FINANCE BILL 2012
EXPLANATORY NOTES
INTRODUCTION

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to Finance Bill 2012 as introduced into Parliament on 29 March 2012. They have been prepared jointly by the HM Revenue & Customs and HM Treasury in order to assist the reader in understanding the Bill. They do not form part of the Bill and have not been endorsed by Parliament.

2. The notes are designed to be read alongside with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So, where a section or part of a section does not seem to require any explanation or comment, none is given.

EXPLANATORY NOTE

CLAUSE 1: CHARGE FOR 2012-13 AND RATES FOR 2012-13 AND SUBSEQUENT TAX YEARS

SUMMARY

1. Clause 1 provides for income tax for the 2012-13 tax year and sets the main rates of income tax for 2012-13 and 2013-14. The clause also makes changes consequent to an additional rate of 45 per cent for 2013-14.

DETAILS OF THE CLAUSE

2. Subsection 1 provides for income tax for 2012-13 and sets the main rates of income tax.

3. Subsection 2 sets the main rates of income tax for 2013-14.

4. Subsection 3 reduces the dividend additional rate to 37.5 per cent; the trust rate to 45 per cent; the dividend trust rate to 37.5 per cent.

5. Subsection 4 reduces the charge on relevant benefits provided under employer-financed retirement benefits schemes, in section 394 (Employer-financed Retirement Benefit Schemes) of Income Tax (Earnings and Pensions) Act 2003 (ITEPA), from 50 per cent to 45 per cent when section 394(2) ITEPA applies because the person receiving the benefits is not an individual.

6. Subsection 5 provides for a consequential amendment to section 640(6) (Grossing-up of Deemed Income) of Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

7. Subsection 6 provides that the amendments made by subsections 3 to 5 inclusive have effect from 2013-14.

BACKGROUND NOTE

8. Income tax is an annual tax. It is for Parliament to impose income tax for a tax year.

9. The rates of income tax for the main rates are determined by Parliament for a tax year. The main rates of income tax currently provided for are the basic rate, the higher rate and the additional rate.

10. Other rates of income tax are included within the Tax Acts.

11. There are alternative rates of income tax for dividends. The dividend additional rate applies to dividend income that would otherwise be taxable at the additional rate.

12. The trust rate of tax is the rate of tax paid by trustees that generally applies to the income of discretionary or accumulation trusts. Trustees are liable to tax on income received at the trust rate of tax, but dividends and other similar income are chargeable at the dividend trust rate.

13. Section 394 of ITEPA prevents individuals, who are liable to the highest rate of income tax, avoiding tax by transferring rights to receive retirement benefits to another person such as a company, which is not liable to the top rate of income tax.

14. Section 640 of ITTOIA sets out the amount of notional tax credit attached to certain capital payments, made by trustees to settlors, that are deemed for tax purposes to be income. A charge to tax on the settlor arises when the capital payment can be matched with undistributed income in the trust. A payment is matched first with the earlier income of the trust. The notional credit is linked to the rate of tax that the trustees have paid on the income with which the capital payment is matched. As the trust rate will decrease to 45 per cent for 2013-14 onwards, the amendment ensures that the notional tax credit for capital payments matched with undistributed income of 2013-14 onwards is also decreased to 45 per cent.

EXPLANATORY NOTE

CLAUSE 2: BASIC RATE LIMIT FOR 2012-13

SUMMARY

1. This clause sets the amount of the basic rate limit for income tax at £34,370 for 2012-13.

DETAILS OF THE CLAUSE

2. Subsection (1) replaces the existing amount of the basic rate limit in section 10(5) of the Income Tax Act 2007 (£35,000) with £34,370 for 2012-13.

3. Subsection (2) disapplies the indexation provisions for the basic rate limit for 2012-13.

BACKGROUND NOTE

4. An individual's taxable income is charged to tax at the basic rate of tax up to the basic rate limit.

5. The basic rate limit is subject to indexation (an annual increase based upon the percentage increase to the retail prices index). Parliament can over-ride indexed amounts by a provision in the Finance Bill.

6. The table below sets out the amount of the basic rate limit for 2011-12, the indexed amount for 2012-13 and the amount specified by this clause for 2012-13:

2011-12	2012-13 indexed	2012-13 by this clause
£35,000	£37,000	£34,370

7. The effect of this clause is to over-ride the indexed amount for the basic rate limit. This clause is part of a package of measures, together with a further clause in this Bill that sets the personal allowance for those aged under 65 in an amount above indexation.

EXPLANATORY NOTE

CLAUSE 3: PERSONAL ALLOWANCE FOR 2012-13 FOR THOSE AGED UNDER 65

SUMMARY

1. This clause sets the amount of the personal allowance for those aged under 65 at £8,105 for 2012-13.

DETAILS OF THE CLAUSE

2. Subsection 1 replaces the existing amount of the personal allowance for those aged under 65 in section 35(1) of the Income Tax Act 2007 (£7,475) with £8,105 for 2012-13.

3. Subsection 2 disapplies the indexation provisions for the personal allowance for those aged under 65 for 2012-13.

BACKGROUND NOTE

4. An individual is entitled to a personal allowance for income tax. The amount depends upon the individual's age and income.

5. Income tax personal allowances are subject to indexation (an annual increase based upon the percentage increase to the retail prices index). Parliament can over-ride indexed amounts by a provision in the Finance Bill.

6. The table below sets out the amount of the personal allowance for those aged under 65 for 2011-12, the indexed amount for 2012-13 and the amount specified by this clause for 2012-13:

2011-12	2012-13 indexed	2012-13 by this clause
£7,475	£7,895	£8,105

7. The effect of this clause is to over-ride the indexed amount for the personal allowance for those aged under 65. This clause is part of a package of measures together, with a further clause in this Bill, that sets the basic rate limit in an amount below indexation.

EXPLANATORY NOTE

CLAUSE 4: PERSONAL ALLOWANCES FROM 2013

SUMMARY

1. This clause amends the income tax personal allowances currently available for people aged under 65, aged 65 to 74 or aged 75 and over in a tax year. It changes entitlement from age to date of birth and fixes the amount of the allowances for people born before 6 April 1948 until the personal allowance for people born after 5 April 1948 is a greater amount.

DETAILS OF THE CLAUSE

2. Subsection 1 provides that the income tax personal allowances currently available for people aged under 65, aged 65 to 74 or aged 75 and over in a tax year are amended in accordance with this clause.

3. Subsection 2 provides that section 35 Income Tax Act 2007 (ITA) (personal allowance for those aged under 65) is amended so that the personal allowance that it provides is available to people born after 5 April 1948.

4. Subsection 3(a) provides that section 36 ITA (personal allowance for those aged 65 to 74) is amended so that the personal allowance that it provides, or the allowance provided by section 35, whichever is the greater, is available to people born after 5 April 1938 but before 6 April 1948.

5. Subsection 3(b) provides that the income-related reduction to the allowance provided by section 36 ITA, only applies if the allowance is greater than the allowance provided by section 35 ITA. The section 36 allowance is not reduced below the amount of the section 35 allowance.

6. Subsection (3)(c) inserts a new section for section 36 ITA that defines “the section 35 amount” as the amount the individual would have been entitled to if they had been born after 5 April 1948.

7. Subsection 4(a) provides that section 37 ITA (personal allowance for those aged 75 and over) is amended so that the personal allowance that it provides or the allowance provided by section 35 ITA, whichever is the greater, is available to people born before 6 April 1938.

8. Subsection 4(b) provides that the income-related reduction to the allowance provided by section 37 ITA, only applies if the allowance is greater than the allowance provided by section 35. The section 37 allowance is not reduced below the amount of the section 35 allowance.

9. Subsection (4)(c) inserts a new section for section 37 ITA that defines "the section 35" amount as the allowance the individual would have been entitled to if they had been born after 5 April 1948.

10. Subsection 5 provides that section 41 ITA (allowances in the year of death), which clarifies that the higher allowance is due if an individual dies before they reach the age of 65 or 75 in the year of their death, is amended to remove specific references to sections 36 and 37 ITA.

11. Subsection 6 provides that the amended allowance provided by section 35 ITA is subject to indexation as provided for by section 57 ITA (indexation of allowances). It also removes the amended allowances provided by section 36 and 37 ITA from the indexation provisions.

12. Subsection 7 amends the references to section 35 ITA in section 508A Income and Corporation Taxes Act 1988.

13. Subsection 8 provides that this clause has effect from the 2013-14 tax year and subsequent years.

BACKGROUND NOTE

14. There are currently three income tax personal allowances provided by reference to an individual's age; one for people aged under 65 in the tax year; one for people aged 65 to 74 in the tax year; one for people aged 75 and over in the tax year.

15. This clause provides that from 2013-14, an individual is entitled to a personal allowance by reference to their date of birth.

16. This clause also provides that from 2013-14, the allowances for people born before 6 April 1948 are removed from the indexation provisions for personal allowances.

17. For 2012-13, the amount of these allowances will be:

Individual aged under 65 in the tax year	£8,105
Individual aged 65 to 74 in the tax year	£10,500
Individual aged 75 and over in the tax year	£10,660

18. The amount of the personal allowance for people aged under 65 will be set by a separate clause in this Bill. The allowances for people aged 65 to 74 and aged 75 and over are set by The Income Tax (Indexation) Order 2011 No. 2926 made on 6 December 2011.

19. The Chancellor has announced that for 2013-14, the personal allowance provided for by section 35 ITA will be £9,205. This will be provided for in Finance Bill 2013.

20. Taken together with the powers provided by this clause, the personal allowances for 2013-14 will be:

Individual born after 5 April 1948	£9,205
Individual born after 5 April 1938 but before 6 April 1948	£10,500
Individual born before 6 April 1938	£10,660

21. Existing legislation specifically clarifies that the allowances for people aged 65 to 74 and aged 75 and over in a tax year are unaffected where the individual dies before their birthday. Setting a personal allowance by reference to an individual's date of birth removes the requirement for this clarification.

EXPLANATORY NOTE

CLAUSE 5: MAIN RATE OF CORPORATION TAX FOR FINANCIAL YEAR 2012.

SUMMARY

1. Clause 5 reduces the corporation tax (CT) main rate for profits other than ring fence profits for the financial year beginning 1 April 2012. It sets the main rate of CT at 24 per cent on non-ring fence profits effective from 1 April 2012.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) substitute the corporation tax main rate of 25 per cent set in Finance Act 2011 with a rate of 24 per cent for the main rate of CT on non ring fence profits for the financial year 2012, with effect on and after 1 April 2012.

BACKGROUND NOTE

3. The main rate of CT is paid by companies with profits of more than £1,500,000 (the upper profits limit).

4. Where two or more companies are associated with one another, the profits limit is reduced. This is done by dividing the limit by the number of associated companies.

5. Profits from oil extraction and oil rights in the UK and the UK Continental Shelf ("ring fence profits") will continue to be subject to a separate main rate of CT applicable to those ring fenced profits. Profits from activities which are not ring fenced will continue to be charged at the main rate of CT applicable to all other profits.

EXPLANATORY NOTE

CLAUSE 6: CORPORATION TAX: CHARGE AND MAIN RATE FOR FINANCIAL YEAR 2013

SUMMARY

1. Clause 6 charges corporation tax (CT) for the financial year beginning 1 April 2013 and sets the main rate of CT at 30 per cent on oil and gas ring fence profits and 23 per cent on non-ring fence profits.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) set the charge and the main rate of CT for the Financial Year 2013.

BACKGROUND NOTE

3. The main rate of CT is paid by companies with profits of more than £1,500,000 (the upper profits limit).

4. Where two or more companies are associated with one another, the profits limit is reduced. This is done by dividing the limit by the number of associated companies.

5. Profits from oil extraction and oil rights in the UK and the UK Continental Shelf ("ring fence profits") will continue to be subject to a separate main rate of CT applicable to those ring fenced profits. Profits from activities which are not ring fenced will continue to be charged at the main rate of CT applicable to all other profits.

EXPLANATORY NOTE

CLAUSE 7: CORPORATION TAX: SMALL PROFITS RATE AND FRACTIONS FOR FINANCIAL YEAR 2012

SUMMARY

1. Clause 7 sets the small profits rate of corporation tax (CT) for the financial year beginning 1 April 2012 at 20 per cent for all profits apart from “ring fence profits” of North Sea oil companies, where the rate is set at 19 per cent. Additionally, it sets the fraction used in calculating marginal relief from the main rate at 1/100 for all profits apart from “ring fence profits”, where the fraction is set at 11/400.

DETAILS OF THE CLAUSE

2. Subsection (1) sets the small profits rate of CT for the financial year 2012.

3. Subsection (2) sets the marginal relief standard and ring fence fractions.

BACKGROUND NOTE

4. Companies with profits up to £300,000 pay CT at the small profits rate.

5. Companies with profits between £300,000 and £1,500,000 (the lower and upper limits) benefit from marginal relief from the main rate.

6. Marginal relief has the effect of gradually increasing the rate of tax for a company as its profits move from the lower to the upper profits limit.

7. The example below illustrates the effect of marginal relief for a company with taxable non-ring fence profits of £500,000. Its tax liability is calculated as follows:

£500,000 @ 24 per cent	£120,000
minus 1/100 of £1,000,000*	£10,000
Tax payable:	£110,000

* £1,000,000 is the difference between the upper limit and the profit.

8. The example below illustrates the effect of marginal relief for a company with taxable ring fence profits of £500,000. Its tax liability is calculated as follows:

£500,000 @ 30 per cent	£150,000
minus 11/400 of £1,000,000*	£27,500
Tax payable:	£122,500

* £1,000,000 is the difference between the upper limit and the profit.

9. Where two or more companies are associated with one another, the profits limits are divided by the number of associated companies.

EXPLANATORY NOTE

CLAUSE 8 SCHEDULE 1: HIGH INCOME CHILD BENEFIT CHARGE

SUMMARY

1. Clause 8 and Schedule 1 impose a new income tax charge on taxpayers whose adjusted net income exceeds £50,000 in a tax year and who are in receipt of child benefit, and to taxpayers whose adjusted net income exceeds £50,000 and whose partner is in receipt of child benefit. In the event that both partners have an adjusted net income that exceeds £50,000, the charge will apply only to the partner with the highest income.

2. The amount of the charge will be 1 per cent of the amount of child benefit for every £100 of income above £50,000. The charge will be on the full amount of child benefit where the individual's adjusted net income exceeds £60,000.

3. The charge will be called the high income child benefit charge and will come into effect from 7 January 2013.

DETAILS OF THE SCHEDULE

4. <u>Paragraph 1</u> inserts details of the charge into Part 10 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) by creating new sections.

5. <u>New section 681B</u> as well as naming the charge, also identifies the person (P) with adjusted net income of more than £50,000 who will be liable to the new charge if one or both of the conditions set out in subsections (3) and (4) are met.

6. <u>Subsection (3)</u> explains the first condition. Condition A is where P is the claimant entitled to receive child benefit and who, if P has a partner, has an adjusted net income that is greater than that of their partner. The reference to each week reflects the weekly nature of child benefit.

7. <u>Subsection (4)</u> explains the second condition. Condition B provides for P to be charged if their partner (Q) is the claimant entitled to receive child benefit and P's income is more than Q's.

8. The effect of this clause is that where there are two partners who both have adjusted net income of more than £50,000, the charge rests with

the partner with the highest income. If both partners have the same income, the charge rests with the claimant to child benefit.

9. Because the charge is by reference to weeks, this sub-section also makes clear in the case of two people living together as partners that the charge will only apply to those weeks of the tax year for which the partnership exists. If the couple break up, P as the partner with the highest income will only be liable for the period from 6 April to the week in which the break up occurs. Conversely, if a couple come together and child benefit is already being paid, the partner with the highest income will only be liable to the charge for those weeks from the date the couple start living together until the end of the tax year.

10. New section 681C details the amount of the charge by reference to a formula, which applies a percentage to the total amount of child benefit received in the year by reference to conditions A and B. The percentage is the lower of 100 per cent and 1 per cent of child benefit for every £100 of adjusted net income above £50,000. The effect of the taper is to gradually increase the percentage charged between income of £50,000 and £60,000. The charge equals the full amount of child benefit for someone with adjusted net income of more than £60,000.

11. Subsection (3) applies a rounding rule that rounds down the result of applying every stage of the formula to the nearest whole number. For example, if someone has income of £57,750 and their partner receives child benefit for two children of £1752 for a whole year, the charge will be 77 per cent of the £1,752 child benefit = £1,349. The percentage is determined as follows £57,750 - £50,000 = 7,750 /100 = 77.

12. New subsection 681D extends the charge where a child is not living with the claimant but with either one or two other individuals who have income over £50,000. It ensures that those with income over £50,000 who live with a child and who receive the value of child benefit directly or indirectly from the claimant are in the same position as someone with income over £50,000 who lives with a child and claims, or whose partner claims, child benefit.

13. Subsection (1) identifies the circumstances under which the new section will apply. These are that:

    a) a person (R) claims child benefit on the basis that they are not living with the child for which they claim but are contributing to the child's upkeep. Under child benefit rules, this amount must be at least equal to the amount of child benefit claimed.

    b) neither R, or where appropriate, R's partner is liable to the charge in new section 681B.

c) the child for whom R claims is living with a person (S).

14. Subsection (2) applies the charge under new section 681B to S as if that person had claimed the child benefit. This addresses the situation where S or S's partner have adjusted net income over £50,000 and receive directly or indirectly from R an amount equivalent to what they would have received if they had claimed child benefit directly.

15. Subsection (4) creates an exemption to the circumstances outlined in subsection (1). This is where R had previously claimed child benefit on the basis that they were living with the child and, after a period of less than 52 weeks, resumes the claim on the same basis. A common example of this is where a parent moves away temporarily for work purposes and leaves the child with a family member until they return.

16. New section 681E details specific situations that are subject to special rules. Section (1) details the two circumstances where amounts of child benefit are disregarded. The first in subsection (a), disapplies the charge and clarifies the effect of the interaction between the charge in new section 681B which is based on entitlement and the election in new 13A Social Security Administration Act 1992 and 11A Social Security Administration Act (Northern Ireland) 1992 which also refers to entitlement. It also removes the need to notify liability to the income tax charge under section 7 Taxes Management Act 1970 which arises on entitlement to child benefit but where, as the result of the election, the amount received is nil. The second in subsection (b) makes clear that no liability arises in respect of any child benefit payment made after the death of a child.

17. Subsections (2) and (3) refer to the situation where there are more than two persons in a relationship, for example, in the case of polygamous marriages that were contracted outside the UK. The provision makes clear that the same amount of the charge applies, whether under new section 681B or under section 681B as extended by section 681D. It also make clear that the charge will apply to the partner with the highest income.

18. New section 681F provides the power for the Treasury to make an order that amends either the amount of the income limit in new section 681B or the amount (X) in the formula in new section 681C (2) (b). Any such order must be made before the start of the relevant tax year. If the effect of the Order is to increase a person's liability, it must be made under the draft affirmative procedure.

19. New section 681G defines the meaning of "partner" for the purposes of this charge and is based on the definition used for Tax Credits because child benefit is a social security benefit.

20. New section 681H contains interpretative provisions. Subsection (2) confirms that the term “adjusted net income” is given its existing meaning as defined in section 58 Income Tax Act (ITA) 2007. This is currently used to determine the amount of the personal allowance for someone aged 65 or over who has income over £100,000.

21. Adjusted net income is calculated in a series of steps. The starting point is “net income” which is the total of the individual’s income subject to income tax less specified deductions, the most important of which are trading losses and payments made gross to pension schemes. This net income is then reduced by the grossed-up amount of the individual’s gift contributions and the grossed-up amount of the individual’s pension contributions which have received tax relief at source. The final step is to add back any relief for payments to trade unions or police organisations deducted in arriving at the individual’s net income. The result is the individual’s adjusted net income.

22. Paragraph 2 makes clear that a person is required to notify his liability to the income tax charge under section 7 Taxes Management Act 1970 in the same way as they are required to notify any other liability to income tax.

23. Paragraph 3 inserts after section 13 in Part 1 of the Social Security Administration Act 1992, a new section 13A. The new provisions provide that an individual or their partner, liable to a tax charge under new section 681B, may choose to elect not to receive the child benefit to which they are entitled if they or their partner do not wish to pay the new charge. It also provides HM Revenue and Customs (HMRC) the power to make directions setting out how an election should be made and when it may be revoked, for example, if either the individual or their partner are no longer liable to pay the charge.

24. Subsection (1) of the new 13A confirms that it is the person who is claiming child benefit who decides whether they wish to elect not to be paid for all the child benefit they are entitled.

25. Subsection (2) says that an election is limited to those who believe their or their partner’s income is at level which will incur the high income child benefit charge in the tax year.

26. Subsection (3) confirms that an election will lead to payments of child benefit ceasing at a date after the election has been made.

27. Subsection (4) Where an election is made at the same time as a claim for child benefit, it will also cover any backdating of the award up to a maximum of three months (in line with the child benefit backdating rules).

28. Subsections (5) & (6) confirm that a person can revoke a previous election and so restore payment of child benefit. The revocation of the election will cover payments of child benefit due after the date of revocation.

29. Subsection (7) This provides that where a person elected not to be paid child benefit on the wrong assumption that they, or their partner, would be liable to high income child benefit charge, the person who made the election has up two years from the end of the relevant tax year to revoke the election and be paid child benefit for that period.

30. Subsection (8) confirms that persons must follow the process set out in subsections (2) to (7) in accordance with HMRC administrative directions under subsection (9).

31. Subsection (9) (a) confirms that HMRC will issue directions as to how an election may be made and revoked and from when they have effect. Subsection (b) confirms that HMRC directions may set out situations in which an election or its revocation is not acted on where either the child benefit award is not being paid at the full rate or there are doubts as to which the person has entitlement.

32. Subsection (10) This confirms that:

    - the definition of what is a 'child' mirrors that set out in child benefit regulations;
    - that an election is applied to the tax year in which it is made; and
    - a 'week' is 7 days starting from the Monday and is attributed to the tax year into which the Monday falls.

33. Paragraph 4 inserts after section 11 in Part 1 of the Social Security Administration (Northern Ireland) Act 1992, a new section 11A. The new provisions provide that an individual or their partner, liable to a tax charge under new section 681B, may choose to elect not to receive the child benefit to which they are entitled if they or their partner do not wish to pay the new charge. It also provides HMRC the power to make directions setting out how an election should be made and when it may be revoked, for example, if either the individual or their partner are no longer liable to pay the charge.

34. Subsection (1) of the new 11A confirms that it is the person who is claiming child benefit who decides whether they wish to elect not to be paid for all the child benefit they are entitled.

35. Subsection (2) says that an election is limited to those who believe their or their partner's income is at level which will incur the high child benefit charge in the tax year.

36. Subsection (3) confirms that an election will lead to payments of child benefit ceasing at a date after the election has been made.

37. Subsection (4) Where an election is made at the same time as a claim for child benefit, it will also cover any backdating of the award up to a maximum of three months (in line with the child benefit backdating rules).

38. Subsections (5) & (6) confirm that a person can revoke a previous election and so restore payment of child benefit. The revocation of the election will cover payments of child benefit due after the date of revocation.

39. Subsection (7) This provides that where a person elected not to be paid child benefit on the wrong assumption that they, or their partner, would be liable to high income child benefit charge, the person who made the election has up two years from the end of the relevant tax year to revoke the election and be paid child benefit for that period.

40. Subsection (8) confirms that persons must follow the process set out in subsections (2) to (7) in accordance with HMRC administrative directions under subsection (9).

41. Subsection (9) (a) confirms that HMRC will issue directions as to how an election may be made and revoked and from when they have effect. Subsection (b) confirms that HMRC directions may set out situations in which an election or its revocation is not acted on where either the child benefit award is not being paid at the full rate or there are doubts as to which the person has entitlement.

42. Subsection (10) This confirms that:

- the definition of what is a 'child' mirrors that set out in child benefit regulations;
- that an election is applied to the tax year in which it is made; and
- a 'week' is 7 days starting from the Monday and is attributed to the tax year into which the Monday falls.

43. Paragraph 5 makes amendments to ITEPA 2003. Paragraphs (5)(1) to (3), (5)(5) and (5)(7) are technical consequential amendments to ITEPA 2003.

44. Paragraph (5)(4) provides for the high income child benefit charge to be included in PAYE regulations so that it can be collected through PAYE unless the taxpayer objects. This means a person's PAYE tax code can be amended so that it includes an adjustment that will collect the tax due for the year in which the deduction is made in the same way

as for other PAYE liabilities. Existing provisions allow an adjustment for collecting tax due from an earlier year.

45. Paragraph (5)(6) is a technical amendment which ensures that the provisions in new section 681F (3) apply.

46. Paragraph 6 inserts amendments to ITA 2007. Paragraph (6)(2) inserts a reference to the new high income child benefit charge to the overview of tax acts that make provision for income tax in section 1 ITA 2007. Paragraph (6) (3) provides for the new high income child benefit charge to form part of an individual's liability to income tax for a tax year. The new charge is added to the list of additional tax charges relating to an individual in section 30 ITA 2007 and will thus be included at step 7 of the calculation of liability to income tax in section 23 ITA 2007.

47. Paragraph (7) contains the commencement provisions. These make clear that the first tax year for which the high income child benefit charge applies is 2012/13. It does not apply to any child benefit entitlement that arises in that tax year before the week beginning 7 January 2013, which is the first Monday in 2013.

BACKGROUND NOTE

48. The new high income child benefit charge is the way the Government is implementing its policy of reducing the amount of child benefit available to families that include someone who has income above £50,000. The reason for this is that it is very difficult to justify taxing people on lower incomes to pay for the child benefit of those with higher incomes.

49. The introduction of a tax charge means child benefit can continue to be paid to all claimants who establish their entitlement to the payment, regardless of whether there is any liability to the tax charge, without means testing at the point of payment. The design of the charge means that only 15 per cent of families with children are affected by the charge.

50. The introduction of a taper for those with incomes between £50,000 and £60,000 smoothes the effect of the charge for those with income nearer to the lower end of the taper.

51. The new charge is based on entitlement to child benefit, rather than to receipt of child benefit. This is consistent with the approach of taxing social security benefits. It also avoids any unintentional element of double taxation that could arise following payment of child benefit as the result of a revocation of an election made under the provisions of

an election not to receive child benefit. The example below demonstrates how this could happen if the receipts basis were used.

52. A child benefit claimant elects not to receive child benefit for the tax year 2014/15 because they believe their income will be above £60,000 making them liable to the high income child benefit charge for 2014/15. In July 2015 the claimant realises their income was lower than expected for 2014/15, revokes the election and receives the amount of child benefit due for 2014/15 in August 2015. This is during the tax year 2015/16 when the level of their income does attract the charge. If the receipts basis were used, the claimant would be liable to the charge on the amount received in 2015/16 for the amounts for 2015/16 and for 2014/15. The entitlement basis ensures the claimant is only liable for the amount to which they were entitled for 2015/16 and that the amount for 2014/15 correctly escapes the charge.

EXPLANATORY NOTE

CLAUSE 9: POST-CESSATION TRADE OR PROPERTY RELIEF: TAX-GENERATED PAYMENTS OR EVENTS

SUMMARY

1. This clause provides for changes to the rules for "post-cessation trade relief" and "post-cessation property relief" which can be claimed by a person after a business has ceased. The changes are designed to prevent tax-generated costs being available for relief against the person's other taxable income or capital gains. The changes apply to post-cessation trade relief with effect from 12 January 2012 and to post-cessation property relief with effect from 13 March 2012.

DETAILS OF THE CLAUSE

2. Subsection (2) adds section 98A of the Income Tax Act 2007 (ITA) to the list of sections with which section 96 of ITA needs to be read.

3. Subsection (3) inserts new section 98A of ITA (Denial of relief for tax-generated payments or events).

4. New section 98A(1) provides that no post-cessation trade relief (including relief by way of claim under section 261D of the Taxation of Chargeable Gains Act 1992) is available to a person in respect of a payment or an event which is made or occurs in consequence of, or in connection with, relevant tax avoidance arrangements.

5. New section 98A(2) defines "relevant tax avoidance arrangements" for the purposes of new section 98A(1).

6. New section 98A(3) defines "arrangements" and "section 261D claim" for the purposes of new section 98A.

7. Subsection (4) adds section 98A of ITA to the list of sections which apply to post-cessation property relief in the same way as for post-cessation trade relief.

8. Subsections (5) and (6) provide commencement rules.

9. Subsection (7) defines "an unconditional obligation" for the purposes of subsections (5) and (6).

BACKGROUND NOTE

10. The Government has become aware of avoidance activity that relies on creating contrived costs in order to claim post-cessation trade relief. This puts at risk substantial amounts of tax.

11. The Exchequer Secretary to the Treasury announced in a written statement on 12 January 2012 that legislation would be introduced with effect from that date to prevent post-cessation trade relief being available where the relief arises from arrangements and a main purpose of the arrangements is to obtain a tax reduction resulting from post-cessation trade relief. A further announcement was made on 13 March 2012 extending the restriction to post-cessation property relief with effect from that date.

EXPLANATORY NOTE

CLAUSE 10: PROPERTY LOSS RELIEF AGAINST GENERAL INCOME: TAX-GENERATED AGRICULTURAL EXPENSES

SUMMARY

1. Clause 10 provides for changes to the rules for the losses that can be claimed by a person from a property business with a relevant agricultural connection. The changes are designed to prevent tax-generated agricultural expenses being available for relief against the person's other taxable income. These changes were announced on 13 March 2012 and will apply on and after that date.

DETAILS OF THE CLAUSE

2. Subsection (2) adds section 127B of the Income Tax Act 2007 (ITA) to sections restricting relief under Chapter 4 of ITA.

3. Subsection (4) inserts new section 127B of ITA (no relief for tax-generated agricultural expenses).

4. New section 127B(1) provides that this section applies if a person makes a loss in a tax year from carrying on a property business with a relevant agricultural connection, either in a sole capacity of as a partner, and that loss arises directly or indirectly in consequence of, or otherwise in connection with relevant tax avoidance arrangements.

5. New section 127B(2) provides that there is no property loss relief for the loss falling within section 127B(1).

6. New section 127B(4) defines "relevant tax avoidance arrangements" for the purposes of section 127B.

7. New section 127B(5) defines "arrangements" for the purposes of section 127B(4).

8. New section 127B(6) defines "the applicable amount of the loss" and "allowable agricultural expenses" for the purposes of section 127B

9. Subsections (5) and (6) provide commencement rules

10. Subsection (7) defines "an unconditional obligation" for the purposes of subsection (6).

BACKGROUND NOTE

11. A person who makes a loss from a property business with a relevant agricultural connection may claim relief against their other income. This is known as “property loss relief”.

12. The Government has become aware of avoidance activity that relies on creating contrived costs in order to claim property loss relief. This puts at risk substantial amounts of tax.

13. The Exchequer Secretary to the Treasury announced in a written statement on 13 March 2012 that legislation would be introduced with effect from that date to prevent property loss relief being available where the relief arises from arrangements and a main purpose of the arrangements is to obtain a tax reduction resulting from property loss relief from a property business with a relevant agricultural connection.

EXPLANATORY NOTE

CLAUSE 11: GAINS FROM CONTRACTS FOR LIFE INSURANCE ETC

SUMMARY

1. This clause affects the taxation of certain life insurance policies, life annuity contracts and capital redemption policies under the chargeable event gain regime. It addresses income tax avoidance by putting beyond doubt that gains liable to income tax are not reduced where there are certain untaxed gains earlier in the life of the policy or contract, or by the use of certain cluster policy arrangements. The measure has effect for relevant policies and contracts made on or after 21 March 2012 and for pre-existing policies where certain events arise on or after this date.

DETAILS OF THE CLAUSE

2. Subsection (1) adds new section 473A to the special rules for life insurance policies, life annuity contracts and capital redemption policies, which are contained in Chapter 9 of Part 4 Income Tax (Trading and Other Income) Act 2005.

3. New section 473A treats connected policies and contracts as a single policy for the purposes of the chargeable event gain regime.

4. Subsections 2 and 3 of new section 473A provide that policies are treated as connected where a policy is issued by reference to another policy (a related policy) on terms that would not be expected in isolation. This will apply where the terms of either policy are significantly more or significantly less favourable than would be expected if the other policy were ignored, or if other related policies were ignored.

5. Subsection 4 of new section 473A provides that if an additional policy is connected to at least one but not all of a number of other policies that are themselves connected, all of these policies will be treated as connected.

6. Subsection (2) amends section 491(2) Income Tax (Trading and Other Income) Act 2005 to impose a restriction on the deduction for gains arising from certain earlier chargeable events (such as part withdrawals) in calculating the amount of gains that may subsequently arise when the same policy comes to an end or is assigned in full. The deduction will only apply to the extent that the earlier gains were attributable to one or more of the persons treated as chargeable to tax under the chargeable event gain regime, or were

taken into account when calculating the income of a person under rules for the Transfer of Assets Abroad (Part 13, Chapter 2 of the Income Tax Act 2007).

7. Subsection (3) amends section 552 Income and Corporation Taxes Act 1988 so that reporting obligations for insurers will not be affected by the restriction on deductions for earlier gains.

8. Subsection (4) ensures that the new rules will apply to all policies and contracts made on or after 21 March 2012.

9. Subsections (5) and (6) ensure that the new rules will also apply to policies and contracts made before 21 March 2012:

- which are varied on or after 21 March 2012 so as to increase the benefits secured. For this purpose, the exercise of an option in the policy or contract, on or after 21 March 2012, is treated as a variation;
- where all of part of the rights are assigned to another person on or after 21 March 2012. This applies whether or not the assignment is for money or money's worth;
- where all or part of the rights conferred by the policy become held as security for a debt on or after 21 March 2012.

BACKGROUND NOTE

10. Gains from life insurance policies, life annuity contracts and capital redemption policies are taxed as income. They can arise on the happening of "chargeable events" such as the maturity of a policy, an assignment for money or money's worth and surrenders of all or part of the rights under a policy.

11. These rules apply to each individual policy. However arrangements have been designed with the aim of deferring income tax that may arise when policies come to an end by 'shifting' into one policy investment profits attributable to premiums paid into a number of different policies. The arrangements ensure that these policies, with no investment gains as a result of the "shift" referred to above, are brought to an end first with no tax liability arising even though economic investment profits may arise from the premiums paid into these policies.

12. This measure removes any scope to defer income tax in this way by recognising the economic position and treating all such interdependent policies as a single policy for the purposes of the

chargeable event gain regime. Standard industry arrangements which divide a sum invested across a number of identical but genuinely distinct and economically self-contained policies will not be affected.

13. The amount of gain when a policy comes to an end is calculated by deducting the total amount of premiums paid into the policy plus gains that have previously arisen under the policy (earlier gains); from the total value of any benefits received over the whole life of the policy. Tax may then be due where any gains resulting from the calculation are included in the income of one of the persons chargeable to tax under the special income tax rules for life insurance policies.

14. However, there was no requirement that the earlier gains need to have formed part of the income of one of these persons. A number of income tax avoidance schemes took advantage of the deduction for earlier gains to reduce the amount of gains liable to income tax when a policy comes to an end. These schemes used arrangements under which earlier gains arose when there was no person liable to tax on them (because, for example, the earlier gains were attributable to a person who was not UK resident) in order to reduce income tax otherwise due on investment profits from life insurance policies. This measure removes such opportunities.

EXPLANATORY NOTE

CLAUSE 12: SETTLEMENTS: INCOME ORIGINATING FROM SETTLORS OTHER THAN INDIVIDUALS

SUMMARY

1. Clause 12 provides for amendments to certain provisions of the settlements legislation (Part 5, Chapter 5 Income Tax (Trading and Other Income) Act 2005 (ITTOIA)) so that the rule in section 624(1) does not apply if a settlor is not an individual. The changes will confirm that income which arises under a settlement and originates from any settlor who is not an individual is not treated as that of the settlor.

2. The change will take effect from 21 March 2012.

DETAILS OF THE CLAUSE

3. Paragraph 1 of the clause provides for amendments to ITTOIA 2005.

4. Paragraph 2 inserts a new subsection (4) in section 627 of ITTOIA which gives exceptions from the rule in section 624(1) of ITTOIA for certain types of income. The rule in section 624(1) states that income which arises under a settlement is treated for income tax purposes as only that of the settlor if it arises during the settlor's life and from property in which the settlor has an interest. The new sub section (4) provides that the rule in section 624(1) does not apply to income arising from a settlement, as defined in section 620(1), which originates from any settlor who was not an individual. The effect of the amendment is that income from a settlement in which the settlor has an interest is not treated as income of the settlor for tax purposes if the settlor was not an individual.

5. Paragraph 3 amends section 645(2) of ITTOIA so that it refers to section 627 as well as to section 644. Where there is more than one settlor, section 644 provides that the settlements legislation has effect as if each settlor were the only one. It then provides that property comprised in, and income arising under, a settlement should be taken to refer to property and income originating from that settlor. The amendment to section 645 ensures that 'income originating from the settlor' has the same meaning in section 627 as it does in section 644.

6. Paragraph 4 gives the commencement provisions. The amendments made by this clause have effect on any income arising from the settlement on or after 21 March 2012.

BACKGROUND NOTE

7. The settlements legislation (Part 5, Chapter 5 ITTOIA 2005) applies in situations including those where a settlor, within the meaning of the legislation, has retained an interest in property or income from it. The aim of the provisions is, broadly, to prevent an individual gaining a tax advantage by diverting their income to another person who is liable to income tax at a lower rate than the individual.

8. Where the settlements legislation applies, the income arising under the settlement is treated as income of the settlor. Income tax is charged on the income as if it had arisen directly to the settlor and as if it was the highest part of the settlor's total income.

9. The purpose of the amendments to the settlements legislation is to confirm that income arising under a settlement is treated as that of the settlor only where the settlor is an individual. The proposed changes would close avoidance schemes that seek to exploit the settlements legislation by using corporate settlors of 'interest in possession' settlor-interested trusts to try to avoid income tax at higher or additional rates which would otherwise be due on dividends paid by a subsidiary of the corporate settlor. The amendments would ensure that the relevant provisions do not apply to settlors who are not individuals and hence that the income would not be treated as that of the settlor in those situations.

10. Where the settlements legislation does not apply to an interest in possession trust, the income arising under the settlement will be taxed on the income beneficiaries of the trust.

EXPLANATORY NOTE

CLAUSE 13: CHAMPIONS LEAGUE FINAL 2013

SUMMARY

1. This clause provides for an exemption from income tax for the non-resident players and officials of visiting teams who compete in the 2013 Champions League final, which is to be held in the UK.

DETAILS OF THE CLAUSE

2. Paragraph (1) provides that no liability to income tax arises in respect of any income from the 2013 Champions League final. The exemption will apply to individuals who are employees or contractors of an overseas team who are not resident in the UK.

3. Paragraph (2) defines income from the 2013 Champions League final as meaning income which is related to duties or services performed by the person in the UK in connection with the final.

4. Paragraph (3) provides that the income to be exempt must relate to contracts that are in place before the final takes place. Income that is subject to tax avoidance arrangements is not exempt.

5. Paragraph (4) defines what is meant by tax avoidance arrangements.

6. Paragraph (5) provides that withholding obligations under section 966 of the Income Tax Act 2007 do not apply to any payment or transfer that gives rise to income benefitting from the exemption.

7. Paragraph (6) provides definitions of "the 2013 Champions League final", a "contractor", an "employee" and "employment", "income" and "overseas team".

BACKGROUND NOTE

8. There will be an exemption from UK income tax for the non-resident players and officials of visiting football teams playing in the 2013 Champions League final, to be held in the UK. A similar exemption was provided for the 2011 Champions League final which was also held in the UK.

9. The employment income, self-employment income and any endorsement income of the players and the teams' officials relating to the Champions League final in the UK will not be liable to UK income tax where the team is an overseas team and those players and officials are not resident in the UK. This exemption only applies where the income is in relation to the match and where the individual works for, or is contracted to, the team or its subsidiaries.

EXPLANATORY NOTE

CLAUSE 14: CARS: SECURITY FEATURES NOT TO BE REGARDED AS ACCESSORIES

SUMMARY

1. This clause ensures that individuals who are provided with security enhanced cars made available for their private use, and who can demonstrate that the nature of their employment creates a threat to their personal security, are not unfairly impacted by the abolition of the £80,000 cap on the cash equivalent of the benefit on company cars made available for private use. It will take effect from 6 April 2011.

DETAILS OF THE CLAUSE

2. Paragraph 2 introduces new section 125(3A) into the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). This provides that section 125(2) ITEPA (which deals with exclusions from treatment as accessories) must be read with new section 125A ITEPA.

3. Paragraph 3 introduces new section 125A. New section 125A(1) provides that the section applies to company cars with a relevant security feature. New section 125A(2) provides that the relevant security feature is not an accessory if it is provided as a result of a threat to the individual's personal security arising from the nature of their employment. New section 125A(3) sets out the types of relevant security features and includes any modification made to the car as a result of the enhancements (in order to make it roadworthy). Finally, new section 125A(4) provides an order making power to introduce further relevant security features should these be required in future.

4. Paragraph 4 deals with a consequential amendment to Part 2 of Schedule 1 to ITEPA (index of defined expressions).

BACKGROUND NOTE

5. The cash equivalent of the taxable benefit of a company car made available for private use is calculated on the basis of (list price + cost of accessories) x (the appropriate percentage (normally based on CO_2 engine emissions)).

6. Because of the nature of their employment, a number of individuals in both the public and private sectors are provided with company cars that have been modified to accept security enhancements such as bullet proofed glass and armour plating. These are currently regarded as accessories for tax purposes and the value of the enhancements falls within the computation of the cash equivalent of the benefit. This may significantly add to the level of taxable benefit resulting in a disproportionate tax liability for some individuals.

7. Prior to 6 April 2011, there was an £80,000 limit on the list price and accessories calculation for the cash equivalent of the taxable benefit. This covered most security enhanced cars.

EXPLANATORY NOTE

CLAUSE 15: TERMINATION PAYMENTS TO MPS CEASING TO HOLD OFFICE.

SUMMARY

1. Clause 15 amends section 291(2)(a) of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The amendment ensures that the first £30,000 of a resettlement payment to an MP who ceases to be a member of the House of Commons is exempt from tax.

DETAILS OF THE CLAUSE

2. Subsection (1) amends section 291 of ITEPA by substituting a new section 291(2)(a).

3. New section 291(2)(a) exempts from the charge to income tax on earnings resettlement payments made under section 5(1) of the Parliamentary Standards Act 2009 (PSA 2009) in connection with a person's ceasing to be a member of the House of Commons.

4. Subsection (2) provides that the amendment has retrospective effect and applies in relation to payments made on or after 1 April 2012.

BACKGROUND NOTE

5. Prior to the enactment of the PSA 2009 and the establishment of IPSA, resettlement grants were payable to any Member of the House of Commons who failed to be re-elected or who did not stand at a General Election in accordance with a resolution of the House of Commons.

6. From 1 April 2012 the Fourth Edition of the MPs' Scheme of Business Costs and Expenses makes provision for a resettlement payment to be made to any MP who leaves office involuntarily following a General Election. As a consequence, tax legislation needs amending in order for existing tax exemptions to continue to apply to such payments made by IPSA.

7. Section 291(2)(a) of ITEPA exempts from the charge to income tax on earnings resettlement grants made to MPs when they cease to be members of the House of Commons when parliament is dissolved, where the grants are made in accordance with a resolution of the House of Commons.

8. As currently worded, the legislation does not apply to similar payments made by IPSA because they are not made under a resolution of the House of Commons.

9. The proposed amendment to section 291(2)(a) will allow the exemption to apply to payments made by IPSA to any MP who ceases to be a member of the House of Commons.

EXPLANATORY NOTE

CLAUSE 16: EMPLOYMENT INCOME EXEMPTIONS: ARMED FORCES

SUMMARY

1. This clause will exempt from income tax, payments of the Continuity of Education Allowance (CEA) by the Ministry of Defence (MoD) to or in respect of serving and deceased members of the Armed Forces.

2. The clause also makes consequential amendments to the existing exemptions for payments of the Operational Allowance and Council Tax Relief to members of the Armed Forces to align the specifications of the legal authority under which these payments are made.

DETAILS OF THE CLAUSE

3. Subsection (1) introduces amendments to Chapter 8 of Part 4 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (exemptions: special kinds of employees)

4. Subsection (2) amends section 297A of ITEPA (exemption for Operational Allowance) so that; "by the Secretary of State" is replaced with "under a Royal Warrant made under Section 333 of the Armed Forces Act 2006".

5. Subsection (3) amends section 297B of ITEPA (exemption for Council Tax Relief) so that; "by the Secretary of State" is replaced with "under a Royal Warrant made under Section 333 of the Armed Forces Act 2006".

6. Subsection (4) inserts new section 297C into ITEPA.

7. New section 297C(1) makes provision for payments of the CEA to or in respect of serving or deceased members of the Armed Forces to be exempt from income tax. New section 297C(2) specifies the legal authority under which payments of the CEA are made.

8. Subsection (5) provides that the amendments made by the clause have effect in relation to payments made on or after 6 April 2012.

BACKGROUND NOTE

9. The CEA is paid to service personnel to provide a continuity of education for their children that would not otherwise be possible if they accompanied their parents on frequent assignments both at home and overseas.

10. The CEA is currently liable to tax but the tax is paid by the Ministry of Defence on behalf of CEA where paid to recipients based in the UK.

11. This new exemption aims to support the principles of the Armed Forces Covenant and in particular the principle that service personnel and their families should not be put at any disadvantage from entering into military life. It seeks to mitigate the financial impact of providing a secure and continuing education acknowledging the particular circumstances in which these men and women serve and the particular difficulties they face.

EXPLANATORY NOTE

CLAUSE 17: TAXABLE BENEFITS: "THE APPROPRIATE PERCENTAGE" FOR CARS FOR 2014-15

SUMMARY

1. Clause 17 relates to taxable benefits on company cars. With effect from 6 April 2014, it modifies the current appropriate percentage bands and carbon dioxide (CO_2) emissions thresholds by revising the appropriate percentage of the relevant threshold up to 12 per cent from 11 per cent.

2. The clause also increases the appropriate percentage for cars with emissions below the relevant threshold but greater than 75g CO_2 per kilometre from 10 per cent to 11 per cent.

DETAILS OF THE CLAUSE

3. Subsection (1) introduces changes to section 139 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (as amended by section 51 of the Finance Act 2011 with effect from 6 April 2013). It provides that subsection (2) is amended to increase the level of the appropriate percentage from 10 per cent to 11 per cent for cars with engine emissions below the relevant threshold, but greater than 75g CO_2 per kilometre. The subsection also amends subsection 139(3) ITEPA so that the appropriate percentage of the relevant threshold is increased from 11 per cent to 12 per cent.

4. Subsection (2) provides that this amendment has effect for 2014-15 and subsequent tax years.

BACKGROUND NOTE

5. Section 139 of ITEPA sets out the basis for calculating the appropriate percentage for cars with CO_2 emissions. The appropriate percentage multiplied by the list price of the car (adjusted for any taxable accessories) provides the level of chargeable benefit for company car tax for employees and of Class 1A NICs for employers.

6. From 6 April 2012, the graduated table of company car tax bands will provide for a zero per cent band for zero emission cars, a 5 per cent band for ultra low emissions cars (1-75g CO_2 per km emissions), a new 10 per cent band for other low emissions cars (76g-100g CO_2 per

km emissions) with a one per cent increase for each rise in emissions of 5g CO_2 per km above 100g CO_2 to a maximum of 35 per cent.

7. Section 51 of the Finance Act 2011 provided for a change to the 10 per cent band for low emissions cars to 76-95g CO_2 per km from 6 April 2013.

8. This clause has the effect of retaining the same emissions values, but instead increases the value of the appropriate percentage by one per cent to 11 per cent for cars with emissions below the relevant threshold, and 12 per cent for cars at the relevant threshold, respectively. The appropriate percentage for cars with zero emissions and those emitting 75g CO_2 or less will remain unchanged for 2014-15.

9. On average, the level of CO_2 emissions produced by new cars fell by more than 5g in the last year. These changes support the Government's commitment to reducing the UK's carbon footprint.

EXPLANATORY NOTE

CLAUSE 18: QUALIFYING TIME DEPOSITS

SUMMARY

1. This clause concerns the deduction of income tax from interest or similar amounts payable by building societies, banks and other deposit-takers on investments that are qualifying time deposits. It removes the exclusion of these investments from arrangements under which financial institutions deduct sums representing income tax at the basic rate from interest they pay to account holders.

DETAILS OF THE CLAUSE

2. Subsection (1) amends section 866(1) of the Income Tax Act 2007 (ITA 2007). Section 866(1) provides that an investment which is a qualifying time deposit is not a 'relevant investment' for the purposes of Chapter 2, Part 15 of ITA 2007 (concerning deduction of sums representing income tax by deposit-takers and building societies from payments of interest on relevant investments). Interest payments in respect of qualifying time deposits are therefore excluded from the tax-deduction requirements set out at Chapter 2, Part 15 of ITA 2007.

3. Subsection (1) restricts this exclusion, so it applies only to interest payments in respect of qualifying time deposits made before 6 April 2012. A qualifying time deposit made on or after 6 April 2012 will by virtue of the amendment made by subsection (1) be a 'relevant investment' for the purposes of Chapter 2, Part 15 of ITA 2007. Building societies, banks and other deposit-takers will therefore be required to deduct sums representing income tax at the basic rate from interest payments they make on these investments.

4. Subsection (2) provides that this clause will be treated as having come into force on 6 April 2012.

BACKGROUND NOTE

5. Income tax is usually due on interest that building societies, banks and other deposit-takers pay to savers and investors. There are, however, circumstances in which income tax will not be due, for example where a saving or investment product is tax-advantaged (such as an Individual Savings Account).

6. Building societies, banks and other deposit-takers usually deduct sums representing income tax from interest payable on most of their savings or investment products. These sums are deducted at the basic rate of income tax and paid to HM Revenue & Customs (HMRC) under the Tax Deduction Scheme for Interest.

7. However, any interest payable on investments that are qualifying time deposits is excluded from these tax-deduction arrangements. This interest is paid gross to investors, and each investor is required to make separate arrangements to account for any tax due to HMRC.

8. The effect of this clause is to remove this exclusion for qualifying time deposits made on or after 6 April 2012. Building societies, banks and other deposit-takers will be required to deduct sums representing income tax at the basic rate from interest they pay on these qualifying time deposits. However, where an investor is not liable to pay tax on interest, for example because their total taxable income is less than their tax-free personal allowance, they can register with their account provider to receive interest payments gross.

EXPLANATORY NOTE

CLAUSE 19 SCHEDULE 2: PROFITS ARISING FROM THE EXPLOITATION OF PATENTS ETC

SUMMARY

1. This clause and Schedule introduce a new tax regime which will allow companies to elect to apply a 10 per cent corporation tax rate to profits attributable to patents and certain other qualifying intellectual property (IP) from 1 April 2013 (on a progressively incremental basis from 2013 to 2017).

DETAILS OF THE SCHEDULE

2. There are three parts to the Schedule. Part 1 introduces amendments to Corporation Taxes Act (CTA) 2010, whereas part 2 provides for changes to other legislation. Part 3 contains the commencement and transitional provisions.

Part 1: Amendments of CTA 2010

3. Paragraph 1 introduces a new part 8A to CTA 2010 concerning the new IP tax regime. It also explains that there are 7 chapters in part 1 covering election to the new IP treatment, qualifying companies, 2 types of determination of IP profits/losses of a trade, provisions for setting off IP losses, anti-avoidance provisions, and supplementary provisions.

Chapter 1: Reduced Corporation Tax rate for profits from patents etc

4. New section 357A(1) outlines an elective regime to provide for a reduced rate of corporation tax for profits from patents and other specified intellectual property for qualifying companies. Under new section 357G(4) the election applies to all of the company’s trades.

5. Where an election is made, new section 357A(2) gives effect to that election not by applying a reduced rate of tax to eligible profits directly, but by granting a deduction from trading profits of such an amount as has the same effect as reducing the main rate of corporation tax on eligible profits to the special IP rate.

6. New section 357A(3) provides the formula for calculating the amount of the deduction.

7. New section 357A(4) sets the special IP rate of corporation tax at 10 per cent.

Chapter 2: Qualifying companies

8. New sections 357B(1) to (3) outline the requirements for a company to be a qualifying company in any accounting period for the purposes of an election under new section S357A. The company must either:

- hold a qualifying IP right or an exclusive licence in respect of a qualifying IP right at some time during the accounting period; or

- have previously held a qualifying IP right or an exclusive licence in respect of a qualifying IP right, and be taxable in the accounting period on income in respect of that right. That income must be attributable to events occurring wholly or partly during a period when the company was a qualifying company and had made an election under new section 357A.

9. The second condition allows a company to apply the Patent Box rules to income received when it would not otherwise be a qualifying company. An example is damages for infringement of patent rights where compensation is received after the expiry of a patent, but where the company had made a Patent Box election at the time of the infringement.

10. In addition, for a company that is a member of a group, new section 357B(5) requires it to also satisfy the active ownership condition of new section 357BE.

11. New section 357B(4) defines a qualifying IP right. The right must be one of those listed in new section 357BB and the company must also meet the development condition of new section 357BC in respect of that IP right. New section 357GC sets out how the ownership conditions are modified where a company is party to a cost-sharing arrangement in relation to the creation and development of a qualifying IP right, or an exclusive licence.

12. New section 357BA defines the term exclusive licence.

13. New section 357BA(1) states that an exclusive licence is one granted by the proprietor, being someone who holds either the qualifying IP right or an exclusive licence over that right, which gives the person holding the licence exclusive rights over some of the IP rights held by the proprietor.

14. New section 357BA(2) specifies that the rights granted under an exclusive licence must at least:

- confer one or more rights to the exclusion of any other person, including the proprietor, in relation to the protected item in at least a whole national territory; and

- either include the right to take legal proceedings for any infringement of the licence-holder's rights, or receive all or the greater part of any damages that might follow from such an infringement.

15. A licence which grants more limited rights which, for example, do not extend to at least one whole country or territory, or where the licence holder can neither bring proceedings for infringement within its territory nor recover any damages, will not be a qualifying IP right.

16. New section 357BA(3) ensures that where certain rights required under new section 357BA(2) are not specifically granted by the licence, but are nonetheless granted by law to the licensee, for example under section 67 of the Patent Act 1977, these rights are treated as if they were granted by the licence.

17. New Section 357BA is subject to an anti-avoidance rule in new section 357F in chapter 6 to ensure that an exclusive licence does not include one where rights are conferred for a main purpose of securing that the licence qualifies for the regime. This is aimed at ensuring that the grant of commercially spurious exclusive rights does not constitute the grant of an exclusive licence for the purposes of this part.

18. A company can vest the rights it holds in an exclusive licence to another member of its group. Where that happens then new section 357BA(4) and (5) ensure that the other company is treated as if it holds the exclusive licence, even if the company holding the exclusive rights retains the right to enforce, assign or grant further licences in respect of the licence. This might be the case where, for example, the original licence holder is a group company whose primary role is the management of the group's intellectual property portfolio, and any exploitation or development of the rights is carried out elsewhere in the group.

19. It is quite possible for the proprietor to grant exclusive licences to several persons for use in the same country or territory, provided that their use of the rights over the protected item is in substantially distinct fields of use so that there is no effective overlap of the exclusive rights granted.

20. New section 357BB specifies the rights to which part 8A applies. Rights specified here are the only types of right that can be qualifying IP in accordance with new section 357B(4).

21. New section 357BB(1) lists the rights currently specified. These are:

- patents granted by the UK Patent Office, under the European Patent Convention or corresponding specified rights granted under the laws of certain specified EEA states;
- Supplementary protection certificates;
- Plant breeders rights granted under the Plant Varieties Act 1997; and
- Community plant variety rights granted under Council Regulation (EC) No 2100/94.

22. New section 357BB(2) allows certain patent applications which are subject to a prohibition on publication on the grounds of national security or safety of the public to be treated as though they had been granted under that Act. This allows the invention which is the subject of such an application to be treated as protected by a right to which part 8A applies.

23. New sections 357BB(3) to (6) specify the circumstances in which a marketing authorisation granted in respect of medicinal, veterinary medicinal or plant protection products is to be regarded as a right to which part 8A applies. The marketing authorisation must benefit from marketing protection or data protection under the various EC regulations specified.

24. New section 357BB(7) gives the meaning of the terms European Patent Convention, specified and supplementary protection certificate used in new section 357BB(1), and rules used in new section 357BB(2).

25. New section 357BB(8) allows the Treasury, by order, to make further provisions in relation to marketing protection or to amend references to EU legislation in new section 357BB in consequence of EU legislation making amendments to or replacing that EU legislation.

26. New section 357BB(9) gives the Treasury power to make any additional changes that are necessary in connection with an order amending the rights to which part 8A applies.

27. New section 357BC sets out four ways (see conditions A to D below) that a company can meet the development condition in respect of an IP right it holds. Where the development condition is met, and provided that the right concerned is also of a type specified by new section 357BB, the right will be a qualifying IP right for that company.

28. New sections 357BC(2) and (3) ensure that a company meets the development condition in respect of an IP right if it carried out qualifying development in respect of the right in question (see new sections 357BD(1) below). Condition A applies where the company has not become or ceased to be a controlled member of a group since carrying out the qualifying development. Where it has, condition B applies if it continues to carry on activities of the same nature as those that amounted to the qualifying development for 12 months after becoming or ceasing to be a controlled member of the group, provided that during those 12 months it does not cease to be a member of that group or become a controlled member of any other group. These activities need not necessarily be in respect of the same protected item or right. When a company is treated as becoming or ceasing to be a controlled member of a group is defined in new sections 357BC(6) and (7).

29. New section 357BC(4) provides for condition C which allows a company within a group that holds either a qualifying IP right or an exclusive licence in respect of such rights to meet the development condition under condition C by virtue of the qualifying development undertaken by another group company. The company undertaking the qualifying development must have been a member of the relevant group when the qualifying development was carried out (even if the company that holds the right was not). However it is not necessary that the company holding the rights was a member of the group at the time the development occurred; it is only necessary that it is currently a member of the group.

30. New section 357BC(5) stipulates condition D to deal with the situation where a company (T), holding IP rights in respect of which it meets the development condition (as in condition B), joins a new group and then transfers the IP rights to another company in the new group. Condition D allows the company to which those rights have been transferred to satisfy the development condition where the transferee either:

- remains a member of the group; or
- transfers its trade to another member of the group; and

taken together (T) and/or the transferee company continue to undertake activities of the same nature as those that amounted to the qualifying development for 12 months after (T) joined the group.

31. New section 357BC(6) sets out when a company is treated as becoming a controlled member of a group. This will happen where a company that was not previously associated with the company acquires control of the company or acquires a major interest in the company.

32. New sections 357BC(7) and (8) set out when a company is treated as ceasing to be a controlled member of a group. This will happen where each company which previously controlled or held a major interest in a company ceases to do so, and the company is no longer associated with those companies. Where a company ceases to be a controlled member of the group, any company that it controls, and any company in which it holds a major interest is also treated as ceasing to be a controlled member of the original group.

33. New sections 357BC(9) and (10) define 'associated', control and 'major interest' for the purposes of this section.

34. New section 357BC(11) ensures that where a group company meets the development condition under either condition B or D of new section 357BC, it is regarded as meeting that condition from the date that either it or the other company respectively joined the group, rather than on the expiry of the 12 month period.

35. New sections 357BD(1) and (2) define qualifying development of an IP right as the creation or development (including a significant contribution to these activities) of an invention. Developing an invention includes developing ways to use or apply the item. Invention is defined by new section 357GE to mean the item or process in respect of which the right is granted.

36. New section 357BD(3) confirms that for the purpose of new section 357BC, qualifying development undertaken before the IP right was acquired, whether by the company which holds the IP right or another member of the group, is taken into account in considering whether the development condition is satisfied.

37. New section 357BE sets out when a company is regarded as satisfying the active ownership condition. Companies that are not part of a group do not need to meet the active ownership condition, by virtue of new section 357B(1).

38. New section 357BE(1) states that a company meets the active ownership condition if substantially all of its qualifying IP rights satisfy either of two conditions.

39. New sections 357BE(2) and (3) set out the first condition, which is met where the company performs significant management of its qualifying IP rights portfolio during the accounting period. In this context management activity includes the formulation of plans and decision-making in relation to the development or exploitation of the IP rights.

40. New section 357BE(4) sets out the second condition, which is met where the company carries out development activity in relation to the particular IP rights during the accounting period, meeting either of the development conditions set out in new sections 357BC(2) or (3). These require the development activity to be carried out by the company that has the IP rights rather than by any other member of the group.

Chapter 3: Relevant IP profits

41. New section 357C sets out the Steps necessary to determine the relevant IP profits of the trade. The relevant IP profits of the trade are the profits that are used in the formula in new section 357A to calculate the appropriate amount of the deduction from the profits of the trade which gives effect to the lower rate of corporation tax.

42. New section 357C(1) outlines the six Steps involved in the computation of the relevant IP profits of a trade.

43. Step 1 specifies that the total gross income of a trade must be calculated. Total gross income of the trade is defined in new section 357CA.

44. Step 2 determines the percentage of the company's total gross income that is relevant IP income, denoted as X per cent. Relevant IP income includes not only the income identified under the various Heads in new section 357CC, but also any notional royalty identified under new section 357CD.

45. Step 3 apportions the total profit or loss of the trade between that attributed to activities of the trade involving the exploitation of qualifying IP rights and other matters. This is achieved by applying the percentage, X per cent, computed at Step 2 to the total profit or loss of the trade for corporation tax purposes adjusted as required by new section 357CG.

46. Step 4 determines any qualifying residual profit figure by deducting an amount representing a routine return, calculated under new section 357CI, from the result of Step 3. Where this is a positive figure, this is the qualifying residual profit, which represents the additional profit over and above a routine return attributed to the exploitation of the all of the company's intangible assets. If the

routine return figure is greater than X per cent of the total profit, then subject to Step 7, there will be a relevant IP loss for the period. No further adjustment is necessary under Steps 5 and 6 where there is a loss at this stage in the calculation.

47. Companies with a qualifying residual profit now make a decision regarding how to calculate the amount of this qualifying residual profit that is attributed to the qualifying IP rights. Step 5 sets out that where the company has not made an election for small claims treatment, it should proceed to Step 6; alternatively if the company has made such election, it should use the simplified procedure set out in new sections 357CL and 357CM.

48. Step 6 deducts from any qualifying residual profit an amount to be attributed to marketing assets. Whilst it is possible that the result of deducting the marketing assets return figure from the qualifying residual profits creates a loss, in practice a company in that position will always be better off making a small claims election and using the alternative method set out in new sections 357CL and 357CM so long as they meet one of the conditions in new section 357CL(2) or (3).

49. Step 7 is the point at which a company includes in its relevant IP profits for the period any additional amount in respect of profits arising in the period where grant of a patent is pending when the patent is granted. The way in which this amount is calculated is set out at new section 357CQ.

50. New sections 357C(2) and (3) specify that any positive sum determined from the Steps set out above is the relevant IP profit for the period, whilst any negative amount will be the relevant IP loss for the period.

51. New section 357CA sets out the calculation of the total gross income of the trade for Patent Box purposes.

52. New section 357CA(1) specifies that total gross income of the trade includes any amounts falling within 5 Heads each of which is further explained in new sections 357CA(3) to (8).

53. New section 357CA(2) specifies that total gross income of the trade excludes any finance income, as defined in new section 357CB.

54. New sections 357CA(3) to (4) define income within Head 1 which includes amounts that are both recognised as revenue in the company accounts, and brought into account in computing the profits of the trade for corporation tax purposes. GAAP is the standard to be used for recognition of revenue items, even where accounts are not drawn up in accordance with that standard.

55. New section 357CA(5) defines income within Head 2 as including amounts received as damages, insurance receipts or other compensation, to the extent that these have not been recognised as revenue in the accounts (and therefore included under Head 1).

56. New section 357CA(6) ensures that any adjustments that are necessary on a change of a company's accounting basis which are treated as receipts for tax purposes are included under Head 3, to the extent that these are not recognised as revenues in the accounts (and therefore included under Head 1).

57. Sections 357CA(7) and (8) set out amounts included in Heads 4 and 5 as any taxable credits from the realisation of intangible fixed assets, and any profits from the sale of pre-2002 patent rights, held for the purposes of the trade which arise during the accounting period.

58. New section 357CB defines finance income as credits arising from financial assets, any amounts treated as a receipt of the trade arising from loan relationships or derivative contracts by virtue of sections 297 and 573 of CTA 2009 respectively, and other amounts economically equivalent to interest which a company receives as a consequence of any arrangement to which it is a party. Income from financial assets includes dividends and other income from shares that forms part of the income of a financial trader.

59. New section 357CC sets out the amounts included in the total gross income of the trade which are to be regarded as relevant IP income. The aggregate of these amounts, together with any notional royalty identified under new section 357CD, will form the relevant IP income used in Step 2 of new section 357C(1). The measure of the income under the Heads of relevant IP income for any accounting period will be the amount that is brought into account for tax purposes in the period. Thus where recognition of the income from a disposal is spread over several accounting periods, then only the part recognised in the current period is treated as relevant IP income.

60. Relevant IP income must fall under one of the Heads identified in new section 357CC(1).

61. Any income which falls within Heads 1 to 5 (see new sections 357CC(2) and (6) to (9) below) will nevertheless not be relevant IP income to the extent that it is excluded income by virtue of new section 357CE.

62. New section 357CC(2) outlines income falling within Head 1. This is not limited to income from the sale of qualifying items which are

items protected by a qualifying IP right. It also includes the income from the sale of items either incorporating the qualifying item, or wholly or mainly designed to be incorporated into it. Thus income from sales of products incorporating a patented component and from the sale of spare parts for such a product will be included under Head 1. Qualifying items are items in respect of which a qualifying IP right held by the company has been granted.

63. For these purposes an item is defined in new section 357GE in chapter 7 as including any substance.

64. New sections 357CC(3) and (4) deal with the distinction between a qualifying item and its packaging. These are treated separately unless the packaging performs an essential function relating to the use of an item. The requirement to treat packaging separately is subject to a de minimis exception in new section 357CF(6) and it should not be relevant for most companies. Companies selling qualifying items will not generally be required to separately identify the value attributable to its packaging. The principal exception, where separate treatment is necessary, is the sale of an item that is not a qualifying item but which is sold in patented packaging. The effect of the rule in such a case is to prevent the income from the sale of the item being regarded as part of the company's relevant IP income.

65. New section 357CC(5) extends the meaning of items incorporating one or more qualifying items in subsection 2(b) to include the situation where a qualifying item and an item designed to incorporate that item are sold together for a single price.

66. New section 357CC(6) provides that income falling within Head 2 is income consisting of any licence fee or royalty received by the company under an agreement which only grants to another person:

- a right in respect of a qualifying IP right held by the company;
- a right in respect of a qualifying item or process; and
- a right granted for the same purposes as the right granted in respect of such qualifying IP right.

'Qualifying process' means a process in respect of which the company holds a qualifying IP right.

67. Licence fees or royalties that exclusively relate to the qualifying IP rights, qualifying items or processes are included in Head 2 income. If a licence agreement provides for the receipt of royalties and / or fees for any other matter, then the rules for a mixed agreement in

new section 357CF must be applied to determine the amount of relevant IP income.

68. New section 357CC(7) outlines income falling within Head 3. This is any income arising from the disposal of a qualifying IP right or an exclusive licence.

69. New section 357CC(8) outlines income falling within Head 4. This is any amount received by the company arising from infringement or alleged infringement of any qualifying IP right held by the company. At the time of the infringement the company must have held the qualifying IP right.

70. New section 357CC(9) outlines income falling within Head 5. This covers other amounts of damages, insurance proceeds or compensation that do not fall within Head 4 (infringement of qualifying IP rights) but which nonetheless arise in respect of the sale of qualifying items or the loss of income which would have been relevant IP income.

71. Examples of amounts that would fall within Head 5 are:

- insurance proceeds received in respect of stocks of qualifying items lost or destroyed by fire, and

- damages in respect of lost income from the sale of qualifying items as a result of the infringement of rights that are protected by IP rights other than qualifying rights. Such rights might relate to trademarks relating to the qualifying item, or a patent that protects features of protected items that are sold only outside of the EU and for which no qualifying IP rights exist in the UK or EU.

72. New sections 357CC(10) and (11) stipulate that income cannot be treated as relevant IP income under new sections 357CC(8) or (9) unless, at the time of the event in respect of which the income is received the company was a qualifying company for which an election under new section 357A in chapter 1 had effect. Where the damages etc. received for the infringement relate partly to periods when the company was a qualifying company and partly to periods when it was not, then a just and reasonable apportionment is to be made to determine the amount which is relevant IP income.

73. Income will be treated as relevant IP income within Heads 4 and 5 even where it is received at a time when the company no longer holds a qualifying IP right, provided that it relates to an infringement which occurred at a time when the company did hold the qualifying IP right and was a qualifying company to which an election under new section 357A had effect. New section

357B(3)(b) ensures that the company is also treated as a qualifying company at the time it receives the amount.

74. New section 357CC(12) specifies that any reference in new section 357CC to a qualifying right held by the company is taken to include a reference to any qualifying IP right in respect of which the company holds an exclusive licence.

75. New section 357CD provides a mechanism for determining the amount of a company's total gross income of the trade which is not relevant IP income but which arises as a direct result of the company's exploitation of a qualifying IP right under any of the heads of new section 357CC. Such income is identified as IP-derived income. An example of this might be the sale of non-patented goods that are produced using a patented process. The aim of this section is to arrive at a further amount of the total gross income that will be treated as relevant IP income. This is achieved by establishing a notional royalty that reflects what the company would pay out of the income generated by the exploitation of the IP in the accounting period to a third party for use of those qualifying IP rights. This amount will be added to the relevant IP income of the trade for use in Step 2 of the calculation of relevant IP profits in new section 357C.

76. New sections 357CD(1) and (2) provide that relevant IP-derived income arises to a company if it holds any qualifying patent (or any exclusive licence in respect of such a patent) and the total gross income of the trade includes an amount arising from the company's exploitation of those qualifying IP rights which is neither relevant IP income under new section 357CC nor excluded income under new section 357CE.

77. New section 357CD(3) allows a company to elect to treat a notional royalty in respect of its IP-derived income as if it were relevant IP income. Where a company has negligible amounts of income that would fall within this section it may decide not to carry out a calculation of any national royalty. Where the company wishes to calculate a notional royalty, no formal election procedure is set down, and the company may simply include the notional royalty election by way of a note to the computations in its corporation tax return (or an amended return) for the period.

78. New sections 357CD(4) and (5) set out how to determine the notional royalty. This is the appropriate amount of any IP-derived income for the accounting period that the company would pay to a third party for the right to exploit any qualifying IP rights used for that accounting period, assuming that the company were not otherwise able to exploit it.

79. New sections 357CD(6) and (7) set out the assumptions that are to be made in arriving at the appropriate percentage of the IP derived income for an accounting period. These are:

- the royalty will be payable at arms length;
- the company, or the company and persons authorised by it, will have the exclusive right to exploit the qualifying IP;
- the rights deemed to be granted are only those that the company actually has in relation to the qualifying IP right. This is most likely to be relevant in cases where, for the example, the company holds a right or licence of limited duration or which is restricted to a particular country or territory;
- the rights are conferred on the later of the start of the accounting period or the date when the company acquired the IP right;
- the percentage is determined at the start of the accounting period; and
- will continue at an unchanged level for subsequent accounting periods.

These assumptions ensure that the notional royalty relates to relevant IP-derived income generated during the accounting period. The amount of the notional royalty cannot exceed the amount of the IP-derived income because it is calculated as a percentage of that income, and any amount in excess of 100 per cent would clearly not be a commercial arrangement.

80. Thus, where there is no significant change in the company's circumstances, the actual percentage used in one accounting period should also be used in the following accounting period. Only if there is a significant change in the company's circumstances would a company need to reassess the appropriate amount in accordance with the above assumptions for a subsequent accounting period.

81. New section 357CD(8) requires that the amount of the royalty must be determined in accordance with article 9 of the OECD model and the transfer pricing guidelines. Both these terms are defined in new section 357CD(9).

82. New section 357CE specifies that two types of income, which could otherwise fall within one of the Heads of relevant IP income outlined at new section 357CA, will not be relevant IP income under any circumstances.

83. New sections 357CE(1) to (3) specify that ring fence income, from UK Continental Shelf oil and gas trades as set out in part 8 of CTA 2010 (see sections 272 and 273), and income arising to a licensee that is attributable to any licence in respect of an item or process, but which is not an exclusive licence is excluded from being relevant IP income.

84. Where it is necessary to attribute an amount of income to a non-exclusive licence in respect of a qualifying IP right as set out in new section 357B(4), then this is to be done on a just and reasonable basis.

85. New section 357CE(4) ensures that where a company has been granted a mixture of exclusive and non-exclusive rights over the invention under a single licence, the licence is to be treated under Part 8A as comprising two separate licences; one an exclusive licence which confers only the exclusive right or related rights and the other a non-exclusive licence covering the non-exclusive rights. Income in respect of the deemed non-exclusive licence is excluded income by virtue of new section 357CE(3).

86. New section 357CF requires a company to make a just and reasonable apportionment of income which includes elements of both relevant IP income and other income, for the purposes of determining the company's relevant IP income.

87. New section 357CF(1) provides that the section will apply to mixed income, and income paid under a mixed agreement.

88. New section 357CF(2) defines mixed income. This is income from the sale of qualifying items together with non-qualifying items as a single unit and for a single price. A qualifying item is one whose sale would produce relevant IP income under new section 357CC(2).

89. New sections 357CF(3) and (4) define a mixed agreement. This is any agreement that provides for any of:

- the sale of a qualifying item, as set out in new section 357CC(2);
- the granting of rights in respect of a qualifying IP rights held by the company under new sections 357CC(6)(a) or (b); or
- a sale or disposal falling within new section 357CC(7);

and also

- the sale of any non-qualifying item, the granting of any rights other than in respect of a qualifying IP right or the supply of any service.

90. New section 357CF(5) requires the amount of relevant IP income to be determined using a just and reasonable apportionment of the mixed income or the income received under mixed agreement. This is subject to a de minimis rule in new section 357CF(6). A company may need to determine appropriate apportionments where none are provided within the agreement, or override the terms of an agreement for tax purposes where it is necessary to do so to arrive at a just and reasonable result.

91. For example, an agreement provides a single price for the sale of a single unit, where the sale includes 50 hairdryers with a patented motor (with the protected IP item (see new section 357CC) owned by the vendor), and 70 curling tongs where the vendor has no interest in any protected IP rights. The vendor's basic wholesale price of the hairdryer is £10 per unit, and the curling tongs £6 per unit. Income from the sale which relates to the hairdryers falls within new section 357CC(2)(b), whereas that relating to the curling tongs does not fall within new section 357CC. A just and reasonable amount of relevant IP income from the sale of the hairdryers could be calculated as:

$$\pounds 750 \times \frac{(50 \times 10)}{(70 \times 6) + (50 \times 10)} = \pounds 407.61$$

92. New section 357CF(6) allows a company to disregard trivial amounts of income that can be attributed to the sale of non-qualifying items, the grant of other rights or the supply of services arising from a sale that generates mixed income, or under a mixed agreement, when calculating relevant IP income. Where there are several non-qualifying amounts it is the aggregate amount which must be considered to determine whether the income is trivial.

93. New section 357CG sets out the adjustments that a company needs to make to its taxable profits from a trade in order to determine its relevant IP profits from that trade.

94. New sections 357CG(2) to (4) provide for the profits of the trade to be adjusted for two amounts, relating to research and development (R&D) tax relief, and financial income or expenses as follows.

95. Adding back any additional deduction for R&D expenditure obtained under part 13 of the CTA 2009 ensures that the company

retains the full benefit of this tax relief even though its IP profits are taxed at a lower rate.

96. Removing any debits in respect of the trading loan relationships or derivative contracts, and any credits in respect of finance income ensures that the method of financing the company's trade will not affect its relevant IP profits, and therefore the amount of tax relief it receives from the reduced rate of tax on those profits. Finance income is defined in new section 357CB.

97. New section 357CG(5) requires a company to use a greater amount of R&D expenditure in computing the profits of its trade in a relevant accounting period where there is a shortfall in R&D expenditure in relation to the trade of the company. The provision operates in situations where a company's R&D expenditure has predominantly been incurred in earlier periods while it was not within the Patent Box regime, and income from the results of that expenditure is mainly received in later periods at a time when it is within the regime, but its R&D expenditure has significantly reduced. It only applies in the four years after a company makes an election under new section 357A.

98. Where there is a shortfall in R&D expenditure in relation to the trade of the company for a relevant accounting period, the provision requires a company to increase the amount of R&D expenditure taken into account in calculating relevant IP profits for that accounting period by the amount mentioned in new section 357CH(2).

99. New section 357CG(6) defines terms used in new section 357CG(5).

100. New section 357CH describes when and how the calculation of a company's relevant IP profits for a relevant accounting period must take account of a greater amount of expenditure on R&D than that which has been incurred in the accounting period. A relevant accounting period is defined in new section 357CG(5) and covers any accounting period beginning within four years of the date that an election into the Patent Box has effect for a qualifying company.

101. New section 357CH(1) specifies that there is a shortfall in R&D expenditure for a relevant accounting period where the actual R&D expenditure in the accounting period is less than 75 per cent of the average amount of R&D expenditure. The actual R&D expenditure for an accounting period is defined in new section 357CH(3), although this is subject to any adjustment through a 'smoothing' procedure described in new sections 357CH(8) to (11).

102. New section 357CH(2) sets out the amount of the adjustment required when there is a shortfall in R&D expenditure for a relevant accounting period. It is to be increased by the difference between 75 per cent of the average R&D expenditure in the relevant period before the company started to use the Patent Box and the actual R&D expenditure for that accounting period.

103. New section 357CH(3) defines the actual R&D expenditure, and specifies that R&D expenditure and relevant accounting period have the meanings given by new section 357CG(6).

104. New section 357CH(4) sets out how to calculate the average amount of R&D expenditure. This is the total amount of R&D expenditure incurred by the company for the relevant period (as defined in new section 357CH(4)) divided by the number of days in that period. This daily figure is then multiplied by 365 to give an annual amount.

105. New section 357CH(5) defines the relevant period for the purposes of new section 357CH. This will generally be the four years prior to the accounting period in which an election under new section 357A by a qualifying company first had effect (or the time since the trade commenced if this is less than four years).

106. New section 357CH(6) directs that where a relevant accounting period is less than 12 months, the average amount of R&D expenditure used to compare with the actual expenditure is proportionately reduced.

107. New sections 357CH(7) to (11) address the circumstance where a company has fluctuating levels of R&D expenditure for different relevant accounting periods. They allow a degree of 'smoothing' which will reduce the frequency and amount of any adjustments required under new section 357CH(2).

108. New section 357CH(8) provides that where, for any relevant accounting period, actual R&D expenditure is greater than the average calculated under new section 357CH(4) the excess can be added to the actual amount of R&D expenditure for the next relevant accounting period. That augmented amount of R&D expenditure is then compared with the average amount to determine whether there is a shortfall in R&D expenditure.

109. New sections 357CH(9) and (10) apply where it is the only additional amount of R&D expenditure included for an accounting period by virtue of new section 357CH(5) that causes there not to be a shortfall for that period. In such a case, any remaining part of the additional amount over and above that which is necessary to

increase the actual R&D expenditure for an accounting period to 75 per cent of the average R&D expenditure may be carried forward for use in the next period.

110. New section 357CH(11) specifies that where an additional amount of R&D expenditure is included for an accounting period by virtue of subsection (8), but it is needed to make up for a shortfall in R&D expenditure for that period then it may be carried forward to the next period, in addition to any excess of R&D expenditure over the average that arises in that period.

111. New section 357CI sets out how to compute a routine return figure for the purposes of Step 4 of the calculation of relevant IP profits. Step 4 aims to exclude an amount of profit which represents a routine return. A routine return is the return which could be expected from the business if the company was not able exploit its qualifying IP rights and other intangible assets.

112. New sections 357CI(1) outlines the three Steps for calculating the routine return figure.

113. Step 1 identifies the total of the routine deductions made by the company in computing the profits of the trade. Routine deductions are those identified in new section 357CJ, and not excluded by new section 357CK.

114. Step 2 applies a mark-up of 10 per cent to the amount identified in Step 1. A cost-plus methodology is a used to determine the arms-length return expected from a trader that does not use unique intangible assets in its trade. The 10 per cent rate reflects the fact that only a proportion of the actual expenses of the trade are used when estimating a routine return figure.

115. Step 3 determines how much of that routine return is to be attributed to profits from the company's relevant IP income. This is achieved on a pro-rata basis using the ratio of relevant IP income to the total gross income figure, as in Steps 1 and 2 of the computation under new section 357C, denoted as X per cent

116. New sections 357CI(2) and (3) ensure that the deductions taken into account for the purposes of determining a routine return also include any expenses incurred on a Patent Box company's behalf by other members of the group, irrespective of whether or not these have been reimbursed, for example by way of a service fee or adjustment to intercompany balances. Where necessary, a just and reasonable apportionment of expenses incurred by the other company should be made to determine the amount to be included in calculating the Patent Box company's routine return.

117. New section 357CJ sets out the meaning of routine deductions for the purposes of new section 357CI. These are the deductions to which a mark-up is applied to determine the routine return from the trade. A number of costs related to financing and the development of IP rights are specifically excluded by virtue of new section 357CK.

118. New section 357CJ(1) sets out six general heads of expenditure, each of which is further explained in new sections 357CJ(2) to (7).

119. New section 357CJ(8) defines various terms used in the descriptions under the six Heads.

120. New section 357CJ(9) permits the Treasury to amend the list of items included in relevant deductions and their descriptions by way of an Order.

121. New sections 357CK(1) to (7) define deductions which are not to be marked up as routine deductions. Any loan relationship or derivative contract amounts are excluded from the routine deductions, as well as certain costs associated with the development of the company's qualifying IP rights. The exclusion of any amounts that have qualified for R&D tax relief, including any additional deduction under part 13 of CTA 2009 at this stage ensures that there is no incentive for Patent Box companies to outsource their R&D activities to other group companies. Capital allowances related to R&D expenditure and patent allowances are excluded, as are certain tax deductions for employee share schemes.

122. New section 357CK(8) permits the Treasury to amend the list of items excluded from being relevant deductions and their descriptions by way of an Order.

123. New sections 357CL and 357CM provide a simpler method for calculating the relevant IP profits of a company where its profits are small. In this circumstance, the company may make an election under new section 357CL(1) and use a formulaic approach in the computation of their relevant IP profits instead of Step 6 as set out in new section 357C. No formal election procedure is set down, and a company may simply include the election for small claims treatment by way of a note to the computations in its corporation tax return (or an amended return) for the period. The rule is intended to relieve companies with smaller profits from the administrative burden of carrying out a full analysis of its marketing assets return as is required under Step 6.

124. New section 357CL(1) sets out that a company can elect for small claims treatment where either of conditions A or B are met.

Condition A is the basic rule which will apply to most companies including all those with small profits. Condition B will apply to companies that have larger amounts of profits in some years, and is intended to ensure that such a company does not only use the small claims treatment for years when it provides a beneficial result compared to calculating a marketing assets return in accordance with Step 6 of new section 357C(1).

125. New section 357CL(2) specifies condition A. This is that the total amount of qualifying residual profit of all of the company's trades taken together does not exceed £1,000,000. In determining this total amount any negative amount of QRP in respect of any of the company's trades is disregarded by virtue of new section 357CL(7).

126. New section 357CL(3) specifies condition B. This is that the total amount of qualifying residual profit of all of the company's trades taken together does not exceed the relevant maximum, and that the total company has not followed Step 6 of new section 357C(1) for the purpose of calculating RIPI (deducting a marketing assets return figure under new section 357CN) for any accounting period commencing within the previous 4 years.

127. New section 357CL(4) gives the relevant maximum amount for a company with no associated companies. This is £3,000,000.

128. New sections 357CL(5) and (6) specify that the relevant maximum is to reduced proportionately where a company has one or more associated companies in relation to which an election under new section 357A has effect and where its accounting period is less than 12 months long.

129. New section 357CL(8) specifies that when determining whether two companies are associated for the purposes of the small claims threshold the rules used for claims to the small profits rate of corporation tax are to be followed.

130. New section 357CM(2)(a) provides that where an election for small claims treatment is made by a company with just one trade, the amount of relevant IP profits is the lower of 75 per cent of the qualifying residual profit of the trade or the small claims threshold.

131. Where a company has more than one trade, the qualifying residual profit of each of the trades is aggregated to determine whether the small claims limit has been exceeded. Any negative amounts of qualifying residual profit in a trade are ignored, by virtue of new section 357CM(4).

132. Where the total does not exceed £1,333,333, the relevant IP profits are 75 per cent of the qualifying residual profit in each trade.

Otherwise the relevant IP profit figure is the small claims threshold – this is a total figure rather than an amount per trade.

133. New section 357CM(5) sets the small claims threshold for a company which has no associated companies that have made an election under new section 357A at £1 million for an accounting period of twelve months.

134. New sections 357CM(6) and (7) reduce the small claims threshold proportionately where a company has one or more associated companies that have made an election under new section 357A, or where the accounting period is less than twelve months respectively.

135. New section 357CM(8) specifies that when determining whether two companies are associated for the purposes of the small claims threshold the rules used for claims to the small profits rate of corporation tax are to be followed.

136. New section 357CN details the method that is to be used to arrive at the marketing assets return figure required for a deduction from qualifying residual profit at Step 6 of new section 357C(1).

137. New section 357CN(1) specifies that the marketing assets return figure is the difference between notional marketing royalty in respect of the trade (NMR) for the accounting period and the actual marketing royalty in respect of the trade (AMR) for the accounting period. The NMR and the AMR are defined by new sections 357CN and 357M.

138. New section 357CN(2) states that the marketing assets return figure is taken to be nil where:

- AMR is greater than the NMR; or
- NMR is less than 10 per cent of qualifying residual profit (see new section 357GE(2) in Chapter 7).

139. New section 357CO outlines the principles to be used in determining the notional marketing royalty figure to be used in new section 357CN.

140. New sections 357CO(1) and (2) specify that the notional marketing royalty is to be determined as the amount of its relevant IP income for the accounting period that the company would pay to a third party for the right to exploit its relevant marketing assets, assuming that otherwise it would have no such right. This is the appropriate amount of the relevant IP income.

141. New section 357CO(3) provides that relevant marketing assets are those marketing assets that are used to generate relevant IP income of the trade in the accounting period.

142. New section 357CO(4) details the assumptions used for deriving the amount of the notional marketing royalty. These are:

- the royalty will be payable at arms length;
- the company, or the company and persons authorised by it, will have the exclusive right to exploit the relevant marketing assets;
- the royalty will be paid only in respect of rights that the company actually holds;
- the right will be granted on the relevant day;
- the appropriate percentage is calculated at the start of an accounting period;
- the same percentage will apply for succeeding accounting periods; and
- the only benefits the company will derive from the exploitation of the rights will be in respect of relevant IP income during the accounting period.

These assumptions ensure that the notional marketing royalty relates only to relevant IP income generated during the accounting period. They will exclude the use of assumptions based on other market practices such as front- or rear-loaded payments, lump sums covering longer periods, etc.

143. New section 357CO(5) defines the relevant day for the purposes of the assumptions made about the appropriate amount.

144. New section 357CO(6) requires that the amount of the royalty must be determined in accordance with article 9 of the OECD model and the transfer pricing guidelines.

145. New section 357CO(7) defines the term marketing asset.

146. New section 357CP sets out how to determine the actual marketing royalty of a trade for an accounting period.

147. New section 357CP(1) states that the actual marketing royalty is X per cent of the total amount paid by the company for the acquisition of, or the right to exploit, any relevant marketing assets, and which

are debited in the calculation of the corporation tax profits of the company's trade for the accounting period.

148. New section 357CP(2) provides that in new section 357CP(1) relevant marketing assets has the same meaning as that given in new section 357CO, and X per cent is the proportion of total gross income of the trade that is relevant IP income, as computed under Step 2 of new section 357C(1).

149. New section 357CQ provides that an amount of profits arising between the date of application to register a patent and the date of grant may be included in the calculation of relevant IP income in the period in which that right is granted. This provision does not apply to qualifying IP rights other than patents. Registration of a patent may take a number of years; the intervening period is generally known as the patent pending period. A maximum of six years' additional profits may be brought in for the period when the right is granted. New section 357BB defines relevant IP rights, and, other than in a case where the exception for patents that affect national security or public safety in new section 357BB(2) applies, requires the right to have been granted. Without this section any income received from the innovation which is the subject of the application, prior to grant, would not be relevant IP income.

150. New section 357CQ (2) provides for a company to elect to include an additional amount in its calculation of the relevant IP profits of the accounting period in which a patent is granted. No formal election procedure is set down, and a company may simply include the election by way of a note to the computations in its corporation tax return (or an amended return) for the period.

151. New section 357CQ(3) sets out how the additional amount is calculated. It includes IP profits arising after the relevant day, in any relevant accounting period, that have not otherwise been included in relevant IP profits of the period. Relevant day and relevant period are defined in new sections 357CP(6) and (4) respectively.

152. New section 357CQ(4) ensures that any relevant IP profits that have been the subject of a set-off of relevant IP losses are disregarded for the purposes of calculating the additional amount.

153. New sections 357CQ(5) and (6) give the conditions which determine which accounting periods will be a relevant accounting periods. A relevant accounting period is any accounting period in which the right is granted, and any earlier accounting period, ending on or after the relevant day, for which the company is a qualifying company and has made an election under new section 357A.

154. New section 357CQ(7) defines the relevant day for the purposes of the section. This will be the later of:

- 6 years prior to the date of grant; and
- either the date of application for the qualifying IP; or
- where a company holds an exclusive licence, the date the licence was granted.

155. New section 357CQ(8) allows a company to be treated as if it was a qualifying company for the purposes of new section 357CQ if the only reason it would not be a qualifying company is that the right had not yet been granted.

156. New section 357CQ(9) allows a company to be treated for the purposes of new section 357A as if it was a qualifying company for the accounting period in which the right is granted if the only reason that it would not qualify is that the company disposed of the right, or the licence to that right before it was granted. This allows a deduction under new section 357A to be made by a company that would not otherwise be a qualifying company for that accounting period.

Chapter 4: Streaming

157. In certain circumstances apportioning the profits of a trade by using the overall ratio of relevant IP income to total gross income, as required at Step 3 of new section 357C, may give rise to a distorted result. This may occur where the relative proportions of income from the exploitation of IP rights and other income differs markedly from the relative proportions of profits derived from such income.

158. New section 357D therefore provides for a company to elect for the provisions of new section 357C to be set aside, and for the relevant IP profits of the trade to be ascertained using the streaming provisions of new section 357DA. It also provides that the provisions of new section 357DA will replace new section 357C where any of the mandatory streaming conditions of new section 357DC is met.

159. New section 357D(1) allows a company to elect to apply new section 357DA. This is a streaming election. No formal election procedure is set down, and a company may simply include the streaming election by way of a note to the computations in its corporation tax return (or an amended return) for the period.

160. New section 357D(2) ensures that where a streaming election is made, it can to be applied to any or all of the company's trades.

This allows a company to pick and choose which of its trades would benefit from a streaming election.

161. New section 357D(3) states that a streaming election has effect for the accounting period in which it is made and each following period, unless the company ceases to use streaming where there has been a change of circumstances as set out in new section 357DB(3).

162. New section 357D(4) stipulates that where a company is required to use streaming because one or more of the conditions in new section 357DC is met, it must apply the provisions of new section 357DA to calculate its relevant IP profits rather than new section 357C.

163. New section 357DA(1) outlines the steps used to determine the relevant IP profits of the trade where either, the company has made a streaming election, or the company meets one or more of the mandatory streaming conditions.

164. Step 1 directs that any credits taken into account in computing the corporation tax profits of the trade other than finance income are to be split in to two streams; a relevant IP income stream (including any notional royalty computed under new section 357CD) and income that is not relevant IP income. Finance income is defined in new section 357CB.

165. Step 2 requires that, having separated the income of the trade into separate streams, all of the amounts deducted in calculating the corporation tax profits of the trade, should now be allocated on a just and reasonable basis against one or other of the streams of income. There is an exception for amounts identified under new section 357CG(3), that is any additional deductions for expenditure on research and development under part 13 of CTA 2009, and any trading loan relationship or derivative contract debits. The effect of not allocating these amounts is that they do not reduce relevant IP profits so that they attract relief at the full corporation tax rate.

166. Step 3 requires that the amounts allocated to the relevant IP income stream under Step 2 above are deducted from that income stream.

167. Step 4 determines any qualifying residual profit figure by deducting an amount representing a routine return, calculated under new section 357CI, from the result of Step 3. Where this is a positive figure, this is the qualifying residual profit, which represents the additional profit over and above a routine return attributed to the exploitation of the all of the company’s intangible assets. If the routine return figure is greater than the figure at Step 3, then subject to Step 7, there will be a relevant IP loss for the period. No further

adjustment is necessary under Steps 5 and 6 where there is a loss at this stage in the calculation.

168. Companies with a qualifying residual profit now make a decision regarding how to calculate the amount of this qualifying residual profit that is attributed to the qualifying IP rights. Step 5 sets out that companies that cannot or have not made an election for small claims treatment proceed to Step 6; those that have made an election use the simplified procedure set out in new sections 357CL and 357CM.

169. Step 6 deducts from any qualifying residual profit an amount to be attributed to marketing assets. Whilst it is possible that the result of deducting the marketing assets return figure from the qualifying residual profits creates a loss, in practice a company in that position will always be better off making a small claims election and using the alternative method set out in new sections 357CL and 357CM so long as they meet one of the conditions in new section 357CL(2) or (3).

170. Step 7 is the point at which a company includes in its relevant IP profits for the period any additional amount in respect of profits arising in period where grant of a patent is pending that are allowed under new section 357CQ.

171. New sections 357DA(2) and (3) specify that any positive sum determined from the Steps set out above is the relevant IP profit for the period, whilst any negative amount will be the relevant IP loss for the period.

172. New section 357DA(4) specifies that the routine return figure referred to in Step 4 is 10 per cent of the aggregate of routine deductions allocated against the relevant IP income stream at Step 2. Routine deductions for this purpose are those identified in new section 357CJ and not excluded by virtue of new section 357CK.

173. New section 357DA(5) applies the rule at new section 357CI(2) and (3) where a routine return in computed in cases where there is a streaming election. The effect of that rule is to ensure that the deductions taken into account also include any deductions incurred on a company's behalf by other members of the group, irrespective of whether or not these have been reimbursed, for example by way of a service fee or adjustment to intercompany balances. Where necessary, a just and reasonable apportionment of amounts incurred by the other company should be made to determine the amount relating to the company's routine deductions.

174. New section 357DA(6) adapts the rule for calculating a marketing assets return figure at Step 6 where the streaming provisions apply.

175. New section 357DB requires that where a company has made a streaming election, the method it uses to allocate deductions between income streams, at Step 2 of new section 357DA, should not change from accounting period to accounting period, unless there is a change of circumstances.

176. New section 357DB(1) states that the phrase method of allocation refers to the method applied at Step 2 of new section 357DA.

177. New section 357DB(2) requires that where a company applies the streaming rules it must use the same method of allocation in each accounting period for which the streaming election has effect. This applies irrespective of whether the rules are applied by election or are mandated.

178. However, new sections 357DB(3) and (4) provide that where there is a change of circumstances in respect of any of the company's trades, which makes the method of allocation inappropriate for an accounting period, the company can choose a different method of allocation, or elect not to apply the streaming election, for that accounting period. If the company chooses a different method then new section 357DB(2) will apply to require that that new method is applied for each subsequent accounting period. No formal procedure is set down, and a company may simply include an election not to apply streaming for the accounting period by way of a note to the computations in its corporation tax return (or an amended return) for the period.

179. New section 357DB(5) provides that where a company elects not to apply streaming for an accounting period under new section 357DB(4)(b), this does not prevent it from making fresh streaming elections in subsequent accounting periods.

180. New section 357DC details the circumstances under which a company is required to apply the streaming provisions of new section 357DA in determining relevant IP profits rather than those of new section 357C, other than where is has made an election to do so. Streaming is mandatory where any one or more of the conditions A to C is met in relation to a trade of the company for an accounting period. If, exceptionally, a company operates more than one trade within the Patent Box, and a mandatory streaming condition is met in respect of only one of the trades, then the company is required to apply streaming only to that trade. As with optional streaming elections, it may continue to apply the provisions

of new section 357C to calculate relevant IP profits of the rest of its trades.

181. New section 357DC(1) sets out mandatory streaming condition A. This is met for an accounting period where the accounts of the company for the period do not recognise a substantial amount of revenue from the trade that is taken into account in computing the profits of the period for corporation tax purposes.

182. This may happen when, for example there are accounting adjustments affecting prior years' statements of income, or where additional income is recognised for tax purposes on the basis of a transfer pricing adjustment covering several periods. The latter position is specifically catered for in new section 357DC(4). In these circumstances the general presumption that there is an indirect link between the ratio of relevant IP income to other income and the relevant IP profits to other profits does not apply, so using the rules of apportionment in new section 357C is inappropriate.

183. New sections 357DC(2) and (3) specify that an amount is substantial if it exceeds the lower of £2 million or 20 per cent of the aggregate of the relevant IP income and such licensing income, subject to a de minimis figure of £50,000.

184. New section 357DC(5) sets out mandatory streaming condition B. A company meets this condition for an accounting period if its total gross income from the trade includes relevant IP income, and a substantial amount of licensing income that is not relevant IP income. Licensing income is defined in new section 357DC(6).

185. New sections 357DC(7) and (8) set out mandatory streaming condition C. A company meets this condition for an accounting period if its total gross income from the trade includes income that is not relevant IP income, and a substantial amount of relevant IP income in the form of licence fees or royalties received under an agreement granting rights to another person over IP rights, where the company itself only holds an exclusive license in respect those IP rights. The reason for this is that the licence income received and the royalties paid would result in very little profit. An apportionment process to determine relevant IP profits would not be appropriate in these circumstances.

186. New section 257DC(9) requires a company to make an apportionment of relevant IP income from such licenses if not all of the company's qualifying IP rights meet the conditions of relevant Head 2 income in new section 357DC(8).

Chapter 5: Companies with relevant IP losses: set-off amount

187. New section 357E identifies a set-off amount where a company has a relevant IP loss for an accounting period that is equal to those losses. This is subject to the transitional rules for the Financial Years 2013 to 2016 whereby the relevant IP profits or losses for the period are reduced to a specified proportion, as set out in paragraph 8(3) of the Schedule.

188. New sections 357EA to EE describe how this set-off amount is to be dealt with in the computations. The principle underlying these rules is that the set-off amount should be matched with an amount of relevant IP profits either in another trade of the company, in other group members who have made an election under new section 357A, or in a later accounting period, to reduce an amount of relevant IP profits in respect of which new section 357A can apply to give a deduction from the corporation profits of the trade.

189. New section 357EA provides that the set-off amount is first allocated against any relevant IP profits arising in the same accounting period in respect of another trade of the company.

190. New section 357EB(1) sets out the rules for allocating a set-off amount where a company is a member of a group in which more than one company has made an election under new section 357A. The effect of the allocation is to reduce both the set-off amount and the relevant IP profits of the other trade to which an election under new section 357A has effect by the lesser of those two amounts.

191. New sections 357EB(2) to (4) provide that where there is another company in the same group that has relevant IP profits for a relevant accounting period, any set-off amount not allocated against another trade of the company is to be allocated against the relevant IP profits of that other company. The effect of the allocation rule is to reduce both the set-off amount, and the relevant IP profits of the trade of other company to which new section 357A can apply, by the lesser of the remaining set-off amount and the relevant IP profits.

192. New section 357EB(5) allows the group companies to jointly determine in which order the set-off amount is to be applied to them where there is more than one company in the group with relevant IP profits against which the set-off amount can be allocated.

193. New section 357EB(6) sets out the order in which the allocation is to be made in the absence of any joint determination by companies in the group. This is firstly to the trade of the company with the highest amount of relevant IP profits, then that with the next highest profits, and so on until the either all of the set-amount has been

allocated or there are no relevant IP profits remaining against which to allocate the remainder.

194. New section 357EC sets out the rules for carrying forward a set-off amount.

195. New section 357EC(1) specifies that the rule applies where some of a set-off amount remains after any allocation has been made against relevant IP profits in other trades in the company, or other relevant group members.

196. New sections 357EC(2) and (3) provide that any set-off amount which remains unallocated from an earlier accounting period is first allocated against relevant IP profits of the company in which the set-off amount arose for the following accounting period. New section 357A does not apply to a matching amount of relevant IP profits.

197. New section 357EC(4) sets out that where any of the set-off amount remains after any allocation has been made against relevant IP profits of the company in the following accounting period, it is treated as a set-off amount for this subsequent accounting period. The allocation rules in the chapter, for instance the group rules in new section 357EB, may then apply to that remaining amount.

198. New section 357EC(5) specifies that where a company has carried forward all or part of a set-off amount, this is to be added to any relevant IP losses in the later period, such that the set-off amount for that period is the sum of the two figures, and the allocation rules in the chapter may then apply to that amount.

199. New section 357ED ensures that where a company in a group ceases to carry on a trade, any set-off amount incurred in the trade which has not been reduced to nil by the operation of new sections 357EA or 357EB continues to be carried forward until such time as it has been fully allocated against relevant IP profits of other members of the group.

200. New sections 357ED (1) to (3) set out how any unallocated set-off amount is dealt with where a company in a group ceases to carry on a trade, no longer falls within the charge to corporation tax, or where an election under new section 357A otherwise ceases to have effect for any reason.

201. New section 357ED(3) specifies that new sections 357EA to 357EC will apply with some modifications to any set-off amount incurred in the company's trade, or trades, which has yet to be allocated against relevant IP profits.

202. New section 357ED(4) modifies the wording of new section 357EB so that it applies in situations where a company ceases to trade, no longer falls within the corporation tax charge or an election under new section 375A ceases to have effect. The modifications act to transfer the unallocated set-off amount to a relevant group member. In the absence of a joint determination to the contrary, this will be the relevant group member with the highest amount of relevant IP profits in that accounting period. However if there are no relevant group members with relevant IP profits for the accounting period, the unallocated set-off amount is to be added to the set-off amount of the company with the largest set-off amount in that accounting period.

203. New sections 357ED(5) to (6) determine when any unallocated set-off amount will finally be extinguished. Where a company is not a member of a group, the amount is extinguished only when the company ceases to carry on any trade. Where a company is a member of a group, the set-off amount will remain to be allocated amongst other members of the group until such time as there is no company in the group that has made an election under new section 357A and is a qualifying company for the accounting period.

204. New section 357EE provides for the transfer of any unallocated set-off amount where the trade of a company is transferred to another group company.

205. New section 357EE(2) directs that in such cases the set-off amount is to become the unallocated set-off amount of the other group company for the accounting period in which it begins to carry on the transferred trade. Where the group company which acquires the trade already has an unallocated set-off amount, the unallocated set-off amount of the transferor company is added to the set-off amount of the transferee company.

206. New section 357EF sets out the tax treatment of payments made between members of a group of companies as compensation for the transfer of relevant IP losses. So long as the payment does not exceed the amount of the relevant IP losses transferred, it will be ignored for the purposes of calculating the corporation tax profits or losses of the company that makes or receives the payment, and neither will it fall to be treated as a distribution.

Chapter 6: Anti-avoidance

207. New sections 357F to 357FB are anti avoidance provisions.

208. New section 357F applies in situations where licences may be entered into for non commercial reasons. This will be where the

main purpose or one of the main purposes of conferring any right in respect of a protected item is to ensure that the licence meets the definition of exclusive licence for the purposes of the new regime. Thus it may apply for example in cases where the exclusivity provided by the agreement was in respect of a spurious commercial right. In such cases, even though the licence may confer the right to the exclusion of all other persons, it will not be regarded as an exclusive licence for the purposes of part 8A.

209. New section 357FA applies in situations where a qualifying item is incorporated into a larger item to ensure that income from the sale of that larger item will be relevant IP income. Where the main purpose or one of the main purposes of the inclusion of the item is to make income from the sale of the larger item relevant IP income, then such income will not be relevant IP income.

210. New section 357FB is a targeted anti-avoidance provision which limits or denies a Patent Box deduction to a company that is party to a scheme entered into in order to secure a tax advantage.

211. New section 357FB(1) applies the section where a company that is entitled to make a deduction under new section 357A is party to a scheme, one of the main purposes of which is to obtain a relevant tax advantage. A scheme is defined in new section 357FB(6).

212. New section 357FB(2) identifies a relevant tax advantage for the purposes of the section where there is an increase in the amount of any deduction due to the company, or another member of that company's group, under new section 357A. This increase must be attributable to:

- avoiding the operation of any provision of the regime, such as the R&D expenditure condition of new section 357CH, or the relevant IP loss provisions of chapter 5, or

- artificially inflating the amount of relevant IP income which is brought into accounts in determining trade profits, or

- a mismatch between relevant IP income and the expenditure incurred in generating that relevant IP income.

213. New section 357FB(3) explains that a company will be regarded as having artificially inflated the amount of its relevant IP income where it is party to a scheme that does either of two things affecting the proportion of relevant IP income and other income used in calculating its relevant IP profits. The first is to include matching amounts of additional income that would be relevant IP income and additional expenses that would be debited in the computation of

profits. The second is to include an additional amount of income that would be relevant IP income where there is a corresponding decrease in other income that is not relevant IP income.

214. New section 357FB(4) sets out when there is a mismatch between relevant IP income and expenditure for the purposes of the rule. This will be where:

- relevant IP income is brought in to account in calculating a deduction under new section 357A for a company, and

- expenditure in relation to that right is brought to account in a different accounting period of that company, or in a different company, where no election under new section 357A was in effect.

215. New section 357FB(5) provides that where the section applies, the deduction to be made by the company is to be limited an amount that ensures that no relevant tax advantage arises.

Chapter 7: Supplementary

216. New section 357G sets out the procedure for making an election under new section 357A.

217. New sections 357G(1) and (2) require a company to provide a notice of election that specifies the first accounting period for which the rules are to apply.

218. New section 357G(3) sets out the latest date by which an election can be made for any particular accounting period. This is the date by which an amended corporation tax return for that period must have been submitted in accordance with paragraph 15 of Schedule 18 to Finance Act 1998.

219. New section 357G(4) ensures that the election applies to all the trades carried on by the company, so that it is not possible to make an election in respect of only some of a company's trades.

220. New subsection 357G(5) ensures that an election made under new section 357A need only be made once, and that the election will continue to have effect until it is revoked.

221. New section 357GA sets out the terms under which a company may revoke an election it has made under new section 357A.

222. New sections 357GA(1) and (2) require a company to give a notice revoking the election, which specifies the first accounting period for which the rules are to cease to apply.

223. New section 357GA(3) sets out the latest date by which an election can be revoked for any particular accounting period. This is the date by which an amended corporation tax return for that period must have been submitted in accordance with paragraph 15 of Schedule 18 to Finance Act 1998.

224. New section 357GA(4) specifies that the revoking of an election has effect for all future accounting periods of the company, until and unless the company makes a new valid election under new section 357A.

225. New section 357GA(5) specifies that a new election under new section 357A can only have effect after five years have elapsed since the company revoked a previous election.

226. New sections 357GB(1) and (2) introduce the amendments that are made to the rules in order for them to apply to a company that carries on a trade in partnership with other persons. In brief, the provisions of the regime are to be applied to the firm as a whole in similar way as they apply to a single company carrying on a trade, subject to the modifications set out in new sections 357GB(3) to (9). A partnership may include both corporate and non-corporate partners, and any deduction to be made in consequence of an election under new section 357A is made only for the purposes of determining the share of a member who is liable to corporation tax.

227. New section 357GB(3) sets out the procedure for a corporate partner to make or revoke an election for the Patent Box, and the effect of its doing so. Any corporate partner in a firm may choose to make or revoke an election under new section 357A. The effect of the election is that the partner's share in the profits (or losses) of the firm is computed as if the election had been made or revoked by the firm. An election made or revoked by one partner has no effect on the shares of any other partner.

228. New section 357GB(4) ensures that references to the time limits applying to the making or revoking of an election are those relevant to the corporate partner rather than the firm.

229. New section 357GB(5) applies the rules in section 1261 of the CTA 2009 for determining accounting periods of the firm where there is a corporate partner.

230. New section 357GB(6) ensures the firm must meet the active ownership condition, even though it is not a member of a group.

231. New sections 357GB(7) and (8) sets out that a firm meets the development condition in respect of an IP right where either the partnership itself, or a corporate partner with at least a 40 per cent

share in the partnership has carried out qualifying development in relation to that right.

232. New section 357GB(9) applies the rules in new section 357BD that determine whether the development condition is met by a company that is at some time a member of a group to a firm.

233. New sections 357GB (10) amends condition B of the active ownership condition where it is to be applied to a corporate partner.

234. New section 357GB(11) modifies the provision for a small claims election, so that it is appropriate to claims made by a corporate partner.

235. New sections 357GB(12) & (13) ensure that any corporate partner who is party to an arrangement designed to secure a return from the firm that is economically equivalent to the receipt of interest is treated as if they had not made an election under new section 357A.

236. New section 357GC sets out how the Patent Box regime is to be applied to a company that is a member of a cost-sharing arrangement.

237. New section 357GC(1) defines a cost-sharing arrangement. This is an arrangement between several parties where one party holds a qualifying IP right, or an exclusive licence over such a right. The arrangement leads to the creation or development of an invention to which each party makes a contribution in terms of funding or other activity. All the parties are entitled to a share of the income attributable to that right proportionate to their participation in the arrangement, or have rights in respect of the invention.

238. New section 357GC(2) treats a company, which is party to the cost-sharing arrangement but which does not hold the qualifying IP rights created or developed under the arrangement, as if it did hold those qualifying IP rights.

239. However, new section 357GC(3) prevents this treatment where the income received by the company in respect of its contributions to the arrangement is economically equivalent to interest.

240. New section 357GC(4) ensures that cost-sharing arrangements which lead to the development of new ways to use or apply an invention are included in the same way as those which seek to develop the invention itself.

241. New section 357GD defines a group for the purposes of the Patent Box regime. This is a company, A, and any other company that is associated with company A. For this purpose, a company (company

B) is associated with company A at any time during an accounting period of company A if any one of following five conditions is met.

242. The first condition is that the financial results of company A and company B meet the consolidation condition. The consolidation condition is defined in new section 357GD(9).

243. The second condition is that company A and company B are connected. Sections 466 to 471 of CTA 2009 apply for the purposes of establishing connection.

244. The third condition is that company A has a major interest in company B or vice-versa. Major interest has the same meaning as in sections 473 and 474 of CTA 2009.

245. The fourth condition is that company A and a third company meet the consolidation condition and that third company has a major interest in company B.

246. The fifth condition is that company A and a third company are connected and that that third company has a major interest in company B.

247. New section 357GD(9) defines the consolidation condition in terms of the financial results of any two companies which :

- Are required to be fully consolidated into group accounts;
- if they are not required to be fully consolidated in such accounts, then this is due to a specific exemption; or
- whether or not there is a requirement for them to be fully consolidated, are actually fully comprised in group accounts.

248. New section 357GD(10) specifies that group accounts means accounts prepared under section 399 of the Companies Act 2006 or any corresponding provision of the law of a territory outside of the UK.

249. New section 357GE provides information on the interpretation of Part 8A.

250. New section 357GE(1) defines ‘invention’, ‘item’, ‘the OECD Model Tax Convention’, ‘the OECD Transfer Pricing Guidelines’ and ‘qualifying residual profit’.

251. New section 357GE(2) ensures that references to the calculations of the profits (or losses) of the trade for a company are to be read as calculations of profit or loss for corporation tax purposes.

252. New section 357GE(4) amends the index of defined expressions in Schedule 4 to the Corporation Tax Act 2010 to include expressions that are defined in part 8A.

Part 2: Amendments of TIOPA 2010

253. Paragraphs 2 to 6 make changes to the transfer pricing rules contained in the Taxation (International and Other Provisions) Act (TIOPA) 2010 including changes to the exemption from the requirement to calculate profits and losses of a potentially advantaged person in accordance with arm's length principles where that person is a small or medium sized enterprise for a chargeable period.

254. Paragraph 4 inserts a new section 167A to TIOPA 2010.

255. New section 167A provides an exception to the general exemption from transfer pricing requirements for a company that is a small enterprise in the chargeable period. This exception applies where the Commissioners for Her Majesty's Revenue and Customs have issued a transfer pricing notice to the company. Such a notice may relate only to provisions affecting the calculation of relevant IP profits under part 8A of CTA 2010. A medium sized enterprise can already be required to use arm's length principles in respect of any provision where a notice to that effect is issued under section 168 TIOPA.

Part 3: Commencement and transitional provisions

256. Paragraphs 7 and 8 set out the commencement and transitional provisions.

257. Paragraph 7 applies the changes made by the Schedule to income arising on or after 1 April 2013. Where the first accounting period to which an election under new section 357A relates straddles the commencement date, only income and expenses arising after commencement is to be taken into account for the purposes of computing its relevant IP profits. Where it is necessary to apportion income or expenses between pre- and post-commencement periods, then this may be done on any basis that provides a just and reasonable result.

258. Paragraph 8(1) provides for the benefits of an election under new section 357A to be progressively increased in relation to relevant IP profits arising in each of the Financial Years 2013 to 2017. For 2013, relevant IP profits to be included in the calculation set out in new section 357A(3) are 60 percent of the amount otherwise calculated in accordance with the Schedule. This rises by 10

percent in each succeeding Financial Year up to and including Financial Year 2017.

259. Paragraphs 8(2) to (4) set out how to determine the set-off amount in respect of an accounting period in the Financial Years affected by the phasing in rule in paragraph 8(1). Where a set-off amount is carried forward to a later accounting period under new section 357EB or 357EC, the amount brought forward is reduced incrementally by 10 per cent per annum, the rate at which benefits are phased in under paragraph 8(1), to give the actual set-off amount.

260. Paragraph 8(5) provides for an apportionment to be made of the profits of an accounting period that falls within more than one Financial Year.

BACKGROUND NOTE

261. The new Patent Box regime will allow companies to elect to apply a 10 per cent rate of corporation tax, starting from 1 April 2013 on a progressively incremental basis with the full rate applying from 1 April 2017, to all profits attributable to qualifying patents, and certain other IP rights.

262. The regime will also apply to other qualifying intellectual property rights such as regulatory data protection (also called data exclusivity), supplementary protection certificates and plant variety rights.

263. Other non-qualifying profits in these companies will continue to be taxed at the main rate of corporation tax.

264. The Patent Box regime will potentially benefit a wide range of companies which receive royalties in respect of qualifying IP rights, sell products, or use patented processes as part of their business.

265. Two consultation documents have been published:

- November 2010: *The Taxation of Innovation and Intellectual Property.* This sets out the high level principles for the Patent Box design and;

- June 2011: *Consultation on the Patent Box*. This is the Stage 2 consultation document which gives more detail on the design proposals.

266. A consultation response document was published in December 2011, along with a *Technical Note and Guide to the Draft Legislation*. An updated *Technical Note and Guide to the Legislation* is being published in March 2012 which reflects the changes made to the draft legislation since December 2011.

EXPLANATORY NOTE

CLAUSE 20 SCHEDULE 3: RELIEF FOR EXPENDITURE ON R&D

SUMMARY

1. Clause 20 and Schedule 3 amend Part 13 of the Corporation Tax Act 2009 (CTA) to make a number of changes to research and development (R&D) relief for both small or medium (SME) and large companies.

DETAILS OF THE SCHEDULE

2. Paragraph 2 of the Schedule increases the rate of the additional deduction for R&D expenditure provided by section 1044 CTA 2009 from 100 per cent to 125 per cent for SME companies.

3. It also increases the relief for pre-trading expenditure claimed as a deemed trading loss by a corresponding amount and reduces the rate of payable tax credit for a SME to 11 per cent of the surrendered loss.

4. Paragraphs 3 to 8 remove, for both SMEs and large companies, the £10,000 per annum minimum R&D expenditure.

5. Paragraphs 9 to 14 clarify that a company in administration or liquidation is not a going concern for the purposes of SME R&D relief and Vaccine Research Relief.

6. Paragraph 15 removes the restriction, to the level of the company's PAYE and NIC liabilities, of the amount of tax credit a SME company may claim.

7. Paragraphs 16 to 32 abolish Vaccines Research Relief (VRR) for SMEs.

8. Paragraph 33 extends both the definition of "externally provided worker" in section 1128 and the qualifying expenditure allowable on "externally provided workers" in section 1129 of CTA 2009. It removes the previous restriction where relief could only be claimed in contractual arrangements involving three parties and applies in both connected party and unconnected situations

BACKGROUND NOTE

9. Additional tax relief for expenditure on R&D was introduced in 2000 for SME companies and in 2002 for all other companies. Further

relief - VRR - was introduced in 2003 for expenditure into vaccines and medicines for strains of TB, malaria and Aids/HIV prevalent in the developing world.

10. A consultation document "Corporate Tax reform: delivering a more competitive system" was published on 29 November 2010 on the HM Treasury website and included consultation on the R&D tax relief. A response document, "Research and Development Tax Credits: response and further consultation" was published on 10 June 2011, and a further response on 6 December, both on the HM Treasury website.

11. Budget 2011 announced increases to the rate of SME R&D relief, together with abolition of the PAYE/ NIC limit and £10,000 pa minimum expenditure.

12. The SME R&D Relief currently gives an additional deduction equal to 100 per cent of the qualifying expenditure. This, combined with the normal deduction for such expenditure, gives a total of 200 per cent.

13. Losses arising from expenditure on R&D can be surrendered by a loss making company in return for a payment at a rate of 12.5 per cent. giving relief of 25 per cent on the original expenditure.

14. The rate of the additional deduction is to be increased to 125 per cent for expenditure incurred on or after 1 April 2012. The rate at which losses can be surrendered will be reduced to 11 per cent, giving relief overall worth 24.75 per cent of the R&D expenditure. The reduction is necessary to keep the value of the relief within the 25 per cent. threshold set out in EU State aid rules.

EXPLANATORY NOTE

CLAUSE 21 SCHEDULE 4: REAL ESTATE INVESTMENT TRUSTS

SUMMARY

1. Clause 21 and Schedule 4 amend Part 12 (Real Estate Investment Trusts) (REIT) of the Corporation Tax Act 2010 (CTA). The amendments relax the conditions of entry to the REIT regime and the requirements while in the regime.

DETAILS OF THE SCHEDULE

2. Paragraph 1 introduces amendments to Part 12 of CTA 2010. All references to amendments to legislation are to Part 12 CTA 2010.

3. Paragraph 2 amends section 525 which requires a company or group that gives a notice to be a REIT to include in the notice a statement that it can meet the REIT regime conditions, including those in section 528 (the company conditions). The amendments change the form of the notice to be given to reflect the changes being made to section 528 as detailed at 4. and 12. below.

4. Paragraph 3 amends section 527 which sets out the conditions for being a REIT in an accounting period. Condition D in section 528, which states that a REIT cannot be a close company, will not apply for the first three years after a company joins the regime.

5. Paragraph 4 amends condition D in section 528, that a REIT cannot be a close company, so that the shareholding of an institutional investor will not, on its own, make a company close for REIT purposes. Paragraph 4 also introduces a new subsection 4A which defines what an institutional investor is for these purposes. In addition new subsection 4B grants a power to make regulations concerning the definition of who is or is not to be regarded as an 'institutional investor' for the purposes of this section.

6. Paragraphs 5-6 amend sections 558 and 559, which cover how the demerger of a REIT is dealt with, to accommodate the changes being made to the conditions to be met by a REIT in section 527.

7. Paragraphs 7-8 amend sections 561 and 562 which deal with breaching the REIT conditions in section 528, so that the REIT does not have to give notice that it has not met condition D in section 528 in the first three years after joining the regime as a consequence of the amendment to section 527.

8. Paragraph 9 introduces new section 562A which determines the circumstances when a breach of condition D in section 528 is either to be ignored or to result in the REIT leaving the regime.

9. Paragraphs 10-11 amend section 572 which deals with notices to leave the regime and introduce new section 573A, so that a notice to leave the regime can be issued in certain circumstances where condition D in section 528 is not met. New section 573A also sets out the time at which the REIT will be taken to have ceased being a REIT.

10. Paragraph 12 amends paragraph 577, which deals with multiple breaches of the conditions by which a company or a group qualifies as a REIT, to reflect the changes being introduced to condition D in section 528.

11. Paragraph 13 provides that the changes in paragraphs 2 – 12 will apply to those electing to become REITs with effect from on or after the date of Royal Assent to the Finance Bill and for existing REITs for accounting periods beginning on or after Royal Assent to the Finance Bill.

12. Paragraphs 14-20 amend section 528(3), the REIT company condition that requires that shares in the company are listed on a recognised stock exchange. The amendment provides that alternatively the condition is met if shares are admitted to trading on a recognised stock exchange. New section 528A is introduced which requires that shares admitted to trading on a recognised stock exchange are listed or traded. This requirement is relaxed in a new REIT's first three accounting periods by section 528B. The introduction of new sections 562B and C deal with when a breach of new section 528A can be ignored and with the consequence, if the breach is not to be ignored, that the group or company ceases to be a REIT from the end of its second accounting period. Section 573B ensures that a REIT can only benefit from section 528B once.

13. Paragraph 21 provides that the changes in paragraphs 14-20 will apply to all REITs for accounting periods starting on or after the date of Royal Assent to the Finance Bill except to the extent, that if they are an existing REIT, they are able to take advantage of the relaxation to section 528A provided by section 528B.

14. Paragraph 22 amends section 530 which requires that 90 per cent of the profits of the property rental business have to be distributed by the date at which the REIT's tax return is filed. This is referred to as the 'distribution requirement'. The amendment extends the date by which profits have to be distributed from three months after the filing date to six months after the filing date. This amendment only applies in

particular circumstances where a stock dividend has been issued and a market value of the stock dividend has had to be used in accordance with section 530(6C)(b) and this has caused the distribution requirement not to be met.

15. Paragraph 23 introduces new section 530A which deals with how the distribution requirement (see 14 above) is to be met in situations where profits of the property rental business are increased after the tax return has been submitted. This clarifies under what circumstances additional time is given to meet the distribution requirement and when a charge to tax for not meeting the distribution requirement can be made.

16. Paragraphs 24-26 amend sections 564 and 565, which charge tax on the amount by which the distribution requirement is not met. The amendments clarify when a charge to tax can be made when the distribution requirement is not met and include the circumstances where the time limit is extended under section 530 or new section 530A. The change in paragraph 22 will apply to distributions made on or after the date of Royal Assent to the Finance Bill. The changes in paragraphs 23 – 25 will apply to accounting periods starting on or after Royal Assent to the Finance Bill.

17. Paragraph 27 amends section 531 ‘conditions as to the balance of business’. This requires that at the beginning of an accounting period, the REITs profits and assets are primarily derived from and involved in its property rental business. Currently condition B in section 531 requires that at least 75 per cent of the assets of the group or company relate to the property rental business. Following amendment the requirement will be that cash and assets involved in the property rental business should be at least 75 per cent of the total assets of the business.

18. Paragraphs 28-32 deal with the consequential changes from paragraph 27 and provide that the changes in paragraphs 27, 28 and 31 will apply to accounting periods beginning on or after Royal Assent and the changes in paragraphs 29 and 30 for REITs joining the regime after Royal Assent.

19. Paragraphs 33-39 abolish the entry charge for companies entering the REIT regime. The abolition applies to those companies that enter the regime on or after the date of Royal Assent to the Finance Bill.

20. Paragraphs 40- 42 amend sections 543 and 544 which limit the amount of property financing costs that a REIT can pay in connection with its tax exempt business. For accounting periods starting on or after the date of Royal Assent to the Finance Bill, the limit will be based on interest and other payments for borrowing and will exclude

the costs of arranging loan finance and other accounting costs will no longer be included. The amendments also limit the amount charged to corporation tax under section 543 (4) to an amount equal to 20 per cent of the property profits.

21. Paragraphs 43-44 amend section 556 which deals with the tax treatment of an asset of the property rental business that is disposed of by way of a trade (ie the disposal is taxed). The amendment ensures that section 556 does not apply to disposals made to another member of the REIT. The amendment takes effect where the disposal is on or after the date of Royal Assent to the Finance Bill.

BACKGROUND NOTE

22. REITs are a tax advantaged vehicle introduced to encourage investment in the property sector. REITs are exempted from corporation tax on the profits and gains arising from their property rental business. REITs have to distribute 90 per cent of the profits of the property rental business to shareholders in whose hands this income is treated as income from property. In this way taxation of income from property is moved from the corporate level to the investor level.

23. The REIT regime was introduced in Finance Act 2006. The legislation was subsequently rewritten to CTA 2010. To date, over 20 REITs have been created with particular focus on commercial property investment.

24. The Government indicated in its response to the 2010 Private Rental Sector consultation that it would look further at the barriers to entry to the REIT regime with the view to facilitating, in the longer term, the establishment of residential REITs. Subsequent further consultation with interested parties suggested that the best way to support the REITs industry in general (and the development of residential REITs in particular) was among other things, to reduce barriers to entry for new REITs and to ensure that the regime does not work so as to inhibit good business practice.

EXPLANATORY NOTE

CLAUSE 22: TREATMENT OF THE RECEIPT OF MANUFACTURED OVERSEAS DIVIDENDS

SUMMARY

1. This clause clarifies the legislation on manufactured overseas dividends (MODs). That legislation provides that where a MOD is received under deduction of tax, some or all of that tax may be treated as overseas tax. The change makes it clear that where there is a difference between the tax deducted, and the tax treated as overseas tax, the difference is not treated as income tax. This clause also makes a similar change for deemed manufactured payments under some stock lending arrangements. The amendments have effect in relation to overseas dividends paid on or after 15 September 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces amendments to the provisions in Part 17 of the Corporation Tax Act 2010 (CTA 2010) which cover the treatment of companies receiving MODs.

3. Where a company receives a MOD, and tax has been deducted under section 922(2) of the Income Tax Act 2007 (ITA 2007), then sections 792 and 793 of CTA 2010 provide that some or all of the tax deducted may be treated as overseas tax.

4. Subsection (2) inserts a new subsection (8) into section 793 of CTA 2010. The new subsection provides that if the amount mentioned in section 792(3)(b) (that is, the amount treated as withheld on account of overseas tax) is not the amount deducted under section 922(2) of ITA 2007, then nothing in the Tax Acts has the effect that the difference between the amounts is to be regarded as an amount on account of income tax.

5. Section 812 of CTA 2010 provides that where there is a stock lending arrangement, dividend or interest income is received by someone other than the lender of the security, and the arrangement does not provide for the lender to receive payments representing the dividend or interest, then the borrower is deemed to have paid a manufactured payment to the lender on the date when the real dividend or interest was paid. Sub-sections 812 (4) and (5) have the effect that tax withheld from these deemed manufactured payments is not treated as overseas tax.

6. Subsection (3) inserts new subsection (5A) into section 812 which provides that any amount, that would otherwise have been treated as an amount withheld on account of overseas tax from the dividends arising in the circumstances covered by section 812, is not an amount on account of income tax.

7. Subsection (4) provides that the amendments made by this clause have effect in relation to overseas dividends paid on or after 15 September 2011.

BACKGROUND NOTE

8. Financial traders and other participants in the financial markets commonly transfer shares on a temporary basis from one party to another as a form of secured loan or to gain access to specific securities. Payments known as MODs are often made by the temporary holder of shares to the original owner as compensation for the dividends arising on the shares which are received by the temporary holder.

9. Where a MOD is paid, the payer must deduct a sum representing income tax equal to the relevant withholding tax on the MOD. A company receiving a MOD from which tax has been deducted is treated as if it had received an overseas dividend paid after withholding a certain amount of overseas tax. The amount of overseas tax treated as withheld can vary between nil and a maximum of the amount deducted.

10. Where the amount treated as overseas tax is less than the amount deducted, it has been suggested that the difference between the two amounts should be treated as income tax, available for set-off or repayment. HM Revenue and Customs does not agree that this is the effect of the legislation but subsection (2) of the amendment introduced by this clause puts it beyond doubt that it is not treated as income tax.

11. Subsection (3) applies to certain deemed manufactured overseas dividends under stocklending arrangements, and has a similar effect to subsection (2), clarifying that withheld tax is not to be treated as income tax.

EXPLANATORY NOTE

CLAUSE 23: LOAN RELATIONSHIPS: DEBTS BECOMING HELD BY CONNECTED COMPANY

SUMMARY

1. Clause 23 modifies the corporation tax rules on loan relationships that apply when the parties to a loan relationship become connected. The clause changes the circumstances in which companies that become connected with pre-existing debt bring in a deemed release in respect of that debt, and the calculation of the amount of that deemed release. It inserts a new anti-avoidance rule to ensure that the existing rules relating to deemed releases can not be circumvented. It also inserts a retrospective provision in relation to particular arrangements circumventing the existing rules where a company becomes creditor to a loan relationship on or after 1 December 2011 and before 27 February 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the loan relationships rules in Chapter 6 of Part 5 of the Corporation Tax Act 2009 (CTA) to be amended. The amendments are to section 362 of CTA under which, a debtor company brings in a deemed release when the debtor and creditor companies become connected and the debt is impaired, and the insertion of a new section 363A.

3. Subsection (2)(a) amends section 362 of CTA so that it applies to all cases where previously unconnected parties to a loan relationship, as debtor (D) and creditor (C) respectively, become connected. Previously section 362 applied where the creditor's rights under the loan relationship were subject to an impairment adjustment.

4. Subsection (2)(b) substitutes new sections 362(3) and 362(4).

5. New section 362(3) changes the calculation of the amount treated as released to the amount by which the pre-connection carrying value (PCCV) of the debt in D's accounts exceeds the PCCV of the debt in C's accounts.

6. New subsection 362(4) defines the PCCV for D and C.

7. Subsection (2)(d) amends the title of section 362 of CTA as the new section no longer only applies to debts where the creditor's rights are subject to an impairment adjustment.

8. Subsection (3) inserts a new section 363A in CTA which will apply to nullify the effect of arrangements that are entered into where the main purpose, or one of the main purposes, of any party entering into the arrangements is to avoid or reduce an amount treated as released under section 361 or 362. ‘Arrangements’ are defined in new section 363A(3).

9. Subsections (4) to (7) set out the commencement provisions. The amendments made to section 362 of CTA have effect where companies become connected on or after 27 February 2012. However, where the companies become connected on or after 27 February 2012 and before 1 April 2012 different subsections (3) and (4) are substituted. Subsection (3) changes the calculation of the amount treated as released to the greater of two amounts. The first amount is similar to that which currently arises under section 362(1)(c) of CTA. The second is the amount by which the pre-connection carrying value (PCCV) of the debt in D’s accounts exceeds the PCCV of the debt in C’s accounts. Subsection (4) defines the PCCV for C and D. New section 363A of CTA will have effect where arrangements are entered into on or after 27 February 2012 or, where the arrangements are entered into before that date, in relation to deemed releases arising on or after that date.

10. Subsections (8) to (12) sets out provisions applying where arrangements are entered into which lead directly or indirectly to, or in consequence of which, company “C” becomes party to a loan relationship as creditor on or after 1 December and before 27 February 2012 and C becomes connected to the debtor before 27 February 2012. ‘Arrangements’ are defined in subsection (9). Where this rule applies the conditions at sections 361(1)(a) to (c) of CTA will be deemed to be met. Thus section 361 of CTA will apply to C at the point it becomes party to the loan relationship.

11. Subsection 10 ensures, in particular, that the normal loan relationship rules apply for partnerships involving companies.

12. Subsection 11 prevents anything done after 27 February 2012, for example a change or a decision to change partnership profit shares or accounting dates, affecting the application of section 361 in accordance with subsection (8) of this clause.

13. Subsection 12 prevents double taxation. If section 361 of CTA applies to a case as a result of subsections (8) to (10) of this clause, then section 362 of CTA will not also apply at the point that C becomes connected to D.

BACKGROUND NOTE

14. The rules that apply to loan relationships work on the principle that amounts taxed and relieved as credits and debits under those rules are the profits and losses arising in accounts drawn up in accordance with generally accepted accounting practice. When a debt is impaired or written off by a creditor company its expense will normally be allowable as a loan relationship debit. When a debtor company is released from a debt it owes, its profit will be taxable as a loan relationship credit.

15. Where a debt exists between connected companies, such credits and debits are not normally brought into account for tax purposes. Specific rules prevent exploitation of this exception when debt is acquired by a new creditor connected to the debtor or when previously unconnected creditors and debtors become connected. This is achieved by imposing a deemed release on the debtor if the debt has been purchased at a discount by a connected creditor or the debt is impaired when the creditor and debtor become connected.

16. HM Revenue & Customs have become aware of arrangements that have been entered into to avoid the tax charge that would normally arise in these circumstances. The changes to the rules both prevent these and similar arrangements achieving this effect from 27 February 2012 and in relation to the particular arrangements retrospectively to 1 December 2011.

17. The calculation of the amount of a deemed release where unconnected parties to a loan relationship become connected was amended in response to comments on the draft legislation published on 27 February 2012. This change has effect from 1 April 2012.

EXPLANATORY NOTE

CLAUSE 24: COMPANIES CARRYING ON BUSINESSES OF LEASING PLANT OR MACHINERY

SUMMARY

1. This clause makes changes to the provisions dealing with the sale of a lessor company in the Corporation Tax Act (CTA) 2010 to ensure that the legislation continues to protect the Exchequer from risks that tax could be lost following a sale of a lessor company. The changes made by this clause will have effect from 21 March 2012 to prevent a risk of forestalling.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces the amendments to CTA 2010.

3. Subsection (2) substitutes new sections 385(2) and (3) into section 385 and makes a consequential amendment to the title.

4. New section 385(2) prevents a loss, carried back under section 37(3)(b) CTA 2010 (relief for trade losses against total profits of earlier accounting periods), from being deducted from profits that are derived from the income amount calculated under the sale of lessors provisions.

5. New section 385(3) identifies that part of the profit derived from the income by treating it as the final amount to be added.

6. Subsection (3) makes a consequential amendment as a result of the insertion of new section 394ZA.

7. Subsection (4) inserts new section 394ZA.

8. New section 394ZA provides that there is a relevant change in the relationship between a lessor company (A) and a principal company on the day before the day on which, for the purposes of Schedule 22 to the Finance Act (FA) 2000 (tonnage tax), a company enters the tonnage tax regime.

9. Subsection (5) makes changes to section 394A to add a further subsection. New section 394A(2) ensures that if there is a qualifying change in the ownership of a company as a result of section 394ZA then the change of ownership is treated solely as occurring as a

consequence of new section 394ZA regardless of whether there have simultaneously been other changes in the relevant relationship between A and a principal company.

10. Subsection (6) makes changes to provisions dealing with the carry back of losses in the context of a leasing business carried on by a company in partnership. It makes changes to section 427 of CTA 2010 to substitute new sections 427(2) and (3) into section 472 and substitutes a new title to the section.

11. New section 427(2) prevents a loss, carried back under section 37(3)(b) of CTA 2010 (relief for trade losses against total profits of earlier accounting periods) in the notional trade carried on by the partner company, from being deducted from profits that are derived from the income amount calculated under the sale of lessors provisions.

12. New section 427(3) identifies that part of the profit derived from the income by treating it as the final amount to be added.

13. Subsection (7) makes consequential changes to section 950 of CTA 2010 (transfers of trade without change of ownership) to ensure that the qualifying change in ownership of a lessor company brought about by section 394ZA is reflected in section 950.

14. New section 950(3A) prevents the tax neutral treatment of a transfer of plant or machinery into a lessor company that has moved into tonnage tax. It does this by treating the principal company or companies of the predecessor and successor companies as different if they would otherwise have been the same. The subsection applies if the lessor company is the successor and there is a relevant change in its relationship with a principal company as a consequence of section 394ZA at any time on or before the day of the transfer. The section makes clear that this treatment applies even when the change in the relationship took place before 21 March 2012.

15. Subsections (8) to (10) deal with commencement.

16. Subsection (8) deals with the effect of the change in the availability of losses to carry back against total profits. The new rules apply when the relevant day falls on or after 21 March 2012 or where there is a qualifying change of ownership as a result of the company entering tonnage tax on or after 21 March 2012.

17. Subsection (9) deals with the effect of new section 394ZA. These provisions have effect where a company enters tonnage tax on or after 21 March 2012.

18. Subsection (10) provides that new section 950(3A) has effect where the transfer day is on or after 21 March 2012.

BACKGROUND NOTE

19. The sales of lessors provisions were introduced in FA 2006 to counter a risk that tax would not be paid on the profits of a leasing business following a sale of the company. There is a similar risk if a lessor company becomes subject to the tonnage tax rules so that its profits cease to be calculated by reference to the normal corporation tax rules. The move into tonnage tax can be achieved in a number of ways without triggering the effect of the sales of lessors provisions and the change in the method of computing profits for tax purposes means that the deferred profits will not brought into charge to tax.

20. The changes made by this clause will ensure that the effect of the sales of lessors provisions is triggered when a company enters tonnage tax so that tax can be collected on the deferred profits of the company.

21. The sales of lessors provisions are designed to collect tax on the deferred profits of the company through an income amount added to the profits in the accounting period when the company changes hands. A matching expense is delivered in the following accounting period and rules prevent this expense from being carried back against the earlier profits and thereby cancelling the effect of the income amount.

22. The changes made by this clause refocus these restrictions so that any loss from an accounting period after a change of ownership cannot be carried back against the profits of the company that are derived from the income amount. This restriction prevents groups from arranging their affairs so that losses are available in the lessor company after the change of ownership which can be used to cancel the effect of the income amount.

EXPLANATORY NOTE

CLAUSE 25: CORPORATE MEMBERS OF LLOYD'S: STOP-LOSS INSURANCE AND QUOTA SHARE CONTRACTS

SUMMARY

1. Clause 25 introduces new rules for the taxation of premiums payable by corporate members of Lloyd's under stop-loss insurance. It also includes an anti-avoidance provision in respect of quota share contracts.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts new subsections (3C) to (3G) into section 225 of Finance Act 1994 (FA).

3. New section 225(3C) provides that the tax treatment described in new section 225(3D) shall apply to any premium payable by a corporate member of Lloyd's in respect of that member's underwriting business which is not already taxed under the rules in section 220(2)(a) of FA 1994.

4. New section 225(3D) sets out the tax treatment for a premium which meets the description in new section 225(3C). The premium will be treated as if it were an amount that had arisen directly as a consequence of that member's membership of the syndicate or syndicates in respect of which the stop-loss insurance was taken out. In addition, it will be treated as if it were payable in the underwriting year in which the profits or losses of those activities are declared.

5. New section 225(3E) provides for the situation where a stop-loss insurance premium is payable in respect of two or more underwriting years. The premium payable in respect of each of those years for the purposes of new section 225(3D) must be determined on a just and reasonable basis.

6. New section 225(3F) sets out the tax treatment where a corporate member of Lloyd's enters into a quota share contract and the main purpose, or one of the main purposes, for entering into that contract was to avoid the tax treatment set out in new section 225(3G). In such a case, the contract will be treated as if it were a stop-loss insurance and any amounts payable under the contract will be treated as premiums. The deemed premiums will be taxed in accordance with new section 225(3D).

7. New section 225(3G) describes the tax treatment referred to in new section 225(3F), the attempted avoidance of which triggers the operation of new section 225(3F). The relevant tax treatment is that amounts are treated as payable in the underwriting year in which the profits or losses arising to a corporate member directly from its membership of one or more syndicates are declared.

8. Subsection (2) provides that the amendment made by this section applies to stop-loss insurance (as defined by section 230(1) of FA 1994) and quota share contracts (as defined by section 225(4) of FA 1994) taken out or entered into on or after 6 December 2011.

9. Subsection (3) provides for the situation where a corporate member enters into a multi-year contract before 6 December 2011. Insurance is deemed to be taken out on the anniversary date of the contract falling on or after the date this Act is passed. Premiums payable under the contract for an underwriting year beginning on or after the day this Act is passed are premiums to be dealt with in accordance with the amendments made to section 225 of FA 1994 by this section.

10. Subsection (4) defines the terms “multi-year contract” and “the anniversary date of the contract”.

11. Subsection (5) provides for the situation where a corporate member enters into a contract for insurance in respect of an underwriting year before 6 December 2011 and that contract is renewed on or after 6 December 2011 for a further underwriting year. Insurance is regarded as taken out on the date of renewal.

BACKGROUND NOTE

12. Following the Budget 2011 announcement, the Government has been consulting with Lloyd’s and interested parties on proposals to amend the timing of the tax deduction for Lloyd’s member-level stop-loss premiums.

13. Taking into account these discussions, the Government has decided to amend the timing of the tax deduction for all premiums payable by corporate members of Lloyd’s in respect of member-level stop-loss insurance taken out on or after 6 December 2011. The legislation will align the timing of the tax deduction for the premiums with the recognition of the profits to which they relate.

14. Following consultation on the draft legislation published on 6 December, the Government decided to make further provisions to deal with multi-year contracts and renewals of contracts taken out before 6 December 2011.

EXPLANATORY NOTE

CLAUSE 26: ABOLITION OF RELIEF FOR EQUALISATION RESERVES: GENERAL INSURERS

SUMMARY

1. This clause repeals sections 444BA to 444BD of the Income and Corporation Taxes Act 1988 (ICTA) that provide for tax relief for equalisation reserves maintained by general insurance companies. It also sets out transitional provisions following on from the repeal

DETAILS OF THE CLAUSE

2. Subsection (1) repeals sections 444BA to 444BD of ICTA.

3. Subsection (2) sets out consequential repeals arising from the repeal of sections 444BA to 444BD of ICTA.

4. Subsection (3) provides that the amendments made by this clause shall have effect in relation to accounting periods ending on or after a date to be specified in a Treasury order. Different days may be specified for different cases.

5. Subsection (4) provides that one sixth of an insurance company's existing equalisation or equivalent reserve is to be treated as a receipt of the company's business in each of the six calendar years beginning with the calendar year in which the date specified in an order made by the Treasury falls.

6. Subsection (5) provides that if there are different accounting periods falling in a calendar year, the receipt is to be apportioned between those periods by reference to the number of days of the calendar year falling in those periods.

7. Subsection (6) provides that if a company ceases to carry on the business in a calendar year before the expiry of the six year period referred to in subsection (4) any remaining balance of the existing equalisation or equivalent reserve is to be treated as a receipt of the company's business in the accounting period in which the company ceased to carry it on.

8. Subsection (7) defines the terms "equalisation reserve", "equivalent reserve", "existing equalisation or equivalent reserve" and "the company's business".

9. Subsection (8) sets out the tax treatment where an insurance company has made an election under section 444BA(4) of ICTA for an accounting period ending before the date specified in a Treasury order and such a sum would have been carried forward as a deductible amount. The amount shall be deducted from the amount of the equalisation or equivalent reserve as it stood immediately before the accounting period to which it would have been carried forward.

10. Subsection (9) provides that references to section 444BA of ICTA include that section as modified by sections 444BB or 444BC of that Act.

BACKGROUND NOTE

11. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

12. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

13. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

14. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a 6 year period commencing from the date that the Solvency II capital requirements come into force. Insurers may also elect to have the full remaining balance of the built-up reserve released to tax in any calendar year during the transitional period.

EXPLANATORY NOTE

CLAUSE 27: ELECTION TO ACCELERATE RECEIPTS UNDER S.26(4)

SUMMARY

1. This clause provides rules to allow an insurance company to make an election to accelerate receipts arising to it under the rules applying in respect of the abolition of relief for equalisation reserves.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that an insurance company may make an election to treat as receipts of the business for a calendar year all of the receipts which would otherwise be treated as receipts of later calendar years.

3. Subsection (2) requires the election to be made in writing to an officer of Revenue and Customs within two years of the end of the calendar year for which it is made. Any such election is irrevocable.

4. Subsection (3) provides that if a company makes an election under section 29 for a calendar year concerning a transfer of business the company may not make an election under this section for the same calendar year.

BACKGROUND NOTE

5. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

6. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

7. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and

corporate and partnership members at Lloyd's, have been included in the consultation process.

8. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a six year period commencing from the date that the Solvency II capital requirements come into force. Insurers may also elect to have the full remaining balance of the built-up reserve released to tax in any calendar year during the transitional period.

EXPLANATORY NOTE

CLAUSE 28: DEEMED RECEIPTS UNDER S.26(4): DOUBLE TAXATION RELIEF

SUMMARY

1. This clause provides rules for the amount to be brought into account in the calculation of double taxation relief where a receipt arises to it under the rules applying in respect of the abolition of relief for equalisation reserves.

DETAILS OF THE CLAUSE

2. Subsection (1) sets out three conditions for this section to apply. Firstly, a receipt must arise to a company as a result of section 26(4) and, secondly, that the company must carry on business through a permanent establishment (PE) outside the United Kingdom for which double taxation relief is due in respect of any income or gain. A third condition relates to the PE concerned and provides that the PE must be one to which double taxation relief regulations applied in respect of apportionment of transfers into an equalisation reserve.

3. Subsection (2) provides that only the appropriate proportion (if any) of the receipt is to be taken into account in calculating the profits or losses on which double taxation relief is calculated.

4. Subsection (3) defines the appropriate proportion of the receipt as being equal to the mean of each proportion found for the relevant period or any other proportion determined on a just and reasonable basis.

5. Subsection (4) defines, other than in cases where a just and reasonable basis has been determined by the company, a proportion for a relevant period as the proportion of the company's premium income constituted by the PE's premium income for the same period.

6. Subsection (5) provides definitions of "the company's premium income", "the PE's premium income" and a "relevant period".

7. Subsection (6) defines "net premiums written" and provides that references to section 444BA of the Income and Corporation Taxes Act of 1988 include that section as modified by regulations made under that Act.

BACKGROUND NOTE

8. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

9. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

10. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

11. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a six year period commencing from the date that the Solvency II capital requirements come into force. Insurers may also elect to have the full remaining balance of the built-up reserve released to tax in any calendar year during the transitional period.

EXPLANATORY NOTE

CLAUSE 29: TRANSFER OF WHOLE OR PART OF THE BUSINESS

SUMMARY

1. This clause provides rules to deal with the transfer of the whole or part of an insurance business where the transferor has receipts arising to it under the rules applying in respect of the abolition of relief for equalisation reserves.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that a transferor and transferee may jointly elect for receipts arising under section 26(4) to be treated in accordance with this section where an insurance company transfers the whole or part of the business to another insurance company under an insurance business transfer scheme.

3. Subsection (2) provides that if the transfer is of the whole of the business or substantially the whole of the business, section 26(6) will not apply. Instead, the receipt which would have arisen in the transfer year under section 26(4) had there been no transfer is apportioned between the transferor and transferee. Any future receipts which would have arisen under section 26(4) are treated as receipts of the transferee and not the transferor. Section 26(6) will apply to any subsequent cessation of business by the transferee.

4. Subsection (3) provides for a transfer of a part of a business which does not amount to substantially the whole of the business. The receipt arising under section 26(4) in the transfer year is apportioned between the transferor and transferee. Also, future receipts arising under section 26(4) are apportioned between the transferor and the transferee. Section 26(6) will apply to any subsequent cessation of business by the transferee.

5. Subsection (4) provides that the appropriate portion of the receipt for the purposes of subsection (3) shall be determined on a just and reasonable basis.

6. Subsection (5) provides that an apportionment under subsection (2)(b) or (3)(a) is to be made by reference to the number of days in the calendar year falling before and after the transfer date.

7. Subsection (6) provides that a receipt arising under section 26(4) which is treated as a receipt of the transferee is treated as a receipt of

the transferee's business which consists of or includes the transferred business.

8. Subsection (7) requires that an election under this section be made in writing to an officer of Revenue and Customs within 28 days from the end of the day on which the transfer of business takes place. Any such election is irrevocable. The election must be accompanied by an explanation of any determinations of issues made for the purposes of this section.

9. Subsection (8) defines "the transferred business" and the "transfer year".

10. Subsection (9) provides that this section will apply to the transferee in the capacity of transferor in respect of subsequent transfers of business by the transferee

BACKGROUND NOTE

11. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

12. The relief currently available is dependent on the regulatory requirement for general insurance companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

13. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

14. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a six year period commencing from the date that the Solvency II capital requirements come into force. Insurers may also elect to have the full remaining balance of the built-up reserve released to tax in any calendar year during the transitional period.

EXPLANATORY NOTE

CLAUSE 30: ABOLITION OF RELIEF FOR EQUALISATION RESERVES: LLOYD'S CORPORATE MEMBERS ETC.

SUMMARY

1. Clause 30 repeals section 47 of the Finance Act 2009 (FA) 2009. The repeal is not effective in relation to transitional provisions being made under this section which are capable of having effect after the date of the repeal.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that regulations made by the Treasury under section 47 of FA 2009 that revoke previous regulations made under that section may include provisions corresponding to the provisions made by section 26(4) to (8) and 27 subject to any modifications specified in the regulations.

3. Subsection (2) repeals section 47 of FA 2009.

4. Subsection (3) provides that the repeal shall have effect for accounting periods ending on or after a date specified in a Treasury order. Different days may be specified for different cases.

5. Subsection (4) provides that the repeal of section 47 of FA 2009 shall not affect any transitional or savings provisions made under section 47 in so far as those transitional or savings provisions are capable of having effect after the date specified in a Treasury order.

BACKGROUND NOTE

6. There is currently a regulatory requirement for general insurance companies (but not members of Lloyd's) to maintain equalisation reserves in respect of certain lines of business. From 1996, amounts transferred into equalisation reserves were made tax deductible and transfers out were treated as taxable receipts of the company's business.

7. Section 47 FA 2009 provided a power to apply similar treatment to Lloyd's corporate and partnership members. The power was used in 2009 to make regulations (The Lloyd's Underwriters (Equalisation Reserves) (Tax) Regulations 2009 (SI 2009/2039)) to allow Lloyd's corporate and partnership members to calculate and hold an

equivalent reserve for tax purposes only. Therefore, as with general insurance companies, amounts transferred into an equivalent reserve were made tax deductible and transfers out were treated as taxable receipts of the member's business.

8. The relief currently available to general insurance companies is dependent on the regulatory requirement for those companies to maintain equalisation reserves. As a result of the European Union Solvency II Directive that requirement will be withdrawn.

9. An informal consultation took place between April and August 2011 with an industry working group. Both the Association of British Insurers and Lloyd's, representing general insurance companies and corporate and partnership members at Lloyd's, have been included in the consultation process.

10. Taking into account these discussions, the Government has decided to repeal the legislation that allows tax relief for equalisation reserves. The Government has also decided to introduce a transitional period for the release of built-up reserves that involves spreading that release in equal instalments over a six year period commencing from the date that the Solvency II capital requirements come into force. Insurers may also elect to have the full remaining balance of the built-up reserve released to tax in any calendar year during the transitional period.

FINANCE BILL 2012

RESOLUTION 21 CLAUSE 31

SCHEDULE 5

EXPLANATORY NOTE

CLAUSE 31 SCHEDULE 5: TAX TREATMENT OF FINANCING COSTS AND INCOME

SUMMARY

1. This clause and Schedule amend the taxation of financing expenses and financing income – commonly called the debt cap.

DETAILS OF THE CLAUSEAND SCHEDULE

2. The clause introduces the Schedule amending the tax treatment of financing costs and income.

3. Paragraph 1 of the Schedule introduces the amendments to the provisions of Part 7 of the Taxation (International and other Provisions) Act 2010 (TIOPA) which sets out the debt cap rules.

4. Paragraph 2 makes a minor change to the definition of dormant company for the purposes of section 262.

5. Paragraph 3 amends section 276 by inserting new section 276(2A). Section 276 describes how an authorised company should be appointed to allocate the disallowance of deductions. New section 276(2A) ensures that relevant group companies that are dormant companies throughout the relevant period of account do not need to sign the appointment of an authorised company. Paragraph 5 introduces a similar rule for the appointment of an authorised company for the exemption of financing income through new section 288(2A).

6. Paragraphs 4 and 6 add an additional requirement to the existing requirements in sections 280 and 292 for statements of allocated disallowances and exemptions. The additional requirement in new section 280(5A) is that a disallowance cannot be allocated against a relevant group company's financing expense if at the time that the financing expense accrued the company was not a relevant group company of the worldwide group. There is a similar provision in new section 292(5A) for the exemption of financing income for a UK group company. Both of these new sections ensure that financing

expenses are disallowed or financing income exempted only if they accrue when the company is a member of the worldwide group.

7. Paragraph 7 inserts new section 296(2A) to amend the computation in section 296 for the failure of a group to submit a statement of allocated exemptions. This excludes from the computation the financing income that accrued to the company when it was not a UK group company.

8. Paragraph 8 introduces new section 305A which is anti-avoidance legislation. New section 305A applies if a large group attempts to remove itself from the application of the debt cap rules by ensuring that the group does not have any relevant group companies in the period of account. If a group does not have any relevant group companies then it is not a worldwide group for the purposes of the debt cap. The legislation has two conditions that have to be met before Part 7 can apply to the large group. The conditions are in subsections (3) and (4) of the new section 305A. The first condition is that during a period of account the group entered into a scheme and the main purpose or one of the main purposes for entering into the scheme or being a party to the scheme is to secure that the group does not contain any relevant group companies. The second condition is that the scheme is not an excluded scheme.

9. Paragraph 9 makes a minor change to the computation of financing expense amounts under section 313. It amends section 313(6) to allow adjustments to be made to financing expenses on a just and reasonable basis where part of the accounting period of the company falls outside the period of account of the worldwide group. It also introduces new section 313(6A) which allows for the amount of financing expenses to be reduced to nil. Paragraph 10 similarly amends section 314(6) and introduces new section 314(6A) for financing income.

10. Paragraph 11 removes section 316(4) which provided that if there was more than one group treasury company in a worldwide group then each of the group treasury companies had to make an election under section 316 for their financing expenses and financing income to be disregarded for the debt cap.

11. Paragraphs 12 and 13 amend sections 329(3) and 330(3) by removing the reference to a transaction and inserts “accrues” so it is clear that amounts that might not be thought of as transactions, such as interest, are included in any apportionment necessary because the company was not a relevant group or UK group company. They also insert new

sections 329(6) and 330(6). These allow an election to override the rules about the treatment of small amounts in sections 329(5) and 330(5).

12. Paragraph 14 inserts new section 331ZA into Part 7. This section enables worldwide groups to elect out of the "small amounts" rule for net financing deductions and net financing income of group companies. The election is made by the reporting body of the worldwide group and will apply to both net financing deductions and net financing income. The election requires the reporting body to provide certain information when making the election such as the first period of account to which it applies, details of the UK group companies at the time the election is made and of any UK group companies that have left the group between the beginning of the first period of account subject to the election and the date that the election is made.

13. New sections 331ZA(3) – (5) specify that the election has effect until it is withdrawn or replaced by a further election. The withdrawal of the election must be made by the reporting body of the worldwide group and must specify from when the election is withdrawn. If the reporting body of the worldwide group is the UK group companies acting jointly then dormant companies are not included in the reporting body.

14. New section 331ZA(6) requires that an election or withdrawal must be made in writing and be received by HMRC within 12 months of the end of the first period of account to which the election applies or for which the election is withdrawn. New section 331ZA(7) requires that the notice of election or withdrawal should be signed by the appropriate person. New section 331ZA(8) provides the definitions of "appropriate person", "relevant time" and "specified period of account".

15. Paragraph 15 inserts new section 337(2) into the definition of worldwide group. This is to ensure that the definitions of relevant group company in section 345 and worldwide group in sections 337 are not self-referential.

16. Paragraph 16 clarifies the definition of ultimate parent in section 339 to prevent foreign entities that would be partnerships if they were formed under UK law from being the ultimate parent of a worldwide group.

17. Paragraph 17 amends section 348 by inserting new section 348(6) which applies new section 348(7) if a group becomes or ceases to be a worldwide group in a period of account. In which case new section 348(7) requires that financial statements prepared for that period of account are ignored and section 348 applies as if the part of the period of account for which the worldwide group is in existence is the relevant period for section 348.

18. Paragraph 18 introduces new section 348A which deals with how the debt cap rules apply to a worldwide group before and after a business combination or demerger. New section 348A(1) has three conditions. The first is that a worldwide group is a party to a business combination or demerger, the relevant event. The second is that as a result of the relevant event there is a change in the ultimate parent of the worldwide group or any other group that is party to the relevant event. "Party to the relevant event" has a wide meaning and includes any groups that are involved in or are the subject of the relevant event. The final condition is that financial statements of the worldwide group are drawn up (or would be treated as drawn up under section 348 but for section 348A) for a period of account during which the relevant event occurs – the straddling period.

19. If these three conditions are met then new section 348A(2) applies Part 7 as if no financial statements had been drawn up by the worldwide group for the straddling period and section 348 does not apply to require the worldwide group to draw up financial statements for that period. Instead Part 7 applies as if financial statements had been drawn up in respect of a period of account beginning at the same time as the straddling period and ending the day before the relevant event and a second period of account beginning on the day of the relevant event and ending at the same time as the straddling period. In effect any worldwide group involved in the relevant event is required to finalise its debt cap computation for the period before the relevant event and begin a new debt cap computation from the date of that event.

20. New section 348A(3) defines "demerger" and applies the section 348(5) definition of IAS financial statements to new section 348A.

21. Paragraph 19 includes "business combination" in the list of expressions taking their meaning from international accounting standards in section 351.

22. Paragraph 20 includes "dormant company" in the list of other expressions in section 353. A dormant company is a company that is

dormant by virtue of section 1169 of the Companies Act 2006 and which is not subject to transfer pricing adjustments arising under section 147. The definition also includes non-resident companies that are dormant under legislation equivalent to section 1169 of the Companies Act 2006.

23. Paragraph 21 introduces a power to make regulations where a change in accounting standards effects how the ultimate parent of a group presents or discloses amounts in its consolidated financial statements. The power is to enable regulations to be made particularly in response to expected changes to International Financial Reporting Standards 10, 11 and 12.

24. New section 353AA allows the regulations to amend Part 7 if there is a relevant accounting change. A relevant accounting change is a change in the way that a company is required or permitted to present or disclose amounts in its consolidated accounts. A change in accounting standards includes the issue, revocation, amendment, recognition or withdrawal of recognition of accounting standards by an accounting body. The regulations may include an election. New section 353AA(5) allows the regulations to apply to a pre-commencement period which is defined as an accounting period or part of an accounting period that begins before the regulations are made. This will enable the regulations to apply to early adopters of the changes in accounting standards if necessary. The regulations will be made under the draft affirmative procedure or negative procedure depending on whether or not they have the effect of increasing any person's tax liability. New section 353AA(9) contains definitions of "accounting body", "accounting standard" and "pre-commencement period".

25. Paragraph 22 gives the commencement dates for the amendments. The power to make regulations where accounting standards change has effect for any change of accounting standards on or after the date of Royal Assent. All other amendments apply to periods of account of the worldwide group ending on or after the date of Royal Assent.

BACKGROUND NOTE

26. Finance Act 2009 (FA) 2009 introduced a package of changes to the taxation of companies on their foreign profits. This package included the introduction of a measure to restrict the interest and other finance expenses that can be deducted in computing the corporation tax payable by UK members of a worldwide group of companies.

27. The debt cap rules introduced as Schedule 15 to FA 2009 have now been rewritten as Part 7 of TIOPA 2010. They broadly operate by requiring UK groups to compare their UK financing costs, as calculated under the Schedule, with the finance costs of their worldwide group. If the UK costs exceed the worldwide costs then the UK companies do not get any relief for the excess.

28. Discussions with industry have identified that some amendments to the debt cap rules would be needed. A number of changes were made in Finance (No.3) Act 2010 but further issues have since arisen.

29. The current Schedule incorporates a small number of changes that arose from consultation with groups and their representatives.

EXPLANATORY NOTE

CLAUSE 32: GROUP RELIEF: MEANING OF "NORMAL COMMERCIAL LOAN"

SUMMARY

1. Clause 32 extends the definition of "normal commercial loan" to include loans that carry a right to conversion into shares or securities in quoted companies that are not connected to the company that issues the loan. This means that the holders of such loans are not considered to hold equity in the issuing company, and so ensures that the group status of the company will not be affected if it issues this type of loan.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that these changes will be made to the Corporation Tax Act (CTA) 2010.

3. Subsection (2) amends section 162(2)(c) of CTA 2010. Section 162(2) contains condition A which must be met in order for the loan to be a normal commercial loan. The amendment provides that condition A is satisfied if the loan carries a right to conversion into shares or securities in a quoted unconnected company (this is defined in subsection (4) of this clause).

4. Subsection (3) amends of section 164(2)(c) so that condition A in section 162(2) is also satisfied where the loan carries a right to conversion into securities that themselves carry a right to conversion into shares or securities in a quoted unconnected company.

5. Subsection (4) inserts a new subsection into section 162(2). New section 162(2A) provides that for the purposes of sections 162 and 164 a company is a quoted unconnected company where it is not connected to the company in which the relevant loan is held and its ordinary shares are listed on a recognised stock exchange.

BACKGROUND NOTE

6. Members of a group or consortium are determined by reference not only to ordinary share capital held, but also to beneficial entitlement to profits available for distribution to equity holders and assets available for distribution to equity holders in a winding up.

7. For these purposes, an equity holder includes ordinary shareholders and loan creditors in relation to loans other than normal commercial loans.

8. Prior to these amendments, loans that carried a right to conversion into the shares or securities of a wholly unconnected listed company would not have fallen within the definition of normal commercial loans; holders of such loans would be treated as equity holders. The amendments will ensure that such loans will be within the definition of normal commercial loans and the holders of the loans will not be treated as equity holders.

EXPLANATORY NOTE

CLAUSE 33: COMPANY DISTRIBUTIONS

SUMMARY

1. This clause provides that certain transactions involving transfers of assets or liabilities between UK resident companies are not excluded from being treated as distributions for the purposes of corporation tax, removing an anomaly left over from the repeal of Advance Corporation Tax by Finance Act (FA) 1998.

2. This clause also removes an overlap between different parts of the legislation which define what a distribution is.

DETAILS OF THE CLAUSE

3. Subsection (2) repeals section 1002 of the Corporation Tax Act (CTA) 2010. Section 1002 CTA excludes from the definition of distribution in section 1000(1) of CTA 2010, paragraph B ("paragraph B distribution"), transfers of assets or liabilities between:

   - UK resident companies neither of which is a 51 per cent subsidiary of a non-resident company and which are not under common control; or

   - UK resident companies where one is a 51 per cent subsidiary of the other, or both are 51 per cent subsidiaries of another UK resident company.

   Such transfers will now be paragraph B distributions if all other conditions are satisfied.

4. Subsection (3) inserts new subsection (2A) into section 1020 of CTA 2010. New subsection (2A) prevents a transfer of assets or liabilities being treated as a distribution under section 1000(1) of CTA 2010, paragraph G ("paragraph G distribution"), where the transfer is also a distribution under paragraph B, or would be if the exclusion of repayment of capital on the shares within paragraph B did not apply.

5. Subsection (4) repeals section 1021 of CTA 2010. Section 1021 of CTA 2010 provides for exception from treatment as a distribution under paragraph G transfers of assets or liabilities between:

- UK resident companies neither of which is a 51 per cent subsidiary of a non-resident company and which are not under common control; or

- UK resident companies where one is a 51 per cent subsidiary of the other, or both are 51 per cent subsidiaries of another UK resident company.

Such transfers will now be paragraph G distributions if all other conditions of are satisfied.

6. Subsection (5) makes consequential amendments.

7. Subsection (6) provides that the amendments apply to distributions made on or after the day on which the Finance Bill receives the Royal Assent.

BACKGROUND NOTE

8. Part 23 CTA 2010 covers the meaning of distribution for the purposes of corporation tax. This includes:

- any distribution out of the assets of the company in respect of shares except amounts that represent the repayment of capital on shares, ("paragraph B distribution") and,

- a transfer of assets or liabilities by a company to its member, or by a member to the company where the benefit to the member exceeds the consideration given by the member, ("paragraph G distribution").

Previously, a transfer of assets or liabilities between a company and its members could fall within both paragraph B and paragraph G if all other conditions of those sections were satisfied.

9. This clause will ensure that where the transfer is a paragraph B distribution, or would be if not for the exception for repayment of capital on the shares, it will not be treated as a paragraph G distribution.

10. Sections 1002 and 1021 CTA 2010 excluded from the definition of distribution in paragraph B and paragraph G respectively transfers of assets and liabilities between:

- UK resident companies neither of which is a 51 per cent subsidiary of a non-resident company and which are not under common control; and

- UK resident companies where one is a 51 per cent subsidiary of the other, or both are 51 per cent subsidiaries of another UK resident company.

11. The predecessor legislation to sections 1002 and 1021 CTA 2010 was introduced to relieve companies from the obligation to account for income tax or (after the imputation system was introduced by FA 1972) Advance Corporation Tax (ACT) on making a distribution in the form of a transfer of an asset or liability to another UK company. Since the abolition of ACT by FA 1998, the legislation is no longer required and is now producing anomalies, with tax treatment depending on the residence of the companies involved.

12. This legislation will align the tax treatment of transfers between UK resident companies with transfers between UK and non-UK resident companies, by allowing transfers between UK companies to be treated as distributions for the purposes of CTA 2010.

EXPLANATORY NOTE

CLAUSE 34: ANNUAL EXEMPT AMOUNT

SUMMARY

1. This clause sets the capital gains tax annual exempt amount (AEA) at its current level of £10,600 for 2012-13 and requires that it rises in line with the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI) from 2013-14 onwards. Automatic indexation of the AEA using the CPI remains subject to override if Parliament determines a different amount should apply.

DETAILS OF THE CLAUSE

2. <u>Subsection (2)</u> provides the AEA to be used in section 3(2) of the Taxation of Chargeable Gains Act (TCGA) 1992.

3. <u>Subsection (3)</u> replaces references to "RPI" and "retail prices index" in section 3 with "CPI" and "consumer prices index".

4. <u>Subsection (4)</u> inserts a definition of "consumer prices index" in section 288 of the TCGA 1992.

5. <u>Subsection (5)</u> states that the figure inserted by subsection (2) of this clause is the AEA for tax year 2012-13 and the base figure to be indexed in future tax years.

6. <u>Subsection (6)</u> disapplies automatic indexation for tax year 2012-13 in order that the AEA for that year is instead the figure inserted by subsection (2).

7. <u>Subsection (7)</u> provides that subsections (3) & (4) have effect for the tax year 2013-14 onwards.

BACKGROUND NOTE

8. Currently, where the RPI for the month of September is higher than the figure for the previous September, the level of the AEA for the following tax year increases in line with the percentage increase in the RPI, unless Parliament sets a different level.

9. At the Autumn Statement 2011, the Chancellor announced that the AEA for the tax year 2012-13 will be frozen at its current level of £10,600 and the planned switch from RPI to CPI, announced at Budget 2011, will take place from 2013/14.

EXPLANATORY NOTE

CLAUSE 35: FOREIGN CURRENCY BANK ACCOUNTS

SUMMARY

1. Clause 35 exempts individuals, trustees of settled property, and personal representatives of deceased persons from capital gains tax on gains made on withdrawals of money from bank accounts denominated in a foreign currency. The clause takes effect from 6 April 2012.

DETAILS OF THE CLAUSE

2. Subsection (4) of the clause makes the main change. It replaces the existing section 252 of the Taxation of Chargeable Gains Act 1992 (TCGA) with a new provision.

New section 252 TCGA

3. Section 252(1) restricts the scope of section 251 TCGA. Section 251 exempts gains on certain debts, including credit balances on bank accounts, from tax on chargeable gains. Where the debt is a "foreign currency debt", section 252(1) limits this exemption to gains accruing to individuals, trustees of settled property and personal representatives of deceased persons.

4. Section 252(2) defines "foreign currency debt" as a credit balance on a bank account in a currency other than sterling.

5. Subsections (2), (3) and (5) of the clause make other changes to the TCGA as a consequence of the main change in subsection (4).

6. Subsection (2) removes a redundant rule concerning the attribution of gains to members of non-resident companies in section 13(5)(c) that referred to the original version of section 252 TCGA.

7. Subsection (3) inserts a new section 251(5A) TCGA to make clear that relevant references in section 251 to debt include references to an interest in debts that a person holds, for example, as a joint owner of the account. It aligns section 251 with new section 252.

8. Subsection (5) repeals the rules in section 252A and Schedule 8A TCGA for calculating chargeable gains and allowable losses where individuals withdraw money from foreign currency bank accounts. The new section 252 prevents chargeable gains or allowable losses

from arising to individuals on any such withdrawals, rendering these rules redundant.

9. Subsection (6) provides for the changes to the TCGA to apply from 6 April 2012.

BACKGROUND NOTE

10. Under the TCGA, for capital gains tax purposes, gains and losses can arise on foreign currency bank accounts because the calculation must be made in sterling. If the exchange rate between sterling and the foreign currency in question changes between the time when the money was put into the account and the time when it is taken out, a gain or loss will arise.

11. At Budget 2011 the Government announced that it would reform the taxation of non-domiciled individuals, including measures to simplify aspects of the current remittance basis rules to remove undue administrative burdens. "Reform of the taxation of non-domiciled individuals: a consultation", issued on 17 June 2011, included a proposal to remove gains and losses on individuals' foreign currency bank accounts from the scope of capital gains tax (CGT).

12. This clause implements the simplification, and extends the exemption from CGT to trustees and personal representatives.

13. The original section 252 TCGA limits the exemption from CGT for foreign currency bank accounts to cases where individuals withdraw money that they have put into their account for personal expenditure abroad. The new section 252 replaces this with a broader exemption.

EXPLANATORY NOTE

CLAUSE 36: COLLECTIVE INVESTMENT SCHEMES: CHARGEABLE GAINS

SUMMARY

1. Clause 36 amends the Taxation of Chargeable Gains Act 1992 (TCGA) to provide a power for the HM Treasury to make regulations about the tax treatment of gains in the holdings of UK investors in assets subject to collective investment schemes and provides powers for HM Treasury to define in regulations the types of schemes affected.

DETAILS OF THE CLAUSE

2. New section 103C provides a power to make regulations about the treatment of investors in collective investment schemes for the purposes of tax on chargeable gains.

3. Regulations made under this section will cease to have effect unless approved by the House of Commons within 40 days.

4. The background note below provides details of the intended use of the power provided.

BACKGROUND NOTE

5. The Government has announced its intention to legislate to enable the UK regulator to authorise, under the UCITS IV directive[1], tax transparent collective investment schemes, to be constituted by contractual arrangements. The purpose of this clause is to provide powers for the appropriate tax treatment of gains made by UK investors on assets held in specified new types of collective investment scheme.

6. As the legislation to enable authorisation of specific types of tax-transparent collective investment scheme is yet to be enacted, this clause provides a power to specify the tax treatment of participants in collective investment schemes. It is anticipated that the power will be used on the enactment of legislation to authorise new schemes.

7. Specific anticipated uses of the power will be to:

a. provide that, for the purposes of tax on chargeable gains, assets held by the investors within certain tax transparent collective investment schemes will not be chargeable assets and that, instead, the investor's interest in the scheme will be treated as if it were a chargeable asset,

b. provide that, for assets held within a transparent scheme where interests in the scheme are treated as being the assets held by the investor then section 212 TCGA will apply to interests within the long term fund of an insurance company,

c. provide a relief for insurance companies which transfer assets to such transparent schemes that will ensure that no chargeable gain arises at the point of transfer, together with a provision to prevent abuse of that relief,

d. enable the provisions in TCGA to be adapted for use with the merger and reconstruction of new and existing types of collective investment scheme so that the provisions will work when applied to interests in tax-transparent schemes and be simplified in application to existing schemes and changes may be made to what constitutes a disposal.

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[1] Directive 2009/65/EC of the European Parliament and of The Council.

EXPLANATORY NOTE

CLAUSE 37: ROLL-OVER RELIEF

SUMMARY

1. This clause preserves the availability of capital gains roll-over relief in relation to farmers' payment entitlements under the European Union (EU) Single Payment Scheme following changes to the Scheme in 2009.

2. The clause also allows for future changes to the relevant classes of assets in roll-over relief to be made by secondary legislation.

DETAILS OF THE CLAUSE

3. Subsection (1) amends class of assets 7A (payment entitlements under the single payment scheme) in section 155 of the Taxation of Chargeable Gains Act 1992 (TCGA) to reflect a change in the EU Regulations governing the scheme.

4. Subsection (2) replaces section 86(2) of Finance Act (FA) 1993 and inserts subsections 2A and 2B. The new subsection (2) allows the Treasury to amend section 155 of TCGA 1992 by statutory instrument so as to add classes of assets or amend existing classes. New subsection (2A) prevents any order being made under the power in subsection (2) which limits classes of assets qualifying for roll-over relief. New subsection (2B) allows for reasonable consequential amendments to be made to section 156ZB (interaction with corporation tax roll-over relief in cases of realisation and reinvestment) of, or Schedule 7AB (roll-over of degrouping charge on business assets) to, TCGA 1992 in line with those changes made through new subsection (2).

5. Subsection (3) repeals an earlier amendment to section 86(2) of FA 1993, which is superseded by subsection (2) above.

6. Subsection (4) applies the change in subsection (1) retrospectively to the time of the change in the EU Regulations in 2009 providing for a continuous availability of capital gains tax roll-over relief for single payment scheme payment entitlements.

BACKGROUND NOTE

7. Roll-over relief (as the reliefs at sections 152-159 of TCGA 1992 are commonly referred to) permits the deferral of some or all of a chargeable gain on the disposal of a qualifying business asset where the consideration received for that business asset is wholly or partly applied in acquiring replacement qualifying business assets.

8. Qualifying business assets are listed in section 155 TCGA 1992. Class 7A refers to the single payment scheme and, more specifically, the EU Regulation under which payments were previously made (Regulation (EC) 1782/2003 of 29 September 2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers).

9. Regulation (EC) 1782/2003 was withdrawn from 1 January 2009 and replaced by Regulation (EC) 73/2009. This meant that without an amendment to class 7A, as listed in section 155 of TCGA 1992, payments made through the single payment scheme would no longer qualify for roll-over relief.

10. Subsection 86(2) of FA 1993 provides a power for new classes of assets to be added to the list of those qualifying for roll-over relief by Treasury Order; an amendment to an existing asset requires primary legislation through the Finance Bill.

EXPLANATORY NOTE

CLAUSE 38 SCHEDULE 6: SEED ENTERPRISE INVESTMENT SCHEME

SUMMARY

1. Clause 38 and Schedule 6 set out the new Seed Enterprise Investment Scheme (SEIS), which is designed to incentivise investment in small, early stage companies.

DETAILS OF THE SCHEDULE

Part 1 of the Schedule

2. Paragraph 1 of the Schedule introduces a new Part 5A to Income Tax Act 2007 (ITA), containing the rules for the new scheme.

Chapter 1 of New Part 5A of ITA

3. New section 257A defines SEIS income tax relief and provides that it will apply to shares issued on or after 6 April 2012 and before 6 April 2017. The new scheme is therefore of fixed length, but can be extended by a Treasury order.

4. New section 257AA provides that an investor is eligible for relief in respect of shares issued to him or her where particular requirements are met. There are requirements which apply to the investor, general requirements, and requirements that apply to the issuing company. These requirements are in Chapters 2 – 4 of new Part 5A.

5. New section 257AB provides that the relief is a reduction of income tax calculated as 50 per cent of the amount the investor subscribes for shares, subject to an overall limit of 50 per cent of £100,000 on the amount of relief that can be received in any one year.

6. New section 257AB(5) allows an investment or part of an investment made in one year to be treated as though made in the previous year (but not in the first year that the new scheme operates), subject to the overall limit for a year.

7. New section 257AC defines two periods of time with respect to which many of the SEIS conditions operate. Period A runs from the company's incorporation to the third anniversary of the share issue (defined at new section 257AC(4) as the "termination date"). Period B runs from the issue of the shares to the termination date.

8. New section 257AD is an overview of chapters 5 – 8 of new Part 5A, which deal with the making of claims, withdrawal of relief, and supplementary matters.

9. New section 257AE(1) mentions new Section 150E of the Taxation of Chargeable Gains Act 1992 (TCGA), which provides a relief from capital gains tax (CGT) on gains on shares which qualify for SEIS relief (see paragraphs 93 below).

10. New section 257AE(2) mentions new Schedule 5BB TCGA, which provides relief from CGT on the disposal of assets where the proceeds are reinvested under SEIS (see paragraphs 97 to 108 below).

Chapter 2

11. New section 257B is an overview of chapter 2 which contains the conditions which apply to the SEIS investor.

12. New section 257BA provides that neither SEIS investors nor their associates may be employees of the company or any qualifying subsidiary in period B (unless also a director).

13. New section 257BB provides that SEIS investors must not have a "substantial interest" in the company, defined at new section 257BF as having more than a 30 per cent stake in the company through ordinary or issued share capital, voting power or rights on winding up, or as having control of the company.

14. New section 257BC provides that SEIS investors must not subscribe for the shares as part of a wider arrangement which includes somebody else subscribing for shares in a company in which the investor – or anyone else party to the arrangement – has a substantial interest.

15. New section 257BD provides that there must be no loans to the investor or their associates which are linked to their subscription for shares.

16. New section 257BE requires the subscription for shares to be for genuine commercial reasons, and not as part of a tax avoidance arrangement.

17. New Section 257 BF defines when a person has a "substantial interest" in a company.

Chapter 3

18. New section 257C is an overview of chapter 3 which contains the general requirements under SEIS.

19. New section 257CA sets out the sorts of shares for which investors can subscribe under the scheme, allowing for shares carrying certain preferential rights to dividends. Shares are still excluded if: they carry preferential rights to assets on winding up; they have any right to be redeemed; the amount and timing of the dividends depend on a decision of the company or any other person; or if they are cumulative. This new definition is the same as that introduced for VCTs in Finance (No 3) Act 2010 and which is also being introduced for the Enterprise Investment Scheme (EIS).

20. New section 257CA(4) provides that shares must be subscribed for wholly in cash and be fully paid up at the time they are issued.

21. New section 257CB requires that the shares be issued to raise money for a qualifying business activity carried on or to be carried on by the company or by a qualifying 90 per cent subsidiary. Qualifying business activity is as defined at new section 257HG.

22. New section 257CC requires that the money raised from the share issue must be spent by the end of period B, for the purpose of the qualifying business activity for which it was raised.

23. Section 257CC(2) provides that spending money on the acquisition of shares or stock in a company does not of itself amount to spending the money for the purposes of a qualifying business activity.

24. New section 257CD prevents "pre-arranged exits", which are any arrangements in place (at the time the shares are issued) for the disposal of shares or securities in the company or its assets, or for its activities to cease, or for the investment to be protected from normal commercial risks.

25. New section 257CE requires the issue of shares to be for genuine commercial reasons, and not as part of a tax avoidance arrangement.

26. New section 257CF is the "no disqualifying arrangements" requirement. Arrangements are "disqualifying" if they are entered into with the purpose of ensuring that any of the venture capital scheme tax reliefs are available in respect of the relevant company's business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business by a person who is a party to the arrangements, or a person connected with such a party. This is the same requirement that is being introduced for the EIS and VCT schemes.

Chapter 4

27. New section 257D is an overview of chapter 4 which contains the conditions that apply to the company.

28. New section 257DA is the "trading requirement", requiring that the company's main purpose throughout period B (and since incorporation) must be to carry on a new qualifying trade or trades. Alternatively if it is the parent company of a group, the business of the group must not consist wholly or as to a substantial part in carrying on non-qualifying activities.

29. Section 257DA(3) provides that if a company intends in the future to have qualifying subsidiaries which will carry on new qualifying trades, then it is treated as a parent company for the purposes of the trading requirement.

30. Sections 257DA(4) and (5) describe how "the business of the group" is to be defined: the activities of the group are to be looked at together as though carried on as one business.

31. Section 257DA(6) provides that certain intra-group transactions are to be ignored in considering what the business of the group involves.

32. New section 257DB provides that the purpose of existence test is not breached due to anything that happens because of the company or a subsidiary being in administration or receivership, or being dissolved or wound up, provided that this is done for genuine commercial reasons and not as part of a tax avoidance arrangement.

33. New section 257DC provides that throughout Period B, the new qualifying trade and any preparation work or research and development leading to it, must be carried on by the issuing company itself or by a qualifying 90 per cent subsidiary.

34. New sections 257DC(4) to (6) provide that this requirement is not breached due to the new qualifying trade being taken over by an unconnected person because of the company or a qualifying 90 per cent subsidiary being in administration or receivership, or being dissolved or wound up, provided that this is done for genuine commercial reasons and not as part of a tax avoidance arrangement.

35. New section 257DD requires the company to have a permanent establishment in the UK throughout period B.

36. New section 257DE requires the company not to be "in difficulty" at the beginning of period B. This means it must not be a "firm in difficulty" under European Commission guidelines.

37. New section 257DF requires the company to be "unquoted" at the beginning of period B and provides that there must be no arrangements at that time for it to cease to be unquoted.

38. A company is "unquoted" if its securities are not marketed to the general public – defined in new section 257DF(3) as being listed on a recognised stock exchange, listed on a designated exchange outside the UK, or dealt with, outside the UK, by any such means as may be designated.

39. New sections 257DF(4) and (5) provide for the Commissioners of HMRC to make the designations referred to in new section 257DF(3).

40. New section 257DG contains the control and independence requirement:

- The control part of the requirement is that the company may not, in period A, control any other company which is not a qualifying subsidiary.
- The independence part of the requirement is that the company may not, in period A, be under the control of any other company – either alone or with any connected person – and nor must there be any arrangements for this to happen (whether in period A or outside it). It may not, therefore, be a subsidiary in period A.

41. New section 257DH requires that neither the company nor any qualifying 90 per cent subsidiary may be a member of either a partnership or a limited liability partnership (or any foreign equivalent) at any time in period A.

42. New section 257DI is the gross assets requirement. Immediately before the shares are issued, the total value of the company's assets (or of the group assets where the company is a parent company), must not exceed £200,000.

43. New section 257DJ is the number of employees requirement. At the time the shares are issued, the company together with any subsidiaries must have fewer than 25 full time equivalent employees.

44. New section 257DK provides that neither the company nor any qualifying subsidiary may have previously raised money under either the EIS or VCT schemes.

45. New section 257DL ensures that any investment under SEIS is kept within the limits which allow SEIS to be regarded under EU regulations as providing *de minimis* and therefore non-notifiable State aid.

46. New section 257DL(1) provides that the amount of all SEIS investment, together with any other *de minimis* State aid received by

the company in the 3 years to the date of the latest SEIS investment, must not exceed £150,000.

47. New sections 257DL(4) to 6) apply so that where a share issue takes above £150,000 the total aid received by the company in the 3 years to the date of investment, the investment in the share issue is apportioned so that relief is given only on the proportion of the investment which doesn't exceed the £150,000 limit.

Chapter 5

48. New section 257E contains rules setting out how relief given to an individual is to be attributed to shares for which the individual has subscribed.

49. New section 257EA provides that SEIS relief can not be claimed more than five years after the SA filing deadline for the year in which the shares are issued.

50. New section 257EB provides that the investor can only claim relief if he or she has a compliance certificate from the company for the shares.

51. New section 257EC defines a compliance certificate. This is a certificate issued by the company stating that the shares meet the requirements for SEIS relief (excluding those requirements that are dependent on the investor).

52. New section 257EC(2) provides that a certificate cannot be issued until the company has supplied a compliance statement to HM Revenues & Customs (HMRC) and new section 257EC(3) that it must have authority from HMRC to issue a certificate.

53. New section 257ED defines a compliance statement. This is a statement to the effect that at the time the statement is made, the requirements for SEIS are met or have been met (excluding those requirements that are dependent on the investor).

54. New section 257ED(3) provides that the company may not make a compliance statement until either it has traded for at least four months, or at least 70 per cent of the money raised by the share issue has been spent for the purposes of the qualifying business activity for which it was raised.

55. New section 257EE provides for an appeal against a decision by HMRC not to authorise a compliance certificate.

56. New section 257EF prescribes a maximum penalty of up to £3,000 where a company negligently or fraudulently issues a certificate or statement or issues one in breach of the conditions in new section 257EC.

57. New section 257EG allows the Treasury, by order, to amend new sections 257EC and 257ED. This is intended to allow changes in the administrative processes without the need for primary legislation.

Chapter 6

58. New section 257F is an overview of chapter 6 which contains provisions dealing with the withdrawal of relief given for SEIS shares ("relevant shares"). Many of the provisions in chapter 6 are counterparts to conditions contained in the preceding chapters, setting out what happens when those conditions are breached.

59. New section 257FA withdraws relief where, before the end of period B, the investor disposes of shares for which SEIS relief has been given. In particular, it contains computational rules setting out how much relief is to be withdrawn.

60. New section 257FA(6) ensures that the death of an investor does not trigger the withdrawal of any relief given.

61. New section 257FB supplements those rules for cases where full relief was not obtained.

62. New sections 257FC and 257FD withdraw relief where the investor holds a call or put option in relation to the relevant shares.

63. New section 257FE withdraws relief where during period A the investor receives any value from the company relating to the relevant shares.

64. New section 257FF provides that relief is not withdrawn where the value received is insignificant (defined in new section 257FG).

65. New section 257FG defines insignificant as an amount that does not exceed £1,000, or if it does exceed that amount is insignificant compared to the amount subscribed for the shares.

66. New section 257FH defines a number of different circumstances in which value is received. These cover various ways in which the company might make payments to the investor. A number of circumstances are excluded – for example where the investor is a director of the company and is reimbursed expenses incurred in performance of his or her duties.

67. New section 257FI defines the amount of value received in the various cases described by new section 257FH.

68. New sections 257FJ – 257FO contain supplementary provisions concerning the receipt of value in particular circumstances.

69. New section 257FP withdraws relief where, during period A, the company or any qualifying subsidiary takes over the trade or assets previously used by another person in their trade, and the investor either had or has more than a half share in the trade, or controls or has controlled the issuing company and controls or has controlled the company which previously carried on the trade.

70. New section 257FQ withdraws relief if the company acquires all the issued share capital of another company in period A, and the investor is a person or one of a group of persons, who control(s) both companies.

71. New section 257FR withdraws relief given where, at some later date, it is found not to have been due.

Chapter 7

72. New section 257G provides for relief to be withdrawn or reduced by making an assessment.

73. New section 257GB sets a time limit for any such assessment, which must be made within six years of the end of whichever is the later of the tax year in which period B ends, or the tax year in which the event causing the withdrawal or reduction occurs.

74. New section 257GC sets out cases where no such assessment may be made.

75. New section 257GD provides that when an assessment is made under new section 257G to withdraw relief as prescribed by particular provisions of chapters 2, 4 and 5, interest is to be charged from 31 January following the tax year in which the assessment is made.

76. New section 257GE requires the investor to notify HMRC if he or she ceases to be a qualifying investor, or if relief should be withdrawn for one of a number of specified reasons and new section 257 DF places a similar requirement on the company.

77. New section 257GG gives HMRC power to require information where either new section 257GE or new section 257GF applies or could have applied.

78. New section 257GH gives HMRC a power to require information in other cases, specifying from whom information may be required in various different circumstances.

79. New section 257GI allows HMRC to disclose to a company that SEIS relief has been obtained in respect of its shares.

Chapter 8

80. New section 257H allows for transfers of shares between spouses or civil partners not to be treated as a disposal. The SEIS relief remains attributable to the shares until a disposal or other relevant event by the spouse or civil partner to whom they were transferred.

81. New section 257HA sets out rules determining which shares are treated as having been disposed of under either new section 257FA or 257H.

82. New section 257HB provides for the continuity of SEIS relief where a new holding company is inserted above a company which has issued shares to which SEIS relief is attributable, resulting in shareholders exchanging their original shares for shares in the new holding company.

83. Providing that certain conditions as specified by section 257HB(2) are met, new section 257HB(3) provides that the original shares are not treated as disposed of, and that the relief which was attributed to them is instead attributed to the shares in the new holding company.

84. New sections 257HC and 257HD ensure that in other respects, the SEIS legislation applies in respect of the new shares as it would have done in respect of the old shares.

85. New section 257HE contains provisions applying to nominees and bare trustees.

86. New section 257HF defines a “new qualifying trade” as being one which has not been carried on by either the company or by any other person for longer than two years at the date of issue of the shares; and neither the company nor any qualifying subsidiary had carried on any other trade before the company in question began to carry on the new trade.

87. New section 257HG defines “qualifying business activity” as either carrying on, or preparing to carry on, a new qualifying trade, or carrying on research and development from which a new qualifying trade will be developed (or which will benefit a new qualifying trade). For a business activity to be “qualifying” it must be carried on by either the issuing company or by a qualifying 90 per cent subsidiary.

88. New sections 257HH and 257HI define the terms "disposal of shares" and "issue of shares".

89. New section 257HJ contains a number of definitions of terms used elsewhere in part 5A.

Part 2 of the Schedule

90. Part 2 provides for relief for capital gains.

91. Paragraph 2 provides for the Taxation of Chargeable Gains Act 1992 (TCGA) to be amended.

92. Paragraph 3 inserts new sections 150E and 150F into the TCGA.

93. New section 150E mirrors existing section 150A TCGA that applies to EIS shares. Section 150E reduces the consideration taken into account for capital gains tax on a disposal of shares by the amount of the SEIS relief attributable to those shares. It reduces or eliminates any chargeable gain on a disposal of shares to which SEIS relief is attributable and provides rules that permit those shares to be identified.

94. New section 150F mirrors existing section 150B TCGA that applies to EIS shares. It modifies the effect of new section 150E to limit the reduction in any chargeable gain on the disposal of shares to which SEIS relief is attributable to the extent that value is received and the SEIS relief reduced in consequence.

95. Paragraph 4 of the Schedule inserts a new section 150G into the TCGA. Section 150G introduces Schedule 5BB to the TCGA, which provides the SEIS re-investment relief.

96. Paragraph 5 inserts new Schedule 5BB into the TCGA – see paragraphs 97 to 108 below.

New Schedule 5BB TCGA

97. Paragraph 1 of Schedule 5BB sets out the conditions for relief and the amount of relief available.

98. Paragraph 1(2) to (4) sets out three conditions for relief:

1. An individual must realise a gain on a disposal of an asset in the tax year 2012-13.

2. The individual must make an investment that qualifies for SEIS relief from income tax, and claim that relief.

3. The individual must claim SEIS re-investment relief in respect of the amount on which the SEIS relief is claimed.

99. Paragraphs 1(5) to (7) sets out the amount of SEIS re-investment relief. Paragraph 1(5) sets the amount on which SEIS relief is claimed ("the SEIS expenditure") against the gain on the disposal of the asset. Paragraph 1(6) provides that the amount of the gain that has the SEIS expenditure set against it is not liable to CGT. Paragraph 1(7)(a) restricts the SEIS expenditure on which relief may be claimed to the extent it has already been used to claim to other SEIS reinvestment relief or to EIS deferral relief. Paragraph 1(7)(b) ensures SEIS re-investment relief is not given against any part of the gain that has already been covered by other SEIS re-investment relief or by EIS deferral relief

100. Paragraph 2 of Schedule 5BB restricts the amount of SEIS re-investment relief that is given under paragraph 1 in two circumstances.

101. Paragraph 2(1) and (2) applies where the amount invested under SEIS exceeds the maximum amount of £100,000 on which an individual can obtain income tax relief in any one tax year. In this circumstance the SEIS re-investment relief is capped at the amount on which SEIS relief is due, applying the formula in sub-paragraph (2).

102. Paragraph 2(3) and (4) applies where SEIS relief is restricted before the claim to SEIS re-investment relief is made. In this case the maximum amount on which SEIS re-investment relief can be claimed is restricted by a similar amount, under the formula in sub-paragraph (4).

103. Paragraph 2(5) gives the order in which the two restrictions in paragraph 2 are to be applied in cases where they both apply.

104. Paragraph 3 of Schedule 5BB sets the time limit for claiming SEIS re-investment relief as the same as the limit that applies for claims to SEIS relief. The paragraph also makes clear that claims to SEIS re-investment relief may be made before effect is given to the claim for SEIS relief on which the SEIS re-investment relief claim depends.

105. Paragraph 4 of Schedule 5BB treats the amount on which SEIS re-investment relief is given as spread ('attributed') equally across all the shares in respect of which the claim to relief is made. This is required in order to be able to recover the correct amount of relief, should this become necessary, under paragraph 5 or 6 of Schedule 5BB (see below).

106. Paragraph 5 of Schedule 5BB applies where the SEIS relief attributed to shares is withdrawn or reduced so that the SEIS re-investment

relief attributed is also withdrawn or reduced in the same proportion. For example, if the SEIS relief were reduced by 60 per cent the SEIS re-investment relief will also be reduced by 60 per cent. Where this happens paragraph 5(2) makes the individual who made the investment liable to CGT for the tax year 2012-13 on a chargeable gain of the appropriate amount. Where paragraph 5 applies to reduce the amount of SEIS re-investment relief attributable to the shares in question, sub-paragraphs (4) and (5) reduce the amount of SEIS re-investment relief remaining attributable to the shares by a corresponding amount.

107. Paragraph 6 of Schedule 5BB modifies the effect of paragraph 5 in cases where the investor in shares to which SEIS re-investment relief is attributable transfers some or all of the shares to their husband or wife or civil partner, and that transfer does not itself lead to relief being withdrawn. Where SEIS re-investment relief is withdrawn or reduced after the transfer, a gain is charged to CGT on the transferee spouse or civil partner in respect of the shares which they hold, and the amount of the gain charged on the original investor is based on only the shares they still hold.

108. Paragraphs 7 and 8 of Schedule 5BB make supplementary provision. Paragraph 7(1) permits all necessary adjustments to be made to give effect to claims or charges under the Schedule, notwithstanding the normal time limits for amending or making assessments to CGT. Paragraph 7(2) provides that when an assessment under paragraphs 5 or 6 to withdraw re-investment relief, interest is to be charged from 31 January following the tax year in which the assessment is made. Paragraph 8 defines various terms in Schedule 5BB.

Part 3 of the Schedule

109. Part 3 makes consequential amendments to ITA (and in particular to the existing EIS and VCT rules in Parts 5 and 6 of that Act) and to the TCGA 1992.

110. Paragraph 7 of the schedule amends the overview of ITA, adding a reference to the new Part 5A.

111. Paragraphs 8 and 9 amend sections 26 and 27, which form part of the computational rules for income tax liability, to add SEIS relief.

112. Paragraph 10 amends section 169, which deals with the EIS rules on directors and the circumstances in which they may qualify for relief in respect of an investment in shares. The rules are amended to allow a paid director to qualify for EIS relief where the relevant investment was made before the end of the qualifying holding period for a holding of SEIS shares which attracted relief.

113. Paragraph 12 amends the EIS rules so that any SEIS investment received by a company in the 12 months to the date of issue of EIS shares, is taken into account in determining the maximum amount of investment which will attract tax relief in that 12 month period.

114. Paragraphs 11 and 13 amend the EIS rules to add a new requirement, that before a company can issue shares qualifying under EIS it must have spent at least 70 per cent of any money raised under SEIS.

115. Paragraph 14 amends the EIS rule determining identification of shares on a disposal, to include those which have attracted SEIS relief.

116. Paragraph 16 amends the VCT rules so that any SEIS investment received by a company in the 12 months to the date of any investment by a VCT, is taken into account in determining whether a holding will form part of a VCT's qualifying holdings.

117. Paragraphs 15 and 17 amend the VCT rules to add a new requirement, that before a company may receive a VCT investment it must have spent at least 70 per cent of any money raised under SEIS.

118. Paragraph 18 introduces amendments to the TCGA.

119. Paragraphs 19 and 20 make amendments to the rules which determine how any gain or loss on disposal of shares which have attracted EIS relief, is to be calculated. These amendments arise as a consequence of other changes in the Schedule and do not materially alter the rules.

120. Paragraph 21 amends Schedule 5B TCGA. Schedule 5B allows individuals to defer the time at which gains on disposals of assets become liable to CGT where they invest in shares under the terms of the main EIS. The amendments made by paragraph 21 ensure that both EIS deferral and SEIS re-investment relief cannot be claimed in respect of the same expenditure.

121. Paragraph 22 amends section 98 of the Taxes Management Act (TMA) 1970 to include the information obligations provided for by sections 257GE, 257GF, 257GG and 257GH. Section 98 lists those information obligations which may carry a penalty if not complied with.

BACKGROUND NOTE

122. The Chancellor announced at Budget 2011 that the Government would bring forward proposals for support for investment in small, early stage companies, in addition to that provided by the EIS and Venture Capital Trusts (VCTs).

123. A consultation document, "Tax-advantaged venture capital schemes: a consultation" was published on the Treasury website on 6 July 2011 setting out proposals and seeking views on a number of design issues.

124. Views expressed in response to the consultation have been taken into account in developing the new SEIS relief. The Government's response to the consultation was published on 6 December 2011 and is available on the HMT website.

125. The Government announced the proposal to introduce SEIS re-investment relief in the autumn statement 2011. HMRC issued a Technical Note outlining the scope of the relief on 6 December 2011 and draft legislation was published on 31 January 2012.

RESOLUTION 26

FINANCE BILL 2012
CLAUSE 39
SCHEDULE 7

EXPLANATORY NOTE

CLAUSE 39 SCHEDULE 7: ENTERPRISE INVESTMENT SCHEME

SUMMARY

1. This clause and Schedule make a range of changes to the Enterprise Investment Scheme (EIS). This increases the annual amount an investor may invest under the EIS, and provides for three simplifications to the EIS rules. A trade which consist substantially in the receipt of feed-in tariffs (with certain exceptions) will become a non-qualifying activity. Monies used to acquire shares or stock in a company will no longer be regarded as employed for the purposes of a qualifying business activity. A "no disqualifying arrangements" test is introduced. The Schedule also raises the thresholds for eligible companies under the scheme, subject to a Treasury appointed day order. The increases in these thresholds are subject to State aid approval.

DETAILS OF SCHEDULE

Part 1

2. Paragraph 1 introduces the changes to be made to Part 5 of the Income Tax Act 2007, dealing with EIS income tax relief.

3. Paragraph 2 removes the requirement for an investor to have subscribed a minimum of £500 in a company in order to qualify for relief.

4. Paragraph 3 of the Schedule increases from £500,000 to £1million the annual amount that an investor may invest under the EIS.

5. Paragraph 4 amends the EIS "connected person" rules so that any loan capital that the investor has in the company is not taken into account when computing whether they are excluded from EIS income tax relief through having a 30 per cent interest in the company.

6. Paragraph 6 widens the definition, for EIS, of the sorts of shares for which investors can subscribe under the scheme to include shares carrying certain preferential rights to dividends. Shares are still excluded if: a) they carry preferential right to assets on winding up; or b) if the amount and timing of the dividends depend on a decision of the company or any other person; or c) if the rights to dividends are cumulative (that is, the right to receive a dividend rolls forward to

future periods if the company has insufficient profits to pay the dividend) The new definition is the same as that introduced, for VCTs, in Finance (No 3) Act 2010.

7. Paragraph 7(2) increases, for EIS, the annual amount of investment that a company may raise under the VC schemes from £2million to £5million. The increase is subject to State aid approval and will come into effect on a day which the Treasury may by order appoint.

8. Paragraph 7(3) provides that where a company has received any other risk capital investment which constitutes a State aid, that investment is also taken into account in calculating whether the £5million limit has been reached.

9. Paragraph 8 amends the rules on how the monies raised by the share issued are to be employed, so that monies used to buy shares or stock in a company will no longer be regarded as having been employed for the purposes of a qualifying business activity.

10. Paragraph 9 introduces a "no disqualifying arrangements" requirement. Arrangements are "disqualifying" if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company's business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business by a person who is a party to the arrangements or a person connected with such a party.

11. Paragraph 11 increases the gross assets limit for EIS from £7million before the EIS investment and £8million afterwards to £15million and £16million respectively. The increases are subject to State aid approval and will come into effect from a day which the Treasury may by order appoint.

12. Paragraph 12 increases the limit on the number of employees that a qualifying company may have from fewer than 50 to fewer than 250. The increase is subject to State aid approval and will come into effect from a day which the Treasury may by order appoint.

13. Paragraphs 13 and 14 exclude as qualifying trades, any which consist substantially in the generation or export of electricity in respect of which the company receives a feed-in tariff under a UK government scheme or a similar overseas scheme. This applies generally where the relevant shares are acquired on or after 6 April 2012. For shares

issued on or after 23 March 2011 and before 6 April 2012, a holding will still qualify providing the subsidised generation or export begins before 6 April 2012. Trades where the electricity is generated by anaerobic digestion or hydroelectric power are not excluded by the legislation. Irrespective of the means by which electricity is produced, trades carried on by community interest companies, co-operative societies, community benefit societies or Northern Irish industrial and provident societies are not affected by the legislation.

14. Paragraph 17 brings the legislation in line with that on the new Seed Enterprise Investment Scheme, by making clear that the death of an investor within the qualifying period for the shares will not trigger the reduction or withdrawal of relief.

15. Paragraph 19 amends the information powers at section 243 of the Income Tax Act 2007, to allow HM Revenue & Customs (HMRC) to seek information in relation to the "disqualifying arrangements" requirement from relevant parties.

16. Paragraph 21 amends the existing definition of "arrangements" to make it clear that "arrangements" includes a single transaction or a series of transactions.

Part 2: Enterprise Investment Scheme: Chargeable gains

17. Paragraph 26 introduces the changes to be made to the Taxation of Chargeable Gains Act 1992 (TCGA), dealing with EIS disposal relief and EIS deferral relief.

18. Paragraph 27 makes an amendment to section 150A of TCGA to ensure that the calculation of any capital gain on the disposal of shares to which EIS relief has been attributable takes account of EIS relief at the appropriate rate.

19. Paragraph 29 increases, for reinvestment relief under Schedule 5B to TCGA, the annual amount of investment that a company may raise under the VC schemes from £2million to £5million. The increase is subject to State aid approval and will come into effect on a day which Treasury may by statutory instrument appoint.

20. Paragraph 30 introduces a "no disqualifying arrangements" requirement. Arrangements are "disqualifying" if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company's business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or

in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business.

21. Paragraph 31 amends the information powers at Paragraph 11 of Schedule 5B, to allow HMRC to seek information in relation to the "disqualifying arrangements" requirement from relevant parties.

22. Paragraph 32 amends the existing definition of "arrangements" to make it clear that "arrangements" includes a single transaction or a series of transactions.

BACKGROUND NOTE

23. The EIS and Venture Capital Trusts (VCTs) encourage investment into small, higher risk trading companies by offering tax incentives to investors in qualifying companies.

24. Following consideration of responses to a consultation document "Financing a Private Sector Recovery", published on 26 July 2010 and to a further consultation, "The path to strong, sustainable and balanced growth" (the "Growth Review"), published on 29 November 2010, the Chancellor announced in his Budget on 23 March 2011 that subject to State aid approval, limits on the size of companies which can benefit under the schemes would be increased.

25. A further consultation document, "Tax-advantaged venture capital schemes: a consultation" was published on the Treasury website on 6 July 2011 seeking views on ways in which the EIS and VCTs might be improved.

EXPLANATORY NOTE

CLAUSE 40 SCHEDULE 8: VENTURE CAPITAL SCHEMES

SUMMARY

1. Clause 40 and Schedule 8 make a range of changes to the Venture Capital Trust scheme (VCT). A trade which consist substantially in the receipt of feed-in tariffs (with certain exceptions) will become a non-qualifying activity . Monies used to acquire shares or stock in a company will no longer be regarded as employed for the purposes of a qualifying business activity. A "no disqualifying arrangements" test is introduced. The Schedule also raises the thresholds for eligible companies under the scheme. The increases in these thresholds are subject to State aid approval.

DETAILS OF SCHEDULE

2. Paragraph 1 introduces the changes to be made to Part 6 of the Income Tax Act 2007, dealing with the VCT scheme.

3. Paragraphs 2 and 3 amend the conditions which a VCT must meet in order to obtain VCT approval, to prevent a VCT from making an investment in any company in excess of the maximum amount permitted in a 12-month period by State aid rules applying to risk capital investment. This applies in respect of any investment made by the VCT on or after 6 April 2012.

4. Paragraph 3(4) describes which previous investments in a company are to be taken into account and includes not only previous VCT, Enterprise Investment (EIS) Schemes or SEIS investment but also any other any other risk capital investment which constitutes a State aid.

5. Paragraph 5 removes the restriction that prevents a VCT investing more than £1million per annum in any single company. The restriction continues to apply where the company is a member of a partnership or joint venture that carries on the qualifying trade.

6. Paragraph 6(2) increases, for VCTs, the annual amount of investment that a company may raise under the VC schemes from £2million to £5million. The increase is subject to State aid approval and will take effect from a day which the Treasury may by order appoint.

7. Paragraph 6(3) provides that where a company has received any other risk capital investment which constitutes a State aid, that investment is also taken into account in calculating whether the £5million limit has been reached.

8. Paragraph 7 amends the rules on how the monies raised by the share issued are to be employed, so that monies used to buy shares or stock in a company will no longer be regarded as having been employed for the purposes of a qualifying business activity.

9. Paragraph 8 increases the gross assets limit for EIS from £7million before the EIS investment and £8million afterwards to £15million and £16million respectively. The increases are subject to State aid approval and will come into effect from a day which the Treasury may by order appoint.

10. Paragraph 9 increases the limit on the number of employees that a qualifying company may have from fewer than 50 to fewer than 250. The increase is subject to State aid approval and will come into effect from a day which the Treasury may by order appoint.

11. Paragraph 10 introduces a "no disqualifying arrangements" requirement. Arrangements are "disqualifying" if they are entered into with the purpose of ensuring that any of the venture capital schemes tax reliefs are available in respect of the relevant company's business, and either: all or most of the monies raised under the scheme are paid to or for the benefit of a party to the arrangements; or in the absence of the arrangements, it would be reasonable to expect that the business would be carried on as part of another business. The legislation includes a definition of "arrangements" which applies for the purpose of this test.

12. Paragraphs 11 and 12 exclude as qualifying trades any which consist substantially in the generation or export of electricity in respect of which the company receives a feed-in tariff under a UK government scheme or a similar overseas scheme. This applies generally where the VCT acquires the relevant holding on or after 6 April 2012. For holdings acquired on or after 23 March 2011 and before 6 April 2012, a holding will still qualify providing the subsidised generation or export begins before 6 April 2012. Trades where the electricity is generated by anaerobic digestion or hydroelectric power are not excluded by the legislation. Irrespective of the means by which electricity is produced, trades carried on by community interest companies, co-operative societies, community benefit societies or Northern Irish industrial and provident societies, are not affected by the legislation.

13. Paragraph 15 introduces an information power to allow HM Revenue & Customs (HMRC) to seek information from those it believes are parties to "disqualifying arrangements".

14. Paragraph 17 adds the new information power to the list already at section 98 of the Taxes Management Act 1970. Section 98 allows

HMRC to seek a penalty for failure to comply with an information notice, or for fraudulently or negligently providing incorrect information in response to an information notice.

BACKGROUND NOTE

15. The EIS and VCTs encourage investment into small, higher risk trading companies by offering tax incentives to investors in qualifying companies.

16. Following consideration of responses to a consultation document "Financing a Private Sector Recovery", published on 26 July 2010 and to a further consultation, “The path to strong, sustainable and balanced growth" (the “Growth Review”), published on 29 November 2010, the Chancellor announced in his Budget on 23 March 2011 that subject to State aid approval, limits on the size of companies which can benefit under the schemes would be increased.

17. A further consultation document, "Tax-advantaged venture capital schemes: a consultation" was published on the Treasury website on 6 July 2011 seeking views on ways in which the EIS and VCTs might be improved.

EXPLANATORY NOTE

CLAUSE 41 SCHEDULE 9: CAPITAL ALLOWANCES: RESTRICTING THE EXCEPTION FOR MANUFACTURERS AND SUPPLIERS

SUMMARY

1. This clause removes an exception from the capital allowances anti-avoidance rules that exists for certain transactions where unused plant or machinery is bought or hire purchased from the manufacturer or supplier, but only where the transaction has an avoidance purpose. This is a change from the 12 August 2011 announcement, which announced the outright repeal of this exception (that is, without the current proviso) in relation to expenditure incurred on or after 12 August 2011. The change now effected by this Clause provides that the exception from the anti-avoidance rules will continue for expenditure incurred on or after 12 August 2011, but before the relevant April start date, but only as long as it is not incurred as a result of a relevant transaction with an avoidance purpose, or as a result of a scheme or arrangement that has an avoidance purpose. (The position in relation to expenditure incurred on or after the relevant April start date is dealt with separately in paragraph 7 of Schedule 9.)

DETAILS OF THE CLAUSE

2. Subsection (1) amends section 230 of the Capital Allowances Act 2001 (CAA) so that transactions with manufacturers or suppliers are no longer exempted from any restriction on the buyer's allowances made by section 217 of CAA (which denies annual investment allowance or first-year allowances).

3. Subsection (2) provides that the change applies to expenditure incurred on or after 12 August 2011.

4. Subsection (3) provides that, in relation to expenditure incurred between 11 August 2011 and 'the next amendment date' (later defined as 1 April 2012, for corporation tax purposes, or 6 April 2012, for income tax purposes) first-year allowances are not denied provided the condition in subsection (4) is met.

5. Subsection (4) sets out the condition, providing that if the amendments made by paragraphs 1 to 7 of Schedule 9 had been in force between 12 August 2011 and the relevant April 2012 start date,

the transaction would not have been caught by the anti-avoidance rule in the revised section 215 and first-year allowances will not be denied.

6. Subsection (5) defines 'the next amendment date' and explains that it means the date defined in paragraph 9 of Schedule 9, that is, 1 April 2012 for corporation tax purposes, or 6 April 2012 for income tax purposes.

BACKGROUND NOTE

7. Chapter 17 of CAA contains anti-avoidance rules that restrict the capital allowances that may be claimed where person B buys, or acquires under a hire-purchase (or similar) contract, plant or machinery from person S.

8. Allowances may be restricted where B and S are connected, where there is a sale and leaseback between B and S or where the capital allowances were the sole or main benefit which might have been expected to accrue from the transaction between B and S. In these circumstances B's allowances may be restricted in two ways. Firstly, B will be prevented from claiming annual investment allowance (AIA) or first-year allowance (FYA) (by section 217 CAA). Secondly, B's qualifying expenditure (the amount on which capital allowances may be claimed) will be restricted (by section 218 CAA).

9. However, where B buys, or hire-purchases, unused plant or machinery from S and S's business is the manufacture or supply of such plant or machinery then section 230 CAA provides an exception from the anti-avoidance rules. For expenditure incurred before 12 August 2011, the exception was from both section 217 and section 218 so that B was able to claim AIA and FYA and there was no restriction of B's qualifying expenditure.

10. However, in light of evidence that the manufacturers and suppliers exception was being used to facilitate avoidance, on 12 August 2011 the Government announced that legislation would be introduced in the 2012 Finance Bill to repeal the exception from section 217 for expenditure incurred on or after 12 August 2011.

11. As a result, although the amount of B's qualifying expenditure is not restricted, the anti-avoidance rules can prevent B claiming AIA or FYA in respect of expenditure incurred on or after 12 August 2011 even where the plant or machinery is acquired from the manufacturer or supplier.

12. However in the light or representations made during the consultation period and following the publication of the draft legislation on 6 December 2011 the Government decided that it was not necessary to wholly repeal section 230 from 12 August 2011. The repeal now applies only to transactions that have an avoidance purpose and normal commercial manufacturer supplier transactions, involving connected parties or sale and leaseback arrangements are not affected... In summary, for expenditure incurred on or after 12 August 2011 section 230 will continue to provide an exception from the restrictions in both section 217 and section 218 unless the transaction has an avoidance purpose.

EXPLANATORY NOTE

CLAUSE 42 SCHEDULE 9: CAPITAL ALLOWANCES FOR PLANT AND MACHINERY: ANTI-AVOIDANCE

SUMMARY

1. This clause and Schedule amends the legislation that counters abuse of the rules for plant and machinery allowances, to make it more effective at preventing Exchequer loss. The changes will apply to expenditure incurred on or after 1 April 2012 (for businesses within the charge to corporation tax) and on or after 6 April 2012 (for businesses within the charge to income tax).

2. The legislation is also amended to confirm the meaning of the word 'assigns' for the purposes of the Capital Allowances Act (CAA)2001.

DETAILS OF THE SCHEDULE

3. Paragraph (1) replaces section 215 of the CAA 2001: *Transactions to obtain allowances,* with new section 215 of CAA: *Transactions to obtain tax advantages*.

4. Subsection (1) of new section 215 provides that plant and machinery allowances will be restricted if a relevant transaction between B and S has an avoidance purpose, is part of a scheme or arrangement that has an avoidance purpose or occurs as a result of a scheme or arrangement with an avoidance purpose.

5. New subsection (2) provides that a relevant transaction can be treated as part of, or occurring as a result of, a scheme or arrangement regardless of when the scheme or arrangement is entered into or whether it is legally enforceable.

6. New subsection (3) defines an 'avoidance purpose': if the main purpose, or one of the main purposes, of a party in entering into a transaction, scheme or arrangement is to enable any person to obtain a tax advantage that would not otherwise have been obtained then that transaction, scheme or arrangement has an avoidance purpose.

7. New subsection (4) provides that a 'tax advantage that would not otherwise have been obtained' in subsection (3) includes an allowance that is in any way more favourable to any person – for example an allowance at a higher rate, claimed sooner or on a greater

amount of qualifying expenditure – than the one that would otherwise have been obtained.

8. New subsections (5) and (6) provide that allowances may be restricted in different ways depending on the kind of tax advantage. Section 217 of CAA denies annual investment allowance or first-year allowance where the transaction has an avoidance purpose. The way in which writing down allowances may be restricted by new section 218ZA is determined by the nature of the tax advantage.

9. New subsection (7) describes two particular kinds of tax advantage: (a) the allowance is calculated using a higher rate than the one that would otherwise be used, or (b) the allowance in respect of an amount of expenditure is available sooner than it would otherwise be. These particular kinds of tax advantage are specified to enable allowances to be restricted in an appropriate way, by new section 218ZA (5).

10. New subsection (8) provides that if a transaction, scheme or arrangement involves more than one tax advantage (for example, allowances at a higher rate on a greater amount of expenditure) then allowances may be restricted in more than one way.

11. Paragraph (2) amends section 57 (3) of CAA to ensure that expenditure excluded by new section 218ZA is not included in the amount of a person's available qualifying expenditure.

12. Paragraphs (3) and (4) amend sections 214 and 216 respectively to reflect the introduction of new section 218ZA. Allowances may be restricted under section 218 where there is a transaction between connected persons (within section 214) or where there is a sale and leaseback transaction (within section 216). If a connected person transaction or a sale and leaseback also has an avoidance purpose, or is part of a scheme or arrangement with an avoidance purpose, then allowances may be further restricted under new section 218ZA(3).

13. Paragraph (5) makes various amendments to section 218 so that section 218 will no longer restrict allowances where there is a transaction to obtain tax advantages within section 215, unless the transaction falls within section 215 *and* section 214 (connected persons transactions) or section 215 *and* section 216 (sale and leasebacks).

14. Paragraph (6) inserts new section 218ZA of CAA which determines how writing-down allowances are to be restricted where there is a transaction to which section 215 applies. New section 218ZA applies even if the transaction also falls within section 214 (because it is a

connected person transaction) or within section 216 (sale and leasebacks). New section 218ZA operates by restricting the allowances that B can claim following the transaction (B is the person who has incurred, or is treated as having incurred capital expenditure on the provision of plant and machinery). Allowances can be restricted by reducing the amount of expenditure on which B can claim allowances, by reducing the rate at which allowances are given or by reversing any timing advantage sought (or any combination of restrictions).

15. New section 218ZA subsection (1) provides that where there is an avoidance purpose the amount of expenditure on which B can claim capital allowances is restricted. The restriction of allowances is made under this subsection *unless* the tax advantage is within section 215(7), that is, either that B's allowances are calculated at a higher rate or B is entitled to an allowance sooner than it would otherwise be.

16. New subsection (2) explains that, if new subsection (1) applies, B's qualifying expenditure is restricted by the amount that would in effect cancel out the tax advantage whether or not the tax advantage arises to B. However, the restriction can never be more than B's expenditure under the relevant transaction.

17. New subsections (3) and (4) provide that if B's writing-down allowances could be restricted both under subsection (1) (because there is an avoidance purpose) and also under section 218 or section 228, then B's allowances are restricted by the amount that is the larger of the two restrictions.

18. New subsection (5) provides that if the tax advantage is within section 215(7) – where B's allowances have been calculated at a higher rate or claimed sooner than they would otherwise have been - then the restriction is that B's writing-down allowances are calculated using the rate that would have been used or the entitlement is delayed to when it would have been available without the tax advantage.

19. New subsection (6) provides that a restriction calculated under subsection (5), by reference to the rate or timing of B's allowances, can be made in addition to a restriction under section 218 or section 228.

20. Paragraph (7) provides that section 230 of CAA, as amended by section 686a, is further amended.

21. Subparagraph (2) amends subsection (1) of section 230 so that the 'exception for manufacturers and suppliers' from the restrictions in sections 218 and 217 will not apply if there is a transaction with an avoidance purpose, or which is part of or occurs as a result of a scheme or arrangement with an avoidance purpose, within section 215.

22. Paragraph (8) inserts new section 268E of CAA which confirms the definition of the terms 'assigns' and 'assignments' which apply for Part 2 of CAA.

23. Paragraph (9) provides that the amendments made by this clause will apply from 1 April 2012 (for corporation tax purposes) and 6 April 2012 (for income tax purposes).

BACKGROUND NOTE

24. Depreciation of fixed assets charged in the commercial accounts of a business is not allowed as a deduction in computing the taxable profits. Instead capital allowances may be given at prescribed rates on certain assets, including plant and machinery. The Annual Investment Allowance (AIA) provides an annual 100 per cent allowance for the first £25,000 (this is the maximum annual allowance from April 2012) of investment in plant and machinery to all businesses. There are also 100 per cent first-year allowances (FYA) available for expenditure on certain types of plant or machinery. Otherwise expenditure on plant and machinery attracts writing down allowance (WDA) at the main rate of 18 per cent per annum or the special rate of 8 per cent per annum (these are the rates that apply from April 2012).

25. Chapter 17 CAA contains anti-avoidance rules that restrict the plant and machinery allowances that may be claimed following certain relevant transactions. A relevant transaction is one in which:

- S sells plant or machinery to B, or
- B enters into a hire-purchase or similar contract for plant or machinery with S, or
- S assigns the benefit of a hire purchase or similar contract for plant or machinery to B

26. Allowances may be restricted where the relevant transaction is

- between connected persons (defined in section 214), or

- a transaction to obtain allowances (defined in section 215), or

- a sale and leaseback (defined in section 216).

27. The anti-avoidance rules are being amended to make them more effective.

28. The 'sole or main benefit' test currently in section 215 is being replaced by a new 'purpose' test that will apply where the main, or one of the main, purposes of a party in entering into a transaction (or a scheme or arrangement of which the relevant transaction is part) is to enable any person to obtain a tax advantage that would not otherwise have been obtained. The tax advantage may arise to a party to the transaction or any other person.

29. A 'tax advantage' is defined in section 577(4) of CAA. The term includes allowances that are 'greater' or more favourable because the amount of qualifying expenditure has been artificially increased, because the allowances have been a claimed at a rate that is too high or because they have been claimed sooner than they should have been.

30. Where a transaction, scheme or arrangement has an avoidance purpose then B's allowances are restricted to, in effect, cancel the tax advantage. To this end, the restriction may be to reduce the rate at which B's allowances are calculated (if the tax advantage B would otherwise obtain is allowances at a rate that is too high) or to reverse any timing advantage sought by B so that B is, in both cases, in the position that B would have been in without the tax advantage. In other situations B's qualifying expenditure is restricted to an amount that has the effect of negating the tax advantage. If appropriate more than one restriction may be made to B's allowances.

31. It is possible that a transaction with an avoidance purpose is also a connected person transaction or a sale and leaseback, in which case the application of the existing rules in section 218 or section 228 must also be considered and the largest applicable restriction made.

32. The 'purpose' test and the consequences of entering into a transaction, scheme or arrangement with an avoidance purpose are consistent with the approach used in other purpose tests elsewhere in the Taxes Acts.

EXPLANATORY NOTE

PLANT AND MACHINERY ALLOWANCES: FIXTURES

SUMMARY

1. This clause and Schedule make the availability of capital allowances to a purchaser of fixtures conditional on: (i) previous business expenditure on qualifying fixtures being pooled before a subsequent transfer on to another person, (ii) the value of fixtures being fixed formally within two years of a transfer. However, in relation to the rule at (ii), there is an alternative method of fixing the value that applies only in some (narrowly defined) cases where an intermediate owner or lessee, who was not entitled to claim an allowance, had failed to determine a fixtures apportionment with the past owner. In addition, the new provisions make a technical adjustment in respect of the Business Premises Renovation Allowances (BPRA) scheme, to enable a new owner to claim plant and machinery capital allowances on any fixtures expenditure not already relieved by BPRA.

DETAILS OF THE SCHEDULE

2. Paragraph 1 is introductory and explains that the Capital Allowances Act 2001 (CAA) is to be amended.

3. Paragraph 2 introduces new sections 187A and 187B into CAA.

New Section 187A Effect of changes in ownership of a fixture

4. New subsection (1) of section 187A sets out the circumstances in which the section applies. It applies if :

- a current owner incurs capital expenditure on acquiring a property containing fixtures from another person, for the purposes of his business;

- that other person, or a previous owner, is treated as having been the owner of the fixtures at a relevant earlier time (see new subsection (2) and new section 187B (4) and (5)) as a result of incurring other expenditure ("historic expenditure") on their provision, for the purposes of a business carried on by that past owner;

- that past, business owner was entitled to claim plant and machinery allowances (PMAs) in respect of the historic expenditure; but -

the new section does not apply if the previous owner was only entitled to relief by virtue of the contributions legislation in section 538, CAA.

5. New subsection (2) explains what is meant by:

   - "the past owner". In respect of an amount of historic expenditure, it is the person who was entitled to claim most recently in respect of that amount; and

   - "relevant earlier time." This has the meaning given by new section 187B (4) and (5).

6. New subsection (3) provides that the qualifying expenditure incurred by the new owner is to be treated as nil if -

   - the "pooling requirement"(see new subsection (4)) is not satisfied;

   - "the fixed value requirement" (see new subsections (5),to (8)) applies but is not satisfied; or

   - "the disposal value statement requirement" (see new subsections (10) and (11)) applies but is not satisfied,

   in relation to the past owner. So, in all cases to which this new section applies, the pooling requirement must be satisfied. In addition, one or other of the "value" requirements will apply and must be satisfied in every case to which this new section applies. (In practice, the "fixed value requirement" will apply in the vast majority of cases and the "disposal value statement requirement" is likely only to apply very infrequently.)

7. New subsection (4) explains "the pooling requirement". It provides that the historic expenditure must have been allocated to a pool in a chargeable period beginning on or before the day on which the past owner ceased to own the fixture, or the past owner claimed a first-year allowance on the expenditure (or any part of it).

8. New subsection (5) explains when "the fixed value" requirement applies. It only applies where the past owner is or has been required to bring the disposal value of the plant or machinery into account in accordance with one of three particular disposal events described in the Table in section 196, CAA. (The relevant disposal events are

items 1, 5 or 9 in that Table. Item 1 covers the case of a market value sale; item 5 covers the case of an incoming lessee paying a capital sum for the lease, which sum falls to be treated in whole or part as expenditure on the provision of the fixture; and item 9 covers the case of a past owner, who permanently discontinues his business, followed by a sale of the qualifying interest in the property, including its fixtures. This last case should be distinguished from the example given in relation to new subsection 10 below, where there is a significant gap between the past owner ceasing his business and later deciding to sell the property, so that the capital allowances disposal event occurs on the earlier occasion.)

9. New subsection (6) explains that the fixed value requirement is met when one of two outcomes occurs. That is, either:

(a) 'a relevant apportionment of the apportionable sum has been made' (see new subsection (7); or

(b) the current owner has obtained certain statements where the property is acquired from someone other than "the past owner", as defined in subsection (2) (see new subsection (8))

The overwhelming majority of commercial property transactions involving second-hand fixtures will fall within new subsection 6(a) (see new subsection (7) below for more information),

New subsection (6) (b) is **a change** from the draft legislation published for consultation on 6 December 2011 (see new subsection (8) below for more information).

10. New subsection (7) explains that a relevant apportionment is made if –

(a) the Tribunal has determined the part of the sale price that constitutes the disposal value of the fixtures, on an application made by one of the affected parties within two years of the purchaser's acquisition; or

(b) there has been a joint election, under either section 198 or section 199 of CAA, as appropriate, between the past owner and the purchaser within two years of the acquisition (or, if an application to the tribunal is made within two years, and not determined or withdrawn, before the end of that period before that application is determined or withdrawn).

11. The overwhelming majority of commercial property transactions involving second-hand fixtures will involve a relevant apportionment,

so that there will be the requirement for a reference to the tribunal, or for a joint election to be made, within two years of a sale. In fact, it is to be expected that a joint election (option (b) above), under section 198 or 199 of CAA, will be the preferred course in the vast majority of cases. This is because it will clearly not be in the interests of either side to incur the trouble and any cost of going to a tribunal unnecessarily, in any case where it would have been possible to agree an apportioned value voluntarily.

12. New subsection (8) introduces a relaxation to the draft legislation published for consultation on 6 December 2011 to help ensure that it applies fairly. Under the consultation draft of the legislation, an immediate purchaser, who was not entitled to claim an allowance (for example, a charity) should have ensured that the "fixed value requirement" was satisfied (either by entering into a joint section 198 or 199 of CAA election with the past owner, or by applying to the tribunal to determine the apportionment) if that purchaser wanted to be able to pass on an entitlement to claim allowances on those fixtures to a new owner in the future.

13. Persons who are not entitled to claim an allowance (such as charities that are not chargeable to tax) buying property from 'past owners' are entitled to make a section 198 or 199 of CAA election, or to apply to the tribunal for a determination of the fixtures value, if they wish to do so. They may wish to do so, in order to enable a future business purchaser to claim in respect of those fixtures, thereby potentially enhancing or protecting the value of their property investment. If they duly elect or apply to the tribunal, they will then be able to provide the election notice or tribunal determination to a new owner, on a later sale, thereby establishing the new owner's entitlement to allowances on those fixtures.

14. However, it is possible that non-taxpayers, such as charities, may have scant knowledge or awareness of the capital allowances legislation and may therefore inadvertently omit to follow either of the election or tribunal procedures for making a fixtures' apportionment. Of course, it may be that the non-taxpayer had informally agreed with the seller that the seller could return a nil disposal value for the fixtures, precisely because the non-taxpayer was uninterested in the capital allowances. Indeed, it could even be that the non-taxpayer obtained the property for a somewhat lower price in consequence of allowing this. In such a situation, the expenditure on the fixtures would have been written off in full in the hands of the seller and it would be in accordance with the underlying policy for those fixtures to have a nil value in the hands the current owner, purchasing the property from the non-taxpayer. However, in a case where it can be formally demonstrated by the past owner that he

returned a specific disposal value for those fixtures, and that it is too late for the non-business purchaser to fix an apportionment with him, a narrowly defined exception from the normal rule appears to be justified.

15. New subsection (8) therefore provides that, in these circumstances, if the current owner obtains a written statement made by the 'purchaser from the past owner' (in our example, say, a charity) that new subsection (6) (a) has not been met and is no longer capable of being met, and also a written statement made by the past owner of the actual amount of the disposal value that the past owner, in fact, brought into account, then the "fixed value requirement" would be regarded as met in that way. The expression 'purchaser from the past owner' in subsection (6)(b) means, in effect, an intermediate owner or lessee who was not entitled to claim an allowance, and who acquired an interest in the fixtures from a "past owner", who was so entitled to claim.

16. New subsection (9) defines various expression used in new subsections (6) to (8), and gives the statutory meaning of "election" for the three affected disposal events. That is, if the disposal event falls within item 1 or 9 of the Table in section 196, the election will be under section 198 of CAA, whereas if the disposal event falls within item 5 of that Table, the election will be under section 199 of CAA.

17. New subsection (10) explains when "the disposal value statement requirement" applies. This provision is designed to cater for a very small subset of disposal events that may have occurred, other than by virtue of an immediate sale of, or grant of a lease of, the fixtures by a person carrying on a qualifying activity. The requirement would apply if, for example, a past owner had previously permanently ceased his business activity, finalising his cessation accounts and tax return, in which he would have been required to bring the market value of the fixtures, at that time, into account, in accordance with item 7 of the Table in section 61 of CAA. If, some years later, he then decided to sell his former business premises with its fixtures to a purchaser, "the disposal value statement requirement" would apply.

18. New subsection (11) explains how "the disposal value statement requirement" is satisfied. This is done by the past owner making a written statement of the amount of the disposal value of the fixtures that he is, or has been, required to bring into account, within two years of the date when he ceased to own them. The current owner must obtain this statement, or a copy of it, either directly or indirectly from the past owner.

Thus if, for example, the immediate purchaser is not a business, but a later purchaser is a business, the later purchaser may obtain the required statement either directly from the past owner, or indirectly from the intermediate owner, who sold the property to the current owner. As with the "fixed value requirement", an intermediate purchaser, who is not a business should ensure that he obtains this written statement from the past owner, if he wants to make sure that he is able to pass on an entitlement to claim on those fixtures to a future owner. However, the later owner is free to try to obtain the statement, or a copy of it, directly from the past owner, if the past owner is still contactable and willing to oblige.

New Section 187B Supplementary provision

19. New subsection (1) of section 187B provides that it is for the current owner seeking to claim allowances to demonstrate whether:

- the fixed value requirement applies and, if so, is satisfied, and
- the disposal value statement requirement applies and, if so, is satisfied

and, for this purpose, to provide a copy of any relevant tribunal decision, election or statement, satisfying the relevant requirement, to HM Revenue and Customs (HMRC) on request. (Although it is considered that it is for the taxpayer to substantiate a claim to capital allowances, so that, from this perspective, and to this extent, this new subsection could be viewed as somewhat superfluous, one of the main policy purposes of the new provisions is to increase the operational clarity and certainty of the fixtures regime. This new subsection is, therefore, intended to put beyond doubt what a current owner will need to obtain and retain in order substantiate a fixtures claim under the new provisions.)

As previously indicated, if a non-business purchases fixtures from a past owner who was entitled to claim allowances on those fixtures, the non-business -

- should make the required election, or obtain a tribunal determination if it wishes to ensure that a known entitlement to claim can be passed on to a future owner;

or, exceptionally, it may be possible to retrieve the situation if -

- that non-business owner makes a written statement, in accordance with section 187A(9)(a), at the time when it sells on the fixtures to a current owner who wishes to claim allowances, if the current owner is also able to obtain (whether directly or indirectly) from the past owner a written statement of the disposal value which the past owner, in fact, brought into account, in accordance with section 187A(9)(b). .

In general, current owners will require to hold on to the appropriate paperwork to demonstrate their entitlement to claim in respect of historic expenditure on fixtures.

20. New subsection (2) provides that amounts stated in either the disposal value statement or a statement provided by a past owner (where a relevant apportionment should have been made, but a non-business owner acquiring the fixtures from a past owner, omitted to do this) have effect in place of any apportionment that could have been made under sections 562, 563 and 564(1).

21. New subsection (3) provides that for the purposes of section 187A the current owner and the past owner may be the same person.

22. New subsection (4) explains what is meant by 'relevant earlier time' in new section 187A (2). It is any time that falls before the earliest time when the current owner is treated as owning the fixtures, but that time must be on or after 1 April 2012 for corporation tax purposes or 6 April 2012 for income tax purposes because of the commencement provisions in Paragraph 13 of the Schedule.

23. New subsection (5) ensures that the legislation does not apply where there has been a sale of an asset that is no longer a fixture at the time of sale, unless that sale is to a connected person. For example: company A owns a building, containing an antique copper water heater, which it strips out and sells to an architectural salvage dealer. Company B, not connected with company A, buys the copper water heater from the dealer and installs it in a property it owns. Company B is not required to establish the disposal value brought into account by Company A and is not precluded from claiming allowances based on what it paid for the asset.

24. New subsection (6) makes it clear that none of the conditions in section 187A (3) in relation to the current owner, affects the disposal value that the past owner must bring into account. So, for example, in a sale and purchase between two businesses, if the fixed value requirement is not satisfied because no election has been made, and neither has the tribunal been asked to determine the part of the sales proceeds that relates to the fixtures, so that the current owner's

qualifying expenditure is deemed to be nil, the past owner is still required to bring in a disposal value, in accordance with section 196 CAA.

25. New subsection (7) provides that expressions used in this section have the same meaning as expressions used in section 187A.

26. Paragraph 3 makes certain consequential amendments to section 198, CAA.

27. Paragraph 4 introduces changes to section 201 CAA.

28. Paragraph 4(3) introduces a new subsection 1A into section 201. The new subsection provides that where new subsection (7)(a) of new section 187A applies, and an application is made to the tribunal, then the time limit in section 201(1) does not apply, but is modified to run to the time the tribunal determines the application or the application is withdrawn.

29. Paragraph 5(1) makes a change to section 563, CAA, so that a question concerning the amount to be fixed in relation to the fixed value requirement can be referred to the tribunal, even if it only affects the liability to tax of one person, rather than of two or more persons. For example, where a taxpayer sells a fixture to a non taxpayer and agreement cannot be reached but the non taxpayer wishes for certainty in relation to the ability of a potential future business owner to be able to claim on those fixtures, then, absent the change to section 563, that matter could not have been referred to the tribunal, but in future it may be referred. Paragraph 5(2) makes a consequential change to the heading of section 563, CAA.

30. Paragraph 6 introduces new section 186A into CAA

186A Fixtures on which a business premises renovation allowance has been made

31. There is a general rule in section 9 of CAA that if any person has claimed an allowance under any Part other than Part 2, then no other person is able to claim a fixture allowance under Part 2. The general rule is relaxed in the case of fixtures on which industrial buildings allowances, or research and development allowances, have been claimed. New section 186A introduces a similar relaxation in relation to business premises renovation allowances (BPRA), ensuring that where a property which has qualified for BPRA, under Part 3A, is sold then the new owner can claim allowances under Part 2, to the extent that the original BPRA qualifying expenditure was not relieved but only to that extent. In all other cases no allowances are available to the new owner. The drafting of new section 186A follows section

186 in most material respects. The only significant change from the consultation draft of the legislation published on 6 December 2011 is that the definition of 'R' has been changed as, unlike the IBA code, Part 3A does not reset 'RQE' following a balancing event (because there is no need to do so). 'R' is now defined as the qualifying expenditure incurred by the past owner on the fixture less the 'net Part 3A allowances' in respect of that asset. 'net Part 3A allowances' are defined as the total of any allowances made under Part 3A (that is, any initial allowance and any writing-down allowance) less the total of any balancing charges made under Part 3A in relation to that expenditure.

32. Paragraphs 7 to 10 make minor consequential amendments to sections 9, 57, 198 and 199 of CAA to include references to the amendments in respect of BPRA and the new section 186A.

33. Paragraph 11 explains that the amendments made by paragraphs 1 to 5 have effect:

- for income tax purposes, in relation to new expenditure incurred on or after 6 April 2012, and
- for corporation tax purposes, in relation to new expenditure incurred on or after 1 April 2012

34. Paragraph 12 explains that the amendments made in relation to BPRA by paragraphs 6 to 10 have effect:

- for income tax purposes, in relation to balancing events which occur on or after 6 April 2012, and
- for corporation tax purposes, in relation to balancing events which occur on or after 1 April 2012

35. Paragraph 13(1) deals with expenditure of a past owner where the period of ownership was entirely before 1/6 April 2012 and provides that neither the pooling requirement nor requirements to fix formally the value of fixtures apply in relation to such a period of ownership.

36. Paragraph 13(2) disapplies the pooling requirement in relation to the new section 187A if the period for which the plant or machinery is treated as having been owned by the past owner ends no later than the end of the two years beginning with the commencement date, as defined in paragraph 13(3). This is a change from the consultation draft of the legislation to cater for the case of a sale in the transitional period to a non-business owner, who is not entitled to claim allowances, and who would, therefore, be unable to pool any hitherto

un-pooled qualifying expenditure on fixtures. In effect, this change disapplies the pooling requirement for an extended period, where the period of ownership of a past owner (who was entitled to claim) ends no later than a period ending on 5 April 2014 (for income tax purposes) or 31 March 2014 (for corporation tax purposes).

37. Paragraph 13(3) gives the meaning of commencement date as used in paragraph 13(1) and the transitional period as used in paragraph 13(2).

The commencement date means

- for income tax purposes, 6 April 2012, and
- for corporation tax purposes, 1 April 2012

The transitional period means

- for income tax purposes, the period beginning with the commencement date and ending with 5 April 2014, and
- for corporation tax purposes, the period beginning with the commencement date and ending with 31 March 2014.

BACKGROUND NOTE

38. At Budget 2011, the Government announced that it would consult on proposals to ensure that the capital allowances rules for fixtures secured their original policy purpose of limiting allowances overall to the fixture's original cost. That is, that the cost of a fixture should be written-off once, and once only, during that fixture's useful economic life.

39. The Government decided to act in order to protect the Exchequer from further tax leakage and to make the rules fairer and clearer for businesses to understand and operate - without giving rise to disproportionate administrative burdens.

40. A formal consultation was launched on 31 May and closed on 31 August 2011. The Government's formal response to the consultation was published on 6 December 2011, together with a draft of the proposed legislative provisions, for a period of technical consultation, which closed on 10 February 2012. Following this technical consultation some changes have been made to the draft provisions to

help ensure the fairer application of the new rules, and these changes are highlighted in the detail of this Explanatory Note.

41. The fixtures legislation is contained in Chapter 14 of Part 2 of the Capital Allowances Act 2001 (CAA). To deliver the policy purpose - that expenditure on a fixture should be written-off against taxable profits only once over its economic life - the current legislation contains rules to limit the allowances that can be given to the lower of original cost (section 62 CAA) or the last disposal value that has been brought into account by any previous owner of the fixture (section 185 CAA).

42. However, the current law does not prescribe when expenditure on fixtures should be pooled, and there is no time limit laid down to govern when a seller and purchaser should agree the part of the sale price of a property that should be attributed to the fixtures.

43. These gaps have given rise to uncertainties and difficult questions of proof. They have led to a large number of 'late' claims by current owners at a time when a single sale value for fixtures can no longer be agreed and brought into account by both parties.

44. This Clause and Schedule are designed to address these practical problems with the existing legislation, in order to ensure that the fixtures regime operates as originally intended in future.

45. An additional technical, fixtures issue, in relation to the Business Premises Allowances scheme (in Part 3A of CAA), emerged during the Government’s consideration of its proposed fixtures changes for Finance Bill 2012. The Government decided to address this issue at the same time as the other changes.

EXPLANATORY NOTE

EXPENDITURE ON PLANT AND MACHINERY FOR USE IN DESIGNATED ASSISTED AREAS

SUMMARY

1. This Clause and Schedule provide 100 per cent first-year allowances (FYAs) for companies investing in plant or machinery for use primarily in designated assisted areas within Enterprise Zones. To qualify for this new relief, the expenditure must be incurred in the period from when an area is treated as being a designated assisted area and 31 March 2017.

DETAILS OF THE SCHEDULE

2. Paragraph 1 is introductory and explains that the Capital Allowances Act 2001 (CAA) is to be amended.

3. Paragraph 2 adds expenditure on plant and machinery for use in designated assisted areas to the categories of expenditure, listed in section 39 of CAA, that can qualify for FYAs.

4. Paragraph 3 introduces new sections 45K to 45N into CAA.

Section 45K Expenditure on plant and machinery for use in designated assisted areas.

5. New section 45K(1) sets out the circumstances in which expenditure on plant or machinery constitutes first-year qualifying expenditure. The conditions are that the expenditure must be incurred:

   - by a company on the provision of plant or machinery for use primarily in an area which is a designated assisted area at that time. (The restriction of the new FYAs to "a company" means that unincorporated businesses and partnerships of companies, even if the partnership may be a body corporate, are not eligible for these new FYAs);

   - in the period of five years beginning with 1 April 2012;

   and -

   - five further conditions (conditions A to E) must also be met.

6. New section 45K(2) sets out the meaning of "designated assisted area": this means an area which has been designated by an order made

by the Treasury, and an area that falls wholly within an assisted area (see new subsection 14). This latter requirement is the first of a number designed to ensure that these new FYAs fall within Commission Regulation (EC) No 800/2008 known as the General Block Exemption Regulation ("GBER") (see new subsection (13)) in respect of State aid. Because they provide a geographically selective benefit, the new FYAs would constitute regional State aid.

7. New section 45K(3) sets out the circumstances in which an area may be designated by an order. There are two requirements:

- the area must fall wholly within an enterprise zone (see new subsection 14), and
- the Treasury and the responsible authority (see new subsection 14) must have entered into a memorandum of understanding relating to the availability of the new FYAs in the area. (The memoranda of understanding, each of which will include a map of the relevant designated assisted area, will be published on the HM Treasury website.)

8. New section 45K(4) ensures that, where appropriate, the order may have retrospective effect. So, for example, if the order so provides, the new FYAs may be made available in respect of qualifying expenditure incurred on or after 1 April 2012, even if the order is not made until some time after Royal Assent to Finance Bill 2012, say, in late August 2012.

9. New section 45K(5) prevents an area being revoked or reduced in size with retrospective effect.

10. New sections 45K (6) to (10) set out the five further conditions (that is, in addition to those in New section 45K(1)), which also have to be met:

- conditions A and B restrict the new relief to UK resident companies, which are liable to corporation tax, and that carry on a trade or a mining, transport or similar undertaking (as mentioned in section 12(4) of Income Tax (Trading and Other Income) Act 2005 (ITTOAI) or 39(4) of Corporation Tax Act 2009 (CTA 2009));
- condition C ensures that the GBER requirement for the expenditure to comprise investment aid, rather than operating aid, is met. This effectively means that the expenditure must be incurred on setting up a new business, expanding an existing business or on a fundamental change to a product or production

process of, or service provided by, a business carried on by a company;

- condition D focuses the relief on new and unused plant and machinery, which is a GBER requirement; and

- condition E is that the expenditure is not “replacement expenditure” (as defined in New section 45K(11)), which is also a GBER requirement.

11. New sections 45K(11), (12) and (13) explain the meaning and scope of “replacement expenditure” and also provide for a just and reasonable apportionment where part only of the expenditure is replacement expenditure.

12. New section 45K (14) defines “assisted area”, “enterprise zone” and “the responsible authority”.

13. New section 45K (15) allows the Treasury to amend the definition of “assisted area” by order, if any changes are made to the areas in the UK which are granted assisted area status. The current list of assisted areas is due to be revised by the Commission with effect from 1 January 2014.

14. New section 45K(16) provides that new section 45K is subject to

- new section 45L (plant or machinery partly for use outside designated assisted areas),

- new section 45M (exclusions from section 45K allowances),

- new section 45N (effect of plant or machinery subsequently being primarily used in an area other than a designated assisted area), and

- section 46 (general exclusions).

Section 45L Exclusion of plant and machinery partly for use outside designated assisted areas.

15. New Section 45L is an anti avoidance rule to prevent exploitation where the company incurring the expenditure intends to use the plant or machinery outside the designated assisted area, but enters into “relevant arrangements”, designed to meet the “for use primarily in the area” test, where the main, or one of the main, purposes of those arrangements is to obtain the FYA, or a greater amount of FYA. For example, a bus operator group of companies, that would normally have set up two new companies to operate two new bus fleets of

similar size in two different areas (where one is a designated assisted area and the other is not), might seek to exploit the new FYAs by setting up one company and using both fleets alternately in both areas, to contrive the result that both fleets are used just over 50 per cent in the designated assisted area. In such a case, the part (here, one-half) of the combined fleet which the group intended to use outside of the designated assisted area would be determined on a just and reasonable basis, and the expenditure on that part would be excluded from the FYA.

Section 45M Exclusions from allowances under section 45K

16. New section 45M(1) provides that expenditure incurred by a person is not first-year qualifying expenditure under new section 45K if it falls within sections 45M(2), (4), (6) or (7). The exclusions in these subsections are GBER requirements.

17. New sections 45M(2) to (5) provide that expenditure does not qualify for new section 45K allowances if the person who incurred the expenditure is, or forms part of, an "undertaking" that is:

- a "firm in difficulty";
- subject to an outstanding recovery order, declaring aid illegal;
- in the fishery or aquaculture sectors;
- in the coal, steel, shipbuilding or synthetic fibres sectors;
- engaged in the management of waste of other "undertakings";

or -

- is engaged in:
  - i. the primary production of agricultural products,
  - ii. on-farm activities necessary for preparing an animal or plant product for the first sale,
  - iii. the first sale of agricultural products by a primary producer to wholesalers, retailers or processers where that sale does not take place on separate premises reserved for that purpose.

18. New section 45M(6) provides that expenditure does not qualify for relief if it is incurred on a means of transport or transport equipment by a person carrying on a qualifying activity in the road freight or air

transport sectors. This does not mean that all expenditure incurred by businesses in those sectors is excluded; only their expenditure on means of transport and transport equipment is ineligible for relief.

19. New sections 45M(7) provides that no new section 45K_allowances are to be made if a relevant grant or relevant payment is made towards that expenditure, or any other expenditure incurred by any person in respect of the same designated assisted area and on the same "single investment project." (See new subsection (12), where "single investment project" is given the same meaning as in the GBER). For example, a company building a new production facility in a designated assisted area cannot receive both the new FYA and **any other State aid** in relation to, say, either the building costs of the actual facility (as opposed to the plant and machinery to be used in the facility, which would qualify for the new FYAs) or, say, staff training costs, to be incurred on training employees on how to use the new equipment. If any company can apply for another State aid in relation to the same project, then it will have to decide which State aid is of greater value to it..

20. The GBER at Article 13(10) explains what a "single investment project" is and the preamble at paragraph 41 further explains that the scope of the project should not be construed narrowly and should be assessed independently from ownership. This means that a "single investment project" is not limited to the project of a single company, but includes one carried out by an undertaking or undertakings, for example, a joint venture. So, if, for example, two companies are involved in the same "single investment project" as a joint venture and one company receives any form of State aid (other than the new FYA) in relation to the project, then neither company can claim the new FYA, even if one of the companies did not receive any other State aid in respect of that joint venture project.

21. A grant or payment is relevant if it is a State aid (other than a FYA under these new provisions), or if it is declared, by Treasury order, to be relevant.

22. This new subsection 45M(7) and the next, subsection 45M(8), together with the cap on these new FYAs (as provided for in paragraph 7 of this Schedule) are designed to ensure that the new FYA rules are fully compliant with the GBER rules about the cumulation of State aid. A large, investment project, that received State aid in excess of the cap, would not generally fall within the terms of the GBER, and would have to be separately notified to the European Commission, before any State aid could be granted. The tax system is not structured to cater for the cumulation of different forms of aid, so, for the purposes of these FYAs, the cap in relation to

a large investment project is calculated with reference to the new FYAs alone. This means that companies with a choice between the new FYAs and other forms of State aid for the same "single investment project" must effectively choose whether to claim the FYA or another State subsidy. If, however, a company that had claimed the new FYAs in one year, only became aware in the next that another State grant would have been more beneficial, then it could still claim the grant, but then the next subsection 45M(8) would apply and the FYAs would become repayable.

23. New sections 45M(8) to (11) provide that if a relevant grant or payment is made after the making of the new FYA allowance, the allowance is to be withdrawn if the relevant grant or payment is made towards the expenditure. If the relevant grant or payment is made toward any other expenditure incurred on the same "single investment project" (which term has the same meaning as in the GBER) then the relief is only withdrawn if the relevant grant or payment is made within 3 years of the qualifying expenditure being incurred. Provision is made for all necessary assessments and adjustments to be made for this purpose. In addition, a person who has made a return, who becomes aware that anything in the return has become incorrect because of the operation of this section, must give notice to an Officer of Revenue and Customs of the necessary amendment, within 3 months of first becoming aware of it.

24. New section 45M(12) defines various terms used in new section 45M.

25. New section 45M(13) makes it clear that any reference to State aid in the section is not to be read narrowly, so as to apply only to State aid that is required to be notified to, and approved by, the European Commission. So, for example, State aid that is brought within the terms of the GBER, so that it is exempt from prior notification, is still a relevant grant or payment.

26. New section 45M(15) states that the Treasury may, by order, make such provision to amend new section 45M as appears to them appropriate to give effect to any future amendments to, or instruments replacing, the particular European Regulations, Guidelines, Directive or Treaty, listed in this new subsection.

Section 45N Effect of plant or machinery subsequently being primarily for use outside designated assisted area.

27. New section 45N(1) of this new section requires that the plant or machinery, in relation to which the new section 45K FYAs have been claimed, must be primarily used by the person claiming the allowance (or a connected person) for at least 5 years within the relevant

designated assisted area. If, within that 5 year period, the person claiming the allowance, or a connected person, begins to use the plant or machinery primarily outside that area, the FYAs must be withdrawn, as if the expenditure had never qualified for the new FYAs. This section is included both to prevent exploitation of the new FYAs and also to satisfy the GBER State aid requirements in relation to regional aid.

28. New sections 45N(2) and (3) define 'relevant time' and 'relevant period'.

29. New sections 45N(4) to (6) provide that all such necessary assessments and adjustments are to be made for the purpose of withdrawing the relief. In addition, a person who has made a return, who becomes aware that anything in the return has become incorrect because of the operation of this section, must give notice to an Officer of Revenue and Customs of the necessary amendment, within 3 months of first becoming aware of it.

30. Paragraph 4 adds new section 45K to the list of provisions to which the general exclusions in section 46 apply. These general exclusions provide that expenditure is not FYA expenditure if, for example, it is incurred on the provision of a car, or on plant or machinery for leasing, or in the chargeable period in which the qualifying activity of the business is permanently discontinued.

31. Paragraph 5 adds expenditure on plant and machinery for use in designated assisted areas to the Table of FYAs, and their respective rates, in section 52(3) of CAA, and sets the rate of these new FYAs at 100 per cent. It also provides an addition to section 52(5), to the effect that the new FYAs are subject to new "section 212U (cap on first-year allowances: expenditure on plant and machinery for use in designated assisted areas)".

32. Paragraph 6 changes section 52A to make it clear that not only can a person not claim an annual investment allowance and a FYA in relation to the same expenditure, but also a person cannot claim a FYA under two or more of the provisions listed in section 39 in respect of the same expenditure.

33. Paragraph 7(1) introduces new section 212U into CAA.

Section 212U Cap on first-year allowances: expenditure on plant and machinery for use in designated assisted areas

34. New section 212U(1) and (2) cap the amount of expenditure incurred on plant or machinery, primarily for use in a particular designated assisted area that can qualify for the new FYAs, at a maximum of

€125 million per person ("the investor"), or at a maximum of €125 million for any such expenditure, incurred by any person, in respect of the same "single investment project". The cap on the new FYAs, is expressed in terms of a "single investment project", in order to ensure compliance with the GBER in relation to the cumulation of aid, and in recognition of the fact that the GBER does not provide a general exemption for large investment projects.

35. New section 212U(3) provides how expenditure incurred in a currency other than the euro is to be converted into Euros for the purposes of the €125 million cap.

36. New section 212U(4) provides that the Treasury may by regulations increase the cap.

37. New section 212U (5) defines terms used in new section 212U and provides that the term "single investment project" has the same meaning as in the GBER.

38. Paragraph 7(2) makes a minor consequential amendment to the heading to Chapter 16B.

39. Paragraph (8) provides that the amendments made by the new Schedule have effect for chargeable periods ending on or after 1 April 2012.

BACKGROUND NOTE

40. The proposal to introduce Enterprise Zones was announced at Budget 2011. The main benefits for businesses in the new zones comprise simplified planning and business rates discounts. The Budget statement also announced that the Government would work with Local Enterprise Partnerships (LEPs) to consider introducing enhanced capital allowances (in other words, first-year capital allowances ('FYAs') in Enterprise Zones in assisted areas.

41. In an HM Treasury Press Notice on 17 August 2011, the Government announced its decision to proceed with the enhanced capital allowances (that is, FYA) proposal. On 26 August 2011, HM Treasury wrote to LEPs providing details of the proposed design of the new 100 per cent FYAs scheme, and seeking bids from the LEPs, based on that design. In addition, the letter outlined the criteria against which the bids would be judged.

42. The Government announced that it would make 100 per cent FYAs available in various designated assisted areas, within specific English enterprise zones in 2011, as well as in an additional zone in Humber,

which was announced in February 2012. At Budget 2012, the Government further announced that it would also make 100 per cent FYAs available in a designated assisted area of the London Royal Docks enterprise zone, in three Scottish enterprise zones (in Irvine, Nigg and Dundee) and in Deeside in Wales. A full list of current zones and designated assisted areas delineated by maps will be published on the Treasury website in due course.

43. The standard rates of writing-down allowances for businesses' qualifying capital expenditure on plant or machinery are either 18 per cent or 8 per cent per annum (the rates that will apply from April 2012), depending on the nature of the asset. 100 per cent FYAs therefore provide business with a valuable tax-timing benefit.

EXPLANATORY NOTE

CLAUSE 45: ALLOWANCES FOR ENERGY-SAVING PLANT AND MACHINERY

SUMMARY

1. Clause 45 provides that where feed-in tariffs or renewable heat incentive tariffs are paid in respect of electricity or heat generated (or gas or fuel produced) 100 per cent first-year allowances (FYAs) are not available under section 45A of Capital Allowances Act 2001 (CAA) for expenditure incurred on the plant and machinery (P&M) that generates or produces it. This change generally applies for expenditure incurred on or after 1 April 2012 (for businesses within the charge to corporation tax) or 6 April 2012 (for businesses within the charge to income tax) but where the expenditure is on combined heat and power systems the change applies from 1 or 6 April 2014.

2. This clause also provides that expenditure incurred on solar panels, on or after 1 April 2012 (for corporation tax purposes) or 6 April 2012 (for income tax purposes), is special rate expenditure for capital allowances purposes.

DETAILS OF THE CLAUSE

3. Subsection (1) provides for changes to be made to Part 2 of CAA. The changes are specified in subsections 2 to 4.

4. Subsection (2) inserts a new subsection 45A(1A) into CAA. This provides that section 45A is subject to the new section 45AA.

5. Subsection (3) inserts new section 45AA into CAA.

6. New subsection (1) of section 45AA provides that expenditure incurred on P&M on or after the relevant dates (see paragraph 9) is treated as though it never qualified for FYAs under section 45A if a payment is made or another incentive is given for the purposes of:

   a. Section 41 Energy Act 2008, in respect of electricity generated by that P&M; or

   b. Section 100 Energy Act 2008 in respect of heat generated, or gas or fuel produced, by that P&M.

7. New subsection (2) provides for the making of assessments, or amendments to assessments, that may be necessary to give effect to new subsection (1), for example if an FYA is given and needs to be withdrawn

because a feed-in tariff or renewable heat incentive tariff is paid subsequently.

8. New subsections (3) and (4) provide that a person who has made a tax return, and later becomes aware that it is incorrect because of subsection (1), must give notice of the amendments required as a result to HM Revenue and Customs within three months of the day on which the person became aware that the return had become incorrect.

9. New subsections (5) and (6) define the relevant dates for new subsection (1). These are, generally, 1 April 2012 for corporation tax purposes and 6 April 2012 for income tax purposes. Where the expenditure is incurred on combined heat and power systems, these are 1 April 2014 for corporation tax purposes and 6 April 2014 for income tax purposes.

10. Subsection (4) amends section 104A CAA. It adds a new subparagraph 104A(1)(g) which designates expenditure on solar panels as special rate expenditure for capital allowances purposes. New subsection 104A(3A) provides that the amendment to 104A(1) takes effect from 1 April 2012 for the purposes of corporation tax and 6 April 2012 for the purposes of income tax.

BACKGROUND NOTE

11. Capital allowances allow the cost of capital assets to be written off in computing the taxable profits of a business. They take the place of depreciation charged in the commercial accounts, which is not allowed for tax.

12. Most businesses are entitled to an annual 100 per cent allowance, the Annual Investment Allowance (AIA), for their investment in most P&M up to an annual limit, which from April 2012 will be £25,000 per annum. For expenditure above that limit, writing-down allowances (WDA) are available, which from April 2012 will be given at the main rate of 18 per cent or the special rate of 8 per cent per annum. The legislation lists (in section 104A of CAA) the categories of expenditure that are special rate; special rate expenditure includes expenditure on integral features of a building and on long-life assets (generally equipment expected to have a useful economic life of 25 years). If expenditure is not designated as special rate then it will attract allowances at main rate.

13. First-year allowances (FYAs) may be available for expenditure on certain types of plant or machinery as an alternative to AIA and WDA. FYAs are special allowances, currently available at a rate of 100 per cent, which provide a cash flow advantage over normal WDAs (as all the qualifying expenditure may be deducted from profits in the year in which it is incurred), as a targeted incentive to invest in particular P&M. FYAs, commonly described as enhanced capital allowances (ECAs), may be

claimed on designated energy-saving P&M that meets the criteria required by either the Energy Technology Product or Criteria Lists.

14. The Energy Act 2008 provided for incentives to encourage low carbon energy and heat generation. The Feed-in Tariffs (FITs) scheme was introduced on 1 April 2010 and is designed to incentivise small scale electricity generation. The renewable heat incentive (RHI) supports heat generation from renewable sources. Generally, technologies that qualify under the FITs scheme will not be eligible for FYAs. However, many, although not all, of the technologies that could qualify for tariffs under the RHI scheme could also qualify for FYAs.

15. FYAs are intended to complement, rather than duplicate, the effects of other Government policies supporting such investment. Therefore, the legislation is being amended so that FYAs will not be available for expenditure on P&M, where the P&M generates heat or electricity or produces gas or fuel that attracts a tariff under either the FITs or the RHI scheme.

16. Businesses will be able to choose whether to claim the benefit of FYAs or tariff payments but will not be able to receive both. Where an FYA is given and a tariff payment is made subsequently, then the FYA will be withdrawn by means of an assessment or an amended assessment.

17. This change will apply to expenditure incurred on or after 1 April 2012 for businesses within the charge to corporation tax, or 6 April 2012 for businesses within the charge to income tax. However, because the RHI tariff rate for 'renewable' combined heat and power (CHP) will not be finalised until after April 2012 FYAs will continue to be available for expenditure incurred on renewable CHP until 31 March 2014 for businesses within the charge to corporation tax and 5 April 2014 for businesses within the charge to income tax, even when RHI tariffs are paid.

18. Expenditure on solar panels incurred on or after 1 April 2012 (by businesses within the charge to corporation tax) or 6 April 2012 (by businesses within the charge to income tax) will be designated as special rate so that it attracts the lower rate of WDA. Capital allowances are intended to provide tax relief that broadly reflects average rates of economic depreciation, so special rate is considered to be the appropriate rate of WDA for these assets. Expenditure on solar panels is being specifically designated as special rate to ensure clarity of treatment for business. The rate of WDA appropriate for expenditure on other plant or machinery that generates electricity or heat that attracts FITs or RHI tariffs will be determined on the facts by applying the normal rules for plant and machinery allowances.

EXPLANATORY NOTE

CLAUSE 46: PLANT AND MACHINERY: LONG FUNDING LEASES

SUMMARY

1. Clause 46 ensures that the rules for calculating the disposal value for the lessee at the end of a long funding lease operate as intended so that the relief available by way of capital allowances does not exceed the net expenditure of the lessee not otherwise relieved.

DETAILS OF THE CLAUSE

Section 70E of CAA 2001

2. Subsection (1) introduces the amendments to section 70E of the Capital Allowances Act 2001 (CAA).

3. Subsection (2) amends section 70E(2A) of CAA to extend the definition of "R" referred to in the formula in that subsection. It will now include not only any "relevant rebate" but also any other "relevant leased-related payment".

4. New section 70E(2FA) defines "relevant lease-related payment" setting out a number of conditions to be met.

5. New section 70E(2FA)(a) contains the first condition and requires a payment to be payable for the direct or indirect benefit of the lessee or a person connected with the lessee. This is irrespective of when the payment was payable and is not therefore restricted only to payments at the termination of the lease.

6. New section 70E(2FA)(b) contains the second condition. It requires the payment to be connected either to the long funding lease or with any arrangement that is connected with that long funding lease.

7. New section 70E(2FA)(c) provides that "relevant lease-related payment" does not include certain types of payment. The excluded payments are initial or other payments the lessee has made to the lessor under the lease together with any payment made by the lessee to the lessor under a guarantee of residual amount. For these purposes "residual amount" is as defined in section 70YE of CAA.

8. The final part of new section 70E(2FA) excludes as "relevant lease-related payments" any payment, or part of any such payment, that has otherwise been brought into tax either as income or as a disposal receipt by the person for whose benefit the payment was payable. This exclusion is extended to persons that would have brought the

payment so into account for tax purposes if they had been within the charge to tax.

9. New section 70E(2FB) explains that for the purposes of new section 70E(2FA) "payment" includes the passing of benefit in any form.

10. Subsection (4) amends section 70E(2G) by extending substitution of an arm's length amount for "relevant lease-related payment", as well as for "relevant rebate", where the lease is not a transaction at arm's length.

11. Subsection (5) provides the amendments made to section 70E of CAA have effect in cases where a "relevant event" occurs on or after 21 March 2012. "Relevant event" is defined in section 70E(1A).

BACKGROUND NOTE

12. The long funding lease rules were introduced into CAA, and other relevant parts of the Tax Acts, by Schedule 8 of Finance Act 2006.

13. These rules provide that where the relevant conditions are satisfied, the lessee, rather than the lessor, is entitled to claim capital allowances for expenditure on the plant or machinery which is the subject of the long funding lease

14. Sections 70B and 70C of CAA provide the rules for how the lessee's qualifying expenditure for capital allowances at the commencement of, respectively, a long funding operating lease or a long funding finance lease is to be calculated. At commencement of the lease this is necessarily an estimate because the lessee actually incurs the expenditure over the course of the lease

15. The rules in section 70E of CAA deal with disposal events and disposal values. For all long funding leases a formula is used though the definition of one part of the formula, "QA" (Qualifying Amount), differs depending upon whether the lease in question is a finance or operating lease.

16. The purpose of the formula is to adjust the amount of capital allowances available to the lessee, which were initially based on estimated expenditure, to match the lessee's actual expenditure less any rebates received.

17. The disclosed avoidance schemes involve arrangements which include transactions the claimed effect of which is that an amount is received by the lessee in connection with a long funding lease which is not taken into account in the prescribed formula for disposal value. The tax effect claimed is that capital allowances due to the lessee exceed net expenditure (not otherwise relieved) by the lessee on the leased asset.

EXPLANATORY NOTE

CLAUSE 47 SCHEDULE 12: FOREIGN INCOME AND GAINS

SUMMARY

1. Clause 47 and Schedule 12 introduce changes to the remittance basis of taxation.

DETAILS OF THE SCHEDULE

Increased remittance basis charge

2. Part 1 of the Schedule introduces an increased remittance basis charge of £50,000 payable by individuals who claim the remittance basis of taxation and who have been resident in the UK in at least 12 of the 14 tax years preceding the tax year in which they make that claim.

3. Paragraph 2 of the Schedule amends section 809C of the Income Tax Act 2007 (ITA) and introduces the 12-year residence test and the 7-year residence test. An individual will meet the 12-year test in any tax year in which they have been resident in the UK in at least 12 of the 14 tax years preceding that year and will meet the 7-year test in any tax year in which they have been resident in the UK in at least seven of the nine tax years preceding that year. It also amends section 809C(4) to provide for two alternative figures for the maximum relevant tax increase of £50,000 (where the 12-year test is met) and £30,000 (where only the 7-year test is met).

4. Paragraph 3 of the Schedule amends section 809H ITA and provides that an individual claiming the remittance basis will be liable to pay the £50,000 remittance basis charge for any tax year in which they meet the 12-year test, and liable to pay the £30,000 annual charge for any tax year in which they only meet the 7-year test. It also substitutes the term 'the applicable amount' for '£30,000' each time it occurs in that section.

5. Paragraph 4 of the Schedule substitutes a new section 809V in ITA. It provides that, in cases where an individual uses their foreign income and gains to pay the £50,000 or the £30,000 annual charge, those income and gains will not be treated as having been remitted to the UK. It also provides that this rule will not apply to the extent that the payments are repaid by HM Revenue & Customs (HMRC).

6. Paragraph 5 of the Schedule provides for the amendments made by paragraphs 1 to 4 to have effect from the start of the 2012-13 tax year.

Remittance for Investment Purposes

7. Part 2 of the Schedule introduces a new tax relief for foreign income and gains which are brought to the UK for the purposes of making a qualifying investment. In such cases, provided the relevant conditions are met, those foreign income and gains will not be taxed under the remittance basis.

8. Paragraph 6 of the Schedule replaces the heading which currently precedes section 809V with 'Relief for money used to pay tax, etc'.

9. Paragraph 7 of the Schedule introduces new sections 809VA to 809VO of ITA.

10. New section 809VA provides that certain income and gains brought to the UK for investment purposes are not treated as remitted to the UK.

11. Subsection (1) of section 809VA sets out the qualifying conditions for the business investment provisions. These are that a relevant event occurs which would otherwise be treated as a remittance of an individual's income and gains and that the individual makes a claim for the relief under this section.

12. Subsection (2) of section 809VA provides that, where the conditions set out in subsection 809VA(1) are met, the income and gains of the individual are treated as not remitted to the UK and therefore not liable to tax in the UK.

13. Subsection (3) of section 809VA defines a 'relevant event' for the purposes of subsection 809VA(1) as an event in which money or other property is either used by relevant person to make a qualifying investment (as defined in section 809VC), or is brought to or received in the UK for the purpose of making such an investment.

14. Subsection (4) of section 809VA provides that the relief provided by this Part is also available in situations where a qualifying investment is made using the proceeds from the sale of property which has been purchased outside the UK using foreign income and gains.

15. Subsection (5) of section 809VA provides that, in order to qualify for the relief, a qualifying investment must be made within 45 days of the money or other property being brought to or received in the UK.

16. Subsection (6) of section 809VA provides that, where only part of the money or other property brought to the UK is used to make a qualifying investment within 45 days, the amount of income and gains which qualifies for the relief provided by new subsection 809VA(2) is to be determined on a just and reasonable basis.

17. Subsection (7) of section 809VA is an anti-avoidance provision which denies the relief provided in subsection 809VA(2) in circumstances where a relevant event occurs, or an investment is made, as part of or as a result of a scheme or arrangement whose main purpose, or one of whose main purposes, is tax avoidance.

18. Subsection (8) of section 809VA provides that an individual is required to make a claim for the relief no later than the first anniversary of 31 January of the tax year following the tax year in which the income and gains used to make a qualifying investment would otherwise be treated as a remittance of those income and gains.

19. New section 809VB deals with cases where money or other property is brought to the UK with the intention of making a qualifying investment but in the event some or all of that money or other property is not invested within 45 days of being brought to the UK.

20. Subsection (1) of section 809VB provides that this section applies to any amount of income and gains which does not qualify for the relief provided by subsection 809VA(2) because it was not used to make a qualifying investment within the 45-day period. It defines the '45-day period' as the 45-day period beginning with the date on which the money or other property was brought to or received in the UK.

21. Subsection (2) of section 809VB provides that the amount referred to in subsection 809VB(1) is treated as not remitted to the UK to the extent that the remaining money or other property is taken offshore (as defined in section 809Z8) within the 45-day period.

22. Subsection (3) of section 809VB provides that, where only a part of the remaining money or other property is taken offshore within the 45-day period, the amount of income and gains which is treated as not remitted to the UK under subsection 809VA(2) is to be determined on a just and reasonable basis.

23. Subsection (4) of section 809VB provides that, notwithstanding subsection 809VA(2), the underlying income and gains in any remaining money or other property which is taken offshore within the 45-day period will be treated as being remitted to the UK if something is subsequently done with those income and gains which would itself count as a remittance.

24. Subsection (5) of section 809VB provides that references to the 'remaining' money or other property in this section are to the amount of the money or other property brought to or received in the UK which is not used to make a qualifying investment.

25. New section 809VC defines a qualifying investment for the purposes of section 809VA.

26. Subsection (1) of section 809VC provides that an investment is made for the purpose of section 809VA where a person either buys newly issued shares in a company or makes a loan to a company.

27. Subsection (2) of section 809VC provides that, for the purposes of this Part, the company in which an investment is made is referred to as 'the target company'.

28. Subsection (3) of section 809VC provides that a person's shares in or rights under a loan to a company, or a mixture of both, are referred to as 'the holding' for the purposes of this Part.

29. Subsection (4) of section 809VC provides that, where conditions A and B are met at the time the investment is made, that investment is counted as a qualifying investment.

30. Subsection (5) of section 809VC provides for the definition of conditions A and B in sections 809VD and 809VF respectively.

31. Subsection (6) of section 809VC provides that any reference to shares in this section includes securities.

32. Subsection (7) of section 809VC provides that, where a loan agreement authorises a company to draw down amounts of a loan over time, entry into that loan agreement is not treated as the making of a loan. Instead, a separate loan is treated as being made each time an amount is drawn down under that agreement.

33. Subsection (8) of section 809VC provides that, in cases referred to in subsection 809VC(7), each time an amount is drawn down under a loan agreement, a separate investment will be treated as having been made. It also provides that references in subsection 809VC(3) to a person's rights under the loan applies to the extent that those rights which relate to the amount are actually drawn down.

34. Example: an individual enters into a loan agreement under which the target company is able to draw down £1 million in four equal amounts of £250,000 over a four-year period. If the £1 million is retained outside the UK before being drawn down, each drawdown will be treated as a separate qualifying investment and receive the relief afforded by subsection 809VA(2).

35. New section 809VD defines condition A for the purposes of subsection 809VC(4).

36. Subsection (1) of section 809VD provides that the investment must be in an eligible trading company, an eligible stakeholder company or an eligible holding company to be a qualifying investment.

37. Subsection (2) of section 809VD defines an eligible trading company as a private limited company (as defined in subsection 809VD(11)) which is carrying on at least one commercial trade (as defined in section 809VE), or is preparing to do so within the next two years, and where carrying on a commercial trade is all, or substantially all, it does or it is reasonably expected to do once it begins trading.

38. Subsection (3) of section 809VD defines an eligible stakeholder company as a private limited company which exists wholly, ignoring minor or incidental purposes, for the purpose of making investments in eligible trading companies (as defined in subsection 809VD(2)). An eligible stakeholder company must actually hold at least one investment in an eligible trading company or be preparing to do so within the next two years.

39. Subsection (4) of section 809VD explains that 'making investments' in subsection 809VD(3) takes the same meaning as in section 809VC.

40. Subsection (5) of section 809VD defines an eligible holding company as a member of an eligible trading group, or a member of a group which is expected to become an eligible trading group within the next two years, and which has a 51 per cent subsidiary which is an eligible trading company. Where the eligible holding company owns the share capital of the eligible trading company indirectly, each intermediary company must also be a member of the group.

41. Subsections (6) to (11) of section 809VD define certain terms used in section 809VD.

42. Subsection (6) of section 809VD defines 'group' as a parent company and its 51 per cent subsidiaries.

43. Subsection (7) of section 809VD defines 'parent company' as one which is not itself a 51 per cent subsidiary of any other company and which has at least one 51 per cent subsidiary.

44. Subsection (8) of section 809VD defines 'eligible group' as one in which the parent company and each of its 51 per cent subsidiaries are private limited companies.

45. Subsection (9) of section 809VD defines 'eligible trading group' as an eligible group in which all or substantially all of its activities, taking the members of the group as a whole, are carrying on a commercial trade.

46. Subsection (10) of section 809VD provides that section 1155 of the Corporation Tax Act 2010 applies to determine whether a company owns the share capital of a subsidiary indirectly.

47. Subsection (11) of section 809VD defines ‘private limited company’ as a body corporate with limited liability, none of whose shares are listed on a recognised stock exchange. It also excludes all limited liability partnerships.

48. New section 809VE defines a commercial trade for the purposes of section 809VD.

49. Subsection (2) of section 809VE provides that for the purposes of section 809VD ‘trade’ includes any activity that is treated as a trade for corporation tax purposes and a business of generating income from land. The meaning of ‘generating income from land’ is provided by section 207 of Corporation Tax Act 2009 and includes generating income from both residential and commercial property.

50. Subsection (3) of section 809VE provides that a commercial trade is one conducted on a commercial basis with a view to making profits.

51. Subsection (4) of section 809VE provides that carrying on research and development activities will be treated as carrying on a commercial trade for the purposes of section 809VD, provided it is intended that a commercial trade will be derived or will benefit from those research and development activities.

52. Subsection (5) of section 809VE provides that preparing to carry on research and development activities is not a commercial trade for the purposes of section 809VD.

53. New section 809VF sets out condition B for the purposes of determining whether an investment is a qualifying investment for subsection 809VC(4).

54. Subsection (1) of section 809VF provides that condition B is met where no relevant person has obtained, or becomes entitled to obtain, any related benefit or expects to obtain such a benefit, whether directly or indirectly. Whether a benefit is ‘related’ is determined by subsection 809VF(3) and a relevant person takes its meaning from section 809M.

55. Subsection (2) of section 809VF defines a benefit for the purposes of this section as including the provision of anything which would not be provided to the relevant person in the ordinary course of business, or would be provided but on less favourable terms. It also provides that a benefit does not include the provision of anything to the relevant person in the normal course of business and on arm’s length terms.

56. Subsection (3) of section 809VF sets out when benefit is ‘related’ for the purposes of subsection 809VF(1). This is widely defined and includes benefits which are directly or indirectly attributable to the

making of the investment (whether the benefit arose before or after that investment was made), and benefits which, it is reasonable to assume, would not be available if the investment had not been made.

57. Subsection (4) of section 809VF provides that references to 'the provision of anything' in subsection 809VF(2) are to the provision of anything in money or money's worth and includes anything which provides any enjoyment or benefit to a person, whether on a temporary or permanent basis.

58. New section 809VG sets out the circumstances in which income and gains which are brought to the UK to make a qualifying investment are treated as remitted to the UK. It also clarifies the relevant grace period which applies for these purposes, and splits combined investments into those that qualify for the relief and those that do not.

59. Subsection (1) of section 809VG provides that subsection (2) applies if foreign income and gains have been used to make a qualifying investment and so are treated as not remitted by section 809VA(2), a potentially chargeable event (as defined in section 809VH) has subsequently occurred and the appropriate mitigation steps (as defined in section 809VI) have not been taken within the relevant grace period (as defined in section 809VJ).

60. Subsection (2) of section 809VG provides that in the circumstances set out in subsection 809VG(1) the affected income and gains are to be treated as having been remitted immediately after the end of the relevant grace period.

61. Subsections (3) and (4) of section 809VG provide that the grace period allowed for appropriate mitigation steps is determined by the type of mitigation step which is required to be taken. Where the appropriate mitigation step is the disposal of the entire holding, the grace period is set out in subsection 809VJ(1). Where the mitigation step is the taking offshore or re-investment of disposal proceeds, the grace period is set out in subsection 809VJ(2).

62. Subsection (5) of section 809VG defines the affected income and gains as that portion of the income or gains which, in the absence of the relief provided in subsection 809VA(2), would have been treated as remitted to the UK, which reflects the portion of the investment affected by the potentially chargeable event.

63. Subsection (6) of section 809VG provides that, where the potentially chargeable event is a disposal of a part of the holding, the portion of the investment affected by that potentially chargeable event is equal to the portion that is disposed of. Where the potentially chargeable event is something other than a part disposal of the holding, the whole of the investment is affected.

64. Example: where the potentially chargeable event is that a company ceases to be an eligible trading company, the portion of the investment affected by that potentially chargeable event is the entire investment. If the appropriate mitigation step is not taken within the relevant grace period, all of the income and gains that were previously treated as not remitted because they were used to make a qualifying investment are treated as having been remitted at the end of that grace period.

65. Example: where an investor disposes of half of a shareholding, but fails to take the appropriate mitigation step within the relevant grace period, the portion of the investment affected by that potentially chargeable event is half.

66. Subsection (7) of section 809VG provides for sections 809VN and 809VO to apply alongside section 809VG.

67. Subsection (8) of section 809VG provides that, where an investment is made which consists partly of funds which qualify for relief under the business investment provisions and partly of other funds, the investment is treated as two separate investments. These combined investments are treated as split into investments which qualify for the relief and those which do not. It also provides that any references in the business investment provisions to 'the investment' and to 'the holding' only relate to qualifying investments.

68. Subsection (9) of section 809VG provides that, where there is a second or subsequent potentially chargeable event in relation to a single investment, the affected income or gains that are treated as remitted do not include any amounts treated as remitted, taken offshore or re-invested or used to make a tax deposit within section 809VK, as a result of a previous potentially chargeable event.

69. Example: an investor disposes of half of their qualifying investment and takes the appropriate mitigation steps in relation to that potentially chargeable event in year one. In year two, they dispose of the remaining half of their investment, but fail to take the appropriate mitigation steps in respect of that disposal. As a result, only half of the investment, and therefore half of the income and gains which the original investment contained, is affected by the second part disposal and treated as remitted to the UK.

70. New section 809VH defines a potentially chargeable event. Where a potentially chargeable event occurs and the appropriate mitigation steps are not taken, income and gains will be treated as remitted in accordance with section 809VG.

71. Subsection (1) of section 809VH provides that a potentially chargeable event will occur where:

- the target company ceases for the first time to be any kind of eligible company;

- the relevant person who made the investment ('P') disposes of some or all of the qualifying investment;

- the extraction of value rule is breached; or

- the 2-year start-up rule is breached.

72. Subsection (2) of section 809VH sets out the circumstances in which the extraction of value rule is breached for the purposes of subsection 809VH(1). The rule is breached if the relevant person who made the investment or any other relevant person receives, or receives the benefit of, value in money or money's worth from either an involved company or from anyone else in circumstances which are attributable to the investment or to any other investment made by a relevant person in an involved company. The extraction of value rule is not breached if the value is received as a result of a disposal of the holding because the disposal is itself a potentially chargeable event.

73. Subsection (3) of section 809VH provides that the extraction of value rule is not breached merely because a relevant person receives value which is treated as income for tax purposes (or would be if the relevant person were liable either to income or corporation tax), provided the value is paid or provided on arm's length terms and in the ordinary course of business.

74. Example: where an individual makes a qualifying investment in a company of which they are a director, the receipt of director's remuneration would not constitute an extraction of value, providing the remuneration is treated as a receipt for income tax purposes and paid on arm's length terms in the ordinary course of business.

75. Subsection (4) of section 809VH defines an involved company for the purposes of subsection 809VH(2) as:

- the target company;

- any eligible trading company in which an eligible stakeholder company has invested or intends to invest;

- any eligible trading company which is a 51 per cent subsidiary of an eligible holding company; and

- any company connected with such a company.

76. Subsection (5) of section 809VH sets out when the 2-year start-up rule is breached. The rule will be breached if the target company is non-operational immediately after the end of the period of two years

from the day on which the qualifying investment was made. The rule will also be breached if the target company becomes non-operational at any time after the end of this period. This ensures that, after the 2-year start-up period has ended, the target company must either be trading, hold shares in at least one 51 per cent subsidiary company which is trading or be a stakeholder in at least one eligible trading company which is trading. Where this is not the case, a potentially chargeable event will occur.

77. Subsection (6) of section 809VH explains that a target company will be non-operational for the purposes of the 2-year start-up rule in subsection 809VH(5) if it is an eligible trading, stakeholder or holding company but does not trade or, as a stakeholder company, does not hold shares in at least one eligible trading company that is trading, or as a holding company, has no 51per cent subsidiaries that trade. An eligible holding company will be non-operational if it is not a member of an eligible trading group.

78. Subsection (7) of section 809VH provides that references to 'trading' in subsection 809VH(6) mean carrying on one or more commercial trades, including research and development activities.

79. Subsection (8) of section 809VH provides that where the potentially chargeable event is a disposal of a qualifying investment and the consideration for the disposal is paid in instalments, then each instalment is treated as a separate disposal and a separate potentially chargeable event.

80. Subsection (9) of section 809VH provides that, where a potentially chargeable event occurs because of an insolvency step taken for genuine commercial reasons, it will not be treated as a potentially chargeable event. However, this does not prevent the receipt of value as a result of the insolvency step from being a potentially chargeable event.

81. Subsection (10) of section 809VH defines an insolvency step for the purposes of subsection 809VH(9). An insolvency step is taken if a company enters into administration or receivership, or is wound up or dissolved. An insolvency step is also taken if similar steps are taken in relation to a company under the law of a country or territory outside the UK. The company taking the insolvency step may be the target company or any eligible trading company that the target company has invested in as an eligible stakeholder or eligible holding company.

82. New Section 809VI sets out the 'appropriate mitigation steps' that must be taken, following a potentially chargeable event, in order to prevent the affected income and gains being treated as remitted to the UK under subsection 809VG(2). The appropriate mitigation steps

must be taken within the relevant grace periods set out in section 809VJ. There are two types of appropriate mitigation steps depending on the type of potentially chargeable event.

83. Subsection (1) of section 809VI sets out the appropriate mitigation steps where the potentially chargeable event is a disposal of all or part of the holding. In this case the proceeds arising from the disposal must be taken offshore or re-invested.

84. Subsection (2) of section 809VI sets out the appropriate mitigation steps for any other potentially chargeable event. In this case the individual must dispose of the entire holding (or whatever part still belongs to the individual at the date of the potentially chargeable event) and either take the proceeds offshore, or re-invest them. For the purposes of the appropriate mitigation steps, the meaning of taking proceeds offshore is dealt with in section 809Z9 and the meaning of ‘ re-invested’ is provided in subsection 809VI(7).

85. Subsection (3) of section 809VI provides that, in cases where the disposal proceeds exceed amount X, it is only amount X that needs to be taken offshore or re-invested as the appropriate mitigation step.

86. Subsection (4) of section 809VI defines the amount ‘X’ for the purposes of subsection 809VI(3). Amount X is equal to the sum originally invested, less so much of that amount that has previously:

- been taken into account in determining the amount of income and gains treated as remitted after a potentially chargeable event;
- been taken offshore or re-invested as an appropriate mitigation step; or
- been used to make a tax deposit that reduces the amount that needs to be taken offshore or re-invested as an appropriate mitigation step.

87. Limiting the amount that has to be taken offshore or re-invested after a disposal in this way ensures that an individual will never be required to take offshore or re-invest more in total than the amount that was actually used to make the investment. If the whole of the holding is sold for more than the sum invested, so that there is a capital gain, then the individual is not required to take offshore or re-invest the amount of the capital gain. However, where there is a part disposal of the holding P is required to take offshore or re-invest the full amount of the proceeds up to the amount of the sum invested, even where the proceeds include an element of UK gain. The total amount that an individual is required to take offshore or re-invest can never exceed the total amount invested.

88. Example: an individual invests £3 million foreign income in an eligible trading company in year one. In year five, they dispose of half of the holding for £2 million. The disposal proceeds are £2 million and X (the sum originally invested) is £3 million. The investor must therefore take £2 million offshore or re-invest it to take the appropriate mitigation step.

89. In year seven, the investor sells the remainder of the holding for £3 million. The disposal proceeds are £3 million but, assuming that the appropriate mitigation step was taken after the first part disposal in year five, amount X is £3 million (the sum originally invested) less £2 million (the amount of the sum invested taken offshore or re-invested on a previous occasion). The investor must therefore take £1 million offshore or re-invest it. In summary, the individual has invested £3 million and has been required to take offshore or re-invest a total of £3 million as the appropriate mitigation steps following two potentially chargeable events.

90. Subsection (5) of section 809VI provides that, in determining amount 'X', the 'amount originally invested' is the amount of money used to make the original investment, or, if the investment was made using property other than money, the market value of that property.

91. Subsection (6) of section 809VI provides that, for the purposes of subsection 809VI(5), where market value needs to be applied because the original investment was made using property other than money, that property must be valued at the date of the relevant event. 'Relevant event' is defined in section 809VA as either the making of a qualifying investment or the bringing of money or other property to the UK for the purpose of making such an investment.

92. Subsection (7) of section 809VI provides that proceeds are re-invested, and the appropriate mitigation steps will be regarded as having been taken, where they are used to make another qualifying investment, whether in the same or a different company.

93. Example: where a share for share exchange has occurred whereby an individual disposes of shares in a qualifying company and simultaneously acquires new shares in the same or another qualifying company, the appropriate mitigation steps will be regarded as having been taken when the exchange takes place. In other words, the exchange will be treated as an immediate reinvestment in another qualifying company.

94. Subsection (8) of section 809VI provides that where a breach of the extraction of value rule takes place in connection with the winding up or dissolution of the target company there is no requirement to dispose of the holding and references to the disposal proceeds in this

section and elsewhere in the business investment provisions are to be read as references to the value received.

95. New section 809VJ sets out the grace periods during which the appropriate mitigation steps must be taken.

96. Subsection (1) of section 809VJ provides a 90-day grace period for the step mentioned in subsection 809VI(2)(a) (disposal of the holding or the part of the holding still retained at the time of the potentially chargeable event). The 90 days starts from either of two points: where the potentially chargeable event is a breach of the extraction of value rule, it starts on the day the value is received. In all other cases it starts on the day on which a relevant person first became aware, or ought reasonably to have become aware, of the potentially chargeable event. 'Relevant person' is defined in the existing section 809M.

97. Subsection (2) of section 809VJ provides a 45-day grace period that operates in two circumstances: first, where the potentially chargeable event was itself a disposal, and second, where the potentially chargeable event was something other than a disposal and the individual has complied with the requirement in subsection 809VI(2)(a) to dispose of the holding (or whatever part of it remains in their possession). The individual has 45 days to take the proceeds offshore or re-invest them. The 45 days starts on the day that the proceeds first become available for use by P or by any other relevant person, or the proceeds first become available for use for the benefit of P or any other relevant person.

98. Subsection (3) of section 809VJ provides that an individual can ask an officer of HMRC to agree to extend a grace period in exceptional circumstances. HMRC will publish guidance on what is meant by exceptional circumstances.

99. Subsection (4) of section 809VJ allows an officer of HMRC to extend the grace period allowed for an appropriate mitigation step in circumstances specified in regulations made by the Commissioners.

100. The Government intends to introduce regulations under this power that will allow grace periods to be extended in the following circumstances:

- when an individual is prevented from disposing of shares due to a 'lock-in' agreement associated with a company becoming listed on a recognised stock exchange such that a holding of its shares would no longer be a qualifying investment; and

- when an individual is prevented from disposing of shares due to a statutory or regulatory barrier such as a 'closed period' following the company's year end.

101. Subsection (5) of section 809VJ allows any regulations made by HMRC to take into account investments made before the regulations come into force.

102. Subsection (6) of section 809VJ provides that any regulations made under the power in subsection 809VJ(4) will not restrict the operation of HMRC's power to extend a grace period in exceptional circumstances under subsection 809VJ(3).

103. Subsection (7) of section 809VJ provides that the powers conferred on an officer of HMRC to agree to extend a grace period for a length of time that is indefinite but which is capable of becoming definite by means identified in the agreement such as the satisfaction of conditions.

104. HMRC will issue guidance about the procedures that individuals will need to follow when making applications to extend grace periods and on the sorts of conditions that might be imposed.

105. New section 809VK provides the conditions under which part of the proceeds from a disposal of a qualifying investment can be retained in the UK to meet a capital gain tax (CGT) liability without being treated as remitted.

106. Subsection (1) of section 809VK sets out the conditions which have to be met before anything can be retained in the UK. These are that:

- there has been a disposal of all or part of the holding;
- the disposal counts as a potentially chargeable event or is part of the appropriate mitigation steps taken in consequence of a potentially chargeable event;
- a chargeable gain accrues on the disposal to the individual who made the investment;
- that individual is chargeable to capital gains tax (but not corporation tax) in respect of that gain; and
- the actual disposal proceeds are less than an amount 'Y'.

107. Subsection (2) of section 809VK defines 'the shortfall' for the purposes of this section as the difference between the actual disposal proceeds and amount 'Y' (as defined in subsection 809VK(4)).

108. Subsection (3) of section 809VK defines 'the actual disposal proceeds' as the disposal proceeds disregarding any effect of subsection 809Z8(4). That subsection provides that, where the disposal is not made by way of a bargain on arm's length terms, the disposal is deemed to be made for a consideration equal to the market

value of the holding immediately before the disposal. This means that the shortfall is calculated by reference to the proceeds which were actually received even where the disposal was not made on arm's length terms.

109. Subsection (4) of section 809VK defines amount 'Y' as the sum of the amount that would otherwise be required to be taken offshore under subsection 809VI(1) or 809VI(2)(b), and the amount resulting when the highest potential CGT rate is applied to the chargeable gain resulting from the disposal.

110. Subsection (5) of section 809VK defines the highest potential CGT rate for the purposes of subsection 809VK(4) as that specified in section 4(3) of the Taxation of Chargeable Gains Act 1992 (TGCA) for trustees and personal representatives, and as specified in section 4(4) of that Act in all other cases.

111. Subsection (6) of section 809VK provides that, where an amount is retained in the UK under the provisions of section 809VK, the amount required to be taken offshore by subsection 809VI(1) or subsection 809VI(2)(b) is to be reduced by the amount which has been retained.

112. Subsection (7) of section 809VK defines 'the permitted amount' as the amount of the shortfall used to purchase a certificate of tax deposit within the 45-day grace period allowed for taking the proceeds offshore or re-investing them.

113. Subsection (8) of section 809VK provides that the reduction provided for in subsection 809VK(6) may not be made unless there is written confirmation to HMRC that the certificate of tax deposit purchased is intended to relate to section 809VK and does not exceed the shortfall calculated under subsection 809VK(2).

114. Example: an individual makes a qualifying investment using £10 million of their foreign income. They subsequently dispose of part of the investment and receive disposal proceeds of £1 million, of which £500,000 are a chargeable gain. This is the first disposal of any part of this qualifying investment and no funds have previously been taken offshore or re-invested as part of a mitigation step required by subsection 809VI(1) and subsection 809VI (2)(b).

115. The actual disposal proceeds are £1 million. The whole of the disposal proceeds would, but for this section, be required to be taken offshore by subsection 809VI(1). The highest potential CGT rate, as provided for an individual under section 4(4) TCGA, is 28 per cent. Therefore amount Y is the sum of £1 million and 28 per cent of £500,000, or £1.14 million. The actual disposal proceeds are less than

Y, and the difference between them is £140,000, which is the shortfall.

116. The individual is therefore allowed to use any amount of the disposal proceeds up to £140,000 to purchase a certificate of tax deposit, provided this is done within the 45-day grace period from the date those proceeds first become available for the individual P to use, as provided by subsection 809VJ(2), and that it is confirmed in writing to HMRC that this deposit relates to this section.

117. The individual places the permitted amount of £140,000 in a certificate of tax deposit within the 45-day grace period. The amount that must be taken offshore under subsection 809VI(1) is reduced by £140,000, so £860,000 of the disposal proceeds must now be taken offshore or re-invested within the same grace period.

118. New Section 809VL describes the effect of taking the appropriate mitigation steps within the relevant grace period.

119. Subsection (1) of section 809VL explains that this section applies if appropriate mitigation steps are taken within the relevant grace period.

120. Subsection (2) of section 809VL provides that where an individual disposes of a qualifying investment and takes the proceeds offshore, subsection 809VA(2) will not prevent those proceeds, or anything deriving from them, from being treated as a taxable remittance in the usual way if they are brought to the UK on any subsequent occasion.

121. Subsection (3) of section 809VL deals with cases where an individual uses the proceeds from a disposal of a qualifying investment to re-invest in another qualifying investment. In such situations, the underlying income and gains (defined in subsection (6)), continue to be treated as not remitted to the UK. It also provides that part 2 of the Schedule will apply to that re-investment in the same way as it applied to the original investment.

122. Subsection (4) of section 809VL sets out rules which apply the business investment provisions in cases where the proceeds from the disposal of a qualifying investment are re-invested in another qualifying investment. These are that:

- the potentially chargeable event giving rise to disposal proceeds will be regarded as the relevant event for the purposes of subsection 809VA(3);
- the underlying income and gains from the disposal are to be treated as the income and gains treated as not remitted to the UK for the purposes of subsection 809VA(2); and

- the amount used to make the re-investment is to be treated as the sum originally invested.

123. Example: an individual disposes of a qualifying investment on 18 March 2015 and re-invests the entire proceeds in another qualifying investment on 31 March 2015. The disposal on 18 March was a potentially chargeable event, and this is counted as the relevant event for the purposes of subsection 809VA(3). The original investment was made with £1 million foreign income which continues to be treated as not remitted to the UK and to retain its original character in the new qualifying investment.

124. Subsection (5) of section 809VL provides further rules which apply where there is a re-investment which uses more than the disposal proceeds from the original investment. In such cases, the investment is to be treated as two separate investments, one of an amount equal to the disposal proceeds from the original investment, and one an amount equal to the balance. Only the former amount is to be regarded as 'the investment' or 'the holding' for the purposes of the business investment provisions.

125. Subsection (6) of section 809VL defines 'the underlying income or gains' as the affected income or gains, or, in cases where the disposal proceeds are partly taken offshore and partly re-invested, a corresponding proportion of the affected income or gains as determined under section 809VG.

126. Subsection (7) of section 809VL requires the individual to make a further claim to business investment relief in respect of any amount re-invested. The deadline for making such a claim is the first anniversary of 31 January following the tax year in which the re-investment is made. It also provides that failure to make such a claim will mean that the appropriate mitigation steps will not be regarded as having been taken and subsection 809VG(2) will apply to treat the original investment as remitted to the UK.

127. Subsection (8) of section 809VL provides that section 809VM makes further provision in relation to cases involving a tax deposit.

128. New section 809VM deals with cases where there has been a disposal of a qualifying investment and part of the disposal proceeds have been put into a certificate of tax deposit to pay the CGT liability arising on the UK gain on that disposal, as provided by section 809VK.

129. Subsection (1) of section 809VM provides the conditions that need to be satisfied for this section to apply. These conditions are that:

- the appropriate mitigation steps were taken within the relevant grace period and so subsection 809VG(2) did not apply;

- the amount required to be taken offshore or re-invested by subsection 809VI(1) or subsection 809VI(2)(b) had been reduced by an amount allowed by section 809VK; and

- without that reduction, the amount that was actually taken offshore or re-invested would not have been enough to satisfy subsection 809VI(1) or subsection 809VI(2)(b).

130. Subsection (2) of section 809VM provides that references to 'the tax deposit' in this section are to the deposit which gave rise to the reduction.

131. Subsection (3) of section 809VM provides that if funds in a certificate of tax deposit by virtue of the provisions in section 809VK are used to meet the relevant tax liability, then the underlying foreign income and gains in those funds shall not be treated as having been remitted to the UK. In particular, the relief afforded by subsection 809VA(2) shall continue to apply to those income and gains.

132. Subsection (4) of section 809VM provides that if any of the certificate tax deposit (CTD) conditions are breached then the underlying income and gains are to be treated as having been remitted to the UK.

133. Subsection (5) of section 809VM defines 'the underlying income and gains'. Where the underlying income and gains relate to funds in a certificate of tax deposit being used to meet the relevant tax liability (as in subsection (3)), then they are to be treated as the portion of the affected income and gains that the payment represents. Where there has been a breach of the CTD conditions, the underlying income and gains are the portion of the affected income and gains affected by the breach.

134. Affected income and gains are defined generally in subsection 809VG(5) and specifically for mixed funds in subsection 809VO(8).

135. Subsection (6) of section 809VM provides for the CTD conditions. These are that:

- the tax deposit must be used to pay the relevant tax liability;

- any funds withdrawn from the tax deposit which are not used to pay the relevant tax liability must be taken offshore or re-invested within 45 days of the day on which the withdrawal is made; and

- any funds not withdrawn or used to pay the relevant tax liability by the due date must be withdrawn and taken offshore or re-invested within 45 days of the due date, defined in subsection 809VM(8)(b) as the date on which the relevant tax liability is required to be paid.

136. Subsection (7) of section 809VM provides that, where funds in a certificate of tax deposit are taken offshore or re-invested within the 45-day period allowed by subsection (6) in line with the CTD conditions, those funds are treated, for the purposes of section 809VL, as if they were disposal proceeds which had been taken offshore or re-invested.

137. Subsection (8) of section 809VM provides definitions of the following terms used in this section:

- ‘the relevant liability’;
- ‘the due date’; and
- ‘re-invested’.

It also provides that references to a withdrawal in this section include any repayment.

138. New section 809VN provides rules which determine the order in which disposals are treated as being made where there are multiple acquisitions and disposals in the same target company or group and where both qualifying and non-qualifying investments have been made.

139. Subsection (1) of section 809VN sets out when the first in, first out rule provided by subsection 809VN(2) is to apply. This is where an individual has made different qualifying investments in either the same target company or the same eligible trading group or in both an eligible trading company and its eligible stakeholder company.

140. The terms ‘target company’, ‘eligible trading group’, ‘eligible trading company’ and ‘eligible stakeholder company’ are defined in section 809VD.

141. Subsection (2) of section 809VN provides that, where income and gains are treated as remitted to the UK under section 809VG, all the investments and holdings are treated as a single investment and a single holding. Any disposal of all or part of that investment or holding is then treated as a disposal of the single investment but with the effect of disposals in the order in which the individual qualifying investments were made, starting with the qualifying investment which was made first.

142. Subsection (3) of section 809VN provides that subsection 809VN(4) applies where foreign income and gains are treated as not remitted to

the UK as a result of one or more qualifying investments, and where a relevant person holds one or more other investments in the same eligible trading company, eligible trading group or a related eligible company in a situation where that other investment is not a qualifying investment.

143. Subsection (4) of section 809VN provides that, where income and gains are treated as remitted to the UK under section 809VG, all the investments and holdings are treated as a single investment and a single holding. Any disposal of all or part of that investment or holding is then treated as a disposal of a holding of all qualifying investments before a disposal of any of the non-qualifying investments.

144. Subsection (5) of section 809VN defines a 'related eligible company' for the purposes of subsection 809VN(3). In the case of an eligible trading company, a related eligible company is an eligible stakeholder company which holds investments in that trading company. In the case of an eligible stakeholder company, a related eligible company is an eligible trading company in which that company holds investments.

145. Subsection (6) of section 809VN provides that subsection 809VN(2) and subsection 809VN(4) apply both where the investments are held by the same relevant person and where they are held by different relevant persons.

146. New section 809VO deals with qualifying investments which are made from a mixed fund. A mixed fund is defined in section 809Q(6) as an overseas fund of money or other property which contains or consists of more than one type of income or gains, or income or gains from more than one tax year. Where an amount is remitted from a mixed fund, there are special ordering rules which determine how the remitted amount is taxed.

147. Subsection (1) of section 809VO provides for this section to apply where a qualifying investment is made from a mixed fund as defined in section 809Q.

148. Subsection (2) of section 809VO provides that the relevant event is treated as an offshore transfer for the purposes of section 809R(4). A 'relevant event' is defined in subsection 809VA(3) as using income and gains to make a qualifying investment or bringing income and gains to the UK for the purpose of making such an investment.

149. Broadly, the effect of treating a relevant event as an offshore transfer is that the amount brought to the UK is treated as containing the same proportions of income, gains and capital as there was in the mixed fund immediately before the transfer took place.

150. Subsection (3) of section 809VO provides that the holding also is to be treated as containing a proportion of each kind of income and capital as there was in the invested property, but equal to the fixed proportion.

151. Subsection (4) of section 809VO defines ‘the fixed proportion’ for the purposes of subsection 809VO(3) as the proportion of income or capital contained in the invested property (as defined in subsection 809VO(5)) which is determined by the application of the offshore transfer rules.

152. Subsection (5) of section 809VO defines ‘the invested property’ as the money or other property which was used to make the qualifying investment.

153. Subsection (6) of section 809VO provides that subsection 809VO(7) applies where the money or other property is treated as not remitted to the UK because an amount is taken offshore, re-invested or used to make a tax deposit.

154. Subsection (7) of section 809VO provides that the amount referred to in subsection 809VO(6) as being taken offshore, re-invested or used to make a tax deposit is treated as containing the fixed proportion of each kind of income and capital as was contained in the holding.

155. Subsection (8) of section 809VO provides that the amount of the different kinds of income and gains in the holding (determined by applying the fixed proportion rule) is ‘the fixed amount’. Where income and gains are treated as remitted to the UK because the appropriate mitigation steps were not taken within the grace period, the amount treated as remitted (the affected income and gains) are so much of the fixed amount of each kind of income and gain as was contained in the amount invested which reflects the portion of the investment affected by the potentially chargeable event. In other words, the mixed fund rules do not apply to determine the amounts remitted.

156. Subsection (9) of section 809VO applies sections 809R(2), 809R(3) and 809S to section 809VO.

157. Paragraph 8 of the Schedule inserts the heading ‘Relief for certain UK services’ after the sections inserted by paragraph 7 of the Schedule.

158. Paragraph 9 of the Schedule inserts the heading ‘Exempt property relief’ immediately before section 809X.

159. Paragraph 10 of the Schedule amends section 809Y ITA by inserting new subsections (6) to (10). These deal with cases where property which has ceased to be exempt property is subsequently used to make

a qualifying investment. Section 809Y(1) provides that property which ceases to be exempt property is to be treated as remitted at the time it ceases to be exempt property.

160. New subsection (6) of section 809Y prevents exempt property from being treated as remitted to the UK under subsection 809Y(1) if it is used to make a qualifying investment, provided that investment is made within 45 days of it ceasing to be exempt property. This rule also applies to anything into which that property is converted. This treatment is only allowed if the remittance basis user (as defined in section 809Z10) makes a claim for this relief on or before the anniversary of 31 January following the end of the tax year in which the property ceased to be exempt property.

161. New subsection (7) of section 809Y provides that references in subsection 809Y(6)(a) to anything into which exempt property is converted are, in cases where the property is sold, to the proceeds of that sale or, where the property is converted into money in some other way, the money into which it is converted. This is also the case when the conversion takes place after the property ceases to be exempt property.

162. New subsection (8) of section 809Y provides rules which apply where subsection 809Y(1) does not apply by virtue of subsection 809Y(6).

163. Subsection (8)(a) of section 809Y provides that the property, or anything into which that property is converted, is treated as containing or deriving from an amount of each of the categories of income and gains set out in the mixed fund rules in subsection 809Q(4)(a) to (h) as is equal to the fixed amount. These amounts do not include any capital contained in the property or from which the property has been derived.

164. Subsection (8)(b) of section 809Y provides that the foreign income and gains which are treated under section 809X as not remitted to the UK will continue to be treated as not remitted, even though the property has ceased to be exempt property

165. Subsection (8)(c) of section 809Y provides that the business investment provisions apply to the foreign income and gains in the same way as they apply to foreign income and gains which are treated as not remitted to the UK under subsection 809VA(2).

166. New subsection (9) of section 809Y defines ‘the fixed amount’ for the purposes of subsection 809Y(8)(a) as the amount of that category of foreign income and gain which was contained in the property when it was brought to or received in the UK.

167. New subsection (10) of section 809Y provides that, where a qualifying investment is made using exempt property (including anything into which that property is converted) together with money or other property, only that part of the investment made using the exempt property is the qualifying investment for the purposes of the business investment provisions.

168. Paragraph 11 of the Schedule removes the definition of a relevant person in subsection 809Z(2)(a).

169. Paragraph 12 of the Schedule amends section 809Z4 and provides that the time in which exempt property is invested in a qualifying investment under section 809VA is not a countable day for the purposes of the temporary importation rule. The temporary importation rule allows exempt property to be brought to the UK without triggering a remittance, provided the number of days it spends in the UK ('countable days') does not exceed 275 in total.

170. Paragraph 13of the Schedule substitutes the phrase 'this Chapter' for 'sections 809L, 809N and 809O' in section 809M.

171. Paragraph 14 of the Schedule removes subsection 809Z7(7).

172. Paragraph 15 of the Schedule introduces the heading 'Meaning of 'foreign income and gains', etc.' for section 809Z7.

173. Paragraph 16 of the Schedule inserts new interpretative provisions in new sections 809Z8 to 809Z10.

174. Subsection (1) of section 809Z8 provides that 'the disposal proceeds' means the consideration for the disposal less any agency fees which are deducted before the consideration is paid or otherwise made available to or for the benefit of the person making the disposal or any other relevant person.

175. Subsection (2) of section 809Z8 provides that subsections 809Z8(3) to 809Z8 (7) apply in determining the consideration for the disposal.

176. Subsection (3) of section 809Z8 provides that, where the consideration is provided in a form other than money, the amount of the consideration is the market value of what is provided at the time of the disposal.

177. Subsection (4) of section 809Z8 provides that, where the disposal is not made on arm's length terms, the consideration is the market value of what is disposed of immediately before the disposal takes place.

178. Subsection (5) of section 809Z8 provides that any disposal made to another relevant person or to a person connected with a relevant person is not treated as being made on arm's length terms and

therefore that the consideration is the market value of what is disposed of immediately before the disposal takes place.

179. Subsection (6) of section 809Z8 defines ‘agency fees’ as any fees and other incidental costs of a disposal charged to the person making the disposal or any other relevant person by or through whom the disposal is effected. It also provides that ‘agency fees’ excludes any costs either charged by a relevant person or in any way applied for the benefit of a relevant person.

180. Subsection (7) of section 809Z8 provides that the exclusion of costs charged by a relevant person or in any way applied for the benefit of a relevant person from the definition of agency fees does not apply where the fees or costs relate to a service provided by the relevant person in connection with the disposal and do not exceed the amount which would be charged for that service if it were provided in the ordinary course of business on arm’s length terms.

181. New section 809Z9 provides further rules which apply when something is taken offshore or used to make a qualifying investment.

182. Subsection (1) of section 809Z9 provides that section 809Z9 applies to the various provisions in the chapter which require something, including disposal proceeds, to be taken offshore or to be used by a relevant person to make a qualifying investment.

183. Subsection (2) of section 809Z9 defines what is meant by ‘taken offshore’. A thing is taken offshore when it is taken out of the UK such that it ceases to be available to be used or enjoyed in the UK by or for the benefit of a relevant person, or ceases to be available to be used or enjoyed in any other way that would count as a remittance of income or gains to the UK.

184. Subsection (3) of section 809Z9 provides for situations in which money is required to be taken offshore or invested and is paid temporarily into a bank account. Under such circumstances, the money will be regarded as having been taken offshore or invested only where the money taken offshore or invested is taken from the same bank account.

185. Subsection (4) of section 809Z9 provides for circumstances in which something other than money is received as sales proceeds. In such cases, that thing will be regarded as having been taken offshore or invested if it is either taken offshore or invested, or if money or property of the equivalent value is taken offshore or invested.

186. Subsection (5) of section 809Z9 defines ‘the equivalent value’ for the purposes of subsection 809Z9(4) as the market value of the thing at

the date of the sale or other disposal which triggered the requirement to send that thing offshore or invest it.

187. Subsection (6) of section 809Z9 provides for situations where consideration is deemed under subsection 809Z8(4) to be equal to the market value because the disposal was not made on arm's length terms. In such cases, the requirement for proceeds to be taken offshore or invested may be satisfied by taking offshore or investing an amount equal to the deemed consideration less any agency fees deducted before the consideration is paid to or for the benefit of a relevant person.

188. Subsection (7) of section 809Z9 prevents an individual taking offshore or investing an asset of the equivalent value if the asset in question falls within one of three categories: it is exempt property under section 809X, or is consideration for the disposal of exempt property, or is consideration for the disposal of an investment qualifying for business investment relief. In these three situations, the individual will already be required, under one of the provisions elsewhere in the chapter, to take offshore or re-invest the money or other property in order to take the appropriate mitigation steps.

189. Subsection (8) of section 809Z9 provides that, where an equivalent amount is taken offshore or invested, it is to be treated as deriving from the thing to which it is equivalent and as having the same proportions of kinds of income and capital as that thing.

190. Subsection (9) of section 809Z9 provides that, where there is provision that requires something to be taken offshore or invested, an individual may satisfy that provision by taking the whole thing offshore, investing the whole thing, or taking part offshore and investing the remaining part.

191. Subsection (10) of section 809Z9 provides that references to something being 'invested' in this section are to something being used by a relevant person to make a qualifying investment.

192. Subsection (11) of section 809Z9 provides special rules for cases covered by subsection 809VB(2) which requires money brought to the UK for the purposes of making a qualifying investment either to be used for that purpose within 45 days or else taken back offshore within the same period. In such cases, references in section 809Z9 to investing are to be disregarded, and if appropriate the date for valuing a property other than money is the date of the relevant event as defined in subsection 809VA(3).

193. New section 809Z10 provides definitions of the following terms used in the Chapter:

- ‘the business investment provisions’ are sections 809VA to 809VO;
- ‘the Commissioners’ are the Commissioners for HMRC;
- ‘market value’ has the same meaning as in TGCA, and in particular sections 272 and 273;
- ‘qualifying investment’ has the meaning given by section 809VC;
- ‘relevant person’ has the meaning given by section 809M; and
- ‘the remittance basis user’ is the individual whose foreign income and gains are potentially subject to the remittance basis.

194. Paragraph 17 of the Schedule provides that the amendments made by part 2 of the Schedule apply to any relevant event which takes place on or after 6 April 2012. A relevant event is defined in subsection 809VA(3) as an event in which a relevant person either makes a qualifying investment or brings or receives money or other property to the UK for the purpose of making such an investment.

Sales of Exempt Property

195. Part 3 of the Schedule introduces a new exemption for the tax which otherwise would arise on the remittance of foreign income and gains when exempt property is sold in the UK. It also treats any UK gain which arises on such sales as a foreign chargeable gain.

196. Exempt property is defined in sections 809X as property deriving wholly or partly from foreign income and gains which meets certain conditions and which would otherwise be subject to tax on the remittance basis if it were brought to the UK. Exempt property does not include property which derives wholly from capital or from UK income and gains or a combination of the two.

197. Under section 809Y(3), exempt property will cease to be exempt property where it is sold or otherwise converted into money in the UK, at which point the foreign income and gains will be taxed on the remittance basis.

198. Paragraph 18 of the Schedule introduces new sections 809YA to 809YD ITA.

199. Subsection (1) of section 809YA provides that exempt property which is sold in the UK will not be treated as a taxable remittance of foreign income and gains where conditions A to F are met.

200. Subsections (2) to (5), (7) and (9) of section 809YA set out conditions A to F for the purposes of section 809YA:

- Condition A is that the exempt property is sold to a person who is not a relevant person (as defined by section 809Z10, and having the meaning as that given in section 809M);

- Condition B is that the sale is made on arm's length terms;

- Condition C is that no relevant person has any interest in, or entitlement to benefit from, the property after the sale has been completed, nor any conditional or unconditional right to acquire such an interest or entitlement;

- Condition D is that the entire proceeds of the sale are released on or before the final deadline (as defined in subsection 809YA(6)), whether they are paid in a series of instalments or in a single instalment;

- Condition E is that the entire sale proceeds are either taken offshore or used to make a qualifying investment under section 809VA within 45 days of the day on which the proceeds are released (as defined in subsection 809YA(10)), or, where the proceeds are paid in instalments, within 45 days of the day on which each instalment is released; and

- Condition F is that, where condition E is wholly or partly met by using the proceeds to make a qualifying investment under section 809VA, the remittance basis user must make a claim for relief under subsection 809YC(2) on or before the first anniversary of the 31 January following the tax year in which the exempt property is sold. The term 'the remittance basis user' is defined for the purposes of this Chapter in section 809Z10 as inserted by paragraph 16 of this Schedule as the individual who would be liable to tax on the remittance of foreign income and gains in the absence of section 809VA.

201. Subsection (6) of section 809YA defines 'the final deadline' for the purposes of condition D as the first anniversary of the 5 January following the tax year in which the sale takes place. This deadline is necessary to ensure that it falls within the time limit for making amendments to an individual's self-assessment for the tax year in which the disposal takes place.

202. Subsection (8) of section 809YA provides that, where any of the sale proceeds are released within 45 days of the final deadline, condition E will be met with respect to those proceeds only where they are taken offshore or used to make a qualifying investment on or before the final deadline.

203. Example: if a part of the sale proceeds are released teo days before the final deadline, they still have to be taken offshore by the final

deadline, rather than having a further 43 days to be sent offshore or re-invested, in order to meet condition E.

204. Subsection (10) of section 809YA defines when sale proceeds are 'released' as the day on which they first become available for use by or for the benefit of any relevant person. This is the case where the proceeds are paid in a number of instalments and where they are paid in a single instalment.

205. Subsection (11) of section 809YA provides that the exemption for sales of exempt property does not apply where such sales are made as part or as a result of a scheme whose main purpose or one of the main purposes of which is tax avoidance.

206. New section 809YB contains supplementary provisions with regard to condition E.

207. Subsection (1) of section 809YB provides that an officer of HMRC can agree to extend the time limit in which sale proceeds, including proceeds paid in separate instalments, must be taken offshore or used to make a qualifying investment in order to meet condition E.

208. Subsection (2) of section 809YB provides that the extension to the time limit stipulated in subsection 809YA(1) can be made only in exceptional circumstances and when a remittance basis user has requested such an extension.

209. New section 809YC describes the effect of disapplying section 809Y.

210. Subsection (1) of section 809YC provides that section 809YC applies where exempt property does not cease to be exempt property when it is sold, or otherwise converted into money, by virtue of section 809YA.

211. Subsection (2) of section 809YC provides that the foreign income and gains which are treated as not having been remitted to the UK under 809X will continue to be treated as not remitted to the UK after the exempt property is sold, even though that property has ceased to be exempt property as a result of that sale.

212. Subsection (3) of section 809YC provides that subsection 809YC(2) will not prevent the underlying income and gains from being treated as remitted to the UK where anything is done with any part of the sale proceeds after they have been taken offshore or used to make a qualifying investment. The underlying income and gains means part or all of the foreign income and gains which were used to purchase the exempt property.

213. Subsection (4) of section 809YC provides that the sale proceeds will be treated as containing or deriving from an amount of each kind of

income and gains mentioned in the mixed fund rules in section 809Q(4)(a) to (h) which is equal to the amount of each type of those income or gains contained in the exempt property when it was brought to or received in the UK.

214. Example: an individual purchases property overseas using £2 million foreign income, £3 million foreign gains and £1 million clean capital. They subsequently bring the property to the UK where it is sold for £8 million. Under subsection 809YC(4), the sale proceeds of £8 million are treated as containing or deriving from £2 million foreign income and £3 million foreign gains. Any clean capital used to purchase the property and any UK gains arising on the sale are disregarded for these purposes.

215. Subsection (5)(a) of section 809YC provides that, where the disposal proceeds are used to make a qualifying investment, the foreign income and gains which continue to be treated as not remitted under subsection 809YC(2) will be subject to the business investment provisions in the same way as those provisions apply to income or gains which are treated as not remitted because they are used to make a qualifying investment under subsection 809VA(2).

216. Subsection (5)(b) of section 809YC provides that, where the disposal proceeds are used to make a qualifying investment, and where other amounts were also used to make the investment, only that part of the investment made using the disposal proceeds is treated as the investment for the purposes of the business investment provisions.

217. New section 809YD provides that a charge to CGT which accrues on a disposal of exempt property in the UK will be treated as a foreign chargeable gain when the sale is made in circumstances in which section 809YA applies.

218. Subsection (1) of section 809YD provides that section 809YD applies to an individual where a chargeable gain (‘the relevant UK gain’) accrues on the sale of exempt property which would, in the absence of section 809YA, be treated as remitted to the UK as a result of that sale under subsection 809Y(1). For the purposes of this section, an individual is either the person to whom the gain accrues or a person to whom part of the gain is treated as accruing by virtue of being a UK resident participator in a company resident outside the UK.

219. Subsection (2) of section 809YD treats the relevant UK gain for the purposes of the remittance basis as if it were the individual’s foreign chargeable gain. In the case of an individual who is taxed on the remittance basis without a requirement to make a claim to do so by virtue of section 809E, it also treats the relevant UK gain as it if were not part of their UK income and gains.

220. Subsection (3) of section 809YD provides that, where the individual is not domiciled in the UK and is taxed on the remittance basis in the applicable tax year, the relevant UK gain is charged as if it were a foreign chargeable gain in accordance with section 12 of TGCA.

221. Subsection (4) of section 809YD defines ‘relevant UK gain’ for the purposes of section 809YD as the gain accruing to the individual or, in the case of a person to whom part of the gain is treated as accruing by virtue of being a UK resident participator in a company resident outside the UK, as that part of the gain which is treated as accruing to him.

222. Subsection (5) of section 809YD defines ‘applicable tax year’ for the purposes of section 809YD as the year in which the relevant UK gain accrues. In cases where the gain accrues when the individual is temporarily non-resident and the gain is treated as accruing in the year in which they become resident or ordinarily resident in the UK (the ‘year of return’), it also defines ‘applicable tax year’ as that year of return.

223. Subsection (6)(a) of section 809YD provides that, in applying this Chapter to a relevant UK gain, any foreign chargeable gains which are treated as contained in the sale proceeds by virtue of subsection 809YC(4) are increased by the amount of the relevant UK gain.

224. Example: an individual purchases property overseas using £5 million of their foreign chargeable gains and £1 million clean capital which they bring to the UK. The property is sold for £7 million. The sale proceeds will be treated as containing £6 million foreign chargeable gains, made up of the £5 million gains used to purchase the property plus the £1 million relevant UK gain accruing on the sale of the property.

225. Subsection (6)(b) of section 809YD provides that, in applying this Chapter to a relevant UK gain, section 809U should be disregarded because it has no relevance to the application of section 809YD.

226. Subsection (6)(c) of section 809YD provides that, in applying this Chapter to a relevant UK gain, anything which is done in relation to any part of the sale proceeds before it is taken offshore or used to make a qualifying investment is not treated as a remittance of any of the relevant UK gain to the UK.

227. Subsection (7) of section 809YD provides that the relevant UK gain is treated as if it were a foreign chargeable gain for the purposes of the following sections of TCGA:

- section 10A (treatment of chargeable gains and losses during temporary non-residence);

- section 12 (treatment of chargeable gains and loses for those UK resident non-UK domiciled individuals to whom the remittance basis applies);

- section 14A (treatment of chargeable gains of a company treated as accruing to a UK resident participator by virtue of section 13 when that participator is a non-UK domiciled individual); and

- sections 16ZB to 16ZD (computation of remitted foreign chargeable gains).

228. Subsection (8) of section 809YD provides that section 809YD applies despite section 14A(2) TGCA, which otherwise holds that the part of the chargeable gain treated as accruing to an individual under section 12 is a foreign chargeable gain if, and only if, the asset is situated outside the UK.

229. Subsection (9) of section 809YD provides that section 809YD does not apply to a chargeable gain where an individual gives notice to HMRC.

230. Subsection (10) of section 809YD provides that a notice given under subsection 809YD(9) must be provided in writing, must identify the gain in question and must be given no later than a year after the 31 January of the year following the applicable tax year and cannot be revoked after that date.

231. Paragraph 19 of the Schedule provides that the exemption provided by paragraph 18 is available for all sales of exempt property sold on or after 6 April 2012.

Nominated Income

232. Part 4 of the Schedule amends the rules which determine the tax treatment of nominated income and gains remitted to the UK.

233. Paragraph 20 of the Schedule disapplies section 809I ITA where the new £10 test is not met.

234. Sub-paragraph (2) of paragraph 20 introduces the £10 test into section 809I(1).

235. Sub-paragraph (3) of paragraph 20 defines a ‘nomination year’ for the purposes of section 809I as any year in which an individual has nominated income and gains under section 809C ITA.

236. Sub-paragraph (4) of paragraph 20 introduces the £10 test as new subsections (5) and (6) of section 809I. An individual will breach the £10 test in a tax year where they have remitted any of their nominated income and gains and the amount of nominated income and gains

from any one tax year which is remitted exceeds £10. Provided an individual never nominates more than £10 of their foreign income or gains from a particular tax year, they will never breach the £10 test.

237. Example: in year one, an individual nominates £15 of foreign income or gains and remits £5 of the nominated amount to the UK. As the total amount of nominated income and gains remitted in year one is less than £10, they do not meet the £10 test and section 809I does not apply. In year two the individual remits the balance of nominated income from year one consisting of £10 to the UK. The cumulative total of nominated income and gains from year one remitted to the UK now exceeds £10, so the ordering rules in section 809I will apply.

238. Paragraph 21 of the Schedule provides that the amendments made by paragraph 20 apply for the tax year 2012-13 or any subsequent tax year.

BACKGROUND NOTE

239. The remittance basis is an alternative basis of taxation which applies to foreign income and capital gains. It is available to UK resident individuals who are not domiciled and/or not ordinarily resident in the UK. Such individuals have the option of electing to be taxed on the remittance basis and those who do so are liable to UK tax on all their income and capital gains which arise in the UK, but only liable to UK tax on their foreign income and capital gains to the extent that they are remitted to the UK.

240. The remittance basis rules were revised in Finance Act 2008. The main revisions were the introduction of an annual Remittance Basis Charge of £30,000 for individuals who had been resident in the UK for at least seven out of the preceding nine years and who wished to claim the remittance basis and a series of provisions to address a number of loopholes and anomalies in the previous remittance basis regime.

241. Further minor changes to the remittance basis were introduced in the Finance Acts 2009, 2010 and 2011.

242. At Budget 2011, the Government announced a package of measures to reform the remittance basis with the objective of ensuring that non-domiciled individuals pay a fair tax contribution and of encouraging them to bring their foreign income and gains to the UK to invest in businesses. It also announced a number of technical simplifications to some aspects of the current rules to reduce undue administrative burdens.

243. On 17 June 2011, the Government published a consultation document, ‘Reform of the taxation of non-domiciled individuals: a

consultation' which sought views on the detailed design of the changes announced in the Budget. Consultation ended on 9 September 2011.

244. The main features of the proposed reforms were:

- the introduction of a higher annual charge of £50,000 payable by individuals who claim the remittance basis and who have been resident in the UK in at least 12 of the 14 tax years prior to the year of claim;

- a new relief to encourage investment by allowing remittance basis taxpayers to remit their foreign income and gains to the UK tax-free where they are used for the purpose of making a commercial investment in a company; and

- a number of technical changes to simplify some aspects of the current remittance basis rules.

245. The Government published its response to the representations made during the consultation on 6 December 2011.

246. Following further consultation, a number of changes were made to the draft legislation, including a new exemption for CGT on sales of exempt property and a new provision to allow individuals taking advantage of the investment relief to retain an amount of the proceeds from the disposal of an investment in the UK to meet any CGT liability. A series of further minor changes were made to the legislation in response to representations made during consultation. The consultation period ended on 10 February 2012.

Increased Remittance Basis Charge

247. Under section 809H ITA, individuals who have been UK resident in at least seven of the nine preceding tax years are required to pay an annual charge of £30,000 to access the remittance basis.

248. Part 1 of the Schedule introduces an increased annual charge of £50,000 payable by individuals who have been UK resident in at least 12 of the preceding 14 tax years. Those individuals who have been UK resident in at least seven of the nine preceding tax years and who claim the remittance basis will still be required to pay the annual charge of £30,000.

Remittance for Investment Purposes

249. Under the existing rules, remittance basis taxpayers are liable to UK tax on any foreign income or capital gains which they remit to the UK, irrespective of the purpose for which those income and gains are used. This can discourage such individuals from making commercial

investments in the UK. Part 2 of the Schedule seeks to remove this disincentive by allowing remittance basis taxpayers to bring their overseas income and gains to the UK without becoming liable to tax provided they are brought to the UK for the purpose of making a commercial investment in a qualifying company.

250. To prevent abuse, there are a number of conditions to prevent an investor from using the relief as a means of enjoying their overseas income and gains in the UK tax-free.

Sales of Exempt Property

251. Sections 809X to 809Z6 ITA contain certain exceptions to the remittance basis which permit an individual to bring property purchased out of unremitted foreign income and gains to the UK without being taxed on the remittance of those income and gains. These exceptions are where the property is:

- a work of art, collectors' item or antique brought to the UK for the purposes of public display at an approved establishment;
- an item of clothing, footwear, jewellery or watch for personal use;
- brought to the UK for the purposes of repair or restoration;
- imported into the UK temporarily for a period of no more than 275 days; or
- worth less than £1,000.

252. Such property is defined as 'exempt property' in section 809X ITA. Under section 809Y ITA, these exceptions cease to be available where the property is sold or otherwise converted into money whilst in the UK. This can be a disincentive to remittance basis taxpayers who wish to sell such property in the UK. The changes introduced by Part 3 of the Schedule seek to remove this disincentive by allowing exempt property to be sold in the UK without a tax liability arising.

253. In order to qualify for the exemption, the entire sale proceeds must be paid to the seller by the first anniversary of the 5 January following the tax year in which the sale takes place. This is in order to ensure that the exemptions can operate within the Self Assessment system.

254. This part of the Schedule also introduces a new rule which treats gains arising on sales of exempt property as foreign chargeable gains where the conditions are met for the exemption from the tax on the remittance of exempt property.

Nominated Income

255. Under section 809H ITA, individuals who have been UK resident in at least seven of the nine preceding tax years are required to pay an annual charge of £30,000 to access the remittance basis. Part 1 of the Schedule introduces a further annual charge of £50,000 for individuals who have been UK resident in at least 12 of the preceding 14 tax years.

256. Under section 809C, such individuals are required to nominate an amount of their foreign income or gains for each tax year in which they are liable to pay the annual remittance basis charge. This nominated amount forms the basis for calculating the annual charge.

257. Where such individuals remit the foreign income and gains which they have nominated under section 809C before any other of their foreign income and gains, the order in which those income and gains are remitted is determined by rules in sections 809I and 809J.

258. The amendments made by part 4 of the Schedule allow such individuals to remit up to £10 of their nominated income or gains each year without having to take steps to ensure that no part of that nominated amount is remitted to the UK before other foreign income or gains.

EXPLANATORY NOTE

CLAUSE 48 SCHEDULE 13: EMPLOYER ASSET-BACKED PENSION CONTRIBUTIONS ETC

SUMMARY

1. Clause 48 and the first four parts of Schedule 13 amend Part 4 of Finance Act (FA) 2004 as it relates to employer pensions tax relief by inserting a number of new sections into FA 2004 as well as providing transitional provisions in order to ensure that the amount on which relief is given in respect of a contribution paid by any employer accurately reflects, but does not exceed, the payments received by the registered pension scheme.

2. Specifically, the Schedule will apply to asset-backed contribution (ABC) arrangements used by some employers to fund their registered pension schemes.

3. An ABC arrangement involves offsetting an employer's legal obligation to pay a pension contribution against the registered pension scheme's legal obligation to purchase an asset from the employer directly or indirectly, using the contribution. There are also ABC arrangements that involve an upfront monetary contribution.

4. These types of arrangement enable an employer, or a person connected with the employer (hereafter referred to as "the employer etc"), to provide for payments over a period of time (or an income stream) to the pension scheme. A more complex ABC arrangement typically involves a special purpose vehicle (for example, a partnership of which the employer is a member (an employer-related partnership)), in which case the employer provides the pension scheme with the income stream indirectly through the vehicle. The income stream is derived from assets of the employer or a connected party including an employer-related partnership.

5. Part 5 of the Schedule contains minor and related amendments to the structured finance legislation[1], which concerns structured finance arrangements (SFAs).

6. Detail of the commencement provisions applicable to these parts is given in the following sections. References to Parts, sections or paragraphs are references to the Schedule unless otherwise stated. Where a reference to a section can mean a reference to it in Part 1 or Part 3, then a reference to the relevant Part is also given.

[1] This legislation is set out in Chapter 2 of Part 16 Corporation Tax Act 2010 for corporation tax purposes and Chapter 5B of Part 13 Income Tax Act 2007 for income tax purposes.

DETAILS OF THE SCHEDULE

7. Part 1 inserts new sections 196B to 196I after section 196A FA 2004. These provisions have effect on the contribution paid between 29 November 2011 and 21 February 2012 under an ABC arrangement.

8. However, new section 196G also applies to pre-November arrangements that are SFAs. In addition, it contains provisions that have effect on certain events that take place on or after 21 March 2012. There are two types of events. The first type places a person in a more advantageous tax position as a result of the application of the new section 196G. The second type relates to an employer ceasing to be chargeable to tax as set out in new section 196H.

9. Part 2 (paragraphs 4-14) introduces transitional provisions for ABC arrangements where the contribution was paid before 29 November 2011 and the SFA rules do not apply. For those arrangements where the contribution was paid before 22 February 2012, which are 'acceptable' SFAs[2], the transitional provision is new section 196G in Part 1 (detail in the next section). If they are unacceptable SFAs[3], then Part 4 (see paragraph 13 below) applies from 22 February and new section 196G in Part 1 only applies to events that occur between 29 November and 21 February.

10. There are also provisions to recover excess relief when an employer ceases to be chargeable to tax by regarding the date of such cessation as the date on which the arrangement is completed. These provisions have effect from 21 March 2012.

11. Part 3 inserts new sections 196B to 196L after section 196A FA 2004. These provisions have effect on the contribution paid on or after 22 February 2012 under an ABC arrangement.

12. However, new section 196I in Part 3 contains provisions that have effect on certain events that take place on or after 21 March 2012. There are two types of events. The first type places a person in a more advantageous tax position as a result of the application of the new section 196I. The second type relates to an employer ceasing to be chargeable to tax as set out in new section 196J in Part 3.

13. Part 4 (paragraphs 18-31) introduces transitional provisions for those ABC arrangements where the contribution was paid before 22 February 2012, the arrangement is not an acceptable SFA and Part 2 does not apply. There are also provisions similar to those included in new section 196J in Part 3 and these have effect from 21 March 2012.

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[2] Acceptable SFAs are those ABC arrangements that meet the qualifying conditions set out in Part 3 of this Schedule and also fall within the SFA rules.
[3] Unacceptable SFAs are those ABC arrangements that do not meet the qualifying conditions in Part 3.

14. Part 5 (paragraphs 32-42) provides for minor and related changes to the SFA rules. They have effect in relation to arrangements whenever made but only on those amounts arising on or after 21 March 2012.

Part 1 – sections 196B to 196I and paragraphs 2-3

15. The new provisions in Part 1 follow the design of the structured finance legislation (see footnote 1) which applies where a person enters into a SFA. This is an arrangement where in accordance with generally accepted accounting practice, a person (the borrower) records in the borrower's accounts a financial liability in respect of a sum (the advance) paid by "the lender", and the advance will be repaid by an income stream.

16. In the case of ABC arrangements, the obligations of the employer and the registered pension scheme give rise to a situation similar to a SFA, where "the borrower" is the employer etc or an employer-related partnership or other relevant person, and the borrower receives money or another asset (the advance) from the pension scheme (the lender). The advance is wholly or partly funded out of the employer's contribution and the lender is entitled to a series of payments in respect of the borrower's asset (the security).

17. The main provisions (new sections 196B to 196D) will deny pensions tax relief (upfront relief) to the employer on the contribution paid using the ABC arrangement if the SFA rules do not apply. Instead deductions against the profits or income of the employer will be given in respect of each payment that the employer makes to the pension scheme (the lender) directly or indirectly under the income stream ("pay as you go" relief). Amounts of an income stream, which were previously taxable in the hands of the employer, are likely to cease to be taxable upon the transfer of the income stream to the lender or a connected person (the lender etc).

18. There are also revenue protection provisions (new sections 196F to 196H) –

- an anti-avoidance provision (new section 196F) to prevent any employer from securing tax relief that exceeds the value made to the pension scheme; and

- a separate set of provisions (new sections 196G and 196H) to recover relief given to an ABC arrangement that is an acceptable SFA when the financial liability is later reduced by an event other than the making of payments including an event where the employer ceases to be chargeable to tax or when a person is placed in a more advantageous tax position by the application of new section 196G.

19. However, in the examples of the events mentioned in the second bullet of the last paragraph, new sections 196G and 196H will only have effect when either event takes place on or after 21 March 2012. Otherwise these provisions will have effect on events that take place on or after 29 November 2011.

20. A series of new provisions – new sections 196E, 196I and 196J – provide for supplementary provisions and application. Paragraph 2 makes consequential changes and paragraph 3 makes provision for commencement of the new provisions.

The simple case – new section 196B

21. New section 196B deals with the simple case where the employer etc is the borrower and the lender is a person who acts for, or is otherwise connected with, the registered pension scheme. It stipulates in sub-section 1 the conditions under which relief under section 196 FA 2004 (upfront relief) will **not** be given to the employer (the borrower) in respect of a contribution paid under the ABC arrangement.

22. New sections 196B(2), (4) and (5) set out these conditions as follows:

- Condition A is that -
  - the borrower (employer etc) receives the advance which is wholly or partly paid or provided by the lender etc out of the contribution in respect of the arrangement;
  - the borrower or a person connected with the borrower (borrower etc) disposes of an asset (the security) to or for the benefit of the lender etc; and
  - the lender etc is entitled to payments in respect of the security.
- Condition B is that the arrangement is **not** a SFA as defined in new section 196J(4); and
- Condition C is that it is reasonable to suppose that the amount of one or more of the payments mentioned above is determined (wholly or partly) on the basis that, in essence, some part of the advance represents a loan (including any advance of money in accordance with new section 196B(7)(c)) which is to be repaid by the payment(s).

23. New section 196B(2) also makes it clear that those arrangements that fall within new section 196C(2) and 196D(2) do not fall within new section 196B(2).

24. New section 196B(3) states that condition A is met even if an entitlement of the lender etc is subject to any condition.

25. New section 196B(6) makes it clear that condition C is met even if repayments of the loan might be subject to any condition, or the

accounts of any person do not record a financial liability in respect of the advance or is not otherwise treated as representing a loan for the purposes of the accounts of any person. However, this is subject to all the relevant circumstances being taken into account in order to get to the essence of the matter.

26. New section 196B(7)(a) ensures that references to a person connected with the borrower or lender do not include the lender or borrower respectively. This means that new section 196B cannot be triggered accidentally just because the borrower and lender are connected. New section 196B(7)(b) ensures that if the borrower is not the employer, the reference to a person connected to the borrower includes a person connected with the employer who would not otherwise be connected with the borrower.

The complex case – new sections 196C and 196D

27. New sections 196C and 196D deal with complex types of ABC arrangement involving a partnership receiving the advance, and changes in profit sharing arrangements in relation to the lender etc.

28. New section 196C will apply where, as part of the ABC arrangement which is used to make the contribution, the employer etc (the transferor) transfers an asset to a partnership and is a member of that partnership immediately after the transfer (whether or not a member immediately before the transfer), and there is a relevant change in relation to the partnership as set out in new section 196E. In that circumstance, new section 196C(1) provides that the employer will **not** receive upfront tax relief under section 196 FA 2004 in respect of the contribution paid to the registered pension scheme when conditions A and B are met.

29. New sections 196C(2) and (5) set out these conditions as follows:

- Condition A is that -
  - the transferor is the employer etc;
  - the transferor or a person connected with the transferor (transferor etc) disposes of the security to a partnership and is a member of the partnership immediately after the disposal;
  - the partnership receives the advance, which is wholly or partly paid or provided out of the employer's contribution, from a person (the lender) other than the transferor;
  - there is a relevant change in relation to the partnership as set out in new section 196E; and
  - the share in the partnership's profits of the person involved in the relevant change is determined by reference to payments in respect of the security.
- Condition B is that the arrangement is **not** a SFA as defined in new section 196J(4).

30. New section 196C(3) ensures that where the transferor is not the employer, the reference to a person connected to the transferor includes a person connected with the employer who would not otherwise be connected with the transferor.

31. New section 196C(4) provides that condition A is met even if the determination of the share of partnership's profits is subject to any condition.

32. New section 196D will apply where the ABC arrangement which the employer uses to make the contribution to the pension scheme also involves a partnership receiving the advance but the security is held by a pre-existing partnership. As part of the ABC arrangement, the partnership receives an advance that is funded in some way by the employer's contribution. In that circumstance, new section 196D(1) provides that the employer will **not** receive upfront tax relief under section 196 FA 2004 in respect of the contribution paid to the registered pension scheme under the ABC arrangement when conditions A and B are met.

33. New sections 196D(2) and (4) set out these conditions as follows:

- Condition A is that -
  - a partnership holds the security at any time before the ABC arrangement is made;
  - the partnership receives the advance which is wholly or partly paid or provided by the lender out of the employer's contribution in respect of the arrangement;
  - there is a relevant change in relation to the partnership as set out in new section 196E; and
  - the share in the partnership's profits of the person involved in the relevant change is determined by reference to payments in respect of the security.
- Condition B is that the arrangement is **not** a SFA as defined in new section 196J(4).

34. New section 196D(3) provides that condition A is met even if the determination of the share of partnership's profits is subject to any condition.

35. New section 196E provides that a relevant change in relation to the partnership occurs (which in turn enables the conditions in new sections 196C and 196D to be met) if one of the conditions - condition X or condition Y - is met. New sections 196E(2) and (3) set out these conditions as follows:

- Condition X is that the lender etc joins the partnership in connection with the ABC arrangement at any time; or

- Condition Y is that there is a change in the lender etc's share of the partnership's profits in connection with the ABC arrangement.

36. References used in this new section and in new sections 196C and 196D are explained in new sections 196E(4) and (5).

Anti-avoidance – new section 196F

37. New section 196F is an anti-avoidance provision to deny upfront relief or recover any relief already given when the employer etc sets up an arrangement (the avoidance arrangement) mainly for the purpose of securing tax relief that will exceed the amount the employer should receive relative to the total amount of payments the employer will make to the pension scheme under the ABC arrangement. This provision will only apply to ABC arrangements where the contribution is paid between 29 November 2011 and 21 February 2012 and its effect continues after 21 February.

38. New section 196F(1) provides that this new provision applies where the employer etc enters into an avoidance arrangement and where upfront relief for the ABC arrangement is not denied under new sections 196B, 196C, or 196D because the arrangement is a SFA.

39. New section 196F(2) provides that where the avoidance arrangement is entered into at or before the time when the advance referred to in new sections 196B, 196C or 196D is received, upfront relief is denied on the contribution paid under the ABC arrangement by deeming that Condition B in one of those sections is met.

40. New section 196F(3) provides that where the avoidance arrangement is entered into after the advance is received, then the amount of the relevant financial liability at the time the avoidance arrangement is entered into is treated as profit or income that is charged to the employer for the period in which that time falls.

41. New section 196F(4) sets out that the amount treated as profit or income is not to exceed the total amount of relief given to the employer in respect of the ABC arrangement. The terms used in this new section are defined in new section 196F(5).

Relief recovery for a financial liability reduction by an event other than the making of payments – new sections 196G and 196H

42. New section 196G is a new provision to recover upfront relief given to an ABC arrangement (including a pre-November arrangement) that is an acceptable SFA when the financial liability is later reduced by an event other than the making of payments. This provision applies to this type of ABC arrangement where the contribution is paid at any time before 21 February 2012 but in the case of those arrangements

with contributions paid before 29 November 2011, it only applies where the event occurs on or after 29 November 2011. There are two exceptions to these commencement provisions and they concern new section 196G(3) and new section 196H (which is an extension of new section 196G) - see details in paragraphs 45, and 48 to 50 below.

43. New section 196G(1) provides that the section applies where the ABC arrangement is an acceptable SFA, and an event, other than the making of payments to the pension scheme, occurs which results in the advance (or part of it) no longer being recorded as a financial liability in the employer's (or partnership's) accounts.

44. If the financial liability is reduced to nil, the ABC arrangement will cease to be a SFA under new section 196G(2).

45. New section 196G(3) cancels the effect of the application of new section 196G if a person is to be placed in a tax position which is more advantageous than the tax position in which the person would have been had new section 196G never applied. This subsection will have effect from 21 March 2012.

46. New section 196G(4) provides that the amount of the reduction in the relevant financial liability immediately before this event will be treated as profit or income chargeable on the employer in the period in which the event occurs.

47. New section 196G(5) provides that the amount treated as profit or income under new sub-section 4 cannot exceed the total amount of relief already given to the employer in respect of the arrangement. The terms used in new section 196G are defined under new section 196G(6).

48. New section 196H is an extension of new section 196G as set out in new section 196H(1).

49. New section 196H provides in new subsections (2) and (3) that the financial liability is treated as being reduced to nil in the relevant period of accounts[4] when the employer who has an ABC arrangement where the contribution was paid between 29 November 2011 and 21 February 2012, ceases to be chargeable to tax on or after 21 March 2012.

50. New sections 196H(4) and (5) set out the circumstances under which such cessation takes place. There are different circumstances depending on whether the employer's business is a company, a limited liability or other type of partnership. These circumstances also include cases where the employer company goes into

[4] The relevant period of accounts is either (a) the relevant accounting period if the employer etc is a company or (b) the relevant tax year if the employer etc is an unincorporated business.

administration or winds up, or the employer partnership dissolves or when an individual who is the employer dies.

Treatment of advances that fall within the SFA rules – new section 196I

51. New section 196I provides that any advance made before 22 February 2012 under an ABC arrangement that is a SFA and that gives rise to a loan within the meaning of Chapter 3 of FA 2004 is not prevented from meeting the definition of a scheme administration employer payment in S180 FA 2004 regardless of whether the advance also meets the definition of a loan for the purposes of FA 2004. This means that no unauthorised payment charge will arise under section 208 FA 2004 purely by virtue of the fact that the advance gives rise to a loan which is not capable of meeting the conditions of section 179 FA 2004.

Supplementary provisions and application – new section 196J and paragraph 2

52. New section 196J provides a number of definitions and other supplementary provisions for new sections 196B to 196I.

53. New section 196J(2) explains the references to relief being given in respect of a contribution paid by an employer under a registered pension scheme.

54. New section 196J(3) refers to the meaning of connected persons in section 1122 Corporation Tax Act (CTA) 2010.

55. New section 196J(4) explains the references to a SFA are to the definition of a type 1, type 2 or type 3 arrangement under Part 13 of the Income Tax Act (ITA) 2007 (for income tax purposes) or Part 16 of CTA 2010 (for corporation tax purposes).

56. New section 196J(5) provides that sections 774 (accounts), 775 (arrangements) and 776 (assets) of CTA 2010 apply to new sections 196B to 196I in the same way as they do for the purposes of Part 16 of CTA 2010.

57. Paragraph 2 make a consequential amendment to section 280(1) FA 2004 (abbreviations) by inserting a reference to CTA 2010.

Commencement and application of new sections 196B to 196J – paragraph 3

58. Paragraphs 3(1) and (2) provide that the amendments made by new sections 196B to 196J shall have effect for contributions paid by employers between 29 November 2011 and 21 February 2012.

59. Paragraph 3(3) provides that new section 196G also has effect for contributions paid before 29 November 2011 where the relevant event as described in new section 196G(1)(d) occurs on or after 29 November 2011. Where this paragraph applies, new sections 196B to 196D also have effect for the purpose of applying new section 196G.

60. Paragraph 3(4) provides that new section 196G(3) only has effect on an event as set out in that section when it takes place on or after 21 March 2012.

61. Paragraphs 3(5) and (6) respectively provide that new sections 196H and 196I also have effect for contributions paid before 29 November 2011 and assumes that new sections 196B to 196D have effect in relation to these contributions for the purposes of applying new sections 196H and 196I.

Part 2 - Transitional rules (paragraphs 4 to 14)

62. Part 2 contains transitional provisions which apply the "relevant effect" of the SFA rules to any pre-November ABC arrangement that does not fall within the SFA rules. These rules apply to income amounts that arise on or after 29 November 2011. There are also rules to introduce a mechanism to make a tax adjustment at the end of any of these arrangements which ensures the employer receives tax relief in respect of the total amount of payments made to the pension scheme under the ABC arrangement.

63. The transitional provision that will apply to pre-November ABC arrangements which are acceptable SFAs is new section 196G. This section recovers any excess relief given where the relevant event occurs on or after 29 November 2011, with the exception of sub-section (3) where the relevant event occurs on or after 21 March 2012, as set out in the preceding section concerning Part 1 of the Schedule. Further detail can be found in that section and is not repeated in this part of the note.

Detail of transitional rules

Paragraphs 4 to 8 – application and interpretation

64. Paragraphs 4-8 provide for application and interpretation of the terms used in Part 2.

65. Paragraph 4 provides that transitional provisions will apply where an ABC arrangement with the contribution paid before 29 November 2011 would **not** have received relief under new sections 196B to 196D in Part 1 had the contributions been paid on or after 29 November 2011 and the arrangement is not 'completed' as determined under paragraph 6 before that date.

66. Paragraph 5 provides that for the purposes of Part 2, the terms used in new sections 196B to 196D in Part 1 have the same meaning as in those new sections and where necessary it is assumed that those new sections have effect in relation to the employer's contribution.

67. Paragraph 6 provides that an ABC arrangement that would be denied upfront relief under new sections 196B, 196C or 196D in Part 1 had the contribution been paid on or after 29 November 2011 is completed if :

- where the arrangement is a simple case, the lender etc is no longer entitled to payments in respect of the security; or
- where the arrangement is a complex case, the share in the partnership's profits of the person involved in the relevant change is no longer to be determined by reference to payments in respect of the security.

68. Paragraph 7 provides that "the completion day" is the earliest of the day on which the ABC arrangement is to be completed as determined as at the beginning of 29 November 2011, or the day on which the arrangement is actually completed, or after 22 February 2012, the day on which a completion event takes place, or after 21 March 2012, an event as set out in paragraph 8 occurs.

69. Paragraph 7(4) explains when a completion event occurs. This is where there is a change in the number of either payments or drawings/other payments, a significant change in the amount of either a payment or a drawing/other payment is to be made, or a significant change in the time at which either a payment or a drawing/other payment is to be made.

70. A "paragraph 8" event occurs when the employer ceases to be chargeable to tax. Paragraph 8 sets out the circumstances, similar to those set out in new sections 196H(4) and (5) in Part 1, surrounding such cessation (see paragraphs 48 to 50 above concerning Part 1).

71. These two paragraphs (7 and 8) prevent the employer seeking to extend the duration of the arrangement or make a material change to the original position as at 22 February or 21 March 2012 (depending on the type of events) to avoid the transitional provisions set out in paragraphs 12 to 14.

Paragraphs 9 to 11 – certain tax consequences not to have effect

72. Paragraphs 9-11 deem the relevant ABC arrangements not to have "the relevant effect" as set out in paragraphs 9(3), 10(3) and 11(2). This means that on or after 29 November 2011, no deduction will be given to any income payments that the borrower (the employer or a

connected party or other relevant person) makes to the lender etc under the ABC arrangement and any income amounts that have been transferred to the lender etc will be bought back into tax charge on the employer etc or other relevant person.

73. Paragraph 9(1) provides that paragraph 9 applies to an ABC arrangement where, had the employer's contribution been paid on or after 29 November 2011, new section 196B in Part 1 would have applied so that the arrangement would have the "relevant effect". The "relevant effect" defined in paragraph 9(3) is that the borrower etc (the employer etc) would receive relief for payments to the lender etc (the pension scheme) made under the arrangement either by way of an income deduction or by an income amount which would otherwise have been charged to tax not being so charged.

74. Paragraph 9(2) deems the arrangement **not** to have the "relevant effect" which is set out in paragraph 9(3). This means that either no relief will be given for any income payments the borrower etc (the employer etc) makes to the lender etc (the pension scheme) under the ABC arrangement or any income amounts that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the employer etc.

75. Paragraph 9(4) defines the relevant effect if the borrower is a partnership.

76. Paragraph 9(5) provides that "amount" in sub-paragraphs 3 and 4 means an amount that arises on or after 29 November 2011 but on or before the completion day as set out in paragraph 7. This means that before the completion day, this paragraph prevents relief for income payments made on or after 29 November 2011 or brings back income amounts into charge from that date.

77. Paragraph 10(1) provides that paragraph 10 applies to an ABC arrangement where, had the employer's contribution been paid on or after 29 November 2011, new section 196C in Part 1 would have applied so that the ABC arrangement would have the "relevant effect". The "relevant effect", defined in paragraph 10(3), is that the transferor etc (the employer etc) would receive relief either by way of an income deduction or by an amount which would otherwise have been charged to tax not being so charged.

78. Paragraph 10(2) deems the arrangement **not** to have the "relevant effect". This means that either no relief will be given for any income payment made by the partnership to the lender etc (the pension scheme) under the arrangement or any amount that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the transferor etc (the employer etc).

79. Paragraph 10(4) provides that for the purposes of sub-paragraph 3, "amount" means an amount that arises on or after 29 November 2011 but on or before the completion day as set out in paragraph 7. This means that before the completion day, this paragraph prevents relief for income payments made on or after 29 November 2011 or brings back income amounts into charge from that date.

80. Paragraph 10(5) provides that in determining whether the ABC arrangement would have the relevant effect, it is to be assumed that the amounts of income equal to the payments mentioned in new section 196C(2)(g) were payable to the partnership before the relevant change occurred.

81. Paragraph 11(1) provides that paragraph 11 applies to an ABC arrangement where had the employer's contribution been paid on or after 29 November 2011, new section 196D in Part 1 would have applied so that the ABC arrangement would have the "relevant effect". The "relevant effect", defined in paragraph 11(2), is that the "relevant member" would receive relief by way of an income deduction or by an income amount which would otherwise have been charged to tax not being so charged.

82. Paragraph 11(3) provides that a "relevant member" is a person who was a member of the partnership immediately before the relevant change in the partnership occurred and the person is not the lender.

83. Paragraph 11(4) provides that for the purposes of sub-paragraph 2, "amount" means an amount that arises on or after 29 November 2011 but on or before the completion day as set out in paragraph 7. This means that before the completion day, this paragraph prevents relief for income payments made on or after 29 November 2011 or brings back income amounts into charge from that date.

84. Paragraph 11(5) deems the arrangement **not** to have the "relevant effect" as set out in paragraph 11(2). This means no relief will be given for any income payments made from the partnership to the lender (the pension scheme) or any income amounts that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the relevant member (the employer etc or other relevant person).

85. Paragraph 11(6) provides that in determining whether the ABC arrangement would have the relevant effect, it is to be assumed that the amounts of income equal to the payments mentioned in new section 196D(2)(e) were payable to the partnership before the relevant change occurred.

Paragraphs 12 to 14 – adjustments

86. Paragraphs 12-14 provides for a tax adjustment on the employer when the ABC arrangement ends to ensure that the total amount on which relief is given to the employer will accurately reflect, but will not exceed, the total amount of payments actually given to the pension scheme under the arrangement.

87. This adjustment mechanism will take into account not just all the payments actually made to the pension scheme but also all the relief in the form of deductions against taxable profits or income given to the employer before and after 29 November 2011. Any deductions and payments given before 29 November 2011 will be cancelled out in the overall adjustment so the amounts set out in paragraphs 12-14 do not include these sums. The adjustment can result in either a charge on the employer or further tax relief.

88. The following example uses the facts as set out in Example 3 in the consultation document, *Employer Asset-backed Pension Contributions*[5] published on 24 May 2011 on both the HMRC and HM Treasury websites, and illustrates how the adjustment mechanism as set out in paragraphs 12-14 works.

Example A

The ABC arrangement does not fall within the SFA rules.
Pension scheme deficit = £400m
Contribution paid under the ABC arrangement = £400m
Yearly payment = £22.5m (of which £2.5m could be a finance charge if the arrangement were a SFA) payable for 20 years.
Two yearly payments were made before 29 November 2011.

Assume that the ABC arrangement will be completed on the day on which it is to be completed at the beginning of 29 November 2011.

Using Amounts A, B and C as defined in paragraph 12(1)
Amount A (relief for E's contribution) = £400m
Amount B (total amount of denied deductions on yearly payments under paragraph 9, 10 or 11) = £405m (including the last payment at year 20)
Amount C = 0 (as the last payment falls within the meaning of "income deduction" as set out in paragraph 12(2) and so paragraph 12(1)(c)(iii) is not met)

Pre-November deductions on yearly payments = pre-November yearly payments = Amount D (which is **not** included in this Schedule) = £22.5m x 2 years = £45m.

[5] http://www.hmrc.gov.uk/budget-updates/march2011/index.htm#24may

As Amount B + Amount C exceeds Amount A by £5m, additional relief arises under paragraph 14 of the Schedule.

So the total relief given to the employer is the sum of Amount A (£400m) and Amount D (£45m), plus the adjustment relief of £5m (see the item above). This is equal to £450m.

Total payments received by the pension scheme = Amount D + Amount B + Amount C = £45m + £405m + 0 = £450m which equals the total amount of relief given.

This means that the employer relief accurately reflects the payments actually received by the pension scheme.

89. Paragraph 12(1) defines Amount A, Amount B and Amount C for the purposes of making tax adjustment as set out in paragraphs 13 and 14:

- Amount A is the total amount of relief given in respect of the employer's contribution paid under the ABC arrangement;
- Amount B is the total of any amounts in respect of which the employer has been denied relief under paragraphs 9, 10 or 11. These are the payments for which a deduction has been denied or the amounts brought back to charge on the employer etc or other relevant person; and
- Amount C is the amount of the payment made under the ABC arrangement before the completion day which is not reflected in Amount B, is not the subject of an income deduction and is not a contribution paid by the employer to the pension scheme, but it nevertheless becomes part of the sums held by the pension scheme.

90. Paragraph 12(2) defines "income deduction" for the purposes of sub-paragraph 1.

91. Paragraphs 12(3) and (4) provide that where, had the employer's contribution been paid on or after 29 November 2011, new section 196B in Part 1 would have applied, Amount C is the payment (if any) which the borrower etc makes to the lender etc in order to acquire the security or an asset in place of the security under the ABC arrangement.

92. Paragraphs 12(5) and (6) provide that where, had the employer's contribution been paid before 29 November 2011, new sections 196C or 196D in Part 1 would have applied, Amount C is the payment (if any) which the employer etc makes to the lender etc in order to reverse the relevant change in relation to the partnership.

93. Paragraphs 12(7) provides that Amount C is to be taken to be nil where, between 22 February 2012 and the day before the completion day, a commitment is given to a "relevant person" directly or indirectly and the commitment is to secure that a person receives money or another asset that is linked to the making of the payment covered by Amount C.

94. Paragraph 12(8) defines "relevant person" as the employer, a person connected with the employer, a person acting at the direction or request, or with the agreement of the employer or the connected person, a person chosen by the employer or the connected person or a class of person so chosen, or a partnership. However, as set out in paragraph 12(9), the relevant person does not include the persons who from time to time are the trustees of the pension scheme or the persons controlling the management of the scheme.

95. Paragraph 13 provides that at the end of the completion day, if the amount of tax relief that has been given to the employer in respect of the contribution paid under an ABC arrangement is greater than the total amount of payments made to the pension scheme, then the excess tax relief in the form of the difference between the two amounts will be recovered from the employer.

96. Paragraphs 13(1) and (2) provide that where amount A is greater than the sum of Amount B and Amount C, the excess will be either treated as a profit or income arising on the employer in the period of accounts (see footnote 4) in which the completion day falls.

97. Paragraph 14 provides that that at the end of the completion day, if the amount of tax relief that has been given to the employer in respect of the contribution paid under the ABC arrangement is less than the total amount of payments made to the scheme, then the employer will be entitled to additional relief. Where the sum of Amount B and Amount C exceeds Amount A, the excess is treated as an employer contribution paid on the completion day for which the employer is to be given relief in accordance with section 196 FA 2004.

Part 3 – sections 196B to 196L and paragraphs 16-17

98. Part 3 follows the design of Part 1 including a reference to the SFA legislation. The main difference is the introduction of new qualifying conditions set out in new sections 196C, E and G that must be met in respect of ABC arrangements in order to qualify for upfront relief.

99. The main provisions (new sections 196B to 196G) of Part 3 will deny upfront relief to the employer on a contribution paid using an ABC arrangement if the arrangement does not meet the new qualifying conditions. Instead deductions against the profits or income of the employer will be given in respect of each payment that the employer

makes to the pension scheme (the lender) directly or indirectly under the income stream ("pay as you go" relief). Amounts of an income stream, which were previously taxable in the hands of the employer, are likely to cease to be taxable upon the transfer of the income stream to the lender or a connected person (the lender etc). However, if the arrangement is an unacceptable SFA with the contribution paid on or after 22 February, relief is only given to the finance charge under the SFA rules.

100. There is a revenue protection provision (new section 196I) to ensure that, where an arrangement is an acceptable SFA and has received upfront relief, excess tax relief is recovered when certain changes or events occur. A balancing tax charge will arise by treating the outstanding financial liability immediately before these events as an amount of income or profit of the employer. If the financial liability is only reduced in part, then only the excess relief will be recovered at the time when that event occurs.

101. The provisions will have effect from 22 February 2012 with the exception of events that are set out in new sections 196I(6) and 196J (see paragraphs 45, and 48 to 50 above which describe similar provisions in section 196G(3) and 196H in Part I); the provisions will only have effect on those events that occur on or after 21 March 2012.

102. A series of new provisions – new sections 196H, 196K and 196L – provide for supplementary provisions and application. Paragraph 16 makes consequential changes and paragraph 17 makes provision for commencement of the new provisions.

The simple case – new sections 196B and 196C

103. All the conditions for the simple case as set out in Part 1 (see paragraphs 21-26 above) remain unchanged with the exception of Condition B where the reference is made to an acceptable SFA rather than a SFA. This new reference is required in relation to new qualifying conditions which are set out in new section 196C.

104. New section 196C set out the following conditions that must be met for those ABC arrangements that fall within Conditions A, B and C of new section 196B before they can qualify as an acceptable SFA:

- the pension contribution promised upfront under the arrangement must be due to be paid to the pension scheme and is not intended to be held in a subsidiary structure;
- the pension scheme being the responsible authority must be the direct lender giving an "advance" (the pension scheme investment) to the employer;

- the advance must be wholly paid out of the promised contribution;
- the contribution must equal both the advance and the financial liability recorded in respect of the advance;
- from the outset, regular payments due to the pension scheme under the arrangement must reduce the financial liability to nil by the earlier of the completion day or 25 years;
- the payments must be of equal amount due at intervals of no more than one year to the next working day and must be received by the pension scheme within three months from the due date to form part of the sums held for the purposes of the pension scheme. In determining if this requirement is met, certain planned increases to the payments can be ignored but such increase must be set at the outset and cannot be higher than the greatest of the increase in the consumer prices index, the retail prices index or 5% per annum;
- the first payment must be due no later than one year after the day on which the advance is paid;
- the total amount of the payments due to the pension scheme must not be less than the contribution; and
- at the outset, no commitment has been given to a "relevant person" (which is not the responsible authority as defined in new section 196C(11)) directly or indirectly and the commitment is to secure that a person receives money or another asset that is linked to the making of any payment in respect of the security.

105. New section 196C(10) defines "relevant person" which has the same meaning as "relevant person" (as defined in paragraph 11(8) of the new Schedule) in relation to Amount C. New section 196C(11) stipulates that the "responsible authority" means the trustees or the persons in control of the management of the pension scheme.

The complex case – new sections 196D to 196G

106. New sections 196D to 196G deal with complex types of ABC arrangement involving a partnership receiving the advance, and changes in profit sharing arrangements in relation to the lender etc as set out in Part 1 (see paragraphs 27-36 above). As with the simple case, the only change in the conditions for the complex case is in relation to Condition B where the reference is made to an acceptable SFA as set out in new sections 196E and G respectively.

107. The new qualifying conditions are similar to those applicable in the simple case (see paragraphs 104 and 105 above) with the exception that a partnership is the party that receives the advance from the

pension scheme and references to payment in respect of security are replaced by references to drawing (including the receiving of distributions from the partnership) and other payment.

Revenue protection provisions – new sections 196I and 196J

108. New section 196I is a new provision to recover excess relief given to an ABC arrangement that is an acceptable SFA. It is extended by new section 196J from 21 March 2012 which describes further events which cause new section 196I to apply.

109. New sections 196I(1), (3), (9) and (10) stipulate the conditions when a balancing charge will arise to recover excess relief from the employer by treating the outstanding financial liability immediately before:

- a change to the original position of the lender (the responsible authority or the pension scheme), for example, when the annual payments are suspended by the employer exercising a right set out in the ABC arrangement at the outset;
- an occurrence or a non-occurrence of an event that does not accord with the original position;
- the financial liability in respect of the advance being reduced to nil by an event other than the making of payments;
- a commitment to a relevant person is given in a similar way to the commitment set out in new section 196C, E or G; or
- an occurrence of an event as set out in new section 196J

as profit or income in the relevant period of accounts.

New section 196I applies to this type of ABC arrangement where the contribution is paid on or after 22 February 2012, but in the case of a "new section 196J" event, it only has effect if the event takes place on or after 21 March 2012.

110. New sections 196I(2), (3), (9) and (10) provide that the amount of the reduction in the relevant financial liability other than by the making of payments will be treated as profit or income chargeable on the employer in the period in which the event occurs.

111. New section 196I(4) sets out that the amount treated as profit or income under new sub-section 3 cannot exceed the total amount on which relief has been given to the employer in respect of the arrangement.

112. New section 196I(5) provides that where a balancing charge applies under sub-section 3, the arrangement ceases to be a SFA.

113. New section 196I(6) cancels the effect of the application of new section 196I if a person is to be placed in a tax position which is more advantageous than the tax position in which the person would have been had new section 196I never applied. This subsection will have effect from 21 March 2012.

114. New section 196I(7) stipulates that new section 196I will not apply in cases where the change in the lender's original position, or the occurrence or non-occurrence of the event arises from an administrative error which is remedied promptly or changes in the pension scheme trustees or the persons in control of the management of the pension scheme.

115. New section 196I(8) stipulates that the occurrence or non-occurrence can be one that is authorised by a term of the ABC arrangement.

116. The terms used in new section 196I are defined in new section 196I(10).

117. New section 196J is an extension of new section 196I, which sets out further events that fall within new section 196J(1).

118. The relevant events are those where the employer, who has an ABC arrangement with the contribution paid on or after 22 February 2012, ceases to be chargeable to tax on or after 21 March 2012.

119. New sections 196J(2) and (3) set out the circumstances under which such cessation takes place. There are different circumstances depending on whether the employer's business is a company, a limited liability or other type of partnership. These circumstances include cases where the employer company goes into administration or winds up, or the employer partnership dissolves or when an individual who is the employer dies.

Treatment of advances under acceptable SFAs – new section 196K

120. New section 196K provides that any advance under an ABC arrangement which is an acceptable SFA with the contribution on or after 22 February 2012 and which gives rise to a loan within the meaning of Chapter 3 of FA 2004 is not prevented from meeting the definition of a scheme administration employer payment in S180 FA 2004. This means that no unauthorised payment charge will arise under section 208 FA 2004 purely by virtue of the fact that the advance gives rise to a loan which is not capable of meeting the conditions of section 179 FA 2004.

Supplementary provisions and application – new section 196L and paragraph 16

121. New section 196L provides a number of definitions and other supplementary provisions for new sections 196B to 196K.

122. New section 196L(2) explains the references to relief being given in respect of a contribution paid by an employer under a registered pension scheme.

123. New section 196L(3) refers to the meaning of connected persons in section 1122 of CTA 2010.

124. New section 196L(4) provides that sections 774 (accounts), 775 (arrangements) and 776 (assets) of CTA 2010 apply to new sections 196B to 196K in the same way as they do for the purposes of Part 16 of CTA 2010.

125. New section 196L(5) provides that a reference to a disposal of an asset includes:

- anything constituting a disposal of an asset for the purposes of the Taxation of Chargeable Gains Act 1992; and
- the taking of any step by virtue of which a person receives an asset, for example, the issuing of shares or any instrument creating or acknowledging indebtedness.

This is to ensure that all types of asset transfers in relation to ABC arrangements are covered.

126. New section 196L(6) stipulates that section 776(2) of CTA 2010 applies for the purposes of sub-section 5(b) set out above.

127. New section 196L(7) sets out the meaning of “non-working day”.

128. Paragraph 16 make a consequential amendment to section 280(1) FA 2004 (abbreviations) by inserting a reference to CTA 2010.

Commencement and application of new sections 196B to 196L – paragraph 17

129. Paragraph 17 provides that the amendments made by new sections 196B to 196L shall have effect on contributions paid by employers on or after 22 February 2012 with the exception of the events set out in new sections 196I(6) and 196J (only those events that take place on or after 21 March 2012 are covered).

Part 4 - Transitional rules (paragraphs 18 to 31)

130. Part 4 contains transitional provisions which apply the "relevant effect" of the SFA rules to those ABC arrangements where the contribution was paid before 22 February 2012, they are not an acceptable SFA, and Part 2 does not apply. These rules apply to income amounts that arise on or after 22 February 2012. There are also rules to introduce a mechanism to make a tax adjustment at the end of any of these arrangements which ensures the employer receives tax relief in respect of the total amount of payments made to the pension scheme under the ABC arrangement.

131. The transitional provision that will apply to ABC arrangements which are an acceptable SFA, and the contribution is paid on or after 22 February 2012 is new section 196I of Part 3. This section recovers any excess relief given where the relevant change or event occurs on or after either 22 February or 21 March 2012 as set out in the preceding section concerning Part 3 of the Schedule. Further detail can be found in that section and is not repeated in this part of the note.

Detail of transitional rules

Paragraphs 18 to 22 – application and interpretation

132. Paragraphs 18-22 provide for application and interpretation of the terms used in Part 4.

133. Paragraph 18 provides that these transitional provisions will apply where Part 2 does not apply and an ABC arrangement with the contribution paid at any time would **not** have received relief under new sections 196B, 196D or 196F of Part 3 had the contributions been paid on or after 22 February 2012, and the arrangement is not 'completed' as determined under paragraph 20 before that date.

134. Paragraph 19 provides that for the purposes of Part 4, the terms used in new sections 196B, 196D or 196F have the same meaning as in those new sections and where necessary it is assumed that those new sections have effect in relation to the employer's contribution.

135. Paragraph 20 provides that an ABC arrangement that would be denied upfront relief under new section 196B, 196D or 196F had the contribution been paid on or after 22 February 2012 is completed if :

- where the arrangement is a simple case, the lender etc is no longer entitled to payments in respect of the security; or
- where the arrangement is a complex case, the share in the partnership's profits of the person involved in the relevant change is no longer to be determined by reference to payments in respect of the security.

136. Paragraph 21 provides that "the completion day" is the earliest of the day on which the ABC arrangement is to be completed as determined at the beginning of 22 February 2012, the day on which the arrangement is actually completed, the day which is the last day of the period of 25 years from the day on which the employer's contribution is paid, or the day on which either a completion event occurs, or, after 21 March 2012, the day on which an event as set out in paragraph 22 of this Schedule occurs.

137. A completion event occurs where there is a change in the number of either payments or drawings/other payments, a significant change in the amount of either a payment or a drawing/other payment is to be made, or a significant change in the time at which either a payment or a drawing/other payment is to be made.

138. A "paragraph 22" event occurs when the employer who has an ABC arrangement ceases to be chargeable to tax. Paragraph 22 sets out the circumstances, similar to those set out in new sections 196H(4) and (5) in Part 1, surrounding such cessation (see paragraphs 48 to 50 in the section covering Part 1 of the Schedule).

139. These two paragraphs (21 and 22) prevent the employer seeking to extend the duration of the arrangement or make a material change to the original position as at 22 February or 21 March 2012 (depending on the type of events) to avoid the transitional provisions set out in paragraphs 29 to 31.

Paragraphs 23 to 28 – certain tax consequences not to have effect

140. Paragraphs 23-28 deem the relevant ABC arrangements not to have "the relevant effect" as set out in paragraphs 23(3), 24(3) and 25(2). This means that on or after 22 February 2012, no deduction will be given to any income payments that the borrower (the employer or a connected party or other relevant person) makes to the lender etc under the ABC arrangement and any income amounts that have been transferred to the lender etc will be bought back into charge on the employer etc or other relevant person.

141. Paragraph 23(1) provides that paragraph 23 applies to an ABC arrangement where, had the employer's contribution been paid on or after 22 February 2012, new section 196B in Part 3 would have applied so that the arrangement would have the "relevant effect". The "relevant effect" defined in paragraph 23(3) is that the borrower etc (the employer etc) would receive relief for payments to the lender etc (the pension scheme) made under the arrangement either by way of an income deduction or by an income amount which would otherwise have been charged to tax not being so charged.

142. Paragraph 23(2) deems the arrangement **not** to have the "relevant effect" which is set out in paragraph 23(3). This means that either no relief will be given for any income payments the borrower etc (the employer etc) makes to the lender etc (the pension scheme) under the ABC arrangement or any income amounts that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the employer etc.

143. Paragraph 23(4) defines the relevant effect if the borrower is a partnership.

144. Paragraph 23(5) provides that "amount" in sub-paragraphs 3 and 4 means an amount that arises on or after 22 February 2012 but on or before the completion day as set out in paragraph 21. This means that before the completion day, this paragraph prevents relief for income payments made on or after 22 February 2012 or brings back income amounts into charge from that date.

145. Paragraph 24(1) provides that paragraph 24 applies to an ABC arrangement where, had the employer's contribution been paid on or after 22 February 2012, new section 196D in Part 3 would have applied so that the ABC arrangement would have the "relevant effect". The "relevant effect", defined in paragraph 24(3), is that the transferor etc (the employer etc) would receive relief either by way of an income deduction or by an amount which would otherwise have been charged to tax not being so charged.

146. Paragraph 24(2) deems the arrangement **not** to have the "relevant effect". This means that either no relief will be given for any income payment made by the partnership to the lender etc (the pension scheme) under the arrangement or any amount that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the transferor etc (the employer etc).

147. Paragraph 24(4) provides that for the purposes of sub-paragraph 3, "amount" means an amount that arises on or after 22 February 2012 but on or before the completion day as set out in paragraph 21. This means that before the completion day, this paragraph prevents relief for income payments made on or after 22 February 2012 or brings back income amounts into charge from that date.

148. Paragraph 24(5) provides that in determining whether the ABC arrangement would have the relevant effect, it is to be assumed that the amounts of income equal to the payments mentioned in new section 196D(2)(g) in Part 3 were payable to the partnership before the relevant change occurred.

149. Paragraphs 25(1) provides that paragraph 25 applies to an ABC arrangement where had the employer's contribution been paid on or

after 22 February 2012, new section 196F in Part 3 would have applied so that the ABC arrangement would have the "relevant effect". The "relevant effect", defined in paragraph 25(2), is that the "relevant member" would receive relief by way of an income deduction or by an income amount which would otherwise have been charged to tax not being so charged.

150. Paragraph 25(3) provides that a "relevant member" is a person who was a member of the partnership immediately before the relevant change in the partnership occurred and the person is not the lender.

151. Paragraph 25(4) provides that for the purposes of sub-paragraph 2, "amount" means an amount that arises on or after 22 February 2012 but on or before the completion day as set out in paragraph 21. This means that before the completion day, this paragraph prevents relief for income payments made on or after 22 February 2012 or brings back income amounts into charge from that date.

152. Paragraph 25(5) deems the arrangement **not** to have the "relevant effect" as set out in paragraph 25(2). This means no relief will be given for any income payments made from the partnership to the lender (the pension scheme) or any income amounts that would have been charged to tax if not for the ABC arrangement will be brought back into tax as a charge on the relevant member (the employer etc or other relevant person).

153. Paragraph 25(6) provides that in determining whether the ABC arrangement would have the relevant effect, it is to be assumed that the amounts of income equal to the payments mentioned in new section 196F(2)(e) in Part 3 were payable to the partnership before the relevant change occurred.

154. Paragraph 26 applies instead of paragraph 23, 24 or 25 if a relevant charging provision under the SFA rules applies to the ABC arrangement.

155. Paragraph 27 applies not to treat the amount of the relevant interest provision as interest if the amount arises on or after 22 February 2012 but on or before the completion day.

156. Paragraph 28 stipulates that new section 196G in Part 1 does not apply in relation to the employer's contribution if the relevant event occurs on or after 22 February 2012. It also states that new section 196H in Part 1 does not apply to the contribution.

Paragraphs 29 to 31 – adjustments

157. Paragraphs 29-31 provide for a tax adjustment on the employer when the ABC arrangement ends to ensure that the total amount on which

relief is given to the employer will accurately reflect, but will not exceed, the total amount of payments actually given to the pension scheme under the arrangement.

158. This adjustment mechanism will take into account not just all the payments actually made to the pension scheme but also all the relief in the form of deductions against taxable profits or income given to the employer before and after 22 February 2012. Any deductions and payments given before 22 February 2012 will be cancelled out in the overall adjustment so the amounts set out in paragraphs 29 to 31 do not include these sums. The adjustment can result in either a charge on the employer or further tax relief.

159. The following example illustrates how the adjustment mechanism as set out in paragraphs 29-31 works in relation to an unacceptable SFA.

Example B

The ABC arrangement is a SFA with contribution paid before 22 February 2012 but it is not an acceptable SFA because of its contingent features.

Pension scheme deficit = £400m
Contribution paid under the ABC arrangement = £400m
Yearly payment = £22.5m (of which £22m is the finance charge as the arrangement is a SFA) payable for 20 years.
Two yearly payments were made before 29 November 2011.
The last payment will vary between £0.5m and £440m depending on the pension deficit level at year 20, i.e. it is a contingent payment.

Assume that the ABC arrangement will be completed on the day on which it is to be completed at the beginning of 22 February 2012.

Using Amounts A, B and C as defined in paragraph 29(1)
Amount A (relief for E's contribution) = £400m
Amount B (total amount of denied deductions on yearly payments under paragraphs 26 and 27) = £22.5m x 18 years = £405m
Amount C = £0.5m (assuming the pension scheme does not have a deficit at year 20 and the employer agrees with the pension scheme to pay the minimum amount for the last payment)

Pre-February deductions on yearly payments = Pre-February yearly payments (which we call Amount D which is **not** included in the Schedule) = £22.5m x 2 years = £45m.

As Amount B + Amount C exceeds Amount A by £5.5m, additional relief arises under paragraph 31 of the Schedule.

So the total relief given to the employer is the sum of Amount A (£400m) + Amount D (£45m) plus the adjustment relief of £5.5m (see the item above). This is equal to £450.5m.

Total payments received by the pension scheme = Amount D + Amount B + Amount C = £45m + £405m + £0.5m = £450.5m which equals the total amount of relief given.

This means that the employer relief accurately reflects the payments actually received by the pension scheme.

160. Paragraph 29(1) defines Amount A, Amount B and Amount C for the purposes of making tax adjustments as set out in paragraphs 30 and 31:

- Amount A is the total amount of relief given in respect of the employer's contribution paid under the ABC arrangement;
- Amount B is the total of any amounts in respect of which the employer has been denied relief under a relevant provision which is, as defined in paragraphs 29(2) and (3), paragraphs 23, 24 or 25, or the relevant charging provision as set out in paragraph 26, or the provision not to treat interest payment as interest as stipulated in paragraph 27, provided that there is no overlap of those payments which are denied relief under the separate provisions; and
- Amount C is the amount of the payment made under the ABC arrangement before the completion day which is not reflected in Amount B, is not the subject of an income deduction and is not a contribution paid by the employer to the pension scheme, but it nevertheless becomes part of the sums held by the pension scheme.

161. Paragraph 29(4) defines "income deduction" for the purposes of sub-paragraph 1.

162. Paragraphs 29(5) and (6) provide that where, had the employer's contribution been paid on or after 22 February 2012, new section 196B in Part 3 would have applied, Amount C is the payment (if any) which the borrower etc makes to the lender etc in order to acquire the security or an asset in place of the security under the ABC arrangement.

163. Paragraphs 29(7) and (8) provide that where, had the employer's contribution been paid before 22 February 2012, new sections 196D or 196F in Part 3 would have applied, Amount C is the payment (if any) which the employer etc makes to the lender etc in order to reverse the relevant change in relation to the partnership.

164. Paragraphs 29(9) provides that Amount C is to be taken to be nil where, between 22 February 2012 and the day before the completion day, a commitment is given to a "relevant person" directly or indirectly and the commitment is to secure that a person receives money or another asset that is linked to the making of the payment covered by Amount C.

165. Paragraph 29(10) defines the relevant person as the employer, a person connected with the employer, a person acting at the direction or request, or with the agreement of the employer or the connected person, a person chosen by the employer or the connected person or a class of person so chosen, or a partnership. However, as set out in paragraph 29(11), the relevant person does not include the persons who from time to time are the trustees of the pension scheme or the persons controlling the management of the scheme.

166. Paragraph 30 provides that at the end of the completion day, if the amount of tax relief that has been given to the employer in respect of the contribution paid under an ABC arrangement is greater than the total amount of payments made to the pension scheme, then the excess tax relief in the form of the difference between the two amounts will be recovered from the employer.

167. Paragraphs 30(1) and (2) provide that where amount A is greater than the sum of Amount B and Amount C, the excess will be either treated as a profit or income arising on the employer in the period of accounts in which the completion day falls.

168. Paragraph 31 provides that that at the end of the completion day, if the amount of tax relief that has been given to the employer in respect of the contribution paid under the ABC arrangement is less than the total amount of payments made to the scheme, then the employer will be entitled to additional relief. Where the sum of amount B and Amount C exceeds Amount A, the excess is treated as an employer contribution paid on the completion day to which the employer is to be given to relief in accordance with section 196 FA 2004.

Part 5 – Related changes to structured finance legislation[6] (paragraphs 32 to 42)

169. Paragraphs 32 – 36 provide for amendments to the structured finance legislation in Chapter 5B of Part 13 ITA 2007.

170. Paragraph 33 amends section 809BZA of ITA 2007, providing that for type 1 finance arrangements, it does not matter if the entitlement

[6] This is the legislation concerning SFAs, which are in turn defined under new section 196J(1)(4) in Part 1 of this Schedule as an arrangement which is a type 1, type 2 or type 3 finance arrangement for the purposes of Chapter 2 of Part 16 Corporation Tax Act 2010 and Chapter 5B of Part 13 Income Tax Act 2007.

of the lender or a person connected with the lender is subject to any condition.

171. Paragraph 34 amends condition A in section 809BZF of ITA 2007 so that an arrangement may be a type 2 finance arrangement where a person connected with the transferor is a member of the partnership immediately after the disposal. The paragraph also provides that type 2 finance arrangements will include finance arrangements where the determination of the shares in the partnership's profits of the person involved in the relevant change is subject to any condition.

172. Paragraph 35 amends section 809BZH ITA 2007, which applies to type 2 finance arrangements, so that any mention of the transferor additionally includes a person connected with the transferor. This applies to section 809BZH(3) ITA 2007, which defines relevant effects, with the consequence that a relevant effect as defined in that subsection may now arise in respect of a person connected with the transferor, as well as in respect of a transferor. It also applies to section 809BZH(2) ITA 2007, with the consequence that where that subsection applies, it may provide additionally that Part 9 of the Income Tax (Trading and Other Income) Act 2005 is to have effect as if the relevant effect had not occurred in relation to a person connected with the transferor.

173. Paragraph 36 amends section 809BZJ ITA 2007 so that for type 3 finance arrangements, it does not matter if any determination of the share in the partnership's profits of the person involved in the relevant change is subject to any condition.

174. Paragraphs 37 to 41 provide for amendments to the structured finance legislation in Chapter 2 of Part 16 CTA 2010. Paragraph 38 amends section 758 CTA 2010, so that for type 1 finance arrangements, it does not matter if the entitlement of the lender, or a person connected with the lender is subject to any condition.

175. Paragraph 39 amends condition A in section 763 of CTA 2010 so that an arrangement may be a type 2 finance arrangement where a person connected with the transferor is a member of the partnership immediately after the disposal. The paragraph also provides that type 2 finance arrangements will include finance arrangements where the determination of the shares in the partnership's profits of the person involved in the relevant change is subject to any condition.

176. Paragraph 40 amends section 765 CTA 2010, which applies to type 2 finance arrangements, so that any mention of the transferor additionally includes a person connected with the transferor. This applies to section 765(3) CTA 2010, which defines relevant effects, with the consequence that a relevant effect as defined in that subsection may now arise in respect of a person connected with the

transferor, as well as in respect of a transferor. It also applies to section 765(2) CTA 2010, with the effect that where that subsection applies, it may provide additionally that sections 1259 to 1265 CTA 2009 are to have effect as if the relevant effect had not occurred in relation to a person connected with the transferor.

177. Paragraph 41 amends section 767 CTA 2010 so that for type 3 finance arrangements, it does not matter if any determination of the share in the partnership's profits of the person involved in the relevant change is subject to any condition.

178. Paragraph 42 states that the amendments made by Part 5 are to have effect whenever the arrangements are made, but that in relation to arrangements made before 21 March 2012, an amount is to be charged to tax or brought into account in calculating any income for tax purposes or deducted from any income for tax purposes only if the amount arises on or after 21 March 2012. It also states that the amendments in Part 5 have no effect for the purposes of new section 196I(4) in Part 1 and have no effect for the purposes of new sections 196C(2)(b), 196E(2)(b) or 196G(2)(b) in Part 3 if the ABC arrangement is one where the contribution is paid before 21 March 2012.

BACKGROUND NOTE

179. This Schedule limits the amounts on which tax relief will be given to an employer in respect of a contribution paid under an asset-backed arrangement so that the relief accurately reflects, but does not exceed, the total amount of payments made to the registered pension scheme. It also contains minor and related changes to the structured finance legislation in the last part of the Schedule (Part 5).

180. The effects of the Schedule do not apply to any straightforward monetary sum that a sponsoring employer gives to the registered pension scheme as a pension contribution or any employer's transfer of an asset to the pension scheme which is unconditional or outright so that the pension scheme gains complete ownership of the asset on an irrevocable basis. In these cases, relief will continue to be given to the employer in respect of the contribution paid under section 196 in Finance Act 2004 provided that the requirements of that section are met.

181. At Budget 2011, the Government announced that it would consult on changing tax rules to prevent unintended and excessive relief arising from employer asset-backed pension contributions, while preserving as much flexibility as possible for employers and their pension schemes to use these contributions, as well as ensuring that the

compliance process is deliverable for Government without creating undue burdens on HM Revenue & Customs or customers.

182. A consultation document, *Employer Asset-backed Pension Contributions* was published on 24 May 2011 and the consultation closed on 16 August 2011. The document invited views on two broad options: (a) providing upfront relief to the employer only for giving a monetary contribution or a cash-convertible asset to the pension scheme, and (b) providing either upfront relief or "pay as you go" relief depending on whether the structured finance legislation would apply to the asset-backed arrangement in order to ensure that the economic substance of the arrangement would be accurately reflected and excessive relief would not arise. The main purpose of the consultation was to establish which option would better meet the Government's objectives as set out in the last paragraph while also ensuring that pensions tax relief would remain fair and sustainable in the long term.

183. Following the consultation, legislation was announced published on 29 November 2011 and 22 February 2012 respectively, which is designed on the basis of the second option above and informed by responses to and information received during the consultation and feedback received on the draft legislation. In order to prevent certain activity or behaviour in relation to these types of arrangement which brings a significant risk to the Exchequer, the legislation has effect from the respective dates of announcement.

184. Amendments to February and structured finance legislation were also announced on 21 March 2012 (Budget Day) to take immediate effect. These amendments are covered in a Budget supplementary document in the form of a Technical Note, which was published on the same day.

185. There are also relieving or clarifying changes to the February legislation, taking effect from 22 February 2012. The full set of legislation has been consolidated into Finance Bill 2012 and published today (29 March 2012).

186. Further detail is available in the consultation document, the two Budget reports and other Budget supplementary documents, the autumn statement, the Written Ministerial Statements made in November and February, the summary of responses document, and the two tax information and impact notes published on 29 November 2011 and 22 February 2012.

EXPLANATORY NOTE

CLAUSE 49 SCHEDULE 14: GIFTS TO THE NATION

SUMMARY

1. Clause 49 and Schedule 14 provide for a reduction in income tax, capital gains tax and/or corporation tax where individual and corporate donors make gifts of pre-eminent objects to the nation in accordance with a scheme set up by the Secretary of State.

DETAILS OF THE CLAUSE

2. The Schedule comprises six parts. Part 1 of the Schedule outlines the circumstances when the tax reduction will apply to a gift of pre-eminent property. Parts 2 and 3 of the Schedule set out the details of how the tax reduction will apply to individual and corporate donors respectively. Part 4 of the Schedule makes general provisions in connection with the tax reduction. Part 5 of the Schedule makes related changes to other provisions in connection with the scheme. Part 6 provides for the Scheme to take effect.

3. Paragraph 1 of the Schedule outlines the circumstances when a gift of pre-eminent property for the benefit of the public or the nation will be a qualifying gift for the purposes of the tax reduction. In particular, a gift that qualifies for the tax reduction must be registered and accepted under the scheme set up by the Secretary of State.

4. Paragraph 2 of the Schedule specifies that the provisions in Part 2 of the Schedule apply to the income tax liability (the liability after following the seven steps as set out under section 23 of the Income Tax Act (ITA) 2007) and capital gains tax liability of individual donors. The donor must be acting in their own personal capacity, so the tax reduction does not extend to individuals who are acting as trustees or personal representatives.

5. Paragraph 3 of the Schedule sets out how the tax reduction is to be applied. If an individual makes a qualifying gift then part of that individual’s tax liability for a relevant tax year is treated as having been paid either from the date the tax should have been paid or from the date the offer was formally registered. The effect of this is to reduce the amount of tax the individual still has to pay for that period. An individual may, subject to agreement in accordance with the scheme, apply the tax reduction against their income tax and/or capital gains tax liabilities in the tax year in which the offer was registered or any of the succeeding four tax years.

6. Paragraph 4 of the Schedule sets out how an individual may allocate the tax reduction across more than one relevant tax year. The "total tax reduction" is first computed under paragraph 4(5). The total tax reduction for an individual is 30% of the value of the qualifying gift. The individual may then agree, pursuant to the scheme, that the total tax reduction amount is to be allocated across the five relevant tax years in whatever amounts they wish, including nil amounts for any year. Where an individual has on a previous occasion made a gift of another pre-eminent object under the scheme, any amount of tax reduction already allocated to a particular tax year in respect of that earlier gift of pre-eminent property is applied in priority to any tax reduction allocated to the same tax year in respect of the later gift. The individual is not required to use the whole of the tax reduction available, for example where the value of the gift is very high and/or the individual knows that their tax liabilities will not be sufficiently large so as to be able to use the full amount of the tax reduction.

7. Paragraph 4(6) of the Schedule provides that HM Treasury may, by order, amend the rate of the tax reduction for individuals.

8. Paragraph 5 of the Schedule enables the individual to specify how the tax reduction is to be split between their income tax and capital gains tax liabilities. If the individual does not express any preference, the tax reduction will be applied first to the individual's income tax liability and thereafter to any capital gains tax liability.

9. Paragraph 6 of the Schedule makes clear that where an offer of a gift is accepted under the scheme, resulting in an amount of the tax liability being treated as having been satisfied, as provided for in paragraphs 3 and 4, then no late payment interest or late payment penalties will be payable on that amount from the date of registration. Paragraph 6(5) specifies that where there are multiple due dates for a tax year, the deemed payment should be allocated to due amounts in a manner that minimises any late payment interest and penalties due. Paragraph 6(7) makes it clear that late payment interest and late payment penalties that accrue before the registration date are not affected by anything in these provisions.

10. Paragraph 7 of the Schedule provides that, where the donor's tax liability for a year subsequently changes, the portion of that tax liability for a relevant tax year (to which the tax reduction has applied) is to be recalculated. In many cases, the effect of this provision is limited. The tax schedule that sets out the tax reduction (as contained in the agreed terms) cannot be revised after it has been agreed, even if the donor's circumstances subsequently change.

> **Example**, a donor, Alan had originally allocated a tax reduction figure of £100,000 to Year 3. Alan's tax liability for Year 3 was

initially found to be £75,000, in which case Alan would have £25,000 of tax reduction figure which could be not be used. However, if Alan's tax liability were subsequently revised and found instead to be £150,000, Alan could then apply the initially unused balance of £25,000 of the tax reduction figure to set against a part of the additional £75,000 liability which had become due after the revision of Alan's tax liability occurred. The unused tax reduction would be available to set against tax liabilities only; penalties or interest due as a result of an enquiry into the person's tax affairs for that year would be payable in full.

11. Paragraph 8 of the Schedule makes provision for the tax reduction to be withdrawn where the qualifying gift is set aside or declared void, for example by order of a Court. Where the tax reduction has already been used, an amount representing the tax reduction (together with any late payment penalties and interest) due up to and including the date of payment, is payable within 30 days of the date the gift was set aside or declared void. Where the tax reduction has not yet taken effect, the normal due dates for the

12. Paragraph 9 of the Schedule allows an individual, who has made an offer under paragraph 1 of this Schedule, to make a request to defer payment of an amount of tax until the negotiations are concluded. Paragraph 9(4) and (5) make it clear that the amount of tax an individual can request to be deferred cannot exceed the proposed tax reduction figure set out in the donor proposal under paragraph 3 (3) of the Schedule. A request to defer payment of an amount of tax must be made at least 45 days before that tax is due to be paid.

Example 1: Single payment date of 31st January: a donor, Beth, has a proposed tax reduction figure of £100,000 which she would like to use to offset her tax liability which is due to be paid in full by 31st January 2014. For HMRC to be able to process this in time and perform the necessary checks Beth will need to make a request to HMRC no later than 15th December 2013 setting out that she would like to defer her payment of tax and how much of the tax reduction she is intending to use.

Example 2: Payments on Account: Chris is due to make a payment on account of his income tax liability on 31st July 2013. Chris will need to make a request to HMRC asking to defer payment of tax and specify the amount of the tax reduction he would like to use no later than 16th June 2013.

13. Under Paragraphs 9(7) and (8) set out that HMRC will look at a range of factors in deciding whether to agree to defer the payment of an amount of tax. Some of these factors could include whether

deferring the payment could pose a risk to the exchequer. In considering whether to agree to a request to defer the payment of an amount of tax HMRC may attach conditions or restrictions.

14. Paragraph 10 (1) of the Schedule provides that where payment of an amount of tax has been deferred under paragraph 9 late payment penalties will not accrue on that amount of tax from the date of registration. This does not affect any late payment penalties or interest accrued before the registration date and these remain payable by the individual. Where an amount of tax is suspended under paragraph 9 late payment interest will continue to accrue from the date that the tax should have been paid but for the Schedule.

15. HMRC may at any time withdraw from the agreement to defer payment of an amount of tax while negotiations are continuing. In such cases the individual will need to pay the outstanding tax and late payment interest within 30 days of a notice being issued by HMRC. Where the outstanding tax and late payment interest is not paid within 30 days individuals will become liable for late payment penalties. Late payment penalties are currently provided for under Schedule 56 to Finance Act 2009.

16. Paragraph 11 of the Schedule sets out what happens when negotiations conclude following a deferral of tax under the provisions of paragraphs 9 and 10.

17. Where a gift is withdrawn or the offer is rejected the individual will need to pay the outstanding amount, including any late payment interest that would have accrued on that portion since the tax was initially due, within 30 days of the negotiations concluding. Where the outstanding tax and late payment interest is not paid within 30 days individuals will become liable for late payment penalties which are currently provided for under Schedule 56 to Finance Act 2009.

18. Where a qualifying gift is made as a result of an offer under the Scheme then the actual tax reduction agreed will be applied to the tax amount that has been deferred as if the tax had been paid when it became due or on the offer registration date if the tax had become due before this date. Where the actual tax reduction figure is less than the amount of tax that has been deferred, so that the individual still owes some tax to HMRC, the individual will need to pay the remaining amount, including any late payment interest that would have accrued on that portion since the tax was initially due, within 30 days of the negotiations concluding. Where the outstanding tax and late payment interest is not paid within 30 days individuals will become liable for late payment penalties. These are provided for in Schedule 56 to Finance Act 2009.

19. Where part of an offer is accepted HMRC will apply the provisions in paragraph 11 as far as it is reasonably practicable to do so. HMRC may allow paragraph 9 to continue to apply to amounts of tax which payment is still deferred pending negotiations on the remaining parts of the offer

20. Paragraph 12 of the Schedule specifies that the provisions in Part 3 of the Schedule apply to the corporation tax liabilities of company donors.

21. Paragraph 13 of the Schedule provides that the tax reduction is to be applied to the accounting period in which the offer is registered. The date on which the corporation tax is treated as being satisfied is the date on which the tax liability became due (or, if the liability was due before the offer of gift was registered, the date on which the offer was registered).

22. Paragraph 14 of the Schedule specifies that the amount of the tax reduction for a gift under the scheme by a company is 20% of the value of the property forming the gift. The company may choose to accept a lower percentage if it wishes, for example where the value of the gift is very high or the company's tax liability for that particular accounting period will not be sufficient to use the full amount of the tax deduction.

23. Paragraph 14(4) of the Schedule provides that HM Treasury may, by order, amend the rate of the tax reduction for a corporate donor.

24. Paragraph 15 of the Schedule makes clear that where an offer of a gift is accepted under the scheme, resulting in an amount of the tax liability being treated as having been satisfied as provided for in paragraphs 13 and 14, then no interest or late payment penalties will be payable on that amount from the date of registration. Paragraph 15(5) specifies that where there are multiple due dates for an accounting period, the deemed payment should be allocated to due amounts in a manner that minimises any late payment interest and penalties due. Paragraph 15(7) makes it clear that late payment interest and penalties that accrue before the registration date are not affected by anything in these provisions.

25. Paragraph 16 of the Schedule allows the tax liability for the relevant accounting period to be recalculated where the company's corporation tax liability for the accounting period subsequently changes. The effect of this provision is limited.

> **Example**, D Ltd had a tax reduction due of £100,000. D Ltd's corporation tax liability for the relevant accounting period was only £75,000 and so D Ltd was not able to utilised £25,000 of

its tax reduction. D Ltd's corporation tax liabilities for the year were subsequently revised to £95,000. D Ltd could therefore use £20,000 of the unused balance of £25,000 to set against the additional £20,000 liability. The unused tax reduction would be available to set against tax liabilities only; penalties or interest due as a result of an enquiry into the company's tax affairs for that accounting period would be payable in full.

26. Where a company carries back losses to a previous year their liability will be recalculated and the tax reduction will be reapplied to the tax liability that arises out of that recalculation. The schedule to set off of the tax reduction (as contained in the agreed terms) cannot be revised after it has been agreed, even if the corporate donor's circumstances subsequently change. So if a company's tax liability after the recalculation is less than it was originally the remaining tax reduction will be lost.

27. Paragraph 17 of the Schedule makes provision for the tax reduction to be withdrawn where the qualifying gift is set aside or declared void, for example by order of a Court. Where the tax reduction has already been used, an amount representing the tax reduction (together with any late payment penalties and interest) due up to and including the date of payment, is payable within 30 days of the date the gift was set aside or declared void. Where the tax reduction has not yet taken effect, the normal due dates for the payment of the tax will apply.

28. Paragraph 18 of the Schedule allows a company, who has made an offer under paragraph 1 of this Schedule, to make a request to defer payment of an amount of tax until the negotiations are concluded. Paragraph 18(4) and (5) make it clear that the amount of tax an individual can request to be deferred cannot exceed the proposed tax reduction figure set out in the donor proposal under paragraph 14 (3) of the Schedule. A request to defer payment of an amount of tax must be made at least 45 days before that tax is due to be paid.

29. Under Paragraphs 18(7) and (8) set out that HMRC will look at a range of factors in deciding whether to agree to defer the payment of an amount of tax. Some of these factors could include whether deferring the payment could pose a risk to the exchequer In considering whether to agree to a request to defer the payment of an amount of tax HMRC may attach conditions or restrictions

30. Paragraph 19 (1) of the Schedule provides that where payment of an amount of tax has been deferred under paragraph 18 late payment penalties will not accrue on that amount of tax from the date of registration. This does not affect any late payment penalties or interest accrued before the registration date and these remain payable by the company. Where an amount of tax is suspended under

paragraph 18 late payment interest will continue to accrue from the date that the tax should have been paid but for the Schedule.

31. HMRC may at any time withdraw from the agreement to defer payment of an amount of tax while negotiations are continuing. In such cases the company will need to pay the outstanding tax and late payment interest within 30 days of a notice being issued by HMRC. Where the outstanding tax and late payment interest is not paid within 30 days individuals will become liable for late payment penalties.

32. Paragraph 20 of the Schedule sets out what happens when negotiations conclude following a deferral of tax under the provisions of paragraph 18 and 19.

33. Where a gift is withdrawn or the offer is rejected the company will need to pay the outstanding amount, including any late payment interest that would have accrued on that portion since the tax was initially due, within 30 days of the negotiations concluding. Where the outstanding tax and late payment interest is not paid within 30 days companies will become liable for late payment penalties.

34. Where a qualifying gift is made as a result of an offer under the Scheme then the actual tax reduction agreed will be applied to the tax amount that has been deferred as if the tax had been paid when it became due or on the offer registration date if the tax had become due before this date. Where the actual tax reduction figure is less than the amount of tax that has been deferred so that the company still owes some tax to HMRC the company will need to pay the remaining amount, including any late payment interest that would have accrued on that portion since the tax was initially due, within 30 days of the negotiations concluding. Where the outstanding tax and late payment interest is not paid within 30 days companies will become liable for late payment penalties.

35. Where part of an offer is accepted HMRC will apply the provisions in paragraph 20 as far as it is reasonably practicable to do so. HMRC may allow paragraph 18 to continue to apply to amounts of tax which payment is still deferred pending negotiations on the remaining parts of the offer.

36. Part 4 of the Schedule makes a number of general provisions.

37. Paragraph 21 provides that an order amending the percentage of a tax reduction is to be made by statutory instrument using the negative procedure.

38. Paragraph 22 of the Schedule defines the property that may be gifted under the terms of the scheme. The definition is intended to the mirror the definition which applies for the Acceptance in Lieu scheme

under section 230 of the Inheritance Act 1984, with the exception of land and buildings. In practice objects or collections of objects may be pre-eminent if they have an especially close association with the UK's history and national life; or are of especial artistic or art-historical interest; or are of especial importance for the study of some particular form of art, learning or history; or have an especially close association with a particular historic setting. The decision as to whether an object is pre-eminent rests with the "relevant Minister".

39. Paragraph 23 of the Schedule defines the term "relevant Minister". The relevant Minister is the Secretary of State for Culture, Media and Sport unless the item, defined in subparagraph (9), as an object or collection of objects, has an interest with one of Scotland, Northern Ireland or Wales. Two levels of interest are defined:

- An item has purely Scottish, Northern Irish or Welsh interest where it is already located in that country and the donor has either expressed a wish that it is displayed in that country or has not expressed a preference about where the item is to be displayed. In such a case the relevant Minister is the Minister of that country.

- An item may have some Scottish, Northern Irish or Welsh interest if it is located in that country or the donor would prefer the item to be displayed in that country. In such a case the relevant Minister is the Minister of that country and the Secretary of State for Culture Media and Sport together.

- Where an item has an interest with more than one country (Wales, Northern Ireland, Scotland & England) the Secretary of State for Culture, Media and Sport will consult with the appropriate Minister from each country.

40. Paragraph 24 of the Schedule defines a number of terms used in the Schedule.

41. Paragraph 25 of the Schedule makes plain that there is no obligation for an offer of a gift under the scheme to be accepted, even if it meets all of the qualifying circumstances pursuant to the scheme.

42. Part 5 of the Schedule makes related changes to other provisions in connection with the scheme.

43. Paragraph 26 amends the Inheritance Tax Act 1984 (IHTA) to provide for an exemption from inheritance tax of a gift of property under the scheme.

44. Paragraphs 27 and 28 of the Schedule amends the inheritance tax rules where the donor of the object under the scheme had received it in a potentially exempt transfer (PET). It ensures that there is no

chargeable transfer if the person from whom the donor received the object dies within 7 years of the PET.

45. Paragraph 29 of the Schedule exempt a gift of a conditionally exempt object from inheritance tax recapture charges. Paragraph 29(3) inserts a new subsection (4A) into section 32 of the IHTA.

46. New subsection (4A)(a) of section 32 IHTA applys where a person inherits a conditionally exempt object on the death of its previous owner. That person may give that object to the nation under the scheme within 3 years of the previous owner's death without triggering the inheritance tax recapture charge that would otherwise have become due on the death of the previous owner and without any need to renew its conditional exemption. Also a recapture charge will not be triggered on the death of the donor.

47. New subsection (4A)(b) of section 32 IHTA ensures that, where a donor gives a conditionally exempt object under the scheme, the gift will not be a chargeable event which would otherwise result in the inheritance tax held over on the object becoming payable.

48. Paragraph 30(2) of the Schedule similarly inserts a new subsection (5A) into section 32A IHTA in relation to gifts to the nation under the scheme of objects conditionally exempt from inheritance tax because of their historical association with an outstanding building.

49. Paragraphs 31 and 32 of the Schedule make consequential amendments to sections 33 and 34 IHTA.

50. Paragraph 33 of the Schedule provides an exemption from Estate Duty and Inheritance Tax (IHT) conditional exemption which would otherwise have become chargeable under Schedule 5 of IHTA on a gift of property under the scheme. The amount of the exemption is the maximum rate of inheritance tax at the time when the gift is accepted which is currently 40%.

51. Where the rate of tax on the disposal is higher than the maximum rate of inheritance tax the donor will need to pay the difference. This provision ensures that the incentive to donate an item which either has an estate duty charge attached to it or where the item is conditionally exempt is broadly similar to that where inheritance tax has been held over.

52. If a credit is due against the estate duty or IHT payable under Section 33(7) of IHTA this credit is set against the balance of the tax due after the exemption is given. Unused credit is not repayable.

53. Subparagraph 6 applies the provisions to Northern Ireland.

54. Paragraph 34 of the Schedule inserts new subsection (1A) into section 258 of the Taxation of Chargeable Gains Act 1992. New subsection (1A) exempts the donor of an object under this scheme from capital gains tax or corporation tax on a chargeable gain, which would normally arise on the disposal of a chargeable asset.

55. Paragraph 35 of the Schedule applies to non-domiciled and/or not ordinarily UK resident donors who use the remittance basis of tax. Normally, a tax charge is triggered when property derived from untaxed foreign income or gains is brought to the UK, subject to a number of limited exemptions. Paragraph 28(3) inserts new section 809YE into the Income Tax Act 2007 which ensures that, where such property has been brought into the UK and has been accepted under the scheme, there will be no charge to income tax or capital gains tax on the remittance of that property.

56. Part 6 of the Schedule provides for the Scheme to take effect.

57. Paragraph 36 of the Schedule provides for the scheme to commence on an appointed day by order of the Treasury. The first tax period to which the scheme may apply is the tax year beginning on 6 April 2012.

BACKGROUND NOTE

58. The details of how the application and acceptance process in connection with the scheme will operate will be set out in detailed guidance when it will be issued by the Department for Culture, Media and Sport later in the year.

59. The basic rules for an individual in deciding how to allocate a tax reduction across the relevant tax years are that:

- the amounts set against each of the five relevant tax years must always add up to no more than the total tax reduction figure;
- such amount must be specified and agreed in advance in respect of each relevant tax year. For example, it will not be possible to specify, that say £100,000 to be set against year 1 in the above example, with £400,000 to be distributed across years 2 to 5 in some way to be specified at a later time; and
- under paragraph 7(2), once the schedule of tax reductions has been accepted within the terms of a qualifying gift, the schedule cannot be varied, even where it is subsequently found that the individual does not have enough tax liability in a relevant tax year to utilise the tax reduction specified for that year. In such a case the unutilised amount of tax reduction will be lost.

60. The following table gives examples of how an individual might choose to apply a total tax reduction of £500,000 across five relevant tax years.

Example

Year 1	Year 2	Year 3	Year 4	Year 5	Total
500,000	-	-	-	-	500,000
-	-	-	-	500,000	500,000
-	100,000	-	300,000	100,000	500,000
200,000	50,000	50,000	50,000	50,000	400,000

EXPLANATORY NOTE

CLAUSE 50: GIFT AID: GIVING THROUGH SELF-ASSESSMENT RETURN

SUMMARY

1. Clause 50repeals, with effect from 6 April 2012, the "SA Donate" scheme which enables an individual, who makes a self-assessment return, to direct HM Revenue and Customs (HMRC) to make any repayment of tax due for the tax year to a charity.

DETAILS OF THE CLAUSE

2. Subsection (1) repeals section 429 of the Income Tax Act (ITA) 2007 which gives effect to the SA Donate scheme.

3. Subsections (2) and (3) make consequential amendments to remove references to section 429 of ITA 2007 from the Taxes Acts.

BACKGROUND NOTE

4. Section 429 ITA 2007 provides for a scheme known as "SA Donate". It enables an individual who makes a self-assessment return to direct HMRC to make any repayment of tax due for a tax year to a specified charity instead of to the individual. In addition to the repayment, provided the individual has paid sufficient income tax or capital gains tax on the amount of the repayment donated to the charity, HMRC also pays the charity the basic rate of tax relating to the repayment in accordance with the gift aid rules at Chapter 2 of Part 8 of ITA 2007.

5. SA Donate has not been well used and is disproportionately expensive for HMRC to administer. It is being withdrawn with effect from 6 April 2012 in order to concentrate HMRC resource on the introduction of an online filing system for charities. Taxpayers who receive repayments of tax from HMRC will still be able to give the money to their chosen charity under gift aid by making a direct gift to the charity.

EXPLANATORY NOTE

CLAUSE 51 SCHEDULE 15: RELIEF FOR GIFT AID AND OTHER INCOME OF CHARITIES ETC

SUMMARY

1. Clause 51 and Schedule 15 make a number of amendments to the law to put onto a statutory footing the current practice of HM Revenue & Customs (HMRC) of making repayments of income tax, including under Gift Aid, to Community Amateur Sports Clubs (CASCs) charitable trusts, charitable companies and eligible bodies.

DETAILS OF THE CLAUSE

2. Clause 51 introduces Schedule 15 which contains provisions relating to CASCs, eligible bodies and charities that make Gift Aid repayment claims and other income tax repayment claims.

DETAILS OF THE SCHEDULE

3. Schedule 15 amends the rules for charitable trusts and companies, CASCs and eligible bodies as defined in section 468 of Corporation Tax Act (CTA) 2010. It allows charities, CASCs and eligible bodies to make claims for repayments of Gift Aid and other income tax outside a tax return. Currently:

- charitable trusts that have been issued with a notice to file a tax return can claim a repayment of income tax, including Gift Aid relief, only on the tax return (section 42(2) of the Taxes Management Act 1970 (TMA));

- if a charitable trust receives a payment on which income tax has been deducted or is deemed to have been deducted, the income tax must be set off against income tax due before it is repaid (section 59B TMA)

- charitable companies, which are subject to corporation tax, can claim a repayment of income tax including Gift Aid relief only after the delivery of a company tax return for the period to which the claim relates (paragraphs 9(1) and (2) of Schedule 18 to the Finance Act (FA) 1998). Eligible bodies as defined in section 468 CTA 2010 are companies for tax purposes and are subject to the same restriction.

- if a charitable company receives a payment on which income tax has been deducted or is deemed to have been deducted, the income tax must be set off against corporation tax due before it is repaid (section 967 CTA 2010). The same restriction applies to eligible bodies.

- CASCs are treated as companies for tax purposes but the Gift Aid legislation in Part 11 of CTA 2010 does not apply to CASCs, so there is no provision to allow CASCs to claim Gift Aid repayments. The Gift Aid legislation used to apply to CASCs (so far as it treated qualifying donations to be received under deduction of tax) but the link was broken when the legislation rewritten for the CTA 2010.

4. Paragraph 1 amends section 538A of ITA 2007 by inserting a new subsection (A1). Section 538A ITA 2007 enables charitable trusts to claim exemption from income tax on Gift Aid, in what is known as a "free-standing claim." A free-standing claim may be made during the tax year in which the income is received. Section 538A currently applies only to free-standing claims for exemption from tax, not for repayment, and it refers only to Gift Aid. New subsection (A1) allows charitable trusts to make free-standing claims for repayment of income tax where they receive a gift that qualifies for Gift Aid relief or other specified income that has suffered a tax deduction. Section 538A is also amended to allow free-standing claims for exemption from tax for the other income specified in new subsection (A1).

5. Paragraph 2 introduces amendments to Part 11 of CTA 2010, which applies to charitable companies and eligible bodies.

6. Paragraph 3 amends section 477A of CTA 2010 by inserting a new subsection (A1). Section 477A CTA 2010 enables charitable companies and eligible bodies to claim exemption from income tax on Gift Aid, in what is known as a "free-standing claim." A free-standing claim may be made at any time during the tax year in which the income is received. Section 477A currently applies only to free-standing claims for exemption from tax, not for repayment. New subsection (A1) allows charitable companies and eligible bodies to make free-standing claims for repayment of income tax where they receive a gift that qualifies for Gift Aid relief.

7. Paragraph 4 inserts a new section 491A in CTA 2010. This section applies the provisions of section 477A to other specified income that has suffered an income tax deduction that is received by charitable companies and eligible bodies. This sets out how charitable companies and eligible bodies can make free-standing claims for this income to be exempt from tax and for repayments of tax.

8. Paragraph 5 introduces amendments to Chapter 9 Part 13 of CTA 2010, which applies to CASCs.

9. Paragraph 6 inserts new section 661D into CTA 2010 which extends the Gift Aid legislation to CASCs. New section 661D CTA 2010 treats qualifying donations to CASCs falling within the Gift Aid provisions of Chapter 2 of Part 8 of Income Tax Act (ITA) 2007 as being received under deduction of income tax, by reference to the current basic rate of tax. The income tax treated as deducted is treated as income tax paid by the club, and the grossed up amount of the donation, is charged to corporation tax. The donation is exempt from corporation tax under section 664 CTA 2010 provided it is used for qualifying purposes.

10. Paragraph 7 inserts new section 665A into CTA 2010. This allows CASCs to claim a repayment, either of income tax treated as deducted by new section 661D CTA 2010 in respect of Gift Aid donations, or of income tax deducted at source from interest income. The repayment can be claimed either by a “free-standing claim” or by a claim included in the CASC’s tax return. The provision also enables the Commissioners of HMRC to make regulations limiting the number of free-standing claims that may be made within a tax year and specifying the minimum amount that may be claimed in a free-standing claim.

11. Paragraph 8 inserts new subsection 413(6) into ITA 2007 to refer to the legislation on gift aid for CASCs in Chapter 9 Part 13 of CTA 2010.

12. Paragraph 9 amends section 59B TMA which provides that where a charitable trust receives a payment on which it bears income tax by deduction, the income tax must be set off against any income tax due. The amendment to this section exempts donations received by charitable trusts which qualify for Gift Aid and other specified income on which income tax has been deducted from the provisions of this section. This means that income tax claimed under Gift Aid or which has been deducted from other specified income may be repaid during the tax year instead of waiting until the end of the tax year to establish if there is income tax liability against which the income tax deducted should be offset.

13. Paragraph 10 inserts new subsection (5) into section 967 of CTA 2010. Section 967 provides that where a UK resident company receives a payment on which it bears income tax by deduction, the income tax suffered must be set against any corporation tax due. New subsection (5) of section 967 CTA 2010 exempts donations received by charitable companies, eligible bodies and CASCs in respect of Gift Aid and certain other specified income from the provisions of this section. This means that income tax claimed under Gift Aid or which has been deducted from other specified income may be repaid during the tax year instead of waiting until the end of the tax year to

establish if there is corporation tax liability against which the income tax should be offset.

14. Paragraph 11 disapplies (in respect of certain sources of income) the requirement in section 42(2) of TMA that, where HMRC has already issued a notice to charitable trustees to make a tax return for the year, and the trustees are to make a claim, that claim must be included in a tax return. New subsection 42(3ZA) TMA provides an expanded list of sources of income in respect of which this requirement does not apply, which includes Gift Aid income. The result is that such claims for tax exemption can be made outside the return. New subsection (3ZB) excludes from the provisions of section 42(2) claims for repayment of income tax in respect of the income listed in subsection (3ZA) so that claims for tax repayment in respect of this income can be made outside the return.

15. Paragraph 12 makes a consequential amendment in paragraph 11 Schedule 8 to FA 2010.

16. Paragraph 13 introduces amendments to Schedule 18 to FA 1998 which applies to charitable companies, eligible bodies and CASCs.

17. Paragraph 14 substitutes a new sub-paragraph (2A) and adds a new sub-paragraph (2B) in paragraph 9 of Schedule 18 to FA 1998. Paragraph 9 prevents a company from making a claim before it makes a return for the period to which the claim relates. The amendments exempt from that provision claims for a repayment of tax under Gift Aid and in respect of other specified income by charitable companies, eligible bodies and CASCs. This ensures that a company may claim a repayment of income tax under Gift Aid, and on other specified income, before it has submitted its tax return and applies to claims by charitable companies, eligible bodies and CASCs.

18. Paragraph 15 amends paragraph 57 of Schedule 18 to FA 1998 by substituting sub-paragraph (1A) with a new sub-paragraphs (1A), (1B) and (1C). Paragraph 57 requires that, if a company has been given a notice requiring it to deliver a return for a particular period, a claim that could be made in the return for that period must be made in the return. The amendment exempts from this requirement claims by charitable companies, eligible bodies and CASCs for a repayment of tax under Gift Aid, and in respect of other specified income, and for exemption from corporation tax in respect of Gift Aid and other specified income .

19. Paragraph 16 makes a consequential amendment in Schedule 8 to FA 2010.

20. Paragraph 17 sets out the commencement dates for the provisions as follows:

- Paragraphs 1 to 4 and 7 take effect from 8 April 2010, the date that Royal Assent was given to FA 2010.

- Paragraphs 6, 8 and 10 take effect in relation to the same accounting periods as CTA 2010.

- Paragraph 9 takes effect in relation to income or donations qualifying for Gift Aid received on or after 6 April 2006. References in the amendment to ITA 2007 are to be read as including a reference to any corresponding earlier enactment that was rewritten in ITA.

- An amendment corresponding to that in paragraph 10(2) is taken as having been made to any earlier enactment that was rewritten in CTA 2010. The corresponding amendment is taken as having effect in Income and Corporation Taxes Act (ICTA) 1988 from 6 April 2000, the date on which Gift Aid in its current form was introduced, or 6 April 2002 for CASCs, the date on which the CASC scheme began.

- An amendment corresponding to that in Paragraph 10(3) is taken as having been made to any earlier enactment that was rewritten in CTA 2010. The corresponding amendment is taken as having effect in ICTA 1988 from 6 April 2006.

- Paragraphs 11 to 16 have effect in relation to claims whenever made, ensuring that the machinery for making free-standing claims works with retrospective effect.

BACKGROUND NOTE

21. HMRC has allowed charitable trusts and charitable companies and eligible bodies to submit income tax repayment claims in advance of filing a tax return ("in-year claims") under their powers of collection and management, although in law some trusts and all companies are allowed to make a claim only in a tax return. This applies to claims for repayment of income tax on income such as bank interest and royalties. It also applies in relation to repayments of income tax under Gift Aid but these in-year repayments were put on a statutory footing by paragraphs 4 to 7 of Schedule 8 to FA 2010. However, those changes to the Gift Aid legislation do not work as intended, so Schedule 15 amends the legislation to allow charities to make free-standing claims for Gift Aid and other income tax repayments.

22. HMRC allows registered CASCs to claim Gift Aid repayments on donations made to them provided that the donations are used for

qualifying purposes. It is the intention that they should be able to claim Gift Aid in the same way as charitable companies. Owing to an error that occurred when legislation was re-written for Corporation Tax Act 2010, CASCs are not treated in the same way as charitable companies for the purpose of the Gift Aid legislation. Schedule 15 amends the legislation to allow CASCs to claim Gift Aid repayments and to put HMRC current practice on to a statutory footing.

EXPLANATORY NOTE

CLAUSE 52: MEANING OF "COMMUNITY AMATEUR SPORTS CLUB"

SUMMARY

1. Clause 52 amends the conditions sports clubs must meet to enable HM Revenue & Customs (HMRC) to register them as Community Amateur Sports Clubs (CASCs). The change puts current HMRC practice onto a statutory footing.

DETAILS OF THE CLAUSE

2. Subsection (1) amends the definition of a CASC by replacing the current legislation in subsection 658(1) CTA 2010 with new sections 658(1), (1A) and (1B). The effect of this is to remove the requirement that all qualifying conditions for a CASC have to be required by the CASC's constitution. The five qualifying conditions listed in new section 658(1) are divided into two groups. The first three conditions are required by new section 658(1A) to be in the constitution of a CASC and to be met in practice. The further two conditions shown in new section 658(1B) only need to be met in practice to satisfy these conditions.

3. Subsection 2 repeals paragraph 31 to Schedule 6 to FA 2010, which introduced the later two qualifying conditions into section 658(1) CTA 2010.

4. Subsection 3 says that the amendments will apply with effect from 6 April 2010, when the last two qualifying conditions were introduced into section 658(1).

BACKGROUND NOTE

5. HMRC registers sports clubs as CASCs provided that they meet certain qualifying conditions. The legislation currently requires all the qualifying conditions to be contained in a club's constitution, although in practice two of the qualifying conditions are not included in the constitution of most, if any, registered CASCs. This clause removes the requirement for these two conditions to be included in the constitution and it puts current HMRC practice onto a statutory footing.

EXPLANATORY NOTE

CLAUSE 53: SITE RESTORATION PAYMENTS

SUMMARY

1. Clause 53 provides for changes to the income tax and corporation tax rules which give a deduction for site restoration payments. The changes will prevent a deduction being given where a payment is made to a connected person until the work to which the payment relates is completed and will deny any deduction where the payment arises from avoidance arrangements. These changes will apply from 21 March 2012.

DETAILS OF THE CLAUSE

2. Subsection (2) replaces the existing section 168(3) of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005 with new subsections (3) and (3A).

3. New section 168(3) provides the rules governing the timing of a deduction depending on whether a payment is made, directly or indirectly, to a connected person or otherwise made.

4. New section 168(3A) provides that no deduction is available for a payment arising from arrangements to which the person is party where the main purpose, or one of the main purposes, of the arrangements is to obtain a deduction for a site restoration payment.

5. Subsection (3) inserts new section 168(7). This defines "arrangements" for the purposes of new section 168(3A).

6. Subsection (5) replaces the existing section 145(3) of the Corporation Tax Act 2009 with new sections 145(3) and (3A).

7. New section 145(3) provides the rules governing the timing of a deduction depending on whether a payment is made, directly or indirectly, to a connected person or otherwise made.

8. New section 145(3A) provides that no deduction is available for a payment arising from arrangements to which the person is party where the main purpose, or one of the main purposes, of the arrangements is to obtain a deduction for a site restoration payment.

9. Subsection (6) inserts new section 145(7). This defines "arrangements" for the purposes of new section 145(3A).

10. Subsection (7) provides commencement rules.

11. Subsection (8) defines "an unconditional obligation" for the purposes of subsection (7).

BACKGROUND NOTE

12. Payments made to restore a site to its original state after use in a waste disposal trade are historically capital in nature and without a specific statutory deduction would not be an allowable trading deduction.

13. The Government has become aware of businesses abusing the intended relief by making payments to connected persons many years in advance of future works and claiming relief is due as a payment has been made. This puts at risk substantial amounts of tax.

14. This clause introduces new rules for income tax and corporation tax purposes to counter the avoidance exploiting deductions for site restoration payments with effect on or after 21 March 2012.

EXPLANATORY NOTE

CLAUSE 54: CHANGES OF ACCOUNTING POLICY

SUMMARY

1. Clause 54 will ensure the change of basis tax legislation, dealing with the consequences of certain changes of accounting policy, applies to the accounting transition adjustments arising from all changes of accounting policy between one period of accounts and the next. The revised legislation will therefore apply to the accounting transition adjustments arising from the proposed changes to UK Generally Accepted Accounting Practice (UK GAAP).

2. Acceptable accounting policies for computing taxable profits are those contained within International Accounting Standards (IAS) and UK Generally Accepted Accounting Practice (UK GAAP). The Accounting Standards Board (ASB) announced in October 2010 that it intends to significantly change what constitutes UK GAAP during 2012. There are a number of areas where the proposed new UK GAAP differs from current UK GAAP resulting in one-off accounting adjustments on transition.

DETAILS OF THE CLAUSE

3. Subsection (1) replaces the term “relevant change of accounting approach” in section 227(3)(a) ITTOIA 2005 with the term “change of accounting policy”. Section 227(4) ITTOIA 2005 is replaced with a new section 227(4) that explains a change of accounting policy can include, but is not limited to, a change from using UK GAAP to using IAS and vice versa.

4. Subsection (2) replaces the term “relevant change of accounting approach” in section 180(3)(a) CTA 2009 with the term “change of accounting policy”. Section 180(4) CTA 2009 is replaced with a new section 180(4) that explains a change of accounting policy can include, but is not limited to, a change from using UK GAAP to using IAS and vice versa.

5. Subsection (3) provides that corresponding amendments are to be treated as having been made to section 64 FA 2002, the predecessor to s227 ITTOIA 2005 and CTA 2009.

6. Subsection (5)(a) provides that the clause applies where a change of basis is adopted for a period of account which begins on or after 1 January 2012.

7. Subsection (5)(b) ensures that the clause will also apply where accounts have not been prepared for periods of account beginning prior to 1 January 2012 where there is a change of basis for those periods of account resulting from adopting an accounting standard that changes on or after 1 January 2012.

8. Subsection (6) defines what constitutes an accounting standard.

BACKGROUND NOTE

9. Acceptable accounting policies for computing taxable profits are those contained within IAS and UK GAAP. The Accounting Standards Board (ASB) announced in October 2010 that it intends to significantly change what constitutes UK GAAP during 2012. There are a number of areas where the proposed new UK GAAP differs from current UK GAAP resulting in one-off accounting adjustments on transition.

10. Current tax legislation governing accounting transition adjustments arising from certain specified changes of accounting policy is at Chapter 14, Part 3 Corporation Tax Act 2009 and Chapter 17, Part 2 Income Tax (Trading and Other Income Act) 2005. The legislation provides that, in particular circumstances, on a change of accounting policy income is taxed once and once only and expenditure allowed once and once only. Current tax legislation would not apply to the accounting transition adjustments arising from the changes to UK GAAP.

11. This clause will ensure that the legislation applies to all changes of accounting policy. The revised legislation will apply to the accounting transition adjustments arising from the changes to UK GAAP.

RESOLUTION 19

FINANCE BILL 2012
CLAUSE 55 to 179
SCHEDULE 16 to 19

EXPLANATORY NOTE

CLAUSES 55 to 179 SCHEDULES 16 to 19: SOLVENCY II & THE TAXATION OF LIFE INSURANCE COMPANIES

SUMMARY

1. This legislation establishes a new regime for the taxation of life insurance companies. It represents a wide-ranging and fundamental revision of both the basis on which life companies' taxable profits are computed and the detailed rules by which those profits are taxed.

DETAILS OF THE CLAUSES

Part 2

Chapter 1

2. Chapter 1 contains sections 55 to 65 which explain the structure of this Part of the Act and define terms used in the legislation.

3. Section 56 defines "life assurance business", and section 57 defines "basic life assurance and general annuity business" (BLAGAB), which excludes "protection business", among other items. Sections 58 to 62 define terms used in section 57.

Chapter 2

4. Chapter 2 sets out the charge to tax on BLAGAB business, which is taxed on an I - E basis.

5. Section 66 explains that BLAGAB, non-BLAGAB long-term business and general insurance are to be treated as separate businesses.

6. Section 67 provides an exception to the separate trade treatment for BLAGAB when substantially all of the long-term business is not BLAGAB.

7. Section 68 imposes the charge to corporation tax on the I - E profit for BLAGAB; the "I - E profit" is explained in section 73.

8. Section 69 gives precedence to the I - E charge over the general charge to corporation tax on trade profits under section 35 of the Corporation Tax Act (CTA) 2009.

9. Section 70 explains what is meant by "the I - E rules".

10. Section 71 applies the general corporation tax charge on trade profits to profits of non-BLAGAB long-term business, subject to Chapter 6 of the legislation and specific rules for transfers of non-BLAGAB long-term business.

11. Section 72 excludes companies carrying on only Permanent Health Insurance (PHI) business from Part 2 of the legislation and from provisions elsewhere in the Corporation Tax Acts which make special provision for long-term business carried on by insurance companies.

Chapter 3

12. Chapter 3 explains the I – E basis.

13. Section 73 sets out the steps used to calculate the I – E profit (where the result is a positive amount) or the excess BLAGAB expenses (where the result is a negative amount). It points to other sections where specific terms are explained.

14. Section 74 lists items that come within the definition of income in step 1 of section 73.

15. Section 75 explains how to calculate the BLAGAB chargeable gains for the purposes of step 2 of section 73.

16. Section 76 explains how to calculate the BLAGAB management expenses for the purposes of step 5 of section 73.

17. Sections 77 and 78 define some of the terms used in the calculation of BLAGAB management expenses in section 76.

18. Section 79 sets out special rules for acquisition expenses (which are defined in section 80). These are expenses that are payable for the purpose of the acquisition of new business. They are spread over 7 years rather than deducted in full when incurred.

19. Section 81 details some specific amounts that are allowable as BLAGAB management expenses.

20. Section 82 applies certain restrictions, which apply to the management expenses of a company with investment business, to the calculation of BLAGAB management expenses.

21. Sections 83 and 85 bring into the new regime the existing provisions allowing relief, in computing I - E profits, for certain annuity payments.

22. Section 86 modifies, for I – E purposes, the rules in CTA 2009 regarding the taxation of profits from property businesses. It provides that a life insurance company may have more than one

property business. There is a separate property business in respect of property held other than for the purposes of the long-term business. Separate businesses are established for property matched to BLAGAB liabilities; for property matched to other long-term liabilities; and for unmatched property held for the purposes of the long term business.

23. Section 87 sets out the treatment, for I – E purposes, of losses from property businesses. To the extent that they are referable to BLAGAB, such losses are to be treated as BLAGAB management expenses.

24. Section 88 ensures that for the purposes of the I – E profit calculation the rules on loan relationships, derivative contracts and intangible fixed assets apply as though the BLAGAB business were not a trade. The relevant rules in CTA 2009 apply accordingly.

25. Section 89 provides for certain BLAGAB miscellaneous income to be treated as I – E receipts in so far as it exceeds miscellaneous losses.

26. Sections 90 and 91 replicate existing provisions which impute investment return for I – E purposes when certain risks under BLAGAB contracts of insurance are reinsured.

27. Section 92 deems certain BLAGAB trading receipts, which would not otherwise fall within the charge to corporation tax, to be I – E receipts.

28. Section 93 requires a comparison between the BLAGAB trade profit and the I - E result and imputes an additional I - E receipt if the former is greater than the latter.

29. Section 94 requires that, in making the comparison in section 93, any exempt dividends referable to BLAGAB are to be included as I - E receipts. This is because all dividends are taken into account when computing the BLAGAB trade profit.

30. Section 95 allows non-BLAGAB allowable losses to be deducted from the shareholders’ share of BLAGAB chargeable gains, but not to the extent that they would create an I - E loss.

31. Section 96 restricts management expenses of an overseas life insurance company carrying on BLAGAB business in the UK where the income of the company allocated to BLAGAB includes FOTRA (free of tax to residents abroad) profits.

Chapter 4

32. Section 97 introduces Chapter 4, which contains rules for the allocation to BLAGAB of investment income and losses, expenses, and chargeable gains and allowable losses for the purposes of I – E.

33. Section 98 requires that investment income or losses, and expenses referable to BLAGAB are to be determined by an acceptable commercial method. It explains what is an acceptable commercial method. HM Treasury is given a power to make regulations prescribing what is, or is not, an acceptable commercial method.

34. Sections 99 to 101 explain how chargeable gains and allowable losses referable to BLAGAB are determined.

35. Section 100 provides that gains or losses on assets are attributable to BLAGAB to the extent that the assets are wholly or partly matched to BLAGAB liabilities. The concept of matching is explained in section 138.

36. Section 101 explains that the extent to which gains or losses on assets, which are not matched to BLAGAB liabilities, are referable to BLAGAB is determined using an acceptable commercial method. The section applies to the unmatched proportion of a gain or loss where the asset is partly matched. It explains what is an acceptable commercial method, and gives HM Treasury a power to make regulations prescribing what is, or is not, an acceptable commercial method.

Chapter 5

37. Chapter 5 sets out the rate of tax to be applied to the policyholders' share of the I–E profit and sets out how that share is to be determined.

38. Section 102 defines the rate of tax applicable to the policyholders' share of the I – E profit as the basic rate for income tax.

39. Section 103 sets out how the policyholders' share of the I – E profit is to be determined. For mutual insurance companies, the whole of the profit is attributable to policyholders.

40. Sections 104 and 105 explain terms used in sections 103 and 104.

41. Section 106 provides for a deduction in the calculation of the BLAGAB trade profits for tax of the accounting period charged at the policyholder rate.

42. Section 107 provides for an adjustment to BLAGAB trade profits in respect of deferred policyholder tax, and explains how it is to be calculated.

43. Section 108 defines terms used in section 107 and specifies the BLAGAB assets and liabilities in respect of which an adjustment may arise under that section. HM Treasury is given a power to amend by regulation the list of BLAGAB assets and liabilities.

Chapter 6

44. Section 109 applies the rules in Chapter 6 to the calculation of BLAGAB trade profit or loss and the non-BLAGAB long-term business profit.

45. Section 110 allows a deduction in calculating profits for sums allocated to policyholders except where certain sums of a capital nature are allocated to with-profits policyholders.

46. Section 111 brings dividends and other company distributions into account as receipts in calculating the profits unless they are capital distributions. This section overrides the general rule that such dividends and distributions are not taxable.

47. Section 112 disapplies the provisions in CTA 2009 which exempt the indexation return on index-linked gilt-edged securities (gilts) from tax under the loan relationship rules in computing trade profits. But the section does not apply where the gilts are held to back index-linked PHI liabilities to policyholders.

48. Section 113 excludes profits, receipts and expenses arising from long-term business fixed capital assets from the computation of profits.

Chapter 7

49. Section 114 explains that Chapter 7 details how to allocate accounting profits, losses and various adjustments between BLAGAB and non-BLAGAB long-term business.

50. Section 115 requires that the allocation is to be in accordance with an acceptable commercial method. The method must be consistent with the method used for the purposes of section 41(allocation of BLAGAB income, etc). The section also gives HM Treasury the power to prescribe cases in which a method is to be, or is not to be, regarded as an acceptable commercial method.

Chapter 8

51. Chapter 8 deals with changes in the allocation of assets and share pooling rules for life insurance business.

52. Section 116 deems a disposal and reacquisition at fair value when an asset moves between the categories set out in the section. This rule

does not apply where none of the profits of a company are taxed on an I - E basis.

53. Section 117 modifies the rules in section 116 for overseas life insurance companies.

54. Section 118 sets out the rules where there is a transfer of business and as a consequence assets transferred move from one category to another.

55. Sections 119 and 120 adapt the capital gains share pooling rules for life insurance companies, including overseas life insurance companies.

Chapter 9

56. Chapter 9 explains how relief is provided for BLAGAB trade losses.

57. Section 123 applies the general trade loss rules in CTA 2009 to BLAGAB trade losses.

58. Section 124 describes how a BLAGAB trade loss may be carried forward to later accounting periods.

59. Section 125 explains the application of group relief rules to BLAGAB trade losses.

60. Section 126 says that losses relieved by way of section 123 or section 125 are to be reduced by the amount of any non-trading loan relationship deficit for the accounting period.

61. Section 127 prevents various reliefs (as identified in section 127(3)) from being set against the policyholders' share of the I – E profit.

Chapter 10

62. Chapter 10 contains the rules on transfers of long-term business.

63. Where there is a transfer of BLAGAB business, Section 128 permits the transferee to receive relief for spread acquisition expenses (see section 79) which would have become available to the transferor in a period after the transfer if the transfer had not taken place.

64. Section 129 sets out the rules for the calculation of BLAGAB trade profits of the transferor and the transferee where there is a transfer of BLAGAB business within a group or from a mutual company to a non-mutual company.

65. Section 130 provides that, when there has been a transfer of business between unconnected parties on or after 1 January 2013, the

transferee will get relief for the amortisation of an asset recognising the value of future profits arising from the business acquired when that amortisation is charged to the accounts .

66. Section 131 applies sections 129 and 130 where there is a transfer of non-BLAGAB long-term business.

67. Section 132 is an anti-avoidance provision, which applies where, on or after 1 January 2013, there is a transfer of long-term business (or part of a business) and the main purpose of a company entering into one or more of the arrangements is an unallowable purpose. Where it applies, the section requires necessary steps to be taken to negate the tax advantage arising.

68. Sections 133 and 134 set out the clearance procedure by which a company can seek confirmation from HMRC that section 132 does not apply.

69. Section 135 states that whether companies are members of the same group for the purposes of Chapter 10 is to be determined in accordance with section 170(2) to (11) of the Taxation of Chargeable Gains Act 1992.

Chapter 11

70. Chapter 11 contains definitions of terms and abbreviations used in this Part.

71. Section 138 explains the concept of matching of assets (or part assets) to liabilities, which is used in Chapter 4 and Chapter 8 of this Part.

Chapter 12

72. Section 142 gives HM Treasury powers to amend the legislation relating to life assurance business by way of secondary legislation in consequence of powers being exercised under the Financial Services and Markets Act 2000 (FSMA 2000).

73. Section 143 allows the meaning of the term “insurance business transfer scheme” to be amended by order following any change to section 105 FSMA 2000.

74. Section 144 provides a power to modify by regulations the legislation relating to overseas life insurance companies.

75. Sections 146 and 147 introduce Schedules 16 and 17, which contain minor and consequential amendments and transitional provisions respectively.

76. Section 148 states that the provisions of this Part are to have effect for accounting periods beginning on or after 1 January 2013.

77. Section 149 ensures that all life insurance companies will have an accounting period ending on 31 December 2012.

Part 3

78. Part 3 provides specific rules for the taxation of life assurance business and other long-term business carried on by friendly societies. Section 150 gives an overview of the contents of Part 3.

79. Section 151 applies the Corporation Tax Acts to long-term business carried on by friendly societies in the same way that they apply to mutual business carried on by insurance companies.

80. Section 152 states that the transfer of business rules in Chapter 11 of Part 1 or elsewhere apply to friendly societies and gives HM Treasury the power to modify those provisions by way of regulations.

81. Section 153 states that certain exempt BLAGAB or eligible PHI business will not be liable to corporation tax, and section 154 defines the term “BLAGAB or eligible PHI business”. Section 155 defines “exempt” BLAGAB or eligible PHI business.

82. Section 156 sets out specific provisions relating to exempt BLAGAB or PHI business (see section 155) for friendly societies whose rules prevent them from writing business above specified values.

83. Section 157 applies on a transfer of business to prevent any long-term business transferred to a friendly society from being exempt unless section 158 applied to the contracts before the transfer.

84. Section 158 allows previously exempt business to remain exempt if it is transferred to an insurance company, or the friendly society converts to a company. Such business comprises a separate business in the insurance company. Section 158 also provides for regulations to be made to modify the rules in the section.

85. Section 159 prevents profits on certain policies from coming within the exemptions from corporation tax provided by the legislation where the limits of the maximum benefits payable to members are breached.

86. Section 160 sets out limits on the value of exempt contracts which a policyholder may hold with one or more friendly societies at any time. Section 161 makes additional provisions for the purposes of section 160.

87. Section 162 provides for a friendly society or insurance company to require a policyholder to make a statutory declaration that the limits in section 105 have not been exceeded.

88. Section 163 allows the HMRC Commissioners to give a direction where it is considered necessary for the protection of revenue that an "old" society is to lose its status as an "old" society in respect of business carried on after the date of the direction.

89. Section 164 exempts a registered qualifying society (as defined) from a liability to tax on profits other than from life assurance business or PHI within "BLAGAB or eligible PHI business", providing the society makes a claim.

90. Section 165 exempts an incorporated qualifying society (as defined) from a liability to tax on profits other than from life assurance business or from PHI within "BLAGAB or eligible PHI business", providing the society makes a claim.

91. Section 166 explains that an insurance company acquiring business other than life insurance business or PHI within "BLAGAB or eligible PHI business" from a friendly society exempted under section 164 or 165 is exempt from corporation tax on the profits from that business. A friendly society converting to an insurance company is likewise exempt. Such business comprises a separate business in the insurance company. Section 166 also provides for regulations to be made to modify the rules in the section.

92. Section 167 explains what happens when business is transferred between friendly societies and sections 164 or 165 previously applied to the transferor. Business other than life insurance business or PHI within "BLAGAB or eligible PHI business" which was exempt in the transferor remains exempt in the transferee.

93. Section 168 allows the HMRC Commissioners to make a direction withdrawing a registered or incorporated society's qualifying status in certain circumstances.

94. Section 169 sets out the circumstances in which a payment by a non-qualifying society to a member is treated as a qualifying distribution.

95. Where a registered friendly society becomes incorporated, Section 170 provides that assets of a branch of the society which are identified under section 6(5) of the Friendly Societies Act 1992 as not transferred to the new company are nonetheless to be treated as assets of the company for tax purposes.

96. Section 171 provides, where a claim is made, for an exemption from corporation tax for unregistered and unincorporated friendly societies whose income does not exceed £160 a year.

97. Section 176 introduces Schedule 18, which contains consequential amendments arising from Part 3.

98. Section 177 introduces Schedule 19, which contains transitional provisions arising from Part 3.

99. Section 178 states that the provisions of this Part are to have effect for accounting periods beginning on or after 1 January 2013.

100. Section 179 ensures that all friendly societies will have an accounting period beginning on 1 January 2013 (even if that would not otherwise be the case).

Schedule 16

101. Schedule 16 contains minor and consequential amendments to other Acts that flow from this new legislation.

102. Paragraph 87 inserts a new section 213A into the Taxation of Capital Gains Act (TCGA) 1992. This provides a power for HM Treasury to make regulations to ensure that the new Controlled Foreign Companies rules in Schedule 20 of FB2012 interact appropriately with section 212 TCGA.

Schedule 17

103. Schedule 17 contains transitional provisions.

Schedule 17 Part 1

104. Paragraph 1 explains that Part 1 of Schedule 17 provides for deemed receipts or deemed expenses to arise on transition for the purposes of computing BLAGAB trade profits and non-BLAGAB long-term business profits. The general rule is that receipts and expenses are treated as arising over a 10-year period.

105. Paragraph 2 explains what is meant by “the 2012 balance sheet” and “the 2012 periodical return”.

106. Paragraphs 3 and 4 deem a balance sheet and/or periodical return to have been drawn up at 31 December 2012 if the company does not have an actual balance sheet and/or periodical return at that date.

107. Paragraph 5 requires the insurance company to calculate the total transitional difference by way of a comparison of the amount attributed to shareholders (that is, amounts which would have been

recognised in profits if an accounts basis had always applied) as at 31 December 2012 with the cumulative taxed surplus at the same date (that is, surplus recognised in the regulatory return and taken into account when computing profits). The paragraph permits HM Treasury to prescribe by regulations adjustments to the method by which the amount attributed to shareholders is calculated.

108. Paragraph 6 requires the insurance company to identify the items which together make up the total transitional difference, and to allocate a positive or negative amount to each item. The paragraph permits HM Treasury to prescribe by regulations how the items are to be determined.

109. Paragraph 7 provides that the items making up the total transitional difference are "relevant computational items" unless they are "excluded items". It specifies certain excluded items and gives HM Treasury power to specify others by regulations.

110. Paragraph 8 apportions the relevant computational items between the pre-transition categories of business, that is, BLAGAB, gross roll-up business (GRB) and PHI. Amounts apportioned to PHI are ignored in applying the rest of the transitional rules.

111. Paragraphs 9 and 10 explain that relevant computational items (or parts of them) allocated to BLAGAB or non-BLAGAB long-term business are treated as receipts or expenses in computing BLAGAB trade profits or profits of non-BLAGAB long term business for accounting periods commencing on or after 1 January 2013.

112. Paragraph 11 describes the 10-year period over which receipts and expenses are treated as arising. The 10-year period begins on 1 January 2013. It excludes receipts which are "relevant court-protected items" (see paragraph 12).

113. Paragraph 12 defines a relevant court-protected item, and provides that receipts arising from such items are treated as arising over a 10-year period beginning on the date the court order ceases to be in force or 1 January 2015, whichever is the earlier.

114. Paragraphs 13 and 14 explain how transitional receipts or expenses are to be treated where there is a subsequent transfer of insurance business.

115. Paragraph 15 deals with the treatment of transitional amounts where an insurance company ceases to carry on long-term business other than as a result of a transfer.

116. Paragraph 16 provides that where there is an unrelieved charge under the financing arrangement-funded transfer legislation in section

83YC of Finance Act 1989 that charge is to be treated as a negative ‘relevant computational amount’.

117. Paragraph 17 is an anti-avoidance provision. Where, on or after 21 March 2012, an insurance company enters into arrangements or does something in connection with the transitional rules, and its purpose is unallowable, an officer of Revenue and Customs may take steps to nullify any tax advantage. An unallowable purpose includes securing a tax advantage in connection with the transitional rules.

118. Paragraphs 18 and 19 set out the clearance procedure by which a company can seek confirmation from HMRC that paragraph 17 does not apply.

119. Paragraph 20 makes special provision for overseas life insurance companies in certain circumstances.

Schedule 17 Part 2

120. Paragraph 21 provides for a company to make an irrevocable election to treat certain contracts of insurance effected prior to 1 January 2013 as having been made on or after that date for the purposes of section 62

121. Paragraph 22 prevents an amount being taken into account in computing BLAGAB trade profits or non-BLAGAB long-term business profits where it was already taken into account in computing trade profits in a period before the transition.

122. Paragraph 23 prevents double relief where an expense appeared in the regulatory return of a pre-transition period and was spread forward into a post-transition period under current tax rules. If that same expense were charged to the profit loss account in a post-transition period, double relief would, but for this paragraph, arise.

123. Paragraph 24 applies to intangible fixed assets which were excluded from Part 8 of CTA 2009 under the old law, but which are brought within Part 8 by this legislation. Expenditure incurred before 1 January 2013 is to be ignored in determining amounts to be brought into account under Part 8.

124. Paragraph 25 makes clear that the transition of assets from the existing categories in section 440 ICTA to the new categories in sections 116 to 118 does not trigger a deemed disposal and reacquisition.

125. Paragraph 26 makes clear that the transition of assets from the existing holdings of securities in section 440A ICTA to the new

holdings in sections 119 to 121 does not trigger a deemed disposal and reacquisition.

126. Paragraph 27 provides rules for the carry forward of the base cost of existing holdings of securities under section 440A ICTA into the new holdings under sections 119 to 121.

127. Paragraph 28 applies in situations where existing rules at section 210B Taxation of Capital Gains Act 1992 would have operated. It gives identification rules where there is a disposal and acquisition of securities around the transition date.

128. Paragraphs 29 to 32 describe the treatment of various losses and excess management expenses carried forward from an accounting period ending before 1 January 2013 into the new regime.

129. Paragraph 33 permits acquisition costs spread forward under section 86 FA1989 from a pre-transition period to be relieved in a post-transition period.

130. Paragraph 34 permits BLAGAB trade losses to be carried back to pre-transition accounting periods under section 37 CTA 2010.

131. Paragraph 35 states that assets previously treated as assets of the shareholder fund for the last period of account ending before 1 January 2013 are to be treated as fixed capital assets from 1 January 2013. The paragraph defines when an asset is to be regarded as having been an asset of the shareholder fund.

Schedule 17 Part 3

132. Paragraph 36 applies where Part 1 of this Act re-enacts an enactment that has been repealed by the legislation. It provides that any statutory instrument which was made under a provision repealed by this legislation and which has effect for accounting periods ending on 31 December 2012 has effect in relation to subsequent accounting periods as if it had been made under the corresponding provision in this legislation.

133. Paragraphs 37 and 38 give HM Treasury a power to make further transitional provisions by way of regulations.

BACKGROUND NOTE

134. The EU Solvency II Directive, which is expected to have effect from 2014, will fundamentally change the regulatory reporting framework on which life insurance company taxation is currently based. As a result of the changes which will be introduced by the Directive, regulatory returns made by insurance companies to the Financial Services Authority will no longer provide the information on which the current basis of taxation relies.

135. A new regime for the taxation of life insurance companies is therefore being introduced, which will apply from 1 January 2013. It aims to simplify the unique and complex rules currently governing life company taxation by bringing them more in line with those which apply to companies generally, and aligning them more closely with the commercial realities of life insurance business. The changes being introduced are extensive; the main points are summarised below.

- Trading profits will be calculated on the basis of life companies' financial statements, in line with general corporation tax rules, rather than being derived from regulatory returns made to the Financial Services Authority, as now.

- Life companies are subject to the "Income minus Expenses" (I minus E) tax basis, which aims to tax (at different rates) profits made by shareholders and the investment return arising for the benefit of certain policyholders. I minus E will continue to apply but, unlike now, only to the type of business where it is appropriate to tax both shareholder profit and policyholder investment return. Life protection business, which does not attract significant investment return, will be excluded from I minus E.

- Three categories of insurance business are currently recognised for tax purposes, all subject to different tax rules. Two of the three existing categories will be amalgamated, reducing their total number to two.

- At present life insurance companies’ investment income, gains and losses are apportioned between categories of business by way of a series of formulae set out in legislation. Under the new regime, the allocation will instead be determined by reference to the actual commercial activities of individual companies.

- Life companies will be brought within the rules on loan relationships and intangible fixed assets which apply to the computation of taxable trading profits for companies generally.

EXPLANATORY NOTE

CLAUSE 180 SCHEDULE 20: CONTROLLED FOREIGN COMPANIES AND FOREIGN PERMANENT ESTABLISHMENTS

SUMMARY

1. Clause 180 and Schedule 20 provide for a new regime for controlled foreign companies (CFC) to be inserted as Part 9A of the Taxation (International and Other Provisions) Act 2010 (TIOPA), and repeal the current CFC rules in Chapter 4 of Part 17 of the Income and Corporation Taxes Act 1988 (ICTA). The clause and schedule also provide for the new regime to apply, with necessary adaptations, to the rules for foreign permanent establishments in Chapter 3A of Part 2 of Corporation Tax Act 2009 (CTA 2009).

2. The new regime introduced by this clause will have effect for accounting periods beginning on or after 1 January 2013.

DETAILS OF THE CLAUSE

3. Clause 180 introduces Schedule 20 which makes provision for rules dealing with controlled foreign companies and foreign permanent establishments of UK companies.

DETAILS OF THE SCHEDULE

PART 1

4. <u>Paragraph 1 of Schedule 20</u> inserts Part 9A after Part 9 of TIOPA.

Part 9A Controlled Foreign Companies

Chapter 1 – Introduction

5. Chapter 1 provides an overview of Part 9A, describing what is contained in each chapter and stating that Part 9A is part of the Corporation Tax Acts.

6. <u>New section 371AA(1) and (2)</u> states that the CFC charge will be charged on UK resident companies which have certain interests in CFCs and that this charge will be by reference to the chargeable profits of CFCs (see <u>new section 371 BA</u> below).

7. New subsection (3) defines a CFC as a non-UK resident company which is controlled by a UK person or persons.

8. New subsection (4) outlines the content of Chapter 2, where the basic details of the CFC charge are set out.

9. New subsections (5) to (10) outline the contents of the subsequent chapters. These include Chapter 3, which sets out how to determine which (if any) of Chapters 4 to 8 apply in relation to the CFC's profits, and Chapters 4 to 8 which set out how to determine which of a CFC's profits (if any) pass through the CFC charge gateway.

10. New subsection (11) provides that nothing in Part 9A affects the liability to corporation tax of a non-resident company itself or of the determination of such a company's chargeable profits under the relevant provisions of the CTA 2009.

Chapter 2 – The CFC Charge

11. New section 371BA outlines the basis on which a CFC charge is to be applied to a UK resident company. The CFC charge is imposed in relation to a CFC's accounting period only if the CFC has chargeable profits for that period and none of the entity level exemptions set out in Chapters 10 to 14 applies for that period.

12. New section 371BA(3) defines a CFC's chargeable profits for an accounting period as its assumed taxable total profits (see Chapter 19) for that period, determined on the basis that:

- its assumed total profits are limited to those profits that pass through the CFC charge gateway, explained in new section 371BB; and

- amounts are to be relieved against those profits (as provided for in step 2 of section 4(2) of the Corporation Tax Act 2010 (CTA 2010)) only so far as is just and reasonable, having regard to the limitation of profits to those that pass through the CFC charge gateway.

13. New section 371BB(1) sets out the steps for determining the extent to which a CFC's assumed total profits for an accounting period pass through the CFC charge gateway.

14. *Step 1* is to determine under Chapter 3 of which (if any) of Chapters 4 to 8 apply for that period. If none of those Chapters applies step 2 is not to be taken as none of the assumed total profits pass through the gateway.

15. *Step 2* is to apply Chapters 4 to 8 so far as required by Step 1 to determine how much (if any) of the CFC's assumed total profits fall within those chapters for the accounting period and hence pass through the CFC charge gateway.

16. New section 371BB(2) provides that subsection (1) is subject to Chapter 9 (exemptions for profits from qualifying loan relationships) and new section 371JE, which provides for adjustments of profits which would otherwise pass through the gateway.

17. New section 371BC provides that, where there are profits that pass through the CFC charge gateway, the CFC charge is determined in accordance with a series of steps. These are used to work out whether or not a charge arises and, if it does, which UK resident companies are chargeable. The detailed rules that explain how these steps are to be applied are provided by subsequent chapters of Part 9A.

Step 1 is to determine in accordance with Chapter 15 the persons ("the relevant persons") who have relevant interests in the CFC at any time during the accounting period. A CFC charge will arise for an accounting period only where a relevant person meets the UK residence condition set out at new section 371BC(2). If there are no such persons no further steps are to be taken and no CFC charge arises for the accounting period.

Step 2 is to determine the CFC's creditable tax for the accounting period in accordance with Chapter 16.

Step 3 is to apportion the chargeable profits and creditable tax of a CFC among the relevant persons in accordance with Chapter 17.

Step 4 limits the CFC charge to chargeable companies, which are companies that hold a specified level of interest in the CFC as determined by new section 371BD. If there are no chargeable companies Step 5 is not to be taken and no CFC charge is to be charged for the accounting period.

Step 5 imposes the CFC charge on each chargeable company. The charge is a sum equal to the appropriate rate of corporation tax on P% of the CFC's chargeable profits, less Q% of the CFC's creditable tax. The appropriate rate, P% and Q% are defined in new section 371BC(3). The charge is calculated as if it were an amount of corporation tax charged on the company for the "relevant corporation tax accounting period" (defined at new section 371BC(3)).

18. New section 371BC(2) sets out the residence condition for step 1, which is met if a company is resident in the UK at a time during the accounting period when it has a relevant interest in the CFC.

19. New subsection (3) defines a number of terms for the purposes of Step 5.

20. New section 371BD provides the definition of a "chargeable company" where a company meets the residence condition (of section 371BC(2)). Such a company is a chargeable company if the percentage of the chargeable profits apportioned to it, together with the percentages of the chargeable profits (if any) apportioned to relevant persons connected or associated with it at any time during the accounting period, are at least 25% of the total chargeable profits of the CFC.

21. So if, following Step 3, two UK resident companies which are members of the same group, respectively have 90% and 10% of the CFC's chargeable profits apportioned to them, they are both chargeable companies.

22. New section 371BE removes from charge companies which are managers of offshore funds that hold a relevant interest in a CFC by virtue of an investment made in order to "seed" a fund. Four conditions must be met. They are set out at new section 371BE(1) as follows:

(a) the CFC is an offshore fund (as defined in section 355),

(b) the genuine diversity of ownership condition set out in regulation 75 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001) is met in relation to the fund,

(c) the fund management condition is met, and

(d) apart from this section, a sum of no more than £500,000 would be charged on C as a chargeable company at Step 5 in section 371BC(1).

23. The fund management condition at new section 371BE(3) itself comprises three conditions. At all times during the accounting period during which a company has a relevant interest in the offshore fund the assets of the offshore fund must be managed by the company with a relevant interest or by a person connected with that company; either the company or the connected person must receive a fee for managing the assets; and the company's relevant interests in the offshore fund must be held only or mainly for the purpose of attracting participants. Participants are defined in

section 362 TIOPA 2010 and must not be connected with the company.

24. New section 371BF provided circumstances in which companies which are participants in offshore funds will not be chargeable companies. Difficulties in identifying when a UK company with an interest in an offshore fund may fall to be a chargeable company are likely to occur when the relevant interest may be close to the 25% threshold set at section 371BD. The proportionate holding in an offshore fund may fluctuate as by their nature offshore funds acquire and lose investors over time.

25. New section 371BF(1) deems a company not to be a chargeable company for the purposes of Step 4 in section 371BC(1) if:

(a) the CFC is an offshore fund (as defined in section 355 TIOPA),

(b) at the relevant time and at all subsequent relevant times, the company reasonably believes that the requirement of section 371BD(1) will not be met in relation to it, and

(c) the meeting of that requirement in relation to the company is in no way attributable to any step:
(i) which was taken by the company or any person connected or associated with the company, and
(ii) which, at the time it was taken, could reasonably have been expected to cause that requirement to be met.

26. Thus where a CFC is an offshore fund, a company participating in the fund will not be a chargeable company provided that at particular points during the accounting period (see below) it reasonably believes that its interest does not exceed the 25% threshold set at section 371BD, and provided that if the 25% threshold is exceeded the cause of exceeding the threshold is not directly attributable to the participant company or any persons connected or associated with it.

27. New subsection (2) defines the relevant time at which the participant company must hold the reasonable belief regarding its interest. The time is the beginning of the accounting period, or if the company has no relevant interests in the offshore fund at the beginning of the accounting period, the time when the company first has a relevant interest during the accounting period.

28. New subsection (3) determines that any subsequent relevant time for considering the reasonable to believe test is any time during the accounting period at which there is an increase or some other change in the relevant interests of the company to which the section applies.

29. New section 371BG provides that a company that has its relevant interests in the CFC by virtue only of a direct or indirect holding of shares in the CFC is not a chargeable company for the purposes of Step 2 of section 371BC(1) if it brings both increases in share value and any dividend or other distribution in respect of the shareholding during the accounting period into account as taxable income.

30. New section 371BG (2) and (3) provide that the requirements in subsection (1) that the company brings both increases in share value and any dividend or other distribution in respect of the shareholding into account as taxable income are taken to be met if:

- the company has relevant interests in the CFC only by virtue of new section 371OB(3) (an interest held by an open-ended investment company (OEIC))or new subsection 371OB(4) (an interest held by the trustees of an authorised unit trust (AUT));
- the CFC is an offshore fund (within the definition of section 355) that does not meet the qualifying holding investments test at section 493 of CTA 2009 (it is a 'bond fund'); and
- the conditions in subsections (1)(b) and (c) are not otherwise met.

31. New section 371BH modifies the application of Step 5 of section 371BC(1) for companies that carry on basic life assurance and general annuity business (BLAGAB). This company is referred to as 'CC'.

32. New section 371BH(1) sets out the conditions for when Step 5 of section 371BC(1) shall be modified in line with new section 371BH(2). The conditions for the BLAGAB company to be a chargeable company are:

(a) CC carries on BLAGAB activities during the relevant corporation tax accounting period
(b) the assets which represent (to any extent) CC's relevant interest in the CFC are held by it for the purposes of its long-term business, and
(c) the life insurance I - E rules apply to CC for the relevant corporation tax accounting period.

33. New subsection (2) provides, where the conditions in new subsection (1) are met, for the modification of Step 5 in the main CFC charging provision (section 371BC(1)). The modifications limit the sum charged to the policyholders' share of the BLAGAB component of the CFC's chargeable profit (see below), which is charged at the 'appropriate rate'. In these steps the CFC's chargeable profit is referred to as 'the apportioned profit'.

34. The appropriate rate is determined by reference to section 102 of the Finance Act 2012 (FA 2012), or an average rate where there is more than one such rate over the period. The CFC's creditable tax to be apportioned to the company is calculated by reference to the proportion the policyholders' share of the BLAGAB component of the apportioned profit is of the whole of the apportioned profit.

35. New subsection (3) sets out how to determine the BLAGAB component of the apportioned profit. This is done by firstly assuming that the whole of the apportioned profit is income falling within section 74 of FA 2012 that is paid to the company at the end of the CFC's accounting period. The BLAGAB component of the apportioned profit is the part of such income as would be referable to C's BLAGAB business.

36. New subsection (4) provides that the policyholders' share of the BLAGAB component of the apportioned profit shall be determined by the rules contained in Chapter 5 of Part 2 of FA 2012.

Chapter 3 - The CFC charge gateway: determining which (if any) of Chapters 4 To 8 applies

37. Chapter 3 of Part 9A applies for the purposes of Step 1 of section 371BB in order to determine which (if any) of Chapters 4 to 8 need to be considered in determining whether any of a CFC's profits pass through the CFC charge gateway. If Chapter 3 does not require any of Chapters 4 to 8 to apply there will be no CFC charge.

38. New section 371CA provides that Chapter 4 (profits attributable to UK activities) will apply for a CFC's accounting period unless any one of four conditions (A to D) is met.

39. Condition A at new section 371CA(2) is met if the CFC does not, at any time in the accounting period, hold assets or bear risks under an arrangement to which both new subsections (3) and (4) apply. These subsections apply where:

- the main purpose, or one of the main purposes, of the arrangement is to reduce or eliminate any liability of any person to UK tax or duty,
- the CFC expects the arrangement to increase the profits of its business at some time by more than a negligible amount, and
- there is an expectation that one or more persons will have liabilities to tax or duty imposed under the law of any territory reduced or eliminated and it is reasonable to suppose that the arrangement would not have been made without there being that expectation.

40. Condition B at new subsection (5) is met if the CFC has no UK managed assets and bears no UK managed risks at any time during the accounting period.

41. Condition C at new subsection (6) is met if the CFC has itself the capability throughout the accounting period to ensure that its business would be commercially effective if its UK managed assets and risks were to stop being UK managed.

42. New subsection (7) specifies that, for the purpose of Condition C, the required capability includes the CFC being able to select providers of goods and services from persons not connected with it and to manage its transactions with such persons.

43. New subsection (8) requires two assumptions to be made in determining whether Condition B is met at any time during the accounting period. The first assumption is that the CFC would continue to carry on the same business as it is actually carrying on at that time. The other assumption is that none of the relevant UK activities, by which any asset or risk was UK managed, would be replaced by activities carried on by any person connected with the CFC at any time, or in any other way which relied to any extent upon the CFCs receiving resources or other assistance from any person connected with the CFC at any time.

44. New subsection (9) determines that an asset or risk is "UK managed" if any of the functions specified in the subsection are managed or controlled to any significant extent through relevant UK activities.

45. New subsection (10) defines relevant UK activities as activities carried on in the UK either by the CFC itself (unless through a UK permanent establishment) or by companies connected with the CFC. In the latter case the meaning is limited to activities under arrangements which it is reasonable to suppose would not be entered into by companies that were independent of each other.

46. Condition D at new subsection (13) is that the CFC's assumed total profits only consist of (one or both of):

- non-trading finance profits, or
- property business profits

47. New section 371CB provides that Chapter 5 (non-trading finance profits) applies for a CFC's accounting period only if the CFC has non-trading finance profits. This is subject to new sections 371CC and 371CD, which deal with incidental non-trading finance profits. The references to non-trading finance profits in the section and

Chapter 5 exclude any profits that fall within Chapter 8 (solo consolidation) or within new section 371CB(3) or (4).

48. New section 371CB(3) excludes profits which arise from the investment of funds held for the purposes of a trade if that trade is carried on by a CFC and no profits of that trade for the accounting period pass through the CFC charge gateway

49. New subsection (4) excludes profits which arise from the investment of funds held by the CFC for the purposes of its UK or overseas property business.

50. New subsection (5) sets out a number of circumstances in which the exclusions in subsections (3) and (4) will not apply. Those exclusions will not apply to non-trading finance profits arising from funds held:

- because of a prohibition or restriction on the payment of dividends imposed under the law of the CFC's territory of incorporation (but see below regarding short term restrictions);
- with a view to paying dividends or other distributions at a time after the relevant 12 month period – this period is defined in new subsections (6) and (7) as being 12 months after the end of the accounting period; subsections (6) and (7) also provide that a prohibition or restriction which ceases to have effect before the end of this period is not covered by subsection (5)(a);
- with a view to acquiring shares in any company, or making a capital contribution to a person;
- with a view to investing in land at a time after the relevant 12 month period;
- only or mainly for contingencies, or
- in order to reduce or eliminate a tax or duty imposed by any territory.

51. New subsection (8) provides that where a chargeable company makes a claim under Chapter 9 (exemptions for profits from qualifying loan relationships) its qualifying loan relationship profits are excluded from the references to non-trading finance profits in this section and in Chapter 5.

52. New section 371CC applies if one or both of the requirements of new section 371CC(1) is met. These are:

Requirement (a) – that the CFC has trading or property business profits (or both);

Requirement (b) – that the CFC has exempt distribution income and a substantial part of its business of the CFC is the holding of shares or securities in companies which are its 51% subsidiaries.

53. New section 371CC(2) provides that Chapter 5 will not apply for an accounting period if the CFC's non-trading finance profits are not more than 5% of the relevant amount, as defined in section 371CC.

54. New subsection (3) defines "the relevant amount" with reference to whether requirement (a) or (b), or both, are met. If (a) is met then the relevant amount is the total of trading or property business profits, as calculated before any deduction for interest or any tax or duty. If (b) is met the amount is the total of the CFC's exempt distribution income. If both (a) and (b) are met the amount is the sum of the two totals. New subsection (9) defines "exempt distribution income" as any dividends or other distributions which are excluded from the assumed total profits of the CFC because they would be exempt under Part 9A Corporation Tax Act 2009.

55. New subsections (4) and (5) apply if requirement (b) is met and at any time during the accounting period a 51% subsidiary of the CFC is also a CFC ("the CFC subsidiary") which has relevant non-trading finance profits determined in accordance with new subsection (6) or (7). In that case the CFC subsidiary's relevant non-trading finance profits are to be added in with the non-trading finance profits of the CFC for the purposes of testing the 5% limit. New subsection (8) excludes any trading profits that pass through the CFC charge gateway for the accounting period from trading profits for the purposes of this section.

56. Subsections (6) and (7) define the CFC subsidiary's "relevant non-trading finance profits" with reference to whether it has an accounting period that is the same as or falls wholly within that of the CFC, or if it has an accounting period which otherwise overlaps with that of the CFC.

57. Subsection (6) deals with a CFC subsidiary whose accounting period either matches or falls entirely within the accounting period of the holding company CFC, provided that by virtue of new sections 371CC or 371CD, Chapter 5 does not apply to the CFC subsidiary for the relevant period. The relevant non-trading finance profits of such a CFC are its non-trading finance profits for the relevant period.

58. Subsection (7) deals with a CFC subsidiary whose accounting period overlaps with the accounting period of the holding company CFC, again provided that by virtue of sections 371CC or 371CD, Chapter 5 does not apply to the CFC subsidiary for the relevant period. The relevant non-trade financing profits of such a CFC are a just and reasonable proportion of its non-trading finance profits for that period.

59. New section 371CD applies where both the requirements of section 371CC(1)(a) and (b) are met but the CFC's tested non-trading finance profits exceed 5% of the relevant amount for the purposes of section 371CC(2). In that case new section 371CD(2) provides that Chapter 5 does not apply for the accounting period if the CFC's adjusted non-trading finance profits do not exceed 5% of the total of the CFC's exempt distribution income.

60. New subsection (3) defines the CFC's adjusted non-trading finance profits as all of its non-trading finance profits less those arising from the investment of funds held for the purposes of the CFC's trade and/or property business within section 371CB(3) or (4).

61. New subsection (5) applies if a CFC subsidiary's relevant non-trading profits are added to the CFC's non-trading finance under section 371CC(5) for the purposes of the test at section 371CC(2). It specifies that the adjusted non-trading finance profits for the test in section 371CD(2) are also to include the CFC subsidiary's relevant non-trading finance profits.

62. The effect of the further 5% rule at section 371CD for a mixed activity company that is not within the 5% limit of section 371CC is therefore that Chapter 5 applies to any non-trading finance profits that are not incidental to the trade or property business, unless that amount is within 5% of the CFC's exempt distribution income.

63. New section 371CE provides that Chapter 6 (trading finance profits) applies for a CFC's accounting period only if the CFC has trading finance profits and at any time during the accounting period the CFC has funds or other assets derived directly or indirectly from UK connected capital contributions.

64. New section 371CE(2) provides that Chapter 6 will not apply and that trading finance profits will be treated as if they were non-trading finance profits if the CFC is a group treasury company in the accounting period and gives a notice to an officer of Revenue & Customs requesting this treatment.

65. New subsection (3) applies the definition of group treasury company at section 316 of TIOPA.

66. New subsections (4) to (6) set out the requirements for giving a notice under this section, which must be within 20 months after the end of the accounting period or a longer period that an officer of Revenue & Customs may allow.

67. New subsection (5) allows a company to give a notice if it would be a chargeable company under section 371BC for the accounting period and the percentage of the CFC's chargeable profits to be apportioned to it would be more than half of the percentage specified in subsection (7).

68. New subsection (6) allows two or more companies to make a notice if they would be chargeable companies under section 371BC for the accounting period and the percentage of the CFC's chargeable profits to be apportioned to them, taken together, would be more than half of the percentage specified in subsection (7).

69. New subsection (7) gives the percentage (X%) for the purposes of subsections (5) and (6) as the total percentage of the CFC's chargeable profits which would be apportioned to chargeable companies if the CFC charge was charged for the accounting period.

70. New section 371CF provides that Chapter 7 (captive insurance business) applies for a CFC's accounting period only if at any time in that period the main part of its business is insurance business and its assumed total profits include amounts derived from contracts of insurance as specified in new subsection 371CF(2). These are contracts entered into with:

- a UK resident company connected with the CFC,
- a non-UK resident company connected with the CFC and acting through a UK permanent establishment, or
- a UK resident person where the contract is linked to the provision of goods or services to the UK resident person. This excludes services provided as part of insurance business).

71. New section 371CG provides that Chapter 8 (solo consolidation) only applies for a CFC's accounting period if either of two conditions is met. The first condition is that at any time in the period the CFC is a subsidiary undertaking which is the subject of a solo consolidation waiver under section BIPRU 2.1 of the FSA Handbook, and the CFC's parent undertaking in relation to that waiver is a UK resident company.

72. The second condition is that at any time in the period the CFC is controlled by a UK resident bank (alone or with other persons)

which holds shares in the CFC, and any fall in the value of those shares would be (wholly or mainly) ignored for the purpose of determining whether the UK resident bank meets the requirements of the FSA Handbook in relation to the bank's capital. This is limited to where the main purpose, or one of the main purposes, of the UK resident bank in holding the shares is to obtain a tax advantage for itself or any connected company.

73. Solo consolidation is an arrangement whereby the FSA allows a regulated financial company to treat an unregulated subsidiary for regulatory purposes as if it were a division of the regulated company. A company that wishes to solo consolidate must apply to the FSA for a waiver.

74. New section 371CG(4) provides definitions of the terms "FSA Handbook" and "UK resident bank" used in the section. Subsections (5) and (6) provide that the Treasury may by regulations amend the chapter, or Chapter 8, to take account of changes to or replacement of the relevant regulatory publications.

Chapter 4 - the CFC charge gateway: profits attributable to UK Activities

75. Chapter 4 applies subject to the conditions given in section 371CA. It determines whether any of a CFC's assumed total profits pass through the CFC charge gateway (see section 371BB) because of UK activities that contribute to those profits. New section 371DB sets out the steps by which any profits falling within this chapter are calculated, but this is subject to exclusions provided for in the rest of Chapter 4.

76. New section 371DA introduces the Chapter. New section 371DA(2) excludes non-trading finance profits and property business profits from the CFC's assumed total profits for the purposes of the Chapter.

77. New subsection (3) defines, for the purposes of the Chapter, the following terms: "the OECD Report", "the CFC group", "the provisional Chapter 4 profits", "the relevant assets and risks", "SPF", "UK SPF" and "non-UK SPF". Subsection (3)(b) specifies that terms used which are also used in the OECD Report have the same meaning for the purposes of the Chapter as they have in that report.

78. New subsection (4) confers powers on the Treasury to permit the amend Chapter 4 to take account of any "relevant document" published by OECD. Subsection (5) defines "relevant document" as one which replaces, updates or supplements the OECD Report, or one that replaces, updates or supplements one which is itself a "relevant document".

79. New section 371DB(1) sets out the steps to determine the Chapter 4 profits which are to be taken in accordance with the principles set out in the OECD Report so far as relevant.

Step 1 is to identify the assets the CFC has or has had and the risks it bears or has borne, in so far as they give rise to the CFC's profits. It calls these "the relevant assets and risks".

Step 2 is to exclude from the relevant assets and risks any asset or risk if the CFC's assumed total profits are only negligibly higher than they would have been if the CFC had not held that asset or borne that risk to any extent at all. This exclusion applies only if the excluded assets or risks together increase the CFC's profits by only a negligible amount (see new section 371DB(2) to (4))

Step 3 is to identify, based on the assumption that the CFC group is a single company, the significant people functions (SPFs) carried out by the CFC group which are relevant to the economic ownership of assets and the taking on and management of risks. The assets and risks that this step is concerned with are those included in the relevant assets and risks from Step 2.

Step 4 is to determine the extent to which the SPFs identified in the previous step are UK SPFs and the extent to which they are non-UK SPFs. If none of them is a UK SPF, then no profits fall within Chapter 4 and no further steps are to be taken.

Step 5 is to assume that the identified UK SPFs are carried out by a UK permanent establishment of the CFC and then to determine the extent to which the assets and risks identified at Step 1 would be attributed to that permanent establishment. It is also assumed for this step that any non-UK SPFs are carried out by the CFC itself.

Step 6 is to exclude assets and risks to which new section 371DC (see below) applies from the relevant assets and risks.

Step 7 is to re-determine the CFC's assumed total profits as if the CFC did not hold the assets and did not bear the risks included in the relevant assets and risks so far as they would be attributed to the permanent establishment at Step 5. "The provisional Chapter 4 profits" are defined as the amount of CFC's assumed total profits left out of the Step 7 re-determined profits.

Step 8 is to determine the profits that fall within the Chapter by excluding from the provisional Chapter 4 profits amounts excluded by new sections 371DD to 371DF.

80. New section 371DC provides for the exclusion of assets and risks at Step 6 in section 371DB(1) where most of the SPFs are not UK

SPFs. New section 371DC(1) applies the exclusion to an asset or risk included in the relevant assets and risks where amount A is not more than 50% of amount B. Amounts A and B are defined by subsections (2) and (3) respectively.

81. New subsection (2) defines amount A as the total of the gross amounts of the CFC's income defined by subsection (2)(a) and additional expenses defined by subsection (2)(b).

82. The gross amounts of the CFC's income are those that would not have become receivable during the accounting period if the CFC had not held the asset or borne the risk so far as it would be attributed to the permanent establishment mentioned at step 5 in new section 371DB(1). An example of such a receipt is a royalty (or part royalty) that the CFC would not have received if it did not hold the relevant Intellectual Property (IP) (or did not hold the whole of it).

83. The additional expenses are those that the CFC would have incurred if it had not held the asset or borne the risk so far as it would be attributed to the permanent establishment mentioned at step 5. An example of such an expense would be a royalty for the use of IP that the CFC would have to pay if it did not hold the IP itself (or did not hold the whole of it).

84. New subsection (3) defines amount B as the total of the gross amounts of the CFC's income defined by subsection (3)(a) and additional expenses defined by subsection (3)(b). The gross amounts of the CFC's income are those that would not have become receivable during the accounting period if the CFC had not held the asset or borne the risk to any extent at all. The additional expenses are those that the CFC would have incurred if it had not held the asset or borne the risk to any extent at all.

85. The exclusion therefore applies if the attribution of assets or risks to UK SPFs required by Step 5 of section 371DB reduces gross income, or increase expenses by less than half of the amount that would follow if the assets or risks were not owned or borne by the CFC at all.

86. New subsections (4) and (5) provide for a bundle of assets or of risks to be treated as if it were a single asset or risk for the purposes of this section. Assets or risks are bundled in this way if it is not reasonably practicable to separate them for the purpose of identification of SPFs.

87. New section 371DD excludes amounts from the provisional Chapter 4 profits where substantial economic value, other than tax savings, arises from the CFC's holding of assets or its bearing of risks.

88. New section 371DD(1) and (2) exclude amounts calculated at Step 7 of section 371DB(1) in relation to the CFC's holding of assets or its bearing of the risks identified in Step 1 and taken into account in Step 7 if:

- the CFC's holding of the asset or its bearing of the risk gives rise to non-tax value for the CFC group; and
- that value (as qualified by subsection (4)) is a substantial proportion of the "net economic value" resulting from the CFC's holding the assets or bearing the risks.

89. New subsection (3) defines the term "net economic value" used in subsection (2). It excludes value directly or indirectly derived from the reduction or elimination of any person's liability to tax or duty imposed under the law of any territory outside the United Kingdom.

90. New subsection (4) defines the term "relevant non-tax value" used in subsection (2). It is the part of the value which results from the CFC holding the asset or bearing the risk that does not derive from the reduction or elimination of any person's UK tax or duty.

91. Overall therefore, non-tax value which results from the CFC holding the asset or bearing the risk is compared to the aggregate of non-tax value and value derived from the UK tax advantage. Foreign tax effects are wholly disregarded for the purposes of this comparison.

92. New subsections (5) and (6) provide for a bundle of assets or of risks to be treated as if it were a single asset or risk for the purposes of this section. Assets or risks are bundled in this way if it is not reasonably practicable to separate them for the purpose of identification of SPFs.

93. New section 371DE excludes amounts from the provisional Chapter 4 profits where they arise from arrangements that independent companies would have entered into.

94. New section 371DE(1) sets out the circumstances (including arrangements) in which subsection (2) will apply.

95. New subsection (2) excludes the amount arising from the arrangements identified in subsection (1), if it is reasonable to suppose that if the UK SPFs were not carried out by companies connected with the CFC then the CFC would enter into arrangements with companies it was not connected with and that those arrangements would:

- be structured in the same way as the actual arrangements and

- have the same commercial effect in relation to the CFC's business.

96. New subsections (3) and (4) provide for a bundle of assets or of risks to be treated as if it were a single asset or risk for the purposes of this section. Assets or risks are bundled in this way if it is not reasonably practicable to separate them for the purpose of identification of SPFs.

97. New section 371DF introduces an exclusion (or 'safe harbour') from Chapter 4 for trading profits. If all the conditions of the safe harbour are met, then all the trading profits of the CFC are excluded from the provisional Chapter 4 profits, and therefore exempt from a CFC charge.

98. With the exception of the management expenditure condition in new section 371DI, the conditions only apply on an entity basis, so that a CFC as a whole will either meet or fail the conditions. The safe harbour conditions provide an alternative to consideration of the detailed SPF (significant people functions) provisions in Chapter 4.

99. New section 371DF(1) provides that all the trading profits of a CFC are excluded from a charge under Chapter 4 if five separate conditions are met. Those conditions are set out in subsequent sections, and relate to:

- business premises
- UK Income
- management expenditure
- intellectual property
- export of goods from the UK.

100. New section 371DF(2) also excludes trading profits from a CFC charge under Chapter 4 in accordance with the management expenditure condition in new section 371DI. The management expenditure condition can be applied to the whole of a CFC or to certain assets or risks of the CFC. This subsection allows for trading profits which arise from certain assets or risks to be excluded from a CFC charge.

101. New section 371DG sets out the business premises condition. New section 371DG(2) requires the CFC to have premises with a degree of permanence in its territory of residence throughout the accounting period, and that those premises are the sole or main base from which the CFC's activities in that territory are carried on.

102. New subsection (3) defines premises to include an office, factory, mine or oil well, and a building site where the work will last at least 12 months.

103. New section 371DH sets out the UK income condition. New section 371DH(2) requires that no more than 20% of the CFC's "relevant trading income" comes directly or indirectly from UK resident persons or UK permanent establishments.

104. New subsection (3) defines "relevant trading income" as the trading income of the CFC excluding any income from UK sales of goods produced in the CFC's territory of residence.

105. New subsections (4) and (5) set out an alternative UK income condition for a CFC whose main business is banking business which is regulated in its territory of residence. The condition is that the "relevant UK trading income" is no more than 10% of the CFC's total trading income. For this purpose, subsection (6) defines "relevant UK trading income" as trading income derived directly or indirectly from UK resident persons or UK permanent establishments, excluding interest received from UK resident companies which are connected or associated with the CFC.

106. New subsection (7) restricts the application of the trading income condition in relation to income from UK companies which have made an exemption election in relation to foreign permanent establishments. In such cases, income is disregarded if the corresponding expense is taken into account in the calculation of the foreign permanent establishments amount for the purposes of section 18A CTA 2009.

107. New section 371DI sets out the management expenditure condition.

108. New section 371DI(2) and (3) limit "UK related management expenditure" to 20% of "total related management expenditure"

109. New subsection (3) defines "total related management expenditure" as the total expenditure incurred by the CFC in relation to staff or other individuals who carry out "relevant management functions." A relevant management function is defined in subsection (5) as a function whereby a person manages or controls any of the relevant assets or risks of the CFC. Relevant assets or risks are defined at section 371DB(1) as assets and risks which give rise to profits.

110. The expenditure incurred by the CFC is categorised in subsection (3)(a) to (c) and covers expenditure incurred on staff or other individuals, and on the engagement of related companies. The related companies' expenditure is itself limited to amounts which relate to the engagement of staff or other individuals.

111. Expenditure in relation to individuals who are not members of staff is included in related management expenditure if those individuals carry out relevant management functions as the result of an arrangement between the CFC or related company and that individual.

112. New subsection (4) defines "UK related management expenditure" as related management expenditure which relates to staff or other individuals who carry out relevant management functions in the UK.

113. New subsection (6) provides an example of a person carrying out relevant management functions, as a person who formulates plans or makes decisions in relation to the acquisition, creation, development or exploitation of assets, or the taking on or bearing of risks. This definition matches the definition of assets or risks that are "UK managed" which is provided by section 371CA(4) in Chapter 3, which determines whether Chapter 4 applies.

114. New subsections (7) to (9) apply in circumstances where the 20% management expenditure condition in subsection (2) is not met, but all the other trading income safe harbour conditions are met. If, for any given asset or risk, the UK related management expenditure is not more than 50% of the total related management expenditure for that asset or risk, then this 50% condition is met and the trading profits which arise from that asset or risk are excluded from the provisional Chapter 4 profits (see Step 7 of new section 371DB).

115. New subsections (10) and (11) allow assets or risks which it is not reasonably practicable to separate for the purposes of the 50% condition set out in subsections (7) to (9) to be considered together in the application of that condition.

116. New section 371DJ sets out the IP (intellectual property) condition for the trading safe harbour.

117. The condition is met unless intellectual property has been transferred to the CFC from related parties in the UK within the previous six years and the transfer has had a significant impact on the profits of the CFC, the total intellectual property held by the CFC, or the value of intellectual property held by the transferor.

118. New section 371DJ(2)(a) defines "the exploited IP". New section 371DJ(2)(b) then asks whether any of that exploited IP was transferred to the CFC by related parties at any time during the accounting period or the previous six years (see subsection (5) or otherwise derived (directly or indirectly) out of or from IP held at times during that period by persons related to the CFC.

119. New subsection (2)(c) asks whether, as a result of those IP transfers, the value of IP held by the related party transferors is significantly less than it would otherwise have been.

120. New subsection (2)(d) then applies the significance condition in all cases where the transferred (or derived) IP is less than the total exploited IP held by the CFC. In cases where all of the exploited IP has been transferred to the CFC by related parties (or otherwise derived as mentioned in subsection (2)(b)), the significance condition does not apply.

121. New subsection (3) contains the significance condition, which is met if IP which has been transferred from the UK (or otherwise derived as mentioned in subsection (2)(b)) forms a significant part of the total exploited IP of the CFC, or if the transfer (or other derivation) of IP from the UK produces CFC profits which are significantly higher than they otherwise would have been. The parts of the exploited IP transferred from the UK is referred to as “the UK derived IP”.

122. New subsection (4) limits the scope of the section in relation to transfers or holding of IP from non-UK resident related persons. Such transfers or holding of IP are relevant only if the IP was held for the purposes of a UK permanent establishment of the foreign company.

123. New subsection (5) defines “the relevant period” as the period covering the accounting period and the previous six years.

Example of Application of IP Condition.

124. A CFC holds intellectual property (exploited IP). Some of this IP has been generated by the CFC’s own trading activity. The rest has been transferred to the CFC from a related company in the UK within the past six years.

125. Prior to transfer, the transferred IP was around 40% of the total IP (by balance sheet value) held by the UK related company transferor. The UK derived IP constitutes 25% of the exploited IP of the CFC (by balance sheet value).

126. As a result of the transfer the CFC’s assumed total profits are 30% higher than they otherwise would have been. The assumed total profits of the CFC do include amounts arising from IP – new section 371DJ(2)(a).

127. Parts of the exploited IP were transferred from persons related to the CFC during the relevant period - section 371 DJ(2)(b). The related

person was a UK related person, so the limitation required by section 371DJ(4) does not apply.

128. As a result of the transfer, the value of IP held by the transferor has been significantly reduced – section 371DJ(2)(c).

129. As only part of the exploited IP has been so transferred, the significance condition has to be considered – section 371DJ(2)(d).

130. The UK derived IP (the transferred IP) is a significant part of the exploited IP, and the profits of the CFC are significantly higher as result of that transfer – section 371DJ(3)(a) and (b). Note that only one of these conditions has to be met in order for the significance condition to be met.

131. Application of section 371DJ in this case means that the IP condition is not met – and therefore the trading safe harbour cannot apply.

132. New section 371DK provides that the export of goods condition is met if no more than 20% of the total trading income of the CFC arises from goods exported from the UK. However, goods which are exported from the UK into the CFC's territory of residence are disregarded.

133. New section 371DL provides an anti-avoidance measure for the trading profits safe harbour. The section applies if it is reasonable to assume that the safe harbour conditions would not have been met in the absence of an arrangement. An arrangement falls within this section if one of the main purposes of an organisation or reorganisation of a significant part of the business is to ensure that one or more of the safe harbour conditions are met. This includes the 50% asset or risk management expenditure condition (for which see section 371DI).

Chapter 5 – The CFC charge gateway: non-trading finance profits

134. Chapter 5 is the charge gateway for certain non-trading finance profits within the main charging provision at new section 371BA(3)(a). The profits are any non-trading finance profits that are included within the CFC's assumed total profits for the accounting period, so far as they fall within one of more of new sections 371EB to 371EE. These sections apply where the CFC has non-trading finance profits derived from one or more of the following categories

- UK SPFs;
- UK capital investment;

- arrangements (typically loans) with the UK;
- UK finance leases.

135. Non-trading finance profits are defined in new section 371VG(1). They are profits from loan relationships which would be chargeable to corporation tax under section 299 of CTA 2009 and non-exempt distributions within Part 9A of CTA 2009. Non-trading finance profits also include profits arising from a relevant finance lease as defined at new section 371VA.

136. New section 371CE(2) also provides for the trading finance profits of a group treasury company to be treated as non-trading finance profits where a notice is given to an officer of Revenue and Customs. This rule enables a group treasury company that has trading finance profits to access the non-trading finance profits rules at Chapter 5 and the finance company exemptions within Chapter 9. Once a notice has been given the deemed non-trading finance profits become chargeable profits of a CFC only if they fall within one or more of new sections 371EB to 371EE.

137. New section 371EB includes within Chapter 5 any non-trading finance profits that are attributable to UK activities. The profits are calculated by applying Steps 1 to 5 and 7 at section 371DB to the CFC's non-trading finance profits. By excluding Step 6 of that section from the calculation, profits are brought into charge without the limitation imposed by section 371DC for cases where less than 50% of the SPFs attributable to managing the asset or risk associated with the non-trading finance profits are UK SPFs.

138. New section 371EC includes within Chapter 5 any non-trading finance profits so far as they arise from the investment of "relevant UK funds or other assets". For these purposes "UK funds" are monetary assets and "other assets" are non-monetary assets.

139. The calculation of the profits that pass through the CFC charge gateway by virtue of the profits falling within Chapter 5 takes account of any expenditure or deduction that would be taken into account in calculating the CFC's assumed total profits. In arriving at the amount of non-trading finance profit that is attributable to capital investment from the UK new subsections 371EC(2) and (3) allow for an additional deduction that represents the difference (if any) between the arm's length fund management fee that it is reasonable to suppose would be charged for managing the funds or assets and the management expenditure actually incurred in realising the non-trading finance profit.

140. New subsection (4) defines "relevant UK funds or other assets" as funds derived, directly or indirectly, from:

- a UK connected company's subscription for shares in, or other type of capital contribution to the CFC, or

- any amounts included within the CFC's chargeable profits for any earlier accounting period to which new Part 9A applied (which are the profits that form part of the reserves of the CFC, which have been subject to an apportionment in a previous accounting period), or

- any amounts which are left out of account in determining the CFC's assumed total profits for that or any earlier accounting period to which new Part 9A applied due to a claim under section 174 TIOPA (transfer pricing: claims by disadvantaged person), or

- any other funds or other assets received by the CFC directly or indirectly from a UK connected company except (by virtue of subsection (5)) a payment for the provision of goods or services, or sums received by way of a loan from the UK to the CFC.

141. New subsection (6) defines "UK connected company" for the purposes of subsection (4) and includes the UK permanent establishment of a non-UK connected company.

142. New section 371ED includes non-trading finance profits to the extent that they arise from an arrangement, directly or indirectly with a UK resident company connected with the CFC, or to UK permanent establishments of non-UK companies connected with the CFC. An arrangement will typically be a loan to a UK resident company. An example of an indirect arrangement would be a loan from the CFC to a non-UK resident person, who then makes a loan to a UK resident company that is connected with the CFC.

143. Profits from such an arrangement are included in Chapter 5 if it is reasonable to suppose that the arrangement has been made as an alternative to making a dividend or other form of distribution, directly or indirectly, to the UK and that the main reason or one of the main reasons for adopting the alternative arrangement is a reason relating to any UK or non-UK tax liability. This test focuses on the reason why the arrangement was made rather than a dividend being paid (or any other distribution being made) to the UK. The section would therefore apply, for example, to profits arising from a loan made by the CFC to the UK to repatriate funds if a loan was made because a dividend paid to the UK would have attracted withholding tax.

144. New section 371EE includes non-trading finance profits within Chapter 5 where they arise from the direct or indirect finance lease

of an asset to a UK resident company or UK permanent establishment of a non-UK company that is connected to the CFC. The rule is limited to those cases where it is reasonable to suppose that the main reason or one of the main reasons for entering into the finance lease rather than directly or indirectly purchasing the asset is a UK or non-UK tax reason. This test focuses on the reason why a finance lease was entered into in preference to another means of obtaining the use of the asset.

Chapter 6 – The CFC charge gateway: trading finance profits

145. Chapter 6 determines the trading finance profits for the purpose of the CFC charge gateway. Profits are within this Chapter to the extent they derive from excess capital or in the case of an insurance business from excess free assets. Trading finance profits are defined by new section 371VG(4). They are profits from trading loan relationships (including amounts within Parts 6 and 7 CTA 2009 that arise from relationships that are treated as loan relationships), distributions treated as trading income and trading profits from a relevant finance lease as defined at new section 371VA.

146. New section 371FA(1) provides the basic rule for determining the profits that fall into this Chapter for an accounting period. There are three steps.

147. The first step is to determine if the CFC's free capital is greater than what it is reasonable to suppose it would be if the CFC was a company which was not a 51% subsidiary of any other company, but carrying on the same business with the same amount of funding. The test will take account therefore of any assets in the form of shareholdings held by the CFC in other companies. The amount of this excess free capital is limited to the extent it derives, directly or indirectly from "UK connected capital contributions" (which is defined in new section 371VA).

148. So for example, a UK company A provides capital of 60 to a non-UK intermediate holding company B, which in turn provides capital of 60 to CFC C. Company B also provides, from its own reserves, additional capital of 40 to C, so that C's total capital is 100. If C was not a 51% subsidiary of A, it would have free capital of 20. C therefore has excess capital of 80, but as only 60 is provided by the UK the amount of excess free capital calculated by step 1 of subsection (1) is limited to 60.

149. The second step uses the same approach as step 1, but only applies if the CFC carries on insurance business (as defined in new section 371VA). This test requires a comparison of the CFC's actual level of free assets, against the amount of free assets it would be expected to have if the CFC was not a 51% subsidiary of any other company

but was carrying on the same insurance business. The amount of any excess free assets is limited to the extent it derives, directly or indirectly from UK connected capital contributions (which is defined in new section 371VA).

150. Where there is either excess free capital as a result of performing step 1, or excess free assets as a result of performing step 2, the third step determines the profits that fall into Chapter 6 as the amount of trading finance profits that it is reasonable to suppose arises from the use or investment of either or both amounts during the accounting period.

151. New section 371FA(2) defines free capital for the purpose of the test in step one as funding that does not give rise to debits that are brought into account in determining the non-trading finance profits or trading finance profits of the CFC. A CFC's free capital is therefore any funding that does not give rise to a deduction that would be taken into account in calculating those profits.

152. New subsections (3) and (7) define free assets for the purpose of the test in step two as the amount by which the value of the CFC's assets exceeds its loan capital. The value of an asset is the amount that it reasonable to suppose the CFC would obtain from an unconnected third party if it transferred all its rights in that asset to that person.

153. New subsections (5) and (6) provide for a reduction in the amount of the free assets for the purpose of the test in step two to the extent the CFC holds assets under certain circumstances. Those circumstances are that the insurance CFC, for regulatory reasons, is required to hold more assets than it otherwise would because it has provided a guarantee to another company connected with the CFC undertaking insurance business and that guarantee is required for regulatory reasons in order for the company connected with the CFC to carry on insurance business.

154. New section 371FB provides for the free capital or free assets to be increased by an amount of loan capital owed by the CFC to the extent that the profits of the lender (where the lender is a connected CFC) in respect of that loan capital, which is a qualifying loan relationship, are exempt under Chapter 9. Section 371FB(3) provides a calculation that determines if E% of the profits arising from the qualifying loan relationship are exempt for the lender, then E% of the qualifying loan relationship is added to the amount of free capital or free assets.

155. New subsection (4) explains what assumptions are to be made in calculating the amount of the profits arising from the qualifying loan relationship. This includes establishing the period over which

the profits of the qualifying loan relationship should be tested in subsection (3). Subsection (5) provides the steps to be taken to establish what amount of those profits are exempt profits. Those steps are taken for each chargeable company that makes a claim under Chapter 9 that relates to the accounting period of the CFC that has lent the loan capital.

156. So for example if an insurance company receives a loan, which is a qualifying loan relationship, of 200, with the profits from that loan being 75% exempt in the lender (which is a connected CFC), then the same proportion of the loan should be disregarded as loan capital, so that 150 is treated instead as being included in the free assets. If a bank were to receive the same loan, its free capital would be increased by 150. In both cases the effect would be to increase the amount being tested (free capital or free assets) by 150.

157. New section 371FC confers a power on the HMRC Commissioners to make regulations setting out conditions under which the third step (and thus Chapter 6) will not apply in relation to the CFC's trading finance profits arising from the CFC's banking business (which is defined in new section 371VA). The regulations may specifically refer to a territory or to banking regulatory requirements of a territory.

158. New section 371FD confers a power on the HMRC Commissioners to make regulations setting out conditions under which the third step (and thus Chapter 6) will not apply in relation to the CFC's trading finance profits to the extent they arise from the CFC's insurance business (which is defined in new section 371VA). The power does not extend to making regulations in relation to profits from captive insurance in Chapter 7. The regulations may specifically refer to a territory or to the insurance regulatory requirements of a territory.

Chapter 7 – The CFC charge gateway - captive insurance business

159. Chapter 7 of Part 9A contains the rules that identify the profits of a captive insurance CFC that are within the scope of the CFC charge.

160. New section 371GA(1) outlines the basic rule for identifying a CFC's profits that fall within Chapter 7. The basic rule charges both underwriting and investment profits arising from captive insurance business written with UK resident persons (whether connected to the CFC or not). The profits are captured under Chapter 7 and pass through the CFC charge gateway to the extent they are within the CFC's assumed total profits and also arise from:

- the CFC's insurance business,

- contracts of insurance falling within new section 371GA(2), and

- where applicable, contracts of insurance where the CFC is resident in an EEA state and the insured (or original insured person) has no significant UK non-tax reason for entering into that contract.

161. New subsection (2) limits the scope of Chapter 7 to UK persons or UK permanent establishments that enter into contracts of insurance with the CFC. Profits are captured to the extent they are derived directly (or indirectly) from a contract of insurance (which is defined in new section 371VA) entered into by a UK resident company or a non-UK resident company acting through a UK permanent establishment, that are connected with the CFC. A contract of insurance between the CFC and a UK resident person (who need not be connected to the CFC) is also included where the insurance relates to the provision of goods or services to that person. It does not include a case where those services are provided as part of an insurance business.

162. Subsection (2)(b) is targeted at situations where the insurance contract relates to the provision of goods or services to the UK resident person. For example, a UK retail group may establish a captive insurance company offshore. It may then market warranty plans, written by the captive insurance company, to UK resident persons at the point of sale of its retail goods. The profits from such insurance are within the scope of Chapter 7.

163. Profits are indirectly derived from a contract of insurance where, for example, the insurance is provided through insurance fronting arrangements. A particular instance would be where company A (a UK resident company) wants to enter into an insurance contract with its connected company B (a captive insurance CFC). If A enters into a fronting arrangement with an unconnected insurance group whereby A enters into an insurance contract with company C (a member of the unconnected insurance group), who then reinsures the risk to company B, then B's profits are within the scope of Chapter 7.

164. New subsection (3) excludes from Chapter 7 premiums paid under a contract of insurance by a connected UK resident company which has made a foreign permanent establishment election (under section 18A, CTA 2009) and where the premium is wholly brought into account for the purposes of determining an exemption adjustment.

165. New subsection (4) outlines the extent to which reinsurance contracts fall within Chapter 7. Amounts arising from reinsurance contracts are captured where the original contract of insurance

would fall within subsection (2)(a). This extends to cases where there is a chain of reinsurance between the original contract of insurance and the final contract of reinsurance.

166. New subsection (6) applies to a captive insurance CFC that is resident in an EEA state, provided the profits do not arise from the activities of a permanent establishment that the CFC has in a non-EEA state (see subsection (5)). Where subsection (6) applies, profits from an EEA resident captive insurance CFC will fall within Chapter 7 where they are derived from either:

- a contract of insurance, for which the insured has no significant UK non-tax reason for entering, or
- a contract of reinsurance, where the original insured has no significant UK non-tax reason for entering into the original insurance contract.

167. New subsection (7) defines UK non-tax reason for the purposes of subsection (6).

Chapter 8 -The CFC charge gateway: solo consolidation

168. Chapter 8 contains the rules that identify the profits which are within the scope of the CFC charge for a CFC that is the subject of a solo consolidation waiver. Solo consolidation is an arrangement whereby the FSA allows a regulated financial company to treat an unregulated subsidiary for regulatory purposes as if it were a division of the regulated company. A company that wishes to solo consolidate must apply to the FSA for a waiver.

169. New section 371HA(1) outlines the basic rule for identifying the profits that fall within Chapter 8 and that are included in the CFC charge gateway. The profits are any amounts in the CFC's assumed total profits (as defined by new section 371SB(9)) which are not also included in the CFC's relevant profits amount. The effect of the rule is to bring into charge amounts that are included in the CFC's assumed total profits, but are not included in its relevant profits amount.

170. New section 371HA(2) defines the CFC's relevant profits amount by reference to section 18A(6) of Chapter 3A of Part 2 of CTA 2009. In doing so it deems the CFC to be a permanent establishment of the UK resident company mentioned in new subsection 371CG(2) or the UK resident bank mentioned in new subsection 371CG(3) and deems the CFC's accounting period to be a relevant accounting period for that UK resident company or bank.

Chapter 9 - Exemptions for profits from qualifying loan relationships

171. New section 371IA(1) introduces Chapter 9 which provides the rules for full and 75% exemption of certain intra-group non-trading finance profits that would otherwise pass through the CFC charge gateway because they fall within Chapter 5. Chapter 9 applies only to profits that arise from qualifying loan relationships as defined at new section 371IG. The business premises condition at section 371DG must also be met.

172. A chargeable company must make a claim to an officer of Revenue and Customs under new section 371IA(2) in order for Chapter 9 to apply. The effect of the claim, given by subsection (3), is that for the chargeable company only, non-trading finance profits pass through the CFC charge gateway only to the extent that they are not exempt under Chapter 9. Where a claim is made, the rules in Chapter 9 apply to all of the non-trading finance profits arising from qualifying loan relationships of the CFC for the accounting period by virtue of section 371CB(8). New section 371IA(9) excludes from Chapter 9, in the same way as they are excluded from Chapter 5, any non-trading finance profits where they:

- arise from the investment of funds held by the CFC for trading purposes;
- arise from the investment of funds held by the CFC for the purposes of a property business;
- fall within Chapter 8 (solo consolidation);
- arise from a relevant finance lease.

173. The finance company full and 75% exemptions are given by way of an adjustment that is made to a CFC's chargeable profits and creditable tax for an accounting period at step 2 of section 371BB(1).

174. New subsection (3) provides that qualifying loan relationship profits form part of a CFC's chargeable profits only to the extent that they are not exempt under Chapter 9.

175. New subsection (5) provides that profits are exempted firstly by applying either the qualifying resources rule or the 75% exemption rule at new sections 371IB and 371ID respectively and then by applying the matched interest rule at new section 371IE, if relevant.

176. New subsection (10) explains that a loan relationship for Chapter 9 purposes is limited to a loan relationship that is a money debt arising from a transaction for the lending of money as defined at section 302(1) CTA 2009. It will not include any other arrangement treated as a loan relationship such that the associated credits and

debits would otherwise fall to be dealt with under Part 5 of CTA 2009.

177. New section 371IB sets out the rules to be applied to establish the extent to which profits from a qualifying loan relationship will be exempt where it is funded out of qualifying resources. The section will apply in respect of a loan relationship only if the company's Chapter 9 claim states that it is to apply. It is not possible to make a claim under this section for full exemption in respect of part of a qualifying loan relationship and a claim under new section 371ID for 75% exemption in respect of the remainder.

178. New section 371IB(2) provides that X% of the profits of a qualifying loan relationship are exempt if the chargeable company ('company C') is able to demonstrate that at least X% of the qualifying loan relationship was funded out of qualifying resources and that the ultimate debtor was resident in the same territory at all times during the relevant period. It is possible that the amount so funded may vary throughout that period.

179. For example a £100m loan is funded at the beginning of an accounting period entirely out of qualifying resources and this loan is increased to £200m half way through the year with the balance of the loan being funded out of non qualifying resources. Throughout the relevant accounting period the percentage of the loan funded from qualifying resources is 100% for the first 6 months and 50% for the second 6 months so that over the year the percentage of profits that are exempt should be 75% (assuming the loan is equally profitable at all times). C's claim should therefore specify X to be 75%. In the second accounting period if the loan remains at £200m throughout the accounting period C's claim should specify X to be 50%.

180. A relevant period is defined by subsection (4) as the accounting period, or if a loan is only outstanding for part of that accounting period that shorter period.

181. Qualifying resources are a source of funds that place no demands on group resources outside the ultimate debtor's territory of residence (the 'relevant territory'). They are defined at new subsections (6) and (7) as:

- profits earned by the CFC from lending to connected companies within the relevant territory that are used for the purposes of the business being carried on in that territory;

- profits that have been earned in the relevant territory by members of the CFC group;

- the qualifying value of relevant pre-acquisition sums or other assets (as defined in new section 371IC);

- funds that arise from ordinary non-redeemable shares issued by the parent company in the group to persons who are not members of the CFC group. The parent company must be a company that is not a 75% subsidiary of another company.

182. Funds in the all but the first of the above four categories may be derived directly or indirectly from the sources listed above, but must be received by the CFC in relation to shares it holds in, or shares it has issued to other group companies.

183. New subsection (10) gives definitions for the purposes of the section and new section 371IC. Subsection (10)(c) states that the relevant territory is the territory where the ultimate debtor (of the qualifying loan relationship) is resident. This means that to the extent they are qualifying resources by virtue of subsection (6)(a) or subsections (6)(b) and (7)(a) together, those qualifying resources have to be derived from the same territory in which the borrower (in respect of the qualifying loan relationship) is resident. Subsection (10)(d) and (e) provide further limitations to qualifying resources in those cases, so that

- loans made to persons outside the relevant territory are not treated as being for the purpose of the business carried on in that relevant territory; and

- profits earned outside of the relevant territory that are distributed to or arise to a company resident in the relevant territory are not treated as earned in the relevant territory.

184. The qualifying value of relevant pre-acquisition funds (if there are any) is determined by new section 371IC. This is the value of funds or other assets represented by the consideration given for shares in a company (referred to as the "target company") acquired by a CFC from persons who not members of the group. The acquisition must take place by way of shares issued in exchange to those persons who are not members of the group by the parent company in the group. Qualifying resources will include the distribution of pre acquisition profits to the CFC or the repayment of share capital by the target company.

185. New section 371IC(4) provides that where the issue of shares by the parent company represents only part of the consideration given for the acquisition or the parent company pays a special dividend (or otherwise makes an extraordinary distribution) to the parent company's shareholders as part of the arrangements then only that part of the value in the company acquired represented by the issue

of shares will be qualifying value. Subsection (5) provides the formula that determines the amount of qualifying value where other such consideration has been given.

186. Where new debt is taken on in the UK as part of the arrangement that creates the qualifying resources then section 371IB(8) and (9) provide that the qualifying loan relationship will be treated as derived from non-qualifying resources in at least the amount of the new debt.

187. New subsections (10)(a), (11) and (12) define "the CFC group". This consists of the CFC together with companies that it is connected with from time to time. It also includes companies that existed before the CFC existed (or before it was part of the group), provided that they were at that time connected with all UK resident companies that now control the CFC.

188. New section 371ID applies to a qualifying loan relationship where a claim has not been made under section 371IB that full exemption should apply to the profits from all or part of that qualifying loan relationship. It provides that 75% of the profits of the qualifying loan relationship shall be exempt.

189. The matched interest rule in new section 371IE applies when

- there remain profits (called "the leftover profits") that are not exempt after the application of sections 371IB or ID; and
- (apart from the application of this section) profits under Chapters 5, 6 or 9 have been apportioned to a UK group company resulting in that company having a finance income amount; and
- the UK members of the group have in aggregate a surplus of net finance income over net finance expenses.

The matched interest rule use terms from the worldwide debt cap rules in Part 7.

190. New section 371IE(2) provides that all of the leftover profits will be exempt if the tested income amount (TIA) exceeds the tested expense amount (TEA).

191. New subsection (3) provides that a percentage of the non exempt profits will become exempt if the CFC charge causes the TIA to exceed the TEA. The excess is referred to in subsection (4) as "E".

192. The TIA may be increased by a CFC charge ("I") or the TEA may be reduced by a CFC charge ("R"). The calculation to determine the

exempt percentage is set out in subsection (4) by reference to the amounts E, I and R.

193. New subsections (7) to (10) provide modifications to the worldwide debt cap rules in Part 7, but only for the purposes of applying this section. It requires that a calculation of TIA and TEA be made for a UK group, if one has not already been made. This includes banking and insurance groups and groups that are not large groups. Subsection (9) provides a limitation that excludes debits, credits and other amounts that arise from banking or insurance business in determining what the finance income amount would be for any company and what the TIA and TEA would be.

194. New section 371IF sets out the steps for calculating the CFC's "qualifying loan relationship profits". The section operates by applying the steps to each qualifying loan relationship.

- Step 1 is to determine the credits from the qualifying loan relationship (which is defined at new section 371IG) that are brought into account for the purposes of determining the CFC's non-trading finance profits for the accounting period. The amount determined is "the Step 1 credits";

- Step 2 is to add to or subtract from the Step 1 credits such debits or credits as arise from derivative contracts or other arrangements that are a hedge of interest rate or FOREX risk relating to the qualifying loan relationship. The amount determined is "the Step 2 credits";

- Steps 3 and 4 are further steps for bringing into account debits and credits (so far as not reflected in the Step 2 credits) for the purposes of determining the CFC's non-trading finance profits for the accounting period. This is done by subtraction from or addition to the Step 2 credits of a just and reasonable proportion of debits or credits to give the CFC's qualifying loan relationship profits for the qualifying loan relationship in question.

195. New section 371IG(1) sets out the conditions for a loan relationship of a CFC to be treated as a qualifying loan relationship. These are where in relation to the qualifying loan relationship

- the CFC is the creditor;

- "the ultimate debtor" is a "qualifying company" (which is defined in new section 371IG(8); and

- new section 371IH does not apply to treat the loan as non-qualifying.

196. New section 371IG(2) provides that the ultimate debtor is the immediate debtor in relation to a qualifying loan relationship unless subsection (3) applies.

197. New subsections (3) to (6) establish who the ultimate debtor is where a loan is used (directly or indirectly) to fund another loan. They provide that the ultimate debtor will be a person ("P") if:

- the loan to the debtor of the CFC is made for the purposes of funding a loan to P;
- the loan to P is not used for the purposes of funding a loan to any other person; and
- the loan to P gives rise to a loan relationship in relation to which P is the debtor.

198. For the purposes of the ultimate debtor rule a part of a loan is treated as a separate loan. This means that where a loan from a CFC to a debtor A is used partly for the purposes of A's trade and partly to fund a loan to B then there will be 2 loans with 2 ultimate debtors, A and B.

199. New subsection (7) disapplies subsections (4) and (5) in respect of loans to a CFC whose main business is banking or insurance and the loan is made in the ordinary course of that business. In that case that CFC is treated as the ultimate debtor. If P is a UK resident qualifying company, subsections (4) and (5) are only disapplied if P is a bank or insurance company.

200. New subsection (8) defines a qualifying company as a company which is connected with the CFC and is controlled by the UK resident persons who control the CFC.

201. New section 371IH(1) sets out the circumstances under which a loan cannot be a qualifying loan relationship where the ultimate debtor is a non-UK resident company. These are where some or all of the borrower's debits are:

- being brought into account for the purposes of determining the profits attributable to a UK PE of the debtor under Part 2 of CTA 2009, or
- are being taken into account for the purposes of determining the profits attributable to a UK property business of the CFC under Part 3 Income Tax (Trading and Other Income) Act 2005.

202. New section 371IH(2) provides that a loan cannot be a qualifying loan relationship where the ultimate debtor is UK resident unless all

the company's debits are taken into account for the purposes of determining the profits attributable to an exempt non-UK PE of the ultimate debtor and an election is made under section 18A of CTA 2009 in relation to the ultimate borrower.

203. New subsection (3) provides that a loan relationship cannot be a qualifying loan relationship where:

- the ultimate debtor is itself a CFC to which Chapters 3 to 8 or Chapter 12 apply in an accounting period and some or all of the debits of the CFC are being brought into account for the purposes of those chapters, and
- as a result there is no CFC charge for the accounting period, or the charge is reduced.

204. New subsection (4) provides that the references to debits in subsections (1) to (3) are to the debits from the loan to the ultimate debtor, and where a loan A is used wholly or partly to fund loan B (as provided for by section 371IG (4) and (5)) the debits are those of loan B.

205. New subsection (5) provides that a loan relationship cannot be a qualifying loan relationship where it is an arrangement, or connected to an arrangement, the main purpose or one of the main purposes of which is to provide, directly or indirectly, funding for a loan relationship to a person from the ultimate debtor. For example, consider a case where a loan is made by the CFC to another non-UK resident company and that company, by an arrangement that is not limited by other parts of this section, arranges for a loan to be made (using the funds from the first loan) by another person to a UK resident company connected with the CFC. The main purpose of the arrangement is for the CFC to make a loan to the UK resident connected company. The loan by the CFC is not a qualifying loan relationship.

206. New subsections (6) and (7) provide that a creditor relationship of a CFC cannot be a qualifying loan relationship where it is:

- sourced to any extent from UK funds (other than a loan) received directly or indirectly from a UK resident company which has a main business of banking or insurance; or
- where the loan relationship was created as part of an arrangement which created new debt in the UK for a UK-resident company carrying on a financial trade taxable under Part 3 CTA 2009.

207. New subsections (8) and (9) provide that a loan cannot be a qualifying loan relationship where third party debt of a non-UK group company is repaid (in whole or in part), and effectively replaced with new UK debt as part of an arrangement the main purpose or one of the main purposes of which is to obtain a tax advantage for any person. Consider for example a case where a UK group company A borrows £100m, which in turn is used to buy shares issued by a connected CFC B, which in turn makes a loan of £100m to an overseas group company C, which in turn repays existing external debt of £100m. The arrangement has created two loans where before there was only one, with the interest on one of the loans being sheltered by B. The arrangement has a main purpose of obtaining a tax advantage for UK company A and so the loan to company C is not a qualifying loan relationship.

208. New section 371II confers on HMRC Commissioners the power to make regulations to amend the definitions of qualifying loan relationship, ultimate debtor and qualifying resources.

209. New section 371IJ provides that a Chapter 9 claim must be made in the chargeable company's tax return for the period and sets out the time limits for the claim and for varying or withdrawing that claim. A later claim may be made, varied or withdrawn if allowed by an Officer of Revenue and Customs. A claim may also be varied or withdrawn outside of the usual time limits where there are changes to the tested income and expense amounts, provided that claim is made within 12 months of such a change and the claim is made to take account of that change (and not for another purpose).

Chapter 10- The exempt period exemption

210. New section 371JA introduces Chapter 10 which provides for a temporary period of exemption for foreign subsidiaries which come under UK control.

211. New section 371JB(1) provides that the exemption applies for an accounting period if:

- the CFC's accounting period ends during an exempt period (as defined by new sections 371JC and 371JD),
- the subsequent period condition is met, and
- the chargeable company condition is met.

212. New subsection (2) sets out the subsequent period condition. This requires the CFC to continue as a CFC for at least one accounting period which begins after the exempt period and that there is no

CFC charge in relation to the CFC's first accounting period to begin after the end of the exempt period.

213. New subsection (3) provides that the chargeable company condition is met if the charging condition in new section 371JC is met and throughout the "relevant period" either a company which has a relevant interest in the CFC at the beginning of the exempt period, or another connected company, is a chargeable company. The effect of this is that the availability of the exempt period is not affected by a transfer of ownership of a CFC within a group if there is at least one connected UK company which would be subject to a CFC charge in respect of the new CFC.

214. New subsection (4) provides the following definitions.

- An "original chargeable company" is a company which would be a chargeable company at the start of the exempt period for the purposes of the charging condition set out in section 371JC.

- The "relevant period" is the period from immediately after the beginning of the exempt period until the end of the subsequent period (the first accounting period beginning after the end of the exempt period).

215. New subsection (5) provides that the exemption is subject to an anti-avoidance rule which is detailed at section 371JF.

216. New section 371JC determines when an exempt period begins.

217. New subsection (1) provides that an exempt period begins at "the relevant time", during an accounting period if:

- the "initial condition" is met (see subsection (2)),

- the charging condition is met at the relevant time, and

- the charging condition is not met at any point during the "relevant preceding period" so long as there is such a period (see subsection (5)). If the company comes into existence at the relevant time, this condition does not apply.

218. New subsection (2) provides that the "initial condition" is met:

- if immediately before the relevant time the CFC is a company carrying on a business, or

- if a company is formed or incorporated at the relevant time, it is formed or incorporated for the purpose of controlling a company or companies that will qualify for the exemption.

219. New subsections (3) and (4) together set out the circumstances in which the "charging condition" is met. Broadly this is where a CFC has chargeable profits for an accounting period and there is at least one chargeable company in respect of those profits.

220. New subsection (5) defines the "relevant preceding period" as the 12 months immediately prior to the relevant time, but disregarding any part of that period before the company came into existence.

221. New section 371JD determines the length of the exempt period.

222. New subsection (1) sets out the basic rule that the exempt period will last for 12 months.

223. New subsections (2) to (5) introduce the ability for chargeable companies to apply for an extension to the 12 month exempt period. A notice must be given to HMRC before the end of the exempt period, and HMRC have the power to extend the exempt period or, if necessary, to further extend an extended exempt period. Notices under this section can only be given by companies which would be chargeable companies at that time.

224. New section 371JE deals with cases where a CFC's accounting period includes part of an exempt period, but where the accounting period does not end during an exempt period. In these circumstances, the normal CFC rules will apply to the CFC's accounting period, but any chargeable profits which arise will need to be adjusted to take account of profits which arise during the exempt period.

225. New subsection (1) applies where an accounting period begins but does not end during an exempt period, and where the chargeable company and subsequent period conditions are met.

226. New subsection (2) adjusts the CFC's assumed total profits to ensure that none of the profits which arise during the exempt period are subject to a CFC charge. The profits which arise during the exempt period are to be determined on a just and reasonable basis.

227. New section 371JF provides an anti-avoidance condition in relation to the exempt period exemption.

228. New subsection (1) determines that the exemption will not apply if either of two conditions, A or B, is met.

229. New subsection (2) sets out Condition A, which is that an arrangement:

- is entered into which has a main purpose of securing a tax advantage for any person,
- is linked to the potential application of the exempt period exemption for one or more accounting periods, and
- involves the CFC either holding assets which give rise to finance profits, or holding intellectual property which gives rise to income.

This condition is intended to target arrangements where groups seek to take advantage of the exempt period exemption by placing mobile, income generating assets within a CFC.

230. New subsection (3) sets out Condition B, which is that:

- an arrangement is entered into which reduces the length of any accounting period to less than 12 months,
- the arrangement has a main purpose of ensuring that the exempt period exemption applies to one or more accounting periods.

This condition is intended to target arrangements whereby the subsequent accounting period is shortened to ensure that the subsequent period condition is met.

231. New section 371JG deals with the amendment of company tax returns in relation to the exempt period exemption. This section extends the amendment time limit of any corporate tax return period in which falls, wholly or partly, a CFC's exempt period. This is necessary because whether any chargeable profits arise to that CFC for that period can only be ascertained once the CFC's position for the subsequent period is established. The effect of the section is to extend the amendment date for any chargeable company's accounting period which includes any part of the exempt period to match the corporation tax return amendment date for the accounting period in which the CFC's subsequent period ends.

Chapter 11 - The excluded territories exemption

232. Chapter 11, introduced by new section 371KA provides for the "excluded territories exemption" (ETE). If a company is resident and carries on business in one of the countries on the list made under the regulation-making power conferred by Chapter 11, and meets the other conditions of the exemptions, then the CFC is regarded as meeting the conditions necessary for exclusion from the CFC charge under Part 9A.

233. New section 371KB(1) sets out the four conditions that need to be met for the ETE to apply for a CFC's accounting period. These are that:

- the CFC is resident in one of the excluded territories specified in regulations for the accounting period;
- the total of amounts (if any) of the CFC's income which falls within Categories A, B, C and D (as set out in new sections 371KE-371KI) is not more than the "threshold" amount for the accounting period (as described in new section 371KD);
- the intellectual property (IP) condition (provided by new section 371KJ) is met; and
- the CFC is not involved in an arrangement, the main purpose or one of the main purposes of which is to obtain a tax advantage (as defined by section 1139 of CTA 2010) for any person at any time during the accounting period.

234. The categories A to D of income are explained in detail below. In essence there is a limitation on the amount of certain classes of income which the CFC can accrue if it is to qualify for the ETE. This threshold is set at 10% of the CFC's accounting profits excluding transfer pricing adjustments for the accounting period in question, or £50,000 if greater. If income falls into more than one category then it is counted only once for the purposes of the test. The IP condition is met if no IP has been transferred to the CFC from the UK in the last 6 years. The targeted anti-avoidance rule aims to ensure that CFCs seeking exemption via the ETE are not engaged in any arrangements giving rise to a tax advantage as defined.

235. New subsection (3) confers a power on HM Revenue and Customs Commissioners to make regulations in connection with requirements of the ETE. The income category and IP conditions may for example be switched off or modified in respect of certain territories in the regulations.

236. To be exempt under the ETE a CFC must have a territory of residence. New section 371KC explains that the rules in Chapter 20 dealing with residency more generally should apply with one exception. This is where it has not been possible to establish a territory of residence under the general rules in Chapter 20 and instead the CFC is treated as resident either in the country in which it is incorporated or, if the CFC is UK incorporated but treated as not resident in the UK under double taxation arrangements, it is treated as resident in the territory of the other party to the relevant arrangements. In these circumstances the CFC will only be eligible

for exemption under the ETE if, at all times during the accounting period, the CFC or persons with interests in the CFC are liable to tax under the law of the territory in question on the CFC's income. One outcome is that a US LLC may be eligible for the ETE provided it can be demonstrated that the LLC itself or the interest holders in the LLC are liable to tax on the income of the LLC in the US.

237. New section 371KE provides the basic rules covering Category A income. This category is concerned with income which is either exempt from tax in the territory or subject to a reduced tax rate in specified circumstances which include a tax holiday or other investment incentive and tax repayment schemes.

238. New section 371KF applies where a CFC has a permanent establishment (PE) in an excluded territory. The effect is to apply the same Category A income conditions to the income from the PE as apply to the income from the CFC's territory

239. New section 371KG covers the basic rule for Category B income. This category is concerned with a CFC's non-trading income which benefits from a notional deduction for interest expense in the CFC's territory so that the income is effectively subject to a reduced tax rate, and where that deduction would not be available for such amounts under the corporation tax assumptions in Chapter 19 which apply Part 5 of CTA 2009.

240. New section 371KH sets out the scope of Category C income. This category includes income from a settlement in relation to which the CFC is a settlor or beneficiary and the CFC's share of any partnership income where the CFC is a partner.

241. New section 371KI provides for Category D income. This category applies in circumstances in which a CFC has related party transactions which result, following the application of transfer pricing rules, in its income being reduced in the CFC's territory and where there is no corresponding increase in any other territory so that the income is effectively subject to a reduced tax rate. This category also includes income which is taxed at a reduced rate by virtue of any ruling, other decision or arrangement by the territory's governmental authorities.

242. New section 371KJ sets the IP condition.

243. New section 371KJ(2)(a) to (d) provide that the IP condition is met unless:

- the CFC's assumed total profits for the accounting period include amounts arising from IP (the "exploited IP");

- all or parts of the exploited IP were transferred to the CFC by a UK related person at any time during the "relevant period" (defined in new subsection (5) as the accounting period in question and the preceding six accounting periods), or it was otherwise derived, directly or indirectly, out of or from IP held by a UK related person at any time during that period;

- as a result of the transfer there has been a significant reduction in the value of the IP held by the UK related person; and

- if only parts of the exploited IP were transferred or derived, the significance condition is met.

244. New subsection (3) provides that the significance condition is met if IP which has been transferred or otherwise derived from the UK forms a significant part of the CFC's total exploited IP, or if the transfer or other derivations of IP from the UK produces CFC profits which are significantly higher than they otherwise would have been.

245. New subsection (4) limits the meaning of references to the transfer or holding of IP by a person related to the CFC where that person is non-UK resident. In such a case the transfer or holding must be of IP which was previously held by that person wholly or partly for the purposes of a UK PE.

Chapter 12- The low profits exemption

246. New section 371LA introduces Chapter 12, which contains the low profits exemption. This chapter exempts a company with low profits from a CFC charge, subject to certain conditions. The exemption applies by reference to either the CFC's accounting profit or its assumed taxable total profits.

247. New section 371LB(1) sets out the basis for applying the low profits test for an accounting period of the CFC.

248. New subsections (2) and (3) provide for the exemption to apply if the CFC's accounting profits or assumed taxable total profits respectively for the accounting period are not more than £50,000. The meaning of accounting profits is given by new sections 371VC and 371VD, and of assumed taxable total profits by new section 371SB(1) to (6).

249. New subsection (4) provides for the exemption to apply if the CFC's accounting profits are not more than £500,000 for the

accounting period and the amount of those profits that represent non-trading income does not exceed £50,000.

250. New subsection (5) makes equivalent provision in terms of the CFC's assumed taxable total profits.

251. New subsection (6) provides for the specified amounts to be proportionately reduced for an accounting period of less than 12 months.

252. New section 371LC provides anti-avoidance rules for the low profit exemption.

253. New section 371LC(1) provides that the exemption does not apply if either of two conditions, A or B, is met.

254. New subsection (2) sets condition A, which applies where an arrangement entered into at any time has as its main purpose or one of its main purposes to secure the low profit exemption for either the relevant accounting period or one or more accounting periods of the CFC, where had it not been for these arrangements, no exemption would have been due.

255. New subsections (3) and (4) set condition B. Condition B applies if at any time during the accounting period, a CFC's business is, wholly or mainly, the provision of "UK intermediary services". A CFC provides UK intermediary services if it enters into a contract with a UK resident person ("the client") to provide the services of a UK resident individual (the "service provider"), which the service provider personally performs, or is under an obligation personally to perform for the client.

256. New subsections (5) and (6) provide that no exemption by reference to accounting profits is available if a third condition, condition C, is met. Condition C applies where in determining the CFC's assumed taxable total profits, Part 21B of CTA 2010 (group mismatch schemes) has effect so as to exclude an amount from being brought into account as a debit or credit for the purposes of Part 5 of CTA 2009 (loan relationships) or Part 7 of that Act (derivative contracts).

Chapter 13- The low profit margin exemption

257. New section 371MA introduces Chapter 13 which sets out "the low profit margin exemption".

258. New section 371MB(1) provides that the exemption applies for a CFC's accounting period if the accounting profits are no more than 10% of the CFC's relevant operating expenditure.

259. New subsection (2) provides for the accounting profit for the purpose of the exemption to be the profit before any deduction for interest.

260. New subsection (3) defines "relevant operating expenditure". This expenditure is the operating expenditure brought into account in determining its accounting profits. The cost of goods purchased is excluded unless they are actually used in the CFC's territory of residence. The cost of any expenditure which gives rise directly or indirectly to income of a connected person is also excluded.

261. New section 371MC provides an anti-avoidance rule to prevent the exemption from applying where an arrangement is entered into which has a main purpose of securing that the exemption applies.

Chapter 14- The tax exemption

262. Chapter 14, introduced by new section 371NA, provides "the tax exemption", an exemption which applies to the CFC as a whole. This exemption applies to a CFC that pays an amount of local tax on its chargeable profits of at least 75% of the corresponding UK tax, provided certain conditions are met.

263. New section 371NB(1) sets out the three steps required to determine if the tax exemption applies for a CFC's accounting period.

- Step 1 requires the CFC's territory of residence for the accounting period to be determined in accordance with the rules at new section 371TB. If the CFC has no territory of residence under these rules, the tax exemption cannot apply.

- Step 2 requires a calculation of the tax paid (the "local tax amount") by the CFC for the accounting period in its territory of residence as established in Step 1. The local tax amount is the tax paid in the CFC's territory for that accounting period in respect of the CFC's local chargeable profits, subject to any necessary reduction determined in accordance with new section 371NC. If however the local tax amount is calculated under designer rate tax provisions defined in new section 371ND then the tax exemption cannot apply.

- Step 3 requires the calculation of the amount of corresponding UK tax for the accounting period based on the provisions contained in new section 371NE. The tax exemption applies if the local tax amount is at least 75% of the amount of the corresponding UK tax.

264. New subsections (2) and (3) provide that where an amount of tax is paid which includes amounts other than the local tax amount, for example where a group of companies pays its tax and files accounts on a consolidated group basis, then an amount is allocated to the local chargeable profits in question on a just and reasonable basis.

265. New subsection (4) defines a CFC's local chargeable profits as the profits calculated on the basis of the tax law of the CFC's territory of residence ignoring any capital gains or losses.

266. New section 371NC(1) explains that the section sets out the reductions that may be necessary in computing the local tax amount for step 2 in section 371NB.

267. New subsections (2) to (4) provide for the local tax amount to be reduced in two circumstances.

- The first is where the CFC has net income that is taken into account when determining the CFC's local chargeable profits, but that would not be taken into account in determining the comparative assumed taxable total profits (essentially under UK tax rules).

- The second circumstance is where the CFC has net expenditure which is not brought into account in determining the CFC's local chargeable profits, but would be brought into account in determining the assumed taxable total profits.

268. In these circumstances, the local tax amount is reduced by the amount referable either to the additional net income or the reduced expenditure. The effect is to put the local and UK measures of tax on a more comparable basis for the purposes of Step 3.

269. New subsection (5) sets out three conditions, all of which must be met if the local tax amount is to be reduced by virtue of new subsection (6). The conditions are that:

- the CFC has paid local tax on its local chargeable profits for the accounting period;

- a repayment of tax, or a payment in respect of a credit for tax, is made to a person other than the CFC under the law of the CFC's territory; and

- the repayment or payment is directly or indirectly in respect of the whole or part of that local tax.

270. If subsection (6) applies, then the local tax amount is reduced (or further reduced after any reduction under subsection (2)) by the amount of the repayment or payment referred to in subsection (5).

271. New section 371ND covers the "designer rate tax provisions".

272. New section 371ND(1) applies for the purposes of step 2 in section 371NB(1). It defines "designer rate tax provisions" as provisions which appear to be designed to enable companies to exercise significant control over the amount of tax which they pay and which are specified as such in Regulations made by the HMRC Commissioners.

273. New subsection (2) explains that the Regulations may make different provision for different cases or with respect to different territories.

274. New section 371NE(1) sets out how "the corresponding UK tax" is to be determined for the purposes of step 3 of section 371NB(1). It is the amount of corporation tax which would be charged in respect of the CFC's assumed taxable total profits for the accounting period. The CFC's assumed taxable total profits are calculated in accordance with new section 371SB taking into account the corporation tax assumptions provided for by new sections 371SD to 371SR.

275. New subsection (2) explains that for the purposes of calculating the amount of corporation tax referred to in the previous sub-section:

- any double taxation relief in respect of the local tax paid by the CFC in its territory of residence when calculating the corresponding UK tax is to be ignored; and
- there must be deducted from what would otherwise be the amount of corporation tax:
  - any amount which, after applying the corporation tax assumptions, would be set off by virtue of section 967 of CTA 2010 (cases in which a company receives a payment bearing income tax); and
  - any amount of income tax or corporation tax actually charged in respect of any income included in the CFC's assumed taxable total profits.

276. New subsection (3) provides that in the section (2)(b) the references to an amount set off or charged do not include any such amount (or so much of any such amount) as has been or will be repaid to the CFC.

Chapter 15 – Relevant Interests in a CFC

277. New section 371OA introduces Chapter 15 which applies for the purposes of determining the persons who have "a relevant interest" in a CFC at step 1 in subsection 371BC(1). The purpose of the relevant interest rules is to work out which UK persons have an interest in a CFC and how much that interest is. The chargeable profits of a CFC are apportioned between the relevant interest holders provided they are UK resident companies and hold a certain proportion of the total interest in that CFC. Not all persons with an interest in a CFC have a relevant interest. For example, if two UK companies have an interest in a controlled foreign company because one holds the shares directly and the other holds the shares in that UK company only the first UK company will hold the relevant interest.

278. New section 371OB contains provisions for the purposes of interpreting the Chapter.

279. New subsection (2) defines the term "indirect" and "direct" for the purposes of determining interests in a company. An indirect interest in a company exists where a person has an interest by virtue of having an interest in another company. It follows that a person who has an interest in the first company other than through another company has a direct interest in that first company.

280. New subsections (3) and (4) cover situations where an interest in the CFC is held by an Authorised Investment Fund ("AIF"). This is covered under two separate subsections because an AIF may take the form of a company or a trust. Both subsections have the effect of ensuring that for the purposes of determining the relevant interests the persons with an interest in the CFC are the share or unit holders in the AIF. The effect is to look through the AIF so that the AIF itself can not be regarded as holding a relevant interest while ensuring that the underlying investors will.

281. New subsection (5) applies in a similar manner to the rules on AIFs so that where a bare trustee or nominee holds an interest for a person or persons, that person or persons (rather than the trustee or nominee) are treated as holding the interest.

282. New subsection (6) defines the term "bare trustee".

283. New subsections (7) and (8) apply in a case not covered by subsection (5) where an interest is held in a fiduciary or representative capacity and there are one or more identifiable beneficiaries. In these circumstances the interest is treated as held by that beneficiary or, if there is more than one beneficiary, the interest is apportioned between them on a just and reasonable basis.

284. New section 371OC determines when a UK company's interest will not be taken to be a relevant interest in a CFC. This will be where an indirect interest in that CFC is held by a UK resident company by virtue of it holding an interest in another UK resident company. This ensures that the relevant interest is held by the UK resident company that is at the bottom of a chain of two or more UK resident companies.

285. New section 371OD applies to prevent the interest of a person related to a UK resident company being a relevant interest to the extent that such an interest may be attributed to a UK resident company. The section operates by determining at new subsection (2) that a "related person's" interest will be a relevant interest unless it is excluded by virtue of new subsection (4) or new subsection (5). The section therefore has the effect of prioritising the interest held by the UK resident.

286. New subsection (1) provides that this section applies if a UK resident company ("UKRC") has a relevant interest in a CFC. Determining the relevant interest of any non UK resident company is relevant where a UK resident company has a relevant interest in the CFC because the proportion of the relevant interest held by persons connected or associated with the UK resident company will be a factor in deciding whether the UK resident company with the relevant interest is a "chargeable company" as defined at section 371BD(1).

287. New subsection (3) defines related person as a person, other than a UK resident company, who is connected or associated with UKRC.

288. An example of how the rule at subsection (4) will operate is that if company A, an overseas company, holds a 100% direct (or indirect) interest in a company B, a UK resident company, and in turn B has a 100% interest in company C, a CFC, then both A and B will have an interest that would without this subsection be a relevant interest. However, subsection (4) operates to prevent A's interest being treated as a relevant interest because it is held only by virtue of B's interest, which is the relevant interest.

289. The operation of the rule at subsection (5) can be illustrated by considering a reversal of the scenario described above. So in this instance B (the UK resident company) holds an interest in A (the overseas company) who has an interest in C (the CFC), with all interests being 100%. In this scenario subsection (5) will operate to ensure that the interest of A is not a relevant interest and the interest of B will be the only relevant interest in the chain.

290. New section 371OE addresses interests held by any person other than a UK resident company. This is set out within new subsection

(1) which states the section only applies in a case where a person ("P") has a direct interest in a CFC which is not a relevant interest by virtue of sections 371OC or 371OD.

291. New subsection (2) provides that P's direct interest is a relevant interest for the purposes of this section unless new subsection (3) applies to it. That subsection applies to P's direct interest so far as it is the same as another person's relevant interest in the CFC which they have indirectly because they have an interest in P.

292. New subsection (4) defines the reference in subsection (3) to "another person's relevant interest" as being a person's relevant interest by virtue of sections 371OC or 371OD. This has the effect that P's interest under this section will only be a relevant interest if it is a direct interest in the CFC that is not otherwise a relevant interest of a person related to a UK resident company or UK resident company by virtue of their own indirect interest.

Chapter 16 - Creditable tax of a CFC

293. New section 371PA defines "creditable tax" for the purposes of step 2 in section 371BC(1). The amount of creditable tax calculated under this section is then apportioned among the relevant persons (in accordance with Chapter 17) for the purposes of step 3 of section 371BC(1).

294. New section 371PA(1) provides that the amount of a CFC's creditable tax for an accounting period is the total of amounts defined in new subsections (1)(a) to (d). This is the total of the following amounts:

- the amount of any relief from corporation tax attributable to any foreign tax which, applying the corporation tax assumptions (in accordance with Chapter 19), would be given to the CFC by virtue of the double taxation provisions at Part 2 of TIOPA 2010 in respect of any income included or represented in the CFC's chargeable profits for the accounting period;
- any amount of relevant income tax which, applying the corporation tax assumptions, would be set off against corporation tax on the CFC's chargeable profits for the accounting period by virtue of section 967 of CTA 2010 (cases in which a company receives a payment bearing income tax);
- any amount of income tax or corporation tax actually charged in respect of any income included or represented in the CFC's chargeable profits for the accounting period; and

- any amount of a foreign CFC charge paid in respect of any income included or represented in the CFC's chargeable profits for the accounting period.

295. New subsection (2) defines "foreign tax" as the local tax amount (which is determined by Chapter 14 – the tax exemption at step 2), and any tax under the law of a relevant foreign territory. "Relevant foreign territory" is defined at new subsection (6) as a territory outside the United Kingdom other than the territory in which the CFC is resident for the accounting period. The local tax amount is broadly the amount of tax paid under the law of the territory in which the CFC is resident in the accounting period.

296. New subsection (3) defines "relevant income tax" as income tax which the CFC bears by deduction on a payment to the extent that the payment is included or represented in the CFC's chargeable profits.

297. New subsection (4) defines "foreign CFC charge" as a charge under the law of a relevant foreign territory (whatever name it is known by) that is similar to the CFC charge. This prevents any economic double taxation.

298. New subsection (5) restricts amounts added to the total amount of creditable tax by subsections (1)(b) to (d) by saying that these amounts should not include so much of any such amount that has been or falls to be repaid to the CFC or any other person whether on the making of a claim or otherwise.

Chapter 17- Apportionment of a CFC's chargeable profits and creditable tax

299. New section 371QA introduces Chapter 17, which contains the rules for apportioning the CFC's chargeable profits and creditable tax, for an accounting period, among the relevant persons for the purposes of step 3 in section 371BC(1).

300. New section 371QB contains provision about interpretation for the purposes of Chapter 17.

301. New subsection (2) applies the interpretation provisions contained in section 371OB to Chapter 17 in the same way as they apply to Chapter 15. These provisions largely deal with the meaning of direct and indirect interests in a company. They specify by whom an interest is treated as held when it is held in a trust.

302. New subsections (3) and (4) define "ordinary shares". This is required for applying the basic apportionment rule set out in new sections 371QC and 371QD. It means for any company, shares of a single class (however described) which is the only class of share issued by the company. The term "share" can also refer to a fraction of a share. Shares issued by a company belong to different classes if they are paid up to different amounts.

303. New subsection (5) describes when a person 'indirectly' holds ordinary shares in a CFC. This occurs when the person directly holds shares in a company "share-linked" to the CFC. The expression "share-linked" is defined in new subsection (6); it essentially means the holding of ordinary shares in the CFC via a chain of companies. The companies in the chain are the "intermediate interest" holders, defined in new section 371QC(6).

304. New sections 371QC to 371QF set out the basic rules for how an apportionment of chargeable profits should be calculated. If certain conditions are met then a formulaic approach is adopted which requires the multiplying together of indirect interests in the CFC through the chain of companies to arrive at the apportionment percentage. If there is more than one chain leading to the same CFC then the relevant interests through each chain are aggregated. If the conditions for the formulaic approach are not met then a just and reasonable approach is to be applied.

305. There are 3 conditions set out in new sections 371QC(3) to (5) that must be met for the formulaic approach in new section 371QD to apply:

- Condition X is satisfied if the relevant persons have relevant interests in the CFC only by direct or indirect holding of ordinary shares in that CFC;
- Condition Y is satisfied if each of the relevant persons has been either only UK resident, or only non-UK resident, throughout the accounting period; and
- Condition Z is satisfied provided a company with an intermediate interest in the CFC only has that interest from holding, directly or indirectly, ordinary shares in the CFC.

306. Where the conditions are met section 371QD applies to apportion chargeable profits and creditable tax to the relevant persons in proportion to their ordinary shareholdings in the CFC.

307. New section 371QD(4) explains that new section 371QE "Indirect shareholdings" and new section 371QF "Variable shareholdings" supplement the application of section 371QD.

308. New section 371QE explains how to calculate the percentage of a CFC's issued shares that a relevant interest holding's indirect interest represents. The calculation is illustrated in the following examples, in which the terms 'P' and 'S' take the meanings given in new section 371QE(2).

Example 1 – indirect shareholdings single chain

Relevant person A owns 80% of the shares in overseas company B, which in turn holds 90% of the shares in overseas company C, which in turn holds 90% of the issued ordinary shares in the CFC.

The fractional interest A has in B is 0.80 and the fractional interest B has in C is 0.90. As C directly holds shares in the CFC its fractional interest is not counted. P is the product of the two fractions: 0.80 x 0.90 = 0.72.

S is 90%, which is the percentage of the issued ordinary shares that A holds indirectly – it is the proportion of the issued shares held by C.

A's relevant interest therefore represents the percentage of the CFC's issued share capital given by multiplying P and S. Hence the percentage is 0.72 x 90%, which is 64.8%.

309. New section 371QE(4) provides the process for determining the relevant interest where the relevant person holds more than one indirect holding of ordinary shares in the CFC. In that case the formula 'P x S' in new subsection (2) is applied to each holding and then the results of each calculation are aggregated.

Example 2 – indirect shareholdings multiple chains

Relevant person A has a relevant interest of 64.8% through one indirect holding in the CFC. A also owns 75% of the shares in overseas company D, which in turn holds the remaining 10% of the issued ordinary shares in the CFC.

The fractional interest A has in D is 0.75 and D holds 10% of the shares in the CFC. As D directly holds shares in the CFC its fractional interest is not counted. P is therefore 0.75 and S is 10%.. The formula 'P x S' in subsection (2) gives the percentage 0.75 x 10% = 7.5%.

A's relevant interest therefore represents the percentage of the CFC's issued share capital give by the sum of the two percentages 64.8% and 7.5%, which is 72.3%.

310. New section 371QF applies to determine the percentage of issued ordinary shares that the relevant person's relevant interest represents, where that percentage holding varies during the accounting period. The relevant interest is to be the sum of the relevant percentages for each holding period. So if during the accounting period the amount of a relevant person's relevant interest changes three times, then the overall relevant interest for the accounting period is found by adding together the relevant percentage calculated for each of the three periods.

311. The relevant percentage for a holding period is given by multiplying the percentage holding in that period by the length of the holding period and dividing by the length of the accounting period.

Example 3 – variable shareholdings

Company A holds 60% of the CFC's issued ordinary shares as a relevant interest during the first 100 days of the accounting period and 80% during the remaining 265 days of the accounting period.

The percentage of the CFC's issued share capital that A's relevant interest represents in the accounting period is the sum of the relevant percentages for the two holding periods:

Holding period 1: relevant percentage is 60% x 100/365 = 16.4%.

Holding period 2: relevant percentage is 80% x 265/365 = 58.1%.

The percentage of the CFC's issued share capital that A's relevant interest represents in the accounting period is 16.4% plus 58.1%, which is 74.5%.

Chapter 18 – Control etc

312. Chapter 18 defines "control" for the purposes of Part 9A. A CFC is defined (in section 371AA(3)) as a non-UK resident company which is controlled by a UK resident person or persons. A company can be controlled either by reference to legal or economic control or by reference to accounting standards.

313. New section 371RA provides an overview of the Chapter by outlining the main "control" tests and the different approach that is taken depending on which control test is being considered. New section 371RB and new section 371RE determine if a company is "controlled" by another person or persons whilst new section 371RD and new section 371RG set out circumstances whereby a

non-UK resident company will be taken to be a CFC when it would not otherwise be the case.

314. New section 371RB outlines how to determine if a company is controlled by a person through legal and economic "control".

315. New subsection (1) introduces the "legal" test where a person controls a company if they have the power to secure that, directly or indirectly, the affairs of the company are conducted in accordance with their wishes through the possession of voting powers or powers conferred through articles of association or other documents that regulate the company.

316. New subsection (2) introduces the "economic" test where a person controls a company if it is reasonable to suppose that the person would receive (whether directly or indirectly) the majority of one or more of the following:

- the disposal proceeds in the event of a disposal of the whole of the company's share capital,
- the income on a distribution if the whole of the company's income was distributed, or
- the company's assets on a winding up or other circumstances,

whether at the time of the disposal, distribution or winding up, or at any later time.

317. The term "indirectly" means that one or more UK persons can control a CFC where one or more overseas companies or entities are interposed between the CFC and those persons.

318. However for the purposes of subsection (2), new subsection (3) provides that any rights which a person has as a "relevant bank" should be ignored.

319. New subsection (4) explains that share capital held by a "relevant bank" and rights to distributions or assets on a winding up held by a "relevant bank" are not included in the whole of the company's share capital, distributable income and assets on a winding up when determining the amount that it is reasonable to suppose a person would receive under subsection (2). So if a bank owns 2 of the 100 ordinary issued shares in a CFC, those 2 shares are ignored in testing for control under subsection (2)(a). The test of whether a person would receive a majority of the proceeds of a disposal of the whole of the shares would be by reference to 98 shares rather than 100 and so a person owning 50 shares would receive a majority of the proceeds if those 98 shares were sold.

320. New subsection (5) defines a "relevant bank" as a bank carrying on a banking business (as defined at new section 371VA) which is regulated in the CFC's territory of residence. Subsection (5)(b) however limits the exclusion for banks to cases where the bank is lending money to the CFC in the ordinary course of its business.

321. New subsection (6) makes it clear that references to a person receiving any proceeds, amounts or assets in subsections (2) and (4) include references to the proceeds, amounts or assets being applied directly or indirectly for their benefit.

322. New subsection (7) states that if two or more persons taken together meet the conditions of the tests at subsections (1) or (2) they will be taken to control the company. Those persons do not have to be connected. So if unconnected companies A and B both own 30% of the voting shares of a CFC, then taken together they control the CFC.

323. New section 371RC introduces an alternative legal and economic control test ("the 40% test") of whether a company is a CFC. The test applies when two persons control a company and one of them is not resident in the UK. If a UK resident person has interests, rights and powers that represent at least 40% of the holdings, rights and powers that give control of a company and a non-UK resident holds at least 40% but not more than 55% of the holdings, rights and powers, the company will be taken to be a CFC. This test will apply mainly to joint venture companies.

324. New section 371RD attributes various rights and powers to a person in order to determine whether a person or two or more persons control a company for the purposes of legal and economic control (including the 40% test).

325. New subsections (2) and (3) provide that there should be attributed to each person ("P") all the following rights and powers to the extent that they would not otherwise be attributed to that person:

- rights and powers which P is entitled to acquire at a future date or will become so entitled to acquire at a future date;
- rights and powers of other persons that fall within new subsection (4);
- if P is UK resident, the rights and powers of other UK residents who are connected to P; and
- rights and powers within new subsection (3)(d).

326. New subsection (3)(d) covers more complex circumstances where P is a UK resident person. It includes rights and powers which would, under subsection (2) be attributed to another UK resident person (identified as “Q”) who is connected to P on the assumption that “Q” were P. This covers situations where there are three persons (for example A, B and C) and A is connected to B and B is connected to C but A and C are not connected. In these circumstances any rights and powers of A are to be attributed to C and vice versa. This then extends to circumstances where there are more than 3 persons (say A to Z) and C is connected to D, D to E and so on forming a chain of connection. In these circumstances (and as long as the persons are UK resident) any rights and powers of any one person are to be attributed to each other.

327. New subsection (4) covers rights and powers so far as they are required or may be required to be exercised on behalf of P, under P’s direction or for P’s benefit. In the case of a loan made by one person to another, these are not limited to rights and powers conferred by the terms of any security relating to the loan.

328. New subsection (5) states that in subsections (3)(b) to (d) and subsection (4) references to rights and powers include rights and powers which the person is entitled to acquire at a future date or will, at a future date, become entitled to acquire.

329. New subsection (6) disapplies section 1122(4) of CTA 2010 (which is otherwise generally applied by new section 371VF(2)(b) for the purposes of Part 9A) when determining whether one person is connected with another for the purposes of section 371RD.

330. New subsection (7) provides that for the purposes of sections 371RB, and 371RC, rights and powers of a person or rights and powers which a person is or will become entitled to acquire includes references to rights and powers that are exercisable jointly with one or more persons.

331. New section 371RE introduces ‘the accounting test’ of control that is based on Financial Reporting Standard 2 (“FRS 2”) issued and updated by the Accounting Standards Board in the UK. For the purposes of Part 9A a person “P” controls a company at any time if P is the company’s “parent undertaking”. FRS 2 sets out the circumstances in which a parent undertaking must prepare consolidated financial statements, including the financial results of any “subsidiary undertaking”. It does not matter if P does not or is not required to prepare consolidated financial statements under FRS2; the section applies by testing whether there would be a parent/subsidiary relationship if P were to apply FRS 2. Both of the terms “parent undertaking” and subsidiary undertaking” take their meaning from FRS 2.

332. However new subsection (2) provides a limitation that a company will not be taken as a CFC at the time in question under the accounting test unless the "50% condition" is met at that time.

333. New subsection (3) sets out assumptions that should be made when determining whether the "50% condition" is met. These are:

- that the company is a CFC at that time;
- that that time is itself an accounting period of a CFC; and
- that section 371BC applies in relation to the assumed accounting period.

These assumptions establish an assumed CFC, an assumed accounting period and assume that the CFC's chargeable profits would be apportioned for that assumed accounting period for any single point in time for the purpose of establishing whether the 50% condition is met at that time.

334. New subsection (4) states that the 50% condition is met if at the time in question the percentage of the CFC's chargeable profits (as calculated using the assumptions in subsection (3)) which would be apportioned to P taken together with its UK resident subsidiary undertakings (if it has any) would be at least 50%.

335. New section 371RF(1) provides that the Treasury may by regulations amend section 371RE to take account of the following:

- any modification, amendment or revision of FRS2, or
- any relevant document.

336. New subsection (2) defines "relevant document" as either a document that replaces FRS2 or a document which replaces, modifies, amends or revises a document that replaces FRS2 or a document that performs the same function on the latter document.

337. New subsection (3) provides that the Treasury may also by regulations make provision that corresponds to the accounting test in section 371RE and uses other accounting standard dealing with consolidated financial statements that can be used instead of section 371RF to determine if a person "controls" a company where that person prepares or is required to prepare consolidated financial statements in accordance with that standard.

338. New section 371RG introduces an anti-avoidance rule that deems a company "C" to be a CFC if it is reasonable to suppose that C

would be a CFC if there wasn't an arrangement, the main purpose, or one of the main purposes, of which is to secure that C is not a CFC. "Arrangement" is defined at new section 371VA as including any agreement, scheme, transaction or understanding (whether or not legally enforceable) and a series of arrangements or a part of an arrangement.

339. If C is deemed to be a CFC under section 371RG, subsection (3) provides the additional deeming provisions to ensure that the rest of Part 9A can be applied. It provides that the person or persons who it is reasonable to suppose would control the company, apart from the arrangement, are taken to control the company and to have attributed to them all interests, rights and powers that it would be reasonable to suppose they would have held if the arrangement had not been put in place.

340. New subsection (5) prevents the anti-avoidance rule applying where all the following conditions are met. These are that an arrangement that would otherwise fall within subsection (4) does not fall within this subsection if;

- the arrangement is solely for a transfer of shares in a non-UK resident company ("X") from a UK resident company to another non-UK resident company ("Y"), so that X becomes controlled by Y either alone or with other non-UK resident companies, or the arrangement is solely for the incorporation or formation of a non-UK resident company ("X") which, on its incorporation or formation, is controlled by another non-UK resident company ("Y") either alone or with other non-UK resident companies;

- at the relevant time Y is not the 51% subsidiary of any other company and the "no CFC charge condition" is met; and

- it is reasonable to suppose that after the relevant time no economic benefit will accrue to any UK resident company directly or indirectly from X or that the total economic benefits which will accrue after the relevant time to UK resident companies (directly or indirectly) from X will be an insignificant proportion of the total economic benefits which will accrue to companies from X.

341. For the purposes of new subsection (5)(a) "controlled" is defined in accordance with section 371RB (with section 371RD).

342. New subsections (7) and (8) determine whether the no CFC charge condition is met at the time when X is transferred or incorporated/formed. In order to do this, Y is assumed to be a CFC, the date of transfer or incorporation/formation of X is deemed to an

accounting period of Y for the purposes of Part 9A and that section 371BC applies to that accounting period. These assumptions together create a deemed CFC and test whether a CFC charge arises. If at either steps 1 or 4 of section 371BC no CFC charge is charged, the no CFC charge condition is met.

343. New subsection (9) defines the relevant time as the time at which the shares in X are transferred to Y or X is incorporated or formed.

344. New subsection (10) provides that economic benefit specifically excludes any benefit that would accrue to a UK resident company from its normal course of business with X. For example if a UK resident company sells goods to the overseas company, the profit from that activity is not treated as economic benefit accruing to the UK resident company.

345. Economic benefit is not specifically defined. It is not limited to the benefit that accrues from the activities of X in just the accounting period when X is transferred or formed, but includes the benefit that could accrue from future activity undertaken by X or from the assets it holds. There is no requirement to calculate the amount of economic benefit; rather the test is whether it is reasonable to suppose that no economic benefit accrues to a UK resident company.

Chapter 19 - Assumed taxable total profits, assumed total profits and the corporation tax assumptions

346. Chapter 19 explains the meaning of a number of terms used in Part 9A: “the corporation tax assumptions”, which apply in calculating the “assumed taxable total profits” and “assumed total profits”.

347. New section 371SB(1) defines a CFC’s “assumed taxable total profits” for an accounting period as what would be the CFC’s taxable total profits of the accounting period for corporation tax purposes applying the corporation tax assumptions.

348. New subsection (2) states that “taxable total profits” has the meaning given by section 4(2) of CTA 2010 which is that they are the profits of a company of an accounting period on which corporation tax is chargeable.

349. For this purpose new subsections (3) to (6) determine that when establishing taxable total profits, chargeable gains should be ignored. However it is necessary to add in the accrued income of a settlement (apportioned on a just and reasonable basis if there is more than one settlor or beneficiary) where the CFC is a settlor or beneficiary of the settlement. If the CFC has received an actual

dividend or distribution from the settlement this is excluded to prevent double counting. New subsection (8) also prevents settlement income being added in to chargeable profits where it has already been charged on a CFC who is a beneficiary.

350. New subsection (9) defines a CFC's "assumed total profits" for an accounting period to be its assumed taxable total profits for the period before taking step 2 in section 4(2) of CTA 2010 i.e. before deducting any reliefs against total profits.

351. New section 371SD provides that for the purposes of Part 9A, the CFC is assumed to be resident in the UK from the beginning of the CFC's first accounting period until the company ceases to be a CFC. The assumption has the effect that the CFC is, has been and will continue to be within the charge to corporation tax, and that its accounting periods are accounting periods for corporation tax purposes. However new subsection (6) provides that this assumption only applies from the beginning of the first accounting period in which the CFC becomes subject to the rules in Part 9A.

352. New subsection (2) provides that new subsection (1) does not also require it to be assumed that there is any change in the location in which the CFC carries on its activities. This means that for the UK tax computation of profits the CFC will be treated as undertaking its trading or business activities outside the UK. The subsection also requires that it be assumed that the CFC does not get the benefit of section 1279 of CTA 2009 (which provides an exemption for profits from securities free of tax to residents abroad – i.e. FOTRA securities).

353. New subsection (3) provides that where the CFC is actually UK resident immediately before the beginning of its first accounting period the assumption of UK residence does not, as a consequence, mean that there is a continuous period of UK residence running from the preceding period. This is ensured by making the additional assumption that the CFC's UK residence from the beginning of the CFC's first accounting period is not continuous with its (actual) UK residence before the beginning of that accounting period.

354. New subsection (4) assumes that a determination of the CFC's assumed taxable total profits has been made for all previous accounting periods back to (and including) the CFC's first accounting period for the purposes of Part 9A. New subsection (5) explains that the assumption in subsection (4) is made in particular for the purposes of applying any relief which is relevant to two or more accounting periods.

355. New section 371SE applies so that the CFC is assumed not to be a close company.

356. New section 371SF(1) assumes that any beneficial claims or elections have been made that would, on the assumption of UK residence, have been available in relation to any relief under the Corporation Tax Acts to the maximum amount that would be available under that provision, and to have been made within any applicable time limit.

357. New section 371SF(2) restricts the application of subsection (1) so that it does not cover a claim or election under section 18A of CTA 2009 (exemption for profits or losses of foreign PEs), section 1275 of CTA 2009 (relief for unremittable income), section 9A of CTA 2010 (designated currency of a UK resident investment company), or regulations made under paragraph 16 of Schedule 8 to Finance Act 2006 (election for a lease to be treated as a long funding lease). An election under section 9A of CTA 2010 is however possible provided a notice is given to an officer of Revenue and Customs to that effect and the requirements with respect to the form of notice and time limits have been complied with (new section 371SH). New section 371SI modifies sections 6 and 7 of CTA 2010 in order that the designated currency election under section 9A can apply, for CFC purposes only, where the CFC does not prepare its accounts in accordance with generally accepted accounting practice.

358. New subsection (3) requires an assumption that a rollover in respect of a reinvestment relief claim for intangible fixed assets has not been made nor will be made by the CFC.

359. New section 371SG allows a chargeable company on provision of a notice to disapply part or all of the claims and election assumptions for an accounting period.

360. New section 371SG(1) applies so that if a notice is given to an officer of Revenue and Customs within given time limits and in the required form it can be assumed that the CFC:

- has not made for the accounting period a specified claim or election otherwise assumed automatically by the corporation tax assumptions at section 371SF(1),

- has instead have made for the accounting period a specified claim or election, being different from one assumed by the corporation tax assumptions at section 371SF(1) but being one which (subject to compliance with any applicable time limit) could have been made by a company within the charge to corporation tax, or

- has disclaimed or required the postponement, in whole or in part, of a specified allowance for the relevant accounting period if (subject to compliance with any applicable time limit) a company within the charge to corporation tax could have disclaimed the allowance or required such a postponement.

361. New subsections (2) and (3) require the CFC's assumed total profits and the amounts to be relieved against those profits at step 2 in section 4(2) of CTA 2010 and creditable tax to be adjusted by applying the assumption set out in the notice, and disapplying the assumption set out at section 371SF(1) to the extent necessary as a consequence.

362. New subsection (4) states that notice under section 371SG(1)(b) can include a claim to rollover relief in respect of intangible fixed assets or a claim in respect of relief for unremittable income under section 1275 of CTA 2009.

363. New subsections (5) to (7) provide a time limit for a notice under subsection (1) and that the notice may only be given by a company or companies that either alone or together would have more than 50% of the chargeable profits of the CFC apportioned to them were the CFC charge to be applied.

364. New section 371SH sets out the assumptions that are treated as being made where a notice is given by a CFC requesting that the CFC is assumed to have made an election under section 9A CTA2010 (designated currency of a UK resident investment company).

365. New section 371SI applies if, in accordance with section 371SH, a CFC is assumed to have made an election under section 9A of CTA 2010, but section 6 or 7 of CTA 2010 cannot apply because the CFC does not prepare its accounts in accordance with GAAP. The effect is to apply sections 6 and 7 to the CFC such that it is required to calculate its profits or losses in accordance with GAAP.

366. New section 371SJ assumes that a long funding lease election has been made (or withdrawn) by the CFC where a notice is given to an officer of Revenue and Customs in the correct form, within the required time limits and by the company or companies eligible to deliver such a notice as above. Where such a notice is made the assumed taxable total profits of the CFC are calculated taking into account regulation 2(5) of the Long Funding Lease (Elections) Regulations 2007 (S.I. 2007/304). New section 371SJ(8) reserves a Treasury power to amend this section in order to take account of any regulations made under paragraph 16 of Schedule 8 to FA 2006 (election for leases to be treated as long funding leases).

367. New section 371SK requires an assumption that any intangible fixed asset created or acquired by the CFC before the first accounting period in which it becomes subject to Part 9A should be

brought into account in the CFC's first accounting period at its value as recognised for accounting purposes at that time. For these purposes there is a requirement to assume that rollover relief has not been claimed nor will be claimed by the CFC in respect of the identified intangible fixed asset.

368. New section 371SL(1) assumes that the CFC is neither a member of a group of companies nor a member of a consortium for the purposes of any provision of the Tax Acts. The main effect of the assumption is to prevent the group loss relief provisions from applying.

369. New subsections (2) and (3) state that any relief potentially deductible is to be ignored in determining the CFC's assumed taxable total profits for the relevant accounting period where under Part 5 of CTA 2010 (group relief) the CFC actually surrenders losses to another UK company by way of group relief (for example from the CFC's loss-making UK permanent establishment), but in applying the corporation tax assumptions the losses would reduce the CFC's assumed taxable total profits for the relevant accounting period. These sections have the effect of restricting relief for losses in the CFC's taxable total profits computation where they have arisen to a UK permanent establishment of the CFC and have been actually group relieved in the UK thereby preventing the losses from being effectively relieved twice.

370. New section 371SM(1) applies if the CFC incurred any capital expenditure on the provision of plant or machinery for the purposes of its trade before the first accounting period in which it becomes subject to Part 9A.

371. New subsection (2) assumes that for the purposes of Part 2 of CAA 2001 (plant and machinery allowances) the plant or machinery was provided for purposes wholly other than those of the trade, and was not brought into use for the purposes of the trade until the beginning of the CFC's first accounting period, and that section 13 of CAA 2001 (use for qualifying activity of plant or machinery provided for other purposes) applies accordingly. This has the effect of bringing in a value equal to the market value of the plant and machinery employed in the trade at the beginning of the CFC's first accounting period.

372. New section 371SN prevents overseas income from being excluded from the assumed taxable total profits of a CFC on the basis that it is unremittable unless it is not possible to remit it either to the UK or to any of the territories overseas in which the CFC is resident. It follows that income arising in a territory of residence of the CFC can never be excluded from the taxable profits calculation even if it is not possible to remit it to the UK.

373. New section 371SO(1) ensures that where the application of the Corporation Tax Acts is dependent upon a purpose test which considers whether a purpose of an arrangement or other conduct is to obtain a tax advantage within the meaning given to it at section 1139(2)(a) to (d) of CTA 2010, the provisions also apply where the arrangement or other conduct has as one of its main purposes the avoidance or reduction of a CFC charge (section 1139(da) of CTA 2010).

374. New subsection (2) states that so far as they would not otherwise do so the Corporation Tax Acts are assumed to apply to the arrangement or other conduct in the same way as they would if the purpose of obtaining the tax advantage under section 1139(2)(da) were the same as obtaining an advantage within the meaning of an actual tax advantage under section 1139(2)(a) to (d). This links the reduction or prevention of a CFC charge to the definition of "tax advantage" arising to a UK company for the purposes of computing the CFC's assumed taxable total profits.

375. New section 371SP ensures that references to a tax advantage at section 1139(2)(da) include any tax advantage arising under section 486D(4) of CTA 2009 as a consequence of the CFC being party to an arrangement that falls within the disguised interest rules in Chapter 2A of Part 6 of CTA 2009.

376. New section 371SQ ensures that references to a tax advantage at section 1139(2)(da) include any tax advantage arising under section 521E(4) of CTA 2009 as a consequence of the CFC being party to an arrangement that falls within the shares accounted for as liabilities rules at section 521C of CTA 2009.

377. New section 371SR ensures that the double tax relief anti avoidance provisions within section 82 of TIOPA apply in computing the creditable tax of a CFC. These rules ordinarily require a notice to be issued by an officer of Revenue and Customs and so the rule applies by assuming that such a notice has been issued.

Chapter 20 - Residence of CFCs

378. New section 371TA sets out the rules for determining the tax residence of a CFC. The rules retain substantially the same effect as the repealed sections 749 and 749A of the ICTA. The rules apply for the purposes of Part 9A but make reference to additional rules relating to residence for the excluded territories exemption (ETE) and the tax exemption (TE).

379. New subsection (1) explains the approach which should be taken to determine the territory of tax residence of a CFC. The first requirement is to step through the general residence rules at new

section 371TB. These are discussed below. If it is not possible to determine a territory of residence under the general rule then new subsection (1)(b) applies, which is in two parts. Under new subsection(1)(b)(i), if a CFC is UK incorporated but under section 18 CTA 2009 it is treated as resident in another territory in accordance with the UK's tax treaty with that territory, then it is treated as resident in that other territory. Otherwise it is treated as resident in the territory in which it is incorporated or formed.

380. New subsection (3) refers to two rules elsewhere in Part 9A where the residence rule is adapted. The first is an additional rule for the ETE set out in section 371KC which requires the CFC, or persons with an interest in the CFC, to be liable to tax in the CFC's territory of residence in order for the rule in subsection (1)(b) to apply. A company is regarded as liable to tax in a particular territory if it is within the charge to tax there even though it may pay no tax because of, for example losses or double tax relief.

381. The second is an additional rule for the TE set out in step 1 of section 371NB(1), which provides that a CFC cannot benefit from TE unless a territory of residence can be determined under the general rule in new section 371TB.

382. New section 371TB provides the general rules to determine the territory in which a CFC is resident. The legislation refers to "territory" throughout rather than "country" so that it covers jurisdictions such as the Channel Islands and the Isle of Man which do not have full independent status. However in its application to federal states such as the U.S.A. and Switzerland "territory" signifies the country and not an individual state.

383. New subsection (1) states that the CFC is taken to be resident in the territory under the law of which it is liable to tax by reasons of its domicile, residence or place of management at all times during the accounting period.

384. This rule may result in a company being regarded as resident in more than one territory and so new subsection (2) states that where there could be two or more eligible territories of residence, the CFC can only be resident in one of those territories.

385. New subsection (3) provides that in determining which of the eligible territories should be the territory of residence the rules in new subsections (4) to (9) should be applied. Where more than one of those subsections may apply to determine the residence of the CFC, the earliest subsection takes precedence.

386. New subsection (4) provides that where an election or designation of residence has been made for an earlier accounting period in

respect of one of the eligible territories, that is the territory of residence.

387. New subsection (5) requires that where the CFC's place of effective management is carried on in one (and only one) of the eligible territories then that territory is the territory of residence.

388. New subsection (6) deals with the case where the CFC's place of effective management is carried on in two or more of the eligible territories. If this is the case, an eligible territory in which more than 50% of the CFC's assets are held (priced at their market value immediately before the end of the CFC's accounting period) is the territory of residence.

389. If a company is resident in more than one territory but the rule in subsection (6) doesn't apply because none of the eligible territories in which effective management is undertaken hold a majority of the CFC's assets, new subsection (7) provides that any other eligible territory in which more than 50% of the CFC's assets are held (priced at their market value immediately before the end of the CFC's accounting period) is the territory of residence.

390. New subsection (8) provides that, if an election is made by certain chargeable companies in accordance with new section 371TC(1) specifying an eligible territory then that territory is the territory of residence.

391. New subsection (9) provides that if an officer of Revenue and Customs designates a territory on a just and reasonable basis (see new section 371TC(5) to (7)) then that territory is the territory of residence.

392. Because earlier subsections take priority over later ones, an election or designation is likely to be made in circumstances where both effective management and all of the CFC's assets are located outside of the territories in which the CFC is liable to tax under the main rule at subsection (1).

393. New section 371TC provides for elections and designations about residence with new subsection (1)(a) to (f) setting out the form in which an election is to be made.

394. New subsections (2) and (3) explain which companies may make an election. These are the companies in the group individually or in combination entitled to more than half of the CFC's chargeable profits if it were to be subject to the CFC charge.

395. New subsections (5) and (6) state that a designation to an eligible territory made by an officer of Revenue and Customs is irrevocable.

Furthermore the officer making the designation, must give notice of the designation to each of the companies which would be likely to be a chargeable company, were the CFC charge to be charged in relation to the accounting period.

396. New subsection (7) specifies what information the notice must contain.

397. New subsection (8) sets out that the election or designation of residence will apply to the CFC's accounting period and each successive accounting period (even if the interest-holders in the CFC or the extent of their interest change) until such time as new subsection (9) is applicable to an accounting period.

398. New subsection (9) provides that the election or designation will not continue to be valid for an accounting period if one or more territories which were eligible territories in the accounting period covered by the original election or designation no longer fall within section 371TB(1), or some other territory also falls within section 371TB(1) in the later period.

Chapter 21 – Management

399. New section 371UA introduces Chapter 21. It includes the framework provisions for collection and management matters relevant to the CFC rules. It explains that the HMRC Commissioners are responsible for the management of the CFC charge, including the collection of sums charged. It also defines, for the purposes of Chapter 21 the terms "closure notice", "discovery assessment" and "the Taxes Act".

400. New section 371UB sets out how the Taxes Acts are to be applied to the CFC charge.

401. New subsections (1) and (2) provide that the CFC charge is to be treated as though it were an amount of corporation tax (as set out in step 5 section 371BC(1)), all enactments which apply generally to corporation tax also apply. This rule is subject to any provisions of the Taxes Act and any necessary modifications.

402. New subsection (3) provides an inclusive list of the enactments that are within subsection (1). They are the enactments relating to:

- returns, accounts statements and reports,
- assessment, collection and receipt of corporation tax,
- rights of appeal, and

- administration, penalties, interest on unpaid tax and priority of tax in insolvency cases.

403. New subsection (4) specifies how new subsection (1) applies for the purposes of two specific references to TMA 1970. It outlines that any references to 'corporation tax' and the 'profits of a company' within TMA 1970 shall include:

- for references to corporation tax - the sum charged at step 5 in section 371BC(1) (the main CFC charging provision), and

- for references to 'profits of a company' - the percentage of the CFC's chargeable profits charged at step 5 in section 371BC(1).

404. New subsection (5) ensures that the statutory provisions on claims and elections required to be made in a company's tax return (Paragraph 10 of Schedule 18 to FA 1998) and those that can be made outside a return (Schedule 1A, of the TMA 1970) shall not apply to an election under section 371TB(8) (election to determine the territory in which the CFC is resident).

405. New section 371UC sets out the procedures for when a just and reasonable apportionment is to be made in relation to the CFC's chargeable profits and creditable tax in preference to the basic rule in section 371QC(1).

406. New subsection (1) outlines the two conditions for the section to apply. There needs to be an apportionment of a CFC's chargeable profits and creditable tax (in accordance with section 371QC(2)), and a company tax return which is made or amended and which adopts a particular basis of apportionment.

407. New subsections (2) and (3) give an officer of Revenue and Customs the power to determine another basis for the apportionment other than that used by the company in section 371QC(2). They also set out the basis on which that determination can be questioned by appeal.

408. New subsection (4) makes clear that the only permissible grounds for questioning the basis of apportionment at subsection (2) is that the officer's determination is not just and reasonable.

409. New section 371UD deals with the manner in which reliefs that may be given against a CFC charge.

410. New subsections (1) and (2) provide for the new section to apply if the chargeable company makes a claim for relief in respect of a "relevant allowance". This claim may be made in relation to a CFC's accounting period where the chargeable company is entitled,

or on the making of a claim would be entitled (apart from the power provided by subsection (2)), to a deduction in respect of a relevant allowance for the relevant corporation tax accounting period.

411. New subsections (3) and (4) provide that the relief is to be given by setting off the "relevant sum" against the sum charged to the company under the main CFC charging provision (step 5 in section 371BC(1)). The "relevant sum" is defined as being the amount equal to the corporation tax at the appropriate rate on the amount of the relevant allowance claimed.

412. New subsections (5) and (6) provide that the "relevant allowance" specified in the claim is to be taken for the purposes of the Tax Acts as having been allowed as a deduction. It is also made clear that no other relief is available against the sum charged on a company at step 5 in section 371BC(1).

413. New subsection (7) provides definitions for the terms used within the section. Those defined are "the appropriate rate", "the relevant corporation tax accounting period" and "relevant allowance". The definition of relevant allowances provides an exhaustive list of the amounts which shall fall within it.

414. New section 371UE is applied by new subsection (1) where a "relevant appeal" involves any question about the application of Part 9A to a particular person and the resolution of that question is likely to affect the Part 9A liability of any other person in relation to the CFC concerned.

415. New subsection (2) defines "relevant appeal" to include only an appeal made under either paragraph 34(3) (amendment of a company tax return) or paragraph 48 (discovery assessment), both of Schedule 18 to FA 1998.

416. New subsections (3) to (6) set out how that relevant appeal is to be conducted. They make clear that any party whose liability is likely to be affected under Party 9A is entitled to be part to the proceedings. It is also provided that the tribunal must determine the Part 9A question separately to any other questions within the proceedings. In addition, the tribunal's determination on the Part 9A question shall have effect as if it had been made in an appeal to which each of the persons affected was a party.

417. New section 371UF(1) introduces the rules for the recovery of the CFC charge (step 5 in section 371BC(1)) on a company ("the defaulting company") where the amount is not fully paid on the date it is due and payable.

418. New subsection (2) provides that in relation to the amounts remaining due and payable, an officer of Revenue and Customs is permitted to give notice of liability to another UK resident company. The officer may give a notice of liability to that other UK resident company when it holds or has held (directly or indirectly) the whole or any part of the same interest in the CFC concerned as is or was held by the defaulting company.

419. New subsection (3) sets out the amounts for which the company receiving the subsection (2) notice ("the responsible company") is liable. The amounts include:

(a) the whole, or corresponding part, of the sum charged that is unpaid when the notice is given,

(b) the whole, or corresponding part, of any unpaid interest on the sum at the time the notice is given, and

(c) any interest accruing on the sum after the notice is given if it is referable to the sum payable by the responsible company under paragraph (a) above.

420. New subsections (4) and (5) apply if amounts payable by the responsible company under subsection (3) remain unpaid after 3 months of the notice being given. It permits for amounts not paid at this point to be recoverable from the defaulting company, without affecting the right of recovery from the responsible company.

Chapter 22 – Supplementary Provision

421. New section 371VA provides a variety of definitions used for the purposes of Part 9A, including "arrangement", "non-trading income" and "trading income".

422. New section 371VB provides the rules for identifying the commencement and cessation of an accounting period of a CFC.

423. New subsections (2) and (3) provide the basic rules. There are two circumstances resulting in the commencement of an accounting period. An accounting period will commence either when a CFC first becomes a CFC, or if it is already a CFC and continues to be a CFC, immediately after the end of the previous accounting period. There are four circumstances which terminate an accounting period. An accounting period will come to an end if:

- the CFC ceases to be a CFC;

- the CFC becomes or ceases to become liable to tax in a territory due to a change in its domicile, residence or place of management;
- the CFC ceases to have any source of income; or
- a company with a relevant interest (as defined in Chapter 15) no longer has that interest or ceases to be within the charge to corporation tax.

424. New subsection (4) applies certain sections of Chapter 2 of CTA 2009 which provide further rules on accounting periods, without affecting subsections (2) and (3).

425. New subsections (5) and (6) provide rules that allow an officer of Revenue and Customs to specify an accounting period by issuing a notice. If it appears to an officer of Revenue and Customs that there is uncertainty as to when an accounting period either commences or ceases then they may issue a notice to the CFC specifying the accounting period which they consider appropriate, which must not exceed 12 months.

426. New subsections (7) to (9) provide for a circumstance where after issuing a notice under subsection (6), further facts come to the knowledge of an officer of Revenue and Customs and it appears to an officer of Revenue and Customs that the accounting period specified in the notice is not the correct accounting period. An officer of Revenue and Customs must issue another notice amending the earlier notice to reflect the correct accounting period. This requires the officer of Revenue and Customs to amend the notice where it appears that the notice is incorrect. A notice or amended notice must be given to each company which the officer of Revenue and Customs considers likely to be liable to a CFC charge in the CFC's accounting period in question.

427. New section 371VC sets out what is meant by "accounting profits". It explains that the CFC's accounting profits for an accounting period are its pre-tax profits for the period. Where the accounting profits are prepared for the accounting period in accordance with generally accepted accounting practice then the CFC's pre-tax profits are to be determined based on the amounts disclosed in its financial statements, unless new subsections (4) and (5) apply.

428. New subsection (4) gives effect to new subsection (5) if the CFC's financial statements for the accounting period are not prepared in accordance with generally accepted accounting practice or the CFC's financial statements are not prepared within 12 months after the end of the CFC's accounting period.

429. If subsection (5) applies to a CFC that normally prepares financial statements according to acceptable accounting practice, its accounting profits must be based on amounts that would have been disclosed in financial statements if its usual practice had been adopted. In any other case the CFC's profits are to be based on international accounting standards.

430. New subsection (6) defines what is meant by "acceptable accounting practice" for section 371VC. It is any of the following:

- International accounting standards,
- UK generally accepted accounting practice, or
- Accounting practice which is generally accepted in the CFC's territory of residence for the accounting period.

431. New subsection (7) explains that references in section 371VC to amounts disclosed in financial statements include amounts comprised in amounts so disclosed. This covers a situation where an amount is disclosed in the financial statements of a CFC as part of a cumulative total or larger balance.

432. New subsection (8) explains the method for converting the CFC's accounting profit (or amounts included in them) into sterling where they are stated in another currency. They should be translated to sterling using the average rate of exchange for the accounting period calculated on daily spot rates.

433. New section 371VD explains the further adjustments required to determine a CFC's accounting profits identified in section 371VC. The computation can be summarised as follows.

CFC’s pre-tax profits for the accounting period per section 371VC	£X
Less:	
Any dividends or other forms of distributions that are not brought into account in determining a CFC’s assumed profit because they exempt under Part 9A of CTA 2009)	(£X)
Any property business profits	(£X)
Any cpaital profits or losses	(£X)
Add:	
Any income accruing to a trustee of a settlement where the CFC is a settler or beneficiary	£X
CFC's share of the partnership income of a partenrship in which the CFC is a partner - where those profits are adjusted on a just and reasonable basis	£X
Accounting profits	£X

434. In the computation above:

- where there is more than one settler or beneficiary of the settlement, the income accruing to the trustees is apportioned between the CFC and the other settlors and beneficiary on a just and reasonable basis,

- partnership for these purposes includes any entity established in a territory outside of the UK that has characteristics of a partnership and partner is to be read accordingly, and

- the pre-tax profits arsing under section 371VC should be adjusted to take account of the transfer pricing rules in Part 4 of TIOPA, unless after making the adjustment, the difference in the profits (which are referred to in the legislation as the assumed total profits) is greater than £50,000.

435. New section 371VE covers cell companies. New subsection (1) explains that Part 9A can apply to both unincorporated and incorporated cells as if they were non-UK resident companies.

436. New subsections (2) and (3) define “unincorporated cell” as an identifiable part of a relevant company (by whatever name known) that meets the conditions in subsection (3). The conditions may be met by reference to the law under which the relevant company is incorporated or formed, the articles of association or other document regulating the relevant company, or the terms of any arrangement entered into by or in relation to the relevant company. The conditions are that assets and liabilities of the relevant company may be wholly or mainly allocated to the unincorporated cell, such that the cell’s liabilities are met wholly or mainly out of its assets

and there are members of the company whose rights are wholly or mainly limited to the cell's assets.

437. New subsection (4) provides that subsection (1) does not affect the status of the non-UK resident company, which is treated as having an unincorporated cell under subsection (2), as a company for the purposes of Part 9A, however it requires the assets and liabilities of the company to be apportioned between it and all the unincorporated cells which are part of the company on a just and reasonable basis.

438. New subsection (5) defines an "incorporated cell". It is an entity that would not (apart from this section) be a company, that is established either under the articles of association or other document regulating a non-resident company. To be an incorporated cell it must have a legal personality distinct from that of the non-UK resident company under the law under which the company is incorporated or formed. This rule applies irrespective of the name given to the incorporated cell.

439. New subsection (6) confirms that subsection (1) does not affect the status of the non-UK resident company, which is treated as an incorporated cell under subsection (5).

440. New subsections (7) and (8) provide the power for the Treasury to make regulations which provide for Part 9A to apply to parts of companies falling within specific descriptions or to other non-corporate entities, as if they were non-UK resident companies.

441. New section 371VF sets out the rules for identifying connected persons for the purposes of Part 9A. This includes persons who are "associated" or "connected" to the CFC as those terms are defined in section 882(2) to (7) and 1122 of CTA 2010 respectively.

442. New section 371VF(3) provides that a person will related to a CFC if any of the three following circumstances exists:

- The person is connected or associated with the CFC (as defined above),
- If there were to be a CFC charge, at least 25% of the CFC's chargeable profits would be apportioned to the person, or
- If the CFC is a CFC by virtue of section 371RC, the person is connected or associated with either or both of the controllers.

443. New subsection (4) covers a situation where a CFC is a CFC because it falls within the anti avoidance rules in section 371RG. In such circumstances, a person will be treated as connected,

associated or related to the CFC, if it is reasonable to suppose that, apart from the arrangements falling within section 371RG(4), the person would be connected, associated or related to the CFC.

444. New section 371VG(1) defines non-trading finance profits for the purposes of Part 9A. It includes:

- any amounts included in the CFC's assumed total profits on the basis that they would be charged to tax under section 299 of CTA 2009 (charge to tax on non-trading profits from loan relationships);
- any amounts charged to tax under Part 9A of CTA 2009 (company distributions);
- amounts arising on relevant finance leases (as defined in section 371VA) which are not trading profits.

445. New subsection (2) provides that the amounts of non-trading finance profits determined under subsection (1) must take account of:

- the treatment of credits and debits relating to a CFC's property business provided by new subsection (3),
- the exclusion of profits to which Chapter 8 (solo consolidation) applies,
- the exclusion of the CFC's qualifying loan relationships if section 371CB(8) applies, and
- that non-trading finance profits should include the trading and non-trading finance profits of a treasury company that has issued a notice to that effect to Revenue and Customs under section 371CE(2)(b).

446. New subsection (3) provides that non trading finance profits should exclude any credits or debits included in determining the CFC's property business profits as defined at new section 371VI(2). These are profits of the CFC arising from debtor relationships that have been entered into for the purposes of the exempt property business rather than for the purposes of on-lending to any other person.

447. New subsections (4) and (5) define trading finance profits as any amounts which are trading profits by virtue of section 297, 573 or 931W of CTA 2009 and any trading profits arising on relevant finance leases, but that in the case of a group treasury company, this is subject to the treatment of trade profits asnon-trading finance profits if a notice under section 371CE(2) is issued.

448. New sections 371VH(1) to (2) provide the basic rules for identifying persons who have an "interest" in a company for Part 9A. New subsection (2) gives four circumstances that will mean a person has an "interest" in a company. In addition to persons having rights obtained by the holding of shares, these include any person who it is reasonable to suppose would receive or participate in distributions of the company, or would be able to secure that income or assets of the company would be applied for the person's benefit. It also includes a person who can control the company, either alone or with other persons.

449. New subsections (3) to (8) expand and provide meanings for some of the terms used in subsection (2).

450. New subsection (4) covers circumstances where a person's entitlement to secure that the income or assets of a company in subsection (2)(c) is contingent (under an any form of agreement) on a default by either the company or any other person. The person will not be treated as having an interest unless the default has already occurred.

451. New subsections (5) and (6) exclude rights that a person has as a loan creditor, which are not "interests" for these purposes. The meaning of loan creditor for these purposes is that given in section 453 of CTA 2010, except that the exclusion in subsection 453(4) of CTA 2010 for loans made in the ordinary course of a banking business is set aside. References to a person being entitled to do anything cover cases their present entitlement to do it at a future date or where they will in the future be entitled to do it.

452. New subsections (7) and (8) exclude from subsection (5) any rights arising from a loan relationship with an embedded derivative. An embedded derivative takes the meaning given to it at section 415(1)(b) of CTA 2009. Section 415 of CTA 2009 operates by reference to GAAP, so where the loan creditor does not prepare accounts under GAAP it is assumed to have done so for the purposes of determining whether a right from an embedded derivative exists.

453. New subsections (9) and (10) cover a situation where a CFC is a CFC because it falls within the control anti avoidance rule in section 371RG. In such circumstances, the rule in section 371RG(3) will determine the persons who have "interests" in the CFC and the nature of those interests.

454. New subsections (11) to(13) cover a circumstance where a person (or two or more persons together) have an interest in a company and that company has an interest in a second company. Each of those persons has an interest in the second company equivalent to a

proportion of the first company's interest, determined by reference to the extent of that person's interest in the first company. For example, where person A has a 50 percent interest in company 1 which has an 80 percent interest in company 2, these provisions treat person A as having an interest equal to 50 percent of company 2's interest. Hence A has a 40 percent interest in company 2.

455. New subsection (14) covers a situation where two or more persons jointly have an interest in a company other than in a fiduciary or representative capacity. It treats them as having interest in equal shares.

456. New section 371VI covers the meaning of "property business profits". By new subsection (1) these are the profits of a CFC, for the accounting period in question that are included in its assumed total profits on the basis that they would be chargeable profits under Part 4 of CTA 2009 (property income).

457. New subsections (2) to (5) provide for further adjustments to be made to the amount of property business profits to take account of credits and debits brought in under Part 5 of CTA 2009 as a consequence of the CFC being in a debtor relationship, where the loan is the subject to the debtor relationship or because the credits and debits relate to a derivative contract or other hedging arrangement entered into by the CFC as a hedge of risk in connection with the relevant property business and are attributable to hedging of risk.

458. New subsection (6) provides a definition of "relevant property business.

459. New section 371VJ provides a power for regulations made under Part 9A to contain incidental, supplemental consequential and transitional provision and savings.

PART 2

Foreign Permanent Establishments

460. Statutory references in the explanatory note for Part 2 of the Schedule are to CTA 2009 unless otherwise stated.

461. Part 2 of the Schedule makes amendments to Chapter 3A of Part 2 of CTA 2009 ("Chapter 3A"), which (if a company so elects) excludes profits or losses arising in foreign permanent establishments ("PEs") from the charge to corporation tax, subject to certain conditions including an anti-diversion rule.

462. Part 2 repeals the existing anti-diversion rule and replaces it with one that adapts the main CFC provisions in Part 1 of this Schedule so that they can be applied to PEs in respect of which an election for exemption from corporation tax has been made. Some other changes are also made to Chapter 3A.

463. Two separate approaches are taken in order to apply the main CFC rules to PEs.

464. With regard to the CFC charge gateway rules in Chapters 3 to 9 of Part 9A of TIOPA 2010, the relevant conditions are adjusted so that the rules are applied to any UK resident company which has a PE, and then, if any CFC chargeable profits arise, they determine whether any of those profits have arisen in the PE(s) (see paragraphs 476 to 490 below).

465. The entity level CFC exemptions in new Chapters 11 to 14 of Part 9A of TIOPA 2010 are applied however to the PEs as if each PE were a CFC, resident in the territory of the PE (see paragraphs 491 to 509 below).

466. Paragraph 3 removes the reference to "UK resident" from section 18A of Chapter 3A. This, together with the amendment in paragraph 5 below, allows a company which is at the time non-UK resident to make an election under that section in relation to a future accounting period when it will be UK resident.

467. Paragraph 4 inserts new sections 18CA and 18CB into Chapter 3A.

468. New section 18CA specifies that income from immovable property used for the business of the PE (having regard to the extent of that use) can be included in profits attributable to PEs for the purposes of section 18A.

469. New section 18CB excludes any profits or losses from any part of the company's business that consists of the making of investments from the computation of exempt amounts, unless the profits or losses are generated by assets which are "effectively connected" with a part of the PE that carries out a trade or overseas property business. "Effectively connected" takes the same meaning that it has in the OECD Model Tax Convention on Income and on Capital. This means that if a PE carries on only investment business, its profits or losses will not be exempt from corporation tax.

470. Paragraph 5 amends the term "relevant day" in section 18F, which refers to the day at which an election for section 18A takes effect. For a non-UK resident company, the relevant day is the day it becomes UK resident. For a UK resident company it is the date at which the next accounting period is expected to begin, or if the

election is made before the company's first accounting period it is the date the first period begins. Sub-paragraph 5(5) revokes elections made when UK companies cease to be UK resident and where non-UK companies, having become UK-resident, cease to be UK resident.

471. Paragraph 6 replaces the current anti-diversion rules in sections 18G to 18I with new sections 18G to 18HE. These new sections apply the new CFC rules in Part 9A of TIOPA to PEs. There is no modification of the Chapter 8 (Solo Consolidation) rules as these rules do not apply to PEs.

472. New section 18G determines how the main CFC gateway rules are to be applied to PEs. The effect of this section is to identify for each PE of a UK resident company whether the profits which would otherwise be exempt under the PE rules ('the relevant profits amount') include any "diverted profits".

473. New section 18G(1) provides that the anti-diversion rule will apply if a company has a PE in a territory outside the UK, the profits of the PE include any "diverted profits", and none of the CFC entity level exemptions apply. The company with the PE is referred to as "company X" and the accounting period of that company as "period X". The PE territory is referred to as "territory X".

474. New section 18G(2) requires that in such circumstances, the "diverted profits" are to be left out of the "adjusted relevant profits amount" for that PE. Such amounts would therefore not be exempt under Chapter 3A.

475. New section 18G(3) defines "adjusted relevant profits" as the relevant profits amount (the amount which would be subject to exemption under Chapter 3A) as adjusted for any chargeable gains or allowable losses. This brings the PE profits or losses into line with the general approach to CFC profits, which exclude gains or losses.

476. New section 18H defines "diverted profits" for the purposes of the anti-diversion rule in section 18G.

477. New section 18H(1) and (2) provides that "diverted profits" are the amount of company X's total profits that pass through the "diverted profits gateway", which is defined by reference to the CFC charge gateway set out in section 371BB of TIOPA, but disregarding Chapter 8 of Part 9A of TIOPA (Solo Consolidation). In applying Part 9A TIOPA, references to the CFC charge gateway are to be read as references to the diverted profits gateway.

478. New section 18H(3) applies the CFC charge gateway rules for the purposes of the diverted profits gateway as they would apply if company X was a CFC resident in territory X with period X as its accounting period and whose assumed total profits equal the total profits of company X.

479. New section 18H(5) provides that the application of section 371BB of TIOPA is subject to the adjustments in new sections 18HA to 18HE, which amend the application of particular CFC rules.

480. New section 18H(6) provides that in applying section 371BB of TIOPA to PEs, subsection (2)(b) is to be omitted. This subsection refers to adjustments to profits in relation to the exempt period exemption in new Chapter 10, which does not apply to PEs.

481. New section 18HA modifies the application of Chapter 3 of TIOPA (which determines whether new Chapters 4 to 8 apply) in respect of PEs. It does this by omitting various references within the Chapter, so that they are not applied to PEs.

482. New section 18HA(a) removes references to the UK activities of the CFC or any UK PE of the CFC for the purposes of Chapter 4.

483. New section 18HA(b) and (f) remove references to Chapter 8, which does not apply to PEs.

484. New section 18HA(c) and (d) remove references to the incidental finance income rules for holding companies.

485. New section 18HA(e) removes references to the group treasury finance income rules.

486. New section 18HB prescribes modification of the UK activities rules (Chapter 4 of Part 9A of TIOPA) as follows.

487. New section 18HB(2) removes a reference to UK SPFs carried on by the CFC other than through a PE in section 371DA of Part 9A of TIOPA; and inserts a reference to banking activity regulated in the UK in section 371DH of Part 9A of TIOPA.

488. New subsection (3) amends the definition of related person in section 371VF of Part 9A of TIOPA by limiting it to persons connected or associated with the CFC.

489. New section 18HC modifies the non-trading finance profit rules (Chapter 5 of Part 9A of TIOPA). The effect of this amendment is that, for PE purposes, all non-trade finance profits of a PE fall within Chapter 5 unless they are excluded by sections 371CB to 371CD TIOPA, which exclude certain non-trading finance profits that are incidental to a trade or overseas property business of the PE.

490. New section 18HD modifies the captive insurance rules (Chapter 7 of Part 9A of TIOPA). The captive insurance provisions apply, but the references in section 371GA(5)(b) of Part 9A of TIOPA to amounts arising from the activities of a PE in a non EEA state are disregarded.

491. New section 18HE prescribes modifications to the exemption rules for profits from qualifying loan relationships (Chapter 9 of Part 9A of TIOPA) as follows:

- The exemptions for qualifying loan relationships are amended so that references to chargeable companies and company C claims are read as references to company X;
- Sections 371IB and 371IC, which deal with loans from qualifying resources, are to be disregarded for the purposes of PEs;
- Section 371IE, which deals with matched interest, is also to be disregarded; and
- In section 371IJ , which deals with claims within new Chapter 9, references to a chargeable company and the relevant corporation tax period are to be read as references to company X and period X accordingly.

492. New section 18I prescribes modifications to the exemptions from the CFC charge for the purposes of defining exemptions from the PE anti-diversion rule for the purposes of section 18I(1)(c). The exempt period exemption in Chapter 10 of Part 9A of TIOPA does not apply to PEs, so that Chapter does not need to be modified but modifications are made that apply for the other exemptions in Chapters 11 to 14 of Part 9A of TIOPA.

493. New section 18I(2)(a) requires references in those Chapters to the application of the exemptions within section 371BA of Part 9A of TIOPA are to be read as references to their application for the purposes of section 18G(1)(c).

494. New subsection (2)(c) restricts the definition of related person in section 371VF(3) of Part 9A of TIOPA by limiting it to persons connected or associated with the CFC.

495. New subsection (3) applies a number of assumptions which are required in order to apply Chapters 11 to 14 of Part 9A of TIOPA to PEs. The overall effect of these assumptions is to deem that the PE under consideration is a CFC resident in the same territory, and whose accounting periods match those of the UK resident company of which it is a PE. The connected or associated persons of, and the

persons with an interest in, the UK resident company are deemed to have the same connections with and interests in the deemed CFC. The assumed total profits of this deemed CFC are taken to be the adjusted relevant profits of the PE. These assumptions enable the PE to be considered as if it was a CFC and for the entity level exemptions in Chapters 11 to 14 of Part 9A of TIOPA to be applied accordingly.

496. New subsection (4) further modifies the application of Chapters 11 to 14 of Part 9A of TIOPA by reference to new sections 18IA to 18ID, which make modifications for specific chapters.

497. New section 18IA prescribes modifications to Chapter 11 of Part 9A of TIOPA (the excluded territories exemption).

498. New section 18IA(2) disregards the category C income condition within Chapter 11 of Part 9A of TIOPA.

499. New subsection (3) disregards section 371KC of Part 9A of TIOPA and applies the residence assumption in section 18HG in its place.

500. New subsection (4) omits section 371KD(3) and references to accounting profits are to be read as references to the adjusted relevant profits amount.

501. New subsections (5) and (6) remove references to PEs and category D income.

502. New subsection (7) requires references to the CFC to be read as references to company X for equity and debt purposes.

503. New subsection (8) provides that section 371KI(2) and (3) of Part 9A of TIOPA which deal with a reduction of income arising from a transfer pricing adjustment are not to apply.

504. New subsection (9) requires references to the CFC to be read as references to company X in applying the IP condition in section 371KJ.

505. New section 18IB prescribes modifications to Chapter 12 of Part 9A of TIOPA (the low profits exemption). Chapter 12 is amended for PE purposes by omitting references to accounting profits in section 371LB and references to group mismatch rules in section 371LC.

506. New section 18IC prescribes modifications to Chapter 13 of Part 9A of TIOPA (the low profit margin exemption). Chapter 13 is amended for PE purposes by omitting section 371MB(2), which refers to accounting profits, and by requiring that references to accounting profits are read as references to the adjusted relevant profits amount before interest deductions.

507. New section 18ID prescribes modifications to Chapter 14 of Part 9A of TIOPA (the tax exemption). Chapter 14 is amended for PE purposes by deeming that the residence assumption in section 18HG(3) applies for the purposes of Step 1 of section 371NB(1).

508. New section 18ID(3) requires references to local chargeable profits to be read as references to the adjusted relevant profits amount, so that sections 371NB(4) and 371NC(2) to (4) are disregarded.

509. New subsection (4) requires references in sections 371NC(5)(b) and section 371NE(3) to the CFC to be read as references to company X.

510. Paragraph 7 inserts new section 18P(3) which provides section 18P(2) does not apply in the case of chargeable gains in relation to the disposal of assets used only for the purposes of a trade carried on by a PE, and chargeable gains in relation to currency or debt where it is, or represents, money in use for a trade carried on by a PE. Section 18P(3) in effect provides some relaxation of the anti-avoidance rule in section 18P(2) where a trade is carried on through a PE.

511. Paragraph 8 inserts new section 227C into FA 1994 (Lloyd's Underwriters) to deal specifically with PEs of corporate members of Lloyds syndicates.

512. New section 227C modifies the application of Chapter 3A in the case of a Lloyd's underwriter.

513. New section 227C(2) requires foreign tax credit regulations made under section 229(1)(d) to be disregarded.

514. New subsection (3) identifies profits or losses of any relevant accounting period which arise to corporate members of syndicates which are profits of a previous underwriting year which began before the relevant day (the date on which a PE election takes effect under section 18F). Those profits or losses are then disregarded for the purposes of Chapter 3A.

515. New subsection (4) similarly identifies profits or losses arising to corporate members from premium trust funds which are allocated under Lloyd's rules or practice to a previous underwriting year which began before the relevant day. Such profits and losses are also disregarded for the purposes of Chapter 3A.

516. Paragraph 9 inserts new section 15(2B) into CAA 2001.

517. New section 15(2B) disapplies section 15(2A) in respect of a plant or machinery lease under which the company is a lessor if profits or

losses arising from the lease are excluded from exempt profits or losses by virtue of section 18C(3).

518. This is because section 15(2A) provides that where a company carries on a business though a PE and an election is made under section 18A CTA 2009, the business carried on in the PE is to be treated as a separate activity from the beginning of the first accounting period after the election is made. Section 18C(3) provides that profits or losses arising from plant or machinery leases are left out of account for the purpose of calculating any relevant profits amount or relevant losses amount under section 18A, if any capital allowance has been made to the company or a connected company in respect of expenditure on the provision of any plant or machinery subject to the lease.

519. This amendment ensures that where profits or losses are excluded from exemption by section 18C(3) the relevant plant and machinery is not also subject to the separate activity treatment of section 15(2A) CAA 2001.

PART 3

Other Amendments

520. Paragraphs 10 to 13 update the statutory references in TMA 1970 to reflect the statutory references in the new CFC rules for the CFC charge.

521. Paragraph 14 repeals Chapter 4 of Part 17 ICTA (i.e. the current CFC rules).

522. Paragraphs 15 to 17 amend FA 1998. The amendments provide for two changes. The first change amends section 32 so that unrelieved surplus advance corporation tax can be set against the CFC charge under its new statutory reference as if it were an amount of corporation tax for the accounting period. The second change amends Schedule 18 (that deals with company tax returns) to reflect the new statutory reference for the CFC charge.

523. Paragraphs 18 to 20 amend paragraphs 54 and 57 of Schedule 22 to FA 2000 (tonnage tax) to ensure that they continue to apply to a CFC which is a member of a tonnage tax group and is a tonnage tax company by virtue of the group's tonnage tax election in the same way as under the current CFC rules.

524. Paragraph 21 repeals section 90 of FA 2002 as a consequence of the repeal of section 747(1B) Chapter 4 of Part 17 ICTA. The latter section disregarded the treaty (i.e. double taxation arrangements)

non- resident provisions in relation to the CFC rules and treated a treaty non-resident company as a UK resident company in certain circumstances.

525. Paragraph 22 amends section 725 of ITA 2007 (transfer of assets abroad: reduction in amount charged where controlled foreign company involved) to ensure that they continue to reduce any charge on an individual under section 721 where the same income has already been charged under the new CFC rules.

526. Paragraph 23 amends paragraph 3 of Schedule 11 to FA 2007 (technical provision made by insurers) to reflect new statutory references to a CFC and ensure they are covered by the paragraph.

527. Paragraphs 24 to 31 make various amendments to CTA 2009 as follows.

528. Paragraph 25 amends the overview section in CTA 2009 to update the relevant statutory reference so as to reflect the replacement of the current CFC rules by those provided by the new CFC rules.

529. Paragraphs 26 amends the disguised interest rules at section 486D by omitting the specific references to CFCs in that section. This is because any arrangement to which the "disguised interest" rules will apply in the new CFC rules in computing a CFC's assumed taxable total profits will fall within section 371SP if there is an arrangement, the purpose, or one of the main purposes, of which is to obtain a tax advantage for any person under section 1139(2)(da) of CTA 2010.

530. Paragraph 27 amends section 486E to ensure that the disguised interest rules continue to be disapplied in relation to CFCs that are held in certain circumstances under a UK holding company.

531. Paragraph 28 amends section 521E (shares accounted for as liabilities) by omitting specific references to CFCs at subsections (5) and (6) of section 521E. This is because any arrangement to which the "shares accounted for as liabilities" rules will apply in the new CFC rules in computing a CFC's assumed taxable total profits will fall within section 371SQ if there is an arrangement, the purpose, or one of the main purposes, of which is to obtain a tax advantage for any person under section 1139(2)(da) of CTA 2010.

532. Paragraph 29 omits section 870 which adjusts the intangible fixed assets provisions in relation to assumptions that should be made when applying these provisions in computing a CFC's chargeable profits. This is because the same assumptions are now contained in section 371SK and apply when computing a CFC's assumed taxable total profits for the purposes of the new CFC rules.

533. Paragraph 30 inserts new section 931CA into Chapter 2 of Part 9A CTA 2009 (exemption of distributions received by small companies).

534. New section 931CA provides that where a CFC charge is charged in relation to a CFC's accounting period and a dividend or other distribution of the CFC is received in an accounting period of a recipient in which the recipient is a small company, the whole or part of the distribution will be treated as exempt as long as certain conditions are met. These conditions are that:

- the whole or part of the distribution is paid in respect of the chargeable profits of the CFC (defined as the chargeable profits that are apportioned to chargeable companies at step 3 in section 371BC(1) of TIOPA);
- the distribution is not of a kind mentioned in paragraph E or F in section 1000(1) of CTA 2010 (certain non-dividend distributions);
- no deduction is allowed to a resident of any territory outside the United Kingdom in respect of the distribution; and
- the distribution is not made as part of a tax advantage scheme.

535. Paragraph 31 updates Condition B in section 931E.The condition is applicable in determining whether a distribution falls into an exempt class for the purpose of Part 9A of CTA 2009. The amendments outlined in the paragraph mean that the statutory definition of "control" in the new CFC rules in the case where control is established by reference to the legal and economic control exercised by a UK resident (with at least 40% of holdings, rights or powers) and a non-UK resident (with at 40% but no more than 55% of holdings, rights or powers) will apply to the same extent that it did in the current CFC rules.

536. Paragraphs 32 to 36 makes amendments to Part 2 of Schedule 16 to FA 2009. The amendments extend the exempt activities test exemption in the current rules for qualifying holding companies for an accounting period that begins on or after 1 July 2009 but before 1 January 2013. Paragraph 47 applies these changes with effect from 30 June 2012 which means there is now no requirement to split an accounting period of a qualifying holding company where the accounting period straddles 1 July 2012.

537. Paragraphs 37 to 39 make various amendments to CTA 2010 as follows.

538. Paragraph 38 amends section 398D. This section restricts the use of losses against profits arising from leasing plant and machinery in certain defined circumstances and extends the restriction to setting losses against apportioned profits of a CFC that relate to the same activity. The amendments ensure that the same restriction of loss relief against apportioned chargeable profits of a CFC continues in the new CFC rules.

539. Paragraph 39 amends the definition of tax advantage at section 1139 to include at section 1139(2)(da) the avoidance or reduction of a CFC charge under Part 9A of TIOPA.

540. Paragraphs 40 to 42 amend section 314 of TIOPA (financing income amounts) and insert new section 314A.

541. Paragraph 41 amends section 314 of TIOPA by including amounts arising from the application of section 314A as finance income amounts.

542. Paragraph 42 inserts section 314A. This section provides that, to the extent that credits would have been included in financing income amounts by virtue of section 314, they will be taken to be included as finance income amounts by virtue of section 314A if certain conditions are met. The conditions are as follows:

- that a sum is charged on a company at step 5 in section 371BC(1) of Part 9A of TIOPA,
- that the CFC's relevant corporation tax accounting period (as defined in section 371BC(3)) is a relevant accounting period of the company in relation to a period of account of the worldwide group, and
- that the CFC's chargeable profits include amounts ("the relevant finance profits") which fall only within Chapter 5 or 6 of Part 9A or which are qualifying loan relationship profits within the meaning of Chapter 9 of Part 9A.

543. New sections 314A(2) and (3) provide that the percentage of the chargeable profits of the CFC that relate to "the relevant finance profits" is to be taken as a financing income amount of the company for the period of account of the worldwide group.

544. New subsection (4) provides that the reference to "the relevant finance profits" which fall within Chapter 5 or 6 of Part 9A is limited to the following qualifying amounts:

- trading loan relationships as defined by section 297 CTA 2009, or

- non-trading loan relationships as defined by section 299 CTA 2009.

Profits however from derivative contracts that are brought into account under Part 5 of CTA 2009 by section 574 of that Act and profits that fall within subsection 314(3) of TIOPA are specifically excluded from being finance income profits under this subsection.

PART 4

Commencement Provision

545. Part 4 contains the commencement provisions relating to CFCs and PEs.

546. Paragraphs 43 and 44 provide the main commencement rules for CFCs.

547. Paragraph 43(1) provides for the CFC charge to be charged in relation to accounting periods of CFCs beginning on or after 1 January 2013 and paragraph 43(2) provides that the first accounting period of a company which is a CFC at the beginning of 1 January 2013 begins at that time.

548. Sub-paragraph (3) provides that the application of sub-paragraph (2) is subject to paragraph 44.

549. Paragraph 44(1) provides for the CFC rules under Chapter 4 of Part 17 ICTA (i.e. the current CFC rules) to continue to apply to accounting periods of CFCs beginning before 1 January 2013.

550. Sub-paragraphs (3) and (4) are applied by sub-paragraph (2) to a company that has an accounting period within the current CFC rules beginning before 1 January 2013 but ending on or after that date. Such a company will not fall within the new CFC rules in Part 9A of TIOPA until its accounting period ends. If the company is a CFC immediately after the end of this accounting period, its first accounting period under the new CFC rules will begin when that period ends. These sub-paragraphs however do not apply to a company which is a life assurance subsidiary at the end of 31 December 2012.

551. Sub-paragraph (5) applies sub-paragraph (6) to a company that is a life assurance subsidiary at the end of 31 December 2012 and, apart from sub-paragraph (6), would have an accounting period within the current CFC rules beginning before 1 January 2013 but ending on or after that date.

552. Sub-paragraph (6) ends the life assurance subsidiary's accounting period mentioned above on 31 December 2012 and the first accounting period under the new CFC rules begins on the 1 January 2013 if the subsidiary is a CFC on this date.

553. Sub-paragraph (7) defines a "life assurance subsidiary" as a company in which a life assurance company has a relevant interest as determined in accordance with Chapter 15 of Part 9A of TIOPA.

554. Sub-paragraph (8) defines a "life assurance company" as a company carrying on life assurance business within the meaning of Part 2 of FA 2012.

555. Sub-paragraph (9) provides that the majority of the consequential amendments made in Part 3 to other parts of the Taxes Acts should be ignored as appropriate in applying the commencement provisions under paragraph 39. This broadly means that the amendments made under Part 3 will not take effect until an accounting period under Part 9A of TIOPA (i.e. under the new CFC rules) begins.

556. Paragraph 45 disapplies the amendment made by paragraph 27(3) of Part 3 (disguised interest: excluded shares) for relevant periods beginning before 1 January 2013 and the current CFC rules will continue to have effect for this period.

557. Paragraph 46 states that the amendment made by paragraph 30 of Part 3 (exemption of distributions received by small companies) will not apply to dividends or distributions received before 1 January 2013.

558. Paragraph 47 provides that the amendment made by paragraph 31 of Part 3 will not apply to dividends or distributions received before 1 January 2013 and that the current CFC rules will continue to have effect.

559. Paragraph 48 treats paragraphs 33 to 36 as having come into force on the 30 June 2012

560. Paragraph 49(1) provides that the amendments made in paragraphs 3, 5 and 9 of Part 2 to the PE provisions at Chapter 3A of Part 2 of CTA 2009 come into force on 1 January 2013 but that the amendment made by paragraph 5(3) has no effect in relation to elections made before this date.

561. Paragraph 49(2) provides that amendments to Chapter 3A of Part 2 of CTA 2009 made by paragraphs 4 and 6 to 8 of Part 2 will have effect for relevant accounting periods beginning on or after 1 January 2013.

PART 5

Transitional Provision

562. Paragraph 50 applies to CFCs which are subject to the temporary period of exemption contained in Part 3A of Schedule 25 of ICTA (i.e. the current CFC rules), where that period continues after the end of the last accounting period for which the current CFC rules apply. This transitional provision ensures that the exempt period under the current CFC rules ends at the same time as it would have under those rules.

563. Paragraph 50(1) sets out the basic requirements for the transitional provision to apply, which are:

- that an exempt period under the current CFC rules began before 1 January 2013;
- that the exempt period does not end before the end of the last accounting period under the current CFC rules; and
- that the new CFC rules apply to the company at the start of the first accounting period under Part 9A of TIOPA (i.e. the new CFC rules).

564. Sub-paragraph (2) determines that the remainder of the exempt period is treated as an exempt period under Chapter 10 of the new CFC rules (the exempt period exemption).

565. Sub-paragraph (3) provides for the remainder of the exempt period to be determined in accordance with the current CFC rules as set out in paragraph 15F of Schedule 25 to ICTA. For this purpose, the current CFC rules are assumed to continue to apply, and the new CFC rules at section 371JD regarding the length of the exempt period are disregarded.

566. Sub-paragraph (4) adapts the application of section 371JB so that an accounting period is exempt if it ends during an exempt period. The other conditions in section 371JB are omitted for the purposes of this transitional provision.

567. Sub-paragraph (5) adapts the application of section 371JE, so that if an exempt period comes to an end during an accounting period, any profits that arise during that exempt period can be exempted from charge under the new CFC rules. The other conditions of section 371JE are omitted for the purposes of this transitional provision.

568. Sub-paragraph (6) disapplies the anti-avoidance provisions at section 371JF for the purposes of this transitional exemption. The

anti-avoidance rules in Part 3A of Schedule 25 to ICTA will continue to apply for the purposes of this transitional provision.

569. Paragraph 51 provides that the CFC (Designer Rate Tax Provisions) Regulations 2000 (S.I. 2000/3158) will continue to have effect under the new CFC rules and that the power of the HMRC Commissioners to make regulations under section 371ND includes the power to revoke or amend these Regulations for the purposes of that section.

BACKGROUND NOTE

570. This measure provides for a new CFC regime to be introduced in Finance Bill 2012 and supports the Government's objective to deliver a more competitive corporate tax system. The policy objectives of the new CFC regime are to:

- introduce a modernised CFC regime that better reflects the way that businesses operate in a global economy whilst maintaining adequate protection of the UK tax base;
- exempt profits where there is no artificial diversion of UK profits; and
- exempt profits arising from genuine economic activities undertaken overseas.

571. The Government announced this measure at the Budget in June 2010 and outlined the policy proposals on 29 November 2010 as part of the Corporate Tax Reform document.

572. Detailed proposals for this measure were published for consultation in *Controlled Foreign Companies (CFC) reform* in June 2011. On 6 December 2011 the Government published *Controlled Foreign Companies (CFC) reform: response to consultation* which provides an update on the developments on the reform of Controlled Foreign Companies rules following consultation and includes a summary of the responses received and a technical note which gives an overview of the legislation. Further updates were published on 31 January 2012 and 29 February 2012. All documents are available on the HM Treasury website.

573. The measure also amends the exemption for profits arising in foreign permanent establishments, so that the anti-diversion rule is brought into line with the CFC regime.

EXPLANATORY NOTE

CLAUSE 181: TRANSFERS WITHIN A GROUP BY COMPANIES CARRYING ON RING FENCE TRADE

SUMMARY

1. Clause 181 amends section 171A of the Taxation of Chargeable Gains Act 1992 (TCGA 1992), which provides an election to transfer a gain or loss from one company to another member of the group. This clause restricts the scope of section 171A. Under the current law where there is a transfer of a ring fence chargeable gain from a ring fence company to a non-ring fence company the ring fence gain is not subject to supplementary charge, because the non-ring fence company does not fall within the scope of the supplementary charge.

2. This clause amends section 171A to ensure that an election cannot be made to transfer a ring fence chargeable gain from a company carrying on a ring fence trade to a company not carrying on a ring fence trade.

3. This clause has effect in relation to chargeable gains accruing, or treated as accruing under section 197(4), in chargeable periods ending on or after 6 December 2011.

4. Where a chargeable period begins before 6 December and ends on or after that date ("the straddling period") this clause has effect as if so much of the straddling period as falls before 6 December, and so much of that period as falls on or after that date were separate chargeable periods.

DETAILS OF THE CLAUSE

5. <u>Subsection (3)</u> inserts <u>subsections (4A) and (4B)</u> into section 171A TCGA 1992.

6. <u>Subsection (4A)</u> provides that an election cannot be made to transfer a ring fence chargeable gain from a company carrying on a ring fence trade to a company not carrying on a ring fence trade.

7. <u>Subsection (4B)</u> provides the definitions of "ring fence chargeable gain" and "ring fence trade".

BACKGROUND NOTE

8. From 1 April 2000 to 20 July 2009 it was possible for two companies ("A" and "B") which were members of a group to make a joint election whose effect was that a disposal by one member of the group A to a person outside the group ("C") would be treated as a disposal by A to B under the no gain/no loss rules in section 171(1) TCGA 1992 and then from B to C.

9. The legislation was changed significantly in Finance Act 2009 (FA 2009) and the effect of an election was altered.

10. Since the changes made by FA 2009 and now included within section 171A TCGA 1992, the effect of an election has been that an amount of a chargeable gain or allowable loss is treated as accruing in another group company. As a result under an election under section 171A the transferee company cannot be deemed to carry on a ring fence trade, and so the supplementary charge does not necessarily apply.

11. This clause amends section 171A TCGA 1992 to ensure that an election cannot be made to transfer a ring fence chargeable gain from a company carrying on a ring fence trade to a company not carrying on a ring fence trade and so not subject to the supplementary charge.

RESOLUTION 39

FINANCE BILL
CLAUSE 182

EXPLANATORY NOTE

CLAUSE 182: SUPPLEMENTARY CHARGE

SUMMARY

1. Clause 182 clarifies the definition of the scope of the supplementary charge (SC) set out in section 330 of Corporation Tax Act 2010 (CTA 2010). The clause provides SC is charged by reference to a company's ring fence profits.

2. This clause has effect from 6th December 2011.

DETAILS OF THE CLAUSE

3. Subsection (1) amends section 330 (2) of CTA 2010 by substituting "company's ring fence profits" for "profits of the company's ring fence trade".

BACKGROUND NOTE

4. The SC is chargeable on a company's adjusted ring fence profits as if it were an amount of corporation tax chargeable on the company.

5. A company's adjusted ring fence profits for an accounting period are currently defined in section 330(2) CTA 2010 as the profits of the company's ring fence trade chargeable to corporation tax, on the assumption in subsection (3) that financing costs are left out of account.

6. It was Government's intention when the legislation was introduced in 2002 that a company's adjusted ring fence profits should include all profits that could arise to a company carrying on a ring fence trade from ring fence activities. In other words the intention was that the scope of the SC should match the scope of ring fence corporation tax (RFCT). This includes chargeable gains which can arise on the disposal of an interest in an oil licence.

7. It remains the Government's view that under the existing law the scope of the SC does match the scope of RFCT. Government is however aware that some in industry take a different view and that they believe that chargeable gains fall outside the scope of the SC.

8. For this reason, this clause clarifies the scope of the SC by ensuring that it matches that of RFCT, in accordance with the intention of the Government when the legislation was enacted in 2002.

EXPLANATORY NOTE

CLAUSE 183 SCHEDULE 21: RELIEF IN RESPECT OF DECOMMISSIONING EXPENDITURE

SUMMARY

1. Clause 183 and Schedule 21 restrict the relief available for decommissioning expenditure for Supplementary Charge (SC) purposes to 20 per cent. They do so by increasing the profits liable to the SC where decommissioning expenditure is taken into account in computing those profits. Where such expenditure reduces the amount of Petroleum Revenue Tax "PRT" chargeable the clause also provides a reduction from profits liable to the SC where the profits resulting from the reduction in PRT would be subject to SC at a rate of more than 20 per cent. The schedule also provides that losses arising from mineral extraction allowances given in respect of decommissioning expenditure are brought within the scope of the provision which extends the periods for which loss relief may be given.

DETAILS OF THE SCHEDULE

2. Paragraph 1 provides that Part 8 of Corporation Tax Act 2010 (CTA 2010) is amended as provided by the following paragraphs of the Schedule.

3. Paragraph 2 amends section 330(2) of CTA 2010 to include a cross reference to sections 330A and 330B.

4. Paragraph 3 inserts into CTA 2010:

   - New section 330A ('decommissioning expenditure taken into account in calculating ring fence profits'),
   - New section 330B ('decommissioning expenditure taken into account for PRT purposes'), and
   - New section 330C ('meaning of 'decommissioning expenditure'')

5. New section 330A(1) provides that section 330A applies where:

   (a) any decommissioning expenditure is taken into account in calculating the profit or loss of any ring fence trade or loss surrendered to the company, and

(b) if that expenditure were not taken into account the amount of the adjusted ring fence profits for the accounting period would be greater than nil.

6. New section 330A(2) provides that an amount equal to the appropriate fraction of the used-up amount of that expenditure is added to the adjusted ring fence profits for the accounting period.

7. New section 330A(3) defines 'the appropriate fraction' and 'the used-up amount'.

8. New section 330A(4) provides that in establishing the extent to which any losses which have been taken into account are attributable to decommissioning expenditure:

   (a) any other amounts which could be taken into account in calculating those losses are assumed to be taken into account before any amounts of decommissioning expenditure, and

   (b) where any group relief has been surrendered, the various companies concerned must specify whether any of those losses is attributable to decommissioning expenditure.

9. New section 330A(5) provides that a company can elect for section 330A(4)(a) not to apply if that paragraph would work unfavourably in the company's case, and for any amounts instead to be taken into account in the order specified in the election.

10. New section 330A(6) provides that in determining the used-up amount, any other amounts that could be deducted in calculating the adjusted ring fence profits are assumed to have already been so deducted.

11. New section 330A(7) provides that a company can elect for subsection (6) not to apply if it would work unfavourably in the company's case, and for any amounts instead to be deducted in the order specified in the election.

12. New section 330A(8) provides that for the purposes of this section, any deduction made under section 330B is to be disregarded.

13. New section 330A(9) provides that section 330A does not apply to any accounting period (including any accounting period beginning before 24 March 2011 and ending on or after that date) for which the rate of SC is less than or equal to 20 per cent.

14. New section 330A(10) provides that 'claimant company' and 'surrendering company' take their meaning from chapter 5, and 'decommissioning expenditure' is as defined by section 330C.

15. New section 330B(1) provides that the section applies where:

(a) any decommissioning expenditure is taken into account in calculating the assessable profit of a participator in any chargeable period from an oil field, and

(b) if that expenditure were not taken into account, some PRT would be chargeable on the participator for the chargeable period.

16. New section 330B(2) provides that an amount equal to the appropriate fraction of the PRT difference is deducted in calculating the amount of the participator's adjusted ring fence profits for the relevant accounting period.

17. New section 330B(3) defines 'the appropriate fraction' and 'the PRT difference'.

18. New section 330B(4) provides that in determining the extent to which any allowable losses taken into account in calculating the assessable profit are attributable to decommissioning expenditure, any amounts of any other expenditure which could be taken into account in calculating those losses are assumed to be taken into account before any amounts of decommissioning expenditure.

19. New section 330B(5) provides that a participator may elect for subsection (4) not to apply if that subsection would work unfavourably and for any amounts of expenditure which could be taken into account in calculating those losses instead to be taken into account in the order specified in the election.

20. New section 330B(6) provides that section 330B does not apply to any accounting period (including any accounting period beginning before 24 March 2011 and ending on or after that date) for which the rate of SC is less than or equal to 20 per cent.

21. New section 330B(7) defines 'assessable profit', allowable loss', 'decommissioning expenditure' and 'the relevant accounting period' for the purposes of this section.

22. New section 330C(1) defines 'decommissioning expenditure' for the purposes of sections 330A and 330B.

23. New section 330C(2) clarifies the interpretation of section 330C(1)(b).

24. New section 330C(3) clarifies the interpretation of sections 330C(1)(c) and (d).

25. New section 330C(4) extends the scope of section 330C(1)(e).

26. New section 330C(5) provides that the Treasury may amend section 330C by secondary legislation.

27. New section 330C(6) provides that an order under subsection (5) may include transitional provision and savings.

28. Paragraph 4 amends section 7 of FA 2011 to include a cross-reference to sections 330A and 330B.

29. Paragraph 5(1) provides that section 40 CTA 2010 is amended as provided by the following sub-paragraphs.

30. Paragraph 5(2) amends section 40(1)(b) to include a reference to allowances under section 403 CAA 2001 made to a company in respect of decommissioning expenditure.

31. Paragraph 5(3) makes consequential changes.

32. Paragraph 5(4) inserts a new section 40(3A) which provides the meaning of 'decommissioning expenditure' in section 40.

33. Paragraph 6(1) provides that the amendments made by the Schedule have effect for expenditure incurred in connection with decommissioning carried out on or after 21 March 2012.

34. Paragraph 6(2) provides the meaning of 'decommissioning' in paragraph 6(1).

BACKGROUND NOTE

35. Effective from 24 March 2011, the rate of Supplementary Charge increased from 20 per cent to 32 per cent.

36. Budget 2011 also announced that legislation would be introduced in Finance Bill 2012, with effect from Budget 2012, to restrict the rate of tax relief for decommissioning expenses to 20 per cent for Supplementary Charge purposes.

37. The Schedule seeks to ensure that the principles governing the restriction of decommissioning relief are applied consistently to PRT and non-PRT fields.

38. The Schedule also seeks to provide consistency of treatment of decommissioning expenditure with regard to the restriction of relief and the access to the extended period for which losses can be carried back.

EXPLANATORY NOTE

CLAUSE 184 SCHEDULE 22REDUCTION OF SUPPLEMENTARY CHARGE FOR CERTAIN OIL FIELDS

SUMMARY

1. Clause 184 and Schedule 22 amend the field allowance legislation in Chapter 7 of Part 8 of the Corporation Tax Act 2010 (CTA 2010). The amendments enable the allowance to be extended to fields that have already been developed.

DETAILS OF THE SCHEDULE

2. Paragraph 2 amends section 334 CTA 2010 (which relates to a company's pool of field allowances) so that it applies in the context of 'eligible oil fields' rather than 'new oil fields'. Section references in the rest of this note are to sections of CTA 2010.

3. Paragraph 3(2) replaces the reference to an initial licensee in a new oil field with a reference to a licensee in an additionally-developed oil field or a new oil field on the authorisation day, provides for such a field to be known as an eligible oil field, and makes clear that a company may hold more than one field allowance for a field at the same time.

4. Paragraphs 3(3) and 3(4) make consequential amendments.

5. Paragraph 4 amends section 338 (which makes provision about holding a field allowance by virtue of the acquisition of an equity share in a new oil field) so that it applies in the context of 'an eligible oil field' rather than 'a new oil field'.

6. Paragraph 5 amends section 339 (which makes provision about the unactivated amount of field allowance) so that it applies for an eligible oil field rather than a new oil field.

7. Paragraph 6(1) provides that section 340 (which gives the conditions to be met for section 341 to apply) is amended by the following sub-paragraphs of paragraph 6.

8. Paragraph 6(2) amends section 340(1) so that it refers to 'an eligible oil field' rather than 'a new oil field'.

9. Paragraph 6(3) makes a consequential amendment.

10. Paragraph 7(1) provides that section 341 (which provides for an amount of a company's field allowance for a new oil field to be activated) is amended by the following sub-paragraphs of paragraph 7.

11. Paragraph 7(2) amends section 341(1) so that it refers to 'the eligible oil field' rather than 'the new oil field'.

12. Paragraph 7(3) inserts three new subsections into section 341.

13. New subsection (4) provides that new subsection (5) applies to determine the amount of a company's field allowance for an eligible oil field to be activated where at the time when the company began to hold the relevant field allowance the company already held one or more other field allowances for the field.

14. New subsection (5) provides that the amount of the company's relevant income from the field in the accounting period is to be reduced by the amount of any earlier field allowance activated for the accounting period.

15. New subsection (6) provides that where the company began to hold two or more field allowances at the same time it can choose the order in which it is to be regarded as having begun to hold them.

16. Paragraph 8 amends section 342 (which gives the conditions to be met for sections 343 and 344 to apply) so that it refers to 'an eligible oil field' rather than 'a new oil field'.

17. Paragraph 9 amends section 343 (which provides for an accounting period to be divided into reference periods for the purposes of section 344) so that it refers to 'the eligible oil field' rather than 'the new oil field'.

18. Paragraph 10(1) provides that section 344 (which provides for an amount of a company's field allowance for a new oil field to be activated in respect of each reference period) is amended by the following sub-paragraphs of paragraph 10.

19. Paragraph 10(2) amends section 344(1) so that it refers to 'the eligible oil field' rather than 'the new oil field'.

20. Paragraph 10(3) makes a consequential amendment.

21. Paragraph 10(4) inserts three new subsections into section 344.

22. New subsection (5) provides that new subsection (6) applies to determine the amount of a company's field allowance for an eligible oil field to be activated where at the time when the company began to hold the relevant field allowance the company already held one or more other field allowances for the field.

23. New subsection (6) provides that the amount of the company's relevant income from the field in the reference period is to be reduced by the amount of any earlier field allowance activated for the reference period.

24. New subsection (7) provides that where the company began to hold two or more field allowances at the same time it can choose the order in which it is to be regarded as having begun to hold them.

25. Paragraph 11(1) provides that section 345 (which gives the conditions to be met for sections 346 and 347 to apply) is amended by the following sub-paragraphs of paragraph 11.

26. Paragraph 11(2) amends section 345(2) so that it refers to ‘an eligible oil field’ rather than ‘a new oil field’ and makes a consequential amendment.

27. Paragraph 11(3) makes consequential amendments.

28. Paragraph 11(4) amends section 345(6) so that it refers to ‘an eligible oil field’ rather than ‘a new oil field’.

29. Paragraph 12(1) provides that section 346 (which provides that the unactivated amount of the field allowance for a new oil field which a transferor holds immediately before a disposal is to be reduced) is amended by the following sub-paragraphs of paragraph 12.

30. Paragraph 12(2) amends section 346(1) so that it refers to ‘the eligible oil field’ rather than ‘the new oil field’ in the first place where the latter term is used.

31. Paragraph 12(3) makes consequential amendments.

32. Paragraph 13(1) provides that section 347 (which provides for a transferee to hold a field allowance or an increased field allowance for a new oil field) is amended by the following sub-paragraphs of paragraph 13.

33. Paragraph 13(2) amends section 347(1) so that it refers to ‘the eligible oil field’ rather than ‘the new oil field’.

34. Paragraph 13(3) amends section 347(2) so that it refers to ‘the eligible oil field’ rather than ‘the new oil field’ in the first place where the latter term is used, and makes a consequential amendment.

35. Paragraph 13(4) makes a consequential amendment.

36. Paragraph 14(1) provides that section 349 (which provides that the Commissioners for Her Majesty’s Revenue and Customs may by order make provision about the oil fields that are qualifying oil fields (section 349(1)), and about the amount of the total field allowance for any description of new oil field (section 349(2)) is amended by the following sub-paragraphs of paragraph 14.

37. Paragraph 14(2) amends section 349(1) to include 'additionally-developed oil fields'.

38. Paragraph 14(3) amends section 349(2) so that it refers to 'eligible oil field' rather than 'new oil field'.

39. Paragraph 14(4) inserts a new subsection into section 349.

40. New subsection (2A) confers a power to make provision about the meaning of terms used in the Chapter.

41. Paragraph 14(5) replaces subsection (3) of section 349 with a new subsection.

42. New subsection (3) provides that an order under this section may amend Chapter 7, include provision having effect for times before the order is made but only if it does not increase the liability to tax of any person, and include provision of a type specified within paragraph (c) of the new subsection.

43. Paragraph 15 inserts a new section into CTA 2010.

44. New section 349A(1) provides a definition of an 'additionally-developed oil field'.

45. New section 349A(2) defines 'consent for development', 'development' and 'national authority' for the purposes of new section 349A.

46. New section 349A(3) provides that an order under this section may include provision having effect for times before the order is made provided it does not increase the liability to tax of any person.

47. Paragraph 16(1) provides that section 357 (which provides definitions for the purposes of the field allowance legislation) is amended by the following sub-paragraphs of paragraph 16.

48. Paragraph 16(2) replaces the existing definition of 'authorisation day'.

49. Paragraph 16(3) inserts a definition of 'eligible oil field'.

50. Paragraph 16(4) makes a consequential amendment.

51. Paragraph 16(5) amends the definition of 'relevant income' to refer to 'an eligible oil field' rather than 'a new oil field'.

52. Paragraphs 17 to 20 make consequential amendments.

53. Paragraph 21(1) provides that the amendments made by paragraphs 14, 15 and 16(3) come into force on the day on which this Act is passed.

54. Paragraph 21(2) provides that the other amendments made by the Schedule come into force in accordance with provision contained in an order made by the Treasury.

55. Paragraph 21(3) provides that an order made under subparagraph (2) may make different provision for different purposes and may provide for amendments which come into force in accordance with an order under that subparagraph to have effect for times before the order is made.

56. Paragraph 22(1) provides that the Commissioners for Her Majesty's Revenue and Customs may by order make any provision of a type specified within the subparagraph in consequence of the amendments made by the Schedule.

57. Paragraph 22(2) provides that an order under paragraph 22 may amend, repeal or revoke any provision made by or under CTA 2010 and may include provision having effect for times before the order is made, provided it does not increase the liability to tax of any person.

BACKGROUND NOTE

58. The field allowance reduces the amount of profits subject to the Supplementary Charge where fields meet specific criteria. The allowance is currently available only for new oil fields. A new oil field is an oil field which is a qualifying oil field (by virtue of satisfying certain criteria) and whose development is authorised for the first time on or after 22 April 2009.

59. The Government recognises the importance of securing ongoing investment in existing North Sea fields and infrastructure. At Budget 2012 the Government therefore announced that it would introduce legislation to amend the scope of the field allowance, giving it the power to make an allowance available to fields whose development has previously been authorised.

60. The Government will engage further with industry on how such an allowance could be structured to facilitate investment while protecting Exchequer revenues. This clause and Schedule make the necessary changes to CTA 2010 so that an allowance can be introduced by secondary legislation at a later date.

EXPLANATORY NOTE

CLAUSE 185: RATES OF TOBACCO PRODUCTS DUTY

SUMMARY

1. Clause 185 provides for changes in the rates of excise duty on tobacco products (cigarettes, cigars, hand-rolling tobacco, other smoking tobacco and chewing tobacco) to have effect from 6 pm on 21 March 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table of rates of duty into Schedule 1 to the Tobacco Products Duty Act 1979. The duty rates on tobacco products are changed as follows:

   i. cigarettes – the *ad valorem* element remains unchanged at 16.5 per cent; the specific duty is increased from £154.95 to £167.41 per 1000 cigarettes;

   ii. cigars – increased from £193.29 to £208.83 per kilogram;

   iii. hand-rolling tobacco – increased from £151.90 to £164.11 per kilogram; and

   iv. other smoking tobacco and chewing tobacco – increased from £84.98 to £91.81 per kilogram.

3. Subsection (2) provides for the new table of duty rates to have effect from 6 pm on 21 March 2012.

BACKGROUND NOTE

4. Smoking kills half of all long-term users and is the biggest single cause of inequalities in death rates between the richest and poorest in the UK. The Government is committed to maintaining high tobacco duty rates to support health objectives and ensure that tobacco duties continue to contribute to government revenues and fiscal consolidation. Research has consistently shown that the price of tobacco products negatively affects demand.

5. This clause increases excise duty on all tobacco products by 5 per cent in real terms (in addition to the retail price index (RPI)). Pre-announced increases of 2 per cent above inflation on all tobacco product duties will be maintained in 2013-14 and 2014-15.

6. The duty increase, together with the consequential VAT, will on average increase the price of a packet of 20 cigarettes by 37p, a pack of 5 small cigars by 12p, a 25 gram pack of hand-rolling tobacco by 37p; and a 25 gram pack of pipe tobacco by 20p.

7. The estimated revenue yield from these changes is £70 million in 2012/13.

EXPLANATORY NOTE

CLAUSE 186: RATES OF ALCOHOLIC LIQUOR DUTIES

SUMMARY

1. Clause 186 provides for increases in the rates of excise duty charged on spirits, beer, wine and made-wine, and cider and perry, to have effect on and after 26 March 2012.

DETAILS OF THE CLAUSE

2. Subsection (2) substitutes a new rate of excise duty for spirits in section 5 of the Alcoholic Liquor Duties Act 1979 (ALDA). The previous rate of £25.52 is replaced by £26.81.

3. Subsection (3)(a) substitutes a new rate of excise duty for beer of a strength exceeding 1.2 per cent but not exceeding 2.8 per cent in section 36(1AA)(za) of ALDA. The previous rate of £9.29 is replaced by £9.76.

4. Subsection (3)(b) substitutes a new rate of excise duty for beer, other than small brewery beer, in section 36(1AA)(a) of ALDA. The previous rate of £18.57 is replaced by £19.51..

5. Subsection (4) substitutes a new rate of excise duty for beer of a strength exceeding 7.5 per cent in section 37(4) of ALDA. The previous rate of £4.64 is replaced by £4.88.

6. Subsection (5)(a) substitutes a new rate of excise duty for sparkling cider of a strength exceeding 5.5 per cent in section 62(1A)(a) of ALDA. The previous rate of £233.55 is replaced by £245.32.

7. Subsection (5)(b) substitutes a new rate of excise duty for still cider of a strength exceeding 7.5 per cent in section 62 (1A)(b) of ALDA. The previous rate of £53.84 is replaced by £56.55.

8. Subsection (5)(c) substitutes a new rate of excise duty for all other ciders in section 62(1A)(c) of ALDA. The previous rate of £35.87 is replaced by £37.68.

9. Subsection (6) provides for the replacement of the Table of rates of duty on wine and made-wine in Schedule 1 to ALDA with a new table showing the new rates of duty.

BACKGROUND NOTE

10. This clause increases the excise duty rates on all alcoholic liquor by 2 per cent above the Retail Price Index (RPI) for all alcoholic drinks.

EXPLANATORY NOTE

CLAUSE 187: REPEAL OF DRAWBACK ON BRITISH COMPOUNDS AND SPIRITS OF WINE

SUMMARY

1. Clause 187 repeals section 22 of the Alcoholic Liquor Duties Act 1979 (ALDA), which provides for the repayment (drawback) of excise duty on 'British compounds' and 'spirits of wine' when they are warehoused for certain purposes. The clause also makes consequential repeal of those primary law provisions which have amended section 22 in the past, and of the provision of the Finance Act 1994 which makes decisions taken under section 22 appealable in the Tribunal.

DETAILS OF THE CLAUSE

2. Clause 187 repeals section 22 ALDA in its entirety, together with paragraph 29 of Schedule 1 to the Isle of Man Act 1979, paragraph 16 of Schedule 8 to the Finance Act 1981, paragraph 24 of the Schedule to the Finance Act 1994 (all of which amended section 22 ALDA) and paragraph 3(1)(ha) to Schedule 5 of the Finance Act 1994 (which makes decisions taken under section22 ALDA appealable in the Tribunal).

BACKGROUND NOTE

3. British compounds are spirits which have, in the United Kingdom, had any flavour communicated to them or ingredient or material mixed with them, not being denatured alcohol. Spirits of wine are plain spirits of a strength of not less than 80 per cent manufactured in the United Kingdom. Section 22 ALDA allows manufacturers of such products to reclaim the excise duty that they have paid on such products when they are exported from the manufacturer's premises or placed in a warehouse for certain approved purposes.

4. Insofar as section 22 permits drawback on export, it is unnecessary, since identical provision is made by the Excise Goods (Drawback) Regulations 1995 ("the EGDR"). To the extent that section 22 permits drawback in other circumstances (e.g. shipment as stores and warehousing for certain purposes, including export), it is undesirable, since there is no such provision for other spirits and there is no present policy justification for having different arrangements for British compounds and spirits of wine to those that apply to other spirits. Further, it is doubtful whether section 22 is fully compliant with EU directive 2008/118, which concerns the general arrangements for excise duty.

5. It follows that the repeal of section 22 will remove redundant legislation from the tax code, produce greater consistency with the arrangements that apply to other spirits and avoid the minor risk of infraction proceedings.

EXPLANATORY NOTE

CLAUSE 188: REBATED FUEL: PRIVATE PLEASURE CRAFT

SUMMARY

1. Clause 188 amends the Hydrocarbon Oils Duties Act 1979 (HODA). It provides for the declaration made by a person when purchasing heavy oil or bioblend for use as fuel for propelling a private pleasure craft to include an acknowledgement that any restrictions and prohibitions under the national laws of other Member States on the use of such fuel outside United Kingdom waters are not affected.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces a new section 14E(7A) into HODA to provide that a relevant declaration must include an acknowledgement that any restrictions and prohibitions under the national laws of another Member State on the use of heavy oil or bioblend as fuel for propelling private pleasure craft outside UK waters are not affected by the UK provisions. "United Kingdom waters" is defined by reference to the meaning given in section 1(1) of the Customs and Excise Management Act 1979.

3. Subsection (2) provides for the changes to have effect in relation to supplies made on or after 1 April 2012.

BACKGROUND NOTE

4. This clause provides that a relevant declaration made by a person purchasing heavy oil or bioblend for use as fuel for propelling a private pleasure craft must include an acknowledgement that any restrictions and prohibitions under the national laws of another Member State on the use of such fuel outside UK waters are not affected by the UK provisions. The changes are being made following a challenge by the European Commission to the UK practice of allowing marked 'red diesel' with the full duty paid to be used in this way, maintaining that it was contrary to EU legislation on the marking of fuels.

5. The changes ensure that red diesel can continue to be used as fuel for propelling private pleasure craft in UK coastal waters and on the inland waterways in accordance with current procedures.

EXPLANATORY NOTE

CLAUSE 189 SCHEDULE 23: AIR PASSENGER DUTY

SUMMARY

1. Clause 189 and Schedule 23 provide for APD rate increases. They also extend the scope of APD to private jets by reducing the de minimis weight limit below which aircraft were not subject to APD from 10 tonnes to 5.7 tonnes. In addition, they give statutory effect to the rate reduction applied, since 1 November 2011, to certain flights departing from Northern Ireland, and provides for the long term devolution of these rates.

DETAILS OF THE SCHEDULE

2. Part 1 gives statutory effect to the rate reduction applied to certain flights departing from Northern Ireland for the period 1 November 2011 to 31 March 2012.

3. Paragraph 1 inserts new sections 30(4B) to (4D) into Finance Act (FA) 1994.

4. New sections 30(4B) and (4C) specifies the rate that will apply to certain 'relevant journeys' (defined in new section 30(4D) from Northern Ireland.

5. New section 30(4D) defines a 'relevant journey' as one which departs from Northern Ireland and, in the case of a journey that involves more than one flight, provides that the second or onward flight must not begin within the UK or any ”Part 1 territories” as set out in schedule 5A to FA 1994.

6. Paragraph 2 makes consequential changes.

7. Part 2 of the Schedule provides for the increase in the APD rates to be applied to each destination band.

8. Paragraph 4 amends section 30 of FA 2004. It sets out the rates for the destination bands and inserts new sections 30(4B) to (4D). These new sections provide for the new reduced rates for passengers on flights from Northern Ireland that are 'relevant journeys' as defined in new section 30(4D), with effect from 1 April 2012.

9. Paragraph 5 makes consequential changes.

10. Part 3 if the Schedule devolves direct long haul rates to Northern Ireland.

11. Paragraph 8 amends section 30 of FA 1994. It inserts new section 30(1A) to disapply rates specified in section 30(2) to 30(4A) in instances where new section 30A (Northern Ireland direct long haul rates of duty) apply. It also omits new sections 30(4B) to 30(4D), which provide for the rates for relevant flights from Northern Ireland for the period from 1 November 2011 to 31 March 2012, and provides for these changes to take effect in relation to the carriage of passengers beginning on or after the relevant day as defined by new section 30A.

12. Paragraph 9 inserts new section 30A which provides that the rates for certain flights may be set by the Northern Ireland Assembly.

13. New section 30A(1) applies the rates from the relevant day to flights where a passenger's journey begins from a place in Northern Ireland which does not end in the UK or any territory specified in Part 1 of Schedule 5A and, where there is more than one flight to that journey, the first flight is not followed by a connected flight beginning in the UK or any other territory specified in Part 1 of Schedule 5A.

14. New sections 30A(2) to (7) defines what rates are to be devolved and specifies that rates may be set to £0.

15. New sections 30A(8) to (10) apply certain current APD provisions to new section 30A. They also define the 'relevant day' to be the day appointed by Order and make consequential changes to section 42(4) and (5) of Finance Act 1994.

16. New subsection 30A(11) to (14) sets out some of the legislative detail concerning the process under which the Northern Ireland Assembly may vary the devolved rates.

17. New section 30A(15) provides that any duty relating to devolved APD paid to the Commissioners be paid into the Consolidated Fund of Northern Ireland.

18. Paragraphs 10(1) to (5) insert new section 33(2A) which provides that aircraft operators only operating routes from Northern Ireland as specified in new section 30A are not required to register under the provisions of section 33 (but instead will need to register under the provisions of new section 33A). It also makes consequential changes to reflect new section 33A.

19. Paragraph 11 inserts new section 33A which provides that the Commissioners may keep a register of aircraft operators operating routes from Northern Ireland as specified in new section 30A, and require such operators to notify to the Commissioners their liability register by a prescribed time.

20. Paragraph 12 makes consequential amendments to section 34(5) to reflect the insertion of new section 33A.

21. Paragraph 13 inserts new section 41A which provides an information sharing agreement in relation to the devolution of the rate to Northern Ireland.

22. Paragraphs 14 and 15 make consequential amendments.

23. Part 4 of the Schedule provides for the extension of APD to passengers in smaller aircraft by reducing the de minimis weight limit below which aircraft are not chargeable aircraft for APD from the current 10 tonnes to 5.7 tonnes. It also amends the definition of a chargeable passenger and provides for new rates for the carriage of chargeable passengers on certain aircraft.

24. Paragraph 17 substitutes section 28(3) to apply sections 29 and 29A for determining whether an aircraft is a chargeable aircraft for the purposes of APD.

25. Paragraph 18 amends section 29. It redefines a "chargeable aircraft" and extends the scope of APD to smaller aircraft by reducing the former 10 tonne de minimis weight limit to 5.7 tonnes. It also removes the reference to an authorised seating capacity and restricts the scope of APD to aircraft fuelled by kerosene (aviation turbine fuel) only.

26. Paragraph 19 inserts a new section 29A, which extends exceptions to APD to aircraft whose operation is related to military, police, customs, search and rescue operations, humanitarian and research and training operations. It also extends the exception to flights operated under a public service obligation.

27. Paragraph 20 inserts new sections 30(4E) to (4H).

28. New section 30(4E) provides for new rates to be applied to the carriage of chargeable passengers on certain aircraft.

29. New section 30(4F) defines these aircraft as being of an authorised take-off weight of not less than 20 tonnes, and with an authorised seating capacity of not more than 18 (excluding members of the flight crew and cabin attendants).

30. New section 30(4H) provides that an aircraft's authorised seating capacity is considered to be more than 18 (and consequently not liable to the rate set out in new section (4F)) if there is a certificate of airworthiness in effect showing this, or if the Commissioners are satisfied that the aircraft has been designed or adapted to seat more than 18 (excluding flight and cabin attendants).

31. Paragraph 21 inserts new section 30A(7A) and provides for how the rates to be devolved and detailed in new sections 30A(4) to (6) are to apply to aircraft defined in new section 30(4F) (ie aircraft with an authorised take-off weight or not less than 20 tonnes, and with an authorised seating capacity of not more than 18).

32. Paragraph 22 amends section 43(1). Previously this section placed outside the scope of APD passengers not carried for reward if the operator was not an air transport undertaking (i.e. an aircraft operator whose main business was not carrying passenger for hire or reward). The change now brings these passengers into the scope of APD, and brings the exclusions in line with those for air transport undertakings where these are restricted to flight and cabin crew. It also excludes certain passengers not carried for reward who perform specific services or duties. These specific services and duties are prescribed in regulation 12 of the Air Passenger Duty Regulations 1994. Furthermore it inserts new section 43(1A) which extends the term 'agreement for carriage' to also include informal arrangements and agreements, such as those between friends and family members.

BACKGROUND NOTE

Part 1 of Schedule 1 - Northern Ireland direct long haul rates of duty from 1 November 2011 to 31 March 2012

33. This rate reduction was introduced in recognition of the unique position of Northern Ireland's airports, and means that the carriage of passengers on certain flights taking off from an airport in Northern Ireland will attract the short haul rate of APD.

34. These flights are those where the journey is direct to long haul destinations or, in a case where there are one or more flights involved, the first connection is made in a long haul destination. For these purposes long haul destinations are those not listed in Part 1 of Schedule 5A.

35. This rate reduction applies to flights that take off from Northern Ireland for the period beginning on or after 1 November 2011 to 31 March 2012.

Part 2 of Schedule 1 - Rates of duty from 1 April 2012

36. As announced at Budget 2011, APD rates are now to be increased annually and in line with inflation. These increases, which also take into account the increase deferred from April 2011, apply to the carriage of chargeable passengers on chargeable flights taking off

from UK airports from 1 April 2012, irrespective of when the flight was actually booked or purchased.

Part 3 of Schedule 1 - Devolution of Northern Ireland direct long haul rates of duty.

37. On 27 September 2011, at the same time that it announced the reduction in APD rates for passengers on direct long haul flights from Northern Ireland, the Government announced that, in order to provide a more lasting solution, aspects of APD would be devolved to Northern Ireland. Part 3 of Schedule 1 includes changes which devolve to the Northern Ireland Assembly the rate of APD to be applied to passengers on direct long haul flights that take off from Northern Ireland, on or after a day to be appointed by order.

38. Part 3 also makes provision for the setting up and maintenance of a separate register of aircraft operators with routes from Northern Ireland. The Commissioners may keep a register of aircraft operators operating routes from Northern Ireland, and if they do, operators currently registered for APD with routes that begin in Northern Ireland will need to register a second time and will need to account for APD on their Northern Ireland routes separately from their other routes. Operators who only operate routes that begin in Northern Ireland will only be required to register on the Northern Ireland register.

39. In addition, to allow for more effective management of the tax, Part 3 introduces provisions for HMRC to disclose information to the Secretary of State, the Treasury or the Department of Finance and Personnel in Northern Ireland.

Part 4 of Schedule 1 - Other Provisions.

40. At Budget 2011 the Chancellor announced that, instead of replacing air passenger duty with a per plane tax, the Government had instead decided to extend the scope of APD to private jets and consulted on how this could be done.

41. There is no ready definition of a private jet, so, in order to extend the scope of APD to private jets, changes to the de minimis weight limit for APD are needed in order to bring smaller aircraft (including private jets) within the scope of the tax.

42. In recognition of the fact that private jets may be customised to provide exceptional standards of luxury travel, new rates of APD will be introduced to apply to these aircraft. These aircraft are to be defined on the basis of weight and seating capacity, so that large aircraft with an authorised weight of more than 20 tonnes and

authorised to seat fewer than 19 passengers will attract new rates of APD.

43. Changes are also required to the definition of a passenger. Under the current APD structure, exemptions apply to passengers who are not carried for reward. As private jet passengers are often carried for no reward or fare (for example, an aircraft owner may be flown in their own private jet) changes to the definition of a passenger are required.

44. Equally private jet passengers are not always flown as part of a formal arrangement or agreement, but instead may be flown as part of an informal agreement such as the type that may exist between family members or friends. In order to ensure that these types of passengers are included in the scope of APD, the interpretation of 'agreement for carriage' will be amended.

45. Part 4 of the Schedule also includes changes to reflect the devolution of direct long haul APD rates to the Northern Ireland Assembly and provides that the new rates to be applied for carriage on aircraft considered to provide exceptional standards of luxury travel (as defined by weight and seating capacity – see para 50 above) are to be twice those to be applied to non standard class travel.

46. These changes apply to flights that take off on or after 1 April 2013.

EXPLANATORY NOTE

CLAUSE 190 SCHEDULE 24: MACHINE GAMES DUTY

SUMMARY

1. Clause 190 and Schedule 24 replace amusement machine licence duty (AMLD) with a new excise duty, machine games duty (MGD), and exempts the takings from machine games from a charge to VAT where those takings are liable to MGD.

DETAILS OF THE SCHEDULE

Part 1 Imposition of Machine Games Duty

2. Paragraph 2(1) of the Schedule defines a machine game as a game that is played on a machine for a prize regardless of whether the game is a game of chance or a game of skill.

3. Paragraphs 2(2) to (6) defines a dutiable machine game as one where any element of its prize is cash, or something that equates to cash, and the maximum amount offered as a cash prize is greater than the lowest charge to play the game on the machine. "Cash" is further defined as money or anything that may reasonably be considered to equate to money, including things of an intangible nature. Paragraph 2(5) provides that if an adult would reasonably assume that these conditions are met, the machine game will be taken to be a dutiable game, even where it does not in fact satisfy these tests. Paragraph 2(6) provides that in order to identify the lowest charge to play a game, for the purpose of determining whether it is a dutiable game, any offer that allows a player to play for nothing or at a reduced cost will be ignored and what would otherwise be the normal charge will be the amount that determines if it is a dutiable game.

4. Paragraphs 3(1) and (2) exclude certain games from the definition of a dutiable machine game if it is a specific form of gambling or there is a liability to, or specific exclusion from, another of the gambling duties. Paragraph 3(3) provides that where a game is played in a number of stages the game will be a dutiable machine game if any one stage on its own, or all the stages together, meet the definition of a dutiable machine game.

5. Paragraph 4 enables the Treasury to specify by order further criteria to take into account in deciding whether a particular game qualifies as a dutiable machine game, and in deciding what should count as a single go at playing any particular game or games.

6. Paragraph 5 makes provision for two types of machines to be defined by reference to the highest charge payable for playing a game and the highest cash prize that can be won from playing a game.

7. Paragraph 6 provides that in any accounting period MGD will be charged on the total net takings from all machines of each type, and prescribes how it will be calculated. Sub-paragraph (6) provides that if a machine changes type during an accounting period the net takings must be calculated separately for the periods before and after the change, and where this is not possible the net takings may be apportioned between the periods either side of the change.

8. Paragraph 7 provides the definition of a person's net takings from a machine as those which are due to them for any period that they are liable for MGD in respect of the machine. Subject to certain stipulations which are specified in this paragraph, or which may be specified in secondary legislation, the net takings are:

- the charges due from players in that period for playing dutiable machine games on the machine; less

- the amounts that are paid out to players as prizes (including the value of non-cash prizes where such prizes are offered by machines also offering at least one cash prize greater than the amount paid to play) in that period as a result of playing dutiable machine games.

9. Paragraph 7(5) provides that any prizes that are paid out unlawfully cannot be treated as payouts when calculating the net takings.

10. Paragraph 7(6) provides for a just and reasonable apportionment of charges or prizes in circumstances where it is not reasonably practicable to make a precise attribution or apportionment. Sub-paragraph (8) gives a power to make regulations if necessary to make provision about when charges or prizes are taken to become due or paid out. Sub-paragraph (9) provides that where a game is played for free, or at a lower cost than would normally be the case, it is the lower charge that will be included in the net takings when the game is played. Sub-paragraph (10) provides that where a player is paid in the form of something that may be redeemed for a prize the prize is taken to be paid out at the time that the thing is redeemed for a prize.

11. Paragraph 8 provides that certain amounts must be disregarded (left out of account) when calculating the takings and payouts described at paragraph 7. This has the effect of creating exemptions in those circumstances. Further exemptions may be provided for by secondary legislation. A draft Treasury order was published for consultation in December 2011. The intention is to make the order under provisions of this paragraph and of Paragraph 39.

12. Paragraph 9 prescribes the standard and lower rates of MGD and makes provision for circumstances where there is a rate change during an accounting period to allow the old and new rates to be applied as appropriate.

13. Paragraph 10 provides that where a person's duty calculation results in a negative amount their liability for that period will be zero, and the negative amount will be carried forward and offset against their liability in the next period. Negative amounts will continue to be carried forward to future periods until such time as the duty calculation results in a positive amount but no repayments or refunds will be made in respect of a negative amount.

14. Paragraph 11 provides that a person is liable for MGD at any time that they are responsible for any premises where dutiable machine games are available for play on a machine that is not an excluded machine. Where there is more than one person who satisfies the conditions specified in paragraph 11(1) each shall be jointly and severally liable for the duty.

15. Paragraph 12 provides the definition of a responsible person for the purposes of determining liability under paragraph 11. A person is defined as a responsible person if they are registered, or registrable, in respect of those premises where machines are available for play. When one of these persons registers for MGD the others will have no liability (further provision about registration is found at paragraphs 20 – 24).

16. Paragraph 13 defines an excluded dual-use machine as one that can be used for playing dutiable machine games and for some other unrelated purpose. It only qualifies as an excluded machine if:

- it is not designed, adapted, or presented to facilitate its use for playing dutiable machine games, or draw attention to such a possibility; or

- the responsible person is unaware, and could not reasonably be expected to be aware, that it is designed, adapted, or presented in such a way.

17. Paragraph 14 provides that MGD will have quarterly accounting periods and that HMRC may:

- direct the day on which an accounting period will begin;

- agree to accounting periods of other than exactly 3 months with starting days other than the first day of the month;

- make transitional arrangements that will allow periods of other than 3 months to be treated as accounting periods in circumstances where someone registers, deregisters or is moving from standard to non-standard periods; and

- specify shorter accounting periods in any case where they believe that a person may not discharge their liabilities.

18. Paragraph 15 provides for the valuation of prizes and includes specific valuation provisions where the prize consists of foreign currency or something, for example, a voucher that may be exchanged for cash.

19. Paragraph 15(4) provides that where a prize consists of foreign currency the value of that prize will be calculated on the last day of an accounting period using the London closing rate from the day before.

20. Paragraphs 15(5) to 15(7) provide that where the prize is a non-cash prize that was obtained from an unconnected third party its value will be the cost of obtaining it from that party. If the prize was obtained from a connected party its value will be the lesser of the amount paid to that connected party, or the amount it would have cost if obtained from an unconnected party. If that cost cannot be reasonably determined it shall be given a value that is just and reasonable. Where the cost of a prize includes VAT paragraph 15(8) provides that the VAT must be included in the value of the prize.

21. Paragraph 16 makes provision for the valuation of the amounts charged for playing a game. Where the charge to play is unclear, or where the charge allows more than one play or covers something in addition to game play (a "composite charge"), this paragraph allows for the charge for playing a game to be determined on a just and reasonable basis. Paragraphs 16(6) and 16(7) provide that in specified, limited circumstances a charge will be attributed to what would otherwise be presented as a free play, or reduced charge. If all of the conditions in sub-paragraph (6) are met the amount of the charge that is due will be the amount that would have been charged in the absence of any offer.

22. Paragraph 17 provides that HMRC is responsible for the collection and management of machine games duty.

23. Paragraphs 18 and 19 provide for HMRC to set out the requirements in respect of MGD returns, payments and assessments in secondary legislation, and that the excise duty assessment provisions in the Finance Act 1994 apply in relation to MGD. A draft of the regulations was published for consultation in February 2012.

24. Paragraphs 20 to 25 make provision about registration and registrable persons, and the publication of the MGD register. Paragraph 20 requires that HMRC maintain a register, the MGD register, and

provides that subject to the exclusion described in paragraph 20(5) no-one may make a machine with dutiable machine games on it available for play on any premises unless a registrable person is registered in respect of those premises. The definitions and descriptions of each of these registrable persons are provided at paragraphs 21 and 22.

25. Paragraph 21(1) provides that the holder of a relevant permit or licence (under paragraph 22) is a registrable person. Where there is a licence or permit specified in that paragraph the holder must register in respect of those premises. Paragraph 21(2) makes provision in respect of tenanted pubs such that the tenant is registrable regardless of whether someone else holds the alcohol licence. Paragraph 21(3) makes provision about registrable persons in respect of travelling fairs and paragraphs 21(4) and 21(5) makes provision about registrable persons in respect of premises that are not covered by paragraphs 21(1) to 21(3).

26. Paragraph 22 defines the licences and permits that are described as "relevant licences or permits" for the purposes of paragraph 21.

27. Paragraph 23 makes provision, and describes the process that HMRC must follow, for compulsory registration when dutiable machine games are available for play on premises for which there is no registration in place. HMRC may give a registration notice to any person believed to be a registrable person in respect of the premises. Paragraphs 23(6) and 23(7) provide for an appeals process against the registration notice and if no appeal is made within the specified time or it is dismissed or withdrawn, HMRC may proceed to register the person in respect of the premises.

28. Paragraph 24 provides for HMRC to set out the procedures and requirements for registration and de-registration in secondary legislation, and prescribes particular aspects and conditions of the registration process that may be provided by those regulations. In particular, paragraphs 24(4), 24(5) and 24(6) make provision in relation to the payment of security, the appointment of a tax representative, and group registrations. A draft of the regulations was published for consultation in February 2012.

29. Paragraph 25 makes provision about the information to be recorded on the MGD register and the conditions that may be attached to its publication.

30. Paragraph 26 provides that in certain circumstances HMRC may give a notice to any person who is believed to be entitled to a share of the takings from a machine on which dutiable machine games are played. The person is referred to in the legislation as a "profit-sharer". That person may become liable to account for MGD for the period specified in the notice. This liability may only be imposed if it

appears that MGD may be chargeable; no-one is registered in respect of the premises; and the responsible persons are not known to HMRC, or are known but overseas. Unless the person, having received a notice from HMRC, can provide HMRC with sufficient information to identify a responsible person, or show that they had taken all reasonable steps to determine that someone was registered in respect of the premises, HMRC may make an assessment for MGD that will be based on that person's share of the machine's takings. Any assessment under this paragraph will be subject to the excise duty assessments and appeals provisions of the Finance Act 1994. If HMRC subsequently identify someone who is responsible, any assessment made against them must take account of the amount that has already been recovered from the other person, but that other person is not entitled to any repayment of the amount for which he was assessed.

31. Paragraph 27 makes provision for the HMRC decisions listed in paragraph 27(2) to be treated as if they were appealable decisions under section 13A of the Finance Act 1994 and covered by the reviews and appeals provisions of that Act.

32. Paragraph 28 provides that the provisions of the Finance Act 2009 that allow for interest to be charged on unpaid duty and assessments may be applied to MGD.

33. Paragraphs 29 to 35 provide that MGD shall become subject to the penalty provisions that already exist in other legislation and which are specified in each of those paragraphs.

34. Paragraph 36 provides that a machine is liable to forfeiture in circumstances where it is, was or is about to be made available for play for dutiable machine games, and either :

- there is no registration for the premises and there is a serious risk that MGD will not be paid, or
- MGD that is due has not been paid in respect of the machine.

35. Paragraph 37 provides that it is an offence to be knowingly involved in the fraudulent evasion of MGD and describes the penalties that may apply to those who are guilty. Paragraph 37(4) qualifies the prescribed penalty provision of paragraph 37(2)(b) to provide that where a person is found guilty on summary conviction of an offence that is committed in Northern Ireland, or in England and Wales before the commencement of s154(1) of the Criminal Justice Act 2003, the maximum term of imprisonment of twelve months that is specified at paragraph 37(2)(b) shall be read as six months. Paragraph 37(5) provides that where fraudulent evasion of MGD is committed by a body corporate, the directors of that body shall be deemed to be guilty of that offence unless it can be proved that they did not

commit, or connive to commit, the offence and that they acted with appropriate due diligence with regard to their role to ensure that no offence was committed.

36. Paragraph 38 adds MGD to the list of betting and gaming duties in section 31 of the Betting and Gaming Duties Act 1981 (BGDA) and provides that an officer of HMRC does not commit an offence when properly undertaking duties in respect of MGD.

37. Paragraph 39 makes provision about orders and regulations that may be made under Part 1 (paragraphs 1-52) of this Schedule and prescribes the Parliamentary procedures that must be followed in respect of the particular statutory instruments containing those orders or regulations.

38. Paragraphs 40(1) and 40(2) provide that HMRC may direct in a published notice that the registration provisions of paragraph 24 shall apply in advance of the implementation of MGD and that that notice may modify those provisions for the transitional period.

39. Paragraph 40(3) provides for transitional arrangements in respect of any person who has been directed, or has been approved, to use accounting periods other than the standard period of 3 consecutive months. These arrangements give the flexibility to provide that the first accounting period for those persons shall start on the MGD go-live date and end on whichever date is appropriate to allow them to then move to the accounting periods that have been directed or approved.

40. Paragraph 41 provides that the definition of "the revenue trade provisions of the customs and excise acts" in the Customs and Excise Management Act 1979 (CEMA) is amended to include the provisions of Part 1 of this Schedule, and that the definition of "revenue trader" in that Act is amended to include those who are responsible persons within the meaning of this Schedule.

41. Paragraph 42(1) makes a consequential amendment to CEMA to substitute a new section 118BC. This new section provides that HMRC's powers of entry and inspection applying in relation to gaming duty shall apply also in relation to MGD, and provides a power to open machines. New sections 118BC (2) and (3) specify what may be inspected and when the inspection may take place, and prescribe the circumstances under which entry or inspection is not permitted. New section 118BC(4) provides that HMRC may require a relevant person to open or operate any relevant equipment and to carry out other operations so that they may determine whether there is any duty liability, and if so, how much. New sections 118BC(5) and (6) define the persons and equipment that may be subject to the inspection powers of this section, while new section 118BC(7) defines "section 10 gaming" by reference to the Finance Act 1997

and prescribes that "premises where a machine is located" are to be interpreted by reference to Part 1 of this Schedule.

42. Paragraph 42(2) provides that civil penalties under the Finance Act 1994 will apply where there is a failure to open relevant equipment for inspection and perform the operations required under new section 118BC.

43. Paragraph 43 amends section 2 of the BGDA to remove the reference to gaming machines as a consequence of the introduction of MGD and the abolition of AMLD.

44. Paragraph 44 amends section 26H BGDA, which provides for exemptions from remote gaming duty (RGD) in circumstances where another gambling tax applies, or would apply but for an express exception.

45. Paragraph 45 inserts a reference to MGD in Schedule A1(7) to BGDA, a new Schedule introduced by the Finance Act 2012. Paragraph 7 of that Schedule stipulates that there will be no payment of double tax relief for general betting duty or pool betting duty where there has been a breach of statutory obligations in respect of the betting and gaming duties listed there.

46. Paragraph 46 inserts a reference to MGD in Schedule 4B(7) to BGDA, a new Schedule introduced by the Finance Act 2012. Paragraph 7 of that Schedule that there will be no payment of double tax relief for remote gaming duty where there has been a breach of statutory obligations in respect of the betting and gaming duties listed there.

47. Paragraph 47 amends the Finance Act 1994 to make MGD subject to the excise duty assessment provisions in section 12 of that Act.

48. Paragraph 48 amends section 10 of the Finance Act 1997, which provides for exemptions from gaming duty, by substituting a reference to MGD for the previous reference to AMLD.

49. Paragraph 49 amends the Borders, Citizenship and Immigration Act 2009 to include MGD in the list of excise duties which are not functions of the Director of Border Revenue.

50. Paragraphs 50 and 51 provide the definitions of specific terms and expressions for the purposes of Part 1 of this Schedule.

Part 2 Removal of Amusement Machine Licence Duty

51. Paragraphs 53 and 54 amend BGDA to omit those provisions that deal specifically with the imposition and administration of AMLD, and remove references to AMLD from those provisions that deal with the general administration of betting and gaming duties.

52. Paragraph 55 omits the reference to an amusement machine licence from the provisions in CEMA about the payment of excise licences by cheque.

53. Paragraph 56 omits the provision in the Finance Act 1997 that provides an exemption from gaming duty by reference to AMLD.

54. Paragraph 57 removes the reference to AMLD from the table of taxes and duties that are subject to penalties for failure to notify etc. in Schedule 41 to the Finance Act 2008.

55. Paragraph 58 removes the reference to AMLD from the list of excise duties for which the Director of Border Revenue has no responsibility to reflect the fact that AMLD is being removed.

56. Paragraph 59 provides a formula which will achieve refunds in respect of the whole months and days which are the subject of the portion of the licence unexpired at the MGD go-live date.

57. Paragraph 59(4) provides that where AMLD is being paid in monthly instalments there may be a liability to pay an amount in respect of any days that form a part-month before the go-live date.

58. Paragraph 59 (5) provides that any person who is entitled to a repayment of more than £10 will be entitled to interest on that amount if they have not been repaid within 90 days of go-live and have notified HMRC of that fact. Interest will be calculated until the day the repayment is made at the rate specified for excise duty payments under s197 of the Finance Act 1996.

59. Paragraph 60 provides that where a licence expires in the final month of AMLD an amount will be payable in respect of the days up to go-live (a "daily rate"). Paragraph 60(6) provides that this rate will be 1/365th of the amount charged for a twelve-month licence. If payment is made before its expiry date, the previous licence will be treated as extended to go-live.

60. Paragraphs 60(7) and (8) provide that the standard requirements for the payment of AMLD and for the enforcement and administration of AMLD shall continue to apply during the 30 day period before go-live. If any machines (for which an AMLD licence is required) are provided for play without a licence in this 30 day period paragraph 60(9) provides that the amount of any assessment for that period will be calculated by reference to 1/365th of the amount charged for a twelve-month licence.

61. Paragraph 61 makes provision in respect of licences that will be granted less than one month before MGD go-live. For licences granted in this period this paragraph disapplies those provisions in BGDA that stipulate the minimum and maximum periods for which a licence application may be made, and provides that these licences

will expire on the day before go-live. Paragraph 61(5) provides that HMRC may direct that the existing administrative arrangements for AMLD shall apply in relation to any final month licences as they do to other licences.

62. Paragraph 62 provides that any legislation that is repealed by Part 2 of this Schedule will continue to have effect after go-live date in relation to things that happened before go-live date.

63. Paragraph 62(3) provides that for assessments to AMLD as a result of a default in the period prior to go-live the assessment shall be made using the amounts of AMLD that were in force the day before the go-live date.

Part 3 VAT Exemption

64. Paragraph 63 substitutes a new section 23 and inserts an additional section 23A into the Value Added Tax Act 1994 (VATA). The new section 23 provides a mechanism for valuing supplies involving relevant machine games, which are defined in section 23A.

65. New Section 23(1) and (2) provide that the amount a person pays to play a relevant machine game is treated as the consideration for a supply of services.

66. Section 23(3), (4) and (5) provide that the value of such supplies is the takings received, less the amount of the winnings paid out, excluding any winnings paid to the supplier or a person acting on their behalf.

67. Section 23(6), (7), (8) and (9) provide for the valuation of tokens inserted into a machine to play a relevant machine game or provided by way of winnings from such a game. Games played solely for prizes consisting of the opportunity to play the game again are not relevant machine games. However a token that enables the machine to be played again may be one of a number of prizes offered by a relevant machine game. Where that is the case, the value of the token is deducted in calculating the value of the relevant supply.

68. Section 23(10) provides that if it is not reasonably practicable for takings and winnings to be attributed to relevant machine games, or apportioned between relevant machine games and other games, the attribution or apportionment is to be carried out on a just and reasonable basis.

69. New Section 23A(1) and (2) define a relevant machine game as a game played on a machine for a prize, unless it is liable to, or is excluded from, specified gambling duties. Relevant machine games may be games of skill, games of chance, or games that involve elements of both skill and chance.

70. Section 23A(3) includes relevant definitions. A "prize" does not include the opportunity to play the game again.

71. Paragraph 64 amends Group 4 (betting, gaming and lotteries) in Part 2 of Schedule 9 (exemptions) to VATA.

72. Paragraph 64 (2) inserts item 1A, which exempts the provision of facilities for playing dutiable machine games from VAT, but only insofar as the takings and payouts from those games are taken into account in determining the charge to MGD. Dutiable machine games may be games of skill, games of chance, or games that involve elements of both skill and chance.

73. Paragraph 64(3) removes Note (1)(d), which excludes gaming machines from exemption under item 1 (exemption of the supply of facilities for placing bets or for playing games of chance for a prize). The introduction of MGD means that it is necessary for the exclusion from item 1 to be framed in different terms.

74. Paragraph 64 (4) inserts Note (1A) which excludes the provision of facilities from item 1 to the extent that those facilities are used to play a relevant machine game.

75. The amendments to Group 4 mean that the provision of facilities for playing games of chance which are not relevant machine games will be exempt from VAT under item 1. The provision of facilities for playing dutiable machine games will be exempt from VAT under item 1A, insofar as the takings and payouts from those games are taken into account in determining the charge to MGD. Other machine games will not be exempt from VAT under Group 4.

76. Paragraph 65 amends paragraph 9 (power to require opening of gaming machines) of Schedule 11 (administration, collection and enforcement) to VATA by substituting a new paragraph (a) which entitles an authorised person to require that a machine on which relevant machine games are capable of being played be opened.

Part 4: Miscellaneous

77. Paragraph 66 provides that this Schedule has effect in relation to the playing of machine games, the provision of amusement machines and supplies made on or after 1 February 2013.

78. Paragraph 67 provides for the Treasury to make transitional or saving provisions for the removal of AMLD and introduction of MGD and prescribes the Parliamentary procedures that must be followed in respect of the statutory instruments containing the regulations.

BACKGROUND NOTE

79. This measure aims to put tax revenues from gaming machines on a more sustainable footing. The VAT treatment of gaming machines has been challenged in the Courts. Introducing MGD and exempting dutiable machine games from VAT will protect tax revenues going forward, and will ensure that operators of gaming machines continue to make a fair contribution to tax receipts.

80. MGD also supports the Government's objective of a fairer tax system by ensuring the taxation of dutiable machine games will be more closely linked to machine takings.

81. MGD will be charged on the net takings from games played on machines where those games offer the player the opportunity to win a cash prize whose value is greater than the cost to play the game once.

82. The rate of MGD that is charged will depend on the maximum cost to play a single game and the maximum cash prize offered for a single game.

83. The standard rate of MGD will be charged at 20 per cent on the takings of dutiable machine games where the maximum cost to play a single game is more than 10p or the maximum cash prize offered for a single game is more than £8. The lower rate of MGD will be charged at 5 per cent on the takings from other dutiable machine games. If a single machine offers games in each category, all of the takings will be charged at the standard rate.

84. If a single machine offers a mixture of dutiable machine games and other services or facilities, only the takings from the dutiable machine games will be liable to MGD.

85. The introduction of MGD and the replacement of AMLD will apply to the playing of machine games from 1 February 2013 and Regulations will be made to allow people to register for MGD before then. The VAT changes will apply to supplies made on or after 1 February 2013.

EXPLANATORY NOTE

CLAUSE 191: AMUSEMENT MACHINE LICENCE DUTY

SUMMARY

1. Clause 191 increases the amounts of amusement machine licence duty (AMLD) payable in respect of licence applications that are received by the Commissioners for Her Majesty's Revenue and Customs (HMRC) after 4 pm on 23 March 2012. The increase is in line with inflation.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table for the existing table of amounts of duty payable on an amusement machine licence contained in section 23(2) of the Betting and Gaming Duties Act 1981. This increases the amount of duty payable on a licence.

3. Subsection (2) provides that this will have effect for any application for an amusement machine licence that is received by HMRC after 4 pm on 23 March 2012.

BACKGROUND NOTE

4. AMLD is a duty of excise that is charged on a licence that allows a gaming machine to be provided for play in the United Kingdom. Other than specific exemptions from the requirement for a licence and certain specific classes of "excepted machines" all amusement machines are subject to the requirement that an amusement machine licence must be granted before the machine can properly be provided for play.

5. The amount of duty that is payable is determined by the number and categories of machines, and the period covered by the licence which can be between one and twelve months. Machine categories are defined by reference to a maximum cost to play a single game and a maximum prize value for winning a single game.

6. The change made by this measure increases the duty payable on an amusement machine licence. The rise is in line with RPI inflation.

EXPLANATORY NOTE

CLAUSE 192: RATES OF GAMING DUTY

SUMMARY

1. Clause 192 increases the gross gaming yield bands for gaming duty in line with inflation for accounting periods starting on or after 1 April 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table for the existing table in section 11(2) of the Finance Act 1997 which has the effect of increasing the gross gaming yield bands for gaming duty.

3. Subsection (2) provides for this change to have effect for accounting periods on or after 1 April 2012.

BACKGROUND NOTE

4. Gaming Duty is charged on any premises in the UK where dutiable gaming takes place. Dutiable gaming includes the playing of casino games such as roulette, baccarat, and blackjack. The amount of duty is calculated by reference to bands of gross gaming yield (GGY) (i.e. gross profits) for that accounting period. For example, duty will be paid at a rate of 15 per cent on the first £2,175,000 of GGY, then 20 per cent for the next £1,499,500 of GGY, and so on. Gaming Duty is charged on premises in respect of accounting periods of six months, normally beginning on 1 April and 1 October, with an interim payment which is calculated and due after three months.

5. The change made by this measure increases the GGY bands but makes no changes to the rates. The basis of revalorisation of the bands is the Retail Price Index (RPI) for the year ended 31 December 2011.

EXPLANATORY NOTE

CLAUSE 193 SCHEDULE 25: REMOTE GAMBLING: DOUBLE TAXATION RELIEF

SUMMARY

1. Clause 193 and Schedule 25 amend the Betting and Gaming Duties Act 1981 (BGDA) to introduce a double taxation relief (DTR) for remote gambling operators who pay General Betting Duty (GBD), Remote Gaming Duty (RGD) or Pool Betting Duty (PBD) in the UK and also pay qualifying foreign taxes on the same transactions in other countries.

DETAILS OF THE SCHEDULE

2. Paragraph 2 inserts into BGDA a new section 5E. This provides that an "eligible bet" is one of a class on which a person is liable to both general betting duty ("GBD") and a qualifying foreign tax where the bet was not made by or on behalf of that person. In the case of an eligible bet, the person may be allowed, as determined by Schedule A1, a credit for some or all of the qualifying foreign tax and may then claim a repayment of GBD which is equal to the amount of any credit. Total repayments to a person for a particular accounting period must not exceed GBD paid in respect of bets of that class.

3. Paragraph 3 inserts into BGDA a new section 8ZA. This provides that an "eligible bet" is one on which a person is liable to both pool betting duty ("PBD") and a qualifying foreign tax where the bet was not made by or on behalf of that person. In the case of an eligible bet, the person may be allowed, as determined by Schedule A1, a credit for some or all of the qualifying foreign tax and may then claim a repayment of PBD which is equal to the amount of any credit. Total repayments to a person for a particular accounting period must not exceed PBD paid.

4. Paragraph 4 inserts a new section 10A into BGDA.

5. New section 10A provides that a qualifying foreign tax is one specified as such in a notice published by the Commissioners (the notice may provide for it to be treated as specified earlier than the date of the notice). The Commissioners are required to specify a foreign tax if it is a gambling tax charged on activities involving betting or gaming the proceeds of which go towards meeting public expenditure.

6. Paragraph 5 inserts into BGDA new sections 26IA, 26IB and 26 IC.

7. New section 26IA provides that "eligible gaming" occurs where a person is liable to pay both remote gaming duty ("RGD") on the provision of remote gaming facilities and a qualifying foreign tax in respect of remote gaming on those same facilities. In the case of eligible gaming, the person may be allowed, as determined by Schedule 4B, a credit for some or all of the qualifying foreign tax and may then claim a repayment of RGD which is equal to the amount of any credit. Total repayments to a person for a particular accounting period must not exceed RGD paid.

8. New section 26IB provides that a qualifying foreign tax is one specified as such in a notice published by the Commissioners (the notice may provide for it to be treated as specified earlier than the date of the notice). The Commissioners are required to specify a foreign tax if it is a gambling tax charged on activities involving betting or gaming the proceeds of which go towards meeting public expenditure.

9. Paragraph 7 inserts a new Schedule A1 into BGDA 1981.

10. New Schedule A1 provides that credit is allowed where neither the notional liability for UK betting duties (calculated by reference to the UK betting duty liability on eligible receipts) nor the notional liability for foreign tax (calculated by reference to the liability to foreign tax in the same accounting period) are zero. Where a credit is allowed it is the lower of the notional UK liability and the notional foreign liability. HMRC are not required to make a repayment to anyone who has a return outstanding for any of the betting and gaming duties and there is a requirement to notify HMRC of any relevant refund of foreign tax with credit then being reduced accordingly. Provision is made for clawback, by means of a repayment to HMRC, in the event that someone who was entitled to a repayment in respect of eligible bets in earlier periods has made a loss in respect of eligible bets later in that same reconciliation period.

11. Paragraph 8 inserts in paragraphs 2 and 2A of Schedule 1 to BGDA powers to enable HMRC to make regulations on the making of claims including the timing and form of claims.

12. Paragraph 9 inserts a new schedule 4B into BGDA.

13. New Schedule 4B provides that credit is allowed where neither the notional liability to UK tax (calculated by reference to the RGD liability on remote gaming profits) nor the notional liability for foreign tax (calculated by reference to the liability to foreign tax in the same accounting period) are nil. Where a credit is allowed it is the lower of the notional UK liability and the notional foreign

liability. HMRC are not required to make a repayment to anyone who has a return outstanding for any of the betting and gaming duties and there is a requirement to notify HMRC of any relevant refund of foreign tax with credit then being reduced accordingly. Provision is made for clawback, by means of a repayment to HMRC, in the event that someone who was entitled to a repayment in respect of eligible gaming in earlier periods has made a loss in respect of eligible gaming later in the same reconciliation period.

14. Paragraph 10 amends section 13A(2) of the Finance Act 1994 so as to provide that HMRC decisions on whether to make a repayment or the amount of any repayment is subject to review and appeal.

15. Paragraph 11 amends Schedule 41 to the Finance Act 2008 so as to apply penalties to the failure to notify HMRC of a refund of a qualifying foreign tax.

16. Paragraph 12 provides for the amendments made by this Schedule to have effect for accounting periods ending on or after 1 April 2012.

BACKGROUND NOTE

17. Following the announcement on 18 July 2011 of a review of remote gambling taxation, the Government has decided to legislate for a DTR for GBD, RGD and PBD in Finance Bill 2012.

18. In respect of accounting periods ending on or after 1 April 2012, operators will be able to claim relief where GBD RGD, or PBD is paid in the UK and the operator has also paid a foreign gambling tax on the same transactions.

19. The measure will enhance the competitiveness of the UK tax system by ensuring that UK based operators do not suffer from double taxation as other countries introduce place of consumption based taxation regimes for remote gambling.

EXPLANATORY NOTE

CLAUSE 194: VED RATES FOR LIGHT PASSENGER VEHICLES, LIGHT GOODS VEHICLES, MOTORCYCLES ETC

SUMMARY

1. Clause 194 provides for changes to certain rates of vehicle excise duty (VED) by amendment of the Vehicle Excise and Registration Act 1994 (VERA). Changes to the rates take effect in relation to vehicle licences taken out on or after 1 April 2012.

DETAILS OF THE CLAUSE

2. <u>Subsection (2)(a)</u> amends paragraph 1(2) of Schedule 1 to VERA to increase the general rate of duty by £5 to £220 except for vehicles with an engine size of 1549cc or less.

3. <u>Subsection (2)(b)</u> amends paragraph 1(2A) of Schedule 1 to VERA to increase the general rate of duty by £5 to £135 for vehicles with an engine size of 1549cc or less.

4. <u>Subsection (3)</u> amends paragraph 1B of Schedule 1 to VERA to change most of the graduated rates of duty which apply generally to light passenger vehicles first registered on or after 1 March 2001. Table 1 provides the rates payable on a first vehicle licence for a vehicle and table 2 provides the rates on all other licences for a vehicle registered on or after 1 March 2001. Table 2 operates so that vehicles emitting over 225 grams of carbon dioxide per kilometre that were registered in the United Kingdom or overseas before 23 March 2006 pay a lower rate than those registered from 23 March 2006 onwards.

5. <u>Subsection (4)(a)</u> amends paragraph 1J(a) of Schedule 1 to VERA to increase by £5 to £215 the rate of duty for Light Goods Vehicles which are not lower-emission vans.

6. <u>Subsection (4)(b)</u> amends paragraph 1J(b) of Schedule 1 to VERA to increase the rate of duty for lower-emission vans by £5 to £135. Lower-emission vans are models which met the Euro 4 air quality pollutant emissions standard early and were registered on or after 1 March 2003 and before 1 January 2007, or that met the Euro 5 air quality pollutant emissions standard early and were registered on or after 1 January 2009 and before 1 January 2011.

7. Subsection (5)(a) amends paragraph 2(1)(b) of Schedule 1 to VERA to increase the rate of duty by £1 to £36 for motorbicycles with an engine size of over 150cc but not more than 400cc.

8. Subsection (5)(b) amends paragraph 2(1)(c) of Schedule 1 to VERA to increase the rate of duty by £2 to £55 for motorbicycles with an engine size of over 400cc but not more than 600cc.

9. Subsection (5)(c) amends paragraph 2(1)(d) of Schedule 1 to VERA to increase the rate of duty by £2 to £76 for motorbicycles with an engine size over 600cc, for motortricycles with an engine size over 150cc and for trade licences for motorcycles.

10. Subsection (6) provides that all new rates under this clause will take effect for licences taken out on or after 1 April 2012.

BACKGROUND NOTE

11. The rate of Vehicle Excise Duty (VED) chargeable on vehicles is dependent on various factors including the vehicle type, engine size, date of first registration and exhaust pipe emissions data. The rate applying to cars registered on or after 1 March 2001 is generally determined by the vehicle's carbon dioxide emissions. A reduced rate of VED applies to cars using alternative fuels or featuring a hybrid fuel-electric powertrain. Alternative fuels include Liquefied Petroleum Gas, Compressed Natural Gas and high blend (at least 85 per cent content) bioethanol.

12. The rate applying to vans registered on or after 1 March 2001 is lower if the van met reduced pollution requirements early, that is, before certain emissions requirements became mandatory for new vans.

13. Cars and vans registered prior to March 2001, and all motorcycles, are taxed by reference to the engine size.

14. This year the Government intends to increase VED rates by no more than inflation. VED rates for Heavy Goods Vehicles (HGVs) and buses are frozen.

15. The changes in rates apply to all vehicle licences taken out on or after 1 April 2012 regardless of the commencement date on the licence.

FINANCE BILL 2012
RESOLUTION 49 CLAUSE 195
SCHEDULE 26

EXPLANATORY NOTE

CLAUSE 195 AND SCHEDULE 26: ANTI-FORESTALLING CHARGE TO VALUE ADDED TAX

SUMMARY

1. Clause 195 and Schedule 26 relate to the imposition of VAT on supplies of self storage and approved alterations to protected buildings from 1 October 2012. The clause and Schedule introduce an anti-forestalling charge applying to such supplies if they are treated as taking place before 1 October 2012 for VAT purposes but the services are carried out or performed, or materials are incorporated into the building, on or after that date. The charge is treated as VAT and is due on 1 October 2012.

DETAILS OF THE SCHEDULE

2. Paragraph 1(1) provides that the Schedule will apply where an order made under sections 30(4) or 31(2) of VATA 1994, coming into force on 1 October 2012, changes the descriptions of exempt and zero-rated supplies ('the changes in VAT liability') and the change made by the Order relates to supplies described in paragraph 3 of the Schedule ('relevant supplies'). Paragraph 1(2) provides for definitions.

3. Paragraph 2 provides for an anti-forestalling charge to apply to a relevant supply where:

   a. it is treated as taking place on or after 21 March 2012, but

   b. if it was treated as taking place on 1 October 2012, it would have been affected by the change in VAT liability, and

   c. the relevant supplies are, in respect of services, carried out or provided, and, in respect of building materials incorporated into the building, after 1 October 2012 ('the post-change period').

   It also provides that the charge is to be treated as VAT.

4. Paragraph 3 provides a description of the supplies of goods and services covered by the Schedule. For self storage supplies, this includes rights or options to receive self storage in future.

5. Paragraph 4 describes the circumstances in which the relevant supplies are linked to the post-change period.

6. Paragraph 5 provides for a power to modify the Schedule by Treasury Order in relation to preventing an anti-forestalling charge from arising in relation to any description of the supplies specified in the Schedule.

7. Paragraph 6 provides that an anti-forestalling charge is the liability of the supplier and that it is due on 1 October 2012. Where a supplier is part of a VAT group registration, it provides that the charge is the liability of the representative member of the group.

8. Paragraph 7 provides the method for the calculation of the anti-forestalling charge including the rate of VAT to apply and how to apportion consideration for supplies partly linked to the post-change period.

9. Paragraph 8 provides that a person liable for the anti-forestalling charge who is no longer a taxable person when it becomes due should account for the charge on its last VAT return. If this is not done and HMRC assess for the charge, any interest is only chargeable from 1 October 2012.

10. Paragraph 9 provides that where there is an anti-forestalling charge under the Schedule, the consideration for the supply is to be increased by the amount of the charge, unless the contract provides otherwise.

11. Paragraph 10 provides that the VAT Regulations 1995 (SI 1995/2518) may be amended to make provision for changes to invoices in respect of the anti-forestalling charge.

BACKGROUND NOTE

12. In his Budget Statement of 21 March 2012, the Chancellor announced changes to the VAT liability of grants of self storage of goods and approved alterations of protected buildings with effect from 1 October 2012. On 21 March 2012, the Exchequer Secretary to the Treasury, in a Written Ministerial Statement, explained that the Government would introduce anti-forestalling legislation to ensure that these liability changes have effect in relation to any supplies contracted for from 21 March 2012 and which are performed on or after 1 October 2012. (Protected buildings are listed buildings or scheduled monuments which are dwellings or are used for residential or charitable non-business purposes).

EXPLANATORY NOTE

CLAUSE 196: EXEMPT SUPPLIES

SUMMARY

1. Clause 196 implements Article 132(1)(f) of Council Directive 2006/112/EC, the Principle VAT Directive ("PVD"). It adds a new Group 16 (supplies of services by groups involving cost sharing) to Schedule 9 ("Schedule 9") of the Value Added Tax Act 1994 ("VATA") which exempts from VAT the supply of services by a group which consists of persons engaged in exempt or non-taxable activities so long as the services are supplied to group members at cost and for the purposes of those activities.

2. This clause also introduces a power, allowing the Treasury to impose conditions in connection with the application of the exemption.

DETAILS OF THE CLAUSE

3. Section 31 of VATA provides that supplies described in Schedule 9 are to be treated as exempt from VAT. The exempt supplies are itemised in a number of different groups in Part II of that Schedule in accordance with their subject matter (for example exempt supplies relating to land are itemised in Group 1). There is an index to the groups in Part 1 of Schedule 9. There is currently no provision in VATA for the exemption contained in Article 132(1)(f) of the PVD.

4. <u>Subsection (1)</u> inserts a reference to a new Group 16 into the Schedule 9 index.

5. <u>Subsection (2)</u> inserts a <u>new Group 16</u> (supplies of services by groups involving cost sharing) into Part II of Schedule 9 which describes the exempt supply as a supply of services by an independent group of persons subject to four conditions namely:

   - the members of the group are each engaged in exempt or non-taxable activities;

   - the supply is made for and directly necessary for those activities;

   - the group merely claims exact reimbursement for those services; and

   - relief from taxation is not likely to cause distortion of competition.

6. Subsection (3) inserts new subsection 31(3) to (5) into VATA, allowing the Treasury to make regulations imposing conditions in connection with the operation of the exemption in the new group 16 and to make consequential and transitional provisions in that connection (including amendment to primary legislation).

7. Subsection (4) sets out the effective date of the clause.

BACKGROUND NOTE

8. The exemption reduces a barrier that might prevent businesses and organisations that have exempt and/or non-business activities for VAT purposes from joining with others to share costs...

9. Businesses and organisations that have exempt and/or non-business supplies are not able to reclaim the VAT they incur on their purchases that relate to such supplies (irrecoverable VAT). If they co-operate by forming a group to provide them with services necessary to their exempt/non-business activity they would normally pay VAT on the supply of those services. This exemption relieves such supplies from VAT but only where the services are supplied by the group to group members at cost and only if relief from VAT does not itself distort competition.

10. The exemption is defined in broad and general terms in the PVD and this is reflected in the clause. HMRC will develop detailed guidance in consultation with taxpayers in order to provide a clear framework within which the exemption can operate effectively and to the benefit of taxpayers whilst ensuring the scope for avoidance or abuse is limited.

11. The exemption will benefit all sectors undertaking exempt and/or non-business activities including charities, universities, further education colleges, banks, housing associations and insurance businesses.

EXPLANATORY NOTE

CLAUSE 197: SUPPLY OF GOODS OR SERVICES BY PUBLIC BODIES

SUMMARY

1. Clause 197 implements Article 13(1) of the Principal VAT Directive (2006/112/EC)("the PVD") by inserting a new section, 41A, into the Value Added Tax Act 1994 (VATA).

2. It applies to Government departments, local authorities and analogous public bodies who supply goods and services when acting within a legal framework, such as a statute, which applies only to them and not to private individuals.

3. Such bodies are not to be treated as taxable persons unless their exemption would lead to distortion of competition.

4. The exemption does not however apply to their engagement in activities described in Annex 1 of the PVD (“Annex 1”) unless those activities are carried out on such a small scale as to be negligible.

DETAILS OF THE CLAUSE

5. Subsection (2) amends section 41 VATA (“section 41”). Section 41 applies VATA to the Crown. Section 42(2) provides for the taxation of goods and services supplied by Government departments in certain circumstances where such supplies are not taxed under general VATA provisions. Sub section (2) deletes section 41(2) and makes a consequential amendment to section 41(3)(b) so that reference is made to the new section 41A of VATA which will determine when supplies by Government departments are taxed.

6. Subsection (3) inserts a new section 41A which provides as follows:

   - New section 41A(1) provides that the section will apply to supplies of goods and services made by a public body (being a body within the ambit of Article 13(1) PVD) which is acting in its capacity as a public authority;

   - New section 41A(2) provides that (where the new section 41 applies) a supply in respect of an activity listed in Annex 1 of the PVD is to be treated as a supply in the course or furtherance of business (and therefore taxable in accordance with section 4 of VATA) unless the activity is on such a small scale as to be negligible;

- New section 41A(3) provides that (where the new section 41 applies) a supply which is not in respect of an Annex 1 activity is only to be treated as a supply in the course or furtherance of a business if relieving it from VAT would lead to a significant distortion of competition

BACKGROUND NOTE

7. Article 13(1) provides that public bodies (Government departments, local authorities and analogous institutions) should not be taxed when making supplies of goods and services unless those supplies arise out of Annex 1 activities (which are not negligible) or relief from VAT would cause significant distortions of competition.

8. There is no explicit transposition of Article 13(1) into UK legislation. HMRC has given effect to the Article by interpreting existing legislation in a way that achieves the correct result for the Article's purposes. However recent litigation has cast significant doubt on whether this approach amounts to an effective implementation of Article 13(1).

9. This provision puts the effective implementation of the article beyond doubt and therefore precludes the possibility of infraction proceedings being taken against the UK. In practice public bodies should see no change to their existing tax treatment as a result of the legislative changes. It also provides a clear legislative base for applying the appropriate test to determine whether a particular supply is taxable in an environment where public and private sector provision is constantly evolving.

EXPLANATORY NOTE

CLAUSE 198: RELIEF FROM VAT ON LOW VALUE GOODS: RESTRICTION RELATING TO CHANNEL ISLANDS

SUMMARY

1. Clause 198 will remove Low Value Consignment Relief (LVCR) from mail order goods imported into the UK from the Channel Islands.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that Group 8 of Schedule 2 to the Value Added Tax (Imported Goods) Relief Order 1984 (S.I. 1984/746) (articles sent for miscellaneous purposes) is amended.

3. Subsection (3) inserts two new Notes into Group 8 which together provide that LVCR will not apply to any goods sent from the Channel Islands under a distance selling arrangement.

4. Subsection (4) provides that the amendment of Schedule 2 by primary legislation does not prevent amendment of that Schedule in future by subordinate legislation.

5. Subsection (5) provides that the amendments have effect in relation to mail order goods imported on or after 1 April 2012.

BACKGROUND NOTE

6. Article 23 of Council Directive 2009/132 provides for Member States to exempt from VAT goods of negligible value imported into the European Union. Member States may set the threshold for exemption at between €10 and €22 (between £9 and £20). The relief is implemented in the UK by Item 8 of Group 8 of Schedule 2 to the Value Added Tax (Imported Goods) Relief Order 1984 (SI 1984/746). Recital 5 of Council Directive 2009/132 makes granting of the relief (at any level) subject to the condition that it is not liable to affect the conditions of competition on the market. Article 23 of the Directive also allows member states to exclude from the relief goods which have been imported by mail order.

7. In Budget 2011, the Chancellor of the Exchequer announced a reduction in the threshold for LVCR from £18 to £15 with effect from 1 November 2011. He also announced his intention to explore further

measures to prevent exploitation of LVCR as it was never intended that LVCR should be used in this way.

8. Most LVCR trade is from the Channel Islands. The Government therefore concluded that the supply of mail order goods to UK customers from the Channel Islands was affecting the conditions of competition on the UK market. The Chancellor therefore announced on 9 November that LVCR would be withdrawn completely for all goods imported on or after 1 April from the Channel Islands.

EXPLANATORY NOTE

CLAUSE 199: GROUP SUPPLIES USING AN OVERSEAS MEMBER

SUMMARY

1. Clause 199 puts on a statutory footing a long standing concession on how the reverse charge on an intra-group supply (which arises when a partly exempt VAT group buys in services through an overseas group member) should be valued. It applies where the representative member of the group satisfies the Commissioners as to the value of the bought in services. It sets out how the charge is to be calculated and allows HMRC to direct that the value of the bought in services is to be an open market value. It also provides a power for subsequent amendments to be made to the valuation provision.

DETAILS OF THE CLAUSE

2. Subsection (2) inserts a provision into section 43(2C)(c) of the Value Added Tax Act 1994 (VATA). Section 43(2C)(c) provides that the value of intra-group supplies falling within section 43(2A) are to be treated as a reverse charge in accordance with section 8 of VATA. The inserted provision provides that the supplies may be subject to the valuation provisions in new paragraph 8A of Schedule 6.

3. Subsection (3) provides for a right of appeal for the taxpayer against an open market valuation direction.

4. Subsection (4) provides for any subsequent order varying the valuation provisions to be subject to the affirmative resolution procedure.

5. Subsection (6) provides that paragraph 1 of Schedule 6 does not apply to supplies valued in accordance with new paragraph 8A of that schedule.

6. Subsection (7) inserts new paragraph 8A into Schedule 6

7. New paragraph 8A applies where two conditions (set out in new paragraph 8A(1)) are met. Firstly a supply giving rise to the reverse charge is made and secondly the representative member of the VAT group satisfies the Commissioners as to the value of bought in supplies.

8. New paragraphs 8A(3) to (5) make provisions as to how the intra-group supplies shall be valued. Where the value of the bought-in supply or supplies is at least open market value, the value of the intra-

group supply is the value of the bought-in supply or supplies (or the element thereof that is a cost component of the intra-group supply in question). Where the value of any bought-in supply is less than its open market value, the Commissioners may direct that the intra-group supply be valued taking an open market value for that bought-in supply (or the element thereof that is a cost component of the intra-group supply in question).

9. New paragraph 8A(6) provides that any direction must be given by notice in writing and must be within 3 years from the date of the intra-group supply.

10. New paragraphs 8A(7) and (8) allow the Treasury by order to amend the valuation provision and make any consequential provisions necessary.

11. Sub-section (8) provides that the changes will have effect from Royal Assent. The current concession will continue to apply until that point.

BACKGROUND NOTE

12. A reverse charge is a mechanism for taxing supplies of services bought by businesses from outside the UK but consumed within the UK.

13. Supplies made by one member of a VAT group to another are disregarded (section 43(1) of VATA). Therefore no VAT would be chargeable when supplies from outside the UK are brought into a UK VAT group by a member belonging overseas. Sections 43(2A) to 43(2E) of VATA are anti-avoidance provisions preventing reverse charges from being avoided by buying in services, ultimately for consumption within the UK, via a VAT group member belonging overseas.

14. This valuation provision is necessary (as was the concession it replaces) to restrict the impact of sections 43(2A) to 43(2E), in appropriate circumstances, to the bought–in services introduced into the UK via an intra-group charge. Without this provision the charge would apply to the use of the overseas group member's own resources included in the intra-group charges as well as the bought in services.

EXPLANATORY NOTE

CLAUSE 200: POWER TO REQUIRE NOTIFICATION OF ARRIVAL OF MEANS OF TRANSPORT IN UK

SUMMARY

1. Clause 200 provides for the introduction on 15 April 2013 of a new notification system for arrivals of means of transport in the United Kingdom, and payment of VAT due.

DETAILS OF THE CLAUSE

2. New paragraph 2(5A) provides that provision may be made by regulations for requiring a relevant person to notify, and make payment of any VAT due in respect of, the arrival in the UK of a means of transport from another member State, or from outside of the member States, to the Commissioners at such time and in such form and manner as they may specify.

3. New paragraph 2(5B) provides that provision may be made by regulations made under new paragraph 2(5A):

   - to specify the particulars to be notified to the Commissioners in relation to the arrival of a means of transport in the UK (including details of any VAT chargeable);

   - for a person specified or of a description specified in the regulations who is not the relevant person to make the notification on behalf of a relevant person;

   - for the notification to contain a declaration given in such form and by such person as may be specified in the regulations in relation to the information contained in the notification, and;

   - to make supplementary, incidental and consequential changes to other parts of the legislation and introduce transitional provisions if need be.

4. New paragraph 2(5C) provides that section 97(3) Value Added Tax Act 1994 ("VATA") (i.e. the affirmative resolution procedure) applies to regulations made under new paragraph 2 (5A) which amend an enactment.

5. New paragraph 2 (5D) introduces definitions for the terms "means of transport" and "relevant person".

BACKGROUND NOTE

6. At Budget 2011, the Government announced a joint initiative between HM Revenue & Customs (HMRC) and the Driver and Vehicle Licensing Agency (DVLA) to combat VAT fraud on road vehicles brought into the UK.

7. From 2013, a person bringing a new or used road vehicle into the UK for permanent use on UK roads will have to notify HMRC within 14 days of the arrival of the road vehicle in the UK. In the case of an acquisition of a new road vehicle from within the EU, private individuals and non-VAT registered businesses will be required to pay any VAT due at the time of notification. VAT registered customers will continue to make payment via their VAT returns. In the case of a road vehicle imported from outside the EU, VAT will continue to be collected under existing arrangements.

8. Until HMRC is notified and any VAT due has been paid or, in the case of VAT registered businesses, is assessed as "secure", it will not be possible to licence and register a road vehicle with the DVLA. Online notification is expected to be the preferred method of communication, although a paper channel will also be available.

EXPLANATORY NOTE

CLAUSE 201: NON-ESTABLISHED TAXABLE PERSONS

SUMMARY

1. Clause 201 and Schedule 27 amend the Value Added Tax Act 1994 ('VATA') from 1 December 2012, to insert a new Schedule 1A. New Schedule 1A changes the rules for determining when a business which makes taxable supplies in the UK but has no establishment here has to register for VAT. Non-UK established businesses will no longer be able to benefit from the UK VAT Registration threshold. The clause also makes consequential changes to other parts of VATA and the Finance Act 2008.

DETAILS OF THE SCHEDULE

Details of the new Schedule 1A to VATA

2. New Schedule 1A applies to any person who makes taxable supplies in the UK but has no establishment here and requires that person to register and account for VAT on those supplies irrespective of their value.

3. New paragraphs 1 and 2 provide that the liability to register arises when a person reasonably anticipates making taxable supplies within the next 30 days, does in fact make such supplies or a business is transferred to that person as a going concern.

4. New paragraphs 5 and 6 provide that the person must notify liability to register within 30 days of the liability arising and the Commissioners must register that person with effect from the date when the liability arises.

5. New Schedule 1A also specifies when a person will cease to be liable to be registered under the new schedule (new paragraph 4) and makes provision for various matters that may arise in connection with registration such as wrongful registration under another Schedule (new paragraph 3), cancellation of registration (both compulsory and by election) and the effective date of such cancellation, (new paragraphs 7 to 12). These provisions also specify the timescales for the notification and execution of various matters relating to cancellation of registration.

6. New Schedule 1A makes particular provision for the possibility that a person may be liable to be registered under the new Schedule and also entitled to be registered under Schedule 3B to VATA (special

accounting scheme for the supply of electronic services in member States) (new paragraph 12).

7. New Paragraph 13 provides that a person liable to registration under the new Schedule may, on request and subject to HMRC's approval, be exempted from registration if that person intends to or makes only zero-rated supplies (and so would, if registered, be entitled to a VAT refund but not liable to pay VAT).

Other amendments of VATA 1994

8. Paragraphs 2 to 17 of this Schedule make amendments that are consequential on the inclusion of the new Schedule 1A.

9. Paragraphs 3 to 17 ensure that VATA applies to Schedule 1A as it applies to Schedule 1 for the following contexts:

- place of supply of goods rules (paragraph 3);
- schemes for farmers (paragraph 4),
- accounting for gold (paragraph 5);
- reverse charge provisions for missing trader intra-community (MTIC) trading activities (paragraph 6);
- regulatory breaches (paragraph 7);
- powers of assessment and related matters (paragraphs 8 to 10); and
- interaction with other registration schedules (paragraphs 14 to 17).

10. Paragraphs 11 to 13 ensure that the relevant parts of Schedule 1 apply only to persons established in the UK.

11. Paragraph 11(4) provides that the value of the taxable supplies of a person established in the UK for the purposes of determining that person's liability to register under Schedule 1 shall include supplies made prior to that person becoming established.

12. Paragraph 18 provides that Schedule 41 to Finance Act 2008 applies to New Schedule 1A as it applies to Schedule 1 for the context of obligations to notify a liability to register and for material changes in the nature of supplies made by exempt persons.

BACKGROUND NOTE

13. These amendments to VATA bring UK law into line with the judgement of the Court of Justice of the European Union in Schmelz C-97/09. The judgement confirmed a business without an establishment in a member State is prohibited from benefiting from that State's VAT registration threshold.

14. Member States are permitted to apply VAT registration thresholds by the provisions of Chapter 1 of Title XII of Council Directive 2006/112/EU, the Principle VAT Directive ('PVD'). The provisions enable member States to relieve small businesses from the burden of VAT registration. Article 283 (1)(c) of the PVD prohibits a threshold being applied to '*a taxable person who is not established in the Member State in which the VAT is due*'.

15. There is an establishment in the UK if:

- The place where essential management decisions are made and the business's central administration is carried out is the UK and/or
- The business has a permanent physical presence with the human and technical resources to make or receive taxable supplies in the UK.

16. The Court in *Schmelz* confirmed that although the restriction of the application of a threshold to domestically established businesses was discriminatory (in that it interfered with the freedom to provide services under article 49 of the EC treaty) it was justified by the need for effective fiscal supervision of the threshold and proportionate to that need. It was therefore a lawful restriction on the application of the threshold.

EXPLANATORY NOTE

CLAUSE 202 SCHEDULE 28: ADMINISTRATION OF VAT

SUMMARY

1. Clause 202 and Schedule 28 amend the Value Added Tax Act 1994 ('VATA') from 31 October 2012 so that the form and manner in which persons are required to make certain communications to the Commissioners for HM Revenue and Customs ("the Commissioners") (and, in some cases, the particulars or information and documents to be provided) can be specified in regulations or in accordance with regulations. The communications are applications to register for VAT, make returns or statements, submit claims or request refunds, keep accounts, notify certain transactions and events and request certification. The clause also makes consequential amendments to the Finance Acts 1996 and 2009 and updates a reference to EU law.

DETAILS OF THE SCHEDULE

2. Paragraph 2 provides that the certificate required to evidence that acquired eligible goods are to be placed in a fiscal warehousing regime must be in the form specified by the Commissioners in or in accordance with regulations.

3. Paragraph 3 provides that the certificate a person gives to a supplier to evidence that supplies of specified services are in relation to goods subject to a warehousing or fiscal warehousing regime must be in the form specified by the Commissioners in or in accordance with regulations.

4. Paragraph 4 provides that a claim by a person requesting a refund of VAT relating to the construction or conversion of certain buildings must be made in the form and manner, contain the information and be accompanied by the documents specified by the Commissioners in or in accordance with regulations.

5. Paragraph 5 provides that businesses established outside the UK who request a refund of VAT incurred in the UK must make such a claim in the form and manner specified by the Commissioners in or in accordance with regulations.

6. Paragraph 6(2) updates the reference to EU law in Section 48 VATA following the replacement of Council Regulation (EC) No 1798/2003 by Council Regulation (EC) No 904/2010.

7. Paragraph 6(3) provides that, where a tax representative is appointed or ceases to act on behalf of another taxable person who is not established in the UK, the required notification must be made in the

form and manner and contain the particulars specified by the Commissioners in or in accordance with regulations.

8. Paragraph 7 provides that a person who wants to apply to join or leave the VAT Agricultural Flat Rate Scheme must do so in the form and manner specified by the Commissioners in or in accordance with regulations.

9. Paragraphs 8 - 11 provides that any notification that is required by any provision of Schedules 1 to 3A to VATA must be made in the form and manner and contain the particulars specified by the Commissioners in or in accordance with regulations.

10. Paragraph 12(2) provides that persons who are required to keep VAT accounts and make VAT returns must do so in the form and manner specified by the Commissioners in or in accordance with regulations.

11. Paragraphs 12 (3), (4) and (5) make consequential amendments to ensure that the wording of paragraph 2 of Schedule 11 VATA is consistent.

12. Paragraphs 12 (6) and (7) provide that a notification of the acquisition of certain goods must be made in the form and manner and contain the particulars specified by the Commissioners in or in accordance with regulations.

Amendment of Finance Acts 1996 and 2009

13. Paragraph 13 repeals:

(a) section 30(2) of the FA 1996 (which amended VATA 94, Section 35(2)), as a result of the amendment made by paragraph 4.

(b) section 77(2)(d) of the FA 2009 (which amended VATA94, Section 39(3)), as a result of the amendment made by paragraph 5.

BACKGROUND NOTE

14. These amendments to VATA will allow the Commissioners of HM Revenue and Customs to determine the form of a number of specific communications (which were previously contained in Schedule 1 to the VAT Regulations 1995) in tertiary law. These prescribed VAT forms are a small subset of the total number of VAT forms that HMRC make available to businesses to facilitate notifications and other communications. The amendments will enable HMRC to update and revise the prescribed VAT forms without having to amend the VAT Regulations 1995 and therefore respond more quickly to changing business needs.

EXPLANATORY NOTE

CLAUSE 203: STANDARD RATE OF LANDFILL TAX

SUMMARY

1. Clause 203 increases the standard rate of landfill tax from £64 per tonne to £72 per tonne for disposals of relevant waste made or treated as made at authorised landfill sites on or after 1 April 2013.

DETAILS OF THE CLAUSE

2. Subsection (1) changes the rate of landfill tax from "£64" to "£72" in sections 42(1)(a) and 42(2) of the Finance Act 1996 (amount of landfill tax).

3. Subsection (2) provides for the increase to apply to disposals of relevant waste made, or treated as made, on or after 1 April 2013.

BACKGROUND NOTE

4. Landfill tax was introduced on 1 October 1996 to increase the cost of disposing of waste and thereby encourage waste producers and the waste management industry to switch to more sustainable alternatives to disposing of waste. There is a lower rate of tax, which applies to less polluting qualifying wastes listed in a Treasury Order, and a standard rate which applies to all other taxable waste disposed of at authorised landfill sites.

5. In the June 2010 Budget, the Government confirmed that the standard rate of landfill tax would rise by £8 per tonne on 1 April each year up to and including 2014. The Government also announced a floor under the standard rate of landfill tax so that the rate will not fall below £80 per tonne from 2014-15 to 2019-20.

6. The Government announced in Budget 2012 that the lower rate of landfill tax, currently £2.50 per tonne, will remain frozen in 2013-14.

EXPLANATORY NOTE

CLAUSE 204: LANDFILL SITES IN SCOTLAND

SUMMARY

1. Clause 204 introduces retrospective legislation to correct an omission in landfill tax legislation in relation to the definition of a landfill site in Scotland. The legislation will have retrospective effect back to 21 March 2000 and will bring Scottish legislation into line with the rest of the UK.

DETAILS OF THE CLAUSE

2. Clause 204 will deem section 66(ba) Finance Act (FA) 1996 to have been in force in Scotland from 21 March 2000.

BACKGROUND NOTE

3. Following the UK's adoption of the Integrated Pollution Prevention and Control Directive 96/61/EC, there was a phased transition as UK landfill sites moved from a regime of licences and resolutions to a system of permits introduced in the Pollution Prevention and Control Act ("PPCA") 1999.

4. The definition of a landfill site in landfill tax legislation cross refers to this environmental legislation. It was recognised that this site-by-site transition to permits would have a consequential impact on landfill tax provisions and, to deal with this situation, the PPCA amended landfill tax legislation to introduce a new subsection (ba) into section 66 of the FA 1996 from a date to be appointed by secondary legislation.

5. These amendments were brought into force in England and Wales on 21 March 2000 and Northern Ireland on 17 January 2003. However, the necessary commencement order was not made in Scotland, thereby unintentionally taking each Scottish landfill site outside the scope of landfill tax from the date its permit took effect. The effect of this clause is to bring section 66(ba) into force from the same date it was brought into force in England and Wales.

EXPLANATORY NOTE

CLAUSE 205 SCHEDULES 29 TO 31: CLIMATE CHANGE LEVY

SUMMARY

1. Clause 205 and Schedules 29 to 31 amend climate change levy (CCL) provisions.

Schedule 29 – Climate change levy

2. This Schedule is split into three parts.

- Part 1 retrospectively amends Schedule 6 to the Finance Act (FA) 2000 ("Schedule 6") to provide that the amount of CCL payable on a supply that has been treated as a reduced rate supply, but which it is later determined should not have been, is 65 per cent with effect from 1 April 2011.

- Part 2 amends Schedule 6 by replacing the suspended exemption from the CCL for taxable commodities used in metal recycling processes with a 20 per cent lower rate from 1 April 2012.

- Part 3 amends the rates of levy set out in Schedule 6, including the reduced rate on supplies of electricity and the lower rate for Northern Ireland gas supplies, with effect from 1 April 2013.

Schedule 30 – Climate change levy: climate change agreements

3. This Schedule amends Schedule 6 to make changes to the administration of the climate change agreement (CCA) scheme from 1 April 2013. Participants in the scheme are entitled to a discount from the CCL in return for meeting energy efficiency or emission reduction targets.

Schedule 31 – Climate change levy: supplies subject to the carbon price support rates and combined heat and power stations

4. This Schedule is split into three parts. Part 1 amends Schedule 6 to:

- introduce a generating capacity threshold at an electricity generating station or combined heat and power (CHP) station below which supplies are exempt from the carbon price support (CPS) rates of CCL;

- introduce an exemption from CCL for all coal used at generating stations with a gross calorific value of 15 gigajoules per tonne or less;

- provide for CPS rates of CCL to be charged on the supplies of gas, liquefied petroleum gas (LPG) and coal used in producing electricity in a CHP station;

- require power generators liable to account for CPS rates of CCL to self-account;

- amend one of the taxable commodities for the CPS rates of CCL to coal, and amend the basis of the charge from weight (i.e. per kilogram) to heat (i.e. per gigajoule);

- introduce an abated rate for supplies of fossil fuels to power generating stations equipped with carbon capture and storage (CCS) technology;

- provide for Treasury regulations to determine the extent to which a supply to a CHP station is attributable to the production of electricity;

- provide for Commissioners' regulations to determine whether, and to what extent, there should be a reduction in CPS rates on supplies to generating stations with CCS technology; and

- make some consequential changes to Schedule 6.

All these changes will have effect on and after 1 April 2013.

5. Part 1 also provides for the Treasury to make regulations to exempt from CCL (including the CPS rates) fossil fuels used in a CHP in producing good quality outputs, except where the output is electricity (meaning that this exemption will mainly cover inputs used to produce heat). The exemption will come into force following discussions with the Commission about State aid, but in any case not before 1 April 2013.

6. Part 1 of the Schedule also contains a provision to prevent forestalling.

7. Part 2 of the Schedule introduces the CPS rates for gas, LPG and coal from 1 April 2014.

8. Part 3 of the Schedule provides for the ending of the exemption from CCL for electricity produced in either a fully-exempt or a partly-exempt CHP station that is supplied by an electricity utility to an energy consumer, with effect from 1 April 2013. As a result of this

Schedule and regulations to be laid later in 2012, any electricity acquired by an electricity utility from a generator after that date will not be eligible for the exemption. However, if the electricity was generated in an eligible CHP station before that date and equivalent amounts of electricity are supplied to a final energy consumer, an electricity utility will be able to exempt the supply up to and including 31 March 2018.

DETAILS OF THE SCHEDULES

Schedule 29 – Climate change levy

9. Paragraph 1 amends the figure set out in paragraph 45A(2)(b) of Schedule 6 (which deals with circumstances in which a supply has been treated as a reduced rate supply but which it is later determined should not have been) from “80” to “65” with retrospective effect from 1 April 2011. The effect is that the amount payable by way of levy on such supplies is, from that date, 65 per cent of the amount that would be payable if the supply were not a reduced rate supply.

10. Paragraph 2 provides for the amendment of Schedule 6.

11. Paragraphs 3, 4, 5, 8 and 9 make consequential amendments to paragraphs 4, 5, 6, 34 and 39 of Schedule 6 respectively as a result of the omission of paragraph 45A from, and the addition of new paragraph 43B to, Schedule 6.

12. Paragraph 6 amends paragraph 14(3A)(a) of Schedule 6 to remove the reference to the exemption for supplies used in recycling processes.

13. Paragraph 7 removes paragraph 18A of Schedule 6 to repeal the exemption for supplies used in recycling processes.

14. Paragraph 10 amends paragraph 42 of Schedule 6 to provide that the full rates of levy will not apply to supplies for use in scrap metal recycling and, instead, a rate of 20 per cent of the full rates will apply. It also inserts new sub-paragraph (1ZA) into the same paragraph to provide that where supplies are both reduced-rated supplies and eligible for the new lower rate by virtue of being for use in scrap metal recycling, the amount of levy payable is the lower of the two rates.

15. Paragraph 11 inserts new paragraphs 43A and 43B into Schedule 6.

- New paragraph 43A specifies the conditions for determining whether a supply is for use in scrap metal recycling, including the requirement for a competing process that is eligible for exemption under paragraph 18 of Schedule 6; the limitation that "metal" means only aluminium and steel; and the limitation that recycling includes only the shredding or fragmentation, pre-heating and first melting of the metal, or its heating in the course of recycling, before solidification.

- New paragraph 43B provides that where an excess of relief has been received the recipient is deemed to have made a taxable supply to itself and must account for the levy due on that supply.

16. Paragraph 12 omits paragraph 45A of Schedule 6 (reduced-rate supplies: deemed supply) because the deemed supply provisions in new paragraph 43B apply to both reduced-rated supplies and supplies used in scrap metal recycling.

17. Paragraph 13 inserts new sub-paragraphs (ca) and (cb) into paragraph 62(1)(c) of Schedule 6 to provide that a relief recipient may claim a tax credit where too little levy relief was received.

18. Paragraph 14 removes the reference to paragraph "18A" in paragraph 101(2)(a) of Schedule 6 as a consequence of the repeal of the exemption, and adds new sub-paragraph (iiia) to that paragraph to provide that the recipient of the supply will be liable to a penalty where the certificate given to their supplier claiming the lower rate was, or becomes, incorrect.

19. Paragraph 15 removes the reference to paragraph "18A" in paragraph 146(3) of Schedule 6, which deals with the making of regulations, as a consequence of the repeal of the exemption for supplies for use in recycling processes.

20. Paragraph 16 removes the reference to paragraph "18A" in paragraph 147 of Schedule 6, which deals with interpretation, and defines "a supply for use in scrap metal recycling" by reference to new paragraph 43A(1).

21. Paragraph 17 repeals section 188 of FA 2003, which introduced the exemption for supplies for use in recycling processes.

22. Paragraph 18 inserts a reference to metal recycling in section 79(2) of FA 2011 to provide that, where the supply takes place in Northern Ireland, the lower rate for supplies for use in recycling processes takes precedence over the lower rate for supplies of gas. It also repeals section 80 of FA 2011, which suspended the exemption.

23. Paragraph 19 provides for the amendments made by paragraphs 2 to 18 of this Schedule to come into effect for supplies of taxable commodities actually made on or after 1 April 2012.

24. Paragraph 20 inserts a new sub-paragraph (ba) into paragraph 42(1) of Schedule 6 to provide for the level of CCL payable on reduced-rate supplies of electricity only to be 10 per cent. It also replaces the table of rates and makes consequential amendments.

25. Paragraph 21 amends the deemed supply provisions in paragraph 43B of Schedule 6 in consequence of the introduction of the new reduced rate for supplies of electricity.

26. Paragraph 22 amends section 79(3)(a) of FA 2011 to revise the rate of CCL applying to gas supplies in Northern Ireland before 1 November 2013.

27. Paragraph 23 provides for the changes in paragraphs 20 to 22 of this Schedule to have effect for supplies treated as taking place on or after 1 April 2013.

Schedule 30 – Climate change levy: climate change agreements

28. Paragraph 1 provides for the amendment of Schedule 6.

29. Paragraph 2 substitutes “Administrator” for “Secretary of State” in paragraphs 44(1)(a), (2A) and (2C) of Schedule 6 to ensure that the reduced rate of levy applies where the Administrator issues and varies certificates.

30. Paragraph 3 substitutes “Administrator” for “Secretary of State” in paragraph 45(1) of Schedule 6 to provide for the issue of variation certificates by the Administrator.

31. Paragraph 4 substitutes “Administrator” for “Secretary of State” in paragraphs 45B(2) and 45B(6) of Schedule 6 to provide for the Administrator to certify unsatisfactory progress towards meeting targets.

32. Paragraph 5 removes the words “with Secretary of State” in the heading before paragraph 47 of Schedule 6.

33. Paragraph 6 amends paragraph 47(1) of Schedule 6 to provide that direct agreements will be made with the Administrator rather than the Secretary of State and contain any terms required by regulations, and to provide that the Administrator will review targets seven-yearly or more frequently.

34. Paragraph 7 amends paragraph 48 of Schedule 6 to provide that where there is a combination of umbrella and underlying agreements under the CCA scheme, both kinds of agreements will be entered into with the Administrator, who will also review targets seven-yearly or more frequently. It also provides that the agreements must contain any terms required by regulations.

35. Paragraph 8 makes a number of consequential amendments to paragraph 49 of Schedule 6.

36. Paragraph 9 inserts the following new paragraphs into Schedule 6:

- Paragraph 52A provides for one or more bodies to be appointed as the Administrator(s) of the scheme by regulations made by the Secretary of State.
- Paragraph 52B provides for the Administrator to administer the scheme in accordance with paragraphs 44 to 52 of Schedule 6.
- Paragraph 52C provides for the Administrator to charge fees, with the consent of the Secretary of State, to recover costs incurred in carrying out its administrative function.
- Paragraph 52D provides for the Secretary of State to make regulations, give directions and issue guidance concerning the administration of the scheme.
- Paragraph 52E provides for the regulations to specify the terms of the umbrella and underlying agreements under the CCA scheme and to provide for a buy-out fee to be paid to the Administrator to make up for a lack of satisfactory progress towards meeting targets.
- Paragraph 52F provides for the regulations to give the Administrator the power to impose financial penalties for contravening a term of an agreement and to terminate agreements if the financial penalty is not paid or the contravention is not remedied. Any regulations made must also confer the right of appeal against decisions to impose penalties or to terminate agreements for failing to pay a penalty or failing to remedy a contravention. The paragraph also provides for regulations to give the Administrator the power to terminate an agreement in specified circumstances not involving a contravention of it.

37. Paragraph 10 amends paragraph 137 of Schedule 6 to add the Administrator of the scheme to the list persons to whom the Commissioners for Revenue and Customs can disclose information obtained or held by them in or in connection with the carrying out of their functions in relation to CCL.

38. Paragraph 11 provides for the changes contained in this Schedule to have no impact on CCAs entered into before the Finance Bill (FB) receives Royal Assent.

Schedule 31 – Climate change levy: supplies subject to the carbon price support rates and combined heat and power stations

39. Paragraph 1 provides for the amendment of Schedule 6.

40. Paragraph 2 amends paragraph 4(2)(b) of Schedule 6 so that deemed supplies under paragraphs 42C and 42D are included in the definition of "taxable supply".

41. Paragraph 3 amends paragraphs 6(1A) and (2A) of Schedule 6 to make the supply of gas to CHP stations (including deemed supplies under paragraphs 42C and 42D) liable to the CPS rates of CCL.

42. Paragraph 4 inserts four new sub-paragraphs into paragraph 14 of Schedule 6. New sub-paragraph (6) introduces a non-CHP station generating capacity threshold of 2 megawatts below which generators will be exempt from paying CCL. New sub-paragraphs (7) and (8) provide that it is the combined capacity of all generating stations (including CHP stations) owned by connected persons that should be taken into account in determining whether the threshold has been reached. New sub-paragraph (9) introduces an exemption from CCL for all coal used at non-CHP generating stations with a gross calorific value of 15 gigajoules per tonne or less.

43. Paragraph 5 amends paragraph 15 of Schedule 6 so that the exemption in that paragraph applies only to the supply of electricity. It also introduces the same provisions for a CHP station that are introduced by paragraph 4 for non-CHP generating stations.

44. Paragraph 6 inserts a new paragraph 15A into Schedule 6. It provides that, in relation to a supply of a taxable commodity in sub-paragraph (2) to a person who intends to cause the commodity to be used in producing any outputs of a CHP station, the Treasury may by regulations determine the extent to which the part of the supply that is not attributable to the production of electricity (as determined in accordance with regulations made under new paragraph 42A(5B)) is exempt from CCL. It also provides that the first regulations made under this power may have retrospective effect. Sub-paragraph (7) fulfils the requirement of the European Union State aid General Block Exemption Regulation (Commission Regulation (EC) No 800/2008) (which permits the granting of an exemption) that the legislation providing for the aid must contain an express reference to that regulation.

45. Paragraph 7 inserts two new sub-paragraphs into paragraph 24(4) of Schedule 6 to provide that where a supply was not treated as taxable when it should have been, or the recipient's intentions change, the recipient is deemed to have made a supply to itself that is subject to the CPS rates.

46. Paragraph 8 amends paragraph 26 of Schedule 6 and paragraph 9 inserts a new paragraph 28A into Schedule 6 to provide for the time of supply in respect of gas in cases where the person liable to account for the levy on the supply is the person to whom the supply is made.

47. Paragraph 10 disapplies paragraph 29 of Schedule 6 (which deals with special utility schemes) in cases where new paragraph 28A applies.

48. Paragraphs 11 and 12 make consequential amendments to paragraphs 34 and 39 of Schedule 6 respectively.

49. Paragraph 13 amends paragraph 40 of Schedule 6 to require those making supplies that are liable to the CPS rates of CCL or who cause the taxable commodity to be used in a CHP station to self-account for the tax.

50. Paragraph 14 amends paragraph 42A of Schedule 6 to make supplies of fossil fuels mentioned in the Table in sub-paragraph (5) to CHP stations that are attributable to the production of electricity liable to the CPS rates of CCL. It provides that the Treasury may make Regulations to determine the extent to which a supply of fossils fuels is attributable to the production of electricity in a CHP station. It also amends the taxable commodity "any other taxable commodity (apart from electricity)" to "coal" and amends the basis of taxation for this commodity from "per kilogram" to "per gigajoule". It also amends sub-paragraph (7) to provide that, under regulations made under sub-paragraph (6), the Commissioners may include provision to determine whether or not paragraph 42B(2) applies (reduction in CPS rates on supplies to generating stations with CCS technology) and, if it does, to determine the reduction in the relevant carbon price support rate.

51. Paragraph 15 inserts three new paragraphs 42B, 42C and 42D into Schedule 6.

- New paragraph 42B(1) provides for the new paragraph 42B(2) to apply for the purposes of determining the amount of CCL payable at the CPS rates where there is a supply of fossil fuels to an electricity generator who uses CCS technology in any calendar year.

- New paragraphs 42B(2) and (3) reduce the CPS rates of CCL by the carbon capture percentage.

- New paragraph 42B(4) specifies how a generating station's "carbon capture percentage" is to be calculated.

- New paragraph 42B(5) defines "generated carbon dioxide" for the purposes of new paragraph 42B(4).

- New paragraph 42B(6) defines "carbon capture and storage technology" and "carbon dioxide".

- New paragraph 42B(7) provides for carbon dioxide captured by a generating station using CCS technology that leaks before it is permanently stored not to affect the station's "carbon capture percentage" where the leak did not occur within the grounds of the station nor in any pipeline, facility or installation maintained by the operator of the station or a person connected to the operator.

- New paragraph 42B(8) provides for carbon dioxide captured that has not leaked in any of the situations set out in new paragraph 42B(7) to be treated as permanently stored.

- New paragraph 42B(9) provides for the "carbon capture percentage" where it is not a whole number to be rounded to the nearest whole number.

- New paragraph 42C(1) provides for new paragraph 42C(2) to apply where a taxable supply of fossil fuels to a generating station has been made on the basis that the lower CPS rates of CCL provided for in new paragraph 42B(2) applied but it is later determined that either a) it should have been subject to the full CPS rate; or b) the level of reduction applied was too much.

- New paragraph 42C(2) deems that where new paragraph 42C(1) applies, the recipient of the taxable supply makes a taxable supply to itself. The value of this self-supply is the difference between the amount calculated as now due and the amount originally paid.

- New paragraphs 42D(1) and 42D(2) provide that where a supply is made on the basis that it is, or is to some extent, subject to the CPS rates and it is later determined that this basis was incorrect so that the amount paid on the supply was too low, the recipient is deemed to have made a supply to itself. The value of this self-supply is the difference between the amount calculated as now due and the amount originally paid.

- Paragraph 16 amends paragraph 62(1) of Schedule 6 to provide for a recipient to reclaim the appropriate amount of CPS rate overpaid where: a) a taxable supply was made on the basis that it was not subject to a lower CPS rate and it is later determined that it should have been; b) the amount of reduction originally given under new paragraph 42B(2) was too small; or c) a taxable supply was made on the basis that it was, or was to some extent, subject to the CPS rates and it is later determined that this basis was incorrect.

52. Paragraphs 17 and 18 amend Schedule 20 to FA 2011 to provide that provisions relating to civil penalties where incorrect supplier certificates are issued in relation to the supplies of fossil fuels to either a CHP station or a power station fitted with CCS technology do not have effect, and make some consequential amendments.

53. Paragraph 19 provides for paragraph 8 of Schedule 20 to FA 2011 (as amended by this Schedule) to apply in relation to amendments made by paragraphs 1 to 16 of this Schedule in the same way they applied to paragraphs 1 to 6 of Schedule 20. It also provides for special time of supply rules for supplies taking place between 21 March (Budget day) 2012 and 1 April 2013 of taxable commodities (other than of gas in a gaseous state) that will become liable to the CPS rates of CCL on and after 1 April 2013. These are designed to prevent avoidance of tax.

54. Paragraph 20 amends paragraph 42A(5) of Schedule 6 (as amended by this Schedule) to introduce revised carbon price support rates for gas, LPG and coal; and provides for the revised rates to come into force on 1 April 2014.

55. Paragraph 21 amends paragraph 20A(1) of Schedule 6 to insert new sub-paragraph (e) to provide that the exemption relates only to electricity actually supplied before 1 April 2018. It also amends paragraph 20A(4)(a) of Schedule 6 to provide that, for the purposes of paragraphs 20A and 20B of Schedule 6, only electricity produced in either a fully exempt or a partly exempt CHP station before 1 April 2013 is considered CHP electricity for the purposes of this exemption.

56. Paragraph 22 provides for consequential repeals needed as a result of the amendments made by paragraph 21 and makes provision for the repeals made by paragraph 22 to come into force on the day appointed by HM Treasury in a statutory instrument.

BACKGROUND NOTE

57. CCL is a tax on the non-domestic use of energy.

58. Under the CCA scheme introduced in 2001, specified energy intensive businesses were allowed to enter into agreements with the Department of Energy and Climate Change (DECC) to meet energy efficiency or emission reduction targets and, as a result, were entitled to pay the reduced rate of CCL on all taxable commodities. The existing CCA scheme is due to come to an end on 31 March 2013. The Government intends to extend the scheme to 2023. Schedule 30 makes changes to simplify the scheme's administration.

59. The reduced rate of CCL is currently 35 per cent for supplies of all taxable commodities. Schedule 29 amends this rate on supplies of electricity only to 10 per cent from 1 April 2013 to help mitigate the impacts of the carbon price floor on energy-intensive industry.

60. Schedule 29 amends the rates of levy from 1 April 2013, necessitating a corresponding increase to the lower rate on gas in Northern Ireland. The Schedule also introduces a 20 per cent lower rate for supplies of taxable commodities for use in certain aluminium and steel recycling processes from 1 April 2012 following State aid approval.

61. Budget 2011 announced that, following consultation, the Government would introduce a carbon price floor on 1 April 2013. This will be achieved by taxing fossil fuels used in electricity generation under the existing CCL and fuel duty regimes. Legislation to implement this policy in respect of CCL was enacted as section 78 of, and Schedule 20 to, the FA 2011. The clause and Schedule 31 contain further legislation announced at Budget 2012 arising from further consultation with business after Budget 2011.

62. In April 2003 the CCL exemption for CHP-produced electricity supplied directly from the station that produced it to a final energy consumer was extended to include indirect supplies from a CHP (i.e. electricity supplied to an energy consumer other than by the CHP station that produced it). Following the proposed introduction of the carbon price floor and the expiry on 31 March 2013 of State aid approval for the indirect supplies element of the CHP exemption, Budget 2011 announced that from 1 April 2013 the indirect supplies exemption would end. However, in circumstances where electricity utilities have a credit balance of levy exemption certificates (which are used to evidence the production of CHP electricity), the Government will continue to allow CCL-exempt supplies to be made in order to use up that credit balance, but only until 31 March 2018.

EXPLANATORY NOTE

CLAUSE 206: INDEXATION OF RATE BANDS

SUMMARY

1. Clause 206 provides that the inheritance tax nil rate band (NRB) will rise in line with the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI) from 2015-16. Automatic indexation of the NRB using the CPI will remain subject to override if Parliament determines a different amount should apply.

DETAILS OF THE CLAUSE

2. Subsection (2) amends section 8(1) of the Inheritance Tax Act (IHTA) 1984 so that the increase in the CPI from one September to the next is used to calculate the increase in the NRB for the following year.

3. Subsection (3) amends section 8(2) IHTA 1984 replacing references to "retail prices index" with "consumer prices index".

4. Subsection (4) replaces the definition of "retail prices index" in section 8(3) IHTA 1984 with a definition of "consumer prices index".

5. Subsection (5) provides that automatic indexation of the NRB in line with the CPI takes effect from the calculation of the NRB for 2015-16. This will apply for chargeable transfers made on or after 6 April 2015 and will also be applied, where appropriate, under paragraph 1A of Schedule 2 to IHTA 1984 for potentially exempt transfers made before that date which fail on or after 6 April 2015.

BACKGROUND NOTE

6. Currently, where the RPI for the month of September is higher than it was for the previous September, then, unless Parliament otherwise determines, the limit of the NRB increases from the 6 April of the following year by the same percentage as the percentage increase in the RPI.

7. Section 155(1)(b) and (4) of Finance Act 2006 provided for the limit of the NRB to be set at £325,000 for the tax year 2009-10.

8. Section 8 of Finance Act 2010 provided that indexation does not have effect by virtue of any difference between the RPI for the month of September in 2010, 2011, 2012 or 2013 and the previous September, thereby freezing the NRB up to and including 2014-15.

EXPLANATORY NOTE

CLAUSE 207 SCHEDULE 32: GIFTS TO CHARITIES ETC

SUMMARY

1. Clause 207 and Schedule 32 provide for a lower rate of inheritance tax (IHT) of 36 per cent to be charged on a deceased person's estate where 10 per cent or more of the net estate has been left to a charity or a registered community amateur sports club. The change will take effect for deaths on or after 6 April 2012.

DETAILS OF THE SCHEDULE

2. Paragraph 1 of Schedule 2 inserts a new Schedule 1A to Inheritance Tax Act 1984 (IHTA).

Details of the new Schedule 1A to IHTA

3. New paragraph 1 provides that the Schedule applies on the death of an individual where the net value of their estate (after deducting liabilities, reliefs and exemptions) exceeds the available nil-rate band. The excess value of the estate above the nil-rate band is subject to IHT at 40 per cent and is referred to in the Schedule as "TP". New Schedule 1A does not apply if the net value of the estate is below the available nil-rate band.

4. New paragraph 2 describes the relief.

- New paragraph 2(1)(a) provides that a part of TP will qualify for the lower rate of IHT if it meets the charitable giving condition.

- New paragraph 2(1)(b) provides that any remaining part of TP that does not qualify for the lower rate is to be taxed at 40 per cent.

- New paragraph 2(2) provides that to meet the charitable giving condition, at least 10 per cent of the 'baseline amount' must be given to charity.

- New paragraph 2(3) and (4) say where provision is made for the 'components', 'donated amount' and 'baseline amount'.

- New paragraph 2(5) provides that the part of TP that qualifies for the lower rate is all of the property in each of the 'components' of the estate where the amount donated to charity is at least 10 per cent of the baseline amount for those components (the '10 per cent test').

- New paragraph 2(6) provides that the lower rate of tax is 36 per cent.

5. New paragraph 3 divides the estate into three parts or 'components' for the purposes of the new Schedule 1A: survivorship, settled property and general. New paragraphs 3(2) to (4) define the property that is included in each of the components.

- The survivorship component is made up of property which passes automatically to a surviving joint owner.

- The settled property component consists of assets in certain trusts in which the deceased had a life interest or right to income immediately before their death and which are treated as part of the deceased's estate.

- The general component includes all other property that makes up a person's estate, including the free estate, which is not part of the survivorship or settled property components. This does not include property subject to a reservation (where the deceased continued to benefit from the property given away) which is treated as part of the deceased's estate. Such property can only qualify for the reduced rate if an election is made to merge it with one of these three components.

6. New paragraph 4 provides that the 'donated amount' for a particular component or part of the estate is the total value of gifts to charities or registered community amateur sports clubs that are paid from that component and which qualify for exemption as gifts to charities or registered clubs under section 23(1) of IHTA.

8. New paragraph 5 provides for the calculation of the 'baseline amount' and sets out three steps to the calculation. The first is to arrive at the value transferred by the chargeable transfer, which is the gross value of assets in the component after deducting liabilities, reliefs and exemptions. The second step is to deduct the proportion of the available nil-rate band that is attributable to the component. The available nil-rate band is the amount left after allowing for any increase that arises from the transfer of unused nil-rate band under section 8A of IHTA and taking into account any chargeable transfers made during the seven years before death. The third step is to add back the value of gifts paid from that component which qualify for exemption as gifts to charities or registered clubs under section 23(1) of IHTA.

9. New paragraph 6 provides that the normal rules for establishing the taxable amount of the estate will apply in determining whether the 10 per cent test has been met with two specific exceptions.

- New paragraph 6(1) provides that for the purposes of calculating the donated amount and the baseline amount, any calculations under section 38(3) or (5) IHTA (grossing up) will be made using the lower rate.

- New paragraph 6(2) provides that, for the purposes of calculating the donated amount (but not the baseline amount) any reduction in the value of a specific gift to charity that would normally arise through the interaction of exemptions and relief under section 39A IHTA is to be ignored.

10. New paragraph 7 provides for an election to merge two (or more) parts of an estate where the donated amount from one component is at least 10 per cent of the baseline amount for that component. If the qualifying component and one or more eligible parts of the estate pass the 10 per cent test when combined, new paragraph 7(3) provides that they are to be treated as a single component which will qualify for the lower rate. The eligible parts of the estate for such a merger include the other components and property subject to a reservation which is treated as part of the deceased's estate. The election has to be made by all the "appropriate persons" specified in new paragraph 7(7), who may vary depending on the parts of the estate being merged.

11. New paragraph 8 provides for an election to opt out of the lower rate for one or more components of the estate so that they are treated in effect as if the charitable donation had failed the 10 per cent test. The election has to be made by all the same appropriate persons as specified in new paragraph 7(7).

12. New paragraph 9 provides the procedure for making an election under Schedule 1A. An election must be made in writing within 2 years of the death and may be withdrawn in writing (by all those entitled to make the election) no later than 2 years and 1 month after the death. New paragraph 9(3) provides that both these time limits may be extended at the discretion of an officer of Revenue and Customs.

13. New paragraph 10 provides interpretation of specific terms used in Schedule 1A.

Consequential amendments

14. Paragraph 2 of the Schedule provides for consequential amendment to IHTA as a result of new Schedule 1A.

15. Paragraph 3 amends the cross reference in section 7 of IHTA (which specifies the rates of tax charged) to take into account the new Schedule 1A.

16. Paragraph 4 inserts a new subsection (2ZA) in section 33 of IHTA to provide that new Schedule 1A is disregarded when considering the rate of tax to be applied to a charge under section 32 or 32A (where conditional exemption no longer applies). The effect of the amendment is that the lower rate of IHT would not apply to any deferred tax even if the 10 per cent test was satisfied originally.

17. Paragraph 5 correspondingly amends subsection (3) of section 78 of IHTA (conditionally exempt occasions involving settled property) by inserting a cross reference to the new subsection (2ZA) and subsection (2A) in section 33. The effect of the amendment is to ensure that new Schedule 1A is disregarded and the appropriate rate of tax is charged when the charge arises under section 78.

18. Paragraph 6 inserts a new subsection (2) in section 128 of IHTA which similarly provides that new Schedule 1A is disregarded when considering the rate of charge under section 128 (where woodlands relief no longer applies). The effect of the amendment is that the lower rate of tax would not apply to the deferred tax, even if the 10 per cent test was satisfied originally.

19. Paragraph 7 inserts a new section 141A of IHTA which specifies how the relief under section 141 of IHTA (relief for successive charges) should be applied where the later transfer, or part of it, qualifies for the lower rate of IHT.

- New subsection 141A(1) provides that the section applies where the later transfer, or part of it, qualifies for the lower rate.

- New subsection 141A(2) provides that the relief is to be apportioned between the components of the estate as set out in the section.

- New subsection 141A(3) provides that where a component of the estate qualifies for the lower rate, the relief due under section 141(3) that is attributable to that component is to be calculated by reference to new subsection (4).

- New subsection 141A(4) provides that the relief due to the estate as a whole must be divided between the components by reference to tax that is payable by each component (rather than by reference to the capital value of the components as would otherwise be the case).

- New subsection 141A(5) provides for merged components to be treated as one component for the purposes of this calculation.

- New subsection 141A(6) provides that any relief not applied against components that qualify for the lower rate is to be applied against components that do not qualify for the lower rate.

- New subsection 141A(7) provides interpretation.

20. Paragraph 8 inserts a new paragraph 14(2A) into Schedule 4 to IHTA. The new sub-paragraph provides that, when the settlor is dead, new Schedule 1A is disregarded in calculating the "second rate" of tax to be applied to a charge under paragraph 8 of Schedule 4. (A paragraph 8 charge arises where the favourable IHT treatment of property, under a maintenance fund direction under paragraph 1 of Schedule 4, ceases to apply). The effect of the amendment is that the lower rate of IHT would not apply to any tax now chargeable even if the 10 per cent test was satisfied originally.

21. Paragraph 9 inserts new subsections 142(3A) and (3B) into IHTA (alteration of dispositions taking effect on death). The effect of the amendment is that where property is redirected to a charity or registered club by means of an Instrument of Variation (IoV) the variation is not to be treated as being made by the deceased unless the persons executing the IoV show that the 'appropriate person' (charity, registered club or, if the property is held on trust, trustees) has been notified of the IoV. This applies whether or not the redirection is sufficient for any part of the estate to qualify for the reduced rate.

22. Paragraph 10 applies the new provisions in Schedule 1A and the consequential amendments to IHTA to deaths on or after 6 April 2012.

BACKGROUND NOTE

23. On death, inheritance tax (IHT) is charged on estates whose net taxable value (after deducting various reliefs and exemptions) is more than the IHT threshold, or nil-rate band. IHT is currently charged at a single rate of 40 per cent on the net taxable value of the estate above the available nil-rate band.

24. The value of an estate for IHT purposes can include not only the assets that the deceased owned immediately before death and is free to dispose of by will (the free estate), but also other assets and property such as interests in jointly owned assets which pass automatically by survivorship on death, interests in certain trusts, and assets given away but from which the deceased continued to benefit.

The various categories of assets are combined to form an aggregate estate that is subject to IHT.

25. As an incentive to encourage charitable giving and support philanthropy, where 10 per cent or more of the deceased's net estate (after deducting exemptions, reliefs and the available nil-rate band) has been left to charity, the taxable estate will be charged at a lower rate of IHT of 36 per cent. The change will apply for deaths on or after 6 April 2012.

26. The total amount left to charity will be compared to the 10 per cent threshold or 'baseline' amount to see if the estate qualifies for the lower IHT rate. For the purposes of this '10 per cent test' the baseline will be the value of the estate charged to IHT after deducting all available reliefs, exemptions and nil-rate band but excluding the charitable legacy itself. If the estate qualifies, the lower rate will apply automatically but the personal representatives or other persons will be able to elect for the lower rate not to apply.

27. For estates which include additional assets to those that the deceased owned before death, the estate will be divided into up to three parts or 'components'. The 10 per cent test will be applied to each component separately and the lower rate will apply to those components that pass the test unless an election is made to opt out.

28. Where a charitable legacy from one or more components of the estate exceeds the 10 per cent minimum it will be possible, by election, to combine components and apply the 10 per cent test to the aggregate. Where the aggregate components meet the test, the lower rate will apply to the merged components. This will enable the benefit from charitable legacies of more than 10 per cent to be spread to other parts of the estate.

EXPLANATORY NOTE

CLAUSE 208: SETTLED EXCLUDED PROPERTY: EFFECT OF CERTAIN ARRANGEMENTS

SUMMARY

1. Clause 208 amends the inheritance tax (IHT) settled property provisions relating to excluded property. Where an individual, domiciled in the UK, acquires an interest in settled excluded property which, as a result of arrangements concerned with that acquisition, gives rise to a reduction in the value of that individual's estate, the property will cease to be excluded property and a charge to IHT will arise. The charge will largely replicate the tax treatment that a UK-domiciled individual would incur if the assets within the offshore trust, which are 'excluded property' and which would otherwise be ignored for IHT purposes, had instead been transferred to a UK trust.

2. The changes will have effect on or after 21 March 2012.

DETAILS OF THE CLAUSE

3. Subsection 1 of the clause provides for amendments to the Inheritance Tax Act 1984 (IHTA).

4. Subsection 2 inserts new sections 48(3D), (3E) and (3F) into IHTA which deal with excluded settled property. Settled property is excluded property if it is situated outside the UK and held in a trust which was set up by a person who was domiciled outside the UK when the settlement was made. The new subsections explain the treatment of arrangements whereby a UK-domiciled individual acquires an interest in such settled property which would otherwise be treated as excluded property.

- New section 48(3D) specifies the circumstances under which settled property held in an offshore trust will not qualify as excluded property. The circumstances are that one or more persons enter into arrangements during the course of which a UK- domiciled individual acquires an interest in settled property which would, but for this subsection, be excluded property and those arrangements give rise to a 'relevant reduction' in the value of that individual's estate.

- New section 48(3E)(a) defines an interest in settled property for the purposes of subsection 48(3D). An individual has an interest in settled property if the property, or any 'derived property' can in any way be paid to, or benefit them, or their spouse or civil partner.

- New section 48(3E)(b) explains when a 'relevant reduction' occurs. A relevant reduction occurs when the value of the individual's estate is reduced as a result of the arrangements.

- New section 48(3F) defines the terms 'arrangements' and 'derived property'.

The effect of the new subsections is that where the conditions in section 48(3D) are met, the settled property is no longer treated as excluded property from the date those conditions are first met.

5. Subsection 3 inserts new sections 74A and 74B into IHTA.

6. New section 74A applies where, by virtue of the conditions in section 48(3D) being met, settled property ceases to qualify as excluded property.

- New section 74A(2) provides that for the purposes of determining whether section 74A applies, section 48(3D) is to apply as if section 48(3B) applied only where the interest in possession mentioned in section 48(3B)(a) falls within section 5(1B). The effect of this subsection is that a charge under section 74A will also arise in limited circumstances where settled property ceases to qualify as excluded property by virtue of the conditions in section 48(3B) being met, and where the interest in possession does not form part of the individual's estate under section 5(1B).

- New section 74A(3) identifies the 'arrangements', the 'individual' and the 'relevant reduction', it explains how the amount of the 'relevant reduction' is calculated and defines 'relevant time'.

- New sections 74A(4) to (6) apply where the arrangements give rise to a 'relevant reduction' in an individual's estate which is attributable to the value of settled property in which that individual is beneficially entitled to an interest in possession. Where a 'relevant reduction' occurs, IHT is charged as if a part of the individual's interest in possession equal to the 'relevant reduction' had come to an end.

- New sections 74A(7) and (8) apply where the arrangements give rise to a 'relevant reduction' in an individual's estate other than one attributable to the value of settled property. They provide that IHT is to be charged as if the individual had made a transfer of value equal to the 'relevant reduction'.

7. New section 74B makes supplementary provision to new section 74A.

- New section 74B(1) provides that a transfer of value arising under new section 74A is immediately chargeable to IHT.

- New section 74B(2) disapplies section 3(2) and section 10(1) of IHTA for the purposes of calculating the 'relevant reduction'. New section 74B(2)(c) prevents sections 102 to 102C of Finance Act 1986 applying to the transfer arising under new section 74A so that a reservation of benefit does not arise.

- New sections 74B(3) to (5) provide that where in the course of the arrangements there is a transfer of value by reason of new section 74A ('the current transfer'), and there is also a 'relevant related transfer' which arises other than by reason of new section 74A, the value transferred by the current transfer is to be reduced by the value transferred by the relevant related transfer.

- New section 74B(6) ensures that where a transfer of value has arisen under new section 74A and the arrangements later result in settled property being treated as forming part of an individual's estate, the transfer under new section 74A shall be cancelled.

- New section 74B(7) explains that 'operation' includes an omission.

8. Subsection 4 provides for consequential amendments to section 201 of IHTA (liability for tax: settled property). A new section 201(4A) ensures that the individual who acquires the interest in the settled property is liable for the new charge under section 74A, and any 10-year anniversary charges under section 64 of IHTA, or charges when property ceases to be relevant property under section 65 of IHTA.

9. Subsection 5 provides the commencement provisions. The amendments are treated as having come into force on 21 March 2012. They have effect in relation to any arrangements entered into either before, or on or after, that date but their effect is limited in relation to arrangements entered into before 21 March 2012.

10. Subsection 6 explains how the provisions apply where arrangements were entered into before 21 March 2012. No transfer of value is treated as arising under new section 74(A) but if the conditions in new section 48(3D) are satisfied before that date, the settled property will be relevant property and subject to charges under section 64 and 65 of IHTA with effect from 21 March 2012.

BACKGROUND NOTE

11. IHT is normally charged on the value of a person's estate at death after deducting reliefs and the nil-rate band. There is a separate relevant property regime that charges IHT on assets held in trusts, which are not included in a person's estate. If a UK-domiciled individual settles assets into an offshore trust, the transfer into trust will be charged to IHT and the value of the trust assets above the nil-rate band will also be subject to IHT.

12. But if the settlor is not UK-domiciled, settled property situated outside the UK is excluded from the IHT charge and is referred to as excluded property. Anti-avoidance provisions ensure that where an 'interest in possession' (IIP) in such excluded property is purchased for value, the trust assets are subject to IHT as part of the purchaser's estate. However, if a UK domiciled individual acquires an interest in excluded property which is not an IIP, there may be no charge to IHT when the interest is acquired and the settled property may escape any subsequent charge to IHT either as part of the individual's estate or under the relevant property regime. In addition, the individual's estate may be reduced by any debt where the acquisition is financed by a loan.

13. The amendments to the settled property provisions relating to excluded property will apply to avoidance schemes where arrangements exploit the excluded property rules by converting UK assets to ones that are excluded from the IHT charge and do not give rise to a transfer of value when that conversion occurs. In future, a transfer of value will arise and the assets will no longer be treated as excluded property and will fall within the relevant property regime.

EXPLANATORY NOTE

CLAUSE 209 SCHEDULE 33: THE BANK LEVY

SUMMARY

1. Clause 209 and Schedule 33 make a number of amendments to Schedule 19 to Finance Act 2011.

2. The Schedule amends the rates at which the bank levy is charged from 1 January 2012 onwards.

3. It also makes amendments to paragraphs 43 and 44 of Schedule 19, Finance Act 2011 which deal with joint ventures. The changes to paragraph 43 ensure that joint ventures are treated consistently across different types of banking groups and relevant non banking groups. The changes to paragraph 44 ensure that no double taxation of joint ventures arises under the bank levy.

4. The Schedule also introduces two new provisions that relate to the relief from double taxation for equivalent foreign levies. Paragraphs 66(9A) which ensures that HM Revenue and Customs has the ability to restrict double taxation relief from the day it is given under a double taxation arrangement where excessive relief is given in respect of the equivalent foreign levy of another jurisdiction and paragraph 67A which allows for the exchange of information where an international tax enforcement arrangement has been entered into in respect of the bank levy.

DETAILS OF THE CLAUSE

Rates 2012

5. Paragraph 1 introduces amendments to the bank levy legislation.

6. Paragraph 2 increases the bank levy rates from 1 January 2012.

7. Paragraph 3 replaces the rates for a chargeable period that falls partly before 1 January 2012. It increases the rates due on the proportion of chargeable short term liabilities and on the proportion of chargeable equity and chargeable long term liabilities for the part of the chargeable period that falls after 1 January 2012.

8. Paragraph 4 provides that the rate changes made by paragraphs 2 and 3 are treated as having come into force on 1 January 2012.

Rates 2013

9. Paragraph 5 increases the bank levy rates from 1 January 2013.

10. Paragraph 6 substitutes sub paragraphs 7(1) and 7(2) of Schedule 19.

11. New paragraph 7(1) provides that new paragraph 7(2) applies if some or all of the chargeable period falls before 1 January 2013.

12. New paragraph 7(2) substitutes a new Step 7, which explains how to calculate the amount of bank levy arising for a chargeable period, where some or all of that period falls before 1 January 2013. Where a number of rates of bank levy may apply during such chargeable periods, paragraph 6(2) inserts into paragraph 17 of Schedule 19 a table setting out the periods ("rate periods") and rates in force for each rate period that are required to determine the amount of bank levy.

13. Paragraph 7 provides that the rate changes made by paragraphs 5 and 6 come into force on 1 January 2013.

Joint ventures

14. Paragraphs 8 to 10 amend paragraphs 43 and 44 of Schedule 19, which relate to the calculation of chargeable equity and liabilities where a relevant group has an interest in a joint venture.

15. Paragraph 8(1) introduces the changes that are being made.

16. Paragraph 8(2) replaces paragraph 43(1)(d) and (e) with a new paragraph 43(1)(d). The changes mean that paragraph 43 will now apply to both UK resident and non resident joint ventures, and will only apply where the liabilities of the joint venture have not already been taken into account when calculating the chargeable equity and liabilities of the relevant group.

17. Paragraph 8(3) substitutes a new paragraph 43(2). New paragraph 43(2)(a) requires the relevant group to determine its chargeable equity and liabilities on the basis that the joint venture is a member of the group, but only to the extent of the group's interest in the joint venture's assets and liabilities. New paragraph 43(2)(b) ensures that the joint venture is treated as if it were not a member of the group in relation to the remaining liabilities and assets.

18. Paragraph 9 amends paragraph 44(7)(b) to ensure that when calculating the chargeable equity and liabilities of a joint venture in its own right, any amounts that are already charged in the venturer's banking group under paragraph 43, are not charged for a second time.

19. Paragraph 10 explains that the amendment made by paragraphs 8 and 9 have effect for all chargeable periods ending on or after 1 January 2012.

Double taxation relief

20. Paragraph 11 of the Schedule adds a new paragraph and a subparagraph into Part 7 of Schedule 19 to the Finance Act 2011.

21. Paragraph 11(1) inserts new paragraph 66(9A) into Schedule 19.

22. New paragraph 66(9A) provides that where double taxation relief is allowed via arrangements entered into by the United Kingdom and another territory regarding relief from double taxation in respect of the bank levy and an equivalent foreign levy then regulations may be made that take effect from the same date that relief is allowed under the arrangements. However regulations under this sub-paragraph will only have this effect if they are made and come into force at the same time as the order giving effect to the arrangements.

23. Paragraph 11(2) inserts new paragraph 67A into Part 7 of Schedule 19. This paragraph allows for the exchange of information where international tax enforcement arrangements have been entered into in association with arrangements regarding relief from double taxation in respect of the bank levy.

24. New paragraph 67A(1) gives effect to arrangements that have been made with any territory or territories outside the UK relating to tax enforcement where the Treasury makes an Order in respect of those arrangements.

25. New paragraph 67A(2) explains that arrangements relating to international tax enforcement may include provisions on the exchange of information and the service of documents in relation to the United Kingdom bank levy or an equivalent foreign levy.

26. New paragraph 67A(3) provides that any Treasury Order that replaces an existing Order made under this Schedule may include appropriate transitional provisions.

27. New paragraph 67A(4) ensures that sections 173(4) and (5) of Finance Act 2006 apply to arrangements which have effect under this paragraph and these in turn allow any Minister or officer in another Government department to disclose any information to the Commissioners for HM Revenue and Customs that may be disclosed to another territory under the arrangements. It also allows the Commissioners or any authorised Revenue and Customs official to disclose such information to the authorised officer of any territory or territories with whom arrangements have been made. Section 173(5) Finance Act 2006 provides that the Commissioners or any authorised Revenue and Customs official may not disclose any information to another territory under the arrangements unless first satisfied that the confidentiality rules applied in the other territory are no less strict than those applying in the UK.

28. New paragraphs 67A(5) and 67A(6) provides the rules regarding the making of the secondary legislation to give effect to the international tax enforcement arrangements.

Transitional provisions

29. Paragraph 12 provides transitional provisions for collecting the additional amounts of bank levy that arise from the amendments relating to the increases of the rates of the bank levy and to the paragraphs concerning joint ventures.

30. Paragraph 12(1) states that paragraph 12 applies where an entity ("E") is charged to the bank levy for an accounting period in respect of a chargeable period that falls wholly or partly on or after 1 January 2012 and one, or more, of the instalment payments for the accounting period in question are due and payable before Royal Assent of Finance Bill 2012.

31. Paragraph 12(2) provides that the effect of the rate changes for 2012, rate changes for 2013 and joint venture amendments are to be ignored when determining the amount of any instalment payment that is due before Royal Assent ("pre-commencement instalment payments").

32. Paragraph 12(3) provides that where there is at least one instalment payment for the accounting period of E which is due and payable on or after Royal Assent ("post-commencement instalment payments"), the amount of the first such instalment payment is increased by the adjustment amount.

33. Paragraph 12(4) provides that where E does not have any post-commencement instalment payments, the adjustment amount will be due and payable 30 days after Royal Assent.

34. Paragraph 12(5) explains how to determine the "adjustment amount" for the purposes of paragraphs 12(3) and 12(4). The adjustment amount is the difference between the pre-commencement instalment payments calculated firstly on the basis that the effects of the 2012 and 2013 rate changes and joint venture amendments are ignored and then on the basis that the effects of the 2012 and 2013 rate changes and joint venture amendments are not ignored.

35. Paragraph 12(6) ensures that references within the provisions of Corporation Tax (Instalment Payment) Regulations 1998 (S.I. 1998/3175) to regulations 4A to 4D, 5, 5A or 5B of those Regulations are to be read as including references to paragraphs 12(1) to (6).

36. Paragraph 12(7) ensures that section 59D of the Taxes Management Act 1970, which provides the general rule for the collection of corporation tax, is also subject to paragraphs 12(1) to (5).

37. Paragraph 12(8) provides definitions of terms used in this Schedule.

BACKGROUND NOTE

38. The bank levy is an annual balance sheet charge based upon the chargeable equities and liabilities of all UK banks and building society groups, foreign banks and banking groups operating in the UK and UK banks in non-banking groups from 1 January 2011 onwards.

Joint ventures

39. A joint venture is an entity where two or more parties ("the venturers") undertake an economic activity that is subject to joint control. International accounting standards currently allow joint ventures to be accounted for in two different ways, using either the equity method (where the investment in the joint venture is recorded at cost) or proportional consolidation where the consolidated balance sheet of the venturer includes its share of the assets and liabilities of the joint venture.

Double taxation relief

40. Part 7 of Schedule 19 to the Finance Act 2011 provides for double taxation relief to be given where a bank or banking group is doubly charged to the UK bank levy and an equivalent foreign levy.

41. Information regarding taxes is often exchanged by the United Kingdom with other territories using Exchange of Information articles in arrangements regarding Income Tax, Corporation Tax and Capital Gains Tax. However where such arrangements do not provide for Exchange of Information in respect of taxes of all kinds or the other territory does not consider their levy to be a tax then those arrangements cannot be used to exchange information relating to the bank levies.

42. The new provision is modelled on the legislation that enacts similar international tax enforcement arrangements for Income Tax, Corporation Tax and Capital Gains Tax.

Transitional provisions

43. Bank levy is treated as if it is corporation tax, and the relevant entity or, in the case of a banking group, the "the responsible member" (see paragraph 54, Schedule 19) is required to both make a return of the bank levy (as part of its company tax return) and to pay the bank levy.

44. Entities that pay the bank levy are required to do so under the provisions of The Corporation Tax (Installment Payments) Regulations 1998 (S.I. 1998/3175).

EXPLANATORY NOTE

CLAUSE 210: PREVENTION OF AVOIDANCE: SUBSALES ETC

SUMMARY

1. Clause 210 amends the Stamp Duty Land Tax (SDLT) rules on a transfer of rights (or subsale) so that the grant or assignment of an option cannot be a transfer of rights.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts new section 45(1A) into the Finance Act 2003 which prevents the grant or assignment of an option from falling within subsection 45(1)(b).

BACKGROUND NOTE

3. Section 45 of the Finance Act 2003 provides, broadly, that there is only one charge to SDLT where the purchaser of an interest in land, before completing that purchase, sells on the interest in land to another person.

4. This measure is intended to address a particular SDLT avoidance scheme that attempts to abuse section 45. Under the scheme, the purchaser of an interest in land, at the same time as completing the purchase, grants an option to purchase that interest to a third party. This scheme is being widely marketed by promoters of SDLT avoidance schemes.

5. It is claimed that the transactions in this scheme fall within section 45 and that therefore no SDLT is payable on the initial purchase. The Government does not believe that this is correct and users of this scheme will be challenged by HMRC.

6. In order to prevent revenues being put at risk and to protect the public from being sold this scheme, the Government wishes to clarify that the grant or assignment of an option does not result in the completion of the original contract being disregarded. The Government believes that the grant or assignment of an option cannot be a transfer of rights and this measure will make that explicit on the face of the legislation.

EXPLANATORY NOTE

CLAUSE 211: RATE IN RESPECT OF RESIDENTIAL PROPERTY WHERE CONSIDERATION OVER £2M

SUMMARY

1. Clause 211 applies stamp duty land tax (SDLT) on the purchase of a residential property at 7 per cent of chargeable consideration where this is more than £2 million.

DETAILS OF THE CLAUSE

2. Paragraph 1 adds the new rate to Table A (Residential property) at section 55(2) Finance Act 2003.

3. Paragraph 2 provides for commencement.

4. Paragraph 3 provides that the new rate does not apply to certain transactions where a contract was entered into before the commencement date.

5. Paragraph 4 provides exceptions to the provision at paragraph 3.

BACKGROUND NOTE

6. The amount of SDLT charged on a freehold purchase, a lease premium or the assignment of a lease is governed by section 55 Finance Act 2003. Tax is charged at a percentage of the chargeable consideration for the transaction. The percentage rate is determined by whether or not the subject-matter of the transaction consists wholly of residential property and by the amount of the consideration. In the case of linked transactions (defined by section 108 Finance Act 2003) the amounts of consideration are aggregated in order to determine the rate of tax payable.

7. The percentage rates are set out at section 55(2) in two tables - Table A: Residential and Table B: Non-residential or mixed - and range from zero per cent to 5 per cent (Table A) and zero per cent to 4 per cent (Table B). Currently the 5 per cent rate applies to wholly-residential transactions where the relevant consideration is more than £1 million.

8. The clause amends Table A (Residential property) to apply the existing 5 per cent rate to transactions where the relevant consideration is more than £1 million but not more than £2 million.

A new rate of 7 per cent is added for transactions where the relevant consideration is more than £2 million.

9. The new rate applies to transactions where the effective date is on or after 22 March 2012. The effective date for SDLT purposes is normally the date on which a contract is completed but may be earlier if "substantial performance" occurs. Substantial performance occurs where the purchaser takes up occupation or pays the whole (or substantially the whole) of the consideration before completion.

10. The new rate does not apply where a transaction was entered into and substantially performed before 22 March 2012, or in other cases where a transaction was entered into before that date, unless there is a variation of the contract or assignment of rights under the contract or the transaction was effected in consequence of any option, right of pre-emption or similar right or there is a sub-sale, on or after that date.

EXPLANATORY NOTE

CLAUSE 212 SCHEDULE 34: HIGHER RATES FOR CERTAIN TRANSACTIONS

SUMMARY

1. Clause 212 and Schedule 34 provides for a higher rate of Stamp Duty Land Tax of 15 per cent to be charged on the acquisition of interests in high-value dwellings by certain persons and bodies of persons.

DETAILS OF THE CLAUSE

2. Subsection 1 provides for amendments to be made to Part 4 of the Finance Act 2003.

3. Subsection 2 provides for amendments to be made to section 55 of FA 2003 in relation to the higher rate, including provision that section 55 does not apply to a transaction to which the higher rate applies. Section 55 sets out the amount of tax chargeable in respect of a chargeable transaction.

4. Subsection 3 inserts a new section 55A FA2003 and introduces a new Schedule 4A.

DETAILS OF THE SCHEDULE

5. Paragraph 1(1) provides a definition of an “interest in a single dwelling”.

6. Paragraph 1(2) provides that an interest in a single dwelling is a higher threshold interest if consideration of more than £2,000,000 is attributable to that interest.

7. Paragraph 2(1) provides that sub-paragraphs (2) to (8) apply to a chargeable transaction which consists of or includes a higher threshold interest.

8. Paragraph 2(2) provides that if the transaction does not include any chargeable interests other than higher threshold interests then it is a high value residential transaction for purposes of paragraph 3.

9. Paragraph 2(3) provides that if the transaction (“the primary transaction”) includes a chargeable interest in other land the transaction is treated for the relevant purposes as two separate chargeable transactions –

(a) one that consists of all the higher threshold interests, and

(b) one that consists of the remainder of the interests included in the primary transaction.

10. Paragraph 2(4) provides for the chargeable consideration for the primary transaction to be attributed between the two transactions in sub-paragraph (3).

11. Paragraph 2(5) provides that the transaction at sub-paragraph 3(a) is a high-value residential transaction for the purposes of paragraph 3.

12. Paragraph 2(6) defines "relevant purposes" as for the purposes of –

(a) paragraphs 3 and 4 of this Schedule,

(b) section 55,

(c) Schedule 5,

(d) Schedule 6B, and

(e) any other provisions of Part 4 of Finance Act 2003 if it is necessary to do so because of the paragraphs (a) to (d).

13. Paragraph 2(7) provides that where the primary transaction is treated as two separate transactions, each of these, but not the primary transaction, is a notifiable transaction for the purposes of section 76.

14. Paragraph 2(8) provides that the provisions relating to land transactions returns apply, as necessary, to the separate transactions under sub-paragraph (3).

15. Paragraph 2(9) provides that the Schedule does not apply to transactions to which section 74 or 75 apply.

16. Paragraph 3(1) provides that where this paragraph applies to a chargeable transaction a higher rate of tax of 15 per cent will apply and that the transaction will not be linked to any other transaction for the purposes of section 55(4).

17. Paragraph 3(2) provides that this paragraph applies to a transaction if it is a high value residential transaction and the conditions in paragraph 3(3) are met.

18. Paragraph 3(3) provides that the higher rate applies where the purchaser is a company, or the transaction is entered into by a partnership one or more of whose partners is a company or the transaction is entered into for the purposes of a collective investments scheme.

19. Paragraph 3(4) provides that references in sub-paragraph (3) to a company do not include a company acting in its capacity as the trustee of a settlement.

20. Paragraph 3(5) provides that where there are joint purchasers, the higher rate applies if any of those joint purchasers meets the condition at sub-paragraph 3.

21. Paragraph 3(6) & (7) provides for special rules that apply to certain partnership transactions chargeable under paragraphs 17 and 17A Schedule 15 to ensure they are within the higher rate charge as appropriate.

22. Paragraph 3(8) provides that paragraph 3(2) and (3) of Schedule 16 do not apply for the purposes of sub-paragraph (3). Therefore, for the purpose of the higher rate, where a lease is granted to a person as bare trustee it will be treated as if it were granted to the person or persons for whom he is trustee.

23. Paragraph 3(9) provides that where the whole or part of the chargeable consideration for a transaction is rent, paragraph 3 has effect subject to section 56 and Schedule 5, which provide for the amount of tax chargeable where the chargeable consideration consists of or includes rent.

24. Paragraph 3(10) provides a power for the Treasury to amend sub-paragraph 3(3) by order to limit the types of person affected by the higher rate SDLT charge.

25. Paragraph 4(1) provides that sub-paragraphs (2) and (3) apply if –

(a) a chargeable transaction includes a chargeable interest in a dwelling,

(b) other transactions include other chargeable interests in that dwelling and are linked to the original transaction, and

(c) the total consideration attributable to all such interests is more than £2,000,000.

26. Paragraph 4(2) provides that each of those interests is treated as a higher threshold interest in a residential property for the purposes of this Schedule.

27. Paragraph 4(3) provides that if the condition at paragraph 3(3) (entities to which the higher rate applies) is met in relation to the original transaction at sub-paragraph 1(a), it is treated as met in relation to any other transactions that are treated as linked with it.

28. Paragraph 4(4) provides that the schedule does not apply to transactions to which section 74 or 75 apply.

29. Paragraph 5(1) provides that the higher rate will not apply to interests acquired by a company in the course of a property development business for the sole purpose of developing and reselling the land, where the company had been carrying on that business for at least two years before the effective date of the transaction.

30. Paragraph 5(2) provides that the higher rate will not apply to interests acquired by a partnership in the course of a property development business for the sole purpose of developing and reselling the land, where the partnership had been carrying on that business for at least two years before the effective date of the transaction

31. Paragraph 5(3) provides for special rules that apply to certain partnership transactions chargeable under paragraph 17 Schedule 15 where the partnership is carrying on a business a property development business.

32. Paragraph 5(4) provides for special rules that apply to certain partnership transactions chargeable under paragraph 17A Schedule 15 where the partnership is carrying on a business a property development business.

33. Paragraph 5(5) defines a property development business as one that consists of or includes buying and redeveloping for resale residential property.

34. Paragraph 5(6) provides that a company is treated as having carried on a property development business if at any time it was carried on by a member of the same group as the company.

35. Paragraph 5(7) provides that companies are members of the same group for the purposes of this paragraph if they are treated as such for the purposes of group relief (see paragraph 1 of Schedule 7).

36. Paragraph 6(1) provides that sub-paragraphs (2) and (3) apply to certain transactions involving a partnership which consist of or include a higher threshold interest.

37. Paragraph 6(2) provides that the partnership transaction is not treated as a high-value residential transaction unless the chargeable consideration is more than £2,000,000.

38. Paragraph 6(3) provides that paragraphs 2(3) to (8) do not apply to the transaction if the transaction includes chargeable interests in land other than a higher threshold interest and the application of paragraph 2(3) and (4) results in chargeable consideration of £2,000,000 or less being attributable to the higher threshold interest.

39. Paragraphs 6(4) to (6) set out what, for the purposes of sub-paragraph (2), the subject matter of the chargeable transaction is in relation to transactions within paragraphs 14, 17 and 17A of Schedule 15.

40. Paragraph 7(1) provides that this paragraph sets out rules for determining what a dwelling is for the purposes of this Schedule.

41. Paragraph 7(2) provides that a building or part of a building is a dwelling if –

(a) it is used or suitable for use as a single dwelling, or

(b) it is in the process of being constructed or adapted for such use.

42. Paragraph 7(3) provides that land that is, or is to be, occupied or enjoyed with a dwelling as a garden or grounds (including any building or structure on such land) is to be taken as part of the dwelling.

43. Paragraph 7(4) provides that land that subsists, or is to subsist, for the benefit of the dwelling is to be taken as part of the dwelling.

44. Paragraph 7(5) provides rules to establish what constitutes a dwelling for the purposes of the charge under Schedule 4A. Sub-paragraph (5) extends the charge to the case where a contract is substantially performed and the contract includes an interest in a building or part of a building which is to be constructed or adapted for use as a single dwelling, construction or adaptation of which has not yet begun.

45. Paragraph 7(6) provides that the meaning of "contract", "relevant deeming provision" and "substantially performed" have the same meaning as in Schedule 6B.

46. Paragraph 7(7) provides that a building used for the purpose specified in section 116(2) or (3) is not used as a dwelling for the purpose of sub-paragraph (2).

47. Paragraph 7(8) provides that where a building or part of a building is used for the purposes specified in sub-paragraph (7), no account is to be taken for the purposes of sub-paragraphs (2) of its suitability for any other use.

48. Paragraph 8(1) provides for Treasury to amend paragraph 7 by order.

49. Paragraph 8(2) provides that the reference in section 116(8)(a) to the "the purposes of subsection (1)" includes a reference to the purposes of paragraph 7(2).

50. Paragraph 9 defines "appurtenant rights" "attributable", "collective investment scheme" and "company" for the purpose of this Schedule.

DETAILS OF THE CLAUSE

51. Subsection 5(1) provides for amendments to Section 74.

52. Subsection 5(2) inserts a new subsection (1A) after the current subsection 74(1) that provides a series of steps to establish if a transaction within section 74 (exercise of collective rights by tenants of flats) is to be treated as a higher threshold interest and chargeable to the higher rate of 15 per cent.

53. Subsection 5(3) provides a consequential amendment.

54. Subsection 6(1) provides for section 109 to be varied.

55. Subsection 6(2) inserts a new subsection 2A in section 109 which provides for the power under subsection 2(b) to include the power to alter the conditions for the application of the higher rate at paragraph 3 of Schedule 4A.

56. Subsection 6(3) provides for consequential amendments.

57. Subsection 7 to 9 make consequential amendments to FA 2003.

58. Subsection 10 sets out the commencement provisions for these amendments including transitional provisions for certain transactions effected after 21 March 2012.

BACKGROUND NOTE

59. The measure forms part of a package designed to ensure that individuals and companies pay a fair share of tax on residential property transactions and to reduce avoidance.

60. This measure aims to dis-incentivise the ownership of high value residential property in structures that would permit the indirect ownership or enjoyment of the property to be transferred in a way that would not be chargeable to SDLT. The intention is to stop or reduce the number of properties that will enter such complex ownership structures. Taken together with the introduction of an annual charge in 2013 on such property owned by the same sorts of non-natural persons, this will result in a reduction in the number of high value properties owned in such structures.

61. The measure has effect for land transactions where the effective date is on or after the date of the Budget (21 March 2012). The effective date is normally the date on which a contract is completed, but may be earlier if the land is occupied or the consideration for the transaction is given before that date.

EXPLANATORY NOTE

CLAUSE 213: DISCLOSURE OF STAMP DUTY LAND TAX AVOIDANCE SCHEMES

SUMMARY

1. Clause 213 amends section 308 of Finance Act (FA) 2004, inserting a new regulation-making power. Section 308 of FA 2004 sets out the obligations of a promoter of a tax avoidance scheme to provide HM Revenue & Customs (HMRC) with information about that scheme. Regulations made under the new power may modify the way section 308 applies in relation to stamp duty land tax (SDLT) avoidance schemes.

DETAILS OF THE CLAUSE

2. New section 308(6) gives HM Treasury the power to make regulations which modify the application of section 308 in circumstances to be described in the regulations.

BACKGROUND NOTE

3. The SDLT Disclosure of Tax Avoidance Schemes (DOTAS) regime was extended from April 2010. From that date, HMRC has been able to issue a scheme reference number (SRN) to promoters when they disclose a scheme. The SRN has to be passed on to any users of the scheme who then in turn have to provide HMRC with the SRN, allowing HMRC to identify the users of the scheme.

4. However, SDLT avoidance schemes that were first disclosed before April 2010 were left out of the SRN regime by “grandfathering” rules. The Government intends to remove these grandfathering rules for certain schemes so that they will fall within the SRN regime. However, in order for this removal to be effective, section 308 of FA 2004 will have to modified in respect of those schemes so that they have to be disclosed by a promoter one further time. The clause gives HM Treasury the power to make regulations to make such modifications to the effect of section 308.

EXPLANATORY NOTE

CLAUSE 214: HEALTH SERVICE BODIES

SUMMARY

1. Clause 214 re-enacts an existing stamp duty land tax (SDLT) relief for acquisitions of interests in land by certain National Health Service bodies. It updates the list of bodies to which the relief applies and repeals the existing SDLT relief and its equivalent stamp duty relief, which is obsolete.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces a new section 67A Finance Act 2003, which provides relief from SDLT for acquisitions by certain health service bodies listed in that subsection.

3. Subsection (2) provides for repeal of existing provisions which are now superseded by the new section 67A.

4. Subsection (3) provides for commencement of the repeal provisions in respect of stamp duty.

5. Subsection (4) provides for commencement of the remaining provisions.

6. Subsection (5) provides for the relief to apply to certain bodies until bodies of that kind are abolished under the Health and Social Care Act 2011.

7. Subsection (6) sets out the bodies to which subsection (5) applies.

BACKGROUND NOTE

8. Section 61(3) to (3C) National Health Service and Community Care Act 1990 (as amended by the Stamp Duty Land Tax (Consequential Amendment of Enactments) Regulations 2005 (S.I. 2005/82)) provides SDLT and stamp duty reliefs for acquisitions by National Health Service Trusts, Primary Care Trusts, Local Health Boards in Wales and Health and Social Services Trusts in Northern Ireland. Section 58 National Health Service Act 2006 extends the reliefs to NHS Foundation Trusts.

9. Paragraphs 132-133 of Schedule 1 National Health Service (Consequential Provisions) Act 2006 amend section 61(3) to refer to NHS Trusts constituted under the National Health Service Act 2006 and the National Health Service (Wales) Act 2006. This amendment

applies to section 61(3) as it stood before it was amended by S.I. 2005/82. It is therefore defective and the provision still refers to Trusts constituted under the 1990 Act.

10. This clause therefore re-enacts the SDLT relief, in the main SDLT legislation in Part 4 Finance Act 2003, and repeals the existing SDLT and Stamp duty reliefs (the latter is obsolete).

11. The clause extends relief to the National Health Service Commissioning Board and clinical commissioning groups established under provisions of the Health and Social Care Act. It provides for relief to apply to National Health Service Trusts in England and to Primary Care Trusts only until those bodies are abolished under other provisions of that Act.

EXPLANATORY NOTE

CLAUSE 215: COLLECTIVE INVESTMENT SCHEMES: STAMP DUTY AND STAMP DUTY RESERVE TAX

SUMMARY

1. Clause 215 gives the Treasury the power to make regulations to provide an exemption or relief from stamp duty or stamp duty reserve tax for transactions relating to collective investment schemes.

DETAILS OF THE CLAUSE

2. Subsection (2) allows the regulations to specify the type of collective investment scheme affected and the circumstances in which an exemption or relief applies.

3. Subsection (4)(a) allows the regulations to modify existing or future primary or other legislation.

4. Subsection (4)(b) makes provision for the regulations to make consequential, supplementary and transitional provision.

5. Subsection (6) provides that a statutory instrument made under this power is subject to the negative resolution procedure.

BACKGROUND NOTE

6. The Government has announced its intention to legislate to enable the UK regulator to authorise, under the UCITS IV directive (Directive 2009/65/EC of the European Parliament and of The Council), tax transparent collective investment schemes to be constituted by contractual arrangements. Transactions relating to the new schemes will need to have an appropriate stamp duty and stamp duty reserve tax treatment. This clause gives the Treasury the power to provide this.

EXPLANATORY NOTE

CLAUSE 216 SCHEDULE 35: AGREEMENT BETWEEN UK AND SWITZERLAND

SUMMARY

1. Clause 216 and Schedule 35 give effect to the agreement signed on 6 October 2011 between the UK and the Swiss Confederation on co-operation in tax matters (as amended by the protocol signed on 20 March 2012). The agreement provides for a one-off levy on financial assets in Switzerland, for a withholding tax to be deducted from income and gains arising in Switzerland and a further levy on the death of an account holder. The withholding tax does not apply where a retention is made under the terms of the 2004 Agreement between the EU and Switzerland on the taxation of savings income ('the EUSA'), but instead a tax finality payment is made so that the overall outcome is equivalent to that achieved by the withholding tax. The Schedule makes clear which UK tax liabilities are satisfied on payment of the one-off levy and sets out the effect of the withholding tax and tax finality payment on UK income tax and capital gains tax liability for the future and the effect of the levy on death on UK inheritance tax liability.

2. In all cases the levy or withholding is avoided if authorisation is given to disclose the assets, income and gains to the UK competent authority.

3. The agreement also provides for enhanced exchange of information.

DETAILS OF THE CLAUSE

4. Subsection (1) is the enabling provision for the UK/Switzerland agreement signed on 6 October 2011 as amended by the protocol. The protocol includes a Joint Declaration concerning the making of a tax finality payment in cases excluded from the agreement because they fall to be dealt with under the EUSA.

5. Subsection (2) provides that the Schedule comes into force when the agreement enters into force. The agreement will enter into force on 1 January following the exchange of diplomatic notes confirming that the appropriate legal procedures in both countries have been completed. It is assumed for the purposes of these explanatory notes that the agreement will take effect on 1 January 2013. The clause itself will take effect on Royal Assent to this Bill.

6. Subsection (3), in common with the approach for other international tax measures, disapplies the normal procedure for laying treaties before Parliament as part of the ratification process set out in section 20 of the Constitutional Reform and Governance Act 2010. Instead, the agreement will receive scrutiny as part of the Finance Bill process.

DETAILS OF THE SCHEDULE

Part 1: Introduction

7. Paragraph 1 contains introductory material.

Part 2: The Past

8. Paragraph 2 sets out the four UK taxes with which this Part of the Schedule is concerned. They are the same four taxes for which the liability for periods up to 31 December 2012 on funds in Switzerland is affected (and may be extinguished) by the payment of the one-off levy under Part 2 of the agreement.

9. The paragraph explains what is meant in the Schedule by the term 'taxable amount' in relation to each of the four taxes.

10. Paragraph 3 explains that this Part of the Schedule sets out the effect on the liability of a person to whom a certificate is given by a Swiss paying agent evidencing that the one-off levy has been applied to the funds in that person's account. That person, who under the agreement must be the beneficial owner of the funds, is called 'P' and the certificate is called a 'Part 2 certificate'. The certificate is used as the basis for determining whether and to what extent UK tax liability on untaxed monies in Switzerland is affected by the payment of the levy.

11. Paragraph 4 sets out whether a taxable amount is a 'qualifying amount' the tax liability on which may be affected by the production of a Part 2 certificate. A qualifying amount is a taxable amount on which P has not paid tax and for which a necessary link with the certificate can be demonstrated.

12. In a case where P is domiciled in the UK or is non-domiciled but has opted for the levy to be calculated using the capital method set out in the agreement, the necessary link is that the taxable amount – for example the amount of income or gain – can be regarded as forming part of the capital by reference to which the levy was applied. This is the amount of cleared capital calculated under Article 9(12) of the agreement and depends on the balance or value of the account at 31 December 2010 and 31 December 2012. It is given the label C_r.

13. To be a qualifying amount it is important that the taxable amount can properly be regarded as being part of C_r. In practice, with movements on accounts, this may not be clear. So paragraph 4 contains a rule that taxable amounts are attributed to assets in the way that produces the most beneficial outcome for P.

14. In a case where P is not domiciled in the UK and has opted for the levy to be calculated using the self-assessment method set out in the agreement, the necessary link is that the taxable amount is included in the omitted taxable base by reference to which the levy was calculated.

15. Further provisions about the interpretation of the conditions for a taxable amount to be a qualifying amount are in paragraph 11.

16. Paragraph 5 explains that a Part 2 certificate is only eligible to give tax clearance to P in a case where none of the exclusions set out in Article 9(13) and Article 12(1) of the agreement applies. If so eligible then paragraph 6 applies. If not so eligible then paragraph 8 applies with the levy being a credit against UK liabilities.

17. Paragraph 6 explains the effect on UK liabilities where P is eligible for clearance on qualifying amounts. In the normal case P gets full tax clearance – 'ceasing to be liable to tax' – (in respect of the four taxes to which the agreement applies) on qualifying amounts. But in a case where funds have directly or indirectly moved from the UK to Switzerland between 6 October 2011 and 31 December 2012 and form part of C_r then the tax liability on qualifying amounts relating to those funds remains in place and instead the appropriate part of the levy is a credit against that liability. The phrase 'the tax due taking account of that amount' is used to indicate all the tax liabilities in respect of a qualifying amount as set out in paragraph 19. Furthermore, as explained in paragraph 9 the phrase also includes associated liabilities to interest and penalties etc.

18. Paragraphs 6(7) to 6(9) contain a cap on the total qualifying amounts that are wholly or partially relieved under this paragraph. Where the levy is calculated on C_r the cap is the value of C_r. Where the levy is calculated on the non-domiciled self assessment basis, it is the value of the omitted taxable base. The cap is necessary because there is no direct link between a qualifying amount that has been paid into an account and the capital sum by reference to which the levy is applied. If the cap applies then the qualifying amounts are relieved in the order which is most beneficial to P.

19. Paragraph 7 clarifies what is meant by P ceasing to be liable to tax on a qualifying amount in relation to each of the four taxes covered by this Part.

20. Paragraphs 7(5) to 7(7) recognise that qualifying amounts (which are, by definition, previously untaxed) should have been returned and that the failure to do so may have resulted in too little tax being paid on items that were returned. The provisions ensure that despite the qualifying amounts being cleared, the liability on other items is what it would have been had the qualifying amounts been properly taken into account. To avoid having to recalculate settled liabilities as far as possible, the qualifying amounts are treated as the top slice of income, gains etc of the relevant period. But where there is additional tax to pay there is also liability to associated interest and penalties.

21. Paragraph 8 explains the treatment of the levy, on production of a Part 2 certificate, in a case where P is not eligible for clearance because one or more of the exclusions set out in Article 9(13) or Article 12(1) apply. The tax liabilities on all qualifying amounts remain in place and instead the levy is a credit against those liabilities, including interest, penalties etc. The credit is applied first to tax in the order set out in sub-paragraph (4), but subject to that, in the way that minimises P's overall liability.

22. Paragraph 9 provides that clearance for tax liabilities or credit against tax liabilities includes clearance for or credit against associated ancillary charges to interest, penalties etc. Where a qualifying amount is part only of a larger taxable amount subject to ancillary charges, then an appropriate apportionment of those charges is made.

23. Paragraph 10 ensures that a repayment of tax previously paid is only due in the limited circumstances where any part of the levy is treated as a payment on account under the terms of the agreement. This provision is about repayment of tax, not about repayment of the levy (with which Article 15 of the agreement is concerned).

24. Paragraph 11 explains the meaning of terms used in paragraph 4 in determining whether an amount liable to tax is a qualifying amount potentially eligible for clearance. Sub-paragraph (2) defines terms for income tax and capital gains tax, sub-paragraph (3) for inheritance tax and sub-paragraph (4) for VAT.

25. Sub-paragraph (5) of paragraph 11 makes explicit that tax clearance for P does not apply to liabilities that are in substance tax liabilities of another person but which have been transferred to P by HM Revenue & Customs (HMRC) under a specific statutory authority.

26. Paragraph 12 provides that if any part of a levy is repaid under Article 15(3) (by HMRC refunding the Swiss authorities) then to the extent that a certificate evidences initial payment of the amount repaid it is disregarded.

Part 3: The Future: income tax and capital gains tax

27. Paragraph 13 sets out the two UK taxes with which this Part of the Schedule is concerned. They are the same two taxes for which the liability for periods from 1 January 2013 on income and gains arising in Switzerland is extinguished by the payment of the withholding tax under Part 3 of the agreement or making the tax finality payment specified in the Joint Declaration.

28. Paragraph 14 explains that this Part of the Schedule sets out the effect on the liability of a person to whom a certificate is given by a Swiss paying agent evidencing that withholding tax or a tax finality payment has been applied. The certificate is used as the basis for demonstrating that UK tax liability on income and gains arising in Switzerland is extinguished by the withholding tax or the tax finality payment. If withholding tax is applied or the tax finality payment is made, the amount of income or gains concerned is called ‘the cleared amount’. ‘The underlying account’ (comprising the portfolio of assets in respect of which the certificate is issued) is not itself cleared as it may include items on which tax has not been paid. The amount of withholding tax or tax finality payment is called ‘the transferred sum’.

29. Paragraph 15 provides that, unless an election under paragraph 16 is made, a person to whom a relevant certificate is issued ceases to be liable to tax on the income and gains to which withholding is applied together with any associated interest and penalties. The withholding tax or tax finality payment (coupled with the retention under the EUSA) satisfies the UK liability on the cleared amount.

30. Paragraph 15(5) attracts the rules in paragraph 7 to the extent that they relate to income tax and capital gains tax. A failure to include items taxed under Part 3 of the agreement or the Joint Declaration in a return may result in too little tax being paid on items that are returned. Attracting those rules ensures that the liability on other items is what it would have been had the cleared income and gains been properly taken into account. To avoid having to recalculate settled liabilities as far as possible, the cleared amount is treated as the top slice of income and gains of the relevant period.

31. Paragraph 16 gives effect to Article 23 of the agreement (and contains corresponding provision for a tax finality payment under the Joint Declaration). It provides that P may elect that the withholding tax or tax finality payment that has been applied is not treated as settling liability if all affected amounts relating to the underlying account are included in a return or amended return. This allows P the option to calculate tax liability on the normal basis with the withholding tax or tax finality payment allowed as a credit against that liability. An election must be made in the return or amended return and accompanied by the certificates issued under Article 30(1) and the Joint Declaration relating to the underlying account. If a

claim is made under Part 3 of TIOPA 2010 for the retention under the EUSA to be credited as a 'special withholding tax' then P is treated as making an election under this paragraph. So in a EUSA case the choice is to claim (with both the EUSA retention and the tax finality payment credited) or not to claim (with neither credited).

32. Paragraph 16(6) allows for the net amount received to be grossed up. So that, for example, if the EUSA retention is made at 35 per cent and the tax finality payment at 13 per cent resulting in P receiving £52 out of an initial income of £100, then section 143 TIOPA 2010 provides that the measure of income for UK tax purposes is £100.

33. Paragraph 17 provides that, except for special withholding tax under Part 3 of TIOPA 2010 any credit for foreign tax that is allowed against liability to income tax or capital gains tax is allowed in priority to any credit under paragraph 15. The special withholding tax is allowed last in accordance with the rule in the EUSA.

34. Paragraph 18 makes it explicit that the only circumstance in which the provision of a relevant certificate to HMRC entitles P to a repayment of any tax paid is as a result of an election under paragraph 16. The tax finality payment and special withholding tax are set against income tax or capital gains tax as appropriate and then against any liability to the other tax, with only the excess eligible for repayment.

35. Paragraph 19 ensures that the tax finality payment under the Joint Declaration is not itself a special withholding tax within Part 3 of TIOPA 2010.

Part 4: The future: inheritance tax

36. Paragraph 20 provides that Part 4 concerns inheritance tax. It applies where an individual P with financial assets in Switzerland dies on or after 1 January 2013.

37. Paragraph 21 explains that Part 4 is concerned with cases where a levy of 40 per cent of the assets of P is applied under Article 32 of the agreement. The paying agent provides a certificate to the appropriate person (the personal representatives or a beneficiary) which will specify the amount of cleared assets.

38. Paragraph 22 provides that the cleared assets are excluded from P's estate with the result that no inheritance tax is payable on them. Clearance also applies to any associated ancillary charges.

39. Paragraphs 22(3) to 22(5) recognise that failure to include cleared assets in an account delivered to HMRC may result in too little inheritance tax being paid on other estate assets. The provisions

ensure that despite assets being cleared, the liability on other assets is what it would have been had the cleared assets been taken into account. To avoid having to recalculate settled liabilities as far as possible, the cleared assets are treated as the top slice of the chargeable transfer. Where there is additional inheritance tax to pay there is also liability to associated interest and penalties.

40. Paragraph 23 gives effect to Article 32(6) of the agreement. It provides that the person delivering an account or further account under section 216 or 217 IHTA 1984 may elect to include the cleared assets. In that case clearance ceases to apply and instead credit is given for the amount of the levy against the inheritance tax due, with repayment if appropriate.

41. Paragraph 24 makes it explicit that the only circumstance in which the provision of a relevant certificate to HMRC entitles P to a repayment of any inheritance tax paid is as a result of an election under paragraph 23.

Part 5: General provisions

42. Paragraph 25 ensures that there is no impediment to the passing of information to the Swiss authorities under Article 36 of the agreement. There is a similar provision in section 173(4) of Finance Act 2006 in relation to other international tax arrangements.

43. Paragraph 26 explains that references to VAT include amounts invoiced as if they were VAT, recoverable as a debt due to the Crown under paragraph 5(2) and (3) of Schedule 11 to VATA 1994.

44. Paragraph 27 defines the meaning of various terms in this Schedule.

BACKGROUND NOTE

45. The UK and Swiss governments signed an agreement on 6 October 2011 providing for co-operation in tax matters. The agreement imposes various levies on financial assets held by and on income and gains arising in Switzerland to UK individuals. In all cases the levy or withholding is avoided if authorisation is given to disclose the assets, income and gains to the UK competent authority. This clause and Schedule give effect to the agreement (as amended by a protocol signed on 20 March 2012) for UK tax purposes. It is expected that the agreement will take effect on 1 January 2013, but that is subject to the passing of enabling legislation and ratification of the agreement in Switzerland.

46. The agreement provides for a one-off levy on financial assets in Switzerland, for a withholding tax to be deducted from income and gains arising in Switzerland and for a levy on assets on the death of an account holder on or after the agreement comes into force. The Schedule makes clear which UK tax liabilities are satisfied on payment of the one-off levy for the past and sets out the effect of the withholding tax and levy on assets at death for the future

47. Cases in which a retention is made under the terms of the 2004 agreement between the EU and Switzerland ('the EUSA') are excluded from the agreement, but the Joint Declaration (contained within the protocol) introduces a tax finality payment to produce an equivalent result to that obtained under the agreement itself. The Schedule sets out the effect of making a tax finality payment.

48. The agreement also provides for enhanced exchange of information by the Swiss authorities to the UK and allows the Swiss authorities to request that a further agreement is made for the provision of information by the UK to Switzerland on similar lines to the approach adopted by the UK with other territories.

EXPLANATORY NOTE

CLAUSE 217: PENALTIES: OFFSHORE INCOME ETC

SUMMARY

1. Clause 217 adds to the list of factors in paragraph 21A of Schedule 24 to FA 2007 that the Treasury must have regard to in classifying a territory into one of the three categories set out in that provision. The classification of the territory determines the range within which a penalty falls in respect of under-declaration, failure to notify or late return of income and gains relating to that territory.

DETAILS OF THE CLAUSE

2. Clause 217 inserts two new paragraphs 21A(4)(d) and 21A(4)(e) of Schedule 24. In classifying a territory they require the Treasury to have regard to the existence and quality of arrangements between the UK and that territory that provide for co-operation in the area of taxation.

BACKGROUND NOTE

3. The extension to the range of factors recognises that agreements are being reached which, while not offering automatic exchange of information, deliver an outcome for the UK that is much better than that which can be delivered through exchange on request. In particular, they enable HMRC to regularise the tax position of UK taxpayers with accounts in those territories. Such agreements, if fully implemented, justify inclusion of territories in category 1, alongside territories that do exchange information automatically.

EXPLANATORY NOTE

CLAUSE 218 SCHEDULE 36: INTERNATIONAL MILITARY HEADQUARTERS, EU FORCES, ETC

SUMMARY

1. Clause 218 and Schedule 36 provide the tax treatment required by the EU Status of Forces Agreement for visiting EU military and civilian staff, in order to enable the UK to ratify the agreement. This treatment is in line with the tax treatment already given to visiting North Atlantic Treaty Organisation (NATO) forces and their civilian staff. The Schedule amends the provisions of the four taxes acts that apply to visiting forces and allied headquarters.

DETAILS OF THE SCHEDULE

2. Paragraph 1 amends section 74A of the Finance Act (FA) 1960 so that the section applies an exemption from Stamp Duty Land Tax (SDLT) not just to land transactions in respect of a NATO headquarters, but also to land transactions in respect of any international military headquarters designated under an Order in Council. It also deletes the redundant subparagraph 4(c).

3. Paragraphs 2 and 3 amend sections 6 and 155 of the Inheritance Tax Act 1984 so that an exemption from inheritance tax applies not only to NATO military and civilian personnel stationed in the UK or attached to a NATO headquarters in the UK, but also to EU military and civilian staff attached to an international military headquarters designated under an Order in Council.

4. Paragraph 3(3) inserts into section 155:

- new subsection 5A which provides that the official earnings of EU civilian staff, who are not British citizens, paid by a government of a Member State, and any movable property they have in the UK solely because they are part of the EU civilian staff, are excluded property and thus not chargeable to inheritance tax in the event of their death.

- new subsection 5B which provides that EU civilian staff are not regarded for the purposes of the Inheritance Tax Act as becoming resident in the UK if their presence in the UK is solely because of being part of the EU civilian staff.

5. Paragraph 3(4) inserts new paragraphs (a) and (b) into subsection 6 of section 155 to define what is meant by EU civilian staff, this covers

both staff working with EU forces in the UK and those attached to international military headquarters situated in the UK.

6. Paragraph 4 amends section 303 of the Income Tax (Earnings and Pensions) Act 2003 so that the section also applies to EU military and civilian staff, as well as to military and civilian personnel working for NATO countries.

7. Paragraph 4(3) inserts new subsection 4A into section 303 which provides that the earnings of EU civilian staff paid by a government of a Member State are exempt from income tax. This exemption does not apply to British citizens and certain other classes of British nationals.

8. Paragraph 4(4) defines what is meant by EU civilian staff and covers both staff working with EU forces in the UK and those attached to international military headquarters.

9. Paragraph 5 amends section 833 of the Income Tax Act 2007 (ITA) so that the section applies to EU military and civilian staff, as well as to military and civilian staff working for NATO countries.

10. Paragraph 5(2) expands the type of headquarters covered from just NATO ones to any international military headquarters designated by Order in Council.

11. Paragraph 5(5) inserts new subsection 3A into section 303 ITA which brings EU civilian staff who are not British citizens, or certain other classes of British nationals, within the provision.

12. Paragraph 5(6) defines what is meant by EU civilian staff, and covers both staff working with EU forces in the UK and those attached to international military headquarters.

BACKGROUND NOTE

13. In 2003 the European Council decided, in pursuit of the Common Foreign and Security Policy, to give the EU the capabilities required to take and implement decisions on the full range of conflict prevention and crisis management tasks defined in the Treaty on European Union (TEU).

14. In order to facilitate the movement of forces between Member States of the European Union in the context of the TEU, an Agreement was drawn up regarding the status of military and civilian staff. This is the EU Status of Forces Agreement. The Agreement was presented to Parliament in March 2009.

15. Although most of the Agreement is not to do with tax, it does provide for tax privileges to be granted to EU military and civilian staff of one Member State, who are present in another Member State to carry out tasks relating to common security and defence policy in accordance with the EU Status of Forces Agreement.

16. The UK cannot ratify the Agreement until all the domestic legislation is in place to give effect to its provisions.

17. Existing tax legislation provides that members of visiting forces and staff of designated NATO allied headquarters, who are present in the UK solely because of their official duties, are exempt from tax on their official remuneration and do not become tax resident in the UK if they are stationed here. There are also provisions providing exemptions from Capital Gains Tax, Inheritance Tax and Stamp Duty Land Tax.

18. This section and schedule expand the existing legislation so that it will also apply to members of visiting EU forces and to the civilian staff which may accompany them, as well as to EU military and civilian staff working at designated international military headquarters in the United Kingdom.

EXPLANATORY NOTE

CLAUSE 219: TAX CONSEQUENCES OF FINANCIAL SECTOR REGULATION

SUMMARY

1. Clause 219 introduces a new power allowing HM Treasury to make Regulations to deal with the tax and stamp duty consequences arising from new types of regulatory capital securities.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces the power and explains that it can be applied to deal with the tax consequences in relation to securities in consequence of any regulatory requirements imposed by EU legislation or other enactments that affect persons who are authorised under the Financial Services Management Act 2000 (FSMA) or their parent undertakings.

3. Subsection (2) provides examples of the way in which the power might be exercised.

4. Subsection (3) ensures that references to enactments, EU legislation or documents in regulations made under the power may automatically be updated to reflect any subsequent amendments to enactments, EU legislation, documents or provisions referred to in the regulations.

5. Subsection (4) sets out the type of changes that may be made to the taxation of securities by regulations made under this power.

6. Subsections (5) and (6) provide that regulations made under the power will be made by Statutory Instrument and must be approved in draft by a resolution of the House of Commons (known as the draft affirmative procedure).

7. Subsection (7) provides definitions of various terms used within this provision.

BACKGROUND NOTE

8. Basel III is a comprehensive set of reform measures developed by the Basel Committee on Banking Supervision, designed to strengthen the regulation, supervision and risk management of the banking sector in response to the financial sector crisis.

9. The Basel III proposals will be implemented into EU law through changes to the existing Capital Requirements Directive, referred to as CRD 4. These will include an EU Regulation (CRR) and an EU Directive (CRD) which will be implemented through national law. These changes are due to commence from 1 January 2013.

10. In response to these changes financial institutions will have to issue new forms of capital that meet the conditions required for regulatory capital. This new power allows HM Treasury to make Regulations that set out the tax and stamp duty treatment of such securities, providing financial institutions with certainty and clarity of tax treatment.

11. The new power is not limited to Basel III securities it will also allow HM Treasury to make Regulations in respect of the tax consequences in relation to securities issued by authorised persons under FSMA 2000 under other regulatory regimes imposed by UK or EU legislation.

EXPLANATORY NOTE

CLAUSE 220: REMOVAL OF SPECIAL PROVISION FOR INCAPACITATED PERSONS AND MINORS

SUMMARY

1. Clause 220 removes the current definition of "incapacitated person" from the Taxes Management Act 1970. This clause also removes linked provisions in the Taxes Management Act (and other similar legislation) that confer certain rights and obligations on the person that represents an incapacitated person. The general legal framework for appointing people to assist those who lack capacity will continue to operate in relation to tax.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) remove provisions of the Taxes Management Act 1970 and the Finance Act 2003 which relate to income tax and stamp duty land tax and confer different rights and obligations on the representatives of incapacitated persons (including minors), and on parents and guardians of minors generally.

3. Subsection (4)(a) removes the definitions of an "incapacitated person" and an "infant" from the Taxes Management Act 1970.

4. Subsections 4(b) to (e) make further consequential amendments to other legislation.

5. Subsections (5) and (6) make provision as to when the changes have effect.

BACKGROUND NOTE

6. In 2010 the Exchequer Secretary to the Treasury gave a commitment to consult, with an intention to update the current definition for tax purposes of an incapacitated person. A consultation document was published on 24 May 2011, and a summary of responses has now been published.

7. The approach taken here removes both the terminology, which is seen as offensive, of the current definition and the linked provisions. As a result of the changes there will no longer be a tax-specific legal framework for incapacitated persons. The general legal framework for appointing people to assist those who lack capacity will continue to operate in relation to tax.

8. The provisions that this clause removes from the Taxes Management Act 1970 are applied for different purposes, and with modifications, by three statutory instruments: the Stamp Duty Reserve Tax Regulations 1986 (S.I. 1986/1711); the Child Trust Fund Regulations 2004 (SI 2004/1450); the Education (Student Loans) (Repayment) Regulations 2009 (SI 2009/470). It is intended that secondary legislation will be made to remove from those instruments the provisions that are linked to the sections of the Taxes Management Act that are removed by this clause.

9. The Registered Pension Schemes (Discharge of Liabilities under Sections 267 and 268 of the Finance Act 2004) Regulations 2005 (S.I. 2005/3452), makes provision in regulation 4 for applications made on behalf of incapacitated persons. The intention is to revoke regulation 4 by statutory instrument.

EXPLANATORY NOTE

CLAUSE 221 SCHEDULE 37: TAX AGENTS: DISHONEST CONDUCT

SUMMARY

1. Clause 221 and Schedule 37 make provision about powers to obtain working papers from tax agents who engage in dishonest conduct, impose penalties on them and allow the Commissioners of HM Revenue and Customs (HMRC) to publish their details. The Schedule will come into force by means of a Treasury order, made by statutory instrument.

DETAILS OF THE CLAUSE

2. Subsection (3) provides that an order to bring the Schedule into force may make different provision for different purposes, and may include transitional provisions and savings.

3. Subsections (4)-(6) cover other orders that may be used to make incidental, supplemental, consequential, transitional and saving provisions but only if they are consequential on the draft Schedule.

4. Subsection (7) provides that a statutory instrument, which contains an order under subsection (4), is subject to the negative procedure.

DETAILS OF THE SCHEDULE

Part 1: Introduction

5. Paragraph 1 provides an overview of the Schedule.

6. Paragraph 2 defines a “tax agent” as an individual who assists others with their tax affairs. The assistance must be in the course of business, so that, for example, general advice by friends, family or volunteer advisers, or broadcasts and lectures is not caught.

7. Under sub-paragraph (2) an individual can be a tax agent even if appointed indirectly.

8. Under sub-paragraph (3) assistance includes providing advice to or acting for a client in relation to tax. Sub-paragraphs (4) to (5) further clarify the meaning of assistance.

9. Sub-paragraph (1) of paragraph 3 defines engaging in “dishonest conduct” as doing something dishonest with a view to bringing about a loss of tax revenue and sub-paragraph (7) provides more detail.

10. Sub-paragraphs (2) and (3) provide that it does not matter whether or not there is an actual loss of tax revenue, or whether the agent was acting on a client's instructions.

11. Sub-paragraph (4) together with sub-paragraph (6) defines a loss of tax revenue.

12. Sub-paragraph (5) cross refers to Part 6 for the definition of the taxes covered by the Schedule.

Part 2: Establishing dishonest conduct

13. Paragraph 4 applies if HMRC determine that a person has engaged in dishonest conduct.

14. Sub-paragraph (2) and (3) provide that an authorised HMRC officer may notify the person of that determination, stating the grounds (a conduct notice).

15. Sub-paragraph (4) sets out the implications of a conduct notice by reference to later paragraphs of the Schedule (tribunal authorisation of a file access notice and a penalty for dishonest conduct).

16. Paragraph 5 provides a right of appeal for the tax agent against HMRC's determination of dishonest conduct, setting out the procedure and what the tribunal may do.

17. Paragraph 6 provides for a criminal offence if a person disposes of a material document which could otherwise be sought under a file access notice.

Part 3: Power to obtain tax agent's files etc

18. Paragraph 7 sets out two cases in which relevant documents may be required by a file access notice. Case A is where a conduct notice has been given without an appeal being made or once the appeal has been resolved. Case B is where an individual has been convicted of a tax related offence of dishonesty but only if it occurred after they became a tax agent. The capacity in which the offence was committed does not matter. In both Cases A and B the tribunal must approve the file access notice.

19. Paragraph 8 allows an officer to require relevant documents by a file access notice to the agent or anyone else who holds the documents.

20. Paragraph 9 describes "relevant documents". These are any documents used by a tax agent in assisting clients with their tax affairs and can be required even if the agent does not own them.

21. Paragraph 10 describes the documents which can be required under a file access notice.

22. Paragraphs 11 and 12 describe how a tax agent may comply with the contents of a file access notice.

23. Sub-paragraph (1) of paragraph 13 sets out the conditions for approval by the tribunal of the file access notice.

24. Sub-paragraphs (1)(b) and (c) set out that before approving the file access notice the tribunal must be satisfied that there has been dishonest conduct or a relevant conviction, and that the notice is justified in the circumstances.

25. Sub-paragraphs (1)(d) and (e) put conditions on HMRC (in addition to any other requirements deriving from tribunal rules).

26. Sub-paragraph (3) provides that the tribunal's decision is final. But there is a further right of appeal for a document-holder who is not the tax agent under paragraph 20 below.

27. Paragraphs 14 and 15 set out restrictions on documents that can be required by a file access notice: documents not in the document-holder's possession or power, material that relates to a pending tax appeal, or which is journalistic or personal.

28. Paragraph 16 provides that a file access notice cannot require production of documents which are more than 20 years old unless the document is of continuing relevance to tax.

29. Paragraph 17 concerns privileged material. Under sub-paragraph (1), a document-holder is not required to provide such material. Sub-paragraph (2) defines privileged material, and sub-paragraph (3) applies regulations made under Schedule 36 to the Finance Act (FA) 2008, covering disputes about whether a document is privileged.

30. Paragraphs 18 and 19 allow HMRC to copy and retain the documents provided and describe the conditions that apply to retention.

31. Paragraph 20 provides a right of appeal against the file access notice on the grounds of onerousness for a document-holder (a third party) who is not the tax agent. It sets out the procedure and the tribunal's powers.

32. Paragraph 21 provides for a criminal offence where a person disposes of a document required by a file access notice (a required document).

33. Paragraph 22 provides for a civil penalty for failure to comply with a file access notice.

34. Paragraph 23 provides for a daily civil penalty for a continuing failure to comply with a file access notice. This does not apply if a person cannot comply with the notice because the document in question has been destroyed, since it is no longer in the person's possession or power.

35. Paragraph 24 says that where an officer of HMRC allows extra time for a requirement to be complied with, which is then met, there is no liability to a penalty.

36. Paragraph 25 provides that if a person has a reasonable excuse there is no liability to a penalty. Sub-paragraph (2) sets out circumstances which do not count as a reasonable excuse.

Part 4: Sanctions for dishonest conduct

37. Paragraph 26 says that a tax agent who engages in dishonest conduct is liable to a penalty.

38. Sub-paragraph (2) sets out the minimum and maximum amount of this penalty.

39. Sub-paragraphs (3)-(7) set out the factors to be taken into account in assessing the penalty, including whether the dishonest conduct was disclosed and the quality of that disclosure.

40. Paragraph 27 provides that where HMRC proposes to assess the minimum penalty for dishonest conduct, and there are special circumstances, HMRC may reduce a penalty, stay (desist from) proceedings, or agree a compromise in those proceedings.

41. Sub-paragraph (3) explains what does not constitute special circumstances.

42. Sub-paragraph (1) of paragraph 28 provides that HMRC may publish information about a tax agent who has incurred a penalty for dishonest conduct.

43. Sub-paragraph (2) sets out what information may be published.

44. Sub-paragraph (3) provides that no information may be published if a penalty has been reduced to or below the minimum.

45. Sub-paragraph (4) applies certain provisions of section 94 of FA 2009 to publishing information about a tax agent (time limits and the ability to make representations to HMRC).

46. Sub-paragraph (5) provides that information about an organisation (including a firm or business) may be published in order to make clear the identity of a tax agent who works for that organisation.

47. Sub-paragraph (6) provides an opportunity for that organisation to make representations about publication.

Part 5: Penalties under this Schedule: Assessment etc

48. Paragraphs 29 and 30 provide machinery provisions for HMRC to assess penalties due under this Schedule.

49. Paragraph 31 provides a right of appeal against a decision to impose a penalty or against the amount of any penalty and describes the procedures for appealing.

50. Paragraph 32 describes the means by which collection of a penalty charged under this Schedule may be enforced.

51. Paragraphs 33 and 34 provide that a person is not liable to a penalty under this Schedule for anything in respect of which they have either been convicted of an offence, or are liable to a penalty under specified penalty enactments.

52. Paragraph 35 provides for penalty amounts in this Schedule to be re-valorised by means of a Treasury order if there has been a change in the value of money.

Part 6: Miscellaneous provision and interpretation

53. Paragraph 36 specifies parts of the Taxes Management Act 1970 (TMA) which apply to this Schedule.

54. Paragraph 37 sets out which taxes are covered by this Schedule.

55. Paragraphs 38, 39, 41 and 42 cover how certain terms should be interpreted for the purposes of this Schedule.

56. Paragraph 40 provides that a loss of tax is taken to have been brought about even if subsequently recovered or properly accounted for.

57. Paragraph 43 describes the relationship between this Schedule and other enactments.

Part 7: Consequential provisions

58. Paragraphs 44 to 52 and 58 describe other legislation which is omitted or amended as a consequence of this Schedule.

59. Paragraphs 53 to 57 make consequential amendments to apply the Schedule for the purposes of National Insurance Contributions.

BACKGROUND NOTE

60. Tax agents play a crucial role in the delivery of the UK tax system. HMRC is able to accept the majority of returns without checking their accuracy individually because of the work done by taxpayers and their agents to ensure those returns are correct.

61. But there are a small number of tax agents who are prepared to act dishonestly and whose actions can affect a larger group of taxpayers. HMRC needs to be able to deter and penalise this behaviour. It also needs to identify the scale of the dishonesty in order to be able to put matters right. This requires HMRC to be able to access the working papers of the dishonest agent to check and correct their clients' returns as appropriate.

62. HMRC has existing powers in respect of agents in sections 99 and 20A of TMA, but these apply only to direct tax and do not work as intended. This provision modernises the existing law, extends it to other taxes and duties and allows HMRC to publish details on its website of dishonest tax agents who are penalised and fail to fully disclose their dishonesty.

63. HMRC has consulted three times on how it should engage with tax agents to raise professional standards. *Working with Tax Agents* was published in April 2009. *Working with Tax Agents: the next stage* was published in December 2009 together with draft legislation in February 2010. Revised legislation was published with a discussion document *Working with Tax Agents: Dishonest Conduct* on 14 July 2011. Draft legislation was also published for comment on 6 December 2011.

64. The measure will be brought into effect by Treasury Order, not expected to be before 1 April 2013.

EXPLANATORY NOTE

CLAUSE 222: INFORMATION POWERS

SUMMARY

1. Clause 222 inserts a new paragraph 5A into Schedule 36 to Finance Act (FA) 2008. It provides a power for HM Revenue & Customs (HMRC) to require a third party to provide the name, last known address and date of birth (if known) of a person for whom HMRC has information from which that person's identity can be ascertained. A notice will only be issued to a person who can be expected to be able to identify the taxpayer from the information provided by HMRC in the notice.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for amendments to Schedule 36 FA 2008.

3. Subsection (2) inserts the new power into Schedule 36.

4. New paragraph 5A(1) provides that an authorised officer of HMRC may issue a notice requiring a third party to provide relevant information about a person, subject to the conditions set out in new paragraphs 5A(2) to (5).

5. New paragraph 5A(6) defines what "relevant information" means.

6. New paragraph 5A(7) ensures that the identity details of all persons must be provided where the identifying information provided relates to more than one person.

7. Subsections (3) to (5) make consequential amendments to Schedule 36 including ensuring that the same rights of appeal apply as for a notice under paragraph 5 of Schedule 36.

8. Subsection (6) updates the reference in section 18D of Taxes Management Act ("TMA") 1970 to sections 17 and 18 of that Act which are repealed by Schedule 23 FA 2011 from 1 April 2012.

9. Subsection (7) provides that the new power, which will come into force on Royal Assent, will apply to tax whenever due.

10. Subsection (8) provides for the amendment in subsection (6) to take effect from 1 April 2012.

BACKGROUND NOTE

11. This new power adds to the range of information powers in Schedule 36 FA 2008 which may be used in carrying out a check of a person's tax position. In a case where the full identity of the taxpayer is not known but information is required from a third party, the existing powers can only be used where a serious loss of tax is suspected. The new power allows HMRC to issue an information notice in a case where identifying information is held (for example a bank branch and account number) in order to find out relevant information. A notice may only be issued to third parties that HMRC believes might have obtained such information in the course of business.

12. Relevant information is narrowly defined and only consists of the name, address and date of birth (if known) of the person to whom the identifying information relates. Once the taxpayer is fully identified in this way any further enquiries that are necessary will be made using the existing powers in Schedule 36.

13. This new power is necessary in order to bring the UK's powers into line with latest international standards as determined by the OECD and the Global Forum on Transparency and Exchange of Information for Tax Purposes.

14. Subsections (6) and (8) update a reference in TMA 1970 that was overlooked in Schedule 23 to FA 2011.

EXPLANATORY NOTE

CLAUSE 223: PAYE REGULATIONS: INFORMATION

SUMMARY

1. Clause 223 provides HM Revenue & Customs (HMRC) with additional powers to require by regulations that certain persons who make payments that are subject to the Pay As You Earn system (PAYE) by electronic means must insert a cross-reference into the information provided to HMRC about that payment and the instruction to the payment service provider to make the payment. The regulations and directions which HMRC intends to make under them will detail who, and which payment services, are affected.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the amendment of section 684 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). Section 684 requires the Commissioners for HMRC (the Commissioners) to make regulations governing the operation of PAYE (PAYE Regulations). Section 684(2) of ITEPA contains a list of items which may be included in the regulations.

3. Subsection (2)(a) inserts into section 684(2) a new item 4ZA. This allows for PAYE Regulations to authorise or require anyone who provides a payment service to supply information to HMRC about payments of PAYE income made by means of that payment service. PAYE Regulations may also include provision authorising or requiring the provision of information about the payment service provided with respect to particular payments. The Commissioners are provided with a power to specify, by means of directions, circumstances in which the above obligations do not apply.

4. New item 4ZA also allows PAYE Regulations to provide that where anyone provides information to HMRC in accordance with one of the above authorisations the supply of that information will not be treated as breaching any obligation of confidence.

5. Subsection (2)(b) inserts new item 8A into the list in section 684(2). It allows PAYE Regulations to require compliance with any directions the Commissioners may give about the form and manner in which information must be provided under the Regulations. It also allows PAYE Regulations to require compliance with directions specifying the information that a person who makes a payment of

PAYE income must provide to HMRC about the method by which the payment is made.

6. New subsection (3C) provides that directions made under new items 4ZA and 8A in section 684(2) may make different provision for different cases.

7. Subsection (4) inserts new subsections (4ZA), (4ZB) and (4ZC) after section 684(4).

8. New subsection (4ZA) confirms that new item 8A in subsection (2) of that section, which allows PAYE Regulations to require compliance with certain directions, does not prejudice the power of the Commissioners under section 684 to make provision in PAYE Regulations dealing with the same subject matter as the directions.

9. New subsection (4ZB) provides that PAYE Regulations may provide for information required under the Regulations to be provided to persons who provide payment services covered by regulations made under new item 4ZA in section 684(2). Item 4ZA provides that PAYE Regulations may require the provider of that service to ensure that means are put in place to allow this to happen, including by directions under new item 8A in section 684(2), and prohibiting the service provider from disclosing that information other than to HMRC.

10. New subsection (4ZC) sets out the meaning of "PAYE information regulations" for the purposes of new subsection (4ZB).

BACKGROUND NOTE

11. PAYE Regulations set out the basic rules governing PAYE and tax deductions to be made from payments to employees. They also set out how employers should report certain information in connection with those payments to HMRC. Section 684 of ITEPA requires the Commissioners to make PAYE Regulations and sets out what types of provision PAYE Regulations may include.

12. The amendments provided by this clause will give HMRC additional powers that will facilitate the introduction of the Real Time Information (RTI) programme. They will allow PAYE Regulations to authorise or require certain persons who make payments that are subject to PAYE by electronic means to insert a cross reference into the information provided to HMRC about that payment and the instruction to the payment service provider to make the payment. This cross reference will enable HMRC to link and check the information submitted to HMRC against payments actually made.

The regulations and directions which HMRC intends to make under this power will detail who, and which payment services, are affected.

13. RTI will improve the operation of PAYE by making the system easier to administer. Under RTI, information about tax and other deductions will be collected and transmitted to HMRC every time an employee is paid.

14. HMRC has engaged extensively with employers and other interested parties about the design and introduction of RTI. A discussion paper 'Improving the operation of Pay As You Earn (PAYE)' was published on 27 July 2010. A second stage of consultation 'Improving the operation of Pay As You Earn (PAYE): Collecting Real Time Information' began on 3 December 2010, and a summary of responses to this consultation was published on 30 September 2011. These documents can be found on the HMRC website at: 'http://www.hmrc.gov.uk/rti/index.htm'.

15. HMRC also sought comments on draft amendments to the regulations dealing with PAYE, National Insurance Contributions and the Construction Industry Scheme, which will provide for the introduction of RTI. The draft regulations were released for comment on Monday 14 November 2011 together with a technical note. The closing date was 9 January 2012.

EXPLANATORY NOTE

CLAUSE 224: NEW TAX ON OWNERSHIP OF HIGH-VALUE RESIDENTIAL PROPERTIES OR DWELLINGS

SUMMARY

1. Clause 224 will allow HM Revenue & Customs (HMRC) to incur expenditure in preparing for the introduction of a new tax to be charged on high-value residential properties owned otherwise than by individuals.

DETAILS OF THE CLAUSE

2. Clause 224 provides HMRC the statutory cover to incur expenses incurred in the preparation for a new tax in respect of high-value residential properties or dwellings owned otherwise than by individuals.

BACKGROUND NOTE

3. HMRC may only incur expenditure where there is statutory cover to do so. In the case of existing taxes, the statutory cover has already been granted.

4. In the case of new taxes, HMRC must receive statutory cover in order to incur expenditure for the introduction of a new tax prior to it coming into force.

EXPLANATORY NOTE

CLAUSE 225 SCHEDULE 38: REPEAL OF MISCELLANEOUS RELIEFS ETC

SUMMARY

1. Clause 225 introduces Schedule 38. Schedule 38 provides for the repeal of miscellaneous reliefs, following the Office of Tax Simplification review of reliefs

DETAILS OF SCHEDULE 38

Part 1: Stamp Duty and Stamp Duty Land Tax

Nationalisation schemes

2. Paragraph 1(1) repeals section 52 of Finance Act (FA) 1946 which provides for exemption from stamp duty for instruments connected with nationalisation schemes.

3. Paragraph 1(2) makes consequential amendments.

Visiting forces and allied headquarters

4. Paragraph 2 repeals section 74 of FA 1960 which provides exemption from stamp duty for transfers of land made in connection with the provision of facilities for visiting forces and allied headquarters.

Shared ownership transactions

5. Paragraph 3(1) repeals section 97 of FA 1980, section 108 of FA 1981 and section 54 of FA 1987. Those provisions provide relief from stamp duty for purchases of residential property under shared ownership schemes.

6. Paragraph 3(2) makes consequential amendments.

Instruments subject to duty of fixed amount

7. Paragraph 4 amends section 87 of FA 1985, removing the power conferred by subsection (2) for HM Treasury to make regulations specifying that certain instruments are exempt from stamp duty of a fixed amount.

Acquisitions

8. Paragraph 5(1) repeals section 76 of FA 1986 and section 113 of, and Schedule 35 to, FA 2002 which provide for a reduced rate of stamp duty for certain company acquisitions and for the withdrawal of the relief in specified circumstances.

9. Paragraph 5(2) makes consequential amendments.

Transfers to registered social landlords

10. Paragraph 6 repeals section 130 of FA 2000 as well as references to that paragraph elsewhere in the Act. That provision provides relief from stamp duty for transfers of land to registered social landlords.

Land in disadvantaged areas

11. Paragraph 7(1) repeals sections 92 to 92B of, and Schedule 30 to, FA 2001. Those provisions provide relief from stamp duty for purchases of residential property in areas designated as disadvantaged.

12. Paragraph 7(2) makes consequential amendments.

13. Paragraph 7(3) provides for any regulations made under section 92 of FA 2001 to continue to have effect for the purposes of section 72DA of the Insolvency Act 1986.

14. Paragraph 8(1) repeals section 57 of, and Schedule 6 to, FA 2003 which provide relief from stamp duty land tax for purchases of residential property in areas designated as disadvantaged.

15. Paragraphs 8(2) and (3) make consequential amendments.

Leases granted by registered social landlords

16. Paragraph 9(1) repeals sections 128, 129 and subsections (3) to (6) and (9) of section 130 of FA 2003. Those provisions provide exemption from stamp duty for certain leases granted by registered social landlords.

17. Paragraph 9(2) makes consequential amendments.

Application and transitional provision

18. Paragraph 10 sets out the commencement provisions that apply to the amendments made by paragraphs 1 to 9.

19. Paragraph 11 provides that, subject to certain conditions, stamp duty disadvantaged areas relief will continue to apply to the completion of contracts entered into on or before 16 March 2005, when the relief for transfers of commercial land was withdrawn.

20. Paragraph 12 provides that, subject to certain exclusions, the relief will continue to apply to the completion or substantial performance of contracts entered into on or before 16 March 2005, when the relief for transfers of commercial land was withdrawn. The exclusions include the variation or the assignment of the contract or the subsale of the property after 16 March 2005.

21. Paragraph 13 provides that claims for relief for transactions with an effective date on or before 5 April 2013 must be made before 6 May 2014.

Part 2: Repeal of harbour reorganisation scheme reliefs

22. Paragraph 14 repeals section 45 of FA 1966 which provides exemption from stamp duty for the transfer of stock or marketable securities to a Harbour Authority in connection with a certified harbour reorganisation scheme.

23. Paragraph 15 repeals section 221 of the Taxation of Chargeable Gains Act 1992 (TCGA). That section provides that chargeable assets transferred from a company to a statutory Harbour Authority under a certified harbour reorganisation scheme are treated for tax purposes as transferred at the value which creates neither a gain nor a loss for the transferor.

24. The effect of the repeal on such a transfer occurring on or after the commencement date is that the assets will be treated as passing at market value.

25. Paragraph 16 repeals sections 991 to 995 of the Corporation Tax Act (CTA) 2010. These sections provide a number of corporation tax reliefs applying where the trade and assets of a company are transferred to a statutory Harbour Authority under a certified harbour reorganisation scheme. The effects of repealing these sections on such a transfer occurring on or after the commencement date are that:

- the trade of the transferor will be treated as discontinued at the date of the transfer for all the purposes of the Corporation Taxes Acts, and the transferee will be treated a starting to carry on the trade at that date;

- the transferee will not be entitled to any surplus losses of the trade incurred by the transferor;

- the transferor will be treated as having disposed of any assets used in the trade which are sold or transferred under the scheme, and will be subject to any allowances or charges arising in accordance with the Capital Allowances Act 2001 (CAA);

- the transferee will not be entitled to corporation tax relief for any allowable capital losses that the transferor would have been entitled to claim if it had continued to carry on the trade.

26. Paragraph 17 makes a number of consequential changes, removing references to section 221 of TCGA.

27. Paragraph 18(1) provides for the amendments made by paragraph 14 to have effect in relation to instruments executed on or after 1 April 2013.

28. Paragraph 18(2) provides for the amendments made by paragraphs 15 to 17 to be effective in relation to transfers of trade and assets under certified harbour reorganisation schemes occurring on or after 1 April 2013.

Part 3: Payments relating to reductions in pool betting duty

29. Paragraph 19(1) withdraws reliefs from corporation tax and income tax, for capital expenditure funded by grants made for the purpose of improving football ground safety and comfort, and withdraws relief from inheritance tax for trustees responsible for administering those grants, both of which were provided for by section 126 of FA 1990.

30. Paragraph 19(2) makes minor consequential amendments to CAA and the Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

31. Paragraph 19(3) provides that these changes shall have effect from 1 April 2013 for corporation tax purposes and from 6 April 2013 for income tax and inheritance tax purposes.

32. Paragraph 20(1) withdraws relief from inheritance tax for trustees administering funds held for the purpose of supporting sports and the arts provided for by section 121 of FA 1991.

33. Paragraph 20(2) provides that this change shall have effect from 6 April 2013.

34. Paragraph 21(1) withdraws reliefs from income tax in respect of payments for the purpose of improving football ground safety and comfort or supporting sports and the arts provided for by sections 162 and 748 of ITTOIA.

35. Paragraph 21(2) makes a minor consequential amendment to section 683(4) of ITTOIA.

36. Paragraph 21(3) states that these repeals shall have effect from 6 April 2013.

37. Paragraph 22(1) withdraws relief from corporation tax in respect of payments for the purpose of improving football ground safety and comfort or supporting sports and the arts provided for by sections 138 and 978 of CTA 2009.

38. Paragraph 22(2) makes a minor consequential amendment to section 976(1)(b).

39. Paragraph 22(3) states that these repeals shall have effect from 1 April 2013.

Part 4: Life assurance

Abolition of income tax relief for life assurance premiums under section 266 of ICTA

40. Paragraph 23 restricts individuals' entitlement to life assurance premiums (LAPR) under section 266 of the Income Corporation and Taxes Act 1988 (ICTA) so that relief will only be due for premiums that are due and payable before 6 April 2015 and for premiums payable before this date that are actually paid before 6 July 2015. This restriction also applies to premiums paid by employers in respect of employees for whom entitlement to LAPR was provided through section 266A of ICTA.

41. Paragraph 24 provides that claims for relief under paragraph 6 of Schedule 14 to ICTA may not be made after 5 April 2016. Paragraph 6 of Schedule 14 to ICTA entitles individuals to make claims and applies where they have not received relief in full by paying premiums to insurers or friendly societies 'net' of the relief.

42. Paragraph 25 restricts the time by which insurers and friendly societies must make all outstanding reconciliations and claims for payment from HM Revenue & Customs (HMRC) under the Income Tax (Life Assurance Premium Relief) Regulations 1978 (S.I. 1978/1159) ("1978 Regulations"). These must be made by the earliest of:

- 6 months from the end of the first accounting period to end after 5 April 2015; and either

- 6 years from the end of the accounting period for which the claim relates; or

- 12 months from the end of the accounting period in which insurance companies or friendly societies have received and retained one or more interim payments of LAPR from HMRC.

For these purposes, 'accounting period' means the period for which the insurance company or friendly society makes up its accounts.

43. Paragraph 25(5) requires HMRC to decide all claims for LAPR made under the 1978 Regulations no later than 5 April 2017.

44. Paragraphs 26 and 27 apply to friendly societies and industrial assurance companies who adopted special schemes to cater for changes to the rate of the relief. The paragraphs ensure that the existing framework for dealing with changes to the rate of relief also applies to the repeal of the relief.

45. Paragraphs 26 and 27, (4)(a) and (b) apply the 'change of rate' framework on the basis that the rate of relief is reduced from 12.5 per cent to nil with effect from 6 April 2015, and ensure that entitlement to the zero rate relief is maintained only for the purpose of giving effect to this framework.

46. Paragraphs 26 and 27, (4)(c) and (d) provide scope for friendly societies and industrial assurance companies to make prospective amendments to the special schemes at any time before the relief is removed, and so that amendments to the special schemes may also apply for premiums that are due and payable before 6 April 2015 but that are actually paid after 6 July 2015.

47. Paragraphs 26 and 27, (5) and (6) allow friendly societies and industrial assurance companies to amend sums assured under certain policies, and make consequential amendments to approved schemes where the prospective amendments have been notified to the Financial Services Authority at least 3 months before the amendments are made.

48. Paragraph 28 provides that legislation providing for LAPR will be repealed from a date to be appointed by the Treasury, under a statutory instrument subject to the negative resolution procedure.

49. Paragraphs 29 and 30 provide that variations or substitutions of qualifying policies (within the meaning of the Income Tax Acts) are ignored for certain tax purposes where the variations or substitutions are made for the sole purpose of dealing with the consequences of the abolition of the relief. The effect of these paragraphs is that such changes will not:

- affect the qualifying policy status of these policies;
- re-set the period for which a qualifying policy must be held before gains are exempt from income tax; or

- be treated as exceeding the corporation tax exemption limit for friendly society tax exempt savings plans.

Removal of claw-backs on relief given under section 266 of ICTA

50. Paragraph 31 removes requirements for insurers to 'claw-back' amounts of LAPR from proceeds payable by an insurer on a second or subsequent surrender of some or all rights under a policy. These requirements will no longer apply to such events arising on or after 6 April 2015.

Abolition of income tax relief relating to certain payments made for benefit of family members etc

51. Paragraph 32(1) removes entitlement to this relief by omitting section 459 Chapter 6 of Part 8 of the Income Tax Act 2007 (ITA).

52. Paragraph 32(2) amends and removes several other supporting provisions in ITA and ICTA, as a direct consequence of removing the relief.

53. Paragraph 32(3) to (5) amend section 609 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which determines the amount of annuity payments that are treated as pension income, and the person liable to tax on this income. The amendment ensures that section 609 of ITEPA continues to apply to the type of annuity for which relief was available under section 459 of ITA, despite the removal of the relief.

54. Paragraph 32(4) provides for section 609 of ITEPA to continue to apply to annuities for the benefit of dependants where all or part of sums paid to acquire these annuities satisfied the conditions for relief in tax years up to and including 2012-13.

55. Paragraph 32(5) imports the parts of section 459 of ITA that identify the type of annuities to which section 609 of ITEPA applies. These new parts of section 609 of ITEPA will apply to sums paid in the tax year 2013-14 or later years, in order to acquire annuities for the benefit of dependants.

56. Paragraph 32(6) provides that the various amendments described above will have effect for 2013-14 and subsequent years, so the last year for which the relief is available will be 2012-13.

Part 5: Capital allowances

Safety at sports grounds

57. Paragraph 33 repeals sections 30 to 32 of CAA and makes consequential changes.

58. Paragraph 34 makes consequential amendments to sections 23(2) and 27 of CAA.

59. Paragraph 35 provides that the repeal has effect in respect of expenditure incurred on or after 1 April 2013 for corporation tax purposes and on or after 6 April 2013 for income tax purposes.

Flat conversion allowances

60. Paragraph 36 provides that Part 4A of CAA does not apply in respect of expenditure incurred on or after 1 April 2013 for corporation tax purposes and on or after 6 April 2013 for income tax purposes.

61. Paragraph 37 repeals Part 4A of CAA.

62. Paragraph 38 makes a number of consequential amendments to CAA.

63. Paragraph 39 makes consequential amendments to FA 2001, ITTOIA and CTA 2009.

64. Paragraph 40(1) provides that the amendments at paragraphs 37 to 39 have effect on or after 1 April 2013 for corporation tax purposes and on or after 6 April 2013 for income tax purposes. But this is subject to paragraphs 41 and 42.

65. Paragraph 41 determines how a company's entitlement to writing-down allowances (WDAs), for the purposes of section 393J of CAA, should be calculated where its chargeable period spans 1 April 2013.

66. It requires that the WDA be calculated as normal for the chargeable period, and time apportioned between the chargeable period falling before and after 1 April 2013 in accordance with this method:

$$\frac{A}{B}$$

where A is the number of days in the chargeable period falling before 1 April 2013 and B is the number of days in the chargeable period.

67. Paragraph 42 is a saving provision. It provides that paragraphs 37 and 40(1) do not affect the operation of sections 393I and 393M to 393P of CAA, in respect of expenditure incurred before 1 April 2013 for corporation tax purposes and 6 April 2013 for income tax purposes.

Part 6: Mineral leases or agreements

Income tax

68. Paragraph 43 repeals sections 157, 319 and 340 to 343 of ITTOIA. Those sections treat half of the mineral royalties that a person may

receive under a mineral royalty agreement or lease as subject to income tax. The paragraph also makes consequential amendments to ITTOIA and the Commissioners for Revenue and Customs Act 2005. These changes have effect for mineral royalties receivable on or after 6 April 2013.

Corporation tax on income

69. Paragraph 44 repeals sections 135, 258 and 273 to 276 of CTA 2009. Those sections treat half of the mineral royalties that a person may receive under a mineral royalty agreement or lease as subject to corporation tax as income. The paragraph also makes a consequential amendment to CTA 2009. These changes have effect for mineral royalties receivable on or after 1 April 2013.

Chargeable gains

70. Paragraph 45 repeals section 201 of TCGA 1992. Section 201 treats half of the mineral royalties that a person receives as a chargeable gain. The paragraph also makes various consequential amendments to TCGA. These changes have effect for mineral royalties which a person is entitled to receive on or after 1 April 2013 for the purposes of corporation tax on chargeable gains, and on or after 6 April 2013 for the purposes of capital gains tax (CGT).

71. Paragraph 46 amends section 202 of TCGA to limit the loss relief that the section provides in respect of mineral royalties leases or agreements to cases where the lease or agreement is entered into before 1 April 2013, for corporation tax purposes, or 6 April 2013, for CGT purposes.

72. Paragraph 47 makes a consequential amendment to section 203 of TCGA, which supplements sections 201 and 202.

Part 7: Miscellaneous

Deeply discounted securities: incidental expenses

73. Paragraph 48 provides for the rules for the calculation of the profit or loss on disposal of deeply discounted securities (DDS) in Chapter 8 of Part 4 of ITTOIA to be amended.

74. Paragraph 48(1) amends section 455 of ITTOIA to limit the provision for the deduction of incidental expenses incurred in connection with the disposal of DDS which are listed securities and which have been held since 26 March 2003. The deduction is limited to expenses incurred before 6 April 2015.

75. Paragraph 48(2) provides the commencement provision.

Grants for giving up agricultural land

76. Paragraph 49(1) repeals section 249 of TCGA (grants for giving up occupation of agricultural land).

77. Paragraph 49(2) amends the heading which section 249 comes under from "Agricultural Land and Woodlands" to "Woodlands".

78. Paragraph 49(3) provides that the repeal in subsection (1) has effect in relation to disposals made on or after 6 April 2013.

Reduction for meal vouchers

79. Paragraph 50(1) provides for the repeal of section 89 of ITEPA.

80. Paragraph 50(2)(a) and (b) provides for consequential omission of section 87(6) of ITEPA (benefit of non-cash voucher treated as earnings) and paragraph 18 in Schedule 7 to ITEPA (transitionals and savings).

81. Paragraph 50(3) provides that the repeal will take effect from 6 April 2013.

Black beer

82. Paragraph 51(2)(a) amends the definition of beer in section 1(3) of the Alcoholic Liquor Duties Act 1979 (ALDA) by removing the exclusion for black beer, making black beer liable to excise duty.

83. Paragraphs 51(2)(b) to (4) make consequential amendments to ALDA.

Angostura bitters

84. Paragraph 52(1) repeals section 1(7) and section 6 of ALDA. The former deems angostura bitters not to be spirits for certain duty purposes, while the latter provides power for the Commissioners of HM Revenue and Customs to direct that angostura bitters are to be treated on importation, for the purposes of duty, as not being spirits.

85. Paragraph 52(2) repeals the provision in Schedule 5 to FA 1994. Schedule 5 makes decisions relating to whether or not to give a direction under section 6 of ALDA appealable at Tribunal.

Tax reserve certificates

86. Paragraph 53(1)(a) repeals section 750 of ITTOIA. That section provides that no liability to income tax arises in respect of interest from tax reserve certificates issued by the Treasury.

87. Paragraph 53(1)(b) repeals section 1283 of CTA 2009. That section provides that no liability to corporation tax arises in respect of interest from tax reserve certificates issued by the Treasury.

88. Paragraph 53(2) makes a consequential amendment to section 369 of ITTOIA.

89. Paragraph 53(3) provides that the repeal made by sub-paragraphs (1)(a) and (2) will have effect in relation to any tax reserve certificates redeemed on or after 6 April 2013. Taxpayers who redeem tax reserve certificates before this date will continue to get relief for income tax.

90. Paragraph 53(4) provides that the repeal made in sub-paragraph (1)(b) will have effect in relation to tax reserve certificates redeemed on or after 1 April 2013. Taxpayers who redeem tax reserve certificates before this date will continue to get relief for corporation tax.

Tax assessors

91. Paragraph 54(1) repeals section 62(2) and 62(3) of FA 1946 which make provision for compensation to be paid to land tax assessors and income tax assessors made redundant as a result of the Act.

92. Paragraph 54(2) makes consequential amendments.

93. Paragraph 54(3) provides for the commencement of the repeal.

BACKGROUND NOTE

94. The Office of Tax Simplification was commissioned by the Chancellor to undertake a review of the reliefs and allowances available in the tax system. Following their review, the Government announced at Budget 2011 that it would repeal seven reliefs immediately and abolish a further 36 reliefs, subject to a period of consultation over summer 2011. The Government response to the consultation was published on 6 December 2011.

EXPLANATORY NOTE

CLAUSE 226 & 227: FINAL PROVISIONS

CLAUSE 226: INTERPRETATION

1. Clause 226 provides for the use of abbreviations for a variety of Acts. For example, it provides for the use of "ICTA" as an abbreviation for the Income and Corporation Taxes Act 1988.

CLAUSE 227: SHORT TITLE

2. Clause 227 provides for the Bill to be known as the "Finance Act 2012" upon Royal Assent.