



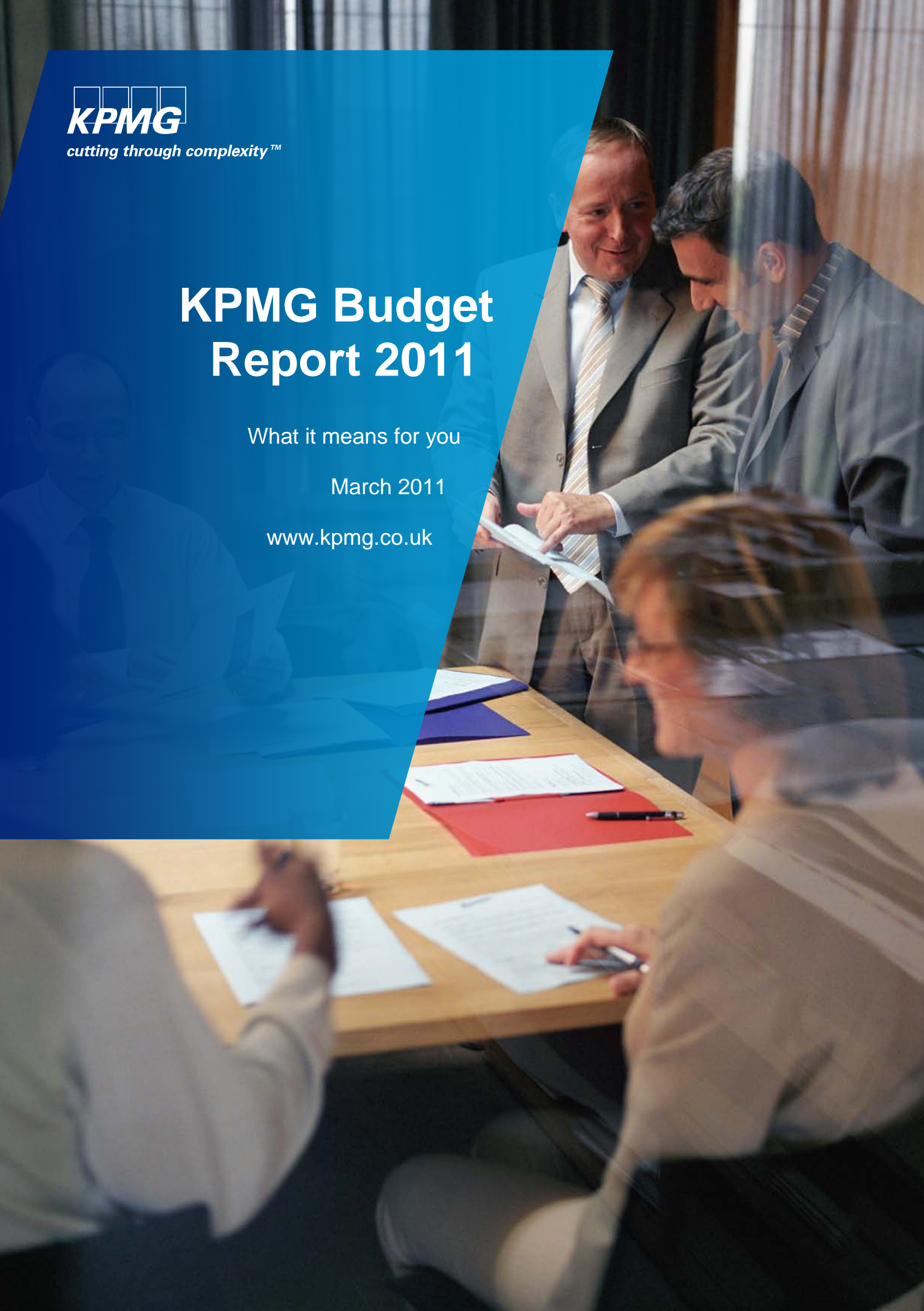
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KPMG Budget Report 2011

What it means for you

March 2011

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Our view



Anneli Collins
Head of Tax Policy

Today's Budget was in general a good budget for business, but there were a few offsetting disappointments. The forthcoming year will be very busy with consultations which have been announced in the Budget.

The further reduction in the main corporation tax rate to 26 percent from April 2011 will be welcomed by companies with larger profits, although it will have no impact on smaller businesses with profits below £300,000 whose corporation tax rate will be 20 percent from April 2011.

Legislation will be introduced in Finance Bill 2011 to exempt the profits of foreign branches of UK resident companies from corporation tax on an elective basis. The changes to the draft legislation should make it easier for companies such as some financial institutions that currently have losses in one or more of their branches to benefit from the régime.

Following consultation, the Government has announced that a number of changes are to be made to the Controlled Foreign Companies (CFC) interim improvements to make it easier for businesses to benefit from them. No further details have been provided at this stage. Similarly, the Government will continue to consult about the patent box with legislation expected in Finance Bill 2012.

Subject to obtaining state aid approval from the European Commission, the rate of additional deduction for expenditure on research and development by small or medium sized companies will be increased to 100 percent from 1 April 2011, giving a total deduction of 200 percent. Other changes will be made to simplify the relief.

A statutory residence test for individuals is being introduced to take effect from 6 April 2012. It is positive to have such a test but whether it will make determining residence more straightforward will depend on the precise test. More will be known after the consultation in June 2011.

There are three measures affecting non-domiciles to start from 6 April 2012 after a consultation document due in June. The annual £30,000 charge will be increased to £50,000 for those non-domiciles who have been resident for more than twelve years. There will be no tax charge if non-domiciles remit foreign income or gains to the UK for commercial investment in UK businesses. Technical simplification will be made to some aspects of the current rules for non-domiciles to remove undue administrative burdens.

The budget brought very welcome news for entrepreneurs by doubling the Entrepreneurs' Relief lifetime limit to £10million from 6 April 2011. There

have been no changes in the qualifying conditions but where the conditions are met this will be worth a maximum tax saving of £1.8million.

The government is proposing a range of changes that will affect the full range of state, public and private sector pension provision. Most of these measures are known only in outline at the present time, with detailed consultation to follow.

The Government has announced that it will consult on the potential integration of the operation of income tax and National Insurance Contributions (NIC). A consultation document will be published later this year. The Chancellor stated that any change would be complex and involve a wide range of policy and implementation issues. It will be a number of years before any merger could take place. In the long term this is likely to reduce the high costs of businesses running these two taxes side by side through the payroll.

The Government has confirmed that it will introduce new disguised remuneration rules to counter tax avoidance by employers and employees via the use of trusts and benefits such as loans. Following consultation, the Government have confirmed that they have amended the legislation to limit the impact on employers and individuals "where it is possible to identify arrangements that cannot be used for avoidance purposes". Employers will need to review very carefully all their remuneration arrangements which involve any party other than the employer to determine whether and to what extent they could be impacted.

The simplification of the tax system by the abolition of tax reliefs will help reduce its complexity. However, it will be important to consider the detail to ensure that significant benefits are not being taken away. Further consultation awaits.

The IR35 régime (the employment intermediaries' legislation) is being retained, following a review by the Office of Tax simplification. However, the administration is to be simplified, HMRC is to provide a dedicated helpline and set up a forum to engage with interested parties. It is hoped that these changes will ease the impact of IR35.

A number of rather minor announcements regarding VAT were made, many of which will not come into effect until 2012. Many consultations were also announced.

Two business sectors will be feeling hard done by today: the North Sea oil and gas producers who are paying for the reduced fuel duties on petrol and diesel by an increase in the supplemental charge from 20 percent to 32 percent. The proposed tax increases can only reduce the attractiveness of investment in the North Sea. The potential for this supplemental charge to be reduced if the oil price falls will be of no consolation to the UK's oil and gas producers.

Banks and building societies will be disappointed by the increase in the Bank Levy rates for 2012 and subsequent periods. Of particular concern will be the uncertainty that has been caused by two changes to the Bank Levy rates in successive months. UK headquartered banks are at a disadvantage to foreign banks, as they pay the banking levy on their worldwide balance sheets, rather than just their UK balances. With British

taxpayers as significant owners in two of the major banks, could this tending towards a tipping point where the UK banking sector is being put at a competitive disadvantage to banks overseas?

Economic Implications



Andrew Smith
Chief Economist

Theoretically this budget counts as broadly “neutral” since the main austerity measures were pre-announced last year. But in practice the fiscal stance is anything but. In 2011-12, current receipts are due to rise by one percent of GDP, reflecting principally increases in VAT and National Insurance Contributions, while spending cuts of a similar size are in the pipeline. In this context, these latest measures cancel each other out. The fuel duty reduction this year is worth almost £2bn but the chancellor is recouping this from North Sea producers.

Thus boxed in, this “budget for growth” has had to rely on relatively low cost efficiency measures aimed at improving the working of the economy, ranging from resuscitating enterprise zones, through de-regulation, to training and apprenticeships to combat youth unemployment. While welcome, supply-side improvements are no quick fix and take time and persistence to come to fruition.

The focus of deficit reduction is on spending cuts and tax rises, but it is also crucially dependent on a return to robust GDP growth. The fall in fourth quarter output has had a knock-on effect on the economic forecast for this year and next, but growth is projected to get back on track further out. To date, though, there is little evidence of the promised rebalancing of the economy. Consumer spending is certainly taking a back seat – this year’s forecast increase has been halved - but exports and business investment have yet to take off.

Slower growth and higher inflation - which is pushing up government spending faster than receipts – have already resulted in some slippage in the deficit reduction programme before it has really begun, but the OBR still thinks the government is on track to eliminate the structural deficit by 2015-16.

As far as policy is concerned we are in uncharted waters with interest rates around zero. Perhaps the greatest risk is that the Chancellor’s strategy relies on monetary policy remaining loose to offset the tight fiscal stance - but this is outside his control and the MPC is becoming increasingly concerned about above target inflation.

Public Sector Implications



Alan Downey
Head of Public Sector

The Chancellor's ambitious 'Budget for growth' needs to be coupled with an equally ambitious programme of public sector reform.

Any plan for growth will only succeed if it also involves the transformation of our public services. Efficient and well-directed public sector spending can help to support and boost the private economy, not just by supporting it through a strong infrastructure and a well-educated workforce, but also by making Britain an attractive place to live and do business.

In a time of unprecedented cuts and a strong commitment on achieving challenging targets for spending reductions many public bodies may be tempted to reduce the frontline provision of services by cutting community health facilities, nurseries, services to older and vulnerable people, arts and cultural events, or programmes to increase labour participation. In order to stop public bodies taking the easy route to cuts and thereby harm the long-term competitiveness of the UK economy, the government should not shy away from radical structural reform.

Over the last decade UK public bodies have fallen well behind private companies in productivity. According to the Office for National Statistics productivity in the public sector declined by more than three percent between 1997 and 2007, while among service providers in the private sector, it improved by more than 20 percent during that period. This has placed a huge and unnecessary strain on the whole UK economy. Reducing public spending alone will not increase efficiency – a radical reform must accompany the cuts.

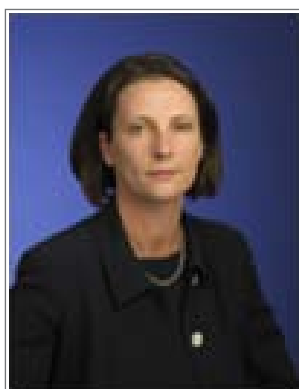
Allowing the private and voluntary sector to participate in this process is critical. The chancellor rightly points out that the UK has one of the most innovative and creative business services sectors. It also has charities and voluntary organisations that are recognised world leaders in their respective fields. The government has the opportunity to benefit from this latent knowledge and enthusiasm by engaging these organisations in reform by stating the problems and allowing all providers - in-house, private or voluntary – to come up with new, innovative solutions rather than just contracting with them for 'doing the job'. Steps to improve procurement and to encourage small groups of public sector workers to establish employee-led mutuals are to be applauded, but they do not begin to address the more fundamental challenge.

Reform needs to cut across government departments – star chambers to police wayward overspenders or non-cutters will not solve the problem. Instead, commitment and leadership from No. 10 and the Treasury in particular are needed to set out a more ambitious and sustainable path to driving public sector reform.

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Corporate Tax



Jane McCormick
Head of Corporate Tax

Other than for the banking and oil and gas sectors, the corporate tax changes announced in the budget are broadly positive. The Chancellor announced that the main rate of corporation tax will now fall by two percent on 1 April 2011, to 26 percent rather than one percent as previously expected. This was a very welcome surprise. Also of note was the announcement that the proposed partial finance company exemption, to be included in the new CFC regime, will result in taxation of one-quarter (rather than one-third, as previously suggested) of the profits derived from overseas group financing arrangements. This will result in a UK effective tax rate of just 5.75 percent once the corporation tax rate falls to 23 percent in 2014. These measures are likely to increase the attractiveness of the UK to multi-national organisations and will hopefully prevent further high profile moves out of the UK to jurisdictions with tax regimes perceived to be more competitive.

On a less positive note the surprise increase in the oil and gas supplementary charge from 20 percent to 32 percent, effectively a windfall tax, is a huge blow to the oil industry and the proposed tax increases can only reduce the attractiveness of investment in the North Sea. Banks were also losers as the Chancellor announced an increase to the bank levy which, although small, is the second increase since the original levy proposals and some banks will be alarmed by the direction of travel.

While there were a number of headlines there was little detail on most of the measures announced in the Budget and, instead, we can expect a number of important consultation documents to be published in the months ahead. As expected we will be seeing consultations on full CFC reform, the proposed patent box and changes to the R&D regime in May. Also of note is a consultation on devolving corporate taxation to Northern Ireland due to be published on 24 March which may eventually result in a reduced tax rate for the region.



Indirect Tax



Gary Harley
Head of Indirect Tax

This was a Budget comprising a lot of rather minor announcements as far as VAT was concerned, many of which will not come into effect until 2012. Many consultations were also announced.

The widely predicted changes to the Low Value Consignment Relief turned out to be rather less draconian than had been anticipated, as the threshold has only been reduced by £3 (to £15) for now (wef 1 November 2011). Under current EU law, the UK could have reduced the limit to £9. The possible sting in the tail here though is the announcement that the UK is looking to agree a derogation from the EU law which could further limit the relief.

The UK found out, again, that when it comes to indirect tax, we are not an island. The previous announcement that Air Passenger Duty was to change at some point from a per passenger tax to a per plane tax has foundered on this rock, as the UK has established that this approach would be illegal under international law. APD is to be frozen until April 2012. At present passengers on private jets are exempt from APD since they do not pay for a ticket – consultations will take place over the next 12 months regarding the application of APD to passengers on such flights.

There was some relief for the hard pressed motorist in the Budget though. The duty on road fuel will decrease by 1p a litre from 6pm on Budget Day. The planned increase next month will be postponed until 1 January 2012 when the duty rate will increase by just over 3p a litre. This is only a temporary and small respite but given the enormous increase in fuel prices over the last few months, due to inflation and the increase in the cost of oil, it will be welcome.



Employee Issues



Jayne Vaughan
Head of Employee Tax

From an employer perspective this year's Budget contained a number of "big ideas" with the detail to follow later. But equally, the Government's new rules on "Disguised Remuneration" are complicated and will potentially impact on employers from 6 April 2011 (if not before). It will be important for employers to take stock in terms of both the Finance Bill, which will be published next week on 31 March 2011, and a number of consultation documents that will be published over the summer. In this respect this Budget leaves a number of open questions and further work to do.

The most significant immediate concern is the new anti-avoidance legislation on "Disguised Remuneration". The Budget documents have confirmed HMRC's intention to amend the legislation where there are unexpected results without an avoidance motive, but given the complex nature of the legislation, it appears inevitable that there will remain hard edges and unintended consequences. Employers will have to carefully review their remuneration arrangements where third parties are involved to see whether they fall foul of the new rules. And they may well want to approach HMRC to confirm that they are not inadvertently impacted.

Another big idea, albeit not new, is the review of non-domicile taxation. In the June 2010 Emergency Budget, the Government confirmed that it would review the taxation of non-domiciled individuals and the ongoing uncertainty has been harming the UK's competitiveness. The Government has recognised that the remittance basis rules are a disincentive to invest in the UK and intend to modify the rules to address this. On the other hand the remittance basis charge is to be raised to £50,000 for individuals who have been resident for 12 or more years. A consultation document will be issued in June with a view to implementing these reforms from April 2012. The Government has also stated there will be no further changes to these rules during the period of this Parliament.

There is also the announcement that there will be a statutory residence test. Currently there is no single statutory test for tax residence in the United Kingdom. An individual who is in the UK for 183 days or more in a tax year will be UK resident. Someone who spends no time in the UK in a tax year is unlikely to be resident. In other cases HMRC and, if necessary, the courts determine a person's residence status from case law principles. Recent cases have demonstrated the real difficulties that can arise.

Again a consultation document will be issued in June with the aim to introduce a statutory residence test from April 2012. The devil will be in the detail but the hope is that the test will provide certainty over an individual's residence status, whilst being sufficiently practical to enable employers to meet their PAYE obligations with the minimum of administrative costs.

The Government has also responded to the suggestion by the Office of Tax Simplification ("OTS") of a merger of income tax and NIC by announcing a consultation that will take place later this year. A merger makes sense from the point of view of administration but may be difficult to achieve in practice. The Government confirmed that the intention is for this to be a simplification and not a revenue raising measure. They also confirmed that NIC is not to be extended to individuals of State pension age and not levied on pensions, savings and dividends.

The Government also responded to the OTS report on IR35. The Government has decided to retain this because it cannot put substantial tax revenue at risk. This will disappoint those who were hoping for the abolition of IR35.

Other changes announced include a tweaking of the company car scale charge rates to encourage greater use of lower CO2 emission vehicles and an increase in the car fuel benefit scale charge. The HMRC Authorised Mileage Allowance Payments for business journeys in privately owned cars have been increased from 40p a mile to 45p a mile for the first 10,000 miles. This change will take effect from 6 April 2011. This rate has remained at the previous 40p a mile level for some few years and with significantly increasing fuel costs this change will be welcomed.



Personal Tax



David Kilshaw
Private Client Chairman

The 2011 Budget measures relating to individuals can be seen at least in part as meeting some of the Government's main policy objectives.

Reducing the fiscal deficit

Limiting future indexation of most tax reliefs and allowances to the CPI rather than the RPI will, on the basis that the former is usually a lower measure, represent an effective tax increase over time (albeit that for the time being the Government is continuing to pursue its policy of increasing the personal income tax allowance by substantially more than the normal indexation basis, at least for basic rate taxpayers).

Specific anti-avoidance measures were announced, and a framework for tackling tax avoidance in general was published for consultation, with a view to protecting current and future tax revenues.

However, most of the tax and national insurance increases coming into force from 6 April 2011 had already been pre-announced and therefore there was less pressure to introduce further tax increases in this Budget.

Encouraging enterprise and competitiveness

The lifetime allowance for entrepreneurs' relief is being doubled to £10 million and the tax benefits of investment in EIS qualifying companies are being enhanced as a means of encouraging and rewarding entrepreneurial activity.

The retention of the remittance basis of taxation for non-UK domiciled individuals (albeit with an increased annual charge of £50,000 for those resident here for 12 years or more), and the ability to remit on a tax free basis foreign income and capital gains for investment in UK businesses can also perhaps be seen as part of the same agenda.

Big Society

Changes to the administration of the Gift Aid scheme which will benefit both small and large donors, and an enhanced IHT relief for charitable bequests (reducing the effective IHT rate from 40 percent to 36 percent), are intended to encourage donations to charity.

Tax simplification

The announcement of a possible merger of the operation of Income Tax and National Insurance Contributions ("NIC") would represent one of the most substantial tax reforms of the past half century. The difficulties with this are recognised by the Government and it is regarded as a long term project. There are clear potential benefits in administration from merging the systems, but there are many issues to consider, such as the

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interaction with the benefits system, and how a merged system would apply to income that is not subject to NIC – for example, pensions and investment income.

The announcement of an intention to proceed with a statutory residence test could represent the opportunity to give certainty on a difficult issue that has led to an increasing amount of litigation in recent years. However, there is no detail on the Government's preferred approach and it could well be the case that it will be no simpler to determine UK residence than under the current rules.

Conclusion

The mix of policy objectives and the fiscal pressures facing the Government mean that the Budget is a "mixed bag" with good and bad news, and some indications of major reforms to the tax and national insurance systems.

Corporation tax charge and main rate

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Brief overview

It has been announced that the main rate of corporation tax will now fall by two percent on 1 April 2011, to 26 percent. The Finance Bill 2011 will also include a provision for a further one percent reduction to 25 percent on 1 April 2012. The further planned annual reductions, of one percent on both 1 April 2013 and 1 April 2014, will be legislated in subsequent finance bills.

The small profits rate of tax will fall by 1 percent to 20 percent on 1 April 2011.

Corporation tax rates for ring fence profits (those arising from oil extraction and oil rights in the UK and the UK continental shelf) will remain at 30 percent and 19 percent respectively.

Key changes announced at the Budget

The main rate of corporation tax will be reduced by two percent on 1 April 2011; this was previously expected to be only a one percent reduction.

The Finance Bill 2011 will also legislate for a further one percent reduction on 1 April 2012. This year-on-year reduction had already been announced but it was unclear when it would be legislated.

The fraction for calculating marginal relief, where a company's profits fall between the small profits rate limit of £300,000 and the main rate threshold of £1,500,000, will be changed from 7/400 to 3/200, to reflect the reduction in the gap between the small profits rate and the main rate of corporation tax.

Our view

This further reduction in the main companies rate will be welcomed by companies with larger profits, although it will have no impact on smaller businesses with profits below £300,000.

Whilst the inclusion, in the 2011 Finance Bill, of a reduction in the main tax rate from 1 April 2012 will provide greater certainty to businesses, the tax accounting implications will require detailed consideration.

What we wrote when the draft clauses were published 9 December 2010

Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

Summary of proposal

As previously announced, the main corporation tax rate will reduce from 27 percent (the rate for the financial year from 1 April 2011 – 31 March 2012) to 26 percent from 1 April 2012.

The Government is also consulting whether the pre-announced reductions to the main rate of corporation tax, reducing to 24 percent from 1 April 2014, should be also enacted in the Finance Bill 2011. If this were to happen, whilst perhaps providing greater certainty to business, the tax accounting implications would require detailed consideration

The small profits rate of tax will be reduced from 21 percent to 20 percent from 1 April 2011.

The corporation tax rates for ring-fence profits (profits arising from oil extraction and oil rights in the UK and the UK Continental Shelf) will remain at 30 percent and 19 percent respectively.

Who is affected

All companies that pay UK corporation tax.

Timing

The main rate of corporation tax rates will reduce to 26 percent from 1 April 2012 and the small profits rate from 1 April 2011.

Our view

This confirms measures already announced in the June 2010 budget. The rate reductions will be welcomed by taxpaying companies. However, the potential tax benefit arising from the reduction in rates may be offset by the proposed capital allowance changes which take effect from 1 April 2012.

Increase in UK oil tax rate

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The issue

From 24 March 2011 there will be an increase in the supplementary charge in respect of profits from oil and gas production in the UK and UK Continental Shelf from 20 percent to 32 percent.

In future years, where the oil price falls below a set trigger on a sustained basis, the Government will reduce the rate towards the original 20 percent rate on a staged and affordable basis. Government considers that a trigger price of USD\$75 per barrel would be appropriate but will set a final level and mechanism after seeking views of oil and gas companies and motoring groups.

Legislation will be introduced in Finance Bill 2012, to restrict tax relief for decommissioning expenses to the 20 percent rate of supplementary charge. The Government announced there will be no restrictions to decommissioning relief beyond this level for the lifetime of this Parliament.

It was stated that Government will work with the Industry with the aim of announcing further, longer-term certainty on decommissioning at Budget 2012.

Who is affected

Upstream Oil and Gas producers operating in the UK.

Timing

The new rules will take effect on or after 24 March 2011.

Our view

The proposed tax increases can only reduce the attractiveness of investment in the North Sea. The potential for the tax rate to be reduced if the oil price falls will be of no consolation to the UK's oil and gas producers.

While the Chancellor spoke about making the UK a globally attractive place to do business this would not appear to apply to UK oil and gas production. With these announcements the effective rate for many North Sea fields has more than doubled in less than a decade.

It is disappointing that these measures were not discussed with industry; the rate change will come as a shock to oil and gas production companies in the UK.

Bank Levy

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Brief overview

The Bank Levy will be a tax based on total chargeable equity and liabilities of banks and building societies where these exceed £20bn. The Levy will be imposed with effect from 1 January 2011. Originally, reduced rates were to be applied for 2011. The Chancellor announced on 8 February 2011 an increase in the rates of Levy for 2011 so that for 2011 as a whole the Levy would be payable at the full rate.

Key changes announced at the Budget

The Chancellor announced that the main rates for the Levy that apply from 1 January 2012 would be increased from 0.075 percent to 0.078 percent for short-term chargeable liabilities and from 0.0375 percent to 0.039 percent for long term chargeable equity and liabilities. It is expected that the change will raise additional revenue of approximately £100m in each full year to which it is applied.

Our view

Banks and building societies will be disappointed by the increase in the Bank Levy rates for 2012 and subsequent periods. Of particular concern will be the uncertainty that has been caused by two changes to the Bank Levy rates in successive months.

What we wrote when the draft clauses were published 9 December 2010

Impact on taxpayer			
Positive	Neutral	Negative	Both positive and negative

Summary of proposal

In the June 2010 emergency Budget, the Chancellor announced the introduction of a Bank Levy, effective from 1 January 2011, in respect of certain equity and liabilities on banks' balance sheets. Following a consultation process which concluded on 5 October 2010, initial draft legislation was published on 21 October 2010, with further details of administration and collection procedures and anti-avoidance measures published more recently. The final draft legislation has now been published.

The Bank Levy will be charged based on total chargeable equity and liabilities reported in the relevant balance sheets of affected banks and building societies. For UK banking groups the levy will be imposed on the group's global consolidated balance sheet whereas for foreign banking groups the levy will be imposed on the UK group/subsidiary balance sheet and a proportion of the foreign bank's balance sheet where that foreign bank operates in the UK through a branch.

In determining chargeable equity and liabilities certain amounts may be excluded, the most important of which are Tier 1 capital, certain insured customer deposits and some insurance liabilities. Certain liabilities may also be reduced by netting against them certain assets or offsetting high quality liquid assets held for regulatory purposes.

The levy will be imposed at a rate of 0.0375 percent for long term liabilities (in excess of 12 months) and 0.075 percent for short term liabilities. A reduced rate applies for 2011 (0.025 percent for long term liabilities and 0.05 percent for short term liabilities).

The levy will not be charged on the first £20 billion of chargeable equity and liabilities and therefore many small banks and building societies would not expect to be affected.

According to the impact assessment the levy is designed to raise £2.6 billion annually from 2013-2014 and will be permanent.

Who is affected

UK banks, banking groups and building societies, foreign banking groups operating in the UK through a permanent establishment or subsidiary and UK banks and banking sub-groups in non-banking groups. The definition of banking group is wider than pure banks and in some cases other financial institutions will need to consider whether they could fall within the definition.

Timing

The Bank Levy will apply to periods of account ending on or after 1 January 2011. Where the period of account starts before 1 January 2011 the Bank Levy due is reduced on a pro-rata basis according to the part of the period falling before 1 January 2011. Going forward, the levy will be payable quarterly in line with the regime for quarterly instalments of corporation tax.

Our view

The imposition of the Bank Levy is a controversial development and many banks will find it hard to reconcile its introduction with the UK's ambitions to maintain a competitive tax regime. However the consultation period has been productive and a number of changes to the original proposals will be welcomed. The legislation is lengthy and complex and banks and building societies will now need to work through the detailed provisions to determine the potential impact.

The most significant change is that the rates at which the levy will be imposed have increased for both short and long term liabilities. The lower rates for 2011 have also increased in both cases. It may be the case that the changes in the rates are designed to ensure the levy meets its revenue raising objectives following the changes made to the legislation during the consultation period. The most significant change has been the introduction of a £20 billion allowance rather than a £20 billion threshold, which is important for smaller and medium sized banks and building societies.

Income tax and NIC reform

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The issue

The Government has announced that it will consult on the potential integration of the operation of income tax and National Insurance Contributions (NIC).

Who is affected

Individuals liable to and who account for income tax and NIC such as employers, employees and the self-employed. The Government has said that it is not the intention to extend NIC to individuals above State Pension age or to other forms of income such as pensions, savings and dividends.

Timing

A consultation document will be published later this year. The Chancellor stated that it will take a number of years to complete the consultation.

Our view

The Chancellor has now announced a review/consultation on integrating the operation of income tax and NIC. In line with the stated aim of the Budget, the Chancellor said this was intended to be a simplification and not a tax raising measure.

The merger makes a lot of sense from an administrative perspective particularly for employers. The two regimes work in a similar way in as much as they both tax earned income but there are very significant areas of inconsistency around how they operate. For many years, the administration of both the income tax and NIC systems has been run by one government department (HM Revenue and Customs), but it often appears to employers that separate organisations administer the two systems. For example, frequently, guidance issued only covers tax or NIC, but not both.

NICs are currently only applied to earned income whereas income tax is generally applied to all income. So merely merging the two rates would make no difference to the take home pay of most employees. However, the recent Office of Tax Simplifications (OTS) report stated that 'The income tax and NIC treatment of benefits varies, with some exempt from both income tax and NIC (e.g. cycle to work), some exempt from income tax only (e.g. pension contributions), some exempt from NIC only (e.g. payments in respect of lost and stolen credit cards) and some exempt from neither (e.g. health insurance). This creates confusion for both taxpayers and employers....'. Qualifying termination payments attract income tax above £30,000 (and, in certain cases more) but no NIC and there are other similar examples of different approaches being taken. The two systems cannot be merged without some give and take at this level unless we are to end up with an extremely complex combined system.

The implication on the UK's tax competitiveness should also be considered if a merger of the two charges resulted simply in an abolition of NIC and a correspondingly higher headline income tax rate. Although the overall tax take may stay unchanged, the change in headline rates could create a negative perception issue for the UK compared to other countries

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which charge a social security tax separate from income tax. To the unsophisticated investor, this could, for example, make UK plc seem uncompetitive when compared to other European neighbours.

It is, at present, unclear how a merged system would interact with the UK's double taxation treaties and reciprocal social security agreements including the European Union agreement.

The Government have also said that they will maintain the contributory principle and reflect this in any changes that it brings forward. This will inevitably create a tension with the desire to simplify but, nevertheless, we welcome the Government's intention to revisit the issue of merging income tax and NIC and argue that this will have real potential to reduce administrative burdens on employers.

Response to OTS report on IR35

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The Government has considered the Office of Tax Simplifications (OTS) report published on 10 March which included comment on IR35 and have decided to retain IR35. The legislation is contained at Chapter 8, Part 2 of ITEPA 2003 but is commonly known as IR35 and applies in situations where an end user contracts with a Personal Service Company (PSC) for the services of a contractor (Director of the PSC). Broadly IR35 applies where the relationship between the end user and the contractor, ignoring the contract with the PSC, would be viewed as an employment relationship.

The issue

The OTS put forward three suggested options for revising the IR35 legislation one of which was to remove IR35 totally. In the past IR35 has received much criticism regarding the difficulties in applying the legislation and particularly that this relies on the definition of employment in determining when IR35 will apply. There has also been some criticism that IR35 had not brought in the extra tax revenues expected whilst increasing costs for contractors as they defended themselves against IR35.

The Government has considered the options put forward by the OTS and has decided that it cannot put substantial tax revenue at risk and are, therefore, retaining IR35. They appear to have recognised some of the difficulties of administering IR35 and are going to provide greater clarity on what they consider is within IR35. They also intend to simplify the administration for all with specialist teams to look at the high risk cases, provide a dedicated helpline and in addition propose to set up a forum to engage with interested parties to monitor the HMRC revised approach. This is intended to clarify what IR35 will cover and thereby reduce the costs of contractors due to incorrect IR35 determinations.

Who is affected?

This will affect many individuals who supply their services via their own PSC including both UK and non UK PSC's where the work is carried out in the UK. In particular it will impact industries such as IT and construction etc where historically significant numbers of contractors have provided services via a PSC.

Timing

The Government has committed to making these improvements to IR35 but has not yet published a timescale.

Our view

This decision will be disappointing for a number of individuals affected by IR35 who may have thought the complete abolition of IR35 was a better outcome. The proof will be in the changes that HMRC bring forward and if they are able to simplify the application of the IR35 legislation. It has yet to be determined if the HMRC teams are able to apply this fairly and consistently. It is welcome that HMRC intend to set up a forum to engage

with those affected and the hope will be that this forum will enable any potential problems to be resolved quickly. It is yet to be seen what impact, if any, these proposed changes will have on the tax receipts.

Disguised Remuneration

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The issue

The Government announced on 9 December 2010 that anti-avoidance legislation will be introduced in Finance Bill 2011 concerning third party arrangements used to avoid, reduce or defer liabilities to income tax and NICs on rewards from employment or to avoid restrictions on pensions tax relief.

A new income tax charge will apply where a third party provides an employee with reward, recognition or a loan in connection with the employee's employment. The Government say that third party arrangements that do not amount to tax avoidance will be excluded "in so far as this is possible without creating additional avoidance risks". In particular, this is to apply to genuine deferred remuneration arrangements common in the financial services sector and which last less than five years and genuine commercial arrangements for the provision of employee car ownership schemes.

The legislation will also apply to pension arrangements involving third parties (which they generally do) and which are used in addition to, or instead of, registered pension plans and where, at present, the rules on the annual and lifetime allowances do not apply.

The legislation will apply to arrangements involving trusts or other third parties and where (i) sums or assets are "earmarked" for employees, (ii) loans are provided to employees (iii) assets are made available to employees or (iv) sums or assets are paid or provided to employees. The legislation will apply equally to remuneration and retirement benefit arrangements, but not to payments otherwise chargeable to tax as pension income.

The new charge will be based on the full amount of any sum of money made available or the higher of the cost or market value where an asset is used to deliver the reward.

The amount will count as a payment of employment income and the employer will be required to account for PAYE accordingly.

The Government invited representations on this measure over the period until 9 February 2011, and on 21 February published a series of FAQs addressing a number of points that were raised.

The Government have confirmed that they have amended the legislation to limit the impact on employers and individuals "where it is possible to identify arrangements that cannot be used for avoidance purposes". The amendments cover "the protection of rewards by group companies, share incentive arrangements and genuine deferred remuneration arrangements". The Government have also confirmed that existing pension savings will be excluded.

The Government note that they regard certain arrangements caught by these new measures as not, in any event, effective under the current law and say they will continue to challenge such arrangements.

Timing

The new rules will take effect from 6 April 2011 but anti-forestalling rules will apply to the payment of sums (including loans) to employees, and in certain other circumstances, between 9 December 2010 and 5 April 2011.

Regulations will be published shortly to apply NICs to amounts chargeable to income tax under the new rules.

Our view

The Government say that approximately 5,000 employers and 50,000 employees will be affected by these measures with a yield to the Exchequer of some £750 million in 2011-12 and subsequent years to 2015/16.

Whilst it is understandable that the Government wishes to clamp down on perceived areas of tax avoidance and is concerned about potential tax leakage through the use of pension arrangements falling outside of the registered regime, there was much concern expressed during the consultation period about the very wide scope of the draft legislation that was published on 9 December 2010.

The FAQs that were published on 21 February 2011 sought to allay this concern by referring to a number of the hard edges and unintended consequences of the new rules and confirming, as the Government now reaffirm, that the draft legislation will be appropriately amended.

Our real concern, however, is the very wide range of circumstances in which third parties are involved in the provision of reward to employees, whether this be in relation to share plans, pension plans, medical insurance cover, relocation assistance etc. This applies equally, if not more so, to international assignees posted to the UK from abroad. Whilst there are a number of prescribed exceptions there will inevitably still be numbers of commercial arrangements which will not tick all the required boxes.

Although the Government say they will, for the most part, exclude group companies from the definition of third parties, this is with the caveat that this will not be so where there are "additional avoidance risks". Whilst we can understand this approach at a conceptual level, the reality is that employers will need to review very carefully all their remuneration arrangements which involve any party other than the employer alone (and whether this is another group company or otherwise) and to determine whether, and if so how, they could be impacted. Indeed employees may well want to approach HMRC to confirm the position since the consequences of inadvertently getting it wrong will be very unwelcome to both employers and employees alike.

Entrepreneurs' Relief - Increase in Lifetime Limit

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The issue

The lifetime limit on gains qualifying for Entrepreneurs' Relief has been doubled from £5million to £10million. Tax payers who have already used the £5million lifetime limit will be able to benefit from the increased threshold and receive and apply the relief to another £5million of qualifying gains after 5 April 2011.

Who is affected?

Individuals and trustees of settlements who have qualifying gains.

Timing

The new rules will take effect from 6 April 2011.

Our view

This is a welcome increase to encourage enterprise. Entrepreneurial share owners will now be able to benefit from an additional £900,000 tax saving under the new limit. This will bring the maximum, total value of the relief to £1.8 million for higher rate tax payers. Qualifying gains are subject to capital gains tax at 10 percent.

It is important to note that the criteria have not been relaxed and therefore to qualify for the relief individuals broadly need to hold five percent of the voting rights and rights to assets on a winding up in an unquoted trading company for which they work. They also have to have held the shares for at least a year.

The increase in relief is not retroactive; any gains made before 6 April 2011 in excess of the previous limit will not benefit from the additional relief. The increased limit will be available for future qualifying gains after 5 April 2011.

Changes to the Taxation of Non-Domiciled Individuals

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

The issue

The previous Government introduced sweeping changes to the taxation of non-UK domiciled individuals (“non-doms”) in Finance Act 2008. The taxation of non-doms will be further reformed as follows:

- The annual £30,000 charge will be increased to £50,000 for those non-doms who have been resident in the UK for twelve or more years and who wish to be taxed on the remittance basis. The £30,000 annual charge will continue for those individuals who have been resident in the UK for at least seven years but fewer than twelve years.
- The tax charge will be removed for non-doms who remit foreign income or gains to the UK for the purpose of commercial investment in UK businesses.
- Technical simplification will be made to some aspects of the current rules to remove undue administrative burdens.

Who is affected

These changes will affect non-domiciled individuals. In particular it will affect those non-doms who have been resident in the UK for twelve or more years.

Timing

The Government will issue a consultation document in June. Legislation implementing these changes will be included in Finance Act 2012 to take effect from 6 April 2012.

Our view

The increased charge to £50,000 will be a real cost to some individuals. However, the other changes are welcome, in particular the assurance that the Government plans no other substantive changes to the taxation of non-doms for “the remainder of Parliament” and the technical simplification of some aspects of the current rules. The ability for non-doms to bring foreign income and gains to the UK to invest in UK businesses is an encouraging step.

Statutory definition of residence

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Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

Positive to have such a test, but the broader effect depends on the definition used.

The issue

The current case law principles for determining whether an individual is resident in the UK are unclear and complex. A statutory residence test will be introduced.

Who is affected

This is relevant for all taxpayers who do not spend all of their time in the UK.

Timing

The Government will consult on this issue in June. Legislation implementing the new statutory test for residence will be included in Finance Act 2012 to take effect from 6 April 2012.

Our view

Whether the new legislation will make it more straightforward in determining an individual's residence status will depend on the precise test which results from the consultation in June. A simple objective test based on days of presence in the UK would be welcome.

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