Analysis

Examining Finance Bill 2013

SPEED READ **Finance Bill 2013 shows the two sides of the government's tax policy – the desire to encourage investment and reward entrepreneurial activity, set against the need to ensure that taxpayers pay tax in line with government policy. So, the Bill includes the proposed cut in the main rate of corporation tax to 20% from 2015 for profits other than ring-fence profits, along with the rate increase to 10% in the research and development above the line tax credit. At the same time it includes, not only the general anti-abuse rule, but a number of specific anti-avoidance provisions which have been announced previously. The Bill also contains clarification in the individual residency rules provided by the statutory residence test, details of the new regime applying to high value property held by 'non-natural' persons, and confirmation of the forthcoming changes to the pension limits.**

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The Bill was published on 28 March. At 629 pages it is some 50 pages shorter than last year's, though with a similar number of clauses and more schedules. It will take a little time to read through the provisions and identify all of the details that have changed since the publication of the draft clauses and the comments below are not intended to be comprehensive. Of course, the process of publishing draft Finance Bill clauses in December and releasing amendments to the clauses, either with responses to consultation or with the Budget on 20 March 2012, means that the majority of the Finance Bill contents were known in advance.

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Rate changes

The Finance Bill includes clauses to enact the reduction in the main rate of corporation tax for profits other than ring fence profits for both 2014 (21%) and 2015 (20%). For financial statements, which have not yet been signed for balance sheet dates pre dating the Budget announcement, the rate change down to 21% and 20% is a disclosure point only. As both the 21% and 20% rate are included within Finance Bill 2013 and will be substantively enacted and enacted during 2013, most companies will, for the first time, be required to measure deferred tax at differing rates at their year-ends, depending upon when deferred tax will reverse.

For interim periods, the tax rates to be used are those substantively enacted (for UK GAAP and IFRS) at the interim period date (not the year-end date). Historically, the Finance Act has rarely been substantively enacted prior to July. If this is repeated this year, for the June 2013 interim period deferred tax should still be recorded at the 23% rate, the rate enacted at the balance sheet date.

The Finance Bill confirms the rates of the research and development (R&D) 'above the line' credit as 10% (49% for ring-fenced companies). The government has also relaxed the PAYE and national insurance contributions (NICs) cap which limits the payable credit to companies with no corporation tax liability. The cap was originally proposed to be set by reference to the 'qualifying' R&D element of staff PAYE and NICs. The Bill confirms that the cap now takes into account the full PAYE and NICs of the company's relevant R&D staff and also includes the PAYE and NICs of externally provided workers from a group company, limited to their qualifying R&D activities.

Combined with the 20% corporation tax rate from 2015, the full benefit of R&D tax relief becomes 8%. The widening of the cap will be welcome news to loss making companies and should help to ensure a positive take up of the above the line scheme. Together with the introduction of the patent box regime with effect from 1 April and the proposed reliefs for the creative sector, the government is signaling that the UK is an attractive location for foreign investment.

Corporation tax

The Finance Bill contains two measures introduced in response to judgments of the Court of Justice of the European Union (CJEU). In respect of the response to the *Philips* judgment (Case C-18/11),) on group relief, no amendment has been proposed following the recent consultation process. Therefore, from 1 April 2013, the restriction in CTA 2010 s 107 on the surrender, by way of group relief, of losses made by UK branches of companies resident in the EU/EEA will only apply where the losses are actually used against non-UK profits, as opposed to being available for use. An updated HMRC technical note is available, although the legislation itself has not changed. It seems that HMRC is also now conducting enquiries into periods ended before 1 April 2013 as if the legislation had retroactive effect.

In respect of elections to defer the payment of certain corporation tax exit charges by companies ceasing to be UK resident and subsequently becoming resident in another EU/EEA Member State, the scope of the deferral has been expanded. The deferral now includes the corporation tax attributable to the revaluation of trading stock (CTA 2009 Part 3 Chapter II), and it is also proposed that UK permanent establishments of non-resident companies incorporated elsewhere in the EU/EEA will be able to defer payment of corporation tax attributable to unrealised gains on assets which cease to be held for the purposes of a UK trade (TCGA 1992 s 25). There are, however, no proposed amendments to the terms of the deferral such that, under the realisation method, tax may only be deferred for a maximum of ten years or until the asset is disposed, whichever is the earlier.

There are a number of additional minor changes to the controlled foreign companies (CFC) regime over and above those published in December 2012. These changes are targeted at specific situations and do not represent fundamental changes to the regime. The Bill makes changes to the worldwide debt cap group treasury company exemption (TIOPA 2010 s 316), amending the conditions that a company has to satisfy in order to make an election and setting out how the election applies to financing expenses and financing income. An amendment will also be made to align the definition of 'group treasury company' within the CFC legislation with the definition for debt cap purposes. The debt cap amendment applies for periods of account beginning on or after 11 December 2012. The CFC measures apply from 1 January 2013, although the amendment regarding group treasury companies is subject to a transitional rule enabling the existing definition to be used for accounting periods ending before 20 March 2013.

Employment tax

In relation to the statutory residence test (SRT), the Bill includes some minor technical changes from the previously published draft clauses in the treatment of years of arrival and departure from the UK and the definition of full time working. However, there are no fundamental changes to the structure of the SRT which remains a complex, three-part test, to determine tax residence, effective from 6 April 2013.

There are circumstances in which individuals are allowed to split a tax year into a period of residence and a period of non-residence when they have come to, or left the UK. The clauses in the Bill expand the circumstances in which an individual can claim this 'split year residence'.

The other significant change in the Bill relates to that part of the law concerning employees who work full time in the UK or full time abroad. The Bill sets out a new methodology to determine whether an employee works full time, detailing how average working hours are to be calculated to confirm whether or not a 35 hour average working week is achieved.

The Bill confirms the exemption from tax of any capital gains made by individuals on the disposal of shares acquired through the adoption of employee shareholder status

The Bill also includes an update to the overseas workdays relief provisions, which will be relevant to foreign nationals coming to work in the UK on or after 6 April 2013. Overseas workdays relief will apply more widely than it has done in the past, but the conditions the taxpayer will have to meet in order to keep the benefit of that relief are likely to be more onerous because of the related conditions around use of bank accounts.

The updated legislation includes an amendment to the transitional rules for overseas workdays relief for those who were not ordinarily resident in the UK in 2012/13, which confirms an extended period over which the transitional rules can apply depending on an individual's circumstances.

As promised, the Bill includes the codification of statement of practice 1/09, allowing a relaxation of the strict mixed fund rules for a single bank account per employee, where it is used for his or her employment income only and provided that certain conditions are met. These conditions include a requirement for the taxpayer to nominate his or her chosen account within prescribed time limits, but now will provide the ability to use a pre-existing account subject to conditions.

In the Budget, the chancellor confirmed his intention to proceed with the concept of an 'employee shareholder'. The Bill confirms the exemption from tax of any capital gains made by individuals on the disposal of shares acquired through the adoption of employee shareholder status. The exemption applies to shares worth up to £50,000 on receipt and the Bill allows the acquisition of existing shares to qualify for the exemption, as well as newly issued shares.

The proposed legislation also confirms that the first £2,000 worth of shares acquired by employee shareholders will not be included in earnings and so will be free from income tax. Further clarification confirms that this exemption is not available if the employee shareholder, or a connected person, has a material interest in the company. In addition to the CGT exemption there will be, in certain circumstances, no income tax charge on the purchase by a company of exempt employee shareholder shares. The legislation will be brought into effect by statutory instrument, subject to the progress of the necessary employment law reforms. These reforms have currently been remitted back to the House of Commons, following defeat in the House of Lords and the government will now need to re-introduce the relevant provision in order to go forward with the reform.

The Bill also includes new inheritance tax provisions on which there has been no prior consultation

Personal tax

The seed enterprise investment scheme (SEIS) was introduced in April 2012 to encourage investment in 'start-up' companies carrying on qualifying trades. An exemption from capital gains tax has been available for the first year (2012/13) for gains reinvested in the same year in SEIS qualifying shares, subject to a £100,000 investment limit. This exemption has been extended into 2013/14 for gains reinvested in that tax year but the exemption will be limited to half of the reinvested amount (which remains subject to a £100,000 overall limit). There is also a relaxation of the SEIS conditions to allow 'off-the shelf' companies, established by corporate formation agents, to qualify for the relief.

The Bill includes a further extension of entrepreneur's relief (ER). Broadly, to qualify for ER, an individual must hold 5% or more of the share capital of the company, for a period of 12 months or more. Budget 2012 removed the requirement to hold 5% or more if the shares were acquired through a qualifying enterprise management incentive (EMI) option. The Bill further revises the conditions to allow the period during which the option is unexercised to count towards the twelve month holding period and to extend the relief to shares acquired as a replacement for EMI shares following certain company reorganisations or takeovers. The amendments apply to disposals of qualifying shares after 6 April 2013 as well as to certain qualifying disposals in 2012/13, subject to an election.

The Bill also includes new inheritance tax provisions on which there has been no prior consultation. Currently, where borrowing is secured against property, the value of that property will be reduced for inheritance tax purposes by deducting the borrowing. The new anti-avoidance rules included in Finance Bill 2013 severely restrict the extent to which such borrowing can be offset where the borrowed funds are used to acquire 'excluded property' or certain assets qualifying for inheritance tax relief (e.g. business property relief and agricultural property relief). This measure is likely to have a significant impact on non-domiciled individuals and those who have borrowings secured on their property in order to invest in their business. It will take effect on Royal Assent.

It should be remembered that the cap on income tax reliefs (which was announced at Budget 2012) comes into force with effect from 6 April 2013. The cap restricts the relief that an individual can claim for certain losses and interest payments to the higher of £50,000 and 25% of their income. HMRC guidance as to the cap's application was published at the same time as the Finance Bill.

Property tax

As expected, an annual tax on enveloped dwellings (ATED) will be introduced from 1 April 2013 for high-value residential property (value exceeding £2mn) owned by certain non-natural persons (NNPs). NNPs include companies, collective investment schemes and partnerships which include a company as a partner. The tax was previously known as the annual residential property tax or ARPT.

The ATED, which will be a flat tax charge based on the market value of the property (normally on acquisition), was announced at Budget 2012 and applies to residential property held in NNP 'envelopes'. Following consultation, a number of reliefs and exemptions have been introduced to prevent most residential property used for commercial purposes from being affected. Details of additional reliefs (for example, for diplomatic properties and property held for charitable purposes) are contained in the Bill. These reliefs and exemptions are to be replicated with effect from Royal Assent in the 15% stamp duty land tax regime which applies to acquisitions of high-value residential properties by NNPs.

A new ATED-related capital gains tax will affect those properties which are subject to the ATED in relation to disposals on or after 6 April 2013. A form of rebasing will be available for the new tax, although gains on such properties may remain subject to tax under other provisions. Draft legislation released in January 2013 suggested that all losses on residential property would be restricted when any part of that loss was ATED-related. This has now been amended so that only the ATED-related proportion of the loss will be subject to restriction.

Anti-avoidance measures

The Finance Bill confirms that the general anti-abuse rule (GAAR) is proposed to have effect for tax arrangements entered into on or after Royal Assent. The changes to the draft legislation issued on 11 December 2012 are procedural. Those tendering for government contracts may be particularly impacted by the GAAR, given its proposed relevance in the procurement process for government contracts (the rules governing that process from 1 April 2013 were contained in *Procurement Policy Note 04/13* also published on 28 March 2013).

Key to how the GAAR will apply in practice will be the advisory panel as it will approve the HMRC guidance on the GAAR and its opinion, together with the guidance, must be taken into account by a court in considering the application of the GAAR to any particular case. An update on the existing draft guidance is expected by 15 April at the latest when the interim advisory panel will be disbanded.

In the Budget, the government announced a number of measures aimed at 'loss-buying' transactions, three addressing realised losses and three specifically targeting unrealised losses. The government anticipates that the measures will raise £1.23bn over the next five years. The changes proposed add to the number of different tests which address the issue of tax loss utilisation following a change in ownership, and which a taxpayer needs to consider, even before factoring in whether the GAAR might be relevant. Not all of the legislation introduced in the Bill requires a tax avoidance purpose to be present and the rules can catch commercial transactions. Legislation for the three changes targeting the buying of unrealised tax losses is not in the Bill but is now separately available for technical consultation until 2 May.

In relation to individuals, amendments are included in the Bill to two anti-avoidance provisions – the attribution of gains to members of closely controlled non-resident companies (TCGA 1992 s 13) and the transfers of assets abroad provisions, which can treat certain income and gains of overseas persons as though they arise to UK resident individuals and companies.

The amendments introduce some additional exemptions from the provisions for 'genuine transactions' and assets held for 'economically significant activities'. The definitions for the exemptions are complex and may prove difficult for an individual to apply in practice. The Bill also includes provisions to deal with transactions that only qualify in part under the 'genuine transactions' provisions.

The new exemptions will apply from tax year 2012/13 but, for the purposes of the transfer of assets abroad legislation, will be limited to transfers after 6 April 2012. There are a number of other, previously announced, amendments to the transfer of assets rules that will apply from 6 April 2013. Proposed amendments to the matching rules on the payments of benefits to certain UK resident individuals have been postponed pending consultation.

The Finance Bill confirms that the GAAR is proposed to have effect for tax arrangements entered into on or after Royal Assent

Finally, Budget 2013 announced an extension of the existing rules governing loans made by close companies to their participators. These rules are now included in the Bill and take effect from Budget Day (20 March 2013). The rules are expanded to ensure that the 25% tax charge, which applies to loans and advances made by close companies to their participators, will also apply where loans are made to certain intermediaries (e.g. trusts and partnerships), and in respect of certain other benefits.

Generally, where amounts are repaid within nine months, the charge will not apply. New provisions ensure the charge will continue to apply where amounts are repaid to the company and then re-borrowed. The provisions appear only to apply to repayments over £5,000 or where the total amount outstanding before repayment is £15,000 or more.

Conclusion

The publication of the Bill will allow taxpayers to focus on the changes that will be effective over the coming months. There may still, of course, be further changes to the Bill in the committee stage before the Bill has its third reading in the House of Commons, probably in early July, at which point it will be substantively enacted. However, with a number of clauses having effect from dates before Royal Assent (expected in July 2013), taxpayers may now wish to consider the impact of the new provisions, if they have not done so already. ■