

Another Budget Bombshell!

The annual budget in March 2006 introduced such far reaching capital tax changes that taxpayers might have hoped to have a respite for quite a while from further shocks of that type. Unfortunately yet more unexpected changes of wide impact were announced in the Pre Budget Report in October this year, just over two months after the 2007 Finance Act received the Royal Assent, so taxpayers clearly need to be prepared for the unexpected at any time.

The changes were in two main areas, one being capital gains tax and the other the tax treatment of those not domiciled in United Kingdom.

Capital Gains Tax

One of the announcements was that there was to be a major reform of the capital gains tax regime as it applies to individuals and trusts. Companies are not affected, and so they will continue to be taxed under the capital gains tax regime which applied generally up to 1998.

The main proposal is that, with effect from the fiscal year 2008/09, there will be a single flat rate of capital gains tax in place of the current structure by which gains are normally taxed at either 20% for basic rate tax payers or 40% for higher rate tax payers. The flat rate proposed is 18% but all the taper relief rules introduced in 1998 are to be abolished and indexation relief is also to be withdrawn.

It will be recalled that taper relief operated to reduce chargeable gains by reference to the period of years for which the asset concerned had been held; for business assets the maximum rate of taper was 75% after only two years of ownership and for non-business assets the maximum rate was 40% after 10 years of ownership. Indexation relief was broadly designed to uplift base costs in assets to reflect retail price inflation over the period that the particular asset was held. This relief was contingently frozen as at April 1998 for the benefit of assets acquired before that time but disposed of subsequently. The contingent relief will be abolished from 6 April 2008.

The final change announced in the Pre Budget Report is that, where an asset was first acquired into current ownership before 31 March 1982, the original historic cost of the asset will no longer be relevant for capital gains tax purposes and all computations for 2008/09 onwards will be based upon the March 1982 valuation of the asset, even if that valuation is lower than the original cost.

In broad terms these changes are likely to have an adverse impact on those who have held a particular asset over many years and where that asset has a comparatively high base cost. Any asset owned since before March 1982 currently benefits from an uplift in the base cost of approximately 104% under the indexation relief rules and there will undoubtedly be cases where the reduction in the rate of capital gains tax to 18% will not be adequate compensation for the loss of indexation relief. An example of those likely to be worst affected is farmers who have owned agricultural land since 1982. The 1982 base cost of farmland is comparatively high by reference to today's values and in addition the land will often currently qualify as a

business asset for taper relief purposes. The loss of both reliefs is likely to give a much higher tax charge on disposal of the land.

Those holding shares in unquoted trading companies will also be adversely affected as, under the taper relief rules, the effective rate of capital gains tax on the shares is currently a maximum of 10% after two years ownership; this will increase to 18% after 5 April next year.

Many representations have been made to the Government about the unfairness of these unexpected changes in a variety of circumstances and it is to be hoped that the Chancellor will see fit to introduce some amendments to his proposals before April next year. Draft legislation for the new capital gains tax regime is expected in the next two months or so and by that time we could also hope to have some response from the Chancellor for the representations made.

It is clear that all those who hold assets potentially within the capital gains tax regime should have their tax position carefully reviewed well before April next year. It may be advisable to take the benefit of the current tax rules before that time; this does not necessarily mean selling the assets concerned, as there can be a benefit in arranging a simple transfer between husband and wife, or in other cases the assets could be put into a trust with advantageous capital gains tax results.

Non-Domiciliaries

Individuals who are not domiciled in the United Kingdom, although resident here, currently enjoy tax privileges in this country which are understood to be unique in Europe. Any foreign income or capital gains which they may have are not taxable in the United Kingdom unless the funds concerned are brought into this country. This is known as the "remittance basis" of taxation and it is subject to some fairly complex rules, largely developed by case law.

In the Pre Budget Report it was announced that with effect for 2008/09, these remittance basis rules will not be available to those who have lived in the United Kingdom for seven years or more unless payment is made of the sum of £30,000 per annum as a minimum tax charge in respect of unremitted foreign income or gains. Effectively therefore, for those who have been living in the UK for seven years or more, the remittance basis of taxation is to be withdrawn next year except for high earners and the wealthy.

More ominously, it was announced that there will be other changes to the remittance basis rules in order to deal with certain loopholes in the current regime, although few details were given.

Once again, draft legislation is expected by the end of December this year, and it will be then appropriate for all non-domiciliaries to review their worldwide financial affairs with a view to taking appropriate action before April next year.

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