DRAFT 2013 FINANCE BILL

11 December 2012

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Introduction

Less than a week after the Autumn Statement, the Treasury released over 1,000 pages of draft legislation for Finance Bill 2013, together with almost 300 pages of overview and other related documents.

The majority of the documents confirm previous announcements, introduce minor changes to help the tax system work better and provide a draft legislative framework for further consultation prior to the release of the full Finance Bill in Spring 2013.

Much of the Government's work on its initial area of focus, to make the UK corporate tax system the most competitive in the G20, has been completed, although there are still many reforming measures in the pipeline. Draft Finance Bill 2013 focuses on incentives for UK businesses to invest, and for individuals to invest in UK businesses. Predictably, having created a world class corporate tax system, legislation is now also proposed to ensure that business pays its 'fair share'.

Amongst all of the reiterations, there are some notable new developments:

- The UK's first ever draft GAAR legislation
- Statutory Residence Test legislation has finally been released after a 12 month delay
- Confirmation of the income tax reliefs to be capped from 6 April 2013
- The holding period to obtain Entrepreneurs' Relief on shares acquired by exercising EMI share options will now start on the date the option is granted, making this previously announced relief relevant to most businesses
- IR35 will be tightened in relation to directors
- The annual residential property tax, to discourage future SDLT avoidance on dwellings over £2 million, has been announced, with CGT measures to follow.

Whilst there are no great surprises or headline-grabbing measures, many of the announcements will be of direct relevance to businesses and individuals.

This update focuses on the main new developments and their relevance to you and your business. We look forward to the next major instalment in Budget 2013 on 20 March 2013, but if you have questions in the meantime on how you might be affected by these announcements please contact either your usual BDO adviser or me.

Kind regards,

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1. BUSINESS AND CORPORATE TAXES

Temporary increase in Annual Investment Allowance

The draft legislation has confirmed how accounting periods which straddle 1 January 2013 should be dealt with, following the temporary increase in the Annual Investment Allowance (AIA) from £25,000 to £250,000 for a two year period from 1 January 2013.

The 24 month period is effectively split into (either two or three) separate chargeable periods as follows:

- The start of the accounting period to 1 April 2012 for corporation tax or 6 April 2012 for income tax (being the date of the previous change in the AIA);
- 1 or 6 April 2012 to 1 January 2013; and
- 1 January 2013 to the end of the accounting period.

The maximum allowance is then calculated for each sub-period (ie number of months in the period multiplied by the relevant AIA entitlement, being £100,000, £25,000 and £250,000 respectively) and added together to give the maximum allowance for the 'straddling period'.

To illustrate, a company with an accounting period from 1 March 2012 to 28 February 2013 would have a maximum AIA for the period of £68,750 calculated as follows:

- **First period** (1 March 2012 to 31 March 2012): £8,333 (1/12 x £100,000)
- **Second period** (1 April 2012 to 31 December 2012): £18,750 (9/12 x £25,000)
- **Third period** (1 January 2013 to 28 February 2013): £41,667 (2/12 x £250,000).

Additional calculation provisions apply where expenditure is actually incurred in either the first or the second period which restrict the qualifying expenditure on which the AIA can be claimed on such assets to the relevant annual limit for the AIA.

How might this affect you?

This increase in allowances has been designed by the Chancellor to encourage businesses to invest in capital items with a view to stimulating growth in the economy. Every business should consider its capital expenditure needs over the medium term, model the AIA availability in the various periods, and then plan the timing of such expenditure to maximise the cash flow.

Controlled Foreign Companies (CFC) rules

A number of changes have been proposed to the new CFC provisions, which will have effect for CFCs with accounting periods beginning on or after 1 January 2013, the same commencement date as for the new provisions.

The amendments are aimed at blocking two tax planning ideas. Firstly, there is a change to widen the scope of finance lease income that is within the new regime. Secondly, there is now a limit on the amount of overseas double tax relief that is available in certain circumstances.

How might this affect you?

The changes announced today should not impact the vast majority of groups, as they are being introduced to address two specific tax planning opportunities of which HMRC has become aware.

However, groups will still generally need to consider how they are impacted by the new CFC regime and which of the exemptions may be applicable in respect of their overseas subsidiaries.

High-end television relief/Animation tax relief/Video game tax relief

Eligible companies will be able to claim tax relief for expenditure on the production of high-end television, animation and the development of video games with effect from 1 April 2013, subject to European State aid approval.

An additional deduction will be claimable in computing taxable profits. Where the additional deduction results in a loss, losses can be surrendered for a payable tax credit. Both the additional deduction and the payable credit will be calculated on the basis of UK core expenditure up to a maximum of 80% of the total core expenditure by the company. The additional deduction will be 100% of qualifying core expenditure and the payable credit will be 25% of losses surrendered.

Productions must be certified by the Department of Culture, Media and Sport as culturally British in order to be eligible for relief.

How might this affect you?

These reliefs have followed intensive industry consultation and are modelled on film tax relief. They will be welcomed by the UK creative sector, helping to sustain its recent success and position as a global leader. It should help prevent such businesses from leaving the UK and encourage others to relocate here. The interaction with other incentives such as R&D Credits and Patent Box could make the UK a globally leading tax environment for creative businesses.

Capital allowances for energy efficient cars

The 100% first-year allowance for expenditure incurred on cars with low carbon dioxide emissions and electric cars will be available until 31 March 2015 (rather than the previous 31 March 2013 expiration date).

The emissions threshold has been reduced such that only cars emitting no more than 95 grams of carbon dioxide per kilometre will equality for the 100% first-year allowances. In addition, the definition of 'main rate car' has been amended such that only cars emitting no more than 130 grams of carbon dioxide per kilometre will be included (qualifying for writing down allowances at 18%).

Cars above this threshold will only qualify for the special rate pool of writing down allowances (at 8% pa).

Cars provided for leasing will no longer qualify for first-year allowances.

How might this affect you?

Whilst these changes have clearly been designed to ensure businesses keep up with the improving emissions ratings of new cars, many businesses will be frustrated that the bar has once again been moved, meaning that company car policies will again need to be re-drafted.

Energy Efficient capital allowances

The first-year tax credit for expenditure incurred on qualifying energy-saving and water efficient technologies (known as enhanced capital allowances) will now be available until 31 March 2018 (rather than the previous 31 March 2013 expiration date).

First-year tax credits allow companies to surrender tax losses attributable to the enhanced capital allowances for a payable tax credit.

The 100% first-year allowance for expenditure incurred on natural gas, biogas and hydrogen refuelling equipment will now be available until 31 March 2015 (rather than the previous 31 March 2013 expiration date).

How might this affect you?

The changes to allowances have been designed to continue to drive the energy efficient agenda. Businesses should continue to review their capital expenditure and where commercially viable seek to benefit from the Government incentives. This would include either purchasing equipment on the existing approved lists, or seeking to include new qualifying products or technologies on these lists.

Amendment to UK group relief rules

Following the European Court of Justice ruling in the Philips case, with effect from 1 April 2013 there will be more clarity on when EEA resident companies can surrender losses from their UK permanent establishments as group relief in the UK. The restrictions will be based on actual use of losses rather than potential future use.

Existing legislation will be amended to prevent a non-UK resident company that is resident in the EEA from surrendering group relief for a loss made by its UK permanent establishment to the extent that the loss is used against the non-UK profits of any person in any period. Where a loss that has been surrendered is later used against non-UK profits, then the benefit of the UK group relief will be withdrawn to the extent that the loss has been used elsewhere.

In both cases the amendments ensure that the losses are not relieved twice, once as group relief in the UK and then again in another country.

How might this affect you?

This simplification of the group relief rules should provide more certainty to EEA resident companies with UK permanent establishments that wish to surrender losses as group relief. Under current legislation, it needs to be demonstrated at the outset that those losses will never be able to potentially be used by another person before they can be surrendered as group relief.

Removing inadvertent restriction on corporate tax group loss relief

Legislation will be introduced for accounting periods ending on or after 1 April 2013 to limit the circumstances in which certain companies cannot claim or surrender group relief because there are arrangements in place for the company to leave a group.

The amended legislation will apply where the company in question leaves the group as a result of conditions imposed by a statutory body in connection with certain commercial arrangements with public authorities.

How might this affect you?

The current rules, which can deny group relief from the date on which ‘arrangements’ to leave the group come into existence, can both be difficult to apply and produce an ‘unfair’ outcome. This limited clarification, and relaxation of these rules, produces a fairer outcome for groups who are forced, for example by external regulators, to make disposals.

Foreign currency assets and chargeable gains

Legislation will be introduced in Finance Bill 2013 to change the chargeable gains calculation for share disposals by companies which have a functional currency other than sterling or which have made a designated currency election (under section 9A CTA 2010).

Companies will be required to compute chargeable gains and losses using their functional currency at the date of disposal (rather than in sterling as at present). Any chargeable gain or loss will then be translated into sterling using the exchange rate at the date of disposal.

There is an exception for companies with an investment business which have made a designated currency election. These companies will be required to use their designated currency if the designated currency is the functional currency the company would have had if it was a standalone entity.

If the designated currency and standalone functional currency differ, these companies must use their actual functional currency, like all other companies.

There will also be special rules for recalculating the base cost of the shares when the functional currency of the company holding the shares changes.

The new legislation will apply to disposals from the date Finance Bill 2013 receives Royal Assent.

How might this affect you?

This simplification measure should reduce the amount of time that is required to prepare chargeable gains calculations when companies do not prepare their accounts in sterling.

Income tax rules on interest

Legislation is being introduced to broaden the situations where interest withholding and other tax-related obligations arise. This follows the recent consultation on possible changes to income tax rules on interest, and introduces the following measures:

- Income tax withholding obligations for payers of compensation where this includes interest;
- Income tax withholding obligations in relation to so-called specialty debts where loan agreements are executed and retained outside the UK;
- Valuation methodology where interest is payable in kind, by way or goods, services or vouchers;
- Requirement for cash settlement of tax withheld from interest payable in kind; and
- Obligation for payers of interest in a non-cash form to provide a certificate stating the gross amount of interest paid and any tax deducted.

These proposals will take effect from the date Finance Bill 2013 receives Royal Assent.

Principles-based anti-avoidance legislation is also being introduced to subject so-called disguised interest to income tax, where this could otherwise fall within the remit of capital gains tax or possibly escape tax altogether. This will facilitate the repeal of targeted measures in relation to guaranteed returns from certain derivative contracts and amounts arising on stock lending and repos. The disguised interest provisions will generally take effect from 6 April 2013 and may affect individuals as well as companies.

How might this affect you?

In the main, these measures will result in additional obligations for banks and building societies, whilst narrowing the scope of general tax planning which could mitigate interest withholding. Companies that have reacted to market conditions by introducing innovative forms of debt financing will also be adversely affected where interest on loans is settled by providing goods, services or vouchers.

The interest consultation process has seen proposals which could damage the UK's competitiveness fall by the wayside, notably the possible restriction of the quoted Eurobond withholding exemption. However, the spectre of unfavourable future changes to the disguised interest rules remains in prospect. This could bring discount arising on deeply discounted securities within the scope of interest withholding for the first time.

Worldwide debt cap

The worldwide debt cap provisions can restrict the availability of financing deductions for certain large groups. Its procedures incorporate measures intended to reduce administrative requirements, including an election to exclude the financing expense of group treasury companies.

Due to perceived abuse, amendments are to be made to the group treasury company exemption so that companies must, at least, undertake substantial treasury activities to be able to make the election in relation to all of their financing income and expense. Otherwise, the election will be restricted to exclude only treasury-related financing transactions. The proposals will take effect for periods of account of worldwide groups commencing on or after 11 December 2012.

How might this affect you?

Large groups with treasury functions facing debt capping are advised to review their arrangements and, if necessary, make appropriate changes to their activities and/or calculations to ensure they are not caught out by these proposals.

Deferral of payment of exit taxes

UK resident companies are required to pay corporation tax on exit charges when they transfer residence to other countries in the European Union or European Economic Area. These exit charges arise on certain unrealised profits and gains when a company ceases to be UK resident.

Companies will be able to elect to defer payment of these charges in one of two ways:

- In six equal annual instalments starting nine months and one day after the end of the accounting period of migration; or
- By allocating the total tax across the different classes of assets giving rise to the profits/gains. For intangible assets, derivative contract and loan relationship profits, the tax would be payable over the useful economic life of the asset. Tax on any other assets would not be due until the earlier of a disposal of the asset or after ten years.

The amounts deferred will, however, be subject to interest.

The new legislation will apply with effect from 11 December 2012.

How might this affect you?

This change is good news for those companies that wish to manage their cashflow when relocating their business within the European community and who, until now, have been required to pay tax on unrealised profits. With careful planning, these exit taxes may often not arise and consequently deferral would not be necessary.

Disincorporation relief

Small companies will be able to disincorporate between 1 April 2013 and 31 March 2018 without a charge to corporation tax on chargeable gains and intangible fixed assets arising as a result of the disincorporation.

The relief will operate by the company and its shareholders jointly claiming to transfer assets from the company to the unincorporated business (being run by one or more of the shareholders) at such a value that no chargeable gains and taxable credits arise. This transfer value will then be applied by the unincorporated business going forward.

The relief will only apply to companies where the market value of the assets transferred (and for which a claim is made) does not exceed £100,000. Other eligibility criteria will also apply.

How might this affect you?

The introduction of this relief will particularly help small companies that may have been incorporated to take advantage of the corporate tax zero rate band that was introduced for a short period a number of years ago. The measure will allow businesses greater flexibility to choose the most appropriate legal structure in which to operate based on current tax rates and regulations.

It is, however, disappointing that the relief will only be available for a limited period and that there is a relatively low cap on the value of the businesses that will be able to benefit.

Small businesses tax simplification

Two measures have been announced to simplify the calculation of taxable income for small unincorporated businesses which will apply from 2013/14.

Eligible small businesses will be able to calculate taxable income on a cash basis, ie they will not be required to apply most normal accounting principles, such as the accruals concept, the bringing into account of debtors, creditors and stock or distinguishing between capital and revenue items.

An ‘eligible small business’ will be a business whose turnover is less than twice the threshold for VAT and certain businesses will be excluded, including limited liability partnerships and partnerships with a corporate member.

All unincorporated businesses will be able to use flat rate allowances for particular items of business expenditure, for example expenditure on vehicles, business mileage and use of home as office.

Businesses that choose to adopt the cash basis will be required to adopt flat rate allowances for business mileage but use of other flat rate allowances will be optional.

Special rules apply to barristers who will be able to choose either to use the new cash basis and simplified expenses or the current accruals basis.

How might this affect you?

These measures will offer a welcome simplification for the smallest of unincorporated businesses, but the future rate of corporation tax at 21% compared to income tax rates of up to 45% will continue to deter many from operating in this way. There are detailed rules on how the cash basis is to be applied.

Community investment tax relief

The rules for individuals and companies investing in community development finance institutions (CDFI) and CDFIs themselves will be relaxed from April 2013, including the ability to carry forward unused relief. This is intended to encourage investment into CDFIs.

There will, however, be a restriction on the amount that companies can invest in CDFIs in accordance with European State aid rules.

Changes to the rules for manufactured payments

With effect from 1 January 2014, manufactured payments will be tax deductible only if made in the course of a trade. No double tax relief will be given in future for manufactured overseas dividends. This is intended to reduce the scope for tax avoidance schemes.

How might this affect you?

This will impact financial traders, in particular those who are party to stock loans and repo transactions. The changes have been the subject of consultation. The intention is to simplify the rules considerably and remove the obligation, which applies in some cases, to withhold tax from manufactured payments or deemed manufactured payments.

Corporation tax treatment of banks' Tier 2 regulatory capital

The changes will affect financial institutions issuing debt capital that qualifies as Tier 2 for regulatory purposes. The amendment is designed to ensure that the terms of debt do not affect the tax deductibility of the interest under technical tax rules (because of, for example, restrictions on when or what interest can be paid) and that it does not inadvertently break the group for tax purposes.

How might this affect you?

The amendment will have retrospective effect on or after 26 October 2012 and will be generally welcomed by the banking industry.

New NHS bodies: VAT and corporation tax

These measures will exempt certain NHS related bodies from corporation tax and add them to a scheme which refunds VAT, ensuring that what would otherwise be irrecoverable VAT does not dissuade government departments and NHS bodies from contracting out activities.

VAT recovery will take effect from 1 April 2013 and the corporation tax exemption will have effect from the date that Finance Bill 2013 receives Royal Assent.

2. PERSONAL AND EMPLOYMENT TAXES

Employment taxes

Entrepreneurs' Relief extended on EMI shares

Changes to permit shares acquired under Enterprise Management Incentive (EMI) options to qualify for Entrepreneurs' Relief (ER), irrespective of how many shares an individual holds, were first announced in the 2012 Budget. These changes would enable employees of many small and medium sized businesses (who qualify under the EMI rules) to pay a 10% rate of tax on the capital gains made on their shares if the disposal takes place on or after 6 April 2013.

Today's announcements go further than expected by confirming that the 12 month holding period for shares that must be satisfied before ER can be claimed will be deemed to commence from the date the option is originally granted (mirroring the hallmarks of the old taper relief system).

As EMI options are often exercised only on a change of control of a company (eg a takeover), this holding period had been identified as a major stumbling block to the Budget proposals having real benefit to businesses. It is welcome news that the Government has listened to feedback from employers and advisers and responded in this positive way. It means that any employees holding qualifying EMI options for more than 12 months should be able to claim ER when they exercise the options and subsequently dispose of the shares.

There are some detailed changes to the capital gains tax (CGT) 'matching rules', including rules on how the shares will be treated on a reorganisation or 'rollover', that will need to be carefully considered in the context of any transactions.

How might this affect you?

Together with the increase in the size of EMI options announced in the Budget in March (from £120,000 to £250,000) this significantly enhances the benefit of EMI options for employers and their employees. This is a major step forward in enabling ER (which many have felt too restrictive) to be used by a wider constituency of employees and so support the Government's aim of increasing share ownership in small and medium sized businesses.

Where companies have already granted EMI options, employees may anticipate a more beneficial tax treatment when the shares are sold. That said, because ER will be lost if there has been a disqualifying event, it makes it even more important that the qualifying conditions for EMI are satisfied throughout the period from grant to the disposal of shares. These rules are very complex so employers will need to carefully monitor this to ensure that there are no unexpected tax charges and employees' expectations are managed.

Where employees have exercised EMI options since 6 April 2012 but have not yet disposed of the shares, ER should be available (provided the shares are disposed of after 6 April 2013), but the detailed transitional rules will need to be considered in assessing the charge to tax.

For companies considering new incentive arrangements, the timing of option grants in relation to a potential exit will be important. Where EMI options have been granted less than 12 months prior to a proposed exit ER will not be available. The draft legislation envisages that any shares rolled over as part of a transaction (ie exchanged for new shares) will fall outside these rules for EMI shares, in which case it would be necessary to satisfy the existing '5% tests' in order to claim ER.

Whilst these changes are welcome for many companies, it does create advantages that are not available to other organisations. Notably, companies backed by private equity are (irrespective of size) not eligible for EMI. Such companies will need to use different approaches to access ER for their employees.

Employee shareholder status

The concept of employee owner status (now rebranded ‘employee shareholder’) was announced at the Conservative Party conference in October. It has received a mixed reaction from business.

The draft Finance Bill contains details of the proposed relief from CGT for shares acquired by individuals who have taken up this status. Individuals adopting this status may receive shares with an initial value of between £2,000 and £50,000. The gains on such shares acquired on or after 6 April 2013 will be exempt from CGT.

Given the concerns with tax avoidance, it is no surprise that there are numerous conditions attached to the exemption. In particular, no individuals with a ‘material interest’ will be eligible for this exemption. Where a transaction occurs no ‘rollover’ will be possible, so relief for employee shareholders will effectively cease at that point. Under the draft legislation the existing share pooling and identification rules are amended to reflect these changes, but there are no limitations on the types of shares that may be used.

There is no further information on the possible relief from income tax mentioned in last week’s Autumn Statement. The proposal was for the first £2,000 of shares to be free of income tax. We await further detail on this as well as for detailed rules on the permissible terms of such shares (for example, what any forfeiture terms or shareholder rights may be).

Other employment taxes changes

A range of minor and administrative changes have been made to the four tax advantaged employee share schemes (ie Share Incentive Plans, Save As You Earn Option Schemes (SAYE), Company Share Option Plans (CSOP) and Enterprise Management Incentives (EMI)). This follows recommendations from the Office of Tax Simplification (OTS), although not all of the OTS’s recommendations have been accepted.

The main thrust of these rules is to harmonise elements of the different regimes (eg in relation to ‘good leaver’ and ‘material interest’ rules). Larger companies operating SIP and SAYE will welcome some of these changes, if only to ease the administrative burden.

For smaller companies, there are two changes, in particular, that are helpful.

First, the time available for those holding EMI options to exercise them with favourable tax treatment after a ‘disqualifying event’ has been extended from 40 to 90 days. Given the complexity of the rules and the potential for loss of ER (mentioned above) this additional period of grace is helpful.

Secondly, it will now be possible to grant CSOP options over certain restricted shares. This will be welcomed by many private companies who have outgrown the EMI limits, but whose share structure previously meant that tax advantaged CSOP options were not a feasible alternative.

The anticipated rules on anti-avoidance (the new General Anti-Abuse Rule and the changes to advance disclosure regime) announced today do not contain anything that should affect commercial incentive arrangements.

How might this affect you?

The impact assessment states that the Government expects that between 20,000 and 40,000 individuals will take up the new status, but it remains unclear what the target audience is for these proposals.

For small and medium sized businesses the use of these arrangements will create a requirement to determine an upfront ‘market value’ for the shares. However, for businesses who already operate employee share incentives and who are familiar with these challenges, they may be a welcome opportunity to move towards a more flexible workforce, and offer an attractive incentive for new hires. The connected changes to the Employment Rights Act (to be included in the forthcoming Growth and Infrastructure Bill) will need to be reviewed before employers are able to conclude on the overall attractiveness of this proposal.

The difficulties created by any upfront tax are clearly worsened if the shares are subject to PAYE and NIC. This will be the case where the shares are ‘readily convertible assets’ (RCAs) and it is unfortunate that the rules on when shares become RCAs are complex and occasionally subjective.

Improved clarity on the rules for RCAs and a more streamlined and consumer-friendly approach to tax valuations from HMRC are two further changes that many businesses are seeking to help embed employee share ownership in the UK.

Capping of previously uncapped income tax reliefs

The Government proposed in Budget 2012 to introduce a cap on the total amount of income tax reliefs that an individual may claim from 6 April 2013. The cap was designed to prevent individuals with potentially large income tax liabilities from utilising the array of income tax reliefs currently available to substantially reduce or eliminate their income tax bill.

Following a consultation process, and the high profile withdrawal of charitable giving from the scope of the cap, the capping of income tax relief that any individual can claim (in respect of certain uncapped reliefs) has been confirmed as the greater of 25% of income and £50,000. The restriction will take effect from 6 April 2013.

The further exclusion of losses on EIS and SEIS shares from the cap is a welcome and positive move. Without this measure, the EIS and SEIS shares would have become considerably less attractive for investors. Only the following income tax reliefs will now be limited to the extent that they can relieved by individuals against general income:

- Trade loss relief against general income – available for losses made by an individual carrying on a trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and business premises renovation allowances (BPRA);
- Early trade losses relief – available to an individual in the first four years of the trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and BPRA;
- Post cessation trade relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the trade;
- Property loss relief against general income – available for property business losses arising from capital allowances or agricultural expenses. This will exclude relief for losses attributable to BPRA;
- Post-cessation property loss relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the UK property business;
- Employment loss relief – available in certain circumstances where losses or liabilities arise from employment;
- Former employees deduction for liabilities – available for payments made by former employees which they are entitled to claim a deduction from their general income in the year in which payment is made;
- Share loss relief on non-EIS/non-SEIS shares – available on capital losses on the disposal (or deemed disposal) of certain qualifying shares;
- Loss on deeply discounted securities – available only for losses on gilt strips and on listed securities held since at least 26 March 2003; and
- Qualifying loan interest – available for interest paid on certain loans. These include loans to buy an interest in certain types of company, or to invest in a partnership.

How might this affect you?

The measure will impact additional rate taxpayers who currently benefit from existing and legitimate income tax reliefs to substantially reduce their tax bill. We would recommend that high earners review their position now with a view to utilising deductions (potentially at a higher rate of income tax relief) against income of the current tax year when these reliefs can be utilised uncapped.

As previously announced, existing capped reliefs such as EIS, SEIS, VCT and pensions, together with ‘overlap relief’, fall outside of the scope of this cap, meaning that total available deductions and reliefs will continue to be far greater than £50,000.

Statutory residence test

The Chancellor announced in 2011 his intention to introduce a statutory residence test to replace the current position which has caused increasing uncertainty for individuals wanting to plan their residence pattern. Following an initial consultation, draft legislation was issued in June 2012, followed by another consultation period. Final draft legislation has now been published which will take effect from 6 April 2013. In addition to the statutory residence test there are provisions to enable tax years to be split into resident and non-resident periods (previously this treatment relied on extra statutory concessions) and anti-avoidance provisions to prevent individuals taking advantage of the new test to avoid tax.

The test is composed of three key elements – an automatic residence test, an automatic overseas test and a sufficient ties test. If the individual does not meet the automatic residence test or sufficient ties test for the relevant year, they should be treated as not resident in the UK. It is therefore necessary to systematically work through the tests in order to determine whether an individual is resident in the UK. HMRC will provide an online tool to assist in this process. However they have confirmed that this may not be relied upon and therefore it is still necessary to seek advice other than in the most straightforward of circumstances.

The automatic residence test

An individual will be automatically resident for the year if they meet one of four automatic residence tests and none of the automatic overseas tests. The tests look at whether an individual:

- Spends 183 days or more in the UK in a tax year;
- Works full time in the UK;
- Has their only home or homes in the UK; or
- In certain circumstances, dies during the year.

The automatic overseas test

An individual will be automatically non-resident if they meet one of the automatic overseas tests. These apply where:

- An individual spends minimal days in the UK in a tax year (fewer than 16 or 46 depending on when they were last UK resident);
- Works full time overseas; or
- In certain circumstances, dies during the year.

The sufficient ties test

If the individual is neither conclusively resident or non-resident when considering the above tests, it is necessary to consider the sufficient ties test. Whether the individual is resident in the UK will depend on the number of ties they have with the UK together with the number of days spent here. The ties are:

- A family tie
- An accommodation tie
- A work tie
- A 90 day tie and
- A country tie*

** Only applicable if the individual was resident for one or more of the preceding three tax years.*

The factors will be applied differently depending on whether an individual is an ‘arriver’ (not resident in the previous three tax years) or a ‘leaver’ (resident in one or more of the previous three tax years).

The table for **arrivers** is as follows:

Days spent in UK	Impact of connection factors on residence status
Fewer than 46 days	Always non-resident
46 to 90 days	Resident if individual has four factors (otherwise not resident)
91 to 120 days	Resident if individual has three factors or more (otherwise not resident)
121 to 182 days	Resident if individual has two factors or more (otherwise not resident)
183 days or more	Always resident

The table for **leavers** is as follows:

Days spent in UK	Impact of connection factors on residence status
Fewer than 16 days	Always non-resident
16 to 45 days	Resident if individual has four factors or more (otherwise not resident)
46 to 90 days	Resident if individual has three factors or more (otherwise not resident)
91 to 120 days	Resident if individual has two factors or more (otherwise not resident)
121 to 182 days	Resident if individual has one factor or more (otherwise not resident)
183 days or more	Always resident

There are detailed definitions of the various expressions used in the draft legislation.

How might this affect you?

The new tests are more complex than we might have hoped for but will bring a welcome degree of certainty to deciding whether an individual is tax resident in the UK and a more robust basis for planning. Given the level of detail and complexity in the draft legislation, and the fact that the HMRC calculator will not provide certainty, professional advice about the application of the new rules to individual circumstances will be essential in all but the simplest of circumstances.

Changes to 'IR35' legislation for office holders

The Government has announced changes to the intermediaries legislation (commonly called IR35) that will impact individuals who hold an office (an executive or non-executive director) on the board of a company and are paid via a personal service company (PSC). Historically, there has been a view that income received by a PSC does not fall within the existing IR35 legislation and is therefore not treated as employment income subject to PAYE. The changes announced today will bring individuals who hold an office through a PSC within the scope of the IR35 legislation.

From 6 April 2013 any payment to a PSC from a third party for the provision of an individual as an 'office holder' will be deemed to be employment income whether the PSC or the individual is registered as the office holder of the engager. This means that HMRC can invoke IR35 and seek recovery of tax under PAYE from the PSC when PAYE has not already been applied. This places office holders in the same position as contractors and other workers that currently have to apply IR35.

How might this affect you?

This measure gives businesses that engage PSCs (or individuals trading via PSCs) more certainty that HMRC should seek recovery of PAYE from the PSC concerned, and removes the confusion the purported introduction of a controlling persons test could have brought. As is currently the case this change will not impact offshore PSCs where any PAYE liability could fall on the engaging business.

Whilst a contractor or worker can challenge IR35 by seeking to demonstrate their employment status before a tribunal, it would appear that whether an individual holds an office will be a question of fact and therefore individuals who operate via a PSCs will now be within the scope of the IR35 legislation. Such individuals, who currently receive income in the form of dividends, may therefore face a significant increase in their tax liabilities, and could seek to increase the fees they charge as a result.

Income tax rates and allowances

The Chancellor announced on 5 December 2012 that the individual personal allowance for those under 65 will increase to £9,440 for 2013/14 from the current rate of £8,105.

The upper limit for the basic rate tax band will be reduced to £32,010 for 2013/14 from £34,370. In the following two years up to 5 April 2016 it will increase but limited to a rise of 1% a year.

The rates of tax for 2013/14 will remain at 20% and 40% for the basic and higher rates but the additional rate of tax will reduce to 45% as announced in the 2012 Budget.

The capital gains tax annual exempt amount which is £10,600 for 2012/13 will rise in line with the consumer price index in 2013/14 and the increase in the next two years up to 5 April 2016 will be restricted to 1% per year.

How might this affect you?

For 2013/14 the first £9,440 of income will normally be sheltered by the personal allowance. Taxable income up to £32,010 will be taxed at 20%. Taxable income between £32,011 and £150,000 will be taxed at 40% with taxable income over £150,000 being taxed at 45%.

As with previous years, in 2013/14 the personal allowance will be reduced for individuals with income over £100,000 resulting in a total loss of the allowance for individuals with total income over £118,880. This gives these individuals a marginal rate of tax of 62%. These individuals will be more disadvantaged than previously with the reduction of the additional rate to 45% and will no doubt look at increasing pension contributions or other measures to reduce their taxable income.

The increase in the personal allowance represents a major step towards the Coalition commitment to increase the personal allowance to £10,000. The reduction in the upper limit for the basic rate band will however mean that an increased number of taxpayers will be drawn into the higher rate band.

The restriction in the increase in the higher rate threshold and the capital gains annual exempt amount to 1% for two years from 2014/15 only keeps them in line with the planned increase in public sector earnings.

Pensions

Lifetime Allowance

The Lifetime Allowance has had a turbulent time since its inception in 2006. It began at £1.5 million and rose to £1.8 million by 2011 before being pegged back to £1.5 million, and it will now be reduced even further to £1.25 million from 6 April 2014. This will bring more individuals within the reach of the tax charges associated with exceeding the new reduced Lifetime Allowance.

There will be a new 'Fixed Protection 2014' regime which will work in the same way as the current Fixed Protection regime (Fixed Protection). Those that elect for the '2014' version will enjoy a lifetime allowance of the greater of £1.5m or the amount in force at the time benefits are taken. However, for those applying for the Fixed Protection 2014 no further contributions to a defined contribution scheme, or accrual of benefits (beyond a permitted amount) in a defined benefit scheme, will be permitted from 6 April 2014.

The Government will also be consulting on a 'personalised protection option', which could protect savings made and allow further accrual of benefits.

How might this affect you?

Those that wish to apply for Fixed Protection 2014 should note that the application process is due to begin during the summer of 2013 and must be completed by 5 April 2014.

The tax-free lump sum for those with Fixed Protection 2014 is subject to the overall limit of 25% of £1.5 million.

The tax-free lump sum for those without Fixed Protection (or any previous protections) will fall to £312,500.

Annual Allowance

The Annual Allowance – the maximum amount of an individual's pension savings that can benefit from tax relief in a tax year – will be reduced from £50,000 to £40,000 with effect from 6 April 2014. If this Annual Allowance is exceeded, the excess is added to the individual's income and taxed at their marginal rate.

However, importantly, the test against the Annual Allowance takes place at the end of the pension scheme year, which for some means that contributions physically made during the 2013/14 tax year may not be tested until after the start of the 2014/15 tax year, by which time the lower amount will be in force.

How might this affect you?

Schemes that have taken steps to cap benefits to the Annual Allowance should review their rules to ensure the cap applies properly.

Individuals that have made plans based on the £50,000 limit should review their savings strategy and take advantage of any tax relief that can be received at 50% before the end of the 2012/13 tax year.

Reviews should take place well before the end of the 2013/14 tax year to prevent an inadvertent breach of the new limits by contributions made in 2013/14.

Schemes are now more likely to be asked to pay the tax charge for the individual, and they should review their Scheme Pays processes. This is especially important for any open defined benefit schemes.

Family pension plans

'Family Pension Plans' were conceived following the reduction of the Annual Allowance from £255,000 to £50,000 in 2011-12. For those employees maximising the £50,000 limit an employer would make pension contributions as part of an employee's benefit package into a registered pension scheme for a family member. The employee was still exempt from income tax and NIC on these contributions and they did not count towards the employee's £50,000 Annual Allowance.

The employee exemption from income tax on such payments is being removed with effect from 6 April 2013.

How might this affect you?

From 6 April 2013 contributions for (non-employee) family members by employers will no longer avoid employee income tax and NICs.

Employers who are considering contributions to pension schemes of employee family members now have a short window of opportunity to continue making contributions. Employees who have utilised this type of planning will now need to re-examine how they fund their pension arrangements.

Bridging pensions

A bridging pension is usually an interim benefit that is paid by a registered pension scheme and is reduced when an individual reaches age 65. This regulation is being altered to reflect the forthcoming and ongoing alterations in State Pension Age (SPA), by removing the specific reference to age 65 and replacing it with an upper limit of SPA.

How might this affect you?

This alteration will mean the avoidance of any bridging pension reduction until SPA is reached.

Any bridging payments after age 65 and before SPA will not be liable to any unauthorised payments tax charges.

Overseas transfers of UK pension savings

Qualifying Recognised Overseas Pension Schemes (QROPS) can receive transfers of UK pension funds – that have received UK tax relief – free of UK tax (providing the transfer amount is within an individual's Lifetime Allowance).

A QROPS must meet certain statutory requirements before a transfer can be made. The Chancellor had already announced in Budget 2012 that the reporting and regulatory requirements of QROPS were being strengthened. New legislation will enact those earlier announcements with effect from the date Finance Bill 2013 receives Royal Assent .

How might this affect you?

Even closer care will need to be taken that any proposed QROPS transfers do not fall foul of future HMRC scrutiny and risk withdrawal of QROPS status, with significant tax consequences.

Reforms to ordinary residence

The concept of ordinary residence is to be abolished from 6 April 2013. To prevent those who were entitled to overseas workday relief from being placed at a disadvantage, this relief will be continued in a statutory form. It will only apply to individuals who are not domiciled in the UK and will be available for the tax year an individual first becomes UK tax resident and the two succeeding tax years. There will be no requirement about the length of time an individual intends to remain in the UK, but they will have to have been non-resident for the three tax years before coming to work in the UK. There will be transitional relief for those who currently enjoy the relief.

In all other cases where a tax liability is determined by reference to ordinary residence it will in future be determined by reference to residence alone.

How might this affect you?

The transitional provisions should protect individuals who benefit currently from overseas workday relief and the removal of any reference to an individual's intention should make the rules easier to administer.

Certain anti-avoidance legislation – the transfer of assets abroad rules – only applies when an individual is ordinarily resident and will in future apply as soon as they become resident and even if they only intend to remain in the UK for a short period. There are limited transitional provisions for individuals who have only recently become UK resident.

Attribution of gains to members of non-resident companies

Chargeable gains realised by non-resident companies which, had they been UK resident would have been close companies (ie controlled by five or fewer participators (broadly shareholders)), are apportioned among the participators in the company and taxed in the hands of UK resident participators to whom, either alone or together with connected persons, more than 10% of the gain is apportioned. Where a participator is non-UK domiciled then UK gains are taxed as they arise whereas foreign gains may benefit from the remittance basis of taxation. There are certain exemptions for gains from disposals of assets used in a trade.

The EU Commission has argued that the provisions breach EU Treaty freedoms and the Government issued a consultation document containing proposed changes to make the legislation compliant with EU law. These proposals are included in the draft legislation for the 2013 Finance Bill and will generally take effect from 6 April 2012 although it will be possible to elect for the existing provisions to apply until 6 April 2013.

The draft legislation contains two new reliefs:

- The first relief is for gains from a disposal of an asset used for the purposes of an economically significant activity carried on outside the UK; and
- The second relief applies where avoiding a liability to tax was not one of the main motives behind the acquisition, holding or disposal of the asset.

The threshold above which apportioned gains are subject to tax is increased from 10% to 25%.

How might this affect you?

The provision is an anti-avoidance provision but catches many innocent situations where UK residents, particularly individuals (as companies can often claim Substantial Shareholdings Exemption) hold shares in non-resident companies and there was no tax avoidance motive. The increase in the threshold from 10% to 25% is to be welcomed but the reliefs are very limited and, while they are also welcome, will be subject to interpretation and it remains to be seen whether they go far enough to satisfy the EU Commission that the revised UK law is now EU compliant.

Amendments to the transfer of assets abroad legislation

The transfer of assets abroad rules are very old anti-avoidance provisions designed to stop individuals avoiding tax by arranging for their income to accrue to non-resident entities, such as offshore trusts and companies. The EU Commission has argued that the provisions breach EU treaty freedoms. Draft legislation has been issued following a recent consultation which makes a number of changes to the rules.

There is a new exemption for ‘genuine’ transactions which are those which HMRC are satisfied is genuine and whose taxation would constitute an unjustified and disproportionate restriction on an EU treaty freedom. There are definitions to clarify where the exemption will apply.

Other amendments are to be made:

- To ensure that it is not possible to claim that a double tax agreement overrides these provisions;
- To clarify the interaction of the provisions with other tax legislation; and
- To clarify the calculation of income that is to be charged under the provisions where the person charged is not the person who made the original transfer of assets.

How might this affect you?

The provisions are only relevant in situations where an individual has set out to reduce tax by the use of offshore arrangements so will not apply to the large majority of taxpayers.

The new relief for genuine commercial transactions is to be welcomed and it will be interesting to see how it will be applied in practice. The change to prevent double tax agreements overriding the provisions clarifies an area where uncertainty has existed up to now and the other changes are broadly to be welcomed as they provide more certainty over the operation of the provisions.

Changes to tax and NIC relief for childcare

A small change will be made to the value of tax and NIC free childcare available to employees who participate in a qualifying childcare voucher arrangement, and will have earnings subject to the additional rate of tax (currently 50% reducing to 45%) from 6 April 2013. It will ensure that the economic benefit of childcare vouchers remains unaffected by the reduction in the additional tax rate.

The weekly value will increase from £22 to £25 for employees with earnings in excess of £150,000 per annum. There are no changes for employees with earnings below this figure.

How might this affect you?

This is an administrative change which will have minimal affect for most employers.

Life insurance policies

Higher and additional rate tax relief for qualifying life insurance policies (QP) is to be restricted. Currently there is no upper limit on the tax relief for premiums payable into a QP and the proposed measures would restrict this relief to £3,600 from 6 April 2013. Transitional rules will apply to policies issued between 21 March 2012 and 5 April 2013.

Additional measures apply to policyholders realising gains who have been resident outside the UK whilst holding policies to more accurately calculate the apportionment of any gain between non-resident and resident periods.

How might this affect you?

Individuals who pay higher or additional rate tax and who had previously benefited from the generous relief will now see this relief restricted and should review relevant investments.

For individuals who have spent any time non-resident, there will be an amendment to how any gain is calculated and in some cases planning should be considered to mitigate the impact.

Non-domicile taxation

Inadvertent Remittances

Draft legislation will be published during January 2013 to further simplify the exempt property rules for non domiciled individuals and to provide relief in the case of certain inadvertent remittances to the UK, for example where exempt property is brought to the UK and lost, stolen or destroyed while in the UK. Exempt property is property purchased using unremitted foreign income and gains which is brought into the UK either:

- Temporarily (up to 275 days);
- For public display;
- For repair; or
- For personal use, such as clothing, jewellery and footwear.

How might this affect you?

This change is unlikely to be of wide application even amongst the non-dom community, however it will be welcome where it does apply. At present an individual may be in the unhappy position where the theft of a possession triggers a UK tax liability if the stolen item was purchased using un-remitted foreign income or gains.

UK-Swiss Confederation Taxation Cooperation Agreement: Remittances

The UK/Swiss Agreement is expected to take effect from 1 January 2013. Under this Agreement, UK residents who directly or indirectly are the beneficial owners of previously undeclared funds in Swiss bank accounts have a choice; broadly whether to disclose the account or allow the assets within the account to be subject to a one-off levy and future withholding taxes.

Legislation is to be introduced in Finance Bill 2013 whereby amounts received by HMRC under the agreement are not treated as taxable remittances themselves where they are made by or on behalf of non-UK domiciled individuals. This is a logical next step in the introduction of the UK/Swiss Agreement. For the withholding tax to be applied, the individual will have opted not to disclose the account. If the account has not been disclosed it is difficult to see how HMRC could deem the withholding tax to be a remittance to the UK. Nonetheless it is useful to have this clarification.

The changes will take effect from the date that the agreement comes into force.

How might this affect you?

The UK/Swiss Agreement is just one of many recent initiatives from HMRC focussing on offshore matters and specifically undisclosed accounts held offshore. Any individual with undisclosed funds in Switzerland or elsewhere should seek advice now about how to make the necessary disclosures to HMRC and bring their tax affairs up to date.

Inheritance tax - non-domiciled spouses

The IHT exempt amount that a UK domiciled individual can transfer to their non-UK domiciled spouse or civil partner will be increased, and non-UK domiciled individuals who have a UK domiciled spouse or civil partner will be able to elect to be treated as UK domiciled for IHT purposes.

The current exempt amount that a UK domiciled individual may transfer to their non-UK domiciled spouse is £55,000, which applies to all transfers whether during lifetime or on death. This will be increased to £325,000 initially, in line with the current nil-rate band, and going forward the level will be linked to future changes to the nil-rate band.

Electing to become UK-domiciled will enable a couple to benefit from uncapped IHT exempt transfers between them, although as a result their non-UK situs assets will come within the IHT net.

How might this affect you?

If your spouse or civil partner is non-UK domiciled, or you are non-UK domiciled but married or in a civil partnership with a UK-domiciled individual, the ability to make IHT exempt transfers between you is restricted. These new measures will increase the current limit in line with the nil-rate band, and the nil-rate band will also be available to cover any transfers made in addition to the exempt amount. Non-UK domiciled individuals will also be able to make a formal election to be subject to the IHT regime to allow all transfer between spouses to qualify for 100% IHT relief.

Capital gains tax – settlors of heritage maintenance trusts

Individuals who have gifted property to Heritage Maintenance Funds carrying on ‘open house’ businesses (ie permitting their homes to be open to the public) will be able to claim hold-over relief for capital gains purposes on the transfer of property to the Fund without the trustees of the Fund having to elect for the income of the Fund to be taxed in their hands rather than continue to be taxed on the settlor.

Currently the trustees must make this election in order for the settlor to claim hold-over relief on the transfer of property into trust. Consequently, when trustees make payments to the settlor for use in the ‘open house’ business, the payment is treated as a taxable receipt of the business.

How might this affect you?

There will no longer be a requirement for the trustees to make an election. Instead, relief can be claimed by the settlor where the trustees could make an election. As well as allowing individuals who wish to set up Funds and carry out open-house businesses to claim hold-over relief, it will allow the trustees to make payments to the settlor (ie reimburse the settlor for their expenditure on the repair and maintenance of the property) without those payments being taxable receipts.

Inheritance tax – trusts and open ended investment companies and authorised unit trusts

Existing tax rules will be regularised to ensure that the trustees of trusts set up by non-UK domiciled individuals who switch assets to open ended investment companies (OEICs) and authorised unit trusts (AUTs) which have qualified as excluded property since 2003, do not incur a tax charge on the occasion of the trust no longer being subject to the relevant property regime. The current IHT rules impose an IHT charge when property comprised in a settlement ceases to be relevant property, but not when the settlement ceases to the relevant property as a result of the property comprised in it ceasing to be situated in the UK. There is no similar exception in respect of relevant property which becomes invested in OEICs or AUTs.

How might this affect you?

Trustees of trusts set up by non-UK domiciled individuals will no longer incur a tax charge when the trust switches from investing in UK assets to OEICs or AUTs, and there will be no requirement to make an IHT return in respect of the transaction. This amendment will be retrospective, so that no tax charge will arise on those trusts which held OEICs or AUTs when the changes originally introduced in 2003 came into effect.

Vulnerable beneficiary trusts

Measures which will take effect from 8 April 2013 will amend the definition of a qualifying vulnerable beneficiary, which until now includes a person in receipt of disability living allowance (DLA) by virtue to entitlement to the care component following the abolition of DLA and introduction of Personal Independence Payments (PIP) under the Welfare Reform Act 2012. The definition of a qualifying person will include a person in receipt of PIP by virtue of their entitlement to the daily living component at either the standard or enhanced rate.

In addition, the qualifying conditions limiting how the trustees can apply trust income and capital are to be aligned to make the rules easier to understand and use. Trustees will be able to apply income and capital of up to the lower of £3,000 or 3% of the trust fund without having to prove that it is for the benefit of the vulnerable beneficiary.

How might this affect you?

If you are a trustee of an existing vulnerable persons trust or a settlor considering setting one up, you will need to check whether the beneficiary qualifies for PIP at the standard or enhanced level to continue to qualify for favourable IHT treatment.

Transitional arrangements will be introduced where a trust ceases to be a qualifying vulnerable beneficiary trust by reason only of the revised capital and income conditions. Trustees of existing vulnerable beneficiary trusts will need to review the level of income and capital applied for the benefit of any beneficiary other than the vulnerable beneficiary.

3. PROPERTY TAXATION

Annual property residential tax and SDLT - high value residential properties

The 2012 Budget included proposals affecting the acquisition and ownership of high value (greater than £2 million) UK residential property by certain 'non-natural' persons (essentially companies, partnerships with corporate partners and certain collective investment schemes).

From 21 March 2012, a 15% rate of SDLT has applied to the acquisition of residential properties costing more than £2 million by certain non-natural persons. During Summer 2012, HMRC consulted on the introduction, from April 2013, of an annual charge on residential property owned by non-natural persons Annual Residential Property Tax (ARPT) and an extension to CGT.

The proposals outlined in the consultation document extended further than an owner's own home and potentially impacted upon genuine property investment and development operations carried out through, for example, overseas companies. The Government has been receptive to responses to the consultation and has proposed a series of reliefs from ARPT which will exclude businesses carrying out genuine commercial activity from the charge. The reliefs will also be mirrored for the 15% rate of SDLT from the date of Royal Assent of the Finance Bill 2013.

This most welcome relief from ARPT and the 15% rate of SDLT will apply for:

- Property development businesses;
- Property rental businesses; and
- Property trading businesses.

There is no qualifying period which will need to be met by these businesses before the relief applies (previously the only exemption was for property development businesses with a two year active history). However, the reliefs above will only apply if the property is not occupied at any time by a connected person. Furthermore, a clawback provision will be introduced such that the relief from the 15% rate of SDLT will only be available provided the conditions are satisfied in relation to the property for at least three years after the acquisition of the property. If these conditions are not met, additional SDLT will be payable.

Relief will also be available for:

- Properties run as a business, for example those open to the public on a commercial basis, or as a venue, location or for accommodation;
- Properties held to provide employee or partner accommodation;
- Properties owned by charities and held for charitable purposes;
- Farmhouses occupied by a working farmer on their farmland; and
- Certain other diplomatic, publically owned properties, or property conditionally exempt from inheritance tax.

ARPT will initially be charged as follows:

Property value	Charge
Over £2 million to £5 million	£15,000
Over £5 million to £10 million	£35,000
Over £10 million to £20 million	£70,000
Over £20 million	£140,000

The property value will be determined by the value of the property at 1 April 2012 or, if later, the value on acquisition. This value is intended to apply for five years from 1 April 2013 to 1 April 2018, at which point the valuation will be updated to that of the property at 1 April 2017.

The charge will be uprated annually, based on the consumer price index. Annual returns and payments will be required. These will usually be due on 30 April but for the first year, returns will be due by 1 October 2013 with payment of the ARPT due by 31 October 2013.

There are detailed rules in relation to what constitutes a ‘dwelling’ for the purposes of the ARPT, and when the charge applies, for example in relation to demolitions and conversions of existing property. As such, a careful analysis will need to be undertaken where the property activities are not straightforward.

How might this affect you?

Notwithstanding the reliefs for genuine business use of residential property, there are detailed anti-avoidance provisions and these will need to be considered to avoid being unwittingly caught by the new charges. Where relief for the 15% rate of SDLT can now be obtained, care will be needed to avoid circumstances which would trigger a further charge within the following three years. Where an additional charge becomes payable in this time, there will be payment and reporting obligations.

Where high value homes are held in existing structures which will be liable to ARPT, detailed consideration will need to be given to the tax implications of maintaining the structure or to ‘de-enveloping’ the property. Those that decide to keep the structures will have an annual reporting obligation, which will be accompanied by a penalty regime for non-compliance.

We recommend that anyone who owns indirectly, or is about to acquire, a residential property in the UK valued at approximately £2 million or greater, seek advice before April 2013.

Extension of capital gains tax – high value residential properties

Although the draft legislation has not yet been published, an overview was published today which includes an announcement from the Government on the extension of the CGT charge to certain disposals of residential property valued at over £2 million which will apply from 6 April 2013.

The charge was originally expected to be extended to any overseas entity that is not an individual, including trustees of an offshore trust. However, it has been announced that it will only be payable by the same non-natural persons which are liable to the Annual Residential Property Tax. This means that non-UK companies holding commercially let residential property will not be subject to UK tax on a capital gain on sale. This will be welcomed by the significant number of overseas investors in UK property for whom an overseas company is the natural choice of entity to carry out these activities.

Furthermore, the CGT charge was expected to apply to the total gain accruing on a disposal of a property. The overview published today states that the charge will only apply to gains accruing on or after 6 April 2013, meaning that the tax will not apply retrospectively, as previously feared.

The rate of CGT will be 28%, with a tapering relief for gains where the property is worth just over £2 million.

For consistency, the Government is considering extending the CGT regime to apply to disposals of high value residential property by UK non-natural persons, although these would generally be subject to corporation tax (currently, at least, at a lower rate).

How might this affect you?

Notwithstanding the reliefs for genuine business use of residential property, there are detailed anti-avoidance provisions and these will need to be considered to avoid being unwittingly caught by the new charges.

We recommend that anyone who owns indirectly, or is about to acquire, a residential property in the UK valued at approximately £2 million or greater, seeks advice before April 2013.

SDLT - transfer of rights

Broadly, the SDLT sub-sale rules prevent a double charge to SDLT where a purchaser immediately sells a property to another party, such that only the ultimate purchaser pays SDLT. However, these rules formed the basis of a number of SDLT avoidance schemes and therefore came under scrutiny by HMRC. The draft legislation published today makes technical changes which should broadly still prevent a double charge in genuine commercial situations, but there is clearer protection against schemes aiming to avoid SDLT altogether. In addition there is now a requirement for claimants to submit a land transaction return to claim sub-sale relief.

How might this affect you?

This forms part of the continuing attention to SDLT avoidance. For genuine commercial transactions, the changes should not significantly impact the SDLT position although they do add further technical complexities for the intermediary purchaser and there is now a requirement for this purchaser to ‘claim’ their exemption from SDLT. Advice should therefore be taken by intermediary purchasers to ensure that the transactions are implemented robustly.

SDLT - leases simplification

An information consultation took place in Summer 2012 with a view to simplifying the SDLT rules that apply to lease arrangements that involve an abnormal rent increase, the substantial performance of an agreement for lease, or a lease that continues after a fixed term. The Government announced today that legislation will be introduced to simplify the reporting requirements where a lease continues after the expiry of its fixed term and where an agreement for lease is substantially performed before the actual lease is granted. The rules on abnormal rent increases will be abolished.

Lease premium relief

Following consultation, there will be a simplification of the complex element of the lease premium rules concerning the tax treatment of long leases as shorter leases. These rules will limit the availability of lease premium relief where leases are of greater than 50 years duration, with effect for leases granted on or after 1 April 2013 for companies and on or after 6 April 2013 for individuals and partnerships.

How might this affect you?

This is a fairly specific technical change which is unlikely to have a significant impact on the tax treatment of property transactions.

REITs

Further to the consultation on UK-REITs earlier this year, measures have been introduced to enable UK-REITs to treat investments in other UK-REITs as part of their qualifying property rental business. Accordingly, Property Income Distributions (PIDs) received by UK-REITs from other UK-REITs will be exempt from tax but in return, 100% of the PID received must be distributed to shareholders within 12 months of the end of the accounting period in which the PID was received. Furthermore, an investment by one UK-REIT in another will be treated as an asset of the investing UK-REIT’s property rental business for the purposes of the balance of business test. The measure will have effect for accounting periods beginning on or after the date Finance Bill 2013 receives Royal Assent.

How might this affect you?

The measure will enable UK-REITs to take strategic interests in other UK-REITs, either as a potential precursor to, or defence from, takeover or as a means of diversification, hedging or short term cash management. However, the failure to extend the definition of ‘institutional investor’ to include UK-REITs means that joint venture arrangements, which are increasingly being used to fund expansion, will not be able to be structured as UK-REITs.

4. ANTI-AVOIDANCE AND ADMINISTRATION

General anti-abuse rule (GAAR)

The GAAR will apply to income tax, corporation tax, capital gains tax, inheritance tax and stamp duty land tax. (NIC will be included later.) It will also apply to the annual residential property tax due to be enacted with effect from 1 April 2013.

The GAAR will only apply to abusive tax arrangements that are entered into the date Finance Bill 2013 receives Royal Assent. However, if an arrangement was subject to an earlier ‘pre-commencement step’ (ie one that took place before Royal Assent), it may be caught by the GAAR.

The GAAR will provide that tax advantages arising from such arrangements are counteracted on a just and reasonable basis.

There will be further consultation over the next couple of months by HMRC with ‘interested parties’ before the final GAAR legislation is included in Finance Bill 2013.

How might this affect you?

The GAAR will provide an additional means for HMRC to tackle tax avoidance schemes. No repeals or changes are proposed for existing mini-GAARs, TAARs or other anti avoidance legislation. HMRC has stated that all forms of tax avoidance will therefore continue to be challenged and counteracted using existing means as well as the new GAAR.

Given the Government’s well publicised objective of promoting fairness in the tax system, the main objective of the GAAR is to deter taxpayers from entering into abusive schemes that might otherwise succeed under current law. It must be assumed that HMRC will seek to use this new weapon in all circumstances where it believes that a scheme or arrangement is artificial or abusive and that existing and specific anti avoidance rules are insufficient.

The GAAR is not aimed at legitimate tax planning. Where arrangements accord with established practice, and HMRC has indicated its acceptance of that practice, the GAAR should not apply. However, it may not always be a straightforward matter to determine where such tax planning becomes ‘abusive’ and subject to the GAAR.

The prudent course of action must be to review, examine and take relevant advice in all cases where anything other than plain vanilla tax planning is being contemplated by taxpayers (whether individuals, companies, trusts etc.), to obtain as much comfort as possible that the GAAR (or any other anti avoidance rule) will not apply. This is especially true as it is still intended that there will be no clearance mechanism.

Penalties for Real Time Information (RTI) late returns

Reporting requirements under RTI will commence for all employers and pension providers (with very minor exceptions), in April 2013. Central to RTI is the submission of what is termed a 'full payment submission' (FPS) on or before each occasion an employee or pensioner is paid. The Government has today released draft enabling legislation to allow penalties to be charged for FPS that are made late or are inaccurate.

Changes for 2012/13

For employers currently participating in the RTI pilot no FPS penalties will be charged for late or inaccurate returns other than for the final FPS due for 2012/13 by 19 April 2013. Employers not participating in the pilot will continue to be subject to the existing PAYE penalty regime.

Changes for 2013/14

There will be no penalties for FPS made late from 6 April 2013 but the current penalty provisions may again apply to final FPS due for 2013/14 by 19 April 2014. However, any 'in year' FPS that are considered to be inaccurate by HMRC may give rise to a penalty.

Changes for 2014/15

The full RTI penalty regime applies from 6 April 2014. HMRC could seek to apply a penalty for any late or inaccurate FPS. The existing provision for a penalty free first default that currently applies to monthly submissions and end of year returns will continue for both inaccurate and late FPS. However, should an employer make a subsequent in year error, the first default is brought back within the scope of the potential penalty provisions. The legislation also simplifies the basis on which HMRC can consider calculating the penalty charged and how it is administered.

How might this affect you?

HMRC will continue to use a risk based approach to assess whether FPS are inaccurate, but as an FPS is due on or before each payment rather than on a weekly or monthly pay period, the risk of inaccuracies or late submissions is significantly increased. Employers will continue to have the same rights of appeal against a penalty, but should use the period from now up to April 2014 to review their systems for capturing all relevant payment data to ensure that they are adequate.

Implementation of UK-US FATCA agreement

Enabling legislation has been drafted to facilitate the introduction, into domestic law, of international agreements to improve tax compliance. The primary focus is the UK-US intergovernmental agreement in relation to the US foreign account tax compliance act, (FATCA). FATCA is aimed at combating tax evasion by US persons by requiring financial institutions to report details of US accounts.

The regulation-making power will help bring UK financial institutions within the ambit of FATCA, without contravening data protection and similar rules, ahead of reporting obligations commencing during 2015. This will involve reports being made to the UK tax authorities which, in turn, will be passed to the US tax authorities. It is also envisaged that the UK-US agreement will facilitate the flow of information from the US to the UK authorities. The legislation contemplates similar tax-related information sharing agreements being concluded with other jurisdictions.

How might this affect you?

The intergovernmental agreement introducing FATCA to the UK is widely drawn and likely to impose reporting obligations on a number of financial services businesses, including fund managers and trustees as well as banks and broking firms. If they have not already done so, such businesses should investigate the extent to which they will be able to comply with FATCA client identification, account reporting and other requirements.

Withdrawing a notice to file a self assessment return

Following the introduction of new automatic late filing penalties, HMRC is currently required to use discretionary powers of collection and management to withdraw notices to file unnecessarily issued self assessment returns and also its 'special reduction' powers to reduce any connected late filing penalty.

The use of these discretionary powers is unwieldy and the proposed legislation will enable HMRC to efficiently revoke notices where they agree that no return is required.

How might this affect you?

This is a helpful measure which should cut down on unnecessary time and expense both for HMRC and the taxpayer in cases where a self assessment income tax, partnership tax or trust tax return is not required. It will be interesting to see in practice what evidence HMRC will require in order to accept that a notice has been incorrectly issued.

Overpayment relief

In order to ensure that overpayment relief is fully compliant with EU law, the treatment of claims made on the basis that tax levied was contrary to EU law is to be legislated. The statute will remove the restriction for claims where the overpaid or over assessed tax has been paid in accordance with the practice generally prevailing at the time. It will also amend the four year time limit for overpayment relief claims to make clear that the four years run from the period to which the mistake relates.

5. VAT AND OTHER INDIRECT TAXES AND DUTIES

VAT

Fuel scale charges

The treatment of fuel supplied at below cost price to employees or individuals has been altered, but the change will have little overall effect on most businesses. A number of concessions that HMRC operated in respect of fuel scale charges have been removed, but similar provisions are being enacted. The change has been required as a result of the Wilkinson case which requires all concessions to be placed on a statutory basis.

From the date Finance Bill 2013 receives Royal Assent, fuel that is provided below market value to an employee or for private use by the owner of a business will be taxed in the same way as any other goods that are provided for private use. The provision will also apply to any fuel supplied to a connected person or a person connected with an employee. An optional valuation scheme will allow businesses to account for the VAT due using a flat rate valuation which will be similar to the current fuel scale charge rates. The legislation will provide a method for this optional charge to be revalued, and for this to occur outside the Budget framework. Specific anti-forestalling legislation will apply to any fuel that is provided from 11 December 2012 at below open market value and used after the date of Royal Assent.

How might this affect you?

This change will have little effect on most businesses. Partially exempt businesses will no longer have the concession of paying a reduced charge for fuel supplied for private use, but will be entitled to recover in full the VAT on fuel supplied for private use.

Energy saving materials

With effect from 1 August 2013, the reduced rate of VAT will no longer apply to the installation of energy saving materials installed in buildings used for charitable purposes.

How might this affect you?

This change will result in increased charges for charities installing energy saving materials, and businesses undertaking such work will need to be aware of the change. Energy saving materials installed in residential accommodation will still benefit from the reduced rate. This removal of the reduced rate from installations in charitable buildings has been expected as a result of infraction proceedings commenced against the UK by the European Commission.

Cable cars

As previously announced, from a date after Royal Assent in 2013 a reduced VAT rate of 5% will apply to the transport of passengers in ‘Cable Suspended Passenger Transport Systems’ where each car or gondola carries ten passengers or less. A reduced rate is being introduced for such transport as it is not possible to extend the zero-rate to cover such means of transport. If the individual cars are capable of carrying ten or more passengers the legislation already zero-rates such transport.

How might this affect you?

This change will affect very few businesses but is to be welcomed as it will reduce the cost for consumers and increase the use of such facilities by commuters and tourists.

Tobacco products duty

Herbal smoking products

With effect from 1 January 2014 herbal smoking products such as herbal cigarettes will become liable to tobacco products duty. An exemption will be retained for any products that are used exclusively for medical purposes, and these will require a licence from the Medicines and Healthcare Products Regulatory Authority to be exempt from duty.

How might this affect you?

This change was expected as it was announced in the 2012 Budget and was the subject of consultation. It will result in the payment of duty on these products but the manufacturers of such products are likely to pass the cost onto consumers.

Climate change levy

Carbon price floor

Changes have been announced to the carbon price floor legislation that affects UK businesses that generate electricity from fossil fuels and is due to come into force on 1 April 2013. The legislation effectively imposes a minimum price on which environmental taxes will be levied and is designed to encourage investment in low carbon power generation.

Changes announced today have provided certain clarifications and have confirmed that combined heat and power stations that generate good quality output will remain exempt from the main rates of Climate Change Levy.

How might this affect you?

These changes will not affect many businesses, but any clarification of the planned tax is to be welcomed.

APPENDIX

In addition to the changes set out in this document, draft legislation has also been released which mirrors the coverage given to certain areas in our previous documents:

Budget 2012: Our In Depth Analysis

- Above-the-line R&D credit for large companies

Autumn Statement 2012

- Main rate of corporation tax – 2013/14 and 2014/15
- Changes to Bank Levy from 2013
- Anti avoidance relating to patent royalties
- Changes to the Disclosure of Tax Avoidance Schemes rules.

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