

The Chancellor, Gordon Brown, presented his pre-budget report at 3.30 p.m. on Monday 5 December. The key announcements, from a financial services perspective, are as follows.

### Income Tax Allowances, National Insurance Contributions, Child and Working Tax Credit Rates 2006-7 and Fuel Duties

These figures have been published and can be found in a [HM Revenue & Customs Press Release](#) (external site opens in a new window).

### Capital Gains: Policies of Insurance

The capital gains tax rules have been changed, with effect from 5 December, so that capital losses arising on disposals of certain insurance policies cannot now be deducted from capital gains in order to reduce or eliminate liability to tax.

The policies caught are mainly general insurance policies but the new rules also apply to capital redemption bonds and non-deferred annuities.

### Inheritance Tax (IHT)

Action has been taken to prevent avoidance of IHT by purchase of interests in excluded property trusts, i.e. trusts containing non-UK assets and originally set up by a person not then domiciled in the UK. Under existing law these trusts, and interests in them, are exempt from IHT.

Certain UK domiciled individuals have been purchasing interests in these trusts from the trustees or beneficiaries, thereby putting their wealth beyond the reach of IHT. The Chancellor has announced that this loophole will be plugged and that interests in excluded property trusts acquired by UK domiciled individuals on or after 5th December 2005 will be regarded as part of the acquirer's taxable estate for all IHT purposes.

### Pre-owned Assets Tax (POAT)

A loophole in the POAT rules has been closed, with effect from 5 December 2005. The loophole allowed an individual to make a gift of property, subsequently enjoy some benefit from it but avoid being caught by either the gift with reservation of benefit or POAT rules.

The planning now targeted, involved the use of an interest in possession trust where assets revert to the settlor on the ending of that interest. The former owner would be given the interest in possession and, under the IHT legislation, the trust property would be treated as being inside their estate. For this reason, the beneficiary was exempt from the POAT charge. On the ending of the interest (for example on the beneficiary's death) the property is then not treated as part of the beneficiary's estate, under an IHT exemption, if it reverts to either the settlor or to the spouse or civil partner or the widow, widower or surviving civil partner of the settlor.

The changes mean that in future the POAT charge will now apply to such arrangements, using a reverter to settlor trust, even though the property in question is treated as part of the former owner's estate. This is intended to clamp down on schemes that were being marketed to exploit the exemptions. Those caught by this rule change will still have the option, under the existing POAT legislation, to elect to have the value of the property fall back into their estate as a deemed gift with reservation for IHT purposes and thus avoid the POAT income tax charge.

## Corporation Tax

The non-corporate distribution and zero per cent rates of corporation tax are to be replaced with a new single banding set at the current small companies' rate of 19%. This change was aimed at so called "tax-motivated incorporations" where many self-employed people were advised to incorporate simply to reduce their tax and national insurance liability. On a more positive note, the changes will simplify the regime for the large number of businesses who have been struggling with the current system.

## Real Estate Investment Trusts (REITs)

Mr Brown announced that legislation to introduce REITs would be included within the Finance Bill 2006. HM Revenue & Customs will publish details of the tax proposals before the end of 2005 and which are known to include the following:

- the regime will be restricted to UK resident companies listed on a recognised stock exchange
- eligible companies will not pay corporation tax on qualifying rental income or chargeable gains
- there will be a 95% minimum distribution requirement.

## Disclosure of Tax Mitigation Schemes

The requirement to disclose tax avoidance schemes will be extended from April 2006 to encompass all schemes where there is a perceived risk of income tax, corporation tax or - for the first time - capital gains tax. In-house experts will also be required to give HMRC notice of any schemes they have devised to save their own companies tax in these areas. They must report within a month after a scheme is implemented and will thus be in a similar position to consultants who devise schemes for other companies.

## Pensions

A number of changes to pensions were announced. Most of these are contained in a [HM Revenue & Customs Technical Note](#) (external site opens in a new window).

## SIPPs

The pensions 'simplification' changes from 6 April 2006 are intended to replace all the many different tax regimes that exist at present with one single universal regime. This means that the same rules will apply to all types of pension scheme.

Currently, pension schemes can invest in most types of asset, but there are restrictions on small self-administered schemes (SSASs) and self-invested personal pensions (SIPPs). Such pension schemes may not invest in residential property or certain other 'prohibited assets', such as antiques, fine wines, works of art, vintage cars, yachts, stamp collections etc. These restrictions were to have been removed from 6 April 2006.

However, in a last minute move, the Chancellor has responded to warnings from many quarters as to the effect on the property market and possible abuses of tax relief and has acted to remove any tax advantages from such types of investment.

This means that, as from 6 April 2006, schemes where the investments can be member-directed (broadly, schemes such as SSASs and SIPPs) will still be unable to invest in residential property and other prohibited assets. Schemes will, however, be able to invest in "genuinely diverse commercial vehicles" that hold residential property, such as a Real Estate Investment Trust on which the Government is consulting.

The effect of the new rules will be that "it is at least no more advantageous to hold [residential property and other prohibited assets] in a pension scheme than it is to hold them personally". There will also be the risk of scheme sanction charges and deregistration.

## Recycling

Anti-avoidance measures will be introduced from 6 April 2006 to stop 'recycling' whereby pension scheme members aged 50 or more could take tax-free cash and recycle this back into the scheme and get further tax relief. HM Revenue & Customs view this practice as an abuse that generates multiple tax-relief on the same money. Details of these new measures are not yet available.

## Lump sum death benefit rules

The Finance Bill 2006 will include provisions to ensure that a lump sum death benefit can be paid on the member's death before age 75 after an annuity or scheme pension is purchased, even if the member had first gone into income withdrawal.

## Protected early pension ages

The Finance Bill 2006 will include provisions for members to keep a protected retirement age where they take early retirement and are later re-employed by the same employer or a different sponsoring employer for the same scheme. Protection will be lost if the aim of re-employment is to avoid employer or employee National Insurance contributions on the pension element of their remuneration.

## Definition of pension credit member

Section 151 of the Finance Act 2004 states that a "member" means any active member, pensioner member, deferred member or pension credit member of the pension scheme. The Finance Bill 2006 will change the definition of a member to include a former spouse who dies in between a court order and pension share coming into effect.

## Definitions of member and employer

The definitions of 'member' and 'employer' will be extended to include ex-members and employers who have ceased to be sponsoring employers.

## Pensions Commission

The pre-Budget report welcomes the broad framework of the Turner report, and re-iterates John Hutton's five principles on which the Government's response will be based. These are that the pension system must promote personal responsibility; it must be fair; it must be affordable; it must be simple; and it must be sustainable. The key principle is affordability. The pre-Budget report goes on to update the Treasury's projections of the long-term cost of state pensions. These show that the cost is higher than previously forecast. The effect of this is to make it more likely that the Government will accept the Turner reforms, as the cost of these reforms now appears to be not so much greater than the Treasury now forecasts without the reforms.

The Government plans to publish a White Paper in Spring 2006.

## Other

Some of the other announcements include:

- in a move to prevent thousands of low-income families from having to repay benefits, families will be able to earn up to an extra £25,000 a year (from the current £2,500) before having to inform HM Revenue & Customs of a change in their income
- the use of dormant (i.e. has not been touched for at least 15 years) bank and building society accounts for the improvement of youth and community services
- a new tax relief will be made available to the producers of 'culturally British' films.

