cutting through complexity

Finance Bill 2014 Draft Clauses

KPMG report

10 December 2013

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OUR VIEW

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It is that time of year again – carols, shopping for Christmas presents, office parties and the release of the draft clauses for the forthcoming Finance Bill 2014.

This is the next stage in the tax policy cycle, which has been established over the past few years, following the Autumn Statement. The proposed tax changes which were initially announced on Budget Day in March 2013 have been consulted on over the summer and now the detail of the draft legislation has been published. In the main, this means that there should be fewer surprises as the underlying principles of the draft clauses have already been discussed, but as always there are some interesting points of detail and in particular some specific anti-avoidance measures where there has been less prior consultation.

The main unexpected change is the new rules regarding deemed salaried members of Limited Liability Partnerships (LLPs). These are significantly broader in scope than previously consulted upon and could affect partnerships with salaried partners where no thought had been given to tax efficient structuring. Together with the other partnership changes, these should be considered in detail by all partnerships. Other anti-avoidance measures which were announced on 5 December during the Autumn Statement include onshore employment intermediaries to bring more individuals within the scope of PAYE and NIC. This will have a considerable impact on some businesses, in particular ones which have tried to re-characterise employees as agency staff. These measures together are expected to raise over £1 billion of additional tax per year. Corporates were also targeted in the Autumn Statement with anti-avoidance measures taking immediate effect in relation to controlled foreign companies, double tax relief, derivative contracts and the debt cap rules.

One area of forthcoming change is a result of a wholesale review of the loan relationship regime, a subject of considerable ongoing consultation. So far we have no draft legislation; we are awaiting clauses on debt funds and companies in partnership due in January 2014, with most of the remaining changes now coming in Finance Bill 2015.

Other areas of no show include the draft clauses on dual contracts (expected January 2014), new childcare allowances (now expected in Finance Bill 2015) and new capital gains rules for disposals of UK residential property by non-residents. In addition we had been hoping for some tidying up of the new statutory residence test and a continued relaxation of the real time information (RTI) obligations for smaller companies. Unfortunately it was announced on 9 December that the relaxation of RTI will only continue for micro employers. As usual the National Insurance measures, such as the reduction of employers NIC for under 21s, do not form part of the Finance Bill and are being legislated for separately in the National Insurance Contributions Bill currently going through Parliament.

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The Government has also announced that following the consultation on proposed changes to the loans to participators legislation, there will be no changes (except to increase to £10,000 the de mininis level of loans) but will keep this area under review.

This year, there is also a focus on sector specific measures. This includes the introduction of new reliefs for onshore oil and gas, with a view to creating an attractive tax environment for shale gas development. Also affected are the offshore gambling industry, with changes to the place of supply for betting duty; film producers, with improvements in the existing film tax reliefs; the investment management sector, with a wide variety of changes; and banks with changes to the structure of the bank levy and banking code. There will also be a tightening of capital gains tax relief on homes for vacant periods before sale.

The Government has requested comments on the draft clauses by 4 February 2014. This is a valuable opportunity for taxpayers to examine the detail of the proposed legislation, both to understand how it might impact them and their business ahead of it becoming law and also to engage with the Government by providing feedback on whether the draft meets policy aims, or has any unintended consequences. Taxpayers considering these draft clauses should remember, therefore, that there is more to come from Finance Bill 2014.

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Measures likely to be of wide interest

Rates, allowances and thresholds

Individuals received mixed news. Those earning up to just under £120,000 will benefit marginally following the 2014/15 personal allowance increase. Basic rate earners with a spouse or partner who does not work full time can (from 2015/16) use up to £1,000 of their spouse's unutilised personal allowance. However, additional and some higher rate earners will feel a modest squeeze from a slight reduction in the 2014/15 basic rate threshold.

There is no change to the previously announced reduction of the main corporation tax rate to 21% from April 2014 and 20% from April 2015.

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Who should read this?

The changes to personal taxes are potentially relevant to all individual taxpayers. Consequential changes resulting from the unification of corporation tax rates will affect some companies.

Summary of proposal

Corporate taxes

In line with the previously announced staged reduction in the corporation tax main rate, the rate of corporation tax for profits other than ring fence profits will fall to 21% in April 2014 before being unified with the small profits rate at 20% in April 2015. As a result of the unification of corporation tax rates the rules for identifying associated companies are no longer needed and will be repealed.

Various other provisions which currently depend on the definition of associated companies will be amended to refer instead to 'related 51% group companies'. This is a new and simpler concept which refers to active companies within a 51% group. The provisions affected are those relating to small profit relief for ring-fence profits, capital allowances for long-life assets, patent box small company treatment, and corporation tax instalment payments.

Personal taxes

The basic, higher and additional income tax rates for 2014/15 will remain at their 2013/14 levels of 20%, 40% and 45% respectively.

The basic rate tax threshold has been set at £31,865 for 2014/15. In line with last year's Autumn Statement, the threshold at which higher rate income tax becomes payable will increase by 1% (i.e. a real terms decrease) in 2014/15 and 2015/16 to £41,865 and £42,285 respectively.

The draft clauses for Finance Bill 2014 (hereafter Draft Finance Bill for simplicity) include measures, confirmed in the recent 2014 Autumn Statement, to increase the personal allowance to £10,000 from 6 April 2014 for those under 65. This realises the May 2010 Coalition Agreement commitment to make the first £10,000 of an individual's income free from income tax.

As announced in the summer, spouses and civil partners will from 2015/16 be able to transfer £1,000 of their personal allowance to their spouse or civil partner, where neither partner is an additional or higher rate taxpayer.

Existing age related personal allowances for individuals above 65 years old remain frozen at their 2012/13 levels (£10,500 for those born after 5 April 1938 but before 6 April 1948, and £10,660 for those born before 6 April 1938). As of 6 April 2013, the age related allowances will remain unchanged until they align with the general personal allowance. From April 2013, age related allowances are

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no longer available except for those born on or before 5 April 1948.

As announced in December 2012, the annual exempt amount for capital gains tax will increase by 1% in 2014/15 to £11,000 and 2015/16 to £11,100.

In line with the 2013 Budget announcements, the Inheritance Tax nil rate band will remain frozen at £325,000 until April 2018.

The annual ISA investment limit will increase to £11,880 from April 2014 (of which £5,940 can be cash).

Class 1 primary National Insurance contributions (NICs) payable by employees will remain at 12%, on weekly income between £153 and £805. A rate of 2% applies on income above this threshold.

In 2014/15, Class 4 NICs will be payable at a rate of 9% on earnings between £7,956 and £41,865, in line with the higher rate threshold. A rate of 2% will continue to apply on income above this level. Class 2 NICs will increase to £2.75 per week.

From 6 April 2015 employers will no longer be required to pay Class 1 secondary NICs on earnings paid up to the Upper Earnings Limit (UEL) to any employee under the age of 21.

Timing

The unification of the small profits rate with the main rate at 20% will take effect from 1 April 2015 and the changes to the associated company rules will take effect for accounting periods beginning on or after 1 April 2015. The changes to the majority of personal tax rates, thresholds and allowances take effect from 6 April 2014.

Our view

The increase in the personal allowance will be welcomed by the majority of taxpayers, though additional and some higher rate taxpayers (i.e. those for whom the personal allowance is fully withdrawn) will feel the squeeze from the slight fall in the basic rate threshold. Though the possibility to transfer £1,000 of personal allowance to a spouse or civil partner from 2015/16 will be widely welcomed, the quantitative impact of the measure for an eligible household will be low, carrying with it a possible tax saving of up to £200.

The changes to corporation tax rates had already been announced but the new 'related 51% group company' test is likely to be a welcome simplification compared to the previous associated companies rules.

Source documents

Income tax: charge, rate limits and personal allowance

Transferable tax allowances for married couples

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Inheritance tax: nil rate band

Corporation tax rates

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Pensions – Protection against reduction in lifetime allowance on 6 April 2014

As expected, the Government has included provision in the Draft Finance Bill to allow members of registered pension schemes to protect the existing value of their benefits against the reduction in the lifetime allowance from £1.5 million to £1.25 million on 6 April 2014.

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Who should read this?

Individuals making pension contributions, members, trustees, and sponsoring employers of registered pension schemes.

Summary of proposal

The pensions lifetime allowance – which sets the maximum amount of tax-relieved pension savings an individual can accumulate over their lifetime – is set to reduce from £1.5 million to £1.25 million on 6 April 2014. As they did in 2012 when the lifetime allowance reduced from £1.8 million to £1.5 million, HM Revenue and Customs (HMRC) will offer individuals the chance to apply for fixed protection. Fixed protection 2014 will allow individuals to retain an underpinned lifetime allowance of £1.5 million provided they have no further build up of benefits in defined benefit arrangements and make no more contributions to defined contribution arrangements.

In addition to fixed protection HMRC will this time also allow individuals to apply for individual protection, and details of this are set out in the Draft Finance Bill.

In summary individual protection will work as follows:

- Individuals with benefits valued at more than £1.25 million on 5 April 2014 can apply;
- They will get a personal lifetime allowance equal to the value of their benefits on 5 April 2014 subject to an overall maximum of £1.5 million and can continue to build up benefits in registered pension schemes. This means for example that if the overall value of their benefits falls they will be able to make further contributions to top up;
- They will revert to the standard lifetime allowance (£1.25 million from 6 April 2014) if this rises back above their personal lifetime allowance (value of their benefits on 5 April 2014) in the future; and
- It will be possible to apply for fixed protection and individual protection (though fixed protection would have to be applied for before 6 April 2014).

Taking into account comments received during consultation, the Government has confirmed that if an individual exceeds the annual allowance after 6 April 2014 and suffers a consequent reduction to their benefit because the scheme pays the tax charge (under 'scheme pays'), this will not affect their personal lifetime allowance under individual protection.

Another change during consultation is that individuals with enhanced protection will be able to apply for individual protection, as long as they do not also have dormant primary protection (i.e. primary protection that they would fall back on if they lost

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enhanced protection). So, where this applies, it will enable an individual who loses enhanced protection to fall back on their personal lifetime allowance under individual protection.

Timing

The provisions will take effect from 6 April 2014. Individuals will have until 5 April 2017 to apply for individual protection.

Our view

The introduction of individual protection will be welcomed by those whose benefits are already valued in excess of the reduced lifetime allowance of £1.25 million. Although individual protection cannot be applied for until after 6 April 2014, there is significant time pressure as individuals must decide whether to also apply for fixed protection before 6 April 2014. The issues are far from straightforward, and those affected are likely to need some assistance. Employers and pension scheme administrators will welcome the decision not to adjust individuals' personal lifetime allowance following a pension debit under 'scheme pays'.

Source documents

Pensions lifetime allowance – individual protection

Pensions tax relief – individual protection from the lifetime allowance charge

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Limited Liability Partnerships (LLPs) and salaried members

The Salaried Members legislation is intended to apply to those members who are more like employees than partners in a traditional partnership. There are three conditions which must ALL be satisfied if the legislation is to apply:

a) The member's reward for services is mainly fixed, or with a variable element based on their performance rather than by reference to the firm's overall profitability (disguised salary);

b) The member does not exert significant influence over the affairs of the partnership; and

c) The member contributes less than 25% of their 'disguised salary' as capital.

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Who should read this?

Individual members of a UK LLP with terms that are more akin to an employment (salaried members) than self employment.

Also, UK LLPs that have members who may be treated as 'salaried members' under the new rules in Draft Finance Bill.

This legislation will not apply to general partnerships or to limited liability partnerships formed under the law of jurisdictions outside the UK.

Summary of proposal

The Salaried Members legislation is intended to identify members who are engaged on terms more closely resembling those of employees. Such salaried members will then be taxed as employees, with the consequential application of PAYE and tax on any benefits in kind. The LLP will also be subject to Class 1 NICs in respect of the salaried member's remuneration.

The legislation, which is included in Draft Finance Bill, introduces a test which requires that all three conditions are to be satisfied if the member is to be treated as a 'salaried member' (employee). If any of the conditions are not satisfied then the member will continue to be treated as self-employed.

Condition A – the member performs services for the LLP in his capacity as a member and is remunerated for these services wholly or substantially wholly (assumed to be 80% or more) through 'disguised salary'.

In summary, 'disguised salary' includes fixed sums and/or variable sums/bonuses which are based on performance rather than the profit or loss of the business as a whole.

Condition B – the mutual rights and duties of the members of the LLP do not give the member under consideration a significant influence over the affairs of the LLP.

This condition is considering the role of the member in the LLP and whether they have significant influence over the business as a whole rather than simply having voting rights on certain aspects. In larger partnerships, it is likely only a minority of individuals will have significant influence over the affairs of the **whole** partnership (e.g. Management Committee) with the rest of the members caught by this condition.

Condition C – the test is whether the amount contributed to the LLP by the member is less than 25% of the 'disguised salary' it is expected will be paid to that member for that tax year.

This condition is looking at the risk borne by the member in relation to the success/failure of the business and whether or not it is a significant risk.

The amount of the capital contribution is based on the amount the

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individual has invested as capital at the time in accordance with the LLP Agreement but will take subsequent changes into account. It will not however include amounts the member can withdraw whilst he remains a member, e.g. undrawn profit, short term loans.

If the member joins or leaves the LLP during the tax year, the relevant capital contribution, for the purpose of this test, will be pro rated accordingly.

Some anti-avoidance legislation has also been included in the Draft Finance Bill:

- Firstly, to prevent the use of artificial structures or arrangements to place members outside the scope of the Salaried Member provisions. Any such arrangements will be ignored in determining whether the legislation applies;
- Secondly, to catch the situation where an individual works for the LLP but his remuneration is paid to a corporate member and this arrangement is put in place to avoid the Salaried Member legislation.

Legislation has also been introduced to allow a tax deduction to be claimed by the LLP for the costs of employing Salaried Members.

The NICs Bill 2013 is currently being debated at the House of Commons and will be amended to include a new clause granting power to HMRC to reclassify certain LLP members as employed earners for NIC purposes.

Timing

The legislation will take effect from 6 April 2014.

For individuals who are members at 6 April 2014, Conditions A and B need to be considered at 6 April 2014.

For individuals who become members after 6 April 2014, Conditions A and B need to be applied on the date on which they become members.

These tests do not need to be reapplied until there is a change in circumstances that mean the results may alter.

Condition C will first be applied at 6 April 2014 or, if later, the date on which the member joins the LLP. It will then be applied at the beginning of each tax year. It will then be applied at the beginning of each tax year. The test will also be reapplied if there is a change in the amount of the contribution or some other change in circumstances which may affect the satisfaction of this condition.

Our view

This Salaried Members Legislation is more widely drawn than anticipated and many UK LLPs will need to consider whether they have members who will be reclassified as Salaried Members.

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Of the three stated conditions, it is the requirement that more than 20% of a member's profit share to be directly linked to the overall profitability of firm that will be of most significance. It is not sufficient for the variable element to be linked to an individual member's performance or that of their wider team or office – it must be linked to the performance of the business as a whole.

Firms which require minimal capital, where it is usual for members to receive guaranteed payments or where drawings are non refundable (even if the firm makes insufficient profit to cover such drawings), may be particularly impacted by this legislation.

Source documents

Partnerships: a review of two aspects of the tax rules – Summary of responses

Overview of Legislation in Draft – para 1.63 and A126

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Mixed partnerships and profit allocations

Legislation to counteract profit allocation schemes used by some mixed partnerships, that were perceived to be abusive, has been introduced in Draft Finance Bill. These anti-avoidance provisions came into force on 5 December 2013 but only in relation to profits earned from 6 April 2014 onwards.

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Who should read this?

These changes should be reviewed by partners who participate in partnerships with mixed members (usually companies and individuals) and should also be considered by those who are considering introducing a corporate partner to a partnership.

Summary of proposal

One of the aspects that the Partnership Consultation Document issued in May 2013 sought to address was the use of certain profit/loss allocation arrangements by mixed partnership members (usually individuals and companies) to reduce tax. The Autumn Statement confirmed that measures would be introduced in the Draft Finance Bill to counteract such arrangements and this legislation has now been published.

The first element of this change will be to reallocate excess profits allocated to, for example, a company to an individual partner where the following conditions are met:

- A corporate partner has a share of the firm's profit;
- This corporate partner's share is excessive;
- An individual partner has the power to enjoy the corporate partner's share or there are deferred profit arrangements in place; and
- It is reasonable to suppose that the whole/part of the corporate partner's share is attributable to that power/arrangements.

Similar legislation (in the form of a targeted anti-avoidance rule (TAAR)) has also been introduced to reallocate a non-individual's profit share to an individual who is not a partner if it is reasonable to assume that the individual would have been a partner but for the new rules and he has the power to enjoy the non-individual's profit share.

It should be noted that legislation will be introduced to avoid double taxation.

The second element will impact situations where partnership losses arising from either a trade, a UK or an overseas property business are allocated to an individual partner, instead of a non-individual partner, to enable the individual to access certain loss reliefs. These measures will deny income tax loss and capital gains reliefs for such losses allocated to an individual if (one of) the main purpose of the arrangements is to ensure the individual gets the relief when the loss rightly belongs to the corporate.

Timing

The above provisions came into force on 5 December but only in relation to profits earned from 6 April 2014 onwards. In situations where the above provisions apply, the profits/losses of the

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accounting period straddling 6-April 2014 will need to be split, with the profits/losses of the post 6 April 2014 period being subject to the new anti avoidance legislation. Accordingly, profits from an accounting period ending on say 30 April 2014 will only be subject to the new rules in respect of the post 6 April 2014 period.

The TAAR referred to above applies these new provisions to non partners where it is reasonable to suppose that they would have been a partner but for these new rules. The legislation has immediate effect as an anti-forestalling measure (but again only for profits rising after 6 April 2014) in order to give current (indeed immediate) meaning and strengthen the application of this TAAR. So a partner ceasing to be a partner after 5 December 2013 in order to potentially avoid this legislation would be caught by the TAAR, but only for profits from 6 April 2014.

Our view

Partnerships with a commercially driven mixed membership structure will need to ensure that the commercial reality is fully reflected in the allocation of profits and losses.

Source documents

Partnerships: a review of two aspects of the tax rules – Summary of responses

Partnerships review: partnerships with mixed membership

Overview of Legislation in Draft – para 1.63 and A129

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Partnerships and Service Companies – compensating adjustments changes

Draft legislation relating to compensating adjustments was published on 25 October 2013 and took immediate effect. This draft legislation related to transfer pricing adjustments made for tax purposes between professional partnerships and their service companies. Where this adjustment had only had effect for tax purposes, HMRC would no longer permit an actual tax deduction for the mark up element on the service company fee. Therefore, without action, there would effectively be double taxation: the mark up would be taxed in the company with no corresponding tax deduction in the partnership.

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Who should read this?

Partnerships that have set up (or are planning to set up) service companies to provide services to the partnership.

Summary of proposal

On 17 September 2013, the Government announced that it would take action against two arrangements involving 'compensating adjustments', one of which related to the application of the transfer pricing rules to service companies owned by professional partnerships. A technical note and draft legislation was published by HMRC on 25 October 2013.

The implications of the new rules are best seen from considering an example.

Suppose the service company incurs costs of £100 million and only recharges the partnership these costs (£100 million) rather than the costs after an arm's-length mark-up to say £105 million.

If the transfer pricing legislation applies to the company, it will be taxed on the arm's-length amount of £105 million, i.e. it will be taxed on an additional profit of £5 million at corporation tax rates. Under the legislation in place prior to 25 October 2013, the partners could then claim a compensating adjustment of £5 million, reducing their taxable partnership profits accordingly. The tax benefit to the partners was therefore the difference between the income tax and NIC payable on the £5 million mark-up and the corresponding corporation tax paid on the mark-up (tax rate difference for the 2013/14 tax year of 24%).

Under the new legislation, the compensating adjustment cannot be claimed by a person (other than a company) within the charge to income tax on partnership profits, i.e. by an individual partner or the trustees of a settlement.

Timing

The draft legislation was published on 25 October 2013 and took effect from that date. This means that the changes take effect in relation to service fees accruing on or after 25 October 2013.

For accounting periods that straddle the 25 October date, the mark-up will be time apportioned between the fee earned before and after 25 October 2013. As regards any apportionment relating to the period before 25 October 2013, it will still be possible to make a compensating adjustment claim.

The draft legislation published on 25 October 2013 has been incorporated in the Draft Finance Bill.

Our view

Impacted firms will need to ensure that any transfer pricing mark-ups, that had previously only been made for tax purposes, need now to be actually put through the accounts in respect of profits

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earned after 25 October 2013. This will result in profits accumulating in the service company. However, for a higher rate taxpayer, the total effective tax rate on profits extracted from a company is now slightly lower than on profits from extracted from a partnership.

Source documents

Overview of Legislation in Draft – para 1.58

Amendments to compensating adjustment legislation: Technical Note and Draft Legislation (published 25 October 2013)

Transfer pricing: restriction on claims for compensation adjustments

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Transfers of assets and income streams through partnerships

Disposals of assets or income streams through partnerships, including limited liability partnerships, will be subject to income tax based on the market value of the asset or income stream where one of the main purposes of, or one or more of the steps in the arrangement is obtaining an income tax or corporation tax advantage.

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Who should read this?

Current and prospective members of LLPs who are considering arrangements whereby assets and income streams are transferred through or by partnerships.

Summary of proposal

The legislation is aimed at countering 'tax attribute' schemes where the transferor and transferee have different tax attributes, for instance, the transferor has losses to use whereas the transferor does not.

This follows the consultation document issued in May 2013 in which HMRC raised concerns about the use of different tax attributes of different members within a partnership to gain a tax advantage.

The legislation in the Draft Finance Bill will govern situations where, directly or indirectly, in consequence of or otherwise in connection with an arrangement there is:

(i) a disposal of an asset (in whole or part) or a right to income by or through a partnership from a member (or a connected person) to another member: and,

(ii) one of the main purposes of one of more of the steps in the arrangement is obtaining an income tax or corporation tax advantage.

In situations where the new legislation applies, the person disposing of the asset or income stream will be subject to income or corporation tax. The tax charge will be based on the consideration given for the asset or income stream, or where such consideration is deemed to be substantially less than market value, on the market value.

HMRC specifically exclude arrangements where family members use partnership profit sharing ratios to allocate profits between them in a tax efficient manner (i.e. planning options envisaged in Arctic Systems), distinguishing them from the ambit of this legislation, due to the fact that in those cases no payment is given for the profits transferred.

Timing

The legislation will have effect in relation to arrangements entered into on and after 6 April 2014 for income tax payers and 1 April 2014 for persons within the charge to corporation tax.

Our view

Partnerships will need to consider carefully the differing tax attributes of their members to ensure that they do not inadvertently fall within this legislation.

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Source documents

Overview of Legislation in Draft – para 1.63 and A135

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Partnerships review: alternative investment fund managers

The deferred remuneration rules in the AIFM Directive (AIFMD) may cause particular tax issues for partners in Alternative Investment Fund Managers (AIFMs) and delegate entities structured as partnerships and LLPs. A new mechanism is to be introduced for remuneration needing to be deferred or paid in instruments pursuant to AIFMD. Under the new provisions, a partner may elect for the remuneration to be deferred (and income tax paid) in the firm itself, with deferral operated on a 'net of tax' basis rather than on a gross basis as would otherwise be the case.

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Who should read this?

AIFM Code Staff and other persons in investment management partnerships and limited liability partnerships (LLPs) affected by the AIFM Remuneration Code.

Summary of proposal

The deferred remuneration requirement of the AIFM Remuneration Code causes particular problems for Alternative Investment Fund Managers (AIFMs) and delegate entities structured as partnerships and LLPs.

Legislation will be introduced in Finance Bill 2014 to provide the following:

- A partner in an AIFM partnership may elect to allocate all or part of their 'relevant restricted profit' to their firm. Relevant restricted profit is deferred remuneration (within the meaning of the AIFMD) together with any remuneration which is awarded in the form of instruments that must be retained for a period of at least six months;
- The firm must pay tax at the additional rate of income tax (currently 45%) on that income, with no reliefs or allowances to be available to set against it;
- Where the relevant restricted profit ultimately vests with the partner who initially allocated it to the partnership, this is treated as taxable income of the partner in the tax year of vesting. Credit will be available for the tax initially paid by the partnership on the profit and any overpayment of tax may be repaid; and
- For capital gains tax purposes, the partner is treated as receiving any securities at a base cost equivalent to the amount of remuneration they represent, net of tax. The same amount is treated as the disposal consideration.

If the deferred remuneration does not vest in the partner who originally allocated the amount to the firm, the payment will be treated like any other partnership distribution. There will be no further tax liability and no entitlement to recover the tax paid on that element of the deferred remuneration.

Timing

The legislation will have effect on and after 6 April 2014.

Our view

This mechanism allows deferral on a 'net of tax' basis rather than on a gross basis for partners in firms affected by the Pay-out Process Rules (PoPR) of AIFMD and is likely to be widely adopted.

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Source documents

Overview of Legislation in Draft – paras 1.63 and A132 to A134

Partnerships review

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Compensating adjustments - "excessive leveraging of companies by individuals"

The Draft Finance Bill is in line with details published and taking effect from 25 October 2013. Individuals can no longer claim a compensating adjustment where interest paid by a company is disallowed to the company under transfer pricing rules. The person receiving such interest will be treated as receiving a qualifying distribution and taxed at the appropriate dividend rate. The highest effective rate for individuals lending to a UK company is 30.55%..

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Who should read this?

Companies backed by management or private equity and the individuals providing finance.

Individual shareholders with loan notes issued to them by companies, this often impacts on owner managed businesses.

Summary of proposal

Further to Danny Alexander's announcement on 17 September 2013 and subsequent consultation, draft legislation and a technical note were published on 25 October 2013. This draft legislation has now been republished as part of Draft Finance Bill. It is aimed at what was described as a 'loophole' in the legislation which permitted individuals to claim a transfer pricing compensating adjustment on amounts where the counter party was a corporate.

The consequences of the legislation are as follows:

- Compensating adjustments on interest received in excess of arm's length which accrues on or after 25 October 2013 are no longer permitted for an individual where the counter party is a company and where some or all of the interest expense is disallowed to the company under transfer pricing rules. The "excessive" interest is instead treated as a qualifying distribution for income tax purposes. Previously, the person could have made a claim for a compensating adjustment which would have resulted in that interest not being subject to tax.
- Because the "excessive" interest is treated as a qualifying distribution, the individual is entitled to a tax credit, and taxed at the appropriate dividend rate. The highest effective rate for an individual who has lent money to a UK company is 30.55%. Thus although the receipt is taxable, it is not taxable at the full income tax rate (highest rate of 45%) that would have applied if it had been taxed as interest without the compensating adjustment (as originally proposed). No claim is required for this treatment, whereas a claim was required under the previous legislation.
- The new rules apply to the trustees of a settlement as well as to individuals.
- Because the affected interest is reclassified as a distribution for income tax purposes, withholding tax is not due on these amounts when they are paid. Whereas in relation to pre 25 October 2013 interest there was normally a requirement for the company to withhold tax which the recipient would need to seek a reclaim via a formal claim.

The transition arrangements are particularly important; in many cases, this interest has been rolled up so individuals have amounts which they have earned but which they have not yet received. The new legislation does not apply to interest which is "referable to a period before 25th October 2013".

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Timing

The new rules affect amounts accruing on or after 25 October 2013.

Our view

These changes seek to align the overall tax paid where a corporation tax deduction is disallowed due to transfer pricing and the counterpart is an individual. The legislation included in the Draft Finance Bill is as expected based on the draft legislation issued on 25 October 2013. This includes welcome amendments to the original proposals such that it should still be possible to claim a compensating adjustment in relation to interest accrued but not paid pre 25 October 2013 and to treat "excessive" interest accruing post 25 October 2013 as a qualifying distribution (subject to income tax at an effective rate of up to 30.55% for an individual who has lent money to a UK company) rather than interest (subject to income tax at up to 45%).

Source documents

Amendments to compensating adjustments legislation: technical note and draft legislation

Overview of legislation in draft

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Changes to the Private Residence exemption (Principal Private Residence Relief)

A tightening of capital gains tax (CGT) relief on homes for vacant periods before sale.

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Who should read this?

Anyone who is considering the disposal of a main residence they no longer occupy and looking to rely on the final period exemption of 36 months in order to reduce/eliminate a chargeable capital gain.

Summary of proposal

Where a residential property has been occupied as the taxpayer's only or main residence throughout the whole period of ownership, any capital gain arising on disposal of the property is exempt from CGT.

Various periods of non-occupation can qualify as if the property had been occupied by the owner and allow the relief to apply in full even though the owner may have resided elsewhere. One such period is the final period exemption, which applies to the period running up to the sale of a property that has been a person's main residence at some time, even though they may not be living in the property at the time of the disposal. In addition they may be claiming Principal Private Residence Relief on another property at the same time. The final period exemption will be reduced from 36 months to 18 months, unless the property owner is an individual who is disabled or living in a care home at the time of the disposal. In the latter case, if certain conditions are met the final period exemption remains 36 months.

There is a transitional provision which allows for disposals under contracts already entered into and completed before 6 April 2015 to continue to benefit from the final period exemption of 36 months.

The changes also apply to beneficial owners who occupy the property as their main residence under the terms of a trust.

Timing

This measure will have effect where contracts for the sale of the property are exchanged on or after 6 April 2014.

This measure will not have effect where contracts for the sale of the property are exchanged on or before 5 April 2014 and completed on or before 5 April 2015.

Our view

This announcement reduces the incentive to 'flip' a house – that is to buy a property, use it as a principal private residence, 'flip' to another property and continue to benefit from the CGT exemption for the next three years.

The halving of the final period exemption came as a surprise and many second home owners and 'accidental' landlords will need to evaluate the implications for them, although the transitional provision should lessen any immediate impact. There may also be an extent to which this measure puts people off relocating for

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work purposes. Commonly, if an owner-occupier is offered a job in a different location to their home, they might rent a flat or house to live in and keep their home for a while before they sell it. The reduction to this final period exemption makes this a less attractive option.

Source documents

Finance Bill 2014/Personal Tax/Capital gains tax private residence final period relief

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Tax efficient investments

In keeping with recent Finance Bills the Government is creating new ways in which individuals can make tax efficient investments in social enterprises. The Government has also sought to amend existing legislation to close loopholes which it deems are being used for tax avoidance purposes.

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Who should read this?

- Social enterprises and individuals who invest in such organisations;
- VCTs and individuals who invest in them; and
- Individuals paying interest on loans to invest in companies in the European Economic Area (EEA).

Summary of proposal

Social Investment Tax Relief

As announced at Budget 2013, new tax reliefs are to be introduced for investments in social enterprises made on or after 6 April 2014, which form part of the Government strategy to decentralise social enterprise and encourage investment. Following a period of consultation, the draft legislation regarding Social Investment Tax Relief (SITR) has widened the size and range of eligible investments from the initial proposals.

SITR mirrors the Enterprise Investment Scheme (EIS) in many ways, but there are important differences. Some of the key differences are set out below.

- the reliefs will be available for certain loans;
- the reliefs will be available for investments by individuals in social enterprises that meet the eligibility conditions. For these purposes a 'social enterprise' will include charities, community interest companies and community benefit societies;
- the social enterprise must have less than 500 employees (this threshold has been increased from the 250 initially proposed);
- the maximum amount that a social enterprise can raise through tax relieved investment over a three year period will be determined by a formula that will take account of, amongst other things, the tax reliefs available to the investee organisation. The exact amount will in part depend on the rate of relief still to be announced, but it would appear that it will be more than £150,000 in total; and
- the money raised through SITR must be used within 28 months.

Tax relief will be available to individual investors in the following ways:

- income tax relief, at a percentage to be confirmed in the 2014 Budget, on the amount of investment, limited to £1 million per tax year;
- deferral of capital gains at £1 for every £1 invested in SITR qualifying investments (until they are subsequently disposed of); and

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- subject to the investment being held for three years, any gain made on disposal will be tax-free.

Rules will be introduced to prevent an investor claiming SITR from also claiming EIS, Seed EIS or Community Investment Tax relief on the same investment.

Anti Avoidance: VCT income tax relief

New rules are to be introduced that will restrict the availability of VCT income tax relief in the following circumstances:

- If an individual subscribing for VCT shares has sold shares in the same VCT and the subscription is conditional upon the purchase of the shares that have been sold (or the purchase of the sold shares is conditional upon the subscription); or
- If the subscription for VCT shares is made within a six month period of a sale of shares in the same VCT (irrespective of whether the subscription or sale comes first).

These rules address Government concerns regarding arrangements that allowed VCT investors who wanted to remain invested in the same VCT to effectively 'recycle' their VCT income tax relief.

The income tax relief is to be restricted by reducing the amount subscribed for the shares by the total consideration given for the 'linked sale(s)' of VCT shares.

The legislation also includes provisions that seek to effectively treat VCTs that have merged as the same VCT. However, an investment made in a separate VCT following a disposal of shares in another VCT should not be impacted even if those VCTs share the same investment manager.

VCT investors who participate in dividend re-investment plans should not be impacted by this change in legislation.

It has also been announced that individuals will qualify for VCT income tax relief if their share subscription is made via a nominee. However, HMRC will need to be informed of the identity of the beneficial owner of the shares.

Loan Interest Relief

Income tax relief for interest paid on certain loans to invest in certain close companies and employee-controlled companies will be extended to investments in such companies resident throughout the European Economic Area. Currently relief is only available on investments in UK resident companies, but will be extended in order to comply with EU law.

Timing

All of the above changes will take effect from 6 April 2014.

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Our view

Social Investment Tax Relief is a welcome relief to encourage individuals to invest in small social enterprises. It remains to be seen how much investment will be raised through this new relief and whether those qualifying businesses that require investment to grow are able to attract investment.

Source documents

Social investment tax relief

Qualifying loan interest relief: changes

Venture capital trusts

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Business Premises Renovation Allowances – a clarification of the legislation

HMRC have issued draft legislation which ensures that relief is only claimed in respect of expenditure on genuine building/conversion works and associated services. The changes noted are based on a consultation process that took place earlier in 2013.

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Who should read this?

Property investors and owner-occupiers.

Summary of proposal

Business Premises Renovation Allowances (BPRA) provide 100% tax relief for building and conversion works undertaken to bring an unoccupied property in a disadvantaged area back into commercial use. The property has to be unoccupied for 12 months for the relief to be available.

The draft legislation provides that only the following expenditure would qualify for the relief:

- The actual costs of construction and building work (relating to the renovation and conversion);
- Certain specified activities (such as architect's fees); and
- Certain associated unspecified activities (such as project management services), limited to 5% of the actual costs incurred.

Additional minor adjustments to the existing legislation include the reduction of the window for balancing events from seven to five years under certain circumstances, and a provision for withdrawal of the relief where it has been claimed on capital expenditure incurred but the work is not completed within 24 months of incurring the expenditure.

Timing

For income tax purposes the amended legislation will take effect from 6 April 2014 and for corporation tax purposes from 1 April 2014.

Our view

It is clear that the changes announced are as a direct result of claims that HMRC have seen that have included expenditure that falls outside of the meaning of conversion and renovation works.

This clarification of the rules confirms our long-held view that relief for such works can only be claimed within the spirit of the legislation and the intention of Parliament in enacting it.

It is also a positive reinforcement of the Government's view that this is a valuable relief, essential to ensure the regeneration of areas blighted through commercial disuse.

Source documents

Business premises renovation allowance

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Offshore Employment Intermediaries

The draft Finance Bill contains provisions concerning those who are employed by an offshore employer but are working for a business in the UK and the operation of PAYE in these circumstances. In addition, it prescribes who is responsible for operating PAYE for workers in the oil & gas sector who are working in the UK or on the UK Continental Shelf where the employer is outside the UK and introduces a certification scheme where the offshore employer is voluntarily operating PAYE which removes PAYE obligations from the oil field license holder. Parallel legislation is also to be introduced for NIC purposes (this has previously been published in draft).

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Who should read this?

This will be of interest to any business that uses the services of offshore employed workers as well as employment businesses in the UK who supply such workers to UK end users. In the oil & gas sector this will be of interest to oil field licence holders on the UK Continental Shelf, as well as any UK parent company of, or UK agency providing services to, an offshore employer.

Senior finance and HR professionals and the tax department will all need to be aware of these changes given the need to comply with the new PAYE regime and the potential additional NIC.

Summary of proposal

Section 689 ITEPA 2003 is being amended to add two new clauses s689(1B) and s689(1C) to impose a requirement, in prescribed circumstances, on any "third person" (usually a UK agency) to apply PAYE on the amounts paid to a worker where the worker is made available to a UK end user;

A new section 689A is inserted in respect of oil & gas workers on the UK Continental Shelf who are employed by a non-UK based employer. This requires that any associated company of the offshore employer will be responsible for the operation of PAYE. If there is no associated company of the offshore employer the oil field license holder will have this responsibility. The draft NIC regulations apply similar provisions but the requirement will apply to any UK "associated presence" of the offshore employer. "Associated presence" appears broader than associated company as it includes associated companies and any UK branch or agency of the offshore employer;

The new rules apply to oil & gas sector workers where an individual is a "continental shelf worker" which means a person in an employment the duties of which are performed (a) in the UK sector of the Continental Shelf and (b) in connection with exploration or exploitation activities (as so defined);

This is subject to a certification procedure moving the responsibility for accounting for the operation of PAYE from the oil field licensee to the offshore employer in prescribed circumstances. A certificate can be withdrawn by HMRC if the offshore employer fails to comply with its responsibilities and it will only be granted to an offshore employer where it is compliant and has no associated UK presence;

The new, tighter, rules for the oil & gas sector will apply for NIC only where the employment of the worker is "in connection with an offshore installation", whereas the PAYE rules have wider application.

HMRC consider that the new NIC rules on oil and gas employees working on the UK Continental Shelf will take precedence over the existing special NIC code for mariners. However, whilst this is

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clearly intended the interaction of the special NIC rules for mariners is not absolutely clear and it is possible that the draft NIC regulations will be amended to make this explicit;

The tax treatment of agency workers is being amended in parallel with these changes (see our separate note on "Onshore Employment Intermediaries – false employment") and PAYE will now apply where a worker provides services, or is personally involved in a service that is being supplied, to an end user. This and the accompanying changes to the NIC position are designed to counter "composite service" avoidance arrangements;

Existing reporting requirement under PAYE Real Time Information (RTI) will apply to the entity responsible for accounting for PAYE/NIC under these new rules. Where responsibility lies with a UK intermediary this will be supplemented by a separate quarterly electronic return for all workers not previously accounted for by that entity under RTI. Further details on this are awaited. A penalty regime for late or incorrect returns will apply, further details of which are awaited.

Timing

The proposed legislation will be applicable from 6 April 2014..

Our view

These changes will require businesses to carefully consider their labour supply chain in terms of the contractual and operational changes that the legislation may require. There will be businesses that are aware of offshore employment businesses in their supply chain but there will equally be some who are not. This is now the right time to review the composition of the supply chain and evaluate the risks.

The Government's new approach will clearly have an impact on many UK based employment businesses. In particular, a UK based associated company of a non UK employer may now become responsible for PAYE/NIC and reporting under Real Time Information (RTI) on behalf of the non UK employer. For the oil & gas sector, this responsibility will in the first instance rest with the UK parent of an offshore employer or any other associated UK presence of that business. But where the non-UK employer has no associated presence the oil field licensee is caught, unless the offshore employer applies for certification. Here again these new rules will require careful consideration in terms of who is impacted, what they need to do to comply and communication across all parties regarding responsibility for the operation of PAYE/NIC. In future this will need to be formalised in terms of contractual commitments between the parties.

Offshore employers should also consider these points because although HMRC will not challenge them directly they are part of the supply chain, and where an offshore employer does voluntarily

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comply this removes the risk from those further up the supply chain. The offshore employed worker also needs to be considered as regards communication as to his/her position on deduction of PAYE/NIC from pay and whether, and if so, how they will be affected by these changes.

KPMG recommends that:

- all businesses which use labour which is sourced from outside the UK should review their existing arrangements well in advance of 6 April 2014. This applies to those operating within and outside the oil & gas sector, albeit the new rules will apply differently in the latter case;
- businesses should revisit their current business model because the changes being applied to NIC are likely to result in a increase in costs for impacted businesses. Existing contracts should also be carefully reviewed;
- the contracts between the agency/end user/licence holder/offshore employer and other members of the supply chain should be reviewed to determine who is contractually liable for the operation of PAYE/NIC and the associated requirements under RTI;
- oil & gas businesses will need to assess whether their offshore employment arrangements on the UK Continental Shelf can be modified to preserve any existing mariner related NIC efficiencies (to the extent that work is not in connection with an "offshore installation").
- employers who are considering ending their offshore arrangements should consider the impact on possible HMRC challenges to existing arrangements, not least given HMRC's recently increased activity in this respect across all sectors.

Source documents

National Insurance Contributions Bill draft regulations and arrangements

Employment intermediaries

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Onshore Employment Intermediaries – false employment

The Government is taking measures to ensure that companies cannot use onshore employment intermediaries to disguise employment as self-employment in order to avoid employment taxes and deny employment rights to their workforce.

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Who should read this?

The Government has identified the construction industry as a particular target for this legislation; however employment agencies will also need to pay close attention to the detail of the draft legislation.

Summary of proposal

HM Revenue & Customs (HMRC) are already consulting on draft regulations aimed at countering National Insurance avoidance through the use of offshore intermediaries. This measure, announced in the Autumn Statement, is aimed at onshore intermediaries who contract with end users to supply workers who are argued to have self-employed status. A consultation document (56 pages) has been issued seeking views on the Government's proposed approach and on the detail of the legislation as drafted.

HMRC are concerned that workers are being moved from employments to agency arrangements and then being supplied as a team providing a 'composite service' to an end user. It is then being argued by the agencies in question that as a composite service is being provided, there is no requirement for 'personal service' on the part of any worker and, as a result, the existing rules do not impose a NIC liability or PAYE obligation. HMRC are also concerned that these arrangements are being forced upon workers without sufficient information of the impact on state benefits or employment rights being provided.

Draft legislation has been released for consultation that amends Chapter 7 of Part 2 of ITEPA 2003 (application of provisions to agency workers). The draft legislation removes the definition of an 'agency contract' under which the worker is obliged to personally provide services to the client, and brings into the scope of Chapter 7 a worker who provides or who is 'personally involved in the provision of services' to a person (the client) by way of a contract with a third party (the agency). This addition has been introduced to encompass the provision of composite services.

Workers within the scope of the revised legislation will be treated as employees of the agency for tax and NIC purposes. As a consequence of the changes, all remuneration receivable by the worker (from any person) as a consequence of the provision of services is to be treated as earnings from that employment and subject to PAYE accordingly (see below).

The draft legislation excludes cases where the services are provided by the individual are not subject to the right of supervision, direction or control by any person. This exclusion is designed to exclude the genuinely self-employed from the draft legislation, and replicates the existing position.

Consequential amendments have been drafted with regard to Chapter 3 of Part 11 of ITEPA 2003 (PAYE: special types of payer)

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to ensure that payments receivable by the worker are categorised as PAYE income and to impose the obligation to operate PAYE on the agency. A new reporting regime will be introduced to underpin the changes based on a quarterly electronic return required from the onshore intermediary. Penalties will apply for non-compliance, but only from 6 April 2015.

Timing

Draft legislation has been released for consultation with Finance Bill 2014, with the changes coming into force from 6 April 2014. Corresponding changes will be made separately to deal with the NIC position.

Our view

The draft legislation is structured in such a way as to include workers involved in the provision of composite services, as intended by Government. However, KPMG is concerned that the wording of the legislation is too broadly drafted.

Currently, the definition of an 'agency contract' does not permit services being provided through a personal service company (PSC) from being brought within the agency rules, as an agency contract requires a worker to be a party to the contract. These PSC arrangements are considered separately under Chapter 8 of Part 2 of ITEPA (application of provisions to workers under arrangements made by intermediaries) (the 'IR35' legislation). As drafted, we consider that in certain instances PSC arrangements may also be caught under the new rules, resulting in the agency having an obligation to operate PAYE on payments receivable by the worker 'in consequence of' providing the services. Such payments may not have been received directly from the end user; they may for example be dividends paid to the worker by the PSC.

In addition, the new legislation also extends to cases where a worker is 'personally involved in the provision of services' and in consequence of this the client pays the worker for the services. This goes beyond the existing 'personal service' requirement. When this is coupled with the *"manner in which the worker provides the services [not being] subject to (or to the right of) supervision, direction or control by any person"* it appears to introduce a more demanding test to avoid the impact of these rules than exists under the current agency rules.

By way of example, consider the case of a self-employed electrician who is introduced by an agency (under an outsourcing contract) to a building developer to provide services, under the supervision of the site foreman (for health & safety purposes). The self-employed worker is unable to provide services personally so arranges a substitute to provide them instead. This would previously not have been caught by the agency rules, the fact of substitution being a determinative factor.

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However, under the draft legislation the services are provided 'in consequence of' the contract between the agency and the building developer. And even though the self-employed electrician does not personally provide the services, he is still personally involved in their provision (as he has personally arranged for a substitute) (s44(1)(a)) and the manner in which the services are provided are subject to the 'supervision' of the site foreman s44(2). As a result, the worker would appear to be treated for tax purposes as if he were holding an employment with the agency. This is presumed to be unintended, but it does illustrate the breadth of the legislation as currently drafted. We will be confirming the position with HMRC.

The Government states in the consultation document that all 'qualifying workers' within this measure will gain entitlement to statutory payments such as sick pay and maternity pay. They add that in the majority of cases the worker will also gain the benefit of being an employee for employment rights purposes. However, they acknowledge that this will depend on the worker being within the case law tests set out by the courts. Those agencies who are potentially impacted will want to review the position carefully in terms of employment law and the Agency Workers Regulations.

Source documents

Onshore employment intermediaries – false self-employment

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Changes for approved employee share plans

In addition to the increases to the Share Incentive Plan (SIP) and Save As You Earn (SAYE) scheme limits announced in the Autumn Statement, the draft Finance Bill 2014 has confirmed the move to self-certification and online filing for all tax-advantaged plans and introduces certain other simplification measures.

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Who should read this?

Finance directors, CFOs, HR directors, compensation and benefits directors, tax directors, reward advisers, any individual with responsibility for reward matters in their organisation.

Summary of proposal

1) Self-certification of SIPs, SAYEs and CSOPs

In relation to SIPs, SAYE schemes and Company Share Option Plans (CSOPs), the requirement to obtain HMRC approval is substituted with a requirement to notify HMRC and a power for HMRC to enquire into a plan and decide it should no longer be tax advantaged.

Notices

Provided the notice is given by 6 July following the tax year in which the first award was made, the plan is 'tax-advantaged' from the earlier of the date of notice or the first grant of award. If notice is given after 6 July following the tax year in which the first award was made, the plan is treated as tax advantaged from that tax year (even if awards were made in an earlier tax year).

The notice must include a declaration that the relevant requirements are met and must be filed electronically, unless HMRC have specifically agreed otherwise.

Enquiries

HMRC have various powers to serve a notice of intention to enquire into the status of a plan. In the case of serious breaches, HMRC have the power to disqualify a plan and impose a penalty, up to twice HMRC's reasonable estimate of the income tax and National Insurance contributions (NIC) that would have been due had the plan not been tax-advantaged. On a serious breach a plan will also be closed. However, the status of awards granted prior to the giving of a closure notice will not be affected.

For other breaches HMRC may impose a penalty of up to £5,000 and require the company to bring the plan into compliance within 90 days. Failure to comply can lead to closure of the plan and further financial penalties.

2) Online filing of notices and annual returns

The requirement to submit an annual return with certain prescribed information and declarations in a prescribed form will remain in respect of SIPs, SAYE schemes, CSOPs and Enterprise Management Incentives (EMI). However, under the new rules the annual returns must be filed electronically unless HMRC has specifically agreed otherwise. New sections will also be added to the forms to enable companies to self certify changes to key features of plans.

There are financial penalties for failing to file annual returns

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electronically as required.

For EMI options, notifications of grant will also need to be made electronically. The notification will need to confirm that EMI option-holders meet the working time requirement. The employer must then keep copies of the working time declarations from option-holders and produce them to HMRC if so requested.

3) Clarifications to the SIP, SAYE and CSOP codes

Several points in relation to these plan type have been clarified or simplified to meet the context of self-certification. These include:

- A new 'purpose test' for SIPs, SAYE schemes and CSOPs, stating that the purpose must be to provide options (or shares, in the case of a SIP) to employees in accordance with the relevant schedule of the Income Tax (Earnings and Pensions) Act 2003 (or, in the case of a SIP, to provide employees with a continuing stake in the company), and a requirement that a plan may not provide benefits except in accordance with the schedule. This will also apply to existing plans if any amendments are made to them after 6 April 2014;
- An explicit prohibition on providing a cash alternative to shares;
- Confirmation that a SIP may require a leaver to sell his shares on cessation of employment, provided certain conditions relating to the price at which the shares can be purchased are met;
- Adjustments to SAYE or CSOP options following a variation of the company's share capital no longer need to be approved by HMRC.

4) Change of control for SAYE and CSOP

Where a company that has granted SAYE options is acquired by an unlisted company or a company that has granted CSOP options is acquired by any other company, under the current rules this is a 'disqualifying event' and the tax-advantaged treatment is lost if options are not exercised before the change of control or the granting company's shares do not remain listed.

Under the proposals, it will be possible to specify in the plan rules that options can be exercised within a period of seven days either before or after the change of control event without jeopardising the tax-advantaged status of the options. (If an option is exercised in anticipation of a change of control and this does not take place, the exercise will be treated as having no effect.)

The definition of a company event on which options can be exercised is clarified as including a non-UK company reorganisation arrangement.

5) Additional requirements for CSOP options

For CSOPs, there is a new requirement for the option to be

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capable of exercise at some time between the third and tenth anniversary of grant and to give the option-holder certain prescribed information about the option at the time of grant.

The terms of a CSOP may be amended after grant, but only on the basis of a mechanism notified to the option-holder at grant, which is based on fair and objective criteria or as provided for elsewhere in the CSOP legislation.

6) Changes to terminology

To reflect the shift from approval to self-certification, legislative references will now be to 'tax-advantaged' schemes rather than 'approved' plans. Instead of 'approved SIP/SAYE/CSOP', references will be to 'Schedule 2 SIP', 'Schedule 3 SAYE Option Scheme' and 'Schedule 4 CSOP Scheme'.

Timing

The proposed legislation will have effect from 6 April 2014.

The first new-form (online) annual returns will be due in respect of the 2014/15 tax year (i.e. will be due by 6 July 2015).

Our view

An earlier concern regarding self-certification was the consequence that if it later transpired that a plan did not meet the statutory conditions, the company was faced with awards being retrospectively treated as fully taxable. It is good news that under the revised draft legislation awards made before a closure notice will remain tax-advantaged, even if penalties may apply if HMRC enquire into the plan and find a breach.

It seems likely that we may see increased HMRC use of penalties for failure to file share plan returns correctly as the new provisions and online filing will make it easier for HMRC to impose them.

Some of the other clarifications and minor amendments (e.g. on a change of control for CSOPs and SAYE schemes) are welcome, as are the increases to the SIP and SAYE scheme limits announced in the Autumn Statement.

Source documents

Draft clauses and explanatory notes for Finance Bill 2014

Employee share schemes: Office of Tax Simplification recommendations

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Changes to unapproved employee share plans

The draft Finance Bill introduces a raft of simplification, and in some cases relaxation, measures applicable to non-tax advantaged employee share schemes. In addition, it is proposed that Form 42 must be submitted online except in certain limited circumstances.

The most wide-ranging changes concern the income tax treatment of share awards held by mobile employees and related corporation tax relief. The gross up charge under section 222 ITEPA 2003 is also relaxed slightly and rollover relief introduced for restricted and nil and partly paid shares.

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Who should read this?

Finance directors, CFOs, HR directors, reward directors, compensation and benefits directors, tax directors, reward advisers, any individual with responsibility for reward matters in their organisation.

Summary of proposal

1) Harmonisation of how share-based awards held by internationally mobile employees are sourced for income tax

Current position

In considering whether and to what extent employment income received by employees who are internationally mobile during a given period is within the charge to UK income tax, it is necessary to consider various different rules under ITEPA 2003 depending on the type of share award.

Proposal

The proposed new legislation seeks to harmonise the rules across the various forms of share awards. This is to be achieved by establishing rules around the relevant periods for each category of employment-related securities (ERS) charge and providing for apportionment within these relevant periods between amounts chargeable and not chargeable to UK income tax.

- The proposed new legislation will only apply where an individual meets the 'international mobility conditions'. These will generally be satisfied if the individual was not UK resident for any part of the relevant period or was UK resident but non-domiciled, taxable on the remittance basis and performing overseas duties.
- The 'relevant period' will depend on the type of award/ERS charging provision. For example, the relevant period in respect of restricted shares is the period commencing on the day the shares are acquired and ending on the day of the chargeable event (e.g. vesting). For securities options, it is generally the period from grant to vest. This is subject to a just and reasonable override.
- Income in respect of securities is treated as accruing equally on each day of the relevant period.
- If for any part of the relevant period, the individual is not UK resident and had no duties in the UK, the securities income earned on those days is 'unchargeable foreign securities income' and not subject to UK income tax.
- If for any part of the relevant period the individual is UK resident but non-domiciled and taxable on the remittance basis and, broadly, has either arrived in the UK within the last three years and satisfies the section 26A ITEPA 2003 requirement for a 3

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year qualifying period of non-residence; or has a foreign employer and performs duties wholly outside the UK (i.e. broadly would have been eligible for foreign securities income relief under the rules currently in Chapter 5A, Part 2, ITEPA 2003), the securities income earned on those non-UK workdays is 'chargeable foreign securities income' and so only subject to UK income tax on a remittance basis.

The existing section 421E and section 474 ITEPA 2003 (exclusions on residence) are removed. This means the restricted securities, convertible securities, securities option and special benefit rules are no longer limited to employees who were UK resident at grant. However, the restricted security legislation is amended so that only employees who were either UK resident or had UK duties at award can make restricted security elections. Importantly, a non-UK resident with UK duties will now need to consider whether to make a restricted security election to remove post-acquisition income tax charges. Employees with RSUs or securities options granted before coming to the UK will now be taxed under the securities options rules rather than the section 62 general earnings rules. This should reduce the scope of the Chapter 3C notional loan provisions. One issue is that it will remain necessary to consider whether an option or RSU has an employer right to cash settlement, which would take it outside Part 7 and mean the gain is treated as general earnings.

It is noted that the National Insurance contributions (NIC) position 'will be aligned as far as possible with the new income tax rules through secondary legislation' (not yet available).

2) Extension of deadline before a section 222 charge arises

Current position

Where an employee receives employment income in the form of shares (or other notional payment), the employer must account for the income tax to HMRC under PAYE where applicable. However, as it is not possible to deduct this amount directly from the shares, section 222 ITEPA 2003 provides that the employee must instead 'make good' the amount of the income tax to the employer within 90 days of the chargeable event. Failure to meet this deadline results in the outstanding amount being chargeable to income tax (and NIC).

Proposal

The proposed new legislation extends the deadline for the employee to make good the amount of income tax to the employer, to the date that is 90 days after the end of the tax year in which the chargeable event arises (that is, 6 July after the end of the tax year).

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3) Introduction of rollover relief in certain circumstances where restricted shares are exchanged for equivalent shares

Current position

Where restricted shares have been acquired (and no joint election has been entered into to disapply the restricted securities regime), an exchange of such securities for new securities (even those with similar restrictions) is treated like any other disposal. An income tax (and NIC) charge will therefore arise on the exchange (or further structuring is required to avoid this).

Proposal

Rollover of restricted securities

It will be possible to exchange restricted securities for new securities provided, broadly, that the market value of the new securities equates to the market value of the old securities.

If no election was made in respect of the original securities, it will not be permitted to make an election in respect of the new securities. The restrictions will continue to apply to the new securities as they would have done to the old securities.

To the extent that any election was made in respect of the old securities, the effect of the election will continue to apply to the new securities as it would have done to the old securities.

If no income tax arose on acquisition of the old securities on the basis that the securities were subject to a forfeiture restriction which falls away within five years (and no election was entered into) and those shares are exchanged for new forfeitable securities, no income tax will arise on the exchange.

If the new securities are not subject to a forfeiture provision, the original forfeiture provision will be treated as removed immediately following exchange (i.e. a chargeable event will occur at this point).

If the new securities are subject to a forfeiture provision, then if the period during which the new securities are subject to forfeiture has not expired before the fifth anniversary of the acquisition of the old securities, the period will be deemed to expire on this date and a chargeable event will immediately arise.

4) Simplification of notional loan rules for nil or partly paid shares

Current position

The sale of shares issued nil or partly paid or on terms where the purchase price is left outstanding can trigger an income tax and NIC charge on the basis that there is a deemed write-off of a notional loan. This usually means that shares have to be paid up before they are sold to avoid triggering the tax charge.

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Proposal

Where shares are sold and the purchaser assumes the liability to pay the outstanding purchase price, it is proposed that this will no longer trigger the tax charge under section 446U ITEPA 2003. This should make it easier to roll over awards under a deferred share plan when the company whose shares are used is taken over.

5) Extension of corporation tax relief on the acquisition of shares by employees

Current position

Corporation tax relief under Part 12, CTA 2009 is potentially available to UK companies when employees acquire shares, broadly on the amount on which the employee is subject to income tax. In order to qualify for this relief, certain conditions must be fulfilled relating to the company, the employee and the shares acquired.

One of the requirements is that the employee must be employed by a company within the charge to UK corporation tax at the relevant time. For shares acquired on the exercise of options, the relevant time is the date of grant of the option; for most other share acquisitions, it is when the shares are acquired by the employee.

This means that if an individual acquires shares while working for a UK company, but is not actually employed by the UK company (e.g. because he is on assignment), no relief is available to that company in respect of shares acquired by such individual. Other structuring then needs to be put in place (e.g. a recharge) to support a general principles deduction, which may not be available for the same amount.

In addition, if a company is acquired by another company, the statutory relief on the exercise of share options will cease to be available on the change of control if neither the target company nor the acquiring company has its shares listed on a recognised stock exchange.

Proposal

Internationally mobile employees

The proposed new legislation extends the availability of corporation tax relief to situations where an individual is working for a company within the charge to UK corporation tax (the 'host employer') but is in fact employed by an overseas company (the 'overseas employer'). The UK host employer will be treated as the individual's employer for the purposes of the relief and relief given for the amount of the gain that is subject to UK income tax.

If relief is available to more than one host employer in respect of a share acquisition, relief may only be given to one such host employer.

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Takeovers

Under the proposed new legislation, where a company would have qualified for the corporation tax relief before a takeover, relief will be available on the exercise of share options provided that the employee acquires shares within 90 days beginning on the date of the takeover.

6) Replacement of the current method of calculating market value of listed securities with a single method based on closing price of the securities on the relevant trading day

Current position

For tax purposes, the market value of shares listed on the Official List may be calculated using either:

- The lower of the two prices shown in the quotations for the securities in the Stock Exchange Daily Official List on the relevant date plus one-quarter of the difference between those two figures; or
- Halfway between the highest and lowers prices at which bargains, other than bargains done at special prices, were recorded in the securities for the relevant date.

Proposal

The above two methods are to be replaced with a single method based on the closing price of the securities on the relevant trading day.

7) Online filing of Form 42

Current position

All annual returns must be made on paper.

Proposal

Form 42 must generally be submitted online. This will apply for tax year 2014/15 onwards so the first online filing deadline will be 6 July 2015.

Timing

The changes for share-based awards held by internationally mobile employees and extension of corporation tax relief in respect of overseas employees: grants and awards made on or after 1 September 2014.

Extension of deadline before a section 222 charge arises: 6 April 2014

All other changes: the date that Finance Bill 2014 receives Royal Assent (likely to be July 2014).

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Our view

All of the measures are to be broadly welcomed, in particular the simplification of the income tax rules on internationally mobile employees and consequent extension to corporation tax relief and rollover relief for restricted securities or securities acquired at an undervalue.

Although the penal section 222 charge has not been abolished, the proposed extension to the deadline will help somewhat, although many companies that inadvertently fail to recover the income tax due on share awards from employees will probably not benefit from the new deadline, particularly where the error occurs towards the end of the tax year.

The changes on the income tax treatment of internationally mobile employees should be simpler for companies to understand and apply, although they will need to make the transition to the new rules and there are some losers (e.g. employees holding 'legal options' coming to the UK).

Aligning the NIC position to the new income tax position could prove more challenging/problematic given the international context, e.g. EEA/reciprocal agreement/other countries and certificates of coverage and the possibility of conflict with social security rules in other countries.

Source documents

Draft clauses and explanatory notes for Finance Bill 2014

Unapproved employee share schemes: Office of Tax Simplification recommendations

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Beneficial loans: Increase in small loans exemption from £5,000 to £10,000

Employers can provide employees with cheap or interest-free loans without generating a taxable benefit if the total outstanding balance on all loans does not exceed £5,000 at any point in the tax year. As of 6 April 2014 this limit will be raised to £10,000.

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Who should read this?

Employers who provide cheap or interest-free loan loans to their employee, and the employees themselves.

Summary of proposal

Employers who provide their employees with cheap or interest-free loans do not currently confer a taxable benefit on the employee where the total of all such loans does not exceed £5,000 at any point in the tax year.

This limit will increase to £10,000 on and after 6 April 2014. Accordingly, employers will no longer be required to report details of such loans where the outstanding balance is £10,000 or less throughout the tax year.

Timing

6 April 2014

Our view

Many employers use the £5,000 threshold to exempt the benefit of interest-free season ticket loans. In this respect, and given the costs of rail travel these days, it is encouraging to see an increase in the threshold so as to cover season ticket loans up to and including £10,000.

Source documents

Overview of legislation in draft

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Tax exemption for employer expenditure on recommended medical treatment

The Government is proposing to introduce a new measure from Autumn 2014 to exempt any benefit in kind or payment of earnings where the employer meets the costs of recommended medical treatment which enables the employee to return to work following a period of absence. This exemption will be capped at £500 per annum

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Who should read this?

Employers who currently pay for medical treatment or are considering providing this in the future.

Summary of proposal

Following an announcement in the 2013 Budget and an informal consultation that took place in the summer 2013, the Government has now published responses to this consultation and the proposed next steps.

Under current legislation, medical treatment is generally chargeable to tax and Class 1 (cash reimbursement) or Class 1 A NIC (benefit in kind) and is reportable on forms P11D. The proposed introduction of this exemption would mean that employers can, without a tax/NIC charge (or reporting obligation) arising,:

- Reimburse employees for the first £500 of costs; or
- Provide employees with medical treatment up to £500.

However, it will be important to realise that only certain medical treatment will qualify for the exemption. In short, qualifying medical treatment will be as follows:

- The medical treatment must be recommended by the new Health & Work service or an occupational health service provided or arranged by the employer; and
- It must be provided with the purpose of helping an employee return to work after a period of absence due to injury/ill health.

Further qualifying conditions are likely to be set out by HM Treasury in regulations.

The introduction of this arrangement will support the Government's aim to widen access to occupational health services and engage employers with the wellbeing of all their employees.

An amendment will be made to the Social Security (Contributions) Regulations 2001 after the Finance Bill 2104 receives Royal Assent to ensure the tax exempt amount will also be free from a charge to National Insurance.

Timing

At a date to be set out in a Treasury Order (which is expected to be in Autumn 2014).

Our view

Many employees will have been surprised that such medical treatment could have been considered a taxable benefit. Some employers who have provided such treatment will have paid the tax due on the employee's behalf.

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Source documents

Implementation of a tax exemption for employer expenditure on health-related interventions recommended by the new health and work assessment and advisory service

Overview of Legislation in Draft

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Tax incentives for employee ownership trusts

From 6 April 2014, new legislation will:

- provide relief from capital gains tax (CGT) on disposals of shares in a trading company (or a holding company of a trading group) to a special trust which is operated on an 'all employee' basis, provided the trust holds a controlling interest in the company and various other requirements are met; and
- provide a number of inheritance tax reliefs for qualifying employee ownership trusts.

Additionally, from 1 October 2014, bonus payments made to employees of a company or group controlled by a qualifying trust will be exempt from income tax up to a cap of £3,600 in a tax year. Again there are various detailed requirements.

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Who should read this?

Likely to be of limited application but of interest to anyone involved with a company or group where a majority of the shares are held in a trust for the benefit of employees (or anyone considering creating such a structure).

Summary of proposal

CGT relief

Under legislation to be introduced in Finance Bill 2014, a disposal of shares to a qualifying trust for the benefit of employees of a company or group may be wholly relieved from CGT if the following criteria are met:

- the company whose shares are disposed of must be a trading company, or the parent company of a trading group;
- the trust which acquires the shares must be operated on an all employee basis;
- the trust must have a controlling interest in the company at the end of the tax year, which it did not have at the start of that year;
- certain participators must be excluded from being beneficiaries of the trust (broadly, 5% participators) and the trust can have no power to make loans to participators and must meet certain other criteria; and
- the claimant must not previously have qualified for relief on the same company's shares.

There are a number of other detailed requirements and anti-avoidance provisions.

Income tax relief

An indirectly employee-owned company or group (i.e. where a majority of the shares are held in a special employee trust and the other control tests are met) can pay a bonus of up to £3,600 per year to employees. The bonus needs to be paid on an all employee basis, although there is some flexibility to vary the level of bonus by reference to salary, length of service or hours worked.

The Government is currently considering how to ensure that existing employee benefit trusts (EBTs) set up for the purpose of employee ownership do not need to amend their deeds or resettle their assets into a new trust in order for the tax exemptions and relief to be available. Further guidance will be published on this in 2014.

Employers will still be potentially entitled to claim a corporation tax deduction for the employee bonus, even though this is exempt from income tax.

The aim of the measures is to provide incentives for growth of the

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employee-ownership sector by increasing the attractiveness of indirect employee ownership structures for businesses.

Timing

6 April 2014 (CGT and IHT) and 1 October 2014 (income tax).

Our view

We believe that this proposal will be of interest to a relatively limited number of companies. The tax incentives will, however, be attractive to those who operate or are considering such indirect employee ownership models which the Government and others are keen to encourage.

Source documents

Supporting the employee-ownership sector – summary of responses

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Corporation tax: amending loss relief provisions

The rules restricting the availability of losses where there is a change in ownership of a company will be relaxed in two ways. First, the insertion of a new group holding company will no longer bring about a change in ownership. Second, a 'significant increase in capital' will only occur where capital after the change in ownership exceeds capital before the change by both £1 million and 25%.

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Who should read this?

Groups contemplating the insertion of a new holding company or the acquisition of companies with non-trading losses carried forward.

Summary of proposal

New section 724A CTA 2010 (Disregard of change in parent company) will be inserted. The insertion of a new group holding company is disregarded provided detailed conditions are met. In summary:

1. The new holding company must possess all the voting power in the old holding company and be beneficially entitled to 100% of its distributable profits and assets on a winding up.
2. Pre-acquisition, the new holding company must not have issued any shares other than subscriber shares or begun to carry on or make preparations for carrying on any trade or business.
3. The consideration for the acquisition of the old holding company must consist solely of shares in the new holding company and the new holding company's share capital post acquisition must be a 'mirror image' of the old holding company's share capital pre-acquisition.

Section 688 CTA 2010 (Meaning of 'significant increase in the amount of a company's capital') is amended. There is a significant increase in the amount of a company's capital if the post change amount (a) exceeds the pre-change amount by at least £1 million, and, (b) is at least 125% of the pre-change amount.

Timing

The amendments will have effect in relation to any change of ownership which occurs on or after 1 April 2014.

Our view

It is a refreshing change to see anti-avoidance measures being relaxed in a pragmatic way. The lack of an exception for the insertion of a new group holding company has long caused anxiety whilst the insignificant level at which a 'significant increase in capital' arose made that measure particularly draconian.

Source documents

Overview of Legislation in Draft – para 1.37 and A71 to A72

Corporation tax: amending loss relief provisions

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Modernising the taxation of corporate debt and derivatives

In June 2013, HMRC commenced a consultation exercise on modernising the taxation of corporate debt and derivatives aimed at reviewing and updating the rules to make them simpler and clearer and at the same time more robust against avoidance. A summary of responses to the consultation document has been published alongside the draft Finance Bill which provides an update on HMRC's thinking. It is to be welcomed that HMRC are taking time to properly consider the responses to the proposals and are approaching the consultation in a collaborative manner.

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Who should read this?

Companies undertaking financing transactions or entering into derivative contracts should be mindful that the accounting treatment may change in the future as a result of the replacement of UK GAAP accounting and that the tax rules may be revised for certain niche areas (partnerships, bond funds) in Finance Bill 2014 and more generally in Finance Bill 2015.

Summary of proposal

Amendments are to be made in Finance Bill 2014 to the following rules:

- Partnerships – The intention here is to retain the current approach but consolidate the existing rules so that each partner is treated as being a party to a share of the partnership loans and derivative contracts.
- Bond funds – Changes are to be made to deal with avoidance issues and the operation of the test for identifying a bond fund.

Other changes, when finalised, are expected to be made in Finance Bill 2015. As a result of the consultation to date, there has been some narrowing of the options under consideration and the intention is to continue to consult with interested parties.

Originally, it had been intended that there would be some amendments to the unallowable purposes rule in Finance Bill 2014. However, it is recognised that it would be preferable to consider these together with the main changes and so any amendments to the unallowable purposes rule will now be deferred until Finance Bill 2015.

Consideration is being given to making changes to ease the transition to new GAAP accounting standards. The areas to be covered include foreign exchange movements on loans treated as permanent as equity, the elections to modify the effect of the Disregard regulations and to update statutory references in secondary legislation following the rewrite of the loan relationship rules into CTA 2009. In addition, HMRC will publish guidance to help businesses to identify significant tax differences that may arise under new UK GAAP.

Timing

The changes to the partnership and bond fund rules are to be made in Finance Bill 2014. The proposed legislation was not published with the rest of the draft Finance Bill but HMRC's summary of responses document indicates that the changes are expected to apply ahead of new UK GAAP accounting changes scheduled for 2015.

Other changes are expected to be made in Finance Bill 2015 and HMRC's summary of responses document indicates that the majority of changes proposed are expected to have effect in

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respect of periods commencing on or after 1 January 2016 at the earliest. Also, transitional measures including appropriate grandfathering of existing instruments are proposed.

Our view

This is very much an interim update on a continuing consultation process. It is to be welcomed that HMRC are taking time to properly consider the responses to the proposals and are approaching the consultation in a collaborative manner. For example, we welcome the decision to allow more time for consultation on key areas such as the unallowable purpose rule as it allows the rules to take into account the entire regime before the end of the process. Also to be welcomed is the engagement to work with business to ease the transition to new UK GAAP.

Source documents

Modernising the taxation of corporate debt and derivative contracts – summary of responses December 2013

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Changes to the controlled foreign company finance company exemption

Two changes are being made to the controlled foreign company (CFC) finance company exemption: the first to prevent the exemption applying to a loan if it is connected with an arrangement that has a main purpose of artificially diverting into a CFC profits that are currently received by a UK group company and the second to tighten existing rules which prevent the exemption applying to a loan when an external debt of a non-UK group company is repaid and effectively replaced with a new UK debt.

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Who should read this?

Any company that is considering using a CFC for holding or making loans to other non-UK resident group companies with the intention of benefiting from the CFC finance company exemption.

Summary of proposal

The new CFC rules in Part 9A TIOPA 2010 include a partial or, in certain cases, full exemption for non-trading finance profits arising on a loan from a CFC to another group company ('qualifying loan relationship' or QLR). In order to qualify for the exemption a loan must inter alia not fall within any of the exclusions in s371IH TIOPA 2010. Two changes will be introduced in Finance Bill 2014 in relation to these exclusions:

1. A new exclusion will prevent a loan made by a CFC from being a QLR if it arises as a result of any arrangement which has a main purpose of transferring out of the UK profits from a loan made by a UK resident group company to a non-UK resident group company. This change is aimed at preventing the reduction of UK profits from existing loans to non-UK group companies using a CFC benefiting from the CFC finance company exemption.
2. An existing exclusion prevents a loan made by a CFC from being a QLR where it is used wholly or mainly to repay external debt of a non-UK group company and that debt is effectively replaced with a new UK debt, as part of an arrangement which has a main purpose of obtaining a UK tax advantage for any person. The exclusion will now apply where the loan from the CFC is used to any extent, other than a negligible one, to repay the external debt of a non-UK group company.

Timing

The first change will apply where a relevant arrangement is made on or after 5 December 2013.

The other change has effect for CFC accounting periods beginning on or after 5 December 2013. Accounting periods which straddle that date must be split into two periods, with the profits arising in the period after 5 December 2013 on a loan which falls within the amended exclusion not benefiting from the exemption.

Our view

The first change is aimed at preventing the reduction of UK profits from existing loans to non-UK resident group companies ('foreign loans') using a CFC benefiting from the CFC finance company exemption. The new provision could potentially apply where an existing foreign loan is transferred out of the UK to a CFC (an example of this is included in the Explanatory Note), where a new loan is made by a CFC to a UK resident group company to allow it to acquire an existing foreign loan from another UK group company and where a CFC makes a new loan to a non-UK resident company

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to allow it to repay an existing loan from a UK group company. Where the provision does apply, the loan transferred to or made by the CFC will not benefit from the CFC finance company exemption. The overall effect is that the profits from such a loan will be subject to a full CFC charge so that there is no change in the amount of UK tax paid.

Groups that are considering establishing an overseas group finance company structure should consider whether this provision could impact on the availability of the CFC finance company exemption to any loans that are either being transferred to, or made by, the CFC. In addition, groups considering implementing other cross-border finance structures using a CFC finance company as a comparator should consider the impact for the purposes of the arbitrage rules in Part 6 TIOPA 2010.

The other change is aimed at circumstances where a CFC makes a larger intra-group loan and only a minority of the total amount of the loan is used to repay the external debt of a non-UK group company and that external debt is effectively replaced with a new UK debt, as part of an arrangement which has a main purpose of obtaining a UK tax advantage for any person.

Source documents

Overview of Legislation in Draft – para 1.38 and A73 to A74

Controlled foreign companies: profit shifting

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VAT: place of supply and the introduction of the Mini-One Stop Shop

From 1 January 2015, broadcasting, telecommunications and e-services (BTE) supplied to EU non-business customers will be subject to VAT where the customer belongs.

A Mini-One Stop Shop simplification scheme will be implemented, allowing suppliers to account for VAT due on all EU supplies of BTE services on a single VAT Return.

Agency rules will be affected by these changes, requiring the UK to amend its legislation.

Non-taxable legal persons will be established according to where their central functions are carried out or where they have a relevant establishment.

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Who should read this?

Suppliers (both EU and non EU) of BTE will want to read this measure to understand how to account for VAT on supplies to EU non-business customers.

Intermediaries operating e-service marketplaces as a platform in the supply of telecoms or e-services will also need to understand how this will affect their EU tax obligations.

Certain organisations, for example, such as research institutes, educational establishments and some universities (i.e. non-taxable legal persons) may be interested to understand how their place of establishment will be determined according to where their central functions are carried out or where they have a relevant establishment.

Summary of proposal

This measure is the UK's adoption of the final part of the 'VAT package'; a series of changes which have been implemented in stages since they were unanimously agreed by EU Member States in 2008.

This measure will change the place where VAT is accounted for from the current rule (where the supplier belongs), to the new rule (where the customer belongs) for intra-EU supplies of BTE to non-business customers. The measure includes a draft Statutory Instrument proposing that this change is applied to Part 3, Sch 4A VATA1994.

To remove a potential avoidance opportunity, the measure also includes a change to non-taxable legal persons' place of belonging. This will become where their central functions are carried out or where they have a relevant establishment, rather than where they are legally constituted. This proposed revision will be implemented via secondary legislation to amend Para 15, Sch 4A VATA 1994.

In an effort to ensure that small e-services developers are not impacted heavily by the changes, the new rules aim to make electronic marketplaces and App stores responsible for VAT where such services are sold through their platforms. In order to implement the new rules around who is responsible for the VAT in these scenarios, the UK must amend its agency VAT legislation. The UK currently derogates from the EU VAT legislation, allowing agents acting in their own name on behalf of another to choose how to treat supplies of services. In order to implement the new rules, the UK must disapply this derogation at s47, VATA 1994 in respect of telecommunications and e-services.

The new place of supply rule change could have a significant impact on administration costs for BTE suppliers with a potential obligation to account for VAT in up to 28 Member States. In order to mitigate this, a simplification scheme called the Mini-One Stop Shop (MOSS) will be implemented across the EU. Under the

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MOSS, suppliers have the option to register in just one Member State and account for the VAT due on all EU supplies of BTE services to non-business customers on a single electronic MOSS VAT Return (except for sales in Member States where the supplier has a fixed establishment). The scheme has different rules for EU and non-EU suppliers; the 'Union scheme' for EU suppliers, and the 'non-Union scheme' for non-EU suppliers. The non-Union scheme will replace the current VAT on Electronic Services (VoES) scheme. The new rules in relation to these schemes will be inserted at Sch 3BA VATA 1994.

Timing

Changes take effect on 1 January 2015. Businesses can submit a request to register for the UK MOSS from 1 October 2014.

Our view

Currently, intra-EU supplies of BTE services to private persons are taxed where the business supplier is established. At the time of writing, the standard VAT rates in the 28 EU Member States vary from 15 to 27%, so a business could gain an advantage by being established in a lower VAT rate jurisdiction. This is exactly what the EU Member States are trying to overcome with these changes so that, from 2015, non-business customers will be taxed according to the VAT rate in their home country. For UK customers, this means they will pay UK VAT on their purchases of BTE services, no matter where the supplier of those services belongs.

The MOSS will be an easement for some, but will not necessarily be the best option for all suppliers. Businesses will need to consider the administration of submitting multiple VAT returns against the requirements of MOSS. For example, MOSS returns must be submitted and paid within 20 days of the last day of the reporting period, a relatively short timeframe, and in some cases records must be kept for a minimum of 10 years.

Disapplying the UK derogation for agents acting in their own name in respect of telecommunications and e-services will benefit certain suppliers of these services, such as small software developers, by pushing the VAT responsibilities onto the large e-service marketplaces and App stores. As these platforms usually work on a commission per sale basis, suppliers will need to be aware of their contractual arrangements to ensure they understand how commission will be calculated in relation to pre or post tax revenue.

Source documents

VAT: place of supply and the introduction of the Mini-One Stop Shop

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Remote gambling taxation reform

This proposal will impact online gambling firms that are located offshore. Historically, such operators have generally not been required to account for UK betting duties because the taxation regime was based on where the supplier is established. From 1 December 2014, the rules for determining whether UK duty is due will be determined by the place of consumption i.e. duty will become due on bets placed by UK customers.

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Who should read this?

This will be of significant interest within the gambling industry particularly those operators who are currently established outside the UK but have a significant UK customer base.

Summary of proposal

Remote Gambling is gambling where the customer participates by internet, telephone, television or other similar methods. The determining factor for whether duty is due is the extent to which the bookmaker or operator is established in the UK. For remote gambling this includes whether the operator has remote gambling equipment in the UK. This has led to the current situation where UK established operators are liable to 15 percent remote gaming duty. In contrast competitors, some of which have moved from the UK, can supply similar services to UK customers without having to account for duty.

The draft legislation makes a variety of changes to the Betting and Gaming Duties Act 1981 (BGDA) so that duty is due when a bet is made by a UK person. Essentially this switches the duty to a place of consumption basis – this means remote gambling operators accepting bets from a UK person will be liable to duty in the UK regardless of where they are based.

A new section 32B is to be inserted into the BGDA which defines a UK person. For individuals this is an individual who usually lives in the UK. The proposal also inserts a new Schedule which concerns suspension and revocation of Remote Operating Licences (ROL). This provides that where a ROL holder breaches certain tax trigger points and fails to rectify them, HMRC will initiate a process that will require the Gambling Commission to suspend an operator's ROL.

Timing

The measure will have effect from 1 December 2014.

Our view

Ever since the announcement of the reform in Budget 2012, the Government has been working closely with the industry. One of the biggest concerns has been around how to determine the place of consumption. For example there was a suggestion that this could be on a bet by bet basis. However the proposed legislation uses the 'usually lives test' which is administratively simpler. The other remaining concern is enforcement i.e. ensuring overseas operators with UK customers register and comply. To encourage compliance there were calls for a reduction in duty from 15% but the Government has kept the rate of duty rate firmly outside the scope of the reform.

Source documents

Remote gambling taxation reform

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Measures of particular interest to specific groups

Simplification of IHT for Trusts

Some of the simplification measures proposed in previous consultation documents are included in the Draft Finance Bill clauses although in a modified form – the simplification of the reporting regime for trust (Inheritance tax) IHT returns by aligning the return filing and tax payment dates for exit and periodic charges, and legislation to clarify the IHT treatment of undistributed income. This should make these areas clearer. However, changes to the calculation of the amounts of IHT due on exit and periodic charges will continue to be subject to consultation and are not included in the Draft Finance Bill.

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Who should read this?

Trustees, trust accountants, other professional and legal advisers who advise on trusts, and those with or considering setting up relevant property trusts.

Summary of proposal

Changing IHT return filing and tax payment dates for exit and periodic trust charges

The due date for the submission of IHT forms declaring exit or periodic (10 year) charges is to be shortened to six months following the end of the month in which the relevant event occurs. The tax payable will also become due at the same time. These changes will only apply to 10 year and exit charges and not to other chargeable events, for example entry charges or on a person's death.

The existing time limit for filing the majority of trust IHT forms is 12 months from the end of the month of the event. For relevant events between 6 April and 30 September the payment date is 30 April the following year. For events between 1 October and 5 April the payment date is six months after the end of the month in which the event took place. This leads to various filing and payment dates that are complicated to work out and in some cases the due date for payment falls before the due date for filing the IHT form. The new measure aligns the return filing and tax payment dates.

Income that may be accumulated

The Draft Finance Bill provides that where trustees have the power or duty to accumulate income, coupled with a power to distribute income, and income arising in a trust remains undistributed (and is not formally accumulated) for more than five years, that income will also be deemed to have been accumulated to capital for the purposes of the 10 year charge only. No reduction in the rate of the IHT charge on such income will be given, unlike other added property that has not been relevant property for the full 10 years. If such income is subsequently distributed it will not be subject to the exit charge regime.

Currently where income is regularly or formally accumulated to capital then this will generally be relevant trust property and taken into account for IHT trust charges. However, where trustees have not formally accumulated income arising in the trust but have the power to accumulate, coupled with a power to distribute, income it is difficult to establish whether and when any undistributed income has effectively been accumulated and thus subject to IHT. The new measure clarifies the position, in a manner broadly favourable to HMRC.

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Simplification of Trust Charges

HMRC previous consultation document on the simplification of trust charges suggested some changes to the way in which the rate of tax which applies on exits and 10 year charges is calculated and how the nil rate band should be used. It was suggested historic information such as the settlor's previous IHT history would no longer be required, that the nil rate band would be shared by all relevant property trusts created by the same settlor and the rate of tax to apply, subject to a proportionate reduction for periods of less than 10 years, would be 6%.

The Government has decided to continue to consult on these changes before bringing forward legislation.

Timing

The new rules for the treatment of undistributed income and the deadlines for filing returns and the payment of IHT will take effect from 6 April 2014. The changes to the calculations of the IHT are expected in 2015 following further consultation.

Our view

The IHT regime for exit and 10 year charges can be difficult to navigate and the calculations of the tax due can be complex. It is welcome that some steps are being taken to make this regime simpler, but as it stands the changes in the Draft Finance Bill are unlikely to make the position much easier for trustees and their advisers. The previous consultation document suggested that the return and payment dates might be aligned with those for the self-assessment cycle. The Draft Finance Bill doesn't go this far and in fact shortens the period of time after the event in which the trustees will need to file their return and pay the IHT. The impact might have been more straightforward for some if dates had been aligned more closely with the self-assessment cycle and this might be seen as an opportunity missed to ease the compliance burden on trustees, perhaps in conjunction with the introduction of online services for IHT in 2015/16, as announced in the Autumn Statement. The shortened period for making the return and tax payment after a relevant event may result in deadlines being missed especially if matters are not dealt with until after the end of the tax year.

The Draft Finance Bill clauses clarify the treatment of unaccumulated and undistributed income. However deeming such income to become capital after five years, whilst longer than the two years originally proposed, could still be too short a period of time in some circumstances and is at odds with the underlying legal position for trust purposes. Trustees with the relevant powers may need to consider their distribution policy.

It is welcome that the Government will continue to consult on the calculation of the IHT on trusts. While the previous consultation

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document proposals would simplify compliance in more straightforward circumstances, they could add to complexity in other situations.

Source documents

Inheritance tax: simplifying charges on trusts: consultation outcome

Autumn Statement documents

Inheritance tax: simplifying charges on trusts

Inheritance Tax: Simplification of trust charges – the next stage

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Banking tax

The full rate of the Bank Levy is to increase to 0.156% from 1 January 2014 and changes intended to broaden the base of the Levy will come into effect from 1 January 2014 and 1 January 2015. Banks will not be surprised to see yet another increase in the rate of the Bank Levy. The outcome of the Bank Levy consultation is broadly as expected with HMRC sensibly concluding that only modest change is warranted.

A helpful change is also proposed to exempt debt releases that occur in a bank resolution.

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Who should read this?

Banks and other firms subject to the Bank Levy.

Summary of proposal

Bank Levy

The full rate of Bank Levy is to increase to 0.156%, rather than 0.142% as previously announced. A proportionate increase to 0.078% in the half-rate applicable to long term chargeable equity and liabilities will be made at the same time.

Following a consultation over the summer, the Government is proposing a number of relatively minor changes to the detailed operation of the Bank Levy:

a) The exclusion for protected deposits will be limited to the amount of the deposit protected under the scheme rather than the amount on which the deposit protection scheme premium or fee is calculated.

b) The treatment of high quality liquid assets will be amended so as to effectively restrict the rate of relief to the half-rate.

c) Derivative contract liabilities will be treated as short term (and hence chargeable at the full rate) regardless of the actual contractual maturity.

d) The definition of Tier 1 capital will be amended to reflect the introduction of Capital Requirements Directive 4 (CRD 4). Additional Tier 1 capital will be an excluded liability for Bank Levy purposes

e) The ability of HM Treasury to amend the Bank Levy regime by regulation in consequence of regulatory change is to be broadened.

f) Liabilities in respect of collateral that banks have passed on to a central counterparty, authorised or recognised under European Markets Infrastructure Regulations, are to be excluded for Bank Levy purposes.

Release of debts in resolution.

Unrelated to the Bank Levy, the Government is proposing, as announced on 26 November 2013, to extend the corporation tax exemption for credits arising on certain debt releases to cases where the release is in consequence of the exercise of a stabilisation power under part 1 of the Banking Act 2009.

Timing

The increase in the Bank Levy rates will take effect from 1 January 2014.

As with previous increases in the Bank Levy, transitional provisions are to apply such that the change in rate should be ignored for the purposes of calculating any instalment payments due prior to Royal

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Assent. An adjustment amount equal to the additional tax that would have been payable prior to Royal Assent in the absence of these transitional rules is instead added to the first instalment for the period concerned which is due after Royal Assent. If there is no such instalment then the additional tax is treated as falling due 30 days after Royal Assent.

The changes to the definition of Tier 1 capital and the treatment of client clearing liabilities for the purposes of the Bank Levy should take effect from 1 January 2014. The remaining amendments to the operation of the Levy should take effect from 1 January 2015.

The new exemption for debt releases in consequence of the exercise of stabilisation powers is to take effect from the date on which the measure was announced, 26 November 2013.

Our view

In publishing the draft legislation to give effect to the various Bank Levy changes, HMRC have noted that the Government has consistently stated an intention to raise at least £2.5 billion annually from the Levy. The OBR forecasts published in conjunction with the Autumn Statement actually show the amounts generated stabilising at £2.9 billion from 2015/16 suggesting that this, rather than £2.5 billion, is now the Government's long-term target.

This round of rate raises will take the Bank Levy to over three times the rate that applied when it was originally introduced in 2011. This is attributable not only to an increase in the amount that the Government hope to raise from the Bank Levy, but to the amount which has been raised being consistently lower than expected. Even with the increased rates and the broadening of the scope of the Bank Levy, the OBR are now showing the £2.9 billion target being achieved a year later than was predicted in March.

The Bank Levy is calculated as a percentage of banks' balance sheets. It is therefore not surprising that as balance sheets shrink, the revenues generated by the Bank Levy have fallen below the levels originally forecast.

The exemption for credits arising to financial institutions on debt releases in the course of resolution by the Bank of England is a welcome measure. The imposition of a tax charge in such circumstances would potentially undermine the effectiveness of the resolution process and the exemption is therefore in line with the Government's broader policy in this area. As it stands, however, the proposed exemption may be too narrowly drawn. This is because in practice an institution would be expected to seek to take action before any application of the stabilisation powers and therefore be unable to benefit from the exemption as proposed.

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Source documents

Overview of Legislation in Draft – paras 1.27 to 1.28 and 1.43 and A52 to A57 and A82 to A83

Bank levy 2014 rate change

Bank levy review

Bank Levy Review 2013 response document

Loan relationships: release of debts: financial institutions in resolution

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Investment Management Tax Measures

The draft Finance Bill 2014 includes several important measures for the Investment Management industry, including the repeal of Schedule 19 SDRT and an extension of existing provisions to allow non-UK AIFs to be managed from the UK without the fund becoming UK tax resident. However a number of anti-avoidance measures will be introduced, including changes to the taxation of partnerships, new measures to prevent the abuse of the 'bond fund' rules and measures to prevent the use by VCTs of converted share premium accounts to make tax-free payments to their investors.

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Who should read this?

These changes are relevant to managers of both traditional and alternative investment funds.

Summary of proposal

Schedule 19 SDRT and other stamp duty changes

Finance Bill 2014 will contain legislation to abolish the 0.5% Stamp Duty Reserve Tax (SDRT) which applies on the surrender of units in unit trusts and shares in open-ended investment companies. Schedule 19 SDRT is currently a significant compliance and cost burden for investment managers. The change will take effect from 30 March 2014.

Legislation will also be introduced in Finance Bill 2014 to abolish stamp duty and SDRT on transfers of listed securities on a 'recognised growth market', which shall include both the Alternative Investment Market (AIM) and the ICAP Securities & Derivatives Exchange (ISDX). These measures will take effect from 28 April 2014. Operators of eligible markets have been invited to apply for recognition.

The Autumn Statement also announced that from April 2014 the stamp duty and SDRT charge on purchases of shares in Exchange Traded Funds (ETFs) that would apply if the ETF were domiciled in the UK will be removed. The announcement to abolish stamp duty on transactions in ETFs will enable the establishment of such funds in the UK and should invigorate the UK market in ETFs, which to date have largely been domiciled offshore.

Management of non-UK AIFs

One of the long running concerns of the UK funds industry has been that where a UK manager manages an offshore fund, that fund could become UK tax resident due to the activities of the manager. There is currently an exemption for offshore funds that are Undertakings for Collective Investment in Transferable Securities (UCITS) to allow for management company passporting under the UCITS IV Directive. However the current law does not extend to other types of offshore funds. Finance Bill 2014 introduces measures with effect from 5 December 2014 to extend the existing exemption to include all non-UK Alternative Investment Funds (AIFs). Importantly, by extending the definition to non-UK AIFs this will now cover closed-end vehicles and umbrella funds that may not otherwise have fallen within the definition of an offshore fund. There is also no longer a requirement for a UK AIF manager (AIFM) as originally proposed in the consultation document issued by HMRC earlier this year. This is a welcome change as it provides certainty to self managed AIFs and branches of non-EU AIFMs carrying out management functions.

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Taxation of Partnerships

Finance Bill 2014 will also introduce significant measures to counter tax driven allocation of partnership profits and disguised employment arrangements. Legislation will also be introduced for income that is required to be deferred under the EU AIFM Directive to be taxed at the level of the partnership. There is further commentary on this issue in the article above on partnerships *(Partnerships Review: Alternative investment fund managers)*.

Corporate debt consultation and 'bond fund' rules

The Chancellor announced in the Autumn Statement that as a result of the recent HMRC consultation on corporate debt and derivative contracts, legislation will be introduced in Finance Bill 2014 to enhance existing anti-avoidance provisions and prevent the abuse of the 'bond fund' rules. This legislation will also permit corporate investors to disapply the bond fund rules in certain prescribed cases. There is further commentary on this issue in the article above on *Modernising the taxation of corporate debt and derivatives*.

Venture Capital Trusts (VCTs)

HM Treasury and HMRC published a separate document on 10 December 2013 summarising the responses received in connection with the VCT share buy-backs consultation (please see the separate section in this document regarding VCT share buy-backs).

That consultation document had also raised concerns regarding the use by VCTs of converted share premium accounts to make tax-free payments to their investors. The Government views such payments as more akin to a return of capital than a 'true' dividend and is concerned that a VCT is currently able to convert its share premium account to distributable reserves and return funds to its investors tax-free during the minimum holding period. The Government is further concerned that returning funds to investors in this manner reduces the cash that a VCT has available to invest in SMEs and that VCTs are potentially able to return capital before having made any qualifying investments.

Therefore, the Government has announced its intention to amend the VCT legislation to address these concerns. No draft legislation on this matter has yet been published as technical workshops will be held to consult on appropriate solutions. However, the document published on 10 December 2013 contains three possible options:

- A company losing its VCT status if capital is returned before at least 70% of the funds raised have been invested in qualifying holdings;
- Treating distributions from converted share premium accounts

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of VCTs as taxable amounts for the recipient; or

- Limiting the level of distributions payable by VCTs from converted share premium accounts.

It is intended that legislation will be included in Finance Bill 2014 to address this issue.

Timing

The measures above are all due to be introduced in Finance Bill 2014. The abolition of stamp duty/SDRT on transactions in securities listed on recognised growth markets and Schedule 19 SDRT will take place prior to Royal Assent – from 28 April 2014 and 30 March 2014, respectively. Draft legislation has yet to be released in relation to the stamp duty measures for ETFs or the changes to the bond fund rules, however these are also likely to be in Finance Bill 2014. The abolition of stamp duty/SDRT on transactions in ETFs is expected to take effect from April 2014.

Our view

A number of the measures to be included in Finance Bill 2014 were initially presented in the Government's **Investment Management Strategy** and are intended to preserve and enhance the UK's position as a leading global investment management centre. The repeal of Schedule 19 SDRT will remove significant complexity for managers and is a clear signal that HM Treasury is committed to enhancing the marketability of UK funds. Similarly the announcement in the Autumn Statement to remove stamp duty and SDRT on UK ETFs may provide impetus to create an ETF market in the UK, which to date has largely been offshore.

However whilst the Government has taken steps to promote UK funds, they have also sought to crack down on planning arrangements that they consider to be abusive, most notably in relation to the allocation of partnership profits to corporate members and disguising employment relationships within partnership structures. These changes are unlikely to trouble most large traditional fund managers, but could be a significant burden to alternative fund managers and hedge funds which are structured as partnerships.

Source documents

Overview of Legislation in Draft – paras 1.41, 1.44 and 1.45 and A80 to A81 and A84 to A87

Schedule 19 SDRT

Abolition of stamp duty and stamp duty reserve tax on growth market shares

Asset management: offshore non-UCITS funds

Venture Capital Trusts

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Institutional Investor status of Real Estate Investment Trusts (REITs)

The Autumn Statement and draft secondary legislation published alongside the draft Finance Bill have confirmed that the definition of 'institutional investor' will be amended to include REITs and their foreign equivalents. This will allow REITs to take larger stakes in other REITs and potentially set up corporate joint ventures (JVs) as sub-REITs.

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Who should read this?

Existing UK REITs and foreign REITs wanting to invest in the UK.

Property Investors interested in establishing UK REITs.

Summary of proposal

In order to join the REIT regime, a company must satisfy a number of conditions. One condition is that it must not be a close company. However a relaxation to this rule was introduced by the Finance Act 2012, enabling diversely owned 'institutional investors' to invest in REITs without the REIT breaching the non-close company condition. However the change in the Finance Act 2012 was of limited benefit to REITs investing in other REITs owing to the exclusion of REITs from the definition of an 'institutional investor'. Therefore REITS have not easily been able to use REITS as vehicles for attracting institutional capital into JV arrangements.

HMRC have been encouraged to make changes to the legislation to enable REITS to invest in other REITS for commercial reasons such as removing barriers to further future investment activity and facilitating easier access to JV financing opportunities. These changes are now being made.

Timing

The measure will have effect on and after 1 April 2014.

Our view

The extension of the 'institutional investors' definition to include REITs and their foreign equivalents is a positive step in providing more flexibility to the UK real estate market. It will allow UK REITs to access increased sources of capital from which to do business and promote a more efficient and competitive UK real estate market by facilitating both domestic and international REIT joint ventures.

It is however disappointing that the extension of the definition does not take account of 'open' companies more generally and their foreign equivalents. As such, the implications for the market are not as wide reaching as they could have been.

Source documents

The Real Estate Investment Trust (Amendments to the Corporation Tax Act 2010 and Consequential Amendment) Regulations 2014

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Oil and gas: Changes to UK onshore regime

Further to a consultation earlier in 2013, the Government have announced new measures, primarily to encourage investment in shale gas, but which will apply to all onshore oil and gas projects.

A new allowance will give companies relief from the 32% supplementary charge to tax. Broadly, the maximum allowance will be 75% of the capital expenditure incurred on the onshore site.

A further change will increase the maximum number of periods for which the Ring Fence Expenditure Supplement can be claimed from six to ten in respect of onshore oil and gas activity.

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Who should read this?

Companies that are planning new investment in UK onshore oil and gas exploration and production, including shale gas.

Summary of proposal

Companies engaged in the exploration and production of hydrocarbons in the UK or UK Continental Shelf are subject to 30% Corporation Tax (CT) and a further 32% Supplementary Charge to Tax (SCT) on relevant profits. Such profits are 'ring fenced' for UK tax purposes and are subject to a range of specific tax rules. This regime applies to shale gas and other unconventional hydrocarbons, as well as conventional oil and gas production.

Onshore allowance

The onshore allowance will provide relief from a company's profits subject to SCT up to a maximum of an amount equal to 75% of capital expenditure incurred by a company in relation to an onshore site. However, this will not be increased by further capital expenditure once production is expected to be, or has already reached, seven million tonnes from the particular site.

The allowance will, in many respects, work in a similar way to the 'field allowance' regime, with which many companies will already be familiar; in particular, in order to utilise the allowance it will need to be 'activated' as production income arises from the particular onshore site.

It will be possible to elect to transfer some or all of the onshore allowance generated by a company from one site, to another site in which it is also a licensee. This may be beneficial in situations where a greater amount of production income is expected from another site and may therefore allow the onshore allowance to be utilised more quickly.

The allowance will not be available for existing onshore projects which have already received development consent. New onshore oil and gas fields will be removed from the scope of existing field allowances, with transitional arrangements for companies currently developing projects, allowing licensees to jointly elect for the new regime not to apply to fields given development consent before 1 January 2015.

Ring Fence Expenditure Supplement (RFES)

Companies can currently claim a 10% p.a. uplift to qualifying ring fence expenditure or losses for up to six accounting periods. This is known as the Ring Fence Expenditure Supplement (RFES). These proposals will allow RFES to be claimed for a further four accounting periods to the extent that losses or qualifying pre-commencement expenditure relate to onshore activities, taking the total number of claims to a maximum of ten.

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Timing

The new onshore allowance will apply to the qualifying capital expenditure a company incurs on onshore oil and gas projects on or after 5 December 2013.

The extension to the number of RFES claims will apply to losses or qualifying pre-commencement expenditure arising or incurred on or after 5 December 2013.

Our view

These proposals reflect the contents of the consultation earlier this year and will generally be well received by the Industry and are at the higher end of expectations. It is encouraging that these changes will apply to all new onshore projects – not just shale gas – and that an election will be available to allow companies to transfer allowances between sites in which they are licensees.

It remains to be seen whether further changes will eventually be introduced to extend the number of RFES claims that can be made to ten for offshore as well as onshore activities. HM Treasury have confirmed that they will continue to discuss this possibility with the Industry.

Source documents

Overview of Legislation in Draft – paras 1.29 to 1.31 and A58 to A61

Harnessing the potential of the UK's natural resources: a fiscal regime for shale gas

UK oil and gas fiscal regime: extension of the ring fence expenditure supplement for onshore activities

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Oil and gas: Substantial shareholding exemption

Following changes to the substantial shareholding exemption (SSE) in 2011 allowing the 12 month qualifying period to be deemed to apply to shares in a new subsidiary in situations where trading assets are transferred to it from another group company, these changes will extend this relief to pre-trading oil and gas exploration and appraisal assets.

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Who should read this?

Companies that are planning a divestment of pre-trading oil and gas exploration and appraisal assets.

Summary of proposal

In 2011 changes were made to the capital gains 'de-grouping' rules and also to the SSE that allowed groups to make disposals of part of their business in a tax efficient manner by hiving down trade and assets into a new subsidiary followed by a disposal of the shares in the new subsidiary to the purchaser.

Specifically, these changes to the SSE allowed the 12 month qualifying period to be deemed to be met in respect of shares in a new subsidiary in certain situations where assets used in a trade are transferred intra-group and the subsidiary uses them in a trade carried on by it at the time of the disposal of its shares. The other conditions for the SSE to apply must also be met, as normal.

Oil and gas companies often spend long periods of time carrying out exploration and appraisal activities, which on a standalone basis are generally treated as pre-trading activities. This presents a particular problem if such parts of the business are disposed, as the previous changes to the SSE described above require the company whose shares are disposed to be carrying on a trade at the time.

The proposed changes will extend the definition of 'trade' for these purposes to include oil and gas exploration and appraisal. Other pre-trading activities will continue to be outside the scope of these provisions.

Timing

Disposals on or after the day of Royal Assent to Finance Bill 2014.

Our view

These welcome proposals had been requested by the industry to help facilitate transactions in the UK North Sea, encouraging increased overall investment.

Source documents

Overview of Legislation in Draft – paras 1.32 and A62 to A63

Oil and gas fiscal regime: substantial shareholding exemption

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Oil and gas: Extension of reinvestment relief

Ring fence reinvestment relief, which eliminates certain chargeable gains on the disposal of oil and gas assets to the extent that the proceeds are reinvested within the ring fence, will be extended to include exploration and appraisal assets.

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Who should read this?

Companies that are planning a divestment of pre-trading oil and gas exploration and appraisal assets and reinvestment of the proceeds in new exploration and appraisal assets.

Summary of proposal

A new reinvestment relief was introduced in 2009 that allowed companies with a UK ring fence oil and gas trade to make a claim for a chargeable gain not to be brought into account to the extent that the proceeds of a ring fence disposal were re-invested in new, qualifying ring fence trading assets within a certain time period.

Since these rules required a company to be trading, companies only carrying on exploration and appraisal activities, or holding undeveloped licences generally could not benefit from them.

These changes will introduce an equivalent reinvestment relief for pre-trading companies carrying on qualifying exploration and appraisal activities or holding licences in undeveloped areas. This new relief will be available to the extent that the disposal proceeds are reinvested in qualifying exploration and appraisal expenditure by the company or another member of its group.

As with the existing reinvestment relief, the proceeds must be reinvested in a period from one year before until three years after the relevant disposal. A chargeable gain will remain to the extent that any proceeds are not reinvested within this time period.

Timing

Disposals on or after the day of Royal Assent to Finance Bill 2014.

Our view

As with the changes to the SSE rules, these welcome proposals had been requested by the industry to help facilitate transactions in the UK North Sea and will help to align the treatment of companies carrying out exploration and appraisal activities with those that have already commenced to trade

Source documents

Overview of Legislation in Draft – paras 1.33 and A64 to A65

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Oil and gas: Bareboat chartering

A cap will be introduced to limit deductions for bareboat charter expenses incurred by oil and gas service companies relating to activities in the UK Continental Shelf. A related measure will introduce a new ‘ring fence’ that will prevent such service companies offsetting profits from services provided in the UK Continental Shelf, with losses from non UK Continental Shelf related activities.

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Who should read this?

UK companies that are party to intra-group bareboat chartering agreements in respect of equipment such as drilling rigs used in connection with oil and gas exploration and production in the UK Continental Shelf.

Summary of proposal

Oil and gas service companies often lease drilling rigs and other equipment from overseas related parties on a ‘bareboat’ basis (i.e. without operating personnel). The associated rental costs are then claimed as a deduction against the UK profits of the service company when it uses such equipment to provide services to oil companies in the UK Continental Shelf.

It is proposed to introduce legislation to cap the amount a UK-based contractor can claim as a deductible expense for leasing payments it makes to associated companies, and also to introduce a ring fence to ensure this profit is not reduced by tax relief from non UK Continental Shelf activities. It is expected that the measure will apply regardless of the location of the recipient of the bareboat payment.

Any excess bareboat charter costs over and above the cap are expected to remain deductible against non-UK Continental Shelf profits of the service company (if any).

The cap is expected to be calculated by reference to the historic capital cost of the asset which is subject to the lease, and to consist of a proxy for capital expenditure at a rate of 4% p.a., plus an amount to represent the possible finance costs of newer assets which will be set at 5% p.a. assuming borrowing to fund half the cost.

Draft legislation has not yet been published, but is expected to be available, alongside a Tax Information and Impact Note in January 2014. There is also expected to be a consultation with the Industry at that point to identify the precise mechanisms to be adopted.

Timing

Leasing payments made on and after 1 April 2014 and associated profits of UK services companies from that date.

Our view

These proposals were not expected and are likely to cause some concern, in particular if the changes reduce the availability of drilling rigs or feed through to higher chartering rates.

Source documents

Draft legislation expected January 2014.

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Other measures

Other measures

The following measures were also included in, or published alongside, the draft clauses for inclusion in the 2014 Finance Bill. For each measure we've included a link to the draft legislation, and other available documents. For other measures (i.e. those not intended to form part of next year's Finance Bill) we have included a link to the information available on the HM Treasury or HM Revenue & Customs website. Where a reference is noted instead of a link this refers to the Overview of Legislation in Draft.

Measures for inclusion in the Finance Bill 2014

Individuals

The following measures are likely to be of particular interest to individual taxpayers. This does not include measures relating to pensions tax which are listed separately:

- Vulnerable beneficiary trusts; and
- Cultural gift scheme (amendments to Estate Duty legislation);

Companies

The following measures are most likely to be of interest to companies:

- Modernising film tax relief;
- Capital allowances – mineral extraction allowances;
- Changes to the debt cap provisions;
- Avoidance schemes using total return swaps;
- Double taxation relief: revenue protection;
- Code of Practice on Taxation for Banks;
- Section 212 FA2012 (insurers Solvency 2 regulatory capital securities); and
- Community amateur sports clubs.

Employers

The following measures are likely to be of interest to employers:

- Share incentive plan limits;
- Tax advantaged employee share schemes;
- Unapproved employee share schemes;
- Company car tax rates 2016-17;
- Income tax: company cars – repeal of s114(3) ITEPA (cars or vans made available for private use); and
- Company car tax: payments for private use of a company car or van.

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VAT

The following measures make changes to the VAT regime:

- VAT: refunds to health service bodies

Environmental taxes

The following measures relate to changes to environmental taxes, including Air Passenger Duty:

- Climate change levy: carbon price support rate for coal;
- Climate change levy: exemption for solid fuels used in certain processes; and
- Climate change levy: exemption for metallurgical and mineralogical processes.

Duties

The following measures relate to changes to duties:

- Vehicle Excise Duty for heavy goods vehicles and reduced pollution certificates; and
- Vehicle Excise Duty: Administrative changes (abolishing paper tax discs).

Stamp Duty and Stamp Duty Land Tax

The following measures relate to Stamp Duty and SDLT:

- Stamp Duty Land Tax: Charities relief.

Tax administration

The following measures relate to the administration of the UK tax system, including HMRC's powers:

- Income tax: indexation;
- Stamp Duty: House of Commons resolution provisions;
- Administration of the Scottish rate of income tax;
- Modernising customs civil penalties;
- High-risk promoters and "follower penalties" – para 1.65; and
- Modernisation of ship and aircraft stores.

Other measures

Individuals

The following measures are likely to be of particular interest to individual taxpayers. This does not include measures relating to pensions tax which are listed separately:

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- Interest relief on loans to purchase life annuities – responses and outcome from previous consultation; and
- Close company loans to participators – responses and outcome from previous consultation.

Employers

The following measures are likely to be of interest to employers:

- Supporting the employee ownership sector – summary of responses to consultation;

Other

The following other documents were published:

- Sharing and Publishing Data for Public Benefit

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