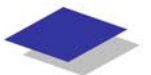


Pre-Budget Report 2 December 2004

Summary of the Main Taxation Provisions

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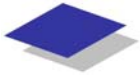
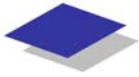


Table of Contents

- 2.** Budget Background
- 3.** What did we know before 2 December 2004?
- 5.** What the Chancellor said...
- 6.** Personal Allowances etc
- 6.** National Insurance
- 7.** Tax Credits
- 7.** Child Benefit and Guardian's Allowance
- 8.** Earnings Cap
- 8.** Capital Gains Tax (CGT)
- 8.** Cars
- 8.** Protecting Tax Revenues
- 10.** Films
- 16.** Child Trust Funds
- 17.** Promoting Saving and Asset Ownership
- 17.** Promoting Financial Inclusion
- 18.** Modernising the Business Tax System and Protecting Tax Revenues
- 20.** Tax Difficulties for Small Businesses
- 20.** Capital Allowances
- 21.** Combining HM Inland Revenue and HM Customs & Excise
- 21.** Employment Implications
- 22.** Other Measures
- 22.** Further Information



Budget Background

Arithmetical Discrepancies?

"Most people agree that when Mr Brown stands up on Thursday 2 December 2004 to deliver his Pre-Budget Report, because it is clear that his arithmetic is all over the place he should admit that his deficit is worse than forecast. Taxes, especially on company profits, are not coming in as expected and he has been spending like it is going out of fashion. In the Budget, he forecast a deficit of £35 billion in the year to April 2005, but it will be nearer £39 billion".

Source Daily Telegraph, 30 November 2004.

History

The Chancellor of the Exchequer is the government's chief financial minister and as such is responsible for raising government revenue through taxation or borrowing and for controlling overall government spending. He is the principal Finance Minister of the Government and is the head of the Treasury. The office of Chancellor of the Exchequer, established under Henry III, originally entailed keeping the Exchequer seal. The Chancellor's plans for the economy are delivered to the House of Commons every year in the Budget speech.

For most of the mediaeval period the office of the Treasurer was within the Exchequer, which managed and accounted for the royal revenue, as well as collecting and issuing money. The Exchequer wasn't always effective at its job: in 1433, for example, war with France had led to a deficit of £30,000 – the equivalent of over £100 billion today.

The origin of the name "exchequer" derives from the chequered table (based on the abacus) which was used from about 1110 for calculating expenditure and receipts. Exchequers were normally held twice a year when the Chief Justice, the Lord Chancellor, the Treasurer and others sat round the chequerboard, auditing the accounts of each local Sheriff who collected and spent money on behalf of the Crown.

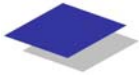
Because the Exchequer was so ineffective in the early days, it tended to be bypassed by monarchs until reformed by the Lord Treasurer Winchester and his successor, Burghley, under Elizabeth 1. By 1584, the deficit had been turned into a surplus equivalent to one year's revenue. Elizabeth called Burghley "both her Treasurer and her principal treasure."

By the 1730s an early version of the public spending survey and the annual Budget had been established. (The word "budget" derives from the term "bougette" – a wallet in which either documents or money could be kept). There were some hiccups in the process. In 1711, the Treasury unveiled a scheme to secure government debt by authorising its subscription into the capital of the South Sea Company - government creditors received stock in the company. When the South Sea Bubble burst in 1720, however, thousands of investors were affected and the Chancellor of the Exchequer was sent to the Tower of London. The Treasury learned a valuable lesson which still holds today: that the National Debt - and public finances generally - need to be managed prudently.

Over the course of the eighteenth century, the financial orthodoxy became one of free trade, balanced budgets and stable exchange rates. In 1789, Pitt the Younger introduced income tax for the first time.

The Exchequer was finally abolished in 1833 when the Treasury became a ministerial department under the Chancellor of the Exchequer. Under Victoria, the powerful position of the Treasury was consolidated by reforms which introduced open competition for posts in the civil service and appointment on merit, coupled with internal reforms to cut paperwork which improved morale and efficiency. At the same time, the Exchequer and Audit Act of 1866 improved the control and audit of public money by establishing a new Audit Department, headed by the Comptroller and Auditor General who continues to audit public expenditure today.

Source: HM Treasury



What did we know before 2 December 2004?

Dormant accounts

In Budget 2004, the Treasury said it would report back on the issue of dormant accounts. The Chancellor wants to latch onto money held in dormant accounts (between £5bn and £20bn is lying around in bank coffers) - savings untouched for a period of up to three years - to be "reinvested in society" and used for good causes.

Basic bank accounts

More than 2m UK households do not have a bank current account. The government said in Budget 2004 that it would work in partnership with the financial services sector and with voluntary and community bodies to tackle financial exclusion. But rigid rules introduced to tackle money laundering since September 2001 can make it hard for people to open accounts, particularly people on low incomes.

Savings and benefits

From April 2006, the threshold above which someone's savings reduces their eligibility for income support, jobseeker's allowance, housing benefit and council tax benefit will change - people with savings of up to £6,000 (instead of £3,000), will have their savings ignored when they are assessed for these benefits.

Childcare

From April 2005, all employer-supported childcare, not just childcare in work-based nurseries, will qualify for National Insurance and income tax relief, capped at £50 a week.

The government is also expanding the range of provision that can qualify for childcare help through tax credits, so that nannies and other types of childcare, such as child minders who look after children over the age of seven, can qualify. But they will need to be accredited before they can qualify for the scheme.

Parents on low to moderate incomes will be able to claim help through the childcare element of the Working Tax Credit - if they use these accredited schemes.

Even grandparents can qualify for tax credit payments under the new accreditation scheme, as long as they are caring for other children as well as their own grandchildren.

Couples with two or more children who have a joint income of up to £43,500 a year and those with one child with an income of up to £32,000 will qualify.

Child Trust Funds

Under the Child Trust Fund scheme to encourage savings, the government will give £250, rising to £500 for low income families, to babies born since September 2002. Every fund may also be topped up by families or friends with extra contributions up to a maximum limit of £1,200 a year.

The government has promised that in addition to the initial payment, it will make another payment to children on their seventh birthday.

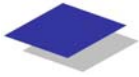
Property Investment Funds (Pifs)

The property industry is eagerly awaiting an update on Property Investment Funds (Pifs), a new way of investing in commercial and residential property. The trusts offer investors easy access to pooled property investments, which have special tax advantages. These type of trusts are already popular in many countries around the world, including Australia and US, where they are known as Real Estate Investment Trusts (Reits).

Housing Benefit

Almost 4m people pay their rent in the UK with help from housing benefit. The government is piloting a new "free market" system, enabling tenants to receive benefit based on the size of their family, where they live and their income - and not the rent they pay. It is said that it will empower tenants and provide an incentive for them to shop around.





Self assessment

The Revenue is rolling out a four page self assessment tax return and, from April 2005, about 1.5m taxpayers, with simple tax affairs including employees and pensioners, will receive a short tax return.

Trusts

The Chancellor was expected to announce the results of its latest consultation on the taxation of trusts in the pre-Budget report (the consultation closed on 5 November 2004).

Inheritance tax

The Chancellor wants to tax people who are living in homes they previously owned, under the so-called "pre-owned assets" rules. From April 2005, there will be an income tax charge where people have transferred their houses to another family member, yet continue to live in it.

Aggressive tax schemes

The government has introduced a new "Tax Avoidance Disclosure regime", an attempt to stop wealthy people from using creative tax avoidance regimes to avoid their tax liabilities. The regime requires the submission of certain tax schemes to the Revenue for inspection before being offered to investors.

Small business tax

The UK's 3.75m small and medium-sized businesses account for more than 50% of business employment and business turnover. Both small businesses and self-employed people should expect the issue of a "discussion" document on taxation.

Also predicted is clarification of the rules concerning the so-called "settlements legislation" which affects husband and wife businesses where the spouse receives a dividend from a family company.

Start-up loans

The Graham review of the Small Firms Loan Guarantee (SFLG), which helps small businesses and start-ups to borrow money, was published in October 2004 - it recommended increasing funding available from £100,000 to £250,000 and limiting loans to start-ups. We can expect something from the Chancellor on this important matter.

Pensions

From 6 April 2006, 8 existing tax regimes will be replaced with one single lifetime limit on the amount of pension savings that can benefit from tax relief.

Budget 2004 said that the lifetime allowance will be £1.5 million in 2006; £1.6m in 2007; £1.65m in 2007; £1.75m in 2009; and £1.8m in 2010.

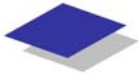
From April 2005, the government is also introducing the option of taking a deferred state pension as a taxable lump sum instead of higher weekly pension payments.

Films

The British film production sector was on tenterhooks ahead of a widely-anticipated clamp down on tax funds in the Chancellor's pre-budget report.

Film producers have been fearing the worst following a strong message from the Inland Revenue about abuses of the system including so-called "double dipping" under tax support mechanism Section 48, Finance Act (No. 2) 1997.

There have been warnings from the film industry that it will be thrown into chaos if the Chancellor closes down the Section 48 tax relief, although a complete closure seems highly unlikely given the government's repeated declarations of support for the sector.



What the Chancellor said...

Gordon Brown began delivering his assessment of the UK economy and highlighting some of his plans for next year's Budget at 12.31 GMT. He has said the preview of the 2005 Budget will show how to make the next 10 years a "British decade".

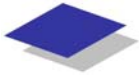
Key points from his speech are:

- ◆ Britain must strive for world leadership in science and technology;
- ◆ He wanted US levels of business creation;
- ◆ UK economic growth next year would be 3.25% - exactly within the 3% to 3.5% range he predicted in Budget 2004;
- ◆ Inflation this year had been 1.25% and was expected to be 1.75% next year;
- ◆ Business investment was expected to rise by 5.75% this year and 4% to 4.5% next year;
- ◆ Britain had 1.2m additional homeowners since 1997;
- ◆ £105m would be released for "necessary security measures";
- ◆ Borrowing was currently 34.3% of national income - a percentage contrasting favourably with Germany and the USA;
- ◆ Around £330m had been saved from NHS drug procurement;
- ◆ He announced plans for further relocation of civil servants outside London including 1,230 from the Ministry of Defence to Yorkshire and 600 from the Office of National Statistics to Wales;
- ◆ Public spending will rise to £579 billion in 2007-08, £607 billion in 2008-09 and £634 billion in 2009-10;
- ◆ In the future, the most successful economies will be the ones that get more people of working age into work;
- ◆ Single parents are to get £40 a week return to work bonus as will people on incapacity benefit;
- ◆ £2.5 billion investment will be pledged to science;
- ◆ Science cities are to be set up in the North of England through the £100m technology investment programme - the first cities would be in Manchester, Newcastle and York;
- ◆ An industry-led science forum would be set up;
- ◆ The main road fuel duties would be frozen;
- ◆ His 'Golden Rule' was being met in this economic cycle by a margin of £8 billion and will be met in the next cycle;
- ◆ New guidelines to schools for enterprise lessons;
- ◆ £1 billion was being made available to reduce pressure on the council tax;
- ◆ Next year, the pension credit will rise faster than inflation;
- ◆ Two million families still had no bank accounts and banks and the government would work to reduce that figure by half;
- ◆ The government would consult on extending the Child Trust Fund and challenged political rivals to support the policy;
- ◆ The National Minimum Income Guarantee for single parents with one child will rise to £258 a week;
- ◆ The government was removing the remaining financial barriers to teenagers remaining in education and training;
- ◆ He announced a clampdown on tax avoidance schemes including abuse of film tax legislation;
- ◆ Life chances of children are often determined before the age of five as well as after and it was in the national interest to give parents time off when they have children and flexible working in the early years. Mr Brown said he would make the welfare state family friendly;
- ◆ Paid maternity leave would be transferable from mothers to fathers;
- ◆ Additional resources would be made available so schools could stay open from 8am to 6pm to help parents.
- ◆ Employers will be able to offer employees an extra £50 a week extra for childcare tax free;
- ◆ Announced a new national employer training programme;
- ◆ £285m would be allocated to extend paid maternity leave from 6 months to 9 months with a goal of an entire year;
- ◆ An extra £50 would be made available for the winter fuel allowance.



Summary

This publication summarises the main proposals announced by the Chancellor on 2 December 2004. The information is derived from the many press releases issued by Government departments immediately after the Chancellor delivered his speech. Given the timescales involved in producing this publication only hours after the press releases became available, this is only a summary and is based on the press releases resourced by us on the day. Accordingly, there may be some proposals that are not covered here.



Personal Allowances etc

Personal allowances and national insurance contribution thresholds for the tax year 2005/06 will rise in line with indexation.

Chancellor Gordon Brown increased the Personal Allowance by £150 from 6 April 2005.

What is yet to be confirmed (to be decided in the 2005 Budget) includes:



Basic and Higher Rate Income Tax Rates



Threshold for Higher Rate Income Tax



Inheritance Tax Threshold



Capital Gains Tax Threshold

Income tax personal and age-related allowances 2005-2006	£
Personal allowance (age under 65)	4,895
Personal allowance (age 65-74)	7,090
Personal allowance (age 75 and over)	7,220
Married couple's allowance* (aged less than 75 and born before 6 April 1935)	5,905
Married couple's allowance* (age 75 and over)	5,975
Married couple's allowance* – minimum amount	2,280
Aged income limit	19,500
Blind person's allowance	1,610
* Married couple's allowance given at the rate of 10%	

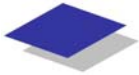


National Insurance

Increases in the NI Contribution thresholds are set out in the Table below. The rates are unchanged.

NIC Contributions 2005/06	
Lower earnings limit, primary class 1	£82 a week
Upper earnings limit, primary class 1	£630 a week
Primary threshold	£94 a week
Secondary threshold	£94 a week
Employees' primary class 1 rate	11 % on £94.01 to £630 a week 1% above £630 a week
Employees' contracted-out rebate	1.6%
Married women's reduced rate	4.85% on £94.01 to £630 per week 1% above £630 a week
Employers' secondary class 1 rate	12.8% on earnings above £94 a week
Employers' contracted-out rebate, salary-related schemes	3.5%
Employers' contracted-out rebate, money-purchase schemes	1%
Class 2 rate	£2.10 a week
Class 2 small earnings exception	£4,345 a year
Special class 2 rate for share fishermen	£2.75 a week
Special class 2 rate for volunteer development workers	£4.10 a week
Class 3 rate	£7.35 a week
Class 4 rate	8%
Class 4 lower profits limit	£4,895 a year
Class 4 upper profits limit	£32,760 a year
Class 4 rate above upper profits limit	1%





Tax Credits

In line with the Government's previous undertaking to uprate the child element of Child Tax Credit by earnings for the rest of this Parliament, it will increase by £65 from April 2005. In addition, the disabled child elements of Child Tax Credit for 2005-06 will be uprated with inflation. In line with the Government's commitment, the elements of the Working Tax Credit for 2005-06 will rise in line with inflation. The first income threshold for tax credits will also rise with inflation.

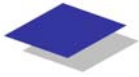
The limits on eligible childcare costs in Working Tax Credit will rise to £175 per week for one child and £300 per week for two or more children from April 2005; the maximum share of eligible costs covered will be 70% in 2005-06, rising to 80% in 2006-07.

Child Benefit and Guardian's Allowance

The rates of Child Benefit and Guardian's Allowance for 2005-06 will rise in line with inflation.

£ per week	2004-05	Change	2005-06
Eldest/only child	£16.50	+£0.50	£17.00
Other children	£11.05	+£0.35	£11.40
Eldest/only Child (Lone Parent Rate)	£17.55	-	£17.55
Guardian's Allowance	£11.85	+£0.35	£12.20

£ per year (unless stated)	2004-05	Change	2005-06
Working Tax Credit			
Basic element	£1,570	+£50	£1,620
Couple and lone parent element	£1,545	+£50	£1,595
30 hour element	£640	+£20	£660
Disabled worker element	£2,100	+£65	£2,165
Severe disability element	£890	+£30	£920
50+ Return to work payment (16-29 hours)	£1,075	+£35	£1,110
50+ Return to work payment (30+ hours)	£1,610	+£50	£1,660
Childcare element of the Working Tax Credit			
Maximum eligible cost for one child	£135 per week	+£40 per week	£175 per week
Maximum eligible cost for two or more children	£200 per week	+£100 per week	£300 per week
Percentage of eligible costs covered	70%	-	70%
Child Tax Credit			
Family element	£545	-	£545
Family element, baby addition	£545	-	£545
Child element	£1,625	+£65	£1,690
Disabled child element	£2,215	+£70	£2,285
Severely disabled child element	£890	+£30	£920
Income thresholds and withdrawal rates			
First income threshold	£5,060	+£160	£5,220
First withdrawal rate (per cent)	37%	-	37%
Second income threshold	£50,000	-	£50,000
Second withdrawal rate (per cent)	6.67%	-	6.67%
First threshold for those entitled to Child Tax Credit only	£13,480	+£430	£13,910
Income disregard	£2,500	-	£2,500



Earnings Cap

The main effect of the pension schemes earnings cap is to set a ceiling on the contributions that can be paid to, and the benefits that can be paid by, tax approved pension schemes.

The cap generally applies to people who contribute to a personal pension scheme, joined an occupational scheme set up since 14 March 1989, or joined any occupational scheme from 1 June 1989 that was set up before 14 March 1989.

From 6 April 2001 the cap applied to people who contribute to stakeholder pension schemes. For 2005-06 the cap is increased to £105,600. In addition, the cap introduced in 1987 on the final remuneration for calculating pension benefits from Occupational Pension Schemes will be aligned with the earnings cap. This will have the effect of taking the cap on tax-free lump sums to £158,400, which is 1.5 times the pension schemes earnings cap.

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	Effective rate of tax for higher rate taxpayer (%)
Less than 1	100	40
1	50	20
2	25	10

Cars

The Government plans to align the VAT fuel scale charge with the company car benefit charge to provide consistent tax incentives for less-polluting cars.

From April 2006, the company car tax diesel supplement will be restored on new diesel cars registered from January 2006.

Protecting Tax Revenues

A package of measures aimed at tackling tax fraud and avoidance was announced by the Chancellor. The reforms are designed to protect revenue for investment in public services and ensure that an unfair burden does not fall on the vast majority of taxpayers who pay their fair share.

A number of the measures have been informed by the disclosure rules introduced in Finance Act 2004. These provide early warning of avoidance schemes, thereby enabling the Government and revenue departments to respond to avoidance in the most effective manner, whether by means of legislation or litigation, without creating unnecessary burdens for compliant taxpayers. The Revenue departments will continue to analyse disclosures received and further action will be taken as and when appropriate.

Details

Tax and National Insurance Contributions avoidance: employee remuneration

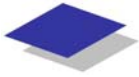
A number of avoidance schemes that seek to sidestep the rules that deal with rewards paid to employees in the form of shares and other securities are being stopped with effect from today. Employers are using these schemes to avoid paying the proper amount of income tax and National Insurance Contributions, particularly in relation to large bonuses in the City.

The measures will:

1. Extend the definition of securities to include certain insurance contracts;
2. Tighten the rules relating to securities that have restrictions or rights of conversion placed on them; and
3. Expand the provisions relating to benefits from employment-related securities.

Further to this announcement, the Paymaster General has today made a written statement to Parliament. This outlines the Government's approach to dealing with any future attempts to frustrate its intention that employers and employees should pay the proper amount of tax and National Insurance Contributions on rewards from employment. Where the Government becomes aware of arrangements that attempt to frustrate this intention it will introduce legislation to close them down, where necessary from today.





Films

A separate analysis on anti-tax-avoidance measures is covered in the next section.

This will have no effect on the vast majority of employers and employees who organise their affairs in a straightforward and ordinary way. In particular, genuine employee share schemes and share option plans will not be affected.

Financial Avoidance

A number of financial avoidance schemes that have come to light as a result of the new disclosure rules are being closed with effect from today. The measures will:

1. Block schemes used by companies to avoid tax on debt securities by manipulating "repo" and stock lending arrangements; and
2. Close down a scheme to avoid income tax involving corporate bonds which have had their interest payments removed ("stripped corporate bonds").

Controlled Foreign Companies

The Controlled Foreign Company (CFC) rules provide an important defence against those seeking to avoid tax by the artificial diversion of profits from the UK. Genuine overseas business is protected from the effect of the rules by a number of exemptions (including the Excluded Countries Exemption). Measures are being introduced to stop a number of avoidance schemes with effect from today and to provide protection against possible future avoidance. These will:

1. Ensure that profits are identified in a way consistent with UK taxation principles;
2. Prevent the artificial reduction of UK tax due by the use of the rules providing relief from double taxation where income passes through a CFC;
3. Prevent groups with several subsidiaries manipulating profits between them by using the Excluded Countries Exemption; and
4. Deny the benefit of the Excluded Countries Exemption where this is being exploited as part of a scheme for tax avoidance.

Double Taxation Relief

Avoidance schemes that have been identified using the new disclosure rules are being closed with effect from 2 December 2004. These schemes seek to exploit the double taxation relief and annual payment rules to increase the amount of relief due. The Government continues to keep this area under review.

Capital Gains: uncommercial use of options to avoid tax

Draft legislation published today counters certain tax avoidance schemes involving

options to acquire or dispose of assets. The options are exercised at uncommercial prices to avoid tax on capital gains or to create or augment capital losses. The new rules will apply in relation to options exercised on or after today.

Life insurance companies

A number of loopholes being exploited by life insurance companies are being closed. New measures will:

1. From 2 December 2004, ensure that the rules on certain transfers of business from one life insurance company to another cannot be used to reduce taxable trading profits artificially;
2. For accounting periods ending on or after 2 December 2004, clarify the circumstances in which companies can treat amounts as 'notional' and therefore exclude them from their computations of taxable trading profits;
3. For periods of account beginning on or after 1 January 2005, clarify the circumstances in which companies can use additional revenue accounts to obtain a more favourable tax apportionment of their investment return; and
4. Update the tax treatment of income and gains attributable to assets not needed to pay policyholder benefits.

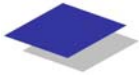
VAT avoidance through off-shore insurance schemes

Legislation is being introduced to block from 3 December 2004, an offshore scheme that seeks to avoid VAT incurred in settling UK insurance claims. This change will only affect certain non-EU businesses in the finance and insurance sectors that incur UK VAT in the course of making exempt financial and insurance supplies to customers that are also outside the EU. Under EU VAT law, there is no right to reclaim this VAT. This change puts the UK legislation on this point beyond doubt.

Ensuring fair input VAT recovery on supplying shares

Legislation is being introduced from 2 December 2004 to ensure fair VAT recovery on supplying shares.

With effect from 3 December 2004, businesses will be prevented from unfairly recovering VAT on the cost of services used to make an incidental financial supply (such as an issue or other supply of shares) to a customer in the EU by mixing these costs with costs related to supplies for which VAT is recoverable. Businesses will now be required in all cases to apportion the VAT



based on the use to which the costs are put. The costs covered include professional fees (legal fees, accountants' fees etc), and the costs of an associate listing on the Stock Exchange.





Alcohol strategy

Further details were announced of the Government's alcohol fraud strategy, including an update on plans for the implementation of duty stamps for spirits. Building on detailed work with the spirits industry, and in light of encouraging signs that HM Customs and Excise are making progress in tackling spirits fraud, the Government is proposing measures, including the adoption of proposals made by the industry, to ensure that duty stamps are an effective and proportionate response to spirits fraud.

Films

As widely expected, the Chancellor announced several measures affecting tax relief for investment in British films.

Measures are being introduced with effect from today to end abuse of tax reliefs for UK film production and ensure that the reliefs operate as intended. These will:

-  prevent the accelerated relief for qualifying British films being claimed more than once on any film ('double dipping');
-  stop structures which use the film reliefs to defer tax beyond 15 years;
-  prevent companies from converting a tax deferral into an outright tax gain by exiting from a film tax deferral arrangement; and
-  prevent partnerships from getting loss relief for money not really at risk.

In addition, the Government will introduce legislation to make the accelerated deductions claimed under the film tax reliefs clearer and easier to enforce.

In light of the steps taken against film tax avoidance both today and in recent years, and of the development of the new tax credit for low budget British films, the Government will consult with the UK Film Council and the industry in a review of the tax relief that is used by large budget British films. The Government appreciates the need for

certainty, given the long lead times for film production. The review will therefore be taken forward on a short time-scale to the end of January 2005, and the Government invites comments from relevant parties on that basis. The need for certainty will also be taken into account in any changes that may arise as the result of this review.



Double Claims For Film Tax Relief

Relief for expenditure on the production or acquisition of a film can be claimed by certain persons under section 42 of the Finance (No.2) Act 1992 ("section 42") or, for "low budget films", under section 48 of the Finance (No.2) Act 1997("section 48"). This legislation has been used in tax avoidance schemes which the Inland Revenue says seek to achieve the benefit of a tax deferral twice (or more) on the same film. The government proposes to introduce legislation in the next Finance Bill which will have effect from 2 December 2004 to counter these schemes.

At the same time, the opportunity will be taken to simplify and align one aspect of section 42 with section 48 for films which start principal photography on or after 2 December 2004.

Background

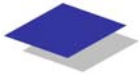
The reliefs were intended to cater for sales and acquisitions of films which involve a receipt which is set against a deduction. However schemes have been devised which seek:

-  to defer the receipt to the person selling the film, so giving two deductions which defer tax; or
-  shelter the receipt permanently, so giving rise to both a tax deferral and a permanent tax gain.

Details of the proposed legislation

The government proposes to introduce legislation in the 2005 Finance Bill to provide that relief under section 42 and section 48 can be obtained only once on any film; and to limit entitlement to relief under section 42 to the total production costs (as is already provided for in relation to relief under section 48).

"Film" Definition
References in this note to a "film" should be read to include a tape or disc unless the context requires otherwise.



The legislation will provide that relief under section 42 and section 48 is available to a person in respect of expenditure on the production or acquisition of a film only if any previous owners of the film have not claimed, and have elected not to claim, relief under those sections in respect of the film.

The legislation will provide for a person who has incurred expenditure on the production or acquisition of a film to elect not to claim relief by giving notice to the Inland Revenue that they have not claimed relief under section 42 or section 48 in relation to a film; for that notice to be irrevocable; and for that person to cease to be entitled to relief in relation to that film. It will also require that person to inform any other person who acquires or has acquired the film from them of their election; and of any elections by earlier owners they know of.

This provision will apply in relation to any production or acquisition expenditure incurred on or after 2 December 2004, unless there was an unconditional obligation to incur that expenditure under a contract entered into before 2 December 2004 or the film is currently in production (that is, principal photography on a film started before 2 December 2004 but the film was not completed by that date). **

For films currently in production, there will be provisions with similar effect to those in section 101 Finance Act 2002 for low budget films to limit relief under section 42 in relation to an acquisition of a film on or after 2 December 2004. That is, relief will be limited to expenditure on the acquisition of the film by the producer, or a person acquiring it directly from the producer, and will not be available in relation to any subsequent acquisition (or in relation to any acquisition by the producer or a person acquiring it from the producer other than the first).

The government also proposes to introduce legislation in the 2005 Finance Bill to align an aspect of section 42 with section 48. Legislation will also be introduced to provide that relief under section 42 in respect of a film will be limited to the total production expenditure on the film. "Total production expenditure" will be defined for this purpose

as it is in section 48 in relation to relief under that section which already has this rule. The provision described in the previous paragraph will apply in relation to production or acquisition expenditure on films which start principal photography on or after 2 December 2004, unless there was an unconditional obligation to incur that expenditure under a contract entered into before 2 December 2004. **

** For the purpose of these paragraphs, a condition which relates only to the Secretary of State certifying under Schedule 1 to the Films Act 1985 that the film qualifies for the purposes of section 40D will be disregarded.

Restricting Film Tax Deferral To 15 Years

The government also proposes to introduce legislation in the 2005 Finance Bill which will have effect from 2 December 2004 to counter arrangements which use film tax reliefs to defer tax beyond 15 years.

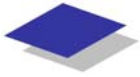
Background

Film tax relief is commonly accessed by film-makers through licensing, leasing or similar arrangements with companies or with individuals in partnership. Typically, the company or partnership (the "investor") will pay to produce or acquire a film, and then licence or lease this film back to a producer or distributor for a specified period. Usually the investor will be guaranteed a minimum amount of licence fees or lease rental payments spread over the period of the licence or lease.

The investor obtains accelerated relief for the cost of the film under section 42 or section 48. They then pay tax in later years on the fees or rental income. This works as a tax deferral for the investor – in effect pushing back the time that tax is paid in return for an investment in a film.

The longer the period that tax is deferred, the more valuable this is to the investor. The Inland Revenue has routinely accepted deferral for up to 15 years.

But a number of schemes have recently emerged which seek longer periods.



Details of the proposed legislation

The provisions will apply to any person carrying on a trade which includes the exploitation of a film, or any person who intends to carry on such a trade, who, on or after 2 December 2004, enters into an agreement that guarantees an amount of income arising from exploitation of that film or amends or extends an existing agreement.

The provisions will apply where:

- the person carrying on the trade claims, or has claimed, relief for expenditure incurred on the production or acquisition of the film under section 42 or section 48 and
- the agreement specifies that any amount of income guaranteed under that agreement will arise more than 15 years after the time that the agreement is made.

Provision will then be made with the effect that, when such an agreement is made:

- the relief (that is, the amount which a person is entitled to deduct on making a claim under section 42 in respect of any expenditure incurred on the production or acquisition of a film) will be restricted. The restricted deduction will be the expenditure claimed multiplied by 15 divided by N, where N is the period, in years, for which income is guaranteed to arise under the agreement;
- the difference between the amount of expenditure in respect of which a claim is made and the (restricted) deduction will be excluded from allocation under section 40B Finance Act 1992 until 15 years and 1 day after the date the agreement is made; and
- any excess relief already claimed will be recovered.

The legislation will also provide for:

- an agreement to be treated as guaranteeing a person an amount of income if the agreement, or any part of it, is designed to secure the receipt by that person of an amount (or at least that amount) of income;
- an agreement which is conditional upon a future event is to be treated as entered into at the earlier of the time it becomes unconditional and the time income first arises under the agreement;

- an agreement (the "later agreement") which is made on or after 2 December 2004 and which guarantees a person an amount of income from exploitation of a film which succeeds, rescinds and replaces, amends or is in addition to any agreement already made, and which guarantees income to a time later than any earlier agreement, to be treated as an extension to the earlier agreement, with effect from when the later agreement is made. That is, for the purposes of any subsequent claims, and for excess relief, it will be as if the first agreement had run to that later time;

- a partnership which carries on the trade to be treated as having claimed any relief under section 42 or section 48 actually claimed by a previous partnership who carried on the trade if the trade has not been discontinued.

There will be excess relief if:

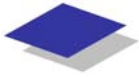
- starting with the relief actually claimed under section 42 and section 48 (which may have been restricted relief) subtracting the maximum relief which could have been claimed if the agreement (or later agreement) had been in place when the person was first entitled to claim and claims had been restricted accordingly adding any amount of excess relief charged on the occasion of any previous agreement or amendment to an agreement the result is greater than zero.

Excess relief will be:

- treated as a trading receipt of the trade in the period of account in which the agreement or later agreement is made; and
- treated as expenditure incurred, for the purposes of section 40B, 15 years and 1 day after the date the agreement is made;
- so relief for expenditure is deferred rather than lost permanently.

Avoidance Using "Exits" By Companies That Have Accessed Film Tax Relief

Some groups of companies are making use of schemes ("exit schemes") intended to convert the deferral of tax offered by special tax reliefs for films into a permanent tax advantage. The government proposes to introduce legislation in the next Finance Bill,



with effect from 2 December 2004, to counter these schemes. A measure was introduced to prevent exits by individuals at sections 119 to 123 of the 2004 Finance Act.

Background



Legislation provides for capital expenditure on the production or acquisition of the master version of a film to be treated as revenue expenditure. It also provides detailed rules as to when that expenditure may be relieved for tax purposes. The main provisions are sections 40A to 43 Finance (No.2) Act 1992 and section 48 Finance (No.2) Act 1997.

Financing in the film industry often relies on an early sale of a film and its lease back to the producer. This allows film makers early access to the benefit of the tax reliefs. The lessor gets an accelerated tax deduction followed by taxable income from the lease or other payments.

However, in some cases the accelerated relief is used effectively (for example, by way of group relief within a group) and then the rights to the future income are transferred out of the group so in effect the deferred tax is not paid.



Details of proposed legislation

The legislation will apply, with effect on and after 2 December 2004, to any company (the "film rights company") that:

-  is a 75% subsidiary, as defined by section 838(1)(a) of the Income and Corporation Taxes Act 1988 ("ICTA"), of the principal company of a group; and
-  owns rights under an agreement (the "film rights agreement") to a guaranteed amount of income arising from a film on which relief has at any time been claimed (either by the film rights company or another company) for production or acquisition expenditure under section 42 or section 48.

The legislation will provide that an agreement guarantees a company an amount of income if the agreement, or any part of it, is designed to secure the receipt by the company of that amount (or at least that amount) of income.




The legislation will also provide that for this purpose the principal company of a group is the company of which the film rights company is a 75% subsidiary and:

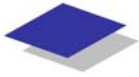
-  to which the film rights company would be able to surrender trading losses (were it to incur such losses) by way of a group claim to group relief under section 402 of ICTA; and
-  which is not itself a 75% subsidiary of any other company to which the film rights company could surrender trading losses by such a claim to group relief.

The legislation will then provide that where a film rights company ceases to be a 75% subsidiary of the company which, immediately prior to the cessation, was the principal company of the group ("exits"): its accounting period for the purposes of corporation tax ceases, and a new one begins; the film rights company will be required to bring into account in the accounting period which ends immediately prior to its exit, a trading receipt, as if it was a receipt of income in respect of the film rights, equal to the film rights value; and the film rights company will be deemed for the accounting period immediately following the exit to have trading losses brought forward under section 393(1) of ICTA from the preceding accounting period equal to the film rights value (in addition to any other losses brought forward).

The legislation will provide for the film rights value of a film to be found from the future receipts from the film rights agreement which would (before any deduction) count as income for tax purposes, computing the value in accordance with generally accepted accounting practice.

The legislation will also provide that if:

-  a film rights company disposes of any rights under an agreement to a guaranteed amount of income arising from a film, whether alone or as part of a larger disposal;
-  that disposal is to a person that is not a 75% subsidiary of the group principal company; and
-  the trading income received by the company for the disposal of the rights to income from the film is less than the film rights value, then the film rights company will be required to bring into account in the accounting period in which the disposal is made,



as a trading receipt in respect of the film, the amount by which the film rights value exceeds the amount actually received as trading income for the disposal ("the rights shortfall"); and



if the person acquiring the rights to income from the film is a company, it will be entitled to deduct as an expense of its trade an amount equal to the rights shortfall.

The amounts received as trading income by the film rights company will include for this purpose any consideration for the disposal of the rights to income from the film which are treated for tax purposes as trading income other than amounts so treated solely by virtue of the new provisions.

Where the film rights company or any branch of that company ceases to be within the charge to corporation tax it will be deemed to have received an amount of trading income equal to the film rights value. These provisions will have effect in relation to exits and disposals on or after 2 December 2004.

Individuals In Partnership: Restriction Of Loss Relief

Various recent film financing schemes seek to avoid legislation which restricts the amount of loss relief that can be claimed by individuals who are trading in partnership. The government proposes to introduce legislation in the next Finance Bill which will have effect from 2 December 2004 to prevent partners obtaining sideways loss relief in excess of their capital contributions to the trade for which they are and remain fully at risk. The Inland Revenue will continue to challenge schemes which do not succeed on the basis of the current law.

Background

Where individuals incur trading losses from a trade they carry on (alone or in partnership) they may be able to set the losses against other income and capital gains. But limited partners, members of a limited liability partnership and other partners who on average spend less than 10 hours per week actively carrying on the trade are broadly restricted to relief which is no more than the capital they actually contribute to the trade. Some seek to avoid these restrictions by, for example, the use of limited or non-recourse loans to provide an amount which counts as

capital contributed but which is not in practice at risk in the way of ordinary capital.

Details of the proposed legislation

First, the legislation will provide additional restrictions on the amount of trading losses that some partners can set against their other income or gains.

The additional provisions will apply to the amounts a relevant partner may claim as relief for trading losses under:



section 380 ICTA 1988 – relief for trading losses against general income of the same or the preceding year of assessment;



section 381 ICTA 1988 – relief for trading losses incurred in the early years of a trade;



section 72 Finance Act 1991 – trading losses relieved against capital gains.

These are collectively referred to below as "relevant loss relief". A relevant partner for this purpose will be an individual who, on or after 2 December 2004, is:



a limited partner (as defined in Section 117 ICTA 1988);



a member of a limited liability partnership;



a general partner who does not spend a significant amount of time in running the trade (as defined in Section 118ZE and 118ZH ICTA 1988).

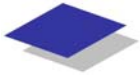
The provisions will apply to:



any individual who becomes a relevant partner on or after 2 Dec 2004 in respect of all trading losses that are allocated to him by the partnership of which he is a relevant partner; and



any individual who was a relevant partner on and before 2 Dec 2004 in respect of all trading losses that are allocated to him by the partnership of which he is a relevant partner, less that partner's share of the pre-commencement trading losses.



For this purpose:

the pre-commencement trading losses of the partnership will be the trading losses (if any) arising for any period (starting with the end of the last period of account of the partnership or the date that trading commenced if later) up to 1 December 2004, and will be computed as if that date were the end of a period of account;

the relevant partner's share of the pre-commencement losses will be the share of those losses specified in the partnership agreement existing at that date.

The provisions will ensure that a relevant partner's contribution to a trade, as it applies in s117(3), s118ZC(2) and s118ZG(1) ICTA 1988, will exclude any part of the amounts contributed to the extent that an agreement or arrangement exists under which the cost of providing those amounts is or could be borne by another person. Note that "another person" could be any partnership, whether or not the relevant partner is a partner of that partnership.

For the purposes of these provisions any individual who claims, or has claimed, relevant loss relief in respect of any period in which he or she was a relevant partner of a partnership, will be treated as if he or she were still a relevant partner, even if he or she has ceased to be so, and whether or not that partnership has ceased to exist or to carry on a trade; and all references to a relevant partner in this note should be read accordingly.

Provision will also be made to deal with circumstances where, at any time on or after 2 December 2004 (the "later time") after a relevant partner has made a capital contribution to a trade, the cost of providing any part (the relevant part) of the relevant partner's capital contribution to the trade, is borne by another person.

The following rules will apply:

where the relevant partner has not received relevant loss relief (either because no claim to relevant loss relief has been made or such a claim has been made and the claim can be amended) then the relevant partner's capital contribution to the trade will exclude the relevant part;

where the relevant partner has benefited from relevant loss relief then a reduced capital contribution to the trade ("reduced contribution") will be calculated by excluding the relevant part from the relevant partner's capital contribution to the trade. The relevant partner will then be deemed to have received an amount of income, chargeable to tax under Case VI Schedule D, at the later time equal to the amount by which the relevant loss relief exceeds the reduced contribution.

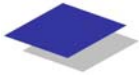
If a relevant partner borrowed (by any form of credit) in order to enable the partner to make a capital contribution to the trade and, if over any period of five years, the costs incurred by the relevant partner on that loan (or any loan that replaces that loan or is used to repay that loan) are not substantially the same as the costs on a loan on ordinary commercial terms, then a part, equal to the outstanding amount of that loan, will be deemed to have been borne by another person at a *later time*. A later time for this purpose is the end of the period of five years referred to above. But this will not apply where a partner has not borne the ordinary commercial costs of that loan on account of his inability to pay.

Second, further provisions will be made, in addition to those introduced in the Finance Act 2004, for individuals who have made film related losses (as referred to in section 119(1)(a) of that Act) sustained by them in a trade carried on in partnership.

These provisions will apply to contributions made on or after 2 December 2004 and to agreements and arrangements made after that date in respect of contributions made earlier. They will provide that:

an individual's capital contribution to the trade (as defined in section 121 Finance Act 2004) will exclude any amount to the extent that an agreement or arrangement exists under which the cost of providing those amounts is or could be borne by another person;

where an individual borrowed (by any form of credit) in order to enable the individual to make a capital contribution to the trade and, over any period of five years, the costs incurred by the individual on that loan (or any loan that replaces that loan, or is used to repay that loan) are not substantially the same as the costs on



a loan on ordinary commercial terms, then a part, equal to the outstanding amount of that loan, will be deemed to have been borne by another person at the end of the period of five years. But this will not apply where an individual has not borne the ordinary commercial costs of that loan on account of his inability to pay.

The proposed legislation will not have effect in relation to any part of an individual's capital contribution to the trade which is borne by another person in the normal course of that individual's domestic, family or personal relationships.

Child Trust Funds

The Child Trust Fund, announced in Budget 2003, is a new savings and investment account for children. Its aim is to ensure that all children have a financial asset behind them when they reach the age of 18. It will help encourage a savings culture for both families and children.

All children born since 1 September 2002, who live in the UK and have Child Benefit claimed for them, will receive at least £250 as an initial endowment; children from lower income families will initially receive £500. Family and friends can contribute up to £1,200 per year to each account. There will be no tax on any money earned in the account.

Child Trust Fund accounts will become fully operational on 6 April 2005.

Following extensive consultation, the Government published its detailed proposals for the Child Trust Fund in October 2003. This included an announcement that the Government will make a further top-up payment to every Child Trust Fund account when the child reaches the age of seven, based on the principle of progressive universalism – a flat rate payment to all children and an additional payment to children in families on lower incomes. As well as helping the accounts to grow, the top-up payment at age seven will encourage additional saving by family and friends and reinforce and support the delivery of financial education in schools by providing a relevant and practical example of saving.

The Inland Revenue will make special arrangements with local authorities to ensure that looked after children do not miss out on the age seven payment.

In the Pre-Budget Report, the Chancellor announced that the Government will now consult on the following issues:



Value of the universal age seven payment into Child Trust Fund accounts - when the Child Trust Fund was announced in Budget 2003, the value of the initial endowment to all children was set at £250. The Government would welcome views on whether £250 is also the correct value for the universal top-up payment at age seven.



Value of the additional payment to children lower income families at age seven - in Budget 2003, the Government announced that the value of the higher initial endowment to children in lower income families would be £500. Around 40% of all children will receive this higher payment - those children in families eligible for the full Child Tax Credit (with household income at or below £13,480 - the limit in 2004-05).



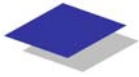
Additionally, the Government has said that children in low income families who qualify for full Child Tax Credit at the child's seventh birthday will qualify for the higher payment at age seven. The Government would welcome views on whether £500 is the correct value for the higher payment to children in lower income families at age seven.



Ratio of progressivity - based on initial endowments of £250 for every child and £500 for poorer children, the ratio of progressivity for the initial endowment into Child Trust Fund accounts is 1:2. The amounts the Government is consulting on for the age seven payment would imply a ratio of progressivity of 1:2. The Government would welcome views on whether 1:2 is the correct ratio of progressivity for the top-up payments at age seven.

HM Treasury is inviting views from industry, consumer organisations, charities and other stakeholders on these issues.

The value of the age seven top-up payments that will be announced will take into account the responses to this consultation.



Promoting Saving and Asset Ownership

The Government says that it seeks to provide targeted support and incentives for saving from childhood, through working life and into retirement. The Pre-Budget Report announces action to further promote saving and asset ownership in the following areas:

Individual Savings Accounts (ISAs)

When ISAs were introduced in 1999 they were guaranteed to run for ten years to 2009 and the overall annual investment limit was set at £5,000, with a maximum of £1,000 in cash. A higher initial annual limit of £7,000, with a maximum of £3,000 in cash, was extended until April 2006. The Government remains committed to ISAs and plans, subject to consultation, to further extend the existing higher ISA limits until 2009.

Matching savings of low-income savers through the Saving Gateway

The interim evaluation of the first Saving Gateway pilot found that the Government matching savings of low-income savers can be an important new dimension in Government support for saving, encouraging genuinely new saving. The Government will launch a larger, £15 million Saving Gateway pilot in 2005. The new pilot, run again with DfES, will investigate alternative rates of matching, measure the impact of matching for a wider range of income groups and will use the support of a wider range of community financial education bodies.

Stakeholder savings and investment products suite

The Stakeholder initiative will be implemented in April 2005, promoting access to a suite of simple, low-cost and risk-controlled savings and investment products. The Government will continue to consult with industry and consumer groups on the most effective way to market these products.

In addition, the Child Trust Fund becomes fully operational in April 2005; all children born since September 2002 will receive an initial £250 and children from low-income families will receive £500. The Government will now consult on a further universal payment of £250 at age seven, with children from low-income families receiving £500.

Promoting Financial Inclusion

Promoting Financial Inclusion, published today alongside the Pre-Budget Report, sets out a package of measures to tackle financial exclusion including a £120m Financial Inclusion Fund to support initiatives to tackle financial exclusion over the next three years, and a Financial Inclusion Taskforce chaired by Brian Pomeroy to oversee progress. The package includes measures to address financial exclusion in three specific areas: access to banking; access to affordable credit and access to free face-to-face money advice.

Access to banking

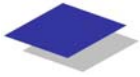
The banks and the government share the aim of reducing financial exclusion. They have agreed to work together towards the goal of halving the number of adults in households without a bank account, and of having made significant progress in that direction within two years. Developments will be reviewed at the end of the two-year period to see if further initiatives are needed.

Access to affordable credit

The Government will consider mechanisms whereby in certain circumstances, private and third sector lenders could apply for repayment to be made by deduction from benefit, in order to boost the ability of private, voluntary and community sector partners to offer affordable loans to those on the lowest incomes;



growth funding will be made available from the Financial Inclusion Fund to boost the coverage, capacity and sustainability of the not-for-profit, or 'third' sector in providing affordable loans to the financially excluded, subject to EC state aids approval;



- the Government will consult on moves to make it easier for credit unions to lend to more vulnerable individuals and those without a saving record;
- the Government will consult on the case for and practicalities of extending the Community Investment Tax Relief scheme to Community Development Finance Institutions specialising in personal lending, any action in this area will be subject to state aids approval; and
- reforms to the Social Fund will be implemented in April 2006, aimed at improving the consistency, transparency and effectiveness of the Fund in helping those people most likely to access high cost credit.

Access to free face-to-face money advice

Funding will be made available from the Financial Inclusion Fund to increase capacity in the face-to-face money advice sector and to pilot models of money advice outreach aimed at reaching those who do not normally present themselves to debt advisers.

Modernising the Business Tax System and Protecting Tax Revenues

The Government is taking forward further proposals to modernise the business tax system. A Technical Note, published today on the Inland Revenue website, covers a range of issues including reform of the schedular system for companies. The Government has also decided to align the tax treatment of leasing with other forms of finance and is consulting on the detail of the new rules.

A package of measures to combat tax fraud and avoidance was announced by the Chancellor.

Business Tax Reform

The Government has issued a Technical Note which takes forward its commitment in Budget 2004 to publish further legislative proposals on the reform of corporation tax, following the two measures (extension of

relief for management expenses and reform of the rules on transfer pricing and thin capitalisation) included in Finance Act 2004.

The Technical Note covers all three strands of modernisation initiated in the August 2002 consultation document *Reform of Corporation Tax*: reform of the schedular system for companies, the tax treatment of capital assets, and tax differences between trading and investment companies. It also takes forward the proposals on the taxation of leasing transactions outlined in the August 2003 consultation document *Corporation Tax Reform*.

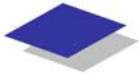
The Technical Note builds on the ideas developed in the previous consultation documents and those put forward by business during the consultation process. In particular, the discussion on the taxation of capital assets recognises the value that business places on the capital allowances system and the difficulties they envisage in using the accounts as a starting point for taxing profits on capital assets or giving appropriate relief for depreciation.

Principles of Corporation Tax Reform

As announced in Budget 2004, the proposals included in the Technical Note focus on those areas where the tax system may create unjustified barriers to modern commercial activity. This focus is consistent with the principles of competitiveness and fairness underlying the Government's reform programme so far.

Schedular Reform

The Technical Note sets out further proposals to modernise the schedular system for companies, including draft legislation covering the core elements. The changes would create a new source of income, with a single set of basic computational rules and a single set of loss relief rules, for the whole of a company's "operating business". The operating business would include trading income and expenses, letting income and expenses, and certain items of miscellaneous income currently within Schedule D Case VI. This would provide a more generous treatment for losses than currently available and would need to be balanced with effective provisions to prevent avoidance. In addition, changes would be made to the way tax relief is given for payments currently treated as "charges".



Taxation of capital assets

The Technical Note addresses the taxation of capital assets. As announced in Budget 2004, the Government has concluded that capital allowances should be retained, rather than being replaced by relief for commercial depreciation, but continues to consider ways in which the system could be modernised.

The Technical Note therefore discusses ideas for modernising the taxation of capital assets by building on those features of the capital allowances system valued by business. It also includes options to modernise the capital allowances system for cars. The Technical Note also discusses the treatment of abortive capital expenditure.

Leasing

The Technical Note sets out the Government's proposals to reform the tax treatment of leases of plant and machinery where they are essentially financing transactions ('funding leases').

The current tax rules treat loan finance and leasing finance differently even though the commercial effect – that the business uses the asset while another party finances its purchase – may be virtually the same.

The Government says that it is economically undesirable for the tax system to bias the decision between lease finance and loan finance. The Government has therefore decided to reform the taxation of leased plant and machinery, to ensure that the choice between different forms of finance is driven by commercial rather than tax considerations.

Trading and investment companies

The August 2002 and 2003 consultation documents discussed the differences in the tax treatment of trading and investment companies. Finance Bill 2004 modernised the treatment of management expenses so that relief is available to companies with investment business, regardless of whether they qualify as investment companies. Reform of the management expenses rules was identified by business as a priority during the consultation process.

The proposals on schedular reform set out in the Technical Note would be a further step forward in reducing these distinctions, bringing trading income and property investment income within the same 'operating business' source.

A further issue, highlighted by business, was the current scope of the substantial shareholdings exemption introduced in Finance Act 2002. In the light of the responses received, the Government will continue to consider the case for extending the exemption to disposals by shareholding companies that are not within the definition of a trading company (or a trading group). However, as the existing exemption has only been in effect since 1 April 2002, some of the behavioural consequences of its operation are just starting to be discernible. The Government says that it intends to keep the effects of the exemption under review.

In particular the Government would like to understand better the implication of any extension for the investment trust and venture capital industries. For example, a change might mean that some investment companies would choose to relinquish their approval status under section 842 ICTA. There might also be more general implications for the way venture capital investments are structured and for the effectiveness of the current tax-favoured venture capital schemes.

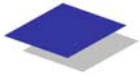
Therefore, the Government would like to use the opportunity of this round of consultation to explore further the behavioural effects of extending the exemption with the venture capital industry and others. The August 2003 consultation document made clear why the Government believed that:



the trading company restriction should not be removed for the company in which the shares are held; and



any extension to the exemption in the case of the shareholding company should not include close-investment holding companies.



Tax Difficulties for Small Businesses

At present, the interaction of the personal and corporation tax regimes can create different results for different legal forms, and behavioural responses can vary accordingly. In some cases these reflect genuine commercial differences but in others there may be a strong element of tax motivation.

The tax effects of the various legal structures available to small businesses are not necessarily straightforward, as they can vary depending on the specific circumstances of the business. The Government is concerned to ensure that entrepreneurs and their advisers are fully aware of the implications of adopting a specific legal structure.

The Government recognises that there are underlying tensions in the tax system. In looking at these tensions the Government will want to ensure that the tax regimes strike the right balance between promoting enterprise and growth and ensuring that everyone pays a fair amount of tax and NICs.

The current system can offer real benefits to a growing company by enhancing the post-tax return on early year profits. At the same time, to a hard working individual who has chosen to remain self-employed, the rules can in some circumstances appear to be giving an unfair advantage to those who have adopted company form for purely tax reasons. The Government wants to ensure that incentives for growth and enterprise do not come to be seen as unfair to others or unduly costly to the Exchequer. Accordingly, the Government would therefore like to invite comments from interested parties to inform its thinking on the strategic development of the personal and corporation tax regimes as they relate to small businesses:



How the government can improve targeting of incentives for growth and enterprise – for instance by adjusting the balance of tax and non-tax incentives;



Whether the Government should consider segmenting owner-managers of companies from other company owners for tax purposes;



how the trade offs between the different tax treatments for different types of business can be managed, including between meeting the objectives of minimising the economic costs of raising tax revenue, and of minimising compliance and administrative costs; and



whether and to what extent businesses would value the benefits of certainty and simplicity over specific incentive structures.

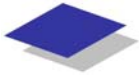
Capital Allowances

Renovation of business premises in disadvantaged areas

In his 2003 Pre-Budget Report, the Chancellor of the Exchequer announced that the Government would introduce a scheme: *Business Premises Renovation Allowance* (BPRA), which would provide 100 per cent capital allowances for the capital costs of renovating or converting unused business premises (*vacant for at least a year*) in disadvantaged areas.

Because BPRA would be targeted selectively on these 2,000 designated, disadvantaged areas in the UK, it would constitute a State aid. The Government is, therefore, in the course of discussing the State aid aspects of the scheme with the European Commission. Budget 2004 announced that, subject to State aid approval, BPRA will be introduced in 2005 and that the draft legislation would be published for public consultation.

The Government has designed a scheme that will be open to individuals and companies who own or lease business property that has previously been unused for 12 months or more. The scheme will allow them to claim upfront tax relief on all their capital spending on the renovation or conversion of the property in order to bring it back into business use. The property must be in a designated Enterprise Area and the capital allowances will be available to the person or company (whether landlord or tenant) who in fact incurs the capital expenditure - as a deduction from their trading profits.



The scheme will run for five years from the date of introduction, which has yet to be determined.

BPRA is intended to operate through the normal capital allowances system and may be claimed in the same way as other capital allowances. It is envisaged that there will be a box on businesses' annual income tax or corporation tax (as the case may be) self-assessment returns, which claimants should complete if they have incurred "qualifying expenditure" in any accounting period.





Consultation on these proposals will run until 1 March 2005 and the Government will then publish the results. It will consider the responses and, subject to that, will legislate to bring the scheme into operation following EC approval. The Government says that it will publish guidance on how it will operate before it comes into force.

Combining HM Inland Revenue and HM Customs & Excise

Details of a new small business unit that will transform tax administration for small businesses were announced by David Varney, Chairman of Inland Revenue and Customs and Excise.

The new unit will sit at the heart of HM Revenue and Customs (HMRC), and will champion the needs of small businesses. It will be charged with improving customer experience and compliance as well as reducing costs – for both businesses and HMRC – by eliminating unnecessary contact. It will ensure that the development and delivery of the tax system takes full account of the needs of small business and that necessary contact is handled effectively, efficiently and comprehensively. Theresa Middleton, a senior official with Revenue and Customs experience, has been appointed to lead the unit.

The longer-term goal for HMRC is to enable its support and compliance staff to take a "whole view" of each customer, tailoring the services provided and minimising the burden of compliance by providing:




-  joined-up systems so that business needs to provide information only once, when possible through a single form;
-  integrated audits covering direct and indirect taxes;
-  a single account through which all payments and repayments may be made;
-  streamlined and effective support and access to information in a way that better suits small business customers, including more effective use of information technologies and the internet.

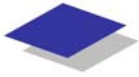
Further details of proposals to integrate and streamline services to small business will be published alongside Budget 2005, with a progress report in the autumn. A review of tax administration for medium-sized businesses will also start soon. The review will focus on future channels of communication between those businesses and HM Revenue and Customs.

The *Commissioners for Revenue and Customs Bill* which will provide the authority to integrate the Inland Revenue and HM Customs & Excise and create HMRC, was introduced to Parliament on 25 November.

Employment Implications

Gordon Brown's main points on employment matters were:

-  an increase in SMP for maternity leave (currently £102.80pw) from six to nine months, with a long-term aim of increasing it to a year;
-  paid maternity leave to be transferable from mothers to fathers; and
-  £50 per week tax-free childcare allowance for parents (as part salary).



Other Measures

Other measures announced on 2 December 2004, but not covered in detail here included:

Double Taxation Relief

The Government have issued a technical note on proposals for further Finance Bill legislation to clarify the way that relief is given for foreign tax paid on trade receipts.

The Government is also making changes to close down loopholes in CFC taxation rules with immediate effect. Details of a change to the way that underlying tax is calculated on dividends paid by CFCs are included in a separate note, which also includes a draft clause, on CFC taxation

Accrued income Scheme

The Accrued Income Scheme (AIS) is an anti-avoidance provision which prevents tax avoidance by individuals and trustees who buy and sell securities. The scheme is complicated and difficult to comply with easily, and there have been calls for it to be simplified.

Following an initial consultation process, the Government announced on 2 December 2004 that it is to proceed with reform of the AIS and is to consult on the fine detail of the reform, with a view to including legislation in the 2006 Finance Bill.

International Accounting Standards

The Government issued draft tax legislation and commentary on the tax implications of International Accounting Standards.

Universities and Research institutions

A Technical Note has been issued on new tax measures to help researchers acquiring shares in spinout companies created with universities and research institutions.

Please contact us if you require any further information on these aspects of the Pre-Budget Report.

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.

Important Notice

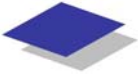
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Publication issued on: 2 December 2004

Ref: 691



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