



CHARTERED ACCOUNTANTS

## Budget 2007 Summary of the main taxation provisions

### Introduction

Gordon Brown used what he made clear was his last Budget to announce major reforms to personal and business tax and to prepare for the next general election. He set out his main aims, which were to promote long-term investment in environmentally sustainable growth, encourage work, promote savings and help families. As always, he included several measures to curb tax avoidance. After leaving the basic rate of tax at 22% for ten years, the Chancellor announced a reduction to 20% from 2008/09. It will be accompanied by the removal of the starting rate for earned income and pensions, although the 10% rate remains for savings income and capital gains. The main rate of corporation tax will also drop by 2% from 2008/09, but the small companies' rate will increase in an effort to reduce the tax advantages of incorporation for small businesses. The Chancellor also announced a major shake-up of tax allowances for businesses' capital expenditure, including a new £50,000 annual investment allowance.

### Budget highlights

- The basic rate of income tax will be 20% from 2008/09.
- Above-inflation increases will be made to the age allowances each year until 2011.
- The higher rate tax threshold will be aligned with the national insurance upper earnings limit from 2009/10.
- The small companies' tax rate will be 20% from 1 April 2007, and will increase by 1% a year in the following two years.
- The main rate of corporation tax will be reduced to 28% from 1 April 2008.
- The 50% first year capital allowance for small businesses will be extended for another year.
- Writing-down allowances will be cut to 20% from 2008/09 and there will be a phased abolition of allowances for industrial and agricultural buildings.
- The rates of R&D allowances will increase.
- The ISA subscription limit goes up to £7,200 overall, with £3,600 for a cash ISA from 6 April 2008.
- Tax avoidance through managed service companies will be subject to new anti-avoidance rules.

### Personal taxation

Income tax allowances and reliefs and credits	2007/08	2006/07
Personal allowance (basic)	£5,225	£5,035
Personal allowance (age 65-74)	£7,550	£7,280
Personal allowance (age 75 & over)	£7,690	£7,420
Married/civil partners (minimum) at 10%*	£2,440	£2,350
Married/civil partners (age under 75) at 10% *	£6,285	£6,035
Married/civil partners (age 75 & over) at 10%	£6,365	£6,135
Age-related relief reduced by 50% of income over	£20,900	£20,100
Child Tax Credit (CTC)		
- family element	£545	£545
- family element baby addition	£545	£545
CTC usually reduced by 6.67% of joint income	£50,000	£50,000
Childcare and childcare vouchers (weekly tax-free limit)	£55	£55
Blind person's allowance	£1,730	£1,660
Rent-a-room tax-free income	£4,250	£4,250
Venture Capital Trust (VCT) up to £200,000	30%	30%
Enterprise Investment Scheme (EIS) up to £400,000	20%	20%

EIS eligible for capital gains tax re-investment relief	<b>No limit</b>	No limit
Registered Pension Scheme		
- annual allowance	<b>£225,000</b>	£215,000
- lifetime allowance	<b>£1,600,000</b>	£1,500,000

### Income tax rates

<b>Rates</b>		<b>2007/08</b>	<b>2006/07</b>
10% on first		£2,230	£2,150
22% (20% for savings income) on next		£32,370	£31,150
40% on income over		£34,600	£33,300
Dividends for:	basic rate taxpayers	10%	10%
	higher rate taxpayers	32.5%	32.5%
Trusts:	standard rate band generally	£1,000	£1,000
	dividends (rate applicable to trusts)	32.5%	32.5%
	other income (rate applicable to trusts)	40%	40%
Pre-owned assets tax (£5,000 minimum taxable)		As income	

### Personal tax reform

The structure of personal tax will be reformed, bringing national insurance contributions (NICs) and higher rate income tax thresholds into line. In 2008/09:

- The basic rate of tax will be reduced to 20%.
- The starting rate of tax (10%) will be removed for earned income and pensions. There will be no changes to dividend taxation.
- Age-related personal allowances will be increased by a further £1,180 above indexation.
- The upper earnings limit (UEL) for employee's class 1 NICs will rise by £3,900 above indexation, with a corresponding increase to the class 4 NICs upper profits limit.

In 2009/10, the basic rate threshold will rise by £800 above indexation and the UEL will be aligned with it. By 2011/12, the personal age allowance for those aged 75 and over will rise to £10,000.

### Individual savings accounts (ISAs)

From 2008/09, the maximum annual amount that may be invested in a cash ISA will rise to £3,600. The maximum for a stocks and shares ISA will be £7,200, subject to an overall subscription limit of £7,200.



#### Tax Tip

**Use your ISA flexibly and invest early in the tax year to get the full benefit.** If you have not already invested in a maxi ISA in the current tax year, you can open day-to-day savings account. As long as you do not deposit more than year, all the interest earned will be tax-free. Remember anyone aged 16 or over can open a cash ISA, so encourage your older children to save in this way as well.

### Rebated commission arrangements for life assurance policies

A new tax treatment will apply to anyone who invests premiums of over £100,000 in any year into short to medium term life assurance policies, capital redemption policies or life annuity contracts where commission is rebated or reinvested in the policy by an intermediary. If the policy owner holds the contract for less than three years after the year in which the £100,000 threshold is crossed, the amount of premium allowed in calculating

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the chargeable gains will be restricted to the true cost to the policy owner, taking into account the value of any commission rebate. The change takes effect for all policies and contracts made after 20 March 2007. It applies to all existing policies and contracts where further premiums are paid after that date.

#### **Personal dividends from non-resident companies**

From 2008/09, individuals who receive dividends from non-UK resident companies will be entitled to the tax credit of one-ninth of the distribution. Their shareholding must be less than 10% of the company, and the total dividends they receive from non-UK companies must be less than £5,000 a year.

#### **Purchased life annuities (PLA)**

An HMRC officer will no longer be required to determine the tax-exempt capital element of a PLA calculated by the insurer. This will clear the way for a re-write of the PLA regulations.

#### **Alternative finance arrangements**

New rules will apply from April 2007 to the taxation of certain types of investment bonds, known as 'sukuk', which satisfy Shari'a law. These bonds will be taxed on broadly the same basis as equivalent conventional securities.

#### **Charities – gift aid**

The limit on the value of benefits that individuals and companies may receive as a result of making gift aid donations of over £1,000 will be increased from 2.5% to 5% of the donation for all donations made after 5 April 2007.

#### **Service charges and sinking funds**

The existing relief from the 40% trust rate of tax for service charges and sinking funds will be given to all private sector landlords. As a result, such funds will normally be taxed at 20%. The change will take effect for income arising after 5 April 2007.

#### **Landlords energy saving allowance**

The current landlords energy saving allowance (LESA) will be extended to cover floor insulation from 6 April 2007. The allowance will be increased to a maximum of £1,500 for each property, rather than each building, and its lifespan will be extended until 2015. LESA will also be made available to corporate landlords who let residential property, subject to state aid approval from the European Commission.



#### **Tax Tip**

##### **Do not forget to claim for the costs of your travel to your investment property.**

HMRC will allow you a mileage allowance for the journeys you make to the property to carry out inspections, repairs, or any other tasks your managing agent does not perform.

#### **Homes abroad owned through companies**

The Finance Bill 2008 will include legislation to ensure that individuals with a home abroad will not face a benefit in kind charge for any private use of the property if they buy it through a company. The exemption will have retrospective effect and will apply if:

- The property is held by a company owned by individuals.
- The company's only activities are incidental to its ownership of the property.
- The property is not funded directly or indirectly by a connected company.
- The property is the company's only or main asset.

#### **Microgeneration**

Householders installing microgeneration for their personal use will not be subject to income tax on any payment for surplus electricity sold to the grid. For these householders, Renewables Obligation Certificates

acquired in respect of electricity generated from microgeneration technologies on their property will not give rise to an income or capital gains tax charge from 6 April 2007.

### **Tax credits**

The child element of child tax credit will be £1,845 for 2007/08 and £2,080 for 2008/09. From April 2008, the threshold for working tax credit will rise by £1,200 to £6,420 and the withdrawal rate will be 39% from April 2008. Currently, the working tax credit is withdrawn at the rate of 37% of income above £5,220 a year.

## **Pensions and employment taxation**

### **Personal pension term assurance**

Individuals will not be entitled to tax relief for their contributions to fund pension-related personal term assurance. The change will not affect relief for contributions paid by employers.

The change will affect all contributions made after 31 July 2007 under occupational registered pension schemes, unless the insurer received the application for the policy before 29 March 2007 and the policy was taken out as part of the pension scheme before 1 August 2007.

For contributions under other registered pension schemes, the change will take effect for all contributions made after 5 April 2007, unless the insurer received the application for the policy before 14 December 2006 and the policy was taken out as part of the pension scheme before 6 April 2007. The relief may be lost if such a policy is varied.

### **Alternatively secured pensions**

The rules for alternatively secured pensions (ASPs) will be amended from 6 April 2007 to require that a minimum income level is drawn. There will also be an unauthorised payment tax charge where ASP funds remaining on a member's death are transferred to the pension funds of another scheme member.

When a person with an ASP dies, the inheritance tax nil rate band will be allocated first to the residual (non-ASP) estate where the ASP death benefits are subject to both an inheritance tax charge and an unauthorised payments charge. Special rules will apply to residual estates which do not attract an IHT liability.

### **Company car and fuel benefit**

Employees provided with a company car who receive free fuel for private travel are subject to a tax charge. This is based on a percentage rate related to the car's CO<sub>2</sub> emissions. The multiplier used with this rate is £14,400 and remains unchanged for 2007/08. From 2008/09, a 2% discount will apply to the company car benefit scales for cars which are capable of running on E85 fuel (ie fuel which is 85% ethyl alcohol (ethanol) and 15% petroleum).



#### **Tax Tip**

**Choose the right company car and reduce your tax.** You can set the full cost of buying a new company car against your company's profits this year if you choose one from over 20 models with an official CO<sub>2</sub> emissions rating of 120 g/km or less. And as the car driver, you will also benefit from a lower income tax charge.

## Business taxes

### Corporation tax rates

Corporation tax rates are changing as part of a package of significant reforms to the business tax system. The main rate of corporation tax will fall by 2% to 28% from 1 April 2008. The small companies' rate will increase by 1% to 20% in 2007/08, to 21% in 2008/09 and to 22% in 2009/10. These increases are aimed at reducing the tax benefits of incorporation for small businesses.

### Capital allowances – plant and machinery

The 50% rate of first-year capital allowances for small businesses' expenditure on most plant and machinery will be extended for another year to 31 March 2008 for businesses charged to corporation tax, and to 5 April 2008 for income tax. There will be a new annual investment allowance for the first £50,000 of expenditure on plant and machinery starting from 2008/09. The government will consult on the details. Writing-down allowances will also change from 2008/09:

- For most plant and machinery, the rate will fall to 20% from 25%.
- For long-life assets, the rate will increase from 6% to 10%.
- Certain fixtures integral to a building will be written down at 10% a year. The details of what constitute integral fixtures will be the subject of consultation.

### Industrial and agricultural buildings allowances (IBAs and ABAs)

IBAs and ABAs will be phased out over the four years to 2010/11, falling from 4% in 2007/08 to 3% in 2008/09, to 2% in 2009/10, to 1% in 2010/11 and abolished thereafter. The first stage, effectively from 21 March 2007, is the withdrawal of balancing adjustments and the recalculation of writing-down allowances when buildings change hands or cease to qualify for allowances.

### Business premises renovation allowance

The scheme for tax relief for capital expenditure on renovating certain business premises will come into effect from 11 April 2007. The provisions, which were introduced in the Finance Act 2005, will give 100% relief on the conversion or renovation of properties in designated disadvantaged areas that have been vacant for at least a year.

### Research and development (R&D) tax relief scheme

The rates of R&D relief will increase from 2008/09 to 130% for large companies and (subject to state aid approval) to 175% for small and medium-sized enterprises (SMEs). The SME R&D relief scheme is to be extended to large companies with fewer than 500 employees from a date to be announced.



#### Tax Tip

**Buy green equipment and save tax.** Choose an energy-efficient or water-efficient item, and even basic fittings such as lighting, heat pumps or toilets could qualify for an enhanced capital allowance. You could then set the full cost of the new equipment against your taxable profits in the year you bought it. Check which items qualify on [www.eca.gov.uk](http://www.eca.gov.uk)

### Venture capital schemes

Technical changes will be made to the rules for the enterprise investment scheme (EIS), the corporate venturing scheme (CVS) and the venture capital trust (VCT) scheme. These include two new limits for companies receiving EIS, CVS or VCT investment. The changes generally take effect from 6 April 2007, subject to limited transitional reliefs. The maximum amount raised from all three schemes must not be more than £2 million in any 12-month period. A company or group of companies must have no more than 50 full-time employees (or their equivalent) at the date on which the relevant shares or securities are issued.

### **Managed service companies (MSCs)**

Legislation will deem income to be employment income where individuals provide their services through MSCs and their income is not already treated as employment income. This means MSCs will have to operate and account for PAYE on all payments that individuals receive for services provided through the MSC. If the MSC does not pay the tax and national insurance contributions, HMRC will be able to recover them from others, principally the MSC's director and the person who provided the company to the individual.

MSCs are mass-marketed service companies that allow individuals who have shares in the companies and provide services to pay less tax because they receive most of their income in the form of dividends. HMRC has found it difficult to apply the existing rules on personal service companies to MSCs. The requirement to operate PAYE starts on 6 April 2007 and the other powers come into effect at various dates during 2007/08.

### **Employer benefit trusts**

Employers making employee benefit contributions by declaration of trust will have their deduction against taxable profits restricted to the level actually paid to an employee in a taxable form within nine months of the end of the relevant accounting period. This applies from 21 March 2007.

### **Capital loss and gain buying**

From 21 March 2007, legislation will aim to stop schemes that exploit an exception in existing anti-avoidance rules. These are intended to prevent groups of companies obtaining a tax advantage where a company changes ownership, and one of the main purposes of the arrangements is for the new owners to gain access to the company's capital losses or gains.

### **Secondments to charities and educational institutions**

Employers subject to income tax will be able to obtain the correct deduction for the salary costs of employees seconded to a charity or educational institution. The change will be effective from 6 April 2007 and corrects errors made when the law was redrafted in 2005.

### **Landfill tax**

The standard rate of landfill tax will increase from £21 to £24 per tonne from 1 April 2007, and to £32 per tonne from 1 April 2008. The lower rate for inactive waste will increase from £2 to £2.50 per tonne from 1 April 2008.



#### **Tax Tip**

##### **Arrange for your company to buy your shares to help solve your business succession problem.**

When you retire from your own company, you would probably like cash in return for your shares, but your younger colleagues may not have the resources to buy you out. One solution is for the company itself to buy your shares and then cancel them, leaving the remaining shareholders controlling the company. You would end up with the cash on which the capital gain should be taxed at no more than 10%. Of course, it all needs careful negotiation with HMRC to avoid the payment being treated as income and taxed at 25%.

### **Empty business property relief**

The empty business property relief on national non-domestic rates will be reduced from 1 April 2008. Office and retail premises will receive 100% relief for a three-month period, and industrial and warehouse premises will receive 100% relief for a six-month period after they first fall empty. Relief will end for property remaining empty beyond these periods. Charities will be exempt from the effects of this reform.

## Capital taxes

### Stamp duty land tax

A number of changes to stamp duty land tax (SDLT) were announced, including:

- Where connected parties exchange property, the values of the two properties will not be 'linked' for determining the rate of tax from the date of Royal Assent.
- Payment of SDLT will no longer have to accompany the SDLT return from Royal Assent.
- There will be an exemption from SDLT for purchases of new zero-carbon homes valued at up to £500,000. For purchase prices above that level, a £15,000 reduction to the normal SDLT liability will apply from 1 October 2007.

### Pre-owned assets tax – late elections

From 21 March 2007, HMRC will be allowed to accept, after the normal deadline, an election for assets to be treated as part of an estate for inheritance tax purposes rather than to be subject to pre-owned assets tax. The change may also apply to elections for 2005/06 that were late.

### Capital gains tax

The capital gains tax annual exemption for 2007/08 will be £9,200 for individuals and a maximum of £4,600 for most trusts. The Finance Bill will contain anti-avoidance legislation, effective from 6 December 2006, aimed at certain capital loss based avoidance schemes.

### Inheritance tax

The inheritance tax nil rate band will increase to £300,000 for 2007/08. It will then rise each year to reach £350,000 in 2010/11.



#### Tax Tip

**Make a will.** If you die without making a will, your assets will be divided between your relatives according to the intestacy rules after inheritance tax is paid at 40% on any value above £300,000 that goes to relatives other than a spouse or civil partner. If you have no surviving relatives, the same tax will be paid, but the Crown (ie the government) will claim the balance. To avoid this, if you have no relatives, make a will leaving your estate to the charities of your choice. Anything left to charity is free of inheritance tax.

### Recognition of stock exchanges

HMRC will be able to designate as a recognised stock exchange for tax purposes any investment exchange designated as a recognised investment exchange (RIE) by the Financial Services Authority (FSA). The move will ensure equal tax treatment for FSA-listed shares, regardless of which RIE is used as the primary market for the shares. The measure will take effect from Royal Assent.

## Value added tax (VAT)

### Registration and deregistration

The VAT registration turnover limit rises to £64,000 from 1 April 2007. The deregistration limit increases to £62,000.

### Reform of VAT fuel scale charges

The basis on which businesses can recover input tax on fuel used for private motoring is changing from engine size to carbon dioxide (CO<sub>2</sub>) emissions. This is in line with the income tax rules for employee benefits. Businesses must use the new scales from the start of their next prescribed accounting period beginning after 30 April 2007.

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## Fuel scale rates – quarterly

New scales apply from the start of the first accounting period beginning after 30 April 2007.

CO <sub>2</sub> Emissions g/km	VAT Fuel Scale Charge	VAT due per car	CO <sub>2</sub> Emissions g/km	VAT Fuel Scale Charge	VAT due per car	CO <sub>2</sub> Emissions g/km	VAT Fuel Scale Charge	VAT due per car
Under 145	182	27.11	175-179	268	39.91	210-214	353	52.57
145-149	195	29.40	180-184	280	41.70	215-219	365	54.36
150-154	207	30.83	185-189	292	43.49	220-224	378	56.30
155-159	219	32.62	190-194	304	45.28	225-229	390	58.09
160-164	231	34.40	195-199	317	47.21	230-234	402	59.87
165-169	243	36.19	200-204	329	49.00	235-239	414	61.66
170-174	256	38.13	205-209	341	50.79	240 & over	426	63.45

## Carousel fraud

HMRC's existing power to combat 'carousel fraud' on electronic goods such as computer chips and mobile phones is extended from 1 May 2007 to certain sorts of electronic equipment ordinarily used by individuals for leisure, amusement or entertainment. It allows HMRC to direct that a VAT-registered business that receives such goods from another VAT-registered business is jointly and severally liable for VAT, if the business had reasonable grounds to suspect that VAT would go unpaid elsewhere in the supply chain.

## Other VAT changes

- Where a business is transferred as a going concern after 31 August 2007, the seller will retain the VAT records, except in cases where the buyer takes over the seller's VAT number.
- Smoking cessation products will become liable to VAT at the 5% reduced rate for one year from 1 July 2007.
- New rules will shorten to ten years the period over which VAT charges on non-business use of land and buildings are paid. The legislation, which follows decisions in the European Court of Justice, will take effect from 1 September 2007.



### Tax Tip

**Switch to the flat rate VAT scheme for small businesses if your business has few costs and overheads, and your turnover is less than £150,000 a year.** The VAT you pay is calculated by multiplying your gross sales by a flat rate determined by the business sector you work in. Purchases are ignored, so there are no complicated VAT set-off calculations. If you start to use this flat rate VAT scheme in your first year of VAT registration, the flat rate you use is reduced by a further 1%, so the savings are even greater.

## Self-assessment and compliance

### Tax return filing dates

Tax returns for 2007/08 onwards made on paper will have to be filed by 31 October. So a 2007/08 paper return will have to be filed by 31 October 2008. The date will be the same for taxpayers who want HMRC to calculate their tax liability (currently 30 September). The present filing date of 31 January will remain for returns filed online.

Taxpayers will still be able to amend a tax return by the first anniversary of the 31 January filing date, whether the return was filed online or on paper. The new dates apply to returns filed by individuals, partnerships and trustees.

### Tax enquiries and incorrect returns

The period during which HMRC can enquire into tax returns will be one year from the date HMRC receives the return, instead of one year from the fixed filing date. The change will apply to tax returns for 2007/08 onwards for individuals, partnerships and trustees, and to accounting periods ending after 31 March 2008 for companies.

There will be a single new penalty regime for incorrect returns for income tax, corporation tax, PAYE, NIC and VAT. Penalties will be determined by the amount of tax understated, the nature of the behaviour giving rise to the understatement and the extent of disclosure by the taxpayer. The new rules will apply from a date to be set, expected to be for return periods starting after 31 March 2008 where the return is filed after 31 March 2009. The rules in the Police and Criminal Evidence Act 1984 (PACE) will be extended to all HMRC's criminal investigations in England and Wales from a date likely to be later in 2007. At present, PACE only applies to former Customs and Excise matters. Similar legislation will apply to Northern Ireland, and new and consistent powers will be introduced in Scotland.

### Online filing and tax payments

All taxes for which HMRC is responsible will be subject to a single set of powers to make regulations to require online filing and electronic payment. Eventually, most businesses will be covered. HMRC will be able to make regulations under which cheque payments of VAT and corporation tax will be treated as made when funds have cleared into HMRC's account.



#### Tax Tip

**Get paid for filing tax returns over the internet.** If you have fewer than 50 employees and you submit your 2006/07 end of year PAYE return to HMRC using the internet, you will receive a tax-free cash incentive of £150. The incentives for the next two years will be lower. If you make your monthly PAYE payments to HMRC by bank transfer, you benefit from an extra three days to pay the funds into HMRC's bank account. Filing your VAT return online will not provide a cash incentive, but you do get up to 10 extra days in which to settle your VAT bill.

## National insurance contributions (NIC)

### Class 1 (Employees)

#### Not Contracted out of State Second Pension S2P

	2007/08	2006/07
<b>Employee</b>		Employee
<b>No NICs where earnings are up to £100 a week</b>		No NICs where earnings are up to £97 a week
<b>11% NICs on £100.01-£670 a week</b>		11% NICs on £97.01-£645 a week
<b>1% NICs over £670 a week</b>		1% NICs over £645 a week
<b>Employer</b>		Employer
<b>No NICs on the first £100 a week</b>		No NICs on the first £97 a week
<b>12.8% NICs over £100 a week</b>		12.8% NICs over £97 a week

Earnings limit or threshold	2007/08			2006/07		
	Weekly £	Monthly £	Annual £	Weekly £	Monthly £	Annual £
Lower limit (LEL)	87	377	4,524	84	364	4,368
NICs start	100	435	5,225	97	420	5,035
Upper limit (UEL)	670	2,903	34,840	645	2,795	33,540

	2007/08	2006/07
<b>Contracted-out S2P rebate</b>		
Reduction on band earnings	<b>£87.01-£670 pw</b>	£84.01-£645 pw
Employer rate reduction		
• Salary-related scheme	<b>3.7%</b>	3.5%
• Money-purchase scheme	<b>1.4%</b>	1.0%
Employee rate reduction	<b>1.6%</b>	1.6%

### Class 1A (Employers)

Most taxable employee benefits	<b>12.8%</b>	12.8%
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### Class 2 (Self-Employed)

	2007/08	2006/07
Flat rate	<b>£2.20 pw £114.40 pa</b>	£2.10 pw £109.20 pa
If earnings over	<b>£4,635 pa</b>	£4,465 pa

### Class 4 (Self-Employed)

	2007/08	2006/07
On profits	<b>£5,225-£34,840 pa</b>	£5,035-£33,540 pa
	<b>8%</b>	8%
	<b>Over £34,840 pa</b>	Over £33,540 pa
	<b>1%</b>	1%

### Class 3 (Voluntary)

	2007/08	2006/07
Flat rate	<b>£7.80pw £405.60 pa</b>	£7.55pw £392.60 pa

*Please note: This summary has been prepared very rapidly and is for general information only. The proposals are in any event subject to amendment before the Finance Act is passed. You are recommended to seek competent professional advice before taking any action on the basis of the contents of this publication. Please give us a call if you would like to discuss the implications of any of the budget measures.*