# Contents

## Finance Act 2011

**(Lecture P671 - 10.38 minutes)**
**(Lecture B671 - 16.07 minutes)**

# 1 CORPORATION TAX & BUSINESS TAX MEASURES

## 1.1 Corporation tax rates

The main rate of corporation tax for the financial year 2011 is 26%, the reduction being effected by Section 4. The main rate for the 2012 financial year will be 25% with a 30% rate applying to ring fence profits (section 5). The small profits rate (applying to profits of up to £300,000) for the 2011 financial year is 20%, with 19% applying to ring fence profits. The marginal relief fraction is therefore 3/200 in financial year 2011(Section 6).

The declining amount of tax differential between unincorporated businesses and limited companies calls into question both advice about incorporation, and the status of very small limited companies. The tax savings both now and over the next 12 months are calculated below, based on the following assumptions :

- Single person operating as a sole trader. The tax and NIC burden includes income tax and Classes 2 and 4 NIC payable.
- Incorporated business excludes any potential benefit from including a value for goodwill on incorporation, assumes that the taxpayer takes the most aggressive view about distribution of profits and draws a salary equal to the employer NIC threshold and the balance by way of periodic dividend.
- A 100% profit distribution route has been considered, which puts maximum disposable income in the hands of the taxpayer. If profits are retained in a company over and above the personal higher rate threshold, this will produce further tax savings.
- These examples exclude another differential arising from operating in the particular business structures; in particular, there will be differences in the cost of business motoring arising from the tax treatment, and the administrative costs borne by the business operating through a limited company. The treatment of goodwill on incorporation may be of interest to substantial businesses, whether through the favourable tax treatment on disposal into the company, or the availability of intangibles relief to the company (for businesses which commenced on or after 1 April 2002).
- No particular attention has been paid to pension contributions, either paid by the individual personally in the case of the self employed individual, or paid by the company. In both cases, this will produce a tax saving at the marginal rate, and there will be no significant difference in the amount that can be contributed to a pension. There is a slight NIC difference between company and sole trader for these purposes.

**Table 1 : Tax & NIC burden self employed to limited company 2011/12**

| Profit | Sole trader | Company | Saving |
|---|---|---|---|
| £10,000 | £885 | £586 | £ 299 |
| £15,000 | £2,335 | £1,586 | £ 749 |
| £20,000 | £3,785 | £2,586 | £1,199 |
| £30,000 | £6,685 | £4,586 | £2,099 |
| £40,000 | £9,585 | £6,586 | £2,999 |
| £50,000 | £13,463 | £9,206 | £4,257 |
| £75,000 | £23,963 | £19,206 | £4,757 |

**The tax saved**

Fluctuating rates of both personal tax and corporate tax have made the picture quite complex over the last few years. Here are the tax savings for various levels of profit over the last few years.

**Table 2 : Tax savings on incorporation 2008 - 2012**

| Profit | 2008/09 | 2009/10 & 2010/11 | 2011/12 |
|---|---|---|---|
| £10,000 | £324 | £274 | £ 299 |
| £15,000 | £674 | £624 | £ 749 |
| £20,000 | £1,024 | £974 | £1,199 |
| £30,000 | £1,724 | £1,674 | £2,099 |
| £40,000 | £2,424 | £2,374 | £2,999 |
| £50,000 | £3,423 | £3,710 | £4,257 |
| £75,000 | £3,485 | £3,772 | £4,757 |

**High Income**

The importance of the use of a limited company to protect high earners from the effect of the 50% tax rate (and the small band of marginal 60% rate) has been widely discussed in the tax press. The basic computations will depend largely on how much an individual draws, but the following assumptions have been used to test the benefits:

In Table 3, all of the post tax profits have been withdrawn by way of dividend. A salary equal to the Earnings threshold has also been paid.

**Table 3 : Tax burden self employed to limited company 2010/11 – no retained profits**

| Profit | Sole trader | Company | Saving |
|---|---|---|---|
| £125,000 | 47,953 | 42,544 | 7,409 |
| £150,000 | 58,453 | 50,887 | 7,566 |
| £200,000 | 84,453 | 73,744 | 10,709 |
| £250,000 | 110,453 | 98,188 | 12,265 |
| £300,000 | 136,453 | 122,633 | 13,820 |

In Table 4 varying levels of retained profits have been considered. The resultant saving against sole trader structure is shown in the indicated columns.

**Table 4 : Tax burden limited company 2010/11 – retained profits as shown (saving as against self employment)**

| Profit | Retain £25,000 | | Retain £50,000 | | Retain £75,000 | |
|---|---|---|---|---|---|---|
| | Total tax | Saving | Total tax | Saving | Total tax | Saving |
| £150,000 | 45,669 | 14,784 | 36,705 | 21,748 | 30,455 | 27,998 |
| £200,000 | 64,716 | 19,737 | 58,387 | 26,066 | 50,455 | 33,998 |
| £250,000 | 89,160 | 21,293 | 80,133 | 30,321 | 72,137 | 38,316 |
| £300,000 | 113,605 | 22,848 | 104,577 | 31,876 | 95,549 | 40,904 |

## 1.2 Capital allowances – writing down allowances

Section 11 deals with the changes to the writing down allowances for plant and machinery. The rate of writing down allowance applying to the main pool and similar expenditure reduces from 20% to 18% on 1 April 2012 for corporation tax and on 6 April 2012 for income tax. The rate applying to special rate expenditure reduces from 10% to 8% on the same date.

For accounting periods spanning the date of change, the appropriate rate is arrived at by time apportioning the old and new rates by reference to the number of days either side of the date of change, rounding (up) to the second decimal place.

## 1.3 Annual Investment Allowance (AIA)

Section 11 makes the changes to the limit of annual investment allowance. The limit for AIA reduces from £100,000 to £25,000 from April 2012 (1 April for companies, 6 April for income tax businesses). It is worth thinking carefully, not only about timing of expenditure, but also about accounting dates, if the client intends to incur substantial expenditure.

The way in which the limit operates for a period spanning 1 or 6 April 2012 is logical, and involves splitting the period as follows:

***Year ended 30 June 2012 (income tax)***

| | |
|---|---|
| Period 1 Jul 2011 to 5 Apr 2012: | |
| 280 days / 366 x £100,000 | £76,503 |
| Period 6 April 2012 to 30 June 2012: | |
| 86 days / 366 x £25,000 | £5,874 |
| Total AIA for the period | £82,377 |

However, the operation of section 11(7) limits the allowance in respect of expenditure in the latter part of any spanning period to the amount calculated for that part of the period. This means in the case of the example above, the maximum expenditure that can qualify for AIA between 6 April 2012 and 30 June 2012 is £5,874.

Where a business needs to incur substantial expenditure in the period up to 5 April 2012, it may be sensible to draw up accounts for the period ending 31 March (or 5 April) **2011**. This may restrict the availability of allowances in 2010/11, but will then leave a complete year as the last period under the £100,000 limit, allowing expenditure of up to £100,000 to qualify for AIA claim for 2011/12. The alternative, of course is to bring forward the date of expenditure to before the date of change (6 April in the case of an income tax business).

## 1.4 Short life asset elections

Short life asset elections are available to segregate expenditure into a separate pool. Presently, a short life election is available on assets (other than cars and special rate expenditure) which are expected to have a life of around four years. If the asset is still owned after four years it is transferred back into the main pool, so the benefit of the short life election is then lost.

For assets acquired on or after 1 April 2011 (6 April for income tax) the period is extended to eight years, so that the election may be beneficial in respect of more types of asset. (Section 12)

## 1.5 Election for designated currency

Although Section 34 and Schedule 7 include anti avoidance legislation affecting investment companies, the provisions also include an important new election available to UK resident investment companies. Such a company is now permitted to elect to use a currency other than its functional currency for tax purposes. The new currency election allows a company to specify its "designated currency" which is used for tax purposes. The intention of the rules as a whole is to prevent investment companies from generating a tax advantage by changing currency, but the election is an important one.

A company may only choose as a designated currency either the currency in which the majority of assets and liabilities are held by the company, or the currency used by the ultimate parent company of the group to which the company belongs.

There is a detailed article on this topic, including examples in *Tax Adviser* magazine of August 2011.

## 1.6 Changes to R & D relief

The rate of additional tax relief available to smaller companies under the research and development tax relief scheme has increase from 75% to 100%, meaning that SME's can now gain a 200% tax deduction for qualifying expenditure. The new rate applies to expenditure incurred on or after 1 April 2011. In consequence, two other rates have been reduced:

- In order to manage the cost of the payable R & D tax credit, the rate payable has been reduced to 12.5% from 14%. So in respect of £100 of qualifying expenditure, the payable tax credit is now £25 (£100 x 200% x 12.5%). This was previously £24.50 (£100 x 175% x 14%).
- SME's will be restricted to 20% additional relief (in addition to the R & D relief) if they further claim under the Vaccine Research scheme. The previous rate was 40%.

Section 43 which implements the change will commence by Treasury Order, allowing time for EU State Aid approval.

## 1.7 Improving CGT for groups of companies

A number of quite complex changes have been introduced with the broad aim of improving and simplifying CGT for groups of companies. The changes were the subject of wide and extensive consultation during 2010, and have generally been welcomed by the corporate tax industry.

Value shifting

The complex anti avoidance rules applying for CGT purposes have been replaced by new provisions intended to counter a tax advantage for corporation tax, but which should be simpler to operate. Section 44 and Sch 9 limit the application of TCGA 1992 s 30 to remove the application of the section to disposals within groups.

New S 31 replaces the existing provisions with a self contained rule which applies to all disposals of shares or securities for the purpose of corporation tax. This section applies where arrangements have been made that have reduced the value of the shares or securities (or a "relevant asset") and the purpose of those arrangements was to obtain a tax advantage. The consideration for the disposal (and thus the chargeable gain or allowable loss) is adjusted accordingly by s 31(2), increasing it by an amount that is just and reasonable, having regard to the arrangements and any tax charge that would arise were it not for this provision.

The legislation has also been written to apply to reverse situations where the disposal occurs before the acquisition, and consequently covers the situation where the value of the shares or securities was increased rather than reduced.

The degrouping charge in TCGA 1992 s 179 is also amended to take account of this adjustment where appropriate.

The changes apply to disposals on or after Royal Assent.

Simplification of the degrouping charge

The changes made by section 45 and Schedule 10 are intended to simplify the degrouping charge, and follow extensive consultation on this subject.

The broad sweep of the changes is to create a new mechanism for the charge, which is set out in new Ss 179(3A) to 179(3H). The new mechanism applies where the degrouping charge arises on a company leaving a group as a result of a disposal of shares by a group company within the charge to corporation tax, including where that disposal is otherwise disregarded for CGT purposes.

The new arrangements will adjust the chargeable gain or allowable loss on the disposal of shares, or alternatively the base cost of a "new" holding of shares or securities (and thus the gain on their eventual disposal), rather than requiring the departing company to account for the degrouping charge. As such the "normal" (i.e. unrevised) degrouping charge will only apply in quite rare circumstances.

There is also an amendment to allow a degrouping charge to be subject to the election to transfer gains and losses within a group of companies.

There are further amendments to ensure that Substantial Shareholding Exemption is still available in a group where part of the trading activity has been transferred to another company in the group.

Pre entry losses

The rules which restrict the use of losses when a company joins a group have also been simplified. The changes are made by section 46 and Schedule 11.

The use of capital losses which arise after a company joins a group will no longer be restricted as a result of an amendment to the definition of a "pre entry loss". This term now only applies to losses of a company that accrue before it became a member of the group in question. Thus the restrictions on the use of losses accruing after the date the company joined the group can no longer apply.

Restricted losses can now be used more widely than previously. Para 6 of Sch 11 allows such a loss to be set off against gains arising on assets used in any trade or business that was carried on by the company before it joined the group. That trade or business need not be carried on by the company at the point of the set off – it can be carried on by any company within the same group. (this represents quite a significant extension as this previously only applied to a ***trade***, rather than a ***business***).

## 1.8 Modernisation of the Controlled foreign companies regime

Detailed consideration of these measures is beyond the scope of this course, but it is worth being aware that the CFC regime is being amended by Finance Act 2011 as an interim measure. Full modernisation of the CFC regime is due in 2012, and draft new rules (running to in excess of 100 pages) have been released for comment. The general thrust of the final regime is to improve the UK's ranking as a base for international holding companies. The current amendments introduce various exemptions from the CFC regime:

- An exemption for intra groups activities where there is limited connection with the UK
- An exemption for CFC's whose main business is the exploitation of intellectual property (IP) and both the IP and the CFC have minimal connection with the UK
- A three year exemption for foreign subsidiaries that as a consequence of an acquisition or a reorganisation come within the scope of the CFC regime
- An exemption for CFC's with a low level of profits, with an accounts based limit of £200,000 per annum as an alternative to the existing £50,000 limit based on chargeable tax profits, and
- Extension of the transitional rules for holding companies until July 2012.

The changes take effect from 1 January 2011, other than the extension for holding companies which is deemed to always have had effect.

## 1.9 Taxation of foreign branches

FA 2011 introduces an optional exemption from corporation tax for profits arising from foreign permanent establishments (PEs) of a UK company. If profits are exempt from corporation tax under these provisions, losses will be excluded to the extent that they arise from foreign PEs. Profits and losses will be treated in this way only when the company has made an election for these rules to apply to it. Once a company has made this election, foreign PE profits will be exempt and losses will be cancelled from the commencement of the next accounting period, subject to a transitional rule.

What is a PE?

A company has a PE when it trades in another state through a branch or other fixed place of business, or through an agent, other than an independent agent. The new rules allow the company to elect that the branch profits (and losses) be exempted from UK corporation tax.

<u>How are exempt profits measured?</u>

There are three ways to measure the profits that can be exempted (the ‘foreign PEs amount’):

- Where the branch is in a full treaty country, the exempted profits are those that would be attributable to the PE in a double tax relief claim under TIOPA
- Where the branch is in a full treaty country, but tax in that territory does not depend on the profits attributable to the PE, the exempted profits are those that would be attributable to the PE if tax in that territory did depend on the profits attributable to the PE. (Some full treaties provide for taxation by the foreign territory in respect of certain profits without any requirement that they are attributable to any permanent establishment in that territory. This provision ensures that the only profits specifically exempted from UK corporation tax are those that are attributable to a permanent establishment in the territory
- Otherwise, the exempted profits are those that would be attributable to the PE in a double tax relief claim under TIOPA if there were a full treaty with that country compliant with the OECD model

Losses are computed the same way.

<u>Exclusions</u>

Certain companies are wholly or partly excluded from the regime:

- The election cannot apply to a ‘small’ company unless the PE is in a full treaty jurisdiction.
- The election cannot apply to close company chargeable gains (which are imputed to UK resident shareholders).
- Insurance companies are excluded in respect of their basic life assurance and general annuity business.

<u>Gains and losses on assets</u>

Exempt profits will include gains on assets, whether as chargeable gains or taken into account in computing income. This specifically applies to gains in respect of immovable property used for the PE’s business. These gains would not otherwise be part of the foreign PEs amount.

There is also a need to make adjustments where the full gain or loss on an asset does not fall within the exemption (for example, an asset is acquired in the UK and only later transferred to the PE).

<u>Capital allowances</u>

Notional capital allowances for machinery and plant are to be computed and allowed as part of the calculation of exempt profits. The normal capital allowances rules are treated as applying to the PE as if it were a separate activity.

The impact of this measure will usually to be to reduce the exempted profits by the amount of capital allowances deemed to have been claimed.

Other provisions

The rules also require adjustment in a number of other areas:

- Certain payments to the PE by a UK resident person are excluded. These are where the payer would be required to deduct income tax from the payment if it were to a company. This does not apply if the company is a bank, as long as the payments are not part of a tax avoidance scheme
- Costs of employee share acquisitions are to be taken into account on a just and reasonable basis
- There is anti-avoidance legislation, designed to prevent the diversion of UK profits to low tax (<75% of UK rates) followed by a claim for exemption. This does not apply if:
  - the PE profits are less than £200,000
  - the tax reduction is minimal or
  - there was no tax avoidance motive.
- There is a mechanism to adjust for PE losses that occurred prior to the election. It is designed to prevent double relief for the losses by 'matching' the pre-election PE losses with post-election PE profits. Those profits are then not exempt, but presumably are extinguished by the losses, anyway, unless the losses have already been used. This provision applies globally unless the company makes a streaming election for the losses of specific territories to be set against future profits of those same territories.

Effect

The legislation applies from the beginning of the next AP to that in which the election is made (or the day that AP was expected to start when the election was made), and then applies to all future APs. It cannot be revoked after the start of the AP in which it becomes effective.

The election also applies to all territories in which the company has (or will have) a PE.

## 1.10 Furnished holiday lettings

The legislation to amend the Furnished Holiday Letting (FHL) legislation is introduced by section 52 and Schedule 14. In summary, some aspects of the favourable tax regime applying to FHL activities is retained, but new more restrictive conditions and amended loss relief provisions make the regime considerably less generous.

Extension to EEA activities

Schedule 14 extends the favourable tax regime applying to FHL activities to properties in the EEA. This treatment has been in place for some time, but has been non statutory until now. Part 4 of Schedule 14 makes the amendments to CGT to allow EEA FHL activities to benefit from the CGT reliefs available to UK FHL operations.

There are provisions to require the segregation of overseas FHL operations from other overseas property activities for both capital allowances purposes and for the purposes of loss relief (see below). EEA FHL activities are also quite separate from the operation of a UK FHL activity for all purposes.

Amendments to ITA allow all EEA FHL activities to be treated as a separate single deemed trade, rather than segregating by reference to the various locations in which properties are operated. The profits of the EEA FHL activity are deemed to be relevant UK earnings for pension purposes (new section 328B inserted into ITTOIA 2005 by Sch 14 para 2(8)).

Qualifying periods

The periods for which a property must be available for letting and actually let increase with effect from **April 2012** as follows:

- The property must be available for letting for 210 days in a tax year (up from 140 days)
- The property must be actually let for 105 days (up from 70 days).

However, the letting test must be applied separately to UK and EEA accommodation – these two sources are separate for all purposes.

Period of grace

New section 326A of ITTOIA 2005 and similar new section 268A of CTA 2009 for companies introduce the period of grace in relation to properties which do not meet the letting condition. Where a property fails to qualify only by virtue of the number of days actually let, a person can elect that the property is to be treated as meeting that condition in the two years following a year in which the condition was actually met. An election is necessary in the first of those years in order to be available in the second. The property must have qualified in one year (the base year) which is 2010/11 or a later year (by virtue of Sch 14 para 6) which means that qualifying under the lower limits in 2010/11 gives access to two years period of grace when the new higher limits come in.

Note that there is no period of grace in respect of the period of availability. If this is breached, the property will fail to qualify in the period. On a multi property site, however, it is possible to average the periods for all of the properties on the site, so this may allow some flexibility for operators.

Loss relief

The change to loss relief for FHL losses applies from April 2011. In income tax it is achieved by simply excluding ITA 2007 Ss 64 – 82 and 89 – 95 from applying to FHL activities. This excludes all of the trading loss relief provisions apart from carry forward against future profits of the same trade (s 83 et seq). So losses incurred on FHL activities can, from 2010/11 only be set against future profits of the same trade, treating EEA and UK activities as separate businesses. There are no sideways relief provisions, nor is there terminal loss relief on cessation of the business.

Capital allowances

From 2010/11 where a property ceases to qualify as an FHL in a period, but it still let, and therefore falls to be treated as a normal letting, the capital allowances rules have been modified to provide that there is a deemed disposal and acquisition at market value of assets in the pool, so that a balancing allowance or charge is taxed on the operator. The market value is capped at the original cost of the assets for this purpose.

Obviously when a property starts to qualify once more as FHL, the operator may wish to treat those assets as reacquired by the FHL business as the availability of capital allowances is more favourable. The operator will therefore probably seek to treat the assets as once again acquired at market value.

Where an operator has a multi property site this may entail some detailed record keeping to allow the adjustments to be made where necessary.

### 1.11 Lease accounting

The tax treatment of leasing activities is presently aligned closely to the accounting treatment. Changes to lease accounting will be implemented for IAS during 2011, and may also be reflected in UK GAAP in 2013. The planned changes to accounting treatment (including the removal of the distinction between finance and operating leases) will compromise the effective application of the tax rules, so Section 53 makes changes so that for tax purposes the business is required to account for the leases using the “old” accounting standards, and the effect of the change is overridden in computing taxable profits.

This is simply achieved by section 53(5) which states that any reference in the Taxes Act to something done in accordance with GAAP is to be construed as if the leasing change (as defined) had not occurred.

### 1.12 Associated companies – small profits rate

For the purposes of the rate of corporation tax only, Section 55 makes the changes to the associated companies rule proposed and consulted on during 2010.

Section 55 replaces CTA 2010 s 27 with a new section 27, effective for accounting periods ending on or after 1 April 2011, so to a certain extent the change is backdated.

The new section limits the attribution of rights to a person where the companies concerned do not have a relationship of substantial commercial interdependence. The attribution of rights is performed under CTA 2010 s 451, and the excluded subsections (4) and (5) therefore **exclude** the following attributions where there is no substantial commercial interdependence:

- Any company which the person has, or the person and his associates have, control

- Two or more companies within the above
- Associates of the person , and
- Two or more associates of the person

Associates are defined for this purpose by CTA 2010 s 448, and include relatives, partners, trustees of settlements of which the person or any relative of the person is or was a settlor. See section 448 for the full definition.

Where a company is affected by the change it may in the first period affected (being a period starting before 1 April 2011) elect that the change does not apply to that period by giving notice up to one year after the end of the accounting period to which the election relates.

The test of substantial commercial interdependence will be made by Treasury Order. The order is SI 2011 no 1784, issued on 21 July 2011.

The Order lists three factors which must be taken into account:

- Financial interdependence
- Economic interdependence, and
- Organisational interdependence.

Each of these is then defined in the Order:

**“Financially interdependent”**

**3.** Two companies are “financially interdependent” for the purposes of article 2 if (in particular)—

(a) one gives financial support (directly or indirectly) to the other, or
(b) each has a financial interest in the affairs of the same business.

**“Economically interdependent”**

**4.** Two companies are “economically interdependent” for the purposes of article 2 if (in particular)—

(a) the companies seek to realise the same economic objective,
(b) the activities of one benefit the other, or
(c) the companies have common customers.

**“Organisationally interdependent”**

**5.** Two companies are “organisationally interdependent” for the purposes of article 2 if (in particular) the businesses of the companies have or use—

(a) common management,
(b) common employees,
(c) common premises, or
(d) common equipment.

As this test is well established and used in VAT for the purposes of the disaggregation rules, advisers should have a reasonable source of case reference to help them interpret the new test at the outset.

### 1.13 Anti avoidance legislation

Anti avoidance legislation included in the Finance Act 2011 but not dealt with in detail here is as follows:

- Section 28 / Schedule 4 – amending the rules in relation to loan relationships and derivatives specifically in relation to arrangements which are not recognised in the accounts. New rules treat all such transactions as if they were fully recognised in the accounts for tax purposes.
- Section 29 – tightening up the anti avoidance rules (ss 418 – 419 CTA 2009) applying to the raising of intra group finance through the issue of convertible securities
- Section 30 / Schedule 5 – group mismatch schemes are when a tax avoidance scheme is predicated on asymmetries in the way that different members of a group bring amounts relating to derivative contracts and loan relationships into account. This legislation is intended to counter the tax advantage obtained.
- Section 31 – avoidance of the de-grouping charge prevented
- Section 32 / Schedule 6 – tightening up (once again) the sale of lessor companies anti avoidance legislation in CTA 2010 Part 9. Commences on 23 March 2011.
- Section 33 – in response to an avoidance disclosure that claims up to 200% tax relief in relation to expenditure by a lessee on plant and equipment subject to a long funded lease.
- Section 54 – withdrawal of the election available to leasing companies on the sale of a lessor company allowing them to elect out of the charge. Effective date 23 March 2011.

# 2 INCOME TAX

## 2.1 Rates and allowances

The tax rates and allowances for 2011-12 are confirmed by Section 1 - 3. They are as follows:

**Table 1: rates and limits for tax 2011/12**

| | **2011/12** | **2010/11** |
|---|---|---|
| Personal allowance | 7,475 | 6,475 |
| Age related allowance : 65 - 74 | 9,940 | 9,490 |
| Age related allowance : 75 and over | 10,090 | 9,640 |
| Income limit for personal allowance | 100,000 | 100,000 |
| Income limit for age related allowances | 24,000 | 22,900 |
| Basic rate band (20%) | 35,000 | 37,400 |
| Higher rate limit (40%) | 150,0000 | 150,000 |
| Additional rate | 50% | 50% |

## 2.2 Disguised remuneration

HMRC has long been known to be hostile to the use of trusts in circumstances that enable tax to be avoided or deferred. During 2009, this was highlighted by the publication of two 'Spotlights' which focused on particular uses of Employer Financed Retirement Benefit Schemes (EFRBS and employee benefit trusts (EBTs.

The June 2010 Emergency Budget announced that legislation would be introduced to *'tackle arrangements using trusts and other vehicles to reward employees which seek to avoid, defer or reduce tax liabilities'*.

Following much speculation, draft clauses were initially published on 9 December 2010. After intense consultation and lobbying, HMRC clarified and redrafted a number of provisions, as reflected in Clause 26 and Schedule 2 to the Finance Bill 2011 published on 31 March 2011. Further amendments were made at Public Bill Committee stage.

Royal Assent was given to the legislation, new contained in new Part 7A of ITEPA 2003 on 19 July 2011 and HMRC has also published several versions of Frequently Asked Questions..

On 18 August 2011, HMRC published Disguised Remuneration Legislation Draft Guidance. This contains the draft guidance that HMRC will introduce into the Employment Income Manual (EIM). The contents are arranged into temporary notes using the designation TEMP. References in this note using this designation refer to this draft guidance.

All statutory references in this note are to ITEPA 2003 unless otherwise indicated.

### What do the rules do?

The legislation applies where:

- There is an arrangement which relates to an existing, former or prospective employee
- It is, in essence, a means of providing rewards, recognition or loans in connection with employment
- The 'relevant third party' operating the arrangement takes a 'relevant step;
- It is reasonable to suppose that, in essence, the step is pursuant to the arrangement or there is some other connection between them

(s554A)

When the legislation applies, the value of the cash or assets which are the subject of the 'relevant step' is treated as employment income (s554Z2) and will be subject to PAYE and NIC (s687A and s695A). See TEMP125 for HMRC's guidance on the PAYE implications of the disguised remuneration rules.

### Relevant third party

A 'relevant third party' includes:

- An employee acting as a trustee
- An employer acting as trustee, or
- Any person other than the employee or employer

(s554A(7))

For the purposes of Part 7A any company in the same group as the employer at the time a relevant step is taken is treated as if they were the employer' (s554A(8)). Therefore, a group company will not normally be a relevant third party unless it acts as trustee of an arrangement or if there is some underlying tax avoidance purpose. However there are limited circumstances set out in Part 7A Chapter 3 where an employer takes certain steps in relation to EFBRS where it can be a relevant third party

### Relevant steps

There are three categories of relevant step which may become chargeable if taken by a relevant third party:

- Earmarking of money or assets for an employee with a view to a later relevant step being taken (s554B)
- Payment of sum to an employee , including the making of a loan, or the transfer or an asset to an employee (s554C)
- Making an asset available to an employee as if the asset had been transferred outright (s554D)

See TEMP9.

### What arrangements are potentially affected?

Broadly, any arrangement which provides employment benefits through a third party, such as an EBT, is potentially affected unless a statutory exclusion applies.

Common historic uses of EBTs that will now fall within the scope of the legislation include:

- A loan from an EBT to an employee made after 6 April 2011, even if it is subsequently repaid (a payment within s554C). A loan from an EBT to an employee made between 9 December 2010 and 6 April 2011 will fall within the transitional anti-forestalling rules which only impose an income tax charge on 6 April 2012 if the loan has not been repaid before that date. See TEMP118
- The allocation of assets from an EBT to a sub-fund established for the benefit of an individual employee and/or his family (earmarking within s554B)
- The distribution of assets from a sub-fund, even if the sub-fund was established before 6 April 2011 (a payment or transfer within s554C)
- The allocation of funds or assets to an EFRBS for the provision of future retirement benefits (earmarking within s554B)

### Exclusions for share schemes

Many companies operate EBTs in conjunction with their employees' share schemes.

Where trustees reserve shares held in an EBT in order to satisfy awards granted to employees under an employees' share scheme, this will, on the face of it, constitute earmarking within s554B. It would be unfortunate if this were to be treated as a chargeable relevant step as an employee may not be aware that earmarking has taken place and may not have received any benefit at that time.

There are a number of specific exemptions in the legislation for arrangements that support common types of employees' share schemes.

These exemptions are, for the most part, only applicable to exclude a charge for earmarking. If the trustees of an EBT grant awards or deliver shares to satisfy awards, these will be treated as separate relevant steps within s554C and separate exemptions may need to be found to cover these.

If, however, an EBT acquires shares to meet future requirements of an employees' share schemes, there will be no Part 7A charge provided the shares are not earmarked for named employees but are simply retained as part of a general pool of shares (see HMRC FAQ 24 and TEMP19). In these circumstances, unless a statutory exemption is available, it is important that the trustees do not have details of the number of shares to be awarded to individuals in order to avoid the earmarking charge.

The statutory exemptions overlap in some cases and are subject to conditions. They apply to:

- Certain steps taken under HMRC approved share schemes, including the grant of awards, acquisition, earmarking and delivery of shares (s554E)
- Earmarking of deferred remuneration (s554H). See TEMP42
- Earmarking for share awards or their cash equivalent (s554J)

- Earmarking for share awards or their cash equivalent where these vest only on an exit (s554K)
- Earmarking for share options or their cash equivalent (s554L)
- Earmarking for share options or their cash equivalent where these vest only on an exit (s554M)

The conditions relating to steps taken under HMRC approved share schemes require that the total number of shares held for the relevant purpose must not exceed the maximum number of shares which might 'reasonably be expected to be required' for those purposes over a ten year period.

The conditions in ss554H, 554J and 554L bear a number of similarities in that:

- The main purpose of the award cannot be the provision of relevant pension benefits but is to defer the receipt of shares or cash to a specified vesting date
- The specified vesting date is not more than ten years from grant (for ss554J and 554L) or 5 years in the case of deferred remuneration under s554H
- The award is revoked if specified conditions are not met and there must be a reasonable chance that those conditions will not be met. See FAQ 17 and TEMP42 for further guidance on the interpretation of this condition
- The number of shares earmarked does not exceed the maximum number which might reasonably be expected to be needed

The conditions for exit-only schemes in ss554K and ss554M are similar except there is no requirement for a vesting date or conditions.

Deemed charges can arise under all the exclusions after the final vesting/exercise date unless the employee receives taxable income as a result of vesting/exercise or the award lapses.

**Exclusions for other employment-related securities and other relieving provisions**

Further exclusions are contained in s554N ITEPA 2003. Broadly, there will be no Part 7A charge for:

- The acquisition of restricted securities, including where a s431 election applies (s554N(1));
- The grant of an employment-related securities option or the transfer of shares following its exercise (s554N(2))
- The acquisition of shares where this has given rise to an income tax charge (s554N(4)-(6))
- The acquisition of shares where full market value has been paid or where an employee has paid tax on this amount (s554N(7))
- Short term loans for the sole purpose of paying the exercise price of a share option, providing this is repaid within 40 days (s554N(13)).

See TEMP52.

There are also potential relieving conditions in s554Z that apply to avoid double tax charges where:

- There is an overlap with an earlier relevant step (s554Z5)
- There is an overlap with other employment earnings (s554Z6)
- An employee pays the exercise price of a market value share option (s554Z7)
- An employee gives consideration for a relevant step at or around the same time – for example if an EBT buys shares from a departing employee (s554Z8). Note: this relief will not apply where an employee acquires shares from an EBT on deferred payment terms. Such arrangements will need to be re-structured with a group company loan to fund the upfront purchase price, although care should be taken where a close company makes a loan to a participator.
- There is a subsequent income tax liability following a relevant step (s554Z13)
- Earmarking has taken place but by reason of an event, is not followed by a further relevant step, provided an application for relief is made to HMRC within 4 years of the relevant event (s554Z14)

TEMP48 contains an overview of exclusions for share schemes.

**Other employment-related exclusions**

There are certain other exclusions for the provision of employment-related benefits:

- Exclusion for relevant steps taken for the purpose of the purchase of a car or its sale-back under an Employee Car Ownership Scheme (s554O). See TEMP37
- Exclusion for construction industry holiday pay schemes (s554E(1)(e)). See TEMP46
- Exclusion for loans made on ordinary commercial terms, provided a substantial proportion of the third party's business involved similar transactions with members of the public (s554F). See TEMP32
- Exclusion for transactions under employee benefit packages where benefits are provided to a substantial proportion of employees (s554G). See TEMP34
- Exclusions where employment income is provided that is exempt under Part 4 ITEPA 2003 (e.g. relocation expenses, travel and subsistence, redundancy payments etc) (s554P). See TEMP39
- Exclusions for employee pension contributions (s554T). See TEMP85

**Implications for pensions**

The introduction of the disguised remuneration rules will significantly affect the use of EFRBS, as trustees will be treated as earmarking when assets are held for the provision of retirement benefits to an individual.

There are various exclusions for payments from, and transfers between, certain types of pension funds, to the extent that payments/transfers derive from rights accrued at specified dates.

Wholly unfunded arrangements should be outside the scope of the rules provided there is no form of security for the pension or, where the benefits are to be provided by the employer directly without any intention to use funds allocated for these purposes by a third party.

### Implications for other EBT-based remuneration planning

As indicated above, ('What arrangements are potentially affected?'), the disguised remuneration rules will prevent tax efficient loans being made from EBTs and will make the use of EBTs for the provision of remuneration unattractive to the extent that the arrangements do not fall within a statutory exclusion.

This may result in funds being trapped in EBTs or sub-funds which cannot be distributed or allocated without incurring immediate income tax charges. There is some protection for income arising on funds or assets already earmarked (s554Q) and for reinvestments deriving from previously earmarked funds or assets (s554R). The full value of further relevant steps under ss554C or 554D will still be chargeable where they are funded by income or gains from the original contribution.

It should be possible for outstanding loans, made before 9 December 2010, to continue, provided that they are not reallocated or reassigned in a manner that would result in a new payment being made.

However, HMRC is continuing to scrutinise arrangements that were in existence before the legislation came into force and is mounting a two-pronged attack by:

- Offering the opportunity to settle outstanding PAYE/NIC on benefits provided before 6 April 2011 to the extent that these would now be taxable under the disguised remuneration legislation see HM Revenue & Customs: Employee Benefit trusts, settlement opportunity
- Considering the scope for IHT charges on contributions made to an EBT by a close company and transfers out of EBTs to sub-funds HM Revenue & Customs: Revenue & Customs Brief 18/11

*The notes on disguised remuneration were prepared for TolleyGuidance by Osborne Clarke*

## 2.3 Tainted charity donations

Section 27 introduces Schedule 3 which deals with tainted charity donations. It is intended that the substantial donors legislation will be repealed in 2013. The new “tainted donations” legislation is intended to prevent abuse of Gift Aid while being simpler for charities to apply.

The legislation applies to gifts or other disposals made by a person to a charity which is eligible for tax relief. This is defined as where the charity can claim a repayment in respect of the gift, and/or where tax relief would be available in respect of it under the following :

- TCGA 1992 s 257 – gifts of chargeable assets
- CAA 2001 s 63(2)(a), (aa) and (ab) – gifts of plant and machinery
- ITEPA 2003 Part 12 – payroll giving
- ITTOIA 2005 s 108 – gifts of trading stock
- ITA 2007 Part 8 chapters 2 and 3 – gift aid and gifts of shares
- CTA 2009 s 105 – gifts of trading stock
- CTA 2010 Part 6 – charitable donations relief.

A donation is a tainted donation if it meets the criteria above and conditions A, B **and** C are met.

Condition A is that the donor or a person connected with the donor enters into arrangements and it is reasonable to assume that the donation would not have been made and the arrangements would not have been entered into independently of one another.

Condition B is that the main purpose or one of the main purposes of the person entering into the arrangements is to obtain an financial advantage for themselves or a linked person either directly or indirectly from the charity to which the donation was made or a connected charity. The person gaining the advantage is referred to as a "potentially advantaged person".

Condition C is that the donor is not a qualifying charity owned company or a relevant housing provider linked with the charity to which the donation is made. In this instance "linked" means one is under control of the other or both are wholly owned or subject to control by the same person.

The definitions include a "linked person" who is the person entering into the arrangements in condition A. A linked person is either the donor or a person connected with the donor at the relevant time (as defined).

Financial advantage

New section 809ZK sets out the conditions under which a financial advantage (as in Condition B) is deemed to be obtained. They look at the arrangements under which the linked person for condition A involve a transaction between that or any other linked person (X) and another person (Y). X is deemed to obtain a financial advantage from the charity to which the donation is made (or a connected charity) if the terms of that transaction are either more beneficial to X or less beneficial to Y than those that might reasonably be expected from an arm's length transaction or the transaction is not of a kind that a person dealing at arm's length in place of Y might be expected to make.

New Section 809ZL then identifies certain financial advantages which can be ignored for this purpose. Where the advantage is applied for charitable purposes only, it is ignored. If the benefit is in response to a gift aid donation by an individual or company (and therefore within the limits prescribed by legislation) it is ignored. The section also excludes benefits that would otherwise be taken into account for tax purposes, such as a benefit given in return for a transfer of trading stock, which would be charged to tax in any event.

Where the tainted donation rules apply, any income tax relief available on the gift is withdrawn. Where the donation was subject to gift aid for income tax, the tax charge includes the tax repayment provided to the charity, and is borne (jointly and severally) by:

- The donor of the gift aid donation
- The donor of the tainted donation (if different)
- Each potentially advantaged person

- Any charity associated with the arrangements which was aware that the tainted donation conditions were breached at the time of the arrangement.

Similar provisions apply to make the same changes to corporation tax relief, inserting new Ss 939A to 939I into CTA 2010. The tainted donations rules apply to relievable charity donations made on or after 1 April 2011. The substantial donor rules are modified slightly by paras 27 to 29 from April 2011, ensuring that no new substantial donor rules are triggered, the donations instead falling under the tainted donations rules. The substantial donor rules are repealed completely in 2013.

The following examples were provided in the Explanatory notes to the Bill:

*Example 1*

A conservation charity offers donors who make donations of £5,000 or more a special membership package called gold membership, which entitles the member to a benefits package consisting of an opportunity to attend an event at which an ‘expert’ will talk about conservation issues, plus 12 monthly newsletters and a charity branded mug.

In this example the donation will not be caught by the new tainted charity donation legislation. The donation of £5,000 and the receipt of a benefits package as a result may be arrangements caught by Condition A of the new legislation. If the circumstances are such as to suggest the donation would have been made without the benefits package, Condition A will not apply. However, these packages are designed to incentivise the donor to make a larger donation and, if the donation was made in order to obtain the benefits package, Condition A of the new legislation would apply. It would then be necessary to consider if the donor receives a financial advantage from the arrangement (Condition B). The legislation gives examples of circumstances in which a financial advantage can arise; however a financial advantage is ignored if it falls within the Gift Aid benefit limits. In this example, it is extremely likely that the value of the financial advantage will fall within those limits (as the packages are normally designed with the Gift Aid benefit limits in mind). If, of course, the sort of expert advice received as part of the benefits package could not be received by a person without making a donation of £5,000 the donation would not be a tax relievable donation in the first place and merely a payment for services from the conservation charity.

*Example 2*

A donor donates £100,000 to a hospital (a charity) in recognition of the excellent treatment received by his son during his stay. The hospital subsequently writes to thank the donor for the unexpected donation.

In this example the donation will not be caught by the new tainted donation legislation. There was no arrangement in place for the hospital to provide any services in connection with the donation, so Condition A of the new legislation does not apply. Even if his son (or any other person connected to the donor) were to receive further ongoing treatment at the hospital, a lack of an arrangement means that the donation will not be caught. The making of a donation is not in itself an arrangement and this legislation clearly refers to both concepts separately. In this example, there is a donation, but there are no arrangements and the hospital may spend the donation as it sees fit. It is not under any obligation to provide the donor (or any member of his family) with specific medical treatment.

However, the position would be different if the donor had agreed with the hospital that in return for a Gift Aid donation of £100,000 the hospital would provide treatment that would ordinarily cost £125,000. In this instance, the first principles of the Gift Aid legislation would apply and the Gift Aid benefit rules would determine that the £100,000 was not in fact a gift and therefore no tax relief would be available. There would not be any need to consider these new rules in this instance. However, if the donor entered into an artificial avoidance arrangement in order to distance himself from the Gift Aid donation (or the return of the benefit), the Gift Aid benefit rules may not operate in this way. The new tainted donation legislation could then apply. Condition A would apply because the donor would have entered into an arrangement (now more complicated and contrived than the original scenario) in connection with their donation. Condition B would also apply because the main purpose of the donor in entering the arrangement is to obtain a financial advantage from the hospital (there being no other reason to enter into such a complicated arrangement). The clear financial advantage would arise from the fact that the donor has received services valued at £125,000 at a cost of £100,000. The donor is not a qualifying charity owned company or relevant housing provider so Condition C would apply. The donation would be tainted and the tax relief denied.

*Example 3*

A US resident donor lives and works in the UK (receiving UK-source income subject to UK tax) and decides he wants to make a £10,000 donation, tax effectively, to a charitable organisation in the US. The donor is linked to the US organisation to which the donation is to ultimately be made. The donor arranges to make his donation to an agency charity recognised by HMRC and, on making the donation, applies Gift Aid so the agency receives £12,500 (£10,000 donation plus a £2,500 Gift Aid repayment) to distribute on the donor's behalf. The donor instructs the agency charity to pass the funds to the US organisation that undertakes charitable activities, and the US organisation spends the charitable funds on charitable activities.

In this example the donation will not be caught by the new tainted donation legislation. The donor enters into arrangements with the agency charity to confirm that his donation, once made, will be routed on to the US charitable organisation. The donation would not have been made to the agency charity in the absence of this arrangement so Condition A is clearly satisfied. The main purpose for entering the arrangement is to increase the funds of the US charitable organisation (a financial advantage) and this organisation is linked to the donor. At first glance it would appear that Condition B is satisfied. However, the legislation provides for certain financial advantages to be ignored. Where the body that receives the financial advantage (in this case the US charitable organisation) applies the financial advantage for charitable purposes only, the financial advantage is to be ignored. In this example, the donation is not therefore 'tainted'.

*Example 4*

Mr A is a trustee of two charities, Charity B and Charity C. Charity B is responsible for running a college and Charity C provides financial support for the college. Mr A also controls Company D which runs a leisure facility (swimming pool, gym, squash) which is used by the students of the college during school hours and fee paying members of the public outside school hours. Company D wants to expand the leisure facility to allow opening to the public in the day and to provide more up-market facilities i.e. this is a wholly commercial development. To fund this, Company D offers interest free loan stock. Mr A makes a Gift Aid donation of £100,000 to Charity B. Company D issues interest free loan stock of £125,000. Charity B subscribes for £125,000 of the loan stock and requests it be issued in the name of Charity C.

In this example the donation will be caught by the new tainted donation legislation. There is an arrangement in place that, in connection with the donation, the charity will provide an interest free loan (by buying loan stock) to a company connected with the donor and the donation would not have been made and the arrangements would not have been entered into independently of one another. Therefore, Condition A of the new legislation will be satisfied. The main purpose of entering into the arrangement is for the donor to obtain a financial advantage (in this instance, an interest free loan for his company) and therefore Condition B is satisfied. The donor is not a charity owned company or relevant housing authority so Condition C is satisfied and the donation is therefore a tainted charity donation and the relief is denied.

## 2.4 Childcare tax relief

The restriction of childcare tax relief for higher rate taxpayers is effected by Section 35 and Schedule 8. The measures have been widely publicised as they took effect from 6 April 2011.

The effect of the measure is to reduce the tax free availability of childcare support (provided by an employer, either as childcare vouchers or through directly contracted arrangements) for those deemed to be "higher earners" by the legislation. In fact the test only looks at the earnings from the employment in respect of which the childcare is provided, and thus will not restrict tax free childcare for those who have unearned income in excess of £35,000, or who have more than one job.

Paragraphs 2 and 4 of Schedule 8 introduce a new condition "D" to the relevant schemes, which require the employer to make and estimate of the employee's relevant earnings amount – this amount to include benefits in kind in addition to pay; the amount is scaled up to a full year if the employee is subject to a part year assessment. The amount is compared to the higher rate limit (currently £150,000) and the basic rate limit (currently £35,000) to determine the amount of tax free vouchers or tax free childcare that can be provided.

**Table: tax free amounts 2011/12**

| | Basic rate and existing members | Higher rate | Additional rate |
|---|---|---|---|
| **Weekly** | £55 | £28 | £22 |
| **Monthly** | £243 | £124 | £97 |
| **Annual** | £2,915 | £1,484 | £1,166 |

The excess is to be reported on form P11D, but is liable to Class 1 NIC if provided as vouchers, and Class 1A if directly contracted.

Those employees who were already members of a scheme before 6 April 2011 (and had a qualifying child by that date) are not affected by the legislation. Otherwise the earnings assessment is carried out when the employee joins the scheme and thereafter at the start of each tax year.

## 2.5 Childcare schemes and salary sacrifice

The childcare legislation provides that the exemption is available only where all employees are offered the benefit is available to all employees on the same terms.

Where an employer offers childcare vouchers in return for salary sacrifice this has an interaction with national minimum wage. Childcare vouchers do not form part of pay for minimum wage purposes, so employers would therefore be forced to exclude employees from a scheme if their salary sacrifice took them to below minimum wage. This of course would cause the scheme to fall foul of the availability rules.

Section 36 rectifies this issue by allowing employers to exclude “relevant low paid employees” from a scheme – with an appropriate definition. The change is backdated to 6 April 2005 when the scheme commenced.

### 2.6 Junior ISA’s

Regulations will introduce Junior ISA’s later this year, to replace the child trust fund savings scheme. Section 40 makes some amendments to primary legislation to enable the introduction of Individual Investment plans for children, and to provide for the tax exemption. There is also a modification of the settlement legislation at section 629 ITTOIA 2005 to exclude income on a Junior ISA from being taxed on a parent.

Parents, friends and family can contribute to the junior ISA, with a contribution limit of £3,600 per annum. The child cannot access the capital in the account until; they reach the age of 18. Income and gains in the invested funds will be tax free.

### 2.7 Limits on benefits in respect of Gift Aid donations

Small gifts in recognition of donations through gift aid are permitted, but there is a financial limit designed to prevent gift aid being used to pay for a normal commercial supply. The limit on the value of gifts in return for larger donations has been increased by section 41 to £2,500. This applies to donations in excess of £10,000, but the value of the gift must not exceed 2.5% of the donation. The new limit applies to donations by individuals from 6 April 2011, and for donations by companies from 1 April 2011.

### 2.8 EIS relief

The rate of relief applying to EIS investments increased to 30% (from 20%) for the 2011-12 tax year. This change is effected by section 42, which will commence by Treasury Order.

### 2.9 Company car benefit table

Section 51 reduces the lowest emissions on the Table for company car tax from 100g/km to 95g/km from 6 April 2013. This will produce a 1% increase in applicable percentage for most drivers from that date.

### 2.10 Benefits under pension schemes

Section 65 introduces Schedule 16 which makes changes to eliminate the requirement to annuitise at age 77 (previously 75).

The new rules abolish the terms unsecured pension and alternatively secured pension and permit those members who do not wish to purchase an annuity to have a “drawdown pension”.

The maximum drawdown pension that a member can take in any year is capped at 100% of the “basis amount” – this is the amount of an annuity which could be purchased with the available fund. The maximum drawdown is recalculated every three years until the member reaches the age of 75 and then every year thereafter. The same rules apply to a dependant for whom provision is made on the death of a member.

Where a member can satisfy a minimum income requirement, he may make a declaration to that effect and then meets the flexible drawdown conditions which allow him to draw any amount of pension off the fund in a year. This is designed to ensure that in general an individual’s fund cannot become exhausted by overdrawing. The flexible drawdown conditions require that the individual is not an active member of a scheme and makes no contributions to money purchase pension arrangements in the year, and can demonstrate that he has a minimum of £20,000 in relevant income available to him during that year. Relevant income includes occupational pensions and social security pensions (but not drawdown pensions). This is designed to ensure that the minimum income requirement is guaranteed until death.

Where an individual takes a drawdown pension the pension is liable to income tax. Where the member is resident outside the UK for less than 5 full tax years, the tax charge will arise when they return to the UK (New temporary non resident rules).

Most of the IHT charges in relation to ASP’s have been abolished, and lump sum death benefits payable at age 75 or over are liable to tax at 55%. Lump sum death benefits payable in respect of members aged less than 75 who have not yet taken their pension are tax free.

## 2.11 Pensions – annual allowance charge

Section 66 introduces Schedule 17 which introduces the new annual allowance arrangements, effective from 6 April 2011.

Amount of annual allowance

The new amount of the annual allowance is fixed by para 4 of the Schedule at £50,000 for 2011/12 and all subsequent tax years. This amount may be increased by secondary legislation in the future.

Rate of tax applying to the annual allowance charge

Para 3 amends the rate of tax applying to the annual allowance charge. Previously 40%, the charge is now made at the appropriate rate, which treats the charge as if it were the top slice of income of the individual for the year. Some taxpayers may therefore pay only basic rate on a modest annual allowance charge, with higher and additional rates applying to parts of the charge as appropriate.

Example

Peter has income of £28,500 for the purposes of the annual allowance charge (income after personal allowance). His annual allowance charge in 2011/12 is £70,000.

The tax on Peter's annual allowance is calculated as follows:

| | |
|---|---|
| At basic rate: £35,000 - £28,500 = £6,500 x 20% = | £1,300 |
| At higher rate: £70,000 - £6,500 = £63,500 x 40% = | £25,400 |
| Total tax charge | £26,700 |

Note that had Peter made contributions himself to his pension arrangement, the limit of the basic rate band would have been increased above £35,000 and that increased limit would have applied for this purpose. (New section 227(4B)).

Carry forward of unused annual allowance

Para 5 introduces new S 228A permitting the carry forward of unused annual allowance. This section permits individuals who have been a member of a registered pension scheme for a tax year, but who have made contributions of less than the amount of the annual allowance to carry forward the unused amount by up to three years. The amount is used up in subsequent tax years when the amount of the contribution paid in the later year exceeds the standard annual allowance for that year. Brought forward amounts are used up on the basis of the oldest amounts first.

For the purpose of the new carry forward rules, the annual allowance in 2008/09 to 2010/11 is deemed to be £50,000, and all other changes by the Schedule are deemed to have taken effect. This means that the carry forward is calculated using the new basis (and therefore will be recalculated if the individual is a member of a defined benefit arrangement) and any excess over the deemed £50,000 annual allowance reduces the amounts available to carry forward.

Example

Lance is a member of a money purchase scheme and has been making contributions to the scheme for many years. His last few years' contributions have been:

| | |
|---|---|
| 2008/09 | £30,000 |
| 2009/10 | £25,000 |
| 2010/11 | £60,000 |

The maximum contribution that Lance can make in 2011/12 is as follows:

2008/09 unused amount £20,000, but £10,000 of this is deemed to be used in 2010/11. 2009/10 unused amount is £25,000. Total unused amounts brought forward

£35,000, added to the current annual allowance in 2011/12 of £50,000 provides a maximum contribution of £85,000.

Changes to pension Input Periods (PIP)

The annual allowance for a tax year is compared to the pension input amount for a pension input period ending in the tax year. The pension input period is often determined by the date the member joined the scheme, but the scheme administrator can nominate an alternative date. Para 16 of Sch 17 specifies that the pension input period will default to 5 April after the member joined the scheme (or became entitled to benefits under the scheme). It is still possible to nominate a different date, but no retrospective changes are permitted.

Calculation of pension input amount

The rules on the calculation of the pension input amount vary according to the type of arrangement in place. For money purchase schemes it is simply the amount contributed to the scheme in respect of the member during the period. This aggregates member and employer contributions together.

For defined benefit arrangements the calculation of the pension input amount has always been driven by the benefits available, and specifically the increase in benefits during the pension input period. For this purpose, the annual pension benefit available under the scheme is multiplied by 16 to arrive at the value for these purposes. Previously the multiplier was 10. Any Lump sum available in addition to the pension is added to this value. In addition, the opening benefits available at the start of the period are uprated to reflect inflation, but the uprating is now subject to CPI and not RPI. The CPI used is the annual increase in the September before the tax year, so the following amounts should be used:

September 2007 – for 2008/09 – 1.8%
September 2008 – for 2009/10 – 5.2%
September 2009 – for 2010/11 – 1.1%
September 2010 – for 2011/12 – 3.1%

Note that it is the responsibility of the scheme administrator to calculate these amounts and provide the member with the information needed to complete his tax return.

Example

John is a member of an occupational defined benefit scheme under which he is entitled to 1/60 of his final salary for each year that he is a member of the scheme (up to a maximum of 40 years) and a lump sum of 1/80 of his final salary for each year of membership. John has been a member of the scheme for 23 years as at 6 April 2011 and his salary at that date was £60,000. By 5 April 2012 (the end of his PIP) his salary had increased to £65,000.

**Opening value of benefits**

| | |
|---|---|
| 23 x 1/60 x £60,000 = £23,000 x factor 16 = | £368,000 |
| 23 x 1/80 x £60,000 | £ 17,250 |
| Total opening benefit value | £385,250 |
| Add inflation factor – CPI at 3.1% | £ 11,943 |
| Uprated opening benefit value | £397,193 |

**Closing value of benefits**

| | |
|---|---|
| 24 x 1/60 x £65,000 = £26,000 x factor 16 = | £416,000 |
| 24 x 1/80 x £65,000 | £ 19,500 |
| Total opening benefit value | £435,500 |
| | |
| Increase in benefit value | £ 38,307 |

Note that a modest increase in salary has produced a large deemed contribution.

Exclusion of annual allowance provisions

Prior to FA 2011, the annual allowance provisions did not apply in a year in which a member took all of the benefits under a scheme (that is the final period of service ending in retirement) or when the member died. This has been modified so that the annual allowance rules now apply in the year of retirement unless the individual has taken his pension on grounds of severe ill health (this is defined in new section 229 (4), introduced by para 6 of Sch 17). The change will prevent those retiring from being able to top up their pension arrangement by very large sums and avoiding a tax charge on the excess contributions.

Tax paid by the scheme

Where the tax liability on the annual allowance charge is more than £2,000, the member may give notice to the scheme administrator to make them jointly and severally liable for the tax in respect of excess contributions to that scheme (new S 237B). Notice must be given by 31 July in the year after the end of the tax year. So for a charge arising in respect of 2011/12 (the first possible year) notice must be given by 31 July 2013 (although in the first year this is likely to be 31 December, as the information on benefits may not be available in time). When the scheme administrator pays the tax due, they must then make an adjustment to the benefits available to the member on a just and reasonable basis. New Section 237F allows HMRC to make any amendments to scheme rules as are necessary to facilitate this change.

Note that where the liability to tax arises as a result of payments into more than one scheme, the member may give notice to one scheme to ask the scheme to meet the liability, but the scheme is under no obligation to accept the liability. Where the liability arises in respect only of contributions to a single scheme, then the scheme administrator has no choice but to accept the liability and adjust the benefits. (Although there are some exceptions allowing the scheme top apply to HMRC to be discharged from liability, such as where payment would be to the overall detriment of the scheme).

Transitional rules – PIP's spanning date of change

Where a PIP started before 14 October 2010 but ends in the tax year 2011/12 it is subject to the transitional rules. These rules recognise that until 14 October 2010 the exact form of the new annual allowance rules was not known and therefore members may have made contributions based on the then annual allowance of £255,000.

The transitional rules split the PIP spanning the date of change (14 October) into a pre-announcement period (up to 14 October) and a post announcement period (up to the end of the PIP which must be in 2011/12). The limit of contributions for the annual allowance is £50,000 in the post announcement period but £255,000 in relation to the tax year 2010/11.

Example

Theresa has a PIP ending on 31 August. She made contributions to a money purchase scheme as follows: 15 September 2010 £90,000; 15 January 2011 £40,000; 15 April 2011 £25,000.

Theresa's allowance for the tax year 2010/11 is £255,000 and her contributions of £130,000 are below this amount. However, her post commencement contributions are £65,000 so unless she has available unused relief from earlier years (2010/11 has already been used up by the contribution of £90,000) she will be liable to a tax charge on the excess over £50,000.

Where the scheme is a defined benefit scheme, a calculation will need to be made for the value of increased benefits for each part of the period – the pre and post commencement. There are some very detailed rules specifying the elements of the computation which are beyond the scope of this session.

## 2.12 Pensions – lifetime allowance charge

Section 67 introduces Schedule 18 which makes changes to the lifetime allowance commencing on 6 April 2012.

New lifetime allowance

The lifetime allowance will reduce from £1,800,000 to £1,500,000 from 6 April 2011. This means that when a member draws benefits or there is another type of Benefit Crystallisation Event (BCE) the value of benefits drawn will be compared to the new lifetime allowance and a charge to tax may be made.

Fixed protection – retaining the £1.8 million limit

Where a member who is not already benefitting from protection under the A day rules (either primary or enhanced protection) wishes to retain the benefit of the £1.8 million lifetime allowance they must notify HMRC in writing by 5 April 2012. For the "fixed protection" to be available the member must make no further pension savings after 6 April 2012, so the decision is really an investment decision and you should not advise on this if you are not registered to give investment advice.

Impact on those with primary or enhanced protection

In general, if a member has primary protection under the A day transitional rules, he will retain the benefit of the £1.8 million limit when he draws his benefits (and this amount will be subject to the multiplier that he benefits from). For those benefitting from enhanced protection, their entire fund was protected from tax charge unless they contributes to a scheme or accrued additional pension rights after a day. There is a small modification to limit enhanced protection to those whose pension benefits in a defined benefit arrangement increase by no more than CPI.

Other changes

There are various points at which pensions legislation uses a measure of 1% of the lifetime allowance. For example, this is a limit applied to the commutation of trivial benefits. In all cases this term is replaced by the sum £18,000 from 6 April 2012, unless increased by Treasury Order.

## 2.13 Other pensions changes

Sections 68 to 71 make some administrative changes in relation to pension schemes, including a number of changes relevant to NEST and related to the Pensions Act 2008 and similar legislation for Northern Ireland. The detail of these changes is not relevant to the adviser dealing with individual clients.

## 2.14 Foreign pensions of UK resident individuals

Anti avoidance legislation was introduced into the Bill after it was initially released to provide for a UK tax charge to arise on a foreign pension paid to a UK resident individual where the pension is paid out of sums or assets that were the subject of a "relevant transfer", which was part of a tax avoidance scheme. This forms section 72 of the Act as finally passed.

A relevant transfer is defined as a transaction or series of transactions as a result of which:

(a) The sums or assets are transferred out of a pension scheme, and
(b) The sums or assets or related sums or assets are transferred into a pension scheme under which the pension is payable.

# 3 CAPITAL TAXES

## 3.1 CGT annual exempt amount

The CGT annual exempt amount for individuals for 2011-12 is £10,600. (Section 8)

## 3.2 Entrepreneurs' relief limit

The lifetime limit for Entrepreneurs' relief was increased from £5 million to £10 million with effect from 6 April 2011. Section 9 gives effect to this change.

# 4 VAT

## 4.1 Business samples

Section 74 amends VATA 1994 Sch 4, para 5 to clarify the position with regard to business samples. New sub para 2(b) now states "the provision to a person, otherwise than for consideration, of a sample of goods." This replaces the previous subsection and Sub para (3) which set additional constraints on the provision of samples. The purpose of para 5 is to exclude the listed items from being regarded as a supply for VAT purpose, as a result of the decision in *EMI* (C-581/08).

## 4.2 Supply splitting

Section 75 tightens up the rules with regard to the zero rated supply of books to prevent supply splitting and consequent attribution of a value to a zero rated element of a single supply. The most obvious example of this was the attempt by BskyB to claim that part of the monthly subscription paid by Sky TV subscribers should be attributed to the Sky magazine, which would, of course therefore be zero rated. The new notes added to Group 3 of Sch 8 state that zero rating will not apply to a supply made in connection with a supply of services where the connected supplies are made by different suppliers. Note 3 defines connected supplies for this purpose as a supply which if made by a single supplier would be treated as a single supply which is a taxable (positive rated) supply or an exempt supply.

## 4.3 Academies

Section 76 introduces a VAT refund scheme for the new Academies, to put them in the smear position as if they remained under local authority control and could therefore obtain refunds of VAT. New VATA 1994 s 33B is inserted to achieve the change.

## 4.4 Low value consignment relief

This relief allows low value imports to be relived of VAT import liability. This permits the shipping of positive rated supplies to consumers from outside the EU, thus providing the consumer with a cost saving. IN consequence many of the major retailers (both online and traditional) now accept orders and ship goods from Jersey, allowing the goods to be imported individually with no VAT charge. This type of arrangement is common in respect of DVD's, CDE's and similar items. The current value for the relief is goods to the value of less than £18, but section 77 reduces this amount to £15 in respect of imports on or after 1 November 2011.

# 5 SDLT

## 5.1 Anti avoidance changes

Section 82 introduces Schedule 21 which is intended to close down three SDLT avoidance schemes. The Explanatory notes indicates that the changes "ensure or put beyond doubt that certain SDLT avoidance schemes are ineffective". In broad terms, the changes:

- Prevent the rules for sub-sales being combined with the alternative finance rules to exclude any charge to SDLT on the purchase of an interest in land.
- Prevent the alternative finance rules from being abused by purchasers setting themselves up as a "financial institution" by obtaining a Consumer Credit Licence.
- Make changes to the exchange of interests rules. These rules were introduced in 2003 to ensure that SDLT was chargeable on an exchange of property based on the market value of the interest acquired. Previously stamp duty had only been charged where there was an equalisation payment. However, the market value rules have been manipulated to produce savings in SDLT, so para 4 of Sch 21 prevents this from being effective.

The changes take effect from 24 March 2011, unless an arrangement was entered into before that date and is completed after without being altered.

## 5.2 Relief for the purchase of multiple dwellings

Where a purchaser buys a number of dwellings in a single transaction the rate of SDLT applicable will rise as it is based on the total consideration. Section 83 and Schedule 22 introduce a new relief which is intended to stimulate investment in the private rented sector by reducing the SDLT charge on a multiple purchase to that which would have applied had the properties been purchased individually.

The relief applies to the purchase of at least two dwellings in a single transaction, and also to linked transactions involving at least one dwelling in each. The relief applies to divide the total consideration for the dwellings (note that some of the consideration may apply to other property and this is excluded) by the number of dwellings and to calculate the SDLT charge accordingly. However, if the average price of the dwellings is then calculated at below the SDLT threshold, the rate to be used is 1%, so the relief cannot be used to eliminate the SDLT charge.

<u>Example</u>

Peter is making an investment in a number of newly constructed flats on a development. He agrees to purchase 20 flats for a total price of £3 million. With consideration of £3 million, the rate of SDLT would be 5% and the SDLT liability would be £150,000.

If Peter claims relief under Sch 22, the SDLT would be recomputed as follows:

Total consideration for dwellings = £3 million

Number of dwellings = 20
Average consideration per dwelling = £150,000.

The rate of SDLT applying to consideration of £150,000 is 1%, so the SDLT on the purchase is £3 million x 1% = £30,000, a saving of £120,000.

Had the purchase been of 25 dwellings, the average price of £120,000 would have fallen below the SDLT threshold of £125,000. However, the minimum rate of 1% would still apply to the purchase.

The relief applies to contracts with a relevant date on or after Royal Assent. The relief is clawed back if there is a change in circumstances such that the relief would not apply had that change occurred at the time of purchase. The time frame for clawback is the shorter of:

- 3 years, and
- The period ending when the property is sold to an unconnected party.

# 6 TAX ADMINISTRATION

## 6.1 Security for PAYE

Section 85 introduces a requirement for businesses to give security (a financial down payment) in respect of PAYE, when requested by HMRC. This is done by amending section ITEPA 2003 s 684 which details matters to be set by the PAYE Regulations. New subsection 4A makes the failure to provide such security as is requested a criminal offence. Although this mirrors similar provisions for VAT (VATA 1994 Sch 11 para 4 & s 72 for offence), most commentators regard this as an unnecessarily aggressive measure.

## 6.2 Data gathering powers

Section 86 introduces new data gathering powers, by the mechanism of Schedules 23 (obtaining data from data holders – new powers) and Schedule 24 which amends FA 2008 Sch 36, which sets out the new information and inspection powers now in force.

New data gathering powers: data holder notice

This provision commences on 1 April 2012. An officer of HMRC may require a data holder to provide data by giving notice in writing. This is known as a “data holder notice”. The purpose of the power is specified in para 2 of Sch 23 as to assist with the efficient and effective discharge of HMRC’s tax functions, whether in respect of a particular function or more generally, and whether in respect of a particular tax payer or group of tax payers or more generally. Para 2(5) sets no limits on the use of the data so obtained. Thus, the power is widely drawn and will be available for almost any purpose HMRC desire, although para 2(3) does not permit it to be used for checking the tax position of the data holder himself.

The notice must specify what data is required under the notice. Data can only be requested where it could have a bearing on chargeable periods ending on or after the applicable day, which is set at 4 years prior to the day on which the notice is given. So for example, a notice given on 23 January 2012 can request data which has a bearing on chargeable periods ending up to 24 January 2008. For income tax, one would assume that this includes data from 6 April 2007 onwards.

The provision of a data holder notice may be pre-approved by the Tribunal (but this is not a requirement). In granting approval, the tribunal may not so do unless the request is made by an authorised officer who, in the tribunal’s opinion has justification for doing so. Normally the data holder should have been notified and given the opportunity to make representations which must be relayed to the tribunal, but this provision may be dispensed with if by so doing the actions of HMRC would be prejudiced.

The relevant data holder has a right of appeal against a data holder notice, unless the notice has been pre-approved by the tribunal, or it relates to data forming part of the data holder’s statutory records. The grounds of appeal are:

- It is unduly onerous to comply with the notice or requirement

- The data holder is not a relevant data holder, or
- Data specified in the notice are not relevant data.

The question as to what is relevant data in respect of a particular data holder is to be specified in Treasury Regulations. No detailed consideration of that issue is made in this session. Notice of appeal must be given in writing within 30 days of the data on which the data holder notice was given, and must state the grounds of appeal.

If the data holder fails to comply, they are liable to an initial penalty of £300, followed by up to £60 per day for each further day of default once the initial penalty has been charged. However, once the daily penalty has been levied for 30 days, HMRC may apply to the tribunal to increase the daily amount of penalty to a maximum of £1,000 per day.

Where the information provided includes an inaccuracy which is either careless or deliberate on the part of the data holder, or where the data holder knows the information to be inaccurate when he provides it to HMRC, or fails to correct it in a timely manner after discovering the inaccuracy, the data holder is liable to a penalty of up to £3,000, although an appeal that there is a reasonable excuse is possible.

***Relevant data holders***

Part 2 of the Schedule sets out who are relevant data holders, and these are organised broadly by reference to the type of data which may be requested from them, although, for example, all charities are relevant data holders.
A broad summary of the list follows:

- In respect of salaries, fees and commission
  - An employer
  - A person concerned with making payments to or in respect of another person's employees with respect to their employment by that other person
  - An approved payroll giving agent
  - A person who carries on a business in connection with which relevant payments are or are likely to be made
- In respect of interest etc.
  - A person by or through whom interest is paid or credited (interest is defined to include dividends on building society shares, payments on redemption in respect of deep discounted securities, foreign dividends and alternative finance returns).
- In respect of income, assets belonging to others
  - A person who (in whatever capacity) is in receipt of money or value of or belonging to another person
- Payments derived from securities – data request is limited to establishing the beneficial ownership of the securities or payment
  - A person who is the registered or inscribed holder of securities
  - A person who receives a payment derived from securities (or would if such a payment is made)
  - A person who receives a payment from a company for purchase of own shares

    - A person who receives a payment chargeable under the demerger rules in CTA 2010 Part 23 Chapter 5.
- Grants and subsidies out of public funds
    - A person who makes a payment out of public funds by way of grant or subsidy
- Licences, approvals etc.
    - A person by whom licences or approvals are issued or by whom a register is maintained
- Rent and other payments arising from land
    - A lessee
    - An occupier of land
    - A person having use of land
    - A person who as agent, manages land or is in receipt of rent or other payments arising from land
- Dealing etc. in securities
    - A person who effects or is a party to securities transactions wholly or partly on behalf of others (whether as agent or principal)
    - A person who in the course of business acts as a registrar or administrator in respect of securities transactions
    - A person who makes a payment derived from securities to anyone other than the registered or inscribed holder
    - A person who makes a payment derived from bearer securities
    - An accountable person within the SDRT regulations.
- Dealing in other property
    - The committee or other person or body of persons responsible for managing a clearing house for any terminal market commodities
    - An auctioneer
    - A person carrying on a business of dealing in any description of tangible moveable property
    - A person carrying on a business of acting as agent or intermediary in dealings in any description of tangible moveable property
- Lloyds
    - A person registered as a managing agent at Lloyd's in relation to a syndicate of underwriting members
- Investment plans
    - A plan manager
    - An account provider in relation to a child trust fund
- Petroleum activities
    - The holder of a licence granted under Part 1 of the Petroleum Act 1998
    - A responsible person in relation to an oil field
- Insurance activities
    - A person involved (in any capacity) in an insurance business
    - A person who makes arrangements for persons to enter into contracts of insurance
    - A person concerned in a non insurance business who has been involved in entering into a contract of insurance that provides cover for any matter associated with the business
- Environmental activities
    - A person involved in subjecting aggregate to exploitation in the UK

    - A person involved in making or receiving supplies of taxable commodities (see Sch 6 FA 2000)
    - A person involved in landfill disposal
- Settlements
    - A person who makes a settlement
    - The trustees of a settlement
    - A beneficiary under a settlement
    - Any other person to whom income is payable under a settlement
- Charities
    - All charities are relevant data holders.

Amendments to FA 2008 Sch 36

Schedule 36 to Finance Act 2008 includes the information and inspection powers relevant to HMRC compliance activity since 2009. Schedule 24 to Finance Act 2011 makes the following amendments to the existing powers.

- The right of HMRC to require information and documents in respect of person or persons unknown in order to check their tax position is extended by the removal of “UK”, thus allowing the power to apply when the information or document is relevant to any tax position of the unnamed individual or class of individuals. (Para 2 of Sch 24 FA 2011) There is a consequential change to allow the power to be used only when the tribunal is satisfied that the person or class of persons may have failed to comply or may fail to comply with the law including the law of a territory outside the UK in relation to tax. This replaces the term “the Taxes Acts, VATA 1994…” thus extending the scope territorially. The change applies from 1 April 2012 but in relation to any tax regardless of when it became due.
- The penalty provisions applying to the provision of inaccurate information or documents (existing para 40A) are amended to include when the inaccuracy is known at the time the information or documents are provided and not notified to HMRC at that time. This change applies to information provided or documents produced on or after 1 April 2012. (Para 3 of Sch 24)
- A new para 49A is inserted to allow for increased daily penalties for default. The current daily amount is capped at £60 per day by para 40. New para 49A (inserted by para 4 Sch 24) allows the officer to apply to the tribunal to increase this amount to up to £1,000 per day where the daily penalty has been levied for 30 days. This procedure applies to failures to comply that begin on or after 1 April 2012.
- Existing para 50 (in Sch 36) provides for tax geared penalties. Para 5 of Sch 24 amends the trigger date in respect of this by adding the date on which the person became liable to the fixed penalty for failure into the triggers. Where a notice can be appealed (i.e. when there is no pre-approval by the tribunal) the test becomes the latest of the date the liability to the fixed penalty arose, the end of the appeal period for the information notice and the date on which the appeal is determined or withdrawn. In other cases the trigger date is the date the person became liable to a fixed penalty for failure. The change commences from Royal Assent.

## 6.3 Mutual assistance for recovery of taxes

Section 87 and Schedule 25 enact in UK law the provisions of “MARD” – EU Council directive 2010/24/EU. Schedule 25 para 3 lifts secrecy requirements for the purposes of making a disclosure to an applicant authority of any member state. Disclosure may be made to persons in the UK or elsewhere in relation to meeting a request from a member state for assistance in accordance with MARD. Para 4 limits the onward disclosure of the information provided and specifies that it is an offence for a public authority to disclose the information other than as permitted by 4(3). No further detailed consideration of these provisions is considered appropriate to this session.

## 6.4 Tax simplification

Section 91 and Schedule 26 repeal certain redundant reliefs, in accordance with the recommendations of the Office of Tax Simplification. Accordingly, the following reliefs have been repealed (some of which are inactive in any event). The legislation where the amendment is made appears in brackets.

- Transitional gift aid relief for charities due to change in rate (FA 1997)
- Millennium Gift Aid (FA 1998)
- Payroll giving supplement (FA 2000)
- Exemption for first £70 of interest on National Savings Bank ordinary account. (ITTOIA 2005)
- Three exemptions from stamp duty (**not** SDLT) have been repealed. (FA 1944, 1953 and 1999)

# 7 RECENT DEVELOPMENTS

## 7.1 Non-dom boss must pay UK tax

HM Revenue & Customs has won an Upper Tier Tribunal appeal against Ernst & Young over the taxation of US profits taken by private equity boss George Anson.

HMRC had appealed a ruling that Anson, manager of US private equity firm HarbourVest's UK operations, was entitled to double taxation relief on profits remitted from the US to the UK. Anson is a non-domicile based in the UK and received a share of profits from HarbourVest's US business.

HMRC had required Anson to pay the remitted income like a dividend, with no credit for tax paid in the US. Ernst & Young, of which Anson is a client, challenged that in the First-Tier Tax Tribunal and won, meaning Anson was able to take the profits while paying only US income tax. It said HMRC's ruling would have led Anson to pay £45 in US tax and £22 in UK tax for every £100 of profit.
The Upper Tribunal overturned the earlier judgment and found in favour of HMRC, denying Anson was being taxed twice on the same amount under HMRC's requirements. It said that while Anson was being taxed on profits in the US, he was still required to pay tax on distributions when that money was remitted to the UK.

An Ernst & Young spokeswoman declined to comment on the case.

*Accountancy, 12 August 2011*

## 7.2 US citizens can offset remittance charge

The Internal Revenue Service (IRS), the tax authority of the United States, has issued a document to confirm that US taxpayers can claim credit for the UK's remittance basis charge.

The publication of *Revenue Ruling 2011-19* means American citizens who are resident in this country and choose to pay tax on the remittance basis can set against their US tax bills the annual £30,000 charge levied by HMRC.

Given the IRS taxes US citizens and green card-holders on their worldwide income, regardless of where they live, American non-doms living and working in the UK previously ran the risk of being taxed twice on the same income.

The situation should now be eliminated, said Dan Crowther, director in the private client advisory practice at KPMG in the UK, who praised the 'sensible and pragmatic ruling'.

## 7.3 Status developments (Lecture P672 – 11.21 minutes)

Recent case law has given fresh hope of resisting an HMRC attack that the taxpayer is employed rather than self-employed, or that IR35 applies where a personal service company provides the services.

ECR Consulting Limited v HMRC TC01174

ECR Consulting was set up in 1993 by R an IT consultant who, having been made redundant, decided to try self-employment. She was advised that because of the complexity of some of her work and the potential for her to be sued, it would be most sensible to set up as a company.

VDS, a company working in billing software, had a number of contracts with power distributors and approached an agency, B, to find them a suitable contractor to help. In February 2002, B approached R to see if her company could help with some work for TXU Energy. She was not interviewed for the position and assumed that VDS had checked her CV on her web site.

There was no direct contract between R and VDS who paid £600 per day for the services but insisted, in view of the level of the daily fee, that should they terminate the contract with B they would not expect to pay a termination fee of the same order.

The first contract ran for approximately six months. About a year later B approached R to work on another project. Given a change to the economy by that time, B offered only £300 per day, with a final agreed rate of £350. Other contracts were agreed at the same rate over the following three years.

HMRC interpreted these facts as indicating that R was effectively an employee of VDS and that IR35 should be apply to her company.

The tribunal reviewed the contracts and arrangements for all of the main 'employed or self employed' tests and concluded that there were three key issues that helped them conclude that R was genuinely in business and IR35 was not relevant.

- **Substitution**: all the contracts allowed for substitution. The end user and the second agency had not interviewed R and had only ever approached ECR to provide 'someone' who was capable of doing the work.

- **Economic risk and reality**: ECR clearly negotiated its fees on a contract by contract basis with a dramatic difference between the first and second contracts.

- **Intention**: VDS preferred to avoid full time employees because the work they did went through peaks and troughs. They had set out to find a consultant, not an employee.

Marlen Limited v HMRC TC01264

Accountax Consulting report that HMRC fell well short of convincing the Tribunal of their contentions that IR35 applies in this case. It involved engineering services provided by Marlen, and Mr Hughes, to two JCB divisions under a series of contracts

It was Mr Hughes's flexibility in terms of hours, holidays and absences that the Tribunal found to be markedly different to employees and, when considered in light of all the elements within this important factor, concluded that the degree of control was not sufficient to constitute a contract of employment.

HMRC's contentions that mutuality of obligations existed within each contract (having accepted there was no on-going mutuality) also bore no reflection of the facts say Accountax. Crucially Mr Hughes, as all contractors, had been sent home without pay when the computers were down. In addition to early terminations by both parties during the course of the engagements, the evidence was compelling that this was a case where no mutuality of obligations existed. In summarising all the factors, the Tribunal did not find one single aspect which was consistent with a contract of employment.

<u>Primary Path Limited v HMRC TC01306</u>

In another case taken by Accountax Consulting, IR35 was held not to apply. The Tribunal's task was to determine whether the services Primary Path supplied to GSK on a specific project, via agencies, were subject to the IR35 legislation. The services were undertaken by Phil Winfield, director of Primary Path Ltd, who was engaged to provide services in respect of the design and build of a specialist interface.

It was found as a fact that the services were carried out with little involvement of the client, other than being checked for standard and quality requirements. The Tribunal said that it was clear Mr Winfield had responsibility for the delivery of his part of the project and the *'level of control or supervision did not go beyond that which one would expect in the hiring of an independent contractor'*; there was no obligation beyond paying for work done; and that the ability to propose a substitute was inconsistent with employment.

The Judge concluded that the position was even more telling when applying the 'in business on account' test and that it was clear the relationship between Mr Winfield and GSK was one for independent services. An issue commented on by the Judge in this case is consistency between the terms of the contract between the agency and the taxpayer and the agency and the client. Often in IR35 cases where there is an agency in the contractual chain there are inconsistencies between the contracts which not surprisingly can protract HMRC's enquiries.

In this case the Judge said there was a *'fair degree of consistency'* between the various contracts/correspondence in place between the parties, which somewhat eased the road to constructing a hypothetical contract in this case. The Tribunal was left in no doubt that the arrangements in question were not caught by the IR35 legislation.

<u>Kuncharalingam v Word by Word Translations Limited</u>

In this case heard before the Employment Appeal Tribunal and published on 17 August 2011, the claimant worked as a Tamil interpreter for the respondent. A document entitled code of ethics and code of conduct, which had been sent to the claimant when he was recruited by the respondent, included in its terms the right of the claimant to provide a substitute interpreter, and it was clear that in practice the claimant did use the services of a substitute to act as an interpreter in his place.

The claimant brought claims against the respondent for unfair dismissal, age discrimination, unlawful deduction from wages and breach of contract. The judge dismissed the claims having found that the tribunal lacked jurisdiction to hear them. The claimant appealed.

It fell to be determined, as a preliminary issue, whether the claimant was an employee or a worker. The court ruled that on the facts of the instant case, it was clear that the judge's conclusion that there was no personal service and accordingly, no jurisdiction to entertain the instant claims, all of which depended on either an employee or worker status, was incapable of being anything other than valid (un-impugnable as expressed by the Appeal Tribunal).

<u>Autoclenz Limited v Belcher & Others – Supreme Court 27/7/11</u>

It is not all good news on the status front, however, as no doubt HMRC will seek to take advantage of the decision in this employment law case if the circumstances permit.

Autoclenz engaged car valeters on a self-employed basis. The contracts contained the common mutuality of obligations and substitution clauses. However, the individuals argued that the clauses did not reflect the actual agreement between the parties and that they were obliged to provide the services personally. The Supreme Court agreed with that view, and found that the substitution and mutuality clauses were not a true reflection of the agreement.

More importantly, the Supreme Court held that when assessing the veracity of contractual clauses Tribunals should take into account the expectations of the parties (e.g. did anyone expect a substitute to be sent?) and the bargaining power between the parties (e.g. was the contract a 'take it or leave it' contract?). The Supreme Court also suggested that the conduct of the parties may be such that it trumps the written terms agreed between the parties. In essence, the decision has widened an individual's scope to claim that the agreed written terms are a sham, and possibly also HMRC's scope to successfully argue employment status.

*Contributed by Gerry Hart*

### 7.4 <u>Plant and machinery loophole closed early</u>

The government has bought forward the removal of a loophole that allowed businesses to accelerate capital allowances claims for plant and machinery and obtain advantageous early tax relief under CAA 2001, s 230.

The closure, which was originally proposed for April 2012, took effect from 12 August 2011, following evidence that suggested not doing so could lead to the loss of significant revenue to the Exchequer.

The change to the law partially repeals the 'exception for manufacturers and suppliers'.

Where expenditure is incurred on or after 12 August to buy or hire-purchase plant or machinery, AIA or FYA is denied, without exception, where the buyer and seller of the plant or machinery are connected, the transaction was put in place solely or mainly to get the benefit of capital allowances, or the plant or machinery was sold and then leased back to the seller and the seller continues to use the plant or machinery for the purposes of a qualifying activity.

Should it emerge that similar schemes exploiting the s 230 exception have been used, the government will consider whether the repeal should be retrospective: have effect before 12 August.

Responses to the original consultation, *Changes to the Capital Allowances Anti-Avoidance Rules for Plant and Machinery*, which closes on 31 August 2011, can still be made and will be taken into account by the government when finalising the legislative changes required to give effect to the repeal.

## 7.5 SSE—joint ventures and entities without ordinary share capital

This Brief states HMRC's view that a group's investment in: (1) a joint enterprise that falls outside the statutory definition of a “joint venture company”; or (2) a company without issued share capital, will not necessarily be treated as a non-trading activity when assessing whether the group is a “trading group” for the purposes of the substantial shareholding exemption. The Capital Gains Manual is being updated to reflect this view.

Corporation Tax and the Substantial Shareholding Exemption: joint ventures and entities without ordinary share capital

The purpose of this brief is to state HM Revenue & Customs' (HMRC's) view of two related aspects of the Substantial Shareholding Exemption that can cause uncertainty as to whether a company is a “trading company” or the holding company of a “trading group” or “trading subgroup”.

The Substantial Shareholding Exemption in Schedule 7AC Taxation of Chargeable Gains Act 1992 contains a special rule for dealing with the activities of certain joint venture companies when considering whether a group is a trading group.

The rule provides for an apportionment of the activities of a company that falls within the definition of a “joint venture company” set out in para 24 of the Schedule.

HMRC is aware that some groups and their advisers take the view that the existence of this rule means that any investment in a joint enterprise that does not fall within the definition of a “joint venture company”will necessarily be treated as a non-trading activity when assessing whether a group is a “trading group”.

HMRC does not agree with this analysis. Where a group has an interest in a company that does not fall within the definition of a “joint venture company” then whether that represents part of the group's overall trading activities or constitutes a separate investment activity will be a question of fact and depend on the circumstances of the case.

Where, for example, the effective management of the joint enterprise is closely integrated with that of the group and it conducts a trade that is similar to or complements that of the wider group, then that would suggest that group's involvement in the enterprise does not represent a separate non-trading activity.

Similarly, a group would not automatically be regarded as having a non-trading investment activity because it has an interest in an entity that does not have issued share capital (and therefore cannot form part of a capital gains group for these purposes). For example, a major UK-based retail group may open a large number of stores in Laputa, using a wholly owned corporation that does not have share capital (reflecting the local company law). The facts would suggest that the venture is part and parcel of the general trading activity when considering whether the overall group is a "trading group" for the purposes of the exemption.

The Capital Gains Manual will be updated to reflect the contents of this brief.

*HMRC Brief 29/2011 2 August 2011*

## 7.6 Common questions on loans to directors (Lecture P673 – 14.18 minutes)

Most readers will be familiar with the basic rules associated with directors' overdrawn loan accounts, including s.455 CTA 2010 (old s.419 ICTA88) issues where the account is overdrawn at the company's year-end (and still overdrawn 9 months and 1 day later).
This article deals with some questions that are commonly asked about the practical side of the rules.

**'Bed and breakfasting' loans**

If no loan is outstanding at the year-end, no s.455 liability arises. Even if there is a loan outstanding at the year-end, no liability arises if the loan is repaid or written off within 9 months. It is not uncommon to find, therefore, that just before the year-end or 9 month dates, the director repays the loan to the company (perhaps by means of a short-term loan from a third party). Once the deadline has passed, the company re-lends the money to him a few days later (so that he may repay the third party loan).

This is of course all perfectly legal and seems to be an easy way around the cash flow issues associated with s.455 payments (which, remember, are a quarter of the outstanding loan). If done around the year-end date, it would also stop the loan from appearing in the balance sheet. How will HMRC respond, though, to such arrangements?

The situation is covered in HMRC's Enquiry Manual at EM8565.

Firstly, to avoid s.455 issues, there will need to be clear evidence that repayment did take place, with any book entries reflecting genuine underlying transactions. If there is no such evidence HMRC will contend that a s.455 liability is still due, or challenge a claim for relief under Section 458 (where repayment of the loan is made within 9 months of the year-end), on the grounds that, viewed realistically, no repayment of the loan was made.

If it appears that the repayment arrangements were not intended to achieve genuine repayment of the loan, the Inspector is instructed to submit cases at an early stage to CT&VAT (Technical), who will consult the Anti-avoidance Group (AAG).

Challenges to the tax effectiveness of the transactions are likely to be based on the *Ramsey* principles (i.e. a series of pre-ordained transactions, at least one of which is inserted for the avoidance of tax). If such bed and breakfasting of loans is done on a regular basis, the chances of the arrangements being challenged will obviously increase.

You can also expect penalties for inaccuracies when a temporary repayment arrangement is successfully challenged. This could be because

- the accounts are incorrect as a result of the balance sheet being carelessly or deliberately misleading (where the bed and breakfasting occurred around the accounting date); or
- even though the loan is on the balance sheet, a carelessly or deliberately incorrect claim for s.458 relief.was made on the basis that the loan had been repaid within 9 months of the end of the accounting period (where the bed and breakfasting occurred around that 9 month date).

**Which debt has been repaid?**

It is normally the case that overdrawn loan accounts are built up with several different loans or advances on different dates. How are partial repayments of the total balance then treated?

*Example*

John's company has a December year-end.

At 31 December 2010 there is an overdrawn director's account of £20,000, relating to an advance on 22 October 2010. On 1 February 2011 and 5 May 2011 two further loans of £5,000 each are made to him.

Following the payment of a dividend, £15,000 of the loan balance is repaid on 28 September 2011.

How big a s.455 payment is therefore required on 1 October 2011?

*Solution*

The parties may choose which of the loans the repayment should be set against. To minimise the s.455 payment, the repayment should be set against the earlier loan, meaning that the s.455 payment would be ¼ of £5,000 (i.e. £1,250).

In fact, if no formal allocation is made by the director or the company, HMRC would in any case normally apply the rule in *Clayton's case* and allocate repayments against earlier loans.

**Avoiding a benefit charge**

Remember that, under the beneficial loan rules, if the loan exceeds £5,000 at any time in the tax year, an interest-free loan to a director produces a taxable benefit that needs to be disclosed on the P11D. (Unlike the s.455 charge, this cannot be avoided by paying off the loan before the accounting year-end.)

The benefit charge can be avoided where the director pays the Official Rate of Interest to the company. However, *this only applies if a legal obligation to pay the* *interest existed <u>during the income tax year concerned</u>*. Just voluntarily paying 'interest' without the legal obligation existing will not avoid the charge.

Where the legal obligation does exist, the interest needs to be paid **by the time that assessment for the year is finalised**, if no benefit is to be chargeable.

However, where such interest is paid after that time, s.191 ITEPA 2003 allows the director to make a claim for the assessment to be recalculated to take the belated interest payment into account. (See EIM26255)

The onus is on the director to claim this relief. He or she can do so at any time up to the end of the general time limits applicable to individuals making claims for repayment of income tax. These time limits are reduced to four years from 1 April 2010 for Self-Assessment taxpayers and from 1 April 2012 for individuals outside the Self-Assessment regime.

*Contributed by Kevin Read*

## 7.7 <u>The return of the tax shelter (Lecture P674 – 9.26 minutes)</u>

Many clients simply aren't interested in tax shelters. They see them as a risky investment and are worried about breaching what can often be tricky rules in relation to getting the relief. However, with high personal taxes, tax shelters are getting a second look. Below I look at one such shelter and consider some of the pros and cons.

Venture Capital Trusts (VCTs) are quoted limited companies whose purpose is to invest shareholders' funds in smaller unquoted and Alternative Investment Market listed trading companies having potential for growth, with a view to making profits. Most VCTs are run by investment managers and raise their funds from private investors. You can invest up to £200,000 in a VCT and get significant tax incentives, including 30% income tax relief. However, they are an investment and as such require investment advice.

<u>What are the tax benefits?</u>

Individuals may be able to secure a number of tax advantages from this sort of investment. However, shares in VCTs must be held for at least five years in order to obtain all the potential tax benefits. In addition, the investment must be made for genuine commercial reasons, and not mainly for the purposes of tax avoidance. The investing individual must also be 18 years of age or more on the date of issue of the shares to be eligible for relief.

<u>Income tax relief</u>

Individuals who subscribe for new ordinary shares in a VCT are granted income tax relief at 30% on up to £200,000 a year, subject to their having sufficient income tax payable to absorb the relief. For these purposes, a husband and wife are treated separately.

The tax relief is due when the shares are issued and can be given by an adjustment to the PAYE coding, or a claim in the tax return.

*Example*

Mr A has taxable income (after deducting his personal allowance) of £68,000 and invests £45,000 in a VCT share subscription in the 2011/12 tax year.

| Income tax | £ |
|---|---|
| Income tax on £68,000 | 20,200 |
| VCT relief (£45,000 at 30%) | (13,500 ) |
| Reduced tax liability | £6,700 |

No income tax on dividends

Dividends received by private investors from VCTs will not give rise to income tax liabilities.

No capital gains tax (CGT) on VCT investments

VCTs do not pay tax on realised investment gains and these gains can be distributed to investors as tax-free dividends. Conversely, there will be no tax relief for any losses incurred.

No CGT on disposal

Individuals will not be liable to CGT on any profits arising from the disposal of VCT shares unless the VCT company is no longer a trust, ie they are taken over by a non VCT. CGT on gains that were deferred when investing in VCT shares before 6 April 2004 will still be due. (CGT deferral relief is no longer available on investments in VCT shares made on or after 6 April 2004).

What companies can a VCT invest in?

There are strict rules regarding the companies in which a VCT may invest. Briefly, a VCT may only invest:

- in a company whose gross assets do not exceed £7 million immediately before the investment, or £8 million afterwards
- in a company or group of qualifying companies with less than 50 employees
- in a company that has raised no more than £2 million in the past year through VCTs, the Enterprise Investment Scheme (EIS) or the Corporate Venturing Scheme.

However, from 6 April 2012, the above limits will increase to include companies who:

- have gross assets of up to £15m before investment
- have no more than 249 employees
- have previously raised investments of up to £10million.

What other conditions apply?

The VCT also has to comply with several other investment conditions in order to qualify for the tax reliefs. These are as follows:

The money raised by the VCT through the issue of the shares must be wholly applied in qualifying activities. The funds must be applied within two years of the share issue, or where the qualifying activity is a new trade, within two years of the start date

At least 10% of the holding in each qualifying company must be in new ordinary shares with no preferential rights

No more than £1 million can be invested each year in an unquoted trading company and any holding in a single company must not exceed 15% of the value of the VCT's total investments at cost

The VCT cannot retain more than 15% of the income derived from shares and securities

A VCT must invest at least 70% of its funds in 'qualifying holdings'

Qualifying companies must be unquoted and the funds raised must be used by the issuing company or by a qualifying 90% subsidiary in carrying out qualifying business activities. Companies listed on the Alternative Investment Market are treated as unquoted for these purposes.

A qualifying company need not be UK resident. However, from 6 April 2011, the company issuing the shares must have a 'permanent establishment' (PE) in the UK. Different rules apply for investments made up to and including 5 April 2011. These rules were changed in order to ensure compliance with EU state aid rules.

In addition, another new condition was introduced with effect from 6 April 2011, excluding companies from qualifying where they are in difficulty. The 'financial health requirement' will disqualify a company if it would generally be regarded as being in difficulty as defined in the European Commission's official journal, 'Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty'.

If these conditions are not fulfilled at the relevant times HM Revenue and Customs has the power to withdraw approval and claw back the investor's tax relief by means of an assessment.

What return do you get from a VCT?

VCTs may be geared either to capital growth or to income generation. The underlying investments of VCTs will vary significantly in their performance and by their very nature, some of the companies invested in will fail while others will give substantial returns.

There can be no guarantees about the outcome of the investments and like all holdings on the stock market, it will not be possible to predict share prices.

Be aware thought that VCTs are high-risk investments. The promise of tax reliefs should not override normal investment considerations.

What if you buy VCT shares on the market?

If you are not the original subscriber to the VCT shares (ie if you purchase the shares second-hand) the 30% income tax relief will not be available. However, subject to the £200,000 pa investment limit, any capital gains arising on the sale of the VCT shares will be exempt (and therefore no tax relief will be available for any losses arising on disposals). In addition, you would not be liable to income tax on dividends and any capital gains made by the VCT itself are still exempt.

How do people decide on a VCT investment?

Issues an investor will need to consider when deciding in which VCT, if any, to invest include:

The investment experience of the VCT managers and their ability to utilise the funds raised

Obtaining professional advice before investing

The VCT share price may be discounted more than conventional investment trusts since buyers of VCT shares on the market will not be entitled to all of the subscriber's tax reliefs

The fact that VCTs constitute a high risk investment. The benefit of tax reliefs should not outweigh the normal investment criteria

Can you claim other tax reliefs as well?

The tax regulations set out how some of the other tax reliefs for investment interact with VCTs. Broadly speaking, VCT relief is given before EIS relief .

Are there any other ways that tax relief can be lost?

If the relevant person or an associate (eg a close relative) receives a loan from the VCT, linked to the subscription for the shares, tax relief will be denied.

*Contributed by Francesca Lagerberg*

## 7.8 Group structures and IHT (Lecture P675 – 5.23 minutes)

Correspondence between HMRC and the Succession Taxes Sub-Committee of the CIOT has recently been published under the title of 'Availability Of IHT Business Property Relief For Group Structures'. This deals with the availability of business property relief for shares in the holding company of a trading group. A difficulty with the interpretation of S105 IHTA 1984 has put the entitlement to business property relief for such shareholders in doubt, but fortunately HMRC have provided some helpful clarification on the issue.

A typical situation would be a holding company whose main activity is holding shares in its trading subsidiaries. However, the holding company has also made loans to those subsidiaries. The question is whether the holding company's business consists wholly or mainly in being a holding company of trading subsidiaries or whether the existence of the loans is a separate business which could then disqualify the company from relief. It was generally thought that the business of being a holding company is a wider concept than merely holding shares and that it includes the provision of loan finance to subsidiaries, in which case the relief would not be in danger, but it was thought sensible to ask HMRC for their opinion.

In a letter dated 10 January 2011, HMRC have confirmed their agreement with this interpretation, taking the view that holding shares, providing loan finance for subsidiaries, providing strategic direction and co-ordination of subsidiaries and a host of other matters are all within the normal scope of the business of a holding company. Thus business property relief should be claimable for the shares of a holding company in most cases.

*Contributed by Robert Jamieson*

## 7.9 Farmers' capital allowances (Lecture B672 – 16.48 minutes)

It is important for farmers to consider how best to maximise capital allowances that are available to them.

With the phasing out of agricultural buildings allowance (FA 2007) and the reduction of both the annual investment allowance and writing down allowances (FA 2011), it is vital that farmers look carefully at the detailed breakdown of any capital expenditure that is incurred.

So for example when buying a new building and equipping it for use, they should consider carefully which expenditure:

- qualifies for 100% enhanced capital allowances
- is covered by the £25,000 annual investment allowance
- has a life of up to 8 years and so can be depooled to obtain a balancing allowance on sale.

## 7.10 Can you reduce tax by going green? (Lecture B473 – 9.51 minutes)

As the government seeks to achieve its emissions targets, it is looking at more ways to encourage 'good' environmental behaviour. There are therefore a number of tax reliefs aimed at promoting green behaviour which are outlined in brief below.

<u>100% allowances for energy-saving plant and machinery</u>

Qualifying expenditure benefits from allowances of 100% of the cost, provided that the product or technology was on a qualifying list or subject to the issue of a certificate at the time the expenditure was incurred or the contract was entered into (although a claim cannot be made until certification is given).

Energy-saving plant or machinery is specified in a technology list or a product list, issued by the Department of Environment, Food and Rural Affairs. The lists can be found at http://etl.decc.gov.uk/etl. Qualifying technology includes energy saving boilers, motors, refrigeration, heat pumps, radiant and warm air heaters, compressed air equipment, solar thermal systems, automatic monitoring and targeting equipment, air-to-air energy recovery equipment, uninterruptible power supplies, along with heating, ventilation and air conditioning zone controls. The technology list is expanded as technology develops and the product list is updated monthly with products that are certified as qualifying for the allowances.

<u>100% allowances for environmentally beneficial plant and machinery</u>

Expenditure incurred on environmentally beneficial plant and machinery benefits from similar allowances to energy-saving technology, but relates to water technology. There is a water technology list, which contains details of the technologies and products that can qualify and it includes certain taps, toilets, flow controllers, leak detection, meters, water reuse systems, cleaning in place equipment, efficient showers, efficient washing machines, small scale slurry and sludge dewatering equipment, vehicle wash waste reclaim units, efficient industrial cleaning equipment, water management for mechanical seals and rainwater harvesting equipment.

Details can be accessed via:

http://wtl.defra.gov.uk/product_search_landing.asp?section=66&xgovk3w=bl1000&xgovf0p=|xgovs9k=ecawater|xgovr3h=wtlproducts|xgovc8h=1000|xgovk3w=bl1000|&xgovd2v=en

Are repayable tax credits available?

Companies (but not unincorporated businesses) meeting the following conditions may surrender losses arising for cash payments:

The losses are attributable to 100% allowances on energy-saving or environmental beneficial plant and machinery

The loss cannot be otherwise relieved by the company

The qualifying expenditure was incurred on or after 1 April 2008 and before 31 March 2013

The credit that will be paid to the company will be 19% of the loss surrendered, but cannot exceed the greater of the total PAYE and National Insurance contributions (NIC) for the loss period, or £250,000.

There are claw-back provisions if the company sells the plant and machinery within four years of the end of the period for which the tax credit was paid.

100% allowances for energy services providers

An energy services provider is a business that provides a range of energy management services, including the provision, operation and maintenance of plant or machinery, aimed towards reducing their client's energy bills. Normally a person who installs a fixture (eg machinery) in land (eg a factory) must have an interest in that land to be able to claim capital allowances. However, special rules have been introduced to enable energy services providers to claim allowances on certain assets used to deliver the energy management service, provided the following conditions are met:

The services provided amount to more than just leasing

An election is made for the provider to claim the allowances

The plant or machinery is on the technology list or product list

The plant or machinery is not for use in a dwelling house

The energy provider, or another person with whom it is connected, carries out all, or substantially all of the operation and maintenance of the plant and machinery

100% allowance for business property renovation

Persons who own or lease a business property that has been vacant for one year or more, in a designated disadvantaged area in the UK, can claim a deduction for 100% of their capital expenditure on the conversion or renovation of the property, in order to bring it back into business use. Expenditure qualifies if incurred between 11 April

2007 and 10 April 2017. The allowance is not available to businesses undertaking certain trades. For further details, please ask for our factsheet on this subject.

Allowances for thermal insulation

Expenditure needs to be incurred in respect of adding insulation to an existing building. Thermal insulation is deemed to include roof lining, double-glazing, draught exclusion and cavity wall filling. This was restricted to industrial buildings until 1 April 2008 but is now available for any commercial building. This allowance is not available on dwelling houses, but residential landlords may qualify for landlord's energy saving allowances instead.

The rate of the allowance is currently 10% *per annum* on a reducing balance basis but this will be reduced to 8% from 1 April 2012 for companies and 6 April 2012 for unincorporated businesses.

150% relief for land remediation

This relief was introduced to encourage the re-development of 'brownfield sites'. Essentially, for every £100 spent on qualifying land remediation, companies (but not unincorporated businesses) can claim a £150 deduction against taxable profits. A repayable tax credit can also be claimed in certain cases.

Land remediation includes the removal of contaminants from land and, from 1 April 2009, the removal of buildings and structures from derelict land. Land is considered contaminated if there are substances (eg poison, pollutants) in, on or under the land which cause, or may cause, harm (or pollution to controlled waters). For further details, please ask for our factsheet on this subject. However, please note that this relief is due to be abolished after 2012.

100% allowances on flat conversions

These allowances are designed to encourage the conversion of empty or underused space above shops and other commercial premises to residential use. The qualifying conditions are:

The property was built before 1980 and any extensions to the building need to have been completed by 31 December 2000

The ground floor of the building is authorised for business use and the floors above were constructed primarily for residential use

The upper floors must have been unoccupied or only used for storage for at least one year before the conversion work starts

The flat cannot have more than four rooms (excluding closets, cloakrooms, small hallways, kitchens and bathrooms)

When converted, the flats must only be available for short term letting and cannot be 'high value' (determined by reference to the weekly rental and the number of rooms)

There must not be more than four storeys above the ground floor (excluding the attic if it is not and has not been used as a dwelling)

100% allowances on natural gas, biogas and hydrogen refuelling equipment

Qualifying expenditure under this category includes storage tanks, compressors, pumps, controls and meters, gas connections and filling equipment. Expenditure must be on new, unused equipment incurred before 31 March 2013.

Expenditure qualifies even if the refuelling station is on the company's premises and is not open to the public.

Energy efficient cars and vans

Expenditure on an electric car or a car with low carbon dioxide ($CO_2$) emissions (being less than 110g/km for expenditure incurred from 1 April 2008 to 31 March 2013) is eligible for a 100% capital allowance. From April 2009, 10% writing down allowances can be claimed for expenditure on cars with $CO_2$ emissions of more than 160g/km and 20% writing down allowances for cars with emissions of between 110g/km and 160g/km. These rates will be reduced to 8% and 18%, respectively from 1 April 2012 for companies, and 6 April 2012 for unincorporated businesses.

From April 2009 the tax deduction for car lease rental payments is restricted by a flat rate disallowance of 15% for cars with $CO_2$ emissions exceeding 160g/km.

100% first year allowances can be claimed on expenditure on zero-emission vans between 1 April 2010 and 31 March 2015 for companies, and between 6 April 2010 and 5 April 2015 for unincorporated businesses.

Reducing income tax and NIC on company cars

An employee provided with a company car will pay tax based on the deemed taxable amount of the car, which is calculated by reference to the car's list price when new and its $CO_2$ emissions. The lower the emissions, the smaller the percentage used to calculate the taxable amount. Therefore, if you provide your employees with a lower emissions car, they will benefit from higher net pay and you will benefit from lower NIC. For further details, please ask for our factsheet on this subject.

What are the charges you should avoid?

There are also additional taxes, which are charged with environmental connotations, which include the following:

Landfill tax (LFT)

LFT is a tax on all material disposed of as waste and deposited in a regulated landfill site. It was introduced to encourage recycling or alternative disposal. There are a number of exemptions, although the exemption for waste from certified contaminated land will be withdrawn from April 2012. As a waste producer, you should review the amount of tax being paid and the type of waste being produced. For example, is the waste capable of being re-used or recycled? If it is not being sorted correctly, you could end up paying £56 per tonne (increasing to £64 per tonne from 1 April 2012) as opposed to £2.50 per tonne, as some types of waste qualify for the lower rate of LFT.

VAT

Most businesses are able to recover the VAT that they incur on purchases, and so the tax will not normally be a 'real' cost for them. However, it will be a real cost of the end consumer. Relief from the standard rate of VAT may be available for certain environmentally friendly supplies that are made by the business. For example, the supply and installation of energy saving materials in residential accommodation and buildings intended for use solely for a relevant charitable purpose may qualify for the reduced rate of VAT.

Similarly, supplies made in the course of renovating, altering, or converting certain residential properties may also qualify for the reduced rate. Further relief is available for the outright sale of certain converted, or substantially reconstructed non-commercial property, which may qualify for the zero rate of VAT.

*Contributed by Francesca Lagerberg*

### 7.11 New degrouping charge (Lecture B674 – 28.53 minutes)

Asset transfers between companies within the same capital gains group are generally treated as taking place on a no gain no loss basis for tax purposes. Recognition of any taxable gain or allowable loss on the disposal of the asset is deferred until such time as it is sold outside the group.

For the last 43 years, the degrouping charge rule (now found in S179 TCGA 1992) has ensured that, if a company leaves its group holding an asset acquired from a fellow group member within the last six years, any gain or loss postponed from that earlier date is reinstated. The purpose of this provision is to counteract a tax advantage which might otherwise be obtained by asset transfers within the group.

Discussions with business have indicated general acknowledgement that some form of degrouping charge is necessary in order to protect the tax system. Without such a charge, it would be possible to avoid corporation tax on the profit from the sale of an asset by transferring it to a newly incorporated company whose shares have been set up with a high base cost and then selling the company rather than the asset so that there was no gain. Indeed, it was the increasingly widespread use of such arrangements which led to the introduction of the degrouping charge in 1968.

However, there are a number of features of the current rules which place a significant burden on groups of companies, especially when an acquisition or disposal of all or part of a group's activities is being contemplated.

Main issues

The main issues which have been identified are:

(i) interaction with the substantial shareholding exemption;

(ii) effective double taxation;

(iii) liability for the degrouping charge;

(iv) time limits; and

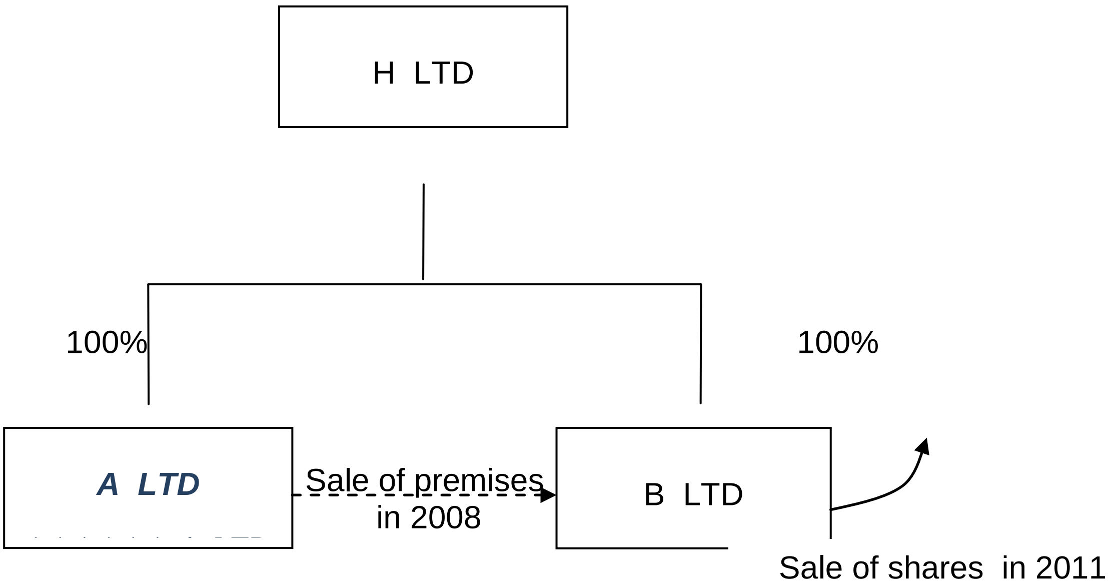
(v) the associated companies exception.

All these problem areas are considered below.

Interaction with the substantial shareholding exemption

A significant concern, which has been widely expressed, is the way in which the degrouping charge rules interact with the substantial shareholding exemption in Sch 7AC TCGA 1992.

A degrouping charge will arise in respect of the transfer of an asset owned by a trading company and yet the share sale which gave rise to the degrouping event may well be covered by the substantial shareholding exemption. For example, H Ltd owns 100% of two trading subsidiaries, A Ltd and B Ltd. Three years ago, A Ltd sold B Ltd business premises worth 300 (but with a base cost of 120), for which B Ltd paid the full price. B Ltd has now been disposed of to another group and H Ltd makes a gain of 750 on the B Ltd shares. Thus:




The position is that H Ltd's gain of 750 on the sale of B Ltd is tax-free by virtue of Sch 7AC TCGA 1992, but there is still a degrouping charge gain of 300 – 120 = 180 which accrues to B Ltd when it leaves the group. The imposition of the charge in these circumstances was one of the major irritations highlighted by business representatives during the consultation period. It was a particular concern for groups which organise their business on a divisionalised basis. Although the disposal of a single business will often involve putting assets into a new company prior to sale, the benefits of the substantial shareholding exemption may not be available (because of the 12-month requirement in Para 7 Sch 7AC TCGA 1992).

Effective double taxation

Another issue stressed in discussions with stakeholders was that double taxation could potentially arise under degrouping, with gains on both the transferred asset and the share disposal being subject to tax. As the Treasury point out:

> 'The rules are mechanical with no test of purpose and no mechanism to reduce the amount of a charge where double taxation would arise.'

Liability for the degrouping charge

A concern expressed by some business representatives is that the degrouping charge could be seen to be targeting the wrong company. Hitherto, the gain falls on the company which leaves the group owning the asset. However, the economic gain being taxed actually arose during the period when the asset was owned by the company which previously transferred it. A consequence of this is that any tax due is payable by the company which has just left the group.

Of course, there will inevitably be commercial arrangements in place for the vendor to reimburse the purchaser for any tax charge.

Alternatively, the vendor and the purchaser can jointly make an election under S179A TCGA 1992 to reallocate the gain to another member of the vendor group. Nevertheless, one commentator has indicated that 'it may not be possible to review all historic transactions to determine potential degrouping charges by the time of the disposal'.

<u>Time limits</u>

A feature of the degrouping charge rules commonly cited in the written responses to HMRC's 2009 discussion document was whether a six-year time limit was necessary or whether a shorter limit would suffice for revenue protection purposes. It is understood that the Government consider the retention of the existing time limit to represent an appropriate balance between minimising compliance burdens and protecting revenue.

<u>The associated companies exception</u>

When degrouping charges were first introduced, the potential for double taxation of gains was identified and an exception was provided which was intended to address this, at least in the majority of circumstances. This is the so-called associated companies exception in S179(2) TCGA 1992 which can switch off the degrouping charge rules where the only asset transfers which have taken place are within a sub-group of companies which are all sold together. In such a situation, there should be no risk of tax avoidance because the asset transfers will not have moved value into or out of any companies other than those included in the sale.

S179(2) TCGA 1992 reads as follows:

> 'Where two or more associated companies cease to be members of the group at the same time, (the degrouping charge) shall not have effect as respects an acquisition by one from another of those associated companies.'

This let-out was recently discussed in *Johnston Publishing (North) Ltd v HMRC (2008)*. In this case, the transfer was between two subsidiaries which, although part of a wider capital gains group, did not form a group of companies by themselves and so were not 'associated' at the time of the transfer. Subsequently, the transferor company was put beneath the transferee company (which was then sold to a third party). The group took the view, widely held by tax practitioners, that the associated companies exception applied, but HMRC disagreed and eventually won the case (by a 2 – 1 majority) in the Court of Appeal. As a result, it has been decided that the statutory wording in TCGA 1992 needs some clarification.

<u>The changes</u>

Significant modifications have been made to the degrouping charge rules by Cl 45 and Sch 10 F(No3)B 2011. These will be in point where a company leaves a group on or after the date of Royal Assent, although, as a result of a Government amendment, the principal company may now elect to have the new rules applying to departures on or after 1 April 2011 – this election must be made on or before 31 March 2012.

The various changes can be summarised as follows:

(i) Where a company leaves a group on a disposal of its shares, the mechanism by which a degrouping charge accrues has been changed. Instead of the deemed disposal giving rise to a chargeable gain (or allowable loss) in the company which acquired the asset, the amount of any gain (or loss) accrues to the group member making the disposal of shares. This is achieved by making an adjustment to the gain (or loss) which arises on the share disposal (see new S179(3A) – (3E) TCGA 1992). The knock-on effect of this rule is that, if the disposal qualifies for the substantial shareholding exemption, so will any degrouping gain (or loss).

(ii) A new provision (S179ZA TCGA 1992) has been brought in which allows a 'just and reasonable' claim to be made to reduce the amount of a degrouping charge to the extent that any gain inherent in the asset leaving the group is reflected in the gain on the shares which are being disposed of. For example, assume that A Ltd and B Ltd are wholly owned subsidiaries of a property investment group. B Ltd has an asset which cost 100 and which has increased in value to 300 by the time that it is transferred to A Ltd. A Ltd subsequently leaves the group. If A Ltd had paid B Ltd 100 for the asset (it is common practice for assets to be transferred between group companies at book value), A Ltd's value would have risen by 200 as a result of the transfer from B Ltd. This increase in value will therefore be taxed when A Ltd is sold. That is why the legislation provides a mechanism to reduce the degrouping charge on a 'just and reasonable' basis in precisely these circumstances.

(iii) For companies leaving groups from the date of Royal Assent, the reallocation provisions of S179A TCGA 1992 have been repealed (Para 5 Sch 10 F(No3)B 2011). In future, a degrouping charge can be transferred around a group by making an election under S171A TCGA 1992.

(iv) Para 6 Sch 10 F(No3)B 2011 amends the substantial shareholding exemption provisions in Sch 7AC TCGA 1992 in a way which allows the relief to apply in situations involving the disposal of part of a group's trading activities to another company in the group. In particular, new Para 15A Sch 7AC TCGA 1992 treats the minimum 12-month substantial shareholding requirement as having been met for the period for which the assets were used in a trade conducted by the group *before* being transferred to the company being disposed of.

(v) The degrouping charge has always featured an important exception for associated companies. This exception has been amended by Para 3(4) Sch 10 F(No3)B 2011 which substitutes new S179(2), 179(2ZA) and 179(2ZB) TCGA 1992. The latest version of the relief clarifies the effect of the let-out and should be referred to as the 'sub-group exception'. No degrouping charge will arise where two or more companies leave the group simultaneously and they were in a sub-group relationship at the time when the asset transfer took place and they remained so at the time when they left the group. This effectively enacts the majority decision in *Johnston Publishing (North) Ltd v HMRC (2008)*.

*Contributed by Robert Jamieson*

## 7.12 VAT and temporary staff (Lecture B675 – 20.05 minutes)

This article considers two recent First Tier Tribunal decisions on the supply of temporary staff, Reed Employment and Moher, and the issues arising. The notes below describe the decisions,

Temp workers and unjust enrichment

Reed Employment Ltd won a dispute with Customs in 1997 which established that it should only have accounted for VAT on the commissions it received from clients, not on the whole of the consideration. It submitted a claim which went back to 1991, originally capped but paid by HMRC in 2003 following the first Marks & Spencer ruling in the ECJ.

The company then made a further claim, going back to 1973, in relation to customers who were wholly or partly exempt and who would therefore not have been able to recover the VAT that had been charged to them. As this was a new claim, HMRC refused it, and the company appealed.

In March 2009, the company made further claims going back to 1973 in respect of supplies to clients who were taxable. HMRC argued that these repayments would unjustly enrich the company. The rules on unjust enrichment were found to be faulty by earlier court decisions and were rectified in 2005.

The Tribunal examined the contracts and the history of the dispute, and concluded that the 2003 claim had to succeed. It was based on the same arguments as the 1997 claim and was made before the unjust enrichment rule was rectified. However, the 2009 claims were new claims, not amendments of the 2003 claims, and they failed to satisfy the new unjust enrichment rule. HMRC were able to refuse them.

Following the 1997 case, HMRC introduced the staff hire concession as a temporary measure to reduce the possibility of distortion of competition between different employment businesses which structured their contracts in different ways; the ESC was withdrawn in 2009 because HMRC believed it was no longer needed: changes in the law affecting temporary workers eliminated the possibility of distortion.

The Tribunal also considered the fundamental question of whether Reed was supplying the services of its workers as principal, or rather supplying an introductory service. If it was supplying introduction only, its taxable income would only include its commission, rather than the whole amount paid by the client. The concession allowed an employment business to account for output tax only on the commission, as long as certain conditions were met.

The Tribunal decided that the proper construction of the various contracts meant that Reed was supplying agency services as a matter of law, not as a concession. The workers supplied no services to Reed; the payment of their wages did not constitute a cost component of Reed's supply. Even if Reed invoiced the client for a single composite amount, nevertheless the worker made the supply of services direct to the client in return for the payment of their wages.

This appears to undermine the basis on which HMRC withdrew the staff hire concession, and further cases may follow to challenge the official view that the consideration paid by clients of employment businesses is taxable in full.

*First Tier Tribunal (TC1069): Reed Employment Ltd*

Graham Elliott, writing in Accountancy in July, says that HMRC have indicated that they will not appeal this decision. He says “this can only mean that HMRC do not see the decision as a threat to current policy”. It could also mean that they do see it as such a threat, and would rather claim that it was decided on its own peculiar facts rather than having the principles confirmed by the Upper Tribunal or higher courts.

Temporary dental staff

A dental nurse established an agency in 1976. It made two types of supply: first, of temporary dental staff to dentists, which was the disputed supply, and secondly, of private permanent staff to dentists for an introduction fee. VAT was accounted for on fees for both types of supply.

In 2001, after the business had been transferred as a TOGC to a company, the proprietors discovered that a competitor was not charging VAT on similar supplies, and asked for a ruling from Customs on its own liability. The ruling was that supplies of dental staff would be exempt if made as principal. It was agreed that the temp staff were supplied as principal, and adjustments were made to current returns on the basis that the business was partially exempt.

Following a claim in 2005, the company reclaimed over £300,000 of output tax it had paid in relation to periods from 08/99 to 09/01. In March 2009 the previous owners of the unincorporated business (who still owned the company after the 1999 incorporation) made a Fleming claim for another £600,000 plus interest which was claimed to have been overpaid between January 1985 and December 1996. HMRC refused this claim, and the decision was upheld on review.

HMRC accepted that their interpretation of the law throughout the period under dispute was that the supply of dentists and dentist auxiliaries by a registered nursing agency constituted an exempt supply of dental care or dental services. However, they now argued that the law, properly construed, did not provide such an exemption: that should be applied only to supplies to patients, not supplies of staff. They changed their view of the law in 2007, but allowed the old basis to continue for businesses which had followed it before and continued to meet the same criteria. That was a concession, and a Fleming claim could not succeed on the basis of a concession.

HMRC also raised the issue of unjust enrichment, but the Tribunal considered that it would only be necessary to examine that issue if the appellant was successful on the first issue of the correct liability of the supply.

The appellant’s case was based on HMRC’s view of the law as set out in Notice 710/2/83, which describes the liability of supplies of nursing staff as agent and as principal. This was the policy throughout the period of claim. It was also clearly the policy which had led to the repayment of output tax to the company in respect of the supplies between 1999 and 2001.

The appellant also argued that the exemption applied to supplies of medical care by certain persons and should be neutral as regards the legal personality through which those supplies were made.

The relationship between the appellant and the nurses was tantamount to employment; the nurses could not make supplies for VAT purposes because of their status, so the supply of dental care that they were involved in was made only by the appellant as the quasi-employer.

The Tribunal examined the way in which the nurses operated. It was accepted by the appellant that they were entirely under the control and supervision of the dentist while they were working in the surgery; the appellant had no direct involvement in the work they did. The Tribunal considered that the supply was in reality a supply of staff made as agent, not a supply of services made as principal. The fact that HMRC had made a substantial repayment on the basis that the exemption applied, and had then accepted that it applied for a considerable further period, was not determinative of the current appeal.

The appellant did not raise the question of legitimate expectation. The Tribunal commented that this was not a case in which the jurisdiction of the Tribunal was in question, as it would have been if the appeal had been based on a concession; both parties agreed that the appeal should be determined on the basis of the law.

The Tribunal considered a number of precedent cases and decided that the case law did not give a clear and settled answer. However, it was clear enough to conclude that a supply of staff should be distinguished from a supply of services, and a supply of staff did not enjoy the exemption. It was not conclusive that the supply was made as principal or as agent: it was the nature of the supply itself that would determine the issue. On the evidence, the appellant was providing staff, and HMRC were therefore correct to refuse the claim.

*First Tier Tribunal (TC1148): Sally Moher t/a Premier Dental Agency*

<u>Supplies of healthcare staff</u>

In 2010 HMRC issued a Revenue & Customs Brief to clarify their policy on the supply of health professionals, nursing auxiliaries, care assistants and support workers by employment businesses. This appears to relate to the change of policy described in the Moher case, and suggests that the 2007 policy change was not widely understood for several years.

The essence of the policy is that an employment business makes a taxable supply of staff if the individual worker comes under the control of the client. If the employment business continues to control the worker, the supply may be exempt under the provision of healthcare services. It seems likely that most such supplies are taxable staff rather than exempt services, and specific examples are given including the supply of locum GPs. The supply is taxable even if the employment business is responsible for making sure that the workers are appropriately qualified and trained.

There is a concession which applies to nursing agencies in certain circumstances. The Brief gives details of the conditions in which HMRC will allow exemption to be applied to what would normally be treated as a supply of staff.

The Brief explains that subcontracted welfare services will be exempt if they are provided to the final consumer, even if they are paid for by a local authority. This is because the service is being provided under the control of the supplier and is not therefore a supply of staff.

As this is a clarification rather than a change of policy, presumably HMRC intend to apply it with retrospective effect.

However, they offer the following reassurance:

If businesses can demonstrate that they have taken reasonable steps to follow our previous guidance and that has resulted in their applying the wrong VAT treatment then we will take that into account when considering whether any corrective action is necessary.

R&C Brief 12/2010

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