Bill receives Royal Assent. The new effective rates of duty are given in the attached table.

Further advice

5. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

The new effective rates of duty 1 September 2006 will be:

Light oils	Effective duty rate per litre (£)
Ultra low sulphur petrol (ULSP)	0.4835
Sulphur-free petrol (SFP)	0.4835
Unleaded petrol that is not ULSP or SFP	0.5152
Aviation gasoline (AVGAS)	0.2884
Light oil delivered to an approved person for use as furnace fuel	0.0729
Other light oil (including leaded petrol)	0.5768
Heavy oils	Effective duty rate per litre (£)
Ultra low sulphur diesel (ULSD)	0.4835
Sulphur-free diesel (SFD)	0.4835
Heavy oil which is not ULSD or SFD (conventional diesel)	0.5468
Marked gas oil and ultra-low sulphur diesel not for road fuel use	0.0769
Fuel oil	0.0729
Kerosene to be used as motor fuel off-road or in an excepted vehicle	0.0769
Biofuels	Effective duty rate per litre (£)
Biodiesel	0.2835
Biodiesel used otherwise than as road fuel	0.0313
Bioethanol	0.2835
Road fuel gases	Effective duty rate per kg (£)
Natural gas (NG)	0.1081
Road fuel gas other than natural gas – e.g. liquefied petroleum gas (LPG)	0.1221

VAT: CHANGES IN FUEL SCALE CHARGES

Who is likely to be affected?

1. All businesses using cars for business purposes that recover input tax on fuel used for private motoring.

General description of the measure

2. The measure amends the VAT scales for taxing the private use of road fuel to reflect changes in fuel prices.

Operative date

3. Businesses must use the revised scale charges from the start of their first prescribed accounting period beginning on or after 1 May 2006.

Current law and proposed revisions

4. The table below shows the revised scale charges and output tax payable in each accounting period.

Cylinder capacity of vehicle	12 month period				3 month period				1 month period			
	£ Scale charge diesel	£ VAT due per car	£ Scale charge other	£ VAT due per car	£ Scale charge diesel	£ VAT due per car	£ Scale charge other	£ VAT due per car	£ Scale charge diesel	£ VAT due per car	£ Scale charge other	£ VAT due per car
1400 or less	£1040.00	£154.89	£1,095.00	£163.09	£260.00	£38.72	£273.00	£40.66	£86.00	£12.81	£91.00	£13.55
1401 to 2000	£1040.00	£154.89	£1,385.00	£206.28	£260.00	£38.72	£346.00	£51.53	£86.00	£12.81	£115.00	£17.13
2001 or more	£1,325.00	£197.34	£2,035.00	£303.09	£331.00	£49.30	£508.00	£75.66	£110.00	£16.38	£169.00	£25.17

5. The scales are set out in Table A in Section 57(3) of the Value Added Tax Act 1994. This table has been updated to reflect changes to the scales.

Further advice

6. An update to notice 700/64 VAT: Motoring Expenses will be available from the National Advice Service. If you have any questions about this change, please contact them on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: REDUCED RATE FOR CONTRACEPTIVES

Who is likely to be affected?

1. Suppliers and purchasers of contraceptive products.

General description of the measure

2. This measure announces a reduced Value Added Tax (VAT) rate of 5% for contraceptive products. The reduced rate will apply to sales of all contraceptive products – including sales by retailers, vending machines or via the Internet – regardless of whether purchased by an individual or organisation such as a sexual health charity or the NHS.

Operative date

3. The Statutory Instrument will be introduced shortly. Subject to Parliamentary approval, it is expected that the reduced rate will be effective from 1 July 2006.

Current law and proposed revisions

4. Contraceptives obtained on the prescription of a medical practitioner are already zero-rated by the Value Added Tax (VAT) Act 1994. Contraceptives that are fitted, injected or implanted by a health professional form part of a VAT exempt supply of medical care. The introduction of this new reduced rate will not, therefore, affect the VAT treatment of contraceptive products supplied in these circumstances.
5. The reduced rate applies to all other contraceptive products including emergency contraception. However, the VAT treatment of fertility monitoring devices or any product used for natural family planning is unaffected.
6. A new Group will be added to Schedule 7A of the VAT Act 1994 by Treasury Order, to introduce the reduced rate.

Further advice

7. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: INCREASED TURNOVER THRESHOLDS FOR REGISTRATION AND DEREGISTRATION

Who is likely to be affected?

1. All businesses whose taxable turnover is close to the current VAT thresholds for registration and deregistration.

General description of the measure

2. The measure increases the annual taxable turnover threshold, which determines whether a person must be registered for VAT from £60,000 to £61,000.
3. The taxable turnover threshold which determines whether a person may apply for deregistration will be increased from £58,000 to £59,000. The existing conditions for determining entitlement or liability to cancellation remain unchanged.
4. The registration and deregistration limits for relevant acquisitions from other European Union Member States will also be increased from £60,000 to £61,000.

Operative date

5. The changes will come into effect on 1 April 2006.

Current law and proposed revisions

6. The increase in the annual taxable turnover threshold means that a person will have to apply for registration if:
7. at the end of any month, the value of the taxable supplies made in the past 12 months or less has exceeded £61,000; or
8. at any time there are reasonable grounds for believing that the value of the taxable supplies to be made in the next 30 days alone will exceed £61,000.
9. If at the end of any month, a person's taxable turnover in the past 12 months or less exceeds £61,000 but HM Revenue and Customs is satisfied that it will not exceed £59,000 in the next 12 months, that person will not have to be registered.
10. Schedules 1 and 3 to the Value Added Tax (VAT) Act 1994 will be amended by statutory instrument to reflect these changes.

Further advice

11. The supplement to notices 700/1 'Should I be registered for VAT', and 700/11 'Cancelling your Registration', will be amended to show the increased limits. This supplement also gives details of the historical registration and deregistration limits. Notices 700/1 and 700/11 respectively give further information on how to register and deregister.
12. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: CLARIFICATION OF POWERS RELATING TO INSPECTION OF GOODS

Who is likely to be affected?

1. This measure could affect any business that owns, or stores on behalf of others, goods intended for onward supply. However, the measure will not require any action on the part of businesses, as it merely confirms the right of HM Revenue and Customs (HMRC) officers to perform certain actions in the course of an inspection of goods.

General description of the measure

2. The proposed measure will provide explicit clarification that the existing power for HMRC officers to enter premises and inspect goods in connection with VAT includes the right to mark any goods inspected (e.g. by applying an HMRC date stamp to the outer packaging) and to record details of the goods by any means (including electronic scanning of barcodes).

Operative date

3. Will have effect when Finance Bill 2006 receives Royal Assent.

Current law and proposed revisions

4. The measure requires a minor change to Schedule 11 of the Value Added Tax (VAT) Act 1994, which contains the power for HMRC officers to enter any premises used in connection with supplies of goods at any reasonable time, and to inspect any goods found on those premises. HMRC consider that the right to stamp the packaging of goods and scan barcodes on the packaging is already implicit within these powers, but some businesses have disputed this. The measure will therefore amend the relevant legislation to make these powers explicit.

Further advice

5. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: POWER FOR HMRC TO DIRECT ADDITIONAL RECORD-KEEPING REQUIREMENTS

Who is likely to be affected?

1. Businesses dealing in goods that may be the subject of a fraud in which VAT charged on the supply of the goods is not paid to HM Revenue and Customs (HMRC).

General description of the measure

2. The measure will allow directions to be issued by HMRC to individual businesses to require them to keep specified records relating to goods that they have traded (for example, IMEI numbers for mobile phones).
3. The measure will only be exercised where HMRC has reasonable grounds to believe that the additional records might assist in identifying supplies on which VAT might go unpaid. This fraud most commonly arises from supplies of mobile phones and computer chips, but the scope of the measure will not be limited to goods of this type.

Operative date

4. Will have effect when Finance Bill 2006 receives Royal Assent.

Current law and proposed revisions

5. The measure requires an amendment to Schedule 11 of the Value Added Tax Act 1994, which will give HMRC the power to specify record-keeping requirements through a notice of direction, and will lay down the conditions under which HMRC may issue a direction.
6. The measure will supplement HMRC's existing power to specify in a published notice record-keeping requirements for all businesses of a particular description. It will enable record-keeping requirements to be imposed where they are necessary to help combat fraud, without imposing a burden on every business of a particular description.
7. The measure will be supported by a specific penalty for failure to comply with the terms of a direction. The notices of direction will contain details of the penalty, so that recipients will be fully aware of their obligations and the consequences of non-compliance. There will be a right of appeal against the issue of a direction and against the imposition of a penalty for non-compliance.

Further advice

8. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

PROTECTING VAT REVENUES: TAXATION OF PHONE CARDS

Who is likely to be affected?

1. Businesses which in future may seek to avoid VAT on phone cards and other face-value vouchers.

General description of the measure

2. There are two elements to this measure:
 - first, it introduces enabling legislation which allows the Government to make orders in the future which specify additional circumstances in which VAT is to be charged on sales of “credit vouchers”; and
 - second, this measure clarifies an existing provision without changing its meaning.

Operative date

3. Will take effect from when Finance Bill 2006 receives Royal Assent.

Current law and proposed revisions

4. The first element of this measure concerns the VAT treatment of face-value vouchers. This change concerns credit vouchers, which are face-value vouchers issued by one person and redeemed by another. Credit vouchers are not subject to VAT because it is expected that VAT will ultimately be charged on the goods or services provided when the voucher is redeemed. Where VAT will not be paid on those goods and services, an existing rule says that the credit vouchers are subject to VAT. This element of the measure will allow the Government to introduce new rules by statutory instrument which can specify additional circumstances in which credit vouchers are subject to VAT.
5. The second element of this measure concerns Article 21 of the VAT (Place Of Supply Of Services) Order 1992 SI 1992/3121. The current wording of this provision is ambiguous. The measure therefore seeks to clarify the wording of this provision, to make it clear and help combat avoidance involving face value vouchers (which are defined in law as a “right to receive services”).

Further advice

6. If you have any questions about this change, please contact Colin Strudwick on 020 7147 0567. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: SCHEDULE 10 – BUILDINGS AND LAND: REWRITE OF EXISTING TAX LAW

Who is likely to be affected?

1. Virtually all businesses registered for VAT, in particular those acting in a capacity of landlord, tenant or owner-occupier.

General description of the measure

2. Rewrite of the option-to-tax provisions in Schedule 10 of the Value Added Tax (VAT) Act 1994 into language that is clearer and easier to use, removing redundant material and adopting a more modern drafting style.
3. The opportunity is also being taken to introduce appeal rights and to make some minor changes to improve practical administration.

Operative date

4. The Finance Bill enabling legislation will come into effect at Royal Assent. A Treasury Order containing the new Schedule will be laid shortly after that.

Current law and proposed revisions

5. Section 51 of the Value Added Tax (VAT) Act 1994 gives effect to Schedule 10 which covers buildings and land, and can be amended by Treasury Order.
6. The law will be changed by primary enabling legislation in the Finance Bill. A Treasury Order subject to the affirmative resolution procedure will be made under that legislation following Royal Assent.
7. The Order made pursuant to the new legislation will make provision for a wholesale rewrite of the Schedule together with incidental, consequential, supplemental or transitional provisions and amendments, such as granting new appeal rights relating to Schedule 10.

8. The Finance Bill will also enable the repeal of rules on developmental tenancies (Schedule 9 Group 1 para 1(b)) and introduce transitional provisions. This would coincide with the repeal of provisions relating to the developer's self-supply charge in Schedule 10.

Further advice

9. A consultation document 'VAT: Schedule 10 – Buildings and Land: Rewrite of existing tax law' was published on 5 December 2005.
10. If you have any questions about this change, please contact Andrea Pierce on 020 7147 0514. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

INTRODUCTION OF A CHANGE OF THE PERSON RESPONSIBLE FOR ACCOUNTING FOR AND PAYING THE VAT ON THE SALE OF CERTAIN GOODS

Who is likely to be affected?

1. Any business selling or purchasing specified goods such as mobile phones, computer chips and some other similar electronic items.

General description of the measure

2. This measure introduces a new legal provision to combat Missing Trader Intra Community (MTIC) fraud in goods such as those referred to above. It changes the person who is liable to account for and pay the VAT on the sale of such goods. Normally the seller of the goods accounts for and pays the VAT chargeable on the sale but this change, when implemented, will require any VAT-registered business purchasing certain goods, which will be specified in secondary legislation, to do so instead. It also introduces a consequential change allowing adjustment of the VAT on the sale when full payment in relation to it has not been made within 6 months.

Operative date

3. It will come into effect at a future date once we have agreed the proposal with other European Union Member States.

Current law and proposed revisions

4. A new section 55A of the Value Added Tax (VAT) Act 1994 is being introduced which specifies the person who is liable to account for and pay the VAT on the sale of certain goods. The new section enables the introduction of secondary legislation to specify the goods to which the section will apply and to specify certain excepted supplies. It also makes provision for the purchase of certain goods to which the section will apply to be included in the taxable turnover of a person for VAT registration purposes. A new section 26AB is also being introduced to allow for an adjustment of output tax (as the bad debt relief scheme will not apply) where entitlement to input tax is disallowed under section 26A of the VAT Act 1994.

5. The secondary legislation is not yet available but will set out in detail the goods to which the reverse charge will apply and will specify certain excepted supplies.

Further advice

6. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: SUPPLIES OF GOODS UNDER FINANCE AGREEMENTS

Who is likely to be affected?

1. Finance companies who sell goods under hire purchase, conditional sale and similar agreements.

General description of the measure

2. Goods may be returned to finance companies before an agreement is completed, either when the customer exercises their right to return the goods and make no further payments, or where the finance company exercises its rights when the customer defaults on the agreement.
3. The measure removes the entitlement of finance companies to treat returned goods as 'neither a supply of goods nor services' for VAT purposes, when sold for a second time, where there is a requirement to adjust the VAT charged on the initial sale.

Operative date

4. The change applies to all finance agreements entered into on or after 13 April 2006 where the goods concerned are delivered on or after 1 September 2006.

Current law and proposed revisions

5. Regulation 38 of the Value Added Tax Regulations 1995 requires an adjustment to the original VAT amount charged where there has been a reduction in the price paid for the goods.
6. Article 4 of the Value Added Tax (Cars) Order 1992 will be amended to introduce a new exclusion to the circumstances where a sale of returned cars can be treated as 'neither a supply of goods or services' and so not be chargeable with VAT. The exclusion will apply where VAT on the first sale can be adjusted. This amendment will impact solely on the sale of returned cars under finance agreements.
7. Article 4 of the Value Added Tax (Special Provisions) Order 1992 will be amended to introduce a new exclusion to the circumstances where a sale of returned goods can be treated as 'neither a supply of goods or services' and so not be chargeable with VAT. The exclusion will apply where VAT on the first sale can be adjusted. This amendment will impact on the sale of a wide range of returned goods under finance agreements.

Further advice

8. A VAT Information Sheet is being issued today containing more detailed guidance on the impact of these changes.
9. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: AUCTIONEERS' FEES

Who is likely to be affected?

1. Businesses and individuals buying works of art, antiques, collector's items and second hand goods at public auction when the goods concerned are subject to temporary importation (TI) arrangements. No VAT is currently due on auction sales of goods held within TI arrangements, but VAT becomes due if the goods concerned are then finally imported into the European Union (EU).

General description of the measure

2. The changes to VAT law will ensure that the commission charged by an auctioneer will be taxed in the same way irrespective of whether the auctioned goods are within TI arrangements or are in free circulation within the EU.
3. The United Kingdom has previously interpreted European VAT law in such a way that one form of commission, the Buyer's Premium, in respect of goods auctioned within TI was taxed by including the commission in the valuation of the goods at final importation into the EU. The effect of this approach was that the commission was taxed at an effective reduced rate of VAT equal to 5%. The European Court of Justice has recently decided that the commission should in fact be taxed by the United Kingdom at the standard rate of VAT (17.5%).

Operative date

4. The measure will take effect shortly after Royal Assent to the Finance Bill.

Current law and proposed revisions

5. Sections 21(1) and 21(2) of the Value Added Tax Act 1994 stipulate that the value of goods being imported into the United Kingdom shall be taken to include incidental expenses such as commission. Section 21 will be amended to ensure that auctioneers' commissions (including Buyer's Premium) will be excluded from the valuation calculation for Import VAT purposes. The effect of the change means that commissions will no longer be taxed at the effective reduced rate of VAT.

6. As a result of the Value Added Tax (Treatment of Transactions) Order 1995 (SI 1995/958), auctioneers' commissions (including Buyer's Premium) relating to sales of goods by auction within TI arrangements are not treated as a supply for VAT purposes. As such commissions will no longer be taxed within the value of goods at final importation, the Order will be amended so that normal taxation provisions will apply to the auctioneers' commissions.

Further advice

7. If you have any questions about this change, please contact Gary Steele on 0151 703 8479 or Maureen Campion on 01989 770 351. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

VAT: PARTIAL EXEMPTION

Who is likely to be affected?

1. Businesses that operate or intend to operate a partial exemption special method to calculate the VAT they can recover. Users of the standard method are not affected.

General description of the measure

2. Businesses that make both taxable and exempt supplies operate a partial exemption method to calculate the VAT they can recover on their costs and purchases. Many large partly exempt businesses operate a bespoke special method that must be approved by HM Revenue and Customs (HMRC).
3. An informal consultation will be held on two changes that will strengthen and simplify the special method regime.
4. The first change would require a business to declare that its proposed special method is fair and reasonable before gaining approval for its use. HMRC could then set aside a method that the business should have known was not fair and reasonable in order to recoup VAT that has been incorrectly reclaimed. This change would help HMRC approve special methods more quickly.
5. The second change would facilitate 'combined methods' that cater for the recovery of VAT relating to overseas supplies. This change will simplify the rules for partly exempt businesses that make overseas supplies.

Operative date

6. The Government intends to introduce the changes from April 2007.

Current law and proposed revisions

7. Section 26(3) of the Value Added Tax Act 1994 requires HMRC to make regulations that secure a fair and reasonable recovery of VAT. To this end, Regulation 102 of the VAT Regulations 1995 (SI 1995/2518) allows HMRC to approve a special method. A special method only provides for the recovery of VAT on costs that relate to taxable supplies made in the UK.
8. The first change means that HMRC would no longer approve a special method without a declaration from the business that 'to the best of its knowledge and belief' it will produce a fair and reasonable recovery of

VAT. If the approved method fails in this respect, HMRC could set it aside and require the business to recalculate past returns to ensure that it only recovers a fair and reasonable amount of VAT.

9. The second change means that HMRC would be able to approve a special method that deals with the recovery of VAT on costs that relate to supplies made outside the UK that confer the right of deduction (for example, supplies of finance and insurance made to customers outside the EU).
10. The changes only require amendments to the VAT Regulations 1995 which would be made by secondary legislation.

Further advice

11. HMRC will be conducting an informal consultation with representative bodies on the implementation of this measure. It will take place from May to July of this year.
12. If you have any questions about this change, or would like to be considered for inclusion in the informal consultation, please contact Patrick Wilson on 0207 147 0595. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

LANDLORD'S ENERGY SAVING ALLOWANCE

Who is likely to be affected?

1. Individual landlords (and other landlords who pay income tax) who let residential property.

General description of the measure

2. The scope of the Landlord's Energy Saving Allowance (LESA) will be extended to include draught proofing and insulation for hot water systems.

Operative date

3. Will have effect from 6 April 2006.

Current law and proposed revisions

4. Under section 312, Income Tax (Trading and Other Income) Act 2005 (ITTOIA), landlords who pay income tax may claim a deduction, the LESA, against profits for expenditure to install loft insulation or cavity wall insulation in a dwelling house which they let. This was extended to cover solid wall insulation in regulations made in 2005 (the Energy-Saving Items Regulations 2005 – Statutory Instrument 2005/1114). The maximum amount which may be claimed is limited to £1,500 per building.
5. Regulations will be made under section 312(5)(c) ITTOIA to enable landlords to claim the allowance for expenditure to draught proof and install insulation for hot water systems in dwelling houses which they let.

Further advice

6. If you have any questions about this change, please contact your local HM Revenue and Customs Enquiry Centre (see the telephone directory for details). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CLIMATE CHANGE LEVY: CHANGES TO RATES

Who is likely to be affected?

16. Suppliers and others liable to account for climate change levy (CCL).

General description of the measure

17. The rates of CCL will remain unchanged for 2006-07 and will increase in line with inflation for 2007-08.

Operative date

18. The new rates shown below will apply to supplies of taxable commodities treated as taking place on or after 1 April 2007.

Current law and proposed revisions

19. The new rates of levy are:

Taxable commodity	Rate
Electricity	£0.00441 per kilowatt hour
Gas supplied by a gas utility or any gas supplied in a gaseous state that is of a kind supplied by a gas utility	£0.00154 per kilowatt hour
Any petroleum gas, or other gaseous hydrocarbon, supplied in a liquid state	£0.00985 per kilogram
Any other taxable commodity	£0.01201 per kilogram

20. These changes will affect the provisions relating to the charging of the levy at the full rate and at 20 per cent of the full rate for energy-intensive users with climate change agreements. The amount of levy payable at the reduced rate is determined by applying 20 per cent to the new full levy rates. The 50 per cent rate for energy used in horticulture is being abolished from 1 April 2006 before the new rates above come into effect.
21. Paragraph 42(1) of Schedule 6 to the Finance Act 2000 will be amended to reflect the new rates.

Further advice

22. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk
23. Information on dealing with supplies that span the date of the changes can be found in section 7.6 of Public Notice CCL 1, "*A general guide to climate change levy*", which is available from the HM Revenue & Customs website. Notice CCL1/3 "*Reliefs and special treatments for taxable supplies*" provides information about the certification process for the relief mentioned in paragraph 5 above.

CLIMATE CHANGE LEVY (CCL) – ABOLITION OF 50% DISCOUNT FOR ENERGY USED IN HORTICULTURE

Who is likely to be affected?

1. Suppliers and others liable to account for and pay climate change levy.

General description of the measure

2. The temporary 50 per cent rate for 2006 energy used in horticulture will be abolished. However, since March, many businesses in the horticulture sector have been eligible to sign climate change agreements and instead benefit from an 80 per cent reduction from the levy in exchange for meeting specific energy efficiency targets.

Operative date

3. On and after 1 April 2006.

Current law and proposed revisions

4. The 50 per cent rate will be suspended for new supplies, and parts of paragraph 42 and all of paragraph 43 of Schedule 6 to the Finance Act 2000 will later be repealed. Other consequential changes will be made to the Schedule to reflect the ending of the discount.
5. There will also be a number of changes to the Climate Change Levy (General) Regulations 2001 – SI 2001/838. The provisions relating to the 50 per cent rate will be progressively withdrawn as there is a continuing need for them pending reconciliation of claims.

Further advice

6. HMRC has already written to all horticultural relief recipients outlining what options are available to them when the exemption ends, and what actions need to be taken at that time.
7. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

CLIMATE CHANGE LEVY (CCL): EXTENSION OF EXEMPTION FOR GAS USED IN NORTHERN IRELAND

Who is likely to be affected?

1. Suppliers of natural gas in Northern Ireland.

General description of the measure

2. When the CCL was introduced on 1 April 2001, the UK obtained state aid approval for an exemption from the levy for natural gas in Northern Ireland, for a period of 5 years. Following renewed state aid approval, the exemption is to continue for another 5 years.

Operative date

3. The original exemption was due to expire after 31 March 2006, but will now be extended to 31 March 2011.

Current law and proposed revisions

4. Paragraph 11A of Schedule 6 to the Finance Act 2000 exempts gas supplies in Northern Ireland. It will remain in place to enable the exemption to continue.

Further advice

5. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

LANDFILL TAX

Who is likely to be affected?

1. Businesses registered for landfill tax.

General description of the measure

2. The standard rate of landfill tax will be increased from £18 per tonne to £21 per tonne. The lower rate of tax, which applies to inactive wastes disposed at landfill, as listed in the Landfill Tax (Qualifying Material) Order 1996, remains unchanged at £2 per tonne.
3. The maximum credit that landfill site operators may claim against their annual landfill tax liability, for contributions made to bodies with objects concerned with the environment, enrolled under the Landfill Tax Credit Scheme, is to be changed from 6 per cent to 6.7 per cent. This should result in an extra £10 million being available to the scheme in 2006-07 with the expectation that this will be targeted at projects using youth volunteers.

Operative date

4. The £21 per tonne rate applies to any standard rated disposal of waste made, or treated as made, on or after 1 April 2006.
5. The change to the credit percentage claimable 'under the landfill tax credit scheme' will come into effect at the start of the new landfill tax contribution year, 1 April 2006.

Current law and proposed revisions

6. Section 42 of the Finance Act 1996 specifies the rates of landfill tax, and will be amended in the Finance Bill 2006.
7. Regulation 31(3) of the Landfill Tax Regulations 1996 specifies the maximum percentage credit claimable under the Landfill Tax Credit Scheme; the regulation will be amended by statutory instrument laid on Budget day.

Further advice

8. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

ALCOHOL DUTY RATES

Who is likely to be affected?

1. Manufacturers, importers, distributors, retailers and consumers of certain alcohol products (beer, wine and made-wine).

General description of the measure

2. Annual Setting of Duty Rates for Alcohol
 - duty on beer will increase in line with inflation, adding 1 penny to a pint of beer;
 - duty on wine and made-wine will increase in line with inflation, adding 4 pence to a 75cl bottle of wine;
 - duties on spirits, sparkling wine and cider will be frozen;
 - the value of Small Brewers Relief will also increase in line with inflation, and will continue to provide 50% duty relief to the smallest brewers.

Operative date

3. Midnight on Sunday 26th March 2006.

Current law and proposed revisions

4. The Alcoholic Liquor Duties Act 1979 and the HM Revenue and Customs Tariff will be amended to reflect the changes.

Further advice

5. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

Alcohol duty rates, including the new duty rates for beer and still wine, are as follows:

Type	Rate
	Rate £ per litre of pure alcohol
Spirits	19.56
Spirits-based RTDs	19.56
Wine and made-wine: Exceeding 22% abv	19.56
	Rate £ per hectolitre per cent of alcohol in the beer
Beer	13.26
	Rate £ per hectolitre of product
Still cider and perry: Exceeding 1.2% - not exceeding 7.5% abv.	25.61
Still cider and perry: Exceeding 7.5% - less than 8.5% abv.	38.43
Sparkling cider and perry: Exceeding 1.2% - not exceeding 5.5% abv.	25.61
Sparkling cider and perry: Exceeding 5.5% - less than 8.5% abv.	166.70
Wine and made-wine: Exceeding 1.2% - not exceeding 4% abv	53.06
Wine and made-wine: Exceeding 4% - not exceeding 5.5% abv.	72.95
Still wine and made-wine: Exceeding 5.5% - not exceeding 15% abv.	172.17
Wine and made-wine: Exceeding 15% - not exceeding 22% abv.	229.55
Sparkling wine and made-wine: Exceeding 5.5% - less than 8.5% abv.	166.70
Sparkling wine and made-wine: 8.5% and above -not exceeding 15% abv	220.54

TOBACCO PRODUCTS: CHANGES IN DUTY RATES

Who is likely to be affected?

1. Manufacturers and importers of tobacco products (i.e. cigarettes, cigars, hand-rolling tobacco, other smoking tobacco and chewing tobacco).

General description of the measure

2. The rates of duty on tobacco products imported into, or manufactured in, the United Kingdom will be increased by 2.65% in line with inflation.

Operative date

3. The rate changes will come into effect at 6pm on 22 March 2006.

Current law and proposed revisions

4. The new rates of duty are:
 - Cigarettes: An amount equal to 22 per cent of the retail price plus £105.10 per thousand cigarettes.
 - Cigars: £153.07 per kilogram
 - Hand-rolling tobacco: £110.02 per kilogram
 - Other smoking tobacco and chewing tobacco: £67.30 per kilogram
5. An amendment will be made to the Table of rates of duty in Schedule 1 to the Tobacco Products Duty Act 1979, as last substituted by Section 1 of the Finance Act 2005 (c.12).

Further advice

6. If you have any questions about these changes, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is on the HM Revenue & Customs website at www.hmrc.gov.uk.

ALCOHOL DUTIES: REDUCING ADMINISTRATIVE BURDENS

Who is likely to be affected?

1. All businesses across the alcohol sector, in particular those that produce spirits, beer, cider, wine and made-wine.

General description of the measure

2. This measure consists of a wide range of changes to excise legislation covering the alcohol sector. It removes a large number of regulatory requirements that are onerous or obsolete. It also introduces a number of simplifications and measures designed to facilitate legitimate trade.

Operative date

3. The repeals to the Alcoholic Liquor Duties Act 1979 will come into force on the date at which the Finance Bill 2006 receives Royal Assent. The Beer, Cider and Perry, Spirits and Wine and Made-wine (Amendment) Regulations 2006 will come into force on 1 May 2006.

Current law and proposed revisions

4. The UK production of dutiable alcoholic liquors (beer, cider, perry, spirits, wine and made-wine) is governed by the Alcoholic Liquor Duties Act 1979 (ALDA), the Beer Regulations 1993, the Cider and Perry Regulations 1989, the Spirits Regulations 1991 and the Wine and Made-wine Regulations 1989. ALDA also contains a variety of provisions intended to protect the revenue on those duties.
5. Various sections of ALDA will be repealed by the Finance Act 2006. These are:
 - Section 12(4) which allows HMRC not to grant or to revoke distillers' licenses where premises are located near other alcohol production premises such as a brewery or a vinegar-maker;
 - Section 14 which provides for the attenuation charge: a provision that imposes a charge if distillers breach a prescribed production formula;
 - Section 15(4) which requires distillers to provide accommodation for the officer at a distiller's warehouse;
 - Section 18(5) which allows HMRC not to licence the keeping of a still for rectifying or compounding where premises are located near to a distillery;
 - Section 21 which contains certain restrictions on the materials a rectifier can operate on or hold;
 - Section 24 which provides for particular restrictions that bar distillers' from other business interests such as retailing or wholesaling of spirits,

brewing etc;

- Section 26 which places particular restrictions on the size of ship and manner of packaging in which spirits can be imported, and the manner in which they can be exported;
- Section 32 which places specific restrictions on the transfer of spirits in a distiller's warehouse without security; and imposes particular conditions on the transfer of spirits in any warehouse;
- Section 35 which allows HMRC to regulate to require returns from alcohol (other than ethanol) traders;
- Section 55A which allows HMRC to regulate to prevent wines or made-wines of a specific alcoholic strength from being fortified after they leave production premises or after importation into the UK;
- Section 67 which allows HMRC to regulate the keeping of alcoholic liquors by wholesalers and retailers.
- Section 69 which bars retailers and wholesalers of spirits from other business interests such as distilling;
- Section 71 which imposes penalties for misdescribing liquor as spirits in certain circumstances;
- Section 74 which provides for the treatment of certain fermented liquors to be deemed wine or spirits depending on how they are held out for sale or their alcoholic strength; and,
- Section 82 which allows HMRC to make regulations concerning the manufacture of stills and the keeping of stills in certain circumstances by persons other than distillers or rectifiers.

6. The Beer, Cider and Perry, Spirits, Wine and Made-wine (Amendment) Regulations 2006 will amend the various alcohol regulations to:

- remove overly prescriptive requirements that govern how cider and perry makers, spirits manufacturers and wine and made-wine producers place, fix and gauge their vessels for examination;
- remove superfluous record-keeping requirements for cider and perry makers, spirits manufacturers and wine and made-wine producers;
- remove specific requirements for cider, perry, wine and made-wine producers to take stock and submit a stock return;
- remove specific regulations governing the treatment of wort or wash and the calculation of gravity in the manufacture of spirits;
- remove requirements for a rectifier or compounder who is authorised to receive duty free spirits to make entry of his premises;
- remove the prohibition of certain operations on small brewery beer such as mixing of beers that would be chargeable with different rates of duty. The amendment provides for the product of such mixing to be chargeable at the standard rate of duty; and,
- introduces a duty point for cider, perry, wine and made-wine made in premises where the producer was required to take out a registration/licence but has failed to do so.

7. The Beer, Cider and Perry, Spirits, Wine and Made-wine (Amendment) Regulations 2006 will also revoke:

- The Wine and Made-wine of a Strength exceeding 1.2 per cent. and not exceeding 5.5 per cent. (Prohibition of Fortification) Regulations 1989 which are no longer needed; and

- The Excise Duty (Relief on Alcoholic Ingredients) Regulations 1978 which have been superseded by other legislation.

Further advice

8. HMRC will publish further guidance on the impact of these changes prior to the Amendment Regulations taking effect on 1 May 2006. In the meantime, if you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

EXCISE: DUTY DEFERMENT GUARANTEES

Who is likely to be affected?

1. All businesses making payments of excise duties when excise goods including alcohol, tobacco and oils are removed to the UK home market from either a producer's premises or an excise warehouse.

General description of the measure

2. Radical reform of the excise duty deferment guarantee system. Following the response to the consultation document issued at PBR, HMRC will introduce a new risk based system for excise duty deferment guarantees along similar lines to the current Simplified Import VAT Accounting (SIVA) system.
3. The exact details of the system, in particular those relating to new or small businesses will be announced after further dialogue with business.

Operative date

4. Date yet to be finalised but no later than 31 March 2007.

Current law and proposed revisions

5. Customs and Excise Management Act 1979 Section 127A provides for the Commissioners of HMRC to make provision for the excise duties on prescribed goods to be deferred subject to conditions or requirements imposed under Regulations or by the Commissioners. The Excise Duties (Deferred Payment) Regulations 1992 provide that security for the duty shall be required in such form and manner as the Commissioners may require.
6. This reform is a change to the form and manner of the security that the Commissioners may require, and will not require any amendment to the current legislation.

Further advice

7. The consultation document "Reform of the excise duty deferment guarantee system" was issued on 22 December 2005. Current information on the duty deferment guarantee requirements is outlined in Notice 101 – Deferring Duty, VAT and Other Charges. A summary of the responses received to the consultation will also be published today on the HM Revenue & Customs website.

8. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

TOBACCO DUTY: DEREGULATORY CHANGES

Who is likely to be affected?

1. Manufacturers of tobacco products.

General description of the measure

2. Under this measure the tobacco products regulations are clarified with respect to the occupancy of registered premises, the inter-premises movement of tobacco products, and the use of tobacco products for testing.
3. Along with these regulatory changes, tobacco manufacturers are allowed to apply for the registration of 'open-air' stores.

Operative date

4. The various changes will come into effect with the Regulations. The decision to permit the registration of 'open-air' stores came into effect in January 2006.

Current law and proposed revisions

5. The storage and treatment in duty suspension of tobacco products is governed by the Tobacco Products Regulations 2001. The changes will be made by means of amending regulations to be laid in due course.
6. These changes extend permitted movements of tobacco product in duty suspension between registered premises. They clarify that registered premises may only be under single occupancy; and that tobacco products on which duty has not been paid and/or which do not bear the fiscal mark may be used for testing by manufacturers. They also make some other minor technical changes.
7. The Tobacco Products Regulations allow the registration of "premises" as a tobacco factory or store. Following requests from tobacco manufacturers, the Commissioners of Revenue and Customs have agreed to recognise a securely enclosed area of ground as well as the more traditional secure building as premises. This will enable tobacco manufacturers to streamline some of their procedures and make more economic use of their sites.

Further advice

8. Necessary amendments will be made to Excise Notice 476 (Tobacco

products duty).

9. If you have any questions about this change, please contact the HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

TOBACCO DUTY: CONTROL OF SUPPLY CHAINS

Who is likely to be affected?

1. Manufacturers of cigarettes and hand-rolling tobacco.

General description of the measure

2. This measure imposes obligations on tobacco manufacturers to monitor and control their supply chains to restrict the supply of tobacco to smugglers. Manufacturers must avoid, so far as reasonably practicable, supplying tobacco to markets where there is not sufficient legitimate demand or where it is likely that the product will be re-supplied to those intending to smuggle it into the UK.
3. Tobacco manufacturers will be liable to penalties of up £5 million if, having been given a formal warning, they do not take the necessary steps to control their supply chains adequately. They will not be penalised for the actions of smugglers, but for failing to take steps available to them to prevent large quantities of tobacco getting into the smugglers' hands.

Operative date

4. The scheme will come into force in Autumn 2006.

Current law and proposed revisions

5. Existing legislation does not impose any such duty on tobacco manufacturers. The Finance Bill will make necessary amendments to the Tobacco Products Duty Act 1979. Subsequent Regulations will set out the detailed administrative provisions required for the operation of the scheme.
6. The legislation will impose a duty on manufacturers to conduct their business in such a way as to ensure, so far as is reasonably practicable, that cigarettes and hand-rolling tobacco manufactured by them, or on their behalf, are supplied in such a manner that they do not become available to those intending to evade UK duty by importing them into the United Kingdom for a commercial purpose.
7. Manufacturers will be required to maintain a written policy setting out the steps to be taken to comply with this duty.
8. Manufacturers will also be required to provide specified information about products notified to them by the Commissioners, which represent a significant proportion of the UK illicit market. In addition, they will in certain circumstances be required to provide information about smuggled product

that has been seized by the Commissioners.

9. If manufacturers do not comply with the duty imposed by the legislation they face a penalty of up to £5 million.

Further advice

10. A dedicated Excise Notice will be published when the scheme comes into effect.
11. If you have any questions about this change, please contact Judith Kelly, (Tobacco Branch, Excise & Stamp Taxes) on 0161 827 0313. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

GAMING DUTY: REVALORISATION OF DUTY BANDS

Who is likely to be affected?

1. Casino operators.

General description of the measure

2. The Gross Gaming Yield (GGY) threshold for each duty band will be increased in line with inflation.

Operative date

3. The changes to the duty bands come into effect for accounting periods starting on or after 1 April 2006.

Current law and proposed revisions

4. The new duty bands are as shown below:

The first £546,500 of GGY	2.5%
The next £1,212,500 of GGY	12.5%
The next £1,212,500 of GGY	20%
The next £2,124,000 of GGY	30%
The remainder	40%

5. Section 11 of the Finance Act 1997 and regulation 5 of the Gaming Duty Regulations 1997 will be amended to reflect these changes.

Further advice

6. If you have any questions about this change, please contact the National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

GAMING MACHINES AND AMUSEMENT MACHINE LICENCE DUTY (AML D)

Who is likely to be affected?

24. Will affect anybody who provides a licensable machine for play in the UK. In particular, the change to the definition of a gaming machine will affect bookmakers who provide fixed odds betting terminals (FOBTs) for play and operators of machines provided under section 16 of the Lotteries and Amusements Act 1976 or section 21 of the Gaming Act 1968 (section 16/21 machines or 16/21s).

General description of the measure

25. More closely aligns excise and VAT definitions of a gaming machine with the Gambling Act 2005 and removes any amusement machine that is not a gaming machine (e.g video or pinball machine) from the scope of AMLD. In addition, there is a minor revision to the definition of an excepted gaming machine to align with the Gambling Act categories.

26. Aligns the AMLD machine categories with those provided by the Gambling Act 2005 and sets new duty rates.

Operative date

27. All of the above changes will have effect for any licences commencing on or after 1 August 2006. There is one important exception detailed by paragraph 8 below.

Current law and proposed revisions

Definition of a Gaming Machine (FOBTs and 16/21s)

28. On 6 December 2005, the definition of a gaming machine in Group 4 of Schedule 9 to the Value Added Tax (VAT) Act 1994 was amended by Treasury Order. In consequence, it is necessary to amend section 23 of the VAT Act 1994, which determines the amount on which VAT is calculated, in Finance Bill 2006. The section 23 definition will be amended with retrospective effect from 6 December 2005.

29. The 6 December 2005 changes imposed a clear liability to VAT on the receipts from FOBTs and 16/21s. Since then general betting duty has not been collected on FOBT receipts, and section 16/21 machines have remained entitled to be licensed as non-gaming machines (category A AMLD). Until 1 August 2006 there will be no additional changes to the tax treatment of FOBTs and 16/21s.

30. With effect from 1 August 2006 the definition of a gaming machine contained in section 25 of Betting and Gaming Duties Act 1981 (BGDA) will be amended (in line with the VAT and Gambling Act 2005 definitions) so that FOBTs and 16/21s are brought within the scope of AMLD and will need to be covered by the appropriate licence. At the same time, further changes to BGDA will remove FOBTs from any charge to general betting duty. This will formalise the tax treatment they received from 6 December 2005.
31. For the elimination of doubt, if a licence were to be taken out for either a section 16/21 or a FOBT from 6 December 2005 until 31 July 2006, for a category other than a gaming machine, that licence will not be valid in relation to those machines after 31 July 2006. From 1 August 2006 a licence authorising the appropriate category of gaming machine (defined by stake and prize) will be required for any premises where FOBTs and 16/21s are available for play. The new rates and machine categories are explained at paragraphs 11 to 14.

Scope of AMLD

32. From 1 August 2006 an amusement machine that is not a gaming machine (e.g. video or pinball machine) will be removed from the scope of AMLD. Prior to 1 August amusement machines that are not gaming machines, and which have a total cost per play in excess of 50p, remain liable to category A AMLD.
33. Section 21 of BGDA currently exempts 2penny gaming machines and gaming machines with a maximum stake of 10p and a maximum prize of £8. From 1 August 2006 the scope of this exemption will be revised:
- The 2-penny machines will remain exempt.
 - Machines with a maximum stake of 10p and maximum cash prize of £5 will be exempt.
 - Machines with a maximum stake of 30p and maximum prize of £8, where the cash element of the prize does not exceed £5 will be exempt.

New categories

34. The current categories of machines, and rates of duty, for AMLD are described in section 23(3) of BGDA. This structure will be replaced by the following six categories of machine (that mirror those provided by the Gambling Act 2005):

A.	A gaming machine that does not fall into any other category.
B1	A gaming machine where the amount required to play the game once does not exceed £2, and the value of the prize that may be won in any one game does not exceed £4,000 in money or as a non-monetary prize.
B2	A gaming machine where the amount required to play the game once does not exceed £100, and the value of the prize that may be won in any one game does not exceed £500 in money or as a non-monetary prize.
B3	A gaming machine where the amount required to play the game once does not exceed £1, and the value of the prize that may be won in any one game does not exceed £500 in money or as a non-monetary prize.
B4	A gaming machine where the amount required to play the game once does not exceed £1, and the value of the prize that may be won in any one game does not exceed £250 in money or as a non-monetary prize.
C	A gaming machine where the amount required to play the game once does not exceed 5p and A gaming machine where the amount required to play the game once does not exceed 50p, and the value of the prize that may be won in any one game does not exceed £25 in money or as a non-monetary prize.

35. Machine operators will need to check which new AMLD category their machines will fall into, but the following is an indicative guide of how new AMLD categories map across to existing AMLD categories:

New category	Relationship to existing AMLD category
A	None. This is intended for new unlimited stake and prize machines that will be allowed in the regional casino, but like the current top category of AMLD, it has been defined for anti-avoidance purposes to capture any gaming machine not falling into any other category
B1	Some current Cat E machines in casinos
B2	Some current Cat E machines in casinos plus bookmakers' FOBTs not currently subject to AMLD. This will also include some 16/21 machines.
B3	Some current category E machines in casinos and bingo clubs. This category will also include some 16/21 machines.
B4	Some current category E machines in casino, bingo halls and registered clubs, plus category D machines in registered clubs.
C	Current category C and B machines found in a variety of locations.

36. The table in section 23 of BGDA, setting out rates of duty, will be replaced by the table below:

Table						
Period (in months) for which licence granted	Category A £	Category B1 £	Category B2 £	Category B3 £	Category B4 £	Category C £
1	435	220	170	170	155	65
2	875	435	345	345	310	130
3	1310	655	515	515	465	195
4	1750	875	690	690	625	255
5	2185	1095	860	860	780	320
6	2625	1310	1030	1030	935	385
7	3060	1530	1205	1205	1090	450
8	3500	1750	1375	1375	1245	515
9	3935	1970	1545	1545	1400	580
10	4375	2185	1720	1720	1555	645
11	4810	2405	1890	1890	1715	705
12	5000	2500	1965	1965	1780	735

37. In comparison to the old rates, the new rates will:

- Increase AMLD in line with inflation;
- Set new higher rates for category A and B1 to reflect their higher stakes and prizes;
- Set a new rate for category B4;
- Make short period licences more affordable.

Other Measures

38. As part of the overall Budget package for gaming machines it was announced that changes would be introduced later this year to simplify some aspects of the administration of AMLD.

Summary

Machine Type	6 th Dec 05 – 31 st Jul 06	Post 31 st Jul 06
FOBT	VAT	VAT + AMLD as a category B2 gaming machine (under the new structure).
16/21	VAT + current category A AMLD	VAT + AMLD as a gaming machine (category under new structure will be either B2 or B3 depending on the size of stake and prize)
Non-gaming amusement machine	VAT + current category A AMLD, if stake in excess of 50p	VAT
AMLD exempt gaming machine (scope of exemption changes on 1 st August. Status quo broadly maintained)	VAT	VAT
All other gaming machines	VAT + AMLD (current categories and rates)	VAT + AMLD (new categories and rates)

Further advice

39.If you have any questions about this change, please contact HMRC National Advice Service on 0845 010 9000. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk

MODIFICATION AND EXTENSION OF THE DISCLOSURE REGIME

Who is likely to be affected?

1. Accountants and lawyers who devise and market certain tax schemes and arrangements, and clients who use them. It also affects others who devise their own schemes in-house.

General description of the measure

2. The disclosure regime is to be extended to include the whole of income tax, corporation tax and capital gains tax.
3. The schemes required to be disclosed will be those that fall within certain hallmarks.
4. The time limit for disclosure of schemes devised in-house is to be reduced to 30 days from the date that the scheme is implemented and a de-minimis provision added so that neither individuals nor businesses that are SMEs will have to disclose in-house schemes.

Operative date

5. Will have effect from 1 July 2006.

Current law and proposed revisions

6. Part 7 of the Finance Act 2004 requires promoters and, in some cases, users to provide HM Revenue and Customs (HMRC) with information ("disclosure") about certain direct tax schemes that might be expected to obtain a tax advantage as one of the main benefits. The Act applies to all the direct taxes, but Regulations restricted disclosure in the initial phase to income tax, corporation tax and capital gains tax schemes that concern either employment arrangements or certain financial products. Stamp duty land tax schemes were added in 2005.
7. The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2004 (SI 2004/1863) will be revoked and new regulations will;
 - apply to the whole of income tax, corporation tax and capital gains tax; and
 - contain hallmarks (descriptions of arrangements in line with the system used for Value Added Tax). If a scheme falls within any one hallmark then it will be notifiable.

8. The hallmarks will fall into three groups;
 - three generic hallmarks that target new and innovative schemes;
 - a hallmark that targets mass marketed tax products; and
 - hallmarks that target areas of particular risk.
9. The three generic hallmarks will be derived from the existing “filters” of confidentiality, premium fee and off-market terms.
10. Two specific hallmarks will concern (i) schemes intended to create tax losses to offset income or capital gains tax and (ii) certain leasing schemes.
11. The Tax Avoidance Schemes (Information) Regulations (SI 1864/2004) will be amended to reduce the time limit for notification of in-house schemes to 30 days from the date of implementation.
12. The requirement to notify in-house schemes will be restricted to persons who are (a) businesses and (b) not SMEs.
13. The changes will apply to schemes that are made available or implemented on or after 1 July 2006.

Further advice

14. Draft regulations will be published in April, together with a partial Regulatory Impact Assessment.
15. If you have any questions about this change, please contact Yvonne DeNetto on 020 7438 6707. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.

INTERNATIONAL TAX ENFORCEMENT ARRANGEMENTS

Who is likely to be affected?

1. This is a technical measure to extend the scope of the UK's powers to enter into international agreements about mutual assistance in the enforcement of taxes. It will have no direct impact on taxpayers or business.

General description of the measure

2. The new powers will allow the UK to enter into bilateral and multilateral arrangements for the exchange of information in relation to both direct and indirect taxes. The existing rules provide for arrangements only in respect of direct taxes.
3. They will also provide for such arrangements to include for the first time provisions on mutual assistance in tax collection in respect of both direct and indirect taxes.

Operative date

4. Will have effect from when Finance Bill 2006 receives Royal Assent.

Current law and proposed revisions

5. Section 788 Income and Corporation Taxes Act (ICTA) 1988 provides the authority to enter into agreements with another territory for the avoidance of double taxation of income and capital gains. These agreements may include provisions on exchange of information for the administration and enforcement of such taxes. Section 815C Income and Corporation Taxes Act 1988 provides the authority to enter into agreements solely concerned with exchange of information in relation to such taxes. There are corresponding provisions in relation to taxes on estates and inheritances in sections 158 and 220A of the Inheritance Tax Act 1984.
6. The new powers will supersede the exchange of information powers in the aforementioned legislation, which will be repealed. They will be replaced with a single power to make arrangements with another territory for the exchange of information, service of documents and assistance in tax collection in respect of both direct and indirect taxes.

7. There will be consequential amendments to the existing rules (section 816 ICTA 1988 and equivalents) allowing HM Revenue and Customs (HMRC) to disclose information to an overseas tax authority where this is authorised under the agreement. Similarly there will be consequential amendments to HM Revenue and Customs' existing powers to obtain information and take recovery action on behalf of an overseas tax authority (section 146 of the Finance Act 2000, and section 134 and Schedule 39 to the Finance Act 2002). Generally, the scope of the powers available to the department will not change, only the range of taxes in respect of which these powers may be exercised. However, from Royal Assent, HMRC will be able to obtain information for all the UK's treaty partners regardless of whether the UK has a domestic tax interest in the information sought.
8. As with the existing law, arrangements made under the new powers cannot have effect until they have first been approved by an affirmative resolution of the House of Commons. There will however be some minor streamlining of the procedures involved.

Further advice

9. If you have any questions about this change, please contact Jeff Worrell on (020) 7147 2723 or Clare Thorpe on (020) 7270 5457. Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk.