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Much of the material in this year's Budget had been trailed previously, either in the Pre-Budget Report or in consultation. But there were a few surprises and plenty to write about. I won't buck the trend!

The Surprises

Let's start off with a couple of surprise items: the revision to the associated companies rules for small companies' relief; and the legislation, after 53 years, of the *Sharkey v Wernher* 36 TC 275 principle.

Small companies' relief — changes to associated companies rules in relation to business partners

From 1 April 2008 the definition of 'control', for the purposes of small companies' relief only, will be amended such that rights or powers of business partners will only be taken into consideration when there are 'relevant tax planning arrangements' in respect of the taxpayer company. 'Relevant tax planning arrangements' will be arrangements involving the participator and the partner which secure a tax advantage by virtue of greater relief under ICTA 1988, s 13.

The upper and lower maximum relevant amounts for the purposes of small companies' relief are reduced where the company has one or more associated companies. The associated company rules require attribution to a person of any rights or powers held by his associates, including business partners. The development of new forms of partnership investments in recent years means that this no longer gives a fair result.

For example, many private equity investors invest through partnerships. The effect of attributing the rights and powers of business partners is that all companies owned by any of those partners were deemed to be associated, even though the members of investment partnerships have no business relationship. Many of these companies cannot determine whether the small companies' rate is available to them, so do not claim it.

This change is welcome, although we have not yet seen any draft legislation, so it is not clear how HMRC will view 'relevant tax planning arrangements' in practice. Furthermore, there are other areas, such as EMI, which affect such companies, that could usefully have been addressed in the same way.

Sharkey v Wernher enacted

In 1955 the House of Lords decided that appropriation of trading stock for personal use should be treated for tax purposes as though the stock had been sold at market value. This is a very familiar tax case and was interpreted widely by HMRC (too widely, in my opinion) as meaning that any non-trading disposal of trading stock should be credited to sales at full retail value. Later cases established a similar principle for items acquired other than in the course of a trade, and the principle was extended in practice to include appropriations into or out of stock.

The draft legislation provides that appropriations into or out of trading stock, or disposals and acquisitions otherwise than in the course of the trade, on or after 12 March 2008, will be treated as having taken place at market value. The legislation only applies to trading stock or to incomplete products. It does not apply to raw materials (which seems strange) or to services provided in the course of a trade. Both corporation tax and income tax versions of the legislation were published.

There is no clear link between these rules and ICTA 1988, s 100/ITTOIA 2005, s 173, which determine the amount attributed to stock on cessation of a trade, when stock is not always brought into account at market value. It seems clear that the new rules are not intended to apply on cessation of a trade but there is nothing in the draft provisions to explicitly give the existing rules priority at cessation.

There is also no link with TCGA 1992, s 161, under which appropriation of capital assets into stock can, by election, be brought into the trading account at cost. Under the new rules the appropriation would always be at market value. So is s 161 being superseded or do the new provisions need redrafting?

It may seem curious that it has taken more than 50 years to codify this principle. But the Notes explain that this is in response to a developing view that *Sharkey v Wernher* has been superseded. FA 1998, s 42 requires 'the profits of a trade, profession or vocation to be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law' for tax purposes. But there was some doubt as to whether a decided case is an 'adjustment required or authorised by law', or whether this phrase refers only to tax legislation. So the new rules should put the matter beyond doubt.

Capital Allowances

Industrial buildings allowances (IBAs)

Following the removal of balancing adjustments last year, we now have draft legislation for the withdrawal of industrial and agricultural buildings allowances by 2011. The 4% writing-down allowance will be reduced by 25% for FY 2008, 50% in FY 2009 and 75% in FY 2010, with no allowances after 31 March 2011. Where chargeable periods overlap financial years the rates will be time-apportioned. Businesses that acquire qualifying properties will be eligible to claim relief until 2011, will 'stand in the shoes' of the person who has disposed of the interest and be entitled to the same allowances as the previous owner would have been able to claim. There are no exceptions, so all claimants will see a reduction in their writing-down rates.

The draft legislation includes a rule, effective from 12 March 2008, to prevent abuse where property qualifying for IBAs is transferred between connected parties in order to obtain a tax advantage (the 'IBA Accelerator' arrangements, which exploited the withdrawal of balancing adjustments to claim multiple allowances).

The removal of IBAs, without any consultation, has affected many businesses which made investment decisions based on anticipated levels of tax relief. This may also have a major impact on tax accounting for certain companies which account under IFRS. There are companies that will be technically insolvent as a result of having to account up front for the loss of IBAs. It is particularly frustrating that the Government has not listened to demands for existing expenditure to be grandfathered so as to reduce the impact of this change.

Plant and machinery allowances

Again, the rate reduction to 20% was announced last year and most of the changes have been trailed in consultation since then. The changes, which are broadly as follows, take effect for companies on 1 April 2008 (6 April for other businesses).

- The annual investment allowance (AIA) provides 100% relief for the first £50,000 of expenditure on plant and machinery (excluding cars) for any business and replaces the current first-year allowance (FYA) for small and medium-sized businesses. There will be a single allowance per group but companies will be able to allocate the AIA between businesses as they see fit.

This may be a simplification but it will reduce the allowances for many businesses that spend more than £50,000 a year.

- Expenditure in the general pool worth less than £1,000 can now be written off in one year to reduce the administrative burden on business.

- The new regime will include a 'special rate pool' for 'integral features', such as electrical systems, cold water systems, etc, which will be written off at 10% p.a. The assets in this pool will be listed in CAA 2001, s 28A.

- Thermal insulation and long-life assets will be added to this special rate pool.

- 'Replacement expenditure' on integral features — where the whole, or more than 50% of the expenditure is replaced in a 12-month period — will be treated as qualifying for a 10% allowance, instead of being a revenue deduction.

The new regime means that taxpayers will take significantly longer to get tax relief, which will affect cash flows and reduce investment. The Government has also ignored requests that existing construction contracts should be grandfathered. Taxpayers incurring expenditure on existing building projects will fall into both the new and existing rules, causing complexity and increasing their administration burden. And concerns raised as to how these new rules work on property transactions have yet to be addressed.

Anti-avoidance

From 12 March the balancing allowances on disposal of a trade will be restricted where these arise as part of arrangements with a main purpose of generating the allowances. This will prevent the artificial creation of balancing allowances simply to avoid tax.

'Green' allowances

There are several 'green' changes, as the Government tries to reinforce its environmental and sustainability image. These include 100% FYAs for investment in certain energy-efficient or environmentally beneficial technologies from summer 2008, extending the 100% FYA for natural gas and hydrogen refuelling equipment for five years, including biogas refuelling equipment, and extending the 100% FYA for low CO_2 cars for five years (reducing the limit from 120 g/km to 110).

The Government has confirmed that companies that make a loss in a period when they invest in items that qualify for 100% enhanced capital allowances can surrender losses for a cash payment. This credit will equate to 19% of the loss surrendered, limited to the greater of the company's total PAYE and National Insurance contributions liabilities for the period for which the loss is surrendered or £250,000. There is a case that this credit, currently only available to companies, should be extended to individuals and partnerships that invest heavily in property.

These new rules are just tinkering with the existing system and it is a pity that recent consultation has not been used as a forum for rethinking the enhanced capital allowances system and for linking the tax reliefs with a building's overall green credentials, such as its Energy Performance Certificate or BREEAM Environmental Assessment Rating.

Although these enhanced allowances are unlikely to change environmental behaviour (due to the difficulties of the system and small items of plant included), we hope that replacing the existing capital allowance treatment for business cars with an emissions-based approach may have an impact and encourage greater investment in less polluting vehicles. From 1 April 2009 for corporation tax purposes the capital allowance treatment of all cars will be reformed. Expenditure on cars with CO_2 emissions above 160 g/km will attract 10% WDAs and expenditure on cars with lower CO_2 emissions will attract 20% WDAs. Subject to State Aid approval, cars leased to those receiving certain disability allowances will qualify for the 20% rate, regardless of CO_2 performance.

Stamp Taxes

Some changes were intended to clarify the legislation or to reduce administration, others to prevent perceived abuse. I will cover these changes only briefly in this article.

● The loan capital exemption from stamp duty and stamp duty reserve tax is extended to sukuk (alternative finance investment bonds) and certain other loans, from Royal Assent. Whilst welcome, these changes have limited application and it remains to be seen whether alternative finance investment bonds will take off in the UK.

● From 13 March 2008 no stamp duty or stamp duty reserve tax is chargeable where consideration does not exceed £1,000 (subject to anti-abuse measures).

● From the same date transfers previously attracting the £5 fixed stamp duty charge, whether or not falling within the Stamp Duty (Exempt Instruments) Regulations 1987 (SI 1987 No 516), will be exempt from the charge to stamp duty.

● The relief from SDLT for zero-carbon homes is to be extended to flats with retrospective effect from 1 October 2007. In most cases it will cost substantially more to meet the conditions than the SDLT saved but it should be easier for a block of flats to meet the zero-carbon standard than for a detached house, so this relief may be of some use.

● The number of notifiable land transactions will be reduced by increasing the notification threshold for non-leasehold transactions (including linked transactions where the aggregated consideration is, or is above, £40,000) to £40,000 from £1,000 previously. Leasehold transactions will only require notification if they are for a term of seven years or more and any chargeable consideration, other than rent, exceeds £40,000, or where the annual rent is more than £1,000.

● Previously a lease for a combination of premium and rent could not benefit from the 0% SDLT rate on the premium if the annual rent exceeded £600. For non-residential leases this threshold has been raised to £1,000. For residential leases the rule is abolished so a lease premium not exceeding £125,000 will not give rise to SDLT. As a result most initial purchases under shared ownership transactions will not suffer any SDLT.

● A number of SDLT anti-avoidance changes have been targeted at avoidance relating to transfers of interests in property investment partnerships and at perceived avoidance involving group transfers or alternative property financing structures.

Other Measures

Rates

As already announced, the main rate of corporation tax was reduced from 30% to 28% for financial year 2008 onwards. The small companies' rate will be 21% for FY 2008 and 22% for FY 2009 onwards. It will be interesting to see whether the reduced main rate will increase the UK's competitiveness or whether the reduction in capital allowances will stifle growth instead.

Anti-avoidance

The new anti-avoidance measures announced were largely in response to disclosures made to HMRC under the Disclosure of Tax Avoidance Schemes (DoTAS) regime. In brief the changes are:

● amendments to the 'sale and finance leaseback' regime will prevent finance lessors from claiming plant and machinery capital allowances except for new assets;

● changes to the long funding lease rules prevent the creation of tax losses that exceed commercial losses and plant/machinery leases granted for a capital sum will create an income charge;

● the regime for taxation of intangible assets in FA 2002, Sch 29 will be amended to clarify that companies cannot break their related party relationships by liquidation, administration or other insolvency proceedings (this change stops related parties bringing intangible assets into the new rules by putting the transferor company into insolvency before transfer to a related party);

● other measures target transactions which involve an interest-like return that is not taxed as interest and also introduce amendments to the existing 'shares as debt' rules (FA 1996, ss 91A to 91G) and to ICTA 1988, s 785A, the income charge on the transfer of rents for consideration; and

- the CFC legislation is also being 'tightened up' in a number of areas.

The wider changes previously announced by the Government seem to have been deferred. The principles-based approach to tax avoidance using financial products has been postponed until Finance Act 2009, largely, I suspect, because the results of consultation demonstrated how difficult this might be to implement in practice. And the discussion document on the taxation of foreign profits has not yet been followed up, either. We are promised a consultation document this Summer but that will not leave much time for meaningful consultation before implementation in 2009.

Changes to the DoTAS regime

Following consultation, legislation will be introduced to improve the process for dealing with Scheme Reference Numbers (SRNs) issued for disclosed tax avoidance schemes. The main points are that co-promoters of a scheme will all be required to pass the SRN to the scheme users, and scheme users who receive a SRN will be required to pass it on to any other person who is a party to the same scheme and who is likely to receive a tax advantage from it.

Also HMRC will be given the power to withdraw an SRN, removing the obligation for the SRN to be passed on to other parties or reported to HMRC. This will presumably be relevant where HMRC decides that a scheme is not offensive, so does not require monitoring.

Repeal of obsolete anti-avoidance provisions

This is a tidying up measure to repeal what are now virtually defunct provisions. They were originally introduced in the 1950s to counter the practice of tax-free dividend buying by share dealers and of reclaiming tax credits by exempt bodies. Subsequent changes in the law mean that these provisions have largely been superseded. Share dealers are now taxed on dividend income, while exempt bodies, such as charities and pension funds, can no longer claim repayment of dividend tax credits.

As a result, ICTA 1988, ss 704B (and its ITA 2007 equivalent) and ss 731 to 736 are being repealed.

Conclusions

This year's Budget has been dismissed as dull and as not containing anything new. While dull might be bad news for journalists, it's not necessarily a bad thing for taxpayers. And lack of novelty is surely the flip-side to prior consultation on major changes in the tax regime. To ask to be involved in policy-making and then to criticise the Budget for not having any surprises is surely wanting to have your cake and eat it!

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