FINANCE ACT UPDATE

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1 BUSINESS AND CORPORATION TAX

1.1 Corporation tax rates

The main rate of corporation tax will reduce to 21% from 1 April 2014; this is an additional reduction of 1% against the planned rate. The main rate will then reduce to 20% from 1 April 2015, at which point we shall have a single rate of corporation tax. The small profits rate remains 20% throughout. The rates proposed are therefore:

	Main rate	Small profits rate	Marginal rate
FY 2012	24%	20%	25%
FY 2013	23%	20%	23.75%
FY 2014	21%	20%	21.25%
FY 2015	20%	20%	N/A

The rate of bank levy will be increased to offset the benefits of the reduction in the main rate in both 2014 and 2015.

Although a single rate presents the opportunity for simplification by abolishing calculations in respect of associated companies, as things stand the opportunity will be lost if the issue of tax payment dates is not addressed. Presently large companies pay tax by quarterly instalments, whereas small companies pay 9 months after the end of the period. Once there is a single rate, small companies will still be forced to compute the number of associated companies to establish whether they are liable to quarterly instalment payments.

HMRC has responded by saying that the opportunity to simplify was welcome, and that with some concerted effort a way should be found to remove the complexities of the associated company rules, probably by changing the trigger to QUIPs.

1.2 Annual investment allowance

The annual investment allowance increased to £250,000 with effect from 1 January 2013, until 31 December 2014. Businesses and companies with accounting periods spanning the date of change will need to follow the transitional rules in Schedule 1 carefully to ensure that the timing of their expenditure makes best use of the available relief. Only the ingoing transitional rules are relevant at present – the closing transitionals will be relevant in a year or so and so are dealt with briefly.

The first step is to compute the overall allowance available for the whole period, simply using time apportionment of the relevant limits.

1.2.1 Example 1 – period spanning 1 January 2013

Company with accounting period end 31 March

Year ended 31 March 2013

Period 1 April 2012 to 31 December 2012 275 days x £25,000 = £18,836

Period 1 January 2013 to 31 March 2013 90 days x £250,000 = £61,644

Total £80,480. Note that if the apportionment is calculated on a monthly basis (as in the HMRC TIIN) the allowance is £81,250.

The second step is to identify which sub-periods have a restricted allowance due to the operation of the transitional rules.

There are three potential transitional periods :

A – the period falling before 1 April 2012 (if any) (6 April 2012 for income tax)
B – the period starting on or after 1 (or 6) April 2012 and ending 31 December 2012
C – the period starting 1 January 2013 and ending at the end of the accounting period.

So for this period, there is no period A, Period B is 1 April 2012 to 31 December 2012, and period C is 1 January 2013 to 31 March 2013.

Where the first straddling period starts on or after the relevant date (1 or 6 April 2012) the restriction that applies to period B is to ignore the transitional rules for the later change and apply the limit which would have applied as if there had been no change on 1 January 2013.

So, in Example 1, the allowance available on expenditure before 1 January 2013 is restricted to £25,000, which is the amount that would have been due for the whole year, had the change on 1 January 2013 not been made.

1.2.2 Example 2 – period spanning both 6 April 2012 and 1 January 2013

Income tax business with accounting period end of 31 January. This is a case where the first straddling period commences before the relevant date, and different restrictions apply.

First, calculate the maximum allowance for the year by time apportioning the relevant limits as before:

Year ended 31 January 2013

Period 1 February 2012 to 5 April 2012 65 days x £100,000 = £17,760

Period 6 April 2012 to 31 December 2012 270 days x £25,000 = £18,443

Period 1 January 2013 to 31 January 2013 31 days x £250,000 = £21,175

Total £57,378

The restrictions on expenditure in periods A, B and C are :

Period A : 1 February 2012 to 5 April 2012 – the maximum under the rules before the latest change was the time apportioned amounts for the previous change. This was

£17,760 + (301/366 x £25,000) = £38,320 in total for the whole 12 month period, with no restriction on the amount that could be spent before 6 April. This is therefore the maximum amount for that period.

Period B : 6 April 2012 to 31 December 2012, no more than £20,560. This is arrived at by ignoring the increase to £250,000, and applying the transitional rules for the reduction to £25,000, i.e. the period 6 April to 31 January 2013 would previously have been subject to a maximum of £20,560 (for 301 days/366). In a real case this would be reduced by the amount of AIA claimed in respect of expenditure in period A which exceeds the time apportioned amount for the period 1 February to 5 April 2012 alone. So if the expenditure in period A exceeds £17,760, the balance is deducted from the notional allowance of £20,560.

Period C : 1 January 2013 to 31 January 2013 – the maximum amount is found by adding the amounts available for periods B and C using the strict time apportionment, that is £18,443 + £21,175 = £39,618

Obviously the three restricted amounts arrived at here total in excess of the maximum for the period as a whole :

£38,320 for period A, £20,560 for period B and £39,618 for period C, so if the maximum expenditure was incurred in any of the earlier periods, it is possible that the amount available in period C is less, by virtue of the overall limit; if periods A or B use the whole amount available this will total £38,320 (whichever period the expenditure is incurred in), leaving only £19,058 for period C.

1.2.3 <u>Second straddling period</u>

The rules for the end of the increased allowance, affecting periods straddling 1 January 2015 are found in para 4 of Schedule 1, and restrict the expenditure on or after 1 January 2015 to the amount calculated by reference to that period alone. So for a March 31 year end, the amount available for the whole period would be:

1 April 2014 – 31 Dec 2014 275/365 x £250,000	= £188,357
1 January 2015 – 31 March 2015 90/365 x £25,000	= £ 6,165

Total £194,522, but with only £6,165 applying to expenditure on or after 1 January 2015.

1.3 Simplifying small business accounts for tax

The new cash basis rules and the simplified deductions for certain expenses have been legislated for in the Finance Bill at ss 17 and 18, together with Schs 4 and 5. The legislation makes modifications to ITTOIA 2005 to provide for the cash basis, so much of the legislation comprises new sections inserted into the existing legislation. These rules apply only for the purpose of income tax.

1.3.1 Eligibility for the cash basis

Only unincorporated businesses are permitted to use the cash basis. Its use is purely optional and a business will elect to use the basis; when a partnership wishes to use the cash basis the election must be made by the partner responsible for the tax return. The maximum turnover for entering the cash basis will be the VAT threshold – now £79,000 (although Universal Credit claimants can start using the cash basis if their turnover is up to twice the VAT threshold – currently £158,000). (New s 31B(5) of ITTOIA 2005). A time apportioned limit applies to a short accounting period, and where an individual is involved in several businesses, the limit will apply to the total income of all of them. Note that the legislation provides that the limit is the VAT Threshold at the end of the tax year, not at the start of the tax year, but as the limit normally rises this should not pose practical problems.

Once using the cash basis, businesses will be required to leave when their turnover for the preceding year exceeds twice the VAT threshold – currently £158,000. Where a person carries on more than one business, the turnover limits apply to the combined receipts of both businesses.

The following businesses are specifically excluded from using the cash basis (New s 31C):

- Partnerships in which any partner is not an individual
- Limited liability partnerships
- Lloyd's underwriters
- Businesses with a current herd basis election, and
- Persons with a profit averaging election under S221 ITTOIA (farmers and creative artists)
- Businesses which have made a claim under Business Premises Renovation Allowance within the previous seven years
- Businesses carrying on a trade of mineral extraction
- Businesses which still own an asset for which research and development capital allowances have been claimed in a previous period (without limit).

1.3.2 The cash basis

An election to use the cash basis is made under new s25A, and this has effect for the tax year for which it is made, and subsequent tax periods until either the business ceases to meet the financial limits relevant to the scheme, or the circumstances of the business change so that GAAP based accounts are more appropriate and an election out of the cash basis is made. Once the election is made to use the cash basis, this applies to all businesses in which the individual is involved.

Accounts for tax purposes will be prepared based on the income as it is received by the business and the expenditure as it is paid. (new s 31 E) This is subject to a number of special provisions. The legislation provides that expenses may be disallowed by law (as would normally apply), but the following special rules apply specifically to the cash basis.

General rules that do not apply under the cash basis

The following general principles in computing the profits of a business do not apply when the business elects to use the cash basis: (all sections in ITTOIA 2005)

- Section 33 – capital expenditure; replaced by new S 33A cash basis : capital expenditure
- Section 35 – bad and doubtful debts
- Sections 36 and 37 – unpaid remuneration
- Section 43 – employee benefit contributions, profits calculated before the end of the 9 month period
- Sections 48 to 50B – car hire
- sections 60 to 67 – tenants under taxed leases
- section 68 – replacement and alteration of trade tools.

New special rules for the cash basis only

The legislation adds new sections to ITTOIA 2005, as follows :

- Section 33A – this is a general prohibition on a variety of types of capital expenditure which either would not normally attract capital allowances, or which is provided for by the mandatory flat rate allowance for business motoring. The excluded capital expenditure falls into the following broad headings:

    - Land, buildings and fixtures acquired at the same time
    - Cars and motorcycles
    - Intellectual property
    - Shares and securities
    - Other businesses
    - Investment assets
    - Non depreciating assets

  This permits expenditure on other assets which would normally attract capital allowances to qualify as incurred.

- Section 51A – This prohibits the deduction of interest paid on a loan, but permits deductions under new section 57B. This rather unusually provides that interest and loan arrangement fees of up to £500 may be deducted in a year (on a paid basis) and there is no requirement that the loan is “wholly and exclusively” for the business.

- Section 55A – restricts rental payments for capital items to those that would obtain a deduction if the capital cost of the item were incurred (thus excluding hire of cars and motorcycles), and in relation to the use in the period or within 3 months after the end of the period (which allows rental payments quarterly in advance, but no more).

- Section 96A - capital receipts in respect of assets for which a deduction has been given under the cash basis (or would have been if an election had been made at the time they were acquired) are to be accounted for as a receipt under the cash basis. Where there is mixed use, the receipt is apportioned as appropriate.

- Section 97A – trading stock at cessation to be valued on a just and reasonable basis and included as a receipt

- Section 97B – work in progress at cessation of the trade when a cash basis election is in place is to be valued on a just and reasonable basis, and included as a receipt.

- TCGA 1992 is also amended. New s47A, TCGA 1992, provides an exemption from a chargeable gains on a wasting chattel used in the trade where a cash basis election is in force at the date of disposal.

1.3.3 Other implications of using the cash basis

Losses

There is no relief for losses under the cash basis other than carry forward against future profits of the same trade. Both sideways relief in the year and carry back (including opening year loss relief provisions) will not apply to cash basis users.

Arm’s length basis

There is also a requirement that all amounts taken into account are based on an arm’s length amount, and adjustments will be required if a transaction is not at arm’s length, subject to some minor exclusions.

Special rules for barristers and advocates in the early years of practice

These rules have provided for a cash basis to apply in the first seven years of practice. These rules are abolished by the introduction of the new cash basis rules, and barristers and advocates may elect to apply the new cash basis at any point in their business, provided the qualifying conditions are met. Where a barrister or advocate has been taxed under the special rules in 2012/13 and does not meet the qualifying conditions for the cash basis, they may continue to apply the special basis until the expiry of the seven year period. The transitional rules which apply after the seventh year of practice are also retained for those who have been taxed under the special rules prior to 2013/14.

Goods for own use

Budget 2013 included an announcement that goods for own use must be subject to an adjustment on a “just and reasonable” basis.

1.3.4 Transitional rules

The accounting rules adjusting from the accruals basis to the cash basis, and vice versa essentially use the existing legislation for a change of accounting basis in s 227 ITTOIA 2005. This provides for the computation of adjustment income or an adjustment expense by comparing the items accounted for under the old and the new basis. Where a business leaving the cash basis generates net adjustment income, this may be spread over the subsequent six years (new s 239A). There are also transitional rules covering capital allowances.

The transitional rules in new s227A ITTOIA 2005 apply to businesses joining and leaving the cash basis, as follows:

- An election has been made for the cash basis for the current tax year but not for the following one i.e., a business leaving the cash scheme; or
- No such election was made for a tax year but one has effect for the following tax year i.e., a business joining the scheme.

The provisions are designed to prevent abuse by moving from one basis to another to avoid income being taxed, or enable double relief for expenses.

Calculation of the adjustment income / expense

Section 231, ITTOIA 2005, requires the amount of the adjustment to be calculated using a step approach as follows:

Step 1 – Add together any amounts representing the extent to which, comparing the two bases, profits were understated (or losses overstated) on the old basis. The amounts are:

- Receipts which on the new basis would have been brought into account in calculating the profits of a period of account before the change, so far as they were not so brought into account;
- Expenses which on the new basis fall to be brought into account in calculating the profits of a period of account after the change, so far as they were brought into account in calculating the profits of a period before the change;
- Deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis so far as they:
    - are not matched by credits in respect of closing trading stock or closing work in progress in the last period of account before the change, or
    - are calculated on a different basis that if used to calculate those credits would have given a higher figure.
- Amounts recognised for accounting purposes in respect of depreciation in the last period of account before the change, so far as they were not the subject of an adjustment for income tax purposes, where such an adjustment would be required on the new basis.

Step 2 – Then deduct any amounts representing the extent to which, comparing the two bases, profits were overstated (or losses understated) on the old basis. The amounts are:

- Receipts which were brought into account in a period of account before the change, so far as they would not have been so brought into account if the profits had been calculated on the new basis;
- Expenses which were not brought into account in calculating the profits of a period of account before the change, so far as they:
    - would have been brought into account for a period of account before the change if the profits had been calculated on the new basis, and
    - would have been brought into account for a period after the change, if the profits had continued to be calculated on the old basis.
- Credits in respect of closing trading stock or closing work in progress in the last period of account before the change so far as they:
    - are not matched by deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis, or
    - are calculated on a different basis that if used to calculate those deductions would have given a lower figure.

An amount so deducted may not be deducted again in calculating the profits of a period of account.

Treatment of the adjustment item

On entering the cash basis (other than at the commencement of the business) the treatment for tax purposes is as follows:

- If the adjustment is positive, it is referred to as adjustment income and is charged to tax as if it arose on the last day of the year (in the case of the cash basis, on the last day of the basis period).
- If the adjustment is negative, it is an adjustment expense and is treated as an expense of the trade arising on the last day of the first period in which the new basis is adopted.

On leaving the cash basis, the business will generally have an adjustment income item on transition back to GAAP accounting (through the inclusion of debtors and unbilled work in progress). Adjustment income arising on leaving the cash basis is spread over six years (s239A, ITTOIA 2005), although an election can be made for an additional amount to be treated as arising in any of those six tax years. This is similar to the treatment adopted for the adjustment income arising on the introduction of UITF 40 for service providers.

1.3.5 Transitional rules – capital allowances

Most of the complications for a business entering the cash basis from GAAP, and moving from the cash basis to GAAP relate to capital allowances. The rules need to cover the following situations:

- Before entering the cash basis, an existing business will have been eligible to claim capital allowances.
- Capital allowances may not be claimed whilst applying the cash basis (with the exception of capital allowances on cars – see section below).

- After leaving the cash basis, capital allowances can be claimed.

New Chapter 17A, Part 2, ITTOIA 2005, provides for adjustments for capital allowances.

Entering the cash basis

Where there is unrelieved qualifying expenditure to carry forward from the previous tax year, a deduction is allowed on the cash basis for the relevant portion of that expenditure. Relevant portion means the amount of the expenditure for which a deduction would be allowed in calculating the profits of the trade on the cash basis if the expenditure was paid during the period.

However, the deduction is restricted by s240D where the asset is not fully paid for, to the amount actually paid. Indeed, if the capital allowances received before entering the cash basis exceed the amount actually paid, the difference is to be treated as a receipt in calculating the profits of the trade in the first year of applying the cash basis.

If the amount of capital allowances has been reduced under ss205 or 207, CAA 2001(reduction where asset provided or used only partly for qualifying purposes), the amount of relevant expenditure actually paid has to be proportionately reduced for the cash basis.

Leaving the cash basis

New s66A, CAA 2001, provides that on leaving the cash basis, any unrelieved qualifying expenditure can be allocated to a new capital allowances pool in the subsequent chargeable period. This allows for the situation that where an asset has been acquired but has not been fully paid for, such as under a hire purchase agreement, the amount still unpaid can be allocated to an appropriate pool when leaving the cash basis.

1.4 Flat rate expenses

The legislation is in Sch 5; it amends ITTOIA 2005, so this does not apply to companies, and there is a further restriction on partnerships in which one or more of the partners is not an individual.

The legislation recognises three distinct types of flat rate deduction, the most important of which is for vehicles. None of the flat rate expense rates is mandatory, but can be chosen by other income tax businesses as an option.

1.4.1 Expenditure on vehicles (new s 94D)

The new rules apply where a deduction would be allowable in computing the profits of a trade for expenditure on a vehicle (or would be allowed if the expenditure were not capital in nature). The vehicles covered are cars, motorcycles and goods vehicles used for the purpose of the trade.

Vehicles are excluded if capital allowances, or in the case of goods vehicles, a deduction under the cash basis, has been claimed in respect of them.

If a business elects to use the flat rate allowance then the flat rate allowance must be used for that vehicle for the remaining period during which it is in use for the purpose of the business.

The relief is calculated at a rate of 45p for the first 10,000 business miles in a year and 25p a mile after that for cars and goods vehicles (with a single 10,000 mile band for all vehicles taken together), and 24p a mile for motorcycles. (new s 94F) However, where an election is made by a business in respect of more than one car, there is a single annual band of 10,000 miles at the higher rate applying across both cars, which may be disadvantageous.

1.4.2 Use of home for business purposes (new s 94H)

The deduction may be claimed if the business uses the facilities in the proprietor's home for business use. The deduction is optional for all businesses, including those operating the cash basis, which would otherwise have to be calculated on an apportioned basis according to the payments made.

The calculation is performed on a monthly basis, and allows a deduction each month according to the number of hours spent wholly and exclusively on work done by the person or any employee in the person.

Deduction : per month or part month

Number of hours worked	Applicable amount
25 or more	£10.00
51 or more	£18.00
101 or more	£26.00

1.4.3 Premises used as both home and business premises (new s 94I)

Where business premises are used mainly for the purpose of the trade, but also as the person's home the person can elect for the flat rate of deduction to apply, whether or not they are using the cash basis of accounting. The calculation of the deduction is based on the total expenditure incurred less a flat rate private use adjustment, based on the number of occupants using the premises as a home or stays there otherwise than for the purpose of the trade.

Private use adjustment : per month or part month

Number of relevant occupants	Applicable amount
1	£350
2	£500
3 or more	£650

1.5 Surrender of losses from EEA companies

Losses can be surrendered for the purpose of UK group relief if they arise outside the UK but are attributable to a UK permanent establishment. This provision is subject to a condition that there is no prospect of relief anywhere else.

From 1 April 2013 the condition is modified in relation to EEA resident companies. They will have to show that the relevant loss has not been relieved anywhere else, rather than it could not be relieved anywhere else. While this is welcome news (and implements the CJEU decision in *Philips Electronics UK Ltd*, the additional relief only relates to losses arising on or after 1 April 2013, with straddling periods apportioned on a time basis, unless that produces a result that is unjust or unreasonable; failing that a just and reasonable basis should be used.

1.6 Research and development expenditure credits

A new scheme of tax credits for R & D has been introduced for the large company scheme – that is companies not entitled to relief under the SME scheme. This is dealt with by Sch 15 FA 2013. The relief is available on a claim by the company.

An “above the line” (ATL) credit of 10% will apply in respect of qualifying R & D expenditure incurred on or after 1 April 2013. The claim will bring the amount into account as a receipt in calculating the profits of the trade – that is the credit is a taxable amount. (The rate for ring fenced trades is 49%)

Qualifying R & D expenditure in the case of an SME claimant (NB special definition for R & D) comprises:

- Qualifying expenditure on sub-contract R & D;
- Subsidised qualifying expenditure, and
- Capped R & D expenditure

that is, expenditure that does not qualify for the SME scheme. All of the terms are defined – see new ss 104C to 104I of CTA 2009.

In the case of a large company claimant it comprises (terms defined at new ss 104J to 104L CTA 2009):

- Qualifying expenditure on in-house direct R & D;
- Qualifying expenditure on contracted out R & D, and
- Qualifying expenditure on contributions to independent R & D.

Where there is a CT liability, the credit will be offset against this liability, and provisions then allow further set-offs, subject to a restriction to the amount the company spends on workers. The amount may also be surrendered to group companies. The structure of the set off rules is quite complex, but eventually at Step 7 any remaining amount is paid to the company. Payment of the credit is restricted to companies which are a going concern, and any payments due when the company is not a going concern are lost, unless the company returns to going concern status before the last day for amending the CT return for the period.

SME's will qualify for ATL relief if they have R & D expenditure which is :

- Subcontracted R & D,
- Subsidised R & D, or
- Capped R & D.

Companies that wish to benefit from ATL relief will make a claim for the relevant accounting period, until 31 March 2016, after which the existing scheme of relief (130%) will be abolished and ATL will be the only additional relief for R & D activities of large companies. Those companies which prefer to remain within the old system of R & D additional deduction may do so until the scheme terminates.

Example

		Super-deduction		Credit
Turnover		2,400		2,400
Other expenses		(1,000)		(1,000)
R&D expenditure	1,000		1,000	
ATL credit	(-)	(1,000)	(100)	(900)
		400		500
Super-deduction		(300)		-
Taxable		100		500
Tax at 23%		23		115
ATL credit		-		(100)
CT payable		23		15

1.7 Television and video games tax relief

Section 36 introduces Schs 16 to 18 which are concerned with a new relief for the television and video games sectors.

1.7.1 Television tax relief (Sch 16 FA 2013)

The relief is available to companies within the charge to corporation tax that are directly involved in the production of high end television. These companies will be able to claim additional deductions in computing their profit, and where those deductions give rise to a loss to surrender those losses for payable tax credit.

The scope of the new relief is clearly set out in new s 1216AB to CTA 2009 (the relief is added as Part 15A of that Act). A television programme (or series) is a relevant programme if :

A – the programme is a drama, a documentary, or an animation
B – the programme is not an excluded programme (see below),
C – for programmes other than animation, the slot length is at least 30 minutes, and
D – for programmes other than animation the average core expenditure (as defined in s1216AG) per hour of slot length is not less than £1 million.

Excluded programmes are :

- Advertisements or other promotional programmes
- News, current affairs or discussion
- Quiz, panel and game shows, variety shows and chat shows
- Competitions and contests and results shows
- Broadcast of a live event or theatrical or artistic performance, and
- Training programmes

Productions must be certified by the Department for Culture, Media and Sport as culturally British to be eligible for relief, and must be intended for broadcast. At least 25% of the core expenditure incurred must be UK expenditure.

The additional deduction is 100% of the qualifying expenditure in the UK, subject to a maximum of 80% of the total expenditure, and the payable tax credit is 25% of the losses surrendered. The production of a relevant programme is treated as a separate trade of the company concerned, and a further tax credit may be claimed if there is a surrenderable loss in that trade (as defined by s 1216CH). The amount of tax credit is 25% of the loss surrendered, which can be paid to the company after setting off against corporation tax, PAYE and NIC and tax on visiting performers.

There is some quite tightly drawn anti avoidance legislation which is designed to prevent abuse, and these rules have been informed by the film production relief which has now been available for six years.

1.7.2 Video games tax relief (Sch 17)

This relief is very similar to television relief, with a video games company making the election. Only one company can be regarded as the developer of a game, and in collaborations, it is the company with the larger part that will claim the relief.

The definition of a video game specifically includes the soundtrack, but excludes games produced for promotional or advertising purposes, and anything produced for the purposes of gambling. Each video game under development will be regarded as a separate trade of the company.

Qualifying video games must be intended for supply, and must be certified by the Secretary of State as a British video game; Regulations will prescribe this “cultural test”. Once again, at least 25% of the core expenditure must be incurred in the UK.

The relief available – 100% of the expenditure in the UK, but subject to a limit of 80% of the total expenditure, and the provision for a payable tax credit duplicate the rules described above.

Schedule 18 provides consequential amendments in relation to both reliefs.

1.8 Relief for employee share acquisitions

Section 40 tightens up the rules in relation to corporation tax deductions in relation to employee share schemes.

The main section providing relief (section 1038 CTA 2009) is replaced by a new s 1038, which reinforces that if relief is available under Part 12 CTA 2009, then no other relief is available in respect of the same costs (the cost of the provision of shares, share options or any related matter), either in the period of the date of acquisition or periods before or after that date. New s 1038A is introduced, excluding relief when the shares are not taken up or when the options lapse.

The changes are intended to counter a change in GAAP which requires companies to account for an expense in these situations; there has been a view that the costs are claimable under GAAP and also under old s1038. While HMRC continues to dispute this argument, the change puts this beyond doubt.

1.9 Community amateur sports clubs

Schedule 21 makes amendments to the CASC rules, amending the qualifying rules, and introducing a number of extra conditions.

1.9.1 Open to the whole community

First, the meaning of "open to the whole community" has been redefined. The relevant part of the definition is in s 659(1)(c) CTA 2010, which relates to the costs of membership. This previously said "its fees (if any) do not represent a significant obstacle to membership or use of its facilities. This now reads:

"*The costs associated with membership of the club for any year* do not represent a significant obstacle to membership of the club, use of its facilities *or full participation in its activities.*" (italics added to identify the changes).

Specifically, it is envisaged that there will be a maximum annual charge specified by the Treasury in secondary legislation, together with a definition of the term "full participation in its activities", and a method for calculating the annual cost of membership.

1.9.2 Organised on an amateur basis

The definition of "organised on an amateur basis" in s 660 CTA 2010 is also amended. The changes mainly introduce a limit on the number of paid players, with the number of paid players at any time, the number for the whole year, the amount for a single player for the year and the total amount for the year all being subject to a specified maximum which is to be given by Treasury Order. A further amendment allows payments in respect of travel to away matches to now include subsistence in relation to away matches.

1.9.3 Social only members

Once again, secondary legislation will specify a limit (as a proportion) on the number of social members – that is those who do not participate in the sporting activities of the club. Clubs with excess social membership will no longer qualify for exemptions as a CASC.

1.9.4 Income limits / exclusions

Regulations will provide for a maximum amount of income that can be received by a club in a period, or the maximum amount of a particular type of income. They may also provide that clubs may not receive income of a specified type and retain their exemption.

1.9.5 Commencement

A commencement order will be issued once the relevant secondary legislation has been written.

1.10 Disincorporation relief

FA 2013, ss 58 to 61 introduce a simple disincorporation relief which will be available for a limited period of five years, in relation to business transfers on or after 1 April 2013; the relief is effective from the date of Royal Assent. It is available on a claim jointly by the company and all of the recipient shareholders, which must be made within two years of the date of transfer; the claim is irrevocable.

1.10.1 Conditions

The qualifying conditions for a business transfer to attract relief are set out in s 59 FA 2013. Five conditions must be met:

A - the business is transferred as a going concern
B - the business is transferred together with all of the assets of the business, or all of the assets other than cash
C - the total market value of the qualifying assets (goodwill and an interest in land not held as trading stock) does not exceed £100,000
D - all of the shareholders to whom the business is transferred are individuals
E - each of those shareholders held shares in the company for the period of 12 months up to the transfer date

1.10.2 Effect of the relief

The relief allows the company to transfer goodwill and an interest in land to the shareholders without incurring capital gains tax in the company.

New s 162B of TCGA 1992 provides that where a valid claim has been made, the disposal and acquisition of any qualifying asset of the business is deemed to be for consideration equal to the lower of:

- The sums allowable under s 38 (acquisition and disposal costs)as a deduction in computing the gain accruing to the company on the relevant disposal, and
- The market value of the asset

However, if the relevant asset is post FA 2002 goodwill (on which amortisation would have qualified as a deduction for corporation tax) the deemed disposal value and acquisition cost is the lower of:

- The tax written down value of the goodwill, and
- Its market value.

Where, however, no tax relief has been claimed, the value is the lower of cost and market value.

Example

Padre Electrical Ltd is a business which deals with electrical and wiring problems in homes and offices. Profits have been stable at around £20,000 per annum. The company has one shareholder (Padre).

The table below details the financial position of the company (S162 TCGA 1992 relief was disclaimed when Padre incorporated his sole trading business):

	Value at incorporation	**Current value**
	£	£
Goodwill	10,000	40,000
Trade premises	23,000	50,000
Machinery and plant	8,000	14,000
Debtors	4,000	9,000
Cash	5,000	7,000
	£50,000	£120,000

Padre Electrical Ltd is essentially a one-man company with the proprietor, Padre, having difficulty understanding that his company is a separate legal entity. Consequently, there have been tax issues relating to Padre's overdrawn director's loan account and additional annual accountancy fees outweighing any tax savings which had been highlighted to him when he incorporated.

Padre would now like to disincorporate.

Assume that Padre's business originally started before 1 April 2002 and was incorporated 10 years ago.

The position without disincorporation relief is:

Tax charge on company

		£	
Gain on goodwill		30,000	
Gain on premises		27,000	
		57,000	
Less:	Indexation allowance (say):		
	£33,000 x 0.400	13,200	
		£43,800	@ 20% = £8,760

Tax charge on Padre with formal winding up

		£	
Distribution (120,000 – 8,760)		111,240	
Less: Cost	50,000		
		61,240	
Less:	Annual CGT exemption	10,900	
		£50,340	@ 10% = £5,034

The total tax bill will be £8,760 + £5,034 = £13,794.

1.11 Tax on disposal of high value property by companies

Schedule 25 introduces a charge to tax on companies making disposals of property which is subject to the ATED regime – that is broadly, residential property with a value of more than £2 million which is owned by a company or other non-natural person. However, companies based in the UK would in any event be liable to tax on a gain, so the new rules affect non-resident companies which have not previously been chargeable on these gains.

The exemptions which apply to the new ATED regime (dealt with later) also apply to this regime (and indeed to the 15% rate of stamp duty land tax) so the regimes are all aligned in terms of scope of charge. The new tax charge applies only to gains accruing from 6 April 2013, and adjustments are made to remove any pre 2013 gains.

The rules are quite complex, and provide not only for a tax charge to arise on a disposal, but also limit the way in which losses can be used on relevant assets (that is, those with a cost in excess of £2 million but for which the proceeds are less than £2 million). There is also a restriction on the amount of loss that is available in any event by limiting the proceeds to £2 million plus £1. Essentially the only relief for these losses is to set against similar gains – and that is the only relief provided for against chargeable gains by the Act. The amendments move the scoping provisions into section 2 of TCGA by adding new ss 2B to 2F.

1.12 Capital allowances – Northern Ireland

Section 67 aligns the rules for capital allowances on energy saving plant and machinery with those in operation in the rest of the UK by removing the 100% first year allowance in respect of assets subject to the renewable heat incentive scheme and (if subsequently implemented in Northern Ireland) the Feed in tariff for electricity generation.

1.13 Capital allowances on cars

Two changes announced previously are enacted by section 68, as follows :

- The qualifying emissions for 100% FYA's reduced to 95g/km on 1 April 2013; the new limit will apply until 31 March 2015. The allowance will not be available to leasing companies (unlike the existing 100% FYA). The allowance only applies to new cars.
- The emissions threshold relating to the main pool (18% WDA) will reduce to 130g/km on 1 or 6 April 2013 – that is for expenditure on or after that date. Cars with emissions of more than this amount will be special rate expenditure and only qualify for 8% WDA. Cars which are leased will be subject to a 15% add back of lease costs for tax purposes based on the same limit, but in relation to leases commencing on or after 1 April 2013 for companies and 6 April 2013 for income tax businesses.

Budget 2013 further announced that the 100% relief for the purchase of a new car emitting no more than 75g/km will be extended from 1 April 2015 for a period of three years, until 31 March 2018. Both this allowance and the 130g/km for main rate cars will be reviewed in 2016. None of these proposals have yet been enacted.

1.14 Gas refuelling stations

The 100% allowance available in respect of expenditure on gas refuelling facilities has been extended to 31 March 2015 by FA 2013, s 69.

1.15 General exclusions from 100% allowances

The exclusion of ships and railway assets from qualifying for 100% first year allowances has been removed, in recognition that the previous favourable tax treatment awarded to such assets has now ceased.

1.16 Lease premium relief

Schedule 28 relates to the relief allowed in the accounts of a trader when a premium is paid in respect of a short lease. Currently, there is a deemed deduction for the amount assessed on the landlord as property income (old Sch A). Where the lease exceeds 50 years, there is normally no property income assessment, unless the term of the lease is affected by Rule 1 of ITTOIA 2005, s 303 or CTA 2009, s 243. In both of those cases, the lease is deemed to have a shorter duration than it technically has. Where Rule 1 applies, a property income charge will arise, but Sch 28 ensures

that no deduction is available in respect of the premium if the lease term would otherwise have exceeded 50 years.

1.17 Rules relating to prohibition and allowance of deductions

There is a basic underlying structure to the rules for computing profits or a trade, property business or similar. The structure provides a hierarchy so that when rules allowing a deduction and prohibiting a deduction conflict, the rules allowing the deduction take precedence.

Section 78 seeks to reverse this principle when the amounts concerned arise directly or indirectly in consequence of or otherwise in connection with relevant tax avoidance arrangements. The changes apply to both ITTOIA 2005 and CTA 2009.

1.18 Close company loans to participators

Anti-avoidance legislation has been introduced to close three loopholes with effect from **20 March 2013**. The changes, which are in Schedule 30:

- Charge close companies on loans they make to participators through intermediaries;
- Charge close companies on other payments they make to participators through intermediaries, and
- Update the repayment rules with an anti-avoidance provision.

Replacement subsection 455(1), CTA 2010 sets the scope of the legislation as follows:

"This section applies if a close company makes a loan or advances money to—

(a) a relevant person who is a participator in the company or an associate of such a participator,
(b) the trustees of a settlement one or more of the trustees or actual or potential beneficiaries of which is a participator in the company or an associate of such a participator, or
(c) a limited liability partnership or other partnership one or more of the partners in which is an individual who is—
    (i) a participator in the company, or
    (ii) an associate of an individual who is such a participator."

This ensures that s 455 bites when the loan or advance is made through a partnership or trust.

New s 464A imposes a 25% tax charge when a close company is party to tax avoidance arrangements, the result of which is to confer a benefit on a participator or an associate of a participator. This applies unless tax is due on the benefit, or s 455 applies to the benefit. This tax charge is also subject to relief under new s 464B where a return payment is made to the company for no consideration. The relief is given in the same way as relief against the s 455 charge.

Practical impact

Introducing a corporate partner into a partnership has been popular for many years and has significant tax advantages for profitable partnerships.

Invariably the partners will also be the owners of the company and as such the profit earned by the business will essentially stay in the same ownership – albeit with a significant element of the profit routed through a company.

The principle tax advantage is securing a lower tax rate on a significant part of the partnership profits.

There are other advantages which include holding cars in the partnership rather than the company so as to avoid any benefits in kind on the partners cars.

Example 1

ABC partnership has three partners – Mr A, Mr B and C Limited. C Limited is owned by Mr A and Mr B.

Mr A drives a Range Rover Sport (£60,000 new) and Mr B drives a BMW X5 (£55,000 new). Both cars are held in the partnership and are used for business and private purposes.

The profit for the year to 31 March 2013 was £400,000. This has been allocated as £50,000 to Mr A, £50,000 to Mr B and £300,000 to C Limited.

C Limited will pay corporation tax at 20% on its profit share. Had the £400,000 profit been allocated to Mr A and Mr B they would have been exposed to the 40% and 45% income tax rates.

In using a corporate partner the partners have avoided a car benefit and halved their immediate tax rates on the £300,000 routed through the company. They still have to extract their profits from the corporate but this could be done when the profits of the partnership are at a lower level or indeed as a capital distribution at a later stage.

<u>Volatile profit levels</u>

Partnerships with volatile profit levels may be attracted to such arrangements. A farming partnership for example could make £50,000 in one year and £500,000 in the next year. Sheltering the good years from the higher rates of income tax would be sensible – especially when a bad year could be just around the corner.

In the bad years the partners can draw dividends from the company.

<u>Working capital requirements</u>

Many businesses structure themselves in this way so as to improve their working capital position. The excess profits are allocated to the company which would then pay corporation tax at 20%. The company will often draw in the region of 20% of their profit allocation – so as to cover their corporation tax liability. The remaining 80% would be left in the partnership so as to fund their working capital requirements. The company invariably has a large capital account in the partnership when using this structure for working capital requirements.

One issue for such partnerships is that they will not be entitled to an Annual Investment Allowance so there is a downside to this structure if the business has significant capital requirements.

<u>Deferred bonus arrangements</u>

Many professional partnerships have adopted this structure. In some sectors significant bonuses are available but the business is keen to reward long term

growth rather than pay out a bonus based on one years performance. By using a corporate partner you can reduce the immediate tax liability until such a time as the bonuses are withdrawn from the company.

Overdrawn partners current accounts

In many cases the corporate partner would only take enough of their profit allocation to cover its corporation tax liability on their allocation. The 80% is left in the partnership and the other partners draw on this sum – effectively making their own current accounts go overdrawn. In many cases the corporate partners current account in the partnership could be significant and likewise the partners current accounts significantly overdrawn! Their intention might be to liquidate the company at some stage and then use their capital distribution from the company to repay their overdrawn current account

Example 2

XYZ partnership has three partners – Mr X, Mr Y and Z Limited. Z Limited is owned by Mr X and Mr Y.

The partners' current account for the year to 31 December 2012 was as follows:

	Total	Mr X	Mr Y	Z Limited
At 1 January 2012	20,000	(500,000)	(450,000)	970,000
Profit for the year	400,000	50,000	50,000	300,000
Drawings	(360,000)	(150,000)	(150,000)	(60,000)
At 31 December 2012	60,000	(600,000)	(550,000)	1,210,000

In can be seen that Mr X and Mr Y are enjoying the use of the partnership profits without paying the top rates of income tax. Eventually Z Limited will be liquidated and Mr X and Mr Y will use their capital distribution to repay their overdrawn partnership current accounts.

Any capital distributions from the company should be taxed at 10% on Mr X and Mr Y.

Where a "replacement" company is planned, clearance should be sought so as to ensure HMRC will not apply the phoenix company rules to the distributions i.e. treat them as income rather than capital.

New Anti-avoidance rules on loans made by close companies

Where a close company makes **a loan or advance on/after 20 March 2013**, s.455 CTA 2010 is now extended to apply if the loan is to:

1. Trustees, where one or more of the trustees, or actual or potential beneficiaries of the settlement, is a participator in the company (or an associate of such a participator); or
2. An LLP or other partnership, one or more of the partners in which is an individual who is a participator in the company (or their associate).

There will be exceptions to the extended scope of the charge, for example for loans made in the ordinary course of a credit business. The provisions giving relief for loans written off or repaid will apply in the normal way.

Scenario 1 will catch loans to Employee Benefits Trusts (EBTs) where beneficiaries (actual or potential) are also participators in the company. EBTs were always caught when they owned shares in the company but these new rules mean that they need not hold shares to be caught.

Scenario 2 will catch loans from a corporate partner back to the LLP of which they are a member. Prior to this change, the lending of money by a corporate partner to the LLP was not regarded as a loan to a participator – it was to the LLP rather than to the individual partners.

In both instances it is important to appreciate that the new rules only apply to loans or advances on or after 20 March 2013. Any loans or advances prior to that date are not caught and as a result can remain outstanding with no s.455 CTA 2010 implications.

<u>Other Transfers of value</u>

HMRC is concerned that the s.455 rules are being avoided by transferring value to participators in other ways. This could include, for example, a situation where

- an LLP is formed by the participator and the close company;
- the close company makes a contribution to the LLP, or leaves profits undrawn in the LLP;
- amounts are then drawn down from the LLP by the participator that are not loans or advances made by the company to the participator.

This sort of arrangement (outlined in Example 2 above) means that the participator will have an overdrawn current account in the LLP, funded by the corporate member.

Part 10 of CTA 2010 is therefore amended to catch arrangements where value is extracted from a close company and the benefit is conferred (directly or indirectly) on a participator (or their associate). A s.455 charge will arise on the value extracted (at the normal 25% rate) where the arrangement

- is not already subject to a s.455 charge; and
- is not chargeable as income of the participator.

Note that there appears to be no restriction on the term “benefit” in the new legislation (s.464A), so it could be interpreted very widely by HMRC.

This change has effect in relation to **arrangements to which a close company becomes a party on or after 20 March 2013**. Relief will be available if the value is returned by the participator for no consideration.

It would therefore appear that any overdrawn loan account as at 19 March 2013 will not be subject to these new rules.

It may be worth considering creating a pre and post change current account in the nominal ledger of the business. In example 2 above all the partners drawings to 19 March 2013 could be added to the pre-change current account. The resultant current account balance as at 19 March 2013 will not create a s.455 liability in the corporate partner.

Example 2 (contd)

The partners' current account as at 19 March 2013 could be as follows:

	Total	Mr X	Mr Y	Z Limited
At 1 January 2013	60,000	(600,000)	(550,000)	1,210,000
Profit for the year	Nil	Nil	Nil	Nil
Drawings	(60,000)	(30,000)	(30,000)	Nil
At 19 March 2013	Nil	(630,000)	(580,000)	1,210,000

There should not be any profit allocation to account for in the period to 19 March 2013 as this will not arise until after the year end when the profit is determined and allocated to the partners current accounts.

Mr X has an overdrawn current account as at 19 March 2013 of £630,000 whilst Mr Y has an overdrawn account of £580,000 at the same date. In my opinion these should be ring fenced as current account 1 in the books and records of the company. Any future drawings and profit allocations should be allocated to current account 2. Providing current account 2 is not overdrawn at the key s.455 dates then the company will not have any s.455 tax to pay.

For those partnerships with a 31 March 2013 year end it is quite likely that no account is taken of any profit for that year when calculating the current account balance at 19 March 2013. The profit is not known or indeed allocated until the year has finished. Logically you might expect the profit to accrue evenly during the year but that is not my understanding of how HMRC would expect the rules to apply. The taxpayer then gets the advantages of posting drawings to the current account up to the 19 March 2013 but not being required to post profit until after 31 March 2013. This will maximize the overdrawn current accounts as at 19 March 2013.

New s 464C deals with repayments and limits relief for repayments under certain circumstances. It denies repayment relief for the s 455 tax where repayments and re-drawings are made within a short time of each other, or where there are arrangements or an intention to make further chargeable payments at the time the repayment is made (and there are subsequent re-drawings) as follows: (note that the legislation here was changed quite significantly by a Government amendment to the Finance Bill)

"(1) Where –

(a) within any period of 30 days –

(i) the qualifying amount of repayments made to a close company in respect of one or more chargeable payments made by the company to a person totals £5,000 or more, and

(ii) the available amount *(see below)* of the relevant chargeable payments made by the company to the person or an associate of the person totals £5,000 or more, and

(b) the relevant chargeable payments are made in an accounting period subsequent to that in which the chargeable payments mentioned in paragraph (a)(i) were made,

the qualifying amount of the repayments, so far as not exceeding the available amount of the relevant chargeable payments, is to be treated for the purpose of this Chapter as a repayment of the relevant chargeable payments."

So what Subs (1) deals with is an outstanding loan ("chargeable payments made by the company in (a)(i)) with repayments of £5,000 or more, and further payments made by the company within 30 days totalling £5,000 or more made in the following accounting period to the original loan. This targets movements across a year end, rather than within the period. The term "available amount" is crucial here. This is defined (for this purpose) as an amount contained in a chargeable payment to the extent that no repayment has been treated as made in respect of it by the previous operation of Subs (1).

The following terminology may help:

"Repayments" – amounts paid by the participator to the company in respect of an outstanding amount of a loan
"chargeable payments" – amounts paid to the participator by the company which would trigger a charge under s 455
"relevant chargeable payments" – amounts paid by the company to the participator which remain outstanding at the end of the 30 days period; (the available amount is any amount not treated as repaid already).
"qualifying amount" (of a repayment) – amounts not so far treated as a repayment.

So subs(1) limits the amount of the repayment which is effective for relief by restricting it to the net amount when the conditions apply.

However, where the repayment gives rise to a charge to income tax on the borrower, the repayment restriction will not bite, and any re-drawing will be treated as a separate loan.

The second restriction applies to larger loans.

"(3) Where –

(a) immediately before a repayment is made in respect of one or more chargeable payments made by a close company to a person, the total amount owed to the company by the person in respect of chargeable payments is £15,000 or more,

(b) at the time the repayment is made, arrangements had been made for one or more chargeable payments to be made to replace some or all of the amount repaid, and

(c) the available amount of the chargeable payments made by the company to the person or an associate of the person under the arrangements totals £5,000 or more,

the qualifying amount of the repayments, so far as not exceeding the available amount of the chargeable payments mentioned in para (c), is to be treated for the purpose of this Chapter as a repayment of those chargeable payments."

Here, the available amount of a chargeable payment is an amount not treated as a repayment by virtue of either subss (1) or (3). This is simpler to follow, and deals with the situation where repayments are made against an outstanding balance of £15,000, where arrangements have been made to repay at least £5,000 of those repayments subsequently. It reduces the repayment for relief purposes to the net amount.

Example

A Ltd is a close company in which Ian, an individual, is a participator. A Ltd's accounting period ends on 31 March 2013. On 25 March 2013 Ian borrows £15,000 from A Ltd. If the loan is not repaid within nine months and a day of the end of the accounting period, A Ltd must pay a tax charge under s.455 of £3,750. On 1 December 2013, a dividend of £9,000 is declared by A Ltd on which Ian is chargeable to income tax. On the same day, Ian repays the remaining £6,000. On 10 December 2013 Ian borrows £3,500 from the company. On 15 December 2013 Ian withdraws a further £2,000 from the company.

For the 30 day rule, there was a loan outstanding of £15,000 and of that £9,000 was repaid (by way of the application of a chargeable dividend towards the amount of the loan) with a loan outstanding of £6,000. Ian repays the £6,000 which is greater than the £5,000 de minimis limit for repayments. Nine days later and fourteen days later respectively, so within the 30 day period, Ian withdraws a further £5,500 (£3,500 + £2,000) which is also in excess of the £5,000 de minimis limit for redrawals. The amount redrawn (£5,500) is less than the amount repaid (£6,000) so it is the redrawn amount which is relevant for determining the amount of relief denied under s.464C.

Example

Tom, a participator in a close company, B Ltd, owes the company £25,000 which he drew on 1 June 2013 during the accounting period ending 30 June 2013. Tom borrows £25,000, on terms of a 31 day loan, from the bank and repays the loan to the close company using the bank loan. 31 days after the repayment to the close company, Tom withdraws £30,000 from the company as a new loan and repays the bank. At the time of the repayment, Tom had made arrangements to withdraw a new payment (i.e. to repay the bank loan) so relief would be denied for the lower amount of £25,000.

1.19 Deferral of CT exit charges

When an exit charge arises due to a company or group becoming non UK resident, there is a charge to tax "the exit charge". This is incompatible with EU freedom of establishment rules, and the UK Government has been challenged over this. Schedule 49 makes arrangement for deferral of the charge and for payment arrangements (payment plans) to be put in place to spread the charge, but many commentators believe that this is insufficient.

1.20 Partnership consultation document

A consultation document has been published on two aspects of the partnership rules which has a closing date for comments of 9 August 2013.

The proposals which were announced at Budget 2013 are directed at:

- removing the presumption of self-employment for some LLP members to tackle the disguising of employment relationships through LLPs; and
- countering the manipulation of profit and loss allocations (by some LLPs and other partnerships) to achieve a tax advantage.

Salaried members of LLPs

Current tax rules mean that individuals who are members of an LLP are taxed as if they are partners in a partnership established under the Partnership Act 1890, even if they are engaged on terms closer to those of employees. The government believes that LLPs are being used and marketed as a means of disguising employment and thus avoid employment income tax and NICs.

The following changes have been proposed:

- remove the presumption that all individual LLP members are treated as partners and hence self-employed for tax purposes; and
- set out the factors which will be taken into account in deciding whether an individual member of an LLP should be treated as an employee for the purposes of employment taxes.

This will be achieved by providing that an individual member who meets either of two conditions will be classed as a salaried member and will be liable to income tax and primary Class 1 NICs as an employee. The LLP will become the secondary contributor and be liable to pay secondary NICs.

The first condition is that a salaried member of an LLP is an individual member of the LLP who, on the assumption that the LLP is carried on as a partnership by two or more members of the LLP, would be regarded as employed by that partnership.

The second condition is that a salaried member of an LLP includes an individual member of the LLP who does not meet the first condition, but who:

- has no economic risk (loss of capital or repayment of drawings) in the event that the LLP makes a loss or is wound up;
- is not entitled to a share of the profits; and
- is not entitled to a share of any surplus assets on a winding-up.

The first condition is more akin to the employed v self-employed income tax rules and consequently the test will be well known to practitioners. The second condition is more akin to employment law and will probably be the harder to avoid.

The absence of a variable profit share will be common to many salaried partners i.e. their profit share is fixed irrespective of the results of the partnership. Many of these partners run the risk of being reclassified from 6 April 2014.

The consultation document proposes to void any arrangements which are implemented specifically to avoid the reclassification. For example, where a salaried partner has his fixed share of £50,000 adjusted to £49,000 plus £1,000 if certain (easy) numbers are met. This would not create a true profit share in HMRCs opinion and as such the partner could still be reclassified.

The consultation document suggests that 5% of a partners profit allocation would need to be dependent on partnership results for it to be regarded as a true profit share.

Where reclassification is in point the key tax changes would be as follows:

- PAYE to be applied to the reclassified "salary"
- P11d issues e.g. car benefit
- Salary becomes tax deductible for the partnership

Debates have already started within affected partnerships as to who bears the employers national insurance!

In my opinion this area of the consultation document requires the most debate as it has the potential to catch many commercial arrangements within LLPs.

I can see HMRCs point if managers are appointed partners in an LLP with the primary aim of reducing national insurance but I struggle to see the logic of reclassifying individuals who are progressing – via a salaried partner position – to full equity in due course.

Allocation of partnership and LLP profits and losses

The second area for proposals concern schemes where partnerships allocate profits or losses in order to reduce tax. These schemes often involve partnerships (not just LLPs) where there is a mixture of individual and company members. They relate to all types of partnerships including LLPs, foreign partnerships and entities established in other jurisdictions that are treated for UK tax purposes as partnerships.

The Government's objective is that tax advantages should not arise where there are inappropriate allocations in three distinct types of arrangement:

- Partnerships with mixed members (typically companies and individuals) where profits are allocated to a member that pays a lower rate of tax.
- Partnerships with mixed members where losses are allocated to a member that pays a high rate of tax.
- Partnership arrangements where members reduce their profit entitlement in return for payment made by other members who will be taxed more favourably on those profits.

The proposals do not cover issues 'where family members use partnership structures to allocate profits between them tax efficiently in circumstances such as those considered in the *Arctic Systems* case.'

Example

QPR partnership has three partners – Mr Q, Mrs P and R Limited. R Limited is owned by Mr Q and Mrs R and their spouses.

The partners' current account for the year to 31 March 2015 is expected to be as follows:

	Total	Mr Q	Mrs P	R Limited
At 1 April 2014	50,000	(300,000)	(350,000)	700,000
Profit for the year	330,000	40,000	40,000	250,000
Drawings	(310,000)	(35,000)	(35,000)	(240,000)
At 31 March 2015	70,000	(295,000)	(345,000)	710,000

In the past R Limited had similar levels of profit allocations but drew very little. This enabled Mr Q and Mrs P to draw in excess of their profit share and accumulate large overdrawn current accounts. Since 20 March 2013 this practice is no longer possible without creating a s.455 liability in the company. As a result, all partners have been withdrawing their profit share. R Limited will then pay dividends to its shareholders.

Practitioners will however need to ascertain whether any of the £250,000 profit share to R Limited needs to be reallocated to Mr Q and Mrs P – they effectively own the company and hence the allocation could be tax motivated!

The key will be whether the £250,000 allocation represents a fair return on capital. The company has an opening capital account of £700,000 and under normal commercial principles would expect a return on that money.

A profit allocation of £250,000 represents a return of 35% and will undoubtedly be regarded as excessive. Practitioners will need to determine what they believe a fair return is and then reallocate the balance to Mr Q and Mrs P (as participators of R Limited) in a fair and reasonable manner.

What represents a reasonable return? This is unsecured money so a return in excess of 10% should be justifiable but how high do you go? Would 20% be reasonable for unsecured money?

Post April 2014 these mixed partnerships may not be achieving their original goals and consideration should be given to liquidating the corporate partners, clearing the overdrawn partners' accounts and then incorporating the business. This would achieve more or less the same advantages as mixed partnerships but there will be some downsides e.g. car benefits.

Conclusion

The consultation document needs to be watched very carefully. We should definitely be discussing the issues with clients and our plans to counter the proposals should they become law. We should however not implement any planning measures until we are sure the new rules are going to become law. There will undoubtedly be changes to the consultation document and these changes will need to be considered before we give firm advice to affected clients.

2 PERSONAL TAX

2.1 Personal allowance and tax bands

The personal allowance for 2013-14 is £9,440, an increase over the amount announced at Budget 2012. Budget 2013 announced that the personal allowance will further increase to £10,000 from April 2014.

The basic rate band has been set at £32,010, or total income of £41,450; this is a reduction of £1,025 from last year.

For 2014-15 and 2015-16, the increase in the higher rate threshold will be capped at 1%. Assuming that the relevant inflation measures will exceed 1%, this means that the higher rate threshold will be:

	Personal Allowance	Basic rate band	Higher rate threshold
2012/13	£8,105	£34,370	£42,475
2013/14	£9,440	£32,010	£41,450
2014/15	£10,000	£31,865	£41,865
2015/16	N/k	N/k	£42,285

The starting rate for savings has increased from £2,710 to £2,790 from April 2013.

2.1.1 Implications for profit extraction policy

As a wide gap opens up between the tax threshold and the NIC threshold, it is worth considering profit extraction policies for small companies.

Company profits £40,000 – all profits to be extracted.

1. Salary equal to employee threshold, NIL liability to NIC

Profit	40,000
Salary	(7,696)
Taxable profit	32,304
Corporation tax	(6,461)
Profit after tax = dividend	25,843

There is no additional tax liability, so the total tax and NIC liability is £6,461, at an effective rate of 16%.

2. Salary equal to personal allowance

Profit	40,000
Salary	(9,440)
Employer NIC	(241)
Taxable profit	30,319
Corporation tax	(6,064)
Profit after tax = dividend	24,255

In addition, there is an employee NIC liability of £203. So the total tax and NIC liability is £6,508, or 16.3%. Further increases in the tax or NIC thresholds may lead to increased salaries to benefit from the personal allowance, but at present, payment at the NI threshold is the best outcome.

2.2 Tax exemptions for London Anniversary Games, and Glasgow Commonwealth Games

Accredited competitors in either of the competitions who are not UK resident, or who are subject to split year treatment in the year in which the games take place are not taxable on any income arising from games related activities – either competing or supporting or promoting the games during the period of the games. The specified periods are :

- London Anniversary Games – 21 to 29 July 2013
- Glasgow Commonwealth Games – 4 March 2014 to 3 September 2014

2.3 Expenses of elected representatives

Section 10 inserts new section 393B into ITEPA which provides for similar tax exemption on UK travel expenses as is already provided to Members of Parliament to :

- Members of the Scottish Parliament
- Members of the National Assembly for Wales, or the Welsh Assembly Government, and
- Members of the Northern Ireland Assembly

2.4 “Family” pension contributions

It has been possible to accept a salary sacrifice and have the contribution paid by an employer into the pension arrangements of a family member. Section 11 removes the exemption from income tax if the payment is not made in respect of the employee.

2.5 Definition of a disabled child

The changes to disability benefits have prompted a number of definition changes. Section 12 adds the term “personal independence payment” to the definition used in the childcare tax exemptions (which permit a longer exemption in respect of a disabled child).

2.6 Universal credit

This benefit has been added to the list of tax exempt social security benefits in ITEPA, and will therefore not be taxable on recipients.

2.7 Changes to employee share schemes

Section 14 introduces Schedule 2 which makes a number of changes to the tax advantaged employee share schemes based on the recommendations of the OTS. The changes affect the following schemes:

- Share Incentive Plans (SIP)
- Save As You Earn Option schemes (SAYE)
- Company Share Option Plans (CSOP)
- Enterprise Management Incentive schemes (EMI)

The changes make administration of the schemes easier and are intended to simplify the rules to make them simpler. The key areas of change are :

- Aligning the rules on retirement of holders, and matching these to current policy
- Favourable tax treatment extended to those leaving employment who are classified as “good leavers”, and alignment of treatment across the types of scheme
- Changes to the “material interest” rules which prohibit participation in some schemes. The rules have been abolished for SIP and SAYE schemes with effect from Royal Assent, and definition increased to 30% for CSOP schemes.
- Changes to the rules in relation to restricted shares for all schemes
- A number of changes to SIP schemes, affecting reinvested dividends, partnership shares and Employee share ownership trusts
- A change to EMI schemes to allow employees holding options to exercise them with favourable tax treatment if a disqualifying event occurs.

2.8 Relief for the payment of patent royalties

Tax relief in respect of payments of patent royalties was abolished in respect of payments made on or after 10 December 2012. Section 15, FA 2013 makes the change to ITA 2007, ss 448 and 449 relating to individuals and other persons respectively.

2.9 Limit on income tax reliefs

These provisions are in s 16 and Sch 3. The limit (or cap) applies to reliefs that are deducted from income under ITA 2007, s23 at Step 2. Those reliefs that do not have a limit on them individually will be restricted in total so that an overall limit of the greater of £50,000 or 25% of income applies. The main reliefs that are affected are trade and property loss reliefs and qualifying loan interest relief. The restriction applies to all losses for which relief is sought in 2013/14 and later years, and in respect of losses incurred in 2013/14 and later years.

Para 6 of Schedule 3 lists the reliefs which are affected in detail, as follows:

(a) relief under section 64 (trade loss relief against general income);
(b) relief under section 72 (early trade losses relief);
(c) relief under section 96 (post-cessation trade relief);

(d) relief under section 120 (property loss relief against general income);
(e) relief under section 125 (post-cessation property relief);
(f) relief under section 128 (employment loss relief against general income);
(g) relief under Chapter 6 of Part 4 (share loss relief);
(h) relief under Chapter 1 of Part 8 (interest payments);
(i) relief under section 555 of ITEPA 2003 (deduction for liabilities relating to former employment);
(j) relief under section 446 of ITTOIA 2005 (strips of government securities: relief for losses);
(k) relief under section 454(4) of ITTOIA 2005 (listed securities held since 26 March 2003: relief for losses: persons other than trustees).

Para 7 lists those reliefs that are unaffected by the cap:

(a) allowances under Part 3A of CAA 2001 (business premises renovation allowances);
(b) deductions for amounts of relief under a provision mentioned in subsection (6)(a) to (e) so far as made from profits of the trade or business to which the relief in question relates;
(c) deductions for amounts of relief under the provision mentioned in subsection (6)(a) or (b) so far as attributable to a deduction allowed under section 205 or 220 of ITTOIA 2005 (deduction for overlap profit in final tax year or on change of accounting date);
(d) deductions for amounts of relief under the provision mentioned in subsection (6)(g)—
    (i) where the shares in question fall within section 131(2)(a) (qualifying shares to which EIS relief is attributable), or
    (ii) where SEIS relief is attributable to the shares in question as determined in accordance with Part 5A (seed enterprise investment scheme).

Technically, these amounts (para 7) are deducted from the total of amounts listed in para 6, the result being subject to the limit of £50,000 or 25% of the income.

2.9.1 Practical summary

- The restriction of set off of trade loss relief against general income will not include relief for overlap profits (and transitional overlap profits) and business premises renovation allowance (BPRA) both of which may be claimed in full without limit.
- The restriction for property losses available against general income (losses arising as a result of capital allowances or certain agricultural expenses) will similarly exclude BPRA which may be claimed in full.
- Relief for losses in the first four years of trade will also be affected, as will post cessation loss reliefs (both trade and property)
- Income tax relief for losses on shares will also be restricted
- The restriction will not apply to the set off of losses brought forward against profits of the same trade or property business.

Examples

Jack's total income in 2013/14 is £160,000. He claims relief for trade losses of £75,000 made in 2013/14 against his total income in 2013/14. Jack's relief limit in 2013/14 is £50,000 as this is the greater of £50,000 and 25% of his income (which is £40,000).

Jill's total income in 2013/14 is £400,000. She claims relief for qualifying loan interest arising in 2013/14 of £125,000. Jill's relief limit is £100,000 as 25% of her income is greater than £50,000.

2.9.2 Calculation of adjusted total income

The measure of income used in the limit is referred to as the adjusted total income. This is calculated in four steps as follows :

Step 1

Total income for the tax year

Step 2

Add back deductions made under the payroll giving rules in arriving at the income for the year

Step 3

Deduct the gross amount of any contributions to pension schemes for which relief has been given at source (ref FA 2004 s 192)

Step 4

Deduct relief for pension contributions to be given as excess relief under net pay arrangements or relief on making a claim (ref FA 2004, ss 193(4) and 194(1)).

The result of these 4 steps is the adjusted total income for the tax year, to which the 25% limit is applied. Clearly, it is only necessary to perform this calculation for taxpayers with total income in excess of £200,000.

Example

Tony has income of £500,000. He pays £60,000 pa into a pension scheme.

Assuming that he makes the contribution (i) thorough the net pay arrangements or (ii) into a personal pension plan with basic rate relief at source. His adjusted total income for the purposes of applying the limit will be computed as follows:

	(i)	(ii)
Total income	440,000	500,000
Adjustment to total income	0	(60,000)
Adjusted total income	440,000	440,000

2.10 Remittance basis : Employment duties performed in the UK and overseas

Section 19 introduces Sch 6 which deals with employments where the duties are performed both in the UK and overseas, the taxpayer is UK resident and has made an election for the remittance basis in the relevant year. Sch 6 introduces new s41ZA which determines the income chargeable on an individual in these circumstances.

Section 41ZA opens with a requirement that amounts determined must be on a just and reasonable basis. The rules go on to establish how deposits into a qualifying account are treated for the purpose of the remittance basis rules, and are the enactment of measures previously applying under SP1/09 to mixed funds. The change affects transfers in 2013-14 onwards.

The new rules identify all remittances which fall into S809L ITA 2007 (UK remittances with further conditions – see s809RA(6)) and treat them as a single remittance at the end of the year – these are termed Condition A transfers. All other remittances are similarly treated as a single remittance - an offshore transfer - at the end of the year. Existing rules (ss 809Q(3) and 809R (4)) are then used to determine the composition (income or gains) of each transfer; the treatment of transfers in this way is only used for these purposes and not for any others. The proportions arrived at are then applied to the individual transfers made during the year.

A qualifying account is nominated by the taxpayer, and commences when at least £10 of general earnings is paid into the account in a tax year in which the individual performs duties both in the UK and overseas. It must be an ordinary bank account in the taxpayer's name. Nomination is done in writing and can be changed at will by the taxpayer, although only one nominated account is available at any time. The rules specify how to deal with a nominated account for a part year.

A qualifying account ceases to be covered by these rules if money other than employment income, interest or the proceeds of the sale of employment related securities (under certain circumstances – see s 809RD(7)) is paid into it. Any other money is known as a prohibited sum, and breaches the deposit rule.

It is possible to rectify up to two breaches in a tax year by withdrawing the funds in a single transfer within 30 days of discovering the breach, but a third breach cannot be rectified, so the account ceases to be a qualifying account with effect from the ***start*** of the tax year. Note that all breaches up to the date of discovery count as a single breach if rectified within the 30 days by a single transfer.

2.11 Remittance Basis : exempt property

Section 20 introduces Sch 7 which deals with exempt property for the remittance basis. The changes make some relaxations to the existing rules, as follows:

- Existing s 809Y ITA 2007 provides for a remittance to be treated as occurring when exempt property loses its exempt status. The amendments provide that if exempt property is lost, stolen or destroyed, this will not constitute a remittance (including property subject to the temporary importation rule in s 809Z4. Further, if compensation is paid in respect of the loss, that will not be regarded as a remittance provided it is taken offshore or used to make a qualifying investment (with associated claim for relief by the due date) within 45 days.
- Existing s 809Z ITA 2007 allows property which is subject to public access to be treated as exempt property, but the rule applies only to works of art, collectors' items and antiques. This latter requirement has been repealed, and although that would seem to open the door to some dubious practice, the object must still be on display at an "approved establishment" such as a museum or art gallery approved under VAT rules.

2.12 Remittance basis – payments on account

S 21 FA 2013 applies the remittance basis rules to payments on account under self assessment. It is well-known that the remittance of a remittance basis charge from a non UK bank account directly to HMRC to pay the remittance basis charge (RBC) of either £30,000 or £50,000 is not treated as a remittance for tax purposes. However, the position with payments on account can be complex, and s 21 seeks to regularise the position.

Where funds are remitted from abroad direct to HMRC and are used to make payments on account (but only that proportion which relates to the RBC) in a year in which no RBC is due, but where it was due in the preceding year the amounts so remitted will not be treated as a remittance where the amount is moved offshore by 15 March after the end of the later year, or such later date as the Commissioners may allow, after a claim. The change applies to payments on account in respect of 2013-13 and later years.

2.13 IR 35 and controlling persons legislation

The outcome of the consultation on this topic was most gratifying. Government has abandoned the proposals for “controlling persons” legislation, and has made a small amendment to the IR35 legislation to make clear that the legislation applies to office holders for tax purposes (it already applies to office holders for NIC purposes). This amendment made by section 22 FA 2013.

2.14 Company car taxation

The rates of benefit in kind on company cars were announced in Budget 2012, with rate set through to 2016/17. Budget 2013 included further announcements on the tax rules for low emission cars which supplement the announcements already made. The new announcements in 2013 are :

- From 2015/16 cars in a new band of 0 – 50 g/km of CO_2 will be taxed at 5% of list price;
- From 2015/16 cars in a band of 51 – 75 g/km of CO_2 will be taxed at 9% of list price.
- As previously announced, the bottom rate in 2015/16 will be 13%, applying to cars emitting more than 75 g/km of CO_2
- From 2016/17 the relevant percentages will be 7% (0-50g/km) and 11% (51 – 75g/km). The minimum rate applying to other cars will be 15% at that time.
- The 4% differential between the three bottom bands will be retained from 2015/16 to 2016/17. After that the differential will reduce to 3% in 2017/18 and 2% in both 2018/19 and 2019/20.

The following Table indicates the level of benefit as a percentage of list price.

<table>
<tr><th>Emissions (g/km)</th><th>2012/13</th><th>2013/14</th><th>2014/15</th><th>2015/16</th><th>2016/17</th></tr>
<tr><td>Zero</td><td>0%</td><td>0%</td><td>0%</td><td rowspan="2">5%</td><td rowspan="2">7%</td></tr>
<tr><td>1 - 50</td><td>5%</td><td>5%</td><td>5%</td></tr>
<tr><td>51 - 75</td><td>5%</td><td>5%</td><td>5%</td><td>9%</td><td>11%</td></tr>
<tr><td>76 - 79</td><td>10%</td><td>10%</td><td>11%</td><td>13%</td><td>15%</td></tr>
<tr><td>80</td><td>10%</td><td>10%</td><td>11%</td><td>13%</td><td>15%</td></tr>
<tr><td>85</td><td>10%</td><td>10%</td><td>11%</td><td>13%</td><td>15%</td></tr>
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<tr><td>95</td><td>10%</td><td>11%</td><td>12%</td><td>14%</td><td>16%</td></tr>
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<tr><td>105</td><td>12%</td><td>13%</td><td>14%</td><td>16%</td><td>18%</td></tr>
<tr><td>110</td><td>13%</td><td>14%</td><td>15%</td><td>17%</td><td>19%</td></tr>
<tr><td>115</td><td>14%</td><td>15%</td><td>16%</td><td>18%</td><td>20%</td></tr>
<tr><td>120</td><td>15%</td><td>16%</td><td>17%</td><td>19%</td><td>21%</td></tr>
<tr><td>125</td><td>16%</td><td>17%</td><td>18%</td><td>20%</td><td>22%</td></tr>
<tr><td colspan="6">And then in increments of 5g = 1% until</td></tr>
<tr><td>185</td><td>28%</td><td>29%</td><td>30%</td><td>32%</td><td>35%</td></tr>
<tr><td>190</td><td>29%</td><td>30%</td><td>31%</td><td>33%</td><td>35%</td></tr>
<tr><td>195</td><td>30%</td><td>31%</td><td>32%</td><td>34%</td><td>36%</td></tr>
<tr><td>200</td><td>31%</td><td>32%</td><td>33%</td><td>35%</td><td>37%</td></tr>
<tr><td>205</td><td>32%</td><td>33%</td><td>34%</td><td>36%</td><td>37%</td></tr>
<tr><td>210</td><td>33%</td><td>34%</td><td>35%</td><td>37%</td><td>37%</td></tr>
<tr><td>215</td><td>34%</td><td>35%</td><td>35%</td><td>37%</td><td>37%</td></tr>
<tr><td>220</td><td>35%</td><td>35%</td><td>35%</td><td>37%</td><td>37%</td></tr>
</table>

The addition of 3% for diesel engines continues until 2016/17, at which point it will be abolished.

Most of these amendments are made by section 23 FA 2013, although the changes for 2016/17 and later have yet to be legislated for.

2.15 Life assurance policy gains

Where an individual has been resident outside the UK for tax purposes for some part of the duration of a life insurance policy contract, current legislation allows the time apportionment of the gain only where the policy is issued by a foreign insurer. Section 24 and Sch 8 extend the time apportionment principle to UK insurers, so that only the portion of the gain relating to UK residence is chargeable. The change to the rules also ensure that the beneficial owner of the policy is considered under this test – that is the person liable to tax on the gain – for the duration of their interest in the policy.

2.16 Qualifying life assurance policies

Qualifying policies are outside the remit of the chargeable event gain legislation. However, for policies issued on or after 6 April 2013, the exemption will be limited to premiums of £3,600 in any year. Legislation in Sch 9 implements this change and explains how "part qualifying" policies will be dealt with in future. Policies taken out before 21 March 2012 will not be affected by the rules unless the policy is substituted

or varied after that date, in which case the maximum premiums will be £3,600. Transitional rules apply to policies issued between 21 March 2012 and 5 April 2013.

There are new information provision rules under which insurers will be required to supply information to HMRC about qualifying policies and "restricted relief qualifying policies" – that is those for which the premium limit is exceeded but meet the qualifying policy requirements in all other respects.

2.17 Transfer of assets abroad

This important anti-avoidance legislation has been amended by s26 and Sch 10.

The principal amendment is to introduce an exemption from charge for genuine transactions entered into on or after 6 April 2012 as a result of EU infraction proceedings. A genuine transaction is one which meets conditions A and B:

A – viewed objectively, the transaction is considered to be a genuine transaction, having regard to any arrangements under which it is effected and any other relevant circumstances, and
Were the individual to be subject to tax on the transaction, the relevant charge to tax would be an unjustified and disproportionate restriction on a freedom protected by a relevant treaty provision (essentially the free movement of capital around the EU).

B - The individual satisfies an officer of Revenue and Customs that, viewed objectively the transaction must be considered to be a genuine transaction, having regard to any arrangements under which it is effected and any other relevant circumstances

However, a transaction cannot be regarded as a genuine transaction if it is made on terms other than arm's length for unconnected persons, or is a transaction that persons so dealing would not have entered into such a transaction, unless it is a transfer wholly for personal reasons to another individual for their personal benefit (with no return consideration or benefit).

Where a transfer is related to a business carried on by the person (the relevant person) outside the UK, the business must consist of the provision by the relevant person of goods or services to others on a commercial basis, and involve:

(a) the use of staff in numbers with competence and authority,
(b) the use of premises and equipment, and
(c) the addition of economic value by the relevant person to those to whom the goods or services are provided,

commensurate with the size and nature of those activities.

The remaining amendments clarify and tidy up the legislation in relation to double charging and treaty relief.

2.18 Deduction of tax from interest

There are a number of technical changes made by s 27 and Sch 11 to the requirement to deduct income tax from interest paid. The main impact of this is that all payments of compensation that include interest will now be subject to deduction of tax at source on the interest element; previously tax was only required to be deducted by building societies and banks in the normal course of business, so much of the interest paid on mis-selling has been paid gross.

2.19 Disguised interest

Sch 12 introduces a new simplified regime to deal with interest-like returns (returns from arrangements which are economically similar to interest) and to tax all such returns as income. This allows the current repeal of some anti-avoidance legislation in relation to futures and options, and in future will allow for the repeal of the deeply discounted securities and accrued income schemes.

2.20 Pensions – lifetime allowance

Sections 47 and 48 deal with further changes to the lifetime allowance applying to tax free pension savings.

Section 47 essentially repeals some of the rules put in place when the last reduction in lifetime allowance was made in April 2012, to create space for the further reduction from April 2014. The rules affected are the power to make regulations, and the new legislation amends the 2012 rules to allow for more regulations to describe the interplay between the various regimes.

Section 48 actually reduces the lifetime allowance – the tax free limit on a person's lifetime pension savings – from April 2014 (for benefit crystallisation events in the 2014-15 year) to £1.25 million. It is presently £1.5 million.

Schedule 22 deals with the transitional rules, largely by introducing further "fixed protection" rules at the date of the reduction (Fixed Protection 2014) to protect those already in excess of the new limit which will work in the same way as previous protection – the beneficiary will no longer be able to make contributions or accrue additional rights under a scheme from 6 April 2014, but will benefit from a lifetime allowance of £1.5 million or the current rate, if higher. As previously, the taxpayer will have to give notice to HMRC that they wish to rely on the protection, but the form and deadline for this election is not presently given, although it would be reasonable to rely on the procedure that applied previously.

2.21 Pensions tax relief – annual allowance

The annual allowance for pension relief on contributions to pension schemes reduces from £50,000 to £40,000 from April 2014, that is for pension input periods (PIPs) ending in the tax year 2014-15. (FA 2013, s 49). It is absolutely essential that advisers understand the rules on PIPs to enable them to advise correctly on this issue. Excess contributions over and above the annual allowance are reported on the additional information pages on the tax return for the year in which the PIP ends

(not necessarily the year in which the contribution was paid). It is taxed as if it were the taxpayer's top slice of income.

2.22 Pension drawdown

The current limit on pension drawdown is 100% of the Government Actuary annuity figures at the relevant age. Section 50 of the Finance Act 2013 amends this limit to 120% of the Government Actuary's figure in relation to pension drawdown years commencing on or after 26 March 2013.

2.23 Overseas pension schemes

Sections 53 and 54 make some changes to the legislation dealing with qualifying recognised overseas pension schemes (QROPS), setting out some additional requirements on schemes and providing sanctions if these are not met, and amending the information and inspection powers to align with those for UK schemes.

2.24 Employee shareholder shares

Section 55 introduces Sch 23 which deals with the tax implications and provision for employee shareholders announced in the autumn of 2012.

2.24.1 Tax treatment on acquisition

New s 226A in inserted into ITEPA 2003 which sets out the amount to be treated as earnings when shares with a market value of no less than £2,000 are acquired by an employee in consideration of an employee shareholder agreement. The excess over £2,000 in market value is treated as earnings from the employment in respect of the shares in the tax year in which they are acquired. This is achieved by deeming that consideration of £2,000 was paid for the shares acquired. If, however, either the employee or a person connected with the employee has a material interest (25%) in the voting rights of the company (or the assets on winding up in the case of a close company) either at the time the shares are acquired or in a period of one year before that date, the whole market value of the shares acquired are treated as employment income in respect of the shares.

2.24.2 Income tax treatment on sale to the company

The potential tax charge on a distribution on the sale of the shares back to the company (the only likely disposal route in most cases) is excluded by new s 385A inserted into ITTOIA 2005, provided that at the time of the disposal the holder is not an employee of, or office holder in the employer company or any associated company.

2.24.3 Capital gains tax treatment on sale

TCGA 1992 is amended to introduce an exemption for the disposal of up to £50,000 worth of employee shares (at market value at acquisition date); where shares in excess of this value are acquired, the exemption is apportioned appropriately. The exemption is not available when either the employee shareholder or a connected

person has a material interest in the employer company. Rules follow about the identification of exempt employee shareholder shares for the purposes of disposals.

2.24.4 Corporation tax relief

Relief is available for the employee shares, and is given on the cost ignoring the deemed consideration by the employee of £2,000.

2.24.5 Employee benefits

No benefit is deemed to arise in relation to the provision of advice regarding an employee shareholder agreement, although this does not extend to specific tax advice, but does include general advice about the tax status of employee shares.

The relevant changes to employment legislation are made separately. It is anticipated that the measures will commence on 1 September 2013.

2.25 Seed EIS

2.25.1 Off the shelf companies

Section 56 makes a change to the rules on SEIS, effective 6 April 2013, to allow shares in companies which were formed by company formation agents to qualify for income tax relief under the scheme. This was an oversight in the original legislation which has not been rectified ab initio, so off the shelf companies will not qualify for SEIOS income tax relief in 2012-13; there seems to be no credible policy reason for this.

2.25.2 Reinvestment relief

The reinvestment relief provided in 2012-13 has been partially extended into 2013-14 by s 57 FA 2013. The extended relief from (rather than deferment of) CGT applies to half of the qualifying amount reinvested in the tax year 2013-14 in relation to gains arising in 2013-14. It was proposed in the Budget 2013 that this would further be extended to 2014-15 but as yet, no legislation has been enacted to achieve this, so the outcome is uncertain.

2.26 Attribution of gains to members of non-resident companies

This important anti avoidance legislation has been the subject of infraction proceedings by the EU. Section 62 FA 2013 seeks to address the concerns expressed while retaining the benefit of the legislation to protect the UK tax base. The legislation is intended to prevent gains being sheltered through the use of non UK resident companies (which are not liable to CGT on disposals).

The amendments first increase from 10% to 25% the qualifying ownership for the attribution rules to be triggered. They then add categories of gains to which the rules do not apply as follows:

- A chargeable gain on an asset used and used only for the purposes of economically significant activities carried on by the company wholly or mainly outside the UK, or
- A chargeable gain on an asset where it is shown that neither the disposal of the asset by the company, nor the acquisition or holding of the asset by the company formed part of a scheme or arrangements of which the main purpose (or one of the main purposes) was the avoidance of liability to CGT or corporation tax.

A further amendment allows the operation of furnished holiday letting to qualify as an acceptable trade, and thus be excluded from the rules. There is also a definition of economically significant activities.

The changes apply to disposals made on or after 6 April 2012, with an option for affected persons to elect for the old rules to apply to disposals before 6 April 2013.

2.27 Community Investment tax relief

Tax relief is available in respect of investment by an individual or a company through an accredited Community Development Finance Institution (CDFI). Changes introduced by Sch 27 allow investors to carry forward unused relief if they are not able to use it all in the year in which the investment is made. These apply to individuals in respect of investments made on or after 6 April 2013, and in respect of investments by companies in accounting periods commencing on or after 1 April 2013.

Sch 27 further introduces a state aid limit of €200,000 applying to corporation tax reductions in the current accounting period and the three preceding years. This applies to investments made on or after 1 April 2013 (and ignores relief in respect of previous investments), but does not apply to individuals.

2.28 Statutory residence test

The legislation is in section 218 and Schedule 45. It applies from 6 April 2013. HMRC has issued special guidance on the legislation which includes a number of worked examples to illustrate the issues; it should be regarded as required reading for those working regularly in this area. References in the following material is to paragraphs of Sch 45.

2.28.1 Application of the statutory residence test

The new regime determines residence for the following tax purposes: (para 1)

- Income tax
- Capital gains tax, and
- As far as the residence of an individual is relevant to them, inheritance tax and corporation tax.

2.28.2 The basic rule

An individual (P) is resident in the UK in a tax year (X) if: (para 3)

(a) The automatic residence test is met for that year, or
(b) The "sufficient ties" test is met for that year.

If neither of these tests is met for a year, P is not UK resident for that year.(para 4)

2.28.3 The automatic residence test

The automatic residence test is split into two divisions. To meet the automatic residence test, an individual must meet at least one of the automatic UK tests, and none of the automatic overseas tests for a year. (para 5)

If the result is inconclusive, then the automatic residence test is not met, and the question of residence will be met only by the sufficient ties test.

2.28.4 Automatic UK tests

183 days test

P spends at least 183 days in the UK in the tax year (X) (para 7)

Home test

P has a home in the UK during all or part of year X at which he is present for a sufficient amount of time (at least 30 days at any time taking any part day as a day (para 8(4)) in year X, and

- There is at least one period of 91 consecutive days in respect of which -
  - the 91 day period occurs when P has that home
  - at least 30 days of the 91 day period is fall within year X, and
  - throughout that 91 day period, either Condition A or Condition B is met or a combination of those conditions is met. (para 8(1))

  Condition A : P has no home overseas (para 8(2))

  Condition B : P has one or more homes overseas but each of those homes is a home where P spends no more than a permitted amount of time (fewer than 30 days – taking a part day as a day (para8(5))) in year X. (para 8(3))

Where P has more than one home in the UK, this test must be applied separately to each home, and this test is met if it is met in relation to any one of the homes.(Para 8(8)). When presence at a home is considered, it is presence during the time that the place is their home and not at other times (para 8(6)). Day counts apply to both consecutive and intermittent days.

Example – UK home

Jane has a home in the UK throughout tax year 2013-14 and tax year 2014-15. She is present in that home on more than 30 days during tax year 2013-14. Jane acquires an overseas home on 1 March 2014 and is present there on 30 days in tax year 2013-14.

Although there is a period of 91 consecutive days, 30 of which fall in 2013-14 (the tax year under consideration), when Jane had both a UK home and an overseas home, there is also a period of at least 91 consecutive days (6 April 2013 to 28 February 2014) when she had a UK home (in which she spent sufficient time in 2013-14) but no overseas home.

Jane is therefore resident in the UK for 2013-14 under the second automatic UK test.

UK working test

P works sufficient hours in the UK, (method described below) as assessed over a period of 365 days, and

- during that period there are no significant breaks from UK work (more than 31 days taken together when P does not work at least 3 hours in the UK, or would have if not subject to annual, sick or parental leave – (para 29)), and
- all or part of the period falls within year X, and
- more than 75% of the total number of days in the 365 day period in which P works more than 3 hours are days when P works for more than 3 hours in the UK, and
- at least one day in that period (also falling in year X) is a day on which P does more than 3 hours work in the UK. (Para 9(1))

The sufficient hours test is performed as follows: (para 9(2))

- Days on which P does more than 3 hours work overseas (including days on which he also works in the UK) are termed disregarded days
- Add up for all employments and trades carried on by P the total number of hours that P works in the UK during the period but excluding any hours worked in the UK on disregarded days. This result is the UK net hours
- Subtract from 365 the number of disregarded days and other days regarded under para 28 as leave or gap days. This is the reference period
- Divide the number of days in the reference period by 7. Round an answer of less than 1 to 1, and all other answers are rounded down to a whole number.
- Divide the UK net hours by the number of weeks arrived at above.
- If the result is 35 or more P is considered to be working sufficient hours in the UK over the 365 days in question.

This test does not apply to P if P has a job on board a vehicle, aircraft or ship at any time in year X, and at least 6 of the trips that P makes in year X as part of that job are cross border trips that either begin or end or begin and end in the UK. (Para 9(3) referred to here as International Transport workers).

Example - 3rd automatic UK test (working in UK)

Henri travels to the UK on 1 July 2013 to start a new job on the following day. His posting finishes on 1 July 2014 and he leaves the UK on 6 August 2014, 400 days after he arrived in the UK. Over the 365-day period to 30 June 2014 Henri calculates that he worked full-time in the UK and has not taken a significant break from his UK work during this period. Part of the period of 365 days falls within the tax year 2013-14 and part falls within the tax year 2014-15.
Over the period of 365 days ending 30 June 2014 Henri works for over three hours on 240 days, 196 (80%) of which are days when Henri worked for more than three hours in the UK. At least one day when Henri does more than 3 hours work in the UK falls within the tax year 2013-14 therefore Henri is resident in the UK under the third automatic UK test for tax year 2013-14.

There is also at least one day when Henri does more than 3 hours work in the UK within the tax year 2014-15, so Henri also meets the third automatic UK test for that year

Additional test – year of death

P dies in the year, and

- for each of the last 3 tax years, P was resident in the UK by virtue of meeting the automatic residence test,
- even if P was not UK resident in year X, the preceding year would not have been a split year,
- when P died either his only home was in the UK, or he had at least one home in the UK, and
- if P had a home overseas during all or part of year X, P did not spend a sufficient amount of time there in year X. (para 10(1))

P spent a sufficient amount of time in an overseas home if he spent at least 30 days there in year X (counting part days as a day), or P was present there for at least some part of every day of year X up to and including the day on which P died. (para 10(2)). IF P had multiple homes overseas, then each of them must be looked at to establish whether P spent a sufficient amount of time in each of them. Once one has met the test, there is no need to look any further. (para 10(4)).

2.28.5 Automatic overseas tests

There are 5 overseas tests. They are:

16 days test

P was resident in the UK for one or more of the three tax years preceding year X, but the number of days in year X spends in the UK is less than 16, and P does not die in year X. (Para 12)

46 day test

P was not resident in the UK for any of the 3 tax years preceding year X, and P spent less than 46 days in the UK in tax year X (Para 13)

Overseas work test

P works sufficient hours overseas, as assessed for year X

- During year X there are no significant breaks in overseas work (as before for the UK working test)
- the number of days on which P does more than 3 hours work in the UK is less than 31,
- the number of days actually spent in the UK is less than 91. Deemed days (see below) do not apply for this purpose.

The sufficient hours overseas test is performed exactly as for the sufficient hours test above, with the UK and overseas terms reversed. (Para 14). This test does not apply to international transport workers as defined above.

Example – Overseas Work

May Ling is considering whether she meets the third automatic overseas test in respect of her work in Italy in the last tax year. She worked for her first employer there for an average of eight hours a day, 5 days a week, between 6 April and 23 August (20 weeks). During that period she took nine days annual leave (there were no embedded non-working days and she has to take leave to cover public holidays).

She ceased that employment and took a break of 30 days to tour around Italy.

She then took up a new employment, again in Italy, between 23 September and 5 April (27 weeks and 6 days). During that period she worked for nine hours and 30 minutes from Monday to Thursday and for four hours on a Friday. She took:

- five days of annual leave (to cover public holidays and a couple of long weekends),
- 10 days of annual leave, with two embedded non-working days (the
- Saturday and Sunday in the middle of this two-week period)
- five days sick leave (with no embedded non-working days).

May Ling spends no time in the UK in the tax year.

Step 1
May Ling has no disregarded days.

Step 2
Net overseas hours:
Employer 1: 18 weeks and one day at (5 days x 8 hours) = 728 hours
Employer 2: 24 weeks at ((4 days x 9.5 hours) + 4 hours) = 1008 hours
Total net overseas hours: 1736 hours.

Step 3
Reference period:
Subtract from 365 days
Disregarded days 0 days
Other days that can be deducted = 9+15+2+5= 31 days
Gap between employments 15 days (total gap 30 days but the amount deducted is limited to 15 days)
Reference period is 319 days.

Step 4
Divide reference period by 7 = 319÷7= 45.57 which is rounded down to 45.

Step 5
Divide net overseas hours by figure at Step 4
= 1736÷45= 38.57.

May Ling works sufficient hours (that is more than 35 hours a week during the tax year). She also meets the third automatic overseas test because she:
- has no significant breaks from work
- does not exceed the permitted limits for working in the UK or spending days in the UK.

Additional test – year of death

P dies in year X, and

- P was not UK resident for either of the two tax years preceding X or
- P was not resident for the preceding tax year before X and the pre-preceding year was a split year by virtue of Case 1, 2 or 3, and
- P spent less than 46 days in the UK in year X. (para 15)

Additional test 2 – year of death

P dies in year X, and

- P was resident in the UK for neither of the two preceding tax years by virtue of meeting the third automatic overseas test for those years, or that holds for the preceding year and the pre-preceding year was a Case 1 split year, and
- P would meet the third automatic overseas test for year X if re-read with the relevant modifications.

The relevant modifications are to look at the period from the start of year X up to the day before the date of P's death, rather than the whole of year X, and the number of days used in calculating the average hours worked is the number from the start of the tax year to the day before P's death.

2.28.6 Practical approach to automatic tests

Give the structure of the tests it is appropriate to commence with the automatic overseas tests, visiting each in turn to establish whether any is met. If any are met

then P is not UK resident for the year X, irrespective of the status of the automatic UK tests.

If none of the automatic overseas tests is met, the automatic UK tests should be considered. If one is met then P is UK resident for the year. If none is met then the automatic test is inconclusive, and the sufficient ties test must be used.

Note that the tests relating to when a taxpayer dies in a year are additional tests to be used in the case of death of P during year X, and not a substitute for the remaining tests. However, where P dies early in the tax year it is likely that some of the automatic tests will not apply by virtue of the number of days before P died.

Assuming that the results of these are inconclusive, we now move to consider the sufficient ties test. The circumstances are therefore:

- P meets none of the automatic overseas tests, and none of the automatic UK tests.

2.28.7 <u>The sufficient ties test</u>

P meets the sufficient ties test for a year if none of the automatic UK tests is satisfied and none of the automatic overseas tests is satisfied, and P has sufficient UK ties for the year. (para 17) Note that we consider the sufficient ties test only where none of the automatic tests are met.

The structure of the sufficient ties test is that both the number of UK ties and number of days spent in the UK determine the residence status. When advising an individual about their status in a year that is not complete, the test can be used to establish the maximum number of days that can be spent in the UK in that year.

2.28.8 <u>UK ties</u>

The following types of tie are identified.(Para 31). The number of ties count is used to count the ties of each type, so if an individual has more than one tie of the same type this only counts as one tie.

- A family tie
- An accommodation tie
- A work tie
- A 90 day tie, and
- A country tie – this only applies to P if P was UK resident in one or more of the three tax years preceding year X.

<u>Family tie</u>

There is a relevant relationship at any time in year X between P and another person, and that person (Q) is UK resident in year X. (para 32)

A relevant relationship is with a spouse or civil partner who are not separated, or living together as if man and wife or civil partners, or with a child of P's under the age of 18. (para 32(2))

The tie with a minor child is excluded if P sees the child for fewer than 61 days in year X, or in the year in which the child turns 18, that part of the year before the child's 18th birthday. (para 32(3))

When determining whether Q is resident in the UK for this purpose (only), a family tie with P is ignored (para 33).

Where a child under the age of 18 is in full time education in the UK at any time in year X, and is UK resident only by virtue of time spent in the UK in term time, they will be treated as non-resident, provided the number of days spent in the UK outside term time is less than 21. Half term and reading weeks are classified as term time and therefore not counted in the 21 days (para 33(3) to (6)).

Example – Family tie

Between May and November Jurgen visited the UK for 125 days, 104 of which were days on which he worked for more than three hours in the UK. When in the UK he stayed in a number of different hotels, so has no accommodation tie. He was not resident in the UK for any of the last three years. Jurgen's 17-year-old son lives and works full-time in the UK and is UK resident.

Under the sufficient ties test of the SRT Jurgen will be resident if he has two or more UK ties. He has a work tie. However the only time Jurgen and his son spent together in the UK during his visit was three weeks in the summer. Therefore Jurgen has no family tie and, having only one tie, is not resident in the UK for that tax year.

Accommodation tie

If P has a place to live in the UK (a home, a holiday home or a temporary retreat, or accommodation available to him) and this is available to P for a continuous period of at least 91 days during year X, and P spends at least one night there in year X, then P has an accommodation tie with the UK. (para 34)

Where the breaks in the time when the accommodation is available to P are of fewer than 16 days then the accommodation is treated as continuously available to P (i.e. the days when it is unavailable are ignored, but the two periods are regarded as continuous). Note that accommodation is available to P even where P has no right to occupy it and no legal ownership of it.

However, if the available accommodation is the home of a close relative of P the number of nights spent there increases to at least 16 rather than one night. A close relative is a parent or grandparent, sibling, child or grandchild aged 18 or over. (para 34(5) & (6)).

Example – Accommodation Tie

Mary has lived and worked in the USA for many years. Her uncle has a holiday houseboat in the UK where he has agreed Mary can stay any time she wishes, for as long as she wishes, when she comes here. Mary's uncle does not allow other people to stay in the houseboat

Last year Mary came to the UK twice. She made arrangements to stay for three weeks with a friend and for four weeks with her brother. Although the houseboat was available for a continuous period of at least 91 days, Mary did not use it at all. Therefore, she had no accommodation tie in respect of the houseboat last year.
This year Mary again visited the UK twice, spending her five-week summer holiday on her uncle's houseboat. This year Mary has an accommodation tie as the houseboat is available for a continuous period of at least 91 days and she has stayed on it for at least one night.

Work tie

P has a work tie with the UK if P works in the UK for at least 40 days (whether intermittently or continuously) in year X. (para 35)

Work for this purpose is more than 3 hours in a day. (para 35)

Where P has a job on board a vehicle, aircraft or ship which involves cross border travel:

- When a trip begins in the UK, P is assumed to do at least 3 hours work in the UK on the day the trip begins
- When a trip ends in the UK, P is assumed to do less than 3 hours work in the UK on the day the trip ends (para 36)

If a cross border trip begins and ends on the same day then P is assumed to do at least 3 hours work in the UK on that day. (para 36 (6)) A cross border trip undertaken in stages must additionally include any days where at least 3 hours is spent in the UK, in addition to the day on which the UK border is crossed. (para 36(7))

90 day tie

P has a 90 day tie in the tax year is P has spent more than 90 days in the UK in either or both of the two tax years preceding year X. (para 37)

Country tie

This tie only applies where P has been UK resident in any of the three preceding tax years to year X.

If the country in which P meets the midnight test for the greatest number of days in year X is the UK (or highest equal with at least one other country), P has a country tie with the UK in year X. (para 38)

2.28.9 Sufficient UK ties

Where P was resident in the UK for one or more of the 3 tax years preceding year X, the following Table applies : (para 18)

Table 1

Days spent by P in the UK in year X	Number of ties that are sufficient
More than 15 but not more than 45	At least 4
More than 45 but not more than 90	At least 3
More than 90 but not more than 120	At least 2
More than 120	At least 1

Where P was resident in the UK for none of the 3 tax years preceding year X, the following Table applies (para 19)

Table 2

Days spent by P in the UK in year X	Number of ties that are sufficient
More than 45 but not more than 90	All 4
More than 90 but not more than 120	At least 3
More than 120	At least 2

Where P dies in year X, the words “more than 15 but” are omitted from Table 1. In addition, if P dies before 1 March in year X, both Tables are treated as if the number of days are reduced by deducting the apportioned number of days for the number of whole months after P’s death. The amount of days to subtract is rounded up if 0.5 or more, and otherwise rounding down. (para 20)

2.28.10 Counting days

If P is in the UK at midnight, that day is counted as a day spent in the UK. The following exceptions apply.(para 22)

If P arrives in the UK on a day and leaves the UK on the next day, provided P does not engage in activities that are to a substantial extent unrelated to P’s transit through the UK then that day does not count as a day spent in the UK. (para 22(3))

If P would not have been present in the UK at the end of the day but for exceptional circumstances beyond P’s control that prevent P from leaving the UK, and P intends to leave the UK as soon as those circumstances permit, those days will not count as days in the UK, subject to a maximum of 60 days.(para 22(4) – (6)).

Exceptional circumstances beyond P’s control are illustrated by example rather than defined. They include natural disasters, war, civil unrest, or sudden or life threatening illness or injury. Note that the example does not confine this illness to P – so it may also apply for example to P’s spouse or minor child who are travelling with them.

Deemed days

The statutory residence test introduces a new principle of deemed days, which are treated as days spent in the UK for all purposes except the overseas work automatic overseas test. (para 23)

The deeming rule applies if P has at least 3 UK ties in a tax year, and was UK resident for at least one of the three tax years preceding year X. If P spends at least 30 days in the UK at some point, but is not present in the UK at the end of the day these are termed qualifying days. Once the number of qualifying days reaches 30 (starting from the beginning of the year and counting forward), each subsequent qualifying day is deemed to be a day spent in the UK by P. Note that deemed days are **not** used *for this purpose* as days in the UK for the purpose of the 90 day test in arriving at the 3 UK ties qualifier above. (para 23(5))

Example – Days and ties

Angharad does not meet any of the automatic UK or automatic overseas tests for the tax year. She spent 35 days in the UK where she was present at the end of the day, but was also present in the UK on 57 other days, leaving the UK before the end of the day. Without the deeming rule she will be non-resident under the SRT sufficient ties test as she has three UK ties but spent only 35 days here. Angharad will however need to consider the deeming rule as she was resident in the previous tax year and has at least three ties under the sufficient ties test, therefore she needs to consider Table 1.

As Angharad was present in the UK on 57 other days and she meets the deeming rule conditions and therefore must include these further days in her day counting. This gives her a total of 62 days spent in the UK (35 days where she was present at the end of the day, plus 27 qualifying days by virtue of the deeming rule); taken together with her three UK ties, this means that she will be resident under the sufficient ties test.

Example – Days and ties

Desmond was resident in the UK for the 2015-16 tax year and needs to establish his residence position for the 2016-17 tax year. He is considering how many days he spent in the UK.

Desmond has three UK ties (a country tie, a family tie and an accommodation tie). In 2016-17 he is present in the UK on 50 days when he is not present at the end of the day and also present at midnight on 44 days.

As Desmond meets all three of the deeming rule conditions, he considers how many deemed days he spent in the UK – there are 20 days above the 30-day limit, so he has 20 qualifying days to include in his UK day count.

Desmond’s total days in the UK are therefore the sum of the 44 days he is present at midnight and the 20 qualifying days, so he spent 64 days in the UK. He then looks at

Table A and sees that 64 days and three ties make him resident for 2016-17 (assuming that the automatic overseas tests do not apply).

2.28.11 Home

A home can be a building or part of a building, or a vehicle, vessel or structure of any kind. The facts will determine whether a particular place is a home, but somewhere used only as a holiday home or temporary retreat will not be regarded as a home. Ownership is not conclusive that something is or is not a home, and in particular, continued ownership is not conclusive that a former home remains a home. (para 25)

2.28.12 Work

Anything in the performance of the duties of an employment or in the course of a trade is work. (para 26) Travelling time is included if the cost of the journey would be allowable for tax against either employment income or the profits of a trade (para 26(4)).

Time spent on training is work if provided or paid for by the employer and undertaken by P to help him in performing the duties of the employment, or where the cost would be deductible in arriving at the profits of a trade. Unpaid voluntary posts do not count as work for this purpose.

Work is treated as done where it is physically performed or done, regardless of the contract of employment or location of the trade.(para 27)

Work done in the course of travelling to or from the UK is treated as done overseas, even if part of the journey is in the UK. Travelling for this purpose is from the time of embarkation to the time of disembarkation.(Para 27(2), (3))

2.28.13 Reference period for sufficient hours work tests

Para 28 specifies the days to be excluded from the reference period in arriving at the average hours worked either overseas or in the UK (see automatic UK tests and automatic overseas tests).

- Reasonable amounts of annual leave or parenting leave taken by P during the period (for all employments and trades whether in the UK or overseas)
- Absence from work due to P being on sick leave and cannot reasonably be expected to work as a result of the illness or injury in question
- Non-working days embedded within a block of leave as above (with at least 3 leave days either before or after the non-working days).

No reduction may be made, however, in respect of disregarded days (which by definition are days on which at least 3 hours' work was carried out).

If P changes employments and there is a gap between the employments during which P does no work, the number of days is reduced to reflect this, subject to a maximum of 15 days, or 30 for multiple changes of employment.

2.28.14 Relevant jobs on board vehicles, aircraft or ships

This applies if Conditions A and B are met (para 30)

A - P either holds an employment, the duties of which consist of duties to be performed on board a vehicle, aircraft or ship while it is travelling, or carries on a trade with similar constraints.

B - Substantially all of the trips made in performing those duties or carrying on those activities are ones that involve crossing an international boundary at sea, in the air or on land (known as a cross border trip).

2.29 Split year treatment

Part 3 of Sch 45 deals with the various cases of split year treatment. Essentially split year treatment relaxes the rules which states that if P is resident in the UK for part of the year, he is treated as resident for the whole of that year. Split year treatment determines when that relaxation applies and how to calculate the UKI and non UK parts of the year.

As respects an individual, a tax year is a split year if the individual is UK resident for that year, and one of the following cases applies:

- Cases 1 to 3 – involving actual or deemed departure from the UK
- Cases 4 to 8 – involving the actual or deemed arrival in the UK.

In brief, the cases are as follows:

2.29.1 Case 1 – starting full time work overseas

The taxpayer (we do not use the terminology P here) must have been UK resident for the preceding year, and there is a period of one or more days that begins with a day in the relevant year (used instead of year X) when the taxpayer does more than 3 hours work overseas, ands with the last day of the tax year, and for this period the taxpayer satisfies the overseas work criteria. (para 44)

The overseas work criteria is that

- The taxpayer works sufficient hours overseas as assessed for that period (as for the automatic tests).
- During that period there were no significant breaks in overseas work
- The number of days in that period on which the number of hours worked in the UK does not exceed the permitted limit (adjusting the number of days by time apportionment), and
- The number of days in that period which are spent in the UK by the taxpayer, but which are not deemed days does not exceed the permitted limit (as adjusted).

Example

Amanda has been living in the UK since she was born and is UK resident for tax purposes. She has worked in the media industry for five years and gets a job as a reporter on a three-year contract based in India. She moves there on 10 November 2013 and lives in an apartment provided by her new employer. She meets the overseas work criteria from 10 November 2013.

She returns to visit her family over the Christmas period for two weeks, and does not work while she is there.
Amanda remains working in India throughout the tax year 2014-15, again only returning for a two-week period over Christmas.

Amanda will receive split year treatment for tax year 2013-14 because:
- she was UK resident for 2012-13 and 2013-14
- she is non-UK resident for 2014-15 and meets the third automatic overseas test for that year

From 10 November 2013 until 5 April 2014 she:
- does not work at all in the UK
- spends 14 days in the UK, which is less, by reference to Table E above than the permitted limit of 37 days.

For Amanda, the UK part of the tax year will end on 9 November 2013, and the overseas part of the tax year will start on 10 November 2013.

2.29.2 Case 2 – partner of someone starting full time work overseas

This applies when the person's partner (spouse, civil partner or person with whom they live as a couple) is in Case 1 either for the relevant year or the previous year, and the person moves overseas in the relevant year to live with their partner while the partner is working overseas.(para 45)

For the balance of the relevant year, the person either has no home in the UK or has homes in both the UK and overseas, but spends the greater part of their time living in the overseas home, and also spends no more than the permitted time (90 days reduced to reflect the remaining complete months in the relevant year before departure) in the UK.

Example

Peter is Amanda's husband. He too had lived in the UK for all his life and was resident in the UK for tax purposes. He travels with Amanda on 8 January 2014 to live with her in India, having given up his job. Amanda and Peter have let their flat in the UK for a three-year period, commencing on 9 January 2014.

Once in India, Peter spends his time following his lifelong hobby as a lepidopterist, cataloguing Indian butterflies. He spends all his time there, except for the Christmas trips to the UK with Amanda.

Peter will receive split year treatment for tax year 2013-14 as he meets the Case 2 conditions:
- he has no home in the UK after 8 January 2014
- he was UK resident for 2012-13
- he is non-UK resident for 2014-15

From 8 January 2014 until 5 April 2014 he spends less than the permitted limit of 22 days in the UK.
For Peter the UK part of the tax year will end on 7 January 2014 and the overseas part of the tax year will start on 8 January 2014, the day he joined Amanda to live together in India.

2.29.3 Case 3 – ceasing to have a home in the UK

The taxpayer was UK resident for the preceding year, and at the start of the year had one or more homes in the UK. There comes a time in the relevant year where the taxpayer ceases to have a home in the UK, and this continues for the balance of the relevant year. In this latter part of the year, the taxpayer spends fewer than 16 days in the UK and is not UK resident for the year after the relevant year. Finally, within 6 months of the start of not having a home in the UK, the taxpayer has sufficient link with an overseas territory, either by being resident there for tax purposes, by being present there for every day of the six month period, or his only home is (or all of his homes are) in that country. (para 46)

2.29.4 Case 4 – starting to have a home in the UK only

The taxpayer is not UK resident in the tax year preceding year, and does not meet the only home test at the start of the year. However at some point in the relevant year (let us call it the "start date") the taxpayer meets the only home test and continues to meet it for the balance of that year. Further, the taxpayer does not have sufficient UK ties from the start of the year until the "start date". (para 47)

The only home test is that either:

- The taxpayer's only home is in the UK, or
- The taxpayer has more than one home, and they are all in the UK.

The sufficient UK ties test is considered for the first part of the tax year, and uses the information in Part 2 of the Schedule, subject to modifications to reduce numbers of days to the relevant amount, by deducting a proportion for the number of complete months after the "start date".

Example

Olan has been working for his employer in Germany for the last 5 years. He had no UK ties and was not resident in the UK. On 1 June 2013 Olan moves to the UK to look for work here. He rents out his flat in Germany on a 2 year lease, from 27 May 2013.

He arrives in the UK and stays in temporary accommodation while he finds a flat to rent. He signs a 12 month lease on a flat in London on 1July 2013.

He starts UK employment on 22 July 2013 and remains in the UK for a further 2 years.

Olan receives split year treatment for 2013-14 as he meets the Case 4 conditions:
- he is non-UK resident for 2012-13
- he started to have his only home in the UK during the tax year and that continued until at least the end of the tax year.
- he had no UK ties from 6 April 2013 to 1July 2013.

For Olan the overseas part of the tax year will end on 30 June 2013, and the UK part of the tax year will start on 1 July 2013, the day he started to have his only home in the UK.

Note: Olan might also meet the criteria for Case 5 or Case 8 split years, but priority is given to the case where the overseas part is the shortest.

2.29.5 <u>Case 5 – starting full time work in the UK</u>

The taxpayer was not resident in the UK in the previous year. There is at least one period of 365 days in respect of which the following conditions are met:

- The period begins with a day that falls within the relevant year and is a day on which the taxpayer does more than 3 hours work in the day
- In the part of the relevant year before the period begins, the taxpayer does not have sufficient UK ties
- The taxpayer works sufficient hours in the UK as assessed over the period
- During the period there are no significant breaks from UK work, and
- At least 75% of the total number of days in the period on which the taxpayer does more than 3 hours work are days when he does more than 3 hours work in the UK.

Once again, the principles established in Part 2 of the Schedule are used, with appropriate modification for this purpose. (para 48)

2.29.6 <u>Case 6 – ceasing full time work overseas</u>

The taxpayer was not resident in the UK in the previous year by virtue of meeting the third automatic overseas test (full time overseas work). However the taxpayer has been UK resident in any of the four tax year immediately preceding that year.

There is at least one period of at least one day that begins with the first day of the relevant year and ends with a day that falls within the relevant year and is a day on which the taxpayer does more than 3 hours work overseas. The period also satisfies the overseas work criteria (see Case 1).

The taxpayer is UK resident in the following year (whether or not by virtue of split year treatment).

2.29.7 Case 7 – partner of someone ceasing full time work overseas

This case is similar to Case 2, but where the taxpayer moves to the UK to be with their partner on their return or relocation to the UK.

2.29.8 Case 8 – starting to have a home in the UK

The taxpayer was not UK resident in the previous year, and had no home in the UK. However there comes a day in the relevant year (the "start day") when for the first time in that year the taxpayer does have a home in the UK, and continues to have a home in the UK for the balance of the relevant year and the following tax year.

For the part of the relevant year before the "start day" the taxpayer does not have sufficient UK ties (with fixed days modified to reflect part year by reference to whole months).

2.29.9 The overseas part of a year

Paragraph 53 sets out the definition of the overseas part of the tax year in respect of each case, which is largely what one would expect from the rules.

2.29.10 Priority between the cases

Paras 54 and 55 set up the priorities where more than one case applies to a taxpayer.

- Case 1 takes precedence over Cases 2 and 3
- Case 2 takes precedence over Case 3
- For the remaining cases the precedence is determined largely according to the earliest split year date as defined in para 53.

2.29.11 Rules about attribution of income in split years

Paras 57 to 103 set out the special rules which determine what income is chargeable in the UK in relation to a split year. In arriving at this point, the taxpayer now has a clear idea of the date his residence changes for tax purposes, and the following paras deal with how income is allocated. In broad terms the following applies:

- Employment income – the portion relating to the overseas part of a split year is excluded unless it relates to duties performed in the UK or duties in relation to overseas Crown employment taxable in the UK (para 58). There are long and complex rules dealing with a variety of types of income such as employment related securities and payments through third parties.
- Foreign pension income – the portion relating to the UK part of the year is chargeable (and remains subject to the 10% deduction in s575(2) ITEPA 2003) (para 72)

- PAYE income – the application of PAYE is restricted to years which are expected to be split years with duties performed both in the UK and overseas. (para 73)
- Trading income – treats the taxpayer as non UK resident for the overseas part of the tax year, requiring separate accounts to be prepared (as previously) (paras 74 – 80)
- Property income – the chargeable portion in the overseas part of the year is the profits arising in the UK (para 81)
- Savings and investment income – the income is split according to when it arises (paras 82 – 88)
- Capital gains – allocated according to the date on which the gain accrues; reporting requirements amended to reflect part year treatment (paras 92 -101)

There are also rules to deal with relevant foreign income charged on a remittance basis (paras 90, 91).

2.30 Anti-avoidance - temporarily non-resident

The anti-avoidance rules reflect the existing approach for CGT purposes under which gains are treated as accruing to an individual if they have been temporarily non-resident when the gain was realised. A similar approach has been taken in respect of certain types of income.

2.30.1 Definition of temporary non-resident

- The individual has sole UK residence for a residence period (Period A)
- Immediately following that period one or more residence periods occur for which the individual does not have sole UK residence
- At least 4 of the 7 years immediately preceding the year of departure were either-
  - A tax year for which the individual had sole UK residence, or
  - A split year that included a residence period in which the individual had sole UK residence, and
- The temporary period of non-residence is 5 years or less.

A residence period is either a whole tax year, or in the case of a split year either the overseas part or the UK part (as relevant). An individual has sole UK residence in a period is they are UK resident and there is no time in the period in which they are regarded as treaty non-resident.

The year of departure is the year in which period A falls.

The temporary period of non-residence is the period from the end of period A to the start of the next period in which the individual has sole UK residence.

2.30.2 Consequences

Where an individual is a temporary non-resident the following changes apply:

- By virtue of replacement s 576A ITEPA 2003, to draw-down of income from a foreign pension in flexible draw down, which is treated as arising in the year of return. Where the individual is taxed on the remittance basis, and any of ss 809B, 809D or 809E ITA 2007 applies, the remittance is treated as made in the year of return
- By virtue of replacement s 579CA ITEPA 2003, to draw down income from UK pensions in flexible draw down, which is treated as arising in the year of return
- By virtue of replacement s 832A ITTOIA 2005, remitted relevant foreign income, which is treated as remitted in the year of return
- By virtue of replacement s 10A TCGA 1992, on gains (net of losses) accruing or deemed to accrue during the period of temporary non-residence, which are deemed to accrue in the year of return (unless already taxable). Foreign gains remitted by taxpayers under the remittance basis are treated as remitted in the year of return. In certain circumstances, gains on assets purchased while temporary non-resident are excluded (see more in new s 10AA TCGA 1992).
- By virtue of new s 394A ITEPA 2003 to lump sum payments under employer financed retirement benefit schemes, which are treated as being made in the year of return
- By virtue of new S 554Z4A ITEPA 2003, to employment income paid through third parties under which a relevant step (payment of a lump sum benefit or a lump sum is a relevant benefit under a relevant scheme) is treated as made in the year of arrival. New s 554Z11A extends this to lump sums remitted to the UK and treats them as remitted in the year of return
- By virtue of new s 572A ITEPA 2003, to UK pension lump sums accrued while temporarily non-resident, which are treated as accrued in the year of return.
- By virtue of new s 401C ITTOIA 2005 to dividends paid by close companies to their material participators, unless the dividends relate to post departure profits (i.e. those arising after the period of temporary non-residence has commenced). This only bites where the payment is subject to a DTT which reduces the tax when the individual is UK resident. There are similar provisions in relation to non UK dividends in closely controlled companies and stock dividends.
- By virtue of new S 420A CTA 2010 to the release of a loan to a participator, which is treated as occurring in the year of return.
- By virtue of new S812A ITA 2007, the limit on liability to income tax of non UK residents is also modified if the income includes relevant investment income
- By virtue of new S465B ITTOIA 2005 to gains on life insurance contracts taken out before departure, which are treated as income in the year of return.

2.31 <u>Ordinary residence</u>

The concept of ordinary residence (OR) is abolished by Sch 46, FA 2013, as previously announced. However, certain reliefs which applied to workers who were not OR now apply to those who meet the S26A (ITEPA 2003) conditions.

An employee meets the requirements of section 26A if the employee was:

- Non UK resident for the previous 3 tax years, or

- UK resident for the previous year, but not UK resident for the three years prior to that, or
- UK resident for the previous 2 years, but not UK resident for the three years before that, or
- Not UK resident for the previous year, but UK resident for the year before that and not UK resident for the three years before that.

The residence status before the three years of non-residence is irrelevant.

There follows a number of changes, substituting “does not meet section 26A requirements” for those for whom OR is relevant, and “meets the s26A requirements” for those for whom not OR is relevant. Most of the reference to Ordinary residence are deleted by Part 2 of the Schedule.

Example

Abdul arrives in the UK on 1 February 2014 to begin a work secondment; he has not previously been to the UK and so has not been resident here before. He leaves the UK on 5 April 2017.

Under the SRT, Abdul is resident in the UK for the tax year 2013-14 and is eligible for split year treatment. The UK part of his split year begins on 1 February 2014. Abdul is also resident in the UK for the tax years 2014-15, 2015-16 and 2016-17. He claims the remittance basis of taxation for the tax years 2013-14, 2014-15, 2015-16 and 2016-17. He is not resident in the UK for the tax year 2017-18.

Abdul’s foreign earnings for 2013-14 (from 1 February 2014), 2014-15 and 2015-16 are eligible for OWR and are only taxable in the UK if and when they are remitted to the UK. In 2016-17 Abdul is not eligible for OWR as he has received the relief in the three preceding tax years. As such his foreign earnings for 2016-17 are fully taxable in the UK.

Provided Abdul remains not resident in the UK for three consecutive tax years following 2016-17 he may be eligible for OWR again from the 2020-21 tax year.

Example

Burril arrives in the UK on 1 March 2014 to begin a work secondment. He has not been to the UK previously and so has not been resident here. He leaves the UK on 5 April 2017.

He is not resident in the UK under the SRT for the tax year 2013-14. He is resident in the UK for the tax years 2014-15, 2015-16 and 2016-17. He claims the remittance basis of taxation for the tax years 2014-15, 2015-16 and 2016-17. He is not resident in the UK for the tax year 2017-18.

Burril’s foreign earnings for 2014-15, 2015-16 and 2016-17 are eligible for OWR and are only taxable in the UK if and when they are remitted to the UK.

Unlike Abdul, Burril is not resident in the UK in 2013-14 (the tax year in which his UK secondment commenced). Burril is therefore eligible for OWR for 2016-17 because this is the third year for which he is UK resident.

Provided Burril remains not resident in the UK for three consecutive tax years following 2016-17 he may be eligible for OWR from the 2020-21 tax year.

3 CAPITAL TAXES

3.1 CGT annual exempt amount

This will increase in 2014 and 2015 by 1%, so the amounts will be as follows :

2012-13	£10,600
2013-14	£10,900
2014-15	£11,000
2015-16	£11,100

3.2 EMI shares

Entrepreneurs' Relief is now available to all shares acquired through the Enterprise Management Incentive (EMI) scheme, by virtue of changes introduced by Sch 24. The minimum 5% holding normally required in relation to disposals of shares has been removed in relation to these shares, and the 12 month holding period commences on the date that the option is granted, rather than when the option is exercised. The changes apply to shares acquired on or after 6 April 2012, which are sold on or after 6 April 2013.

3.3 Annual tax on enveloped dwellings

As announced in 2012, the new annual tax on enveloped dwellings (worth at least £2 million) (ATED) has been implemented from 1 April 2013. The arrangements for the first year of charge are different to those for future years, to allow for the administration of the tax to be set up. The legislation is in FA 2013, ss 94 – 174 and Schs 33 – 35. Chargeable periods start on 1 April 2013 and run for 12 months.

3.3.1 Who is liable?

Companies, partnerships and collective investment schemes are liable – so any owner who is not a natural person. (ss 94 – 96). Where a partnership is liable (in the case of a corporate member having an interest in the property), the members are jointly and severally liable to the tax.

3.3.2 How much is the charge?

The rates of ATED for the first year will be: (s 99)

Value of property £m	Amount of charge £
2 – 5	15,000
5 – 10	35,000
10 – 20	70,000
Over 20	140,000

The sums shown are annual amounts so if the chargeable person only has an interest in the property for part of the chargeable period, the charge is time apportioned.

The value of the property is defined as the taxable value (market value – s 102) of the interest in the property on the relevant day, which is the first day of the chargeable period if the interest was owned at the start of the period, or otherwise the date on which the interest was acquired. However, the valuation mechanism sets up valuation dates which are used in all valuations and apply to a relevant day falling between that date and the next valuation date. The dates are :

1. 1 April 2012
2. 1 April 2017
3. 1 April 2022 and so on.

In addition, the date of any substantial acquisition or disposal by a relevant person is also a valuation date. (ss 102 -103).

Section 101 provides for the chargeable amounts to be subject to annual indexation equal to CPI, rounded down to £50. Treasury orders will specify the new chargeable amounts before 1 April each year.

3.3.3 Administration

The charge arises at the start of each year of ownership, on 1 April of each year. Normally the charge will be self assessed on 30 April each year with payment and returns due by that date.

In the first year of operation (starting 1 April 2013) the return for the period is due by 1 October, with tax payable by 31 October. If a person comes within the charge to ATED after 1 April 2013 and before 31 March 2014, the return is due by 1 October, or 30 days after coming within the charge, if later. Payment of tax is then due by 31 October or the due filing date if later.

Because the tax for a year is normally self assessed and collected in advance, this gives rise to the need for interim relief, and finally a return of the adjusted chargeable amount, which adjusts the charge reported on the initial return for the year. The adjusted chargeable amount return is made:

(a) when the claimant has not made a claim for interim relief and the adjusted chargeable amount is greater than the amount originally charged, or
(b) when a claimant has made a claim for interim relief and the adjusted chargeable amount is less than the amount arrived at after the last such claim.

The return is due by 30 days after the end of the chargeable period (that is, at the same time as the next return). Additional tax due is payable on the same date.

3.3.4 Interim Relief

Relief is available on a claim if the property reduces in value in the chargeable period or if during the period the use of the property takes it outside of the charge to tax (see the exemptions above), or the relevant interest ceases. This is known as interim relief and must be claimed before the end of the chargeable period. (s 100)

3.3.5 Other reliefs

Sections 132 to 150 provide for relief from ATED in the case of certain chargeable persons, or certain uses of the dwelling. If on a day a chargeable person is within the reliefs, they are not chargeable to ATED in respect of that day, and the adjusted chargeable amount is calculated accordingly.

- S 133 – property rental businesses; the charge does not apply on any day when the dwelling is being exploited as a source of rental receipts in the course of a property rental business, run on a commercial basis and with a view to profit. The exemption continues for void periods provided a tenant is sought without undue delay. Days are not exempt under this relief if the property is occupied by a non-qualifying individual (definition in s 136). Section 135 further compromises the relief in both preceding and following periods for non-qualifying occupation.
- S 134 – property rental business, but property is being prepared for sale, demolition or conversion. Occupation subsequent to use in the rental business by a non-qualifying person will deny this relief.
- S 137 – dwellings open to the public; Either the dwelling is being exploited as a source of income in a qualifying trade in the normal course of which the public are offered the opportunity to make use of, stay or otherwise enjoy the dwelling as customers of the trade on at least 28 days in any year, or it is under preparation for such a use without delay (subject to commercial constraints and unavoidable delays).
- S 138 – property developers; the interest is held by a person carrying on a property development trade, and the interest is held exclusively for the purpose of developing and reselling the land in the course of the trade. Use to generate rents is acceptable, but occupation by a non-qualifying individual will deny relief.
- S 139 – relief is also available is property developers make exchanges of dwellings, that is take dwellings in part exchange for a sale of a property.
- S 141 – property traders; this relief is similar to that in s 138, but the trade carried on is that of property trading, not developing.
- S 143 – financial institutions acquiring the interest in the course of lending (probably by repossession). This relief is self explanatory, but the chargeable person must intend to sell the property without undue delay. Occupation by a non-qualifying person denies relief.
- S 145 – occupation by certain employees or partners; Relief is available on dwellings purchased by a trading partnership, company or group to provide the dwelling to an employee (with less than 10% interest) or partner (with less than 10% interest) for occupation solely or mainly for the purposes of the trade.

- S148 – farmhouses; The farmhouse must form part of land occupied for the purposes of a qualifying trade of farming, and the person carrying on that trade must either be the chargeable person or someone connected to them. The farmhouse is then subject to relief if it is occupied by a farmworker (as defined) who occupies it for the purpose of the trade, or a former long serving (at least 3 years) farm worker or their surviving spouse of civil partner.
- S 160 – providers of social housing; this is largely self explanatory, and deals with both commercial operations where the dwelling was acquired by public subsidy and non-profit making social housing provider or registered social landlords.

3.3.6 Exemptions

Charitable companies are excluded from the charge provided they hold the interest for relevant charitable purposes. This is subject to an exclusion where an person donated the property to the charity under arrangements which may provide for his (or a linked individual's) future occupation of the dwelling. (s 151)

Public bodies are not regarded as companies for the purposes of ATED, and are therefore outside the scope of the charge (s 153) with similar provision for bodies established for national purposes – the listed bodies are:

- the Historic Buildings and Monuments Commission for England;
- the Trustees of the British Museum;
- the Trustees of the National Heritage Memorial Fund, and
- the Trustees of the Natural History Museum.

Finally, a dwelling which is subject to the conditional exemption from inheritance tax for heritage property (s 31 IHTA 1984) is treated as having a taxable value of nil.

3.3.7 Other provisions

Schedule 33 sets out provisions regarding returns, enquiries, assessments, appeals, determinations and related matters; Schedule 34 Part 1 deals with information and inspection powers, and Part 2 with penalties.

The penalty provisions place the returns within the scope of Sch 24 FA 2007 in respect of inaccuracies, and in Schedule 55 FA 2009 in relation to late returns. With regard to late payment of tax, Sch 56 FA 2009 has been amended to include payments of ATED, with a penalty date 30 days after the tax was due.

Schedule 35 sets out the transitory provisions for the first year of charge and other miscellaneous amendments.

3.4 IHT – debts due by the estate

Schedule 36 of FA 2013 limits the deduction of liabilities from the estate under certain circumstances. The measure is a response to various avoidance schemes and arrangements which seek to exploit the blanket deduction for liabilities.

New S162A excludes liabilities which have been incurred in financing the purchase, maintenance or enhancement of value of any excluded property. Where, however, the property has been sold for full money's worth, or has ceased to be excluded property the liability can be recognised.

New S162B similarly excludes liabilities in relation to relevant business property (relievable property).

New S175A precludes liabilities from being recognised where they are not discharged after death, apart from for commercial reasons (where the debt is due to an arm's length party unconnected with securing a tax advantage.

3.5 IHT – election to be treated as domiciled in the UK

New s 267ZA to IHTA 1984 provides for this election. A person may irrevocably elect to be treated for the purposes of IHTA 1984 as domiciled in the UK if either of the following conditions is met:

A - at any time on or after 6 April 2013 and during the period of 7 years ending on the date of election the person had a UK domiciled spouse or civil partner, or

B - a person who has been UK domiciled for at least 7 years to the date of death, dies on or after 6 April 2013, and that person was the spouse or civil partner of the person wishing to make the election.

Where condition A is met it is known as a lifetime election, and for condition B it is known as a death election.

The election is made in writing, and takes effect from the date specified in the election. The earliest possible date is 6 April 2013, but in the case of a lifetime election, it can be up to 7 years before the date of election, and for a death election, up to 7 years before the date of death. The conditions above must be in place at the specified date (married or civil partner and was UK domiciled at the time).

Death elections must be made within 2 years of the date of death.

3.6 IHT – transfers to non-domiciled spouse or civil partner

The limit on transfers to non-domiciled spouses or civil partners which was previously £55,000 has been increased so that it is set at the amount of the nil rate band at the date of the transfer. This is implemented by s 178 and takes effect for transfers of value made on or after 6 April 2013.

3.7 SDLT : pre-completion contracts

Sections 194 and 195 and Schedule 39 deal with pre-completion contracts, which essentially provide for a land transaction by way of a transfer of rights and an eventual conveyance. This is an area of sophisticated avoidance, and s 194 closes the avoidance schemes, with Sch 39 imposing the charge on the purchaser in respect of the transaction, but with additional safeguards against avoidance.

3.8 SDLT higher rate relief

There are some relaxations to the 15% SDLT rate imposed at Budget 2012 to residential property worth £2 million or more. The changes are implemented by Sch 40 FA 2013.

Where the exemptions and reliefs to the annual charge (ATED) apply the rate will revert to the normal 7% rate for properties of that value, provided the exemption conditions are complied with for three years after the transaction. If the conditions are broken, further SDLT will become due, and in particular if the property becomes used for personal or family occupation.

3.9 SDLT and leases

Schedule 41 makes changes intended to simplify some of the areas of SDLT in relation to property leases. The changes are based on informal consultation, and abolish the abnormal rent increases provisions and streamline the reporting requirements where a lease continues after the expiry of its fixed term and where an agreement for a lease is substantially performed before the lease is granted.

3.10 Vulnerable beneficiary trusts

Schedule 44 modernises the legislation in relation to trusts with a vulnerable beneficiary. One of the most important aspects is to redefine “vulnerable beneficiary” in line with current benefit structures and modern practice. The Schedule also aligns the permitted application of capital across the taxes to make the legislation more coherent.

4 VAT

4.1 Private use of road fuel

Schedule 38 makes changes to the valuation of fuel on which VAT is recovered and then it is used for private journeys. The changes enact two concessions, redraw the law to comply with EU legislation and simplify the structure of the wording to make it more easily understandable. The changes also remove the annual update of the Table from the Budget process, and require the Treasury to update and publish figures annually.

The net effect of all this is that businesses have the following options in relation to the purchase of road fuel and recovery of VAT in relation to private use:

- Treat all road fuel purchased as a business asset and adjust for private use using the published scale charge amounts
- Keep accurate mileage records for all business and private miles travelled and use these to apportion the cost of the fuel or to arrive at a value for the deemed VAT charge (an option which was not published as available), or
- Not treat road fuel as a business asset and therefore recover no VAT on it at all.

Where a charge is made for private fuel then the deemed supply rules will not take effect. VAT will be due on the payments made by the employee. A new Schedule 6 Para 2A will apply open market value where the payments from the employee are lower than the accepted rates.

4.2 Energy saving materials – reduced rate

The reduced rate applying to the installation of energy saving materials in relevant charitable buildings has been abolished by s 193, with effect from 1 August. The reduced rate remains available for installations in private dwellings and residential accommodation.

5 THE GAAR

5.1 Fundamental approach

The GAAR Study Group Report was based on the premise that the levying of tax is the principal mechanism by which the state pays for the services and facilities that it provides for its citizens, and that all taxpayers should pay their fair contribution. This same premise underlies the GAAR.

It therefore rejects the approach taken by the Courts in a number of old cases to the effect that taxpayers are free to use their ingenuity to reduce their tax bills by any lawful means, however contrived those means might be and however far the tax consequences might diverge from the real economic position.

The position is therefore that so far as the operation of the GAAR is concerned, Parliament has decisively rejected this approach, and has imposed an overriding statutory limit on the extent to which taxpayers can go in trying to reduce their tax bill. That limit is reached when the arrangements put in place by the taxpayer to achieve that purpose go beyond anything which could reasonably be regarded as a reasonable course of action.

The primary policy objective of the GAAR is to deter taxpayers from entering into abusive arrangements, and to deter would-be promoters from promoting such arrangements. If a taxpayer is undeterred, and goes ahead with an abusive arrangement, then the GAAR operates so as to counteract the abusive tax advantage which he or she is trying to achieve. The counteraction that the GAAR permits will be a tax adjustment which is just and reasonable in all the circumstances. The appropriate tax adjustment is not necessarily the one that raises the most tax.

There may be tax avoidance arrangements that are challenged by HMRC using other parts of the tax code, but if they are not abusive they are not within the scope of the GAAR.

The GAAR is designed to counteract the tax advantage which the abusive arrangements would otherwise (i.e. in the absence of the GAAR) achieve. This means that it will usually be necessary to determine whether the arrangements would achieve their tax avoiding purpose under the rest of the tax code (i.e. the non-GAAR tax rules), before considering whether the arrangements are "abusive" within the meaning of the GAAR.

However, there may be some arrangements which appear to be so blatantly abusive that it would be appropriate for HMRC to invoke the GAAR without first completing the exercise of determining whether the arrangements would achieve their intended tax result under the rest of the tax rules. It is therefore not possible for a taxpayer to object to the use of the GAAR simply because all other means available to HMRC to tackle what they consider an abusive arrangement have not been utilised.

5.2 Taxes to which the GAAR applies

The GAAR applies to: (s 206(2))

- Income tax;
- Capital gains tax;
- Inheritance tax;
- Corporation tax;
- Any amount chargeable as if it were corporation tax, or treated as if it were corporation tax, such as a CFC charge, the bank levy, the oil supplementary charge and tonnage tax;
- Petroleum revenue tax;
- Stamp duty land tax; and
- The annual tax on enveloped dwellings.

It is intended that the GAAR will be extended to cover National Insurance Contributions ("NICs"). This will be contained in separate legislation; the NICs provisions will follow the same principles and contain the same procedural safeguards as the GAAR which applies to the taxes listed above.

The GAAR applies to tax arrangements entered into on or after Royal Assent.

5.3 Tax arrangements

The GAAR applies to "tax arrangements" which are "abusive":

S 206 (1) "This Part has effect for the purpose of countering tax advantages arising from tax arrangements that are abusive."

In broad terms a tax arrangement is any arrangement which having regard to all of the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of the arrangement. (s 207(1)). "Arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable). (s 214) The GAAR applies to tax arrangements entered into on or after Royal Assent.

Note that the definition of "tax arrangements" is widely drawn and deliberately sets a low threshold. Accordingly, it is likely that many transactions that would achieve some tax advantage will fall within this definition. However, it does not follow that these would all be affected by the GAAR; the abusive test prevents all but the abusive arrangements from being counteracted.

5.4 Tax advantage

The expression "tax advantage" is defined (in s208) to include

- relief or increased relief from tax;
- repayment or increased repayment of tax;
- avoidance or a reduction of a charge to tax or an assessment to tax;
- avoidance of a possible assessment to tax;

- a deferral of a payment of tax or an advancement of a repayment of tax; and
- avoidance of an obligation to deduct or account for tax.

This definition of "tax advantage" is inclusive (i.e. it is not necessarily exhaustive) and is intended to have a very wide meaning. It is intended to cover any form of tax benefit, for example: increasing deductions or losses; decreasing income or gains; obtaining timing advantages; obtaining or increasing repayments of tax; or ensuring that a potential tax charge does not arise or is reduced.

5.5 Abusive tax arrangements

It is recognised that taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made. The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable.

The definition of abusive in the legislation is the so called "double reasonableness test", which is in s 207(2), and follows below:

Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—
(a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,
(b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
(c) whether the arrangements are intended to exploit any shortcomings in those provisions.

The legislation then goes on to identify some specific indicators of abuse or absence of abuse to assist with analysis of particular arrangements: (s 207(4) & (5))

(4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
(a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
(b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
(c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,
but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

(5) The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.

5.6 Taxpayer safeguards

There is a range of taxpayer safeguards built into the GAAR legislation, starting with the double reasonableness test of abusive. The safeguards include:

- Placing the burden of proof on HMRC to show that particular arrangements are abusive;
- The double reasonableness test (see above);
- Allowing the court or tribunal to look at the purpose of the legislation which it is alleged has been abused, in coming to a decision;
- Requiring HMRC to refer instances of abuse to the GAAR panel for a ruling before the case can progress any further

5.7 Dealing with abuse – counteraction

If it is determined that an arrangement is abusive, then the GAAR provides that the tax advantage that the arrangement sets out to achieve will be counteracted by the making of adjustments. The adjustments must be just and reasonable, and are made by way of an assessment, the modification of an assessment or disallowance of a claim, or otherwise. (S 209) However, no counteraction is permitted unless HMRC has met the procedural requirements in Sch 43 (notice of counteraction and procedure for reference of the case to the GAAR advisory panel).

In most cases it will be a relatively straightforward exercise to decide what adjustments need to be made to achieve a just and reasonable result (e.g. increasing taxable income, or decreasing allowable deductions, by a clearly identifiable amount). There is also a provision for consequential relieving adjustments to be claimed within 12 months after the GAAR adjustments become final where the changes made mean that some other tax paid would be reduced.

There will be some cases, though, where the exercise is less straightforward. This would be the case, for example, where the taxpayer might have carried out any one of several alternative non-abusive transactions to achieve the same non-tax purpose if the abusive one had not been carried out. In this scenario the just and reasonable counteraction would be to select the transaction which a taxpayer would most likely carry out in such circumstances, and to adjust the tax consequences on the basis that this alternative transaction had been carried out. It is important to note that the most likely alternative transaction would not necessarily be the one which would result in the highest tax charge.

5.8 Impact on priority rules

All priority rules in tax legislation covered by the GAAR are now subject to the GAAR – that is they rank after the GAAR (s 212).

5.9 Impact on self-assessment and penalties

Some of the taxes that the GAAR impacts upon are self-assessed. So a taxpayer must consider whether the arrangements they have entered into would be regarded as abusive under the GAAR, and if so then the self-assessment return must make an appropriate adjustment to reflect the fact that the GAAR would be applicable. Failure to do so could leave the taxpayer open to penalties for failing to take reasonable care in completing the tax return.

In practical terms this means that it is possible for penalties to be imposed for breach of the self-assessment requirements in cases where a taxpayer has completed the self-assessment return on the basis that a tax-avoiding arrangement has succeeded in reducing the tax bill, when it should have been obvious that the arrangement was abusive and would be caught by the GAAR. Similar considerations apply to those taxes that do not operate on a self-assessment basis.

A taxpayer who is uncertain whether an arrangement is within the scope of the GAAR may wish to make a ‘white space disclosure’ in the self-assessment return indicating the uncertainty.

5.10 GAAR guidance

The GAAR must be interpreted by the courts in accordance with the guidance on the GAAR which must be approved by the GAAR panel. (S 211(2) FA 2013). Accordingly, the first version of the guidance has been issued and comprises the following:

- Part a; status and purpose of the guidance material
- Part b; what the GAAR is intended to achieve and how it does this
- Part c; specific points, and
- Part d; examples
- Part e is not approved by the GAAR panel (and is not required to be) but is persuasive for the courts. It deals with the procedural arrangements for the GAAR.

From time to time, the GAAR guidance will be updated, and advisers will be well advised to ensure that they are aware of the current position.

6 OTHER TAX ADMINISTRATION DEVELOPMENTS

6.1 UK – Swiss tax agreement

Section 221 sets in place the legislative machinery to collect the tax arising as part of the UK – Switzerland tax agreement. The tax is actually collected by the Swiss banks and passed to HMRC, so primary legislation is needed to create the tax charge. It comes into force on 1 January 2103.

6.2 Other international agreements to improve tax compliance

Section 222 is enabling legislation to give statutory power to make an agreement to implement the US FATCA rules, and to permit any agreement to be reached regarding exchange on information with another territory, or other agreements which improve tax compliance in the UK.

6.3 Disclosure of Tax Avoidance Schemes

Enabling powers to require the provision of information by clients to promoters for onward disclosure to HMRC, and for HMRC to open an enquiry following the disclosure of details are made by s 223. Regulations will put flesh on the bones of these rules.

6.4 HMRC powers : Proceeds of Crime Act

Schedule 48 updates and clarifies the powers of HMRC officers in relation to the Proceeds of Crime Act 2002. In particular, all references to Customs and Excise and Inland Revenue have been replaced by Revenue and Customs. The Schedule also introduces limits to the powers of officers by nominating excluded matters which officers may not deal with.

6.5 HMRC information gathering powers

HMRC's powers to accumulate data about taxpayers take another big step forward now that powers have been legislated for to obtain bulk data from businesses handling credit card and debit card transactions (merchant acquirers). The legislation is in s 228 FA 2013, and is brief. The information will relate to businesses accepting debit and credit card payments, rather than underlying personal transactions. The policy objective is stated to be compliance activity in respect of businesses that do not declare all of their sales.

6.6 Penalties – RTI returns

Schedule 50 introduces the legislation to impose penalties under RTI.

6.6.1 Late returns

Where P fails to make a return for any month by the due date, a penalty applies. However, no penalty can arise on the first such failure in a tax year, or during the "initial period" which is specified by the Commissioners, but commences on the date when P was required to file under the RTI rules. P cannot be liable for more than one

penalty in respect of any month (even if more than one return was made late). The precise amount of penalty applying will be specified in Regulations, but will be based on the number of employees concerned and the number of previous penalties incurred in the tax year under this provision.

6.6.2 Extended failure

Separate (and additional) penalties apply where RTI returns are very late. An extended delay is when a return is filed more than 3 months late. The penalty will be 5% of the payments due on the return. Every return subject to extended delay is liable to a penalty.

6.6.3 Late payment of PAYE etc.

The existing regime has been amended so that a penalty triggers in respect of each late payment except the first in the tax year. The rates of penalty have also been amended. The existing penalty legislation is amended as follows:

- The first late payment in a tax year continues to be regarded as “not a default” for the purposes of this legislation (as now)
- For the first second and third defaults in respect of the tax year, the penalty is chargeable at the time of the default at a rate of 1% of the tax comprised in the default
- For the fourth, fifth and sixth defaults in respect of the tax the penalty is chargeable at the time of the default at 2% of the amounts comprised in the default
- For the seventh, eighth and ninth defaults in respect of a tax year the penalty is chargeable at the time of the default at 3% of the amounts comprised in the default, and
- For the tenth and subsequent defaults a penalty is chargeable at the time of the default at a rate of 4%.

This allows for the late payment penalties to be issued during the year, which will be much more effective in producing better compliance than the annual penalty notice currently issued.

There is a by-product in that lower penalties will apply :

Example – late payment penalties

X Limited has made a total of 10 late payments in relation to a tax year. Each payment was for £6,000.

Current penalty regime

The penalty is calculated based on nine defaults, as the first late payment does not count as a default for this purpose. In that case, the penalty is a total of 3% of all of the amounts paid late – a total of £54,000 (ignoring the first). The penalty is therefore £1,620.

Amended penalty regime

The penalty is levied for each default as follows :

Defaults 1, 2 and 3 (after the first which is ignored)	(1% x £6,000) x 3 =	£ 180
Defaults 4, 5 and 6	(2% x £6,000) x 3 =	£ 360
Defaults 7, 8 and 9	(3% x £6,000) x 3 =	£ 540

Total penalty £1,080

Once again, these amendments apply from 2014-15.

6.7 Withdrawing a notice to make a self-assessment return

Legislation in now in force under which HMRC can withdraw a notice to make a self-assessment return where an officer is satisfied that no return is necessary. (s 233 and Sch 52).