







# Budget alert

2011

## Introduction

---

*This Budget Alert is based on the Budget Speech presented to the House of Commons by the Chancellor of the Exchequer, the Rt Hon George Osborne, on Wednesday 23 March 2011 and on related Government announcements.*

In some respects, this year's Budget was unlike any of its predecessors. Committed as it is to restoring the UK tax system's reputation for predictability, stability and simplicity, the Government published draft clauses for inclusion in the Finance Bill 2011, along with explanatory notes, back in December 2010. One of the aims was to allow more time for pre-legislative scrutiny in the hope that the quality of the resultant legislation would be improved. Taken together with the Corporation Tax Roadmap, which appeared in November last year and which set out the Government's broad direction of travel over the next five years, this increased show of transparency is designed to provide business with greater certainty. Indeed, in a recent Ernst & Young survey of tax departments ahead of the Budget, almost half of the 85 respondents cited ongoing changes to the tax system as being the biggest deterrent to growing their business in the UK. So, with so much already in the public domain, one might have been forgiven for thinking that everything was already done and dusted and that the Chancellor's scope for manoeuvre was limited in the extreme.

The reality was that the Chancellor was on his feet for almost an hour to promote his plan for growth. In presenting a fiscally neutral Budget, he set out four economic ambitions, namely that Britain should have the most competitive tax system in the G20 (no longer restricted to corporate tax), be the best place in Europe to start, finance and grow a business, be a more balanced economy, by encouraging exports and investment, and have a more educated workforce that is the most flexible in Europe.

On the revenue-raising side, he hit the oil and gas companies hard, by increasing the supplementary charge on profits from 20% to 32% with immediate effect. This came as a big surprise and will raise £2bn of additional revenue. He continued to focus attention on the banks by increasing the Bank Levy from 1 January 2012, and raised a further £1bn over the life of the Parliament by changing the underlying indexation basis for direct taxes from the Retail Prices Index to the Consumer Prices Index from April 2012. As expected, the Government continues to target tax avoidance.

His give-aways were many and varied. The previously announced 1% reduction in the main rate of corporation tax to 27% from 1 April 2011 was trumped by a surprising 2% reduction to 26%, with further 1% reductions to follow in each of the succeeding three years. This will result in a rate of 23% from April 2014. The extended period of consultation is clearly paying dividends as several changes have been made to much of the draft legislation, including amendments to the interim controlled foreign companies rules and the taxation of foreign branches. The raising of the £30,000 annual charge on non-doms to £50,000 from April 2012 after 12 years of living in the UK was less severe than some had feared, while the news that the complex tax remittance rules will be suspended where such remittances are used to fund investment in British business is a welcome bonus. The increase in the rate of tax relief for investors under the Enterprise Investment Scheme (EIS) from 20% to 30% with effect from 6 April 2011 and the change to the size of company which will qualify for EIS are both designed to stimulate investment in private enterprise. The doubling of entrepreneurs' relief from £5m to £10m from 6 April 2011 will be appreciated by successful entrepreneurs and the news that the 50% income tax rate is a temporary measure signals that the UK should be viewed as a low tax, high enterprise regime.

The Chancellor paid credit to the work of the Office of Tax Simplification and has abolished no fewer than 43 reliefs no longer considered necessary, among them the millennium Gift Aid system which will not be needed for another 989 years. This, at a stroke, removes over 100 pages from the statute book and begins the work of simplification. He also announced that he is to consult on another of their recommendations, namely the merging of National Insurance and income tax. The aim is not to increase taxes but to simplify them, although the Chancellor is under no illusions as to the size of the task ahead and recognises that this will take several years to achieve.

With some exceptions, this Budget is likely to be seen as a move in the right direction, signalling to the world that Britain is open for business.

We begin with the ITEM Club's economic report, analysing the implications of the Chancellor's proposals. The ITEM Club is sponsored by Ernst & Young.

## ITEM Club

---

Having set the broad parameters for this Budget in last year's Finance Bill and Spending Review the Chancellor's room for manoeuvre this year was very limited. However, with family budgets under such intense pressure, it was important to provide more than just a few crumbs of comfort. It was also important to help bolster confidence and keep the recovery on the road.

*This year's £1,000 increase in personal income tax allowances was announced last year and next year's increase of £630 was leaked yesterday. No surprise there then. However, the 1p cut in fuel duties - when the plan was for an increase of 5p - was a welcome surprise. This is to be paid for out of the higher profits being made in the North Sea, helping to keep the Budget changes fiscally neutral. The benefits will vary across different families, but will provide the most relief where rising fuel prices hit hardest: in hard-pressed rural communities.*

*Chancellors are in the business of taking away with their right hand whatever benefits they give with their left, and George Osborne is no exception. This year, North Sea companies, the banks and non-doms are helping to ease the squeeze on lower income households. But middle income households will pay for this later, as they suffer from fiscal drag and see their tax payments rising faster than their salaries. That effect will be reinforced next April by the switch from the RPI to the CPI as the default indexation assumption for income tax allowances. RPI inflation normally runs ahead of CPI inflation, by about 0.75% a year, and next year this gap will widen further as interest rates begin to rise, boosting RPI inflation. The default indexation assumption used for fuel, tobacco, alcohol and other excise duties will remain the RPI. The Chancellor now has the best of both worlds, with income taxes boosted as the CPI holds back allowances and indirect taxes boosted as the RPI pushes up duties.*

*Although the Budget measures were fiscally neutral, the public sector borrowing forecasts published by the Office for Budget Responsibility (OBR) were significantly worse than they were last year. This is basically because of a weaker economic outlook, starting with a downgrade from 2.1% to 1.7% in this year's GDP growth figure. However, the Government's fiscal objective is largely insulated from this economic outturn because it is framed in terms of the underlying or structural deficit, which would be struck if the economy were running at full potential.*

*The GDP downgrade has occurred because the OBR, like many other forecasters, has been caught out by the high level of inflation. With wages and salaries unable to compensate, this has squeezed household disposable incomes and spending. This pressure is slow to ease, meaning that growth in demand over the rest of the forecast period must come from investment and exports rather than household spending. This seems realistic, in line with our own projections. Indeed, if anything the OBR forecast is too cautious.*

*The Chancellor was at pains to support business by rolling back regulation and encouraging enterprise. He had an impressively long list of measures under that heading: including enterprise zones, planning controls, tax simplification and further reductions in corporation tax. It is not clear whether this package amounts to very much. For example enterprise zones do not have much of a track record. They can stimulate new jobs and investment but often just move them down the road. However, with the regions under intense pressure from spending cuts it is surely worth another try.*

*Having said that, with a moratorium on new regulation and exemptions for small companies this package is encouraging, particularly given that small companies will be vital in creating the jobs, that help to rebalance the economy away from government spending. It is too early to say whether this is a plan for growth, but, in our view, the Chancellor did remarkably well in the straightened circumstances in which he found himself.*

## Employment tax

---

### **Change to the company car fuel benefit charge**

*With effect from 6 April 2011, the company car fuel benefit charge is to be increased from £18,000 to £18,800.*

The rise in the charge will increase the employees' income tax and employers' national insurance contribution (NIC) costs.

**This increase in the charge continues the policy to discourage the provision of fuel for private motoring by employers and is part of a wider initiative to encourage businesses to become more environmentally friendly.**

### **Company car tax rate 2013/14**

*Legislation is being introduced in Finance Bill 2012 to implement changes in respect of company car taxation.*

Announced today, the new rules will impose an increase of 1% on the appropriate percentages for all vehicles with carbon emissions between 95g/km and 219g/km from 6 April 2013.

There will be no changes to the percentage rates for cars with carbon emissions of less than 95g/km.

**The changes continue to encourage employers to provide their employees with lower emission vehicles and supports the Government's commitment to reduce greenhouse gas emissions.**

---

## Increase in approved mileage allowance payments (AMAPs)

*With effect from 6 April 2011, the AMAPs rate for the first 10,000 miles will increase to 45 pence per mile. The passenger supplement is to be extended to volunteers.*

The AMAPs rates for cars and vans will rise from 40 pence per mile for the first 10,000 miles to 45 pence per mile. The rate for mileage above 10,000 miles will remain at 25 pence per mile. NIC relief will follow the tax treatment. In addition, an allowance for passenger payments currently in place for business employees, at 5 pence per mile, will be extended to volunteers.

This is a welcome update to a long standing mileage reimbursement rate. Many employers pay less than the AMAP rates so employees who receive less will be entitled to a larger amount of Mileage Allowance Relief (MAR).

---

## Reduced childcare relief for higher earners

*As previously announced, the Government will reduce the tax relief for childcare vouchers and directly-contracted childcare from 6 April 2011, capping the relief at the basic rate. In addition, legislation will be introduced to relax the 'open generally to all employees' condition for employer-supported childcare schemes.*

Legislation will be introduced in Finance Bill 2011 to cap the tax relief available to employees joining an employer supported childcare scheme on or after 6 April 2011 at approximately the same level for all taxpayers. National insurance relief will be aligned with this in subsequent legislation. Amounts paid over the allowances will need to be reported on form P11D for tax purposes and the Class 1 NIC paid via the payroll.

Employees already participating in a scheme will not be affected by this change but for new employees, employers will be required to undertake and maintain records of a 'basic earnings assessment'. If this is later found to be incorrect, providing the employer used the best available information at that time, it will be considered to be accurate for that tax year.

Legislation is also to be introduced to relax the 'open generally to all' condition to remove the unintended impact of workers who are close to National Minimum Wage, and, therefore, unable to participate in a salary sacrifice scheme for childcare vouchers, breaking the condition and so resulting in the scheme losing tax relief.

**These measures demonstrate the Government's intention to increase fairness in the tax system but the reduction in relief available will provide an additional administrative burden for employers.**

The introduction of the 'basic earnings assessment' requires employers to evaluate the tax bracket applicable to all new participants of a childcare scheme and employers must also maintain these records as they will be reviewed as part of an employer compliance review.

That employers are only required to use the best available information is a welcome concession. However, employers will need to consider how they demonstrate that they are following these requirements.

The relaxation of the 'open generally to all' condition is also a welcome confirmation of HMRC practice.

---

## Reduction in the NIC contracting-out rebate

*The Department for Work and Pensions announced on 3 February 2011 details of the contracted-out rebate percentage rates that will apply to contracted-out salary-related pension schemes from 2012.*

Employees can leave the State second pension and join a contracted-out pension scheme. They receive a pension from that scheme rather than the additional State pension. To reflect this, they and their employer pay lower rates of Class 1 NIC and receive a rebate of NIC. From April 2012, if an individual is in a contracted-out salary-related scheme, the employer and the employee will pay more NIC, because the employer's rebate will reduce from 3.7% to 3.4% and the employee's rebate will reduce from 1.6% to 1.4%.

**This reduction increases both the employer's and the employee's costs and is, therefore, unwelcome at this time.**

---

## CPI indexation of national insurance contributions rates, limits and thresholds

*From 2012/13 the basis for indexation of certain NIC rates etc., will be in line with the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI).*

In the June 2010 Emergency Budget, the Government announced a review of how the CPI could be used for the indexation of taxes and duties while protecting revenue. The move from RPI to CPI means that more low earners will build up entitlement to contributory benefits and statutory payments. However, the move will bring additional employees into NIC in due course.

Self-employed persons previously excluded from NIC will now also build up entitlement to contributory benefits.

Whilst the charge from RPI to CPI will bring more low paid employees to NIC charge, they will have entitlement to benefits that depends on a Class 1 NI contribution history.

---

## Disguised remuneration

*The Government has confirmed that anti-avoidance legislation relating to disguised remuneration will be introduced in the Finance Bill 2011 but that the legislation will be revised to limit its impact on arrangements which cannot be used for tax avoidance.*

On 9 December 2010, draft legislation was published aimed at countering arrangements to defer or avoid income tax and NIC, commonly involving trusts. The draft legislation was widely drawn with potential for considerable impact on arrangements which were not intended to confer tax advantages. HMRC consulted with business, representative bodies and professional advisers. The Government today has confirmed the previously understood position that the legislation will be amended to reflect certain of the concerns raised during the consultation

The Budget announcement is welcome confirmation that the draft legislation will be amended. The revised legislation is yet to be published (expected shortly). The detail of the revised legislation will need to be considered and each company's arrangements reviewed to assess whether any changes are required.

---

## Income tax and NIC reform

*The Government has announced a consultation on the possible integration of the income tax and NIC system. The intention is to reduce the burden on businesses but to maintain the NIC contributory principle.*

Employers have responsibility for accounting for both income tax and NIC to HMRC. However, the income tax and NIC legislation is not aligned in many ways. The Government has recognised that any change will be complex and involve a wide range of policy and implementation issues. The most important announcement is that the NIC contributory principle will be maintained as it provides for entitlement to contributory benefits such as the basic state retirement pension.

**We welcome any change that reduces the burden on business. However, similar attempts were made in the 1990s to integrate the income tax and NIC systems without much change due to the complexity of the proposed changes.**

---

## Improvements to administration of IR35

*The Government has stated its intention to make clear improvements in the way IR35 (the intermediaries legislation) is administered.*

The Government intends to improve the administration of the intermediaries legislation, known by the original press release number 'IR35'. These improvements will include greater pre-transaction certainty with a dedicated helpline staffed by specialists, publishing guidance on those types of cases HMRC views as outside the scope of IR35, targeting compliance activity and setting up an IR35 Forum to monitor HMRC's new approach.

**Any move by Government to increase clarity and certainty in respect of IR35 is welcome.**

---

## Personal tax

### Capital gains and personal tax rates and allowances

*From 6 April 2011, the capital gains tax annual exempt amount will be increased to £10,600 in line with statutory inflation.*

*From 6 April 2012, the personal allowance for individuals aged under 65 will be increased by £630 to £8,105. The basic rate income tax limit will be reduced to £34,370.*

*There are no proposed changes to the rates of income tax and capital gains tax.*

From 6 April 2011, the personal allowance for individuals aged under 65 will increase by £1,000 to £7,475. To ensure that only basic rate taxpayers benefit from this increase, the basic rate income tax limit will be reduced to £35,000.

From 6 April 2011, the capital gains tax annual exempt amount will be increased to £10,600. It was also confirmed that, from 6 April 2012, the capital gains tax annual exempt amount will rise in line with the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI).

From 6 April 2012, the personal allowance for those aged under 65 will be increased by a further £630 to £8,105 and the basic rate limit will be reduced to £34,370. All other income tax, personal allowances and limits that are subject to indexation will be increased in line with the RPI.

**Following the £1,000 increase in the personal allowance for 2011/12, the additional £630 increase in the personal allowance from 2012/13 is the next step towards the Government's longer-term commitment to ensure that no one**

earning less than £10,000 pays income tax. The reduction to the basic rate limit means that higher rate taxpayers also benefit from today's announcement but only at 20%

The measures announced which replace RPI by CPI from 2012/13 as the underlying inflationary measure for capital gains tax is in line with the Government's long term-intention to assess all direct taxes against CPI. As the RPI measure is generally thought to be a more beneficial measure of inflation since it takes account of more consumer costs, it is arguable whether this move is indeed welcome.

---

## Charitable donations and inheritance tax

*Various measures will be introduced to give effect to the Government's stated aim of encouraging charitable giving and philanthropy.*

The Chancellor announced today:

- ▶ A reduced rate of inheritance tax will apply where 10% or more of a deceased individual's net estate (ie after deducting applicable inheritance tax exemptions, reliefs and the tax-free 'nil-rate band') is left to charity. In these cases, the rate of inheritance tax applicable to the rest of the estate will be reduced from 40% to 36%. The new rate will apply where death occurs on or after 6 April 2012. The Government will issue a consultation document on the detailed implementation of this measure before the summer. It has stated that the relief is designed so that the benefit of the tax saving will be received by charities and not in payments to other beneficiaries.
- ▶ The Government will consult on proposals to introduce a tax reduction for taxpayers who give a work of art or historical object of national importance to the State. The consultation process will take place over the summer. It is not stated what form the tax reduction might take, whether it will be a reduction in income tax, capital gains tax or inheritance tax, or when it might be introduced.
- ▶ The maximum value of the benefits that a donor can receive as a result of making a donation to charity will increase from £500 to £2,500. The new limit will be subject to the existing rule that the benefit must not exceed 5% of the gift, so the increase will only affect those giving more than £10,000 under Gift Aid. The measure will take effect for donations made by individual donors on or after 6 April 2011, and is estimated to affect a few hundred donations, and hence donors, per year. Examples of benefits typically given by charities to donors include discounts and theatre tickets.
- ▶ The Self-Assessment Donate scheme, under which taxpayers due a repayment of tax could direct HMRC to pay it to a charity of their choice will be abolished for repayments of tax on tax returns for 2011/12 and subsequent years, and

for any repayments for earlier tax years made on or after 6 April 2012. The scheme was introduced in 2005 but HMRC has stated that it has not been well used, is not cost-effective and is vulnerable to fraud without extensive upgrading, and that the resources saved will be used to support an online claims system for charities claiming Gift Aid.

These would appear to be positive measures, explicitly intended to encourage giving by 'the wealthiest', in accordance with the 10 point action plan for philanthropy announced by the Culture Secretary in December 2010. The tax reductions proposed for charitable donations and gifts of works of art to the State are in addition to existing exemptions from inheritance tax for gifts to charity and certain national bodies, and for gifts of national heritage property, and will be welcomed, especially by charities. The proposals to reduce inheritance tax may prompt many to revisit their wills and consider amending them to increase their charitable bequests.

---

## Review of non-domicile taxation

*The Government has announced that it will enter into consultation in June 2011 with a view to implementing various reforms to the taxation of non-UK domiciled individuals from 6 April 2012.*

In the June 2010 Emergency Budget, the Coalition Government confirmed that it intended to review the taxation of non domiciled individuals. It has been announced that it will introduce the following changes, subject to consultation, to take effect from 6 April 2012:

- ▶ Increase the current annual remittance basis charge from £30,000 to £50,000 for non-domiciliaries who have been UK resident for 12 or more tax years and who wish to claim the remittance basis. The existing £30,000 charge will be retained for those who have been UK resident for at least seven out of the past nine years and fewer than 12 years.
- ▶ There will be no charge to tax where non-UK domiciliaries remit foreign income or capital gains for the purpose of commercial investment in UK businesses.
- ▶ Simplify some aspects of the current tax rules for non-domiciliaries to remove undue administrative burdens.

The Government also announced that there will not be any other substantive changes to the non-UK domicile rules for the remainder of this Parliament.

**We welcome the opportunity to engage in the consultation process with the Government in respect of these proposed changes. Clarification will be sought over whether the new 12 year test will include the tax year in question and also what will qualify as a commercial investment as well as how such investments could be structured, i.e., via trusts/companies/partnerships etc. This commercial investment opportunity**

could potentially allow otherwise 'tainted' income/gains to be remitted without UK tax arising.

Whilst we expected changes to the taxation of non-UK domiciliaries, the measures announced today are not as severe as originally anticipated. In particular, the Government is allowing non-UK domiciliaries to continue to claim the remittance basis regardless of how long they have been UK resident, albeit paying a higher annual charge in certain circumstances.

---

## Statutory residence test

The Government has announced that it will be entering into consultation in June 2011 with a view to introducing a statutory definition of residence to take effect from 6 April 2012.

The current rules that determine tax residence for individuals are unclear and complicated. Presently, taxpayers and HMRC will normally refer to a combination of sources, namely:

- ▶ The very limited current legislation
- ▶ Case law
- ▶ HMRC's residence and domicile guidance document (HMRC6) which is based on its interpretation of judicial decisions

Consequently, there can be great uncertainty for individuals in determining their residency status, either on arrival in or departure from the UK, or where they have spent periods of time in the UK, particularly over several years. The plethora of recent cases has shown how difficult it can be to determine residency.

The introduction of a statutory definition of residence from 6 April 2012 is generally to be welcomed as it should provide greater clarity and certainty for individuals and provide them with more assurance when considering any pre-arrival or pre-departure tax planning. However, the 'devil will be in the detail' and it may be the case that the new statutory definition will make it harder for individuals to lose UK residency. There may, therefore, be both winners and losers from the new rules.

Entrepreneurs' relief: increase in the lifetime limit

The lifetime limit on gains qualifying for entrepreneurs' relief (ER) has been increased from £5m to £10m for disposals made after 5 April 2011. No other changes to the relief have been made.

ER was introduced in April 2008 and applies a 10% rate of tax to qualifying capital gains up to a maximum lifetime limit.

The lifetime limit has now been increased to £10m from an original limit of £1m of qualifying gains. The original limit was increased to £2m for gains made after 5 April 2010 and £5m for gains made after 22 June 2010.

The relief is available if an individual or trustees of certain settlements make a disposal of business assets. Business assets include:

- ▶ A business or part of a business
- ▶ Business assets used for the purpose of a business carried on by the qualifying beneficiary of a trust
- ▶ Assets that were in use for the purpose of the business when the business ceased
- ▶ Shares or securities of certain companies.

The company must within the qualifying period be:

- ▶ The individual's (or beneficiary's) personal company (they must hold at least 5% of the ordinary share capital and voting rights in the company) and the company must be either a 'trading company' or the 'holding company' of a trading group, rather than.
- ▶ The individual/beneficiary must be either an officer or employee of that company (or a group company).

These criteria must have been met for at least 12 months.

**This further extension of ER is worth an additional £900,000 of tax saving for entrepreneurs. This welcome move means a large number of business owners will pay capital gains tax at 10% on the disposal of their businesses. The relief is now worth £1.8m in tax savings.**

The size of the savings now makes it even more important to check that the asset to be disposed of will meet the qualifying criteria for at least a year before the disposal is made. Consideration should also be given to maximising the relief for spouses and ensuring imminent disposals take place after 5 April 2011 where the gains are in excess of £5m.

---

## Enterprise investment scheme (EIS) and venture capital trusts (VCT)

*The rate of income tax relief given under EIS will be increased. This change applies to subscriptions made after 5 April 2011. Further legislation will be included in Finance Bill 2012 to increase the maximum size of qualifying company for EIS and VCT, the maximum annual amount that can be invested in a company, and the annual amount of EIS investment an individual can make. These changes take effect for investments made after 5 April 2012.*

The rate of income tax relief given under EIS will be increased from 20% to 30% of the amount subscribed for shares.

Legislation to be included in Finance Bill 2012 will increase for both EIS and VCT:

- ▶ The employee limit to <250
- ▶ The gross assets limit to £15m before the investment
- ▶ The maximum annual amount that can be invested in an individual company to £10m

In addition, the annual amount an individual can invest through EIS is increased to £1m.

These changes are subject to State Aid approval.

Legislation will also be introduced in Finance Bill 2012 to provide that companies whose trade consists wholly or substantially in the receipt of feed-in tariffs or similar will only be eligible for EIS and VCT relief where commercial electricity generation commences before 6 April 2012. Shares issued before 23 March 2011 will not be affected.

Additionally there will be consultation on further changes including the use of EIS for seed investment.

**These are welcome changes which encourage investment in smaller companies that may find it hard to attract external investment. The changes mean the cost of every £100 invested in an EIS company from 6 April 2011 will reduce from £80 to £70.**

---

## Restricting pensions tax relief

*From 6 April 2011, the annual allowance for tax relief on pension savings for individuals will be reduced to £50,000. From 6 April 2012, the lifetime allowance will be reduced to £1.5m. Annual allowance tax charges exceeding £2,000 will be able to be met from the pension fund itself.*

### Current position

Transitional rules announced in the 2009 Budget apply up until 5 April 2011, whereby a special annual allowance will apply for contributions made by individuals with income of £130,000 or more in 2010/11.

New very complex provisions were due to take effect from 6 April 2011 but these measures have been repealed and there is instead to be a simpler system.

### Recent announcements

In a Treasury statement made on 14 October 2010 it was announced that from 6 April 2011 the annual allowance will be reduced to £50,000. The annual allowance charge will be linked to the individual's marginal tax rate. Any unused annual allowance can be carried forward for three years.

It was further announced that from 6 April 2012, the lifetime allowance for tax years 2012/13 onwards will be reduced from £1.8m to £1.5m. Those with pension savings above £1.5m or who believe that the value of their pension pot will rise to above this level through investment growth without any further contributions or pension savings, will be able to apply for a new personalised lifetime allowance of £1.8m providing they cease accruing benefits in all registered pension schemes before 6 April 2012.

Draft legislation was introduced in December 2010 which confirmed the above Treasury announcements. Proposed transitional arrangements in relation to the reduction in the Lifetime Allowance is included in the draft legislation. Pension savers who believe that they will exceed the Lifetime Allowance have until April 2012 to apply for a new fixed protection which allows them to keep a Lifetime Allowance of £1.8m. There are conditions attached to the application of fixed protection, including that pension savers will no longer be able actively to contribute to their pension plan.

Further draft legislation was introduced in March 2011 which includes provisions to enable individuals to make an election to meet any annual allowance tax charges from 6 April 2011 in excess of £2,000 from their pension plans. Annual allowance charges will arise where an individual makes pension contributions in excess of £50,000 per tax year.

The new rules, which have been confirmed in the Budget, are a considerable improvement for most pension savers over the previous incarnation of the pension tax reforms. However, the significantly lower annual and lifetime pension contribution limits mean that individuals, particularly high earners, will need to review whether their planned retirement provisions can be met solely out of approved pension plans.

---

## Pension annuitisation

*The requirement to annuitise one's pension by age 75 has been removed from April 2011.*

As announced in the Government's Emergency Budget in June 2011, the age at which pension scheme members must purchase an annuity was extended from 75 to 77 as a temporary measure.

Permanent measures were announced in the Budget, with legislation to be introduced in Finance Bill 2011 to remove the effective requirement to annuitise by age 75 from April 2011. This will include changes to the annuitisation requirements, income drawdown pension arrangements and the related inheritance tax rules.

**The Budget announcement will give more freedom for pensioners to dictate their pension arrangements and will allow people to plan their own retirement to suit their needs.**

---

## Furnished holiday lets (FHLs)

*The Government has decided to proceed with the proposals to restrict loss relief from a single FHL business effective from 6 April 2011 and the new occupancy rules effective from 6 April 2012.*

Previously announced: Losses from FHLs would not be available to be offset against other personal income from 6 April 2011. UK FHL losses may only be utilised against future profits from

the same UK FHL and European Economic Area (EEA) FHL losses may only be offset against future EEA profits from the same FHL

A property will need to be available for letting for a minimum of 210 days per year and to be actually let for a minimum of 105 days per year to qualify as a FHL. The revised thresholds will apply from 6 April 2012. Businesses which meet the occupancy threshold in one year may elect to be treated as meeting it in the following two years, provided certain conditions are met. The ability to average occupancy rates across the properties in a business will continue, as will the current regime of capital allowances and capital gains tax reliefs.

Announced today: The Government will proceed with legislation in the Finance Bill 2011 to revise the tax rules for FHLs, extend the regime to the EEA, and to confirm, with effect from 6 April 2011, that loss relief may only be offset against income from the same FHL business. Minor amendments will be made to ensure the occupancy election applies from 2010/11.

**The restriction of tax losses for FHLs will make FHLs slightly less attractive. In addition, some businesses currently benefiting from the FHL rules may no longer qualify once the new occupancy threshold conditions are introduced.**

---

## Taxation of savings

*The individual savings account (ISA) annual limit will be increased from 2012/13 by reference to the CPI rather than RPI. As part of the Government's 'investment plans for children', Junior ISAs will be introduced to encourage minors to begin to save. Qualifying time deposits (QTD) will be taxed at source from 2012/13.*

The Government announced in the June 2010 Emergency Budget that, from 6 April 2011, the ISA subscription limits would be increased in line with inflation using the RPI. However, today's Budget instead confirmed that ISA limits from 2012/13 will be linked to the CPI. Additionally, and as announced in October last year, the Budget confirmed that a new tax-advantaged ISA account will be introduced for UK resident children who do not hold a Child Trust Fund. Draft legislation, to be announced on 31 March 2011, will set out the terms of the Junior ISAs which are expected to be available from Autumn 2011.

Furthermore, it was confirmed that interest received in respect of qualifying time deposit (QTD) accounts which is currently paid gross will be subject to 20% tax deducted at source from 2012/13 onwards. The Government will informally consult on the implementation of the change during May 2011.

**Whilst taxpayers will welcome continued increases to ISA limits, an increase by reference to the CPI is likely to be lower than if the RPI measure were retained. The introduction of Junior ISAs goes a little way to appease those parents who missed out on a Child Trust Fund while they were available.**

**Some investors may now consider QTDs less attractive given the cash flow disadvantages that arises from QTDs having 20% tax withheld at source.**

---

## Indirect tax

### VAT: Changes to registration and deregistration thresholds

*The VAT registration and deregistration thresholds for UK businesses have been increased whilst, for overseas businesses, the registration threshold has been abolished.*

From 1 April 2011, the VAT registration and deregistration thresholds will increase by £3,000 to £73,000 and £71,000 respectively. However, for businesses not established in the UK, the registration threshold will be removed completely (i.e., a nil threshold will apply).

The £3,000 increase in the thresholds for UK businesses is larger than normal and should allow some small businesses to escape the VAT net. However, whilst the change for overseas businesses brings the UK into line with other EU countries, it could discourage certain businesses from trading in the UK.

---

### VAT: Low value consignment relief

*From 1 November 2011, the Low Value Consignment Relief (LVCR) threshold, below which goods imported from outside the EU are relieved of VAT, will be reduced from £18 to £15.*

LVCR was introduced in the UK in 1984 at a level of £18, the maximum permitted under EU law. In order to limit this relief, HMRC has announced that the LVCR threshold will be reduced to £15 with effect from 1 November 2011. The Government will also explore options with the European Commission to limit the scope of the relief further (specifically, to prevent it from being exploited for unintended purposes). In the event that such discussions do not produce a workable solution, the Government does not rule out the possibility of reducing the LVCR threshold even further in Budget 2012.

**The rapid increase in recent years in the volume of UK online sales (e.g., CDs and DVDs) has triggered a number of Parliamentary debates and related press comments highlighting the cost to the Exchequer of LVCR and the competitive disadvantage faced by UK businesses supplying similar goods. The £3 reduction in the LVCR threshold would appear to be an initial step to address these concerns, although this is unlikely to have a significant impact (pending any other future changes), as shipments of goods valued below £15 will continue to be eligible for VAT relief.**

---

## VAT: Cost-sharing exemption

*The Government has announced that it will continue to consult on the options for implementing the VAT cost sharing exemption into UK law.*

The exemption in EU law is intended to apply to bodies such as charities carrying on a non-taxable activity, and to businesses carrying on an exempt activity. It removes the added VAT cost which can arise when costs and resources are shared between such bodies/businesses.

This exemption is mandatory under EU law and should, therefore, be enacted into UK law. The Government recognised this in June 2010 when, as part of the Emergency Budget, it stated its intention to introduce the VAT cost-sharing exemption and undertook to launch a formal public consultation. Today's Budget announcement merely confirms that the consultation is continuing.

It remains to be seen if and how the UK will implement this exemption (e.g. whether financial services businesses will be included). The European Commission is currently taking infringement proceedings against Germany for limiting the exemption to certain sectors only. The UK will no doubt follow these proceedings with interest and may seek to delay taking any further action pending the final judgment.

---

## VAT: Business samples

*UK legislation will be amended to extend the VAT relief for businesses providing samples for marketing purposes, in line with a decision of the European Court of Justice (ECJ).*

As announced on 9 December 2010, the Government intends to amend the UK VAT legislation to extend the relief from VAT on business samples. The current legislation allows the first in a series of samples given to a recipient to be free from VAT, but not subsequent samples to the same recipient. However, following the ECJ decision in EMI (C-581/08), it has now been confirmed that any number of genuine samples provided by a business to the same recipient can be free from VAT. HMRC invited retrospective claims for overpaid VAT in Revenue & Customs Brief 51/10.

**The measure is unchanged from a previous announcement of a draft Finance Bill clause and gives a significant benefit to businesses which provide samples.**

---

## VAT: Value splitting: printed matter

*This measure (unchanged from a previous announcement of a draft Finance Bill clause) is an anti-avoidance measure to counteract what HMRC perceives as VAT avoidance where zero-rated printed matter supplied by a second entity is ancillary to a positive rated supply by a first entity.*

The measure, which will take effect from Royal Assent to the Finance Act 2011, applies where the supply of printed matter is connected with a supply of services and the supplies are made by different suppliers. 'Connected' for these purposes is defined as the printed matter being ancillary to the supply of services such that, if they had both been made by one supplier, they would have been treated as a single supply. The test does not require the parties to be connected persons. If this test is satisfied, the supply of the printed matter is excluded from zero-rating.

**The type of arrangement targeted by this measure is typically that of a magazine being supplied by a broadcaster through a separate entity. Case law has suggested that, under basic VAT law principles, separate supplies by separate suppliers cannot be fused together for the purposes of the ancillary supplies test. This anti-avoidance measure achieves for HMRC the same objective through denial of the zero-rating in this scenario.**

---

## VAT: Online filing

*The Government continues its drive to move businesses towards online filing.*

Legislation will be introduced to make mandatory online filings mandatory for:

- ▶ VAT returns and electronic payments for businesses with a turnover below £100,000 from 1 April 2012 (this follows the mandatory filings for larger businesses and new registrations from April 2010).
- ▶ VAT registration/deregistration and notifications of changes of registration details from 1 August 2012.

**The further move to online filing, which will be subject to a consultation in June 2011, is in line with the Government's 'digital agenda'.**

---

## VAT: Re-regarded supplies within VAT groups

*A concession concerning VAT charged on supplies within VAT groups is to be made law.*

When certain services are bought-in by an overseas member of a UK VAT group, and supplied on to another member of that VAT group, they are not disregarded and may thus be subject to VAT. This was an anti-avoidance measure introduced in 1996. There is a concession which has allowed the value of such 're-regarded' services to be the value of the services bought in rather than the value charged on within the VAT group. Since the list of relevant services was deleted from the VATA 1994 as a result of the VAT Package place of supply changes implemented on 1 January 2010, some concerns have been raised as to the concession's continued application. The concession will, therefore, be enshrined within VAT law by including a clause within Finance Bill 2012.

The concession is useful as it reduces the VAT costs of a partially exempt business by not including internal costs, and it also reduces the administration involved in calculating the VAT charge. Legislating for it is, therefore, welcome. HMRC has also confirmed that the concession will continue to be applied in the meantime so as to maintain the effect originally intended.

---

## VAT: Other Budget announcements

The Budget material also includes the following announcements:

- ▶ The fuel scale charges for private use of business fuel will increase by in more than 10% for VAT accounting periods beginning on or after 1 May 2011.
- ▶ A new VAT refund scheme from 1 April 2011 for academies' non-business VAT costs will put them on the same footing as local authority maintained schools (unchanged from a previous announcement of a draft Finance Bill clause).
- ▶ The Finance Bill 2012 will include enabling legislation for VAT and duty reliefs for diplomatic missions, international bodies and visiting NATO forces, replacing existing extra statutory concessions.
- ▶ The Finance Bill 2012 will include, after the issue of draft legislation in Autumn 2011, legislation to clarify the VAT treatment of public bodies when carrying out statutory duties in competition with the private sector.
- ▶ The Finance Bill 2012 will include, after consultation, a new online notification system for road vehicles imported into the UK from 2013, with payment of VAT linked to vehicle registration, to combat fraud in this area.

---

## Insurance Premium Tax (IPT): legislating for extra-statutory concessions

*Two more IPT concessions are now to be legislated.*

As part of the review of all extra statutory concessions (ESCs) following the House of Lords ruling in the Wilkinson case, the Government has announced that legislation will be made to preserve the tax effect of two IPT ESCs - ESC 4.5 'Discounted Insurance' (from 1 April 2011) and ESC 4.2 'De Minimis Provisions' (from a date later this year) - by putting them on a statutory footing.

Legislating for these concessions is welcome and was necessary following the Wilkinson case.

---

## Air passenger duty

*The Government proposes to extend Air Passenger Duty (APD) to private and business jets, a return to a simple two*

*or three band regime to remove the anomalies in taxation of flights of varying distance, and a review of the definition of what constitutes 'premium travel'. In addition, the expected increase in the APD rates due on 1 April 2011 has been delayed until 1 April 2012.*

As widely anticipated, the suggested 'per-plane' duty has been set aside and in its place a set of proposed measures has been put under consultation. It is proposed that the present exemption for 'small' aircraft (ie less than 10 tonnes in weight or carrying fewer than 20 passenger) is removed and the maximum APD charge of what is currently £170 be levied on a per-passenger basis for aircraft with a maximum take-off weight exceeding 5.7 tonnes, irrespective of the distance travelled. Other proposed changes include a possible return to a simplified band structure in an attempt to tax travel in accordance with distance, and a review of the definition of different classes of travel in response to some airlines' view that 'premium economy' seats are unfairly taxed at the higher rate of APD.

It is proposed that the APD exemption for transit passengers within the UK will remain intact to protect regional passengers and also protect the status of the UK as an international transit hub.

**The proposed changes under consultation do not come as a surprise given the Government's green agenda and the concerns that stakeholders have expressed in the disparity in bands together with the parliamentary campaign in respect of flights to the Caribbean. The removal of the private jet exemption will have a significant impact on private, corporate and 'on-demand' aviation and also some smaller operators and there will undoubtedly be interesting debates in the consultation phase on the regulatory and legal status of the operators of small aircraft.**

---

## Landfill taxes

The Landfill Communities Fund (i.e., money that can be spent on improving communities around a landfill site) will be increased to a potential value of £78.1m of claimable credit in 2011/12. This will be achieved by raising the maximum credit that landfill site operators can claim on contributions made to the fund against their Landfill Tax liability to 6.2%. The standard rate of Landfill Tax will increase to £64 per tonne on 1 April 2012 in accordance with previous announcements. The lower rate will be frozen at £2.50 per tonne.

---

## Climate change levy (CCL)

*CCL will increase in line with inflation from 1 April 2012. The reduced rate of CCL applicable to energy-intensive businesses will be further reduced from 35% to 20% from 1 April 2013. The Government has also identified a number of existing reliefs which are due to expire on 31 March*

*2011 which it is seeking EU approval to extend under State Aid provisions.*

As part of reforms introduced to the Climate Change Agreements (CCAs), the industry agreements giving entitlement to CCL reductions, the reduced rate of CCL that energy-intensive businesses enjoy will be amended from 35% to 20% for electricity only from 1 April 2013. The CCA reforms and simplification measures will be published as part of a consultation in the summer.

The Government is seeking approval from the European Commission to extend the CCL exemptions for taxable commodities used in certain types of transport (such as rail freight and certain public passenger rail services) and in recycling processes. It is expected that the exemptions should be able to extend beyond 1 April 2011.

**The reduced rate of CCL will mitigate the increased cost to these businesses of the carbon price floor, and is part of a wider reform package which aims to simplify the CCA scheme.**

---

## Introduction of a carbon price floor

The Government confirmed today that it would introduce a new tax on those who supply fossil fuels to electricity generators to supplement the carbon price inherent in the EU Emissions Trading Scheme. The new 'carbon price floor' mechanism would impose an additional levy, set each year by the Government, aiming to bring the carbon price for fossil fuel used for electricity generation up to £16 per tonne of CO<sub>2</sub> in 2013, rising to £30 per tonne of CO<sub>2</sub> by 2020.

In practice this is an additional tax of £4.94, £7.28 and £9.86 per tonne of CO<sub>2</sub> in 2013/14, 2014/15 and 2015/16 respectively. The new carbon price support rates will be implemented through the Climate Change Levy (CCL) for non-oil fossil fuels and, for oil, through fuel duty reclaims.

Changes to the draft legislation include a reduced carbon price support rate for electricity generation from quality Combined Heat and Power (CHP), with further consultation required with the industry. The current CCL exemption for electricity generated in CHP plants which is supplied indirectly to an energy consumer will still be removed from 1 April 2013.

Anti-avoidance provisions applying from today will affect businesses that invoice or receive payment before 1 April 2013 and will define what acceptable business practice is during the transition to the new legislation.

The Government also expects to introduce further detail for CHP and Carbon Capture Storage (CCS) facilities in the Finance Bill 2012.

**The chosen carbon price is broadly in line with the £20-£40 per tonne of CO<sub>2</sub> band that was consulted upon. Carbon price support will add further to the cost of energy in addition to the EU Emissions Trading Scheme, Climate Change Levy,**

**Renewables Obligation and, for some businesses, the Carbon Reduction Commitment. As acknowledged by the Treasury, this can be expected to feed into consumer tariffs and impact all electricity consumers indirectly.**

---

## Other carbon measures

*The Government announced several other carbon measures including:*

- ▶ **Carbon Reduction Commitment Energy Efficiency Scheme:** As expected the Government has confirmed that allowances will be priced at £12 per tonne of CO<sub>2</sub> and it will publish draft regulations to implement allowance sales later in 2011.
- ▶ **Carbon Capture and Storage (CCS):** The Government has restated its commitment to funding for four CCS demonstration plants, but will now fund its commitments to CCS demonstrations from general taxation. Funding of CCS from general expenditure, will mean electricity consumers will not need to pay higher electricity bills to fund direct investment in CCS projects.
- ▶ **Green Investment Bank:** The Government has announced that the initial capitalisation of the bank will be £3bn and that it will begin operation in 2012/13, a year earlier than previously anticipated. The Bank will only be granted borrowing powers from 2015/16 if targets for debt reduction have been met.

---

## Aggregates levy: rates and Northern Ireland Credit Scheme

*The Government has postponed the planned increase in the rate from £2.00 per tonne to £2.10 per tonne that was due to take effect from 1 April 2011 for a year. The rate increase will now take effect from 1 April 2012. Subject to EU State Aid approval, the Government will also reinstate the Aggregates Levy Credit Scheme (ALCS) in Northern Ireland, which was suspended late last year after an adverse State Aid ruling in the European Court of Justice.*

---

## Alcohol and tobacco duties

*In line with the previously announced draft Finance Bill clause, an additional duty of 25% of the general beer duty will be introduced on beers over 7.5% abv (equivalent to an extra 25 pence on a 500ml can of 9% abv beer). The rate for beer between 1.2% abv and 2.8% will be reduced by 50%. The Government will also explore legislative options to tackle alcohol fraud. Alcohol duty rates will increase by 2% above inflation with effect from 28 March 2011. This will add 4 pence to a pint of beer, 15 pence to a bottle of wine and 54 pence to a bottle of spirits.*

*Tobacco duty rates increase by 2% above inflation with effect from 6pm on 23 March 2011. Duty on hand-rolling tobacco will increase by an additional 10%. The structure of cigarette taxation will change, reducing the ad valorem component to 16.5% and the specific component to 25% above inflation. This will add 50 pence to a packet of economy cigarettes and 33 pence to a packet of premium cigarettes. HMRC and the UK Border Agency will announce a renewed strategy to combat tobacco fraud in April 2011.*

The 2% above inflation increase to both tobacco and alcohol duties was widely expected based on earlier Government statements and is in line with the publicised policy of ongoing annual increases in response to the health lobby's concerns on the effects of alcohol and tobacco on public health.

The changes to high and low strength beer duty are designed to encourage a move away from the consumption of 'super strength' beers in favour of lower alcoholic strength varieties. The move towards increasing the specific element of tobacco duty demonstrates that the Government is trying to avoid an increase in lower-priced cigarette consumption as a result of tobacco duty rises. This has gone hand-in-hand with renewed efforts to tackle fraud to ensure that the illicit market does not benefit from these measures.

---

## Fuel duties

*The Chancellor announced three key changes to the fuel duty regime.*

- ▶ The fuel duty escalator will be replaced by a fair fuel stabiliser. The Government has proposed that when the price of oil is above \$75 a barrel, the stabiliser will take effect and fuel duty rises will be restricted to inflation. If the price dips below this level, the rate will increase by 1% above inflation.
- ▶ The fuel duty increase planned for April 2011 will now be delayed until 1 August 2012.
- ▶ The main fuel duty rate will be cut by 1 pence per litre from 23 March 2011 and will increase by 3.02 pence per litre from 1 January 2012.

In addition, the duty rate for leaded petrol and compressed natural gas will change by the same monetary amount as main fuel duty. Duty on aviation gasoline and rebated oils will change in proportion to the main rate. Changes were also announced to rural fuel duty rebates.

The fuel duty escalator was announced in Budget 2009 and was designed to increase fuel duty by 1% above inflation each year until 2014/15.

The trigger point of the stabiliser is yet to be finalised and this will generate much discussion in the oil industry. The

reduced level of fuel duty will benefit not only consumers but also many industries that rely on delivering products by road. The Government has been under significant pressure from lobby groups and whilst the delay of the fuel duty increase was expected, the cut in fuel duty was a surprise to many commentators and fits with the policy of supporting manufacturing industries and low income households, both of whom are disproportionately disadvantaged by fuel duty increases. This change also results from the high levels of inflation and oil prices, although the Chancellor stressed that he could not be held accountable for the latter.

---

## Vehicle excise duty (VED)

*Rates will increase by indexation from 1 April 2011 with the exception of most Heavy Goods Vehicles (HGV) where rates are frozen in 2011/12. However, exceptional rates of VED for certain heavy goods vehicles will still be introduced as proposed in the draft Finance Bill. Discount rates for Euro VI Reduced Pollution Certificates will remain the same as for previous Euro standards and these will be backdated for vehicles purchased before 1 January 2012.*

Freezing rates for HGV will be welcomed by hauliers and heavy road transport reliant businesses.

---

## Gambling duty changes

*Amusement machine licence duty (AML) will be replaced in 2013 by a new machine games duty (MGD). In the meantime, AML rates will increase, along with the gross gaming yield (GGY) bandings for gaming duty.*

As announced on 9 December 2010, the Government intends to introduce MGD to replace AML. Games played on machines which are liable to MGD will also become exempt from VAT. Initial legislation for MGD will be set out in the Finance Bill 2011, with the final legislation planned for the Finance Bill 2012. Implementation is planned for early 2013. There will be consultations on the design and technical aspects of the new duty during 2011.

The rates for AML will increase in line with inflation for any licence applications that are received by HMRC after 4pm on 25 March 2011. The GGY bandings used to calculate gaming duty will also increase in line with inflation for any accounting periods starting on or after 1 April 2011.

**It is likely that there will be winners and losers under the proposed MGD regime, despite its aim to be fiscally neutral overall. There is currently a lack of certainty for the industry as to how the new duty will work and this could lead to difficulties in planning for affected businesses over the next two years.**

## Corporate tax

---

### Corporate tax rate

The Government previously announced its commitment to reduce the main rate of corporation tax to 24% by 2014, with a 1% reduction (to 27%) expected in Finance Bill 2011. This was surpassed today with an additional 1% reduction (to 26%).

Rules to simplify the application of the small profits rate for associated companies were also expected. The Government announced its inclusion of the 9 December 2010 draft legislation in Finance Bill 2011 with no changes required following consultation.

The main rate of corporation tax rate will now be reduced by 2% (to 26%) with effect from 1 April 2011. The previously announced annual 1% cuts will also be maintained, creating a 23% main rate by 2014. The small profits rate will also be reduced to 20% with effect from 1 April 2011, as announced previously. The reduction in the rate does not affect ring fence profits with the main rate still remaining at 30% and the small profit rate remaining at 19%.

Additionally, the Government is looking to devolve the setting of the corporate tax rate in Northern Ireland to the Northern Ireland Executive to help 'rebalance' the local economy (Consultation Paper due 24 March 2011).

For associated companies, draft legislation was made available on 9 December 2010 and the Government considers there to be no need for further changes after consultation. New rules will apply to accounting periods ending on or after 1 April 2011. The new rules seek to associate companies where there is 'substantial commercial interdependence' between them (to be defined by secondary legislation). It was proposed that a company will be considered to be associated if the company is financially, economically or organisationally interdependent. However, a company may still be associated even if substantial commercial independence is not present if a company controls another company through its shareholding and has rights to the assets on winding up.

**These measures should generally be welcomed and support the Government's objective of delivering a competitive corporate tax system. Tax rates are a function applied to the calculated tax base and creating a competitive 'low tax' jurisdiction also relies on measures impacting the calculation of that tax base. The associated company changes are as expected and a welcome step in the right direction, but some concern remains on how the broad definition of 'substantial commercial interdependence' will be interpreted in practice.**

---

### Bank levy

*The Government published legislation in 2010 for a levy on certain liabilities of banks and banking groups operating in the UK to encourage banks to move away from perceived higher risk sources of financing. This is expected to raise £1.9bn in 2011 rising to £2.6bn per annum.*

In February, the Government scrapped plans to introduce the bank levy at an initially reduced rate and announced that full rates of (on average) 0.075% and 0.0375% would apply from the outset. Today, the Chancellor announced increases in these rates for 2012 onwards to 0.078% and 0.039%. This is to offset the benefit to bank levy payers of the additional 1% reduction in the rate of corporation tax to 26% from this April, also announced today.

HMRC has already published guidance on the practical aspects of the bank levy including the process for nomination of 'responsible members' prior to the Finance Bill 2011 receiving Royal Assent. This was reiterated in today's Budget, along with a general invitation to banks to discuss the levy and its application with HMRC. Scope, consolidation, allowances and calculation are all areas that levy payers are likely to seek to discuss.

**The additional increase in the bank levy from January 2012 will be perceived by some to be an unwelcome and disproportionate cost for levy paying banks. The continuing absence of clarity about what mechanisms will be introduced to eliminate double taxation is unsatisfactory, both from a policy perspective and because of the adverse impact on forecasting, pricing and business decisions for levy payers. Further detail on the interpretation of what will qualify as protected deposits and clarification of the netting rules to provide for full multilateral netting would also be welcome when the revised draft legislation is published.**

---

### Controlled foreign company (CFC) reform

*Interim improvements to the current CFC regime will take effect for accounting periods beginning on or after 1 January 2011 with broader reform on course for Finance Bill 2012. An ultimate effective rate of 5.75% is promised for overseas group financing arrangements.*

The previously published draft legislation for interim improvements contained new proportionate exemptions for intra-group trading companies with limited UK connection and for CFCs that exploit intellectual property (IP) where the IP and the CFC have minimal UK connection. The draft rules amend the current exemption for CFCs with de minimis profits, increasing the limit from £50,000 to £200,000 per annum (to be calculated on an accounts basis). They also introduce a statutory three-year grace period so that there will be exemption for foreign

subsidiaries that come within the scope of the CFC regime for the first time as a result of a reorganisation or change of ownership, subject to there being no change in the activities carried on. Finally, the transitional rules for superior and non-local holding companies will be extended to 2012.

Following the consultation, the rules have been amended, notably to extend the availability of the three-year temporary exemption to previously UK-headed groups or sub-groups that choose to return to the UK. The rules will be applicable to accounting periods commencing on or after 1 January 2011.

In November 2010, the Government announced its intention to introduce a reformed, entity-based CFC regime that is targeted towards overseas profits that have been artificially diverted from the UK. To date, only the details of proposals for IP and finance companies have been released for consultation.

For IP, the new regime seeks to manage risks arising from CFCs with IP-related profits by focusing the scope proportionately on companies holding IP connected with the UK that have 'excessive profits' arising from artificially diverted UK profits.

The proposal for finance companies is to introduce a partial exemption, which will operate by reference to the debt:equity ratio of the finance company compared with a set threshold and apply a CFC charge to any equity in excess of the threshold. The Government has today proposed a debt:equity threshold of 1:3, effectively meaning that only a quarter of a fully equity funded overseas finance company's profits will be subject to CFC taxation. When the 23% corporate tax rate takes effect in 2014, this will reduce the effective CFC tax rate for group financing entities to 5.75%. A consultation document is expected in May, with more detail.

**The consultation document is eagerly awaited. It will be interesting to see whether today's announcements will entice formerly UK-parented groups back to the UK.**

---

## Taxation of foreign branches

*For accounting periods commencing on or after Royal Assent, UK companies will be able to make an irrevocable election for the profits of their foreign branches to be exempt from UK tax.*

In December 2010, the Government published draft legislation that will apply on an irrevocable 'opt-in' basis to exempt the trading profits, including chargeable gains and any connected investment income of a company's foreign branches, with no relief in respect of foreign branch losses. The election will take effect from the commencement of the next accounting period, subject to transitional rules relating to certain losses arising in previous years. For large and medium companies, the exemption will apply for branches in all territories. For small companies, the exemption will not extend to branches in non-treaty countries. Rules will be included to counteract the artificial diversion of profits to exempt branches.

Following the consultation process over the winter, the Budget confirmed that the exemption will operate broadly as drafted but that as a result of the consultation, certain changes have been made, in particular, to allow certain life insurance companies to benefit, to ensure that business can apply the transitional rules in practice and to ensure that the anti-avoidance rules are targeted and proportionate. In addition, rules relating to capital allowances and withholding taxes have also been developed.

Little detail has been published in relation to these changes; more detail is expected when the Finance Bill is published next week.

**Branch reform is welcomed and the publication of draft legislation is eagerly anticipated. It is hoped that one of the signalled changes will be an automatic presumption that existing branches do not fall within the anti-avoidance rules.**

---

## Research & development (R&D) credits

*R&D credits for small and medium-sized businesses (SMEs) will be increased.*

Credits have been available for many years on qualifying R&D, either as an enhanced tax deduction or (for SMEs) by the payment of a credit. The November 2010 consultation document asked for views as to how the current scheme can be improved to encourage more R&D activity in the UK. Following this consultation, it has been announced that, subject to State Aid approval, the R&D credit available to SMEs will be increased for expenditure on or after 1 April 2011 to 200% of the qualifying expenditure, and for expenditure on or after 1 April 2012, to 225%. Further changes will be made in 2012 to remove some existing restrictions in the current scheme.

**The change goes further than the recommendations of the Dyson review in 2010, both in terms of the amount of the credit, and the fact that it would apply to SMEs across the board, rather than refocusing credits to high-tech companies.**

---

## Patent box

*The Government has announced the publication of a further consultation document on the proposed patent box in May 2011, with legislation proposed for Finance Act 2012.*

The November 2010 consultation document on corporate tax reform included proposals for a new regime for the taxation of profits arising from patents. The current proposal is that a 10% rate should be applied to income (after associated expenses) arising on or after 1 April 2013 from patents that are first commercialised after 29 November 2010. The rate would also apply to income that is embedded in the price of patented products. However, it is not currently intended to apply this rate to the passive holding of patents, or to extend it to IP other

than patents. Representations on the proposals were made on 4 March 2011 and we await the results of these representations when the further consultation document is published in May.

The patent box regime is overall a welcome development, though it is disappointing that the current proposals do not include IP other than patents, a move that is regarded by the Government as being too expensive. Our view is that the tax rate should be applied to patents as soon as they are registered, rather than waiting for 'commercialisation' (a term which is not currently defined). Also it is not clear why the Government wishes to exclude passive patent income from the regime. It is to be hoped that some modifications may be made to the proposed regime to take these points into account.

---

## Tackling tax avoidance - Strategy and practice

*A paper has been published setting out the approach of the Government and HMRC to tackling tax avoidance. This builds on existing initiatives.*

One strand of the strategic approach is a possible General Anti-Abuse Rule or GAAR. A study group will report by the end of October 2011. For the time being, at least, targeted anti-avoidance measures will still be needed.

There will be a rolling process of review of 'high-risk areas' with a roughly one-year timetable for consultation, publication of draft clauses and legislation. The first focus areas are income tax losses and unauthorised unit trusts, targeted for legislation in FA 2012. Alongside this will be consultation with a view to improving the legislative framework and, at the same time, countering perceived abuse in relation to capital allowances, use of double tax treaties and pension scheme contributions, again targeted for FA 2012.

One concern expressed by HMRC is that taxpayers enter into avoidance schemes, even where they are thought likely to fail, simply to delay payment of tax. Accordingly, it is proposed that some schemes will be listed, with strong incentives to pay the tax at issue early, including additional late payment charges.

As regards practice, the paper focuses on how HMRC plans to tackle the three core elements of its anti-avoidance strategy; prevention, detection and counteraction. The Code of Practice on taxation for banks is cited as an improvement of the design of policy and legislation. The rules requiring disclosure of tax avoidance schemes are seen as a key element in the detection of avoidance, and are to be built on in the future. Improved counteraction is to be based on clear risk assessment, application by HMRC of a clear governance framework to ensure consistency of approach, publication of the basis on which HMRC is prepared to settle contentious issues, and international cooperation.

**Overall the proposals suggest a clearer, more coherent, approach is to be adopted with improved governance. This**

has to be welcomed. Most of the initiatives build on proposals already announced but the proposal to counteract the cash flow advantages from listed schemes is new. It is encouraging that improving the policy and design of legislation is explicitly mentioned as part of the initiative to improve prevention of avoidance.

---

## Reduction in plant and machinery allowances

*From 1 April 2012 (corporation tax) or 6 April 2012 (income tax), there will be a 2% reduction in the rates of capital allowances, the main rate pool going down from 20% to 18%, and the special rate pool from 10% to 8%. In addition, from April 2012 the 100% annual investment allowance (AIA) will be reduced from £100,000 to £25,000.*

The above changes were announced in the Emergency Budget in June last year and were part of the Coalition Government's promise to reform the corporation tax system and reduce headline rates, by simplifying reliefs and allowances. It was expected to include both a simplification of the existing capital allowances regime, and a significant reduction to the rates of relief. This was, therefore, better than expected news for businesses investing in plant and machinery, which have one year from April 2011 to benefit from the reduction in the corporation tax rate before the capital allowances rates fall.

The changes in rates will introduce transitional arrangements for businesses whose chargeable period span 1 April (corporation tax) or 6 April (income tax).

**Businesses have been given time to plan for the reduction in writing down allowances with the reduction being deferred until 1 April 2012, and the reductions were not as severe as expected. However, it is a surprise that the regime has not in general been simplified.**

**The reduction in the 100% AIA from £100,000 to £25,000 was the main disappointment and will hit small businesses the hardest.**

---

## Short-life assets (SLA)

*From April 2011, businesses incurring expenditure on an item of plant or machinery will be able to make a SLA election in respect of that item if they expect to sell or scrap it within an eight-year cut-off period. The exceptions to SLA treatment will continue.*

SLAs are assets which are only expected to be used in a trade for a short time before they become obsolete and are sold or scrapped. Electing for plant or machinery to be treated as a SLA ensures that, if the asset is sold or scrapped before a certain cut-

off point, the total allowances given over the period of ownership equal the actual net cost of the asset to the business. This cut-off point has been extended from the current four years to eight years.

This will extend the existing SLA regime to businesses investing in assets with longer useful lives and will benefit those which invest sums in plant and machinery in excess of the annual investment allowance. It will also help to ensure that the UK capital allowances system better reflects economic depreciation for assets with longer useful lives.

---

## Additional capital allowances measures and consultations

*The Government has introduced a number of measures and consultations.*

The business premises renovation allowance has been extended for a further five years from 2012.

A new Renewable Heat Incentive is due to be introduced in summer 2011 and will sit alongside the feed-in tariffs regime to incentivise heat generation from renewable sources. Where the electricity and heat generation is undertaken by a business, the business may also be entitled to claim capital allowances. There is some uncertainty over the rate at which allowances may be claimed and it may be dependent on the business circumstances and the site of the installation. A consultation document will be issued in May 2011 and it is intended that legislation will be included in Finance Bill 2012.

The Enhanced Capital Allowances list of designated energy-saving technologies will be updated during summer 2011, subject to agreement with the European Commission.

The Government will consider, in some cases, the scope for introducing an enhanced system of capital allowances to support Enterprise Zones in assisted areas, where there is a strong focus on high value manufacturing.

There is currently legislation which applies to transactions where the sole or main benefit of the transaction is to obtain allowances. The Government intends to make this anti-avoidance more effective and will be consulting on this measure in May 2011.

The Government will be publishing a consultation document in May 2011 which concerns plans to introduce changes to the capital allowances fixtures rules such that businesses must pool their expenditure on fixtures in a building within a short period of acquiring the building, in order to qualify for capital allowances.

At this stage, there is little detail available on the above consultations. We await further clarity on these measures. With the exception of the anti-avoidance and the fixtures mandatory pooling the above are designed to encourage investment and growth in the economy, which is to be welcomed.

---

## Corporate capital gains: Degrouping charges

*Changes are to be made to the proposed new degrouping rules to address some specific issues arising from the draft legislation published in December 2010, and to counter perceived abuse of the associated companies exception.*

Under the draft legislation published in December it is proposed that, for certain share sales on or after the date the Finance Bill receives Royal Assent, degrouping charges arising will be added to the consideration for the share sale and so potentially be eligible for Substantial Shareholding Exemption (SSE). This is to correct the fact that, currently, a degrouping charge can arise where a company acquires an asset as part of a trade transferred into it prior to the company being sold, which seems inequitable if the overall sale of the company's shares benefits from SSE. It was announced today that amendments will be made to clarify the operation of the new rules in certain specific cases, and to 'clarify the intent' of the new rules. Legislation will also be put into the Finance Bill to address perceived abuse of the associated company exemption, which would apply to degrouping events occurring on or after 23 March 2011.

**The reform of the degrouping charge is a welcome change that will considerably reduce the burden of degrouping charges in many company sale situations. It will, however, be interesting to see what the 'clarification' of the new rules will be when the Finance Bill is published.**

---

## Corporate capital gains: Value shifting and depreciatory transactions

*A new motive test is being introduced to determine whether a value shifting adjustment would arise on disposals, on or after the date the Finance Bill receives Royal Assent, of shares or securities whose value has been materially reduced. In addition, the depreciatory transactions rules are to be restricted so that they only look at transactions in the six years prior to a disposal.*

The rules as published in the draft Finance Bill are to apply where the purpose behind the reduction in value is the tax benefit, and do away with the prescriptive exemptions, with the exception that reductions in value arising from arrangements that 'consist solely of the making of an exempt distribution' (such as certain pre-sale dividends) would be excluded under the new rules. The Budget has confirmed that no changes to the consultation draft clauses are to be made.

The intention behind these new value shifting rules was to make them simpler and more certain. However, the new rules, though shorter, are not likely to be simpler in practice and do appear to extend the scope of the value shifting

provisions. Draft guidance released in January has created further uncertainty.

---

## Corporate capital gains: Capital losses after a change of ownership

*The rules in Sch 7A TCGA 1992 relating to unrealised capital losses on a change of ownership are to be repealed, and their application to realised losses will be narrowed.*

The provisions announced in the draft Finance Bill repealed the application of Sch 7A to unrealised losses so that, for the deduction of losses on or after the date of Royal Assent of the Finance Bill, such losses will only come within the scope of the motive based anti-avoidance rule in s184A. The streaming provisions in Sch 7A will continue to apply in relation to realised capital losses, but will be amended to allow losses to be used in any business (rather than just a trade) carried on by the company immediately before it joined the new group and then carried on by any member in the acquirer group. There is also greater clarity provided on the application of the rules in situations involving multiple changes of ownership. The Budget has confirmed that no changes to the consultation draft clauses are to be made.

These are welcome changes and are a simplification of the current rules, following up representations first made in 2006 (when the motive based rule in s184A was introduced) that the duplication in Sch 7A could be removed.

---

## Amendments to the worldwide debt cap (WWDC) legislation

*The WWDC rules have been in effect since 1 January 2010, but amendments continue to be made as part of ongoing consultation to address practical issues with the application of the rules.*

Practical issues identified as part of the continuing consultation on the WWDC rules include anomalies caused by the operation of the de-minimis amount. Informal consultation on such practical issues is promised in June 2011 with further legislation due to be released in draft in the autumn and enacted in Finance Bill 2012.

HMRC's response to the practical concerns being raised by companies and the tax profession is welcomed and it is to be hoped that these concerns are addressed without adding extra complexity or uncertainty for taxpayers.

---

## Plant and machinery leasing - anti-avoidance

*HMRC announced on 9 March 2011 that measures will be introduced in Finance Bill 2011 to tackle a tax avoidance scheme by which it believes businesses are claiming tax relief twice on one amount of expenditure.*

The long funding lease regime was originally introduced in Finance Act 2006 and, since that time, has been subject to continued changes to tackle perceived avoidance. The proposed legislation, which will take effect from 9 March 2011, will apply where there is a residual amount guaranteed in connection with a long funding lease where it is reasonable to assume that any payment made under such a guarantee would lead to relief being given as a result of making that payment. The intended effect of the changes is to give relief only once.

**Ongoing changes to the long funding lease regime as a result of continued avoidance suggests that HMRC's approach to avoidance in this area may be overly reactive. The desirability for a stable regime remains, particularly against the backdrop of changes to lease accounting.**

---

## Sale of lessor companies - preventing avoidance

*HMRC has announced significant changes to the sale of lessor companies regime with the stated aim of preventing avoidance in this area.*

The sale of lessor companies regime was introduced in December 2005 to address a risk that tax on the deferred profits of a lessor company would not be paid in full following a sale of the company. Despite successive changes to the regime since it was introduced, HMRC has become aware of continued activity which purportedly seeks to gain a tax advantage on the sale of leasing companies. Significant changes have been introduced which take effect from today including, but not limited to:

The withdrawal of the election for an alternative treatment to apply.

- ▶ Changes to the anti-avoidance provisions, which will now counter attempts to manipulate the value of plant or machinery, the calculation of the tax written down figure or the amount of the income of a company that is derived from leasing.

The need for a stable, commercially driven taxing regime in this area remains. It is our view that a general commercial purpose test applying to the sale of lessor companies legislation is now long overdue.

---

## Changes to lease accounting

*During 2010, changes to accounting standards in relation to the treatment of lease arrangements were signalled. Depending on the particular accounting standards adopted, these could start to take effect during 2011.*

Legislation in response to these accounting changes was included in December's draft clauses for Finance Bill 2011. The intention of this legislation is to provide for continuity of tax treatment, notwithstanding the changes to accounting.

This is achieved by requiring businesses that account for leases using accounting standards that have been changed on or after 1 January 2011 to continue to apply all tax legislation as if such changes had not taken place.

Publication of this legislation is welcome as it should provide for certainty in relation to the tax treatment of leases through consistency with the current treatment.

However, the increased inconsistency between accounting and tax rules over time will result in an increased compliance burden.

---

## Group mismatches

*The Finance Bill will include principles-based anti-avoidance legislation intended to catch schemes which use mismatches between the ways a transaction is accounted for by connected parties to generate a tax advantage.*

A group mismatch scheme will exist where there is a scheme likely to secure a tax advantage which arises as a result of asymmetries in the way amounts are brought into account, where this is a main purpose of the scheme.

HMRC issued a consultation document in relation to these changes in March last year and draft legislation in December. It is proposed that the new rules should come into effect when the Finance Bill receives Royal Assent. At the same time, various targeted anti-avoidance provisions aimed at specific group mismatch schemes will be repealed.

The rules will affect existing arrangements but only with respect to profits and losses accruing after the date of Royal Assent.

The rules will have broad scope so existing arrangements need to be reviewed. It is hoped that amendments to the drafting will reduce uncertainty and the risk that the rules could apply in inappropriate circumstances.

---

## The Disregard Regulations and functional currency elections

*The 'Disregard Regulations' help companies manage cash*

*tax volatility arising from fair value accounting or exchange differences. Refinements are to be introduced to assist in problem scenarios. But 'reverse matching' under which exchange differences are not taxed on loan relationships or currency derivatives that hedge a company's own foreign currency share capital will be severely restricted.*

However, separate primary legislation published in draft in December 2010 will allow investment companies to elect to have tax computed in a currency other than their accounting functional currency, subject to conditions being met.

This will help in some, though not all, scenarios where reverse matching has proved useful.

---

## Corporation tax avoidance: Derecognition

*The Finance Bill will contain amendments to the anti-avoidance rules on amounts not fully recognised for accounting purposes, expanding their scope to any case where there is a specific intention to avoid tax.*

Existing legislation applying to the loan relationships regime and derivative contracts regime deny a tax advantage where amounts are derecognised for accounting purposes. This legislation applies only where certain specific conditions are met. The new rules remove these specific conditions and instead include a broader tax avoidance test.

Where, as a result of arrangements a main purpose of which is to obtain a tax advantage, an amount is not recognised in accordance with GAAP in relation to a loan relationship or derivative contract, the amounts to be brought into account for tax purposes will have to be determined on the assumption that no amounts have been derecognised.

The new rules were announced on 6 December 2010, the date from which they are also effective. They also affect existing transactions from that date. One tightening of the rules requiring recognition of amounts relating to derivative contracts at the point of recognition will only apply from Budget day.

In consultation we expressed concern that the rules could apply to certain commercial arrangements where a company did not itself have an avoidance purpose. It is to be hoped that amendments to the draft are sufficient to eliminate this risk.

---

## Writing down allowances (WDAs) on ships leased to tonnage tax companies

*Draft legislation was released in December 2010 to address the difference in WDAs for ships leased to tonnage tax companies and other ships.*

Legislation will be introduced in Finance Bill 2011 to align the rates of WDAs on the first £40m of expenditure including where the ship is a long-life asset.

The legislation differs from the draft legislation as it now extends to expenditure incurred on or after 1 January 2011 (the effective date) under an agreement preceding this date.

**This is a further simplification measure, although it may actually disadvantage certain lessors claiming WDAs depending on the asset.**

---

## **Real Estate Investment Trusts (REITs)-consultation planned**

*Following recommendations by the Office of Tax Simplification (OTS), the Government has announced that it will informally consult on ways to improve and simplify the REIT regime and reduce barriers to entry, including the 2% conversion charge.*

The industry has been lobbying for some time to remove various restrictions, and two changes in particular are expected alongside the removal of the 2% conversion charge, being the so-called listing requirement and the non-close company condition.

The removal of these barriers should enable relatively small property investment businesses to benefit from the regime, providing a more level playing field for investors in the sector as well as promoting the growth of the REIT market in the UK.

**In theory, the removal of direct tax at the investment vehicle level on capital gains should encourage faster growth of investment portfolios with lower leverage requirements for re-investment. Announcement of a consultation and the general desire to seek growth of the REIT sector and the simplification of the REIT rules are welcomed.**

---

## **Company distributions**

*As noted in the Budget materials, HMRC has been holding working-group meetings to discuss areas of uncertainty in respect of the taxation of company distributions, particularly in the areas of foreign dividends and distributions in specie. Although HMRC would hope to deal with a number of issues by guidance it now appears to have accepted that some legislative change is likely to be required in Finance Bill 2012.*

**In the interim period before legislation, taxpayers may wish to consider carefully the tax treatment of any distributions in respect of specific transactions and possibly seek non-statutory clearance from HMRC.**

---

## **Alternative finance**

*The Government has announced that it will make regulations to introduce direct tax rules for Shariah-compliant variable loan arrangements and derivatives in 2011 following consultation with industry.*

These changes are designed to cater for the Shariah-compliant equivalent of variable rate loans to bring these within the alternative finance provisions and to treat them in the same way as conventional variable rate loans. In addition, a regime is to be introduced to deal with the developing area of Islamic finance derivative products, which currently do not fall within the rules relating to derivative contracts in Part 7 Corporation Tax Act 2009. The intention is to treat Islamic finance derivatives in a similar way to conventional products.

**These changes are part of a continuing process of adapting UK tax rules to facilitate the development of Islamic finance in the UK in response to the needs of the industry.**

---

## **Employer asset-backed pension contributions**

*The Government is proposing to restrict the amount of tax relief available to employers when they make asset-backed contributions to their pension schemes.*

A consultation document will be issued in spring 2011 on restricting the tax relief available on the contribution of assets to employer defined benefit contribution schemes to that which accurately reflects the increase in the fair value of pension plan assets. Legislation will be introduced in Finance Bill 2012.

**A number of companies have sought to reduce their pension deficit by contributing assets to their pension scheme and thereby assist the cash flow impact of reducing the deficit. It is proposed that from 2012, the corporation tax relief given will be restricted to the increase in the fair value of the pension plan assets which may not be equal to the value of the contributed asset when considered in isolation.**

---

## **Transfer pricing - alignment with OECD guidelines**

Following the publication in July 2010 of an updated version of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Administrations ('The OECD Guidelines'), the Finance Bill confirms that this version is to be used in interpretation of the transfer pricing provisions for accounting periods beginning on or after 1 April 2011 (2011/12 for income tax).

The transfer pricing provisions in Part IV TIOPA 2010 are to be interpreted as best secures consistency with the 1998 OECD Guidelines but there is no clarity as to how the provisions tie in with later versions of the OECD Guidelines. It has, therefore, been necessary to include an amending provision as detailed above.

The change may not be as fundamental as it appears but, in applying the revised version, differences in the application of the transfer pricing provisions could arise in particular circumstances.

---

## Tainted charity donations

*Anti-avoidance legislation is to be included in Finance Bill 2011 to replace the existing substantial donors to charities legislation.*

The new legislation is aimed at catching donors who enter into arrangements to give donations to charities for the purpose of receiving an advantage from the charity.

Following consultation the following additional changes have been made:

- ▶ A focus on 'financial advantages'
- ▶ A new carve out for relevant housing providers and charitable payments made to a charity for onward transmission to a non-charity body
- ▶ A shorter transitional period before the existing legislation is repealed (reduced from five years to two)

This change is in line with expectations and in line with the Government's objective of a fairer tax system. It is expected to be welcomed by charities as the changes should reduce their administrative burdens as the target for recovery of relief is the donor. It is expected that the new legislation should not affect outright bona fide donations.

---

## Consultation on taxation of bank capital instruments

*The Budget announced a consultation to clarify, and if necessary change, the taxation of certain bank capital instruments.*

The Basel III rules for bank capital impose more stringent requirements relating to loss absorbency for additional going concern capital (structured tier 1), tier 2 and contingent capital (COCO) instruments.

These include (depending on the instrument) no economic accumulation (alternative coupon settlement mechanisms are prohibited), economic perpetuity, write down and conversion in certain events.

Under current UK tax law the treatment of some of these features is unclear both in isolation and cumulatively.

**This will be an important consultation as the Basel III requirements will lead to an enormous issuance of instruments of this type.**

---

## Tax transparent fund

*Following an announcement in the previous Budget, the Government has confirmed its intention to put forward legislation in Finance Bill 2012 to introduce a UK tax transparent investment fund vehicle.*

The asset management industry requested a UK tax transparent vehicle to enable full advantage to be taken of the new UCITS IV directive and support the competitiveness of the UK asset management industry, especially as compared to Luxembourg and Ireland which already have such vehicles.

**The confirmation of a timeframe for the introduction of a tax transparent vehicle in the UK is to be welcomed.**

---

## UCITS IV: Management company passport

*Provisions will be included in Finance Bill 2011 to ensure that a foreign UCITS fund established and regulated in another EEA State will not be considered tax resident in the UK.*

The UCITS Directive provides harmonised rules across the EU for the regulation of retail collective investment schemes. The latest version of the Directive (known as UCITS IV) allows non-UK funds to be directly managed by UK asset managers. Under UK case law, there was a concern that the actions of the UK asset manager could constitute the central management and control of the non-resident fund and therefore make the fund UK tax resident. These provisions will ensure that is not the case.

**This is a very welcome announcement and continues the Government's aim of ensuring the UK is an attractive location for the asset management industry.**

---

## HMRC data-gathering powers

*These provisions update HMRC's powers to collect information for risk assessment purposes and will be used with particular specialist legislation. Whilst generally intended to modernise existing legislation, there is also some widening of powers.*

These changes update HMRC's power to obtain information from third parties as part of HMRC's ongoing 'Review of Powers'.

The powers do not apply to cases where HMRC is looking at a named individual (under Sch~ 36 FA 2008), but to their bulk and specialist information powers. The powers cover a wide range of 'data holders' in areas including employment issues, deposit holders, issuers of licences (e.g., local authorities), payers of rent, etc.

The most significant change is likely to be the widening to allow HMRC to collect data on behalf of other tax jurisdictions.

**In the main the proposals are uncontroversial. The broadening of the scope of the powers to include the ability to collect data on behalf of other jurisdictions is a reflection of the increasingly global approach being taken by HMRC to protect tax revenues.**

---

## **Insurance Premium Tax (IPT): legislating for extra-statutory concessions**

*Two more IPT concessions are now to be legislated.*

As part of the review of all extra statutory concessions (ESCs) following the House of Lords ruling in the Wilkinson case, the Government has announced that legislation will be made to preserve the tax effect of two IPT ESCs - ESC 4.5 'Discounted Insurance' (from 1 April 2011) and ESC 4.2 'De Minimis Provisions' (from a date later this year) - by putting them on a statutory footing.

Legislating for these concessions is welcome and was necessary following the Wilkinson case.

---

## **Anti-avoidance of Stamp Duty Land Tax (SDLT): land exchanges**

*Anti-avoidance measures are to be introduced to combat the perceived abuse of the exchange provisions in Para 5 SDLT 4 FA 2003.*

Where property is exchanged SDLT is, broadly, payable on the market value of the property being acquired (regardless of the consideration actually given). The new rules attempt to impose SDLT on the greater of the market value and the actual consideration paid for the land transactions.

The provisions have effect in relation to transactions with an effective date on or after 24 March 2011 (subject to transitional provisions).

**These measures should prevent the perceived abuse of the market value rules to mitigate SDLT.**

---

## **Anti-avoidance of SDLT: alternative property finance relief**

*Anti-avoidance measures are to be introduced to combat the abuse of alternative property finance relief.*

A relief exists to prevent multiple charges to SDLT in Islamic property financing structures involving financial institutions.

The relief was used in certain structures which purportedly were designed to avoid SDLT. The most common of these combined sub-sale relief with the alternative property financing relief. The measures announced prevent such a combination.

Consumer credit licences were also used as part of these structures. The definition of financial institution for these purposes is, therefore, to be changed to omit entities which qualify solely by reason of holding a consumer credit licence.

The provisions have effect in relation to transactions with an effective date on or after 24 March 2011 (subject to transitional provisions).

**These structures were comparatively aggressive. Although it seems to put beyond doubt that sub-sale relief may no longer be used in such structures, it is less clear that the amended definition of a financial institution will be as effective.**

---

## **Sundry changes relating to stamp taxes**

*Sundry announcements have been made to the stamp duty land tax (SDLT) regime.*

- ▶ Following consultation, the removal of Social Landlord Relief, Disadvantaged Areas Relief and certain other redundant reliefs post 2012.
- ▶ Enactment of measures to reform Stamp Duty Reserve Tax in relation to unit trusts and OEICS.
- ▶ The announcement (in the Autumn) of the outcome of the review into SDLT relief for first time buyers.

**Although a review of the first time buyers legislation and the changes to the Stamp Duty Reserve Tax legislation are both to be welcomed, neither of these is likely to go far enough.**

---

## **Stamp duty land tax (SDLT) reform of rules for bulk purchases**

*Relief is to be introduced for purchases of multiple residential properties from the same vendor.*

Currently where a purchaser acquires a number of properties from the same vendor, or persons connected with him, and the

transactions are linked, the consideration must be aggregated to determine the rate of SDLT applicable. A relief will be introduced for residential transactions under which the consideration will be aggregated and then divided by the number of properties concerned, giving a mean consideration for the properties. The appropriate rate of SDLT will be based upon this mean consideration (subject to the minimum rate of 1%).

This relief will apply:

- ▶ Even where six or more properties are acquired (which would otherwise be treated as commercial, and outside the scope of the relief).
- ▶ Where the properties are acquired 'off-plan'.

However, a three-year clawback of the relief will apply to off-plan properties where the number of properties acquired is later reduced.

The measures will take effect for transactions with an effective date on or after Royal Assent to the Finance Bill.

It is welcome that, after several years of lobbying by the property industry, finally the rules relating to bulk purchases of residential properties are to be reformed.

---

## Oil and gas measures

*The Budget 2011 measures which were anticipated to have a positive impact for the oil and gas industry have been unexpectedly overshadowed by a dramatic rise in supplementary charge from 20% to 32%.*

Effective from 24 March 2011, the rate of supplementary charge levied on ring fence profits will be increased from 20% to 32%. Supplementary charge is levied on ring fence profits in addition to the ring fence corporation tax rate of 30%, which remains unchanged. Consequently there is now a combined corporation tax and supplementary charge rate of 62% on ring fence profits and for companies with fields liable to petroleum revenue tax the effective tax is now 81%.

The Government has also announced that as part of the 'fair fuel stabiliser' policy, if in the future the oil price falls below a set trigger price, suggested to be \$75 a barrel, for a sustained period, the supplementary charge will be reduced back towards 20%.

No further detail relating to this trigger price and rate reduction has been provided but the Government indicates that there will be consultation with the industry.

Coupled with this change is the announcement that legislation is to be introduced to restrict the tax relief for decommissioning expenditure to the 20% rate of supplementary charge.

A further new oil and gas measure announced today is in relation to the operation of the intangible fixed assets regime. Legislation

is to be issued which makes it clear that the scope of this regime does not extend to any intangible asset which derives its value from or is connected with an oil licence.

Previously announced measures include:

- ▶ A minor change to field allowance to correct a flaw in the original legislation.
- ▶ The oil asset swaps legislation has been amended so that cash settlements on certain swaps are not taxable.
- ▶ The ring fence reinvestment relief exemption is amended to include exploration and development costs.

**The increase in supplementary charge is an unexpected announcement and could have a detrimental impact on investor confidence in the oil and gas industry. The change potentially undermines much of the working relationship that has been built between industry and Government and arguably demonstrates to the industry an absence of fiscal stability in the UK oil and gas regime.**

---

## Life assurance companies: Changes to apportionment rules

*Finance Bill 2011 will amend s432C ICTA 1988 which deals with the apportionment of investment return in the non-profit funds of life companies.*

The purpose of the apportionment in s432C is to allocate the investment return of the non-profit fund of a life assurance company between life assurance and other long-term business and between the basic life assurance and general annuity and gross roll-up businesses within life assurance business. The form of the section enacted in FA 2007 could be interpreted as allocating to gross roll-up business a greater amount of investment return than to life assurance business as a whole. The section is to be amended to make it clear that the amount allocated to gross roll-up business is not to exceed the amount allocated to life assurance business.

**This is a sensible amendment following industry consultation, clarifies the legislation and brings it into line with its clear purpose.**

---

## Life assurance companies: Solvency II

*The Government has published a Technical Note outlining a new tax regime for life assurance companies to take effect from the introduction of Solvency II now expected on 1 January 2013. The Technical Note sets out the framework of the new regime as agreed by Ministers following the consultation process begun on 10 March 2010 and outlines both the areas requiring further consultation on*

*matters of detail and the way in which that consultation is to be carried out.*

Taxation of life insurance business profits is currently based on returns made to the Financial Services Authority. Under the Solvency II regulatory framework, these returns will no longer exist and it is necessary to institute a new basis for the taxing of life insurance business profits. It is also recognised that further changes may be needed to address the introduction of the IFRS Phase II standard for insurance contracts but these will only be addressed once the final standard is published.

The principal decisions announced in the Technical Note are:

- ▶ Life insurance profits will be based on the profit before tax in the financial statements.
- ▶ Profits from mutual business will continue not to be taxed.
- ▶ Deductions will be available for policyholder bonuses and technical provisions, unallocated divisible surplus and tax paid on policyholder profits.
- ▶ Basic life assurance and general annuity business will still be taxed on the I minus E basis with a minimum profits test comparing I minus E profit to the trade profit for this business based on the financial statements. All other insurance business will be taxed purely on trade profit based on the financial statements. Transitional provisions will allow for the carry forward of existing losses across this change.
- ▶ The tax treatment of a life assurance company's assets will be determined on first principles as revenue or capital not by reference to what is in the long-term fund but existing treatments will be grandfathered on transition.
- ▶ Income and gains will be attributed to the categories of long-term business as far as possible on a factual basis in accordance with commercial reality.
- ▶ Exempt dividends attributable to gross roll-up life assurance business will continue to be taxable in trade profit.
- ▶ Transfers of business between third parties will be taxed by reference to profit in the financial statements. Profits and losses on transfers between connected parties will be disregarded.

Transitional provisions will be introduced to spread the effect of the difference between accumulated tax and accounting profits. For items such as deferred acquisition costs where there is already provision in tax legislation, the existing approach of disregarding the effects of the transition will be followed. For the balance, a 10-year spreading of the impact is proposed. There may also be a deferral of tax for two years where the availability of profits is restricted by a Court order.

**All of these proposals have been subject to extensive consultation with the industry and others which will continue as draft legislation is developed for Finance Bill 2012. Ernst & Young will continue to play a full and active part in this.**

It is a testament to the constructive and helpful approach taken by all parties in the face of the clear need for change that the decisions announced today advance the life assurance tax regime so far in the direction of greater simplicity and clarity.

---

## **Life assurance companies: Changes to protection business**

*The Government has announced a prospective change to the way in which protection life assurance business is taxed. Protection business written on or after 1 January 2013 will no longer fall within the I minus E regime for life assurance business but will be taxed on accounting profits. Business written before that date will not be affected.*

Protection life assurance business does not result in the holding of significant cash and investment balances by a life assurance company so that the level of investment return is low relative to other life assurance products. There are, however, significant expenses from distribution and administration.

Currently, protection business is included in the I minus E regime and income from investment life assurance business can be offset against the expenses arising from protection business. The benefit of the offset is passed onto policyholders in the form of lower premiums. Not all companies, however, have the right mix of business to benefit from the offset. Companies which cannot do so either suffer a pricing disadvantage or find the business at best less profitable. This change will remove these relative disadvantages.

This change has been subject to extensive consultation with the industry to see if a consensus for change could be achieved and that consultation needs to continue. The course now put forward would remove a fiscal obstacle to competition and change the balance of advantage between providers although the removal of the opportunity for relief may make these products more expensive for consumers.

---

## **General insurance companies: Claims equalisation reserves**

*The Government has announced its intention to legislate in Finance Bill 2012 to maintain the tax relief for claims equalisation reserves for general insurance business. The position will be reviewed again when discussions on accounting for insurance contracts are concluded. The Technical Note sets out the framework of the continuing consultation process with the industry and makes it clear that the relief is to be dependent upon a robust justification for it being put forward.*

For both general insurers and Lloyd's corporate members, the move to Solvency II for regulatory purposes has caused

uncertainty in the area of claims equalisation reserves. These are required for general insurers under the current regulatory environment but will not exist under Solvency II. Solvency II may result in the need for both general insurers and Lloyd's corporate members to release these reserves.

We welcome the Government's willingness to continue discussions on the grounds of ensuring that the UK tax regime remains competitive for both general insurers and Lloyd's corporate members in a Solvency II environment.

---

## **Lloyd's: Corporate member level stop loss and quota share insurance**

*The Government has announced its intention to introduce legislation in Finance Bill 2012 to align the tax treatment of member level premiums and recoveries. Whilst this change would remove what has been seen as an anomaly in the tax treatment of member level reinsurance contracts, it is difficult to introduce and, therefore, legislative changes will be preceded by an informal consultation period running from April 2011 onwards.*

During 2010, HMRC altered its guidance on corporate member reinsurance contracts to state that premiums paid are deductible on a declarations basis. This alignment to the treatment of recoveries was challenged by Ernst & Young on behalf of a group of Lloyd's insurers, and Counsel's opinion was obtained to support the view that premiums paid should be deducted on an accounts basis.

We welcome HMRC's agreement to correct its guidance to reflect this position for which we have argued pending the introduction of new legislation.

# Ernst & Young contacts

<b>London</b>	1 More London Place, London SE1 2AF	020 7951 2000
	Becket House, 1 Lambeth Palace Road, London SE1 7EU	020 7951 2000
<b>Aberdeen</b>	Blenheim House, Fountainhall Road, Aberdeen AB15 4DT	0122 465 3000
<b>Belfast</b>	Bedford House, 16 Bedford Street, Belfast BT2 7DT	0289 044 3500
<b>Birmingham</b>	No 1 Colmore Square, Birmingham B4 6HQ	0121 535 2000
<b>Bristol</b>	The Paragon, Counterslip, Bristol BS1 6BX	0117 981 2050
<b>Cambridge</b>	Compass House, 80 Newmarket Road, Cambridge CB5 8DZ	0122 355 7000
<b>Channel Islands</b>	Royal Chambers, St Julian's Avenue, St Peter Port, Guernsey GY1 4AF	0148 171 7400
	Liberation House, Castle Street, St Helier, Jersey, JE1 1EY	0153 428 8600
<b>Edinburgh</b>	Ten George Street, Edinburgh EH2 2DZ	0131 777 2000
<b>Exeter</b>	Broadwalk House, Southernhay West, Exeter EX1 1LF	0139 228 4300
<b>Glasgow</b>	George House, 50 George Square, Glasgow G2 1RR	0141 626 5000
<b>Hull</b>	Lowgate House, Lowgate, Hull HU1 1JJ	0148 259 0300
<b>Inverness</b>	Barony House, Stoneyfield Business Park, Stoneyfield, Inverness IV2 7PA	0146 366 7000
<b>Leeds</b>	1 Bridgewater Place, Water Lane, Leeds LS11 5QR	0113 298 2200
<b>Liverpool</b>	20 Chapel Street, Liverpool L3 9AG	0151 210 4200
<b>Luton</b>	400 Capability Green, Luton, Beds LU1 3LU	0158 264 3000
<b>Manchester</b>	100 Barbirolli Square, Manchester M2 3EY	0161 333 3000
<b>Newcastle upon Tyne</b>	Citygate, St James' Boulevard, Newcastle upon Tyne NE1 4JD	0191 247 2500
<b>Nottingham</b>	City Gate West, Toll House Hill, Nottingham NG1 5FY	0115 954 2090
<b>Reading</b>	Apex Plaza, Forbury Road, Reading RG1 1YE	0118 928 1100
<b>Southampton</b>	Wessex House, 19 Threefield Lane, Southampton SO14 3QB	0238 038 2000

### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com)

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

© Ernst & Young LLP 2011. Published in the UK.  
All Rights Reserved.



In line with Ernst & Young's commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

[www.ey.com/uk](http://www.ey.com/uk)

1227438.indd (UK) 02/11. Creative Services Group.