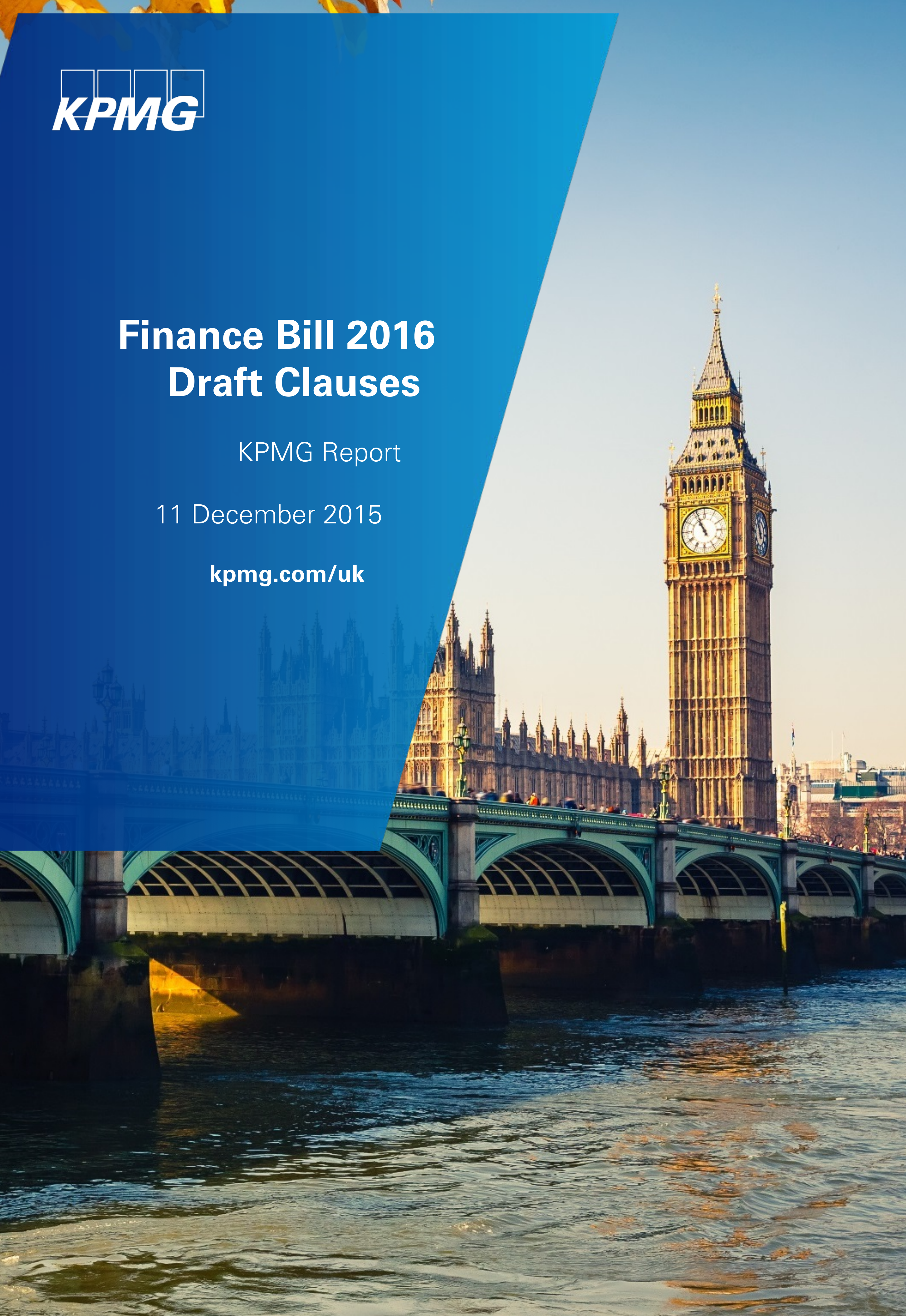
Finance Bill 2016 Draft Clauses

KPMG Report

11 December 2015

kpmg.com/uk



CONTENTS

The draft clauses in overview

Has the Chancellor been a good Father Christmas this year?

As an advance Christmas present for tax advisors and their clients, the Government published on 9 December 2015 draft clauses for its forthcoming Finance Bill 2016 for consultation. There are no unexpected measures covered by the draft clauses, however we are still awaiting draft legislation on certain key measures.

The draft clauses for the new Apprenticeship Levy are due to be published in the New Year. The rate (0.5%) and the annual allowance (£15,000) are already known, but more details are needed on many of the key issues. Also unknown are some of the details relating to the reform of the tax treatment of non-domiciled individuals, particularly the aspects relating to offshore trusts. Here we are expecting the Government's response to the consultation held in the Autumn in early 2016 but the new legislation will be included in the Finance Bill 2017. We also await the new rules relating to the additional 3% stamp duty land tax for persons buying 'additional residential properties'. This had been expected this year, but will now be published next year.

The draft clauses reflect the significant changes to the taxation of savings, introducing a personal savings allowance for basic and higher rate taxpayers and abolishing the withholding of income tax on interest payments by National Savings and Investments, building societies and banks, announced in the March Budget. Also the £5,000 dividend allowance is introduced together with the abolition of the tax credit associated with dividends which has the net impact of increasing the rates of income tax on UK and overseas dividends.

Whilst there are some provisions relating to employment taxes, such as the introduction of a tax exemption for trivial benefits in kind costing £50 or less, and the expected new rules relating to travel and subsistence for employment intermediaries, the ever continuing stream of consultations continues with a review of the taxation of living accommodation provided by employers. Another employment tax aspect, not included in the draft clauses, is the confirmation that the current PAYE reporting relaxation for employers with nine or fewer employees, allowing them to report to HMRC all payments made in a tax month at the end of that month, rather than "on or before" payment will come to an end on 5 April 2016. This will increase the burden on small employers to comply with the real time information requirements of the PAYE system. For HMRC, this will enable them to increase their digitalisation of the tax system and co-ordinate appropriately with the Department of Work and Pensions in their delivery of the new Universal Credit system.

There are further changes for investment managers subjecting their carried interest to income tax where the underlying investments have been held for less than four years on average.

Companies have got some chunky draft legislation to consider. There are 48 pages of draft clauses dealing with the new hybrid rules introduced following the conclusions of the OECD project on base erosion and profit shifting (BEPS). These rules effectively prevent a tax deduction in the UK for a cross border payment where that payment is not subject to the relevant foreign tax. The clauses also cover situations where there is a double deduction for the same payment. Multinational companies will need to consider the application of these rules very carefully.

Another change following the BEPS conclusions is the expected changes to the Patent Box regime which restrict its availability and link its benefits to research and development incurred by the relevant company. Companies will need to have detailed transfer pricing style methodologies in order to compute the profits which are eligible for the reduced corporation tax rates.

Asset managers will be busy considering the 24 pages on SDLT seeding relief for PAIFs and COACSs, and changes to the treatment of transactions in COACS units. The scheme of the legislation was trailed at Autumn Statement. But the level of complexity was not.

Four new reliefs from the super SDLT rate of 15% and ATED occupy part of the draft bill. They address specific businesses that were inadvertently caught up in the anti-avoidance provisions for 'enveloping' residential properties. Unfortunately, gaps in the coverage of the reliefs still exist. So other businesses may have longer to wait to be taken out of the regimes.

The detail has also been published regarding the requirement for large businesses to publish on the internet their tax strategy as it relates to UK taxation. Companies will need to take advice on what their strategies should be, as a comparison between different businesses will now be able to be undertaken.

Lastly there are some changes to the loan relationship and derivative contract rules, which address three situations where interactions with accounting rules or other parts of the tax legislation may lead to unintended and unfair outcomes. The changes can prevent tax deductions on non-market loans from individual, or certain non-UK, company lenders. There is also the introduction of rules confirming that credits are not taxable where previously loan relationship debits have been disallowed under transfer pricing rules and rules to ensure that taxable exchange gains and losses arising as part of a hedge of foreign exchange risk are not restricted as a result of applying the non-arm's length rules.

So in summary, no unexpected presents this year, but a few to be delivered after Christmas. As usual their impact will depend on close investigation of the detail.

Below we consider in more detail the key areas where draft clauses have been published for Finance Bill 2016.

The draft clauses can be found **here**, and the Government has requested any comments on the draft by 3 February 2016.

Measures of general interest

Rates, allowances and thresholds

July's Summer Budget saw the Chancellor announce cuts in corporation tax, whilst reforming the tax treatment of dividends and introducing a main residence nil rate band for Inheritance Tax. In addition to these, the draft Finance Bill 2016 also includes provisions for the operation of the Personal Savings Allowance.

Who should read this?

Tax rates, allowances and thresholds are relevant to all taxpayers.

Summary of proposal

Personal taxes

From April 2016 the personal allowance will increase to £11,000 and the higher rate threshold (together with the NICs Upper Earnings Limit) to £43,000.

Broadly, income will be taxed at the following rates:

	2015/16	2016/17
Personal Allowance	£10,600	£11,000
Personal Savings Allowance (see below)[a]		£1,000
Personal Dividend Allowance (see below)[b]		£5,000
Basic rate (20%)	£10,601 – £42,385	£11,001 – £43,000
Higher rate (40%)	£42,386 – £150,000	£43,001 – £150,000
Additional rate (45%)	Over £150,000	Over £150,000

The personal allowance continues to be restricted at a rate of £1 for every £2 of income over £100,000.

With the other thresholds for NICs remaining unchanged, the gap between the point at which NICs and income tax become payable will widen further (NI primary threshold at £8,060 for 2015/16). However, the Office of Tax Simplification is currently looking at closer alignment of income tax and NICs: in the longer term we may, therefore, see moves towards alignment.

The annual exempt amount for capital gains tax was set at £11,100 from 6 April 2015 and is not currently set to change.

The nil rate band (NRB) for inheritance tax is presently £325,000 and will remain unchanged until 5 April 2021. However for deaths on or after 6 April 2017 the Government has introduced a £175,000 main residence nil rate band, which applies where the matrimonial home is inherited by a direct descendent. This gives the headline £1 million total combined NRB for a married couple. For further details on the operation of this main residence NRB and downsizing provisions (see separate article below).

The Lifetime Allowance for the value of rights built up in registered pension schemes will be reduced from £1,250,000 to £1,000,000 with effect from 6 April 2016. Whilst the Annual Allowance for pension contributions will remain at £40,000 in the first instance, under changes included in Finance (No.2) Act 2015 a new restriction will apply such that this is reduced at a rate of £1 for every £2 of income over £150,000 down to £10,000 for gross earnings over £210,000.

Personal Savings Allowance[a]

From April 2016, a tax-free allowance of £1,000 for basic rate taxpayers (or £500 for higher rate taxpayers) will apply to savings income as defined at s18 of ITA 2007. This will not be available to additional rate taxpayers, nor will it apply to dividend income as a separate allowance for that will be established.

For this purpose higher rate tax payers are individuals whose income is charged to tax at the higher or dividend upper rate (or would be but for the operation of this new savings allowance or the new dividends allowance). Additional rate taxpayers are defined similarly.

Where the allowance is available the income will attract a rate of 0% tax as opposed to basic or higher rate tax.

The draft legislation also provides that banks will no longer need to withhold basic rate tax at source on interest payments.

Taxation of Dividends[b]

From 6 April 2016 dividend income received in excess of the allowance will be taxed at rates of 7.5% where this falls within the basic rate income tax band, 32.5% in the higher rate band, and 38.1% in the additional rate band. This will apply to both UK and non-UK source dividends.

For individuals there will also be a tax free dividend allowance set at £5,000 although no such allowance is available for trusts. Dividend income that is within the dividend allowance will still count towards an individual's basic or higher rate limits and the rate of tax due on income in excess of the allowance.

UK dividends will no longer carry a tax credit. However they will continue to be treated as disregarded income for non-UK residents and so there should still be no additional UK income tax liability in respect of the UK dividends received by non-residents.

Interest and dividends received via an Individual Savings Account (ISA) will continue to be tax free.

Corporate taxes

As previously announced, the new unified rate of corporation tax will remain at 20% for Financial Years 2015 and 2016 and will be reduced to 19% from April 2017 and then to 18% from April 2020. Legislation for this was included in Finance (No. 2) Act 2015. No further changes are proposed for Finance Bill 2016.

Timing

The changes to the majority of personal tax rates, thresholds and allowances take effect from 6 April 2016, while the reduction in the corporation tax rate and the new main residence nil rate band do not come into effect until April 2017.

Our view

With the triple lock introduced in July set to ensure that the rates of income tax and Class 1 NICs will not rise for the duration of the Parliament, 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 Conservative Party manifesto promised that the income tax personal allowance would rise to £12,500, and the threshold at which 40% tax becomes payable would increase to £50,000, both by the end of the current Parliament. We await further details of exactly when and how these changes will be made.

Daniel Crowther
Partner

T: +44 (0)1223 582163
E: daniel.crowther@kpmg.co.uk

Jonathan Peall
Senior Manager

T: +44 (0)20 7694 5374
E: jonathan.peall@kpmg.co.uk

Edward Ullathorne
Assistant Manager

T: +44 (0)121 232 3870
E: edward.ullathorne@kpmg.co.uk

Improving Large Business Tax Compliance – outcome of consultation

Following consultation, the Government will legislate for the required publication of a tax strategy by large businesses as well as a narrowly targeted 'Special Measures' regime in the Finance Bill 2016.

In the light of representations made during the consultation, a proposed Code of Practice has been reshaped into a Framework for Co-operative Compliance. This sets out common principles that both HMRC and businesses can use to work professionally and co-operatively.

Who should read this?

This package of measures will be of interest to tax teams, finance directors and board members with responsibility for tax compliance of large businesses.

Around 2,000 of the largest businesses in the UK with group turnover in excess of £200 million per annum or a group balance sheet total in excess of £2 billion are affected.

Summary of proposal

Publication of a tax strategy

The measure will introduce a legislative requirement for all large businesses to publish on the internet an annual tax strategy, in so far as it relates to UK taxation.

The strategy will cover four areas:

- The approach of the UK group to risk management and governance arrangements in relation to UK taxation;
- The attitude of the group towards tax planning (so far as it affects UK taxation);
- The level of risk in relation to UK taxation that the group is prepared to accept; and
- The approach of the group towards its dealings with HMRC.

Non-publication of an identifiable tax strategy or an incomplete tax strategy based on the four areas outlined above could lead to an initial £7,500 penalty subject to the usual HMRC appeals process.

Special measures regime

The Government is legislating to provide that large businesses with an ongoing history of aggressive tax planning and/or refusing to engage with HMRC may be subject to special measures.

A business in this position will be advised that they may be at risk of being put into special measures. A 12 month improvement period will then allow HMRC and the business to work together to resolve issues. At the end of the period, the business will either have improved and so not enter special measures, or be notified of entry into special measures. At this stage no sanctions are triggered.

Businesses who enter special measures risk sanctions if they demonstrate further instances of the behaviours that led to their inclusion. Sanctions could include removing access to non-statutory clearances, removing the defence of 'reasonable care' or potentially naming as being in special measures. Businesses enter special measures for a minimum of two years. Two years from entry into special measures HMRC will conduct an 'exit review' to decide whether the behaviours have improved and the business should exit special measures, or whether an extension of special measures is required.

Framework for cooperative compliance

In response to representations the proposed 'Code of Practice on Taxation for Large Businesses' has been reshaped into a 'Framework for Cooperative Compliance'. A draft Framework has been published on which there will be further consultation in the next few months, and once the consultation is completed final additional guidance will be provided.

Timing

The measures will have effect for accounting periods commencing on or after the date of Royal Assent to Finance Bill 2016.

Our view

Tax strategy transparency

In response to representations we think the Government has taken positive steps in amending the original proposals so that:

- A named individual at the Executive Board level will not have to be accountable for a business's published tax strategy;
- There will not be a requirement that the published strategy includes whether the business has a target UK effective tax rate (ETR), and what this is; and
- There will be no requirement that businesses publish factual information to evidence the practical application of the business's published tax strategy.

However the requirements do appear to capture a wider scope of businesses than those in the Senior Accounting Officer (SAO) regime, by also including groups that are impacted by the UK implementation of the OECD's country by country reporting requirements.

Special measures regime

Whilst there is a certain amount of reassurance that the special measures will be tightly drawn to target only those businesses who are the most persistent in exhibiting high risk behaviours, we note that no new governance procedures or safeguards are to be put in place.

We also note that despite representations, the Government remains of the view that it is appropriate to consider removing 'reasonable care' as a defence in cases where a business shows a pattern of persistently aggressive behaviours towards tax, and where there is significant risk of this behaviour continuing once the business is in special measures. We have concerns regarding an administrative ability awarded to HMRC to remove a taxpayer's statutory defence against potential penalties.

Framework for cooperative compliance

In response to the representations, this measure has landed in the right place, with the list of behaviours expected of businesses as proposed in a Code of Practice replaced by a bilateral Framework for cooperative compliance. The Framework includes a common set of principles and ways in which large businesses and HMRC can work together to ensure that the right tax is paid at the right time. We agree with the approach that compliance with the Framework is part of HMRC's existing risk management approach for large businesses.

Julie Hughff
Partner
T: +44 (0)20 7311 3287
E: julie.hughff@kpmg.co.uk

Chris Davidson
Director
T: +44 (0)20 7694 5752
E: chris.davidson@kpmg.co.uk

Kevin Elliott
Director
T: +44 (0)20 7311 2487
E: kevin.elliott@kpmg.co.uk

Reforms to the taxation of non-domiciles

The draft Finance Bill clauses include changes to who will be treated as domiciled for UK tax purposes.

Who should read this?

Long term residents in the UK who are not UK domiciled, those born in the UK with a UK domicile of origin who acquire a non-UK domicile and then return to the UK, and trustees of certain trusts.

Summary of proposal

In the July Budget 2015, the Chancellor announced that statutory changes would be introduced to the rules on domicile for UK tax purposes, as reported in our Summer Budget Commentary (*New definition of domicile for tax purposes*). Draft legislation setting out the new deemed-UK domicile tests for income tax, capital gains tax (CGT) and inheritance tax (IHT) was first published on 30 September 2015 in the Government's consultation on *Reforms to the taxation of non-domiciles*.

The legislation in so far as it relates to IHT is now contained, with some amendment and new provisions relating to certain trusts, in draft clause 43 of Finance Bill 2016. The Government have stated that further draft legislation covering the income tax and CGT aspects of the changes will be published in early 2016 alongside HM Treasury's response to the consultation. Where we refer below to the proposed changes to income tax and CGT, our comments are based on the draft legislation published in the September consultation.

From April 2017, those resident in the UK for at least 15 out of the past 20 tax years will be deemed UK domiciled for all UK tax purposes. Further detail is set out below.

In addition, individuals born in the UK with a UK domicile of origin at birth who have left the UK and acquired a domicile elsewhere, and who subsequently return and become UK resident, will be deemed UK domiciled whilst so resident (such persons are referred to below as 'UK returners'). For IHT purposes at least there will be an additional requirement that a UK returner was UK resident in at least one of the immediately preceding two tax years before they are deemed domiciled.

Also announced in the July Budget (see our Summer Budget Commentary *Changes to IHT on UK residential property owned through offshore companies*) were changes to the IHT rules on UK residential property. From April 2017 the Government intends to bring the value of all such property held through offshore companies of non-UK domiciled individuals or their trusts into the scope of IHT in the same way as if the property were owned personally. Legislation to implement this will be included in Finance Bill 2017 and a consultation is awaited in the New Year on the details.

15 out of 20 year rule for income tax and CGT

UK residents who are not domiciled in the UK can elect to be taxed on their non-UK sources of income and capital gains only to the extent that they are remitted to the UK ('the remittance basis' of taxation).

Draft legislation contained in the September consultation inserts new provisions into the remittance basis legislation. These provide that an individual will be deemed UK domiciled (such that in a tax year in which they are UK resident the remittance basis will not be available to them and they will be taxed on their worldwide sources of income and gains regardless of whether they are remitted to the UK) in a tax year if they have been resident in the UK for 15 or more of the previous 20 tax years.

These new rules will take effect from 6 April 2017. Tax years of residence prior to that date will be taken into account, as will years which are split years for the purposes of the Statutory Residence Test (SRT) and years when an individual is under the age of 18. For the purposes of determining whether or not an individual was UK resident prior to 2013/14 (before the introduction of the SRT), the previous rules on residence governed by case law and HMRC guidance will apply. It will not be possible to elect to apply the SRT to these earlier years.

15 out of 20 year rule for IHT

Currently individuals who have been resident in the UK for 17 or more out of 20 tax years (including the tax year in question) are treated as deemed domiciled for IHT purposes. Once deemed or actually domiciled in the UK an individual's worldwide assets are within the scope of IHT (for individuals not so domiciled, only their UK assets are within the IHT net).

Clause 43 of draft Finance Bill 2016 sets out changes to the Inheritance Tax Act 1984 intended to bring the deemed domicile test for IHT into alignment with the new deemed domicile test described above for income tax and CGT from 6 April 2017. Deemed domicile for IHT will be brought forward such that an individual who has been UK resident in 15 or more of the preceding 20 tax years will be deemed UK domiciled. Effectively, deemed IHT domicile will apply from the start of the 16th year rather than the start of the 17th year of residence as currently. The draft clause does not however appear to require the individual to be UK resident in the 16th year to be deemed domiciled for IHT. This does not appear to be entirely consistent with the income tax and CGT provisions and we are seeking clarification from HMRC as to whether this is the Government's intention.

Once an individual is deemed domiciled under the new 15 out of 20 year rule for IHT and has been resident for 20 or more years, it will be necessary for them to be non-UK resident for six or more consecutive tax years to lose that deemed domicile status. The rules governing the ability of non-domiciled spouses/civil partners of UK domiciled persons to make an election into UK domicile for IHT purposes to benefit from the 'spouse election' for IHT will be amended in line with this, such that the election will cease to have effect once the elector has been non-resident for more than six consecutive tax years.

Domicile of UK returners

Clause 43 of draft Finance Bill 2016 also contains the new rules governing the domicile of UK returners for IHT purposes. Individuals who were born in the UK with a UK domicile of origin at birth, who subsequently obtain a domicile (of choice or dependency) outside of the UK, will be deemed to be UK domiciled in the UK for IHT purposes in any tax year in which they are UK resident provided they have also been UK resident in at least one of the immediately preceding two tax years. This latter proviso is to be welcomed as it provides a "grace period" such that circumstances of short temporary residence in the UK, such as to visit a sick relative or to obtain high quality medical care, will not cause an individual to be deemed domiciled for IHT, which could otherwise cause drastic and unfair results.

The SRT split year rules will not apply. Where a tax year is a split year for SRT purposes, the individual will be deemed domiciled for IHT throughout the whole year, whilst foreign income and gains arising in the overseas part of the tax year will not be taxable in the UK as a result of the SRT split year rules.

An individual who is deemed domiciled under these new rules for UK returners but does not meet the new 15 out of 20 years test will cease to be deemed domiciled in the first tax year in which they cease to be UK resident.

The legislation published in the September consultation indicated that the same rules would apply to UK returners for income tax and CGT purposes, although we will have to await publication of further legislation to confirm this. The consultation document did however indicate that the grace period would only apply for IHT.

Excluded property trusts

Trusts settled by individuals at a time when they are not domiciled in the UK at general law nor under the current IHT deeming provisions are known as excluded property trusts (EPTs). EPTs are broadly exempt from the usual IHT charges applicable to trusts if and to the extent that they hold non-UK assets.

From 6 April 2017, EPTs settled by UK returners whilst they have a non-UK domicile for IHT will cease to be EPTs if and when the UK returner becomes deemed domiciled for IHT under the new rules above for UK returners. Accordingly all property in the trust (both UK and non-UK assets) will become subject to 10 year and exit charges using time apportionment rules for periods when non-UK assets are, and are not, excluded property. There will be no exit charge if the UK returner settlor subsequently leaves the UK. In those circumstances it appears that the trust becomes an EPT again in their first year of non-residence, provided their non-domiciled status is maintained.

These new rules will not affect EPTs settled by non-domiciled settlors who may become deemed domiciled for IHT under the new 15 out of 20 year rule.

Timing

6 April 2017

Our view

The impact of the new rules on foreign domiciled individuals living in the UK will depend largely on how long they have been resident in the UK. There may be opportunities to take action before April 2017 for those who might be impacted by the changes and appropriate specialist advice should be taken.

Whilst the choice of 15 years seems arbitrary, the new 15 out of 20 year deeming rule is in our view an appropriate way to achieve the Government's policy aim that individuals who live in the UK for a long time should pay UK tax on their personal worldwide assets in the same way as an individual who is domiciled in the UK.

It is to be welcomed that the Government have listened to requests from interested parties to include a grace period for UK returners from an IHT perspective. Not having a similar proviso for income tax (and to a lesser extent CGT) purposes would present difficulties in the context of international assignments to work in the UK and it is to be hoped that a similar grace period or one for work related assignee duties will be included in the relevant legislation when it is forthcoming.

Given the new deemed domicile provisions for UK returners it will be important to be able to identify place of birth when considering an individual's domicile. The application of the rules to future generations will potentially be manageable in some situations by planning ahead when having children.

The new UK returners' rules indicate that HMRC accept that it is possible for an individual to obtain a non-UK domicile of choice which is maintained should they subsequently return to the UK (assuming they are not then deemed domiciled under the new rules).

The new provisions for EPTs add more intricacy to the already complex rules for 10 year charges. The rules may present trustees with difficulties in knowing whether they have a liability to a 10 year charge as well as record keeping challenges.

Legislation governing the impact of these new domicile rules on the income tax and CGT treatment of non-UK resident trusts, their settlors and beneficiaries will be included in Finance Bill 2017. This is a complex area and it is hoped that the Government's policy objectives in relation to offshore trusts as outlined in the *Reforms to the taxation of non-domiciles* consultation can be achieved in a fairer manner than the solution proposed in the consultation.

Mike Walker	**Rob Luty**	**Elizabeth Fothergill**
Partner	Director	Senior Manager
T: +44 (0)20 7311 8620 E: mike.walker@kpmg.co.uk	T: +44 (0)161 246 4608 E: rob.luty@kpmg.co.uk	T: +44 (0)20 7311 4954E: elizabeth.fothergill@kpmg.co.uk

Trivial Benefits exemption

Legislation for a statutory exemption from tax and NIC for trivial benefits-in-kind, delayed from the pre-election Finance Bill, will feature in Finance Bill 2016.

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

Under the current rules, 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, with the value of the benefit-in-kind being 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.

Following recommendation by the Office of Tax Simplification, the Government announced in last year's Autumn Statement that it would introduce a statutory exemption from income tax and National Insurance for trivial benefits (with a cost of less than £50). Draft legislation, for inclusion in Finance Bill 2015, was published in December 2014, but the measure was omitted from the pre-election Finance Bill introduced to Parliament in March this year.

The draft legislation which has now been published differs from the previous version only in the inclusion of a £300 annual limit (per director or office holder) on trivial benefits provided to directors or other office holders of close companies, or to member of their families or households.

Key conditions (in addition to the £50 per benefit and £300 per annum limits) are:

- 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.

Where a benefit is provided to more than one person and it is "impracticable to calculate the cost of providing it to each person" (because of its nature or the scale on which it was provided), then the average per person cost is used to calculate the value of the benefit.

Corresponding changes are also to be made to the Employer-Financed Retirement Benefits (EFRBS) regulations to allow the trivial benefits exemption to apply to trivial benefits provided to former employees.

Timing

6 April 2016 (in line with the other changes to the benefits and expenses rules which were legislated for in the pre-election Bill, but a year later than originally intended).

Our view

We understand that the original proposals were dropped from the pre-election Finance Bill in March this year because of concerns that the exemption could be used for avoidance purposes (presumably through an attempt to deliver a significant proportion of remuneration in the form of qualifying trivial benefits). The introduction of a £300 limit per employee per annum is intended to address this possibility.

An annual cap was considered during the initial consultation on the measure and had been rejected as creating too much of an administrative burden on employers. It is, therefore, welcome that although the Government has felt the necessity to introduce a cap, they have restricted its ambit.

The exemption will provide greater certainty for those employers providing trivial benefits to employees on the appropriate tax treatment of those benefits, and remove much of the administrative burden even where the cap does apply.

Colin Ben Nathan Partner T: +44 (0)20 7311 3363 E: colin.ben-nathan@kpmg.co.uk	**Mike Lavan** Director T: +44 (0)20 7311 1437 E: mike.lavan@kpmg.co.uk	**Alison Hobbs** Manager T: +44 (0)20 7311 2819 E: alison.hobbs@kpmg.co.uk

Employee share schemes

There will be some changes to both tax-advantaged and non-tax-advantaged share plans in Finance Bill 2016. In particular, legislation will clarify that restricted share unit (RSU)-type awards will be taxed under the 'securities options' rules where relevant. There are some other changes that are generally simplification measures designed to ensure the share scheme rules work as intended.

Who should read this?

These changes are relevant to companies that operate employee share plans or otherwise grant equity interests to employees.

Summary of proposal

The main change relates to RSU type awards (i.e. a conditional right to receive a specified number of shares on a future date if conditions are met). These are a popular form of employee share award in UK listed and international companies. Following significant changes to the UK tax and NIC sourcing rules for internationally mobile employees who have been awarded employment-related securities and options that took effect from 6 April 2015, there has been a lot of uncertainty on the correct charging provision for RSUs and whether the 'securities option' or 'general earnings' rules apply. This has a number of implications including whether the new National Insurance Contribution (NIC) sourcing rules apply. It is proposed that, with effect from 6 April 2016, RSUs will be taxed under the 'securities options' rules rather than the 'general earnings' rules.

HMRC indicate that the other changes are intended to simplify and clarify the law and make some minor technical corrections. The detailed measures are:

- Where a company has failed to self-certify a tax-advantaged Share Incentive Plan (SIP), Save As You Earn (SAYE) plan or Company Share Option Plan (CSOP) by the relevant deadline, new legislation will ensure that HMRC can accept a 'reasonable excuse' claim for the failure on or after 6 April 2016.
- A SIP will lose its tax-advantaged status from the time of a disqualifying event. Altering rights attaching to shares in a company in a way that materially affects the value of shares in a SIP trust will be a disqualifying event. Shares in a SIP receiving different treatment from other shares in that class will also be a disqualifying event. HMRC intend this change to enforce the principle that preferential shares in a SIP cannot be issued to selected employees (as a SIP is intended as an 'all-employee' plan). This change will have effect for disqualifying events occurring on or after the day on which Finance Act 2016 is passed.
- It is currently necessary to obtain HMRC agreement to use a share price on a date earlier than the date of grant as the basis for determining the exercise price of an option under a SAYE plan or a CSOP (e.g. to use the share price on the date of invitation under a SAYE plan). Proposed changes will allow HMRC to publish guidance to specify acceptable approaches without the need to obtain HMRC agreement. This is a further move towards self-certification of tax-advantaged plans. No effective date is given so it is expected this change will take effect when Finance Act 2016 is passed.
- Since 2014 companies under the control of employee ownership trusts with corporate trustees have been able to grant Enterprise Management Incentives (EMI) options. In a change to be backdated to 1 October 2014 the disqualifying events rules for EMI options are to be brought into line so that coming under the control of an employee ownership trust with a corporate trustee will also not prejudice the tax advantages of EMI options.
- The EMI legislation provides for tax-advantaged replacement options to be granted following a company reorganisation as defined. Currently, the definition of a company reorganisation includes a situation where an acquiring company becomes bound or entitled to acquire outstanding minority shares under the 'drag-along' provisions in the Companies Act 2006. In a change to be backdated to 17 July 2013 the legislation is to be tidied up so as to refer to the corresponding 'tag-along' provisions as well.
- Where there is a 'disqualifying event' for the purposes of the EMI legislation, the income tax advantages of the EMI options can be preserved if the option is exercised within 90 days of the disqualifying event. The prescribed period in the EMI capital gains tax legislation is currently 40 days and this will increase to 90 days (i.e. be brought into line with the income tax rules) with effect for disqualifying events occurring on or after the date Finance Act 2016 is passed.

Timing

As noted above the different measures will take effect on various dates.

Our view

The clarity around RSU awards is welcome, although there will still be some uncertainty in relation to RSUs where the company has a right to cash settle. Our expectation is that, until the new rules come into force in April 2016, provided there is no manipulation or tax avoidance, HMRC will generally accept either a securities option or general earnings analysis if applied consistently.

The other changes are generally minor tidying up changes. However, the new rules requiring companies to self-certify SIPs, SAYE plans and CSOPs were introduced with effect from 6 April 2014 and the first deadline for self-certification was 6 July 2015 (although this was extended to 4 August due to problems with the new HMRC online system). Given that reasonable excuse claims for a failure to self-certify a SIP, SAYE plan or a CSOP can only be made from 6 April 2016, companies that missed the extended 4 August 2015 deadline will want to clarify the status of their plans with HMRC, particularly given that some awards might now need to be treated as non-tax advantaged.

Alison Hughes
Senior Manager

T: +44 (0)20 7311 2626
E: alison.hughes2@kpmg.co.uk

Richard Rolls
Senior Manager

T: +44 (0)20 7694 1091
E: richard.rolls@kpmg.co.uk

Loan relationships and non-market loans

A new provision is being introduced to restrict relief for notional interest deductions which could otherwise give rise to an asymmetrical tax treatment between the borrower and the lender in prescribed circumstances.

Who should read this?

UK companies which borrow at less than a market rate of interest for a fixed term.

Summary of proposal

The background to the new provision is best understood by way of an example.

Suppose a UK company borrows 100 from a shareholder with the loan being interest free and repayable after five years. The company could borrow at a market interest rate of 10%.

Within the accounts, applying new GAAP accounting standards, the loan liability is initially recognised at its fair value/net present value of, say, 60 and the 40 difference between this and the amount borrowed is credited to a capital contribution reserve in equity. The liability is written back up to face value over the term of the loan with debits of 40 being recognised in profit and loss over the five year term ('notional interest deductions').

Following changes made in Finance (No.2) Act 2015, for periods beginning on or after 1 January 2016 it is expected that the upfront credit will not be taxable. However, the notional interest deductions should be deductible subject to the application of other tax rules, e.g. transfer pricing and debt cap.

The new provision will deny relief for the notional interest deductions where the lender is not within the charge to UK corporation tax unless they are a company resident or effectively managed in a 'good' treaty jurisdiction, broadly, where the UK has a double tax treaty which includes a non-discrimination article. So, for example, a loan from a UK resident individual would be caught.

Where part but not all of the upfront credit is taxable, a proportion of the notional interest deductions in each period will continue to be deductible subject to other tax rules.

For completeness, it is noted that on 30 October 2015 HMRC published draft guidance on the tax treatment of term loans with a non-market rate of interest, covering such matters as the application of the transfer pricing rules. This guidance should also be considered.

Timing

The changes apply from 1 April 2016 whatever a company's year-end.

Our view

The new provision is a sensible measure in that the aim is to ensure that tax relief is only available for notional interest deductions arising with new GAAP accounting standards in appropriate circumstances.

Rob Norris
Director

T: +44 (0)121 232 3367
E: rob.norris@kpmg.co.uk

Mark Eaton
Director

T: +44 (0)121 232 3405
E: mark.c.eaton@kpmg.co.uk

Loan relationships and derivatives: exchange gains and losses

Where loans and derivatives are not at arm's length, exchange gains and losses may be left out of account for tax purposes. From 1 April 2016, new rules ensure that where a loan or derivative is matching the foreign currency risk on another loan or derivative, or is subject to matching under regulations, then only the unmatched exchange gains and losses may be left out of account under the non-arm's length rule for foreign exchange.

Who should read this?

UK companies that use loans or derivatives to hedge foreign currency risks.

Summary of proposal

Where a loan or derivative is not at arm's length, the amount of exchange gains and losses brought into account for tax purposes can be restricted. For example, if only 60 of a foreign currency borrowing of 100 would have been advanced on an arm's length basis then only 60% of the exchange gains and losses arising on the borrowing are brought into account for tax purposes.

This rule can cause problems where the loan or derivative is acting as a hedge of foreign exchange risks. For example, if a foreign currency borrowing of 100 is hedging a foreign currency loan asset of 100 then restricting the exchange gains and losses that are brought into account on one of the loans will mean that the company is no longer hedged from a tax perspective.

From 1 April 2016, this arm's length rule will only apply to unmatched exchange gains and losses. Hence all matched exchange gains and losses should remain taxable. The change is intended to ensure that the non-arm's length rules for foreign exchange do not create a taxable foreign exchange exposure in a company where no foreign exchange exposure exists commercially or in the accounts.

A similar rule which can apply to exclude exchange gains and losses on certain borrowings with equity like features (equity notes) is also to be restricted to unmatched exchange gains and losses from 1 April 2016.

A loan or derivative will be 'matched' with another loan or derivative to the extent that it is intended by the company to eliminate or substantially reduce the foreign exchange risk of the other loan or derivative. A loan or derivative will also be 'matched' if exchange gains and losses are disregarded under regulations, e.g. as a hedge of a share investment.

Timing

The changes have effect from 1 April 2016 regardless of the accounting period.

Our view

The existing rules introduce a risk that a company has a foreign exchange exposure for tax purposes where no foreign exchange exposure exists commercially or in the accounts. The changes are intended to remove this concern enabling companies to have greater certainty that they are hedged from a tax perspective.

Rob Norris	**Mark Eaton**
Director	Director
T: +44 (0)121 232 3367	T: +44 (0)121 232 3405
E: rob.norris@kpmg.co.uk	E: mark.c.eaton@kpmg.co.uk

Loan relationships and derivatives: transfer pricing rules

Amendments are being made to the rules on loan relationships and derivative contracts, to ensure that credits are not taxable to the extent that they represent the reversal of debits which have previously been disallowed under the transfer pricing rules.

Who should read this?

Companies where the effect of new GAAP accounting standards (IFRS, FRS 101 or FRS 102) results in debits being recognised in the accounts which subsequently reverse giving rise to credits.

Summary of proposal

The intention behind the new provision is best understood by way of an example which is based on draft guidance issued by HMRC on 30 October 2015.

On 1 January 2014, a UK company borrows 100,000 from a shareholder paying 10% interest, repayable after five years. The company could borrow at a market interest rate of 15%.

Accounting

With old GAAP accounting standards, the borrowing is carried in the accounts at its face value of 100,000. New GAAP accounting standards are adopted on 1 January 2015 and the liability is restated to be, say, 85,000. Total debits of 15,000 are recognised in profit and loss over the remaining four year term of the borrowing.

In the period to 31 December 2015, the borrower recognises a finance charge of 13,000, being a 10% interest charge plus a debit of 3,000 as the liability is written back up to face value of 100,000 at maturity.

Tax treatment

Absent the transfer pricing rules, there would be a transitional credit of 15,000 taxable over the 10 years to 31 December 2024, at 1,500 per year.

In the period to 31 December 2015, the starting point is that the company has a net debit of 11,500. However, on an arm's length basis, the company would only have been able to borrow 60,000 and so relief for the finance charge in the accounts is restricted to 6,000 (60,000 at 10%). A similar analysis is applied for periods to the maturity of the loan on 31 December 2019.

The potential issue is that from 2020 onwards, transitional credits of 1,500 are recognised each year which may not be adjusted under the transfer pricing rules. This is because the transfer pricing rules do not, typically, apply to reduce taxable profits.

The aim of the new provision is to enable an otherwise taxable credit to be reduced to the extent it corresponds to an amount which has previously been disallowed under the transfer pricing rules. In the example, we would expect this to mean that none of the transitional credits of 1,500 recognised in each of the four years to 31 December 2024 would be taxable.

Timing

The changes apply from 1 April 2016 whatever a company's year-end.

Our view

The tax analysis of term loans with a less than market interest rate is not at all straightforward. One option is to avoid the issue by structuring the funding in an alternative manner, perhaps as interest bearing debt or as equity. However, if loans with less than a market interest rate are being used, it is recommended that the tax treatment is considered carefully.

The amendments are expected to help with one of the issues which can arise.

Rob Norris
Director
T: +44 (0)121 232 3367
E: rob.norris@kpmg.co.uk

Mark Eaton
Director
T: +44 (0)121 232 3405
E: mark.c.eaton@kpmg.co.uk

Hybrid mismatches

New anti-hybrid rules are to be introduced to implement the final recommendations under Action 2 of the OECD's base erosion and profit shifting (BEPS) project. The rules are aimed at counteracting tax avoidance through hybrid mismatch arrangements which result in a deduction for a payment with no corresponding inclusion in ordinary income or a double deduction for the same payment.

Who should read this?

Multinational groups with a UK parent or UK subsidiaries which have hybrid arrangements involving a mismatch in tax treatment within the UK or between the UK and another jurisdiction.

Summary of proposal

The new anti-hybrid rules will apply in four broad scenarios:

1. Payments made under hybrid financial instruments or transfers (such as a repo or stock loan), as well as by and to hybrid entities (including reverse hybrids), that are tax deductible for the payer, but are not fully included in the ordinary income of the payee (including under a controlled foreign company (CFC) regime of an investor jurisdiction) – in these cases, where the payer is within the charge to UK corporation tax, the payer's UK tax deduction will be reduced by an amount equal to the mismatch. Where the payee is within the charge to corporation tax and it is reasonable to suppose that the mismatch has not been fully counteracted under the UK's anti-hybrid rules or equivalent rules in another jurisdiction, an amount equal to the mismatch will be treated as income arising to the payee chargeable under Section 979 CTA 2009. In order to tax income treated as arising to a UK limited liability partnership, where it is a reverse hybrid, the normal rules that treat an LLP as transparent for UK tax purposes will be disapplied. (Please see draft Chapters 3, 4, 5 and 6.)
2. Payments made by hybrid entities that are tax deductible for the hybrid entity and also the investor in the hybrid entity – in this case, where the investor is within the charge to UK corporation tax, its UK tax deduction will be denied, unless it is deducted from dual inclusion income. Where the hybrid entity is within the charge to corporation tax and it is reasonable to suppose that the mismatch has not been fully counteracted under rules equivalent to the anti-hybrid rules in the investor jurisdiction, the hybrid entity's UK tax deduction will be denied, unless it is deducted from dual inclusion income. (Please see draft Chapter 7.)

3. Payments made by dual resident companies that are deductible for UK corporation tax purposes and also for the purposes of a non-UK tax – in this case, the company will not be able to obtain a UK tax deduction for the payment, unless it is deducted from dual inclusion income. (Please see draft Chapter 8.)
4. Payments that are deductible for UK corporation tax purposes which form part of a wider series of arrangements that also includes a hybrid mismatch arrangement as described in scenarios 1, 2 or 3 above – in this case, the payer will be denied a UK corporation tax deduction for the payment. This will prevent the effect of a hybrid mismatch arrangement being 'imported' into the UK (for example, through an ordinary loan), but only to the extent that the hybrid mismatch has not been counteracted under other parts of the UK's anti-hybrid rules or equivalent rules in another jurisdiction. (Please see draft Chapter 9.)

In each of these situations (apart from scenario 3 above), the new rules will apply either where the parties to the arrangement are members of the same control group or where they are related persons and, additionally, where the payment is made under a structured arrangement (i.e. one which is designed to secure the hybrid mismatch or where the mismatch is priced into the terms of the arrangement). 'Control groups', 'related persons' and 'structured arrangement' are specifically defined terms for the purposes of this draft legislation.

For the purposes of scenario 1 above, there are a number of situations in which a mismatch will not be considered to arise, for example, where the payee is not taxed on the payment because it is not liable to tax on any income or profits which it receives (e.g. a tax haven company) or because it is not taxed on the grounds of sovereign immunity. Also, an amount will be considered to be included in ordinary income of a payee if it is included as income in a period of the payee which begins within 12 months of the end of the period of the payer in which the deduction is claimed, or in a later period if the taxpayer can provide evidence to justify the timing difference.

The new rules will replace the existing arbitrage rules and, unlike those rules, will be self-assessment provisions and apply automatically if the relevant conditions are satisfied.

Timing

The new anti-hybrid rules will apply, in relation to scenarios 1 and 4 above, to payments made on or after 1 January 2017 and, in relation to scenarios 2 and 3 above, for accounting periods beginning on or after 1 January 2017 (with an accounting period straddling that date treated as two separate periods).

Our view

The new rules are generally in line with the OECD's recommendations under BEPS Action 2, although there do appear to be some differences. A number of examples illustrating the application of the new rules will be published on 22 December 2015, which should be helpful.

The draft legislation excludes banks' and insurers' regulatory capital instruments, but the Government intends to use regulations to apply the anti-hybrid rules, or modified rules, to such instruments at a future date once it has had time to consider the issues and options in this area.

The Government also acknowledges concerns that have been expressed on the impact of the new rules on capital market transactions, but notes that the rules on hybrid transfers only apply to related parties and structured arrangements, such that ordinary commercial transactions between unconnected parties will be excluded. There is also a targeted exclusion for financial traders.

Robin Walduck	**Michael Bird**	**John Addison**
Partner	Director	Manager
T: +44 (0)20 7311 1816	T: +44 (0)20 7694 1717	T: +44 (0)20 7694 4458
E: robin.walduck@kpmg.co.uk	E: michael.bird@kpmg.co.uk	E: john.addison@kpmg.co.uk

Company Distributions

HMRC have announced a new Targeted Anti Avoidance Rule (TAAR) and changes to the Transactions in Securities (TiS) rules that aim to ensure individuals pay income tax on the distribution of retained profits from close companies. In addition to these changes HMRC have also published a consultation looking at the distributions legislation more widely.

Who should read this?

Shareholders of close companies.

Summary of proposal

TAAR

The TAAR will treat a distribution on the winding-up of a company as an income distribution where the following conditions are met:

- An individual (S) who is a shareholder in a close company (C) receives from C a distribution in respect of shares in a winding-up;
- Within a period of two years after the distribution, S continues to be involved in a similar trade or activity; and
- The circumstances surrounding the winding-up have the main purpose, or one of the main purposes, of obtaining a tax advantage.

The intention of this change is to stop the practice of individuals regularly creating and liquidating companies in order to benefit from capital gains treatment on the distribution of retained profits. The draft legislation does not contain any provisions for a clearance procedure for the TAAR.

Changes to Transactions in Securities legislation

The following changes will also be made to the anti-avoidance TiS rules:

- Amendment of the fundamental change of ownership exclusion so that it looks at the economic interest of a shareholder rather than simply direct ownership of the target company;
- Clarification that the reserves of group companies are taken into account when applying the TiS rules;
- Changes to allow the rules to apply where a distribution can be paid to an associate of an individual;
- Changes to the avoidance test such that it looks at the purpose of the transaction as a whole, rather than the purpose for the individual shareholder; and
- Changes to bring distributions in liquidations and repayments of share capital or premium within the scope of the rules.

Consultation

A consultation document has been issued alongside the draft clauses, looking at both the potential effect of the Finance Bill 2016 changes and the distributions legislation more generally. The consultation document notes that the changes to the taxation of dividends (as announced in the Summer Budget and taking effect from 6 April 2016) "will increase the incentive to arrange for returns from a company to be taxed as capital rather than income". The stated aims of the consultation are to:

- Give the Government an understanding of whether there are parts of the current distributions legislation which "are proving an incentive to shareholders to carry out transactions that in effect convert income into capital for tax reasons";
- Identify how any such areas might be addressed; and
- Identify whether any changes might have a negative impact on "normal business" (i.e. not tax-motivated) transactions.

The consultation runs until 3 February 2016 – a shorter than usual period, which the consultation document itself notes is because of the timing of Budget 2016. We might reasonably, therefore, expect to hear more on this issue from the Chancellor next March.

Timing

The measures will take effect from 6 April 2016.

Our view

The new TAAR and the amendments to the TiS rules focus on bringing liquidations and repayment of share capital within the scope of income tax and close down perceived gaps in the TiS rules.

However, the wider consultation on distributions and the forthcoming increase in the rate of taxation on dividends from 6 April 2016 make it clear this is a key area of focus for HMRC at present.

We would therefore encourage shareholders of close companies to consider their short to medium term cash requirements, taking account of the impact of these changes.

Craig Rowlands
Senior Manager

T: +44 (0)20 7311 4682
E: craig.rowlands@kpmg.co.uk

Graham Charlton
Senior Manager

T: +44 (0)117 905 4132
E: graham.charlton@kpmg.co.uk

Inheritance Tax: main residence nil rate band and downsizing

Legislation is to be introduced to enable an individual's estate to benefit from the availability of the main residence nil rate band for Inheritance Tax purposes even after downsizing from, or selling, a residence.

Who should read this?

Anyone considering their exposure to inheritance tax, especially those who have, or are considering, downsizing or selling their home.

Summary of proposal

Inheritance tax is charged at 40% on the chargeable value of an individual's estate to the extent that this value, together with any chargeable lifetime transfers in the previous seven years, exceeds the nil rate band.

The nil rate band is currently £325,000.

Finance (No. 2) Act 2015 introduced an additional nil rate band (the residence nil rate band or RNRB) on death if the deceased's interest in his/her home is inherited by a lineal descendant. The value of this additional nil rate band is limited to the lower of the statutory cap (which increases from £100,000 in 2017/18 to £175,000 in 2020/21 and, thereafter, increases with CPI) and the value of the deceased's net interest in the relevant property on death.

Following the introduction of this measure, the Government issued a consultation document to seek views about its extension to cases where the deceased had either downsized from a more valuable residence, or sold a residence, prior to death. Such an extension was considered appropriate as, otherwise, individuals would be disadvantaged by, and dis-incentivised from, such downsizing and/or selling because of the consequent restriction on their available additional nil rate band.

The draft Finance Bill 2016 includes, in Clause 44, the draft legislation to introduce this measure.

In cases of downsizing and/or disposal the legislation introduces a further additional nil rate band called the "downsizing addition". Essentially, this addition seeks to compensate the individual for the RNRB that they have lost by reason of the downsizing/sale. In very simplified terms this lost RNRB is calculated via a three-step process:

1. Calculate the percentage of the then available RNRB that the individual could have claimed had they died at the time of disposal of the former residence.
2. Calculate the percentage of the currently available RNRB that the individual is actually able to claim on death.
3. Deduct these two percentages from each other and the lost RNRB is the resulting percentage multiplied by the RNRB that the individual is otherwise able to claim on death.

This calculated lost RNRB is then given as a downsizing addition to the actual RNRB to which the individual would have otherwise been entitled; however, this addition is only given to the extent that the lower value property and/or other assets within the estate are bequeathed to lineal descendants.

These rules are complicated by the ability for a surviving spouse to use any RNRB and/or downsizing addition that was unused by a deceased spouse. They are also further complicated by the requirement to taper the nil rate band in excess of £325,000 by £1 for every £2 that the overall estate exceeds £2 million.

Further rules apply where the former residence was disposed of prior to 6 April 2017. These rules are necessary because there are no RNRB limits applicable to those earlier periods which makes the calculation of the percentage in step 1 above troublesome. For these purposes, the legislation dictates that one should assume that the RNRB limit for those earlier periods was £100,000.

The additional nil rate bands available to an individual on death – both the original RNRB available in respect of any home still within the estate and the downsizing addition – cannot together exceed the maximum available RNRB for that year.

The deceased's personal representatives need to make a claim for the downsizing addition either within two years of the end of the month in which the person dies or, if later, within three months of the personal representatives first acting as such. Where there has been more than one sale or downsizing event, the deceased's personal representatives are required to nominate which former residence is to qualify for the downsizing addition.

Timing

These rules apply to deaths on or after 6 April 2017 and in relation to downsizing moves or sales on or after 8 July 2015.

Our view

This is an unnecessarily complex set of rules. It would have been simpler to merely increase the nil rate band to £500,000 and taper it for estates over £2 million; this would have simplified the measure enormously without losing much of its focus on providing additional IHT relief to those mid-value estates that have been inflated by rising house prices.

The measure appears to discriminate against those who have never owned their own property or, at least, have not done so since 8 July 2015.

The rules are complex and the above is a simplification of the manner in which they operate; the rules should be reviewed carefully to ascertain how they would apply in specific circumstances.

Ian Reid
Senior Manager

T: +44 (0)117 905 4389
E: ian.reid@kpmg.co.uk

Oliver Pinsent
Senior Manager

T: +44 (0)117 905 4356
E: oliver.pinsent@kpmg.co.uk

Office of Tax Simplification to be permanently established

The OTS is to be permanently established by statute, with the draft legislation also giving details on its operation and governance.

Who should read this?

Simplification of the UK tax system is likely to be of interest to many taxpayers.

Summary of proposal

The Office of Tax Simplification (OTS) was originally established as a non-statutory office of HM Treasury to provide independent advice on simplifying the UK tax system to the Government for the duration of the last Parliament. At the Summer Budget, the Chancellor announced that the role of the OTS would be expanded, and that the office itself would be made permanent and put on a statutory footing. The draft legislation to do so will form part of Finance Bill 2016.

The function of the OTS is now defined as advising the Chancellor on simplifying the tax system, whether at request or of their own accord, including simplifying the administration of taxes. The OTS will also be required to publish an annual report on their work for the year, and will be subject to a review every five years by the Treasury.

Timing

The legislation giving statutory footing to the OTS will be included in Finance Bill 2016.

Our view

We welcome the permanent establishment of the OTS and the fact that its statutory remit is a broad one, which allows for the OTS itself to choose areas of the tax system to examine.

It is unclear whether, as drafted, the OTS's statutory remit would allow it to review draft legislation as well as that already in force. Any such review would allow the OTS to provide another perspective as part of the existing consultation process, and could help to ensure that any proposed changes are evaluated against the long-term goal of simplification of the UK tax system. We await with interest to see whether such a review does form part of the OTS's work in future, and how its remit evolves within the boundaries of this statutory framework.

Sharon Baynham
Director

T: +44 (0)118 964 4926
E: sharon.baynham@kpmg.co.uk

Alison Hobbs
Manager

T: +44 (0)20 7311 2819
E: alison.hobbs@kpmg.co.uk

Kayleigh Havard
Assistant Manager

T: +44 (0)1293 652763
E: kayleigh.havard@kpmg.co.uk

Data-gathering from Electronic Payment Providers and Business Intermediaries

HMRC's data-gathering powers will be extended to include information held by electronic payment providers – for example providers of stored-value cards and digital wallets – and business intermediaries.

Who should read this?

Anyone operating a business which involves providing electronic payment facilities or facilitating retail transactions.

Summary of proposal

HMRC already have the power under Schedule 23 Finance Act 2011 to obtain information on a routine basis from various sources including merchant acquirers (which process credit-card and similar transactions on behalf of retailers). Such data are used to identify businesses which are not declaring or may be under-declaring their income.

Following a consultation in July 2015, HMRC have published draft Finance Bill clauses extending the Schedule 23 powers to additional types of data-holders, together with draft regulations specifying the data which may be required. The data-holders affected are providers of payment services by which value is stored electronically, such as digital wallets and stored-value cards, and providers of services (whether or not electronically) to enable or facilitate transactions between suppliers and their customers ('business intermediaries'), including advertising boards, app stores and booking and reservation services.

HMRC have also published a draft clause clarifying the operation of the daily penalty provisions under Schedule 23.

Timing

The Finance Bill clauses will take effect from Royal Assent. The Regulations are expected to be made by the end of summer 2016.

Our view

The clauses reflect the need for HMRC's data-gathering powers to keep pace with the development of the online economy. HMRC have deliberately limited the definition of 'electronic payment providers' to services involving some form of electronically stored value, but it remains to be seen whether they will seek to extend this in future to other types of electronic payment.

HMRC have given undertakings as to how these powers will be used in order to limit the burden imposed on data-holders, but there may nevertheless be some concern at their potentially wide scope. Concerns were expressed during the July 2015 consultation in relation to the territorial scope of these powers and the potential for discrimination against electronic service providers, and these are likely to remain. In particular it remains unclear how HMRC propose to apply these powers in relation to electronic service providers which do not have a permanent establishment in the UK.

Stephen Whitehead
Senior Manager

T: +44 (0)20 7311 2829
E: stephen.whitehead@kpmg.co.uk

Criminal offence for offshore tax evaders

This measure introduces a new criminal offence for offshore tax evasion which does not require the prosecution to demonstrate the taxpayer intentionally sought to evade tax. Conviction can result in a fine or prison sentence of up to six months.

Who should read this?

Anyone with income or gains arising outside the UK.

Summary of proposal

This measure introduces a new criminal offence where people fail to notify HMRC of their liability to pay tax, fail to submit a return or submit an inaccurate return.

The offence only relates to income tax and capital gains tax that is charged on or by reference to offshore income, assets or activities.

The offence only applies if the income tax and/or capital gains tax underpaid or understated exceeds a threshold amount; which is yet to be set but will not be less than £25,000 of tax lost per tax year.

The offence will not apply in relation to offshore income, assets or activities reportable to HMRC in accordance with certain international arrangements such as the Common Reporting Standard.

There can be no conviction if the taxpayer can satisfy the court that they have a reasonable excuse for failing in their obligation to notify or file a return or took reasonable care to get the return right.

The offence can result in an unlimited fine or prison sentence of up to six months.

The measure will not apply to trustees of settlements or the executor/administrator of a deceased person.

Timing

Legislation will be introduced in Finance Bill 2016 to insert new sections into the Taxes Management Act 1970. The operative date is not set yet. This will depend on a number of other changes HMRC are making in relation to offshore tax evasion, to ensure they all become operative at the same time. The offence will not be retrospective and will first apply in respect of the tax year in which the offence is introduced. If the commencement order is made in, say, September 2017, then returns filed in relation to the tax year 2017/18 would be the first to be impacted.

Our view

Tax evasion is illegal and we support the Government and HMRC's approach to tackling this.

HMRC have had some difficulty in proving the necessary guilty knowledge (intent) in front of the courts. In addition, HMRC received criticism from the Public Accounts Committee for the lack of prosecutions in respect of people who had undisclosed income and gains hidden in offshore assets.

There are some key changes that have been introduced following the consultation process that are welcome. Firstly, the threshold to bring the offence has increased to not less than £25,000 of tax lost per tax year arising from income or gains of an offshore asset. This means only those with significant undisclosed liabilities will be impacted. Secondly, the offence will not apply to offshore assets in jurisdictions where information is reported to HMRC under the Common Reporting Standard.

Over 90 countries have committed to the automatic exchange of tax information under the Common Reporting Standard, meaning that by 2018 HMRC will be in receipt of a huge amount of information.

It remains the case though that removing the need to prove intent by the taxpayer is a significant change. There is a major difference between those whose deliberate conduct results in a tax loss and those whose behaviour is at worst careless. It will therefore be important to see how HMRC will use this new criminal sanction in practice, but the concern has to be that careless (rather than deliberate) omissions could result in a criminal offence.

Now more than ever UK taxpayers must be sure their tax affairs are fully compliant as this offence could have a significant impact beyond tax evaders.

Derek Scott
Associate Partner

T: +44 (0)20 7311 2618
E: derek.h.scott@kpmg.co.uk

Jim Keys
Senior Manager

T: +44 (0)20 7694 4106
E: jim.keys@kpmg.co.uk

Increased civil sanctions for offshore tax evaders

This measure strengthens existing civil sanctions (such as financial penalties and so called "naming and shaming") and introduces a new asset-based penalty for those who evade their UK tax responsibilities using offshore transfers and structures.

Who should read this?

Those with income or gains arising or transferred offshore who evade their UK tax responsibilities.

Summary of proposal

There are a number of sanctions being introduced or amended, which will apply to income tax, capital gains tax and inheritance tax on offshore income, gains or property, or income or gains that arise in the UK, but are transferred offshore and not declared to HMRC.

- Minimum penalties for offshore inaccuracies involving "deliberate" and "deliberate and concealed" behaviour will be increased by 10%. Penalties for careless behaviour remain at the same rate;
- Taxpayers will be required to provide additional ancillary details on how the evasion took place to secure maximum penalty reductions where deliberate behaviour led to the evasion. Ancillary details may include structures used, how the funds were transferred offshore, and/or details of any enabler that facilitated the evasion;
- The naming provisions will be strengthened, so that in the case of offshore inaccuracies, only taxpayers who make full **unprompted** disclosures will be protected from having their details published. The provisions will also be strengthened to allow naming of individuals who use an entity (such as a company or trust) to evade UK tax. Current provisions only allow for the naming of the entity; and
- A new penalty is being introduced based on the value of the asset involved in the offshore evasion, such as an offshore bank account where the interest was not declared, or an offshore property with undeclared rental income. It will apply in only the most serious cases of offshore evasion; the behaviour leading to the evasion must be "deliberate" or "deliberate and concealed".

Timing

The measure will be introduced in Finance Bill 2016 but will be subject to a commencement order.

Commencement will be co-ordinated with the final disclosure facility which will provide a means for taxpayers to correct any tax non-compliance related to offshore income or gains. That disclosure facility is expected to run from April 2016 to September 2018.

Draft clauses for the asset based penalty will be published in early 2016.

Our view

HMRC aim to strengthen naming provisions to enable them to name those that hide behind entities, such as companies and trusts, when committing offshore tax evasion, and restrict protection from naming for those offshore evaders who do not come forward to HMRC unprompted.

HMRC's current disclosure facilities such as the Liechtenstein Disclosure Facility (LDF) and those relating to Jersey, Guernsey and Isle of Man all close to new registrations on 31 December 2015. HMRC had said it was to introduce a new harsher facility with increased penalties. The final disclosure facility is expected to run from April 2016 to September 2018.

HMRC will be in receipt of tax information from those offshore jurisdictions operating the Common Reporting Standard prior to the closure of the final disclosure facility.

It is clear that anyone who has undisclosed liabilities is always better coming forward to HMRC than adopting a strategy of thinking or hoping they will not be investigated. These measures, and others announced today, reinforce that point.

Derek Scott
Associate Partner

T: +44 (0)20 7311 2618
E: derek.h.scott@kpmg.co.uk

Jim Keys
Senior Manager

T: +44 (0)20 7694 4106
E: jim.keys@kpmg.co.uk

Civil sanctions for enablers of offshore tax evasion

A new financial penalty and a new naming power are being introduced for those who have deliberately assisted tax evaders to hide assets and taxable income and gains outside of the UK.

Who should read this?

Individuals and businesses who deliberately assist taxpayers to hide assets, income and gains offshore.

Summary of proposal

This measure introduces new civil penalties and naming provisions for those who have deliberately assisted taxpayers to hide assets and taxable income and gains outside of the UK ("enablers").

The penalty will only apply in relation to income tax, capital gains tax and inheritance tax.

The penalty only applies where:

- The enabler's behaviour was deliberate; and
- The evader has received a penalty relating to offshore tax non-compliance, either through deliberate behaviour or because they failed to take reasonable care.

The penalty for the enabler can be up to 100% of the tax evaded.

Naming will be reserved for the most serious enablers. In addition, enablers who have been given the maximum penalty reduction for a full disclosure (whether prompted or unprompted) will be protected from publication.

Timing

The measure will be included in Finance Bill 2016 but will be subject to a commencement order.

Our view

Penalties and naming provisions focussed on those who have deliberately assisted the taxpayer shows HMRC's desire to crack down on evasion at all levels.

It is potentially a powerful tool in HMRC's armoury.

Derek Scott
Associate Partner

T: +44 (0)20 7311 2618
E: derek.h.scott@kpmg.co.uk

Jim Keys
Senior Manager

T: +44 (0)20 7694 4106
E: jim.keys@kpmg.co.uk

Serial avoiders special regime

As previously announced the Government is pressing ahead with the introduction of a special regime for 'serial avoiders'. The regime will allow HMRC to issue a warning notice to a taxpayer where certain types of arrangements are defeated. The warning notice will cover a five year period and will place an annual obligation on the taxpayer to confirm that no further schemes have been used or, if they are, to provide details. The regime will also allow HMRC to impose increasing sanctions where, during the five year warning period, the taxpayer uses further arrangements that HMRC defeats. These sanctions include penalties, denial of access to certain tax reliefs and, in certain circumstances, public 'naming and shaming'.

Who should read this?

The regime applies to taxpayers who use arrangements disclosable under the Disclosure of Tax Avoidance Scheme regime or the VAT Disclosure Regime, arrangements counteracted by the GAAR, arrangements where the taxpayer has adjusted their tax return in accordance with a Follower Notice and certain VAT arrangements.

Summary of proposal

Where HMRC defeats a relevant arrangement it must send the taxpayer a notice putting them 'on warning' for five years. There is no formal right of appeal against a warning notice. For these purposes a defeat can occur in five different circumstances:

- A counteraction notice has been issued in respect of the arrangements under the General Anti-Abuse Rule (GAAR);
- A follower notice has been given in reference to the arrangements and the taxpayer has taken the required action under the notice (generally adjusting the open return or appeal to concede the advantage), or the tax advantage has otherwise been counteracted;
- The arrangements were or should have been disclosed under the Disclosure of Tax Avoidance Scheme (DOTAS) regime and have been counteracted;
- The taxpayer is a party to arrangements which have been or should have been disclosable under the VAT Disclosure Regime and the resulting tax advantage has been counteracted; or
- The arrangements are disclosable VAT arrangements to which the taxpayer is a party, the arrangements relate to the VAT position of another person who has supplied goods or services to the taxpayer, and the arrangements have been counteracted.

In each case the adjustment or counteraction must be final.

During the warning period taxpayers must make an annual notification to HMRC of any further avoidance schemes they have used or that they have not used any such schemes.

Continued use of arrangements during the warning period can incur further sanctions as follows:

- Where a taxpayer uses a further avoidance scheme during the warning period and this is defeated by HMRC a penalty of 20% of the understated tax may be imposed. Subsequent defeats of further schemes will incur increasing penalties of up to 60% of the tax advantage that is counteracted.
- Taxpayers who use three schemes during the warning period which are ultimately defeated by HMRC can have their details, including their name and address or registered office, published by HMRC. There is no formal right of appeal against a decision to publish this information.

Taxpayers who use three schemes in the warning period which exploit reliefs may have access to certain reliefs withdrawn for a period of three years. If no further avoidance schemes are used in this time which exploit a relief and are ultimately defeated the taxpayer will be able to claim reliefs in relation to the three years provided they are still within the time limits to do so.

Timing

The legislation will come into force on 6 April 2016 and warning notices can be issued in respect of arrangements defeated on or after that date. If a taxpayer notifies HMRC before 6 April 2017 of their firm intention to concede their case then no sanctions will be applied under the regime in relation to that case.

Our view

This is a further tranche of deterrent based legislation aimed at altering the behaviour of taxpayers. The power of HMRC to 'name and shame' with no formal right of appeal against such a decision will be particularly contentious but does demonstrate the direction of travel with regard to those who are perceived to be gaming the system.

The rules have the potential to apply to situations where taxpayers have conceded or settled a tax position once an enquiry has begun. It is not limited to situations where a taxpayer settles because they conclude the planning will not survive litigation. In the context of a Disclosure regime that is regularly extended and is expected to be further widened in the near future, the remit of the rules may be wider than some would anticipate.

Sharon Baynham
Director

T: +44 (0)118 964 4926
E: sharon.baynham@kpmg.co.uk

Measures of interest to specific groups

Patent Box: Substantial Activity – changes to comply with new international rules

Following the OECD base erosion and profit shifting (BEPS) report, the Government is making changes to the UK Patent Box rules which will restrict the benefits available to the proportion of research and development the company itself has undertaken in developing the qualifying intellectual property (IP) right.

Who should read this?

Companies that generate profits from holding and exploiting patents and other IP rights such as certain marketing authorisations and plant variety rights.

Summary of proposal

This measure introduces new rules for the UK Patent Box regime that will apply to new entrants (those that elect to use the regime for the first time for periods from 1 July 2016) and new IP (patents and similar IP rights applied for from 1 July 2016). The rules incorporate the 'nexus approach' set out in Action 5 of the OECD report on BEPS, restricting the benefits available from the regime to the proportion of research and development (R&D) the company itself has undertaken in developing the qualifying IP right.

The new rules will require companies to track research and development expenditure incurred to the level of an IP asset, product or product family as appropriate, in order to calculate an 'R&D fraction'. This fraction will then be applied to the profits attributable to the IP asset, product or product family. The method of calculating those profits will be similar to that used in the current regime, but all companies will be required to follow the streaming rules, which are further modified so that a separate streaming calculation has to be completed for each IP asset, product or product family. The appropriate 'R&D fractions' are then applied to the profits from each streaming calculation and the results aggregated to provide the Patent Box profits that will benefit from the 10% rate.

Transitional rules for 'grandfathered' IP are provided for companies that have elected into the current regime for periods prior to 1 July 2016. Such companies that only have existing IP (patents and similar IP rights applied for before 1 July 2016) will be able to use the current Patent Box rules for profits up until 30 June 2021. Such companies that have both existing and new IP from 1 July 2016, will be required to apply both the current and new rules until 30 June 2021. Only the new rules will apply from 1 July 2021.

There is a special provision for IP acquired on or after 2 January 2016 from a connected person (company or individual) and which does not qualify for, or already benefit from, an IP regime (the UK Patent Box or a similar overseas regime). Acquisitions include either the legal transfer, or exclusive license, of a qualifying IP right. This IP will be treated as 'new IP' and it will only benefit from the current rules until 31 December 2016. Any acquisitions of qualifying IP after 1 July 2016 will be treated as 'new IP'.

Timing

The legislation will come into effect from 1 July 2016, but companies should be aware of a number of dates that could have an impact depending upon their circumstances (see above).

Our view

The 25 pages of draft legislation published are complex and will require detailed analysis. The rules are likely to reduce the benefits available to the majority of businesses (particularly those that have R&D centres based overseas) and introduce significant compliance burdens in addition to those required under the current rules.

There probably are not very many surprises for those that are familiar with the detail of the consultation document published on 22 October 2015. The draft legislation maintains the basis of the current Patent Box regime in many areas although key points worth noting are the requirements to split income from a product or product family between existing and new IP and to complete a streaming calculation for each IP asset, product or product family in addition to tracking and tracing R&D expenditure at the same level. These rules increase the complexity of the regime giving rise to significant additional compliance burdens including the need for complex valuation exercises in relation to products with old and new IP which are likely to be very difficult to apply in practice. A simplified approach, particularly for those businesses that have a limited number of IP rights and where the majority of R&D is done in-house, would have been welcome and we would hope to see changes in these areas in the final Finance Bill. The definition used for R&D expenditure is based on the R&D tax credit rules and so includes expenditure on 'externally provided workers', workers that are contracted in to the company to undertake R&D. This is likely to help companies that undertake R&D operations in sister companies in the UK (or overseas) through this type of arrangement. It will of course add a further layer of complexity for those that don't.

Those that have been following developments of these rules closely might be surprised to see that new entrants to the regime will be required to track and trace expenditure back to 1 April 2013 (and have the option to do so for up to 15 years). An election is available to allow new entrants, that do not have sufficient information to do this for periods before 1 July 2016, to calculate their 'R&D fraction' based on expenditure of the trade as a whole.

Companies that are considering whether IP needs to be transferred on or before 1 January 2016, to ensure that it can benefit from the 'grandfathering' rules will need to ensure that as a minimum, the company that currently owns the IP can meet the qualification conditions for the current regime. There is no requirement to elect into the regime or to transfer, or grant an exclusive licence over, the IP.

Those that were expecting to see provisions increasing the competitiveness of the regime or dealing with cost-sharing arrangements, the 'rebuttable presumption' and business acquisitions will be disappointed as these are absent. HMRC have said that provisions in respect of the latter three items will be included in the final legislation, but of course this gives businesses limited opportunity in which to comment on these rules.

Comments on the draft legislation have been invited by HMRC and we would encourage businesses to ensure that their views are heard.

Carol Johnson
Director

T: +44 (0)20 7311 5629
E: carol.johnson@kpmg.co.uk

Jonathan Bridges
Partner

T: +44 (0)20 7694 3846
E: jonathan.bridges@kpmg.co.uk

Replacing wear and tear allowance with tax relief for replacing furnishings in residential property

The "wear and tear" allowance (a fixed percentage of rents) to cover the deemed cost of replacing furnishings in let residential properties is to be replaced with an allowance for the actual costs incurred in replacing such items.

Who should read this?

Landlords of furnished residential property currently claiming the 10% wear and tear allowance.

Summary of proposal

A proposal to replace the existing wear and tear allowance for let residential property was announced at the Summer Budget 2015, although it was overshadowed by the introduction of a restriction on the relief for landlords for finance costs on let residential property introduced at the same time.

A consultation on the proposals ran over the summer and a response to this has been published alongside the draft legislation. This confirms that from April 2016, landlords of furnished residential property will no longer be able to claim the 'wear and tear allowance' (a flat relief of 10% of rental income). Relief will instead be given for costs actually incurred.

The new relief will be available to both corporate and non-corporate landlords of residential property, and in respect of expenditure on unfurnished or part- or fully-furnished property. The relief will not apply to properties let as 'furnished holiday lettings' or to commercial property lets, both of which are eligible for capital allowances on such items.

The initial costs of fitting out and furnishing the property will not qualify for relief, but the capital cost of subsequent replacements will be allowed in the year in which the expenditure is incurred.

The relief will cover the replacement cost of furnishings, appliances, kitchenware and similar "provided solely for the tenant's use". Examples given in the consultation document include:

- Moveable furniture or furnishings;
- Televisions;
- White goods; and
- Carpets and curtains.

The draft legislation states that only the net cost of replacement will be allowed (e.g. proceeds of sale of old items must be deducted from the cost of the new item). In addition and importantly the relief will only be available for the cost of "like for like" replacements – any element of improvement in the standard of furnishing would need to be identified and disallowed.

Fixtures (including boilers and fitted bathroom and kitchen units) do not qualify for this relief, but relief may already be available for such items where they qualify as repairs to the property.

Timing

1 April 2016 (for corporation tax)/6 April 2016 (for income tax).

Our view

One of the Government's stated intentions in removing the current wear and tear allowance is to give "a more consistent and fairer way of calculating taxable profits": a flat 10% rate gives a greater deduction in areas where rents are higher, although the costs actually incurred by a landlord may be the same as those in a lower-rent region. The new measures achieve this, but at the cost of replacing a simple and easy to operate relief with one which is likely to increase administration for both businesses and for HMRC.

Those landlords who currently claim wear and tear allowance will need to ensure that, from April 2016, they keep records of actual expenditure on qualifying items – potentially a substantial increase in administration, particularly for those who may rent a property temporarily (such as individuals on assignment from the UK).

As the relief is only available for like-for-like replacement, not any element of improvement, a landlord will need to identify any element of improvement and exclude it from a claim to relief based on the market value of a like-for-like replacement. This can be difficult in practice, as technological and pricing changes can mean that it is difficult to distinguish what constitutes an "improvement", and will increase the administrative burden on landlords.

Although the changes sacrifice the simplicity of the wear and tear allowance they do help to level the playing field for those landlords who do not let their properties fully furnished. Under the current rules those letting unfurnished or partly furnished properties cannot claim relief for replacement of any furnishings (including freestanding white goods), which are provided in many "unfurnished" rental properties.

Daniel Crowther
Partner

T: +44 (0)1223 582163
E: daniel.crowther@kpmg.co.uk

Matthew Fox
Senior Manager

T: +44 (0)20 7694 3992
E: matthew.fox@kpmg.co.uk

Alison Hobbs
Manager

T: +44 (0)20 7311 2819
E: alison.hobbs@kpmg.co.uk

VAT: changes to the reduced rate for the installation of energy-saving materials

Following EC infringement proceedings, the Government has narrowed the scope of the reduced rate of VAT for energy saving materials to align UK and EU law.

Who should read this?

Businesses that provide and install energy-saving materials, and businesses and individuals who have them installed.

Summary of proposal

Infringement proceedings by the European Commission (EC) against the UK culminated in a Court of Justice of the European Union (CJEU) Judgment in June 2015. The CJEU agreed with the Commission that the UK had implemented the relief, by way of the application of the reduced rate, in a way that was not in accordance with EU law. These legislative changes narrow the scope of the reduced rate for energy saving materials, and are aimed at aligning the UK domestic rules with EU legislation.

The changes seek to retain as much of the existing relief as is possible and has done this by limiting the items removed from the existing relief combined with using alternative vires in the VAT Directive. The main change is the removal from the reduced rate of the installation of solar panels, wind turbines and water turbines.

Timing

Subject to the responses to a consultation that ends on 3 February 2016, the legislation is expected to be applied from 1 August 2016 but highlights that supplies that have taken place, either in terms of being paid for or contracts signed prior to 1 August 2016, are unaffected by these changes.

Our view

The UK fought the infringement proceedings and point out that they have tried to retain as much of the relief as possible. In terms of the exclusions, wind turbines, water turbines and solar panels are still popular and these appear to have been excluded on the basis that they generate electricity and therefore HMRC do not consider that their installation represents the provision, construction, renovation or alteration of housing. This appears to contradict HMRC's treatment on the construction of new dwellings where they accept that wind turbines, water turbines and solar panels are 'building materials'. This point may well be raised as part of the responses to consultation.

Dan Smith
Director

T: +44 (0)20 7311 4379
E: daniel.smith3@kpmg.co.uk

John Rippon
Senior Manager

T: +44 (0)151 4735197
E: john.rippon@kpmg.co.uk

Annual Tax on Enveloped Dwellings and 15% rate of Stamp Duty Land Tax

New reliefs will be introduced from the Annual Tax on Enveloped Dwellings (ATED) and the super 15% rate of Stamp Duty Land Tax (SDLT) for companies, partnerships and collective investment schemes acquiring and holding residential properties over £500,000 for certain qualifying business purposes.

Who should read this?

Flat management companies, providers of home reversion plans (equity release schemes), companies acquiring/holding residential property for property-rental businesses and companies acquiring residential property for non-residential use.

Summary of proposal

Legislation will be introduced in the Finance Bill to relieve companies, partnerships and collective investment schemes acquiring and holding residential properties for certain qualifying business purposes from the super 15% rate of SDLT and ATED. The super SDLT rate and ATED will not apply to residential properties acquired/held:

- For accommodation by employees of a property-rental business;
- For caretaker accommodation by tenant-run flat management companies;
- By authorised providers of home reversion plans (equity release schemes); and
- For conversion into non-residential use for the purposes of a trade or demolition in preparation for using the land for the purposes of a trade.

In addition, changes will be made to existing ATED legislation for alternative property finance arrangements in Scotland. The changes are consequential on the devolution of SDLT on land transactions in Scotland. They ensure that the financial institution providing the finance is not liable to the tax but where the person receiving that finance is a company or a collective investment scheme that person is, subject to the availability of reliefs.

Timing

The legislation will take effect from 1 April 2016.

Our view

The extension of an existing relief and the introduction of the new reliefs is welcomed. But it is regrettable that these businesses were liable to the super SDLT rate and ATED at all. The super SDLT rate and ATED are aimed at *individuals* 'enveloping' residential properties. Moreover, gaps still remain in the coverage of the reliefs. Further legislative changes are expected in this area, albeit probably not until Finance Bill 2017.

Sean Randall
Associate Partner

T: +44 (0)20 7694 4318
E: sean.randall@kpmg.co.uk

Daniel Crowther
Partner

T: +44 (0)1223 582163
E: daniel.crowther@kpmg.co.uk

Stamp Duty and Stamp Duty Reserve Tax: Deep in the Money Options

Transfers of UK securities to higher rate depositary receipt and clearance service systems as a result of an exercise of an option will now be charged at 1.5% of the higher of the option strike price and the market value of the securities.

Who should read this?

Businesses or individuals who enter into option contracts (e.g. those involved in equity arbitrage), depositary receipt issuers and clearance service providers.

Summary of proposal

This is an anti-avoidance measure introduced to prevent stamp duty and Stamp Duty Reserve Tax (SDRT) avoidance where UK securities are transferred to depositary receipt or clearance service systems as a result of the exercise of deep in the money options (DITMOs).

Previously tax was chargeable at the higher rate of 1.5% and calculated solely by reference to the low strike price of the DITMO. The draft changes introduce a charge to stamp duty or SDRT on transfers to higher rate depositary receipt and clearance service systems as a result of the exercise of an option on the higher of the strike price of the option and the market value of the securities, at the date of execution of the transfer instrument in the case of stamp duty, or the time of the transfer in the case of SDRT. The draft changes apply to all such options and is not limited to DITMOs.

Options which are not exercised for delivery to depositary receipt or clearance service systems, or those exercised for delivery to clearance service systems which have entered into arrangements with HMRC to disapply the higher rate 1.5% charge, will be unaffected.

There will be a period of consultation until 3 February 2016 to consider whether the measures are sufficient to prevent the perceived avoidance and whether there could be any potentially adverse implications.

Timing

The measure has effect from 16 March 2016 (Budget Day) and will apply to options which are entered into on or after 25 November 2015 and exercised on or after 16 March 2016.

Our view

DITMOs have been fairly widely used in the equity arbitrage sector. For some time HMRC have been trying to determine the extent to which the use of DITMOs is legitimate or contrived. The introduction of the measure follows those enquiries. The fact that it will extend to all options is presumably to prevent the complexity of having to define what constitutes a DITMO. It does however appear to mean that an element of double charge could arise if an option is made in writing and subject to stamp duty on its grant.

Sean Randall
Associate Partner

T: +44 (0)20 7694 4318
E: sean.randall@kpmg.co.uk

Fiona Cole
Senior Manager

T: +44 (0)121 232 3073
E: fiona.cole@kpmg.co.uk

SDLT for Property Investment Funds (PAIFs and COACSs)

Draft legislation introduces a relief from Stamp Duty Land Tax (SDLT) for Property Authorised Investment Funds (PAIFs) and Co-ownership Authorised Contractual Schemes (COACSs) on acquisitions of interests in land located in England, Wales or Northern Ireland from a 'seed' investor in the fund. The relief is subject to portfolio and diversity of ownership tests, and anti-avoidance rules. The legislation also deems the units in a COACS to be shares in a company holding the fund property, with the result that transfers of units in COACSs would be free of SDLT.

Who should read this?

Institutional investors in UK real estate.

Summary of proposal

PAIFs and COACSs will have a 'seeding period' within which to acquire a £100 million portfolio of interests in land located in England, Wales or Northern Ireland. The portfolio must consist of at least 10 properties for commercial property portfolios or 100 residential units for residential property portfolios. If in a mixed portfolio more than 10% of the properties are residential, the portfolio will be treated as residential. The seeding period is 18 months or until the fund is opened to non-seeding investors if that happens earlier.

Acquisitions within the seeding period should be free of SDLT provided that the only consideration is the issue of units by the fund to the vendor.

There are various anti-avoidance conditions for the relief, which include:

- The seeding investor must have made no arrangements to sell his seed units; and
- The transaction must be bona fide and not part of arrangements with a main purpose of tax avoidance.

The PAIF or COACS operator is liable for the SDLT, so the fund must have suitable arrangements in place to ensure it knows who beneficially owns the seed units and is aware of any unit sales.

Once granted, the relief can be withdrawn (wholly or partly) where:

- The PAIF or COACS still holds the seeded property and ceases to qualify as a PAIF or COACS during the seeding period or pursuant to arrangements made within three years of the end of the seeding period;
- The £100 million portfolio test is not met at the end of the seeding period;
- The seed investor disposes of seed units within three years of the end of the seeding period; or
- Certain connected individuals occupy seeded residential property.

There is an additional withdrawal trigger for COACSs where they fail to meet a diversity of ownership test at the end of the seeding period or at any time within three years of the end of the seeding period. Broadly, the test aims to ensure the fund is marketed broadly and does not limit investment to specific persons or groups of connected persons.

With regards to transfers of interests in these funds, a COACS will be treated as a company and its units will be treated as shares in the company with the result that no SDLT would be chargeable on transfers of the units. This puts COACSs on the same footing in this regard as PAIFs (as well as unit trust schemes) as these are already treated in this way.

Timing

The relief for transfers of seed property takes effect from Royal Assent unless (broadly) contracts have already been entered into. It is not clear from the draft legislation from what date a COACS is deemed to be a company, but the guidance suggests Royal Assent.

Our view

The overall thrust of the legislation is not unexpected but the detail is complex and many parts of it will be difficult in practice to interpret. How the legislation applies to COACSs that are in existence before Royal Assent is not clear. The relief does not apply to transfers of interests in land in Scotland (i.e. there is, as yet, no comparable land and buildings transaction tax relief) which will act as a disincentive to investment in Scottish properties by PAIFs and COACSs.

Simon Yeo	Fiona Cole	Nathan Hall
Senior Manager	Senior Manager	Partner
T: +44 (0)20 7311 6581	T: +44 (0)121 232 3073	T: +44 (0)20 7311 5217
E: simon.yeo@kpmg.co.uk	E: fiona.cole@kpmg.co.uk	E: nathan.hall@kpmg.co.uk

Capital gains tax and disposals of UK residential property

Three amendments have been made to existing legislation which applies to non-residents who dispose of UK residential property. Primarily the changes seek to provide clarity and prevent the risk of double tax charges. The Government has also taken steps to allow for a change to the tax payment date on disposals of UK residential property by UK residents from April 2019.

Who should read this?

Owners of UK residential property.

Summary of proposal

There are four areas covered by the draft Finance Bill clauses, being:

1. Since 6 April 2013, the disposal of high value UK residential property worth £2 million or more owned by a corporate has been chargeable to capital gains tax (CGT). The charge to tax is commonly referred to as a charge to ATED CGT and is based on the appreciation in market value between 6 April 2013 and the disposal proceeds. On 6 April 2015, all non-UK resident owners of UK residential property (i.e. all owners, not just corporates) have been chargeable to CGT if their property is sold. This is commonly known as Non-Resident CGT (NRCGT) and is based on the appreciation in market value between 6 April 2015 and the disposal proceeds.

   The draft Finance Bill 2016 clauses made amendments to the computations to put beyond doubt that a non-UK resident corporate will not pay tax on the same capital gain under both the ATED CGT regime and the NRCGT regime, i.e. a double tax charge should not arise.
2. When a UK residential property is sold, there can be an element of a capital gain (i.e. the pre-6 April 2013 gain) that is not chargeable to ATED CGT or NRCGT. CGT anti-avoidance legislation can apply to charge this element of the capital gain on the ultimate owners of the property (UK resident individual shareholders if the owner is a non-UK company, for example).

   The draft Finance Bill 2016 clauses include amendments to existing legislation to put beyond doubt that there is neither double counting nor under-counting when calculating the element of the gain that can be taxable under the CGT anti-avoidance legislation.
3. The Government will give HMRC powers to prescribe circumstances when a NRCGT return is not required by non-residents. This change gives HMRC the power to agree a return is not required. We do not know yet in what circumstances the powers will be invoked.

4. The Spending Review and Autumn Statement 2015 announced a requirement for the CGT due to be paid within 30 days of completion of any disposal of residential property. This will mean UK resident property owners will have to pay their tax much sooner, as the liability is currently not due until 31 January following the end of the tax year in which the disposal occurred. This requirement will be introduced from April 2019 to ensure that HMRC's digital systems are ready to provide support, making paying this tax simpler and quicker for taxpayers.

Timing

In terms of timing, following the numbering of measures set out above:

1. The legislation will apply retrospectively to all applicable disposals since 6 April 2015.
2. The legislation will apply to disposals made on or after 25 November 2015.
3. The powers are to be introduced from Royal Assent of Finance Act 2016.
4. The change to the legislation appears to be a procedural one to allow the due date for the payment of CGT to be changed. We anticipate the new payment date will apply to disposals where the conveyance is completed after 6 April 2019.

Our view

The changes affecting the rules applicable to non-UK residents owning property in the UK appear to provide clarification to existing legislation so are useful but not significant.

The changes to the collection of CGT on disposals of all UK residential property post April 2019 will no doubt be a revenue raising measure for the Government. However, there will be associated compliance obligations as assessing the capital gain that is taxable in such a short time may not be straightforward in all cases. How the tax will be collected in a timely fashion remains to be seen.

Mike Walker	Rob Luty	Francesca Power
Partner	Director	Senior Manager
T: +44 (0)20 7311 8620	T: +44 (0)161 838 4608	T: +44 (0)115 935 3545
E: mike.walker@kpmg.co.uk	E: rob.luty@kpmg.co.uk	E: francesca.power@kpmg.co.uk

Employment intermediaries: relief for travel and subsistence expenditure

As previously announced, travel and subsistence relief will be restricted for those engaged via personal service companies and other employment intermediaries from 6 April 2016.

Who should read this?

Employment intermediaries, and workers engaged through such intermediaries, claiming travel and subsistence relief for home to work journeys.

Summary of proposal

The draft Finance Bill clauses include the expected measures restricting the availability of travel and subsistence (T&S) relief for those engaged through employment intermediaries, including umbrella companies and personal service companies (PSCs).

From 6 April 2016, when considering whether T&S relief is available, an individual who is engaged through an employment intermediary and:

- is supplying personal services to a third party; and
- is under the "supervision, direction or control" of another person when carrying out their work;

- will have to consider each engagement as a separate employment. This is intended to ensure that such individuals cannot obtain relief for home to work travel (for which relief is not generally available), whilst retaining relief for other T&S expenses.

Supervision, direction or control

A consultation on the proposals ran over the summer, and the Government's response (published alongside the draft Finance Bill clauses) notes that a key concern of respondents was the subjective nature of the "supervision, direction or control" test. Despite these concerns, the Government has gone ahead with the use of the "supervision, direction or control" test, stating in the response document that although "a minority of engagements will be hard to categorise…clear guidance should help ensure businesses and individuals are able to understand when a worker is under the right of supervision, direction or control in the manner they undertake their work". HMRC are to review the existing guidance on supervision, direction or control and provide further guidance in relation to the T&S restriction ahead of its implementation.

The legislation is drafted such that it is presumed that a right of supervision, direction or control exists: that is, the onus is on the taxpayer to prove that it does not where they believe that the restriction should not apply.

Personal service companies

Another concern raised in response to the consultation was the interaction of the proposed rules with the existing intermediaries' legislation (IR35). The proposals have been amended so that the restriction will only apply to PSCs in respect of contracts that fall within IR35 (or which would do so but for the fact that the individuals receive all their income in the form of employment income).

PSCs within IR35 will not need to further consider the supervision, direction or control test – all engagements falling within IR35 (or which would but for income being received as employment income) will be subject to the restriction.

Anti-avoidance

The draft legislation includes provisions disregarding arrangements intended to circumvent the restriction.

Transfer of liability

As expected, the draft legislation includes transfer of liability provisions. However, following consultation the Government has decided not to take forward either of the two options originally proposed, but instead a third, suggested as part of the consultation process.

Under the revised proposals the directors of an employment intermediary may become jointly and severally liable for any debt where there has been (in the words of the response document) a "deliberate misapplication" of the rules. In situations where an intermediary is provided with false documentation leading to relief being given incorrectly, the debt may instead be transferred to the person who provided the documentation.

Timing

The restriction comes into effect from 6 April 2016.

Our view

The draft legislation follows several stages of consultation and contains few major surprises. In particular, the Government's decision to retain the "supervision, direction or control" test, albeit despite concerns raised in the consultation stage, is not unexpected. The quality of the promised HMRC guidance will be key in ensuring that the measures are properly targeted and straightforward to apply, and we hope that it will be published well in advance of the 6 April implementation date.

One area where the detail of the legislation does differ from what might have been expected is in the definition of employment intermediary itself. Rather than adopting the definition already in use for the purposes of the existing employment intermediaries quarterly reporting requirements (s716B ITEPA 2003), the draft clauses have a more restricted definition of a person "who carries on a business…of supplying labour". This would seem to exclude intermediaries supplying services (for example catering or security), and will help to ensure that the measure is properly targeted at those claiming relief which would not be available under general T&S principles.

Colin Ben-Nathan Partner T: +44 (0)20 7311 3363 E: colin.ben-nathan@kpmg.co.uk	**Mike Lavan** Director T: +44 (0)20 7311 1437 E: mike.lavan@kpmg.co.uk	**Alison Hobbs** Manager T: +44 (0)20 7311 2819 E: alison.hobbs@kpmg.co.uk

Investment managers: performance linked rewards

The new draft rules are the latest instalment of a succession of recent measures reforming the UK taxation of returns to asset managers. On 8 July 2015, HMRC issued a consultation on the taxation of performance linked rewards, proposing new rules to operate alongside the new carried interest rules introduced earlier this year (which seek to tax carried interest as a gain at 28% as a minimum). The draft Finance Bill legislation implements the proposals in the consultation, the means by which HMRC will introduce for the first time a legislative test to determine those payments of carried interest to asset managers that will attract income tax treatment and those which will retain capital gains tax treatment, as set out in the new carried interest rules introduced earlier this year. As drafted, these new rules further add to the complexity of the carried interest taxation regime. The new legislation also includes some small but interesting changes to the disguised investment management fee rules.

Who should read this?

Investment executives directly affected by the changes and Finance Directors, Chief Financial Officers and Heads of Tax dealing with the tax affairs of these executives.

Summary of proposal

Income-based carried interest

The new rules introduce the concept of 'income-based carried interest'. This is carried interest that will no longer attract capital gains tax treatment and will instead be taxed as income, within the disguised investment management fee rules. Such carried interest would therefore be charged to tax at 45% (plus 2% National Insurance) rather than a minimum 28% for carried interest within the capital gains tax rules. For income-based carried interest the source of the income, i.e. UK or non-UK, will also need to be considered under disguised investment management fee principles.

Average holding period

The amount of carried interest that will be reclassified as income-based carried interest is the 'relevant proportion' of a sum of carried interest arising to an individual. Broadly, that relevant proportion is calculated based on the average holding period of relevant investments of a fund, weighted by their original cost.

Relevant investments are those by reference to which the sum of the carried interest is calculated. As such, this could be all of the fund's investments in a 'whole fund' carry arrangement, or just the relevant investment for a pure 'deal by deal' arrangement.

Once the average holding period is established, an individual can assess where their carried interest receipt falls on a sliding scale of income vs capital – this starts at 0% of the carried interest being income-based where the average holding period for relevant investments is 48 months or more, rising to 25%, 50% and 75% between 48 and 36 months, and 100% being income-based where the average holding period is less than 36 months.

Whole fund arrangements

The length of time that an investment is held for is calculated either as the time for which it was held before being disposed of, or the time it was held for at the point the carried interest arises. The implication is that a carried interest receipt 'stops the clock', and when carry arises in whole fund arrangements both disposed and retained investments are taken into account to calculate the whole fund average holding period at that point.

HMRC appear to recognise that this could lead to an unfair result where a fund has an early investment which is extremely successful and the disposal of which triggers carry within four years, despite the general strategy of the fund being longer term investment. In certain scenarios, the rules allow for a claim to be made to apply capital treatment to carried interest that would otherwise be treated as income-based, with the capital treatment being withdrawn if the average holding period for the fund over its whole life turns out to be less than 48 months.

Disposals

There are complex provisions around what constitutes a disposal for the purposes of calculating the average holding period, especially where there are part disposals of assets. The rules vary depending on whether the investment fund has a relevant interest. This has different definitions in different scenarios, but broadly considers whether the fund mainly holds majority stakes in trading companies and is therefore a 'controlling equity stake fund', or has greater than 40% or controlling interest in the company being part disposed of. If these criteria are satisfied, then for the purposes of the holding period definition part disposals are treated as taking place when the whole investment is exited (and therefore do not bring down the average). Otherwise, fractional parts of single investments that are sold via part disposals are each considered as separate investments for the purposes of the calculation.

There are also rules covering deemed disposals of investments even though some of the holding is retained.

Hedging and derivatives

There are complex provisions relating to hedging and derivative instruments, such as those that exclude hedges for foreign exchange and interest from being separate investments under the rules when particular criteria are met. Derivatives may be investments for the purposes of calculating the overall average holding period relating to carried interest.

Debt funds

There are specific provisions regarding direct lending funds, which are broadly defined as funds providing interest-bearing finance to unconnected companies at arm's length rates and under commercial terms. The default position will be that carried interest in respect of such funds is to be treated wholly as income-based carried interest. There is, however, an exception where 75% of the loans made by a fund will have at least a four year term, the fund is a limited partnership, and investors are repaid capital and a preferred return prior to carry being paid. This should generally ensure that debt funds are on a fairly level playing field with equity houses, although careful thought will need to be given to the new rules to identify whether direct lending funds can support capital based carry going forward.

Disguised investment management fees

There are also changes at the very end of the published legislation to the definition of a 'disguised fee', which could have implications for a number of structures.

Firstly, there is no longer a requirement that arrangements involve at least one partnership. As such, wholly corporate fund structures will now need to consider the rules, whereas previously they would have been outside their scope. Another seemingly small but significant change is that the fee no longer has to arise from the scheme in respect of which the investment management services are performed, and instead can arise from any 'investment scheme'. This may therefore capture executives who no longer work for the scheme. This is reinforced by the change of the requirement for the individual being someone who 'performs investment management services' to being someone who 'at any time performs or is to perform investment management services'.

Timing

The measures will apply to sums of carried interest arising on or after 6 April 2016.

Our view

The draft legislation is very detailed and will need to be digested further. However in general, private equity houses with very traditional investment profiles (i.e. majority stakes in trading companies held over around five years) should retain the capital treatment of their carried interest, albeit they may still need to work through the detailed rules to confirm the position. More problematically, houses with even slightly alternative strategies such as minority holdings or fund of funds will need to consider the very complex provisions in substantial detail to determine where they fall within the rules.

Taxpayers will be aware that HMRC have introduced a number of measures to target the tax treatment of returns to investment managers over the past 12 months which will add substantially to the tax compliance burden of investment funds and investment managers. HMRC have indicated they are receptive to comment on the draft rules, and therefore the final legislation may incorporate changes resulting from any industry concerns raised.

Paul McCartney	Graham Taylor	Jennifer Wall
Partner	Senior Manager	Senior Manager
T: +44 (0)20 7311 6495	T: +44 (0)20 7694 3310	T: +44 (0)20 7694 1088
E: paul.mccartney@kpmg.co.uk	E: graham.taylor@kpmg.co.uk	E: jennifer.wall@kpmg.co.uk

Bad Debt income tax relief for Peer to Peer investments

The Government has published details of a new bad debt income tax relief enabling investors to offset losses they realise from peer to peer (P2P) loan investments against interest they receive from other P2P investments held when determining an amount subject to tax.

Who should read this?

Income tax payers who invest or are interested in investing in peer to peer lending.

Summary of proposal

The introduction of bad debt relief for investors holding P2P loans through a regulated platform will mean that losses realised by way of default on such loans can be offset against interest they receive from other P2P loans. Effectively this will allow investors to consider their overall lending portfolio as a whole when arriving at an amount subject to tax. HMRC have issued guidance to help investors determine when a loan can be considered "irrecoverable" and classified as a bad debt. It is expected that P2P platforms will support this analysis and advise investors accordingly.

Relief will be provided automatically for losses realised after 6 April 2016 and offset against interest received from other P2P loans held on the same P2P platform.

Relief will also be provided for losses realised between 6 April 2015 and 5 April 2016 with submission of a claim. This will permit an offset of losses against other interest income received in the same tax year from other eligible P2P loans.

Finally, from 6 April 2016, where losses exceed income within any single P2P platform, investors will be able to make an election to offset "excess bad debts" against interest received on other P2P platforms, or carry amounts forward to offset against interest received on other P2P platforms for a maximum of up to four tax years.

In arriving at a taxable value, the relief will apply before any tax free Personal Savings Allowance available is applied to an individual's savings income.

Any unexpected recoveries the investor receives following a valid claim for bad debt relief will be subject to income tax as an interest receipt.

More complex rules surrounding the operation of relief have also been released to support the position where loans are assigned between investors.

The new relief will not be available to persons subject to corporation tax.

Timing

The bad debt relief will be introduced with automatic application from 6 April 2016, but investors will be able to claim relief on losses arising on all eligible P2P loans from 6 April 2015.

Our view

The introduction of bad debt relief for P2P loans is a positive step to align the tax treatment of these investments with other similar "collective" investments available in the market where the investor is subject to tax on the broader return of the overall investment. This will be a boost to P2P platforms and may lead P2P investments to be viewed as more attractive by investors as the inherent risk in making such loans will be in part mitigated by the knowledge that tax relief will be available where loans become irrecoverable.

Gavin Shaw
Senior Manager

T: +44 (0)20 7694 4667
E: gavin.shaw@kpmg.co.uk

Daniel Crowther
Partner

T: +44 (0)1223 582163
E: daniel.crowther@kpmg.co.uk

Abolition of duty to deduct tax from interest on certain investments

From 6 April 2016, the obligation for banks and building societies to deduct UK income tax on deposit interest will be removed as a result of the introduction of the new Personal Savings Allowance for individuals.

Who should read this?

Banks, building societies and other institutions who deduct income tax on deposit interest under the Tax Deduction Scheme for Interest (TDSI).

Summary of proposal

Currently, deposit-takers such as banks and building societies are required to deduct 20% tax from payments of interest on relevant investments under TDSI. Relevant investments are broadly, deposit accounts on which interest is paid to individuals, certain partnerships and personal representatives.

From 6 April 2016, banks and building societies will no longer be required to deduct sums representing income tax from deposit interest due to the introduction of the new Personal Savings Allowance (PSA) for individuals.

As outlined in the Rates, allowances and thresholds section above, the new PSA provides a 0% savings rate of tax on the first £1,000 of interest earned by basic rate tax payers (£500 for higher rate tax payers). There will be no PSA for additional rate tax payers.

Timing

This measure takes effect for interest paid on and after 6 April 2016.

Our view

While this measure helps to encourage savings by providing tax benefits to individuals, it potentially represents an important administrative simplification for financial institutions and for HMRC.

It also highlights HMRC's desire for individuals to take more responsibility for their finances and tax affairs with the requirement to self-assess their interest income in excess of the PSA.

Tom Aston	Sam Keeble-Carter	Victoria Smallman
Partner	Senior Manager	Manager
T: +44 (0)20 7311 5811	T: +44 (0)117 905 4727	T: +44 (0)117 905 4799
E: tom.aston@kpmg.co.uk	E: sam.keeblecarter@kpmg.co.uk	E: victoria.smallman@kpmg.co.uk

Exclusion of energy generation from the tax-advantaged venture capital schemes

Companies whose trade consists substantially of energy generation activities will be excluded from the venture capital schemes (EIS, SEIS, VCT and SITR).

Who should read this?

Companies whose trade involves energy generation and their investors.

Summary of proposal

Energy generation activities including the generation or export of electricity, the generation of heat and the production of gas or other fuel will be added to the excluded activities list for the venture capital schemes (Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS), Venture Capital Trusts (VCT) and later on, the enlarged Social Investment Tax Relief (SITR)) from 6 April 2016.

Timing

From 6 April 2016 all energy generation activities will be excluded from the venture capital schemes. When the SITR is enlarged, energy generation will not be an eligible activity.

Our view

This is the natural conclusion of the Government's move to exclude energy generation from the venture capital schemes, which began in 2012. The Government feels that energy generation is not the kind of higher-risk investment that the schemes are meant to support and is taking this measure to ensure that the schemes remain well targeted and sustainable.

Graham Charlton	Edward Brown
Senior Manager	Manager
T: +44 (0)117 905 4013	T: +44 (0)117 905 4308
E: graham.charlton@kpmg.co.uk	E: edward.brown@kpmg.co.uk

Extension of the averaging period for farmers and simplification of the two-year averaging rules for farmers and creative artists

This measure will enable an individual who carries on a qualifying trade of farming, market gardening or the intensive rearing of livestock or fish, to average their profits over two or five years for income tax purposes. The current position allows averaging of profits over a two year period.

The legislation will also simplify the rules for farmers, and for creative artists who are eligible for two-year averaging, by removing marginal relief.

Who should read this?

Individuals who are eligible to average their business profits for income tax purposes under the averaging rules for farmers and creative artists.

Summary of proposal

This will enable an individual carrying on a qualifying farming trade, profession or vocation, either alone or in partnership, to claim averaging for a period of five consecutive years. Individuals will continue to have the option to average over two years. For these purposes the definition of a qualifying trade does not include a trade where the individual's profits are derived from creative works.

The legislation will also simplify the rules for farmers and creative artists by removing marginal relief so that full averaging relief will be available where the profits of one year are 75% or less of the profits of the other year. The current rules allow for a reduced marginal relief where profits are between 70% and 75%.

Timing

The measure will have effect for averaging claims made for the 2016/17 and subsequent tax years.

Our view

The Government recognises that farmers typically have fluctuating profits as they are unable to control various factors such as the weather, disease outbreaks and fluctuating market prices. 'Averaging' assists farmers by allowing them to spread their profits (and therefore their tax liabilities) over consecutive years to offset the effects of these fluctuations. Increasing the period over which farmers can average their profits from two years to five years, whilst retaining the current two-year rule, will provide them with additional assistance in managing this volatility. In view of the financial uncertainty that many farmers face the option, from April 2016, of potentially averaging profits from as far back as 2012 will be very welcome.

Abolition of marginal relief for both farmers and creative artists is also welcome as a further relaxation and simplification of the rules.

Judy Hill
Manager

T: +44 (0)117 905 4361
E: judy.hill@kpmg.co.uk

Brian Miles
Senior Manager

T: +44 (0)117 905 4025
E: brian.miles@kpmg.co.uk

Produced by Create Graphics | CRT053003 | December 2015 Produced by Create Graphics | CRT029536