



Chancellor's emergency Budget 2010

KPMG Budget Report

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Our View



Anneli Collins
Head of Tax Policy

Overall the Budget is likely to get a mixed response from Business, with some winners and losers. However it is a good example of expectation management, since most will be left thinking it could have been worse.

In particular, the fact that the Corporate Tax reduction is not currently matched by substantial relief restrictions will lead many to breathe a sigh of relief.

However, companies should not feel too complacent; there are huge issues up for future consultation including a general reform of the corporate tax system, taxation of foreign profits, a possible general anti-avoidance rule and amendments to the research and development tax regime, so we should reserve final judgement until we see the full impact of the proposals. Still, at present, this Budget will be welcomed by many, since if taxes have to rise, many businesses would prefer it to be via indirect taxes like VAT (although here there will be some significant losers, such as retail).

All in all the Budget looks like good news for the UK's competitiveness. This will improve with the phased reduction in the main rate of corporation tax from 28 percent to 24 percent over four years, starting next year. And while the VAT rise is significant, it still leaves us firmly 'in the pack' compared to other EU countries (although again there are specific industries, such as leisure, that may be worse off comparatively).

The main proposals

The Chancellor's rule of thumb is that deficit reduction will need to be achieved based on the 80:20 rule, with 80 percent achieved through spending cuts and 20 percent from tax rises. The bulk of the tax rises will come through the increase in VAT to 20 percent from January next year from which the Chancellor hopes to raise about £12 billion annually.

In addition capital gains tax rates will rise from 18 percent to 28 percent for higher rate taxpayers – this is not as great an increase as was anticipated by many speculators before the Budget. The rate seems to have been chosen to maximise the tax take whilst still encouraging capital investment, and entrepreneurs will benefit from the increase in the lifetime limit to £5 million.

Against this, the UK's tax competitiveness for companies will improve with the phased reduction in the main rate of corporation tax from 28 percent to 24 percent by one percent for each of the next four years. Small companies will also benefit from a reduction in their rate to 20 percent from next April. These reductions are partly funded by reductions to capital allowances, with reductions in writing down allowances and the annual investment allowance – although the suggestion is that the corporation tax rate reductions should leave manufacturers better off overall. So far nothing has been said about interest restrictions, nor have R&D relief changes been announced, but the Chancellor has said there will be a full Corporate Tax reform review by the Autumn, including R&D and Capital Allowances, and consideration of whether a General Anti Avoidance Rule (GAAR) is needed.

Interestingly the previous Government's proposed increase to employers' National Insurance Contributions seems to be staying – but the revenue raised is to some extent offset by the increase in thresholds at which such contributions start to be made.

A number of measures were introduced as part of rebalancing the economy from over-dependence on London, the South of England and the financial services sector:

- a regional growth fund will be introduced to support business employment outside the south of England, where new businesses will get a substantial reduction in their employer's National Insurance Contributions.
- a bank levy based on balance sheets will be introduced from January next year. The intention is for the levy to encourage banks to move to less risky funding profiles, and further measures to address the high profile issue of bank bonuses will be consulted upon. Banks may be smarting at the combined effect of the levy and the VAT increases, but will benefit from lower headline tax rates – and simultaneous statements from the French and German governments suggest that UK banks are not going to be singled out in the international arena. They may though be worried about the hint of a further levy to come on remuneration following discussions at the G20.

The Chancellor has clearly picked up on the requirements for predictability, stability and simplicity in the UK tax system. Its full programme for reform will be set out in early autumn. It intends to move towards a more territorial basis for the taxation of foreign profits of companies, and to continue to counter tax avoidance. Consultation will take place in relation to the taxation of intellectual property and the part R&D tax credits can play in increasing innovation.

Economic Implications



Andrew Smith
Chief Economist

This is very much a kill or cure budget. The Chancellor announced the toughest fiscal squeeze since the war, aimed at correcting the current structural deficit in the public finances – the part which will not go away even when the economy is back firing on all cylinders – within the lifetime of the parliament.

The new measures come on top of tax increases and spending cuts already in the pipeline, in total amounting to 6 percent of GDP over the next five years.

But there is no certainty that private demand will bounce back to fill the gap left by these cuts. Sluggish personal income growth and inevitable public sector job cuts will constrain consumption at home, while weak growth in Europe will also limit export potential. With overall demand at best lacklustre, businesses may also be reluctant to invest.

So the hoped for rebalancing of the economy towards exports and investment still looks some way off. Against this background, monetary policy will have to stay loose to compensate for the tight fiscal stance for there to be any chance of meeting the official GDP growth forecasts of 1 ¼ percent this year, 2 ¼ percent in 2011 and around 2 ¾ percent a year thereafter.

Public Sector Implications



Alan Downey
Head of Public Sector

The Chancellor underlined in this emergency Budget in the starkest possible terms the scale of the crisis facing the public sector. At first glance the sheer extent of cuts and tax rises seems shocking, but the Chancellor ought to be congratulated on putting together a comprehensive and balanced package of measures.

Public sector jobs will inevitably decrease dramatically in the next few years as a result of the 25 percent expenditure cuts facing most public sector bodies – a topic avoided during today's speech. But the big question is: how can this rebalancing be achieved with minimum pain, cost and disruption? Often public sector employees leave one employer, only to be reemployed by another part of the public sector, which is simply wasteful and inefficient.

The government should set up a 'redeployment' scheme for public sector employees. If one organisation, needs to reduce headcount, the surplus staff should be 'recycled' into another school or council where there are vacancies, minimising job losses and the cost of redundancies dramatically.

The Chancellor missed the opportunity to use this Budget as a platform to set out a blueprint for a radical public sector reform. The real issue the country faces is how to bring about the fundamental changes in the way public services are provided.

In future public services need to deliver more for a lot less. We need to protect the services the public really values, rather than simply what they are used to getting. Demoralised public service staff and providers need to be re-motivated, and a sustainable culture of fast-paced and ambitious reform is required.

However, despite the cuts, there was one piece of really good news in the Budget – the Chancellor's capital spending plans. These will provide a boost to transport and the construction industry and be good for jobs and the economy.

The development of modern transport links and infrastructure is one of the biggest public policy issues of today. Our society needs reliable, low-carbon transport, sustainable energy and water solutions, and decent public services for our growing and ageing populations. The way our country deals with this issue will determine our future attractiveness and competitiveness.

By not slashing capital spending plans the Chancellor's has signalled the Government's belief in the link between infrastructure development and a strong economy.

Corporate Tax



Anneli Collins
Head of Tax Policy

From the Chancellor's Budget statement, it is clear that the Government has picked up on business's desire for predictability, stability and simplicity in the UK tax system. However, given the anticipated announcements on Corporation Tax reform such as potential restrictions on interest relief and losses and the move towards a more territorial system, little substantive detail was announced as to how these aims will be achieved – the full programme of reform will not be published until the early autumn.

The Government's view is that a broad tax base, a low rate and a more territorial approach will improve competitiveness. The announcement to reduce the headline rate from 28 percent to 24 percent over the next 4 years will clearly be welcomed in this regard – even though it is partly funded by the reduction in capital allowances. From 1 April 2012, WDAs will be reduced from 20 percent to 18 percent for the main rate pool (10 percent to 8 percent for the special rate pool) and the annual investment allowance will be reduced to £25,000 per year.

Another theme of the Chancellor's Budget is the desire to rebalance the economy from the dependence on the South of England-centric financial services sector. The introduction of a levy based on banks' balance sheets from 1 January 2011 is intended to encourage banks to move to less risky funding profiles and will represent a contribution in respect of the potential risks they pose to the wider economy.

The Government has also set out its intention to move towards a more territorial basis in relation to the taxation of foreign profits of companies. Consequently, over the summer, consultation will take place in relation to the Controlled Foreign Company regime to make interim improvements to make the rules easier to operate. These interim measures will be legislated in spring 2011 with more substantive reform anticipated the following year.

In addition, consultation will be launched to introduce a more territorial basis for taxing the profits of foreign branches and for retaining branch loss relief. Further consultations have been announced in relation to the taxation of intellectual property and the part R&D tax credits can play in increasing innovation. However, no formal announcements have currently been made as to restrictions on the availability of relief for interest.

The Government has produced a framework for making future tax policy which reiterates its desire for a simple, predictable and stable tax system. The principle is to be welcomed provided that consultations are carried out efficiently and lead to clear legislation within a sensible timeframe. As part of this process the Government is considering the case for a general anti-avoidance rule whilst maintaining its commitment to tackling avoidance schemes as they emerge.

Indirect Tax



Gary Harley
Head of Indirect Tax

The key indirect tax changes this time were the much heralded rate changes. The main one, of course, was the 2.5 percent standard rate VAT increase effective from 4 January 2011. In this, the UK are following the lead of Spain, Portugal, Greece and Finland, all of whom are set to increase their VAT rates from 1 July 2010. The six month lead up to the UK increase will be welcomed by businesses as it will give them time to amend systems and prepare for a new rate. It also gives consumers some breathing space in which to bring forward major expenditure, which in itself might give the economy a boost.

The increase will generate approximately £13bn a year. As VAT is such a major revenue raiser, the Chancellor felt that the increase was unavoidable if he is to show he is serious in tackling the budget deficit. But it would seem that, by going for a 2.5 percent standard rate increase, he has managed to preserve the current UK zero rate reliefs for food, etc, which will come as a great relief to lower income families for whom VAT is a proportionately greater cost. Apart from consumers, the main burden of the rate rise will be felt by charities and the exempt sectors such as finance and insurance for whom VAT is a cost.

However, the UK's rate will still be just below the EU average. It looks as though the complex anti-forestalling rules that applied when the rate reverted back to 17.5 percent in January 2010 will apply again to prevent businesses crystallising advance tax points and applying 17.5 percent to transactions that will not actually take place until after the rate change, except in very limited circumstances. As was the case in 2010, businesses will have to cope with a rate change and some place of supply changes at the same time, as the second part of the VAT Package comes into effect on 1 January 2011.

In order to retain parity between the taxes, the higher rate of IPT that applies to travel insurance and extended warranties sold with some consumer goods, must also increase to 20 percent on 4 January 2011.

The standard rate of IPT increases by 1 percent to 6 percent on the same date. There are already measures to prevent avoidance between now and 4 January 2011.

Most of the other Budget measures were reiterations of announcements made in the March 2010 Budget.

Employee Issues



Ian Hopkinson
Head of Employee Tax

Employers will be disappointed, if not surprised, that the increase in National Insurance Contributions (NICs) of 1 percent for employees and employers will be going ahead from 6 April 2011. This is to some extent mitigated by the announcement that the level at which employers start to pay NICs will increase by £21 per week above indexation. The cost of the combined measures will therefore be disproportionately borne by businesses employing relatively higher paid employees, but some sectors, including manufacturing, will benefit.

The Government has also announced a three year scheme whereby, in targeted regions, new businesses will be exempted from up to £5,000 of class 1 NICs for each of the first 10 employees hired in their first year of business. The countries and regions that are covered comprise Scotland, Wales, Northern Ireland, the North East, Yorkshire and the Humber, the North West, the East Midlands and the South West. This is a welcome measure and will hopefully encourage the establishment of new businesses in these areas.

The position on pensions tax relief for higher earners is still very unclear – and 6 April 2011 looms ever closer. This Government has announced that it is inclined towards a simpler approach than that favoured by the previous Government; in particular, it is attracted to setting a lower annual allowance of £35,000 – £45,000. Employers, the pensions industry and all those individuals affected will be hoping that this key issue is resolved speedily and that common-sense is applied so that the new regime is as administratively straightforward as possible. At the same time the Government has confirmed that, for those higher earners looking for an alternative to pension saving under the registered regime, it intends to include Employer-Financed Retirement Benefit Schemes within the scope of (as yet unspecified) anti-avoidance legislation to take effect from 6 April 2011.

On capital gains tax, the headline rate for higher and additional rate taxpayers rises from 18 percent to 28 percent. This will negatively impact the attractiveness of HMRC approved employee share schemes and will be disappointing for employees who will have seen a rise in their capital gains tax rate from an effective rate of 10 percent (after two years of business asset taper relief) to 18 percent and now to 28 percent.

The Government has announced that it will be exploring how the PAYE system could be improved to reduce costs and make the system easier for employers and HMRC to administer. This is to include consultation on approaches that could support more frequent or real time PAYE data. This is a welcome move and we shall await further details with considerable interest.

Finally, the Government has said that it remains committed to a review of the IR35 rules for those operating through personal service companies. It will be interesting to see what emerges from the review – anything that simplifies the position will surely be most welcome.

Personal Tax



David Kilshaw
Head of Private Client

If there was one thing everyone knew before going into the budget, it was that the rate of capital gains tax was going to increase. The only questions were how the government was going to implement this and by how much the rate would rise? Now we have the answer. The government is returning to the system of two rates of capital gains tax, depending on income, that the previous Conservative Government introduced in 1988. However, the rates will not increase to the level of income tax rates, instead they are being kept at 18 percent for basic rate taxpayers and rising to 28 percent for higher rate taxpayers. The big surprise for many is that these rates will apply to all disposals made after midnight tonight.

The 28 percent rate of capital gains tax will also apply to disposals made by trustees. Furthermore, hidden in the detailed press notes is the fact that those who pay the £30,000 remittance basis charge will also pay capital gains tax at 28 percent, regardless of their income levels.

There was some speculation that the capital gains tax annual exemption might be reduced, but the Chancellor has opted to maintain its current level of £10,100 and to continue linking it to inflation.

The other major question going into the budget was how generous the 'generous exemptions' for business assets would be and what was meant by 'business assets.' It appears that the definition of 'business assets' will not be altered from that already in place and that Entrepreneurs' Relief will be extended to cover the first £5 million of qualifying gains over a lifetime. This new lifetime limit will also apply from midnight tonight.

Prior to the Budget many individuals were concerned that the relief from capital gains tax on the disposal of their main residence might be removed. These fears appear to have been unfounded and the exemption remains.

The Coalition Agreement positioned the capital gains tax increase as a way of paying for the increase in the income tax personal allowance, with a target for the personal allowance of £10,000 by the end of the Parliament. In a first move towards this, the personal allowance will increase to £7,475 with effect from 6 April 2011. On the Government's figures, the predicted extra revenues from capital gains tax are under a quarter of the personal allowance increase. Much of the remaining cost will be recovered by reductions from 6 April 2011 in the higher rate threshold, which will pull more people into the higher rate tax net.

Further, it seems that there are no plans to reverse the withdrawal of personal allowances for those with income in excess of £100,000. This is disappointing given the effective marginal rate of income tax of 60 percent that is created by the withdrawal mechanism.

As expected from the Coalition Agreement, the Labour Government's announcements with regard to employee's National Insurance will be introduced with limited change. This means that for 2010/11 the NIC rates and thresholds will, with two exceptions, remain unchanged from the 2009/10 figures. However, from 6 April 2011 the main rates of Class 1 and Class 4 NIC will be 12 percent and 9 percent respectively; and the higher rate of Class 1 and Class 4 NIC will be increased to 2 percent.

The rate of employee and employer contributions will rise by 1 percent with effect from 6 April 2011. This is mitigated to an extent by the fact that the threshold at which employers will start to pay National Insurance Contributions will increase by £21 to £131 per week with effect from 6 April 2011.

The review of the complicated legislation intended to withdraw higher rate relief for pension contributions from higher earners will be seen as a relief to many. The Government intends to maintain the revenue yield, but is prepared to achieve this in a simpler way if possible, such as the implementation of a lower annual allowance.

The Labour Government's plans to abolish furnished holiday lettings have been abandoned, with a public consultation to be announced before any changes are made to the existing legislation. These appear likely to reduce the cost of the relief. In the meantime, for 2010/11 the reliefs for furnished holiday lets remain available for those properties in the UK and Europe that meet the strict qualifying conditions.

Finally, the confirmation of a review of the taxation of non-domiciled individuals will be viewed by many with trepidation. This community is still reeling from the complete overhaul of the remittance basis in 2008 and it is to be hoped that any further changes to this very complex legislation will only be introduced following detailed consultation.



Top 9 Measures

Corporation Tax Reform

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The Government has set out a high-level roadmap of corporation tax reform, setting out a number of key measures, including:

- A phased reduction in the corporation tax rate from 28 percent to 24 percent partly funded by reductions to capital allowances (small profits rate of corporation tax reduced to 20 percent);
- A reduction in the rates of writing down allowances for new and unrelieved expenditure on plant and machinery from 20 percent to 18 percent for the main pool (and from 10 percent to 8 percent for the special rate pool), and a reduction in the Annual Investment Allowance from £100,000 to £25,000 per annum;
- Full reform of the Controlled Foreign Company (CFC) rules, with consultation on interim improvements;
- Consultation on a move towards a more territorial basis for taxing profits of foreign branches including the scope for branch exemption and retention of branch loss relief;
- A consultation with business to review the taxation of intellectual property (IP) and the support research and development (R&D) tax credits provide for innovation and the proposals of the Dyson review;
- The formation of a business forum, chaired by the Exchequer Secretary, to consult with multinational businesses on the UK's tax competitiveness including the long-term aims of reform of the corporate tax system.

Who is affected

All taxpayers are affected – in particular multinational businesses.

Timing

The main rate of corporation tax will be reduced to 27 percent for the financial year commencing 1 April 2011, with further cuts of 1 percent

per year until 2014-15 (with the rate then remaining at 24 percent for future years).

The reduction in capital allowances rates and the annual investment allowance will take effect from 1 April 2012.

Full reform of the CFC rules is to be completed in spring 2012, with consultation taking place over the summer on interim improvements to be introduced to the CFC rules in spring 2011.

The consultation with business to review the taxation of IP and R&D tax credits will take place in autumn 2010.

Finally, a more detailed programme for reform of the corporate tax system will be set out in the autumn.

Our view

Whilst details of the proposed consultations are very limited, the Budget commentary does confirm the core aims of the Government in relation to corporate tax reform: greater certainty, simplicity and improved competitiveness.

The reduction in the corporation tax rate is a welcome measure, although the benefit of the reduction is to be phased over the next four years rather than introduced with immediate effect as indicated pre-election. The required reduction in rates of capital allowances partly to fund this rate reduction is not as radical as feared, which is encouraging and in line with the Government's pledges to protect industry. There is no comment on any restriction on the deductibility of interest. To the extent that this is a measure that the Government is considering, our view is that it will be critical to allow for detailed and wide-ranging consultation on this specific matter rather than it being one of many proposals in the wider and more general discussions on reform.

It is pleasing to see that the Government proposes to consult fully and widely with business on wider corporation tax reforms. To the extent that this signals a bolder and more holistic approach to the corporate tax regime we consider this announcement encouraging but consultation should be efficient and move towards legislation in a sensible timeframe.

It is positive also to see the Government's commitment to CFC reform, although it is disappointing that after a consultation period stretching back to 2007 the implementation of the reform is to be delayed by yet another year to 2012. It is hoped that this Government will tackle the cost and administrative burden of complying with the rules when implementing both the interim measures and the reform itself.

We welcome the decision of the Government to consult with business to review the taxation of IP and R&D tax credits before deciding upon any

changes and we will participate fully in such consultations. Finally, whilst there was no announcement, the Red Book makes reference to the potential introduction of the patent box regime. Whilst the proposal is included as one of many previously announced measures the Government now confirms will be implemented, the wider consultation on IP may mean this will be revisited.

Bank Levy

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

An annual levy is to be imposed on UK banks and overseas banking groups carrying on business in the UK.

The levy will be based on total liabilities excluding Tier 1 capital, insured retail deposits, repo secured on sovereign debt and policyholder liabilities of retail insurance businesses within banking groups.

The levy will be set at 0.07 percent, with a lower initial rate of 0.04 percent in 2011. There will be a 50 percent reduced rate for longer maturity wholesale funding (i.e. greater than one year remaining to maturity).

The levy will not be deductible for corporation tax purposes.

Who is affected

UK banking groups and building societies, UK branches and subsidiaries of foreign banks and banking groups, and UK banks in non-banking groups, where the relevant aggregate liabilities amount to £20 billion or more.

Timing

The bank levy will take effect from 1 January 2011.

Our view

The International Monetary Fund (IMF) submitted an interim report on a financial levy for banks to the G-20 Ministers in April 2010. Initial feedback from the G-20 Finance Ministers' meeting in South Korea suggested that it may be difficult to reach agreement on a global approach to a bank levy. While the position is still to be discussed in the G-20 summit meeting on 26 June, the UK Government has decided to adopt a unilateral approach, albeit with similar commitments from France and Germany. The balance sheet approach is similar to the Financial Crisis Responsibility Fee proposed, but yet to be enacted, in the US. The UK will also continue to consider the option of a Financial Activities Tax, based on profits and remuneration, in consultation with international partners.

The levy raises a number of issues:

- To what extent will this unilateral approach result in foreign banks moving business out of the UK (e.g. to Asia) to reduce the impact of the levy? This may be more difficult for UK headquartered banks given the consolidated balance sheet approach, absent a complete migration overseas.
- For UK banking groups with overseas subsidiaries or branches in countries that may levy a similar balance sheet tax (e.g. US, France, Germany) there is a real risk of double taxation as the levy will not be covered by tax treaties.
- The announcement suggests unequal treatment for non-banking entities (e.g. insurance companies and asset managers) that are part of a banking group as compared with stand-alone entities.
- The Bank Payroll Tax regime introduced both significant uncertainty in determining the scope of the regime and an additional compliance burden. The £20 billion balance sheet test is welcome in excluding many of the smaller banks. However, yet another tax regime for banks is an unwelcome compliance burden. In particular, foreign banks with UK branches will need to pay close attention to their capital attribution methodology.
- The levy is designed to encourage banks to increase retail funding with a likely increase in rates offered. The higher funding cost is likely to filter through to the asset side.

The levy is subject to a summer consultation process and we hope that many of the above problems can be resolved during this period.

Announcement of a consultation on a General Anti-Avoidance Rule (GAAR)

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The Government has announced that it will consider whether a General Anti-Avoidance Rule (GAAR) should form one element of strengthened tax anti-avoidance measures.

Who is affected

All taxpayers are potentially affected.

The impact will depend on the exact form and scope of the GAAR, if implemented; if its scope is poorly defined, taxpayers may need to consider it prior to entering into nearly all transactions.

Timing

HMRC have announced that they will engage informally with interested parties over the summer to explore whether there is a case for developing a UK GAAR.

Our view

This measure was widely anticipated. In the Coalition Agreement, the Conservative and Liberal Democrat parties confirmed their commitment to tackling tax avoidance and stated that there would be detailed development of the Liberal Democrat proposals in this area.

Immediately prior to the election, Vince Cable set out his party's proposal to introduce a General Anti-Avoidance Principle (GAAP) to ensure tax is paid in accordance to the spirit of the law and not just the letter of the law. He also proposed a pre-clearance procedure through

HMRC for companies to check the tax liability of a transaction before it is undertaken.

The proposal to consider the introduction a single, universal GAAR does seem to support the Government's commitment to simplify and reform the tax system and tackle what it perceives to be unacceptable tax avoidance.

However, if the objective of the GAAR is to reduce complexity, its introduction should be coupled with the repeal of the many and complex specific targeted anti-avoidance rules already in place. It is far from clear that the Government will take this approach.

Furthermore, even if a GAAR is introduced as a replacement to existing targeted anti-avoidance measures, there remains the risk of further complexity and uncertainty unless the following points are clearly addressed:

- definitions of key terms which the GAAR seeks to employ, for example, 'tax avoidance' must be sufficiently clear to provide certainty as to the GAAR's scope to taxpayers
- if a purposive approach to applying the GAAR is to be adopted, its intention must be clear and applicable to the arrangement in question. Currently much tax legislation passes through Parliament without debate, and the application of the legislation is often based on secondary legislation and HMRC guidance so that Parliament's intention is not clear. In addition, the position of transactions that are not within the contemplation of Parliament at the time the GAAR is introduced, and therefore not within its original intention, would also need to be addressed.

To the extent that a GAAR is introduced, we would welcome the establishment of a clearance mechanism. However, this would, in our view, require a comprehensive change to the administrative system; both to ensure that clearances are provided on a timely basis and also to provide proper recourse to a taxpayer in the event of a clearance being denied. On the second of these points, aside from recourse to the Tribunals the only option currently available to taxpayers wishing to challenge HMRC decisions is judicial review. Judicial review is no substitute for a proper appeals process; the taxpayer can only turn to it if all other remedies have been exhausted, yet it must do so within three months of the decision being given, and the taxpayer must demonstrate that the decision was wrong and unreasonable.

VAT: Change of Standard Rate

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The standard rate of VAT will increase to 20 percent.

Who is affected

Individuals and businesses unable fully to recover the VAT they incur on purchases will be directly affected.

Individual consumers are likely to see the prices of standard rated goods and services increase. Sectors such as financial services, charities and educational establishments will be particularly badly hit as the irrecoverable VAT they suffer on standard rated goods and services will increase.

Goods and services on which VAT is not currently charged will remain unaffected. These include items such as food, children's clothing, books and supplies connected with charities which are zero rated as well as certain exempt services such as education, finance, health and welfare and land.

Timing

The new rate will come into effect on 4 January 2011.

Our view

An increase in the standard rate was almost inevitable. The UK's last VAT increase was back in 1991 and the UK currently has the third lowest standard rate in the EU.

The increase to 20 percent will still leave the UK below the EU average, which by January is expected to be at least 20.36 percent. In addition with the lowest possible reduced rate of 5 percent and extensive zero rating, the Government will no doubt be keen to point out that UK consumers will still be paying less VAT than their European counterparts.

One of the alternatives to increasing the VAT rate would have been to broaden the scope of VAT by narrowing the scope of the UK's zero

rating. However an increase in the standard rate is simpler and, once effective, will have an almost immediate impact on revenue.

The introduction of the rate increase on 4 January 2011 will give businesses more time to prepare for the required changes than the temporary VAT decrease announced in 2008. However, this timing decision has probably more to do with giving the economy more time to continue its recovery rather than reflecting the needs of business. Retailers however will not welcome the timing of the change. The previous reversion to the current standard rate on 1 January 2010 was widely criticised by the retail sector as it impacted on January sales.

Once again businesses will need to configure ERP and accounting systems to accommodate the change. Businesses should consider the extent and how quickly they pass costs on to their customers. Retailers are likely to pass on the increase quickly.

However, any business which incurs irrecoverable VAT will see an increase in costs and will have to consider whether to suffer this cost or pass it on to its customers in the form of increased prices.

In the VAT exempt sector, financial institutions, charitable organisations, educational establishments and other public service providers may wish to review their planned future expenditure. Accelerating expenditure projects before the VAT rate increase on 4 January 2011 will lead to an overall reduction in the irrecoverable VAT they incur but it appears that the same wide reaching anti-forestalling provisions will apply as applied to the 2010 rate increase. So it seems that merely advance invoicing or prepayment will not be effective as opposed to advancing the supply of the underlying the goods and services.

Increase in the Insurance Premium Tax (IPT) Rates

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The standard rate of IPT will increase to six percent and the higher rate to 20 percent.

Who is affected

Insurers, insurance intermediaries and insureds.

Timing

The increase in the IPT rates will take effect from 4 January 2011. Legislation will be introduced in the Finance Bill 2010 to provide for the rate increase.

For insurers using the Special Accounting Scheme, the new rates will have effect for premiums (received under taxable insurance contracts) that are written into their records as due to them on or after 4 January 2011.

For insurers using the Cash Received method, the new rates will have effect for premiums (received under taxable insurance contracts) on or after 4 January 2011.

Anti-forestalling provisions are already in place to prevent tax avoidance. These provisions apply to both accounting schemes and in relation to defined advance payments and extended cover.

Our view

The rise in the standard rate is not unexpected.

The current five percent rate is one of the lowest across Europe, therefore a rise is to be expected. Further rate rises cannot be ruled out, given that the average European IPT rate is ten percent. This rise will inevitably result in a premium increase for insureds, with the

consequence being that some may fail to take out or renew essential, and often compulsory, insurances.

The increase in the higher rate of IPT moves in line with the increase in the standard rate of VAT to discourage VAT Avoidance.

Adjustments to National Insurance Contributions

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The previously announced increases to employee and employer National Insurance Contributions (NIC) rates remain in force. It was widely expected that the employer contribution rise of 1 percent would not happen. But in fact both employee and employer contributions will rise by 1 percent with effect from 6 April 2011.

Therefore employee contributions between the lower and upper earnings threshold will rise to 12 percent, and to 2 percent for earnings above the upper earnings threshold.

The employer contribution rate increases from 12.8 percent to 13.8 percent. This is mitigated, to an extent, by the fact that the level at which employers will start to pay NIC will increase by £21 per week above indexation from 6 April 2011. The value of indexation will be determined by data available in the autumn.

Who is affected

Employers and employees.

Timing

The new rules will take effect from 6 April 2011.

Our view

The Government is continuing with the previously announced changes in NIC. Clearly, this will be felt by employees in their take home pay although the lower paid will be assisted by the increase in the personal allowance from £6,475 to £7,475. Although the effect for employers is somewhat mitigated by the increase in the level at which they start to pay NIC, it will still represent a real increase in employer costs for many employers. Whilst this will have assist those employing relatively large numbers of lower paid workers it will be of rather less help to other employers.

HMRC Treasury Document – Restricting pensions tax relief

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

Under existing legislation, pensions tax relief will be restricted for those with gross incomes of £150,000 and above from tax year 2011/12 onwards.

The government has now said that it will consider proposals to replace this measure with a reduced annual allowance on the value of pensions savings that can benefit from full marginal rate relief. An annual allowance in the region of £30,000 to £45,000 is suggested as a possible alternative in order to ensure that the same tax yield is generated.

Adopting this alternative approach will be subject to resolution of a number of key issues. These include consideration of ways to place a value on defined benefit pension accrual, and protection of basic rate individuals and those experiencing a one-off spike in pension accrual.

Who is affected

This is uncertain until proposals are finalised. However, the likelihood appears that it will affect those with annual pension savings valued in excess of an allowance set somewhere in the range of £30,000 to £45,000. This implies many more people being subject to some restriction of their pensions tax relief – though this restriction would be far less penal than the existing legislation as far as those with gross incomes over £150,000 are concerned.

Timing

No timing is given for the review process. Repeal of the existing measures will take place only when the government has decided on the detail of its approach.

Our view

We welcome the Government's decision to consider an alternative to the existing tax relief measures, which are widely seen as inequitable, burdensome on employers and pension schemes, and likely to be highly damaging to UK pension provision. However, the alternative approach would nonetheless impose a new tax burden on a far greater number of people and could still add greatly to employers' and pension schemes' costs if ways are not found to avoid administrative complexity. If the government does proceed with a greatly reduced annual allowance, we would argue strongly that the legislation should include a robust statutory indexation basis that could be seen to steadily reduce the impact of the measure over time.

The personal allowance, basic rate limit and national insurance thresholds for 2011-12 – BN01/PN02

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

The income tax personal allowance for those aged under 65 will be increased from £6,475 to £7,475 with effect from 6 April 2011. The basic rate limit for income tax (the amount above which higher rate income tax at 40 percent is payable) will be reduced to ensure that higher rate taxpayers do not benefit from this increase. HM Treasury suggest that this may be a reduction of around £2,500 although the precise reduction will not be known until the retail prices index figure for September is available.

A commitment to increasing the personal allowance to £10,000 over the course of the Parliament has also been announced.

HMRC state that the Upper Earnings/Profits Limit ('UEL/UPL') for national insurance will continue to be aligned to the higher rate threshold for income tax. HM Treasury, however, state that the national insurance threshold may not be decreased by as much as the reduction to the basic rate limit.

The secondary threshold for national insurance which governs the point at which employer's national insurance is due will be increased by £21 per week above inflation (see commentary in Key Measure – Adjustments to National Insurance Contributions).

Who is affected

This is relevant for individual taxpayers.

Timing

These changes will be introduced with effect from 6 April 2011. Details of the thresholds will be released in the autumn.

Our view

It is encouraging to see increases to the income tax personal allowance announced after the allowance was frozen for the 2010/11 tax year. However, while the proposed increase in the personal allowance will benefit many taxpayers, only those on low and middle incomes are likely to benefit given the proposed changes to the basic rate limit and national insurance. Until the thresholds and limits are published later in the year, precise detail on winners and losers will be uncertain.

Employers will benefit from the increase to the secondary threshold. However, the 1 percent increase in national insurance rates for both employees' and employer's national insurance announced in March is still to be introduced. The national insurance rates for the self employed will also be increased by 1 percent.

It appears that there is some confusion between HM Treasury and HMRC on whether the link between the UEL/UPL and the basic rate limit will be maintained. This may be due to the fact that a pound for pound reduction would mean that whilst the 40 percent income tax rate would be triggered at a lower threshold, at the same time taxpayers would benefit by the lowering of the income level above which national insurance reduces from 11 percent to 1 percent (12 percent to 2 percent from April 2011).

It is disappointing that the withdrawal of personal allowances for those with income over £100,000 has been retained. Combined with the increase in the personal allowance, this gives rise to an effective marginal rate of tax of 60 percent (62 percent including national insurance for earnings) on income between £100,000 and £114,950 with effect from 6 April 2011.

Capital Gains Tax and Entrepreneurs' relief

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

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The issue

As widely expected, the Capital Gains Tax ('CGT') rate was increased in the Budget. As under the previous Conservative Government there will be different rates for basic rate and higher rate taxpayers. However, contrary to many predictions the rate will not follow income tax rates exactly, with CGT being kept at 18 percent for basic rate taxpayers up to any unused basic rate band and rising to 28 percent for higher rate taxpayers.

Entrepreneurs' Relief is to be extended so that the first £5 million of gain will be taxed at 10 percent. The £5 million limit is a lifetime limit.

The conditions for qualifying for Entrepreneurs' Relief are complex and there are a number of conditions which must be met but, broadly, the following assets would qualify for the relief:

- the whole or part of a business(as defined for this purposes) as a going concern;
- disposals of assets, or interests in assets, which were used for the purposes of the individual's business that has now ceased, provided they were in use for those purposes at the time of the cessation;
- shares or securities of a company or of an interest in such shares and securities; and
- assets used in a partnership or company if the disposal coincides with the individual's withdrawal from the partnership or with the sale of their shares in the company.

In most cases the assets must have been held for at least one year and, in the case of shares, the individual must for the same period also:

- own at least 5 percent of the ordinary share capital and have at least 5 percent of the voting rights; and
- be an officer or employee (full or part-time) of the company, or one of the companies in the group.

Trustees will pay CGT at 28 percent (except where they qualify for Entrepreneurs' relief) and non-domiciled individuals who pay the remittance basis charge of £30,000 will also always pay CGT at 28 percent regardless of their income levels.

Who is affected

Individuals disposing of capital assets and those with shareholdings/interests in businesses that meet the qualifying conditions for Entrepreneurs' relief.

Timing

The new rates (and the extended relief for business assets) will come into effect from midnight on 22 June 2010.

Our view

It is a surprise to no-one that the rate of capital gains tax has risen, but it will nevertheless be a disappointment to many, particularly as there is to be no relief for inflation. The CGT rate for some assets will have risen from 10 percent in 2007/08 to 28 percent now. Such frequent changes in CGT could discourage capital investment since taxpayers do not know what percentage tax rate to expect when disposing of assets, so it is to be hoped that taxpayers can now expect a period of stability now.

The Coalition Agreement promised 'generous exemptions' for 'business assets' and it is now clear that this meant extending Entrepreneur's Relief. It is pleasing to see the extension of Entrepreneurs' relief to the first £5 million of lifetime gains. Unfortunately, this relief still appears too narrowly focused and will not apply to many assets which would have qualified for business asset taper relief, one example is EMI option holders and employees who hold shareholdings of under 5 percent with less than 5 percent of the votes.

Despite much lobbying from the British Venture Capital Association, the Chancellor does not seem prepared to extend Entrepreneur's relief to Private Equity style investments. It is also disappointing that many employees will not qualify for relief in respect of shareholdings in their employing groups and the disposal of assets used in a business will not qualify unless the whole or a part of the business is also sold.

There had been much speculation that the relief from CGT on any gain on an individual's main home (known as principal private residence relief) would be withdrawn, but there has been no such announcement and this exemption remains unchanged.

In addition, the annual exemption will not be cut as speculation suggested but will remain at £10,100 and will continue to rise in line with inflation.

The emergency Budget Report proposals and other tax changes are summarised on these pages. The emergency Budget Report proposals may, however, be amended significantly before enactment. The content of this communication is intended to provide a general guide to the subject matter and should not be regarded as a basis for ascertaining liability to tax or determining investment strategy in specific circumstances. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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