DRAFT CLAUSES FINANCE BILL 2011

INTRODUCTION

As part of the Coalition Government's "new approach" to tax policy making it is keen to establish a convention that the majority of changes to tax law are confirmed no later than 3 months before the tax year in which they come into effect or before publication of the Finance Bill. Whether such a convention will be established remains to be demonstrated. Today's publication of draft clauses (in effect a draft Finance Bill) some 3 months in advance of Budget Day (already announced for 23 March next!) is a good start.

The draft clauses also meet another of the requirements of the new approach: predictability. The draft clauses largely bring together measures previously announced or which are the culmination of ongoing consultation. Again to be welcomed.

Perhaps the main new announcements, but certainly no surprise, are the measures targeting tax avoidance by way of "disguised remuneration", as described in the draft clauses but more easily recognised as the use of Employee Benefit Trusts and Employer Financed Retirement Benefit Schemes in remuneration planning. The changes here together with a summary of the other draft clauses are detailed below:

PERSONAL TAX CHANGES

Disguised remuneration

The Government has announced plans to prevent Employee Benefit Trusts (EBT) and Employer Funded Retirement Benefit Schemes (EFRBS) in particular from providing money, assets or loans to employees without incurring a tax charge.

From 6 April 2011 any sum, asset or loan from an EBT, EFRBS or other intermediary will be treated as remuneration and subject to PAYE. Anti-forestalling rules will apply to any similar transaction between 9 December 2010 and 5 April 2011 and will deem a tax charge to arise on 6 April 2012 unless the money has been refunded before that date.

Furnished holiday lettings

The revised changes announced today are very much in line with the previously published consultation document. The extension of FHL treatment to properties located in the EEA, which has been in existence informally since April 2009, will be placed on a statutory footing.

FHL properties, both in the UK and in the EEA, will continue to qualify for advantageous CGT treatment, including entrepreneurs' relief. However from April 2011 the beneficial income tax rules will be withdrawn so that losses can only be carried forward against future profits from the same trade (the ability to offset against general income or carry back against a previous year will be lost).

From April 2012, the required number of days that a property must be available for letting and actually let will be extended to 210 and 105 respectively (from 140 and 70). Effectively this means a property must be available for 30 weeks a year and actually be let for 15 weeks.

Capital allowances are still available for FHL properties. Those which will now fail to qualify for FHL status can of course be treated as ordinary furnished residential lettings and would be eligible for wear and tear allowance rather than capital allowances.

Pensions

From 6 April 2011 the annual amount that an individual can contribute to their pension scheme will be reduced from £255,000 to £50,000. However, various anti-forestalling measures have been in place for the last eighteen months which have effectively restricted the amount payable to £30,000, with any excess being subject to income tax to claw back the higher rate tax relief.

Providing an individual is already a member of a pension scheme, any unused proportion of the £50,000 limit will be available to carry forward for up to three tax years allowing higher contributions to be made in the future. This will be seen as good news for the self-employed who suffer from variable profits and may have been adversely affected by the reduction in the annual allowance. Individuals who made no contributions will have the full £50,000 to carry forward, providing they had a scheme in existence during that year. From April 2011 when the new rate applies, the £50,000 allowance will be deemed to have applied to the three preceding tax years. Another welcome rule allows unused relief brought forward to be utilised in preference to the current year's allowance.

The requirement to purchase an annuity at age 75 will be removed and new rules will be introduced to provide a more flexible regime for drawing down income.

BUSINESS TAX CHANGES

Corporation tax rates

The main rate of corporation tax is to be reduced by a series of 1% cuts from the current rate of 28% to 24% for the financial year beginning 1 April 2014. Accordingly, the main rate for the financial year beginning 1 April 2011 is 27%, reducing to 26% for the financial year 2012, etc.

The small profits rate of corporation tax is to be reduced to 20% (from 21%) from 1 April 2011.

The Associated Company rules as they apply in determining the profits thresholds benefitting from the small profits rate of corporation tax are to be simplified. The measures here seek to ensure that companies are only treated as under common control (and thus "associated" resulting in a lowering of the profit threshold at which the main rate of corporation tax applies) where there is substantial commercial interdependence between them. The factors to be taken into account in determining "substantial commercial interdependence" are to be set out in regulations and will have regard to the degree to which the companies are financially, economically and organisationally interdependent.

Capital allowances
The rate of writing down allowance (WDA) on the main pool of plant and machinery expenditure is to reduce to 18% from 20%. Similarly the rate of WDA with respect to the special rate pool of plant and machinery expenditure is to reduce from 10% to 8%.

The maximum amount of the annual investment allowance (AIA) is to be reduced to £25,000 from £100,000.

These changes in capital allowances will result in complex computations of allowances where the accounting period spans more than one financial year.

The above measures will have effect from 1 April 2012 for companies and from 6 April 2012 for unincorporated businesses.

Taxation of foreign branches
An "opt-in" exemption for corporation tax for foreign branch profits is to be introduced

A UK resident company will be able to make an irrevocable election for its foreign branches to be exempt from corporation tax. Profits or losses attributable to each foreign branch will be excluded from the company's worldwide profits calculation, with the resulting net amount subject to corporation tax. As the exemption will prevent relief for branch losses the regime is to be optional.

The exemption will apply to branch profits computed by reference to any relevant tax treaty. For branches in territories where there is no treaty the exempt profits will be determined having regard to the principles set out in the OECD model treaty.

The exemption will extend to chargeable gains and losses attributable to an exempt branch as well as any investment income which is "effectively connected" to the branch.

A number of measures are included to protect the Exchequer.

- A transitional rule provides where a company opts into exemption the branch profits will only become exempt once the losses of the branch arising in the immediately preceding 6 years have been "matched" by profits (except in the case of very large losses where all the losses must be matched before the exemption applies).
- To protect the UK tax base against the artificial diversion of profits a CFC type regime with limited exclusions is to be introduced pending the formal reform of the CFC regime in 2012.
- Although the regime is potentially available to all UK resident companies, small companies are to be excluded from benefit where the branch is located in a territory with which the UK does not have an appropriate tax treaty.

The new regime will be available for accounting periods commencing on or after a date to be specified in 2011.

Controlled foreign company
A number of interim improvements are to made the CFC regime pending full reform of the CFC rules to be implemented, following further consultation, in 2012.

The main improvement (the intra group activities exemption) is a new exemption for a CFC which carries on essentially "foreign to foreign" trading activities involving transactions with other group companies where there is little or no risk of erosion to the UK tax base. The exception will apply regardless of the proportion of the CFC's transactions with group companies provided these do not involve the UK or do so only to a limited extent.

Profits derived from IP with little or no connection to the UK are also to benefit from a full exemption where the CFC itself has a minimal UK business connection.

A statutory exemption for a period of up to 3 years is to be introduced for foreign subsidiaries that come within the scope of the CFC regime as a consequence of a reorganisation or change to UK ownership.

The *de minimis* exemption is increased to a profits threshold of £200k for a UK headed group with at least one large company as a member.

Corporate chargeable gains: simplification
The rules dealing with capital losses after a change in ownership are to be simplified. Notwithstanding a targeted anti-avoidance rule introduced in Finance Act 2006 to prevent capital loss buying, the pre-existing rules continue to apply. These require capital losses to be "streamed" such that they can only be utilised in a prescribed way. These streaming rules extend to losses on assets which had not been realised at the time the company joined the group but are realised subsequently (latent losses). Although these streaming provisions are to be retained, the requirement to identify and stream latent losses is to be removed.

The value shifting rules which seek to target tax motivated arrangements to obtain a tax advantage through the reduction in value of a company before a share sale are to be replaced by a targeted anti-avoidance rule.

The depreciatory transaction rules are modified to exclude depreciatory transactions which occurred more than 6 years before the disposal of the shares or securities by the company.

Corporate capital gains: de-grouping charges
The de-grouping charges triggered where a company leaves a group as the result of a disposal of shares by a group company will now be made by way of an adjustment to the consideration taken into account in calculating the gain or loss on the disposal of the shares. As a consequence any exemption or relief available on the share disposal will effectively apply to the de-grouping charge. In particular, this will enable the substantial shareholding exemption (SSE) to potentially apply to the de-grouping charge.

A related change is to allow the SSE to apply where trading activities are transferred to a newly incorporated company in anticipation of a sale of that group company.

Provision is made for a reduction in the amount of the de-grouping charge on a just and reasonable basis having regard to the amount of share capital of the company being sold and the circumstances under which the company leaving the group acquired the asset.

The ability to roll-over a de-grouping charge on the acquisition of a replacement asset is removed
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Changes are made to clarify the circumstances when the associated companies exception applies.

Anti-avoidance
A number of anti-avoidance measures are introduced directed at large companies involved in corporation tax avoidance which seek to exploit the asymmetrical tax treatment of inter-group loans or derivatives or through the de-recognition of loan relationships and derivative contracts.

VALUE ADDED TAX

Academies – Refunding Irrecoverable VAT
With effect from 1 April 2011, Academies will be treated in the same way as Local Authority Schools with respect to VAT incurred on costs used in carrying out their non business activities such as the provision of free education.

Under the normal VAT rules such VAT is not recoverable, but a refund mechanism allows Local Authorities to submit claims to HMRC to recover this VAT. This refund mechanism is being extended to Academies.

For Academies which are VAT registered, the claims will be made on their normal VAT returns. For those Academies which are not VAT registered, a claims mechanism will be introduced.

VAT Zero-rating – Splitting of Supplies
With effect from the date the 2011 Finance Bill receives Royal Assent an anti avoidance measure is being brought in which will withdraw the zero-rate from printed matter where it is supplied in conjunction with a supply which is either exempt, or taxable at a rate other than the zero-rate.

Ordinarily, if a single business supplied both the main supply, together with printed matter which was ancillary to the main supply, the entire supply would be subject to VAT at the rate applicable to the main supply. Businesses have been circumventing this by arranging for the printed matter to be supplied by a different, sometimes connected, business so as to argue that part of the supply can be zero-rated.

When the measure comes into force, the printed matter will no longer be zero-rated, but will instead be standard-rated.

Samples
Current VAT law provides that where a business provides a series of identical samples to the same person, then it must account for VAT on all but the first one in the series. This has been held to be in breach of EU law, so effective immediately (and with retrospective effect for the last 4 years) this restriction is removed.

The 2011 Finance Bill will amend the existing UK legislation to reflect this change.

CHARITIES

Substantial Donor Rules

After more than two years of both formal and informal consultation, it is welcome news that the existing rules targeting charities entering into transactions with substantial donors will be curtailed and new provisions targeting donors will be introduced with effect from 1 April 2011. The new provisions are underpinned by the adoption of a purpose test approach.

Legislation in Finance Bill 2011 will introduce new rules to deny tax relief on donations where the donor is party to arrangements, the main purpose of which is to obtain an advantage for the donor or a connected person. Under the new rules, the tax would be recovered from the donor or certain other parties involved in the arrangements and the charity should only be at risk if it is knowingly involved in the relevant arrangements.

Whilst no new substantial donors will be created after 1 April 2011, the old rules will continue to apply to charities in respect of their relevant transactions with existing substantial donors. The rules will, however, be softened so that the charity will only incur a tax charge if a transaction is made as part of an arrangement that would not have occurred independently of the associated donation.