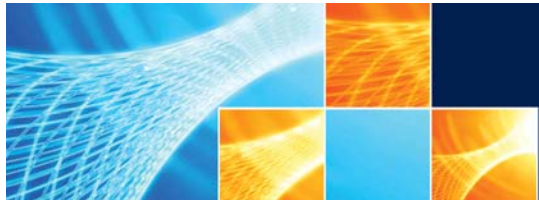




Taxation in the United Kingdom

Contents

1. Principles of taxation in the United Kingdom
2. Taxation of individuals
3. Taxation of companies
4. Taxation of partnerships and limited liability partnerships (LLPs)
5. International tax matters
6. Other taxes



1. Principles of taxation in the United Kingdom

Tax system

The main taxes in the UK are:

- income tax
- corporation tax
- capital gains tax
- NIC (National Insurance contributions, a payroll levy)
- inheritance tax (on gifts and death transfers)
- VAT (Value Added Tax - the main indirect tax)
- stamp duty (a duty on certain transfers of assets, primarily shares)
- stamp duty land tax (a duty on land transfers).

There are other taxes which are less important or specific to certain industries such as IPT (insurance premium tax) and PRT (petroleum revenue tax) and duties on such items as tobacco, alcohol and petrol.

The bulk of government revenue comes from income tax, corporation tax and VAT.

Who and what is taxable?

An individual who is resident in the UK is liable to UK tax on all his income and capital gains, whether from UK or overseas sources, subject to certain exceptions.

Non-resident individuals are liable to income tax on UK source income, but are not generally subject to capital gains tax, again with some exceptions (for example, capital gains from the sale of assets of a UK branch of a business are chargeable on their non-resident owner).

Trustees of a trust and individuals who are partners in a partnership or members of a limited liability partnership are also liable to income tax and/or capital gains tax.

Companies which are resident in the UK are chargeable to corporation tax in respect of their profits wherever these arise. Non-resident companies may be liable to corporation tax or income tax or both in respect of their UK source income or gains.

Residence is determined according to (sometimes complex) rules which are different for individuals as compared with companies. However, an individual in the UK for some temporary purpose only, and not with the intention of establishing residence here, is UK resident for any year of assessment in which he is physically present in the UK for six months or more in aggregate, and is not resident for any year of assessment in which he is not physically present in the UK for six months or more. Companies are UK resident if they are incorporated or have their central management and control here.



The concepts of ordinary residence and domicile (also complex) may also be important in determining how, for example an individual is taxed, but do not apply to companies.

Tax year

The tax year runs from 6 April to the following 5 April for income tax and capital gains tax purposes. For example, the 2006/2007 tax year runs from 6 April 2006 to 5 April 2007.

Although the tax year is not relevant for corporation tax the *financial year* determines the rates of tax that are applied to a company's profits.

The *financial year* runs from 1 April to the following 31 March. For example, the financial year 2006 runs from 1 April 2006 to 31 March 2007.

Returns

The United Kingdom has a self-assessment system for both income and corporation tax.

Where an individual is issued with a tax return in the early months following the tax year, it must be filed by 31 January following the end of the tax year.

A limited company must normally file its return within twelve months of the end of its period of account.

There are requirements for taxpayers to notify chargeability to tax where a return is not issued.

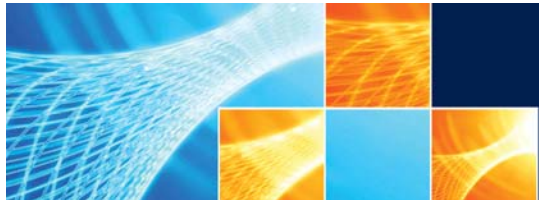
There is a system of penalties where returns are filed late and/or where chargeability is not notified within the appropriate time scale.

Self-assessment returns can be filed electronically, but the majority are still filed as paper returns.

Payment of tax

Payments on account of income tax have to be made by 31 January in the year of assessment and 31 July immediately following the year of assessment. These are normally based on the previous year's liability, with each payment amounting to 50 per cent of that amount. The taxpayer has the right to reduce the payments on account if he considers that his actual liability will be less.

Payments on account are not required where substantially all of the taxpayer's liability is deducted at source, for example under PAYE (as it will be for the majority of taxpayers).



Under corporation tax, companies must pay their tax liability by nine months after the end of their accounting period. When they are 'large' companies/groups that have profits in excess of £1,500,000 then quarterly payments have to be made.

Anti-avoidance

Currently there is specific anti-avoidance legislation and more general case law (contained in such tax cases as *Furniss v Dawson*).

In general the UK tax authorities will not enter into pre-transaction rulings, except in specific instances set out in tax legislation.

2. Taxation of individuals

Basis of charge

UK tax liability may depend on an individual's domicile (the country or state which is his 'natural home'), on whether or not he is resident in the UK for a particular tax year (which is primarily a matter of physical presence) or occasionally on whether or not he is ordinarily resident in the UK.

An individual who is resident in the UK is liable to UK income tax or capital gains tax on all his income and gains, whether from UK or overseas sources, subject to limited exemptions.

Individuals who are resident but not ordinarily resident or not domiciled are only taxed on certain transactions to the extent that the proceeds are remitted to the UK. For example, an individual who is resident but is not ordinarily resident in the UK is only taxed on emoluments in respect of duties wholly performed abroad to the extent that they are remitted to the UK.

A non-resident individual is liable to UK income tax on UK source income. He is generally not liable to capital gains tax with specific exceptions such as on sale of assets of a UK branch of his business.

The importance of domicile

Domicile is a specific concept of English law which is very different from residence. It is an attempt to identify the country or legal system with which an individual is most closely identified.

The UK authorities have recently announced a review of the concepts of residence and domicile. It is not clear whether this will lead to any changes to the rules.

Under the present law, when a person is born he normally acquires the domicile of his father, this is a "domicile of origin". Should his father's domicile change during his minority, the change of domicile follows that of the father. A domicile of origin can be lost only if steps are taken to cut ties with the country in which the domicile is held and then replace it with a domicile of choice.



To establish a domicile of choice it is necessary to establish, not only residence in a country, but there must be an intention of remaining there permanently or indefinitely. Mere temporary residence, even for a number of years, is insufficient to change domicile.

A foreign domiciled UK resident is liable to tax on all income from UK sources and on gains from the disposal of UK assets. Income from foreign investments or from gains on the disposal of foreign assets are taxable only in so far as these sums are brought to the UK ("remitted").

An amount of foreign income and gains is treated as remitted here where it is received in cash either by:

- a) bringing the cash itself to the UK, usually via a bank account;
- b) the sale in the UK of assets purchased abroad out of foreign income and/or gains.

In addition, foreign income and gains are treated as remitted to the UK if;

- a) these funds are used abroad to pay off the capital or interest on a loan from a UK bank or any other UK debt;
- b) the funds are used to repay the capital of a loan from a foreign bank if the funds borrowed were brought to the UK;
- c) the funds are deposited as security for a loan with a foreign bank and the loan is brought to the UK.

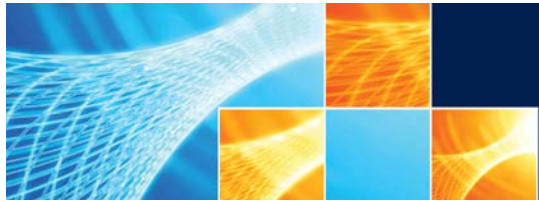
This basis of assessment gives scope for a foreign domiciled individual who intends to become resident in the United Kingdom to arrange his affairs to minimise the income and gains that he needs to remit to the United Kingdom to fund his living expenses. In its simplest form, such planning takes the form of establishing an off-shore capital account prior to becoming resident here, into which any cash sums owed or arising before UK residence is assumed are credited. The account must be kept free of any additions of income or gains arising after UK residence is taken up. Remittances can then be made to the UK from the capital account without incurring any liabilities to UK tax. Income or capital gains arising subsequently can be used for expenditure outside the United Kingdom.

There is scope for more sophisticated planning including the use of off-shore trusts which can provide tax savings.

What is deductible?

The self-employed may deduct revenue (as opposed to capital) expenses which are incurred wholly and exclusively for the purposes of their trade, subject to specific rules for certain categories of expense.

Employees may deduct revenue expenses subject to the much tougher requirement that these must be incurred "wholly, exclusively and necessarily" for the purposes of their employment, again subject to specific rules in certain instances.



Costs of acquiring and disposing of assets liable to capital gains tax (and certain other costs) may be deducted from disposal proceeds in arriving at the capital gain chargeable. There may also be indexation allowance and/or taper relief which will further reduce the gain. An individual is exempt from capital gains tax on the first £8,500 (for 2005/2006) of his capital gains. There may be other exemptions such as the disposal of the individual's main residence.

Tax rates

For 2005/2006 (the year ended 5 April 2006), income tax rates are as follows:

	Rate	On taxable income	Tax on Band
Starting rate	10%	on first £2,090	£202
Basic rate	22%	£2,091 - £32,400	£6,877
Higher rate	40%	over £32,400	

UK residents and certain non-residents are entitled to deduct a personal allowance (£4,895 for 2005/2006) from their income on arriving at taxable income.

Capital gains are treated as the top slice of income, with dividends forming the second top slice and other savings income the third top slice after dividends. Other income forms the bottom slice of income.

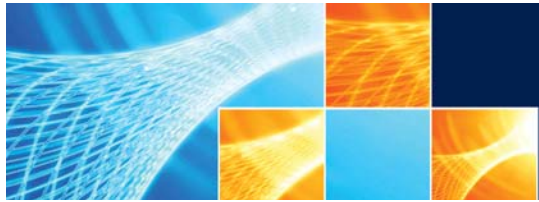
Dividend income is deemed received net of a 10% tax credit. This tax credit is treated as covering any liability to income tax where income falls within the basic rate limit. Where income exceeds the basic rate limit, dividend income is taxed at a special rate of 32½%, from which the 10% tax credit is deducted.

Savings income, other than dividend income, is taxed at 10% for income in the starting rate band and 20% for income falling between the starting and basic rate limits. Savings income in excess of that level is taxed at the usual higher rate of 40%.

Personal allowances; reliefs

Income tax

	2005-2006
	£
Personal allowance	4,895
– age 65-74	7,090
– age 75 or over	7,220
Married couples allowance	
– age 65-74	5,905*
– age 75 or over	5,975*
*Relief restricted to 10%	



Capital gains tax

	2005/2006
	£
Annual exempt amount	8,500
Chattel exemption (max. sale proceeds)	6,000

Taper relief thresholds:

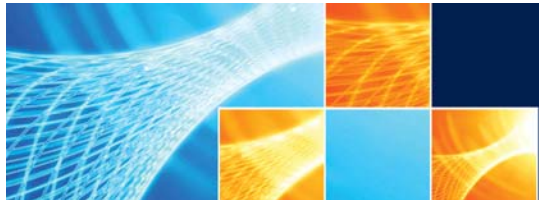
Gains on business assets			Gains on non-business assets		
Number of complete years after 5.4.98 for which asset held	Percentage of gain chargeable for disposals in 2005/2006	Equivalent tax rates for higher rate/ taxpayer	Number of complete years after 5.4.98 for which asset held	Percentage of gain chargeable	Equivalent tax rates for higher rate/ taxpayer
0	100	40	0	100	40
1	50	20	1	100	40
2	25	10	2	100	40
3	25	10	3	95	38
4	25	10	4	90	36
5	25	10	5	85	34
6	25	10	6	80	32
7	25	10	7	75	30
8	25	10	8	70	28
9	25	10	9	65	26
10 or more	25	10	10 or more	60	24

Indexation allowance sought to exempt from capital gains tax the portion of a gain which arose due to retail price inflation. However, indexation was frozen at the level that it reached in April 1998. No indexation will be given to individuals after that date.

3. Taxation of companies

Basis of charge

Companies which are resident in the UK are chargeable to corporation tax in respect of their profits wherever these arise. Non-resident companies may be liable to income tax rather than corporation tax in respect of UK source income in certain circumstances.



Rate of tax

Corporation tax rates are as follows:

Year to 31 March 2006	
Lower and upper limits for profits	Rate
£	%
1-10,000	0*
10,001-50,000	23.75
50,001-300,000	19
300,001-1,500,000	32.75
1,500,00 and above	30

The lower and upper limits must be divided by the total number of associated companies.

* - Measures were introduced from 1 April 2004 to ensure that any distributed profits are subject to corporation tax of at least 19%. The nil band benefit is therefore withdrawn where retained profits are paid out in the form of dividends.

Where a company pays dividends or makes other distributions (other than to another company), on or after 1 April 2004, profits equal to the amount distributed will be taxed (on the company) at a rate of at least 19% (the rates applying to profits between £50,001 and £300,000). Both the nil rate band and distributed profits legislation disappear with effect from 1 April 2006.

Which companies are UK resident?

Companies incorporated in the UK are resident here for tax.

Companies not incorporated in the UK are resident here for tax if their central management and control abides here.

Which non-resident companies are taxable?

A company which is a non-resident of the UK but is carrying on a trade in the UK through a branch or agency is liable to corporation tax on trading income or capital gains arising from the branch and its assets; and/or it may be liable to income tax at the basic rate (currently 22%) if it has UK source income unconnected with a UK trading branch.

What is deductible?

Expenses of a trade or rental business are usually allowable if they are incurred wholly and exclusively for the purpose of that trade or rental business and are of a revenue rather than a capital nature. However, there are special rules for the treatment of interest or exchange losses, where generally the tax treatment follows the treatment in the accounts. Certain expenses are specifically disallowable, including the depreciation charge calculated for the purposes of the accounts and business entertaining



expenditure. Other expenses are specifically allowable on a 'paid' basis, including contributions to a company pension scheme and 'true' royalty payments.

There are special rules for determining what costs are allowable when calculating a capital gain.

Tax relief for capital expenditure

Capital allowances are available on plant and machinery and on specified buildings such as industrial buildings and certain other commercial expenditure such as that on hotels.

The plant and machinery capital allowance is typically an annual 25% (6% for assets expected to have a useful economic life of at least 25 years) depending on the category with, for example, an initial allowance of 40% for expenditure by a small or medium size business.

Research and development expenditure may attract a 100% initial allowance. Various other expenditure can also attract 100% capital allowances.

For industrial buildings there is no initial allowance, but the annual allowance is 4%.

Specific Items

Dividends

Dividends from UK companies are tax free for corporation tax purposes except in specified circumstances.

Capital gains

Are calculated according to specific rules (which are sometimes different from the rules for calculating capital gains of individuals or trustees).

Group relief

Losses of one group company arising in specified circumstances may be transferred to other members of the same group.

Relief for tax losses

Tax losses carry forward with no time limit. However, there are anti avoidance provisions. For example, in specific circumstances where the company changes ownership the pre-change of ownership losses will be forfeit.

Research & Development

In certain circumstances small and medium sized companies can gain 50% additional tax relief for revenue expenditure on R&D. Large companies can claim 25% of qualifying expenditure.



Other taxes

In addition to corporation tax on their income and gains, companies may be liable in appropriate circumstances to income tax, NIC (in respect of employers), VAT and customs duties, stamp duty, and other industry specific taxes such as Petroleum Revenue Tax or insurance premium tax.

4. Taxation of partnerships and limited liability partnerships

Basis of taxation

Each individual partner (or member in the case of a limited liability partnership) is liable to income tax or capital gains tax on profits and/or capital gains according to his or her own residence status.

Similarly partners (or members) which are companies are liable to corporation tax on their share of profits or gains calculated under corporation tax rules.

Partnership tax returns

Individual and corporate partners (or members) must include their share of profits and gains in their own returns. However, the Revenue generally requires a partnership return to be submitted showing details for the whole partnership.

5. International tax matters

Double tax treaties

The UK has the widest double tax treaty network in the world.

Withholding tax

In the absence of a double tax treaty, withholding tax on payments from the UK are as follows:

dividends, nil;

royalties (UK source patent and copyright, excluding film, only), 22%;

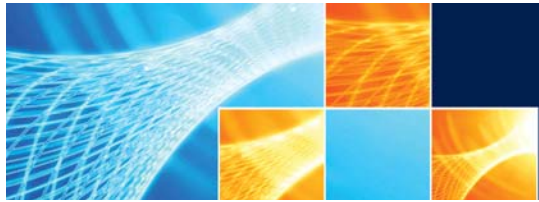
interest, 20%.

Where there is a double tax treaty, the treaty may stipulate a lower rate.

The European dimension

European Community law is effective in the UK by virtue of European Community Act 1972 s2. Judgements in the European Court of Justice have supremacy of over domestic legal decisions.

European Community statements have extensive application to UK indirect tax (i.e. VAT) but have thus far been of less significance for direct tax.



The UK has complied with the Council of the European Communities directive 90/435/EEC under which dividends paid to a "parent" in one EC member state by a subsidiary in another EC member state should not suffer any withholding tax.

6. Other taxes

National Insurance Contributions

Class I national insurance is a payroll tax.

The following is a summary of Class I (not contracted out) rates:

From 6 April 2005

Employee	£0 - £94	nil	
	£94 - £630	11%	
	over £630	1%	
Employer	£0 - £94	nil	
	above £94	12.8%	

Note: All the above figures represent weekly earnings.

Class II and Class IV national insurance are payable by self employed individuals working as sole traders or through a partnership.

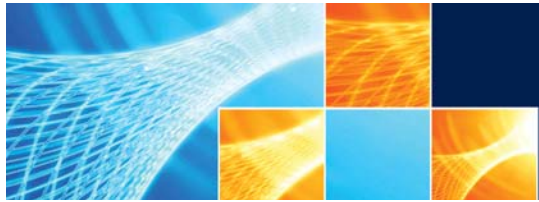
Stamp duty and stamp duty land tax

Stamp duty is payable on the transfer of shares at 0.5% of the consideration.

For transfers of property ad valorem stamp duty land tax rates are as follows (from 17 March 2005):

Amount or value of consideration	Rate of duty (rounded up to the next £5 multiple)
£120,000* or less	Nil
£120,001 - £250,000	1%
£250,001 - £500,000	3%
over £500,000	4%

* £150,000 for commercial property



Inheritance tax

	Gross rate of tax	Transfers on death Lifetime transfers
Gross cumulative transfer (on or after 6 April 2005)	%	%
£		
1-275,000	Nil	Nil
275,001 upwards	40	20

Note

Estate on death taxed as top slice of cumulative transfers in the seven years before death. Most lifetime transfers (other than to discretionary trusts) are potentially exempt, only becoming chargeable where death occurs within seven years.

Annual exemption £3,000
Small gift exemption £250

Inheritance tax is charged on death and certain lifetime transfers (for example to discretionary trusts).

Individuals domiciled in the UK are liable to inheritance tax on all chargeable transfers whether or not the property is situated in the UK. Individuals not domiciled in the UK are only liable, with exceptions, to inheritance tax on chargeable transfers of property in the UK.

Domicile is a highly technical concept, and does not necessarily correspond with either residence or nationality. Domicile for inheritance tax purposes is wider than that for other tax purposes. The UK authorities have recently announced a review of the concepts of residence and domicile.

VAT (Value Added Tax)

VAT is a tax on consumer expenditure and is collected on business transactions and imports.

The basic principle is to charge VAT at each stage on the supply of standard-rate goods and services (output tax). If the customer is registered for VAT and uses the supplies for business purposes, he will (with exceptions) receive credit for this VAT (input tax). The standard rate of VAT is currently 17½%.



Other taxes

Local taxes

Local authorities raise revenue by levying the "Council Tax", which is based on the capital value of residential properties with a discount for single occupiers. The uniform business rate, set by the central government at a fixed national rate, is applied to the annual rental value of all business property.

Insurance Premium Tax (IPT)

IPT applies to most general insurance where the risk is located in the UK and is payable on all sums received by the insurer for insurance contracts at a rate of 5% of gross premiums, inclusive of commission. A higher rate of 17.5% applies to insurance sold with specified goods and services (domestic appliances, motor vehicles, and travel insurance sold by tour operators and travel agents).

Landfill tax

Landfill tax is payable by landfill site operators for waste disposal at landfill sites in the UK that are broadly licensed under environmental law.

This information is published without the responsibility on our part for loss occasioned to any person acting or refraining to act as a result of any information published hereon.

© Horwath Clark Whitehill LLP, London, UK. Revised edition February 2006.