

# The UK June Budget 2010

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In contrast to the Labour pre-election Budget in March, the highly anticipated second Budget of 2010 contained some unexpected announcements, although fewer than might have been feared.

In the most trailed change to the tax rules in today's Emergency Budget, the Chancellor appears to have taken a "half way house" position on capital gains tax by, effectively, retaining the difference between the capital gains tax and income tax rates that existed for the highest rate taxpayers before this April's increase in the top rate of income tax to 50%. Accordingly, the changes announced are:

- (i) an increase in the capital gains tax rate on gains arising after today to 28% for people whose total income and capital gains for this and future tax years exceeds the upper limit for basic rate income taxpayers (currently £37,400 and excluding gains made on or before today for this tax year); and
- (ii) an increase in the lifetime limit of gains qualifying for tax at 10% under the entrepreneurs' relief regime to £5 million.

Other than for gains on assets qualifying for entrepreneurs' relief (which in general only assists owner managers, rather than investors), there is no distinction between "business" and "non-business" assets. While the changes do not go as far as many people feared, the British Private Equity and Venture Capital Association ([BVCA](#)) have noted that they move the UK from 7th to 15th place in the table of our international competitors, with only France now having a higher rate of tax on capital gains.

Although the rise in capital gains tax is effective from midnight tonight, many of the other contentious announcements are diluted with a delayed implementation date, such as the rise in VAT from 17.5% to 20% which will take effect from 4 January 2011.

The Budget also included some welcome measures for SMEs with the Government announcing a new Enterprise Capital Fund of £37.5m to provide additional equity finance for small businesses and a commitment to implement previously announced favourable measures such as the Growth Capital Fund and the Green Investment Bank.

We have briefly mentioned some of the most important announcements below.

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## Funds

**Asset management industry consultations** - The Government intends to consult formally and informally on issues affecting the asset management sector including the possible introduction of a tax transparent contractual fund vehicle, the taxation of investment trust companies, regulations dealing with Funds Investing In Non-Reporting Funds (FINROFs) and stamp duty reserve tax (SDRT) in the context of investments in underlying funds.

**Funds providing finance for businesses** - The Government announced the creation of a new Enterprise Capital Fund providing an extra £37.5m of equity finance for small businesses, the Growth Capital Fund, and a Regional Growth Fund. It is also planning to put forward detailed proposals on the new Green Investment Bank, announced in the December 2009 pre-budget report, intended to address barriers to investment in the low-carbon economy.

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## Business tax

**Corporation tax rates** - The main rate of corporation tax, currently 28%, will be reduced to 27% for the 2011 financial year i.e. on and after 1 April 2011. There will be further reductions to 26% in 2012-2013, 25% in 2013-2014 and 24% in 2014-2015. The small companies rate of corporation tax will also fall from 21% to 20% with effect from 1 April 2011.

**Capital allowances** - As was expected, the quid pro quo for the phased reduction in the headline corporation tax rate is a reduction in the rate of capital allowances on plant and machinery from: (i) 20% to 18% for expenditure allocated to the main rate pool; and (ii) 10% to 8% for expenditure allocated to the special pool. The new rates will apply to the calculation of capital allowances for accounting periods ending on or after 1 April 2012 for businesses within the charge to corporation tax and 6 April 2012 for businesses within the charge to income tax. In addition, the maximum amount of expenditure qualifying for the annual investment allowance is to reduce from the current limit of £100,000 to £25,000 with effect from April 2012. These changes will clearly reduce the benefit that businesses will obtain from capital investment in plant and machinery.

**Increasing tax competitiveness of the UK** - One of the Government's focuses in this Budget is improving the tax competitiveness of the UK, particularly from a corporation tax point of view. With this in mind, it is setting up a new "business forum" to consult with multinational business on the UK's tax competitiveness, creating an independent Office of Tax Simplification and has published proposals for improving the way tax policy is made.

**Company distributions** - The Chancellor has announced changes to extend the types of distributions that come within the scope of the dividend exemption for UK corporate recipients. Currently, distributions are not exempt if they are of a "capital nature". The unspecified nature of this term has caused some concern and has led to the potential that HMRC's previous position had to change so that UK companies would be subject to tax on distributions from other UK companies that were previously exempt from tax. Today's changes, which apply retrospectively to distributions made on or after 1 July 2009 (when the corporate dividend exemption was introduced), makes it clear that all distributions received by UK companies are exempt (provided they meet the general requirements for exemption), irrespective of whether they might be characterised as "capital" in nature, unless they are subject to tax under a specific provision. For instance, dividends paid out of reserves created by a capital reduction will be explicitly within the scope of the dividend exemption. The other effect of this change is that such dividends paid by UK companies will also be within the charge to income tax for non-corporate recipients if paid on or after today. Corporate recipients can elect for the changes not to apply to distributions received by them prior to today.

**Consultations on CFCs, foreign branch profits and IP** - Several consultations have been announced in relation to the Government's aim to create the most competitive corporate tax system in the G20. Changes to the controlled foreign company (CFC) rules are now expected in spring 2012, but consultation on certain interim changes to be legislated in spring 2011 will take place this summer. Consultation on taxing foreign branch profits will also take place this summer. The Government also plans to consult on the taxation of intellectual property, including the Dyson Review proposals, but no date is given for this consultation.

**Bank levy** - The Government is planning to consult on and introduce a levy on banks' balance sheets with effect from 1 January 2011. The proposal is to set the levy at 0.04% initially, increasing to 0.07% from 2012.

**VAT** - The Government announced that the standard rate of VAT would change from 17.5% to 20%. The 20% rate will apply in relation to supplies made on or after 4 January 2011. Anti-forestalling legislation will be enacted to apply an additional 2.5% charge to supplies made under certain artificial arrangements which seek to avoid the effect of the increase in the standard rate and declare VAT at the current rate of 17.5%, for example by issuing invoices in advance or by prepaying for supplies. These anti-avoidance rules appear similar to the rules applied to the previous changes in the rate of VAT. There were no changes announced in relation to the scope of VAT so supplies which are currently exempt, zero rated or reduced rated supplies remain so.

**Venture capital trusts and Enterprise Investment Scheme** - Certain changes to the VCT and EIS regimes are required as a condition for approval under the State aid rules. The requirement that a VCT must be listed on the official list in the UK will be replaced with a requirement for listing on any EU regulated market. VCTs are currently required to hold 30% of their qualifying holdings in eligible shares. This requirement will be changed to 70% but the definition of eligible shares will be expanded to include shares with certain preferential rights to dividends. Documentation and structures previously used to accommodate the 30% holding test will need to be reviewed in light of the changes. For EIS and VCT purposes the requirement for investee companies to carry on a trade in the UK will be replaced with a requirement for the company to have a permanent establishment in the UK. Further, certain shares will be excluded from qualifying from the EIS or VCT legislation if it is reasonable to assume that company would be treated as an "enterprise in difficulty" for the purposes of the European Commission's Rescue and Restructuring Guidelines. These provisions had been announced previously.

**Consortium relief** - The Government announced that it intends to extend the "link company" provisions to allow any company established in the European Economic Area to be a link company rather than only UK resident companies as is currently the case. The Government has also announced that it intends to introduce a further test to the rules which restrict the amount of losses that may be claimed from a consortium company by a corporate shareholder - the new proposed test will restrict the proportion of losses that can be claimed by reference to the proportion of voting rights and the extent of control the member holds in the consortium.

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## Employment and incentives

**Employment related securities** - Geared growth arrangements will be the subject of a consultation undertaken in 2010. It is not yet known what arrangements will be captured by the review, but it could feasibly deal with arrangements such as ratchet shares,

flowering shares, hurdle shares and sweet equity. The stated aim of the consultation procedure is to develop proposals to ensure that employment income from employment-related securities is subject to income tax and NIC rather than CGT.

**Employee Benefit Trusts (EBTs)** - The Government confirmed its commitment to introducing legislation that will restrict the use of EBTs that are established to reduce, eliminate or defer charges to income tax and NIC. Such changes are proposed to take effect from 6 April 2011. The proposed legislation will also apply to employer-financed retirement benefit schemes (EFURBs).

**Banks and financial activities tax** - With a view to tackling what it calls "unacceptable bank bonuses", the Government will consult on a remuneration disclosure scheme and explore the costs and benefits of a new Financial Activities Tax on profits and remuneration.

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## Anti-avoidance and disclosure

The Government has announced that it intends to take a more strategic approach to tackle tax avoidance, focussing on long-standing avoidance risks and continuing to shut down avoidance schemes as they emerge. The targeted anti-avoidance measures, and consultations that will take place in due course, are summarised below.

- **General Anti-Avoidance Rule** - The Government has announced that over the summer of 2010 it will engage informally with interested parties to explore whether there is a case for developing a General Anti-Avoidance Rule (GAAR). This is said to be part of wider work on improvements to the tax policy making process, and which the Government will be discussing with interested groups in due course.
- **Inheritance tax on trusts** - The Government has announced that it will consult over the summer on bringing inheritance tax on trusts within the Disclosure of Tax Avoidance Schemes (DOTAS) regime. DOTAS requires promoters (and in some cases users) of tax schemes falling within certain descriptions to provide information about the scheme to HMRC within prescribed time limits.
- **Stamp Duty Land Tax** - The Government has announced that it will examine whether changes to the rules on Stamp Duty Land Tax on high value property transactions are needed to prevent avoidance in this area.
- **Authorised Investment Funds** - Legislation will also be introduced, with immediate effect, to prevent corporate investors from making use of Authorised Investment Funds to create a credit for UK tax purposes, where no UK tax has been paid by the Funds.
- **Accounting derecognition** - The Government has announced, with immediate effect, an extension to the rules dealing with "derecognition" of loan relationships and derivative contracts. At present, in certain circumstances, where accounting practice allows or requires a loan or derivative or its associated cash flows to be "derecognised" in the company accounts, the tax rules override that and require the profits and losses to be computed as if the asset in question was fully recognised. Measures will be introduced in the Finance Bill to extend the circumstances in which amounts shown in a company's accounts are fully recognised for tax purposes, in relation to loans and derivatives.

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## Personal tax

**Income tax** - As expected, there were no changes to income tax rates however the following announcements were made regarding changes to the personal allowance and income tax and NICs thresholds:

- The personal allowance for under 65s will increase by £1,000 to £7,475 from 6 April 2011.
- The thresholds for income tax and NICs will be reduced accordingly to ensure that higher rate taxpayers do not benefit from this increase.
- The secondary threshold, which is the point at which employers start to pay Class 1 NICs, is to be increased by an extra £21 per week above indexation.

**Non-domiciliaries** - The Budget statement refers briefly to the announcement made in the Coalition Agreement that the Government will review the taxation of non-domiciled individuals. No further details are given, but there is an implied acknowledgement of the need for certainty and stability for those bringing skills and investment to the UK.

**Pensions** - The Government announced today it is considering restricting pensions tax relief from 6 April 2011, by reforming the existing pension savings allowances principally by reducing the annual allowance. HMRC have indicated that the annual allowance may be reduced to the region of £30,000 - £45,000. The reduced allowance could replace legislation due to take effect on 6 April 2011 which restricts tax relief on pensions contributions to basic rate relief for earners who earn in excess of £150,000 per tax year, which would need to be repealed.

**Trusts** - We reported on the announcement in relation to the income tax adjustment mechanism for settlors of settlor-interested trusts in our [Pre-Election Budget 2010](#). It was announced that this measure will have effect for repayments relating to income tax chargeable on or after 6 April 2010 and that the Government intends to legislate this measure as soon as possible after the summer recess.

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