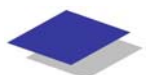


Pre-Budget Report 10 December 2003

Summary of the Main Taxation Provisions

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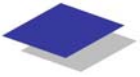


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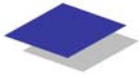
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Introduction

When Chancellor Brown introduced his 2003 pre-Budget proposals he delivered a bullish view of the growing economy. However, he admitted the UK will have to borrow £10bn more than he had predicted earlier this year. He told MPs that Britain would be £37bn in the red this year.

Mr Brown announced a series of measures aimed at widening childcare provision and taking more young people out of poverty. A cap on council tax rises was also announced.





Personal Allowances etc

Personal allowances and national insurance contribution thresholds for the tax year 2004/05 will rise in line with indexation.

Chancellor Gordon Brown increased the Personal Allowance by £130.

Increases in other allowances are set out at the end of this paper.

What is yet to be confirmed (to be decided in the Budget statement in March 2004) includes:

-  Basic and Higher Rate Income Tax Rates
-  Threshold for Higher Rate Income Tax
-  Inheritance Tax Threshold
-  Capital Gains Tax Threshold

National Insurance

Increases in the NI Contribution thresholds are set out at the end of this paper.

There is to be no increase in National Insurance contribution percentage rates.

Tax Credits

The child element of the Child Tax Credit is to be increased by £180 to £1,625 a year from April 2004.

The family element remains unchanged at £545.

The disabled child element is to be increased by £60 to £2,215 a year from April 2004.

The basic element of the Working Tax Credit is to be increased by £45 to £1,570 a year from April 2004.

There will be consultations aimed at promoting take up of the Pension Credit.

Other Pre-Budget Announcements

Capital Gains Tax (CGT)

The Chancellor made no new announcements and the favourable rates of taper relief on business assets remain as follows:

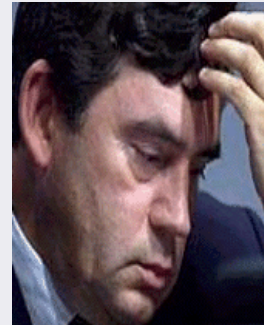
Whole years Asset held from 6 April 1998	Percentage of gain charged to tax	
	Percentage of gain charged to tax	Effective rate of tax for higher rate taxpayer (%)
Less than 1	100	40
1	50	20
2	25	10

Corporation Tax Reforms to research & development tax credits

The definition of R&D for tax purposes is being simplified. A draft new definition is being published today and the views of business will be sought before it comes into force. This clearer definition will reduce companies' compliance costs by making it easier for them to decide at the outset whether their activities will qualify for the credit.

The definition of qualifying costs is also being clarified and widened to include materials consumed, software, water and fuel used directly in the R&D. In addition, the Government will continue discussions with business to understand whether any direct costs are outside the currently proposed change and how any such costs might be brought within the schemes while minimising compliance burdens and cost effectively supporting R&D.

The Government will introduce changes to ensure the credit is available where large companies subcontract to non-corporation tax chargeable entities and will make minor changes to ensure that staff costs for benefits in kind do not qualify for the credit. The

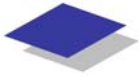


Among other measures announced:

- Plans to give amateur sports clubs tax breaks
- Plans for incentives for using "green" fuels
- £190m to be spent as part of the New Deal on financing time off and skills training
- Mandatory skills courses for the long term unemployed
- The relocation of 20,000 civil service jobs out of London.
- A freeze on duties on spirits for the rest of the Parliament coupled with a "stamping" scheme aimed at preventing duty evasion

Incorporation/ Dividend warning for small companies



The Government is concerned that the longstanding differences in tax treatment between earned income and dividend income should not distort business strategies, or enable reductions by tax planning of individuals' tax liability, and that support should continue to be focused on growth. The Government will therefore bring forward specific proposals for action in Budget 2004, to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company, and so protect the benefits of low tax rates for the majority of small businesses.



Government response to Defining Innovation, the consultation document published in the summer can be found on the Inland Revenue website.

Relief for the expense of managing investments

The Government will extend corporation tax relief for the expenses of managing investments by lifting the requirement to qualify as an investment company from 1 April 2004. This measure was widely welcomed in the Corporation Tax Reform consultation. This will benefit companies by:

-  removing an outdated restriction that creates difficulties for some groups. Up to now, many groups have had to introduce extra companies in order to create investment companies that do not themselves have trades. This layer of complexity will be removed; and
-  facilitating group re-structurings, which may be desirable for commercial reasons and may help to reduce the administrative impact of the transfer pricing changes.






Corporation tax reform – transfer pricing and thin capitalisation

Transfer pricing and thin capitalisation rules exist to ensure a fair division of profits between related entities. The transfer pricing rules require transactions between related enterprises, such as companies within the same group, to be priced as if they had been between enterprises dealing at arm's length. If a transaction would not have taken place at all between unrelated enterprises, then it can be treated for tax purposes as if it had not occurred. The thin capitalisation rules deny a tax deduction for excessive interest payments between certain related parties.

The UK's transfer pricing and thin capitalisation legislation generally only apply where one party to a transaction is outside the UK. Some doubts have been expressed as to the interaction of these rules with European law. While the Government does not accept that there is any incompatibility, it recognises the importance for business of certainty in tax law. The measures announced today will remove any uncertainty by extending the scope of transfer pricing rules to transactions within the UK from 1 April 2004. The thin capitalisation legislation will be repealed, and the transfer pricing rules

will be adapted to enable them to undertake the same role.

This change would, if made in isolation, increase administrative burdens. Therefore the Government is implementing measures to mitigate the effect, including:

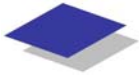
-  an exemption for small and medium sized businesses to ensure that over 95 per cent of businesses do not have to worry about transfer pricing when making a tax return;
-  to protect tax revenue, the rules will be retained for transactions with certain overseas territories and, for medium sized businesses, the Inland Revenue will retain a reserve power to apply the rules in exceptional cases justified by significant tax at risk;
-  a relaxation of the penalty regime for a transitional period of two years to give businesses time to adjust to the new rules;
-  steps to ensure that the new rules will not result in double taxation. Every adjustment to the taxable profits of one party to a transaction will be matched by a compensating adjustment for the other party, to ensure that both are taxed on a consistent basis. Special rules for loan guarantees and accrued interest will ensure that normal commercial lending arrangements will not be disturbed by the extension of the transfer pricing regime; and
-  new guidance on both the Inland Revenue's risk-assessment strategy and on documentation requirements, helping business to reduce the cost of tax compliance and the documentation that they need to keep to comply with transfer pricing rules.

Draft legislation and a summary of responses to the consultation on the management expenses and transfer pricing changes can be found on the Inland Revenue website.

VAT Measures VAT flat rate scheme

The flat rate scheme was introduced in April 2002 and offers significant compliance cost savings for the smallest businesses by reducing their record-keeping requirements and simplifying the calculation of VAT due.

Following a review of the scheme, improvements announced today and coming into effect on 1 January 2004 will include further simplification of the administration of



the scheme to enable more businesses to benefit from overall compliance savings, new lower rates and recognising the particular demands of VAT on new business, a discounted rate of 1 per cent below the normal rates for newly-registered small businesses. The new rates will range from 2 to 13.5 per cent (1 to 12.5 per cent for newly-registered businesses), compared to existing rates of 5 to 14.5 per cent.

Renovation of business premises

The Government is currently discussing the State Aid implications of an allowance to help with the renovation of business premises in Enterprise Areas, which have been vacant for a year or more. Subject to state aid approval the Government aims to introduce the allowance in 2005; further details will be published at the Budget.

Construction Industry Scheme

The Chancellor announced in Budget 2003 that a new Construction Industry Scheme would be introduced in April 2005. This scheme has been developed in detailed discussions with the industry, who have expressed concern that the April 2005 start date would leave it insufficient time to prepare properly for the change. The Government therefore decided that, in order to ensure a smooth and orderly transition to the new scheme, implementation will be deferred until April 2006. The Government plans to include the necessary legislation in Finance Bill 2004.

Pensions

The Government's second consultation document (Simplifying the taxation of pensions: The Government's proposals) has now been issued.

The National Audit Office will report in advance of Budget 2004, on whether or not the Government will introduce the simplified regime which includes a lifetime limit on contributions of £1.4 million.

Access to finance

Bridging the finance gap: next steps in improving growth capital for small business, published alongside the Pre-Budget Report today, sets out the Government's intention to take forward a pathfinder round of Enterprise Capital Funds (ECF), which will adapt the US Small Business Investment Company model and inform any decision about the scope for a long term ECF programme.

The paper sets out proposals to remove, from 6 April 2004, the current capital gains tax deferral relief for investments in Venture Capital Trusts (VCTs) and replace it with an enhancement, of equivalent value, to the incentives to invest through income tax relief.

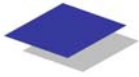
In light of the recent relative weakness of the VCT market, the paper also sets out proposals to provide a temporary stimulus to VCT fundraising for a period of two years. The Government's favoured option is a temporary increase in the value of income tax relief from 20 per cent to 40 per cent, with the value of the additional 20 per cent paid directly to the VCT rather than the investor.

Subject to discussion with the industry, the Government also intends to increase to £200,000 from 6 April 2004, both the annual investment limit for VCTs and the threshold for income tax benefits under EIS.

The Government has also announced that there is to be an independent review of the Small Firms Loan Guarantee to ensure that, in light of a changing debt market, small businesses continue to receive the support that they need to overcome barriers to raising debt finance. Because the demand for finance by businesses is as important as ensuring its supply, the paper also sets out a package of measures to promote knowledge and awareness among small businesses of the financing options available to them.

Small and medium-sized company thresholds

The Companies Act 1985 defines a company as a small or medium sized company for its first financial year if it meets two of more of the following requirements in that financial year. Once a company has qualified as a small or medium sized company it will continue to be a small or medium sized company unless it fails to meet two or more of the requirements for two years in a row.



Where a large company reduces in size, to become a small or medium sized company it must meet two or more of the requirements for two successive years:

	Turnover (not more than)	Balance sheet total (not more than)	Number of employees (not more than)
Small	£2.8 million	£1.4 million	50
Medium	£11.2 million	£5.6 million	250

The DTI will be laying regulations shortly and it is expected that they will come into force in January 2004. The following increased thresholds will replace those above for accounting periods ending on or after the date the regulations come into force:

	Turnover (not more than)	Balance sheet total (not more than)	Number of employees (not more than)
Small	£5.6 million	£2.8 million	50
Medium	£22.8 million	£11.4 million	250





Employer Training Pilots

Employer Training Pilots (ETPs) were introduced in six local Learning and Skills Council (LSC) areas in September 2002 to test new measures to improve access to training.

ETPs offer a package of support to help low-skilled people in work gain basic skills or their first level 2 qualification. Employers that offer their low-skilled staff paid time off to train are provided with compensation for wage costs (varying according to pilot area and size of firm). Training is free or heavily subsidised, and is delivered in the way that most suits the employers' businesses. Both employees and employers are offered free information, advice and guidance. The pilots were extended for a further year and doubled to cover six new areas in the 2002 Pre-Budget Report.

Tax and Accounting

The Inland Revenue is continuing to work with consultative groups to look at the detail of IAS and of complementary changes to UK GAAP that will apply in 2005. As a result of work done so far legislation will be introduced to:

-  ensure that accounts prepared in accordance with either IAS or UK GAAP will be an acceptable starting point for computing taxable profits;
-  ensure the R&D tax rules continue to allow the special reliefs and credits in the year in which expenditure is incurred, whatever the accounting treatment;
-  continue the current tax treatment of most hedging arrangements using derivative contracts and foreign currency liabilities; and
-  amend the corporate debt and derivative contracts legislation to reflect the changes made by IAS 39 and complementary revisions to UK Accounting Standards .

Property Investment

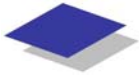
A consultation will be published at Budget 2004 to consider the most appropriate structure and conversion charge for a tax transparent property investment trust, alongside the taxation of related property investment products. Following informal discussion with industry, the Government has also today published draft legislation showing how a model for the taxation of property derivatives might operate. This will also be of interest to those using or advising on the use of equity derivatives for investment purposes.

Tax Avoidance

Trusts

From 6 April 2004 the tax rate paid on the income and capital gains of trusts will increase from 34 per cent to 40 per cent (and the corresponding dividend trust rate from 25 per cent to 32½ per cent).

This removes a distortion that provides avoidance opportunities for some higher rate taxpayers, but will not affect the position of taxpayers not liable at the higher rate who receive income from a trust, who will continue to be able to reclaim any excess income tax paid by the trustees on their behalf.



In order to reduce compliance burdens for small trusts, the Government will be consulting on a modernised income and capital gains tax regime for trusts. In particular the Government will aim to reduce the tax burdens on smaller trusts and to ensure that trusts established to protect the vulnerable are not disadvantaged by the tax system. The Inland Revenue will publish details of the modernisation proposals on 11 December 2003.

With immediate effect, the capital gains “gifts relief” legislation will be amended to counter tax avoidance schemes that involve the transfer of assets into a trust. Draft clauses for this change are being published today on the Inland Revenue website together with draft Explanatory Notes. This legislation will be included in Finance Bill 2004.

Action will also be taken against avoidance of the Inheritance Tax rules for Gifts with Reservation, where the former owner continues to enjoy the benefits of ownership of an asset. Finance Bill 2004 will legislate to impose a charge on the benefit gained from using the asset, following consultation on the detailed workings of this measure.

Construction industry

The Inland Revenue is increasing compliance activities in the Construction sector to ensure that everyone understands and meets their tax obligations. To tackle non-compliance in the construction industry by contractors routinely ignoring their responsibilities both as contractors and employers, and by sub-contractors using artificial schemes. As part of the reform of the Construction Industry Scheme, there will be a new employment status declaration for contractors, and the Inland Revenue will be increasing its compliance activities in this sector to ensure that all involved understand and meet their tax obligations.

Film Tax Relief

Film Tax Relief has encouraged a substantial amount of investment in UK films, much of which occurs because the investors enjoy immediate tax relief on the purchase or production of the film with the expectation that they will pay tax on income received from the film in subsequent years. However, the tax avoidance industry has marketed schemes to allow investors to convert the tax deferral into a permanent tax advantage.

From today, where an investor exits from a film business in a way that gives rise to an unwarranted tax advantage, they will be subject to a charge that will remove the advantage. Details of the proposed legislation are published on the Inland Revenue website.

Payments to employees by third parties connected to the employer

The law will be clarified in cases where connected third parties, such as companies in the same group as the employer, make payments to employees. Regulations will be laid before Parliament shortly to ensure these payments cannot be treated as gratuities exempt from National Insurance Contributions. These changes will not affect tips paid to waiters and others in similar employment.

Foreign Earnings Deduction (FED) for Seafarers

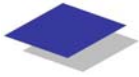
The FED provides a 100 per cent tax relief to encourage UK seafarers to work on UK deepwater vessels, which could be called upon in times of conflict. However, the relief is currently being exploited by some oil and gas workers on offshore installations around the world, to receive a tax relief that was never intended for them. Steps will be taken to make clear that employees working on offshore installations are not entitled to claim this relief. This will take effect from 6 April 2004.

Gift Aid relief

Improvements to the Gift Aid scheme introduced in Budget 2000 have had the unintended effect of widening the impact of the special statutory exemption available to some heritage and conservation charities. As a result, these charities have introduced schemes that grant free day admission in return for a donation that attracts Gift Aid. The Government has acted to maintain the integrity of the Gift Aid scheme and intends to take steps to close this loophole in the legislation in Finance Bill 2004. The details of the measure will be discussed with the charities concerned.

VAT on assigned debts

The Government is introducing new rules to prevent VAT avoidance on debts assigned by companies to connected businesses, protecting some £20 million VAT a year. Businesses that are not paid by their customers for goods and services are able to claim from Customs the VAT they charged, but have been unable to collect. Normally



the VAT is repaid to Customs if the business subsequently receives payment from its customer, but this does not apply where the debt has been assigned to another business. Legislation effective from 11 December prevents an avoidance scheme where businesses assign debts to connected businesses in order to retain any VAT subsequently paid to them.

VAT: abusive grouping

A paper *Tackling VAT group abuses* is to be issued, setting out proposals for a new legislative definition of eligibility to join a VAT group, based on accounting standards for consolidating subsidiaries in group accounts. The new criteria will focus on the realities of control and economic benefit to determine whether VAT grouping should be allowed. As well as providing greater certainty to taxpayers, the new rules will help tackle abuses of VAT groups through artificially contrived grouping arrangements.

Partial exemption

Partly exempt businesses (which make both taxable and VAT exempt supplies) may use either a standard method or a bespoke method to calculate the VAT that they are entitled to reclaim from Customs. Where a bespoke method gives an unfair or over-generous result, Customs cannot terminate that method unless they have already prepared a fairer method or negotiated one with the business.

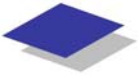
Legislation, to take effect from 1 January 2004, will allow Customs to set an effective date from which they can correct the effects of unfair methods. This will help to ensure that sensible negotiations of new, fairer methods take place in a timely manner, helping to prevent losses of some £50 million a year under the current rules caused by deliberate delays in reaching such agreements, in a way that will not affect compliant businesses.

Tax & NIC Tables



Income tax personal and age-related allowances 2004-2005	£
Personal allowance (age under 65)	4,745
Personal allowance (age 65-74)	6,830
Personal allowance (age 75 and over)	6,950
Married couple's allowance* (aged less than 75 and born before 6 April 1935)	5,725
Blind person's allowance	1,560
Married couple's allowance* (age 75 and over) - Note 1	5,795
Married couple's allowance* - minimum amount	2,210
Aged income limit	18,900
* Married couple's allowance given at the rate of 10%	

NIC Contributions 2004/05	
Lower earnings limit, primary class 1	£79 a week
Upper earnings limit, primary class 1	£610 a week
Primary threshold	£91 a week
Secondary threshold	£91 a week
Employees' primary class 1 rate	11 % on £91.01 to £610 a week 1% above £610 a week
Employees' contracted-out rebate	1.6%
Married women's reduced rate	4.85% of £91.01 to £610 per week 1% above £610 a week
Employers' secondary class 1 rate	12.8% on earnings above £91 a week
Employers' contracted-out rebate, salary-related schemes	3.5%
Employers' contracted-out rebate, money-purchase schemes	1%
Class 2 rate	£2.05 a week
Class 2 small earnings exception	£4,215 a year
Special class 2 rate for share fishermen	£2.70 a week
Special class 2 rate for volunteer development workers	£3.95 a week
Class 3 rate	£7.15 a week
Class 4 rate	8%
Class 4 lower profits limit	£4,745 a year
Class 4 upper profits limit	£31,720 a year



Further Information

If you would like to receive further information about this subject or other publications, please call us – see our contact details on the next page.

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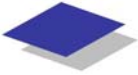
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