# Newsletter: KPMG Gibraltar

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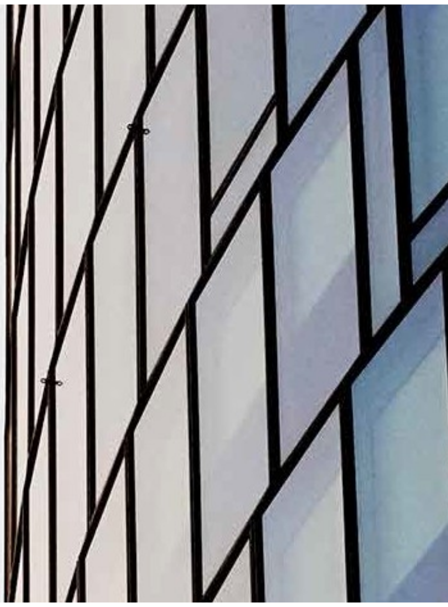

We hope you will enjoy this issue of our Tax Newsletter. Our purpose is to try and keep you abreast of topical UK tax issues which may affect you, your business, and/or your clients.

## *A Anderson v HMRC [2016]* - First-tier Tribunal decision

In this case, HMRC claimed that the taxpayer had not paid sufficient capital gains tax ("CGT") on the sale of his shares in Anson Limited, which had been reported on his 2007/08 Self Assessment tax return ("tax return").

HMRC opened an enquiry in relation to the taxpayer's 2008/09 tax return and, upon investigation, believed they had discovered that the open market value of the shares disclosed on the taxpayer's 2007/08 tax return was in fact less than the actual open market value of the shares and, as such, the CGT calculated by the taxpayer had been understated.

As HMRC did not have an enquiry open in respect of the taxpayer's 2007/08 tax return, they raised a discovery assessment in February 2013, totalling £830,389, on the grounds that the taxpayer had acted carelessly when disclosing the open market value on their 2007/08 tax return. The taxpayer appealed against the discovery assessment.

The First-tier Tribunal ("FTT") agreed that HMRC had made a genuine discovery on the basis that their Shares and Assets Valuation team believed that the open market value of the shares was higher than the figure disclosed by the taxpayer. However, as the open market value obtained by the taxpayer was reliant on professional advice received, the FTT did not agree that the taxpayer had acted carelessly and, as such, the taxpayer's appeal was allowed.

## Consultation: Reforms to corporation tax loss relief

On 26 May 2016, the Government published a consultation document on reforms to corporation tax loss relief. This follows the announcement at Budget 2016 of two proposed changes to the way the loss relief rules currently apply for corporation tax

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purposes. To increase flexibility it will be possible for losses arising from 1 April 2017 to be carried forward and set against future profits arising from different activities within the company itself and against future profits made by other members of the same group. However, many larger companies and groups may find they are worse off as a result of the changes, because from the same date it is proposed to restrict the losses (whenever generated) which can be offset in each period to 50% of profits, subject to an allowance of £5 million per group. The consultation document seeks views on the detailed design and implementation of these new rules.

Some key features of the proposals are:

- the amounts affected are trading losses, non-trading loan relationship deficits, management expenses, property business losses and non-trading losses on intangible fixed assets. The treatment of capital losses will not be affected;
- for the purposes of the 50% limit, amounts which are offset against total profits (including group

relief) would be allocated proportionately to trading and non-trading profits;

- brought-forward amounts which arose before April 2017 would be offset before other brought-forward amounts, in accordance with existing rules but subject to the 50% limit;

- each group will have an allowance of £5 million of profits which could be relieved in full by brought-forward losses. The allocation of this allowance among group companies, and among types of profit within each company, will be at the group's discretion;

- the group definition for the purpose of the £5 million allowance would be wider than the normal group relief group although specific proposals have not been put forward at this stage;

- for groups which include banking companies, the £5 million group allowance would be available only for losses which are not subject to the banking loss restriction. Relief for losses subject to the bank loss restriction would be limited to 25% of banking companies' profits, but this relief could be topped up to 50% by any available non-restricted losses;

- brought-forward losses surrendered to a bank by a non-banking company would be disregarded in calculating the bank surcharge;

- brought-forward losses arising from April 2017 would be able to be surrendered to or by group companies on the same basis as group relief, and to or by consortium companies on the basis of the consortium membership at the time when the losses arose;

- as now, trading and property business losses would expire when the activity ceases; and

- existing anti-avoidance and change of ownership rules would continue to apply and consideration is being given to a rule to protect against profit-shifting designed to accelerate the use of losses.

The Government's desire to maintain some existing restrictions and to limit potential avoidance has meant that the proposals are more complex than might have been expected, especially while losses are still being carried forward from before April 2017. Groups may find themselves having to make detailed calculations in order to maximise their use of relief.

This consultation is open until 18 August 2016, and draft legislation will then be published at the Autumn Statement followed by a period of technical consultation ahead of its inclusion in the 2017 Finance Bill. Groups which may be affected will want to consider carefully how the proposals are likely to impact them and may wish to respond to the consultation document.

Should you have any queries, please contact Robert Rotherham.

## Entrepreneurs' Relief and Share Classes

Entrepreneurs' Relief ("ER") is an important capital gains tax relief potentially available to both business owners and employee shareholders that can reduce the tax rate on the sale of shares to just 10% on the first £10 million of lifetime gains. This can potentially save up to £1 million per shareholder on the sale of a business and as such is an important relief, particularly for private company shareholders. One of the key requirements of the relief is that the shareholder holds at least 5% of the ordinary share capital in the company.

### *A number of recent challenges by HMRC taken to tribunal*

There have been three recent cases taken to tax tribunals on what constitutes ordinary share capital for the purposes of both ER and Share Loss Relief. The taxpayer lost in the first two cases and was relatively fortunate to succeed in the third.

These cases highlight the importance of ensuring that the qualifying conditions are met, particularly where a company has different share classes, deferred shares, redeemable shares or similar.

It is always important, therefore, to understand the ER status of a shareholding, even if a sale is not immediately on the horizon.

If you would like to discuss this matter further, please contact Justine Howard.

## Changes to Stamp Duty Land Tax surcharge on purchases of additional dwellings

Finance Bill amendments have been tabled to give effect to Government assurances that two types of transaction that were inadvertently subject to the Stamp Duty Land Tax ("SDLT") surcharge (3% of the purchase price paid on top of the standard SDLT rates) will be excluded from the surcharge with retrospective effect.

A summary of these amendments, which can be found here – from page 29, are detailed below.

### *Granny annexes*

Under the current legislation, an individual acquiring a dwelling that contains a self-contained dwelling on the grounds could be subject to the SDLT surcharge as more than one dwelling would be acquired in the transaction. A new condition, condition C, will be inserted, with effect from 1 April 2016 according to the Explanatory Note, to clarify that a self-contained dwelling will not be counted as a separate dwelling if it is a 'subsidiary' to another dwelling. A dwelling (Dwelling A) is a subsidiary to another dwelling (Dwelling B) if:

- Dwelling A is situated within the grounds of, or within the same building as, Dwelling B; and
- determined on a just and reasonable basis, the chargeable consideration attributable to Dwelling B is two thirds or more of the chargeable consideration for all the dwellings purchased (including Dwelling A) within its grounds.

Note that an individual may still be subject to SDLT surcharge for the purchase of such a dwelling if they already own another dwelling and are not replacing a main residence.

The explanatory note to this amendment can be found here.

*Alternative finance arrangements*

Currently, the surcharge applies to acquisitions of dwellings by banks and other financial institutions providing alternative property finance (including Sharia'a mortgages). Such financing arrangements usually involve a financial institution buying the property and selling it on or leasing it to an individual, i.e. the person receiving the finance. The amendments provide that the transaction under which the financial institution acquires the dwelling will not attract the surcharge if the conditions are met for SDLT alternative finance arrangement relief.

The explanatory note to this change can be found here.

*Power to exclude transactions*

The Government will also have the power to prevent certain transactions from being subject to the SDLT surcharge by amending the SDLT surcharge rules by regulation. This assists the Government in addressing any anomalies in the SDLT surcharge rules in their teething phase. The power will also allow some transactions to become subject to the surcharge where that is incidental or consequential to the exercise of the power.

The explanatory note to this change can be found here.

Should you have any queries with regard to the above, please contact Justine Howard.

## Patent Box amendments in Finance Bill 2016-17

On Tuesday 28 June 2016, the Government published a number of amendments to the new Patent Box legislation previously published in the Finance Bill 2016 on 24 March 2016. The amendments address feedback on the legislation and provide flexibility for businesses that have to apply the rules and further clarification on how the rules are intended to operate in some areas. The Patent Box rules are being amended to comply with new international rules set out by the Organisation for Economic Co-operation and Development as a result of Action 5 of the Base Erosion and Profit Shifting project. The new rules were applicable from 1 July 2016.

There are some welcome changes for groups that are looking to reorganise business structures, as they now have some further flexibility to do this without losing the benefits of grandfathering transferred Intellectual Property ("IP"). The Patent Box company will be able to 'stand in the shoes' of the transferor where qualifying IP is acquired as part of a transfer of a trade, or part of a trade.

In certain circumstances, payments for qualifying IP rights do not need to be deducted when calculating profits that will benefit from the Patent Box. This avoids the company having their Patent Box benefit affected twice (when calculating profits and in the Research & Development ("R&D") fraction) where they are paying another person for the IP right.

Acquisition costs of qualifying IP have now been defined to include payments for the assignment of, or grant of a licence over, the right and for the disclosure of information where the company goes on to register a qualifying IP right as a result of the disclosure. Discussions with HM Treasury suggested that IP acquisition costs should be included in the R&D fraction when the expenditure was deducted in the tax computation, but the amendment suggests all costs should effectively be included in year one.

Restrictions in the amount of sub-contracted expenditure to unconnected and connected parties to 65% have now been removed. This is likely to impact companies that sub-contract R&D to related parties, potentially reducing their Patent Box benefits as the amount of 'bad' expenditure to be included in the R&D fraction will be increased.

For companies with small claims, the rules have been simplified to reduce compliance burdens. Where certain criteria are met, the company can have a simplified treatment in relation to streaming, notional royalties and calculating their marketing asset return.

Finally, there have been a number of other changes including:

- processes and products that only incorporate one patent can be included in a product or product family sub-stream;

- expenditure on R&D undertaken by a foreign branch will be treated as being expenditure sub-contracted to a connected party where the company has made an election for Foreign Branch Exemption; and

- new anti-avoidance legislation has been included to ensure that the R&D fraction is not manipulated to increase Patent Box benefits.

We would recommend companies that have not yet made Patent Box claims to consider whether they can still elect into the old regime and benefit from grandfathering. Companies that are already using the regime should consider how these new rules will impact them.

Should you have any queries with regard to the above, please contact Robert Rotherham.

## Indirect Tax: The implications of leaving the EU

With the UK voting to leave the EU there will be VAT & Customs Duty changes for both UK businesses and global businesses trading with the UK. Whilst there is the much discussed uncertainty as to which of the many trading models the UK will ultimately negotiate and how it will access Free Trade Agreements ("FTAs") etc., it is clear that every international trading business will be required to undertake a thorough review of its supply chains. It is only through having an in-depth understanding of the existing supply chain models and identifying how VAT and Customs Duty currently apply that businesses will be able to begin to assess the impact of any required changes to their VAT and Customs Duty accounting and administration, and proactively plan to manage these changes. We recommend that businesses adopt a proactive approach to assessing the indirect tax impacts of leaving the EU.

For VAT, the forthcoming transition from dispatches to exports and from acquisitions to imports will introduce changes to procedure as well as cash flow profiles of trading activities.

Leaving the EU will mean that UK VAT law will no longer be required to adhere to EU VAT law. Where your business takes advantage of reliefs or benefits underpinned by an EU law right, it is prudent to assess the impact on its operations if such reliefs/benefits were to be at risk in the future. Armed with this information, your business can proactively influence the debate on the application of the UK's VAT and Customs Duty rules in the future.

The EU is a Customs Union - this allows freedom of movement of goods between Member States without customs formalities/duties/tariffs. Leaving the EU Customs Union would almost certainly mean that customs formalities and duties/tariffs will, by default, be imposed on UK-EU trade in goods.

The administrative costs of trading with the EU will increase due to the re-imposition of customs formalities. These could include challenges such as the real time preparation and submission of customs declarations, determining the origin of goods, delays in movements of goods due to customs clearance procedures, providing financial securities, registration requirements for customs (EORI) and VAT purposes and the cash flow impact of moving from acquisition to import VAT accounting.

In addition, the UK may no longer be able to take advantage of the EU's FTAs with countries such as Mexico, South Africa, Chile, Switzerland, South Korea (as well as ones in the pipeline e.g. USA, Canada, Japan). While this could lead to a better or worse position than the current agreements afford, negotiations take time and in the meantime business has to operate in the fog of uncertainty.

In the context of political uncertainty as to what the ultimate outcome of our decision made on 23 June 2016 will mean, there is the natural temptation to want to wait and then react to the new reality when the negotiations have concluded and the nature of the changes is certain. It is equally clear that Article 50 and the orderly mechanism by which a Member State leaves the EU provides a period of time in which to analyse, decide and implement changes.

In the context of efficiently managing indirect taxes, our recommendation is to start the process of assessing the indirect tax impact on your supply chains and operating models without delay.

Should you have any queries with regard to the above, please contact Sandra Skuszka or Paul Cawley.

## HMRC consultation on partnership taxation

HMRC have published the consultation document announced at Budget 2016, the aim of which is to clarify how partners calculate their tax liabilities and to improve the tax reporting for partnerships, so that the information provided can be more easily linked up to individual's digital tax accounts.

The Government is aware that there are a number of areas in which the taxation of partnerships is not always certain, particularly considering the wide variety of modern partnerships. The consultation is intended to make calculating and reporting profits easier for partnerships.

The consultation is relevant to general and limited partnerships, Limited Liability Partnerships (LLPs) carrying on business with a view to profit, and foreign entities classified as partnerships for UK tax purposes.

The consultation covers and sets out proposals for the following areas.

*Clarification of who is the partner chargeable to tax*

Uncertainty can arise where partners in a partnership or members of an LLP have contended that they are acting as a nominee or agent for someone else and therefore are not liable for tax. The Government proposes to change the rules to make it clear that, for tax purposes, a person will be treated, and presumably taxed, as a partner if they are listed as a partner in the partnership return.

*Business structures that include partnerships as partners*

Currently, it can be difficult to identify who should be paying the tax on a share of partnership profit where one or more of the partners are themselves LLPs or other entities transparent for tax purposes. The proposals (which exclude Investment Funds see below) would treat those responsible for paying the tax on a share of partnership profit as partners in the first partnership for income tax, capital gains tax and corporation tax purposes, with details of these partners reported by the nominated partner of the first partnership.

It is noted that this could increase the amount of potential penalties for late or incorrect filing.

*Investment Funds structured as partnerships- tax administration*

The Government is looking for suggestions on how to improve tax administration for partnerships with investment income only, as investment funds structured as partnerships can have many non-residents or non-taxable entities as partners, which may cause them an administrative burden.

*Trading and property income - tax administration*

Recognising that in rare circumstances the nominated partner of trading and property partnerships may be unable to establish the details of all the partners, the Government has suggested that payments could be made on account to HMRC on behalf of any unidentified partners.

*Allocation and calculation of partnership profit*

Proposals have been made to legislate the following:

*Profit sharing arrangements* – The profit sharing arrangements (PSA) as set out in the partnership or LLP agreement will be the determining factor in identifying the partners' profit shares.

It will become vital that PSA are reviewed and kept up to date.

*Allocation of tax adjusted profit to partners* – The basis of allocation of tax adjusted profit between the partners should be the same as the allocation of the accounting profit or loss.

This could have implications for example where a specific disallowable, such as a private use of car, is allocated to a partner. In future this may need to be within the PSA (as above).

*Companies chargeable to income tax* – The profits of company partners liable to income tax will be calculated as if a non-UK resident company were carrying on the business.

*Non-chargeable persons* - For non-chargeable persons, it is proposed that the nominated partner in the partnership will need to provide details of the ultimate partners. If they do not, the share of profit or loss will be calculated as if the partner was a UK resident individual.

The closing date for comments is 1 November 2016.

### *Benham (Specialist Cars) Ltd v HMRC [2016]* – First-tier Tribunal decision

In this case, the taxpayer made a claim under s153A TCGA 1992 for rollover relief on business assets that ceased to take effect when no relevant business assets were acquired within the time limits against which to set the gain. HMRC wrote to the taxpayer to amend the company's return for that period in order to tax the gain, and the taxpayer appealed to the First-tier Tribunal ("FTT") on the basis that HMRC should have instead raised a discovery assessment under paragraph 41 Schedule 18 FA 1998. This would have allowed the taxpayer to make a claim to carry back trading losses to reduce the corporation tax liability for the relevant period to nil.

The FTT agreed with the taxpayer that if a company makes a declaration under s153A TCGA 1992 (in effect a provisional claim) but fails to follow up with an actual claim, HMRC have to use the assessment or amendment powers in Sch 18 FA 1998, as appropriate. They cannot rely on s153A(4)(a) TCGA 1992 to amend the self-assessment independently of what Sch 18 FA 1998 says. In this case, as HMRC had not opened an enquiry into the return, they could not amend it and could only proceed by making a discovery assessment. The distinction was important because HMRC's approach would have deprived the company of the possibility of claiming to carry back a loss from the subsequent period to cover the additional liability.

The FTT concluded that the disputed decision, though not a nullity, was ineffective because it lacked statutory basis, and as there was no right of appeal against it, the appeal had to be struck out.

Further details in respect of this case can be found here.

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