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Welcome to this special Emergency Budget issue of Business Update.

Few Budget announcements have faced such feverish speculation, but on the whole the measures announced on 22 June were not as bad as many had feared. We have outlined what the changes announced by George Osborne, including those to VAT, Corporation Tax, Capital Allowances and Entrepreneur's Relief, mean to UK businesses.

In this issue, we also feature an article written by Robert McKechnie of Green Oak Solutions, looking at the implications of new carbon legislation, which came into effect on 1 April 2010.

Following a European Court of Justice Ruling last year there is an opportunity for VAT paid on specific postal services to be reclaimed in some instances. We have outlined the circumstances under which companies might be eligible for a refund and how they would go about making a claim.

Finally, in this issue we have also included an article on tax relief available to companies for research and development.

John Shuffrey



THE EMERGENCY BUDGET: WHAT DOES IT MEAN FOR UK BUSINESS?

01

The Coalition Government's Emergency Budget introduces some significant changes to the headline rates of business taxation and also proposes a number of consultations and reviews of taxes affecting businesses. We outline the key changes below:

VAT

The change that has probably attracted most attention is the proposed increase in the rate of VAT from 17.5% to 20%, which is to take effect from 4 January 2011. It remains to be seen whether this increase will adversely affect the general economic recovery but it can be expected to have some negative impact on those businesses that are not able to fully recover input VAT, including those in the financial and property sectors.

Corporation Tax

The other main change affecting companies is the proposed reduction in Corporation Tax rates. From 1 April 2011 the full rate will fall from 28% to 27%, with the intention that the rate will be further reduced over the next three years to 26% in 2012, 25% in 2013 and 24% in 2014. At the same time, the small companies' rate will be reduced from 21% to 20% rather than, as intended, increased to 22%. The upper and lower profit limits above and below which the full and small companies' rates apply

remain unchanged for the 16th year in succession at £1.5 million and £300,000 respectively. Had these been increased by the rate of indexation since 1994, the limits would be over £2.25 million and £450,000.

Capital Allowances

The cost of the reduction in Corporation Tax over the next five years is expected to be £10 billion. This will be financed in part by £6 billion of reductions in capital allowances that take effect from 2012-13.

The Annual Investment Allowance that provides 100% tax relief on qualifying capital expenditure, and which was increased from £50,000 to £100,000 in the last Budget, is to be reduced to £25,000. The annual writing down allowance will decrease from 20% to 18% for general pool expenditure and from 10% to 8% for special rate pool expenditure (eg integral features, long life assets and certain cars). Businesses that invest heavily in capital equipment and may wish to bring forward expenditure on qualifying plant and machinery. When coupled with the phasing out of industrial buildings allowances, which commenced in 2008/09 and which will be withdrawn completely after 1 April 2011, it seems that tax relief on investment by

businesses, in particular manufacturers, in their infrastructure is not considered a priority.

Bank levy

Additional revenue of up to £2.5 billion per annum is expected to be raised by a Bank Levy that will be introduced in January 2011. The levy will be based on banks' balance sheets and is intended to encourage banks to move to less risky funding profiles.

Entrepreneurs

An increase in Capital Gains Tax (CGT) was widely anticipated, but the increase from 18% to 28% for individuals whose taxable income and gains exceed the upper limit of the basic rate band is probably lower than many people expected.

For entrepreneurs there is an increase in the lifetime limit for Entrepreneurs' Relief (ER) from £2 million to £5 million from 23 June 2010 and an introduction of a flat rate of 10%, which will ensure that the increase in CGT rates will not affect the 10% rate available on asset and share disposals that qualify for ER.

National Insurance

There are two changes to reduce the cost to employers of National Insurance. The threshold for employer National Insurance Contributions (NICs) will be increased by £21 a week above indexation. It is expected that



the number of employees for whom employers pay no NICs will rise by 650,000. In addition, new businesses set up after 22 June 2010 outside London and the south-east will be exempt from the first £5,000 of employer's NIC for each of the first 10 employees. The scheme will start later this summer and will run for three years.

The European Union

UK tax policy is increasingly affected by rules made by the EU. As a consequence of these, there are minor changes affecting companies seeking to issue shares under the Enterprise Investment Scheme (EIS). Firstly, companies which are in difficulty will no longer be permitted to issue shares under EIS and the requirement for the EIS company to carry

on a trade "wholly or mainly" in the UK will be removed.

The reliefs given to Furnished Holiday Lettings (FHLs) in the UK were considered contrary to EU law and were to be abolished. This decision has been reversed and FHLs in the UK and elsewhere in the European Economic Area will continue to attract special tax treatment for 2010-11. The Government will consult over the summer about a new tax treatment for FHLs, to apply from next year.

Corporation Tax reform

As part of the programme to rewrite tax law, two new Corporation Tax acts were introduced in 2009 and 2010. The Government has now announced that a detailed programme for reform of Corporation Tax will be published in autumn 2010. Hopefully, this will be a considered reform that will avoid a recurrence of the problems surrounding the introduction of the 'Worldwide Debt Cap' legislation in 2009 in respect of which fourteen separate changes will be made in the forthcoming Finance Bill.

Other consultations and reviews

Looking ahead, the Government plans a consultation for new legislation to replace the existing Controlled Foreign Company rules, under which UK companies may be taxed on the profits of companies resident in low tax-territories in which they hold shares.

The Government has also stated that it remains committed to a review of IR35 and small business tax and will release further details shortly.

In order to protect tax revenues, the introduction of a General Anti-Avoidance Rule (GAAR) is also to be considered. Many of the UK's international competitors have GAARs in place and the Government may draw some comfort from this that a GAAR in the UK will not affect our international tax competitiveness.

One final proposal is for the creation of an independent Office of Tax Simplification to look critically at ways our increasingly complex tax system can be simplified.

02

VAT AND POSTAL CHARGES

A European Court of Justice Ruling last year ruled that the UK had failed to implement EU VAT law correctly by exempting all services provided by Royal Mail (the UK's only "universal service provider" (USP)) from VAT.

The Government has since announced plans to introduce VAT on some of the Royal Mail's services with effect from 31 January 2011. In broad terms, this will apply to any service which is individually negotiated or not subject to any price or regulatory control. This includes services provided by Parcelforce.

Other services will remain exempt as services provided by a USP under a licence duty. This includes services provided to private postal operators requiring access to Royal Mail facilities.

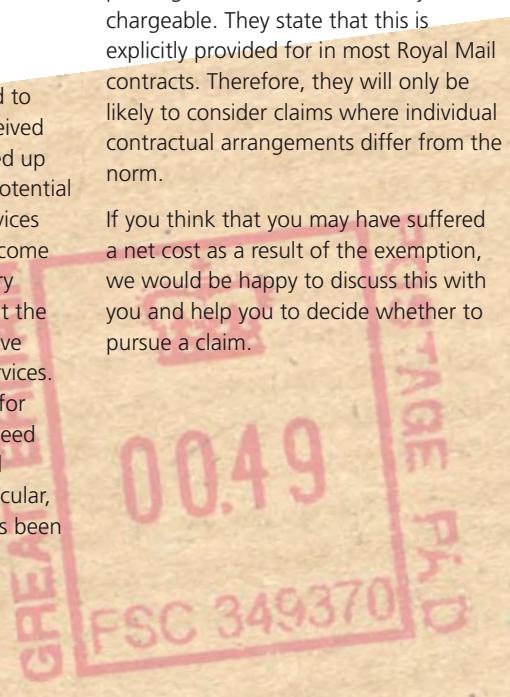
A full list of exempt and taxable services is published on the Royal Mail website and in an HM Revenue & Customs (HMRC) Technical Note on VAT and Postal Services dated 24 March 2010.

The changes are likely to impact mainly on businesses selling goods over the internet or catalogue operators, which currently benefit from using Parcelforce rather than other postal delivery firms.

HMRC announced in Revenue & Customs Brief 19/10 that it would consider claims for VAT considered to be overpaid on postal services received previously. Claims can be submitted up to four years retrospectively, but potential claims can only apply to those services provided in the past which will become taxable with effect from 31 January 2011. The basis for a refund is that the price paid for the services must have included VAT payable on those services. HMRC indicated in the Brief that, for a claim to be valid, it would also need to consider the precise contractual arrangements agreed and, in particular, obtain evidence that input VAT has been incurred.

HMRC has subsequently clarified the position further and it now seems clear that it will resist claims where the contractual terms stated that the price agreed was exclusive of any VAT chargeable. They state that this is explicitly provided for in most Royal Mail contracts. Therefore, they will only be likely to consider claims where individual contractual arrangements differ from the norm.

If you think that you may have suffered a net cost as a result of the exemption, we would be happy to discuss this with you and help you to decide whether to pursue a claim.



FINANCIAL IMPLICATIONS OF NEW CARBON LEGISLATION

The CRC Energy Efficiency Scheme, previously known as the Carbon Reduction Commitment (CRC), began on 1 April 2010 and will have financial, compliance, audit and reputational implications for many businesses and organisations. The legislation will affect approximately 20,000 UK companies and public sector organisations, with 5,000 required to fully participate.

The CRC is a cap and trade scheme which requires participating organisations to purchase allowances to cover emissions generated by electricity and gas. If your business uses more than 6,000 MWh of electricity (around £500,000), which is settled on the half-hourly market, then it is likely that you will be required to participate.

The implications of the CRC are far-reaching. The obligations of participating companies include:

- measuring their carbon emissions accurately and providing an annual footprint report to the Environment Agency
- producing an evidence pack that contains supporting information and back up to the footprint report
- advance purchase of carbon allowances to cover future

In the introductory phase of the scheme, organisations will be able to purchase allowances from the Government at a rate of £12 per tonne of CO₂. When the scheme moves into the capped phase, starting in 2013, the Government will cap the number of available allowances. Companies will be required to bid for available allowances, which is likely to result in higher prices.

Organisations will need to purchase allowances beginning in April 2011. So an organisation that believes it will have a CRC footprint of 100,000 tonnes of CO₂ will have an allowance cost of £1.2 million. This money will be recycled back later in the year.

League table

There is an annual requirement to submit a footprint report that contains usage and emissions from core or regulated emissions sources. The information in this report will be used to produce a league table of participants, which will be published by the Department of Energy and Climate Change, highlighting good performers and exposing laggards. The amount of cash recycled to participants will be based upon an organisation's league table position, with up to +/- 10% swing in the first period. Payments will be recycled in October or six months after the initial purchase.

Penalties

There are both civil and criminal penalties for non-compliance. Organisations that fail to register will be charged £5,000, plus £500 for every day that they fail to register. Inaccurate reporting will also be penalised, with a fine of £40 for every tonne of CO₂ misstated, where the degree of inaccuracy is 5% or greater. It is speculated that this could rise to £75 in future phases.

Company directors will be required to sign-off on key information, including the annual footprint report and supporting evidence pack.

Accounting and compliance

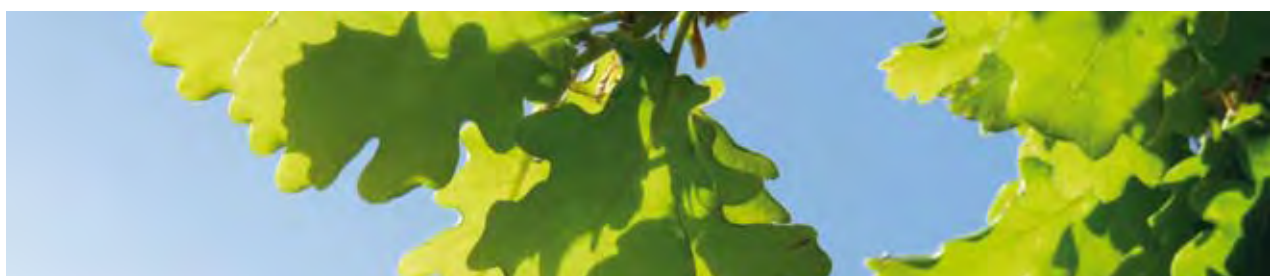
Finance Directors will need to be aware of the accounting implications of the CRC. Considerations include:

- provisions will need to be made for the allowance, purchases and subsequent recycled payments (including any bonus or penalty)
- financing may be required for the allowance purchase and six-month period before recycling
- robust processes will be needed to ensure the quality of energy and emissions data collection as well as an internal audit programme
- a full understanding of compliance implications will be needed in order to reduce any exposures

From a balance sheet perspective, organisations purchasing allowances will recognise an asset in the form of allowances, but they will also need to handle the fact that each allowance is entitled to a refund from the Government. Determining the level of this refund is difficult, because it will ultimately be decided by the organisation's league table position.

In summary, the CRC represents the first piece of "mainstream" carbon emissions legislation that puts a direct value on carbon. It will affect many organisations, including local authorities, NHS Trusts, retailers, banks and manufacturers, amongst others. The CRC could have a major impact upon your business and it is important that you start planning for it now.

This article was written for Business Update by Robert McKechnie of Green Oak Solutions Ltd.



RESEARCH AND DEVELOPMENT TAX RELIEF

A valuable tax relief is available to companies incurring expenditure on research and development (R&D).

The relief is available to companies only, not to sole traders or partnerships. The company can benefit from a healthy uplift in the tax deduction for its expenditure on qualifying R&D. In the case of all but the largest companies, a tax loss can be surrendered in return for a payable tax credit generating a cash payment from HM Revenue & Customs (HMRC).

The size definition used for these purposes extends the favourable tax credit repayment regime to companies with fewer than 500 employees and either an annual turnover not exceeding €100 million or balance sheet assets not exceeding €86 million. If the company is part of a group then these limits have to be considered for the group as a whole, but nevertheless the more favourable repayment regime is potentially available to a significant number of companies.

For smaller companies, the enhanced tax relief on allowable R&D costs is 175%. In other words, the company's income on which Corporation Tax is paid is reduced by £17,500 for each £10,000 of qualifying R&D costs. In the case of large companies, the percentage is 130% rather than 175%.

Perhaps the most attractive feature of the regime for loss making smaller companies is the ability to claim an immediate cash repayment from HMRC. The cash repayment is at a rate of 24.5% of the eligible R&D expenditure; in other words, a cash repayment of £2,450 for each £10,000 of qualifying costs.

The cash repayment is capped by the amount of the Payroll Tax and National Insurance paid over by the company, and is not available to large companies.

Will my company's R&D work qualify for relief?

Although the Government is keen to show its support for companies carrying out innovative R&D, there are some restrictions on the nature of the work which is eligible.

A company can only claim relief for R&D projects seeking to achieve an advance in science or technology through the resolution of scientific or technological uncertainty. Although the current R&D relief scheme is derived from earlier reliefs targeted at pure scientific research, many more technologies will potentially be within the relief. For example, work in software engineering will be subject to the same fundamental criteria for being R&D as work in say textile science.

R&D work will typically be innovative, involve systematic testing in exploring whether something is possible or technologically feasible and how to achieve that in practice. It has to be something which is not readily deducible by a professional working in that field.

There will be uncertainty as to whether what the company is seeking to achieve can actually be achieved. Unsuccessful and abortive R&D projects can also be eligible for the relief.

An eligible R&D project will be looking to appreciably improve some scientific or technological characteristic, rather than minor improvements or routine upgrading. Work on resolving system

uncertainty may be eligible, for example uncertainty about the best way to combine individual components or devices and processes.

What costs will qualify?

The main element of the claim is likely to be for the staff costs of a company's employees directly involved in a project. There are special rules which affect the amounts claimed in respect of sub-contracted R&D, and where the work is subsidised, for example by receipt of a grant.

When and how can I claim?

For most companies, relief can still be claimed for periods ending in the last two years. So, for companies with a calendar year, the opportunity to claim relief for the year to 31 December 2008 ends at the end of 2010.

If your company is carrying out R&D work and you would like to explore the availability of the R&D tax relief, please don't hesitate to contact us directly.

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