

17 March 2004

## PROTECTING REVENUES

A package of measures to tackle the problem of tax avoidance, protect revenues for investment in public services and maintain the integrity of the tax system was announced by the Chancellor today.

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### DETAILS

#### Tackling Tax Avoidance

The Government is introducing a new disclosure measure to counter large-scale avoidance of direct taxes. This will require those who devise and market certain avoidance schemes to provide the Inland Revenue with details of these schemes. This will improve transparency and allow the Inland Revenue to make a swifter and more targeted response to deliberate abuses of the tax system.

This will be complemented by measures to improve transparency in VAT transactions. A register of VAT abusive avoidance schemes will be published, and businesses with an annual turnover of £600,000 or more will be required to disclose use of these schemes to Customs and Excise. Businesses with an annual turnover of £10 million or more will also be required to disclose details of VAT schemes and arrangements that meet certain criteria.

The Inland Revenue and Customs & Excise have begun discussions with the tax administrations of Australia, Canada and the United States to establish a joint task force to increase collaboration and coordinate information about abusive tax transactions. They plan to share expertise, best practices and experiences within the framework of the four countries' existing tax treaties. Representatives of the four administrations will be meeting in Washington shortly to finalise plans for this initiative.

#### Small business tax incentives

The Government is committed to support for all types of small business, and believes that transition to the corporate legal form can be an important step in the development of a business. At the same time the Government wants to ensure that the support provided for small companies to promote growth and enterprise does not encourage businesses to incorporate solely for tax reasons.

As set out in the 2003 Pre-Budget Report, the Government announces specific proposals to ensure that the measures it has introduced provide support for businesses that reinvest their profits and grow their businesses. The Government will also take steps to reinforce compliance with the tax system by the smallest companies, while ensuring that compliant businesses do not face additional burdens. The measures announced today are:

- a minimum corporation tax rate of 19 per cent on profits distributed to individuals on or after 1 April 2004, with the zero-rate on retained profit remaining to incentivise businesses to re-invest;
- the requirement for newly incorporated businesses to disclose basic tax information will be strengthened; and
- the extension, for one year from 1 April 2004, of first year allowances for small enterprises from 40 per cent to 50 per cent, to provide a cash flow boost to up to 3.8 million small enterprises when they need it most.

The Government will also consider measures to strengthen anti-avoidance legislation on loans made to shareholder directors of close companies.

To ensure that targeted tax incentives support the Government's objectives for growth, enterprise and productivity, the Government proposes to consider the issues raised by the interaction with the tax system of definitions of income of self-employment, and the remuneration paid to owner-managers, in a discussion paper which will be issued at the time of the 2004 Pre-Budget Report.

### **Modernising trusts**

The 2003 Pre-Budget Report announced a series of measures designed to tackle complex tax avoidance schemes using trusts, and made clear the Government's intention to protect the most vulnerable. The Government has been clear since the outset of consultation that the income tax charge on pre-owned assets, which takes effect from April 2005, would not affect legitimate transactions between family members.

The Government has also consulted on ways to make the system of trust taxation less burdensome for those not using trusts for tax avoidance purposes. The Government has today announced that it will:

- bring in new rules so that trusts set up for the most vulnerable are taxed as if the vulnerable person was receiving the income and gains directly, therefore ensuring that they enjoy the full benefit of their personal allowances and lower rate bands; and
- introduce a basic rate band for trusts, which means that around 30,000 trusts that receive small amounts of taxed income will have no further liability and will no longer have to submit a self assessment return every year.

### **VAT grouping**

In light of responses to the consultation announced at the 2003 Pre-Budget Report, new modified legislation is being introduced that is more targeted on cases where there may be avoidance. This will primarily affect businesses in the VAT exempt-sectors that use artificial structures that allow a customer to be VAT grouped with a supplier who is, to all intents and purposes, independently owned. The new rules will come into effect from 1 August 2004.

### **VAT avoidance on commercial buildings**

Legislation to be introduced on 18 March 2004 blocks a VAT avoidance scheme relating to land and buildings. Businesses who are likely to be affected are those which are not entitled to recover all the VAT they incur on the purchase of land or buildings, and which avoid VAT by the use of artificial structures designed either to increase the amount of input VAT they can claim or to spread the VAT cost of purchase or construction over a number of years.

### **VAT on demonstrator cars**

Upon receipt of a derogation from the European Union, new rules - in place from Royal Assent - will tackle underpayments of VAT on the private use of demonstrator cars. These rules will affect motor dealers and manufacturers who seek to avoid paying VAT when they make demonstrator cars available to employees.

### **Partnerships**

New measures are being introduced with immediate effect to close down corporation tax avoidance schemes involving companies operating through partnerships. The schemes usually operate through artificial manipulation of profit shares between UK and offshore partners. The changes ensure that taxable profits wrapped up in untaxed increases to a company's share in a partnership are charged properly to corporation tax.

### **Stamp Duty Land Tax**

Legislation will be introduced with effect from Royal Assent to bring certain partnership transactions, where the partnership property includes an interest in land, within the scope of Stamp Duty Land Tax (SDLT).

Currently, most transfers of an interest in land into, within or out of a partnership, are excluded from SDLT and can effectively be transferred between persons without payment of SDLT. To improve fairness and to tackle potential avoidance by using partnerships to invest in property, the legislation will bring such transfers within the scope of SDLT.

Budget Note IRBN 38 detailing the changes has been issued today.

### **Petroleum Revenue Tax**

Effective from today, two measures will be introduced to protect Petroleum Revenue Tax (PRT) revenues: one to prevent the generation of artificial costs through the trading of assets with low market value at artificially high prices between connected companies; the other to prevent the creation of a loss, which can be set against the PRT liability in another field as a result of the successive transfer of a field interest towards the end of field life. The potential revenue loss from these loopholes is over £1 billion in the long term, with at least £200 million at risk now.

### **Jointly owned assets**

From 6 April 2004, the Government will legislate to ensure that married couples will be taxed on dividends from jointly owned shares in close companies (mainly companies owned by their directors or five or fewer people) according to their actual ownership of the shares. For example if a spouse is entitled to 95% of the income from some jointly owned shares they will pay tax on 95% of the dividends from those shares. This closes a loophole currently being exploited by owners of close companies, and will not apply to income from jointly owned shares in non-close companies or to other assets in joint names such as rental property.

## **Red diesel**

Budget 2004 announces an increase in the duty on rebated gas oil ('red diesel') and fuel oil of 2.42 pence, to narrow the differential between these and the main road fuels and reduce the overall attractiveness of oils fraud. When combined with the ongoing impact of other measures under the UK oils strategy, this will assist Customs in achieving the aim of reducing the illicit oils market in England, Scotland and Wales to no more than 2 per cent in 2006.

## **Accrued Income Scheme**

The Government will be consulting stakeholders on how to make the Accrued Income Scheme (AIS) simpler and easier. Since its introduction in 1985, the AIS has grown in complexity, and can be difficult to understand and comply with.

## **Inland Revenue New Compliance Package**

A package of measures to improve compliance in direct taxes was announced today. The package provides additional resources for the Inland Revenue to improve how it manages compliance and enforcement in key high-risk areas. The package specifically focuses on improving compliance through:

- improving information management to better target and improve the effectiveness of compliance activity within the department;
- a set of enabling measures to raise awareness of tax obligations, including a publicity campaign and direct contact;
- measures to identify non-compliant ghosts and moonlighters, and then working with these people to keep them compliant; and
- expanding specialist teams in specific areas.

## **Alcohol strategy**

Budget 2004 confirms the introduction of legislation implementing tax stamps for spirits from April 2006, helping consumers, traders and Customs to identify spirits on which UK duty has not been paid. This will save an estimated £160m a year in revenue losses from spirits fraud. A package of measures will be introduced to help minimise and offset the additional costs to business, including:

- subject to further detailed discussion with industry, seeking to implement the scheme without requiring upfront payment for stamps – preventing increased cash flow costs;
- setting aside a £3 million fund for assistance with capital investment, targeted at the smallest firms, to mitigate upfront costs;
- meeting the production and distribution costs associated with tax stamps; and
- to help absorb any costs passed through into prices, freezing spirits duty for the remainder of this parliament, meaning that by 2005-06 the tax on a bottle of spirits will be 36p lower in real terms than in 2003-04.

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## NOTES FOR EDITORS

### **Government strategy to tackle fraud and avoidance**

*Measuring and Tackling Indirect Tax Losses*, published alongside the 2003 Pre-Budget Report, set out progress in the Government's strategies to reduce losses in indirect tax regimes through fraud, avoidance and general non-compliance.

### **Accrued Income Scheme**

The AIS prevents avoidance of income tax where a person sells a security just before the interest payment date and buys it back shortly afterwards. It works by apportioning the interest on a time basis between the seller and buyer and taxing each party accordingly.

### **Small Business Tax Incentives**

The corporation tax main rate is 30 per cent. The small companies' rate is 19 per cent for companies with taxable profits between £50,000 and £300,000, and the starting rate is zero for companies with taxable profits of £10,000 or less. Marginal relief applies to companies with profits between £10,000 and £50,000, and between £300,000 and £1,500,000.

From 1 April 2004, profits that are distributed from a company to an individual will be subject to a minimum of 19 per cent corporation tax. The lower rates above will continue to apply to profits that are reinvested in the company, or distributed to corporate entities, and companies with taxable profits subject to a rate of corporation tax of 19 per cent or higher will be unaffected.

Newly incorporated businesses are asked to complete the Inland Revenue Form CT41G, which provides basic tax information on the company and the company directors. Many companies already comply with this information request. Legislation will be brought forward in Finance Bill 2004 to make completion of this form compulsory.

Section 419 of the Income and Corporation Taxes Act is an anti-avoidance provision that applies a notional tax rate of 25 per cent to loans made to directors of close companies under specific circumstances.