



Ernst & Young's response to the Pre-Budget Report 2009

ITEM CLUB VIEW

Alistair Darling faced a difficult balancing act in the Commons today. He needed to support the economy in the short term while convincing the financial markets that he would halve the deficit in the medium term. And he needed to pave the way for a general election without further straining the public finances.

While the Chancellor provided very little support for the recovery - and indeed will begin to withdraw the fiscal stimulus in the New Year - he did nothing to derail it. The fiscal changes will not come in until 2011. The two-year slowdown on public sector pay and the capping of government pensions contributions will save £4bn a year, with a similar sum being raised by the increase in National Insurance Contributions (NICs). However, these figures are largely offset elsewhere within medium term fiscal projections that have barely changed since Budget 2009. In particular, with spending totals in cash terms the same, the pay and pensions proposals will just make them a little easier to meet in real terms.

Despite the steep downgrades to the economic forecast, which saw the Budget forecast of a fall of 3½% in GDP this year revised to one of 4¾%, the deterioration in the fiscal arithmetic was negligibly small. Borrowing increased by just over £2bn this year and £3bn in 2010/11. These stable projections are supported by the fiscal outturn so far this year, which has been broadly in line with the Budget forecast.

Normally we would expect a reduction of 1¼% fall in GDP (the downward revision in the GDP forecast for this year) to increase public borrowing by nearly 1% of GDP within two years. The reason that this has not happened this time is that the Treasury made a very cautious assumption about the effect of the recession (and the subsequent recovery) on the deficit, saying that most of the deterioration was structural rather than cyclical and would remain with us long after the recovery. Budget 2009 put the structural or underlying borrowing figure at 9.8% of GDP this year. The recent behaviour of the economy and the deficit means that this has now been revised down in the PBR, to 9.0%.

This benign outcome reflects the more realistic economic framework that the Chancellor has been using to project his finances, which should make them more robust and reliable going forward. This marked

contrast with the previous scenario analysis - which meant upward revisions to borrowing even when the economy did better than expected - is quite striking.

Having said that, it is our view that the medium term projections have been relied upon to achieve the Chancellor's objective of halving the deficit. The growth forecasts of 3½% for 2011 and 2012 are - as the Chancellor said - in line with the Bank of England's forecast, but we remain very cautious. Forecasts of a strong recovery have to be supported by strength in consumer spending as well as investment and exports and this one is no exception - saying that consumer spending will grow by 3% in 2011. These projections are based on the view that there is a lot of spare capacity in the economy and this will cause output to bounce back sharply almost automatically. It did that after the last recession. However, this time the consumer is cashed out and cautious. In our view, the next Chancellor will not just have to spell out the full detail of the departmental spending cuts but will also have to announce further tax increases.

In this respect, this was always going to be a political Budget. Business organisations immediately dubbed the increase in NICs as 'a tax on jobs.' This will, of course, hit employees as well as employers, as will the action on public sector pay and pensions, although the windfall tax on bankers' bonuses should help to make this medicine a bit more palatable. The freezing of the threshold for inheritance tax is more interesting. It may help to soak up a bit more of the red ink on the fiscal arithmetic but opens up a clear divide between the Labour and Conservative tax proposals as we move towards the election.

ERNST & YOUNG ANALYSIS

EMPLOYMENT TAX MEASURES

Bank payroll tax

Not to anyone's surprise the Chancellor has taken measures against bonuses paid to those in the banking sector. He announced that legislation is to be introduced in the Finance Bill 2010 which will include a bank payroll tax. This tax, which will be applicable to bonuses awarded after the announcement on 9 December 2009 to 5 April 2010 (the 'chargeable period'), will be set at 50% and payable on a bonus paid to a banking employee if that bonus exceeds £25,000. All discretionary and contractual bonuses paid during the chargeable period will be caught although there will be an exception for contractual bonus entitlements where the payer had no discretion as to the amount of the bonus because of a pre-existing contractual obligation existing at the time.

This tax charge is imposed on the bank. The employee will only suffer the normal PAYE and NIC withholdings on the bonus he or she receives.

Those entities affected by this new tax charge (broadly banks and building societies) are:

- ▶ UK resident banks
- ▶ Certain foreign banks carrying on a trade in the UK
- ▶ Not one of the above but is a member of a banking group and either
 - a UK resident investment company or UK resident financial trading company, or
 - a foreign financial trading company
- ▶ a building society
- ▶ UK resident investment company or UK resident financial trading company that is a member of a building society group.

The legislative definition, which runs to nearly three pages, goes into more detail as to the type of companies which are included within the above. It is wide ranging and will affect those companies dealing, arranging safeguarding or administering investments.

The tax will apply to 'banking employees'. This has currently been defined by HMRC as someone whose duties comprises banking employment and who is either resident in the UK in 2009/10 or performs their duties wholly or in part in the UK. 'Banking employment' has been defined as one where the duties are wholly or mainly concerned, whether directly or indirectly, with 'Relevant Regulated Activities' namely activities regulated by the Financial Services and Markets Act 2000.

Clearly this will capture those employed by a bank etc. It will, however, also capture individuals who provide 'banking services' to a bank via arrangements involving a third party rather than being directly employed by the bank. 'Banking Services' have been defined as services directly or indirectly concerned with activities that are 'Relevant Regulated Activities' namely activities regulated by the Financial Services and Markets Act 2000.

Neither does this new tax apply to just cash bonuses. Anything which is earnings under section 62 ITEPA, or not earnings but constitutes a benefit will also be caught. So will a loan, if the main purpose or one of the main purposes is the avoidance of the payroll tax. Awards under long term incentive plans that are granted within the chargeable period or will vest (even if granted prior to 9 December 2009) within the chargeable period, may also be subject to Bank Payroll Tax. Whether or not such awards are caught will be dependent upon whether a 'contractual obligation' exists. Factors to be considered in determining whether such an obligation exists will include the type of performance measures and the level of remuneration committee/company discretion available as to whether the LTIP is ultimately payable.

Regular salary, wages and benefits, awards under an approved share option scheme or a SAYE scheme are not caught.

Nor does the bonus need to be paid or provided direct by the employer. The tax charge will also apply to bonuses paid or provided via an intermediary.

Any arrangement made during the chargeable period to make a payment in the future which would have been caught by these new rules had it been paid in the chargeable period will be caught by these provisions.

The draft legislation includes anti avoidance provisions. For example these will catch payment under these new rules where bonuses are delayed and paid or provided after 5 April 2010.

The tax is due and payable on 31 August 2010.

It will not be surprising to note that the banking industry is unhappy about these provisions. For what appears a simple tax 11 pages of draft legislation has just made UK tax legislation even more complex. We suspect that the banking industry will also be concerned with the comment in the technical note which accompanied the draft legislation. This states that the period of charge could be extended until the relevant provisions of the Financial Services Bill come into place.

Pensions: implementing the restriction of pensions tax relief - a consultation document

HM Treasury has today issued a 124 page consultation document following up on the announcement in Budget 2009 that pension relief will be restricted to basic rate relief for individuals with income over £150,000 on both the individual's and the employer's contributions to the pension scheme.

The consultation document uses gross income including **employee and employer** contributions over £150,000 so that "*... the restriction of pensions tax relief should apply as fairly as possible to individuals in different types of pension scheme and employment, and with different remuneration arrangements.*"

The consultation has also introduced a new threshold to these rules which excludes individuals with pre-tax income, including employee's pension contributions and charitable donations, of less than £130,000. The consultation explains that this has been introduced to provide certainty for whether individuals are affected and to reduce the administrative burden on scheme administrators.

The consultation document says that this floor will mean that 300,000 individuals are caught by these rules, about 2% of pension savers, who receive around 25% of the tax relief on pension contributions.

As proposed in the Budget earlier this year, the restriction will be tapered for those with income between £150,000 and £180,000 so phasing the

restriction in as income levels increase. This has become more relevant as the definition of income over £150,000 using gross income and employer contributions will mean that individuals paying tax at 40% on their income will also suffer this restriction on their pension relief.

In order to account for this, the mechanism for applying the taper is complex, applying different rates of restriction depending on the underlying rate of tax which would have been due on that income. The consultation document specifically asks for views on this method of restriction and so this may not be how the tapering is effected.

At this stage the consultation document has identified that valuing pension contributions to a Defined Contribution (DC) scheme is straightforward as money is placed into the scheme. It has also recognised that the valuation of annual contributions to a Defined Benefit (DB) scheme is not simple to determine as the entitlement to benefits is dependent on criteria other than the money put into the scheme such as years of service and final salary or average salary over the employment, for example.

The Government has stated that it recognises that the valuation method currently used for the purposes of calculating the pension inputs for the annual and lifetime allowances may not give a fair result, although the calculation is comparatively simple. As an alternative, the value could be determined by an actuarial calculation.

So at this stage it is not clear how the pension value will be determined but the Government has put forward three proposals:

- ▶ the flat factor, already in place for the annual and lifetime allowances
- ▶ A cash equivalent transfer value (CETV) calculation, which is a complex actuarial calculation, or
- ▶ age-related factors (ARF), which is a simplified version of the CETV but gives fewer distortions by taking into account further factors such as age, dependants' benefits and Normal Pension Age (NPA) but keeping things simple enough for individuals to do the calculation themselves.

The hope here is that the result will be fair but it is difficult to imagine that individuals will be able to undertake these calculations easily.

Taxes payable as a result of the restriction will be collected via self-assessment. However, if the tax due is in excess of £15,000 then an employee can elect to have it paid from their pension with an appropriate reduction in the value of the pension benefits. This may not be appropriate for some under-funded DB schemes or if the pension scheme is overseas it may not allow such withdrawals. In those situations it has been suggested that the tax due could be spread over three years.

In order to collect the tax, there will be an obligation on employers to identify any employees with pay and benefits over £130,000 and provide details to the pension scheme providers who will be required to provide a pension benefits statement to employees by 6 July following the end of the tax year.

What this does not seem to take into account is the work the employer may need to complete to identify whether an employee's benefits would put them over the threshold as they may well be preparing the P11Ds during that period.

Responses to the consultation are due in by 3 March 2010. As there may be a different Government in place when these are reviewed, it may be that the goalposts will be moved again.

Pensions: Further limitation of tax relief for 'high income' individuals.

In anticipation of the limitation of tax relief on pension contributions for people earning £150,000 or more, anti forestalling rules were introduced to prevent individuals from increasing their normal regular pension contributions ahead of 6 April 2011. These rules introduced a special annual allowance of £20,000, which in certain circumstances can be up to £30,000.

An associated tax charge applies where the special annual allowance is exceeded, unless the excess pension savings are normal regular pension savings paid under agreements made prior to 22 April 2009 and which were paid quarterly or more frequently. For defined benefit schemes, increases under existing pension scheme rules as at 22 April 2009 including increases due to normal pay rises and progression were not affected.

The Chancellor has announced that:

- ▶ for the purpose of defining income of £150,000 effective 6 April 2011 this will

include the value of employer pension contributions

- ▶ tax relief for individuals with income less than £130,000 before including employer pension contributions will not be restricted effective 6 April 2011

As a result of the above, with effect from 9 December 2009 the anti forestalling rules will now apply to individuals whose relevant income is £130,000 or more for the tax year or for either of the two preceding two tax years. For such individuals, the special allowance and associated tax charge will apply in the same way as to those with relevant income of £150,000 or more. However, normal regular pension savings made under arrangements that were in place before 9 December 2009 should not be affected.

For the purpose of calculating whether an individual has 'relevant income' of £130,000 or more it is necessary to include the amount of a salary sacrifice made in return for an employer pension contribution, if the salary sacrifice agreement is made on or after 9 December 2009.

The extension of the anti forestalling rules to relevant income of £130,000 or more will come as a surprise to many individuals who would not be expecting the £150,000 relevant income limit to be reduced so soon after its introduction. Where companies have pension salary sacrifice arrangements that are subject to annual renewal, they need to consider the arrangements carefully to avoid these being a post 8 December 2009 arrangement which may result in their employees being caught by the new £130,000 amount.

Individuals who have already made or considering arrangements to sacrifice bonuses after 8 December 2009 will need to review their position to determine whether they will be caught by the change.

NIC increase

As expected, the Chancellor refrained from increasing personal tax rates further. However, NIC will now increase by 1% from 5 April 2011. The Chancellor announced 0.5% increase in his 2009 Budget and this further increase came as a surprise. He did provide some relief by increasing the lower earnings limit to compensate lower earners for the increases.

Salary sacrifice: restricting the tax exemption for workplace canteens

It is proposed to remove the tax exemption applicable to workplace canteen facilities (free or subsidised meals), where those facilities are enjoyed by employees in conjunction with a salary sacrifice or flexible benefits scheme. The withdrawal of the exemption will apply with effect from 6 April 2011 but will not affect facilities provided outside any salary sacrifice or flexible benefits arrangement. For arrangements affected, employees will be chargeable on a P11D reportable benefit on which their employer will pay Class 1A NIC of 13.8%.

The Australian government amended their equivalent legislation about 18 months ago. It appears that HMRC has followed the Australian approach to legislating against canteen salary sacrifice schemes.

Whilst unwelcome news to many employers, those who are currently considering such arrangements now have clarity on the longevity of these arrangements and can plan accordingly.

Company car tax

A series of changes in relation to company car and van taxation have been announced. From 6 April 2010:

- ▶ (applying for five years) company cars and vans which are propelled solely by electricity will have no benefit in kind charge. The current benefit in kind charge for an electric company car is 9% of list price of and for an electric van £3,000. Perhaps this exemption for five years should have been extended to hybrid cars as well
- ▶ from April 2010 the fuel benefit charge multiplier for company cars is to increase from £16,900 to £18,000. The fuel benefit for company vans is to increase from £500 to £550.

From 6 April 2012, the emissions thresholds will reduce by 5g/km and the tax bands will commence from 10% rather than the current 15%, this will remove the separate category for Qualifying Low Emissions Cars (QUALECS). The 10% band will apply for cars with emissions of up to 99g/km.

CORPORATE MEASURES

Risk transfer schemes

This is a follow-up announcement to a press release in July 2009 in connection with 'Risk Transfer Schemes' (RTSs). RTSs are broadly defined but the essence is that a commercial advantage is obtained which, in substance, amounts to a company receiving a higher interest return or incurring a lower interest cost, where the economic risk that this incurred to achieve this end is transferred to the exchequer through the tax treatment of the arrangements. For example, companies might seek to benefit from the interest rate differential between GBP and another currency in certain hedging arrangements. For example, a company would hedge its investment in a Japanese Yen foreign operation by using a Yen/Sterling currency swap for a 'grossed-up' amount in order to produce a post-tax hedge. Whilst exchange differences on the swap were taxable/deductible the exchange differences on the foreign operation were not.

Revised draft legislation has been published following an initial consultation period. The main change to the original draft is the introduction of additional provisions dealing with 'ring-fenced profits' and 'ring-fenced losses'. These might allow offset of losses and profits arising from such arrangements instead of an absolute denial of loss relief. In broad terms, this change is to be welcomed, particularly because it will not always be clear whether there is a reasonable alternative to using hedges that are grossed up for tax and, therefore, whether the legislation will apply.

It is also announced that this legislation will come into effect from 1 April 2010 which should give companies sufficient time to unwind existing arrangements in an orderly manner.

Worldwide Debt Cap (WWDC)

As announced in HMRC's technical paper of 9 November 2009, draft legislation has been published detailing several technical changes to the debt cap rules. The closing date for comments on the draft clauses is 29 January 2010.

Background to the operation of the WWDC

If a worldwide group passes the gateway test, it will not have to apply the detailed debt cap rules and potentially suffer a net disallowance of finance

expense. Broadly, a group will pass the gateway test if the 'UK net debt' of the group (which includes external and intra-group net debt of certain UK group companies) is no higher than 75% of the 'worldwide gross debt' of the group (which includes only gross external debt of UK and non-UK group companies).

If the gateway test is failed, a group will need to disallow the excess of the sum of the tested expense amounts (broadly, the excess of finance expense over finance income of each relevant UK group company) over the available amount (broadly, the gross external finance expense of the worldwide group per the consolidated financial statements). Where a group has suffered a disallowance, it can also exempt the sum of the tested income amounts (broadly, the excess of finance income over finance expense of each UK group company) as long as this sum does not exceed the amount disallowed.

Main changes

The main changes are:

- ▶ Removing accounting mismatches and preference shares from the gateway test, giving rise to a more consistent application of this test in calculating UK net debt and worldwide gross debt.
- ▶ Excluding securitisation companies (as defined in section 83(2) and 84(2) FA 2005) from the main debt cap rules but not from the gateway test.
- ▶ Allowing companies ('protected companies') to elect that no disallowance shall be allocated to them under the main rules (subject to any disallowance that cannot be allocated to other relevant group companies). This should benefit companies that require certainty that no part of their interest costs will be disallowed, eg, to protect their credit rating, but will lead to any disallowance caused by their activities to be allocated to other relevant group companies.
- ▶ An anti-avoidance rule restricting the allocation of disallowances to dual-resident investing companies (DRICs) under the main rules (subject to any disallowance that cannot be allocated to other relevant group companies). This is intended to ensure that the group relief restrictions in

section 404 ICTA 1988 cannot be sidestepped by use of the disallowance and exemption allocations.

- ▶ Relaxing the Treasury company exemption from the main debt cap rules, allowing more companies the scope to fall within this exemption (the original definition was difficult to apply).
- ▶ Removing mismatches in the main rules in relation to debts owed by, and finance leases and debt factoring entered into by, partnerships, between amounts reflected in the consolidated accounts as external finance expense and amounts computed for loan relationship purposes.
- ▶ Providing the power to make regulations to remove mismatches in the main rules in relation to the computation of the tested expense and income amounts and the available amount, by adjusting either the tested expense/income amount or the available amount. An example of where such regulations may be drafted is where the consolidated and single company accounts measure the same debt in different ways and, therefore, give rise to different finance expenses for accounting and tax purposes. Such regulations may have retrospective effect as they can take effect from the beginning of the calendar year in which they are made.
- ▶ Including guarantee fees in a company's financing income amounts to mirror treatment of such amounts within financing expense amounts.
- ▶ Widening the exclusion from being an ultimate parent to certain collective investment schemes represented by non-UK partnerships that are corporate entities, to reduce the number of 'supergroups' that would otherwise exist for debt cap purposes.

Whilst most of these changes are to be welcomed as they either produce a more consistent set of rules, or provide additional relieving provisions or expansion of existing exemptions, they may also add extra complexity and an additional ongoing compliance burden for groups. Furthermore, the regulations in relation to amending the tested expense, tested income or available amounts can be retrospective to the start of the financial year

which is an unwelcome measure as it will provide uncertainty for groups in this area.

Consultation on 'patent box' regime proposed for 2013

This measure is designed to recognise the value of innovative and creative activity in the UK. The proposal is to apply a 10% rate of corporation tax on income arising from patents from April 2013 (the so-called 'patent box'). The Government will consult with business on the detailed design of the patent box regime in time for Finance Bill 2011 and the regime is intended to apply to patents granted after the legislation is passed.

The proposals for the patent box are a welcome recognition of the importance of innovation and the need for a lower tax regime to remain competitive internationally. However, the apparent narrowness of the regime is at odds with the international trend and the delayed implementation is a surprise. An unintended consequence of the announcement may be renewed focus on the costs of holding existing intangibles in the UK and the case for groups reviewing this position.

Controlled foreign companies

An update on the reform to the CFC rules will be made in 2010 which is not a surprising announcement. The reform is anticipated to take effect in 2011 although this is not guaranteed.

Capital gains rules for groups of companies

Following a consultation document released earlier this year, on which responses have now been received, it was announced today that a further consultation document will be published soon that will detail the proposals to simplify the capital gains regime for groups of companies. No indication was given as to what proposals might be contained in the document

Taxation of foreign branch profits

There will be preliminary discussions as to whether there should be a move to an exemption regime for foreign branch profits. This is in response to representations for the UK tax treatment of foreign branch income and dividends to be aligned following the introduction of the dividend exemption from 1 July 2009.

Research and development (R&D) tax credits

The Pre-Budget Report announces a well-timed change to the R&D regime for small and medium enterprises (SMEs) that should result in many more companies being able to access the tax relief and (more importantly in the current economic climate) surrender losses generated by eligible R&D activity for cash. The removal of the requirement to own the intellectual property resulting from R&D activity removes an onerous provision which was difficult to interpret and utilise in practice. It will provide a welcome simplification to the rules surrounding SME R&D tax relief and should incentivise smaller entities to review their activities and compile claims for relief.

SMEs undertaking qualifying R&D activities are currently eligible for an enhanced deduction of 175% of the qualifying R&D expenditure, or the company can claim a cash credit (up to 175% of the eligible spend) if it is in a loss making position and has paid sufficient PAYE and NIC.

The timing of the change for accounting periods ending on or after 9th December 2009 is good news for December year-end companies. They will be able to benefit from the change almost immediately (subject to filing an R&D claim with signed statutory accounts).

In conjunction with last year's increase in the qualification criteria for SMEs to companies with a headcount of at least 500 and either turnover of less than €100m or total assets of less than €86m, this change continues the positive trend of increasing investment in innovation by small and medium enterprises in the UK and will hopefully benefit a large number of companies.

Sale of lessor companies: alternative treatment

A new election for an alternative treatment under Schedule 10 Finance Act 2006 has been introduced. Broadly the election is designed to encourage commercial transactions which have been adversely affected by the inability of some groups to utilise the full benefit of the matching Schedule 10 relief. Where an election is made, the tax timing benefit will be recouped by isolating the profits of the business following the sale of the company rather than through the imposition of an immediate charge.

We welcome the introduction of this election and the recognition that many transactions involving the sale of lessor companies are commercially driven. However, we consider that commercial transactions could be better facilitated through the introduction of a main purpose provision.

Sale of lessor companies: consortium arrangements

Amendments have been made to Schedule 10 Finance Act 2006 in order to counter certain transactions which have sought to avoid or reduce the charge brought into account on the sale of a lessor company which is a consortium company or one that is owned by a consortium company. The amendments provide that an indirect 75% subsidiary of a company owned by a consortium will be treated as 'a company owned by a consortium'. Therefore, arrangements which introduce an intermediate holding company between the consortium company and its leasing subsidiary should no longer be effective.

Whilst we note the necessity for legislation to achieve its intended purpose and to provide a level of consistency across the taxpayer base, the continued amendment of the sale of lessor companies regime is introducing additional complexity which runs counter to the Government's stated intention of simplifying the UK tax system.

Capital allowances: anti-avoidance

Draft legislation has been published to prevent capital allowance buying transactions. The Government's intention to introduce this legislation was announced in July 2009 following disclosure of certain transactions which sought to transfer the entitlement to capital allowances to profitable groups by way of a company sale. The new legislation includes an unallowable purpose test which is intended to allow wholly commercial arrangements to continue to take place.

We understand the Government's motivation to address transactions which take place wholly for tax reasons and hope that the unallowable purpose test contained within the legislation will facilitate commercial transactions.

Plant and machinery leasing: anti-avoidance

Legislation is to be introduced which will have effect from 9 December 2009 in relation to transactions which seek to generate a tax loss where there is no commercial loss. The legislation will apply to restrict capital allowances entitlement to the present value of the amounts that it is reasonable to expect will be brought into account as income in connection with the lease.

We note the Government's continued attention to tax motivated transactions that produce a tax loss where there is no commercial loss.

Tax and accountancy: changes to accounting standards on financial instruments

This is an expected announcement to deal with various changes proposed by the IASB (International Accounting Standards Board), and expected to be replicated by the UK ASB to the accounting treatment of financial instruments. The measure will introduce primary legislation which will enable HMRC to subsequently introduce secondary legislation to ensure that the corporation tax treatment of financial instruments is properly adapted for such changes, including transitional adjustments.

This should be a positive measure to ensure a reasonable alignment between tax and the amended accounting rules and to minimise mismatches and distortions arising from the change in accounting treatment. The treatment of convertible bonds and other similar hybrid securities could be of particular interest where bifurcation of embedded derivatives will no longer be required. Similarly, the tax treatment of impairment losses will likely be of significance to banks especially in the current economic environment. Changes may be needed to the tax treatment of repos.

Index-linked gilt-edged securities

There is currently an exemption from corporation tax in respect of the increase in value of index-linked gilts for both companies and individuals, to the extent that it is attributable to changes in RPI. It has been announced that this exemption will in some circumstances no longer be available for companies in respect of such gilts held on or after

9 December 2009. This provision appears to be targeted at companies which hold such gilts but then hedge the exposure to RPI through derivative contracts so as to capture the tax benefit but without being exposed to the RPI risk. As there have recently been falls in RPI, the exemption from tax may not necessarily have been advantageous to companies: the proposed legislation will only apply where there are increases in RPI.

The draft legislation is designed to only apply where there are arrangements whose purpose is to hedge the RPI exposure. The accompanying Technical Note state that the legislation is not intended to apply in the inverse scenario, where a company has an existing commercial exposure to changes in inflation and index-linked gilts are used to hedge that risk. The draft legislation is designed also to apply where index-linked gilt and hedge are held by different associated companies.

Simplifying unallowable purpose tests

HMRC has published a summary of comments on the discussion document of 31 July 2009.

A number of the responses stressed that purpose tests should not operate as an alternative to effective and well written legislation. HMRC intends to ensure that policy owners examine the pros and cons of a purpose test and the potential impacts of such a test in determining whether a purpose test is appropriate and if so, how it should be designed.

There was also a strong feeling that any counteraction should not exceed the quantum of the tax advantage identified. HMRC has agreed that any legislative counteraction should be clearly stated and if such counteraction exceeds the amount of the tax advantage then such an outcome should be a specific policy objective of the provision and the effect should be proportionate.

HMRC has committed to redrafting and enhancing the framework and purpose test guidance. This will, among other aims, relate the guidance to practical situations. The intention is that the framework will be available for adoption from summer 2010. HMRC believes it would be expensive to embark on a programme of rewriting the existing purpose tests, however existing tests may be considered on a case by case basis where simplification benefits exist. Simplification may

well be achieved in the cases where appropriate filters can be identified and HMRC has stressed its ongoing willingness to consider suggestions for filters.

Although we welcome the intention to relate the proposed guidance to real world situations we believe it is unlikely that the generic guidance will be appropriate for all specific unallowable tests, even where the test has been drafted in accordance with the framework. We consider that it will be beneficial to have separate guidance on HMRC's views for each specific test of unallowable purpose. The guidance will, of course, remain merely a statement of HMRC's opinion and taxpayers may not find themselves in agreement with it. We remain of the view that counteraction measures should not exceed the quantum of the tax advantage identified.

Simplifying transactions in securities (TiS) legislation

HMRC issued a consultation document on 31 July 2009 putting forward a package of proposals to clarify the existing TiS legislation. HMRC has now published a summary of the responses it received to that consultation document.

Corporation tax

HMRC will consider the scope for repealing the whole of the TiS legislation as it applies for corporation tax. It has indicated that it is unclear whether this can be achieved in time for the Finance Bill 2010, although the repeal of s704 A is envisaged in that Finance Bill.

Income tax

HMRC proposes to proceed with the refocusing of the legislation by the introduction of a purpose test. It will review the detail of other proposed changes, in particular:

- ▶ the use of the close company definition within the TiS legislation and whether this will bring partnerships and private equity companies into scope
- ▶ the proposed filter for a fundamental change in ownership
- ▶ the potential for modernising the counteraction process

HMRC confirmed that it intends to provide detailed guidance though it recognises that, by itself, that

guidance will not reduce the number of clearance applications

HMRC has indicated that it does not intend to consider:

- ▶ introducing a statutory exemption where a person holds only a small (say 5%) holding of shares
- ▶ introducing a right of appeal to the First Tier Tribunal if a clearance application is refused
- ▶ reducing the figure of 75% to be used in ascertaining whether there is a fundamental change in ownership.

The general aim of the proposals is welcome. It is to be hoped that, with the addition of any targeted anti-avoidance rules deemed necessary, the TiS legislation can be repealed for corporation tax. We recognise HMRC's concerns in regard to both a de minimis exemption and the percentage to be used in determining a fundamental change in ownership. We welcome the proposal to provide better guidance as to HMRC's view on particular situations and practical issues. However, while we welcome the proposals as a whole, we are not convinced that the total package of proposals will achieve the reduction in clearance applications that is hoped for.

Code of practice on taxation for banks

As expected, after a period of consultation HMRC has today published the final version of the code of practice (the 'Code') on taxation for banks (first announced earlier this year).

The Government expects that all banking groups operating in the UK, and any other organisations to the extent they carry out banking activities in the UK, to adopt the Code on a 'voluntary' basis. (Smaller banks may simply adopt the first section of the Code.) While the implementation assessment states that banks are expected to adopt with effect from today, the technical note accepts that 'banks may require time to consider the implications for them of the Chancellor's announcement, but adoption and implementation should take place soon after'. Adoption is by advising the usual point of contact with HMRC (there is no requirement that an individual should sign) and there are no requirements as to how the bank makes the decision to adopt.

The stated aim of the Code continues to be to encourage banks to follow the spirit as well as the letter of the law and there continue to be three main requirements: to have governance around tax integrated into business decision making, to work with HMRC to build open and transparent relationships, and to only carry out tax planning which supports business operations and does not achieve results contrary to the intentions of Parliament.

Ernst & Young is strongly in support of efforts to support transparency and good governance in the banking sector (and throughout business). One helpful change made as a result of the consultation process has been the removal of the requirement in the previous draft of the Code to disclose in advance transactions whose results might be contrary to the intentions of Parliament.

However, there remain concerns on the planning provisions of the Code. These require that banks should not engage in tax planning other than that which supports genuine commercial activity, and that banks should not enter into transactions or remuneration arrangements, or promote transactions, where they reasonably believe that the tax results are contrary to the intentions of Parliament. While there is helpfully now reference in the technical note to the usual tax courts' approach to Parliamentary intentions, there also continue to be references to broader concepts of looking at whether the tax result is too good to be true. This makes the application of the planning provisions uncertain and in practice will give HMRC considerable discretion.

The planning provisions also continue to raise broader issues of principle. Given the pressure on banks to adopt, the code arguably shifts power from Parliament into HMRC who will be tasked with policing it and away from the goal of clear law. The Code has a potential impact on the competitiveness of the banking sector and of UK PLC - and may simply displace behaviour.

A bank's decision on whether or not to adopt the Code and HMRC's view as to how it is being implemented largely go to HMRC's risk assessment. However, the response document states that HMRC will be publishing annual details of progress on implementation split by categories of bank - this is clearly significant and arguably could be seen as an extension of the name and shame policy of highlighting particular taxpayers. Other factors will also be key to the decision on

whether or not to adopt, for example, wider business issues, relationships with Government and the public sector, and decisions made by other banks etc.

Oil and gas

As predicted the Pre-Budget Report contains further changes to UK oil and gas tax regime - albeit these are more a refinement of the measures announced in the April Budget and contained in Finance Act 2009. These changes demonstrate the continuing engagement between industry and HM Treasury on oil and gas fiscal policy, and, more importantly, that the Treasury is willing to take on board feedback from industry. In itself that is a good thing, and something not to be taken for granted.

The changes are in two main areas:

- ▶ The criteria for field allowance for high pressure/high temperature fields has been lowered slightly (with a corresponding reduction in the relief available); and generally field allowance will now also be available for previously decommissioned fields provided they meet the qualifying criteria.
- ▶ The chargeable gains rules will be amended such that qualifying expenditure for the reinvestment exemption will now include drilling costs (whether exploration, development or in fill wells); and, where production licences are swapped, the cash paid in respect of the period between signing the deal and the transfer actually taking place will now also be exempt.

The Chancellor claimed that the amendments to field allowance would facilitate eight new developments which would be a very welcome boost to the UK Continental Shelf when oilfield service companies have been experiencing pressure on costs and a downturn in activity.

It is hard to escape from the conclusion that ongoing changes to the regime are not the best way to secure the maximum exploitation of the UKCS but, on the other hand, with the country's growing national debt, and the differing priorities amongst some of the oil and gas companies themselves, a fundamental redesign of the fiscal regime was never on the cards.

Life insurance companies: apportionment of income and gains

Life offices where there has been an inherited estate attribution often retain some element of the inherited estate within a with profit company non-profit fund investment reserve. Some companies have then undergone transactions which have affected the section 432C ICTA 1988 fractions in those funds, leaving a relatively large percentage of PHI business. When the surplus on the inherited estates has been emerged, no tax has been payable on the PHI proportion, resulting in potentially significant amounts falling out of tax.

Section 432CA applies for accounting periods beginning on or after PBR 2009. It applies only to companies that are not non-profit companies for the purposes of section 83YA FA 1989 and those where the investment reserve (Form 14, line 51 amount) is less than the form 14, line 51 amount for the previous period of account. The section effectively apportions the line 51 reduction using the apportionment fractions of previous years by matching the reduction to previous increases or to the amount at 31 December 2009. The balance of the section 432C amount is apportioned in accordance with the s432C fractions for the year. In this manner, HMRC expect to prevent companies managing their apportionment fractions in future so that amounts brought out of the investment reserve fall out of tax.

It was at first expected that the legislation would seek to tax all future increases in the form 14 line 51 amount as well as taxing reductions by reference to the fractions for 2009. The outcome is the result of consultation between HMRC and the industry and is an excellent example of the fruits of co-operation.

Life assurance consultation

The consultative process begun on 15 May 2006 is still dealing with two remaining issues.

The legislation relating to venture capital investment partnerships (VCIPs) has proved awkward to apply in practice because of difficulties in companies obtaining information relating to underlying investments. HMRC is now considering whether a change resulting in VCIPs being taxed in a similar manner to loan relationships or by way of

an annual deemed disposal would reduce the compliance burden on taxpayers.

Section 444ABD ICTA 1988 currently denies relief for a loss to a transferor occasioned by a transfer of long-term business. Where this loss is simply a reversal of surplus and is matched to a relief for the re-emergence of the surplus in the transferee, this treatment is clearly appropriate. HMRC is, however, considering whether relief can be made available where this particular fact pattern is not present.

Solvency II

Consultation began in July 2009 on changes needed to the life assurance tax regime as a result of the implementation of Solvency II from 31 October 2012.

Solvency II has no effect upon the cash flows relating to income, gains and expenses and the working assumption is currently that the I-E regime will continue, absent a political decision to the contrary. However, the taxation of the shareholders profits is expected to need major changes since this is currently based upon an FSA return which will cease to be available.

HMRC has sought responses from interested parties by way of questionnaires dated 9 September 2009 and 25 November 2009.

Although three bases have been considered: the continuation of the existing basis, use of the Pillar III financial returns and the use of the IFRS income statement, convincing arguments would need to be advanced for IFRS not to be used given that not to use it would distinguish life assurance from other businesses.

Effort is now being focused on the supporting legislation and fiscal adjustments needed to make IFRS work for life companies. These include:

- ▶ provisions to ensure relief for items deductible in the IFRS income statement which might otherwise not be deductible for tax such as provision for future bonuses and unallocated distributable surplus
- ▶ provisions to replicate agreed aspects of the life assurance tax regime such as relief for policyholder tax and recognition of exempt dividends, and

- ▶ relief for amounts whose availability to shareholders is subject to clear legal restrictions.

There is still much work to be done here before HMRC issue the consultation document expected to accompany Budget 2010.

PERSONAL TAX MEASURES

Changes to personal tax rates

Tax allowances

The Government has confirmed that the income tax allowances will be frozen for 2010/11 at the same levels as those for 2009/10. As previously announced, the personal tax allowance will be reduced by £1 for every £2 of income over £100,000. Individuals with income over £112,950 will, therefore, have no personal allowance with effect from 6 April 2010.

Rates and thresholds

For 2010/11 the basic and higher rates of income tax will remain at 20% and 40% and the income levels at which they start to apply will also be frozen at the same as 2009/10.

As announced in the Budget 2009 an additional taxable band of 50% on incomes over £150,000 will be introduced from 6 April 2010, and the top rate for dividends will increase to 42.5% from the same date.

It was announced today that the level at which the taxpayer starts to pay the higher rate of income tax will be frozen in 2012/13.

Gift Aid

It has been announced following a review of the Gift Aid system, that possible reforms to the scheme will be published on the HM Treasury website on 15 December 2009.

Withdrawal of the furnished holiday lettings rules

As previously announced, the special tax rules for furnished holiday lettings (FHL) will be withdrawn from 6 April 2010. This will have effect for income tax, capital gains tax and corporation tax. From 6 April 2010 (1 April 2010 for companies) the tax

treatment of FHL businesses will be the same as for other property businesses.

FHL losses incurred prior to 6 April 2010 and unused at that date will no longer be available to be offset against total income of that year or the preceding year. These losses together with any unutilised losses generated after 6 April 2010 will be treated as losses carried forward from a property business and may be offset against future profits of that property business. Individuals may still offset other property business losses against profits of their property business in the year. In addition FHL income will not be treated as relevant UK earnings for pension relief purposes.

Capital allowances will no longer be allowable for plant and machinery used within let property. However, the 10% wear and tear allowance and the landlords energy saving allowance will be available where applicable.

With effect from 6 April 2010, FHL landlords will no longer be entitled to the following capital gains reliefs:

- ▶ Business asset roll-over;
- ▶ Entrepreneurs' relief;
- ▶ Relief for gifts or business assets; and
- ▶ Relief for loans to trades

For some taxpayers, the withdrawal of the favourable income and capital gains tax treatment will have a significant tax impact. Such taxpayers may want to take tax advice on any options available to them before 6 April 2010.

Inheritance tax bands

The inheritance tax nil rate band of £325,000 has been frozen for chargeable life-time transfers and death transfers made on or after 6 April 2010. This is a reversal of Finance Act 2007, which provided for the limit to be increased to £350,000 from 6 April 2010.

The ability to 'combine' two amounts of the nil rate band for married couples on the second to die has, however, been preserved.

Though the Government claims that inheritance tax is payable by only 3% of Estates, this 'freezing' measure will be particularly disappointing to home owners, who have seen increases in the value of their home in recent years. Indeed, rather than a freeze on the level of the nil rate band, many have

called for a significant increase, to take away the inheritance tax burden from the middle classes.

Inheritance tax (IHT) avoidance using trusts

Legislation is being introduced from 9 December 2009, to counter two perceived planning arrangements that enabled a UK domiciled taxpayer effectively to put assets into a trust without triggering a 20% entry charge.

The first arrangement involved the purchase of an interest in possession for full market value. Previously the purchase itself would not have given rise to an IHT charge and the trust fund would be within the relevant property regime (ie subject to 10 year and exit charges).

The legislation now provides that where an interest is purchased on or after 9 December 2009 at full market value, the interest in possession will be treated as part of a person's estate, and liable at 40% upon death. If the interest comes to an end during the beneficiary's lifetime and capital is paid out, this will be treated as an immediately chargeable transfer at 20%. In addition, the trust fund will also be taxable under the relevant property regime, subject to 10 yearly charges (presently 6%) and exit charges if funds are taken out of the trust.

A second measure applies where an individual transfers assets into a trust in circumstances where on or after 9 December 2009 the settlor (or spouse/civil partner of the settlor) become entitled to a future interest in the trust or where a future interest is purchased.

Previously, where the settlor/spouse became entitled to a future interest (commonly known as reversionary interest) this was taken into account when calculating the reduction in the value of their estate on the transfer into trust and consequently reduced the 20% entry charge.

From 9 December 2009, where the settlor becomes entitled to a reversionary interest or purchases a reversionary interest in a trust, then when that reversionary interest is either gifted to another person or comes to an end in circumstances where the settlor obtains an interest in possession, IHT will be charged based on the value of the reversionary interest immediately before it came to an end. This charge will be at 20% of the reversionary interest.

These proposals affect a small number of inheritance tax schemes, which have been perceived as 'loopholes' by HMRC. However, in appropriate cases, trusts still remain suitable vehicles for the preservation and passing on of family wealth to future generations.

Seafarers

Under current legislation, the earnings of seafarers who are ordinarily tax resident in the UK are eligible for a 100% tax relief where those earnings relate to duties carried wholly or partly outside the UK in an eligible period.

Finance Bill 2010 will include legislation which will extend eligibility for this exemption to seafarers who are EU or EEA residents in order to comply with the EU Treaty.

INDIRECT TAX MEASURES

VAT: reversion of standard rate to 17.5% from 1 January 2010

The Chancellor confirmed that standard rate of VAT, which had been temporarily reduced to 15% from 1 December 2008, will revert to the previous 17.5% from 1 January 2010. This had been the stated intention of the Government in the original announcement of the reduction in the PBR 2008 and goes ahead despite protest from businesses, particularly the retail sector, that a rate change on 1 January raises major administrative difficulties.

The normal tax point rules will apply for supplies of goods and services. However, the Government has introduced specific anti-forestalling legislation, which will create an additional 2.5% charge, in specified situations where the Government believes that supplies are being invoiced or paid for before 1 January 2010 outside normal trading patterns to secure the 15% rate on supplies made to businesses who are not able to take full input tax credit on their purchases.

The normal tax point rules will operate broadly as follows:

Retailers (accounting for VAT on cash receipts basis) - 15% VAT rate applies to all takings received up to and including 31 December 2009 - 17.5% VAT rate applies to all takings received on

or after 1 January 2010 except where the goods were taken away or delivered before 1 January 2010 (in which case the 15% rate applies) - see special arrangements detailed below for businesses operating over midnight on 31 December 2009

Businesses selling goods/services mainly to other VAT-registered businesses and issuing VAT invoices (accounting for VAT on invoice basis) - 15% VAT rate applies to invoices issued or payments received (including deposits and prepayments but beware of the anti-forestalling legislation) up to and including 31 December 2009 - 17.5% VAT rate applies to invoices issued or payments received on or after 1 January 2010 except:

- ▶ to extent that a tax point at the 15% rate has already been established
- ▶ or where it can be demonstrated that the goods were delivered or the services were completed before 1 January 2010 (in which case the 15% rate applies)

Where services are supplied which span 1 January 2010, the supplier can choose to make an apportionment between the services supplied up to 31 December 2009 (at the 15% VAT rate) and on or after 1 January 2010 (at the 17.5% rate). If the supplier chooses to make an apportionment, records must be retained to support the basis of apportionment.

Businesses operating over midnight on 31 December 2009 - The Government recognised the practical difficulties faced by certain businesses operating over midnight on 31 December 2009 (for example the prospect of telling a bar full of people at 00.01 on 1 January 2010 that drinks could not be served for a while in order to facilitate the cashing up of the tills and the amendment of prices!). A special arrangement has been agreed by the Government for

- ▶ pubs, clubs, restaurants or similar establishments
- ▶ retail shops (but not online retailers)
- ▶ providers of telecommunications

whereby VAT may continue to be accounted for at 15% until the earlier of when they close that trading session or 6 am on 1 January 2010.

A further proposal is to extend, within the retail price marking legislation, the period by which

retailers must reprice their stocks to 28 days after the VAT rate change.

Anti-forestalling legislation - This legislation is complex and any businesses that expects to take significant prepayments before 1 January 2010 or to pre-invoice before 1 January 2010 or grant a right before 1 January 2010 to have goods or services supplied in the future, where the actual delivery of the goods or services will take place after 1 January 2010, should consider the legislation to ensure that a liability to the supplementary charge will not inadvertently be triggered

The fundamental approach of the anti-forestalling measures is that where a supply spans the VAT rate change, in the sense of there being an actual tax point before 1 January 2010 in the form of an invoice or a pre-payment and a basic tax point on or after 1 January 2010 in the sense of the delivery of the goods or services **and** certain specified conditions, which HMRC takes as indicating abuse of the tax point rules, a supplementary charge of 2.5% arises upon the supplier on 1 January 2010 or later thereby negating the perceived tax point abuse. The conditions are broadly that:

- ▶ the recipient of the supply is not able to take full input tax credit on the supply, and
- ▶ connected persons are involved, or
- ▶ the supplier arranges funding, or
- ▶ an invoice does not have to be paid in full within six months, or
- ▶ the amount exceeds £100,000 and the arrangement is outside normal commercial practice

The legislation is intended to apply to those seeking to abuse the change in VAT rate and HMRC state it is likely to affect very few businesses. The danger is that the legislation may apply to businesses whose normal commercial practices involve prepayments or pre-invoicing. One situation has already emerged relating to hire purchase agreements where HMRC has conceded that the supplementary charge would have arisen in an unintended manner and a last minute amendment to the law has had to be made.

Fuel scale charges - The fuel scale charges will increase from 1 January 2010 to reflect the 17.5% VAT rate

VAT flat rate scheme - The percentages applied by businesses with a turnover up to £150,000 who opt to use the VAT flat rate accounting scheme will change from 1 January 2010 to reflect the 17.5% VAT rate. HMRC stress that not all the rates will return to those applicable prior to the December 2008 VAT rate decrease.

VAT: place of supply of services

The PBR material confirms that secondary legislation will be introduced with effect from 1 January 2010 to make the following changes to the VAT regulations as part of the 2010 EU VAT place of supply changes:

- ▶ changes to the time of supply for cross-border supplies of services where VAT is accounted for by the business customer
- ▶ new requirements to record intra-EU supplies of services that are taxable in another EU country

The new legislation will also introduce

- ▶ changes to the requirements for recording the intra-EU movement of goods
- ▶ a new electronic method for reclaiming VAT incurred in another country

VAT: enforcement of judgments in litigation

The PBR material announces an HMRC policy change which is particularly relevant to VAT litigation.

HMRC refer to the situation of litigation where a judgment has been delivered at one stage of the appeal process but it is known that the case will be further appealed. HMRC points to the inconsistency in this scenario that, where the judgment has gone against HMRC, it will normally invite claims from affected taxpayers (subject to the caveat that the claims will be clawed back with interest in the event of the judgment being overturned) whereas, where the judgment has gone in favour of HMRC, it does not consistently seek to collect the tax before the litigation is ultimately finalised.

The PBR material announces that, with effect from 1 April 2010, HMRC will change its practice and move to a consistent approach under which it will also seek to collect tax following Tribunal and

Court judgments in its favour, even if it is known that a further appeal is to be made.

VAT and excise duties: consultation on penalties for failures to make returns

The PBR material includes a consultation on proposed changes to the penalties for failures to make VAT and excise duties returns, which will bring the penalty models into line with those introduced for direct taxes in Finance Act 2009. The consultation document includes draft legislation and explanatory material. It has been necessary to accommodate within the proposed legislation the fact that, in general, indirect tax returns are made more frequently than direct tax returns. Responses are requested by 3 March 2010.

Insurance Premium Tax: anti avoidance measure

The PBR material includes details of anti-avoidance legislation, to be implemented with immediate effect on 9 December 2009, to negate the IPT benefit of what HMRC describes as 'premium splitting' whereby an administration fee is charged under a separate contract.

HMRC has drafted legislation which ensures that IPT will be chargeable on administration fees to insured individuals acting in a personal capacity (which will generally prevent this applying to commercial brokers).

The charge covers not just intermediary fees for introduction but claims handling fees too. It brings into the definition of premium any charge for services which are commonly supplied in connection with claims/payments handling or the arrangement/administration of insurance contracts. However it also covers more generally a payment under any contract which the individual insured is required to enter by the insurance contract, or would be unlikely to enter without also entering into the insurance contract.

Charges solely for administration of adjustments to the insurance contract (address changes, cancellations, etc) are not covered, and payments for spreading premiums are also excluded.

Insurance Premium Tax: legislation of current ESC

The PBR material includes a third consultation on the future of a tranche of extra statutory concessions, which HMRC is unable to maintain following the *Wilkinson* House of Lords judgment on the scope of HMRC's power to grant ESCs. One of the ESCs affected is ESC 4.5 *IPT: arrangements for discounted insurance*. This will be legislated to enable it to continue.

The consultation document can be accessed in the Supplementary Documents page of the Pre-Budget Report 2009 section of the HMRC website.

Bingo duty: future rate reduction

The Chancellor announced an intention to cut the rate of bingo duty from 22% to 20%. No decision has yet been taken on the effective date of the cut and fuller details will be given at Budget 2010

Landline duty: introduction

The Chancellor announced that, in order to fund the development of a superfast broadband network, a new landline duty of 50p per month for each line will be introduced from 1 October 2010. The Department for Business, Innovation and Skills will be consulting on the detail of the duty.

Climate change levy: changes

The Chancellor announced that the plastics and laundries sectors have joined the climate change agreements scheme whereby the sector and individual businesses qualify to pay a reduced rate of climate change levy in return for setting targets for reducing their emissions and/or energy use.

The reduced rate of climate change levy will increase from 20% of the full rate to 35% of the full rate from 1 April 2011.

Landfill tax: modernising legislation

The PBR material confirms that, following publications of the responses to a Budget 2009 consultation, the Government will continue a dialogue with landfill operators on technical and definitional issues to improve the operation of the tax and remove anomalies.

Excise duty: biofuels

As announced in Budget 2008, the duty differentials for biofuels will cease from 1 April 2010. The Chancellor announced that the duty differential will continue for two years for biofuels made from used cooking oils.

Excise duty: consultation on compliance checks

The PBR material announces a second consultation on the compliance checking framework for excise duties and on future plans to modernise excise administrative law. Responses are requested by 3 March 2010.

Time to pay applications

The Chancellor announced that the HMRC Business Payment Support Service, launched in the PBR 2008, will continue. This service allows businesses facing temporary financial difficulties to negotiate time to pay arrangements for their tax liabilities with HMRC.

Whilst there is no doubt that this service has helped many businesses, there is evidence that HMRC is taking an increasingly detailed interest in the financial affairs of businesses both before granting time to pay arrangements and in relation to time to pay arrangements already granted, to ensure that businesses pay the full amounts which they can to move out of the arrangements as soon as possible. With this in mind, the PBR material includes information that HMRC will, in future, require businesses seeking time to pay arrangements worth £1m or more to provide an Independent Business Review (IBR) in support of their request.

It is expected that the new requirement will be implemented from April 2010 and HMRC will informally consult on how this will work prior to implementation. HMRC states that IBRs will be relevant to around one in every thousand businesses seeking time to pay arrangements, a very small minority of substantial businesses with substantial debts.

HMRC POWERS

Working with tax agents: revised consultation document published

In April 2009 HMRC published a consultation document to seek views on how it interacts with tax agents and where the system could be improved; the aim being to improve the way in which HMRC and tax agents work together to ensure clients' returns and claims are correct when submitted. A number of responses were received (including from Ernst & Young), as a result of which a response document and revised consultation document were published today. Most of HMRC's concern centred around how it deals with the small number of tax agents that it perceives are not working to acceptable standards.

In the revised consultation document HMRC is proposing a number of new or revised procedures and powers which are targeted at specific problem areas involving small parts of the tax agent population, including:

1. Revised procedures for disclosure to professional bodies in the case of misconduct
2. Aligned and modernised legislation to tackle deliberate wrongdoing by tax agents resulting in some cases in penalties and/or publication of the name of the agent, and
3. A new procedure for dealing with 'high volume agents', i.e. those agents that make claims or requests for repayment on behalf of a large number of clients.

Comments on the revised proposals are sought by 3 March 2010.

One thing that HMRC has made clear is that, in the light of responses received to the first consultation document, it is no longer pursuing the possibility of requiring agents to be registered or regulated. It hopes that such regulation will be achieved in the large majority of cases through interaction with the professional bodies to which most agents belong. HMRC recognises that there may be difficulties in dealing with agents who are not affiliated to any professional body. There HMRC considers that its only recourse may be civil sanctions, though what these sanctions might be would be the subject of a future consultation.

It is welcome that HMRC is engaging with taxpayers in relation to its relationship with tax

agents. It is in the interest of all parties to target the small minority of agents who assist in the submission of deliberately incorrect claims and returns. In this respect, the proposals being put forward appear reasonable. However the proposals must provide adequate protection against the excessive use by HMRC of any increased powers, so that they are used in a properly targeted fashion.

Equitable liability

The Government has announced an intent to introduce legislation to codify the current concession published in Tax Bulletin 18. Where a taxpayer fails to submit a tax return under self-assessment, HMRC is able to issue a determination (estimate of the tax due) in the absence of the return. This estimate normally exceeds the true tax liability. Once issued, a determination can only be replaced by a taxpayer filing a return within twelve months from the issue of the Determination. Sometimes, for a variety of reasons, taxpayers fail to submit the correct notification of tax liability on time. The concessionary treatment, which enables HMRC to reduce the tax being sought under the Determination down to the true tax liability only applies where a taxpayer can show that the figure of tax due is excessive, they can demonstrate the correct amount due, and are prepared to bring their tax affairs up to date, including payment of tax interest and any penalty. The concession can usually only apply on one occasion, although it may cover a number of years' liabilities.

Equitable Liability is a sensible and pragmatic solution, and codifying it in the legislation should be welcomed by all.

Tackling offshore evasion

Following the success of the Offshore Disclosure Facility in 2007, under which £450m of additional tax revenues were recovered, and the recent Tax Tribunal decision enabling HMRC to access information from up to 300 UK banks relating to their customers' offshore bank accounts, the Government announced it will introduce legislation to ensure that those taxpayers that fail to declare offshore income will face the tough penalties applied for deliberate tax evasion. There will also be a new notification requirement for offshore accounts in certain jurisdictions supported by a separate penalty regime. Evading tax in relation to

offshore income could result in combined penalties of up to 200% of the unpaid tax.

This will further support HMRC's drive to ensure that taxpayers come forward and disclose tax liabilities relating to offshore income under the New Disclosure Opportunity, the window for which closes on 4 January 2010.

Disclosure of tax avoidance schemes (DOTAS) - stamp duty land tax

Regulations are to be introduced to extend the Disclosure of Tax Avoidance Schemes (DOTAS) to residential property with a value of £1m or more. The Regulations will also introduce arrangements for HMRC to require disclosure by users of *all* SDLT avoidance schemes.

Existing schemes would, however, be grandfathered (so users would not be required to disclose them).

These Regulations will come into effect no later than 1 April 2010.

The rules governing disclosure of SDLT avoidance schemes are different from those which govern direct tax. Currently, an SDLT anti avoidance scheme is only discloseable if the property is not wholly residential and the value of the property exceeds £5,000,000. The Regulations would:

- ▶ extend the disclosure rules to include residential properties whose value is at least £1,000,000
- ▶ extend the disclosure rules to include mixed non residential and residential properties where the residential value is at least £1,000,000 or the value of all the property is at least £500,000,000
- ▶ the requirement for users of such schemes to inform HMRC of their use of the scheme.

The £1,000,000 threshold seems a little low where properties in London/South East are concerned (where the average house price is £317,600).

Disclosure of tax avoidance schemes: Consultation document

A consultative document has been published in respect of proposed changes to the regime, which are largely aimed at improving compliance and

widening the scope of the types of transactions which are disclosable. HMRC has invited comments on the following proposals:

- ▶ Changes to the rules which trigger disclosure, which are aimed at overcoming steps taken by some promoters to delay the disclosure of certain marketed schemes.
- ▶ A power to require persons who introduce clients to a promoter to provide information about the promoter to HMRC. This is aimed at assisting HMRC in identifying promoters who are suspected of not complying with the regime.
- ▶ Significantly increased initial penalties for a failure to disclose a disclosable scheme.
- ▶ An obligation on promoters to provide HMRC with details of the clients who are notified of disclosure scheme reference numbers. HMRC states that this would help to identify scheme users who fail to report the scheme reference number and to highlight schemes which were being used widely.
- ▶ Revisions and extensions to the disclosure hallmarks. The proposals include new hallmarks covering employment arrangements, income into capital arrangements and transactions involving uncooperative tax havens.

It is likely that, if enacted, these proposals would result in an increase in the number of arrangements which are disclosable and consequently would add to the compliance burden on promoters.

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