



# Chancellor's Pre-Budget Report 2009

## KPMG Full Commentary

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# Our View



**Sue Bonney**  
Head of Tax

## ***The best that can probably be said about today's PBR is 'it could have been a lot worse'***

Commenting on what today's Pre-Budget Report (PBR) holds for businesses and individuals, Sue Bonney, Head of Tax at KPMG Europe LLP, said:

The PBR included little by way of surprises – we expected to see a levy on bankers' bonuses and a return to a 17.5 percent standard rate of VAT, and the deferral of the increase in the small companies tax rate by 1 percent were all known in advance. What we didn't expect was the extra £3 billion that will be paid by employers, employees and the self-employed in additional National Insurance contributions from April 2011, which will come as a blow to many businesses and will do nothing to enhance the UK's competitiveness or to accelerate the UK's economic recovery. We were also surprised by the announcement that £5 billion would be raised annually from attacking avoidance schemes – although it is not clear which avoidance schemes will be targeted.

The pre-announced changes will have little effect on the public finances – the levy on bankers' bonuses will raise just 0.1% of total tax revenue this year, whilst reduced company car tax on electric vehicles benefits taxpayers by just £5 million next year – compared to total tax receipts of £530 billion.

In a speech full of references to growth and innovation, the only targeted measure towards this seems to be the new tax regime for profits arising from patents. Whilst undoubtedly welcome, the new regime won't be introduced until 2013. This seems a long way off for businesses that can today go elsewhere and get relief straight away.

Many of the measures introduced are complex and overly onerous on business. This is contrary to what businesses want – simple, easy to understand tax rules that they can implement without unnecessary complication.

# Economic Implications



**Andrew Smith**  
**Chief Economist**

## ***Recession over, but damage to public finances will take years – and tough measures - to repair***

In the Budget last April, the Treasury underestimated the depth of the recession this year and has had to revise its forecast of the decline in GDP from 3 ½ percent to 4 ¾ percent. But with signs that the economy may now be bottoming, the Chancellor stuck with his forecast of 1 ¼ percent growth next year – now pretty much mainstream – rising to over 3 percent a year from 2011 to 2014, well above the consensus.

With recovery expected to be driven initially by a revival of consumer spending, much depends on the speed with which the debt-laden personal sector seeks to repair damaged balance sheets; a sharper than anticipated rise in savings would slow consumption and overall growth.

Unfortunately, even as strong a rebound as forecast will not fill the yawning gap in the public finances, expected to be around 12 percent of GDP both this year and next. The Chancellor aims to halve the deficit over the next four years through a combination of cyclical recovery, tax rises and a freeze on public spending in real terms from 2011 to 2014 – which are designated to do most of the heavy lifting.

Government department budgets are to be cut by around 9 percent in real terms by 2014, a squeeze which will actually reverse much of the increase enjoyed in the good times.

The details are still unknown but to the extent that spending on schools, hospitals and the police will, in the Chancellor's words, be 'protected' and continue to rise, spending will have to be cut that much more drastically in other areas.

# Public Sector Implications



**Alan Downey**  
**Head of Public Sector**

## *Those who were expecting a plan for reducing public expenditure will be disappointed*

The Chancellor has announced a significant number of new spending commitments plus a guarantee to increase spending in real terms on health and education, and to maintain spending on the police. This is clearly a pre-election view of the world which will need to be revisited immediately after the election.

The policy of protecting 'front-line public services' will come at a hefty price for public sector workers. They will be hit in three ways:

- firstly, they will see their pay increases capped at one percent in 2011-12 and 2012-13. That is a real terms cut in pay for two years running;
- secondly, public sector workers will be required to make a bigger contribution to their pensions, at a total cost of £1 billion a year; and
- thirdly, like those in the private sector, public sector workers will pay an extra 0.5 percent in National Insurance contributions.

It would seem fairer to public sector workers to share the burden of reducing public spending to some degree with the recipients of benefits and services.

We have been waiting for an announcement on where the axe will fall, but it is clear that at this stage in the electoral cycle, the Chancellor's weapon of choice is a butter knife rather than an axe.

# Corporate Tax



**Simon Palmer**  
**Head of International Tax**  
**Services**

The 2009 Pre-Budget Report has been the subject of significant press speculation. The windfall tax on bankers' bonuses was expected, although the mechanics of the one-off non-deductible levy mean that it is the banks that will bear the cost, not the bankers, although it remains to be seen to what extent the bank pass the cost on.

The deferral of the increase in the small companies' corporate tax rate was also part of the press speculation.

What was not expected was an additional 0.5 percent increase in NICs, which is forecast to raise more than £3 billion per annum from 2011. This is covered in detail in the employer's section of the commentary. This additional charge will do nothing to improve the competitiveness of the UK in attracting or retaining global businesses.

Potentially improving the tax competitiveness of the UK is the announcement of a new tax regime for UK registered patents. However, the new regime will only apply from 2013 so it does little to encourage businesses to stay in or move to the UK given that tax reliefs for a wider range of intellectual property are already available elsewhere in the EU.

Another area of major significance to the tax competitiveness of the UK is the ongoing review of the Controlled Foreign Company (CFC) regime. As expected there was no announcement in the PBR other than confirmation that details on the proposed shape of the new CFC regime will be published in the new year.

It is interesting to see that discussions are to commence on the possibility of introducing an exemption for foreign branch profits. While many groups with established profitable overseas branches are likely to welcome such a proposal, there will be many others with loss-making operations, particularly in start-up situations, that value the UK tax relief currently available.

The announcements on the Disclosure of Tax Avoidance (DTAS) rules widen the scope of the regime and will impose significant extra compliance burdens on businesses and their advisors, as well as potentially accelerating consequential changes to the legislation.

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# New tax on Bankers bonuses

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

A new Bank Payroll Tax will be introduced with immediate effect. This will be set at 50 percent and applied to the total amount of bonuses to which bankers are entitled, to the extent that the individual bonuses exceed £25,000. It will be payable directly by the bank to HM Revenue and Customs (HMRC). The tax will apply whether the bonus is provided directly by the bank or through an intermediary.

The Bank Payroll Tax will apply to bonuses comprising money, money's worth, benefits and loans. It does not apply to regular salary, wages, benefits or certain approved share schemes.

The draft legislation includes very broad anti-avoidance measures designed to counteract any payments made by way of Employee Benefit Trusts or similar vehicles, via loans to employees or in other ways where, in substance, a bonus exceeding £25,000 has been awarded.

The legislation is widely drafted to cover all bonuses to banking employees including remuneration which for any reason is not subject to UK income tax on the employee.

Bank Payroll Tax will not affect the income tax or national insurance liabilities of bank employees.

Bank Payroll Tax will not be taken into account when computing the banks' profits or losses for corporation tax or income tax purposes.

A technical note, including draft legislation and explanatory notes, has been published by HMRC and runs to some 31 pages.

## Who is affected

The Bank Payroll Tax will be applied to 'Taxable Companies'. 'Taxable Companies' comprise banks, financial businesses and holding companies in banking groups, building societies, financial businesses and holding companies in building society groups and UK branches of

foreign banks that provide a bonus exceeding £25,000 to a banking employee.

A banking employee is defined as someone who is (i) employed by a Taxable Company in 'Banking Employment' (or otherwise performs 'Banking Services' for a Taxable Company under arrangements involving 'another party'), (ii) whose duties relate, either directly or indirectly, to activities that are 'Relevant Regulated Activities', and (iii) who is either resident in the UK in 2009/10 or performs their duties wholly or partly in the UK.

'Banking Employment' means employments which wholly or mainly involve duties that relate to 'Relevant Regulated Activities'. 'Relevant Regulated Activities' comprise acquiring deposits, dealing in investments as principal or agent, arranging deals in investments, safeguarding and administering investments on behalf of clients and regulated mortgage activities.

## Timing

The new rules take effect immediately from 9 December 2009 and will be operative until 5 April 2010 for all discretionary bonuses that are awarded. There is an exception for contractual bonus entitlements where the bank has no discretion as to the amount of bonus because of a pre-existing obligation at the time of the Chancellor's announcement.

The draft legislation also brings arrangements for future payments within the scope of Bank Payroll Tax where the arrangement is made during the period to 5 April 2010. The making of the arrangement will be regarded as an award of a bonus to the employee and so trigger payment of Bank Payroll Tax.

The due date for payment of tax is 31 August 2010. The detailed provisions for collection and assessment will be published in due course. This will include provision for penalties and interest.

## Our view

The Chancellor has explicitly issued a challenge to the UK banking sector to focus on building up their capital position instead of paying large bonuses to employees. In what may be seen as a politically motivated decision in the run up to an election, it concentrates the line of fire on the banks with the justification given being the financial support afforded by the government over the last year.

Banks will now have to consider whether they will effectively bear the tax directly or whether the burden will fall on the employee by reducing bonus pools or a mixture of both.

With the introduction in the last year of the Remittance Basis Charge for non-domiciled employees of £30,000 per annum, the 50 percent tax rate, a (now) 1 percent National Insurance increase from 6 April 2011, restrictions on pension tax relief for higher earners and now a Bank Payroll Tax, banking employees are feeling the brunt.

It will be interesting to see how this impacts on London as a competitive global financial centre. The financial sector is vital to the UK economy and needs to maintain its competitiveness in the international arena in order to retain its global status and attract new business.

For banks with overseas employees working at their UK offices, the draft legislation suggests that these employees will also be covered by the new 50 percent Bank Payroll Tax. But the position for employees who work, or have worked, only for a short period in the UK, or partly in the UK and partly abroad, is not clear. This may raise complex tracking issues for employers in calculating what is included in this Bank Payroll Tax and what is not.

There is a particular concern that the Bank Payroll Tax could apply to investment managers. The draft legislation and notes released by HMRC give a very broad definition of a bank and do not appear to provide a specific carve out for asset managers. Specifically, there is concern with the inclusion of dealing in investments as principal, dealing in investments as agent, arranging deals in investments and safeguarding and administering investments.

We expect more clarity from HMRC over the coming weeks and affected parties should contact KPMG if they wish to make representations ahead of next year's Finance Bill.

# Amendments to 'worldwide debt cap' legislation

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The worldwide debt cap rules were introduced by Finance Act 2009 as part of the package of reforms to the taxation of foreign profits of companies. The purpose of the rules is, broadly, to ensure that the UK corporation tax deduction for financing costs does not exceed the group's external financing costs on a worldwide basis.

Although the basic working of the worldwide debt cap rules remains unchanged, amendments are being made, following representations from business and advisors, to ensure the rules operate as intended. These changes were announced by HM Treasury on 9 November 2009 and the draft legislation, to be included in Finance Bill 2010, has now been published for comment. The main changes relate to the following:

- **Gateway Test:** To avoid a potential mismatch as a result of the use of different accounting standards, where a relevant group company has a 'relevant liability' which is also a 'relevant liability' of the worldwide group, the value to be placed on that liability for the purposes of computing the company's net debt amount is to be that shown in the consolidated financial statements.
- **Gateway Test:** To put the position beyond doubt, issues of preference shares are to be specifically excluded from the definition of 'relevant liabilities' and holdings of preference shares are to be excluded from 'relevant assets'.
- **Qualifying financial service group exemption:** The definition of 'financial instruments' is to be extended to include all dealings in derivatives (including options, futures and contracts for differences). This extension should, in principle, allow more groups to satisfy this exemption.

- **New 'protected company' election:** Groups will be able to elect (irrevocably) for a company to be 'protected' from suffering a debt cap disallowance. The election is intended to benefit companies that require certainty that no part of their interest costs will be disallowed under the debt cap, e.g. to protect their credit rating. Disallowances must first be allocated to companies which are not protected and which are not dual resident investment companies ('DRICs') and, only if it is not possible to allocate the whole of the total disallowed amount in this way, must the excess then be allocated against 'protected companies' and lastly against DRICs.
- **Guarantee fees:** Financing income amounts will be extended to include guarantee fees. This removes the existing asymmetry where the payment of a guarantee fee gives rise to a financing expense amount but the corresponding receipt does not give rise to a financing income amount.
- **Revised group treasury company election:** So that non-treasury income (such as trading income) of 'quasi-treasury' companies does not prevent 'genuine' group treasury companies satisfying the 90 percent test, this test will now be applied separately to each UK group company which has income from treasury activities. However, it will continue to be necessary for all companies in the group which fall within the group treasury company definition to make the election for it to be valid.
- **Non-Departmental Public Bodies:** The interest paid by companies to non-departmental public bodies which are not within the charge to corporation tax will not be a financing expense of that company.
- **Inclusion of ancillary costs in the available amount:** By way of clarification, a definition of 'ancillary costs' is included which is similar to the definition of allowable charges and expenses for loan relationship purposes.
- **Partnerships:** Currently where a UK company is a partner in a partnership which has external borrowings, its share of the related finance expense is included in the tested expense amount, but may not be included in the available amount. To avoid this potential mismatch, the rules will specifically provide for the partners' share of the financing expense to be included in calculating the available amount.
- **Collective Investment Scheme definition:** The definition of a CIS will be extended for the purposes of the debt cap rules to include an entity that would be a CIS within s235 Financial Services and Markets Act 2000 but for the fact that it is a body corporate.

- **Securitisation companies:** Securitisation companies have their own tax regime in Finance Act 2005 and will be excluded from the detailed debt cap rules. However, securitisation companies will still be taken into account in assessing the gateway test and whether the group is a qualifying financial services group.
- **Accountancy mismatches in applying the detailed debt cap rules:** HMRC will continue to consult on mismatches between the basis of calculating the available amount and the tested amounts (e.g. fair value hedges). However, the legislation provides HMRC with the power to make such changes by way of regulations.

### Who is affected

Groups of companies (but not groups that consist wholly of small or medium-sized enterprises).

### Timing

The changes will have effect for periods of account of the worldwide group beginning on or after 1 January 2010, when the debt cap rules come into force.

### Our view

These changes are generally positive as they remove some of the uncertainties and potential mismatches that are possible in the current legislation. In particular, the amendments made to the group treasury company election should allow 'genuine' treasury companies to be taken out of the rules, where this is beneficial.

However, the proposed changes will, in some cases, result in additional complexity in calculating whether groups meet the gateway test and in doing the detailed calculations. Whilst the 'protected company' election is a sensible measure, it is not clear that it achieves its aim in providing adequate certainty that a company will not suffer a debt cap disallowance. For example, if it is not possible to allocate the worldwide group's total disallowed amount amongst 'non-protected' companies, or if no statement of allocated disallowances is made, there could still be a disallowance in a 'protected' company.

# Deferral of increase to small companies corporation tax rate

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The small companies corporate tax rate will remain at 21 percent until 1 April 2011.

In the Finance Act 2009, legislation was introduced to keep the small companies rate at 21 percent from 1 April 2009 but for the rate to increase from 1 April 2010 to 22 percent. It has been announced in the PBR that the increase to 22 percent will be deferred for a further year and will now take effect from 1 April 2011.

The fraction used in smoothing the difference between the main rate of corporation tax and the small companies rate will remain at 7/400 as a consequence.

## Who is affected

Companies or groups of companies with UK profits chargeable to corporation tax lower than the lower relevant maximum amount (currently £300,000) and companies or groups of companies with UK profits between the lower relevant maximum amount and upper relevant maximum amount (currently between £300,000 and £1,500,000). The limits stated need to be pro-rated depending on the length of the accounting period.

## Timing

The measure will have effect on and after 1 April 2010.

## Our view

This is a positive step which should help approximately 850,000 small companies.

# 'Patent Box': A New 10% Corporate Tax Rate on Income from Patents

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The Government has announced it will consult on the introduction of a new 10 percent corporate tax rate for income from patents.

A number of EU countries have introduced beneficial corporate tax regimes for companies exploiting Intellectual Property ('IP'). These include the so-called 'Patent Box' regime which was introduced by the Netherlands in 2007 to provide low rates of tax on IP-related income. There are also IP regimes in Spain, Belgium and Luxembourg.

In the 2009 Budget, the Government announced that it would consider evidence for changes to the way the tax system encourages innovative activity and the relative attractiveness of the UK to global firms as they make decisions on where to locate their research and development and innovation activities. As was widely expected, it has proposed a Patent Box style regime.

Few details are available at present. Further detail will be published when the Government releases its consultation document.

## Who is affected

The measure appears to apply to all UK corporate taxpayers.

The scope is limited specifically to holders of patents stemming from the UK, and would not apply to other forms of IP such as trademarks, designs or licences. The main beneficiaries of the measures are therefore likely to be hi-tech industries such as pharmaceuticals and biotechnology. There is no indication at this stage of how the new regime would affect existing rules on amortisation deductions for

acquired intangibles (introduced in Finance Act 2002) or Research and Development tax credits.

## Timing

The measures will apply from April 2013. Consultation is expected to be completed in time for Finance Bill 2011 and the legislation will apply to Patents granted after the legislation is passed.

## Our view

This announcement was widely expected, and is a positive statement by the Government that it is thinking seriously about international tax competition. It looks, though, to be limited in its scope, urgency and ambition. Several European countries already have IP Box legislation in place, the Netherlands have already announced moves to improve and widen their own rules (theirs is becoming a more widely drawn 'Innovation Box'), and other countries such as Luxembourg and Switzerland have had more generous IP incentives in place for many years.

Limiting the application of the measures under consultation to patents only implies that few taxpayers may actually stand to gain from the new regime. The Patent Box is unlikely to provide sufficient incentive on its own for large, geographically mobile companies to centralise operations and investment in the UK.

However, there is time for things to change. The announcement in the PBR is only the start of a consultation, which will be an important opportunity for industry and the professions to engage with Government on incentives for innovation and investment in the UK. A move to broaden the scope of the measures beyond patents to, for example, intangibles within the regime introduced in Finance Act 2002, would be an obvious improvement.

# Review of powers, deterrents and safeguards

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The HMRC Powers Review team has issued a number of further consultation documents, impact assessments and summaries of responses to previous consultations. These include the following:

### Interest – Working Towards a Harmonised Regime

Finance Act (FA) 2009 introduced legislation to provide for a harmonised regime for charging and paying interest on tax payments. Corporation tax and petroleum revenue tax were not covered by this legislation and HMRC have now published draft legislation to deal with this. This maintains the present position that different rates are applied to corporation tax paid by instalments. Like the FA 2009 provisions, the new legislation will be brought into force by statutory instruments on a phased basis.

### Meeting the obligations to file returns and pay tax on time

Legislation covering a range of direct and indirect taxes was introduced in FA 2009. HMRC have now published draft legislation to extend the same principles to the remaining indirect taxes including VAT and Excise Duties. Implementation will be staged over the next few years.

### Excise: Modernisation and Compliance Checks: the next stage

This document sets out proposals for modernising the regime for excise duty compliance. Legislation is to be introduced in the 2010 Finance Bill with a view to implementation in 2011.

## **Working with Tax Agents – The Next Stage**

A consultation document on this topic was issued at the time of the 2009 Budget. HMRC have now issued a further document containing more specific proposals, together with an impact assessment and a summary of responses to the previous consultation. The new consultation document envisages a twin-track approach in which HMRC would prioritise work on revised procedures for disclosures to professional bodies, legislation to deal with deliberate wrongdoing by tax agents, and new legislation relating to agents who make a high volume of repayment claims. In the longer term HMRC will work on developing appropriate responses to persistent shortcomings in the work of tax agents which fall short of deliberate wrongdoing.

## **Tackling Offshore Tax Evasion**

HMRC have issued a consultation document and impact assessment covering two proposals for additional legislation to deal with offshore tax evasion. Under the first proposal, offshore non-compliance, whether careless or deliberate, would be subject to penalties at the same scale as deliberate domestic non-compliance. This would mean that the minimum penalty would be 20 percent of the undeclared tax even where a full unprompted disclosure was made, and penalties could be as high as 70 percent even where no concealment is involved. These penalties would apply for tax periods commencing on or after 1 April 2011, but HMRC have also said that they intend to seek penalties at similar levels for earlier years on the basis that the non-compliance is deliberate.

Under the second proposal, some individuals who have bank accounts in certain jurisdictions would be required to notify them to HMRC. Depending on the jurisdiction, this would either apply to all bank accounts or to accounts where the balance was over £25,000. Notification would be required within 60 days of the accounts becoming notifiable. Failure to comply would attract an initial fixed penalty, followed by a period of daily penalties and then by tax-gear penalties. This penalty would be in addition to the penalties for under-declaration, so that in the most serious cases the aggregate penalty could be as high as 200 percent of the evaded tax. The document does not specify when this proposal would be implemented.

The document also proposes some changes to the information requirements relating to non-resident trusts.

## **Bulk and specialist information powers**

HMRC have issued a summary of responses to the consultation document which was published on 9 July 2009. A further consultation document, containing draft legislation, is to be issued in due course.

## Who is affected

All taxpayers and tax agents are potentially affected by these proposals.

## Timing

See the discussion of individual proposals above.

## Our view

The first three documents represent a continuation of the process of modernisation of the UK's tax compliance framework following the merger of the Inland Revenue and HM Customs and Excise in 2005.

The previous consultation document on working with tax agents provoked a considerable amount of discussion. HMRC have sensibly decided to focus initially on their proposals for dealing with deliberate wrongdoing by agents and with the specific issues presented by high volume repayment agents. KPMG will be examining these proposals in detail and will respond to the consultation in due course. At this stage, HMRC have given little detail of their thinking in relation to the remaining issues raised by the previous document. KPMG's view continues to be that such issues should be addressed by HMRC in consultation with the relevant professional bodies and in a spirit of collaboration rather than confrontation.

The measures to deal with offshore non-compliance are part of HMRC's offshore strategy which has involved, among other things, the 2007 Offshore Disclosure Facility, the 2009 New Disclosure Opportunity (for which the deadline is now 4 January 2010), and the Liechtenstein Disclosure Facility which runs until 2015. As part of this process, HMRC have issued information notices to numerous banks and financial institutions requiring disclosure of details of offshore bank accounts. Whether or not these proposals are implemented as set out in the document, they leave no doubt that HMRC are determined to tackle the issue of offshore tax evasion.

# Consultation on the Disclosure of Tax Avoidance Schemes regime (DTAS)

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The DTAS regime was introduced in 2004 and imposes obligations on promoters and users of certain tax avoidance schemes. A promoter is required to disclose details of the scheme to HMRC within certain time limits. A taxpayer who expects to obtain a tax advantage from the scheme is required to notify HMRC of its use either on their tax return or by filing a separate form.

The information that HMRC obtains from the regime can inform future legislation and, by identifying taxpayers who use disclosed schemes, also inform HMRC's compliance work.

Currently, HMRC become aware of taxpayers using disclosed schemes when they receive their tax returns. With inadvertent omissions by some taxpayers and having to wait until the tax return is submitted for information from taxpayers that do properly comply, the DTAS regime is not as effective for HMRC as it could be. The consultation proposes two alternatives to deal with this. Either disclosure by taxpayers will have to be on separate forms due significantly earlier than current tax return deadlines or a new requirement will be imposed on promoters to provide information to HMRC about clients to whom they have provided the proposed schemes.

For a scheme to be disclosable it must trigger at least one of eight hallmarks. The hallmarks describe certain features of the scheme. Some hallmarks are generic whilst other hallmarks target specific areas that HMRC view as high risk, for example, certain leasing transactions.

The consultation document issued today proposes three new hallmarks that target specific perceived risk areas:

- Employment schemes. The hallmark catches arrangements that seek to reduce or defer a tax liability arising from an employment whether the tax liability is the employer's, the employee's or the liability of another person. The hallmark contains certain exclusions which cover statutory reliefs such as approved share plans, certain option arrangements and pension schemes.
- Income into capital schemes. This hallmark catches schemes that seek to gain a tax advantage by substituting a capital receipt for an income receipt. The hallmark includes arrangements where the capital disposal would normally be expected to be exempt. Again, the hallmark details specific exemptions which are primarily statutory reliefs including, for example, Enterprise Management Incentives arrangements and certain share, share option and pension arrangements.
- Offshoring schemes. The final new hallmark covers offshore territories. It is triggered where a tax advantage is secured, or is expected to be secured, as a result of a transaction involving certain tax haven jurisdictions. The proposal is that the tax havens concerned would be those territories identified by the G20 as uncooperative.

The consultation document also identifies elements of the existing hallmarks that HMRC wish to strengthen. In some circumstances the amendments will widen the scope of existing hallmarks. For example the hallmark dealing with loss schemes originally only applied to individuals but the proposal is that this be extended to certain corporate loss-buying schemes.

The consultation document also proposes higher penalties under the DTAS regime. For the most part these are targeted at tax advisers who do not disclose schemes to HMRC. However, there is an indication that HMRC may seek to extend the higher penalties to taxpayers in certain circumstances.

### **Who is affected**

All taxpayers that implement disclosable.

### **Timing**

The consultation period will run from 9 December 2009 to 19 February 2010.

## **Our view**

The opportunity to consult with HMRC on these proposed changes is sensible. KPMG will be considering the proposals in more detail and issuing a response.

If either of the proposals to accelerate the provision of information to HMRC is implemented, this could lead to legislation changes being made more quickly to close down disclosed schemes than is currently the case.

The hallmark proposals are, for the most part, targeted at specific areas that HMRC perceive to be high risk. The introduction of new hallmarks and the widening of some existing hallmarks will inevitably lead to more disclosures being made. This will impact on the number of taxpayers required to notify Scheme Reference Numbers (SRN) to HMRC adding to their compliance burden.

The proposal to remove the off-market terms hallmark and the attempt to clarify other areas of the rules is a positive change.

Currently taxpayers are required to notify an SRN for all years in which they obtain a tax advantage. For some planning this means that clients need to remember to declare the SRN for many years. Although not mentioned in this consultation document, we would also be pleased to see any proposals that HMRC have to voluntarily de-register certain schemes so that this compliance burden is removed for taxpayers.

# Code of Practice on Taxation for Banks

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The Chancellor announced on 16 March 2009 that HMRC, after a period of consultation, would publish a Code of Practice to encourage banks to comply with the spirit as well as the letter of taxation law. The Code asks banks to have governance around tax, to ensure that tax is integrated into business decision-making and to have open and transparent relationships with HMRC.

A response document and supplementary guidance note have been published by HMRC.

## Who is affected

The Code is intended for all banks operating in the UK and for any organisations undertaking banking activities in the UK. The Code therefore applies to the following:

- Groups that undertake banking-type activities, including:
  - firms listed as banks by the Financial Services Authority;
  - UK subsidiaries of overseas banking groups;
  - UK branches of overseas banking companies;
  - securities houses; and
  - building societies as defined by section 119 Building Societies Act 1986.
- Banks owned by, and banking-type activities of, predominantly non-banking groups, including:
  - insurance groups;
  - retailers; and
  - motor manufacturers.

For these predominantly non-banking groups, the Code only applies to the banking activities of the group, whether carried out by the bank or other members of the group.

## Timing

The Code is introduced from 9 December 2009. However, the supplementary guidance note acknowledges that banks may require time to consider the implications of the Chancellor's announcement, but adoption and implementation should take place soon after. To help implementation, HMRC are willing to discuss any issues arising with banks.

## Our view

It was not expected that the consultation would result in any significant changes to the Code as announced on 16 March. The good governance aspects of the Code are not controversial and reflect the tax policies already in place for most banks.

The most contentious element of the Code is the requirement of the bank to determine whether a proposed transaction is contrary to the 'intentions of Parliament'. This element of the Code is to be retained despite the uncertainty that it creates. In response to the concerns raised, HMRC suggest that banks answer this question by asking whether the tax consequences are too good to be true, so that the consequences would be a surprise to HMRC. Banks are unlikely to view this response as particularly helpful.

There are some helpful amendments to the Code, in particular:

- The Code no longer demands that banks initiate dialogue with HMRC if they are in doubt as to whether the tax result of a proposed transaction is contrary to the 'intentions of Parliament'. Instead, the bank may choose to do so. This is not expected to make a difference to the level of transparency but it clarifies the tone of the discussion between the bank and HMRC.
- Banks not managed within the Large Business Service should adopt only section 1 of the Code. This is in response to representations that elements of the Code would be inappropriate for smaller banks. However, it is not clear whether this will make any practical difference given that section 1 summarises all aspects of the Code.

# Capital allowance buying: anti-avoidance

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation is to be introduced to counter the sale of companies for the benefit of their capital allowances. This follows on from the highly publicised 'Domino's Pizza' structure which led to the anti-avoidance announcements in HMRC's Technical Note of 21 July 2009. The PBR announcements include further changes and draft legislation.

## Summary of structure

The planning which is targeted is broadly the acquisition of a company with an entitlement to capital allowances on plant and machinery which is considerably in excess of the balance sheet value of the plant and machinery.

HMRC envisage that this may arise in a variety of situations, including the acquisition of a company which has historically disclaimed allowances by a purchaser which is able to use the allowances in the future and thus values the target company principally for its tax assets.

The specific structure which triggered the 21 July 2009 announcements was as follows. A Special Purpose Vehicle (SPV) would be set up offshore and would acquire assets and lease them out. It would dispose of the right to, say, 90 percent of the lease rentals receivable, then migrate into the UK, triggering an entitlement to capital allowances. The SPV would later be sold to a profit-making UK group of companies which would use the capital allowances by way of group relief.

## Proposed legislation

Proposed new sections 212A-S Capital Allowances Act 2001 (CAA 2001) will apply if all the following conditions are met:

- a company carries on a trade, either alone or in partnership;
- there is a 'qualifying change' in relation to the company on the relevant day – very broadly, a qualifying change is a change of

ownership (including situations involving changes of consortium stakes and partnership ratio changes);

- there is a 'relevant excess of allowances' – broadly Tax Written Down Value (TWDV) exceeds balance sheet value; and
- the qualifying change has an unallowable purpose.

In these circumstances, losses arising from capital allowances in the company are streamed against future profits of the activities as they were on acquisition. The losses may not be surrendered as group relief. If profitable activities are added to the company the profits cannot be sheltered by the streamed allowances. There are complex computational provisions to deal with, inter alia, the position where a company has a number of pools and the position for postponed ship allowances.

The provisions are wide-ranging. However, the presence of the 'unallowable purpose' test is intended to ensure that they do not catch bona fide commercial transactions. There is an 'unallowable purpose' if the main purpose or a main purpose of any person being concerned in the 'change arrangements' is to obtain a relevant tax advantage for any person. HMRC guidance indicates how they intend to apply this purpose test in practice.

On the relevant day, an accounting period is treated as coming to an end and the calculation of TWDV and balance sheet value is performed at this point. The assets measured are broadly those items of plant or machinery on which the company is entitled to claim allowances. Balance sheet value is Net Book Value (NBV) or net investment in the lease in the case of finance leased assets.

A qualifying change of ownership requires one or more of conditions A to D to be satisfied. Conditions A and B reflect concepts used in Schedule 10 Finance Act 2006.

- Condition A is that there is a change of the capital allowance company's principal company on the relevant day.
- Condition B is there is an increase in a consortium principal company's ownership proportion in the company.
- Condition C is that a company transfers its trade on the relevant day to a corporate partnership and Chapter 1 Part 22 Corporation Tax Act 2010 (CTA 2010) applies (no change of ultimate ownership).
- Condition D is that the capital allowances company is trading in partnership and there is a reduction in its partnership share on the relevant day.

New aspects, applicable only to changes of ownership on or after 9 December 2009, are:

- transactions on the relevant day which have the effect of reducing TWDV are to be ignored;
- the provisions will now also apply to companies with postponed allowances in respect of ships (under section 130 CAA 2001). Previously these allowances were not within the rules; and
- condition A applies where there is no principal company at the beginning of the relevant day but there is one (or more) at the end of the day.

### **Who is affected**

Businesses which had been planning to implement structures involving the acquisition of companies for the benefit of capital allowances.

Other corporate transactions involving the acquisition of a company where allowances have been postponed need to be cognisant of these rules but they should normally find comfort in the main purpose test.

### **Timing**

The main principles of the new rules were announced on 21 July 2009 and if enacted will apply to changes of ownership on or after 21 July 2009.

Some additional changes were announced on 9 December 2009 (see above). If enacted these will have effect for changes of ownership on or after 9 December 2009.

### **Our view**

The structures which triggered this change in law were essentially tax avoidance schemes. By contrast, the structures affected by the change range from the creation of synthetic tax deductions to the rather different territory where genuine economic outlay had been made by one taxpayer and the tax benefit of this was transferred to another taxpayer.

# Sale of Lessor Companies: Election for Alternative Treatment

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Schedule 10, Finance Act 2006 (FA 2006) was introduced to counter avoidance involving the sale of companies carrying on a plant and machinery leasing business ('the leasing company'). The legislation operates by bringing into charge an amount of income that is taxable on the leasing company during the seller's period of ownership and giving a corresponding relief in the leasing company during the buyer's period of ownership.

In the current economic climate, the inability of the buyer to make use of this corresponding relief in the leasing company has had an adverse impact on the sale of leasing companies. The measure allows for the leasing company to irrevocably elect out of the charge. The main effects of the election for the leasing company are that:

- going forward, its taxable leasing profits would be ring-fenced to prevent the leasing company's taxable profits being sheltered by a range of possible tax reliefs essentially relating to activities other than leasing at the date of sale, including losses carried forward or group relief ; and
- capital allowances will not be available for expenditure on 'independent assets'.

Further, there are a number of anti-avoidance provisions including a new specific 'unallowable purpose' test for the leasing company's capital expenditure. The test seeks to restrict tax advantages described as a reduction in profits or a creation or increase in losses.

### **Who is affected**

Sellers and buyers of companies carrying on a plant and machinery leasing business.

### **Timing**

The new rules will allow the election to be made for changes in ownership of leasing companies taking place on or after 9 December 2009.

### **Our view**

This is a relieving measure which, by switching off the Schedule 10, FA 2006 provisions for the electing out leasing company being sold, may thus enable non-tax motivated sales of leasing companies to proceed. However, the rules preventing capital allowances on independent assets means that the buyer of the leasing company may be faced with a number of significant tax and commercial issues and constraints going forward such as how to let the leasing company's business run off without leakage of the leasing company's goodwill.

# Sale of Lessor Companies: Consortium arrangements

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Schedule 10, Finance Act 2006 was introduced to counter avoidance involving the sale of companies carrying on a plant and machinery leasing business ('the leasing company'). The legislation operates by bringing into charge an amount of income that is taxable on the leasing company during the seller's period of ownership and giving a corresponding relief in the leasing company during the buyer's period of ownership.

In the case of a sale of a leasing company owned by a consortium where there is a charge resulting from a change in the relative interests in the leasing company, special rules apply to ensure that the charge and relief are reduced proportionately.

HMRC consider that Schedule 10 is being neutralised in two circumstances. The first is where a leasing company owned by a consortium inserts a new intermediate holding company. Due to specific relieving provisions, the insertion does not trigger a Schedule 10 charge as there is no economic change in ownership. However, the insertion also has the effect (because the Schedule 10 rules are linked to the group relief rules) that the inserted company is no longer treated as a company owned by a consortium. Thus when a consortium member sells its share in the intermediary holding company no Schedule 10 charge arises.

The second is more complex and also relies on the insertion of an intermediary holding company. It does not avoid Schedule 10 charge completely but HMRC consider that as little as 26 percent of the income that would have been charged absent the planning is taxed.

Amendments have been made to Schedule 10 in effect substituting 90 percent for 75 percent in the relevant paragraphs to fill the gap in the operation of the provisions.

### **Who is affected**

Sellers and buyers of companies carrying on a plant and machinery leasing business who are contemplating such structured arrangements.

### **Timing**

The new rules will apply to any qualifying change of ownership in a leasing company taking place on or after 9 December 2009.

### **Our view**

This is a specifically targeted anti-avoidance measure designed to remove an anomaly in the operation of the Schedule 10 rules.

# Plant and machinery leasing – targeted anti-avoidance

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation is to be introduced to counter two specific plant and machinery leasing structures which had been disclosed to HMRC under the Disclosure of Tax Avoidance Schemes (DTAS) system.

## Structure 1 – Rent strip followed by immigration

### Summary of structure

In this structure a Special Purpose Vehicle (SPV) was set up offshore. The SPV arranged to lease an asset without at that stage having incurred expenditure on the asset. The SPV sold, say, 90 percent of the lease rentals receivable to another offshore entity. The SPV then migrated into the UK, and subsequently incurred the capital expenditure. The SPV was thus entitled to capital allowances on 100 percent of the expenditure but was only taxed on 10 percent of the income.

### Proposed legislation

Proposed new sections 228MA-MC Capital Allowances Act 2001 (CAA 2001) will apply if arrangements are in place, when a lessor incurs capital expenditure on plant and machinery, such that the lessor's economic value in the lease is less than its capital expenditure. In these circumstances, the lessor's qualifying expenditure will be limited to the present value of amounts the lessor may reasonably expect to receive from the lease, including the present value of the residual value less rental rebates.

## **Structure 1 variant**

### ***Summary of structure***

A variant structure involved generating a deduction in the SPV in respect of a rebate of rentals. The structure was as described above but the lease would be terminated shortly after commencement and the asset sold for, say, £100. The lessee would pay a termination rental of £100 to the SPV, and the SPV would pay a rebate of rentals of £100 to the lessee. The SPV's capital allowances position would be neutral. The SPV would be taxable on only £10 of the termination rental because £90 would be payable to the offshore receivables purchaser. SPV would however claim a deduction of £100 for the rebate of rentals paid to the lessee.

### ***Proposed legislation***

The proposed new legislation is contained in section 60A Corporation Tax Act 2009 (CTA 2009) and for non-corporates at section 55B Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005). Broadly, the deduction for a rental rebate is limited to the amount of income that has been taxable. The rules apply only to non long funding leases.

We note that (unlike section 228MA CAA 2001) draft section 60A CTA 2009 applies whether or not planning arrangements have been entered into. It thus potentially impacts bona fide transactions where lease portfolios are acquired. However, there are provisions to ensure that the disallowed element of rebate is treated as a capital loss to the extent that the rebate exceeds the capital expenditure incurred by the lessor. Thus a taxpayer who acquires an asset with unencumbered market value in excess of the value of rentals receivable and sells it subsequently would suffer a restriction in its deduction for rebate of rentals but would have an equal and opposite capital loss ensuring that the capital gains and Schedule D Case I positions are both neutral.

In addition, following a section 343 Income and Corporation Taxes Act 1988 (ICTA 1988) transfer, the successor is treated as having received income received from the lease by a predecessor.

## **Structure 2 – recourse sale of rentals followed by emigration**

### ***Summary of structure***

A UK lessor who had claimed capital allowances would sell, say, 90 percent of lease rentals receivable such that a sale was not recognised. Thus there would be a structured finance arrangement (section 774A-D ICTA 1988) and the transfers of income stream rules (Schedule 25 Finance Act 2009) would be disapplied. The lessor would then migrate

from the UK. In calculating the capital allowances disposal value on migration, the market value of the leased assets would be depressed by the sale of the rentals, thus the lessor would be likely to generate a balancing allowance rather than a balancing charge.

### ***Proposed legislation***

A new section 64A CAA 2001 will apply where arrangements have been entered into to reduce the disposal value which is brought into account under Items 1, 2 or 7 of the table in section 61(2) CAA 2001. The provisions apply where the reduction in disposal value is attributable to rentals payable under the lease. The value must be calculated as if the arrangements did not exist.

### **Who is affected**

Businesses planning to implement these specific structures. Acquirers of lease portfolios may be technically affected by the provisions regarding the taxation of rebates but the changes should not be adverse.

### **Timing**

The new rules broadly affect structures implemented on or after 9 December 2009. The effective date for partly implemented structures is as follows:

- **Structure 1:** expenditure incurred on or after 9 December 2009 is affected.
- **Structure 1 (variant):** rebates of rentals payable on or after 9 December 2009 are affected.
- **Structure 2:** disposal events occurring on or after 9 December 2009 are affected.

### **Our view**

The above structures were tax avoidance schemes. Our initial view is that the proposed changes should not have any unintended impact on normal commercial leasing activities. The changes to the capital allowances rules specifically require arrangements to have been entered into. The changes to taxation of rebates do not require the existence of arrangements but it appears that the draft legislation ensures that transactions in a non-avoidance context should not be affected adversely.

# Stamp duty and stamp duty reserve tax anti-avoidance: Transfers of shares to depositary receipt systems and clearance services

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

An anti avoidance measure is to be put in place to block relief from the 1.5 percent charge where UK shares are issued into a European Union (EU) depositary receipt system or clearance service and then transferred to a non-EU system. The charge on issues into EU systems was out-lawed by a European Court of Justice (ECJ) judgement and the measure is intended to block schemes under which shares are routed through an EU system in order to obtain a relief on transfers to the non-EU system.

## Who is affected

UK companies listed on non-EU stock exchanges and those involved in providing a market in shares of such companies.

## Timing

Legislation to be introduced in Finance Bill 2010 will change the rules with effect from 1 October 2009 when HMRC first announced the intention to introduce this measure.

## Our view

Although this was not specifically considered by the ECJ, it is our view that the ECJ decision is applicable to shares issued to non-EU depositary schemes/clearance services. Therefore this measure should have little effect, though HMRC may dispute this analysis.

# Empty rates exemption extended

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

From 1 April 2008, tax relief for business rates on empty properties was scrapped. Previous to that, once a property had been empty for a prescribed period of time (3 months for shops and offices and 6 months for industrial properties), landlords paid business rates at 50 percent of the basic occupied business rates. The changes in 2008 resulted in landlords paying business rates at 100 percent following the relevant 3 or 6 months void periods.

The British Property Federation and other commentators claimed that the scrapping of the relief was having a severe effect on the property, retail and manufacturing sectors, and was hampering regeneration by preventing redevelopment in an economic downturn.

For the 2009/2010 financial year, the Government gave temporary tax relief by scrapping empty property rates in respect of buildings on which the rateable value is less than £15,000. The Government will extend this relief for the 2010/2011 financial year in respect of buildings with a rateable value of less than £18,000. The increase in the threshold reflects the effects of business rates revaluation.

## Who is affected

The Government has estimated that owners of 70 percent of all vacant buildings in the UK will benefit from the temporary relief.

## Timing

The relief will be extended from April 2010 for one year.

## Our view

The fact that the relief is only temporary is unlikely to satisfy the severe backlash against the reforms introduced in April 2008. It is unlikely that the modest extension of this relief will assuage those concerns. The British Property Federation has petitioned for the pre-April 2008 position to be restored. In addition, the industry view is that the 70 percent estimate of vacant buildings is not a true reflection of the impact of the measure as it includes non building assets such as ATMs.

# Purchase of debt at a discount to face value

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

As previously announced, changes have been made to the rule which can apply to create a taxable profit in the borrower where a loan relationship is purchased at a discount to face value.

Previously there was an exception to this charging provision where the debt was purchased in an arm's length transaction and the purchaser was not connected with the borrower during the three year period ending twelve months before the purchase. The Government is of the view that this exception was intended to help commercial rescues of insolvent groups but was being used in much wider circumstances by solvent groups to buy-in their own debt without creating a taxable profit. Accordingly, this exception has been repealed. In addition, changes have been made to the rules applying to the waiver/capitalisation of purchased debts.

Going forward, where:

- a loan is purchased and the consideration provided is less than the face value;
- the purchaser is not connected with the seller; and
- the purchaser is connected with the borrower immediately after the purchase;

the borrower will be required to recognise a taxable profit broadly equivalent to the discount, unless any of three new exceptions apply.

As with the now repealed exception, the three new exceptions each require that the purchase of debt is an arm's length transaction. In addition, the following conditions must be satisfied.

## The corporate rescue exception

- There must be a change in the ownership of the borrower in the period beginning one year before and ending thirty days after the acquisition of the debt (using the change in ownership definition in an existing anti-avoidance provision, in section 769 Income and Corporation Taxes Act 1988);

- It is reasonable to assume that, but for the change of ownership, the borrower would, within one year of the change of ownership, have entered insolvent administration, insolvent receivership, insolvent liquidation etc; and
- It is reasonable to assume that, but for the change of ownership, the purchase of the debt would not have been made.

#### **The debt for debt exception**

- The consideration given by the purchaser for the acquisition of the debt consists only of a new loan which has the same face value as the old debt and, at the time of the acquisition, has substantially the same market value as the old debt.

#### **The equity for debt exception**

- The consideration given by the purchaser for the acquisition of the debt consists only of shares forming part of the ordinary share capital of the purchaser, shares forming part of the ordinary share capital of a company connected with the purchaser or an entitlement to shares falling within either of these categories (e.g. a warrant to acquire such shares).

The detailed requirements for these exceptions to apply means that they are much more closely targeted than previously.

#### **Waiver or capitalisation of purchased debt**

If a debt is purchased at a discount to face value and it is subsequently repaid or written up in the books of the purchaser above cost, the excess would be taxable. Accordingly, many groups which have purchased debt will look to waive or capitalise the debt to avoid this.

The existing tax rules, which provide that no taxable profit arises on the waiver of connected party debts or the capitalisation of debts in exchange for the issue of ordinary share capital, have been amended. Going forward, where either the corporate rescue exception or the debt for debt exception have applied at the time of the purchase of the debt, the borrower will be required to recognise a taxable profit on a subsequent waiver/capitalisation. The amount of the profit to be recognised will, broadly, be the excess of the face value of a debt over the consideration paid less any profits that have been brought into charge in respect of the purchased debt in the period between the date of acquisition and date of waiver/capitalisation.

It is possible for transactions to fall within more than one exception and HM Revenue and Customs (HMRC) are to provide guidance on the treatment in these circumstances.

## Who is affected

Companies which purchase debt at a discount to face value where they are not connected with the seller but they are connected with the borrower.

The circumstances where the changes are relevant are potentially much wider than the situation where a group buys in debt from third party lenders. For example, the revised legislation will be relevant where the shares and debt of a company are purchased from a third party if the consideration for the debt is less than face value.

## Timing

The changes apply to purchases of debt taking place on or after 14 October 2009.

## Transitional rules

There are transitional rules to assist with transactions which were current at 14 October 2009. The changes do not apply to debt purchases in the following circumstances:

- The purchase is made on or after 14 October 2009 pursuant to an agreement entered into before that date.
- The purchase is made in the period between 14 October 2009 and 31 January 2010 and, broadly, a proposal for the acquisition of the debt was made between the parties before that date.

HMRC have confirmed that they will provide non-statutory clearances regarding the application of the transitional provisions.

The amendments to the rules on the waiver of purchased debts apply from 14 October 2009 and the amendments to the rules on the capitalisation of purchased debts apply from 9 November 2009.

## Our view

As has been seen with the recent experience on the rules for disguised interest and the worldwide debt cap regime, legislation is of better quality in terms of achieving the policy objective and providing certainty of treatment, where it is subject to consultation.

The changes made to the rules on the purchase of debt were announced in a Ministerial Statement on 14 October 2009 without warning which led to a great deal of uncertainty for taxpayers in relation to transactions which were current at that time. It must be acknowledged that HMRC immediately recognised this and have been helpful in providing guidance on the application of the rules and draft legislation is now available. However, we consider that it would have been better if the proposals had been subject to a period of consultation to identify the circumstances where it is appropriate for the charging provision to apply and how this should be achieved.

# Film tax relief

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

A change has been announced to the way in which a loss incurred by a film production company may be surrendered for a film tax credit.

Under current film tax relief rules, in any accounting period after the first period, the loss which may be surrendered by a film production company for a tax credit is currently the lesser of:

- the available qualifying expenditure (cumulative qualifying expenditure to date, less any previously surrendered amount); and
- the loss incurred in that period.

HMRC has become aware of that the way in which the legislation operates restricts the available tax credit in an unintended way.

The proposed revision will adjust the way the amount which may be surrendered for a tax credit is calculated. The calculation will become the lesser of:

- the available qualifying expenditure; and
- the loss for the period plus any unsurrendered loss brought forward.

Draft legislation and an explanatory note have been published on HMRC's website.

## Who is affected

UK film production companies making films with production spends spread over two or more accounting periods and which have some overseas expenditure.

## Timing

Legislation effecting the change will be introduced in Finance Bill 2010. The measures will have effect for accounting periods ending on or after 9 December 2009 and will be treated for those periods as always having had effect.

## Our view

The change is positive as it corrects an unintended anomaly in existing legislation whereby a film production company may be restricted on the amount of film tax credit which it can claim where there is increased UK spend in second or later production accounting periods.

# Changes to financial standards on financial instruments

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The International Accounting Standards Board is proposing to make changes to the accounting standard which applies to loans and derivatives (IAS 39). It is likely that the UK's Accounting Standards Board will make corresponding changes to the equivalent UK accounting standard (FRS 26).

Legislation is to be introduced in Finance Bill 2010 to provide powers to enable the legislation to be amended to in response to changes to accounting standards.

## Who is affected

Companies that have adopted International Accounting Standards and FRS 26, typically companies with listed shares or debt.

## Timing

Legislation in the form of regulations included in statutory instruments will have effect on or after 1 January in the period in which the regulations are made.

It is possible that companies will be able to adopt certain accounting changes retrospectively for periods beginning in 2009. Finance Bill 2010 will include powers so that tax changes will apply retrospectively.

## Our view

HMRC are consulting on the implications of proposed changes to accounting standards for loans and derivatives. This will provide a useful opportunity to make representations on the form the final legislation should take.

# Research and Development (R&D) tax relief – removal of Intellectual Property (IP) ownership condition for Small or Medium Enterprise (SME) Companies

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

There is currently a requirement for SME companies claiming R&D tax relief under the SME R&D tax relief scheme that they own any IP created as a result of the R&D expenditure they incur. This requirement is contained in ss1052 and 1053 of CTA 2009. This condition potentially prevents SME companies that are carrying out R&D from getting tax relief on their R&D expenditure.

In some circumstances, for example when the R&D expenditure incurred by the SME is subsidised by a third party, SME companies that are prevented from claiming under the rules of the SME scheme may instead claim under the less generous large company R&D tax relief regime. However, if the SME does not own the IP, this alternative is also blocked.

The effect of the IP ownership condition has been to deny some SMEs any additional tax relief at all for R&D expenditure, when there is no similar restriction for large companies.

The Government has decided to remove this anomaly. The new legislation will not include IP ownership conditions restricting entitlement to R&D tax relief under either the small or large R&D tax relief schemes.

### **Who is affected**

SMEs carrying out R&D. Note this covers companies that are within the larger SME limits contained within ss1119 and 1120 CTA 2009.

### **Timing**

The new rules will take effect for R&D expenditure incurred by larger SMEs in accounting periods ended on or after 9 December 2009.

### **Our view**

This is a sensible measure that corrects a long standing anomaly. It will mean that more SME companies will now be eligible to claim R&D relief, and the process of establishing the entitlement to claim should be simplified.

# Transactions in securities and unallowable purpose test: HMRC responses to consultation

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

HMRC have published a summary of the responses received on the consultation documents concerning Transactions in Securities (TiS) and unallowable purpose tests.

The key points arising are as follows:

- HMRC is to consider further whether the close company definition should be amended for TiS purposes to take account of concerns raised about private equity portfolio companies. These companies could be brought within the scope of the TiS regime as a result of extending the definition of an affected company to include close companies.
- HMRC is to consider the possibility of repealing the TiS legislation for corporation tax purposes.
- HMRC maintain their intention to interpret unallowable purpose legislation in a punitive manner such that tax payers may owe more tax as a result of the legislation than would have been the case if no planning had been done.
- It is disappointing that HMRC have rejected calls for a clearance procedure in respect of unallowable purpose tests so failing to alleviate taxpayer uncertainty in relation to these tests.

### **Who is affected**

Taxpayers undertaking TiS.

The changes to the unallowable purposes test are potentially wide ranging.

### **Timing**

Currently HMRC expect that the revised legislation relating to the TiS rules for income tax will be included in Finance Bill 2010. Corporation tax changes may be deferred to enable more detailed work to be undertaken.

HMRC intend to have a revised text on unallowable purposes test available in Spring 2010 to be adopted by Summer 2010.

### **Our view**

It is encouraging that HMRC are considering concerns raised during the consultation process.

# 100% First Year Allowances ('FYA') for electric vans

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The Government will, subject to state aid approval, introduce legislation to allow a 100 percent FYA for capital expenditure on new and unused electric vans.

## Who is affected

Businesses investing in electric vans for the purposes of their qualifying activity.

## Timing

Subject to confirmation on the state aid position, this measure will have effect for expenditure incurred on or after 1 April 2010 for corporation tax purposes or 6 April 2010 for income tax purposes.

## Our view

This is a positive addition to the assets that qualify for 100 percent FYA and should incentivise businesses to consider electric vans as a viable option given the potential tax benefits.

# North Sea Fiscal regime

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Changes are to be made to chargeable gains on the transfers of oil licences and a widening of the scope of field allowance.

## Chargeable gains

Finance Act 2009 introduced an exemption from chargeable gains for transfers of UK oil fields and UK oil licence interests where the proceeds of the sale were reinvested in the UK or UKCS on certain types of oil related assets. The changes announced will extend the types of assets that can be invested in to include expenditure on exploration and development including costs of drilling.

Finance Act 2009 also introduced an exemption from chargeable gains on the swap of UK and UK Continental Shelf (UKCS) oil licences in some circumstances. Those transactions typically include interim period payments that in the existing rules fall outside of the exemption regime. Rules will be introduced which will remove some of those payments from the scope of taxation on chargeable gains.

## Field Allowance

Finance Act 2009 introduced a relief which reduced profits subject to supplementary charge on qualifying fields. One of the classes of qualifying field is a High Pressure High Temperature field. The thresholds are to be relaxed with the value of the allowance being increasing on a straight-line basis from £500 million for a 166°C field to £800 million for a field operating at 176.76°C.

Finance Act 2010 will also extend the scope of the field allowance to cover fields that have previously been decommissioned but are being redeveloped.

## Who is affected

Oil and gas companies that operate in the UK or on the UKCS.

## Timing

The chargeable gains changes will have effect on or after Budget Day 2010.

The changes to the field allowance rules for High Pressure High Temperature fields are to have effect from 1 April 2010 with the redeveloped field changes to have effect from 22 April 2009.

## Our view

On the whole, we expect that the industry will welcome the changes that have been proposed in the PBR 2009. Although all of the changes are positive, it is questionable whether an increasingly complex and constantly changing tax environment is good for the stability of this industry.

# Corporate investment in index-linked gilts with associated hedging arrangements

Impact on tax payer			
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## The issue

The component of the return on index-linked gilts which is equivalent to the inflationary change (i.e. the Retail Price Index ('RPI') component) is exempt from Corporation Tax. These sections provide the taxing mechanism for loan relationships represented by index-linked gilt-edged securities. The securities are taxed on changes in 'fair value' but changes in that value attributable to movements in the RPI are exempt from charge by means of a statutory adjustment to the carrying value of the gilt equal to the RPI movement over the relevant period.

It was therefore possible to invest in such gilts but then avoid any exposure to the RPI movement by entering into a swap of the RPI based return, either within the investing company or another company within the group. Thus, the investor would receive a tax free RPI based return on the gilt. The payment for the swap and corresponding receipt would be deductible/taxable and, therefore, tax neutral.

From 9 December 2009, the inflation based RPI return will not be exempt under CTA 2009 section 400 if the company or another company within the group has entered into arrangements which eliminate the holder of the gilt from economic exposure to the inflation component of a security.

### **Who is affected**

Companies that hold index-linked gilt-edged securities and also enter into arrangements, or are a member of a group that enters into arrangements, to hedge against the inflation component of the return.

### **Timing**

The changes apply to returns on index-linked gilts held on 9 December 2009.

### **Our view**

This is a targeted anti avoidance section with precise application.

# Risk-Transfer Schemes

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation will be included in the 2010 Finance Bill to restrict Exchequer exposure to losses arising from 'over hedging' and 'under hedging' structures. The strategy of over or under hedging was designed to produce gross foreign exchange exposures in individual companies which were within the charge to tax, where the true economic exposure on the group was smaller. The measures will align the tax impact of such arrangements to the real economic loss arising from those transactions.

The measure is therefore intended to target arrangements which seek to achieve enhanced interest returns or lower borrowing costs for tax payers by passing foreign exchange risk on to the Exchequer. This is generally achieved by fragmenting transactions amongst different group companies such that one company in the group can get tax relief for a larger foreign exchange loss than the aggregate economic loss to the group as a whole. The value of the tax relief on the foreign exchange difference at the entity level is designed to offset the economic exposure to the group as a whole. Such transactions are referred to in the draft legislation as 'risk transfer schemes'.

The draft legislation seeks to ring-fence the loss from the risk transfer scheme such that it may only be relieved against profits from the same arrangement. Thus, the tax relief on such arrangements will be restricted to the real economic loss at group level.

## Who is affected

Groups of companies that are party to a risk transfer scheme. In many cases it will be clear where a group has entered into a risk transfer scheme. However, it will be important to ensure that the legislation does not have unintended consequences for purely commercial arrangements.

## Timing

The draft legislation will have effect for accounting periods beginning on or after 1 April 2010 (with a deemed accounting period commencing on 1 April 2010 for periods that straddle the commencement date). The draft legislation is subject to further consultation. The closing date for representations is 31 January 2010.

## Our view

This measure was first announced in the 2009 budget and an initial technical note was published by HMRC on 10 August 2009. A number of concerns were raised in relation to the initial draft legislation and it is positive that HMRC have announced a further consultation period on the revised legislation.

# Life Assurance Companies: Apportionment of Income and Gains

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

On 15 July 2009, the Treasury published a Written Ministerial Statement on Life Assurance Taxation. The proposed apportionment of income and gains follows on from this.

Measurement of 'life assurance trade profits' or the profits of gross roll-up business are driven off the regulatory Financial Services Authority return, rather than the statutory accounts, and this may include the deferral of certain amounts. HMRC have identified at least one taxpayer where there is an advantage achieved from the existing apportionment rules when such amounts cease to be deferred and are recognised in the regulatory return. According to HMRC, as a result of certain transactions, when the deferred profits are recognised they escape tax altogether.

The proposal is to amend the apportionment rules so that for future recognition of these deferred profits, the apportionment will be based on that applying for the period from which the profits have been deferred, and not for the period in which they are brought into account. For amounts which have already been deferred, the apportionment fractions for the period including 9 December 2009 will apply.

## Who is affected

Life assurance companies and friendly societies that have a non-profit fund but are not non-profits companies.

## Timing

The changes will apply for periods of account beginning on or after 9 December 2009. Where amounts have been deferred previously, the apportionment fractions for the last period beginning before 9 December 2009 will be applied when such amounts are recognised.

## Our view

For most life assurers this may have little effect, on the basis that their apportionment fractions might be expected to be reasonably stable year on year.

Following consultation with the industry and advisers, the wording of the draft legislation published on HMRC's website is an improvement on the original proposal in the written ministerial statement. However, the draft legislation is likely to need further refinement, for example to deal with the position where business is transferred between companies.

The proposed introduction of the Solvency II regulatory regime in 2012 will require changes to the taxation of life assurers, including apportionments, and may remove the requirement for this provision.

# Stamp Duty Land Tax: Consultation Document on Disclosure of Tax Avoidance Schemes

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The disclosure rules for Stamp Duty Land Tax (SDLT) schemes currently only apply to promoters of schemes involving non-residential property with a value of at least £5 million. They do not apply to schemes involving only residential property and do not require users of schemes, as opposed to promoters of schemes, to notify HMRC as they have to do for other taxes.

The current SDLT avoidance schemes regulations will be amended such that schemes which involve:

- residential property with an aggregate value of at least £1 million (or mixed residential and non-residential property where the residential element is valued at least £1 million); or
- mixed residential and non-residential property where the value of all the property is at least £5 million will be disclosable.

Users of all SDLT avoidance schemes, for both commercial and residential property, will be required to report the use of the scheme back to HMRC. HMRC will produce a form for users to report the scheme used.

## Who is affected

Promoters and users of SDLT schemes.

## **Timing**

The regulations will be amended in the New Year and the provisions will have effect for 'new' schemes promoted from 1 April 2010.

## **Our view**

This is an expected change on which there has been consultation. It will give HMRC greater visibility of the extent to which SDLT schemes are used by taxpayers.

# Help for taxpayers not submitting returns on time

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Where taxpayers who had fallen behind in their tax affairs have had determinations issued by HMRC based on estimates of their tax liability, these amounts are legally due, even if the actual amount owed is less. Previously, by concession, HMRC had collected only the amount of tax which the individual actually owed, even if they had missed the deadline to provide the necessary information, provided they brought their tax affairs up to date.

The effect of this measure is to put this concession on a statutory basis.

## Who is affected

Any tax payer who has fallen behind with their tax affairs.

## Timing

The start date for the measure will be confirmed in the legislation and the concession will continue until that date.

## Our view

It is pleasing to see that the Government has responded to representation from KPMG and others to continue this practice of treating taxpayers fairly.

# Indirect Tax



**Gary Harley**  
**Head of Indirect Tax**

From an indirect tax perspective, the Pre-Budget Report included little of note. Despite lobbying from the retail sector, the standard rate of VAT will revert to 17.5 percent on 1 January 2010.

The key indirect tax announcement concerned Insurance Premium Tax (IPT). Anti-avoidance rules have been introduced following the Homeserve Membership Ltd High Court case earlier this year. New legislation treats arrangement fees charged to the customer separate from the insurance premium as part of the premium and liable to 5 percent IPT. The new treatment applies to fees paid on or after 9 December.

Elsewhere the other indirect announcements included a proposed reduction in Bingo Duty from 22 to 20 percent, an increase in the reduced rate of Climate Change Levy (CCL) and amendments to the VAT Flat Rate scheme percentages for small businesses.

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# New IPT anti-avoidance measure to address administration fees charged in relation to personal insurance contracts

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

A new anti-avoidance measure will be introduced in the Finance Bill 2010 to restrict the circumstances in which fees charged to privately insured individuals in relation to a taxable insurance contract may be treated as outside the scope of IPT.

Under draft legislation published today, new sub-sections 1AA to 1AE will be added to Section 72, Finance Act 1994 which lays down the definition of 'insurance premium' on which IPT is applied.

## Who is affected

Insurance intermediaries who sell taxable insurance products covering the personal risks of private individuals and the insurers that underwrite such policies.

## Timing

The new rules will affect relevant fee payments made on or after 9 December 2009.

## Our view

This measure first trailed in HMRC's Business Brief issued in August 2009 in the wake of the Homeserve Membership Limited ('Homeserve') High Court decision of 18 June 2009. The Brief made clear HMRC's intention to address what it perceived as unacceptable IPT avoidance, where fees are charged in place of what would ordinarily be taxable insurance premia.

The new sub-sections 1AA to 1AD mean that many fee arrangements will now fall within the IPT net, including (but not limited to) those motivated by IPT avoidance purposes. IPT is likely to apply to all policy arrangement and similar fees that are charged to an insured person who takes out a taxable insurance contract in a personal capacity.

Sub-section 1AE excludes charges for contract amendments or cancellation or for paying by instalment or by debit/credit card, provided those charges arise under a contract that is separate from the insurance contract.

The new measures may have a significant impact on insurance intermediaries who currently charge administration fees in relation to personal lines insurance in the UK and for the insurers who ultimately declare and pay the tax. Such businesses may need to amend their processes and systems to ensure that the IPT on affected fees is correctly charged and reported.

# Bingo Duty Rate Change

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Reduction in the rate of bingo duty from 22 percent to 20 percent.

## Who is affected

Bingo operators.

## Timing

The new rules will be formally announced at the budget.

## Our view

In the 2009 Budget, the Chancellor increased Bingo Duty from 15 percent to 22 percent. At the same time they introduced a VAT exemption for bingo. HMRC had previously considered this package of amendments to be fiscally neutral. However, the industry has subsequently argued that the irrecoverable VAT arising from exemption caused a net loss to bingo operators from the change. Consequently, the industry has been campaigning for a reduction in the rate to 15 percent. It is encouraging that the Government have acknowledged that the rate of 22 percent was too high but it still does not appear to meet the cost of irrecoverable VAT.

# Climate Change Levy – changes to the reduced rate

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The reduced rate of climate change levy is to rise from 20 percent to 35 percent of the full levy charge.

## Who is affected

This change will affect those businesses with facilities covered by Climate Change Agreements (CCAs), ie. energy intensive businesses who have undertaken to reduce emissions/improve energy efficiency. They will suffer an increased amount of Climate Change Levy (CCL) on their energy bills, thereby increasing energy costs.

It will also affect utility companies supplying energy to businesses with CCAs as it will impact on their pricing. They will need to consider whether or not the increase will be passed on to their customers or absorbed by them.

## Timing

The new reduced rate will apply from 1 April 2011.

## Our view

Businesses and their sector organisations will be disappointed that their attempts to promote environmental 'good behaviour' by signing up to CCAs is to be rewarded with an increase to their overall energy costs. With renewable energy still in short supply, and often chargeable at a premium, for many energy intensive businesses there will be no alternative but to accept this CCL increase. It will be necessary for businesses within the CCA to issue new reduced rate certificates to their energy suppliers.

It is understood that this measure will enable the scheme to continue to operate within the EU Framework for energy taxation.

# VAT Flat Rate Scheme: Changes to the Flat Rate Percentages

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The flat rate scheme is a simplification for low value turnover businesses to account for VAT on a flat rate percentage based on their sector. The percentages were recalculated in December 2008 to reflect the reduction to 15 percent. This measure ensures that the rates are based on a VAT rate of 17.5 percent and also reflect the latest data about business VAT liabilities in each sector.

## Who is affected

Businesses who either use or are seeking to use the Flat Rate Scheme.

## Timing

The new rates will have effect on or after 1 January 2010.

## Our view

The changes to reflect the reversion to 17.5 percent were expected. The notice makes reference that the changes reflect the latest business data. On comparison to the rates prior to December 2008 a number of the categories have changed. Whilst some have decreased there is an overall increase.

# Review of powers, deterrents and safeguards

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The HMRC Powers Review team has issued a number of further consultation documents, impact assessments and summaries of responses to previous consultations. These include the following:

### Interest – Working Towards a Harmonised Regime

Finance Act (FA) 2009 introduced legislation to provide for a harmonised regime for charging and paying interest on tax payments. Corporation tax and petroleum revenue tax were not covered by this legislation and HMRC have now published draft legislation to deal with this. This maintains the present position that different rates are applied to corporation tax paid by instalments. Like the FA 2009 provisions, the new legislation will be brought into force by statutory instruments on a phased basis.

### Meeting the obligations to file returns and pay tax on time

Legislation covering a range of direct and indirect taxes was introduced in FA 2009. HMRC have now published draft legislation to extend the same principles to the remaining indirect taxes including VAT and Excise Duties. Implementation will be staged over the next few years.

### Excise: Modernisation and Compliance Checks: the next stage

This document sets out proposals for modernising the regime for excise duty compliance. Legislation is to be introduced in the 2010 Finance Bill with a view to implementation in 2011.

## **Working with Tax Agents – The Next Stage**

A consultation document on this topic was issued at the time of the 2009 Budget. HMRC have now issued a further document containing more specific proposals, together with an impact assessment and a summary of responses to the previous consultation. The new consultation document envisages a twin-track approach in which HMRC would prioritise work on revised procedures for disclosures to professional bodies, legislation to deal with deliberate wrongdoing by tax agents, and new legislation relating to agents who make a high volume of repayment claims. In the longer term HMRC will work on developing appropriate responses to persistent shortcomings in the work of tax agents which fall short of deliberate wrongdoing.

## **Tackling Offshore Tax Evasion**

HMRC have issued a consultation document and impact assessment covering two proposals for additional legislation to deal with offshore tax evasion. Under the first proposal, offshore non-compliance, whether careless or deliberate, would be subject to penalties at the same scale as deliberate domestic non-compliance. This would mean that the minimum penalty would be 20 percent of the undeclared tax even where a full unprompted disclosure was made, and penalties could be as high as 70 percent even where no concealment is involved. These penalties would apply for tax periods commencing on or after 1 April 2011, but HMRC have also said that they intend to seek penalties at similar levels for earlier years on the basis that the non-compliance is deliberate.

Under the second proposal, some individuals who have bank accounts in certain jurisdictions would be required to notify them to HMRC. Depending on the jurisdiction, this would either apply to all bank accounts or to accounts where the balance was over £25,000. Notification would be required within 60 days of the accounts becoming notifiable. Failure to comply would attract an initial fixed penalty, followed by a period of daily penalties and then by tax-geared penalties. This penalty would be in addition to the penalties for under-declaration, so that in the most serious cases the aggregate penalty could be as high as 200 percent of the evaded tax. The document does not specify when this proposal would be implemented.

The document also proposes some changes to the information requirements relating to non-resident trusts.

## **Bulk and specialist information powers**

HMRC have issued a summary of responses to the consultation document which was published on 9 July 2009. A further consultation document, containing draft legislation, is to be issued in due course.

## Who is affected

All taxpayers and tax agents are potentially affected by these proposals.

## Timing

See the discussion of individual proposals above.

## Our view

The first three documents represent a continuation of the process of modernisation of the UK's tax compliance framework following the merger of the Inland Revenue and HM Customs and Excise in 2005.

The previous consultation document on working with tax agents provoked a considerable amount of discussion. HMRC have sensibly decided to focus initially on their proposals for dealing with deliberate wrongdoing by agents and with the specific issues presented by high volume repayment agents. KPMG will be examining these proposals in detail and will respond to the consultation in due course. At this stage, HMRC have given little detail of their thinking in relation to the remaining issues raised by the previous document. KPMG's view continues to be that such issues should be addressed by HMRC in consultation with the relevant professional bodies and in a spirit of collaboration rather than confrontation.

The measures to deal with offshore non-compliance are part of HMRC's offshore strategy which has involved, among other things, the 2007 Offshore Disclosure Facility, the 2009 New Disclosure Opportunity (for which the deadline is now 4 January 2010), and the Liechtenstein Disclosure Facility which runs until 2015. As part of this process, HMRC have issued information notices to numerous banks and financial institutions requiring disclosure of details of offshore bank accounts. Whether or not these proposals are implemented as set out in the document, they leave no doubt that HMRC are determined to tackle the issue of offshore tax evasion.

# Biofuels Duty

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation will be introduced in Finance Bill 2010 to amend the duty rates for biodiesel and bioethanol for road use, alongside changes to other duty rates for hydrocarbon oils and alternative fuels.

The current 20 pence per litre (ppl) duty differential for biodiesel and bioethanol will cease, with duty being charged at the same rate as main road fuels thereafter. The duty on main road fuels will be increased over a four year period, starting on 1 April 2010, by 1 ppl above indexation in each year.

A relief scheme will be introduced so that producers can continue to benefit from a 20 ppl duty differential in relation to biodiesel produced only from waste cooking oil. The scheme will allow producers to offset an allowance of 20 ppl against duty that is payable.

## Who is affected

Businesses producing and importing hydrocarbon oils and alternative fuel products, and businesses producing biodiesel from waste cooking oil.

## Timing

This will be implemented from 1 April 2010.

## Our view

Whilst the removal of the differential was expected, the relief scheme for biodiesel produced from waste cooking oil is welcome.

# Employee Issues



**Ian Hopkinson**  
**Head of Employee Tax**

For employers and employees, the 2009 Pre-Budget Report included some very significant announcements, albeit that there had been much speculation beforehand! The 'windfall tax' on banker's bonuses perhaps came as no great surprise but nevertheless this will hit banks hard in terms of needing to balance their retention of key staff with the punitive 50 percent levy. [This is covered in the Corporate Tax Section of KPMG in the UK's PBR commentary.](#)

The announcement that National Insurance Contributions (NICs) will increase by an additional 0.5 percent - on top of the 0.5 percent announced in last year's PBR - from 6 April 2011 was certainly not expected and will not be welcomed. This is forecast to raise in excess of £3 billion and will be paid by all employees, employers and the self-employed. NICs is often referred to as a 'tax on jobs' and this will not help as regards maintaining and creating the employment needed to stimulate UK economic growth going forward.

The consultation on the introduction of the pension tax relief restriction from 6 April 2011 for those on incomes of over £150,000 will need to deal with some very difficult issues. If there was a map then many would be clear in saying that this is definitely not the place from which to be starting!

There has been speculation about lower tax rates for electric cars and vans and the changes that have been announced tie in with the environmental agenda. Will 2010 be the year of the electric car? With a zero car benefit charge for at least 5 years this should certainly stimulate new models coming to market.

It was somewhat surprising that nothing further was said on employer-provided childcare vouchers, as the Government have made recent announcements in this area and said that further detail would be forthcoming.

Less surprising was the clampdown announced on employer-provided canteen arrangements and salary sacrifice schemes as HMRC have been attacking this area for sometime.

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# Increase in NIC rates

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

From 6 April 2011, Class 1 and Class 4 National Insurance Contributions (NIC) will increase by a further 0.5 percent (in addition to the 0.5 percent rate increase announced in the 2008 Pre-Budget Report). This will mean that from 6 April 2011 the NIC rates will be increased as follows:

- the Class 1, 1A and 1B employer rate – rises from 12.8 percent to 13.8 percent;
- the main rates of Class 1 and Class 4 NIC will rise from 11 percent to 12 percent and from 8 percent to 9 percent respectively; and
- the higher rate of Class 1 and Class 4 NIC will rise from 1 percent to 2 percent.

For tax year 2011/2012, the primary threshold and lower profits limit will be increased by £570 above plans announced in the 2008 Pre-Budget Report to compensate the lowest earners for the increases in Class 1 and Class 4 NIC.

## Who is affected

Employers, employees and self-employed persons.

## Timing

The increased NIC rates take effect from 6 April 2011.

## Our view

This is an unwelcome surprise. The employer's NIC rise will now be twice what was expected – 1 percent rather than 0.5 percent. The cost to employers will be significant and will most likely hit employers just as they are emerging from recession. This coupled with the freezing of the 40 percent tax band means that it is going to cost employers significantly more to put a pound in their employees' pockets.

# Pensions tax relief: extension of anti- forestalling measures

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The anti-forestalling measures that currently apply in respect of those with income of £150,000 or more are extended, from 9 December 2009, to include those with income of £130,000 or more.

In the 2009 Budget, the Government announced its intention to restrict tax relief on pension contributions with effect from 6 April 2011 for individuals with taxable earnings of £150,000 or more. Included in the 3-month consultation launched today is comment on how this restriction will be introduced.

One aspect that has been confirmed is that the income definition for the £150,000 threshold will include the value of employer pension contributions. However, tax relief for those with incomes below £130,000, before the inclusion of employer pension contributions, will not be restricted. This means that some individuals with income between £130,000 and £150,000 who may not previously have expected to have been caught by the 2011 changes will in fact be caught. They may therefore have an incentive to increase their pension savings prior to the change.

The Finance Act 2009 already contains measures to prevent those with income over £150,000 from seeking to forestall the 2011 change by increasing their pension saving – in excess of their normal, ongoing, regular pattern – prior to 6 April 2011. This is now extended this anti-forestalling regime to those with income over £130,000.

## Who is affected

Individuals with incomes of £130,000 or more who, on or after 9 December 2009, change their normal pattern of regular pension contributions or the way in which their pensions are accrued, and whose

total annual pension accrual exceeds the special annual allowance of £20,000 (or up to £30,000 in some cases).

The detailed rules that currently apply to those with income of £150,000 or more under the Finance Act 2009 will apply similarly to those with incomes of £130,000 or more. Any saving which is not within an individual's regular pattern of saving and was made from 6 April 2009 up to and including 8 December 2009 will not be subject to the anti-forestalling restriction. However, this saving will reduce the amount of the special annual allowance available for 2009-10.

### **Timing**

The new rules take effect from 9 December 2009.

### **Our view**

Whilst the exclusion from the post April 2011 regime of employer pension contributions for those on incomes of less than £130,000 is welcome, this clearly comes at the price of individuals with income between £130,000 and £150,000 being caught by the anti-forestalling rules.

# Restriction on pensions tax relief from April 2011

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Those with gross incomes of £180,000 or more will have tax relief restricted to basic rate on all pension savings. For those with gross incomes of between £150,000 and £180,000, relief will be tapered.

The taper will operate as a series of steps where the rate of tax relief is gradually reduced from 50 percent to 20 percent as gross income rises from £150,000 to £180,000. The government is consulting on the size and number of the steps.

The restriction will apply to all contributions to money purchase pension arrangements.

For defined benefit pension arrangements, a 'deemed' contribution will be calculated to reflect the value of the pension accrued. The government is consulting on how to assess this value, but its preferred approach is to use age-related factors varying by both age and normal pension age. The restriction on relief will be applied to this deemed contribution.

The restriction on relief will operate by collection of a recovery charge through the self-assessment system. Where the tax charge exceeds £15,000 it is proposed that a pension scheme will be able to pay the charge on an individual's behalf, with an appropriate reduction in their benefit.

It has been clarified that those affected will be individuals with 'gross income' of at least £150,000 **and** 'relevant income' of at least £130,000.

These terms are defined in the draft legislation. 'Gross income' includes both the personal **and** employer pension contributions to registered pension schemes. 'Relevant income' includes the individual's contributions only, ie no deduction for personal pension contributions can be made. Furthermore, salary sacrifice arrangements for pension

contributions entered into after 8 December 2009 will not reduce relevant income.

So, for example, if your relevant income (ie excluding employer pension contributions) is £125,000 you would be unaffected even if your employer contributions would take gross income above £150,000. Similarly, an individual would be unaffected if relevant income is £135,000 and employer pension contributions are £10,000.

### **Who is affected**

Individuals with 'gross income' of at least £150,000 and 'relevant income' of at least £130,000.

### **Timing**

The restriction applies from 6 April 2011.

### **Our view**

This restriction in pensions tax relief from April 2011 adds yet another layer of unwelcome complexity to the pensions tax regime. And the proposed definition of gross income could bring many more people within the scope of the restriction than might previously have been envisaged, albeit that the position on employer contributions is relaxed for those with relevant income of less than £130,000.

Employers may want to consider and develop alternative reward strategies for higher earning employees over the next couple of years, in place of saving within the registered pensions regime. For example, through employer-financed retirement benefits scheme (EFRBS).

If increasing numbers of executives are forced out of pensions saving, then it must also add to the pressure on the sustainability and level of occupational pension schemes generally, particularly defined benefit plans.

# Changes to Company Car tax charges and the Fuel Scale Charge

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The current graduated rate of company car tax bands will be extended down to a new 10 percent band, and all CO2 emissions moved down by 5g/km on 6 April 2012. The new 10 percent band will apply to CO2 emissions up to 99g/km. The current low emissions rate for QUALECs – Qualifying Low Emission Cars will therefore no longer exist as a separate category.

The Fuel Scale Charge, levied on employees receiving private fuel from their employer for a company car or van is to increase to £18,000 (from £16,900) for a company car and £550 (from £500) for a company van. These figures are also used to calculate the corresponding Class 1A NIC charge for employers.

## Who is affected

Any employees who receive private fuel for a company car or van and their employers.

## Timing

The new company car bands will take effect from 6 April 2012.

The new rules on the Fuel Scale Charge will take effect from 6 April 2010.

## Our view

The changes in the company car bands continue the theme of encouraging people to drive greener vehicles. The increase in the Fuel Scale Charge means that this is an increasingly expensive benefit for employers to provide for their staff.

# Company provided electric cars and electric vans

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Car and van benefit charges for electronically-powered cars and vans provided by companies to their employees will be reduced to nil.

In addition, a 100 percent First Year Capital Allowance (FYCA) will be introduced on new and unused electric vans. This is subject to this being compatible with State Aid rules.

## Who is affected

Any companies who provide electrically-powered cars and vans to employees.

## Timing

The new rules reducing the car and van benefit charges to nil where they are electronically-powered will take effect from 6 April 2010 and will apply for a period of 5 years. The 100 percent FYCA rate for electric vans will apply for expenditure incurred on or after 1 April 2010 (for corporation tax) or 6 April 2010 (for income tax).

## Our view

Currently there are not a vast number of electric vehicles and they are expensive. By exempting electric company cars and vans from company car/van tax and providing for a 100 percent FYCA for electric vans there will be a real incentive for employer's to invest in this technology, and for employees to want to switch to electric.

In time it is hoped that they will encourage further development of the technology, reduce the cost of electric cars and vans, increase demand and so have a beneficial effect on the environment.

# Salary sacrifice: restricting the tax exemption for workplace canteens

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Changes are to be made to the exemption from tax on free or subsidised canteen meals where employers and employees have entered into salary sacrifice or flexible benefits arrangements.

Legislation will be introduced in Finance Bill 2010 to amend section 317 ITEPA 2003 to restrict the exemption for the benefit of free or subsidised meals where an employee has an entitlement to these in conjunction with salary sacrifices or flexible benefits arrangements. The exemption will continue to apply in relation to general subsidies for canteens that are available to all employees.

## Who is affected

Employees who enjoy the use of free or subsidised meals at workplace canteens as part of salary sacrifice or flexible benefit arrangements and their employers.

## Timing

The new rules will take effect from 6 April 2011.

## Our view

This change will not affect traditional workplace canteens provided on a free or on a subsidised basis to all employees and unconnected with flexible benefit or salary sacrifice arrangements. However, the Government is clearly concerned about the potential tax/NIC cost where meals are provided in lieu of salary which would otherwise have been subject to tax/NIC. HMRC have been attacking arrangements involving the use of electronic swipe cards in workplace canteens and salary sacrifice over the last couple of years. However, they have clearly decided that additional legislation is also required to amend the terms of the existing canteen exemption.

# National Minimum Wage (NMW) and ‘travel schemes’

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

In conjunction with the Department for Business, Innovation and Skills (BIS) HMRC are to consult in the New Year on changes to the NMW Regulations to counter perceived exploitation relating to entitlements to social security benefits and ‘travel schemes’. ‘Travel schemes’ are described as certain arrangements relating to the expense rules on travel to a temporary workplace and in which temporary workers may participate. Certain social security benefits are earnings-related and can be reduced where reduced National Insurance Contributions (NICs) are payable.

## Who is affected

This may affect those operating in the business services sectors who supply temporary workers to end-user clients. This will most likely be via an agency or umbrella-employer arrangements. The ‘travel schemes’ referred to are likely to involve the introduction of tax exempt travel allowances (usually via a Form P11D dispensation) in lieu of an equivalent amount of taxable/NICable wages.

## Timing

The consultation will commence in the New Year at a date yet to be announced.

## Our view

It is known that HMRC are now actively targeting agencies and umbrella-employer arrangements. The concern here appears to be around temporary workers who are earning at or around the NMW and consequential loss of social security benefits, and whether the NMW regulations are adequately framed to deal with this issue. It remains to be seen what action the government may take.

# Income tax rates

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

There will be no increase in the level at which the higher rate income tax band of 40 percent starts for tax year 2010/11 and it will remain at taxable income of £37,400. Similarly the lower rate bands and allowances will also be frozen.

## Who is affected

Individuals with taxable income set to fall in the higher rate tax band.

## Timing

This will apply for tax year 2010/11.

## Our view

This is an unwelcome move as earnings growth, while limited currently, will bring more people into the 40 percent rate.

# Amendment to Enterprise Management Incentives (EMI) legislation

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

EMI is a tax efficient share option plan aimed at small companies to help them recruit and retain key employees. In order to qualify for EMI, a company has to meet various conditions with respect to size, independence and trade.

Following discussions between the Government and the European Commission (the 'Commission'), the Commission has agreed to grant EMI State Aid approval until April 2018, subject to a change to the current EMI rules. Following the change, a qualifying company's trading activities will no longer be required to be 'wholly or mainly' in the UK - instead a company is only required to have a 'permanent establishment' in the UK.

## Who is affected

Companies operating or looking to implement an EMI plan for its employees.

## Timing

The amendment will apply to options granted on or after 6 April 2010.

## Our view

It will be reassuring for companies operating or considering an EMI plan that the discussions between the Government and the Commission have reached a conclusion and, subject to this change, EMI complies with State Aid guidelines and will have State Aid approval until April 2018.

# Seafarers' Earnings Deduction: EU and EEA Residents

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

At present, to qualify for the Seafarers' Earnings Deduction, an individual must be ordinarily resident in the UK. If the individual meets all the qualifying conditions, earnings for his or her duties as a seafarer on a ship, wholly or partly outside the UK, are subject to 100 percent tax relief. However, the government have accepted that the requirement to be ordinarily resident in the UK is not compatible with the EU treaty. Accordingly, legislation will be introduced to extend the relief to all EU and EEA resident seafarers.

## Who is affected

EU or EEA resident seafarers who are currently liable to UK taxation on their earnings for seafarers' duties on a ship.

## Timing

The new rules will take effect from 6 April 2011.

## Our view

This is a positive change, albeit that it may affect a relatively limited number of individuals. Although it removes UK taxation on their seafarer earnings, as residents in an EU or EEA country, they are nevertheless likely to be subject to tax on their earnings in that country.

# Enterprise Investment and Venture Capital Schemes

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

As set out in Supplementary Documents published on HMRC's website, draft legislation has been issued to implement changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs).

The proposed changes are intended to align the schemes more closely to the European Commission (EC) definition of a small enterprise to secure State Aid approval.

The draft legislation also:

- applies a new requirement that to qualify under either scheme, a company must not be in difficulty;
- replaces the requirement that to qualify under either scheme a company must undertake its qualifying trade wholly or mainly in the UK, with one that the company must have a permanent establishment in the UK;
- removes the requirement that a VCT's shares must be included in the UK Official List, replacing it with one that its shares must be traded on an EU regulated market; and
- changes the rules governing the amount of a VCT's investment that must be held as equity.

HMRC has also today published a separate Technical Note ('Enterprise Investment Scheme (EIS) and Partnerships') confirming its current view that companies carrying on their qualifying activity in partnership (including a Limited Liability Partnership) do not qualify under the EIS.

## Who is affected

Businesses seeking to fall within the EIS or VCT regime and individuals seeking to invest in qualifying EIS and VCT investments.

## Timing

The new legislation is intended to take effect from 6 April 2010. HMRC have invited comments from stakeholders on the draft legislation. Comments are requested by 1 February 2010.

HMRC's views in respect of companies carrying on their activities through a partnership apply to existing structures, subject to certain concessions where approval has been granted, and new structures.

## Our view

Importantly, the tax reliefs available for qualifying investments are unchanged. Replacing the requirement that a company must carry on its trade wholly or mainly in the UK with the proviso that a company must have a permanent establishment in the UK may be significant for businesses operating both in the UK and overseas. HMRC's view in respect of companies operating in a partnership is relevant for business structures going forward in particular.

# Personal Tax



**David Kilshaw**  
**Head of Private Client**

For individuals, the 2009 Pre-Budget Report was the dog that didn't bark.

Despite much speculation there has been no increase to the capital gains tax rate of 18 percent, nor was there any increase to the IHT rate or the introduction of a higher tier of inheritance tax.

For most, the main impact will be the further increase in National Insurance by 0.5 percent from 2011/12, coupled with the freezing of the personal tax allowances and thresholds for 2010/11. This will mean that from 6 April 2011 the main rates of Class 1 and Class 4 NIC will be 12 percent and 9 percent respectively; and the higher rate of Class 1 and Class 4 NIC will be increased to 2 percent. The previously announced 50% rate of income tax will begin from 6 April 2010 above £150,000. This will produce an effective marginal tax rate of 52 percent on some earnings from 6 April 2011.

More high earners will also see tax relief on their pension contributions reduce as employer contributions are included in the calculation for people with base incomes over £130,000, rather than £150,000. And of course, bankers will see their discretionary bonuses subjected to a 50 percent levy.

The announcement that the Chancellor is freezing the inheritance tax nil rate band from 6 April 2010 at £325,000 means the IHT headache is returning for middle England householders. Since 1997, the IHT starting point has increased by only 51 per cent compared with an increase in house prices of over 130 percent for the UK as a whole. Likewise to freeze the 40 percent tax band in 2012/13 (as well as for 2010/11), continues the trend of increasing the number who pay income tax at this higher rate.

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# Income tax rates

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

There will be no increase in the level at which the higher rate income tax band of 40 percent starts for tax year 2010/11 and it will remain at taxable income of £37,400. Similarly the lower rate bands and allowances will also be frozen.

## Who is affected

Individuals with taxable income set to fall in the higher rate tax band.

## Timing

This will apply for tax year 2010/11.

## Our view

This is an unwelcome move as earnings growth, while limited currently, will bring more people into the 40 percent rate.

# Increase in NIC rates

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

From 6 April 2011, Class 1 and Class 4 National Insurance Contributions (NIC) will increase by a further 0.5 percent (in addition to the 0.5 percent rate increase announced in the 2008 Pre-Budget Report). This will mean that from 6 April 2011 the NIC rates will be increased as follows:

- the Class 1, 1A and 1B employer rate – rises from 12.8 percent to 13.8 percent;
- the main rates of Class 1 and Class 4 NIC will rise from 11 percent to 12 percent and from 8 percent to 9 percent respectively; and
- the higher rate of Class 1 and Class 4 NIC will rise from 1 percent to 2 percent.

For tax year 2011/2012, the primary threshold and lower profits limit will be increased by £570 above plans announced in the 2008 Pre-Budget Report to compensate the lowest earners for the increases in Class 1 and Class 4 NIC.

## Who is affected

Employers, employees and self-employed persons.

## Timing

The increased NIC rates take effect from 6 April 2011.

## Our view

This is an unwelcome surprise. The employer's NIC rise will now be twice what was expected – 1 percent rather than 0.5 percent. The cost to employers will be significant and will most likely hit employers just as they are emerging from recession. This coupled with the freezing of the 40 percent tax band means that it is going to cost employers significantly more to put a pound in their employees' pockets.

# New tax on Bankers bonuses

Impact on tax payer			
Positive	Neutral	Negative	Both positive and negative

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## The issue

A new Bank Payroll Tax will be introduced with immediate effect. This will be set at 50 percent and applied to the total amount of bonuses to which bankers are entitled, to the extent that the individual bonuses exceed £25,000. It will be payable directly by the bank to HM Revenue and Customs (HMRC). The tax will apply whether the bonus is provided directly by the bank or through an intermediary.

The Bank Payroll Tax will apply to bonuses comprising money, money's worth, benefits and loans. It does not apply to regular salary, wages, benefits or certain approved share schemes.

The draft legislation includes very broad anti-avoidance measures designed to counteract any payments made by way of Employee Benefit Trusts or similar vehicles, via loans to employees or in other ways where, in substance, a bonus exceeding £25,000 has been awarded.

The legislation is widely drafted to cover all bonuses to banking employees including remuneration which for any reason is not subject to UK income tax on the employee.

Bank Payroll Tax will not affect the income tax or national insurance liabilities of bank employees.

Bank Payroll Tax will not be taken into account when computing the banks' profits or losses for corporation tax or income tax purposes.

A technical note, including draft legislation and explanatory notes, has been published by HMRC and runs to some 31 pages.

## Who is affected

The Bank Payroll Tax will be applied to 'Taxable Companies'. 'Taxable Companies' comprise banks, financial businesses and holding companies in banking groups, building societies, financial businesses and holding companies in building society groups and UK branches of

foreign banks that provide a bonus exceeding £25,000 to a banking employee.

A banking employee is defined as someone who is (i) employed by a Taxable Company in 'Banking Employment' (or otherwise performs 'Banking Services' for a Taxable Company under arrangements involving 'another party'), (ii) whose duties relate, either directly or indirectly, to activities that are 'Relevant Regulated Activities', and (iii) who is either resident in the UK in 2009/10 or performs their duties wholly or partly in the UK.

'Banking Employment' means employments which wholly or mainly involve duties that relate to 'Relevant Regulated Activities'. 'Relevant Regulated Activities' comprise acquiring deposits, dealing in investments as principal or agent, arranging deals in investments, safeguarding and administering investments on behalf of clients and regulated mortgage activities.

## Timing

The new rules take effect immediately from 9 December 2009 and will be operative until 5 April 2010 for all discretionary bonuses that are awarded. There is an exception for contractual bonus entitlements where the bank has no discretion as to the amount of bonus because of a pre-existing obligation at the time of the Chancellor's announcement.

The draft legislation also brings arrangements for future payments within the scope of Bank Payroll Tax where the arrangement is made during the period to 5 April 2010. The making of the arrangement will be regarded as an award of a bonus to the employee and so trigger payment of Bank Payroll Tax.

The due date for payment of tax is 31 August 2010. The detailed provisions for collection and assessment will be published in due course. This will include provision for penalties and interest.

## Our view

The Chancellor has explicitly issued a challenge to the UK banking sector to focus on building up their capital position instead of paying large bonuses to employees. In what may be seen as a politically motivated decision in the run up to an election, it concentrates the line of fire on the banks with the justification given being the financial support afforded by the government over the last year.

Banks will now have to consider whether they will effectively bear the tax directly or whether the burden will fall on the employee by reducing bonus pools or a mixture of both.

With the introduction in the last year of the Remittance Basis Charge for non-domiciled employees of £30,000 per annum, the 50 percent tax rate, a (now) 1 percent National Insurance increase from 6 April 2011, restrictions on pension tax relief for higher earners and now a Bank Payroll Tax, banking employees are feeling the brunt.

It will be interesting to see how this impacts on London as a competitive global financial centre. The financial sector is vital to the UK economy and needs to maintain its competitiveness in the international arena in order to retain its global status and attract new business.

For banks with overseas employees working at their UK offices, the draft legislation suggests that these employees will also be covered by the new 50 percent Bank Payroll Tax. But the position for employees who work, or have worked, only for a short period in the UK, or partly in the UK and partly abroad, is not clear. This may raise complex tracking issues for employers in calculating what is included in this Bank Payroll Tax and what is not.

There is a particular concern that the Bank Payroll Tax could apply to investment managers. The draft legislation and notes released by HMRC give a very broad definition of a bank and do not appear to provide a specific carve out for asset managers. Specifically, there is concern with the inclusion of dealing in investments as principal, dealing in investments as agent, arranging deals in investments and safeguarding and administering investments.

We expect more clarity from HMRC over the coming weeks and affected parties should contact KPMG if they wish to make representations ahead of next year's Finance Bill.

# Inheritance Tax: nil rate band

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The proposed increase in the Inheritance Tax (IHT) threshold to £350,000 for transfers on or after 6 April 2010 has been abandoned. The IHT threshold will therefore be frozen at £325,000.

## Who is affected

Estates and certain trusts with assets between £325,000 and £350,000.

## Timing

The increased threshold was previously to apply to the estates of individuals who die after 5 April 2010, and to trusts taxed after that date.

## Our view

The proposed increase in the IHT threshold was originally included in Finance Act 2007 as the last in a series of rapid rises to the IHT threshold to address the way that house prices had risen more quickly than the IHT threshold historically. Since 1997, house prices in the UK have risen by over 130 percent. Over the same period the IHT threshold has increased by around 51 percent and the RPI by around 35 percent.

Abandoning this final increase may mark the end of attempts to prevent large numbers of home owners falling into the IHT net. It also shows that it is not prudent to plan on the basis of pre-announced IHT reliefs.

Retaining the current threshold may renew interest in 'nil rate band' trusts in Wills, which had been expected to decline following changes to IHT in recent years.

# Measures to counter Inheritance Tax planning

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

New rules are being introduced to block two complex Inheritance Tax (IHT) planning arrangements designed to enable trusts to be created without an immediate charge to IHT. The arrangements involve the creation or purchase of certain interests in trusts.

## Who is affected

Individuals contemplating using either of the arrangements.

## Timing

The new rules will affect arrangements which had not been implemented before 9 December 2009.

## Our view

Trusts are often used by individuals who wish to make gifts but would like to benefit from the legal protections afforded by trusts to beneficiaries. The Finance Act (FA) 2006 extended tax charges on lifetime transfers to trusts. Since then such transfers in excess of the available nil rate band have generally attracted an immediate inheritance tax charge at 20 percent.

Some individuals have entered into more complex arrangements to establish lifetime trusts without an immediate tax charge. There is precedent for similar arrangements being blocked by legislation and this development should not surprise those affected.

Inheritance Tax planning is unusual in that it may need to remain effective for a longer period than other planning, typically up to the death of the individual, and therefore it should be undertaken with the possibility of changes in law over that period in mind.

However, it is noteworthy that in this case where the arrangements were made before 9 December 2009 the Inheritance Tax benefit is preserved, even if the individual affected has not yet died.

# Restriction on pensions tax relief from April 2011

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Those with gross incomes of £180,000 or more will have tax relief restricted to basic rate on all pension savings. For those with gross incomes of between £150,000 and £180,000, relief will be tapered.

The taper will operate as a series of steps where the rate of tax relief is gradually reduced from 50 percent to 20 percent as gross income rises from £150,000 to £180,000. The government is consulting on the size and number of the steps.

The restriction will apply to all contributions to money purchase pension arrangements.

For defined benefit pension arrangements, a 'deemed' contribution will be calculated to reflect the value of the pension accrued. The government is consulting on how to assess this value, but its preferred approach is to use age-related factors varying by both age and normal pension age. The restriction on relief will be applied to this deemed contribution.

The restriction on relief will operate by collection of a recovery charge through the self-assessment system. Where the tax charge exceeds £15,000 it is proposed that a pension scheme will be able to pay the charge on an individual's behalf, with an appropriate reduction in their benefit.

It has been clarified that those affected will be individuals with 'gross income' of at least £150,000 **and** 'relevant income' of at least £130,000.

These terms are defined in the draft legislation. 'Gross income' includes both the personal **and** employer pension contributions to registered pension schemes. 'Relevant income' includes the individual's contributions only, ie no deduction for personal pension contributions can be made. Furthermore, salary sacrifice arrangements for pension

contributions entered into after 8 December 2009 will not reduce relevant income.

So, for example, if your relevant income (ie excluding employer pension contributions) is £125,000 you would be unaffected even if your employer contributions would take gross income above £150,000. Similarly, an individual would be unaffected if relevant income is £135,000 and employer pension contributions are £10,000.

### **Who is affected**

Individuals with 'gross income' of at least £150,000 and 'relevant income' of at least £130,000.

### **Timing**

The restriction applies from 6 April 2011.

### **Our view**

This restriction in pensions tax relief from April 2011 adds yet another layer of unwelcome complexity to the pensions tax regime. And the proposed definition of gross income could bring many more people within the scope of the restriction than might previously have been envisaged, albeit that the position on employer contributions is relaxed for those with relevant income of less than £130,000.

Employers may want to consider and develop alternative reward strategies for higher earning employees over the next couple of years, in place of saving within the registered pensions regime. For example, through employer-financed retirement benefits scheme (EFRBS).

If increasing numbers of executives are forced out of pensions saving, then it must also add to the pressure on the sustainability and level of occupational pension schemes generally, particularly defined benefit plans.

# Pensions tax relief: extension of anti- forestalling measures

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The anti-forestalling measures that currently apply in respect of those with income of £150,000 or more are extended, from 9 December 2009, to include those with income of £130,000 or more.

In the 2009 Budget, the Government announced its intention to restrict tax relief on pension contributions with effect from 6 April 2011 for individuals with taxable earnings of £150,000 or more. Included in the 3-month consultation launched today is comment on how this restriction will be introduced.

One aspect that has been confirmed is that the income definition for the £150,000 threshold will include the value of employer pension contributions. However, tax relief for those with incomes below £130,000, before the inclusion of employer pension contributions, will not be restricted. This means that some individuals with income between £130,000 and £150,000 who may not previously have expected to have been caught by the 2011 changes will in fact be caught. They may therefore have an incentive to increase their pension savings prior to the change.

The Finance Act 2009 already contains measures to prevent those with income over £150,000 from seeking to forestall the 2011 change by increasing their pension saving – in excess of their normal, ongoing, regular pattern – prior to 6 April 2011. This is now extended this anti-forestalling regime to those with income over £130,000.

## Who is affected

Individuals with incomes of £130,000 or more who, on or after 9 December 2009, change their normal pattern of regular pension contributions or the way in which their pensions are accrued, and whose

total annual pension accrual exceeds the special annual allowance of £20,000 (or up to £30,000 in some cases).

The detailed rules that currently apply to those with income of £150,000 or more under the Finance Act 2009 will apply similarly to those with incomes of £130,000 or more. Any saving which is not within an individual's regular pattern of saving and was made from 6 April 2009 up to and including 8 December 2009 will not be subject to the anti-forestalling restriction. However, this saving will reduce the amount of the special annual allowance available for 2009-10.

### **Timing**

The new rules take effect from 9 December 2009.

### **Our view**

Whilst the exclusion from the post April 2011 regime of employer pension contributions for those on incomes of less than £130,000 is welcome, this clearly comes at the price of individuals with income between £130,000 and £150,000 being caught by the anti-forestalling rules.

# Help for taxpayers not submitting returns on time

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Where taxpayers who had fallen behind in their tax affairs have had determinations issued by HMRC based on estimates of their tax liability, these amounts are legally due, even if the actual amount owed is less. Previously, by concession, HMRC had collected only the amount of tax which the individual actually owed, even if they had missed the deadline to provide the necessary information, provided they brought their tax affairs up to date.

The effect of this measure is to put this concession on a statutory basis.

## Who is affected

Any tax payer who has fallen behind with their tax affairs.

## Timing

The start date for the measure will be confirmed in the legislation and the concession will continue until that date.

## Our view

It is pleasing to see that the Government has responded to representation from KPMG and others to continue this practice of treating taxpayers fairly.

# Transactions in securities and unallowable purpose test: HMRC responses to consultation

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

HMRC have published a summary of the responses received on the consultation documents concerning Transactions in Securities (TiS) and unallowable purpose tests.

The key points arising are as follows:

- HMRC is to consider further whether the close company definition should be amended for TiS purposes to take account of concerns raised about private equity portfolio companies. These companies could be brought within the scope of the TiS regime as a result of extending the definition of an affected company to include close companies.
- HMRC is to consider the possibility of repealing the TiS legislation for corporation tax purposes.
- HMRC maintain their intention to interpret unallowable purpose legislation in a punitive manner such that tax payers may owe more tax as a result of the legislation than would have been the case if no planning had been done.
- It is disappointing that HMRC have rejected calls for a clearance procedure in respect of unallowable purpose tests so failing to alleviate taxpayer uncertainty in relation to these tests.

## **Who is affected**

Taxpayers undertaking TiS.

The changes to the unallowable purposes test are potentially wide ranging.

## **Timing**

Currently HMRC expect that the revised legislation relating to the TiS rules for income tax will be included in Finance Bill 2010. Corporation tax changes may be deferred to enable more detailed work to be undertaken.

HMRC intend to have a revised text on unallowable purposes test available in Spring 2010 to be adopted by Summer 2010.

## **Our view**

It is encouraging that HMRC are considering concerns raised during the consultation process.

# Enterprise Investment and Venture Capital Schemes

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

As set out in Supplementary Documents published on HMRC's website, draft legislation has been issued to implement changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs).

The proposed changes are intended to align the schemes more closely to the European Commission (EC) definition of a small enterprise to secure State Aid approval.

The draft legislation also:

- applies a new requirement that to qualify under either scheme, a company must not be in difficulty;
- replaces the requirement that to qualify under either scheme a company must undertake its qualifying trade wholly or mainly in the UK, with one that the company must have a permanent establishment in the UK;
- removes the requirement that a VCT's shares must be included in the UK Official List, replacing it with one that its shares must be traded on an EU regulated market; and
- changes the rules governing the amount of a VCT's investment that must be held as equity.

HMRC has also today published a separate Technical Note ('Enterprise Investment Scheme (EIS) and Partnerships') confirming its current view that companies carrying on their qualifying activity in partnership (including a Limited Liability Partnership) do not qualify under the EIS.

## Who is affected

Businesses seeking to fall within the EIS or VCT regime and individuals seeking to invest in qualifying EIS and VCT investments.

## Timing

The new legislation is intended to take effect from 6 April 2010. HMRC have invited comments from stakeholders on the draft legislation. Comments are requested by 1 February 2010.

HMRC's views in respect of companies carrying on their activities through a partnership apply to existing structures, subject to certain concessions where approval has been granted, and new structures.

## Our view

Importantly, the tax reliefs available for qualifying investments are unchanged. Replacing the requirement that a company must carry on its trade wholly or mainly in the UK with the proviso that a company must have a permanent establishment in the UK may be significant for businesses operating both in the UK and overseas. HMRC's view in respect of companies operating in a partnership is relevant for business structures going forward in particular.

# Review of powers, deterrents and safeguards

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

The HMRC Powers Review team has issued a number of further consultation documents, impact assessments and summaries of responses to previous consultations. These include the following:

### Interest – Working Towards a Harmonised Regime

Finance Act (FA) 2009 introduced legislation to provide for a harmonised regime for charging and paying interest on tax payments. Corporation tax and petroleum revenue tax were not covered by this legislation and HMRC have now published draft legislation to deal with this. This maintains the present position that different rates are applied to corporation tax paid by instalments. Like the FA 2009 provisions, the new legislation will be brought into force by statutory instruments on a phased basis.

### Meeting the obligations to file returns and pay tax on time

Legislation covering a range of direct and indirect taxes was introduced in FA 2009. HMRC have now published draft legislation to extend the same principles to the remaining indirect taxes including VAT and Excise Duties. Implementation will be staged over the next few years.

### Excise: Modernisation and Compliance Checks: the next stage

This document sets out proposals for modernising the regime for excise duty compliance. Legislation is to be introduced in the 2010 Finance Bill with a view to implementation in 2011.

## **Working with Tax Agents – The Next Stage**

A consultation document on this topic was issued at the time of the 2009 Budget. HMRC have now issued a further document containing more specific proposals, together with an impact assessment and a summary of responses to the previous consultation. The new consultation document envisages a twin-track approach in which HMRC would prioritise work on revised procedures for disclosures to professional bodies, legislation to deal with deliberate wrongdoing by tax agents, and new legislation relating to agents who make a high volume of repayment claims. In the longer term HMRC will work on developing appropriate responses to persistent shortcomings in the work of tax agents which fall short of deliberate wrongdoing.

## **Tackling Offshore Tax Evasion**

HMRC have issued a consultation document and impact assessment covering two proposals for additional legislation to deal with offshore tax evasion. Under the first proposal, offshore non-compliance, whether careless or deliberate, would be subject to penalties at the same scale as deliberate domestic non-compliance. This would mean that the minimum penalty would be 20 percent of the undeclared tax even where a full unprompted disclosure was made, and penalties could be as high as 70 percent even where no concealment is involved. These penalties would apply for tax periods commencing on or after 1 April 2011, but HMRC have also said that they intend to seek penalties at similar levels for earlier years on the basis that the non-compliance is deliberate.

Under the second proposal, some individuals who have bank accounts in certain jurisdictions would be required to notify them to HMRC. Depending on the jurisdiction, this would either apply to all bank accounts or to accounts where the balance was over £25,000. Notification would be required within 60 days of the accounts becoming notifiable. Failure to comply would attract an initial fixed penalty, followed by a period of daily penalties and then by tax-geared penalties. This penalty would be in addition to the penalties for under-declaration, so that in the most serious cases the aggregate penalty could be as high as 200 percent of the evaded tax. The document does not specify when this proposal would be implemented.

The document also proposes some changes to the information requirements relating to non-resident trusts.

## **Bulk and specialist information powers**

HMRC have issued a summary of responses to the consultation document which was published on 9 July 2009. A further consultation document, containing draft legislation, is to be issued in due course.

## Who is affected

All taxpayers and tax agents are potentially affected by these proposals.

## Timing

See the discussion of individual proposals above.

## Our view

The first three documents represent a continuation of the process of modernisation of the UK's tax compliance framework following the merger of the Inland Revenue and HM Customs and Excise in 2005.

The previous consultation document on working with tax agents provoked a considerable amount of discussion. HMRC have sensibly decided to focus initially on their proposals for dealing with deliberate wrongdoing by agents and with the specific issues presented by high volume repayment agents. KPMG will be examining these proposals in detail and will respond to the consultation in due course. At this stage, HMRC have given little detail of their thinking in relation to the remaining issues raised by the previous document. KPMG's view continues to be that such issues should be addressed by HMRC in consultation with the relevant professional bodies and in a spirit of collaboration rather than confrontation.

The measures to deal with offshore non-compliance are part of HMRC's offshore strategy which has involved, among other things, the 2007 Offshore Disclosure Facility, the 2009 New Disclosure Opportunity (for which the deadline is now 4 January 2010), and the Liechtenstein Disclosure Facility which runs until 2015. As part of this process, HMRC have issued information notices to numerous banks and financial institutions requiring disclosure of details of offshore bank accounts. Whether or not these proposals are implemented as set out in the document, they leave no doubt that HMRC are determined to tackle the issue of offshore tax evasion.

# Furnished holiday lettings

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation will be introduced in Finance Bill 2010 to withdraw the furnished holiday letting (FHL) rules from 2010-11. Draft legislation and a technical note have been published.

## Who is affected

Individuals, partnerships, trustees and companies who have income or capital gains from the commercial letting of furnished holiday accommodation.

## Timing

The withdrawal will have effect for income tax purposes for profits and losses arising from 6 April 2010. For capital gains tax the withdrawal has effect for disposals from 6 April 2010.

For corporation tax purposes the withdrawal has effect for profits and losses arising in accounting periods starting on or after 1 April 2010 and for capital gains arising on disposals on or after 1 April 2010.

## Our view

The draft legislation and technical note provide that once the rules are withdrawn FHL businesses will be taxed as an ordinary property business.

For most FHL businesses, this will be unfavourable as FHL businesses tend to be able to obtain favourable tax treatments and reliefs under current rules compared to other property businesses.

However, a positive measure is that where capital expenditure has been incurred prior to the withdrawal of the rules, capital allowances will still be available going forward. In addition, FHL businesses will be able to claim wear and tear allowance.

# Capital gains tax: Private residence relief and adult placement carers

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Legislation will be introduced in Finance Bill 2010 to preserve the entitlement to private residence relief where an adult placement carer uses part of their home exclusively for the purposes of their business as a carer.

## Who is affected

Individuals who set aside part of their house exclusively for use under a local authority adult placement scheme.

## Timing

The measure will have effect for disposals on or after 9 December 2009.

## Our view

This is a positive measure for individuals allowing or who have previously allowed part of their main residence to be used for the purposes of a local authority adult placement scheme.

# Income Tax Treatment of Shared Life Carers

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Changes are to be made to the taxation of Shared Lives carers.

## Who is affected

Those who provide accommodation, care and support for up to three individuals who have been placed with them under a local authority Shared Lives scheme.

## Timing

The changes will have effect from 6 April 2010.

## Our view

This will be a positive measure for Shared Lives carers.

# Clean energy cash-back and boiler scrappage scheme

Impact on tax payer			
Positive	Neutral	Negative	Both winners and losers

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## The issue

Where individuals generate low carbon, renewable energy for personal use and feed excess electricity into the National Grid, they receive 'Feed-in Tariffs' by their electricity provider per KWh exported. The Chancellor announced that these Feed-in Tariffs will not be subject to Income Tax in the hands of the individual. The government predict that feed in tariffs are worth on average £900 per household.

Where households replace old boilers for new, they will be entitled to a scrappage allowance of £400.

## Who is affected

Individuals who generate low carbon, renewable energy for personal use and feed excess electricity into the National Grid.

Households replacing boilers.

## Timing

The legislation is expected to be introduced with effect from 1 April 2010.

## Our view

This will provide a benefit to those taxpayers who have sufficient funds to invest in renewable energy creating technology. It is unlikely to provide a benefit to low-income household without the capital to invest. However, the £400 allowance for replacing boilers will be more widely applicable. The Government has announced they will consult next year on how they can help low-income families.

The Pre-Budget Report proposals and other tax changes are summarised on these pages. The Pre-Budget Report proposals may, however, be amended significantly before enactment. The content of this communication is intended to provide a general guide to the subject matter and should not be regarded as a basis for ascertaining liability to tax or determining investment strategy in specific circumstances. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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