

Welcome

We hope you will enjoy this issue of our Tax Newsletter. Our purpose is to try and keep you abreast of topical UK tax issues which may affect you, your business and/or your clients.



Draft 2012 Finance Bill published

The UK government published draft clauses for Finance Bill 2012 on 6 December 2011 in preparation for the 2012 Budget Statement that will be issued on 21 March 2012.

The key measures to be aware of are as follows.

- Continued downward reduction in the main rate of corporation tax to 24% for the year commencing 1 April 2013.
- Changes to the controlled foreign company ("CFC") legislation effective from 1 April 2012. Under the new regime, a CFC's chargeable profits will be apportioned to the UK and taxed on any UK resident company with a 25% interest in the CFC unless those profits meet the "Gateway", "safe harbours", "finance company partial exemption" or "entity-level exemptions" tests. The draft CFC legislation is extremely complex but it should mean in practice that most trading profits are exempt. The legislation will apply for accounting periods beginning on or after the date on which Finance Act 2012 receives Royal Assent.
- New patent box regime with effect from 1 April 2013 which, if corporations have opted to enter the regime, will result in a preferential rate of 10% applying to profits generated from patents. There will be transitional rules phasing in the benefits from 2013/14 to 2017/18.
- Amendments to Research & Development ("R&D") relief, including the relaxation of eligibility rules for expenditure on externally provided workers.
- Changes to the remittance basis rules for non-UK domiciled individuals, including the simplification of the rules in respect of nominated income and the taxation of assets remitted to the UK to be sold, and the removal of a charge when foreign income or gains are remitted to the UK for the purpose of commercial investment in qualifying UK companies.
- Introduction of a higher £50,000 remittance basis charge for non-UK domiciled individuals who have been UK resident for 12 or more of the 14 tax years preceding the year of the claim.

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- 100% capital allowances years for eligible businesses established in certain enterprise zones for expenditure incurred on plant and machinery between 1 April 2012 to 31 March 2017.
- Additional conditions to be met in order to claim plant and machinery allowances on the sale and purchase of fixtures. In order to claim allowances, the most recent owner who was entitled to claim allowances must have pooled their expenditure or claimed a first-year allowance on it, and the value of the fixtures must be agreed within two years.

The draft clauses will be subject to consultation until 10 February 2012.

The implementation of a new statutory residence test for individuals has been deferred until April 2013. Draft legislation is expected in April 2012 for consultation and inclusion in the Finance Bill 2013, along with draft legislation amending the main offshore income tax and capital gains tax anti-avoidance legislation for individuals.

HMRC focus on UK's wealthiest taxpayers

HM Revenue & Customs ("HMRC") have formed an "Affluence Unit".

The Affluence Unit is described as *"made up of experts from across the department"* and it is understood that HMRC are taking a coordinated approach using teams who deal with corporate entities, residence and domicile issues, and trusts and estates. HMRC highlight that this unit is to use *"new and innovative risk assessment techniques to identify areas where wealthy individuals are avoiding and evading taxes and duties."*

One of the first areas the Affluence Unit has identified to target is wealthy individuals who own land and

property abroad. Other groups identified include commodity traders and people holding offshore accounts.

OECD releases a discussion draft on the definition of "permanent establishment"

Article 5 of the OECD Model Tax Convention includes the definition of the treaty concept of "permanent establishment" ("PE"). While the principles are well established, the practical application of Article 5 is often very difficult, particularly as operating models evolve. An OECD working party has been considering various questions related to the interpretation and application of the definition of PE and its preliminary proposals for additions and changes to the commentary on Article 5 have now been published. The intention of many of the proposals is to reflect the changing ways that enterprises carry out their business.

The discussion draft includes the following topics:

Can a farm be a PE?

Can a home office be a PE?

Time requirements for the existence of a PE.

Presence of foreign enterprise's personnel in the host country.

Meaning of "place of management".

Additional work on a construction site.

Does a development property constitute a PE?

Meaning of "to conclude contracts in the name of the enterprise".

Comments from interested parties have been invited by 10 February 2012, in advance of the next meeting of the working party. The final

version of the changes may be included in the next update of the OECD Model Tax Convention which is currently scheduled for 2014.

M&S Court of Appeal judgment

On 14 October 2011, the Court of Appeal published its decision in the Marks & Spencer ("M&S") case.

The case concerns the ability of a profitable UK parent company (M&S plc) to offset losses generated by its overseas subsidiaries (and this appeal relates to losses in Germany and Belgium) against its UK profits under the UK group relief rules. The case went to the European Court of Justice ("ECJ") where it was argued that in not allowing EU subsidiaries to surrender losses to UK group companies, the UK group relief rules were contrary to EU law. The ECJ found the UK rules did restrict M&S' freedom of establishment but this was generally justifiable. However, it was not proportionate to apply the restriction where the EU subsidiary had, in its state of residence, exhausted the possibilities for offsetting losses in the current or previous accounting periods and there was no possibility for the losses to be taken into account in future periods. It was then up to the UK Courts to apply this ruling to the actual facts. Therefore, six years after the ECJ decision, there is now greater clarity on making such type of claims.

Many of the principles of the case have already been settled; however, the Court of Appeal considered five key questions.

- When the no possibilities test ("NPT") must be satisfied. HMRC contended that the NPT should be satisfied at the end of accounting period in which the losses crystallised. The Court of Appeal rejected this argument (agreeing with the Upper Tribunal ("UTT")) and stated the NPT must be

M&S Court of Appeal judgment (continued)

satisfied by the time the actual claim is made.

- Whether sequential/cumulative claims are allowed. M&S had made a number of claims, some when the NPT was not met, and later claims when it was. HMRC argued that sequential/cumulative claims cannot be allowed as claims must be made at the end of the accounting period when the losses arose (hence unlikely to meet the NPT). The Court of Appeal rejected this argument and affirmed the UTT's decision that such claims are allowed as *"any formal statutory requirement must be 'disapplied or moulded' so that the right is not rendered 'practically impossible or excessively difficult'"*. Therefore successive claims are allowed in relation to the same loss and that claim which satisfies the NPT can be relied upon, after which the other claims can be withdrawn. M&S' later claims when the NPT was met (for Corporation Tax Self Assessment periods) were therefore valid.
- Whether all or some of the losses must meet the NPT. HMRC appealed against the UTT decision that the NPT should be applied on a Euro by Euro basis (which would allow a proportion of losses to satisfy the NPT even if all do not). According to HMRC, if a single Euro of the loss was used then none of the losses would meet the NPT. The Court of Appeal agreed with the UTT decision that the ability to use losses was on a Euro by Euro basis.
- Should the principle of effectiveness allow M&S's pay and file period claims to succeed?

The taxpayer appealed against the UTT decision, arguing that the principle of effectiveness should permit its pay and file period claims which were made in time but when the NPT was not met to be remade despite being out of time. The Court of Appeal rejected this argument. It was held that the pay and file six year and three month claim period did not breach this right, as at the time the claim period expired, the taxpayer had no EU law right to make the claim because the NPT was not met - the pay and file claim periods expired on 30 June 2005 and the NPT was only satisfied in a later period. The Court of Appeal stated that the principle of effectiveness allowed a taxpayer to "vindicate" its legal rights but does not create new legal ones. The judgment does not state whether the principle of effectiveness can be relevant if a taxpayer has an EU right but it is unaware of it before the time limit expires.

- What is the correct method of calculating the overseas losses? The Court of Appeal re-affirmed the UTT position which is:
 - i) identify the taxable losses under the surrendering company's tax rules (it is necessary to start at this point to calculate what if anything has been or could be used in that local territory);
 - ii) identify those losses available to be used against any subsequently earned profits (as calculated in that local territory) on a first in, first out basis;
 - ii) identify the amount which would equate to the commercial profit or loss in the statutory accounts by

removing the adjustments made to the local profits or losses for the purposes of identifying the taxable losses identified in at stage 1;

- iv) apply UK tax adjustments to the commercial profits or losses identified at stage 3 to arrive at an equivalent UK taxable loss; and
- v) reduce that figure, identified at stage 4, by the amount of the overseas losses utilised at stage 2. The result is the amount available for group relief in the UK. In particular, this recognises that a loss for UK group relief purposes is in the year of assessment of the claimant company when recomputed according to UK tax rules and not the year of loss in the surrendering company

The issues in the case itself have been litigated through the English courts and at the ECJ since 2002. However, in the current environment, a reduction of the effective tax rate and a potential receipt of tax refunds are important issues for most companies and all taxpayers who have submitted such claims should now revisit those claims with a view to settling and asking for repayments.

Individuals receiving letters from HMRC regarding Swiss investments

HMRC are in the process of issuing letters to individuals entitled "Swiss investments" in relation to the HSBC Geneva data theft.

Individuals are being asked to confirm that their tax affairs are compliant and that they have not held any accounts or assets offshore or confirm that they will be

Individuals receiving letters from HMRC regarding Swiss investments (continued)

making a disclosure either under or out of the Liechtenstein Disclosure Facility. Included in the letter are details of the suspected undisclosed account and the name the account is held in (which may be the name of an offshore company). It should be noted that confirmation of compliance applies to all offshore accounts, assets, etc, ie confirmation is not restricted to the accounts HMRC include in their letter.

The letters are being issued in tranches and individuals included in the first tranche must provide a response to HMRC no later than 21 December 2011. If HMRC do not receive a response, they may start a detailed investigation which could be a criminal investigation.

If you and/or your client have received such a letter from HMRC and wish to discuss how to proceed, please contact Justine Herridge in our Isle of Man office.

HMRC letter regarding Isle of Man Property Trading Partnership planning

HMRC are issuing letters to individuals who carried out Isle of Man Property Trading Partnership planning. The letters appear to be an update stating HMRC's position following the verdicts reached by the Court of Appeal in the *Huitson* and *Shiner* cases.

Two cases were lodged by taxpayers *Huitson* and *Shiner* seeking Judicial Review of the retrospective legislation introduced in Finance Act 2008. *Huitson* was an IT contractor making his services available through an Isle of Man partnership. *Shiner* was a property developer who entered into a land

trade through an Isle of Man partnership. The Court of Appeal heard the cases on 2, 3 and 4 November 2010 and the judgements handed down were released on 25 July 2011. The Court of Appeal found against both taxpayers. An appeal can be made to the Supreme Court. It is not yet known whether the taxpayers will proceed with an appeal. If you and/or your client have received a letter from HMRC with regard to the aforementioned planning and require assistance in dealing with it, please contact Justine Herridge in our Isle of Man office.

New tax transparent fund pooled investment vehicle

Further details have been announced regarding the proposed new tax transparent fund ("TTF"), a new form of pooled investment vehicle which may be of relevance to investment managers and institutional investors such as insurance companies and pension funds.

HM Treasury will be given powers in Finance Act 2012 to make regulations for two categories of regulated asset pooling vehicle: a contractually based co-ownership fund transparent for income but opaque for chargeable gains, and a partnership-based fund transparent for both income and gains.

Regulations are also proposed to provide that assets of the new class held within the long-term fund of an insurance company will be deemed to be annually disposed of and reacquired, to give relief to insurance companies on transfer of assets into the new tax transparent schemes and to simplify the application of the current chargeable gains rules to the merger and reconstruction of both new and existing types of collective investment schemes.

A regulatory consultation document will be published later this month or in early 2012.

If you wish to discuss this further, please contact David Parsons in our Isle of Man office.

ECJ decision regarding Gibraltar

The final decision in the long running case of the EU Commission and Spain v Gibraltar and the United Kingdom was given by the European Court of Justice ("ECJ") on 15 November 2011. This decision, although long awaited, has, in the end, no impact on Gibraltar and some commentators have suggested that the whole saga has been "unnecessary and pointless", as well as costly.

Although the ECJ decision set aside the original decision of the EU Court of First Instance (the General Court) given in December 2008, the case actually concerned a Gibraltar tax regime for companies proposed in 2002, which was never implemented in Gibraltar. The ECJ concluded, following an appeal by Spain and the EU Commission, that the proposed regime was "materially selective" and, therefore, breached the EU state aid rules even though it was abandoned years ago.

However, the ECJ did not consider the matter of "regional selectivity", which relates to the question of whether Gibraltar has the right under EU law to set its own tax rates and rules. The General Court had ruled several years earlier that Gibraltar did have the right

ECJ decision regarding Gibraltar (continued)

to set its own tax rules and the Gibraltar Government has announced that this latest ruling "leaves intact our taxation powers."

The Chief Minister in office at the time of the latest decision, stated that "the General Court's favourable ruling of December 2008 and the opinion of the Advocate General to the ECJ of April 2011 are the only judicial pronouncements on the question of regional selectivity and Gibraltar, and both robustly confirmed in our favour that the principle of regional selectivity does not apply to disentitle us from having a different and more favourable tax regime than the UK, of which we are not a region."

Therefore, this final decision does not relate to or impact the current low tax rate and beneficial tax system that was introduced for companies from 1 January 2011, which looks likely to continue into the foreseeable future.

GAAR report published

HM Treasury has now published its report on a General Anti-Avoidance Rule ("GAAR"). The report, written by a committee chaired by Graham Aaronson QC, has recommended that the UK does not introduce a broad spectrum general anti-avoidance rule. Instead the report recommends a "moderate rule" targeted at "abusive arrangements". The UK government is now considering the recommendations prior to reporting back at Budget 2012. Any proposals should then fall within the normal tax policy cycle with formal consultation taking place during summer 2012 and legislation included in Finance Bill 2013 (draft clauses for which would be expected to be published in late

2012).

The recommendation is that the GAAR should initially apply to the main direct taxes – income tax, capital gains tax, corporation tax, petroleum revenue tax and national insurance contributions.

Consideration should be given to extending it to Stamp Duty Land Tax at a later stage but it should not include Value Added Tax.

The over-arching principle is that the rule "should target those highly abusive contrived and artificial schemes which are widely regarded as intolerable, but that it should not affect the large centre ground of responsible tax planning" and "where there can be reasonable doubt as to which side of the line any particular arrangement falls on, then that doubt is to be resolved in favour of the taxpayer".

If an arrangement is an "abnormal arrangement" which has an abnormal feature or features specifically designed to achieve an "abusive tax result" then it becomes "shortlisted" for consideration as a potential target for the GAAR. The report excludes "reasonable tax planning" which is described as "arrangements made to secure tax benefits which can be regarded as a reasonable response to choices afforded by the legislation". It also states that there should be an automatic exclusion from the operation of the GAAR for any arrangement which is entered into entirely for non-tax reasons.

The report makes it clear that the GAAR is aimed at artificial tax planning while allowing "responsible tax planning". It should mean that tax planning which is an integral part of commercial arrangements is not affected. It does, however, open up a debate about the purpose of any piece of legislation and whether or not it has been used in a reasonable

way. It will also create an issue for taxpayers, who will want to ensure with certainty that what they are doing will not be caught by the GAAR.

Certificate of residence

HMRC have now made available an online form for individuals who need to prove that they are UK resident in order to claim exemption from tax in certain other countries, eg under a double taxation agreement. To apply for a certificate of residence, go to <http://www.hmrc.gov.uk/news/cert-of-residence.htm>.

Update regarding the Liechtenstein Disclosure Facility

From 1 December 2011, individuals who wish to make use of the Liechtenstein Disclosure Facility ("LDF") will be asked to demonstrate that they have a "meaningful connection" with Liechtenstein.

HMRC will require a completed "Confirmation of Relevance" form from the individual's financial intermediary in Liechtenstein. This form must be provided to HMRC when registering under the LDF. Financial intermediaries will be expected to apply minimum investment levels or other qualifying terms.

The requirement to evidence a "meaningful connection" to Liechtenstein is not new and has been in place since the LDF was launched in 2009. It is now, however, necessary to provide proof of this before HMRC will allow an individual to register under the LDF.

New French reporting requirements for trustees

Trustees who own French assets or are trustees of a trust which has a French resident settlor or beneficiary will shortly be subject to new reporting requirements in France.

As part of the French Tax Reform the French legislator has created new reporting requirements which will apply from 1 January 2012 for trusts in either of the following circumstances:

- the settlor or at least one of the beneficiaries are French tax residents; or
- the trust owns one or several French assets.

The penalties for non compliance are high (e.g. 5% of the value of all the assets or rights in the trust wherever situated).

Below is a summary of the new provisions prepared by our French tax colleagues.

Within the framework of the French tax reform relating to foreign trusts, the French legislator has created reporting requirements when either the settlor or at least one of the beneficiaries are French tax residents or when the foreign trust owns one or several French assets.

The trustee is responsible for this reporting.

Pursuant to this new provision, the trustee must disclose to the French Tax Authorities:

- *the main features of the trust (setting up, modification, main articles etc...); and*

- *the fair market value of the assets held by the trust at 1st January of each year.*

Failure to report triggers a €10k penalty or, if higher, a penalty of 5% based on the value of all the assets or rights in the Trust (even those which are outside the territorial scope of French wealth tax!).

The settlor and the beneficiaries are jointly liable with the trustee for the payment of the penalty. These provisions will apply as from 1st January 2012.

In view of the penalties incurred and in order to anticipate the consequences of the new tax regime applicable to foreign Trusts (in particular, wealth tax, inheritance and gift tax), the situation of each foreign Trust concerned by the French tax reform should be reviewed.

For instance, the following options could be considered, especially:

- *amendments to the existing Trusts in order to comply with French rules and avoid higher inheritance and gift tax rates etc; and*
- *setting up of sub-Trusts for French assets or French beneficiaries.*

The trustees should anyway inform their clients that a penalty may be due in case the Trust is not disclosed to the French Tax Authorities as from 1st January 2012. The trustees who would fail to provide such information might be considered by the clients as responsible for the payment of such penalty in case of a tax audit."

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