

# SAGE **SME** EMERGENCY BUDGET SUMMARY

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By Rebecca Benneyworth

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## SME Emergency Budget Summary

### Overview

The Chancellor set out his Emergency Budget with a view to addressing the difficult economic situation that the UK now faces, and out of necessity some of the detailed measures affecting businesses are either set some way in the future or set out in outline rather than in detail. In a Budget intended to both increase taxes and cut public expenditure, businesses must not be expecting a giveaway – far from it; but has the Chancellor gone about his task in the “least bad” way from a business perspective?

### Business tax measures

#### *Corporation tax rates*

A reduction in both the main rate and the small company rate of corporation tax were promised in the run up to the general election, with suggestions that this would be paid for by changes in the capital allowances regime.

In the event, rather than slash the main rate of corporation tax, the Chancellor has proposed a steady reduction over a four year period – the first reduction not coming through until April 2011, and therefore not hitting the tax revenue stream until the first quarter of 2012 at the earliest. From there on in we shall see annual reductions in the main rate of tax taking us from the present 28% down to an EU-beating 24%. In reducing the rate, the Chancellor hopes to keep the UK as competitive a tax regime as possible for larger international businesses, attracting both investment and tax revenues to the UK. It might be argued that by announcing a four stage reduction in one, companies have more certainty about the international tax landscape, allowing businesses to plan for lower taxes, and benefitting from the promise of lower rates before they actually bite.

For companies with profits of no more than £300,000 in a year, the small company rate of corporation tax is more relevant. The last government increased the small company rate steadily, with annual 1% increases from 19% to 22% proposed by Brown in his last Budget. The last of these increases never in fact came to pass, as it was delayed once the recession started and has been looming over us for a few years now. As promised in the general election campaign, the planned rise will not come, and we will see the small company rate reduce by 1% next year to 20%. At the same time, the reduction in the main rate of corporation tax also reduces the effective rate borne on profits of between £300,000 and £1.5 million, known as the small company marginal rate. The changes in the two rates will produce the following marginal rates of corporation tax over the coming years:

Financial year starting 1 April	Main rate	Small company rate	Marginal small company rate
2010	28%	21%	29.75%
2011	27%	20%	28.75%
2012	26%	20%	27.5%
2013	25%	20%	26.25%
2014	24%	20%	25%

### Planning/advice

The prospect of lower rates of corporation tax does not present any immediate planning issues. Clearly, companies incurring trading losses will wish to obtain relief for those as early as possible in view of the higher rate of relief available on them, but cash flow considerations would always indicate that this would be preferable in any event. Companies seeking to invest or spend money which attracts a deduction from profit for tax purposes may well decide that earlier is better in terms of the tax savings generated by earlier expenditure.

### ***Capital allowances***

The planned changes to capital allowances were certainly not as bad as many had anticipated. When they were in opposition, the Conservatives proposed a massive cut in capital allowances to pave the way for the reduction in corporation tax rates. In the event, the Chancellor has taken a more balanced approach by taking a less aggressive attitude to the cuts in capital allowances, relying on making small changes to the existing regimes intended to reduce the cost of allowing tax relief on capital expenditure without hitting capital investment too hard. He has also deferred the impact of changes until April 2012 to allow businesses wishing to invest to grow in the next 21 months the benefit of favourable tax relief.

### Reduction in annual investment allowance

The annual investment allowance is available to almost all businesses, of whatever size. The allowance permits them to claim tax relief on capital expenditure of up to the annual limit in the year in which the expenditure is incurred. This provides both immediate tax relief for capital expenditure, and for very small businesses the added benefit of simplicity in that no record of capital expenditure and the allowances claimed on it is necessary – items are merely claimed for as purchased.

When the annual investment allowance was introduced in 2008, the annual limit of expenditure was set at £50,000. This applies to almost any item of equipment that a business might wish to purchase – with the exception of cars. At this limit, the then Chancellor stated that 98% in number of all businesses would have their full annual capital spend covered by the new allowance; this presented a significant acceleration of tax relief as against the previous system of limited first year allowances.

From April 2010 the annual expenditure limit was increased to £100,000; in view of the statistics about useage of the allowance, it is fair to conclude that many smaller businesses would not see any particular benefit from the increase in allowance, apart from those who have an occasional need to spend large sums of money, rather than an annual spend of a lesser amount.

From April 2012, the annual limit of the allowance will reduce to £25,000. As such, the allowance will be more closely targeted on the very small businesses which benefit from the immediate write off and the simplicity that the AIA offers, while the cost of the allowance in tax terms reduces significantly. Nevertheless, large businesses will still be able to claim AIA – but in a group of related businesses the allowance is available only once, so for larger business the benefit is marginal.

### Planning/advice

Clearly, the reduction in the limit poses a planning issue for businesses which anticipate spending more than £25,000 in the future on plant and equipment. Businesses that are in a position to do so may well decide to investigate the benefits and possibility of incurring expenditure between now and March 2011, thus attracting an allowance of the full £100,000 limit of expenditure before it is withdrawn. Businesses that have accounting periods spanning 1 April (5 April for income tax businesses) may need some specific issues considered, as the reduction in the allowance (and indeed the recent increase) come with transitional rules which may make planning precise dates of expenditure tricky. The lead in time of 21 months also allows those businesses which will need to organise finance for this investment to start planning early to ensure that they are ready to invest before the more generous regime comes to an end.

### Changes in rates of writing down allowances

From April 2012, there will be a small reduction in the rates of capital allowances for both the main pool and the special rate pool, effectively delaying tax relief for expenditure on which annual investment allowance is not available. The reduction will save quite significant sums of money, given that almost all business claim capital allowances on plant and machinery the amounts involved run into billions a year.

The Chancellor indicated that reducing the rates slightly on both pools would more closely match commercial depreciation. This of course depends on the economic life of the assets concerned, and different industry sectors will have differing views about the impact of the change. However, as a broad guide, writing down assets on a reducing balance basis (as is the case for capital allowances) indicates the following useful lives over a range of allowance rates:

Rate of WDA %	Time to write off 80% of cost (yrs)	Time to write off 90% of cost (yrs)	Time to write off 95% of cost (yrs)
6%	27	38	49
8%	20	28	36
10%	16	22	29
18%	9	12	16
20%	8	11	14
25%	6	9	11

So, since before the changes made in 2008, businesses will see quite an improvement in the time taken to write off long life assets, for which the rate will move to 8% (from 6% in early 2008), and in respect of other assets there is a more significant adverse change – with the rate moving down from 25% to 18% in 2012 – increasing the tax life of an asset by one third.

#### Planning/advice

The combined impact of the two reductions in rate of writing down allowance on plant and machinery may prompt some businesses to consider whether outright purchase of assets is still the most tax efficient method of acquiring them. For short term leasing, the tax changes planned may make a difference to lease/purchase decisions, but long term leasing of equipment carries the same tax treatment as purchase so there would be no impact in making a change. Accelerating expenditure ahead of the reduction will not make a significant difference as the reduced rate will apply from 2012 in any event. One key technical planning point for businesses turning over capital investment on a shorter term basis is to ensure that elections for “short life asset treatment” are made as appropriate, and recognise the changing financial dynamic brought about by reduced WDAs. The election effectively enables the full net cost of the asset to be claimed once it is disposed of, and so can accelerate tax allowances significantly.

#### Zero emissions goods vehicles

The term ‘zero emissions’ has been a recent adoption which essentially covers electrically propelled vehicles. The technical definition is a vehicle that cannot under any circumstances emit CO<sub>2</sub> when driven. We already have favourable rates of capital allowances (100% first year allowances) for zero emission cars, but there is now a further measure to provide 100% first year allowances on zero emissions goods vehicles. The allowance commences in relation to expenditure on or after 1 April 2010 (or 6 April for income tax businesses) and will apply to purchases up to 31 March 2015 (5 April 2015). There are some restrictions on the relief to meet EU State Aid regulations, but these should be of little relevance to SMEs. While the availability of zero emission goods vehicles is presently limited, over the life of the allowance this measure will provide a sensible tax incentive to all businesses to review their purchasing policy.

## ***Research and development tax scheme***

The current scheme to provide high levels of tax relief for expenditure on research and development was much in the news over the last two months, and there were suggestions that the generous scheme might be curtailed. If this is planned, the change will not be made in the current financial year, as the only announcement about R&D tax relief was to relax the requirement that SME claimants must own the intellectual property that arises from any expenditure they make. The definition of SME for this purpose is a special one, allowing companies with up to 500 staff to qualify for the more generous tax regime.

The change will apply to expenditure incurred in an accounting period ending on or after 9 December 2009, as this change was originally announced in the December pre Budget report by Mr Darling. Affected companies may now be reviewing the qualifying conditions in some detail to establish whether new claims are possible.

## ***Furnished holiday lettings (FHL)***

Businesses run as furnished holiday letting activities benefit from a more favourable tax regime than that available to other landlords, in that their business is treated more as a trading than an investment business. As a result, capital allowances can be claimed on furniture and equipment, and there are favourable loss relief rules. Disposal of such a business attracts CGT Entrepreneurs' Relief, meaning that the tax charge on sale would only be 10%.

However, the rules that have applied for many years were thrown into disarray in 2009 when it was announced that the favourable tax treatment would apply to activities within the European Economic Area, rather than being confined to the UK. The extension to Europe was a concern, and rather than see the cost of the scheme spiral, the last government decided to abolish the scheme from April 2010. The tourist industry expressed real concern at the potential impact of the change, and the abolition was put on ice in a deal between the government and opposition parties in the run up to the general election, with businesses and advisers unsure what would happen next.

June's Budget has brought excellent news for those in the sector with an announcement that the favourable tax regime will now be retained, although with some changes. There will be a review during 2010 to decide how the scheme might be modified, with the treatment of tax losses a key area for examination. The tax rules which applied up to April 2010 have been retained for one more year, and we shall see the scheme continue to operate in the future, subject to some small amendments, possibly extending the required letting period to secure the advantageous tax treatment. The application of the scheme to the EEA is not in doubt.











### ***Pensions investments and purchased annuities***

The government promised, in opposition, to remove the requirement for pension funds at maturity to be used to purchase an annuity; this will allow those saving for their retirement more flexibility in how the funds saved are used to provide an income. While this will be done in the medium term, it is clear that this will be a major reform requiring careful thought, so as an interim measure this Budget extends the limit for purchasing an annuity from the 75<sup>th</sup> birthday of the saver to the 77<sup>th</sup>. This will provide sufficient time to bring new legislation forward to achieve the change desired.

### ***Pensions savings – high earners***

In order to reduce the cost of giving tax relief on pension contributions, proposals were made in 2009 to limit tax relief on pension contributions to basic rate only with effect from April 2011; the change was intended to apply to taxpayers with income in excess of £150,000. As a result of this proposal, more legislation was also brought forward to prevent those affected in 2011 from increasing their contributions to their pensions in 2009 and 2010 to avoid the impact of the change. All of this legislation is now complete – and indeed much of it is now in force.

The government has reviewed the position, not least because of the complexity of the two new sets of rules. It has been decided that the same outcome can be achieved simply by reducing the annual amount (known as the annual allowance) that members (or their employers) may contribute tax free. The current annual allowance is £255,000, which allows a total of this amount to be contributed by the member or his employer and obtain the full benefit of tax relief (at marginal rates for the member concerned). Payments in excess of this in a tax year produce a tax charge on the member concerned.

There will be an announcement of the outcome of the review in the autumn of 2010, but as an indication the Budget states that a revised annual allowance would be of the order of £30,000 to £45,000. The legislation commencing in 2011 known as the high income excess relief charge would be repealed in consequence.