A Budget for business?

MOHAMMED AMIN OF PRICEWATERHOUSECOOPERS LLP CONSIDERS WHAT THE BUDGET MEANS FOR CORPORATE TREASURERS.

Britain's Chancellor of the Exchequer Brown attends photo-call ahead of delivering Budget speech in central London

PHOTOGRAPHER: TOBY MELVILLE, REUTERS

If this was indeed Gordon Brown's last Budget, he has certainly made it a memorable one. But how did this year's announcement fare from the treasurer's perspective?

A TAX REGIME FOR SUKUK (ISLAMIC BONDS) After reading all 81 of the Budget Notes issued by the government, the change with the most important long-term consequences for treasurers may well be legislation to enable sukuk to be issued by UK companies.

As Islam is generally considered to prohibit the receipt or payment of interest, various structures have been developed by Muslims to facilitate commercial finance arrangements. Sukuk enable businesses to raise finance similar to that provided by conventional tradable bonds while remaining Shariah compliant. This is best illustrated by an example (see *Figure 1*).

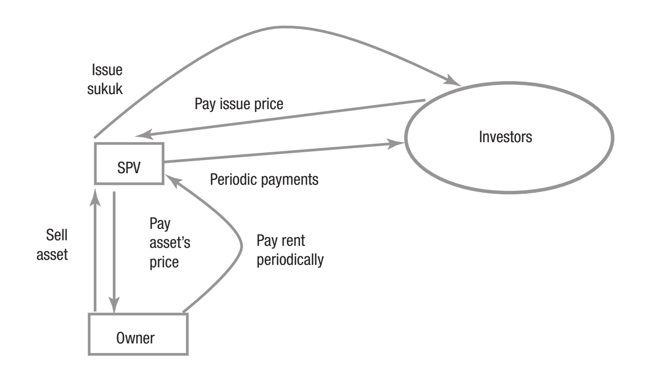
- The sponsoring owner sells an asset to a special purpose vehicle (SPV), normally a company owned by a charity.
- The SPV pays for the asset by issuing participation certificates (sukuk, plural of 'sakk' meaning certificate in Arabic) to investors.
- The SPV earns rent by leasing the asset back to the original owner, and pays the cash received onwards to the investors.
- At the end of the arrangement, the owner buys back the property, and the proceeds are used by the SPV to retire the sukuk.

Over the last decade, the volume and aggregate size of sukuk issuance has grown rapidly, although it is still dwarfed by the conventional bond markets. Most sukuk with international investors are legally structured by UK-based law firms, and often marketed by UK-based banks. However, a number of taxation issues have prevented issuance from the UK. Furthermore, although some secondary trading in sukuk takes place in the UK, there has been uncertainty regarding the tax consequences as the sukuk legally represent an indivisible ownership interest in the underlying asset.

The Budget changes should eliminate these taxation concerns. Accordingly, London is likely to become a key centre for sukuk issuance and trading, cementing its position as the world's financial capital. There are also two specific points for UK treasurers:

1. The company seeking finance does not have to be Islamic, although it should not engage in certain prohibited activities such as alcohol distribution or gambling. Accordingly, treasurers should consider the possibility of issuing sukuk as a way of diversifying their sources of finance, tapping the large pool of capital in the Muslim world seeking investment.
2. The tax rules that prevented UK sukuk issuance also prevented UK issuance of hybrid capital or hybrid debt. Accordingly, UK companies issuing hybrid capital typically need to issue via an offshore SPV. The

Figure 1. Typical sukuk structure



legislative changes introduced for sukuk may enable hybrid debt to be issued directly by UK companies.

CAPITAL ALLOWANCES A number of changes have been made to capital allowances. Leaving aside rules affecting only small and medium enterprises, the key changes are:

- Industrial buildings allowances are being phased out. As well as factories, the changes will eliminate capital allowances on hotels, tunnels, bridges, highway concessions, agricultural buildings, and commercial buildings in enterprise zones.

- The rate of writing down allowance on plant and machinery is being reduced from 25% to 20%.

- Conversely, the rate of writing down allowance on long-life assets (those with an expected life exceeding 25 years) is being increased from 6% to 10%.

Overall, most large companies will pay more tax as a result of these changes, unless they have large amounts of long-life assets.

STAMP DUTY RELIEF AND TREASURY SHARES There is a relief from stamp duty where one company acquires another and there is essentially no change in real ownership. This often applies where a public company wishes to superpose a new holding company by share exchange, so that all the shareholders of the new parent are the original shareholders of the old company.

It has been problematical qualifying for this relief if the old company happens to own some of its own shares which are held in treasury. Meeting the requirements of the relief has entailed cancelling the shares held in treasury, or having the old company accept shares in the acquiring company. To eliminate the problem, the shares of the old company which are held by itself will no longer be counted when considering whether the required continuity of ownership exists for the stamp duty relief.

SALE AND REPURCHASE (REPO) TRANSACTIONS Repo transactions are regularly used in the securities markets, to enable owners of securities to raise finance by selling them with a binding contract to repurchase. Similarly, repos allow investors to lend money to such companies without credit risk, since the loan is secured by ownership of the security (typically a government bond) that is the subject of the repo transaction.

The tax rules governing repo transactions are quite old, very prescriptive and have been amended many times. Two recent tax cases have demonstrated that the repo rules contain scope for avoidance, in that participants in repo transactions can have amounts taxable which are lower (or higher) than their economic profit or expense. Accordingly, the rules are to be recast so that the taxable amount under a repo transaction equals the commercial profit or loss recorded in the participant company's accounts.

TAX PAYMENT BY CHEQUE At present, when corporation tax or VAT is paid by cheque, the tax is deemed to be paid when HM Revenue & Customs (HMRC) receive the cheque. Accordingly, even allowing for the small amount of extra time allowed for payment by electronic transfer, companies are often better off paying by cheque, since they do not lose the funds until the cheque clears. At a future date (expected to be in 2010 for VAT and 2011 for corporation tax) payment will be required to be made electronically in most cases, and if payment is made by cheque instead, the tax will not be deemed to be paid until cleared funds are received by HMRC.

CORPORATION TAX The mainstream rate of corporation tax is being reduced from 30% to 28% from 1 April 2008, except for North Sea oil and gas profits which remain at 30%. This change should be seen in the context of a global trend towards lower corporate tax rates, as countries compete to attract mobile businesses.

HOLIDAY HOMES OWNED BY COMPANIES It is very common for holiday homes in countries such as Spain to be owned via offshore companies. This can reduce transfer taxes on the purchase of the property and also avoids the owner having an asset that is subject to the local inheritance rules of the country. The company is typically equity funded, and the new owner of the property becomes the 100% owner of the offshore company's shares.

Several years ago, the *Regina versus Dimsey and Allan* case established that such a company owner is treated as a director of the company for employment tax purposes, regardless of whether he is legally a director. Any occupation of the property is treated as a benefit in kind, so the taxpayer is taxed on a benefit they have financed. For several years, taxpayers and professional bodies have argued that this is unjust.

The benefit in kind charge is to be eliminated by legislation in 2008 and will be retrospective. In the meantime, HMRC will stop pursuing such charges.

THE DOG THAT DIDN'T BARK IN THE NIGHT With apologies to Sherlock Holmes, the hardest thing to spot in a Budget is that which is missing. Over the last few years, there has been a significant amount of litigation before the European Court of Justice (ECJ), contending that various aspects of the UK's tax system do not comply with its obligations under the European Union Treaties. Various representations have been made to the government about the competitiveness of the UK tax system when compared with other countries such as Ireland or the Netherlands. Neither the Budget speech nor the additional material released by the Treasury addressed these issues, apart from a change giving tax credits to individuals receiving small amounts (under £5,000) of dividends from portfolio holdings (under 10%) in overseas companies which is in response to the ECJ's decisions in the cases of Manninen and Meilicke.

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