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Stop Press - Budget 21 March 2007 - Corporation Tax and VAT Highlights

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The Chancellor in his Budget speech today announced a number of changes affecting the corporate world. In what is expected to be his last Budget, he opted for the headline grabbing reduction of the principal rate of corporation tax (but not quite yet) and also introduced a number of technical changes.

The key points of interest that companies, traders and their advisers should be aware of are set out below.

Corporation tax highlights

1. **Corporation tax rate**

With effect from 1 April 2008 the principal rate of corporation tax will be reduced to 28%. The small companies rate of corporation tax for profits lower than £300,000 will become 20% with effect from 1 April 2007. Where profits fall between £300,000 and £1,500,000 marginal relief from the full rate of corporation tax is granted. The fraction used is currently 11/400. Following the change to the small companies rate this fraction will be adjusted to 1/40.

The reduction in the principal corporation tax rate to 28% indicates that the UK is finally taking some action to compete with other EU jurisdictions that have lowered their tax rates on corporate profits in recent years. It may even act as an incentive for a greater use of the UK as a holding company location. This may be the case where a UK parent has underlying subsidiaries located in non-EU jurisdictions where the total tax rate is 28% or more taking into account local taxation on profits and withholding tax on dividends paid to a UK parent company. Although under current law inbound dividends to the UK remain taxable, if the combined rate of local tax on profits and withholding tax equals at least 28% then double tax relief should ensure that no UK tax will be payable on receipt of the dividend by a UK parent.

2. **Capital allowances**

Various changes are made to the existing capital allowances system. The temporary rate of 50% first year allowances for small enterprises is to be extended for another year. From 2008/09 the rate of writing down allowance on plant and machinery will be reduced to 20% from 25% and the rate of writing down allowance on long-life asset expenditure increases from 6% to 10%. Writing down allowances on industrial and agricultural buildings will be gradually phased out leading to their final withdrawal in 2010/11.

3. **Corporate capital loss and gain buying**

The Finance Bill will contain provisions designed to extend anti-avoidance rules contained in sections 184A and 184B TCGA 1992 designed to prevent groups of companies from securing a tax advantage in circumstances where a company changes ownership and one of the main purposes of the arrangement is that the new owners might gain access to capital losses or gains realised by that company.

4. **Loss buying**

The Finance Bill will contain provisions taking effect from 21 March 2007, designed to prevent companies buying the trading losses of corporate Lloyds members who are leaving the market and with which they have no previous economic connection. The intention is that companies will no longer be able to access group relief where there is a change in the group relationship after the losses are known, but before they are recognised for tax purposes as a result of the special Lloyds accounting system.

5. **General insurers reserves**

As announced in the Pre-Budget Report provisions in the Finance Bill will repeal the current rules dealing with the tax treatment of the reserves of general insurers. The current rules in section 107 Finance Act 2000 will be altered so that the amount of reserves that are allowed for corporation tax purposes are limited to an “appropriate amount”.

6. **Sale and purchase agreements (“Repos”)**

With effect from a date to be announced a new corporation tax regime will be introduced for repo transactions. Under the current legislation in Section 730A and 737C TA 1988, repos are taxed in accordance with their economic and accounting substance as financing transactions. The new rules will bring in a simpler accounts-based tax regime. Profits and losses made by companies from their repo transactions will be based directly on entries in accounts prepared under generally accepted accounting practice.

VAT highlights

1. **VAT registration and deregistration thresholds**

With effect from 1 April 2007 the registration threshold is increased to £64,000 from the previous figure of £61,000. Registration for VAT is compulsory when the value of 'taxable supplies' made by a business exceeds £64,000 at the end of any 12 month period. Alternatively, VAT registration is also compulsory where there are reasonable grounds for believing that the value of taxable supplies to be made in the next 30 days alone will exceed £64,000. (In broad terms taxable supplies are either standard rated supplies or zero-rated supplies made by a person in the course of a business. Standard rated supplies are subject to VAT at 17.5% and zero-rated supplies subject to a 0% rate.)

The threshold used for determining whether a person may deregister for VAT purposes is increased with effect from 1 April 2007 to £62,000.

2. **Transfers of going concerns**

Currently, under section 49 Value Added Tax Act 1994, where a business is transferred as a going concern the VAT records of the business are required to be preserved by the transferee instead of the transferor unless HMRC direct otherwise at the transferor's request. With effect from 1 [^^] September 2007 business records will normally be retained by the seller instead of the buyer of the business although the seller will be required to provide the buyer with the information needed to comply with VAT law. In the rare case where the buyer takes over the seller's VAT number then records will be transferred to the buyer.

3. **Joint and several liability**

Under Section 77A Value Added Tax Act 1994 HMRC are allowed to direct that a VAT registered business that receives certain goods from another VAT registered business is jointly and severally liable if they have reasonable grounds for suspecting that VAT would not be handed over to HMRC elsewhere in the supply chain. At present these provisions apply to telephones and computers and their parts and accessories. With effect from 1 May 2007 the types of goods covered will be extended to include certain types of electronic equipment of a kind ordinarily owned by individuals and used by them for the purposes of leisure, amusement or entertainment. It is also being made clear that the legislation extends to satellite navigation systems.

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