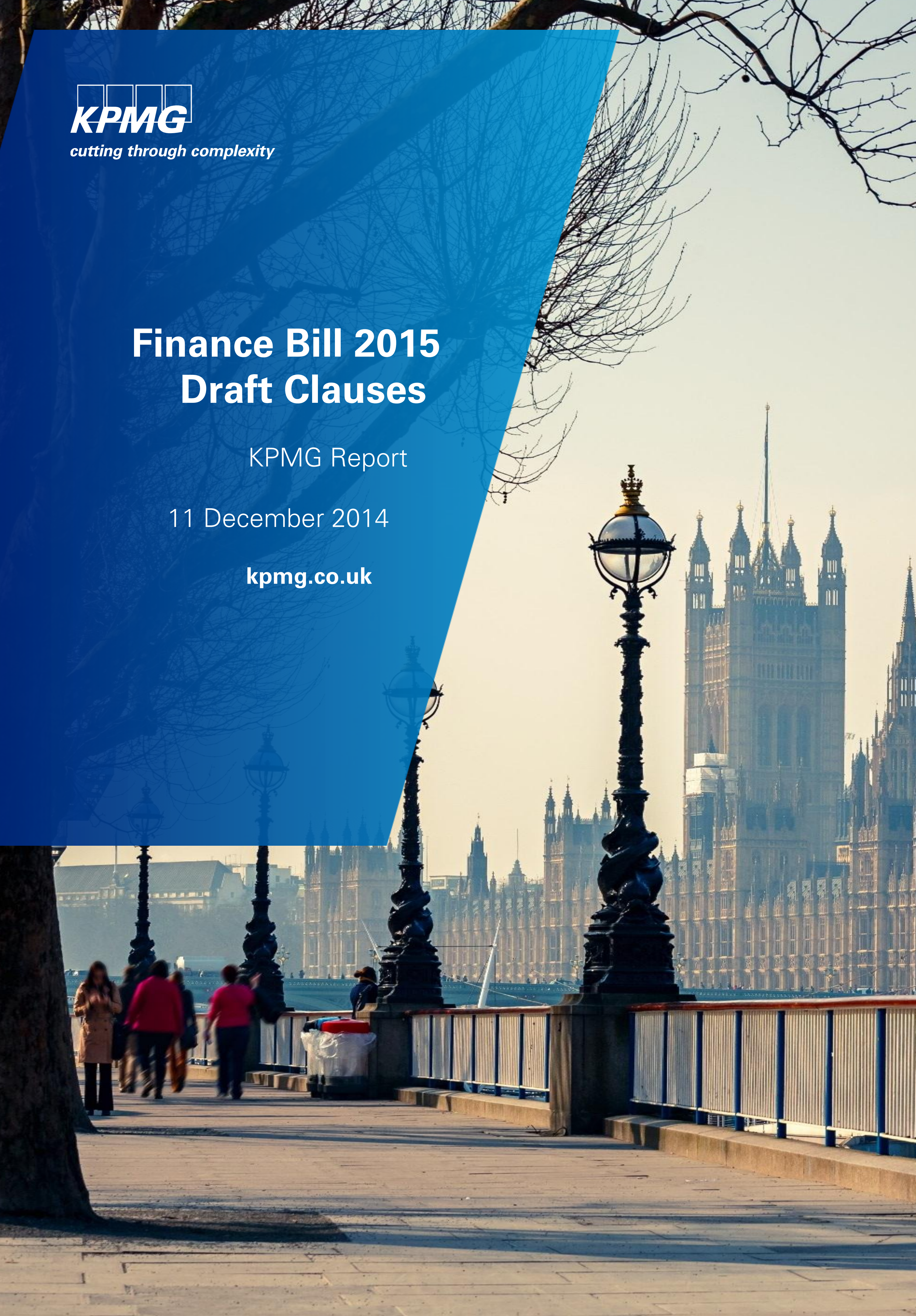

KPMG
cutting through complexity

Finance Bill 2015 Draft Clauses

KPMG Report

11 December 2014

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Our view

Following the excitement of the Autumn Statement on 3 December, the draft clauses for the Finance Bill 2015 were published on 10 December 2014 for consultation

Whilst this has a far lower public profile, it is the detail in these provisions which shed light on how the new tax provisions are likely to work in practice. HM Revenue & Customs (HMRC) are requesting that any comments on the draft legislation are sent to the relevant policy lead on the subject by 4 February 2015.

A focus of attention has been on the new diverted profits tax which will apply from 1 April 2015. This is a new tax, separate from corporation tax, which is payable at 25%. It is aimed at multinationals entering into contrived arrangements to divert profits from the UK either by arranging their affairs so as to avoid having a UK permanent establishment (PE) or by making payments which end up in a low tax structure which lacks substance. Small and medium sized companies are not affected and rules relating to PEs only apply where the turnover in the UK exceeds £10 million. The tax is only payable following a notice issued by HMRC, but once such a notice is issued, it must be paid in 30 days. There is then a 12 month review period to decide if the amount has been correctly calculated before the taxpayer can appeal to the courts. The rules are clearly aimed at driving a change of behaviour but there is a concern they give potentially too much discretion to HMRC and do not help stability and simplicity in our tax system given, in particular, further changes which will undoubtedly arise from the Base Erosion and Profit Shifting (BEPS) process.

The draft legislation provides for HMRC powers to introduce country by country reporting based on the general OECD guidance issued on 16 September 2014, but detailed regulations are not expected until next year. These rules will only affect UK headed multinational groups and will come into effect on 1 January 2016. It is disappointing to see that the impact assessment suggests that one-off first year costs for groups will be ‘negligible’. This does not reflect the potential compliance burden that was highlighted in the consultation responses to the OECD, and also our practical experiences of gathering and reporting this type of data.

Other new material for companies includes revisions to the corporate debt and derivatives contracts legislation. This is the outcome of a long consultation process so not unexpected. However some elements relating to corporate partnerships have been deferred until a later date.

The draft legislation also includes a restriction for R&D tax relief so that the cost of materials incorporated in products sold or transferred are not eligible for the relief. This is offset by an increase in the above line expenditure credit for large company R&D to 11% from 1 April 2015, and an increase in the rate of relief for small and medium sized enterprises to 230% from 1 April 2015.

Another focus is on the draft legislation introducing a new capital gains tax charge on disposals of UK residential property by non UK residents. This is complicated by the interaction with the existing Annual Tax on Enveloped Dwellings (ATED) related capital gains tax charge on disposals of UK residential property by corporates (including non UK residents). One impact of these rules is to change the long existing principal private residence exemption for all individuals so that it only applies to properties in the territory in which the individual is resident (or spends at least 90 days in a tax year).

The benefits of Entrepreneurs’ Relief (10% capital gains tax) are enhanced by an ability to hold over the relief on gains reinvested in Enterprise Investment Scheme (EIS) and other venture capital investments. However, the relief will not be available where a business is transferred to a close company in which the business owner is a participator. This is linked with a corresponding restriction for the company which obtained a tax deduction on the amortisation of the goodwill and other intangible assets acquired on such a transfer. This will increase the tax cost of business incorporations.

From an employment taxes perspective, a key development is the draft legislation in relation to simplifying the administration of employee expenses in connection with employer reporting of qualifying expenses and benefits. This measure will remove the Form P11D employer reporting requirement and the need for employers to apply for a reporting dispensation in relation to such expenses and benefits, i.e. those for which the employee would, in any event, be able to claim a deduction. It will apply from 6 April 2016, the lead time being to enable employers to take stock on what their dispensations presently cover and to adjust to the new approach. It flows from one of the key recommendations made by the Office of Tax Simplification as part of its Review of Employee Expenses and follows a period of consultation by HMRC. This measure has generally been welcomed by employers, although concerns have been expressed on the need for good quality guidance and support from HMRC to assist employers in transitioning to the new approach.

At the same time, the Government has also decided to prevent qualifying expenses and benefits, as well as 'scale rate' payments, being paid tax free where this occurs as part of salary sacrifice arrangements. In particular, the Government has reiterated its concern around the reduction in employee and employer National Insurance Contributions (NIC) that results from implementation of salary sacrifice in this situation which they say is 'not in line with the spirit of the relevant NICs regulations'. This is clearly aimed at arrangements whereby tax and NIC free scale rate payments are paid in lieu of salary and to cover employee travel and subsistence expenses of site-based workers. The Exchequer yield from this measure over the four years to 5 April 2020 is estimated at £360 million.

A key concern to all taxpayers will be the new power being given to HMRC to collect unpaid taxes direct from their bank accounts. This measure has been consulted upon over the summer, and, as previously announced, additional safeguards have been created.

The landmark change to SDLT for residential property transactions from a slab system to a slice system was published in a separate draft Stamp Duty Land Tax Bill, currently going through Parliament. The new system applies to all UK residential property purchases completed from 4 December 2014 unless in pursuance of a contract exchanged before that date in which case the purchaser may choose which system – slab or slice – applies.

Similarly, the pension tax changes are being legislated in a separate Taxation of Pensions Bill. These measures to legislate for specific changes in separate tax bills will shorten the actual Finance Bill 2015 when it is presented to Parliament in spring 2015. As the General Election is due to take place on 7 May 2015, this requires a Finance Act to be on the statute books by the end of March 2015 so that income and other taxes can be collected from April 2015. Normally when a General Election arises, this results in a short Finance Bill prior to the election with limited contentious measures. Given that the date of the General Election has been known in advance for a long time, it is likely that all the measures published in draft on 10 December 2014 will be legislated for by the end of March.

The key documents published on 10 December were the *Overview of Legislation in Draft* and the Draft Clauses and the *Draft Clauses and Explanatory notes for Finance Bill 2015*. In preparing this commentary we have noted within each measure other specific documents relating specifically to the issue.

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Measures likely to be of wide interest

Rates, allowances and thresholds

Last week's Autumn Statement saw some changes to the previously announced personal tax rates and allowances for 2015/16. The higher than expected increase in the Personal Allowance and the increase in the overall threshold at which Higher Rate tax becomes payable for 2015/16 will be welcome news for the majority of taxpayers and those with earnings below the Higher Rate threshold will also benefit from a small increase in the National Insurance primary earnings threshold. Those with earnings above the upper earnings/profits limit will see a small increase in their National Insurance bills as the band of earnings subject to the full rates of National Insurance increases.

Who should read this?

The changes to personal taxes are potentially relevant to all individual taxpayers.

Summary of proposal

Personal taxes

The Autumn Statement announcements, making changes to the income tax Personal Allowance and the transferable Personal Allowance available to certain couples, and to the National Insurance Contributions (NICs) thresholds, mean that for individuals, the picture has changed slightly from the Budget. The expected position for 2015/16 can be summarised as follows:

- The Basic, Higher and Additional income tax rates for 2015/16 will remain at their 2014/15 levels of 20%, 40% and 45% respectively.
- The Basic Rate tax threshold has previously been set (by Finance Act 2014) at £31,785 for 2015/16 and FB 2015 raises the Personal Allowance, for those born after 5 April 1938, to £10,600. As a result the threshold at which Higher Rate income tax becomes payable has increased from £41,865 in 2014/15 to £42,385 in 2015/16.

As previously enacted, from 2015/16 spouses and civil partners born on or after 6 April 1935 will be able to transfer part of their Personal Allowance to their spouse or civil partner, where neither partner is an Additional or Higher Rate taxpayer. The maximum amount of the transferrable allowance will be £1,060.

Existing age-related Personal Allowance for individuals born before 6 April 1938 remains frozen at its 2012/13 level of £10,660, although the income limit will be increased to £27,700, and for those born after 5 April 1938 but before 6 April 1948, the Personal Allowance is aligned with the general allowance of £10,600. For those entitled to the Married Couples Allowance, the minimum is raised to £3,220 and the maximum to £8,355.

The Annual Exempt Amount for Capital Gains Tax of £11,100 for 2015/16 and the freezing of the Inheritance Tax nil rate band at £325,000 were confirmed in Finance Act 2014.

The annual ISA investment limit will increase to £15,240 from April 2015.

Class 1 primary NICs payable by employees will remain at 12%, on new thresholds of weekly income between £155 and £815. A rate of 2% applies on income above this threshold.

In 2015/16, Class 4 NICs will be payable at a rate of 9% on self-employed earnings between £8,060 and £42,385, 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 £2.80 per week.

Corporate taxes

The Autumn Statement made no change to the corporation tax rates announced at the Budget. There is therefore no change to the previously announced proposals under which the rate of corporation tax for profits other than ring fence profits will be unified with the small profits rate at 20% as of April 2015.

Timing

The changes to the majority of personal tax rates, thresholds and allowances take effect from 6 April 2015. The unification of the small profits rate of corporation tax with the main rate at 20% will take effect from 1 April 2015.

Our view

The raising of the income tax Personal Allowance and the primary threshold for National Insurance is good news for Basic Rate and most Higher Rate taxpayers although the effect will be relatively modest. Some of the reduction in income tax for Higher Rate taxpayers will be negated by a small rise in NICs as a result of the widening of the band at which earnings are chargeable at full rates. The overall reduction in income tax and National Insurance for most will be less than £4 per week although married/civil partnership Basic Rate taxpayers who are eligible to benefit from the transferrable Personal Allowance will see an additional reduction of tax of up to £212 a year.

Source documents

- *Tax and tax credit rates and thresholds for 2015/16*
- *Personal allowance for 2015/16*

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Diverted profits tax

The Diverted Profits Tax represents a major development in the UK's taxation of multi-national groups. Non-UK resident groups making sales of more than £10 million to UK customers and UK companies achieving an effective tax rate (ETR) benefit through payments to group companies will need to carefully consider the impact of draft provisions, which are intended to have effect from 1 April 2015.

Who should read this?

The diverted profit tax is relevant to large multinational groups.

The tax does not apply where the entities defined in the legislation are small or medium sized enterprises.

Summary of proposal

The proposal is to charge a 25% Diverted Profits Tax in two situations:

1. Where a non-UK resident company makes annual supplies of goods or services to UK customers of more than £10 million (this figure includes sales made by connected companies) and the related UK activities are designed to 'avoid' creating a UK permanent establishment (PE) (i.e. a taxable presence in the UK as defined for UK tax

purposes). In addition, the mismatch condition and/or the tax avoidance condition must be met (described below). There are demanding conditions on the expenses which can be deducted in computing the profits which have been diverted, so that the profits of a 'deemed' PE under these provisions are likely to be higher than the profits which would have been attributed to an actual PE.

2. Where a UK resident company makes payments to related parties under arrangements that are designed to secure an overall reduction in tax and there is insufficient economic substance. There are complex conditions, but generally this will apply where the payment would not have been made but for the tax advantages; where a payment would have been made otherwise, then the amount of that payment remains within the scope of transfer pricing, and should not be challengeable under these provisions.

   This charge also applies to the UK permanent establishment of a non-UK resident company and is described as having "a primary function to counteract arrangements which exploit tax differentials."

There are detailed clauses which set out how such diverted profits are to be calculated; these include significant subjective elements. The charge will be computed by a designated HMRC officer who will issue a notice, against which the taxpayer can make representations. It should be noted that while the tax itself is not subject to self-assessment, there is a duty on a company which meets the requirements of either of the above situations to notify HMRC of any accounting period for which it is reasonable to assume taxable diverted profits might arise to it. Notification is required within three months of the end of the accounting period. Failure to notify attracts tax geared penalties. A significant part of the legislation deals with the collection mechanism where the company which is to be charged is not currently within the scope of UK corporation tax. Following the Autumn Statement last week there were questions about whether the draftsman could set out a Diverted Profits Tax which worked practically, and these seem to have been answered.

In addition to the draft legislation, HMRC Guidance was also published on 10 December 2014. Aspects of the examples contained therein have been used below to illustrate the operation of the Diverted Profits Tax.

Sale and marketing subsidiary – avoidance of PE

Consider a group providing online services. Contracts with UK customers are concluded with the group's European sales and service hub, which is non-UK resident. While there is a UK resident group company which engages with UK customers, it does not complete the sales contracts, and is remunerated by the hub on a cost plus basis.

In this simple case, if one of the main purposes of the arrangements is to avoid UK corporation tax, the provisions are likely to apply.

In a more complex example, the hub company may pay royalties to an overseas intellectual property (IP) holding company, which pays no tax on its receipts. In that case, in computing the liability of the hub company to diverted profits tax, the profits of its avoided UK PE could be computed with a restriction of the deduction for royalties, if they are considered to be greater than an arms' length amount.

It should be noted that a just and reasonable credit is allowed (for both UK corporation tax and corresponding non-UK tax paid in respect of the profits of the hub company) against any liability it has to diverted profits tax.

IP holding companies- entities lacking economic substance

Suppose that a UK company pays a royalty of £100 million to a group IP holding company in a low tax jurisdiction, where the income is taxed at 10%.

The tax reduction arising from the deduction of the royalty is £20 million, and tax of £10 million is paid. Therefore the tax reduction is £10 million (£20 million less £10 million). The tax paid by the recipient is less than 80% of the tax reduction in the UK payer arising from the royalty and therefore there is a tax mismatch. The economic substance condition then tests whether the contribution of economic value of the staff of the IP holding company is less than the financial benefit of the tax reduction of £10 million. In the corresponding HMRC example the further development of the IP is undertaken by a group company so that the staff of the IP holding company do not contribute any significant economic value, and certainly less than the economic value of the tax reduction.

For a diverted profits tax charge to arise, it must be reasonable to assume that the royalty would not have been paid absent the tax differential. Thus in this situation a diverted profits charge should only arise if it is reasonable to assume that the IP would have been held in the UK.

It would appear, that where a non-UK parented group, already holding IP outside the UK, starts a UK business and licenses in the IP, this provision is not likely to apply. However, in future this would need to be considered carefully if ongoing development of the IP takes place in the UK.

In contrast, where a UK company transfers its IP to an overseas IP holding company, then this provision appears to allow HMRC to challenge the deduction of royalties (by a diverted profits charge) even where the royalty is arms' length in amount. This appears to be the case even where the UK company pays an exit charge on the transfer.

Offshore leasing companies - entities lacking economic substance

The HMRC guidance gives an example where an offshore leasing company is set up in a zero tax location to lease plant and machinery to a UK trading company. The lease creates a tax mismatch as the payments are deductible in the UK trading company, but are not taxed in the hands of the leasing company. If the leasing company has few staff, then it is likely that the value they contribute will be less than the benefit of the reduction in tax as a result of the leasing income. If, as the guidance suggests, it is reasonable to assume that the leasing company's involvement in the transaction was designed to secure the tax reduction, the provisions would then apply. The guidance suggests that the amount of diverted profits is the difference between the deductions claimed for the lease payments and the capital allowances which the UK trading company would have been entitled to if it had acquired the assets itself.

Finance companies - entities lacking economic substance

Where a UK company pays interest, for example to an overseas group finance company, then it may hope to fall outside these provisions because there is an exclusion for a provision which involves only loan relationships. However, the definitions here are broad, and if the finance company itself is funded through an arrangement which involves elements other than loan relationships, it will be necessary to consider carefully whether the situation falls outside these rules.

Timing

These provisions will apply from 1 April 2015; in particular there are provisions for splitting accounting periods, so they apply from that date, rather than to accounting periods starting after that date. This leaves groups with little time to consider their group structure, so for those who consider they may be affected, this is a priority issue. For example, groups may structure such that they have an actual UK PE. However, in the examples of arrangements within the provision dealing with 'entities lacking economic substance', it is harder to see what actions groups might take before 1 April 2015.

Our view

There are elements of this legislation which will 'wither' when the Base Erosion and Profit Shifting (BEPS) proposals are enacted in the UK. The implementation of BEPS in the UK will increase UK taxable profits for some groups, so to the extent that BEPS results in more corporation tax at 20%, it will reduce the diverted profits tax payable at 25%. However, it seems likely that the main effect of these provisions will be to push some of the targeted groups into adopting a BEPS-compliant structure earlier. Many groups will prefer to pay additional corporation tax under the normal mechanisms rather than risk falling into these provisions with their subjectivity, tight payment requirements (when HMRC have issued a notice the tax must be paid in 30 days) and penal tax rate. Thus the projections of tax raised by this measure may actually be a reflection of an increased corporation tax take rather than a yield from this tax.

These provisions show the UK not just at the forefront of BEPS, but acting unilaterally out in front of BEPS, and it will be interesting to see how this is received by other OECD countries and what its impact is on the wider implementation of BEPS.

Notwithstanding the Government's reasons for wanting to do this, the UK has, in some ways, jumped the gun in terms of the BEPS project. The latest KPMG in the UK Tax Competitiveness Survey shows that companies value 'stability' and 'simplicity' above all else in terms of tax legislation. The Diverted Profits Tax rules tick neither box. However, in a small nod to simplification, these rules do not apply to companies whose UK revenue is less than £10 million per year (including sales made by connected companies)..

Source documents

- Diverted Profits Tax: guidance
- Diverted Profits Tax: policy paper

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Changes to the core rules on the tax treatment of loan relationships and derivative contracts

Following a long period of constructive consultation since June 2013, draft legislation has been published as part of a process to update the rules on loan relationships and derivative contracts to refocus the identification of taxable profits and losses, limit the scope for tax avoidance and better deal with the consequences of new GAAP accounting.

Who should read this?

These changes are relevant to all companies with loans and derivatives.

Summary of proposal

The starting point for the taxation of profits and losses from loan relationships and derivative contracts will continue to be the debits and credits recognised in GAAP compliant accounts as adjusted for specific rules, e.g. for loans between connected companies.

There are a number of changes and these are summarised below.

Follow the profit and loss account

A fundamental change is that there will be a movement away from taxing profits and losses from loan relationships and derivative contracts, broadly, wherever they appear in the accounts to a 'follow the profit and loss account' approach. This includes amounts which have previously been recognised in Other Comprehensive

Income and are subsequently transferred to the company's profit and loss account (section 308(1A) CTA 2009 for loans and section 597(1A) CTA 2009 for derivatives). Other Comprehensive Income is an accounting statement of changes not disclosed in the profit and loss account.

As a result, profits and losses from loan relationships and derivative contracts which are initially recognised in Other Comprehensive Income may be taxed in a later period, i.e. when transferred to the profit and loss account.

This general rule will be supplemented by specific rules dealing with certain matters which are recognised in Other Comprehensive Income but not subsequently transferred to the profit and loss account. In particular, where a company ceases to recognise a loan relationship or derivative contract in its accounts, profits and losses which have been recognised in Other Comprehensive Income will be taxed or allowed at the time when it is not expected that the amounts will be subsequently transferred to the profit and loss account (section 320A CTA 2009 for loans and section 604A CTA 2009 for derivatives).

It is recognised that in accounting periods beginning before 1 January 2016, amounts may have been recognised in Other Comprehensive Income and taxed or allowed applying current rules, but will be transferred to the profit and loss account in periods covered by the new rules. Without transitional rules, such amounts would be taxed or allowed again when recognised in the profit and loss account. Transitional adjustments, determined on a just and reasonable basis, are to be brought into account over the five years from the start of the accounting period beginning on or after 1 January 2016. The adjustments are spread as 40% in year one, 25% in year two, 15% in year three, and 10% in each of years four and five. If the company ceases to be within the scope of corporation tax (e.g. migrates tax residence from the UK) or starts to be wound up, any remaining transitional gains or losses are taxed or allowed at that time.

Fairly represents

Currently, the legislation says that the credits and debits which are to be taxed or allowed should 'fairly represent' profits and losses from loan relationships and derivative contracts. The relevance of this 'fairly represents' wording has never been entirely clear, even after it was considered by the Supreme Court in the *DCC (UK) Holdings* case. HM Revenue & Customs (HMRC) have concluded that this wording is no longer required as a result of the other changes.

In terms of commencement, if the 'fairly represents' requirement has prevented a debit or credit from a loan or derivative being brought into account in an accounting period beginning before 1 January 2016, no debit or credit is required to be brought into account in a subsequent accounting period to the extent that it represents the reversal of the credit or debit previously excluded.

Accounts drawn up for longer than 12 months

Where a company prepares its accounts for a period exceeding 12 months, profits and losses from loans and derivatives will be allocated between accounting periods on a time basis but GAAP profits and losses are to be used if the time apportionment basis would work unreasonably or unjustly (section 307(2A) to (2C) CTA 2009 for loan relationships and section 595(2A) to (2C) CTA 2009 for derivative contracts). Currently, the better view is that the apportionment is determined as though GAAP compliant accounts were drawn up at the end of each accounting period.

Debits or credits taken to the carrying value of an asset or liability

Currently, debits and credits from loan relationships and derivatives which are taken to the carrying value of a fixed capital asset or project (e.g. a subsidiary) are deductible, broadly, in the same way as if they were recognised in the profit and loss account. Going forward, this treatment will apply to debits and credits taken to the carrying value of both assets and liabilities for which taxable profits and losses are not calculated in accordance with GAAP.

This treatment does not apply to intangible fixed assets for which a 4% election has been made (revised section 320 CTA 2009 for loans and section 604 CTA 2009 for derivatives).

It is envisaged that this treatment would not apply to, say, interest taken to trading stock because taxable profits and losses would be calculated using GAAP amounts, i.e. when recognised within cost of sales in the profit and loss account.

Debits and credits recognised in equity

Currently, debits and credits from loans and derivatives recognised in equity are taxable and allowable (section 321 for loans and section 605 for derivatives). These provisions will be repealed for loan relationships entered into in an accounting period beginning on or after 1 January 2016.

This has the potential to particularly impact on companies operating in the financial sector, for example in respect of capital instruments issued by a bank. It is, however, anticipated that SI 2013/3209 will be revised to allow for coupons on regulatory capital securities to be tax deductible even if recognised in equity.

Restriction on debits from revaluation of loan assets

There is currently a provision which denies relief for revaluation debits in respect of loan assets apart from those arising from impairment or a release (section 324 CTA 2009). The provision is to be amended to make it clear that it does not apply to deny relief where fair value hedge accounting has been adopted such that the carrying value of a loan is adjusted for the fair value movement of a hedged risk.

For example, this could be relevant where a fixed interest borrowing is hedged by an interest swap contract (receive fixed rate and pay floating rate) and the carrying value of the borrowing is adjusted for movements in the fair value of the hedged interest risk, with corresponding debts and credits being recognised in the profit and loss account. Currently, the HMRC manuals provide helpful guidance such that, typically, this issue does not cause difficulties (CFM 33210).

Either a company has ceased to be or is not a party to a loan relationship or derivative contract

The legislation is being revised to make clear what amounts are to be brought into account when a company has ceased to be or is not a party to a loan relationship or derivative contract (section 330A CTA 2009 for loans and section 607A CTA 2009 for derivatives). This can be relevant because accounting standards may recognise profits and losses at a time when the company is not a party to a 'qualifying' loan relationship or derivative contract.

'Qualifying' loan relationships/derivative contracts include not only an actual loan relationship/derivative contract but also something that would be a loan relationship/derivative contract if the definition were extended to any person and not just a company.

A company is required to bring amounts into account, as recognised in the profit and loss account, as if the company were a party to a 'qualifying' loan relationship or derivative contract and if any of the following conditions are satisfied:

- Amounts in respect of a loan relationship/derivative contract continue to be recognised after the company has ceased to be a party to it;
- Amounts are recognised in the accounts in respect of a transaction which has the effect of transferring to the company all or part of the risk or reward relating to a loan relationship/derivative contract, without a corresponding transfer of the rights and obligations, e.g. with a sub participation agreement;
- Amounts are recognised in the accounts as a result of a related transaction (acquisition or disposal of rights or obligations under a loan relationship/derivative contract) to which a company has ceased to be a party; or

- Amounts are recognised in the accounts because the company may enter into a loan/derivative contract or related transaction but has not yet done so.

There are rules to prevent double counting.

- A debit is not to be brought into account if (1) it is brought into account by another company, (2) it reduces taxable profits of another company for the purposes of the controlled foreign company (CFC) rules or (3) it is allowable for the purposes of income tax (section 330B CTA 2009 for loans and section 607B CTA 2009 for derivatives).
- In relation to credits, on making a claim by a company, HMRC must make such consequential adjustments as are just and reasonable where, under these provisions, a credit is brought into account and (1) it is brought into account as a credit by another company, (2) it is brought into account for the purposes of the CFC rules by another company or (3) it is charged to income tax on a person (section 330C CTA 2009 for loans and section 607C CTA 2009 for derivatives).

Special rules for loans between connected companies

For loans between connected companies, the rules which adjust the accounting debits and credits will continue to apply with the following amendments.

Currently, debits and credits must be brought into account using an amortised cost basis of accounting (section 349(2) CTA 2009). This will continue to be the case but the meaning of amortised cost will change to follow the accounting definition. This will be a basis of accounting under which the loan is measured in the company's balance sheet at its 'amortised cost' using 'the effective interest method', but with that amortised cost being adjusted as necessary where the loan is the hedged item under a designated fair value hedge.

The terms 'amortised cost' and 'the effective interest method' take their meaning for accounting purposes (new section 313(4) and (4A) CTA 2009). This change will apply to loans between connected companies entered into in accounting periods beginning on or after 1 January 2016.

There are rules which can exclude debits and credits from loans between connected companies and these are being adjusted, as follows.

- First, where there is a related transaction in relation to a connected companies loan, credits must not be less and debits must not be more than they would have been if the related transaction had not been entered into, e.g. thereby denying relief for a loss on disposal of a loan asset (section 352 CTA 2009). Going forward, this provision will not affect credits and debits attributable to certain changes in interest rates (new section 352(3A) to (3C) CTA 2009). In addition, if debits have been reduced (by section 352 CTA 2009), no credit is required to be brought into account in respect of any reversal (new section 352A CTA 2009).
- Where the carrying value of a connected companies loan asset has been adjusted as a result of being a hedged item under a fair value hedge, certain rules which would normally deny relief for a debit are amended where there is a reversal of such amounts. Also rules which prevent a credit being taxed on a release of a loan are being amended. This is relevant for the rules which deny relief for debits arising from the impairment or release of connected loans (section 354 and section 358 CTA 2009). It is understood that the change is being made here to clarify the workings of the rules rather than make a substantive change.
- In addition, the rule which excludes credits arising in the borrower from a release of a connected loan (section 358 CTA 2009) is amended so that, going forward, it is made clear that this does not apply to exchange gains or losses.

Amendments to the unallowable purposes rule

The unallowable purposes rules for loans and derivatives are modified as follows.

- The rule can apply to a reduction in a credit to be brought into account in the same way as to a debit.
- For the purposes of the unallowable purposes rule, the term 'related transaction' is extended to include anything which equates, in substance, to a disposal or acquisition of rights or obligations (section 442 CTA 2009 for loan relationships and section 691 CTA 2009 for derivative contracts).

Tax adjusted carrying value of loans and derivatives

A new term, the 'tax adjusted carrying value' is introduced (section 465B CTA 2009 for loans and section 702 CTA 2009 for derivatives). This means the carrying value for accounting purposes as adjusted for certain tax rules, for example the rules which deny relief for the impairment for a loan between connected companies. The intention here is that various tax provisions will more clearly apply to the appropriate figures, for example the following.

- Where a company changes the basis of accounting, the starting point is that the difference between the carrying value between the old and the new bases of accounting is taxed or allowed. The rules will now work more effectively by picking up the carrying value as used for tax purposes (section 316 CTA 2009 for loans and section 614 CTA 2009 for derivatives).
- The intra-group transfer rules for loan relationships and derivative contracts currently deem the consideration to be the 'notional carrying value', but, going forward, the 'tax adjusted notional carrying value' will be used (section 340(6)(b) CTA 2009 for loans and section 625(6)(b) CTA2009 for derivatives).

Change in functional currency and designated currency elections

There are anti-avoidance provisions which exclude exchange gains and losses of an investment company that would not have arisen but for a change in the company's functional currency (section 328(2A) CTA 2009 for loans and section 606(2A) CTA 2009 for derivatives). It is to be made clear that these do not apply when an investment company has made an election to prepare its computation using a designated currency. In terms of commencement, these changes apply from 1 January 2016, irrespective of a company's year-end, with an accounting period which straddles that date being treated as two separate accounting periods.

Tax treatment of credit loss allowances

The proposed introduction of International Financial Reporting Standards 9 (IFRS 9) in 2018 requires the use of a new impairment model, typically resulting in the earlier recognition of credit losses. Many financial institutions will be obliged to recognise significant 'catch up' losses on adopting the new standard.

Amendments are to be made to secondary legislation during 2015 so that transitional adjustments arising on the first adoption of IFRS 9 will be spread over 10 years.

Timing

The revised rules which will apply to accounting periods beginning on or after 1 January 2016 unless otherwise stated above.

Our view

The draft legislation reflects a long period of constructive consultation since June 2013 and is part of a process to update the rules on loan relationships and derivative contracts to refocus the identification of taxable profits and losses, limit the scope for tax avoidance and better deal with the consequences of new GAAP accounting.

Source documents

- Corporation tax: modernising the taxation of corporate debt and derivative contracts

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Amendments to the loan relationships late interest rule and the equivalent for discounted loan notes

The rules relating to late paid interest and the equivalent for discounted loan notes are to be repealed. This will apply where the loans are held by companies and there is a control relationship between them and for certain joint venture arrangements.

Who should read this?

Companies who are applying the late interest rule and the equivalent for discounted loan notes where there is a control relationship between the borrower and lender and for certain joint venture arrangements.

Summary of proposal

As announced on 3 December 2014, following a review of the legislation on corporate debt, certain of the rules relating to late paid interest and the equivalent for discounted loan notes are to be repealed.

The rules were originally introduced to counter avoidance regarding the timing of relief for interest and discount. Since 2009, the scope of the rules has been narrowed such that borrowing from companies has typically only been affected if the lender is resident in a tax haven jurisdiction. This has resulted in the rules having limited application for intra-group loans other than for companies using the rules to control the timing of deductions to avoid trapped losses arising.

The rules are being repealed where the loans are held by companies and there is a control relationship between them and for certain joint venture arrangements. However, the rules will continue to be relevant in other circumstances, e.g. where the loan is made to a close company by a participator.

Timing

The repeal of the rules will take effect for new loans entered into on or after 3 December 2014. Existing loans will be impacted for amounts accruing from 1 January 2016, unless material changes are made to the terms of the loan or there is a change in the person holding the debt before then, in which case the amendment will apply from the date of the change.

The 1 January 2016 commencement date for existing loans is expected to coincide with certain other reforms arising from the consultation.

Our view

The changes are likely to be relevant for groups which have structured intra-group loans to fall within the avoidance provisions to defer the timing of relief.

Currently, HMRC guidance provides that, when applying the close company/participator test of connection, where loans are made from complex multi-investor partnerships, such that it is impractical to establish the extent to which the late interest rule may apply, broadly, relief can be taken on a paid basis (CFM35980 and CFM37310). It is not anticipated that the proposed changes will impact on this treatment.

Source documents

- *Draft legislation: Corporation Tax – preventing abuse of late paid interest rules*

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Reliefs for the refinancing of companies in financial difficulties

Three new reliefs are being introduced to help with the restructuring of companies which are in financial difficulty – a relief for releases of loans and two changes where there is a substantial modification of the terms of borrowing.

Who should read this?

The provisions are relevant to companies in financial difficulties where a third party lender is prepared to release a loan and where loss-making groups are refinanced, typically via an 'amend and extend' restructuring of the borrowing terms.

Summary of proposal

Three new reliefs are being introduced to help with the restructuring of companies which are in financial difficulty.

Release of borrowings

A new relief for releases of loans is being introduced so that a taxable profit will not arise for the borrower if, immediately before the release, it is reasonable to assume that there would be a material risk that, without the release and related arrangements, at some time in the next 12 months the borrower would be unable to pay its debts as they fall due or the value of the company's assets will be less than the amount of its liabilities (new section 322(5B) CTA 2009).

Substantial modification of the terms of borrowing

Provisions are being introduced to deal with the situation where a debt is modified or replaced, resulting in a 'substantial modification' for accounting purposes, giving rise to additional debits and credits with new GAAP accounting.

By way of background, with 'old' UK GAAP (excluding FRS 26), typically a substantial modification to the terms of a borrowing does not result in profits or losses being recognised. However, with new GAAP accounting standards, when the terms of a debt are substantially modified, the 'original' liability is derecognised or taken off the balance sheet and a 'new' replacement liability is recognised on the balance sheet at its fair value. Broadly, any excess of the carrying amount of the original liability over the fair value of the new liability is credited to the profit and loss account. Subsequently, the debt is written back up to face value with debits going to the profit and loss account.

For example, if a company amends the terms of a borrowing of 100 and the accounting is to derecognise the liability of 100 and recognise a 'new' liability at its fair value of 70, the borrower would recognise a refinancing credit of 30 with debits of 30 being recognised over the remaining term of the debt.

If the refinancing credit is taxable such that cash tax is payable, this would represent a significant downside for the borrower at a time when it is trying to secure new funding terms.

Going forward, if a substantial modification of a borrowing takes place for accounting purposes, the borrower is not required to recognise a taxable profit in respect of the reduction in the carrying value of the liability if a condition is satisfied.

The condition is that, immediately before the modification or replacement, it is reasonable to assume that, without the modification and related arrangements, there would be a material risk that at some time within the next 12 months the borrower would be unable to pay its debts as they fall due or the value of the company's assets will be less than the amount of its liabilities.

In these circumstances, debits representing the reversal of the non-taxable credit are not deductible (new section 323A CTA 2009).

Overall, the effect is to disregard, for tax purposes, the credit and debits arising from the modification of the borrowing terms.

Transitional relief for companies whose borrowings have been substantially modified and subsequently adopt new GAAP accounting

The rules described above are supplemented by some regulations which were laid before Parliament on 2 December 2014 (SI 2014/3187) and which provide for a transitional relief where there is a substantial modification of a company's debt in the comparative period to the adoption of new GAAP accounting.

The effect of the regulations is to not tax the transitional credit and treat the reversal of the credit as non-deductible if the conditions are met.

Further details are provided in *Weekly Tax Matters* of 5 December 2014.

Timing

The reliefs will apply to a release, modifications or replacement of a loan on or after 1 January 2015. The transitional regulations apply to periods of account beginning on or after 1 January 2015.

Our view

These are important changes which deal with problems that have already been faced by companies which have been applying new GAAP accounting standards and which are expected to be more common following the mandatory transition to such accounting standards for periods of account beginning on or after 1 January 2015.

Source documents

- *Modernising the taxation of corporate debt and derivative contracts*

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Targeted anti avoidance rules (TAARs) for loan relationships and derivative contracts

A TAAR is being introduced to counteract the effect of arrangements if their main purpose, or one of the main purposes, is to enable a company to obtain a tax advantage under the loan relationship and derivative contract rules. There is an exclusion where the obtaining of the tax advantage can reasonably be regarded as consistent with any principles on which the loan relationship and derivative contracts rules are based and the policy objectives of these provisions.

Who should read this?

Companies will need to consider the possible impact of the TAARs if arrangements are entered into which seek to obtain a tax advantage in respect of loan relationships and/or derivatives.

Summary of proposal

A TAAR is being introduced to counteract the effect of arrangements if their main purpose, or one of the main purposes, is to enable a company to obtain a tax advantage under the loan relationship rules (section 455B to 455D CTA 2009). A similar rule will apply for derivative contracts (sections 698B to 698D CTA 2009).

The situations where a company obtains a tax advantage include arrangements which increase debits or reduce credits brought into account, or impact on the timing of when debits and credits are brought into account.

If one of the TAARs applies, adjustments are to be made to debits and credits on a just and reasonable basis.

There is an exclusion for arrangements if the obtaining of the tax advantage can reasonably be regarded as consistent with any principles on which the loan relationship and derivative contracts rules are based (whether expressly or implied) and the policy objectives of these provisions.

The legislation includes examples of outcomes that may indicate that this exclusion should not apply, but only where it is reasonable to assume that such an outcome was not anticipated when the relevant provisions were enacted.

For example, the TAAR could apply where the effect of arrangements is that taxable profits are lower than the economic profit or deductible losses are higher than the economic loss or the arrangements prevent or delay the recognition of profits or losses in the accounts.

This additional anti-avoidance rule for loan relationships and derivative contracts has enabled HMRC to repeal a number of specific anti-avoidance provisions. For example, the provision to counter arrangements to circumvent the rules applying to debt purchased at a discount to face value (section 363A CTA 2009).

Timing

The TAARs and the repeals of existing anti avoidance legislation will apply to arrangements entered into on or after 1 April 2015.

Our view

Currently, it is necessary to consider the purpose for which a company is a party to a loan/derivative or undertakes a related transaction (the unallowable purposes rule). Going forward, it will also be necessary to assess whether the tax outcome can reasonably be regarded as consistent with the principles on which the legislation was based, and if it is reasonable to assume that the result was anticipated when the relevant provisions were enacted.

In effect, this represents a general anti-avoidance rule which only applies to the regimes for loan relationships and derivative contracts.

Source documents

- *Corporation tax: modernising the taxation of corporate debt and derivative contracts*

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Amendments to the rules for designated currency elections made by investment companies

The rules related to designated currency elections of investment companies are being revised. For example, the results of any parts of the business, such as a branch, will now be calculated as though the functional currency of the branch were the same as the designated currency.

Who should read this?

Investment companies who have already made a designated currency election or are considering making an election in the future.

Summary of proposal

An investment company can elect to prepare its corporation tax computations in a designated currency provided that certain conditions are satisfied, e.g. that a significant proportion of its assets and liabilities are denominated in that currency.

The rules regarding when the election can be made, the effect of the election and when the election is to be revoked are being revised. For example, the results of any parts of the business, such as a branch, will now be calculated as though the functional currency of the branch were the same as the designated currency.

Timing

The changes apply from 1 January 2016, irrespective of a company's year-end, with a period of account which straddles that date being treated as two separate periods.

Our view

For many companies, the proposed changes are not expected to be significant. However, it is recommended that the potential implications are reviewed, particularly if the company has branches.

Source documents

- *Corporation tax: modernising the taxation of corporate debt and derivative contracts*

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Relief for expenditure on Research & Development (R&D)

The rate of the R&D Expenditure Credit for large company R&D has increased from 10% to 11% and the rate of relief for Small and Medium Enterprises (SMEs) has increased from 225% to 230%. This is accompanied by a narrowing of the definition of qualifying expenditure for R&D relief where a company sells, transfers or hires out products produced through R&D activities.

Who should read this?

Innovative companies that are claiming or are thinking of claiming R&D relief.

Summary of proposal

The measure increases the rate of the research and development (R&D) Expenditure Credit for large company R&D from 10% to 11% and the rate of relief for Small and Medium Enterprises (SMEs) from 225% to 230%.

The proposal also narrows the definition of qualifying expenditure for R&D relief in relation to consumable items under both the SMEs and large company schemes.

Consumable items include materials and utilities such as water, fuel and power that are consumed or transformed during the R&D activities. Where a company sells, transfers ownership of, or hires out a product that incorporates consumable items and which was produced in the course of undertaking R&D, the costs of those consumable items will not be qualifying expenditure for R&D relief. This includes materials, components or machine parts that make up a finished product or items that are used or physically or chemically changed in some way during its production.

The restriction will apply where the R&D is in the product itself or relates to the process of producing the product. The proposals will apply to expenditure incurred on or after 1 April 2015.

The rules ensure that where only part of a product, or only some of a number of products, are sold, transferred or hired out then an appropriate proportion of expenditure on consumable items is treated as non-qualifying. This means that the costs of consumables that relate to products, or parts of products, that are recycled into additional trials or discarded will still be qualifying expenditure for R&D relief.

Timing

The provisions will apply to expenditure incurred on or after 1 April 2015.

Our view

The R&D regime provides an incentive to businesses to innovate, contributing to growth in the UK economy. A further increase in the rates of relief for both SMEs and large companies will further incentivise R&D activity in the UK, which is great news for the UK economy. The recent introduction of the R&D Expenditure Credit is already influencing the decisions of global companies on where to locate R&D activity. An increase in the rate to 11% should strengthen the UK's position to attract high tech, innovative activity and the jobs associated with this.

HMRC have, for a number of years, had concerns regarding the application of the R&D rules to situations where goods that are produced as a result of R&D activity are sold. So at the same time as increasing the generosity of the incentives available from the regime, the measure attempts to refocus those incentives to the costs of materials and utilities that are not used in the production of goods.

In our view, SMEs that are required to sell the products of their R&D to maintain cash flow and engineering and manufacturing companies which provide specialist and first in class products or develop and use innovative manufacturing processes could be significantly affected by this measure. We do, however, welcome the fact that consumable costs will remain eligible where products are recycled into further trials or discarded. We recommend that taxpayers consider the impact of the proposal on their R&D claims and participate in the Government consultation to ensure that the rules are appropriately targeted.

Source documents

- *Research and Development tax credits: increasing generosity*
- *Corporation tax: research and development tax credits: consumables*

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Arrangements offering a choice of income or capital return to shareholders

For UK tax resident companies, returning cash to shareholders and offering them the choice of income or capital treatment will no longer be effective with such returns being taxed as dividend income to the extent that they are received on or after 6 April 2015. This will remove the potential advantage of having returns taxed as capital gains with the benefit of the CGT annual exemption.

Who should read this?

UK tax resident companies seeking to return cash to shareholders, including any companies that have already entered into arrangements (commonly known as 'B share schemes') to return cash under which any part of the return may fall to be made on or after 6 April 2015.

Summary of proposal

The charge to income tax on dividends and other distributions from UK tax resident companies is to be extended to include 'alternative receipts'. An 'alternative receipt' arises where (i) shareholders are given the choice of receiving a dividend or some other receipt from the company or a third party; (ii) the other receipt is of substantially the same value as the dividend; (iii) they have chosen the other receipt; and (iv) the other receipt would not otherwise have been subject to income tax. For these purposes, it doesn't matter whether the shareholder's choice is conditional. A shareholder will be treated as having chosen the alternative receipt where it is received due to a failure, whether through action or inaction, to choose the dividend.

The alternative receipt will be liable to income tax as a qualifying distribution (i.e. dividend plus tax credit) with the ability to claim a consequential adjustment for any tax other than income tax paid on the receipt.

Timing

The measure will take effect from 6 April 2015 and will apply to amounts received on or after that date irrespective of when the arrangements to return cash were entered into.

Our view

Historically, HMRC regarded the income/capital choice conferred by B share schemes as tax motivated and for this reason had refused to grant clearance for such schemes under the transactions in securities rules. When those rules were amended such that they applied only to close companies, B share schemes became the norm for listed groups seeking to return surplus cash.

Although the difference between the highest rates at which dividends and capital gains are taxed is relatively small, taxpayers subject to these rates have benefitted from increases in the annual capital gains exempt amount.

Arrangements entered into already under which shareholders may receive part of their return on or after 6 April 2015 are also caught, so the shareholders concerned will not get the benefit of their 2015-16 capital gains exempt amount on this part of their return.

The inclusion of alternative receipts from third parties ensures that shareholders are still caught where obtaining capital treatment relied upon the B share being sold back to the company via a bank or broker.

Source documents

- *Income tax: special purpose share schemes*

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Changes to Principal Private Residence Relief

Principal Private Residence Relief (PPR) from capital gains tax is to be restricted from April 2015 where a residence is located in a territory in which the taxpayer is not resident. A new day count test, which broadly requires the taxpayer to spend at least 90 midnights at the residence in order for it to be eligible for the relief, will be introduced.

Who should read this?

UK and non-UK resident taxpayers (including trustees and personal representatives of a deceased person) with more than one residence who have made or wish to make an election for PPR from capital gains tax (CGT); employees and employers of assignees to and from the UK.

Summary of proposal

As announced in the Government's response to the consultation 'Implementing a capital gains tax charge on non-residents', changes will be made to PPR from CGT that affect both UK and non-UK resident taxpayers. Without any change to the current PPR rules, a non-UK resident with a UK residential property could nominate it as their main residence to obtain PPR, and thereby avoid the extended CGT charge. HMRC believe this would undermine the extension of the CGT rules to non-residents (see separate section on page 50 of this commentary).

Currently, an individual (and in certain circumstances trustees and personal representatives) is entitled to relief from CGT on the sale of their only or main residence. Where an individual has lived in the property from the date of purchase to the date of sale, any gain arising on the sale is covered by PPR and is fully exempt from CGT. The last 18 months of ownership of the property are covered by the relief, even where the individual has not actually lived in the property during that period.

Taxpayers with more than one residence are able to elect to choose which residence is their main residence for PPR and this will continue. However, a new rule is being introduced, from 6 April 2015, for situations where the property is located in a different 'territory' to that in which the taxpayer is resident. The new rule will restrict the availability of PPR for both non-UK residents with property in the UK and UK residents with property located in another country. The Finance Bill contains the draft legislation to incorporate these proposals into law from 6 April 2015.

The new restriction on PPR

From 6 April 2015 any residence owned by a UK or non-UK resident will only be capable of qualifying for PPR if it is located in a territory in which the individual is resident or, where it is located in a different territory, the individual meets the 'day count test' in relation to the residence.

In determining the residence status of the individual, the Statutory Residence Test will apply in the UK. For other territories, an individual will be treated as resident there if they are liable to tax in that territory by virtue of their residence or domicile, albeit they will not be treated as so resident if that tax liability arises only in relation to income from sources in that territory or capital situated there. They cannot therefore be treated as resident for this purpose in a country that does not have any taxation. Where an individual is resident in another territory for part only of a tax year, they will for these purposes be treated as resident there if they are actually resident for at least half of the tax year.

The legislation refers to 'territory' rather than country. This appears to be so that it covers jurisdictions such as the Channel Islands which do not have full independent status as countries. In its application to federal states such as the USA and Switzerland, we understand from HMRC that 'territory' is intended to mean the country and not an individual state. This may need to be clarified before the legislation is enacted.

The day count test

The day count test will be met if the individual or their spouse/civil partner spend at least 90 midnights in the property in the tax year (although no one day can be counted twice by virtue of both the individual and their spouse/civil partner being there at the same time). Where the individual has an interest in more than one dwelling in the territory in which the property is located, midnights spent in those other dwellings can be aggregated with days spent in the property in question to determine whether the 90 midnight threshold is met.

Where the individual owns the property for a part only of a tax year, the 90 day threshold in the day count test will be reduced pro-rata.

Whilst there appear to be a couple of drafting issues with the legislation, the above is the apparent intention of the day count test.

Periods of absence

As well as the last 18 month period of ownership other periods of absence from the property (in particular a period whereby an individual cannot occupy the property because they are required by their employer to work outside the country) can also be covered by the relief, provided the property is occupied as the main residence both before and after the period of absence.

In order to accommodate the new PPR rules for properties owned elsewhere than where an individual is resident:

- It will not be possible to claim PPR on one property and also relief for another property for the same period under the absence relief rules, save for the last 18 months;
- An non-resident individual must meet the 90 days occupation test in respect of a property after a period of absence in order for the absence relief to apply to that property.

Individuals who have occupied a property as a main residence for all but the last 18 months will still be able to qualify for full relief even if they dispose of the property whilst non-UK resident. For example, an individual who occupied a property for five years whilst UK resident and then left the UK and became non-resident would be able to sell the property within 18 months of leaving the property and not suffer any CGT due because the last 18 months qualifies for relief.

A difficulty with absence relief under the current rules is that although the property has to be re-occupied as a principal residence there is no minimum period of occupation that is specified in the legislation. It is the quality of occupation that is important not just the period of occupation (although it must be more than merely temporary accommodation). For non-residents we now have a clear minimum of 90 midnights as being the minimum period of re-occupation. For individuals who recommence UK residence there is still no minimum period of occupation required to qualify for absence relief in the draft legislation. It is, however, likely that 90 midnights would be viewed as the minimum period required.

Timing

The new restriction on PPR will apply from 6 April 2015.

The taxpayer will have, as under the current rules, two years from the date of acquisition of a second or subsequent property to make an election for PPR where permissible under the new rules. Where an election has been made previously for a property which from April 2015 is not capable of benefiting from PPR, the election should be varied in favour of a property which does qualify for the relief no later than 5 April 2017 to avoid there being a period during which the relief is not being used at all.

Our view

In practice, under the new rules, UK tax residents will typically continue to obtain PPR for their UK homes as with the current rules. Individuals who retire abroad but keep their homes in the UK, will be treated as entitled to PPR for the years they were in the UK, but will be subject to the 90-day rule thereafter for each tax year from 2015/16 onwards (apart from the last 18 months of ownership). The same will apply to international assignees who become non-UK resident but keep their UK property, which was their main residence before departure.

A UK tax resident with an overseas second home must from 6 April 2015 satisfy the new 90 day rule (unless they are also resident in the relevant territory), even if they have already elected for the second home overseas to be their main residence for PPR.

From 6 April 2015 individuals may have to seek overseas advice to determine whether or not they are 'resident' in a territory in which they have a dwelling, in order to determine whether they need to meet the day count test before being able to make an election for the property to be their main residence for PPR.

Impact on assignees and their employers

Many assignees to and from the UK keep residential property in their home location and may sell the property while on assignment. Typically these assignees, particularly those from the UK, would expect such a sale to be free of UK CGT. However, these assignees may be caught by these new rules.

Assignees who are tax equalised (i.e. are guaranteed a net after tax salary with the employer paying the tax due) may expect the employer to pay the CGT bill on the disposal of their old pre assignment residence. This is because in broad terms the equalisation policy intends that the assignees would pay the tax that they would pay at home and if they were resident they would be able to claim PPR.

Employers will need to check their policies carefully, particularly any provisions regarding exceptions to the policy and decide whether they wish to pay the tax on the disposals of principal residences or not and include appropriate comment in their tax equalisation policies.

Employees may be more reluctant to take up overseas assignments unless they receive some assurance that any tax costs associated with the sale of their former private residence will be met. In addition, employers who decide to meet these costs will face higher costs of overseas assignments.

The new 90-day rule and the Statutory Residence Test

The new 90-day rule for PPR may – in certain circumstances – have an impact on an individual's residence status under the Statutory Residence Test (SRT).

For example consider the situation of an individual who:

- has been non-UK resident in the previous three tax years;
- has not been working in the UK;
- has family resident with him overseas;
- has a home overseas; and
- has only one statutory 'tie' with the UK, that 'tie' being available accommodation.

This individual can spend up to 183 days in the UK without becoming UK tax resident under the SRT. This might enable the individual to spend 90 nights visiting the UK and benefit from PPR without becoming UK tax resident (although for individuals working outside the UK, their work obligations may make this impossible in any event).

After one tax year, that individual will acquire one more 'tie', because he will have spent 90 days in the UK in the previous year. That means that in the second year, the individual could spend up to only 120 days in the UK if he does not want to become UK tax resident.

Under the third automatic overseas test of the SRT an individual is non-resident for a tax year if:

- they work sufficient hours overseas;
- there are no significant breaks;
- the number of UK days where more than three hours work is performed in the UK is less than 31; and
- the number of days in the UK is less than 91.

An individual could theoretically meet the new 90 day count test for PPR and satisfy the above SRT test. However, this would be a very risky strategy as staying just one extra day would break the non-residence test and could make the individual UK tax resident for that year.

It appears that the broad intention is to prevent non-residents being able to benefit from PPR. There do in practice appear to be some, albeit limited, circumstances in which a person can simultaneously accrue PPR and be non-resident on an ongoing basis.

Source documents

- *Implementing a capital gains tax charge on non-residents: summary of responses*

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Simplifying the administration of employee benefits and expenses

As announced in the Autumn Statement, legislation will be introduced in Finance Bill 2015 to exempt from tax certain expenses payments and benefits-in-kind provided to employees. This follows an announcement at Budget 2014 and public consultation over the summer. The legislation will apply where employees would have been eligible for tax relief if they had incurred and met the cost of the expenses or benefits themselves. This exemption will replace the rules that require employers to report business expenses on employees' Forms P11D, or to otherwise obtain a dispensation from P11D reporting from HMRC. Under the old rules, where business expenses have been reported on Forms P11D individuals would subsequently claim a deduction via their Self Assessment tax return – this will no longer be necessary with the introduction of an exemption. However, the exemption will not apply where expenses are paid as part of a salary sacrifice arrangement. These changes will have effect from 6 April 2016. A summary of responses to the public consultation was published alongside the draft clauses.

Who should read this?

All employers who:

- Currently pay or reimburse expenses or benefits to their employees;
- Have a current P11D reporting dispensation in place;
- Currently pay or reimburse expenses or benefits as part of a salary sacrifice arrangement.

Summary of proposal

Under the current legislation, employers can apply to HMRC for a P11D reporting dispensation in respect of payment and reimbursement of business expenses and provision of certain benefits. Once granted this removes the need to report such items on an employee's Form P11D. The proposed legislation moves the position to a system of automatic exemption for qualifying expenses and benefits, with the object of removing unnecessary administration and cost for employers.

The draft legislation also provides for a similar exemption regime for payment of flat rate expenses, albeit that certain conditions will need to be met in order to enable such payments to be paid tax free. These will include a system to check that expenses would be deductible if claimed by the employee and are actually being incurred.

As part of this move away from dispensations, the Government has resolved that payments of qualifying expenses and benefits made as part of a salary sacrifice arrangement will not meet the requirements for exemption.

Timing

The proposed revisions will come into effect on 6 April 2016, but with enabling legislation being included in Finance Bill 2015. Corresponding changes will be made for NIC purposes which will be effective from the same date.

Our view

The exemption approach has its origins in the Office of Tax Simplification's Review of Employee Expenses. The Summary of Impacts for this measure anticipates that 200,000 business could benefit from reduced administration of £9.3 million per annum.

However, abolition of the longstanding Form P11D reporting dispensation process in relation to qualifying expenses and benefits will mean a considerable change for employers, and they will therefore need to ensure that their systems, policies and procedures are appropriate for the new regime, even in the absence of the requirement for a Form P11D dispensation.

Further clarification and guidance will be issued by HMRC ahead of the exemption being introduced, which we hope will be clear and comprehensive for employers to follow. Employers should ensure that they have considered their specific arrangements and what is currently covered by their existing Form P11D dispensations well ahead of the commencement date. For example, the draft legislation makes provision for certain flat rate payments to be paid tax free, but only where paid in accordance with the Regulations, or where approval has otherwise been given by HMRC.

It is no surprise to see salary sacrifice mentioned as part of the draft legislation, given the concerns raised by the Government during the consultation phase about 'abuse' in relation to certain travel and subsistence arrangements. However, many felt that there were other ways in which such abuse could have been tackled short of an outright prohibition against salary sacrifice arrangements and they will be disappointed by the Government's approach.

For those employers who currently have salary sacrifice arrangements in place in respect of paid or reimbursed expenses, careful consideration will need to be given to managing change ahead of 6 April 2016. This should include consideration of the relevant employment law position (particularly where employee take home pay will fall) and communication with employees to explain what will happen going forward.

Source documents

- *Employee Benefits and Expenses – exemption for paid or reimbursed expenses – Summary of responses*

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Real time collection of tax on benefits in kind and expenses through voluntary payrolling

Primary legislation is being introduced to allow HMRC to amend the PAYE regulations to allow the voluntary payrolling of benefits in kind.

Who should read this?

Any employers who are currently, or are considering, payrolling benefits in kind.

Summary of proposal

The Chancellor announced at the 2014 Budget that the Government would consult on the payrolling of benefits in kind. The draft Finance Bill contains legislation to allow HM Revenue & Customs (HMRC) to introduce regulations to put the voluntary payrolling of benefits in kind on a statutory footing. An intention of this legislation is to make the PAYE system more accurate, as the employer will operate PAYE on the taxable amount of the benefit in kind in real-time without having to wait for HMRC to issue amended PAYE coding notices following the submission of forms P11D after the tax year end.

Consultation on the technical aspects of the scheme will continue, with regulations being introduced to allow from 6 April 2016 the payrolling of:

- Company cars;
- Car fuel benefit;
- Medical insurance; and
- Subscriptions such as gym membership.

In particular HMRC will consult on the 'extent to which employers would, in practice, decide to payroll medical benefit and not car benefit'. Another specific point they wish to explore is the extent to which employers may wish to exclude certain employees from the payrolling of benefits in kind, for example seconded expatriate employees or directors.

The Government states that it wishes to strike a balance between flexibility and consistency amongst employers. The response document states that to provide the flexibility required by respondents, when an employer has started payrolling benefits in one tax year they will be able to opt out again from the start of another tax year. The document raises the point that the employees' PAYE codes will need to be re-issued with the benefits in kind reinstated if the employer does opt out of payrolling benefits. However, the response document does not consider that codes will also need amending when the employer 'opts in' to the scheme if an overpayment of tax is to be avoided.

HMRC will also explore further a number of options raised by respondents, namely:

- End of year reconciliations;
- Sudden fluctuations in the taxable amount of benefits in kind;
- Reduced pay;
- Internationally mobile employees;
- One-off benefits in kind;
- The interaction with Universal Credit;

- Using the form P11D as a sweep-up to report benefits not payrolled;
- Year-end reconciliations;
- The interaction with PAYE Settlement Agreements; and
- The 50% deduction limitation.

Timing

The 2015 Finance Bill will contain enabling legislation to allow HMRC to introduce PAYE regulations that will allow the statutory payrolling of benefits in kind with effect from 6 April 2016. The payrolling of benefits in kind will be voluntary so employers will be able to commence the payrolling of benefits at a later date. It is expected that most employers will wish to commence payrolling of benefits in kind at the start of a tax year.

Further consultation on the technical details of the scheme will continue and further PAYE regulations may then be made.

Our view

It is clear from the response document that there are still a large number of technical points to be ironed out before this voluntary payrolling of benefits in kind is introduced.

As well as the issues discussed above, the exact form of the reporting under Real Time Information (RTI) needs to be agreed. This is perhaps one of the most urgent points as software developers will need time to amend their software to meet the new specifications. This will be particularly so if the Real Time Information report is to replace the form P11D reporting. The removal of form P11D reporting is one of the reasons given for the enthusiasm with which the payrolling of benefits was welcomed by respondents.

Respondents welcomed the option to account for Class 1A NICs in real-time when the benefits were being payrolled, provided that it was optional. They took the view that there was a balance between paying in advance and administrative burden at the year end. We await further details on how this will work.

The legislation and the consultation response document issued at the same time is only a step towards the payrolling of benefits in kind and there is a lot of work to be done before it can be rolled out successfully.

Source documents

- *Real time collection of tax on benefits in kind and expenses through voluntary payrolling*

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Statutory exemption for trivial benefits-in-kind

The Government will introduce a statutory exemption from tax and NIC for trivial benefits-in-kind costing less than £50.00.

Who should read this?

Employers who provide low cost or low value benefits-in-kind who currently have to collate and report this information to HMRC.

Summary of proposal

Currently employers must collate details of benefits-in-kind provided to their employees and report these annually to HMRC – either on a Form P11D/P9D or through their PAYE Settlement Agreement. The value of the benefit-in-kind is subject to UK tax and NIC. There is no *de minimis* limit applicable whereby reporting is not required, although by concession it is possible to agree with HMRC that a benefit is considered to be 'trivial' and does not need to be reported.

The Finance Bill introduces a statutory definition of 'trivial', placing an upper limit on the value of the benefit of £50.00. The initial consultation suggested a figure of £30.00. Other conditions that also apply include:

- that the benefit cannot be cash or a cash voucher;
- that the benefit is not provided as part of a salary sacrifice arrangement or any other contractual obligation; and
- that the benefit is not provided in recognition or anticipation of particular services or duties performed in the course of employment.

Timing

The changes will be introduced from 6 April 2015.

Our view

This was initially proposed by the Office of Tax Simplification in their report on the UK expenses and benefits system for employees.

The adoption of the proposal and new statutory provision is a welcome simplification of the existing concessionary exemption, saving employers and HMRC the time and expense of agreeing what constitutes a trivial benefit on a case-by-case basis.

The Government has listened to representations and will now allow non-cash vouchers to be covered by the exemption. The Government has agreed with respondents' views that it would be difficult to define 'irregular benefits' and has therefore decided that instead the benefit should not be in respect of particular services performed. The Government has also agreed with respondents' views that an annual cap would be too much of an administrative burden.

Source documents

- *Income tax - Statutory exemption for trivial benefits in kind*

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Abolition of the £8,500 threshold for benefits-in-kind

The Government will abolish the £8,500 threshold at which employees pay tax and NIC on certain benefits-in-kind provided by their employer.

Who should read this?

Employers who provide benefits-in-kind to employees who earn less than £8,500 per annum.

Summary of proposal

Currently UK tax and National Insurance contributions (NIC) on the value of all benefits-in-kind provided to employees arises only where their total income exceeds £8,500 per annum. Where an individual's total income is less than this threshold, then certain benefits-in-kind can be provided free of tax and NIC. Unless the benefits-in-kind are included in an employer's PAYE Settlement Agreement, the benefits will be reported on a Form P11D for the employees at or above the income threshold and a Form P9D for those below it. Although there are some exceptions where both the employee and employer pay NIC on the value of the benefit-in-kind provided, NIC is generally only a cost for the employer.

A Form P9D only requires an employer to report certain classes of benefits – relocation expenses, living accommodation, vouchers and personal liabilities assumed on the employee's behalf amongst them. Benefits such as private medical insurance, company cars and low cost or interest free loans which are reported on a Form P11D can therefore be provided to individuals on low incomes free of tax and NIC.

With the abolition of the £8,500 income threshold all benefits-in-kind will be brought into charge for tax and NIC and all employees will pay tax and NIC in the same way.

Measures will be introduced to ensure that Ministers of Religion are not adversely impacted by this change. Firstly, the existing exemptions for those in lower paid employments will remain in place so that payment of accommodation costs (primarily utility costs) or cash allowances paid to meet these costs will continue to be tax and NIC free. A new exemption covering other benefits-in-kind provided to Ministers whose total income is below £8,500 will also be introduced. They will, therefore, remain in the same position as they were in before Finance Bill 2015.

A further exemption for employees who work as carers and who live in the home of the person for whom they are caring will also be introduced. There will be no tax or NIC arising from the provision of this benefit for either the carer or the person providing the accommodation benefit.

Timing

The changes will be introduced from 6 April 2016.

Our view

These measures were initially proposed by the Office of Tax Simplification (OTS) in their report on the UK expenses and benefits system for employees, with various consultations taking place after the publication of the OTS report.

Overall, the new measures will simplify procedures for employers and save both time and administrative costs, as they will no longer need to track and differentiate between groups of employees. In accepting the recommendations of the OTS and in introducing these measures, the Government has taken account of the responses to the consultation that there would be few employees earning below the income threshold but who were in receipt of benefits-in-kind. They have opted for simplicity and have introduced specific measures for the groups identified in the consultation as being adversely impacted by these changes. They have also taken account of the fact that many respondents felt that the reduction of administrative costs would offset any increased NIC which become payable.

The measure will increase tax costs for any other individuals on low incomes who receive benefits-in-kind and whose total income is not taken out of tax completely by the increased personal allowance. If there are employees in this position then employer costs will also increase with additional NIC being payable. If this affects anyone it is likely to be small employers, and would be an unfortunate outcome of a welcome simplification of the rules.

Source documents

- *Abolition of the £8,500 threshold for lower paid employment and form P9D*

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Changes to the benefit-in-kind and fuel scale charges for company cars/vehicles

HMRC have published draft legislation that amends the rates used to calculate the taxable benefit-in-kind for company cars and vans. They have also changed the multipliers used to arrive at the fuel scale charge which, in turn, defines the benefit-in-kind that arises when an employee receives fuel for private motoring.

Who should read this?

Employers that provide company cars/vans, and employees provided with company cars/vans that are made available for private use.

Summary of proposal

As announced at Budget 2013 and Budget 2014, legislation will be introduced in Finance Bill 2015 to increase the appropriate percentages for calculating the benefit charge for cars.

From 6 April 2017, the graduated table of company car tax bands will provide for:

- a 9% band for cars with emissions of 0-50g CO_2 per km;

- a 13% band for cars with emissions of 51-75g CO2 per km; and
- a 17% band for other low emission cars (76g-94g CO2 per km).

There will then be a 2% increase on this rate for each rise in emissions of 5g CO2 per kg from 95g CO2 up to the existing maximum of 37%.

The legislation will also increase the appropriate percentage for cars without a CO2 emissions figure and for cars registered before 1 January 1998, in both 2017-18 and 2018-19. From 6 April 2017, the appropriate percentage for:

- (cars with a cylinder capacity of up 1,400cc) will be set at 18%;
- (cars with a cylinder capacity greater than 1,400cc but no more than 2,000cc) will be set at 29%; and
- (cars with a cylinder capacity greater than 2,000cc) will remain at 37%.

The maximum percentage for diesel cars registered on or after 1 January 1998 will be set at 37% for 2015-2016.

With effect from 6 April 2015, the van benefit charge (currently nil) will increase on a tapered basis for company vans which cannot in any circumstances emit CO2 by being driven (zero-emission vans). The van benefit charge for zero emission vans will be 20% of the value of the van benefit charge for vans which emit CO2 in 2015-16 it will increase to 100 as follows:

- 40% in 2016-17;
- 60% in 2017-18;
- 80% in 2018-19; and
- 90% in 2019-20.

From 2020-21 it will be 100% with a single van benefit charge applying to all vans. This means that employees using zero-emission vans for more than insignificant private use will now be liable for the charge, although the full charge will not come into effect until 2020-21.

Although outside of Finance Bill 2015, an Order was laid before the House of Commons on 2 December 2014 which will take effect 6 April 2015. This Order confirms the following:

- Company car benefit-in-kind multiplier will change from £21,700 to £22,100.
- Van benefit-in-kind multiplier will change from £3,090 to £3,150.
- Van fuel scale charge benefit-in-kind multiplier will change from £581 to £594.

Timing

These measures will begin to take effect on 6 April 2015.

Our view

These measures are in line with expectations and are not, relatively speaking, complex. The increases in the various benefits-in-kind will result in larger tax payments by employees to HMRC. Employer Class 1A NIC costs will also increase. Currently the tax on car and van related benefits-in-kind are typically collected through additional payroll deductions via adjustments to employee PAYE tax codes. This mechanism may shift from PAYE code adjustments towards voluntary payrolling of benefits following new Regulations which set out the statutory framework for voluntary payrolling (see above).

Source documents

- [Income Tax: company car tax rates and bands for 2017 to 2018 and 2018 to 2019]
- [Income Tax: van benefit charge for zero emission vans]

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Abolition of Employer NIC for apprentices under 25.

From 6 April 2016, Employer NIC will not be charged on earnings from apprenticeships for the under 25s. The exemption is restricted to earnings up to the Upper Earnings Limit (UEL) which is currently £805 per week. Earnings in excess of the UEL will be subject to employer NIC at the normal rate of 13.8%. Legislation for this measure will be included in a National Insurance Contributions Bill rather than in the Finance Bill.

Who should read this?

All employers who have or are considering implementing apprenticeships.

Summary of proposal

Employer NIC will not be charged on earnings from apprenticeships for the under 25s. The future NIC Bill will contain provisions to allow a definition of 'apprentice' to be determined following a consultation in the New Year.

Changes will need to be made to payroll software to allow apprentices to be identified on the payroll, and employers will need to invest in training for their employees so that apprenticeships can be correctly identified.

Timing

The measure will be effective from 6 April 2016.

Our view

We view this as a broadly positive measure, which is targeted specifically at promoting apprenticeships in the job market, and which eases the financial burden on employers. It will be interesting to see how the definition of 'apprenticeships' develops during the consultation in the New Year.

Source documents

- [National Insurance contributions – abolition of employer contributions for apprentices under 25]

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Entrepreneurs' relief: exclusion of goodwill in certain circumstances. Restriction to corporation tax relief for internally generated goodwill.

Entrepreneurs' relief in respect of goodwill has been withdrawn where an individual, trustee, or member of a partnership transfers their business to a close limited company to which they are a 'related party' with a corresponding restriction to the corporation tax relief where a company acquires goodwill and other intangible assets from related individuals.

Who should read this?

Individuals, trustees and members of partnerships who are considering incorporation or a sale of their business to a close limited company in which they will be a shareholder.

Companies who acquire internally-generated goodwill and customer related intangible assets from a 'related party' on the incorporation of the business.

Summary of proposal

Where an individual, trust or partner transfers their business to a close limited company to which they are a 'related party' (for example, on incorporation), Entrepreneurs' relief will no longer be available in respect of goodwill transferred.

The term 'related party' is defined as a participator or associate of a participator in a close company. This broadly means anyone with a share or interest in the capital or income of the company or their spouse/civil partner, parent/child or remoter, brother/sister or partner. The legislation will apply to transfers to both UK close limited companies and non-UK resident companies which would be categorised as a close company if they were resident in the UK.

Anti-avoidance provisions are also included in the legislation to capture those who are party to relevant avoidance arrangements.

This change has been made alongside a measure to restrict corporation tax deductions under the intangible asset regime where goodwill and other intangible assets are acquired from related party individuals. This will only apply to close companies making acquisitions from their individual participators.

Prior to this, a deduction was allowed on the acquisition of goodwill, etc. on incorporation. Together with Entrepreneurs' relief this created a 10% tax charge on the individual disposing of the business but future corporation tax deductions on the same consideration. This benefit was not available to unincorporated businesses which were not transferred to a company or start-up businesses that had always been operated in a company.

Timing

The legislation relating to the restriction of goodwill applies to consideration received in the form of cash or debt in respect of disposals of goodwill on or after 3 December 2014.

The corporation tax restriction also applies to all transfers on or after 3 December 2014 unless made pursuant to an unconditional obligation entered into before that date. Where an accounting period commences before 3 December 2014, the accounting period is split so that this measure only applies to debits arising from the notional accounting period commencing on 3 December 2014.

Our view

This measure has been introduced to remove an advantage for the owners of unincorporated businesses who were able to crystallise the value of internally generated goodwill via a transfer to a related company in return for cash or debt that they could then potentially extract at the 10% CGT rate, effectively converting a future income stream into capital. In addition a corporation tax deduction was available for the consideration paid. This measure has no impact on other capital gains tax reliefs available on incorporation

Businesses looking to incorporate therefore need to consider the consequences of both this measure and the restriction of corporate tax relief for transferred goodwill.

Source documents

- *Draft legislation - restriction of entrepreneurs' relief*
- *Explanatory note - restriction of entrepreneurs' relief*
- *Draft legislation - restriction of corporation tax relief on the acquisition of goodwill from related individuals*
- *Explanatory note - restriction of corporation tax relief on the acquisition of goodwill from related individuals*

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Changes to Venture Capital schemes

The Government has announced proposals to increase the amounts that can be invested in individual organisations under Social Investment Tax Relief (SITR), a relief that was introduced from 6 April 2014.

Additionally, the Government plans to extend the scope of SITR to 'community energy generation undertaken by qualifying organisations'. At the same time such organisations, along with all 'other companies benefiting substantially from subsidies for the generation of renewable energy', will be excluded from benefiting from the other venture capital schemes.

Who should read this?

Social enterprises and individuals who invest in such organisations, as well as venture capital investors, and companies involved in the generation of subsidised renewable energy generation.

Summary of proposal

Social Investment Tax Relief (SITR)

SITR was introduced in April 2014 to attract private investment in social enterprises.

The Government is to request EU approval to increase the amounts that can be invested in an individual organisation from the current limit of £275,000 over a three year period, to:

- an annual limit of £5 million; and
- an overall limit on the amount that can be invested in an individual organisation of £15 million.

In addition, legislation will be introduced in Finance Bill 2015 to permit secondary legislation extending SITR to social enterprises that engage in small scale horticultural and agricultural activities which under the reforms to the Common Agricultural Policy will no longer qualify for subsidies. Broadly, land holdings of less than five hectares in England and Wales, and three hectares in Scotland and Northern Ireland will no longer qualify for subsidies, and will become eligible for SITR.

The changes will come into effect on or after 6 April 2015, subject to State aid clearance.

The Government will consult further in early 2015 on changes to extend SITR to a wider range of social impact bonds, and to provide for investments to be made indirectly, through a form of venture capital trust scheme, i.e. a 'Social VCT'.

Generation of renewable energy

Legislation will be introduced in Finance Bill 2015 to extend the scope of SITR to 'community energy generation undertaken by qualifying organisations'. At the same time such organisations, along with all 'other companies benefiting substantially from subsidies for the generation of renewable energy', will be excluded from benefiting from the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs).

The above changes to EIS, SEIS and VCTs will take effect for qualifying holdings issued on or after 6 April 2015. The changes in respect of community energy schemes will take effect when the changes to extend SITR are implemented, i.e. as soon as possible on or after 6 April 2015, subject to State aid clearance.

In order to make it easier for investors and companies to access EIS, SEIS and SITR a new online system will be introduced in 2016.

Timing

Subject to State aid clearance, the above SITR changes will come in effect on or after 6 April 2015.

The restrictions on the EIS, SEIS and VCTs will come into effect for qualifying holdings issued on or after 6 April 2015.

Our view

The extension of SITR is designed to increase the amount of investment available to social enterprises seeking finance.

It has become increasingly common for venture capital scheme investments to be targeted at renewable energy activities, and HMRC perceive that many of these opportunities are relatively low risk offering capital protection and a predictable income stream. Therefore, the purpose of the proposed restrictions on the venture capital schemes is to ensure that they support 'riskier, early stage and developing' activities.

Source documents

- *Income Tax and Capital Gains Tax: change to venture capital schemes for companies and community organisations benefitting from energy subsidies*
- *Income Tax and Capital Gains Tax: enlarging the social investment tax relief scheme*

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Strengthening penalties for offshore non-compliance

HMRC strengthen their armoury of penalties for non-compliance which involves an offshore matter. This supports and enhances HMRC's offshore evasion strategy.

Who should read this?

Individuals, personal representatives and trustees with undeclared income, gains or assets overseas.

Summary of proposal

Following consultation, the Government will introduce legislation on enhanced civil penalties in relation to tax offences in connection with an offshore matter.

There are four elements:

- Extending the existing offshore penalty regime (which applies only to Income Tax and Capital Gains Tax arising offshore) to include Inheritance Tax;
- Extending the offshore penalty regime to offences where the proceeds of domestic non-compliance are hidden offshore;
- Updating the penalty territory classification system from the current three categories to four, where the existing lowest level will apply to territories that adopt automatic tax information exchange under the Common Reporting Standard (CRS); and
- Introducing a new aggravated penalty which is triggered following a movement of assets to avoid the CRS.

Timing

The changes will come into effect from April 2016, except for the new aggravated penalty which will come into effect following Royal Assent to Finance Bill 2015.

Our view

We are supportive of these proposals.

HMRC have clearly set out their offshore evasion strategy and for those who choose not to engage and disclose historical liabilities the cost of non- compliance will increase.

It is understandable that offshore penalties are extended to those who hide domestic non- compliance offshore as at present only income and gains actually arising offshore is subject to the higher penalty regime.

The introduction of the Common Reporting Standard (CRS) fundamentally changes the automatic exchange of information environment and this will result in HMRC receiving data regarding information of overseas assets from multiple jurisdictions. Those who seek to circumvent the CRS will also face an aggravated penalty (of a further

50%) which illustrates that HMRC will come down hard on those who are detected from their investigation work and have not taken advantage of the disclosure facilities currently available

Source documents

- *Tackling offshore tax evasion: Strengthening civil deterrents – summary of responses*

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Other measures

Draft clauses for the following other measures, also likely to be of wide interest, were also published:

- *Pension Flexibility 2015*
- *Direct recovery of debts*
- *Accelerated payments and group relief*
- *Enhanced capital allowances for zero-emission goods vehicles*
- Income tax – miscellaneous loss relief anti-avoidance
- *Air passenger duty – children's exemption*

Measures of particular interest to specific groups

Bank loss relief restriction

A limit of 50% of the amount of historic losses (trading losses, non-trade loan relationship deficits and excess management expenses) of banks and building societies which can be offset against the relevant profits arising in each period after 1 April 2015. This does not affect the total losses available, but should mean that groups with significant losses may begin paying cash tax much sooner than they might previously have expected.

Who should read this?

Banking companies and building societies expecting to carry forward losses beyond 1 April 2015.

For these purposes a 'banking company' is broadly defined as an authorised person under the Financial Services and Marketing Act 2000 that also carries out certain regulated activities.

Summary of proposal

The proposal caps the offset of restricted losses in any given period at 50% of relevant profits. Relevant profits are an affected company's total profits (or the element relating to trading profits or non-trading profits in the context of restricted trading losses or non-trading loan relationship deficits) before the offset of most reliefs given against total profits other than loss carry-backs. In particular this means that restricted losses are effectively set off after group relief, limiting groups' ability to use group relief to mitigate the impact of the measure.

The legislation is also drafted so as to require the use of restricted management expenses in priority to other types of restricted loss. This again is a change from the existing priority rules and makes it more difficult for affected companies to preserve this more flexible type of loss.

A targeted anti-avoidance rule is aimed at arrangements intended to artificially increase the profits of a company with restricted losses (hence increasing the amount of the historic loss available for offset) so as to secure a tax advantage. This would, for example, block arrangements which transfer profits around the group to accelerate the use of the restricted losses whilst otherwise being economically neutral. The rule does not incorporate a motive test to protect commercial arrangements, but does exclude arrangements with economic benefits other than the corporation tax benefit which exceed the value of the tax advantage.

The draft legislation incorporates an important exemption targeting the 'challenger' banks. This exemption operates by excluding from the restriction any losses sustained in the first five years of a new banking business. Unsurprisingly the rules are drafted so as to try and prevent use of this exemption by established banking groups, broadly by ignoring or curtailing this five-year start-up phase where a new bank is, or becomes part of, an established group.

Timing

The restriction applies to the offset of losses accruing prior to 1 April 2015 against profits of accounting periods ending on or after that date. Companies with accounting periods straddling 1 April 2015 are treated for these purposes as if a new accounting period commenced on that date.

An anti-forestalling measure means that the offset of potentially restricted losses against profits accruing prior to 1 April 2015 should also be blocked if those profits arise from arrangements entered into after the measure was announced (3 December 2014) with a main purpose of securing a tax advantage from the fact that the restriction does not otherwise bite prior to 1 April 2015.

Our view

The introduction of a loss-relief restriction applying only to the banking sector was justified in the Government's announcement on the basis of the public support given to the sector during the financial crisis. This link with the crisis and its aftermath is reflected in the fact that only losses accruing prior to 1 April 2015 are caught and the Government will expect some public sympathy for its proposals. From the perspective of the banks, already making a significant additional cash tax contribution as a sector through the Bank Levy, the justification for this further measure may seem less clear – although the limitation to losses accruing prior to 1 April 2015 will be welcome nonetheless.

Building societies and banking groups with historic losses will now be examining their position to assess the likely impact. The proposed restriction applies only to regulated entities and the corporate partners of partnerships carrying on regulated activities. There are also exemptions for companies carrying on particular regulated activities (insurance companies, pension scheme managers, investment trusts, asset managers, commodities traders and spread betting companies). Accordingly not all of a given banking group's losses will necessarily be within the scope of the restriction, although conversely the definition may potentially catch some financial services companies which would not usually be thought of as 'banks'.

The cash flow disadvantage created by the restriction is in theory just one of timing, matched by a reduction in cash tax in the future as the banks do eventually utilise these losses. For those banks described in the Chancellor's speech, however, which were already expecting it to take 15 to 20 years to utilise their historic losses, a theoretical doubling of this period will substantially reduce the value attributed to those losses. The impact of the proposed change on existing approaches to deferred tax asset recognition is already generating discussion as affected banks begin to draw up their 2014 financial statements.

It continues to be possible to claim group relief, although the requirement to offset group relief prior to determining the restriction on using historic losses will increase the group relief required to fully shelter the profits of affected entities. Whilst this is presumably intended to ensure that cash tax remains payable if the company would, to some extent, be relying on historic losses to shelter its profits, in some individual cases this may actually deliver a tax benefit by allowing the use of group relief that would previously have been wasted.

Multinational groups will be scrutinising the impact of the proposals on their ability to claim double tax relief in the hope that the changes may in some cases allow value to be obtained for relief previously wasted, mitigating the overall cost of the change.

Attempts to engineer a reduction in the impact of the measures should be restricted by the anti-avoidance provisions described above. The broad scope of the targeted anti-avoidance rule applying from 1 April 2015, in particular the absence of a purpose test, will however also concern many institutions seeking to execute wholly commercial arrangements. It is to be hoped that the anti-avoidance rule will be more closely targeted prior to enactment and not cut-down by guidance as has been the case in the past.

Notwithstanding these anti-avoidance provisions, the Government's own policy costings document accompanying the Autumn Statement indicated an expectation that behavioural change will cut the additional revenue raised over the next five years to around £3.5 billion from the 'almost £4 billion' referred to in the Chancellor's speech. The Office of Budget Responsibility has also assessed the uncertainty around the forecast revenues from this restriction as 'very high'. Given the Government's track record of frequent changes to the Bank Levy regime to address potential shortfalls in forecast revenue, there will be some anxiety that these proposals could similarly be further tightened if the boost to the Exchequer (estimated at on average just under £700 million for each of the next five years) falls below expectations.

Source documents

Draft legislation, a TIIN and a technical note were all published online on 3 December 2014.

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Changes to the oil and gas fiscal regime

The draft Finance Bill 2015 introduces the first measures of the review of the fiscal regime for oil and gas companies. The measures being introduced include a reduction in the supplementary charge from 32% to 30%, an extension in the number of periods that a company can make a Ring Fence Expenditure Supplement (RFES) claim from six to ten, and a new cluster area allowance for high pressure high temperature fields.

Who should read this?

Companies involved in oil extraction or related activities subject to the ring fence corporation tax regime.

Summary of proposal

Supplementary charge

The supplementary charge to corporate tax was introduced as an additional 10% charge on ring fence profits in 2002. The initial rate of 10% has been increased on two occasions and since 24 March 2011 has been at 32%. Effective from 1 January 2015 the rate will be reduced to 30%.

RFES

The Ring Fence Expenditure Supplement (RFES) allows companies to claim a 10% per annum uplift to qualifying pre-commencement expenditure or losses for up to six accounting periods. This was extended to ten accounting periods for onshore activities in Finance Act 2014. The draft Finance Bill 2015 allows a claim for a further four periods for offshore activities. It will be available for losses or pre-commencement expenditure incurred after 5 December 2013. This date brings the offshore regime into line with the onshore regime.

The original RFES legislation (s307 – 329 CTA 10) is being amended to reflect this extension. Provisions are also being introduced so that companies are not able to claim the supplement in the additional four periods for expenditure, losses or supplement generated prior to 5 December 2013.

As part of the legislation being introduced those sections relating to the extended onshore supplement are being removed.

Cluster allowance

A new allowance is being introduced for high pressure, high temperature (HPHT) projects. A cluster area will be an offshore area determined by the Secretary of State and will be treated as not including any part of a previously authorised oil field, unless decommissioned.

The allowance will be equal 62.5% of the capital expenditure incurred in relation to a cluster from 3 December 2014. The relief is given by way of a reduction against a company's ring fence profits when calculating the supplementary charge. Transitional arrangements are in place for companies currently developing projects. There will be no change to the existing ultra HPHT field allowance.

Timing

Supplementary charge

The rate change will be effective from 1 January 2015.

RFES

Claims in years 7 to 10 will be available in respect of losses or pre-commencement expenditure incurred after 5 December 2013.

Cluster allowance

The allowance is available for capital expenditure incurred from 3 December 2014.

Our view

These proposals reflect the first round of reforms following the Government's review into the fiscal regime for Oil and Gas companies. It is a positive step towards reducing the tax burden for the industry in order to increase investment and maximise economic return from the UK Continental Shelf (UKCS).

The Autumn Statement and subsequent announcements also set out a plan for further reform. Specific measures under review include replacing the current range of field allowances with a basin-wide Investment Allowance that would be based on expenditure, exploration incentives to provide financial support for seismic surveys in under-explored areas of the UKCS, and reform of the tax treatment of infrastructure and decommissioning.

Source documents

- *Draft legislation: Corporation Tax – high pressure high temperature cluster area allowance*
- *Corporation tax: extension of Ring Fence Expenditure Supplement*
- *Corporation tax: oil and gas taxation and the reduction in supplementary charge*
- *Driving investment: a plan to reform the oil and gas fiscal regime*

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Disguised investment management fees brought into charge to income tax

As announced at last week's Autumn Statement, the Government has published legislation to tackle what they perceive to be tax avoidance, where certain amounts paid by collective investment schemes directly or indirectly to individuals are not currently taxed as trading or employment income.

Who should read this?

Anyone advising on collective investment schemes, or individuals remunerated by collective investment schemes.

Summary of proposal

A number of private equity and other collective investment schemes (funds) structure their fee arrangements such that individual managers can, to some extent, be taxed based on the underlying nature of the funds' profits. Typically a UK entity would be paid, and taxed on, an arms' length remuneration for the service it performs.

The draft measures seek to ensure the whole of any 'disguised fee' paid by a fund is taxable on the recipient as either trading income or employment income. Essentially, where an individual receives an element of 'disguised fee', and this is not already taxed as employment or trading income, then that amount will be taxed as if the individual is carrying on a deemed trade.

The rules state that where investment management services to which the 'disguised fee' relates are undertaken to any extent in the UK, the deemed trade will be deemed to be wholly taking place in the UK.

The term investment management services is defined; it has a broad definition and is therefore likely to catch a wide range of activities.

There is a carve out for certain returns, such as co-invest and carried interest, although certain conditions in relation to such returns need to be met in order to fit within these rules.

Timing

This is expected to come into force on 6 April 2015 (and will apply to any income arising after that date, regardless of when the arrangements were entered into). Further clarity is required as to the treatment of amounts advanced before the effective date which will remain outstanding until some later date.

Our view

The legislation is aimed at combating tax advantages derived from certain commercial arrangements. As drafted, the effect of the legislation may be wider reaching than some expected as it could bring certain carried interest and co-invest arrangements into the charge to income tax. For example, this may apply to carried interest where the preferred return is lower than legislated, or where the carried interest is calculated by reference to unrealised gains.

The current drafting does not make clear that genuine co-investment should not be affected. Given that the policy objective is to allow genuine commercial investment into a fund by individuals involved in managing the fund to be recognised as such for tax purposes, it must be hoped that this will be amended.

It remains to be seen the extent to which the provisions can be clarified and/or improved before being passed. The precise impact of the rules is likely to vary depending on the detail of individual arrangements. Taxpayers should consider their structures and discuss with their advisers how the rules will affect them.

Source documents

- [Investment Managers: Disguised Fee Income]

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Capital Gains Tax – deferred Entrepreneurs' Relief on invested gains

Capital gains which are eligible for Entrepreneurs' Relief (ER), but which are instead deferred into investments which qualify for the Enterprise Investment Scheme (EIS) or Social Investment Tax Relief (SITR), will remain eligible for ER when the deferred gain is realised.

Who should read this?

Individuals who realise gains qualifying for ER on or after 3 December 2014 and are considering reinvesting the gains into EIS or SITR qualifying investments.

Summary of proposal

Gains which qualify for capital gains tax ER, but which are deferred into investments which qualify for EIS or SITR will remain eligible for ER as and when the gain is ultimately realised.

This will be of benefit for gains realised on or after 3 December 2014 and subsequently deferred into EIS or SITR that would be eligible for ER but which previously might not have qualified for ER at the future point in time when the gain is ultimately realised, for example when the EIS/SITR shares are sold.

Timing

The measures will apply to gains on disposals which take place on or after 3 December 2014.

Our view

These proposals allow individuals to benefit from both the deferral of gains and from ER and should encourage more investment in business via EIS and SITR. This should help support the growth of start-up companies and social enterprises.

Source documents

- [Deferred entrepreneurs' relief on invested gains]

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Annual tax on enveloped dwellings (ATED) – simplification of filing procedures and increase in annual charges

The draft Finance Bill 2015 contains legislation to simplify the compliance burden for 'non-natural persons' that hold dwellings worth over a particular amount (currently £2 million but dropping to £500,000 over the next two years) and are eligible to claim an ATED relief. Instead of filing multiple returns for dwellings that are acquired during the year, from 1 April 2015 one 'relief declaration return' will be required.

As detailed at Autumn Statement, the draft Finance Bill 2015 confirms the 50%+ increase to the ATED charges applying to dwellings worth over £2 million.

Who should read this?

Simplification of filing procedures: any company, partnership or collective investment scheme that holds UK residential property for business purposes, e.g. residential property funds, investors, house builders and student accommodation providers.

Increase in annual charges: any individual holding UK residential property for personal occupation through a corporate structure, i.e. via a company, partnership or collective investment scheme.

Summary of proposal

Although various reliefs from ATED are available to 'non-natural persons' (meaning companies, partnerships with one or more corporate members and collective investment schemes) that hold dwellings for qualifying business purposes, the relief must be claimed in an ATED return annually for every dwelling held on 1 April and every time a dwelling is acquired or created through the year. The draft Finance Bill contains amendments to simplify the method by which relief is claimed.

From 1 April 2015 the relevant company, partnership or scheme will be required to file a single annual return claiming the relevant relief. The return will cover all dwellings held on 1 April 2015 and will also be deemed to include all dwellings acquired or created within the reporting year (1 April to 31 March) that would also benefit from the relief such that only one return per entity per relief per year should be required.

The reliefs are subject to conditions (as detailed in the Finance Act 2013) and relate to:

- Property rental;
- Property trading;
- Property development;
- Businesses involving dwellings open to the public;
- Dwellings used for trade purposes (occupation by certain employees or partners);
- Farmhouses used in a farming business;
- Dwellings held by financial institutions in the course of a business of lending money; and
- Dwellings held by providers of social housing.

The ATED charges are to be increased by just over 50%.

Rates

Property value	Annual charge 14/15	Annual charge 15/16	Annual charge 16/17
Over £500,000 up to £1 million	-	-	*£3,500*
Over £1 million up to £2 million	-	*£7,000*	*£7,000 + CPI*
Over £2 million up to £5 million	£15,400	£23,350	£23,350 + CPI
Over £5 million up to £10 million	£35,900	£54,450	£54,450 + CPI
Over £10 million up to £20 million	£71,850	£109,050	£109,050 + CPI
Over £20 million	£143,750	£218,200	£218,200 + CPI

*Bands and charges in italics are unaffected by the Autumn Statement changes and were introduced by the Finance Act 2014.

Timing

Applicable to dwellings held in chargeable periods beginning on or after 1 April 2015.

Our view

Any reduction to the annual compliance burden for businesses is to be welcomed. However, it is disappointing that HMRC did not accept the alternative option preferred by many, of an exempt status for relevant companies, enforced by risk-based audits, to completely remove the requirement for any annual filing. A precedent exists with this approach for intermediary relief under stamp duty reserve tax.

The current proposal will also be disappointing for corporate groups holding dwellings in multiple companies because a separate return will be required for every company rather than a composite return for the group.

The increase in the ATED charges is to discourage individuals acquiring properties through non-natural persons for purposes that include SDLT avoidance. It follows from the SDLT changes that apply to residential property transactions announced at Autumn Statement.

Source documents

Filing procedures

Draft Clauses & Explanatory Notes For Finance Bill 2015 – pages 432-435 and 439-441.

Increased rates

- Annual Tax on Enveloped Dwellings: increased charges
- Annual Tax on Enveloped Dwellings: reducing the administrative burden for businesses
- Capital Gains Tax: changes to threshold amount for Annual Tax on Enveloped Dwellings-related Capital Gains Tax

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UK Residential Property – Capital Gains Tax for non-UK residents

The Government intends to extend a capital gains tax charge to cover disposals of UK residential property by non-UK residents in general from 6 April 2015. This is to equalise the position with UK residents, and to bring the UK in line with the tax systems of most other countries. This new measure would be in addition to the extension of the capital gains tax regime to certain non-UK resident companies holding UK residential property that was introduced from 6 April 2013.

Who should read this?

Non-UK resident owners of residential property in the UK.

Summary of proposal

What's the issue?

The UK Government had already announced that from April 2015 a capital gains tax (CGT) charge will be introduced on future gains made by non-UK residents disposing of UK residential property. Following a consultation, draft legislation and guidance has been released as part of the draft clauses for Finance Bill 2015.

What will be taxable?

Capital gains accruing post 6 April 2015 on disposals of residential property located in the UK.

Residential property is defined as property suitable for use as a dwelling. Property of any value is within these new rules (i.e. there is no *de minimis* value of property below which the charge will not apply). More detail on the definition of residential property is set out below.

There will be no change to the taxation of non-UK residents owning UK commercial property, or holding UK property as trading stock, and therefore these categories will not be subject to the new CGT regime. (Gains on these categories of property may already be subject to tax as trading income depending on circumstances. This aspect is not addressed further in this commentary).

Who is affected?

The following table sets out the categories of non-UK resident owner who will be affected by the new charge. The table also details the rate(s) of tax that will apply to gains, and any other relevant information that may affect the tax liability arising. This notes where an owner could be elegible for Principal Private Residence relief (PPR) – more information on the PPR changes arising from the consultation can be found on page 23 above.

Identity of seller	Tax rate	Other matters
Non-UK resident individual (and personal representatives of the deceased)	18% or 28%	■ Tax rate depends on level of other UK source income/chargeable gains in the tax year of disposal. ■ CGT annual exempt amount available (£11,000 for 2014/15). ■ Losses are only available to be offset against gains on disposals of UK residential property in same or subsequent tax years. ■ Could be eligible for PPR.

Identity of seller	Tax rate	Other matters
Non-UK resident trustees	28%	■ CGT annual exempt amount available (£5,500 for 2014/15). ■ Losses – same as for individuals (see above). ■ Takes priority over existing anti-avoidance legislation that taxes trustee capital gains on UK resident settlors/beneficiaries. ■ Could be eligible for PPR.
Non-UK resident company (not widely held)	20% or 28%	■ Tax rate is 20% (but if already within the scope of the Annual Tax on Enveloped Dwellings (ATED) CGT regime rate will be 28% – see interaction with ATED regime below). ■ No exemption from the CGT charge, unlike the ATED CGT (i.e. if the company is a property investor/developer). ■ Indexation allowance will be available. ■ A form of group relief will be available to allow losses to be utilised against gains on disposals of UK residential property in the same group.
Non-UK residents owning residential property through a partnership	Depends on identity of the partner – individual, trust, or company -rates apply as above	■ For non-UK resident entities that are classified as partnerships when taking into account the application of the law in the local jurisdiction that are treated as transparent for UK tax purposes, the individual partners will be chargeable to CGT accordingly. ■ Non-transparent non-UK partnerships are taxed in the same way as companies.

Who is not affected?

The Government has indicated that it does not wish to put barriers in the way of genuine institutional investment in UK residential property. Therefore it has included some specific exemptions from the charge:

- Specific classes of qualifying institutional investors will be exempt provided they meet 'genuine diversity of ownership' tests; and
- All other non-UK resident companies and funds will be subject to a 'narrowly controlled' test (similar to existing close company tests) to determine whether they can potentially fall outside the scope of the tax charge.

The aim of the exemptions is to ensure that the new charge applies only to private and family ownership structures, while at the same time limiting avoidance opportunities through the use of funds as ownership vehicles.

Application to widely held companies and funds

Non-resident companies may fall within the new charge but will only do so if they meet the 'closely held company' test.

Unit trusts and open-ended investment companies (OEICs) will not be subject to the charge providing they meet a 'Widely marketed fund' condition for at least five years before disposal of the asset or the duration of asset ownership. The test looks at whether there are appropriate investor documents produced and whether the fund is marketed widely and appropriately to the targeted investor categories.

The 'closely held company' test is similar to the existing close company test. The basic position is that a close company is one under the control of five or fewer participators, but there are some modifications, as follows:

A company will not be close if it can only be close by virtue of the inclusion in the test of a participator which is itself not a closely held company or is a 'qualifying institutional investor'. These are:

- Unit trusts which meets the widely-marketed fund condition;

- An OEIC that meets the widely-marketed fund condition;
- A pension fund defined widely to include foreign pension funds; or
- A person with sovereign immunity from tax.

For these purposes, the unit trust or OEIC has to meet the widely-marketed fund condition for the shortest period out of the length of ownership of the asset by the non-resident company, the period of five years ending with asset disposal and the period of the funds participation in the company prior to asset disposal.

Partnerships will not be treated as aggregators of investors unlike in the normal close company rules.

There are provisions to ensure that the closely held company test applies to each individual cell of a protected cell company separately.

The draft legislation indicates that these exemptions will need to be claimed, but it is not clear how such a claim process will operate.

Definition of residential land

The draft legislation defines residential land as any interest in land which is or at any time in the period of ownership since 6 April 2015 included a dwelling. It will also include land bought on 'off plan' purchases that are intended to be used as a dwelling. An interest in land does not include a licence to occupy land.

A dwelling is any property used or suitable for use as a dwelling or in the process of being constructed or adapted for this use.

There are some specific exemptions from the definition of a dwelling, including most types of communal property including school buildings, hospitals, prisons, residential homes and hotels.

A significant issue during the consultation was whether student accommodation would be exempted under this definition. The Government have clearly listened to responses which highlighted inconsistency in various existing definitions and have proposed an exemption for 'purpose built student accommodation' (PBSA) that is either:

- A building purpose-built built for use by students with at least 15 bedrooms (in either a hall or 'cluster flat' format) occupied at least 50% of the year by students; or
- Certain accommodation managed by a higher or further education establishment.

It does not appear that buildings converted for use by students rather than purpose built will be exempted from the charge.

The charge will apply on land on which residential accommodation is due to be built but only once construction has started, however as set out above, disposals 'off plan' will be counted as residential.

A building will cease to be treated as a dwelling if it has become unsuitable for that use due to damage unless caused by the owner and also on completion of demolition. In practice this means that certain gains may need to be apportioned for periods of residential and non-residential use.

How will the rebasing work?

The default position will be to 'rebase' the property to its market value at 6 April 2015 so that only the gain realised over that value (after deduction of any allowable costs incurred after that date) is subject to the charge.

Should the owner not wish to rebase they will have the option to ‘time apportion’ the whole gain over the period of ownership. This option will not be available if the disposal is also subject to ATED-related CGT (see below).

Owners will also have the option to neither rebase nor time apportion the gain, and instead to compute the gain (or loss) over the whole period of ownership.

Interaction with anti-avoidance rules

Where a gain is subject to tax under these new rules, it will not be subject to tax again under existing anti-avoidance rules that can attribute gains of a non-UK resident trust to UK resident settlors/beneficiaries; or gains of a non-UK resident company to UK resident participators. The new charge will therefore take precedence. For properties purchased before 6 April 2015 by non-UK resident trustees/companies, the pre-April 2015 element of any capital gain can still be taxed under existing anti-avoidance rules.

The ATED/high value property CGT rules were introduced from 6 April 2013 to combat perceived tax avoidance involving the use of ‘non-natural persons’ to hold UK properties. These rules will remain in force and could in principle apply to a UK property disposal in addition to the new extended charge. Any gain that is potentially subject to both charges will be liable to the existing ATED/high value property CGT rules in priority. If a gain is not fully chargeable to the existing rules in this way, any balance of the gain will be charged under the new rules.

Reporting the disposal to HMRC

This aspect has not been included in the published draft legislation as HMRC are continuing to consult. However the latest suggestion from HMRC is that a payment on account process rather than withholding tax at source from the disposal proceeds will be introduced as follows:

Seller already has an established relationship with HMRC via a live self assessment record	Obligation to report disposal within 30 days of conveyance	Submission of tax return showing computation of capital gain/loss	Payment of tax
Yes	Yes	Disposal reported on self assessment return and return submitted in advance of 31 January following the tax year end of disposal.	Payment of tax due in advance of 31 January following the tax year end of disposal.
No	Yes	Tax return submitted within 60 days following the date of conveyance (i.e. 30 days after the first obligation to report).	Payment of tax due within 60 days following the date of conveyance (i.e. 30 days after the first obligation to report).

It is assumed that an established relationship with a live self assessment record means that the non-UK resident seller is already submitting a self assessment tax return (such as a return under the non-resident landlord scheme). HMRC have confirmed that a live self assessment record does not include an ATED related CGT return.

HMRC say that an obligation to report will remain even if a disposal yields a capital loss or no gain or if the chargeable gain is less than the annual exempt amount. They also say that obligation to report will provide the method for a claim for PPR to be made.

Timing

The new measures are intended to be included in Finance Bill 2015, and will take effect from 6 April 2015.

Our view

The published draft legislation answers many of the questions outstanding as to how rebasing of gains will be undertaken. The new rules also need to be considered in conjunction with the proposed new rules for PPR.

The interaction with the ATED/high value property charges will need to be considered carefully to ensure that they have the effect of making clear which gains are subject to each regime. The layering of the two regimes together does add to the complexity.

The precise detail of the reporting and tax payment on account system is awaited in order to determine how burdensome this may be.

Source documents

- *Capital Gains Tax: non-residents and UK property*

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Increase to Remittance Basis Charge

Non-UK domiciled individuals who are long term residents of the UK may need to pay an increased remittance basis charge in order to elect for the remittance basis of taxation.

Who should read this?

Non-UK domiciled individuals who live in the UK.

Summary of proposal

UK resident non-domiciled individuals can elect to pay tax on foreign income and gains remitted to the UK, rather than being taxed on an arising basis on their worldwide income and gains.

Where a non-domiciled individual has been resident in the UK for a number of tax years, they may need to pay a charge each year, known as the remittance basis charge (RBC), in order to make the election to be taxed on the remittance basis.

The Government plans to increase the annual RBC for those who elect to use the remittance basis.

In particular:

- For those who have been UK resident for twelve of the last fourteen tax years, FB 2015 increases the RBC from £50,000 to £60,000.
- In addition, FB 2015 introduces a new charge of £90,000 for people who have been UK resident for seventeen of the last twenty tax years.

The RBC paid by non-UK domiciled individuals who have been UK resident for seven out of the last nine tax years remains unchanged at £30,000.

The Government also plans to consult on making the remittance basis election apply for a minimum of three tax years.

Timing

The measure will be included in FB 2015 to take effect from 6 April 2015.

Our view

These changes are unlikely to be met with objection from the general population. They mean that non-UK domiciled individuals who claim the (often beneficial) remittance basis of taxation will need to contribute more in tax to the UK exchequer, where they have been resident in the UK for at least twelve tax years.

In light of these changes, non-UK domiciled individuals who have been resident in the UK for twelve out of the last fourteen tax years or longer should consider whether they have sufficient foreign income and gains to make paying the increased RBC amount worthwhile in the future.

The decision as to whether to claim the remittance basis will also become more important and complex if the outcome of the planned consultation is such that a remittance basis election will apply for a minimum of three tax years, although there is currently no planned date to introduce such a measure.

Source documents

- *Increase to remittance basis charge*

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Bad debt relief on peer-to-peer lending (and other crowd funding proposals)

A new tax relief will be introduced allowing individuals who have incurred losses from lending through peer-to-peer (P2P) platforms to offset these against other P2P income.

The Government will also consult on developing an income tax withholding regime across P2P lending platforms and continues to explore ways to include crowd funded investments within Individual Savings Accounts (ISAs). Draft legislation for these measures has not been included in the draft clauses for Finance Bill 2015, and the measures are likely to be legislated post-election.

Who should read this?

These measures will be of interest to lenders willing to lend money and borrowers seeking loans through P2P and debt-based security platforms. It will also be of interest to platforms that facilitate such loans/debt, as well as the wider crowd funding industry.

Summary of proposal

As announced in the 2014 Autumn Statement, the Government set out three tax focussed measures intended to support P2P and crowd funding platforms:

1. From April 2016, a new tax relief will be introduced for individuals who have incurred losses from lending through P2P platforms. The relief will enable individuals to offset losses from irrecoverable debts against interest income arising through P2P lending when calculating their taxable income. It is intended that the changes will have effect for loans made from 6 April 2015. Draft legislation concerning the operation of the relief will be published in 2015, with a view to being included in the Finance Bill 2016.

- The Government will also be consulting with the industry about developing a 20% income tax withholding regime across all P2P lending platforms from April 2017.
- Finally, the Government builds on its consultation on including P2P loans into ISAs by announcing they will launch a new consultation examining the inclusion of crowd funded debt based securities into ISAs. HMRC's initial consultation on including P2P loans within ISAs closes on 12 December 2014.

Timing

The loss relief provisions for P2P lenders will have effect for loans made from 6 April 2015. Draft legislation concerning the operation of the relief will be published in 2015, with a view to being included in the Finance Bill 2016.

Following consultation, the income tax withholding regime is likely to be implemented from April 2017.

HMRC's initial consultation on including P2P loans into ISAs closes on 12 December 2014. The Government will build on this with a new consultation on the inclusion of crowd funded debt based securities.

Our view

These proposed changes and new provisions are likely to be welcomed by all stakeholders in the alternative finance market and crowd funding industry.

The introduction of the loss relief will be welcomed by P2P lenders who look to P2P platforms for investment opportunities. These platforms can offer investors competitive gross returns however, until now the quantum of the return subject to tax did not always reflect the economic reality of the return obtained by the lenders. This was because income tax was paid on all interest received in the year, regardless of any defaults on principal. The newly introduced tax relief for losses will therefore go some way to aligning P2P lending with other similar investments. This may also provide a boost to borrowers as any increased investment as a result of this measure will in turn provide increased access to finance.

With regards to the withholding regime, given that more than half of investors in P2P arrangements are basic rate taxpayers, this measure is likely to be welcomed by investors. The operation of a basic rate (20%) withholding tax will mean a reduced compliance burden where investors are no longer required to pay tax through the self assessment system.

The withholding regime will also bring the industry in line with similar investments where returns are paid net of basic rate tax. This will however mean an increased compliance burden for P2P platforms which are likely to be required to operate this withholding tax regime and this will mean a huge change for the market in general. These proposals will therefore be observed with some interest by potentially affected P2P platforms.

The inclusion of P2P loans and crowd funded debt based securities in ISAs will also be a welcome change for the industry as a whole. It may provide an incentive for investors who will be attracted to investing through ISAs, potentially broadening the appeal of such investments and raising their profile.

Finally, separately the Government has also announced its intention to introduce a new online system for EIS and SEIS companies making it easier for companies and investors to access these investment schemes. This is likely to be of interest to not only crowd funding platforms supporting investments in EIS and SEIS qualifying companies, but also to crowd funding platforms themselves who are keen to obtain investment via these arrangements. This is particularly relevant to crowd funding due to the number of investors platforms are able to attract and the significant compliance burden the current paper-based EIS and SEIS system creates.

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Improving the operation of the Construction Industry Scheme

HMRC had previously consulted on changes to improve the operation of the Construction Industry Scheme (CIS). Following this HMRC have proposed improvements to CIS and are now engaged in a technical consultation on the draft amendments to the legislation. Responses are due by 7 January 2015.

Who should read this?

This is of interest to mainstream construction businesses, those businesses whose work includes construction, businesses registered due to the level of construction spend and those who act as subcontractors under contracts involving construction operations.

Summary of proposal

A series of changes will be introduced to improve the operation of the Construction Industry Scheme (CIS) making it easier for businesses to access gross payment status, reduce administration burdens and move more transactions online. These changes include:

- The threshold for the ‘turnover test’ being reduced to £100,000 in multiple directorships;
- The initial and annual compliance tests focusing on fewer obligations;
- The nil return obligation being amended;
- Joint ventures where there is already one member with gross status being allowed easier access to gross payment status;
- The rules allowing an earlier repayment to liquidators in insolvency proceedings; and
- Mandatory filing of CIS returns being required and an online verification facility being introduced.

The measures will have effect at different times (please see below).

HM Revenue & Customs (HMRC) expect that these measures will have a nil Exchequer impact and that the costs of the changes to HMRC will be offset by administrative savings.

Timing

This measure will have effect from 6 April 2015 for nil returns, joint ventures and repayments in cases of insolvency, from 6 April 2016 for mandating online filing of CIS returns and changes to gross payment status tests and from 6 April 2017 for mandating of online verification.

Our view

We welcome the improvements that are being proposed and believe they will go a long way to streamlining the operation of the CIS and enabling more businesses to register for gross payment status. The revision of the nil return requirement to a voluntary arrangement is helpful but will not remove the need to tell HMRC that there are no payments due to be reported in that month. We still await the draft legislation on the proposed changes around the compliance tests and online filing that will take effect from 6 April 2016 and 2017 respectively. The quicker repayments in cases of insolvency will also be helpful and should assist the winding-up process.

The responses to the technical consultation on the draft regulations should be sent to HMRC by 7 January 2015. Further regulations will also be issued to address changes to apply from 6 April 2016 and 2017. Whilst all the changes are welcome the regulations will need to be carefully reviewed to ensure that there are no unintended consequences.

Source documents

- *Draft legislation - improving the operation of the Construction Industry Scheme*

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Employment intermediaries: determination of penalties

Finance Act 2014 introduced legislation to prevent tax avoidance by UK agencies engaging workers via non-UK agencies and false self-employment. The information reporting regime applies for quarterly returns, the first of which is due on 5 August 2015. The amendment announced to the penalties legislation will allow HMRC to impose targeted penalties directly where required returns are not submitted.

Who should read this?

This measure is relevant to agencies and other employment businesses who supply workers to end users as part of a supply chain.

Summary of proposal

Finance Act 2014 made amendments to the rules which impose a PAYE liability on the supply of workers via agencies and other employment businesses, where PAYE would not otherwise apply. This was underpinned by a quarterly reporting regime with the first return being due by 5 August 2015. HM Revenue & Customs (HMRC) had been relying on the existing penalty regime under s98 TMA 1970 to apply penalties for late reports, but has realised that would entail holding a First Tier Tribunal (FTT) hearing. The revision to s100 TMA 1970 inserts a new sub-section 2A which allows an officer of the Board to apply his/her judgement on when a penalty can be imposed. This is intended to allow HMRC to take speedy and targeted action to apply penalties in cases of non-compliance, without relying on initial recourse to the FTT.

Timing

This will take effect from 6 April 2015 with the first quarterly return due on 5 August 2015.

Our view

HMRC have taken action to strengthen the penalty regime underpinning the new reporting requirements. This will allow HMRC to impose penalties much more quickly and therefore should increase the deterrent for not submitting the required reports on time. Businesses involved in the supply of agency workers should ensure they have the required information, which is quite detailed, to ensure their quarterly returns are submitted on time, as well as recognising that they have a reporting responsibility in the first place.

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NIC Employment Allowance extended to personal carers and support workers.

The Employment Allowance is not currently available to employers who engage employees in the course of their personal, domestic or household affairs. From 6 April 2015, the EA will be available to individuals employing personal carers or support workers.

Who should read this?

Individuals employing care or support workers.

Summary of proposal

The Employment Allowance (EA) introduced in the National Insurance Contributions (NIC) Act 2014 provides for a £2,000 allowance against the cost of Employer NIC. The EA is available to most employers – however, specific employers are currently excluded, including individuals who employ workers in the course of their personal, domestic or household affairs. As a result of this exclusion, individuals who employ care or support workers in their homes are not currently able to benefit from the EA. From 6 April 2015, these employers will be removed from the exclusion and will be able to benefit from the EA, reducing the cost of care provision by up to £2,000.

Timing

The measure will take effect from 6 April 2015.

Our view

This is a positive step to correct what we had regarded as an anomaly in the legislation on the Employment Allowance when it was originally enacted.

Source documents

- [National Insurance contributions: employment allowance extension to personal carers]

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Simplifying the calculation of IHT on settled property and targeting avoidance through multiple trusts

The Government is clamping down on taxpayers exploiting an IHT loophole by revising the IHT rules on multiple settlements made on different days. They are also making some simplifications to the rules calculating rates of tax for ten year anniversary and exit charges for relevant property trusts.

Who should read this?

Trustees and individuals (both UK domiciled and non UK domiciled) who are either considering creating a settlement or who have already created one or more trusts or had intended to use multiple trusts (pilot trusts).

Summary of proposal

Relevant property trusts are subject to Inheritance Tax (IHT) charges every ten years and when settled property ceases to be relevant property (except by virtue of becoming excluded property), for example on an exit from the settlement.

The rate at which tax is charged is found using a complex process which includes taking into account the settlor's previous cumulative lifetime total of chargeable transfers, the initial value of property in settlements created on the same day (related settlements) and the initial value of property in the settlement which is not relevant property. By only taking into account related settlements, it has been possible to reuse the nil rate band in a subsequent trust created on a different day by only settling a nominal amount with a view to adding property at a later date, for example on death.

In previous consultation documents the Government has proposed to simplify the calculation of the rate of tax by removing some of the elements from the calculation, such as related settlements and initial values of non-relevant property, and to prevent avoidance through the use of multiple trusts by introducing a single settlement nil rate band which would have to be shared, at the settlor's direction, across new settlements and additions to settlements. However, as announced in the Autumn Statement, the proposal for the settlement nil rate band has been dropped.

The draft clauses of the Finance Bill 2015 only make limited simplification to the calculation of the rate of tax by removing the need to take into account non-relevant property in the same settlement. However, it will still be necessary to take into account the initial values of related settlements and to make reference to the settlor's cumulative lifetime total.

In addition, the calculation of the rate will now also need to take into account additions of property to other settlements on the same day. The new same day additions rule is intended to prevent the exploitation of the rules by the use of multiple trusts and will affect the nil rate band available on the chargeable occasion.

There is some protection for additions to charitable trusts and also additions which represent regular premiums (at least annual) to life assurance policies. Also existing trusts to which no additions are made on or after 10 December 2014 will be outside the same day additions rule.

In order to give those who had planned to use pilot trusts time to adjust their affairs if they so wish, there will also be protection for existing trusts which receive additions on the death of the settlor before 6 April 2016 under a will on terms which are substantially the same as existed immediately before 10 December 2014.

Timing

This measure will apply to all charges arising on or after the proposed commencement date of 6 April 2015 in respect of relevant property trusts created on or after the publication of draft legislation on 10 December 2014. To prevent forestalling, the same day addition rules will also apply to relevant property trusts created before 10 December 2014 where there are additions made to more than one settlement on the same day on or after 10 December 2014 when calculating IHT charges from 6 April 2015.

There is added protection for additions to multiple settlements existing immediately before 10 December 2014 which arise on death before 6 April 2016 under a will on terms which existed immediately before 10 December 2014. This is to allow a period of time for those affected to change their will and avoid unwanted tax consequences.

Our view

The Government has long signalled its intention to make changes to the IHT charges on trusts but the measures proposed do not bring any significant simplification to the calculation process and indeed add another layer of complexity as a result of tackling the issues of multiple trusts.

Source documents

- *Inheritance Tax: simplifying charges on trusts and new rules to target avoidance through the use of multiple trusts*
- *Inheritance tax: A fairer way of calculating trust charges – consultation response*

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Some corrections to a few IHT anomalies

The Government has corrected three anomalies within the Inheritance Tax (IHT) legislation.

Who should read this?

Personal representatives, individuals and trustees (especially trustees of heritage property and trustees of pre-22 March 2006 trusts contemplating a succeeding life interest for the spouse of the current life tenant).

Summary of proposal

It is not unusual for a deceased person's estate to be left on discretionary trust and for the trustees to then exercise their discretion and appoint the assets out to beneficiaries. In many cases this will be to the surviving spouse/civil partner and this usually enables the appointment to be treated for IHT purposes as if it was a legacy to the surviving spouse and thus qualify for spouse exemption.

However there is a pitfall in s144 IHTA 1984 that if the appointment out takes place within three months of death, the appointment is not treated as being made by the deceased's will and exemptions will not be due. The Finance Bill removes this, by providing that even though the appointment would not otherwise trigger an exit charge, because it took place within the first three months, it will nevertheless be read back into the will and, where relevant, can therefore pass under spouse or civil partner exemption.

Secondly, where a relevant property trust comprises heritage property which has not been the subject of conditional exemption or the relevant capital gains tax relief, it is potentially subject to the IHT charge on ten-year anniversaries. To gain exemption from the charge the current legislation requires trustees to make a claim and obtain a heritage property designation before the ten-yearly charge arises. This departs from the general regime for conditional exemption and can cause difficulties for trustees and parties engaged in designating heritage status.

The proposed amendment will allow trustees to make a claim for exemption within two years of the ten-year charge arising giving them more time and putting them on the same footing as trustees and individuals subject to other IHT charges.

The final anomaly relates to a gap in the legislation which was created due to changes made in 2006 and applies to pre-22 March 2006 settlements where the settlor or their spouse had an interest in possession when the trust came into being and the spouse or settlor has a succeeding life interest. Under current provisions where the first spouse has a pre-March 2006 interest in possession which has continued after March 2006 and their spouse then takes a succeeding interest in possession, whilst their spouse is still alive, the trust does not become a relevant property trust. The amendment will mean that settled property will become relevant property once the second spouse takes their life interest and such property will then be subject to the relevant property charges. There are some transitional provisions which will apply to such trusts which benefit from the provisions at the time of Royal Assent.

Timing

The amendment to provisions governing a trustee's appointment from a will trust within three months of death applies to cases where the testator's death occurs on or after 10 December 2014.

The other amendments will apply to all charges arising on or after the date that Finance Bill 2015 receives Royal Assent.

Our view

KPMG welcomes the removal of the trap for the unwary who distribute assets from a will trust within three months of death and the extension of the time limit for claims for conditional exemption for trustees of heritage property. The position in relation to life interests for spouses or civil partners whilst both individuals are alive is now put on a similar footing to other trusts, but perhaps reduces the flexibility that was given to married couples/civil partners who could previously benefit from the existing rules.

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Other measures

Draft clauses for the following other measures, also likely to be of interest to particular groups, were also published:

- *Children's TV tax relief*
- *Simplifying link company requirements for consortium claims*
- *Stamp Duty Land Tax – shared ownership*
- *Stamp Duty Land Tax – alternative property finance reliefs*
- *Flood defence relief*
- *Inheritance tax exemption for emergency services personnel*. A *consultation response* has also been published.
- *Inheritance tax – interest changes to support new digital service*
- *Inheritance tax – extending the exemption for medals and other awards*
- *VAT refunds to strategic highways companies*
- *VAT – refunds of non-recoverable VAT for the London Legacy Development Corporation*
- *Alcohol duty – registration of alcohol wholesalers*
- *Fuel duty for aqua methanol*
- *Carbon price floor: excluding combined heat and power*
- *Landfill Tax – compliance work in relation to the lower rate*. A *summary of responses* to the earlier consultation has also been published.
- *Aggregates Levy – credits in Northern Ireland*
- *Tax exemption for travel expenses of members of local authorities*
- *Exemption from income tax of the Bereavement Support Payment*
- *Exemption from income tax and National Insurance – lump sums provided under the armed forces early departure scheme*
- *Income tax – deduction at source from interest paid on private placements*
- *Gift aid intermediaries*
- *VAT – power to provide for refunds to certain persons*
- *VAT – refunds of VAT to search and rescue charities*
- *Tobacco duty anti-forestalling*. A *summary of responses* to the earlier consultation has also been published.
- *Changes to the Disclosure of Tax Avoidance Scheme rules*. A *response* to the earlier consultation has also been published.

- *Promoters of tax avoidance schemes*

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