



Draft Finance Bill 2012

Over the summer of 2011, HM Treasury and HMRC entered into a series of consultations, both formal and informal, in relation to the tax policies announced at Budget 2011.

Some of these consultations were addressed in the Autumn Statement but the majority of responses to consultations have been published today alongside draft legislation to be included in Finance Bill 2012 on these and other matters. Some areas will be subject to further consultation.

The draft clauses are open to technical consultation until 10 February 2012.

Key areas addressed in today's documents include:

The full reform of the Controlled Foreign Company rules

The proposals change the legislation from a 'guilty until proven innocent' approach to an 'innocent until proven guilty' approach. This new approach will be significantly simpler to operate and will be more competitive. Although we are still waiting for some detail, of particular note is the long-anticipated new overseas group finance company regime which taxes profits at 25% of the UK rate (so giving a rate of 5.75% in 2014), rather than the full rate. The case for full exemption for finance profits in certain limited circumstances is still being considered. There is also a gateway test designed to exempt most overseas trading companies from the CFC rules without needing to consider the detailed tests.

Legislation on the Patent Box

The draft legislation contains a set of rules that are sufficient to allow companies to begin the process of evaluating the potential benefits of the regime. The new proposals are likely to make the regime more coherent and sensible with key sources of potential complexity being rethought and reduced.

A Statutory Residence Test (SRT)

HM Treasury has confirmed that implementation of the SRT will be delayed until 6 April 2013. The reason for the delay is to give more time to deal with a number of detailed issues that have emerged from the consultation. This will mean that the current subjective tests remain in place for at least another year.

The tax treatment of non-UK domiciled individuals

The Government has confirmed that the 'Remittance Basis Charge' - the amount paid by non-UK domiciled individuals to access a preferential tax regime - will rise from £30,000 to £50,000 once an individual has been resident in the UK for 12 years. Legislation has been published which would allow non-UK domiciled individuals to make investments into UK businesses without triggering a tax charge on the remittance of funds into the UK. However we believe that a number of issues may limit the attractiveness of this relief.

Tax simplification

The Government has decided not to proceed with the abolition of a number of reliefs identified by the Office of Tax Simplification. In particular at a time when the construction industry is struggling, the retention of land remediation relief will be a much needed boost. The Government has also confirmed that 'for exceptional reasons' it will not abolish the late night taxis relief.

High-risk tax avoidance

Over the summer the Government consulted on proposals to deter the use of certain tax-avoidance schemes by listing them in regulations and attaching certain statutory consequences to their use. In consultation, the proportionality and effectiveness of the measure was questioned and the Government has decided not to include it in Finance Bill 2012.

Tax rates

The draft clauses confirm the intention to reduce the mainstream rate of Corporation Tax to 24% from 1 April 2013.

On a general note, it is good to note that a number of the measures announced today have evolved from those proposed in the consultation process. In a number of cases, the views of business and advisors have been considered and the draft legislation developed accordingly or even put on hold.

This Alert provides a summary of today's measures and more detailed proposals for Corporation Tax, Personal Tax and Indirect tax changes. There are also overviews of measures affecting specific industry areas such as Banking, Insurance and Oil and Gas. We are continuing to look at the detail and implications of many of these measures and more specific alerts may be sent out by our specialist in the next few days as we consider the draft legislation in more depth.

Corporate taxation

CFC reform

The Government has announced significant changes to its proposals for the reform of the UK's Controlled Foreign Company (CFC) rules, following representations regarding the extent of change and complexity of the new regime.

The reform of the UK's CFC rules forms part of the Government's Corporate Tax Road Map and is an important step in its ambition to create the most competitive tax system in the G20.

A key element of the new regime is the Finance Company Partial Exemption (FCPE) which, where available, will in most situations give rise to an effective 5.75% corporation tax rate on profits from overseas intra-group finance income. Today's announcement identifies a number of significant relaxations of the rules as well as areas in which further work is to be undertaken:

- ▶ The rules will apply to mixed activity companies, removing the needs for groups to restructure their current operations to take advantage of the new rules. A foreign subsidiary must have a business establishment in its territory of residence but will not now be required to have local management.
- ▶ The Government is considering whether full exemption might be appropriate in limited circumstances. It is also considering whether the CFC charge arising under the FCPE might be limited to the aggregate net borrowing costs of the UK members of the group.
- ▶ The exemption is to be extended to allow insurance and banking groups to access the rules, though it will not be available to insurance or banking companies themselves or to loans made to them. More details including potential anti-avoidance provisions are to follow.

The revised proposals contain a new concept of a wide 'Gateway' the intention of which is broadly to exclude all but the most high risk companies from the scope of the CFC charge. It operates by identifying only those circumstances where there has been artificial diversion of UK profits: broadly, where there is a significant mismatch between key business activities undertaken in the UK and the profits arising from those activities which are allocated outside the UK.

Business profits arising in a foreign subsidiary (together with profits which arise from investments

that are incidental to its trade or property business) will only be within the scope of the CFC rules where:

- ▶ The majority of the profits from the assets or risks are connected with UK activity by reference to 'significant people functions' (SPFs)
- ▶ This separation of assets or risks from activity does not give rise to substantial non-tax value, and
- ▶ The arrangement which creates this separation would not be entered into between independent companies.

The Gateway will contain an additional capitalisation condition for financial sector businesses. Further work is being carried out with the banking and insurance industries to design an appropriate safe harbour as a proxy for this condition. One welcome development is the removal of the restriction on reinsurance from the UK.

This means that profits derived from the exploitation of intellectual property (IP) (which are of particular interest to many businesses) should only be taxable to the extent there are UK SPFs or activity is being carried out in the UK by the business' key entrepreneurial risk takers (KERTs). The amount attributable to such activity is to be determined by applying OECD branch profit attribution principles and may be reduced by the application of some of the more detailed exemptions.

Where the general provisions of the Gateway do not apply in whole or in part, a new series of mechanical safe harbours (which replace the previous Territorial Business Exemptions (TBEs)) have been developed as an alternative route out of the regime. These cover general commercial activities, incidental finance income, insurance, banking, property and leasing with further work to be done in respect of the funds industry.

There is very little detail regarding the way in which the new CFC regime will apply to foreign branches, other than the observation that the revised focus of the regime on SPFs, KERTs and capitalisation is in line with the way profits and capital are attributed to branches.

Draft legislation has been published today, with further draft clauses covering certain specific areas to be published in January 2012, the aim being to include final legislation in Finance Bill 2012.

We welcome the significant progress which has been made since the June 2011 consultation. This represents a critical step in the process of moving towards a truly competitive UK tax regime.

Patent Box

The first draft of legislation setting out the proposed Patent Box rules, which will tax net income from patents at 10%, has now been released.

The rules focus on rewarding activities involving the development and management of patented technology, in line with the Government's desire to promote innovation as part of a competitive tax regime.

The legislation reflects a number of changes from the original proposals, showing the development of the Government's thinking in response to input from stakeholders. While the type of IP which qualifies for the regime remains unchanged, the legislation provides greater flexibility to deal with commercial situations that appeared to fall outside the scope of the initial proposals. Additionally, the window for benefitting from the regime between application and grant of a patent has been extended from 4 to 6 years.

There are also a number of changes to the computation of qualifying profits including a reduction in the mark-up applied to determine routine profit (to 10%), a revised method for attributing residual profit to patents, and the introduction of a 'clawback' mechanism where R&D expenditure falls after entering the regime.

The new regime provides an opportunity for businesses of all sizes to obtain additional benefits from their research and development activities. Now is the time for businesses to start evaluating the potential benefits of the regime and to ensure they are best placed to access these from 2013.

Real estate investment trusts: expansion of regime

The draft legislation relating to REITs answers a few of the remaining unanswered questions about the role that REITs can play in encouraging additional investment into the property sector in the UK.

The abolition of the conversion charge will enable investment property held in corporate structures to be re-based, tax free, and the changes to the listing requirements will increase accessibility of the regime, but the changes confirm that REITs will have to be listed at all times, and the shares will need to be traded.

A three year period of grace for new REITs to meet the close company requirements should encourage investment in fledgling REITs and may encourage

more investors to hold property through REIT structures rather than offshore funds.

We now also have an answer to the question of what role REITs can play in the portfolios of institutional investors. Pension funds, Authorised Unit Trusts, insurance businesses and sovereign immune investors will be able to hold controlling stakes in a REIT beyond the three year period of grace for close companies. This should be welcome news for such investors.

Crucially this package of measures could help to provide additional fund raising opportunities for corporate occupiers such as retailers and leisure operators, and the Government hopes that these changes will also encourage additional investment in residential property and support the construction of new housing stock.

Distributions in the form of assets and liabilities

The tax treatment of transfers of assets and liabilities between UK resident companies will be aligned with the rules that apply to transfers between UK resident and non-UK resident companies.

This change is intended to ensure that the transfer of assets and liabilities between UK resident companies can be treated as distributions for the purposes of Corporation Tax Act (CTA) 2010. Under the existing legislation, some or all of such a transfer between UK resident companies might be excluded from being a distribution as defined in CTA 2010.

The concern was that the transaction might then give rise to a part disposal of the relevant shareholding as it could be treated as a capital distribution within TCGA 1992. The measures remove the existing UK to UK rules, as well as removing an overlap that previously existed between certain sections of CTA 2010.

The measures were the subject of debate in a joint working group, in which Ernst & Young participated, and are welcomed in providing certainty that the transfers of assets and liabilities (including distributions in specie) will be exempt from corporation tax. The joint working group continues to discuss other points of uncertainty associated with the distributions legislation and HMRC is planning to produce guidance on these issues.

R&D tax credits

It is proposed that the rate of additional deduction under the SME regime will be further increased from 100% to 125% from April 2012, with the payable tax credit rate conversely falling to from 12.5% to 11%. A broadening of the requirements under the Externally Provided Worker (EPW) regime has also been proposed.

The increase in additional deduction rate for SMEs by 25% from 1 April 2012 follows a similar rise in April 2011. The reduction in rate of payable credit is to ensure that the criteria for State Aid approval continues to be met. The proposed changes to the rules defining EPWs are intended to broaden the scope for inclusion of eligible external specialists.

Further changes include an abolition of Vaccine Research Relief from 1 April 2012 and clarification of the meaning of 'going concern' for SME tax credits. The removal of the PAYE/NIC cap and the £10,000 minimum spend requirement announced in the 2011 Budget are also included.

The draft legislation continues to increase the attractiveness of the incentive for SMEs by raising the deduction rate. The widening of the rules regarding EPWs is welcome news and should allow the inclusion of commercial arrangements with additional parties to be considered. Overall these changes should simplify the administration of the R&D scheme which can act as a deterrent for companies making claims.

Last week's Autumn Statement confirmed the Government's intention to move the large company R&D tax relief scheme to an above-the-line credit to encourage R&D activity by larger companies. The specific detail of this was not included in today's draft Finance Bill but will be available for consultation in the 2012 Budget, with draft legislation in the 2013 Finance Bill.

Capital allowances: mandatory pooling of fixtures

Legislation will be introduced to make capital allowances for fixtures dependent on the pooling of expenditure by the vendor prior to a disposal, and on the seller and the purchaser either agreeing a value for fixtures or by instigating formal proceedings to agree the value within two years of a transfer.

The new legislation applies from 1 April 2012 for corporation tax or 6 April 2012 for income tax, with transitional rules until April 2014. The original proposal to make pooling mandatory within one to

two years after acquisition of the fixture has been amended so that instead, it will be mandatory for the vendor to pool expenditure on fixtures at any time prior to their disposal or transfer, to enable the new owner to make a capital allowances claim.

In addition, the proposal to introduce a Record of Agreement on disposal of fixtures between two parties has been dropped. Instead, taxpayers must either, use existing procedures within the Capital Allowances Legislation and enter into a joint election to agree the value of the fixtures, or refer the matter to a First Tier Tribunal for an independent determination.

Furthermore, the proposals to make the capital allowances fixtures anti-avoidance rules more effective and change the current election system have both been dropped in response to feedback received during the consultation process.

It is encouraging to see that the views of businesses and advisors have been considered and the draft legislation developed accordingly.

The move from introducing time limits to pool allowances on fixtures within a short time after acquisition or installation to any time prior to transfer is a positive step that will benefit businesses, particularly those undertaking large capital projects that span a number of years.

The use of existing legislation to achieve the desired policy objective is preferable to the introduction of new legislation and process.

Capital allowances: feed-in tariffs and renewable heat incentives

Legislation is to be introduced with effect from April 2012 restricting the nature of energy saving plant and machinery that attracts 100% Enhanced Capital Allowances (ECAs).

Plant and machinery generating electricity or heat culminating in the taxpayer claiming the feed-in tariff (FIT) or renewable heat incentive (RHI), will not be entitled to claim 100% ECAs. Expenditure that would have been eligible for ECAs may attract allowances within the main plant and machinery pool of 18% pa on a reducing balance basis. These changes will not affect expenditure incurred on Combined Heat and Power (CHP) plants until April 2014.

Capital expenditure incurred on the provision of solar panels will no longer attract either 100% ECAs or 18% WDA, and will be restricted to claiming writing down allowances within the Special Rate Pool of 8% pa on a reducing balance basis.

The overall changes made to the capital allowances regime affecting energy saving plant and machinery attracting the FIT or RHI have not been as restrictive as had been envisaged. Whilst investors in solar PV technologies will be further disappointed following this reduction in allowances coupled with the recent reduction in the level of FIT available, investors in CHP will be encouraged by their delayed inclusion in these rules.

Enterprise zones: first year allowances for designated areas

100% temporary First Year Allowances (FYAs) will be available for companies investing in new and unused plant and machinery for use in designated assisted areas within the new Enterprise Zones for a five year period commencing April 2012.

Following the announcement on Enterprise Zones in Budget 2011, the Government introduced Enhanced Capital Allowances to certain areas where there is a strong focus on manufacturing. These 100% FYAs are available for expenditure incurred on new and unused plant and machinery between 1 April 2012 and 31 March 2017 used in a designated assisted area within an Enterprise Zone.

The maximum level of expenditure that can attract FYAs is €125m for each investment area, and more detailed conditions will apply to companies seeking to claim the FYA.

The introduction of FYAs for these areas is a positive step to attract new businesses to these areas in need of investment, although due to their restrictive conditions businesses should ensure they are entitled to claim these FYAs before committing themselves to this investment.

Land remediation relief

Land remediation relief is to be retained. It currently provides a deduction of 100%, plus an additional deduction of 50%, for qualifying expenditure incurred by companies in cleaning up land that was acquired from an unconnected person in a contaminated state.

The Government has considered the responses from companies and representative bodies who argued that removing it would affect the regeneration of uneconomic brown-field sites making some proposed schemes financially unviable. It has decided that the removal of this relief, in conjunction with the already agreed removal of the landfill tax exemption, would risk undermining the Government's plans to support the housing and construction sectors through planning reforms and

the release of large areas of publicly owned land for development.

The decision to not repeal land remediation relief will be welcomed by companies and property developers who are already experiencing financial pressures in the construction and housing sectors.

Capital allowances: anti-avoidance rules for plant and machinery

Amended provisions in relation to plant and machinery anti-avoidance were published today. These were originally announced in a consultation document published in May 2011.

Under the draft legislation four key changes have been proposed to legislation that currently applies to restrict capital allowances that may be claimed in respect of certain 'relevant transactions'. These apply from 1 April 2012:

The 'transactions to obtain allowances' provisions in Section 215 CAA 2001 will be replaced by a main purpose, rather than sole or main benefit, test.

Where the new Section 215 applies, the advantage the transaction sought to obtain will be cancelled out

'Relevant transaction' explicitly includes novations and other transfers, due to a clarification of the term 'assigns'.

The exemption providing for manufacturers acting in the ordinary course of their business is repealed from 1 April 2012 where obtaining a tax advantage is one of the main purposes of their participation in the arrangements.

Overall, the changes appear to move towards a more subjective purpose consideration and a broadening application of the specific anti-avoidance sections in Part 2 CAA 2001. Taxpayers should consider these provisions very carefully before undertaking any connected party or sale and leaseback transactions involving plant and machinery.

Worldwide debt cap

The draft finance bill clauses contain several changes to the debt cap rules. In addition, HMRC has released a summary of responses to its consultation exercise.

The main changes are:

- ▶ A new rule deals with mergers, acquisitions and demergers. Where there is a new ultimate parent company of a worldwide group during a period of account as a result of such a

transaction, the debt cap should apply as if a period of account ended and another began on the date of the merger, acquisition or demerger.

- ▶ Where a new company joins a worldwide group during a period of account, the group cannot now disallow financing expenses or exempt financing income which arose before the company was a member of the worldwide group.
- ▶ Where a company's accounting period straddles a worldwide group's period of account, the debt cap calculations for that company should now be done on a 'just and reasonable' rather than 'proportional' basis even if that reduces its financing expense or income amount to nil.
- ▶ A new anti-avoidance rule is to be introduced to deal with schemes that prevent the debt cap from applying by inserting entities into groups so that the worldwide group contains no relevant group companies. It has been suggested that companies without share capital could 'break' the worldwide group such that the debt cap might fail to apply.
- ▶ Small tested income and expense amounts (so called 'de-minimis' amounts) for individual companies are disregarded under the debt cap rules, which may cause a potential mismatch where financing income amounts are disregarded but financing expense amounts are not. Groups can now elect to include these de-minimis amounts in the debt cap calculations.
- ▶ A welcome change is that dormant companies do not have to sign the document appointing an authorised company, which was a previous concern and would have created a significant administrative burden.
- ▶ HMRC has taken a new regulatory power to deal with changes to generally accepted accounting practice where they have an impact on the debt cap.
- ▶ The rules have effect for periods of account that end after Royal Assent of Finance Act 2012. However, the new anti-avoidance rule catches schemes entered into at any time prior to the end of this period of account.

Foreign exchange hedging

New regulations were released today that amend the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (the 'Disregard Regulations').

Where a company has a capital asset consisting of shares, ships or aircraft it generally does not recognise any taxable gain or loss on them until they are disposed of. If the company hedges its foreign exchange risk from such an asset with a financial instrument which is a loan relationship or derivative contract, exchange differences on the financial instrument could be taxed as they arise.

This potential mismatch is prevented by the Disregard Regulations. Foreign exchange gains and losses on the hedging financial instrument are disregarded when they arise. Instead, they are held over until the capital asset being hedged is finally disposed of.

The new regulations state that the date on which a company can start to disregard foreign exchange differences on a financial instrument is the date upon which the relevant asset is matched to the hedging financial instrument.

The change was made to counter perceived avoidance arrangements that sought to disregard foreign exchange differences on financial instruments for periods before the hedged assets were acquired. The regulations have effect from 6 December 2011.

Manufactured overseas dividends (MODs)

A previously announced anti-avoidance measure prevents companies that receive MODs from treating tax deducted from them as income tax. The amendments in the draft Finance Bill were announced on 15 September 2011 and take effect from that date.

Banking

Bank levy

As announced in the Autumn Statement the Bank Levy rate is to be increased to 0.088% for short term liabilities and to 0.044% for long term liabilities. The increase is intended to apply to all or part of any period that falls on or after 1 January 2012, although the additional amounts arising from the rate change are only payable after FB 2012 receives Royal Assent.

Other changes include the following:

- ▶ Amendments to the netting rules to deal with liabilities arising from short selling, and to deal with assets which are on balance sheet but posted as collateral. This is intended to be retrospectively effective for the whole of 2011

- ▶ Retrospective application of changes to double taxation arrangements and to extend powers for information sharing between fiscal authorities
- ▶ A specific change to the joint venture rules to prevent a double charge arising in certain situations

The rate increase is the third in a year, and is driven by the Government's objective to raise at least £2.5bn per annum from the banking sector. This suggests the rate could be reviewed again if revenue from the levy fails to reach Government targets.

Regulatory capital instruments

The Government has announced that it continues to examine the tax treatment of regulatory capital instruments.

The forthcoming Basel III reforms are expected to lead to new forms of capital instruments being issued in the market. In recognition of this, the Government announced in Budget 2011 that it would work with the banking industry to seek certainty as to the tax treatment of these instruments. HMRC has already undertaken an informal consultation and the findings are published on its website.

Whilst we believe it should be possible to structure Basel III compliant Tier 1 capital in tax-deductible form under current law, the government have committed to 'provide legislative certainty' in advance of 2013.

Oil and gas

Carbon price support rates

Following a consultation period, which ended earlier this year, the Government has reiterated its intention to introduce a 'carbon price support rate' or 'carbon price floor' from 1 April 2013.

The Government hopes that the introduction of such a floor price will encourage the development of low-carbon power generation. It was previously announced that the intended floor was to start at around £16 per tonne of carbon dioxide and rise in a linear fashion to a figure of £30 per tonne by 2020.

The draft legislation published today contains details of some carbon price support rates, together with expected reliefs relating to carbon capture and storage projects and combined heat and power stations.

The introduction of a measure which has the objective of reducing the nation's carbon footprint is to be welcomed but there are concerns over the impact of this green tax on the UK's international competitiveness. Unlike the related EU Emissions Trading Scheme this measure will only apply to the UK and is another cost that will ultimately be borne by the consumer.

Decommissioning relief

Draft legislation issued today outlines how the restriction of the rate at which decommissioning relief is given is intended to operate.

Budget 2011 introduced a 12% rise in the rate of the supplementary charge that applies to ring fence trades, taking the combined ring fence corporation tax and supplementary charge rate to 62%. At the same time, the Government announced its intention to restrict the rate at which decommissioning expenditure is relieved to a combined 50%.

The draft legislation issued today seeks to identify 'decommissioning expenditure' taken into account in the supplementary charge calculation, and provides that a proportion of that expenditure is effectively added back. In response to industry concerns, PRT repayments arising from decommissioning losses are to be offset against this increase; this ensures that decommissioning expenditure in a fully PRT liable field may be relieved at the combined PRT, ring fence corporation tax and supplementary charge rate of 75%. The amendments will have effect for decommissioning expenditure incurred on or after Budget Day 2012.

While the draft legislation was expected, the announcement in Budget 2011 was an unwelcome surprise for the Industry, with many fearing this to be the first step in widening the gap between the rate at which profits are taxed and costs relieved. Recent discussions with Government in relation to certainty over future decommissioning relief have been encouraging, as attempts to rebuild confidence in the stability of the oil and gas tax regime continue.

Scope of supplementary charge

Draft legislation issued today intends to clarify the application of supplementary charge to ring fence chargeable gains.

Industry has historically been of the view that the supplementary charge does not apply to gains arising on the disposal of oil fields, however HMRC has recently stated that the policy intent of the

original legislation was for supplementary charge to apply to these gains.

Draft legislation puts beyond doubt that supplementary charge does apply to such gains accruing on or after 6 December 2011, while HMRC is likely to continue with its contention that the legislation always had this effect.

The draft legislation also ensures that a gain continues to be liable to supplementary charge even where it is transferred to a non ring fence group company; HMRC appears to accept that, prior to today's changes, supplementary charge did not apply to the transferred gain in these circumstances.

This could lead to a tax on capital disposals of 62%, which could be questioned on policy grounds, since the proceeds received for the disposal are already reduced to reflect the 62% corporate tax a purchaser will pay on the future profits from the field. Whilst the recently enacted ring-fence reinvestment relief means many chargeable gains will be exempt from tax altogether, for gains held over prior to the introduction of reinvestment relief, this amendment could lead to a substantial, unexpected tax liability for some companies.

Insurance

The most fundamental changes for nearly 100 years are to be made to the tax regime for life assurance business and friendly societies, as a result of the introduction of the 'Solvency II' regulatory regime. The new legislation incorporates tax law re-write principles to those parts of the regime which are remaining substantially unchanged.

Another consequence of the introduction of the Solvency II regulatory regime is that claims equalisation reserves are to disappear. Changes are therefore being made to end the existing relief for claims equalisation reserves for general insurance business.

Changes are also to be made to the timing of relief for stop loss premiums. These are insurance premiums paid by Lloyd's corporate members to cap losses for specific events or specific claims periods.

For more information on these changes please refer to our separate [life assurance and insurance industry alert](#).

Funds

Tax transparent fund vehicles

Draft tax regulations have been released to facilitate the proposed introduction of a tax transparent fund vehicle in 2012. The new vehicle will allow UK pooled 'master fund' investment vehicles to be established under the recently implemented UCITS IV Directive. The regulations are limited in scope and primarily enable the introduction of new legislation, although they do anticipate that:

- ▶ Investors will only be taxed on chargeable gains when they dispose of their interest in the fund and not when the fund makes gains on the underlying investments
- ▶ Exemptions from stamp duty and SDRT will be provided under certain circumstances and SDRT charges under Schedule 19 FA 1999 will not apply to tax transparent funds
- ▶ A tax transparent fund will not be subject to UK corporation tax
- ▶ No chargeable gain will arise to an insurance company when transferring assets to transparent funds. Insurance companies will be deemed to dispose of their interest in the fund at the end of each accounting period.

The changes announced are welcomed and we look forward to further details as they emerge.

Personal taxation

Statutory residence test

On 6 December 2011, HM Treasury confirmed that the introduction of a UK Statutory Residence Test (SRT), previously proposed to take effect from 6 April 2012, would be delayed until 6 April 2013.

The reason for the delay is to give more time to deal with a number of detailed issues that have emerged from the consultation, but we are left with the current arguably vague and subjective tests derived from case law in order to determine whether someone is UK resident or not for another year.

Given the lack of clarity surrounding the present rules on residence, this will be seen as a very disappointing announcement for businesses hoping to invest in the UK (and, indeed, for UK businesses seeking to staff investments abroad) and is not well aligned with the Government's objective of enhancing UK competitiveness.

The certainty that the SRT was expected to provide would have allowed businesses to make much more reliable assessments of the costs of sending individuals to or from the UK. The delay is likely to generate confusion for individuals who have come to or left the UK in the six months following the release of the consultation.

Reform to taxation of non-UK domiciled individuals

The Government is increasing the remittance basis charge (RBC) for long term residents of the UK. At the same time they will introduce a number of simplifications to the remittance basis.

The draft legislation published in December 2011 introduces an increased RBC for individuals who have been resident in the UK for any part of 12 out of the previous 14 tax years. With effect from 6 April 2012, these individuals will have to pay an increased RBC of £50,000. Those who have been UK resident for seven out of the previous nine years but still less than 12 will continue to have to pay the £30,000 charge.

At the same time, there is a welcome change to the nominated income rules which means that up to £10 of nominated income can be remitted to the UK tax free without triggering complex matching rules. These changes mean that individuals who choose only to nominate £1 of income will no longer need to maintain separate bank accounts to hold nominated income. Those wishing to claim

credit for the RBC in other jurisdictions may still need to maintain separate accounts.

There has also been a change to the rules regarding property brought to the UK for sale here. From 6 April 2012, subject to certain conditions, including the proceeds of the sale being removed from the UK within 45 days of receipt, assets can be brought to the UK and sold here without the funds that have been used to buy the asset being treated as remitted to the UK.

The increase to the remittance basis charge is likely to result in an increase in the number of individuals moving to the arising basis of taxation with all the associated complications of this. It may also increase the number of non-domiciled individuals leaving the UK.

The simplifications to the rules regarding nominated income are particularly welcome as this has always been an unnecessarily complex area of the tax code. The changes to the rules regarding asset sales may well be beneficial for UK auction houses.

Non-UK domiciled individuals: encouraging business investment

The Government is proposing a tax relief from 6 April 2012 designed to encourage non-domiciled individuals to invest into UK companies

It is proposed that, non-UK domiciled individuals will be able to invest overseas income and gains in qualifying investments in the UK without incurring a tax charge. The relief would effectively treat the amounts used to make the investment as not remitted to the UK.

Individuals as well as certain offshore trusts and companies will be able to make the investment either by subscribing for shares and securities or by making a loan to a private limited trading company. However, if the company ceases to meet the necessary conditions, the investment is sold, or value is extracted on non-arms length terms then the funds invested must be withdrawn from the UK within 45 days to prevent a tax charge arising.

In principle, the introduction of this relief is very positive. However, at present there are a number of barriers which will limit the attractiveness of the relief and it is hoped that some of these can be removed as part of the continuing consultation. In particular it is far from clear that private equity investments would qualify for the relief.

Capital gains tax: foreign currency bank accounts

The Government has removed foreign currency bank accounts from the scope of capital gains tax

As part of the consultation into the taxation of non-UK domiciled individuals, the Treasury proposed to exempt from capital gains tax foreign currency bank accounts in the hands of individuals. Following lobbying by Ernst & Young as well as others, this proposal has now been extended to all foreign currency bank accounts of individuals, trustees and personal representatives. With effect from 6 April 2012, gains on foreign currency bank accounts will not be chargeable and losses will not be allowable.

In our response to the consultation, Ernst & Young suggested that those affected should have the option to elect for this treatment to apply to foreign currency gains for earlier tax years, eg. 2011/12 but this suggestion has not been adopted.

The calculation of gains and losses on foreign currency bank accounts is a huge burden for individuals and trustees resulting in little tax for the treasury and this change will come as a great relief. It is disappointing that, given the Treasury acknowledges the low tax take from these gains, the relief cannot be extended to prevent the need for complex and time consuming calculations for 2011/12.

Late-night taxis

The tax relief available on provision of late-night taxis by employers to their employees is to be retained.

No income tax charge arises where employers pay for employees' transport home from work when working late, provided certain conditions are met. The Office of Tax Simplification had proposed that this relief should be abolished, along with a number of others. Following consultation, it has been decided that the relief will be retained.

This will be a welcome reprieve for many businesses which utilise the relief, particularly in the financial sector. If the relief had not been retained, it could have led to increased costs for business as in many cases the costs would still have been met by the employer, but with an additional tax burden to be met via PAYE Settlement Agreements. Employers will need to continue to monitor compliance with the conditions, as HMRC has scrutinised this area closely in the past.

Tax-advantaged venture capital schemes

Following-on from announcements made in the Autumn Statement, further details on the Seed Enterprise Investment Scheme (SEIS), and changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) reliefs, have been published.

From 6 April 2012, individual investors who subscribe for shares in a SEIS company will obtain 50% income tax relief, regardless of the investor's marginal rate of tax. To qualify, an individual must not have an interest of more than 30% in the SEIS company and must hold their shares for at least three years. In addition, SEIS shares may be disposed of free of capital gains tax.

Further draft legislation is expected which will provide for a capital gains holiday for gains realised in 2012/2013 that are invested through SEIS in the same year. This means that for certain investors in SEIS the after-tax cost of every £100 invested is limited to just £22. The scheme is subject to an annual investment limit of £100,000 per investor.

The SEIS applies to smaller, unquoted trading companies, which means those with twenty five or fewer full-time employees and assets of up to £200,000. The relief is subject to a cumulative investment limit of £150,000 per company.

As anticipated, there are a number of changes to the EIS and VCT schemes which are designed to focus the schemes better on higher risk activities and relax certain stringent requirements which may have previously restricted their take-up. Subject to State Aid approval, Finance Bill 2012 will include previously announced measures to increase certain thresholds for both the individual investor and the investee company.

Gifts of pre-eminent objects

A new philanthropic measure is being introduced which will allow individuals and companies to reduce their income tax and/or capital gains tax liabilities (individuals,) and corporation tax liabilities (companies) where the taxpayer donates pre-eminent objects, or collections of objects, to the nation. This tax reduction does not apply to individuals acting as trustees or personal representatives.

It is proposed that taxpayers will receive a reduction in their UK tax liability based on a fixed percentage of the value of the object they are donating. Individuals will be able to spread the tax reduction

forward across a period of up to five years starting with the tax year in which the object is offered. UK resident and non-domiciled individuals will be able to donate non-UK sited assets, derived from overseas income/gains, without triggering an income/capital gains tax charge on remittance into the UK.

This new scheme, in combination with the existing Inheritance Tax Acceptance in Lieu (AiL) scheme, will have an annual limit on the tax reductions available totalling £30m.

This measure will commence on a date to be appointed by the Treasury but will apply to tax years from 2012/13.

This measure is a welcome addition to the current philanthropic tax planning options for taxpayers. Individuals will need to be careful not to waste relief if they wish to spread the tax reduction over more than one year.

IHT: reduced rate for estates leaving 10% or more to charity

For deaths on or after 6 April 2012 inheritance tax (IHT) will be charged on estates at a rate of 36 per cent where 10 per cent or more of that estate has been left to charity.

A reduced rate of IHT will be applied to estates which have made a 10% donation to charity. For this purpose the 10% is calculated by reference to the total estate after all reliefs, exemptions and the nil rate band have been applied, but excluding the charitable donation itself.

Where part of the estate is in trust, or there are jointly held assets, the test will be applied separately to each part of the estate. If the aggregate passed to charity from one part of the estate exceeds 10%, two or more elements can be merged and the comparison made again.

Each part of the estate which meets the 10% test, either alone or when merged with another part will qualify for the reduced 36% rate.

This is a positive measure which will encourage individuals to consider charitable giving as part of their will. Many individuals will wish to review the terms of their will in the light of the new relief.

Indirect taxation

VAT: cost-sharing exemption

Legislation will be introduced to implement the EU VAT cost-sharing exemption into UK law.

Following continued consultation over the summer, the Government has announced that legislation will be introduced to implement the VAT cost-sharing exemption into UK law from the date of Royal Assent (i.e. Summer 2012).

The mandatory exemption in EU law allows businesses and organisations making VAT exempt and/or non-business supplies (such as banks, charities, housing associations, insurance companies, residential care homes, universities and further education colleges) to form groups to achieve cost savings and economies of scale. It removes the added VAT cost which can arise when costs and resources are shared between such businesses/organisations.

The fact that HMRC has not sought to exclude any particular businesses (in particular, the financial services and insurance sectors) from the benefit of the VAT cost-sharing is to be welcomed, as is HMRC's undertaking to engage with stakeholders to develop detailed guidance that will be published before legal implementation.

It would appear that HMRC has also changed its requirement of independence and decided to allow one member to control the cost-sharing vehicle. However, the draft legislation does not contain all of the conditions which will be set out in secondary legislation which is yet to be published.

VAT: change to registration threshold and online registration

Legislation will be introduced to remove the VAT registration threshold for non-established businesses making taxable supplies in the UK with effect from 1 December 2012. An online system for VAT registration, de-registration and changes to business details will be introduced in October 2012.

As announced at Budget 2011, the annual VAT registration threshold (currently £73,000) will be removed for businesses not established in the UK (i.e. a nil registration threshold will apply). However, this change will now take effect from 1 December 2012, rather than 1 August 2012 as previously announced.

From October 2012, secondary legislation will enable the use of electronic channels for online

VAT registration, de-registration and variation of registration details. This measure will provide incentives for businesses to use online services by offering quicker and more accurate processing.

Whilst the removal of the registration threshold for overseas businesses brings the UK into line with other EU countries, it could discourage certain businesses from trading in the UK. The further move to online filing is in line with the Government's 'digital agenda'.

Climate change levy (CCL)

Legislation will be introduced to amend the CCL rates on electricity from 1 April 2013, as announced in the Budget 2011.

The reduced rate of CCL on electricity will be amended from 35% to 10%, correcting an omission in legislation introduced in Finance Act 2010. As of 1 April 2012, a lower rate of 20% of the full rates of CCL will also be introduced for supplies of taxable commodities used in steel and aluminium recycling. However, the exemption from the CCL for supplies of electricity by an electricity utility generated in a Combined Heat and Power station to business energy consumers will be removed from 1 April 2013.

As part of reforms announced in Budget 2011, the Climate Change Agreements scheme, the scheme giving entitlement to CCL reductions, will be extended to 2023. Current participating sectors will continue to be eligible. Following consultations, legislation will also be introduced to simplify and streamline the scheme from 1 April 2013.

Air passenger duty

Legislation will be introduced to extend Air Passenger Duty (APD) to business jets with effect from 1 April 2013. APD rates will increase from 1 April 2012 as set out at Budget 2011.

As announced in the Autumn Statement, legislation will be introduced to extend APD to business jets and smaller aircraft. Passengers on aircraft with an authorised take off weight of 5.7 tonnes and above will attract APD on flights that take off from a UK airport from 1 April 2013.

Legislation will also introduce new premium rates of APD for passengers on flights using aircraft with a certified authorised weight of 20 tonnes or more and fewer than 19 seats. Flights in this category will be liable to APD at double the prevailing standard business/first class rates.

The Government has also announced that APD rates will increase from 1 April 2012 as set out at Budget 2011 and confirmed that the reduced rate for direct long-haul flights from Northern Ireland will be given statutory effect.

The postponement of the change extending APD to business jets and smaller aircraft, from April 2012 to April 2013, will come as welcome news to affected operators given the need to design and implement suitable accounting systems to cater for what will be a significant additional compliance burden.

Gambling duty changes

Amusement Machine Licence Duty (AMLDD) will be replaced in February 2013 by a new Machine Games Duty (MGD). Following the review of remote gambling taxation, legislation will also be introduced to provide double taxation relief on gambling duties from April 2012.

As announced at Budget 2011 and following consultation over the summer, legislation will be introduced for a new MGD. This duty will come into effect on 1 February 2013 and will replace the current AMLDD. With the introduction of MGD in 2013, games played on machines which are liable to MGD will become exempt from VAT. Following the consultation, only gaming machines with cash prizes will be within the scope of MGD. There will be two rates of MGD, with the lower rate applying to machines with maximum stakes of 10 pence and maximum cash prizes of £8. The rates of MGD have yet to be announced and further consultation with industry remains open until 10 February 2012.

Following a review of remote gambling taxation earlier in 2011 and an informal consultation, legislation will also be introduced to provide double taxation relief for Remote Gaming Duty (RGD), General Betting Duty (GBD) and Pool Betting Duty (PBD).

Relief will be afforded to UK operators offering remote gambling to overseas customers, where those operators pay GBD, RGD or PBD in the UK and also pay qualifying taxes on the same transactions in other countries. The measure will have effect for accounting periods for UK gambling duties ending on or after 1 April 2012.

It is likely that there will be winners and losers under the new MGD regime, despite its aim to be fiscally neutral overall.

HMRC powers

Changes to Stamp Duty Land Tax disclosure rules

The current property valuation thresholds will be removed and the grandfathering rules will be removed from certain Stamp Duty Land Tax (SDLT) avoidance schemes. These changes could apply as early as from Royal Assent to the Finance Bill but are subject to regulations being made at that point.

Currently SDLT schemes are only notifiable if they concern either commercial property with an aggregate value of £5m or residential property with an aggregate value of £1m or more. The removal of the thresholds means that the SDLT disclosure regime applies irrespective of the value of the property.

The removal of the grandfathering provisions means that anybody implementing any SDLT schemes involving SDLT 'sub-sale relief' (relief under section 45 Finance Act 2003) will be required to notify HMRC that they have used the scheme.

These amendments are an attempt by HMRC to halt the apparently dwindling numbers of disclosures of such schemes which have been made since the change to the penalty regime in April 2011 and to address those residential schemes which have, thus far, gone unreported.

HMRC information powers

Changes are to be made to HMRC's information powers to bring these into line with international standards for exchange of information on request.

Under the draft legislation published on 6 December it is proposed to extend HMRC's information powers in Schedule 36 Finance Act 2008 relating to taxpayers for whom it holds identifying information but not full identity details. The new power, which will be available in respect of all UK direct and indirect taxes as well as for exchange of information with overseas tax authorities, will allow HMRC to obtain the name, last known address and/or date of birth (in the case of an individual) of taxpayers for whom it holds identifying information.

To comply with international standards, the new power will apply without HMRC having to show that a serious loss of tax is suspected. The process for obtaining identity information under this power will involve HMRC issuing a notice, setting out the identifying information it holds, to a person it believes will be able to identify the taxpayer from that information, and who can be expected to have

obtained the relevant identity details in the course of business. Unlike existing powers to obtain information about persons whose identity is known, the new power will not require HMRC to obtain the approval of the Tribunal.

The need for HMRC to amend its information powers to bring these into line with international standards is accepted. It is however concerning that this provision - if enacted in its present form - would introduce the new power without a requirement for Tribunal approval which applies to HMRC's comparable existing powers.

UK/Switzerland tax agreement

Legislation will be introduced in Finance Act 2012 to give effect to an agreement to implement a withholding tax on UK individuals beneficially owning, directly or indirectly, bankable assets in Switzerland. This agreement was published on 6 October, is expected to come into force on 1 January 2013, and is subject to ratification in Switzerland.

We have discussed this agreement in detail in previous alerts. In summary, it provides for a one-off levy on assets held in Switzerland that will extinguish past undeclared liabilities to UK income tax, capital gains tax, inheritance tax and VAT (and any interest/ penalties) arising on those assets. The levy will be charged unless the individual chooses to authorise disclosure of certain details by the relevant Swiss paying agent. It is expected that any non compliant individuals who authorise such a disclosure will also make a voluntary disclosure to HMRC.

The agreement also provides for an ongoing levy on income and capital gains which arise on Swiss assets after the date the agreement comes into force, which will discharge corresponding income and capital gains tax liabilities. Again the levy will be charged unless the individual authorises disclosure of certain details by the Swiss paying agent. In both cases, special rules apply for non-UK domiciled individuals. The agreement provides for enhanced exchange of information powers.

The draft legislation published today will give effect to the agreement under UK law. It sets out how payment of the levy will extinguish an individual's liability for the relevant taxes/ any interest and penalties, and that where the levy does not do so (as where the individual is subject to certain HMRC investigations the levy will be treated as a credit against the tax, any interest and penalties. It largely codifies what would be anticipated from the relevant part of the agreement, but contains some

further detail, which broadly reflects our discussions with HMRC.

In addition to this draft legislation, and to the developing FAQs published by HMRC, we expect to see much of interest in the guidelines which the Swiss fiscal authorities are expected to issue early next year. The practical impact on non- UK domiciles continues to be an area of focus.

Dealing with dishonest tax agents

Legislation is to be introduced providing for civil penalties, 'naming and shaming', and access to the working papers of, dishonest tax agents.

Draft legislation published today provides for HMRC to make a determination that a tax agent is engaging in or has engaged in dishonest conduct, to be known as a conduct notice. The individual concerned may appeal against the conduct notice, but once a conduct notice has been issued it will be a criminal offence for documents relevant to that notice to be concealed or destroyed. With the permission of the tribunal, HMRC may also follow up a conduct notice by requiring access to the tax agent's files.

The legislation also provides for penalties of up to £50,000 for a tax agent who engages in dishonest behaviour, and allows HMRC to publish details on its website of dishonest agents subject to a penalty.

Action against dishonesty in the tax system is to be encouraged wherever that arises, though care needs to be taken to ensure that the measures are well targeted and that innocent parties are protected.

Further information

For further information, please contact your usual Ernst & Young contact or one of the following:

Claire Hooper	chooper@uk.ey.com	0207 951 2486
Chris Sanger	csanger@uk.ey.com	0207 951 0150

Ernst & Young LLP

Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit www.ey.com/uk.

Ernst & Young refers to the global organisation of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place,
London SE1 2AF.

© Ernst & Young LLP 2011. Published in the UK.
All Rights Reserved.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.