EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Finance (No. 3) Bill as introduced into Parliament on 31 March 2011. 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 AND MAIN RATES FOR 2011-12

SUMMARY

1. Clause 1 imposes the income tax charge for 2011-12 and sets the basic rate of income tax at 20 per cent, the higher rate at 40 per cent and the additional rate at 50 per cent.

DETAILS OF THE CLAUSE

2. Subsection (1) imposes the income tax charge for 2011-12.
3. Subsection (2)(a) sets the basic rate of income tax at 20 per cent.
4. Subsection (2)(b) sets the higher rate of income tax at 40 per cent.
5. Subsection (2)(c) sets the additional rate of income tax at 50 per cent.

BACKGROUND NOTE

6. Income tax is an annual tax re-imposed by Parliament (even if the proposed rates are the same as for the previous year). The table below sets out the main rates and rate limits for 2011-12 and for reference includes the amounts for 2010-11:

<table>
<thead>
<tr>
<th>Rate Type</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic rate</td>
<td>£0 - £37,400 at 20 per cent</td>
<td>£0 - £35,000 at 20 per cent</td>
</tr>
<tr>
<td>Higher rate</td>
<td>£37,401 - £150,000 at 40 per cent</td>
<td>£35,001 - £150,000 at 40 per cent</td>
</tr>
<tr>
<td>Additional rate</td>
<td>Over £150,000 at 50 per cent</td>
<td>Over £150,000 at 50 per cent</td>
</tr>
</tbody>
</table>

The basic rate limit of £35,000 as identified in the table above is set by clause 2 of this Bill.
EXPLANATORY NOTE

CLAUSE 2: BASIC RATE LIMIT FOR 2011-12

SUMMARY

1. Clause 2 sets the amount of the basic rate limit for income tax at £35,000.

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 (£37,400) with £35,000 for 2011-12.

3. Subsection (2) disapplies the indexation provisions for the basic rate limit for 2011-12.

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 2010-11, the indexed amount for 2011-12 and the amount specified by this clause for 2011-12:

<table>
<thead>
<tr>
<th>2010-11</th>
<th>2011-12 indexed</th>
<th>2011-12 by this clause</th>
</tr>
</thead>
<tbody>
<tr>
<td>£37,400</td>
<td>£39,200</td>
<td>£35,000</td>
</tr>
</tbody>
</table>

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 that include a further clause in this Bill and the reduction in the Upper Earnings Limit and Upper Profits Limit provided for by separate National Insurance Contributions’ Regulations.
EXPLANATORY NOTE

CLAUSE 3: PERSONAL ALLOWANCE FOR 2011-12 FOR THOSE AGED UNDER 65

SUMMARY

1. Clause 3 sets the amount of the personal allowance for those aged under 65 at £7,475 for 2011-12.

DETAILS OF THE CLAUSE

2. Subsection (1) replaces the existing amount of the personal allowance for those aged under 65 (£6,475) with £7,475 for 2011-12.

3. Subsection (2) disapplies the indexation provisions for this allowance for 2011-12.

BACKGROUND NOTE

4. Individuals are 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. For 2011-12, the personal allowances for people aged 65 to 74 and aged 75 and over have been increased by indexation.

6. The table below sets out the amount of personal allowance for individuals aged under 65 for 2010-11, the indexed amount for 2011-12 and the amount specified by this clause for 2011-12:

<table>
<thead>
<tr>
<th></th>
<th>2010-11</th>
<th>2011-12 indexed</th>
<th>2011-12 by this clause</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>£6,475</td>
<td>£6,785</td>
<td>£7,475</td>
</tr>
</tbody>
</table>

7. The effect of this clause is to over-ride the indexed amount for the personal allowance for individuals aged under 65.
EXPLANATORY NOTE

CLAUSE 4: MAIN RATE FOR FINANCIAL YEAR 2011

SUMMARY

1. Clause 4 sets the main rate of corporation tax (CT) for the financial year beginning 1 April 2011 at 26 per cent on non-ring fence profits.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) amend, with effect from 1 April 2011, the main rate of CT for the financial year 2011, set by section 2(2)(a) Finance Act 2010, from 27 to 26 per cent.

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 5: CHARGE AND MAIN RATE FOR FINANCIAL YEAR 2012

SUMMARY

1. Clause 5 charges corporation tax (CT) for the financial year beginning 1 April 2012 and sets the main rate of corporation tax at 30 per cent on oil and gas ring fence profits and 25 per cent on non-ring fence profits.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) set the charge and the main rates of CT for the financial year 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: SMALL PROFITS RATES AND FRACTIONS FOR FINANCIAL YEAR 2011

SUMMARY

1. Clause 6 sets the small profits rate of corporation tax (CT) for the financial year beginning 1 April 2011 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 3/200 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 2011.

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:

\[
\begin{align*}
\text{£500,000 @ 26 per cent} & \quad \text{£130,000} \\
\text{minus 3/200 of £1,000,000*} & \quad \text{£15,000} \\
\text{Tax payable:} & \quad \text{£115,000}
\end{align*}
\]

* £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:

\[
\begin{align*}
\text{£500,000 @ 30 per cent} & \quad \text{£150,000} \\
\text{minus 11/400 of £1,000,000*} & \quad \text{£27,500} \\
\text{Tax payable:} & \quad \text{£122,500}
\end{align*}
\]

* £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 7: INCREASE IN RATE OF SUPPLEMENTARY CHARGE

SUMMARY

1. Clause 7 provides for an increase in the supplementary charge in respect of ring fence trades from 20 per cent to 32 per cent.

2. The new rate will have effect for accounting periods beginning on or after 24 March 2011. Where an accounting period begins before and ends on or after 24 March 2011 the new rate will apply to the profits time-apportioned to the part of the accounting period that runs from 24 March 2011.

3. The Instalment Payments Regulations will, in the first place, continue to operate as if the rate of supplementary charge had not been changed. The payment dates and the amounts of the payments in respect of the supplementary charge at the old rate and in respect of CT will be unaffected.

4. The Regulations will apply separately to the increased amount of the charge in respect of the period beginning on 24 March 2011. That period is treated as an accounting period for the purposes of the Regulations and the amount of the charge is equal to the amount of the increase.

DETAILS OF THE CLAUSE

5. Subsection (1) amends section 330A of Corporation Tax Act 2010 by changing the rate of supplementary charge in respect of adjusted ring fence profits from 20 per cent to 32 per cent.

6. Subsection (2) brings the change into effect for accounting periods beginning on or after 24 March 2011 but with regard to subsection (3) for a ‘straddling period’.

7. Subsection (3) provides that subsections (4) to (9) apply where an accounting period begins before 24 March 2011 and ends on or after that date (the ‘straddling period’).

8. Subsection (4) provides that for the purpose of calculating the supplementary charge for the straddling period, so much of that period that falls before 24 March 2011 and so much that falls on or after that date are treated as separate accounting periods and the adjusted ring fence profits for that period are apportioned between the
two separate accounting periods in proportion to the number of days in each period.

9. **Subsection (5)** provides that the amount of the supplementary charge for the straddling period is the sum of the amounts for the two periods as calculated under subsection (4).

10. **Subsection (6)** provides that for a straddling period the Instalment Payments Regulations apply as if the increase in the supplementary charge had not occurred but also provides that the Regulations apply separately in accordance with subsection (7) to the increase in the amount of supplementary charge for that period that arises as a result of the rate increase.

11. **Subsection (7)** provides that in the separate application of the Regulations to the additional amount of supplementary charge that arises as a result of the increase in the rate, the Regulations have effect as if:

- the straddling period were an accounting period beginning on 24 March 2011;
- supplementary charge were chargeable on the company for that period; and
- the amount of that charge were equal to the increase in the amount of supplementary charge for the straddling period that arises as a result of the rate increase.

12. **Subsection (8)** provides that any reference in the Regulations to the total liability of a company is to be read:

- as a reference to the amount that would be the company’s total liability for the straddling period if the increase in the rate had not occurred
- as a reference to the amount of the supplementary charge for the deemed accounting period under subsection (7).

13. **Subsection (9)** provides that, for the purposes of the Regulations, a company is to be regarded as a large company for the deemed accounting period under subsection (7) only if it is a large company for the straddling period. The increase in the rate of supplementary charge is not taken into account when determining whether a company is a large company for the straddling period.

15. Supplementary charge was introduced in 2002 and applies to companies producing oil and gas in the UK or on the UK Continental Shelf. Special tax rules apply to such companies. A ‘ring fence’ is placed around their profits and the normal rules that allow those profits to be reduced by losses from other activities carried on by the company or from losses arising to other companies in the same group are disapplied. The rules work by treating ring fenced activities as a separate trade.

16. The supplementary charge is applied to adjusted ring fence profits. These are defined as the amount of profit (or loss) arising from any ring fence trade less any financing costs.

17. The rate of supplementary charge when introduced was 10 per cent and for accounting periods beginning on or after 1 January 2006 is 20 per cent.

18. Where an accounting period begins before 24 March 2011 and ends on or after that date (the ‘straddling period’), for the purpose of calculating the amount of supplementary charge for that period the period before 24 March 2011 and the period starting on that date are treated as separate accounting periods, and the company’s adjusted ring fence profits for that period are apportioned to the two separate accounting periods in proportion to the number of days in those periods. The lower rate of supplementary charge applies to the earlier period and the higher rate to the later period. The amount of the supplementary charge for the straddling period is the sum of the two amounts.

19. For straddling periods the Instalment Payments Regulations apply as if the increase in the rate of supplementary charge had not occurred. But the Regulations also apply separately to the increase in the amount of supplementary charge that arises as a result of the rate increase. That amount is treated as though it were for an accounting period beginning on 24 March 2011 and the instalment payment dates will then arise accordingly.
EXPLANATORY NOTE

CLAUSE 8: ANNUAL EXEMPT AMOUNT

SUMMARY

1. Clause 8 confirms the capital gains tax annual exempt amount (AEA) for the tax year 2011-12 and revises the procedure for automatically increasing the AEA by reference to inflation.

DETAILS OF THE CLAUSE

2. Subsection (1) introduces the changes subsections (2) and (3) make to section 3 of the Taxation of Chargeable Gains Act 1992 (TCGA).

3. Subsection (2) replaces the existing section 3(2) of TCGA with a new one that provides that the annual exempt amount (AEA) for a tax year is £10,600. Subsection (4) of the clause provides that this change applies for the tax year 2011-12 and subsequent tax years.

4. Subsection (3) replaces section 3(3) and (4) of TCGA with new section 3(3) to (4). Subsection (6) of the clause provides that these changes take effect for the tax year 2012-13 and subsequent tax years.

5. New section 3(3) to (4) of TCGA modifies the statutory procedure for “indexation” of the AEA in two ways. “Indexation” refers to the provisions that automatically increase the AEA for every year where there has been a “relevant increase” in the retail prices index (RPI), unless Parliament sets some different figure. First, new section 3(3) of TCGA provides that the amount in section 3(2) of TCGA is replaced in each year the AEA is indexed and that amount continues to be the AEA for future years (unless altered again). Secondly, new section 3(4) of TCGA provides that the Treasury must make an order setting out the indexed AEA for the next tax year every time there is a relevant increase in the RPI. Previously the Treasury had to make an order every year regardless of whether the RPI had increased or not.

6. New section 3(3A) and (3B) of TCGA restates the rules for how the indexation of the AEA is to be applied in computing the AEA for a tax year and does not change the existing position. Section 3(3A) explains when a “relevant increase” in RPI occurs. Section 3(3B) sets out how to index the AEA when there is a relevant increase in the RPI.
7. Subsection (5) disapplies indexation of the AEA for the year 2011-12. The amount (£10,600) for that year is set by subsections (2) and (4) (see paragraph 3 above).

BACKGROUND NOTE

8. Individuals do not have to pay capital gains tax (CGT) unless their chargeable gains (net of all allowable losses) for a tax year exceed the “annual exempt amount” (AEA) for the year. The AEA is not available to non-domiciled individuals who claim the remittance basis of taxation for the tax year. Personal representatives of deceased persons are entitled to the AEA for the tax year in which the individual dies and the following two tax years. Trustees of settled property are entitled to a fraction of the AEA available to an individual. In most cases the fraction is one-half, but a smaller fraction applies in some cases. Trusts for the benefit of certain vulnerable individuals are entitled to the full AEA available to an individual.

9. The AEA is automatically increased by reference to inflation, as measured by the retail prices index (RPI) for the 12 months to September in the preceding tax year. Parliament can override automatic indexation and set a different figure in the Finance Act.

Example of automatic indexation (notional figures)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>AEA for Year 1</td>
<td>£10,000</td>
</tr>
<tr>
<td>RPI increase for 12 months to September in Year 1</td>
<td>2.4%</td>
</tr>
<tr>
<td>AEA is therefore increased by 2.4%</td>
<td>£10,240</td>
</tr>
<tr>
<td>Round this up to nearest £100: AEA for Year 2</td>
<td>£10,300</td>
</tr>
</tbody>
</table>

10. The 12 months to September 2009 were unusual in that RPI did not increase over the period. The Treasury issued an order confirming that the AEA for the next tax year, 2010-11, would be the same as the amount for the previous year. The changes in clause 8 mean that in future, where there is no increase in RPI, no order will have to be made. The previous year’s figure will automatically carry forward and apply to the later year (unless Parliament exercises its power of override).

11. The clause does not make any further changes to the rules for setting the AEA. In particular, the rules on entitlement to AEA outlined in paragraph 8 above and the formula for indexing the AEA illustrated in paragraph 9 above are unchanged.
EXPLANATORY NOTE

CLAUSE 9: ENTREPRENEURS' RELIEF

SUMMARY

1. Clause 9 increases the lifetime limit for chargeable gains qualifying for capital gains tax (CGT) entrepreneurs’ relief to £10 million from 6 April 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) of the Clause amends subsections (4) and (4A) of Section 169N of the Taxation of Chargeable Gains Act 1992 (TCGA). References in section 169N to the lifetime limit that applies to total gains eligible for entrepreneurs’ relief are increased from £5 million to £10 million.

3. Subsection (2) provides that the increased lifetime limit will have effect for qualifying disposals that take place on or after 6 April 2011.

BACKGROUND NOTE

4. Gains in respect of which entrepreneurs’ relief is claimed are liable to capital gains tax (CGT) at a rate of 10 per cent. The amount of an individual’s gains that can qualify for entrepreneurs’ relief is subject to a lifetime limit (section 169N TCGA).

5. This lifetime limit applies to the aggregate of gains that benefit from entrepreneurs’ relief, whatever the year in which the disposals took place. Any gains in excess of the lifetime limit are liable to CGT at the same rates as other chargeable gains (18 per cent and 28 per cent).

6. For trustees, the limit is that of the beneficiary of the settlement who meets the conditions for the trustees to claim the relief.

7. This clause increases the lifetime limit on total gains eligible for relief from £5 million to £10 million for qualifying disposals that take place on or after 6 April 2011.
EXPLANATORY NOTE

CLAUSE 10: PLANT AND MACHINERY WRITING-DOWN ALLOWANCES

SUMMARY

1. Clause 10 reduces the rates of writing-down allowance for new and unrelieved expenditure from the relevant date: 1 April 2012 (corporation tax) or 6 April 2012 (income tax). The main rate is reduced from 20 per cent to 18 per cent and that for special rate expenditure from 10 per cent to 8 per cent. For chargeable periods which straddle the relevant date the rate of writing-down allowance is a hybrid of the rates before and after the change.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the amendment of Part 2 of the Capital Allowances Act 2001 (CAA) which covers plant and machinery allowances.

3. Subsection (2) reduces the main rate of writing-down allowances from 20 per cent to 18 per cent.

4. Subsection (3) amends section 104D of CAA to reduce the rate of writing-down allowance for expenditure in the special rate pool from 10 per cent to 8 per cent and also inserts new section 104D(1A).

5. New section 104D(1A) preserves the rate of writing-down allowance of 10 per cent for special rate expenditure on assets for a ring fence trade chargeable to tax under section 330 of the Corporation Tax Act (CTA) 2010.

6. Subsection (4) makes amendments to the legislation that refers to writing-down allowances for special rate expenditure in order to reflect the fact that there are two rates of writing-down allowance (8 per cent and 10 per cent).

7. Subsection (5) provides for the amendment of Part 10 of Schedule 22 to the Finance Act (FA) 2000 in relation to expenditure incurred before 1 January 2011. Schedule 22 to FA 2000 provides an alternative regime (“tonnage tax”) for calculating the profits of a shipping company for the purposes of corporation tax. Part 10 contains provisions that place restrictions on the availability of capital allowances on ships leased into the tonnage tax regime.

9. Subsection (8) explains that the changes made by this section apply to chargeable periods that either

- begin on or after the relevant date, or
- begin before, but end after, the relevant date.

10. Subsection (9) provides, in effect, that where a chargeable period begins before the relevant date but ends after it, a person is entitled to writing-down allowances at either X per cent (main rate expenditure) or Y per cent (special rate expenditure) rather than at 18 per cent or 8 per cent respectively. X and Y are determined using the formulae given subsequently. This subsection also ensures that the substitution of X per cent or Y per cent for 18 per cent or 8 per cent respectively, applies also for the purposes of Part 10 to Schedule 22 to FA 2000.

11. Subsection (10) provides the formulae to calculate X per cent and Y per cent. These rates are calculated by first multiplying the rate of writing-down allowance applicable before the relevant day by the proportion of the chargeable period that falls before the relevant date. Similarly, the rate of applicable writing-down allowance after the relevant day is multiplied by the proportion of the chargeable period that falls on or after the relevant day. The rate (X per cent or Y per cent) for the chargeable period is the sum of these two rates.

12. Subsection (11) provides that X and Y should be rounded up to the nearest second decimal place if either is a figure with more than two decimal places.

13. Subsection (12) gives the meaning of the terms in the formulae which are used to arrive at X and Y. In effect, the apportionment of the chargeable period is calculated by reference to the number of days before and the number of days on or after the relevant date.

14. Subsection (13) gives the relevant date for corporation tax purposes (1 April 2012) and income tax purposes (6 April 2012).

BACKGROUND NOTE

15. Capital allowances allow businesses to write-off the costs of certain capital assets, including plant and machinery (P&M), to arrive at their business profits. They take the place of commercial depreciation, which is not allowed for tax.
16. There are certain first-year capital allowances (FYAs) which allow 100 per cent of a business’s expenditure on specific environmentally beneficial plant or machinery (P&M) to be written-off in the year the expenditure is incurred. There is also an Annual Investment Allowance (AIA), which allows businesses to write off the whole of their expenditure on most P&M, up to a limit, in the year it is incurred. (The current AIA limit is £100,000 p.a., set to reduce to £25,000 p.a. from April 2012.) Expenditure on P&M not covered by these allowances attracts writing-down allowances (WDAs) at either the main rate or special rate. In order to simplify calculations, different items of expenditure are pooled together and the rate of allowance is applied to the total. Special rate expenditure includes, but is not restricted to, that on long-life assets, integral features and some cars.

17. The changes to the rates of WDA made by Clause 10 are being made as part of the package of corporate tax reforms announced at the June 2010 Budget, which includes the phased reduction in the main rate of corporation tax (CT), and changes to the small profits rate and the AIA. The wider package is intended to create a more competitive corporate tax system to support enterprise and long-term economic growth. Reducing the rates of WDAs will mean that businesses continue to receive full tax relief to reflect the depreciation of plant and machinery assets, but over a slightly extended timeframe. The intention is that the rates of WDAs will continue to broadly align with average rates of depreciation across the economy.

18. Expenditure on P&M incurred wholly for the purposes of a ring fence trade (i.e. one within the definition of “oil-related activities”) taxable under section 330(1) of CTA 2010, remains entitled to WDA at 25 per cent (or 10 per cent for special rate expenditure).
EXPLANATORY NOTE

CLAUSE 11: ANNUAL INVESTMENT ALLOWANCE

SUMMARY

1. Clause 11 provides legislation to reduce the amount of the entitlement to annual investment allowance (AIA) from £100,000 to £25,000. The reduction is effective for expenditure incurred on or after 1 April 2012 for persons within the charge to corporation tax (CT) and on or after 6 April 2012 for persons within the charge to income tax. The clause also restricts HM Treasury’s power to amend the amount of the maximum AIA by way of secondary legislation to a power to increase the maximum amount.

DETAILS OF THE CLAUSE

2. Subsection (2) amends section 51A(5) of the Capital Allowances Act 2001 (CAA) so that the maximum AIA that can be claimed for a 12 month chargeable period is reduced from £100,000 to £25,000.

3. Subsection (4) provides that the reduction in the limit has effect in relation to expenditure incurred on or after the relevant date. “Relevant date” is defined in subsection (13) of this legislation as 1 April 2012 for CT purposes and from 6 April 2012 for income tax purposes.

4. Subsection (5) provides that where a chargeable period begins before and ends on or after the relevant date then subsections (6) and (7) of the legislation will apply.

5. Subsection (6) provides that the maximum allowance in such a period will be the sum of each maximum allowance that would be found if the actual chargeable period were split into two chargeable periods. The first beginning with the first day of the chargeable period and ending with the day before the relevant date. The second beginning on the relevant date and ending with the last day of the chargeable period.

6. So where a business has a chargeable period that spans the relevant date of the reduction, the maximum allowance for that business’s transitional chargeable period is the sum of:

   a. the maximum AIA entitlement based on the previous £100,000 annual cap for the portion of a year falling before the relevant operative date; and
b. the maximum AIA entitlement, based on the new £25,000 cap for the portion of a year falling on or after the relevant date.

7. For example, a company with a calendar year chargeable period from 1 January 2012 to 31 December 2012 would calculate its maximum AIA entitlement based on:

a. the proportion of a year from 1 January 2012 to 31 March 2012, that is, $\frac{3}{12} \times £100,000 = £25,000$; and

b. the proportion of a year from 1 April 2012 to 31 December 2012, that is $\frac{9}{12} \times £25,000 = 18,750$.

The company’s maximum AIA for this transitional chargeable period would therefore be the total of (a) + (b) = £25,000 + £18,750 = £43,750.

8. Subsection (7) provides that for expenditure incurred in the part of the chargeable period falling on or after 1 (or 6) April 2012, the maximum entitlement is given only by reference to subsection 6(b). Returning to the example above, this rule does not affect the business’s maximum AIA for the chargeable period as a whole (which is £43,750) simply the amount of expenditure after the relevant start date that may be covered.

9. For example a company with a calendar year chargeable period would have a maximum entitlement under subsection (6) of £43,750. If the company incurred no qualifying expenditure in the period January 2012 to 31 March 2012 and spent, say, £30,000 in the remainder of the year the maximum AIA available to that company would be £18,750.

10. Subsection (8) provides that subsections (6) and (7), with the modifications specified in subsections (9) to (11), apply in relation to businesses that are required by CAA to share a single AIA where one or more of those businesses has a chargeable period that falls within subsection (6).

11. Subsections (9) and (10) provide the rule for determining the maximum allowance that can be shared between businesses.

12. Subsection (11) ensures that where more than two businesses with different chargeable periods share an AIA, the maximum AIA that a business can claim is reduced (but not below nil) by any amounts allocated to another business or businesses with the same or later (ending) chargeable period(s).

13. For example, if four companies in a company group with different chargeable periods ending in the financial year 2012-2013 were
required to share a single AIA their individual maximum amounts might look like this:-

<table>
<thead>
<tr>
<th>Example: related companies with chargeable periods (CPs) ending in the transitional year: 1.04.12 to 31.03.13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>A</td>
</tr>
<tr>
<td>B</td>
</tr>
<tr>
<td>C</td>
</tr>
<tr>
<td>D</td>
</tr>
</tbody>
</table>

The rule in subsection (9) provides that the absolute maximum AIA that the companies can share is £93,750. However, subsection (11) provides that companies C & D cannot each claim £25,000 AIA and if between them companies C & D did claim amounts totalling £25,000 then companies A & B’s maximum claim would be reduced by £25,000. Similarly if company B did claim the reduced maximum of £18,750 following claim(s) by companies C & D, then company A could only claim the reduced balance of £50,100.

14. Subsection (12) provides that where an AIA has to be shared the special rules in relation to unincorporated businesses with chargeable periods longer than 12 months are not affected by the transitional provisions in subsections (8) to (11).

15. Subsection (13) gives the relevant dates.

**BACKGROUND NOTE**

16. Since 1 April 2008 (CT) and 6 April 2008 (income tax) most businesses, regardless of size, have been able to claim the AIA on up to £50,000 of their expenditure each year on plant and machinery (subject to certain conditions mentioned below). With effect from 1 April 2010 (CT) or 6 April 2010 (income tax) the maximum amount of the AIA was increased from £50,000 to £100,000 for expenditure incurred on or after those dates.

17. This measure is part of the wider package of corporate tax measures announced in the June 2010 Budget that also included phased reductions in the main rate of CT, and changes to the small profits rate and the rates of writing-down allowances (WDAs). The package
is intended to create a competitive corporate tax system, to support enterprise and long-term economic growth.

18. This measure refocuses the simplification and cash-flow benefits offered by the AIA on smaller businesses.

19. Businesses are able to claim the AIA in respect of their expenditure on both general and “special rate” plant and machinery. The AIA is effectively a 100 per cent allowance that applies to most qualifying expenditure (apart from cars) up to an annual limit or cap. Where businesses spend more than the annual limit, any additional qualifying expenditure is dealt with in the normal capital allowances regime, entering either the main rate or the special rate pool, where it will attract WDAs at the 20 per cent or 10 per cent rates respectively. As part of the wider package of reforms, announced in the June 2010 Budget, those WDA rates are to be reduced to 18 per cent and 8 per cent respectively, with effect from April 2012.

20. Because the AIA is a generous relief there are certain restrictions

It is available to:

- Any individual carrying on a qualifying activity (this includes trades, professions, vocations, ordinary property businesses and individuals having an employment or office);
- Any partnership consisting only of individuals; and
- Any company (subject to certain restriction).

21. In the case of companies in a group there is one AIA available to all the companies in the group.

22. In the case of singleton companies, each receives its own AIA unless, for example, it and another company are under common control. In cases where companies are under common control (for example, two companies owned by the same individual) each company will still be entitled to a separate AIA, unless they are engaged in “similar activities” or share the same premises in a financial year.

23. The rules provide that a company is related to another company in a financial year and, separately, that an unincorporated qualifying activity is related to another qualifying activity in a tax year, if either or both of:

- The shared premises condition; and
- The similar activities condition
are met in relation to the companies or the qualifying activities in that financial year or that tax year, as the case may be.

24. The rules provide businesses with almost complete freedom to allocate the AIA between different types of expenditure. For example, they may allocate it first against any expenditure on “integral features”, qualifying for the lower ten per cent “special rate” of WDA.
EXPLANATORY NOTE

CLAUSE 12: SHORT-LIFE ASSETS

SUMMARY

1. Clause 12 increases the period over which expenditure on plant or machinery can be given “short-life asset” (SLA) treatment from four years to eight years from the end of the chargeable period in which the expenditure is incurred. SLA treatment ensures that if the asset (for which a SLA election has been made) is sold or scrapped before the relevant cut-off point, the total allowances given over the period of ownership will be brought into line with the actual net cost of the asset to the business. This change applies to expenditure incurred on or after 1 April 2011 (for corporation tax) and on or after 6 April 2011 (for income tax). It effectively increases the range of assets for which a SLA election may be beneficial.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the amendment of Part 2 of the Capital Allowances Act 2001 (CAA).

3. Subsection (2) makes the substantive changes to section 86 (short-life asset pool), effectively extending the cut-off period from four years to eight years in relation to expenditure incurred on or after the “designated day”. Subsection 2 makes these changes in the following steps.

4. Subsection 2(a) replaces “four-year”, each time it appears in subsection (2), with the word “relevant”, so that now section 86(2) refers to “the relevant cut-off”.

5. Subsection (2)(b) replaces the existing section 86(3) with a new section 86(3) and (3A).

6. New section 86(3) defines “the relevant cut-off” as either the fourth or the eighth anniversary of the end of the relevant chargeable period, depending on whether the qualifying expenditure was incurred either before or on or after the “designated day” respectively.

7. New section 86(3A) defines both “the designated day” and “the relevant chargeable period”. “The designated day” is:
   - for corporation tax (CT) purposes, 1 April 2011; and
for income tax purposes, 6 April 2011.

“The relevant chargeable period” is the chargeable period in which the qualifying expenditure on the SLA was incurred, or if the qualifying expenditure was incurred in more than one chargeable period, the first chargeable period in which any of the qualifying expenditure was incurred.

8. Subsection (3) makes a consequential amendment to section 65 of CAA (the final chargeable period), substituting “relevant” for “four-year” in section 65(3), so that a SLA pool will end at “the relevant cut-off” (see paragraph 6 above) without waiting for the “final chargeable period” to be triggered by a disposal event in terms of section 61(1) of CAA.

9. Subsection (4) amends ‘four-year cut-off” to “relevant cut-off” in section 87 of CAA (short-life assets provided for leasing) and makes a consequential amendment extending the designated period to eight years. If within the first eight years from first use, leased plant or machinery in respect of which a SLA election has been made starts to be leased to a lessee who does not carry on a qualifying activity, then the short-life asset pool comes to an end and the balance of unrelieved expenditure is added to the main pool.

10. Subsections (5) & (6) make further minor consequential amendments to CAA.

BACKGROUND NOTE

11. The SLA regime is intended to enable tax allowances to be brought into line with the actual depreciation of plant or machinery when an item is scrapped or sold within a specified cut-off period from its acquisition.

12. The current cut-off point is four years from the end of the chargeable period in which the asset is acquired, which is now being extended by clause 12 to eight years from the end of that chargeable period.

13. A business investing in plant or machinery (subject to certain exceptions, see paragraph 15 below) can elect for SLA treatment. The expenditure is then allocated to a ‘single asset pool’. Writing-down allowances are given on the reducing balance each year, currently at 20 per cent (set to reduce to 18 per cent from April 2012). If the item is scrapped or sold within the cut-off period, the remaining balance of expenditure in the pool is compared with the disposal proceeds. A further allowance, or charge, is made for the difference. This ensures that allowances given to this point match the actual net cost to the business of the SLA.
14. If the asset is not disposed of within the specified cut-off period, the remaining expenditure in the single asset pool is transferred to the main capital allowances pool, where writing-down allowances will continue to be available in the normal way.

15. The exceptions to SLA treatment are listed in section 84 CAA and include most cars and all expenditure on ‘long-life assets’ (assets with a useful economic life of at least 25-years) and ‘integral features’ of a building or structure.

16. The extension to the SLA cut-off period effected by this Clause extends the potential benefits of the regime to businesses investing in assets with longer useful lives in the business. In general, an election will be beneficial if the asset depreciates faster than the rate at which capital allowances are given and it is disposed of before the cut-off date. The extension is likely to benefit those businesses that make substantial investments in plant or machinery in excess of the Annual Investment Allowance maximum (currently £100,000 a year, set to reduce to £25,000 a year from April 2012).

17. The extension is available in respect of qualifying expenditure on plant or machinery incurred on or after 1 April 2011 (for CT), and on or after 6 April 2011 (for income tax). The exceptions to SLA treatment (see paragraph 15 above) have not been changed.
EXPLANATORY NOTE

CLAUSE 13: RATES OF ALCOHOLIC LIQUOR DUTIES

SUMMARY

1. Clause 13 provides for increases in the rates of excise duty charged on spirits, beer, wine and made-wine, and cider, to have effect on and after 28 March 2011.

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 £23.80 is replaced by £25.52.

3. Subsection (3) 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 £17.32 is replaced by £18.57.

4. Subsection (4)(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 £217.83 is replaced by £233.55.

5. Subsection (4)(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 £50.22 is replaced by £53.84.

6. Subsection (4)(c) substitutes a new rate of excise duty for all other ciders in section 62(1A)(c) of ALDA. The previous rate of £33.46 is replaced by £35.87.

7. Subsection (5) 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 new rates of duty.

8. Subsection (6) provides for the changes to come into force on 28 March 2011.

BACKGROUND NOTE

9. This clause increases the excise duty rates on all alcoholic liquor by 2 per cent above inflation for all alcoholic drinks.
EXPLANATORY NOTE

CLAUSE 14: GENERAL BEER DUTY: REDUCED RATE FOR LOWER STRENGTH BEER

SUMMARY

1. Clause 14 provides for a reduced rate of general beer duty on lower strength beers. It also takes lower strength beer out of the scope of reduced rates for small breweries.

DETAILS OF THE CLAUSE

2. Subsection (2) provides for a new reduced rate of general beer duty for lower strength beer in new section 36(1AA)(za) of the Alcoholic Liquor Duties Act 1979 (ALDA). The reduced rate applies to beer of a strength exceeding 1.2 per cent alcohol by volume (abv) but not exceeding 2.8 per cent abv.

3. Subsections (3) to (5) amend ALDA so that the reduced rates applicable to small brewery beer do not apply to lower strength beer.

BACKGROUND NOTE

4. The reduced rate of general beer duty is introduced as part of the Government’s review of alcohol taxation to tackle problem drinking.

5. The purpose of the measure is to encourage industry to produce, and drinkers to consume, lower strength beers.

6. The measure is being introduced in parallel to the introduction of a new charge of excise duty on high strength beers (i.e. exceeding 7.5 per cent abv) with effect from 1 October 2011.

7. Small brewery beer in the lower strength range is charged with duty at the lower strength rate and not at the reduced rates associated with small brewery relief. This approach minimises the complexity of the duty regime that could result if these reduced rates overlapped. It also complies with Article 4 of Directive 92/83/EEC (OJ No.L136, 31.10.1992, p21) on the harmonization of the structures of excise duties on alcohol and alcoholic beverages. That Article fixes the extent by which the small brewery beer rates can be set below the standard national rates of duty.
EXPLANATORY NOTE

CLAUSE 15 SCHEDULE 1: NEW HIGH STRENGTH BEER DUTY

SUMMARY

1. Clause 15 and Schedule 1 provide for a new charge to excise duty on high strength beers. This is payable in addition to general beer duty and HM Revenue & Customs (HMRC) are responsible for collecting this duty. The Schedule also makes consequential amendments to the Alcoholic Liquor Duties Act 1979 (ALDA).

DETAILS OF THE SCHEDULE

2. Paragraph 1 inserts new section 37 into ALDA, which provides for a new charge to excise duty on high strength beer. That section sets out the circumstances in which the duty is chargeable, the date from which it applies and the duty rate applicable. The new duty is charged on beer of a strength exceeding 7.5 per cent alcohol by volume (abv).

3. New section 37(5) provides for high strength beer duty to be charged and paid and the amount chargeable to be determined and become due in accordance with regulations made by the Commissioners for HMRC.

4. Paragraphs 2 to 12 make consequential amendments to ALDA, including renaming the excise duty on beer charged by section 36(1) of ALDA “general beer duty”.

BACKGROUND NOTE

5. High strength beer duty is introduced as part of the Government’s review of alcohol taxation to tackle problem drinking.

6. The purpose of the measure is to encourage industry to produce, and drinkers to consume, lower strength beers.

7. This is an additional tax to the excise duties covered by Directive 2008/118/EC (OJ No L9, 14.01.2009, p12) and is made using the derogation provided for in Article 1(2) of that Directive.

8. The measure is being introduced in parallel to changes to the taxation of lower strength beers that sees a reduced rate of general beer duty brought in for beers over 1.2 per cent abv and not exceeding 2.8 per cent abv with effect from 1 October 2011.
9. Schedule 1 was notified in draft to the European Commission in accordance with Directive 98/34/EC, as amended by Directive 98/48/EC.
EXPLANATORY NOTE

CLAUSE 16: RATES OF TOBACCO PRODUCTS DUTY

SUMMARY

1. Clause 16 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 23 March 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table of duty rates 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 is reduced from 24 per cent to 16.5 per cent; the specific duty is increased from £119.03 to £154.95 per 1000 cigarettes;

   ii. cigars – increased from £180.28 to £193.29 per kilogram;

   iii. hand-rolling tobacco – increased from £129.59 to £151.90 per kilogram; and

   iv. other smoking tobacco and chewing tobacco – increased from £79.26 to £84.98 per kilogram.

3. Subsection (2) provides for the new table of duty rates to have effect from 6pm on 23 March 2011.

BACKGROUND NOTE

4. Smoking kills half of all long-term users and is the biggest single cause of inequalities in death rates between rich and poor in the UK. Successive Governments have followed a policy of using tax to maintain the high price of tobacco and help reduce smoking.

5. Research has consistently shown that the price of cigarettes affects demand.
6. This clause increases excise duty on all tobacco products by at least 2 per cent in real terms, thereby helping to provide a further deterrent to smoking, as well as maintaining a contribution to government revenues. This is in accordance with the March 2010 announcement of increases of two per cent above retail price inflation in 2011 for all tobacco duty rates.

7. The composition of excise duty on cigarettes has been adjusted so that a greater proportion of the tax is based on the quantity and a smaller proportion on the recommended price. This will support health objectives by targeting the duty increase on cheaper cigarettes.

8. A further increase of 10 per cent in duty on hand rolling tobacco will reduce the difference between the duty on hand-rolling tobacco and cigarettes, thereby supporting health objectives.

9. The duty increase, together with consequential VAT, will on average increase the price of a packet of 20 economy cigarettes by 50p, a packet of 20 premium cigarettes by 33p, a pack of 5 small cigars by 10p, a 25 gram pack of hand-rolling tobacco by 67p; and a 25 gram pack of pipe tobacco by 17p.

10. The estimated revenue yield from these changes is £80 million in 2011-12.
EXPLANATORY NOTE

CLAUSE 17: RATES OF GAMING DUTY

SUMMARY

1. Clause 17 increases the gross gaming yield bands for gaming duty in line with inflation for accounting periods starting on or after 1 April 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table for the existing table in section 11 (2) of Finance Act (FA) 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 beginning on or after 1 April 2011.

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 yields (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 £2,067,000 of GGY, then 20 per cent for the next £1,425,000 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 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 2010. In this case the RPI was calculated at 4.66 per cent.
EXPLANATORY NOTE

CLAUSE 18: AMUSEMENT MACHINE LICENCE DUTY

SUMMARY

1. Clause 18 increases the amounts of amusement machine licence duty (AMLD) payable in respect of licence applications that are received by HM Revenue & Customs (HMRC) after 4pm on 25 March 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes a new table for the existing table of amounts of AMLD in section 23(2) of the Betting and Gaming Duties Act 1981 which increases the amount of duty payable on licences.

3. Subsection (2) provides that the increase in duty will have effect for any application for an amusement machine licence that is received by HMRC after 4pm on 25 March 2011.

BACKGROUND NOTE

4. AMLD is a duty of excise that is charged on a licence that allows gaming machines to be provided for play in the UK. Other than specific exemptions from the requirement for a licence and certain specific classes of “excepted machines” all gaming machines fall within the scope of AMLD. The amount of duty that is payable is determined by the period that is covered, between one and 12 months, and the numbers and categories of machines. Machine categories are defined by reference to their maximum prize values and cost to play.
EXPLANATORY NOTE

CLAUSE 19: FUEL DUTIES: RATES OF DUTY AND REBATES
FROM 23 MARCH 2011

SUMMARY

1. Clause 19 provides for changes in rates of duty and rates of rebate on products charged to duty under the Hydrocarbon Oil Duties Act 1979 (HODA). Duty rates on the main road fuels are decreased by 1 penny per litre (ppl) and effective rates of duty on non-road are decreased by the same proportion as main road fuels. The duty rates on natural gas and road fuel other than natural gas are decreased to maintain the differential with the main road fuels. Duty on leaded petrol is decreased by 1 ppl and on aviation gasoline by 0.65 ppl. These changes come into effect from 6pm on 23 March 2011.

DETAILS OF THE CLAUSE

2. Subsection (2) amends the rates of duty on unleaded petrol, aviation gasoline, light oil other than unleaded petrol or aviation gasoline and heavy oil in HODA.

3. Subsection (3) amends the rate of duty on road fuel gases.

4. Subsections (4) – (6) amend the effective rate of duty on fuel oil, gas oil, light oil for use as furnace fuel and biodiesel for off-road use.

BACKGROUND NOTE

5. Budget 2011 announced that the fuel duty escalator was being abolished and replaced with a fair fuel stabiliser. As part of the fair fuel stabiliser fuel duty will increase by RPI only when oil prices are high. However, if the oil price falls below a set trigger price on a sustainable basis, fuel duty will increase by RPI plus 1 ppl in each such year. The Government will set a final trigger price and mechanism after seeking views from oil and gas companies and motoring groups.

6. To ease the burden on motorists at a time of record pump prices, Budget 2011 announced that the 1 April 2011 increase would be deferred and implemented on 1 January 2012. Until then, duty on the main rates is being cut by 1 ppl.
EXPLANATORY NOTE

CLAUSE 20: FUEL DUTIES: RATES OF DUTY AND REBATES FROM 1 JANUARY 2012

SUMMARY

1. Clause 20 provides for changes in rates of duty and rates of rebate on products charged to duty under the Hydrocarbon Oil Duties Act 1979 (HODA). Duty rates on the main road fuels are increased by 3.02 pence per litre (ppl) and effective rates of duty on non-road fuels are increased by the same proportion as main road fuels. The duty on natural gas maintains the differential with the main road fuels, while the differential for road fuel gas other than natural gas is reduced by the equivalent of 1 ppl. Duty on leaded petrol is increased by 3.02 ppl and on aviation gasoline by 1.96ppl. These changes come into effect on 1 January 2012.

DETAILS OF THE CLAUSE

2. Subsection (2) amends the rates of duty on unleaded petrol, aviation gasoline, light oil other than unleaded petrol or aviation gasoline and heavy oil in HODA.

3. Subsection (3) amends the rate of duty on road fuel gases.

4. Subsections (4) – (6) amend the effective rate of duty on fuel oil, gas oil, light oil for use as furnace fuel and biodiesel for off-road use.

BACKGROUND NOTE

5. Budget 2011 announced that the fuel duty escalator was being abolished and replaced with a fair fuel stabiliser. As part of the fair fuel stabiliser fuel duty will increase by RPI only when oil prices are high. However, if the oil price falls below a set trigger price, on a sustainable basis, fuel duty will increase by RPI plus 1 ppl in each such year. The Government will seek views from oil companies and motoring groups before setting the oil trigger price.

6. To ease the burden on motorists at a time of record pump prices Budget 2011 announced that the 1 April 2011 increase would be deferred and implemented on 1 January 2012.
EXPLANATORY NOTE

CLAUSE 21: VED RATES FOR LIGHT PASSENGER VEHICLES, LIGHT GOODS VEHICLES, MOTORCYCLES ETC.

SUMMARY

1. Clause 21 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 2011.

DETAILS OF THE CLAUSE

2. Subsection (2)(a) amends paragraph 1(2) of Schedule 1 to VERA to increase the general rate of duty by £10 to £215 except for vehicles with an engine size of 1549cc or less.

3. Subsection (2)(b) amends paragraph 1(2A) of Schedule 1 to VERA to increase the general rate of duty by £5 to £130 for vehicles with an engine size of 1549cc or less.

4. Subsection (3) 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 on 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. Subsection (4)(a) amends paragraph 1J(a) of Schedule 1 to VERA to increase by £10 to £210 the rate of duty for Light Goods Vehicles which are not lower-emission vans.

6. Subsection (4)(b) amends paragraph 1J(b) of Schedule 1 to VERA to increase the rate of duty for lower-emission vans by £5 to £130. 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)(a) of Schedule 1 to VERA to increase the rate of duty by £1 to £16 for motorbicycles and motortricycles with a cylinder capacity (engine size) of not more than 150cc.
8. Subsection (5)(b) amends paragraph 2(1)(b) of Schedule 1 to VERA to increase the rate of duty by £2 to £35 for motorbicycles with an engine size of over 150cc but not more than 400cc.

9. Subsection (5)(c) amends 2(1)(c) of Schedule 1 to VERA to increase the rate of duty by £3 to £53 for motorbicycles with an engine size of over 400cc but not more than 600cc.

10. Subsection (5)(d) amends paragraph 2(1)(d) of Schedule 1 to VERA to increase the rate of duty by £4 to £74 for motorbicycles with an engine size over 600cc, for motortricycles with an engine size over 150cc and for trade licences for motorcycles.

11. Subsection (6) provides that all new rates under this clause will take effect for licences taken out on or after 1 April 2011.

**BACKGROUND NOTE**

12. 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 in or after March 2001 is generally determined by its 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 (85 per cent content) bioethanol.

13. The rate applying to vans registered in or after March 2001 is lower if the van meets reduced pollution requirements early, that is, before certain emissions requirements became mandatory for new vans.

14. Cars and vans registered prior to March 2001, and all motorcycles, are taxed by reference to the engine size.

15. 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, excepting for certain HGVs without road friendly suspension where rates are revised to remain consistent with EU law (see clause 22).

16. The changes in rates apply to all vehicle licences taken out on or after 1 April 2011 regardless of the commencement date on the licence.
EXPLANATORY NOTE

CLAUSE 22: VED RATES FOR CERTAIN GOODS VEHICLES WITHOUT ROAD-FRIENDLY SUSPENSION

SUMMARY

1. Clause 22 provides for the introduction of higher rates of vehicle excise duty for certain heavy goods vehicles 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 2011.

DETAILS OF THE CLAUSE

2. Subsections (2), (3) and (4) amend Part 8 of Schedule 1 to VERA, to insert references to new paragraph 11D, whereby rates for goods vehicles are determined by reference to tables following paragraphs 9(1), 9A(2), 11(1) and 11A(2) subject to the provisions of paragraph 11D.

3. Subsection (5) introduces new paragraph 11D to Part 8 of Schedule 1 to VERA. Paragraph 11D specifies the categories of heavy goods vehicle without road-friendly suspension to which higher rates of vehicle excise duty will apply, and the rates for these.

BACKGROUND NOTE

4. Vehicles over 3,500 kilogrammes in weight and which carry goods are subject to vehicle excise duty under Part 8 of Schedule 1 to VERA.

5. Vehicle excise duty for goods vehicles is set according to vehicle weight, the number of vehicle axles and the pollution emissions level. Factors tending to increase the rate are a higher weight, fewer axles and higher emissions. This arrangement reflects the relative contribution to pollution levels and impact on roads infrastructure.

6. EU minimum rates of taxation for goods vehicles weighing between 12 and 44 tonnes are applicable to all EU member states, including the UK. Factors affecting the minimum rate for a vehicle are its weight, number of axles and type of suspension. For member states outside of the Euro (€) the application of these minimums is based on the exchange rate published in the Official Journal of the European Union on the first working day of October.
7. In the light of the movements in exchange rates the UK is introducing higher rates of vehicle excise duty for certain categories of heavy goods vehicle without air suspension or equivalent. This ensures consistency with EU law on minimum rates of taxation.
EXPLANATORY NOTE

CLAUSE 23: RATES OF CLIMATE CHANGE LEVY

SUMMARY

1. Clause 23 increases the rates of climate change levy (CCL), broadly in line with current inflation, with effect from 1 April 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) replaces the table of rates in paragraph 42(1) of Schedule 6 to the Finance Act 2000.

3. Subsection (2) provides for the change to have effect for supplies treated as taking place on or after 1 April 2012.

BACKGROUND NOTE

4. CCL came into effect in April 2001. It is a tax on the non-domestic (i.e. business, service and public sector) use of energy (gas, electricity, liquefied petroleum gas and solid fuels), and is aimed at promoting energy efficiency.

5. Since they were first increased in 2007 the rates have kept pace with inflation so that the levy maintains its environmental effect. On each occasion the rates have increased the changes have been legislated for in the previous year’s Finance Act.
EXPLANATORY NOTE

CLAUSE 24: RATE OF AGGREGATES LEVY

SUMMARY

1. Clause 24 repeals section 16 of the Finance Act (FA) 2010 which increased the rate of aggregates levy from £2.00 per tonne to £2.10 per tonne for aggregate subjected to commercial exploitation. This increase was due to come into force for commercial exploitation on or after 1 April 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) repeals section 16 of FA 2010.

3. Subsection (2) confirms that the rate of aggregates levy continues to be set at £2.00 per tonne for aggregate subjected to commercial exploitation on or after 1 April 2011.

4. Subsection (3) provides that the section is treated as having come into force on 31 March 2011.

BACKGROUND NOTE

5. Aggregates levy came into effect on 1 April 2002. It is designed to bring about environmental benefits by making virgin aggregates (i.e. rock, gravel or sand) better reflect the true environmental cost of extraction and by encouraging recycling and the use of alternative materials. FA 2008 set the rate from 1 April 2009 at £2.00 per tonne.

6. FA 2010 legislated for an increase to £2.10 per tonne, effective from 1 April 2011. This increase is being repealed in the current Bill in order to ensure that no additional tax burden is placed on quarry operators in Northern Ireland following the suspension of the aggregates levy credit scheme. That scheme provided for operators in Northern Ireland to receive a credit of 80 per cent of the full rate where they signed up to agreements committing them to environmental improvements in the operation of their quarries. The scheme was suspended with effect from 1 December 2010 following a ruling in the European General Court. However, the Government is working with the Commission to reintroduce the scheme as soon as possible. It is intended that the increase in the rate of aggregates levy to £2.10 will now be introduced with effect from 1 April 2012.
EXPLANATORY NOTE

CLAUSE 25: STANDARD RATE OF LANDFILL TAX

SUMMARY

1. Clause 25 increases the standard rate of landfill tax from £56 per tonne to £64 per tonne for disposals of relevant waste made or treated as made at authorised landfill sites on or after 1 April 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) substitutes “£64” for “£56” 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 2012.

BACKGROUND NOTE

4. Landfill tax was introduced on 1 October 1996 to increase the cost of landfilling waste and thereby encourage waste producers and the waste management industry to switch to more sustainable alternatives to landfilling 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 2011 that the lower rate of landfill tax, currently £2.50 per tonne, will remain frozen in 2012-13.
EXPLANATORY NOTE

CLAUSE 26 SCHEDULE 2: EMPLOYMENT INCOME PROVIDED THROUGH THIRD PARTIES

SUMMARY

1. Clause 26 and Schedule 2 insert a new Part 7A into the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) and make necessary amendments to legislation as a result of that insertion. The Schedule introduces rules that will apply in certain circumstances where employees and their employers enter into arrangements which result in a payment of money or the provision of an asset by a third party rather than the employer. The new rules create a tax charge which will apply to:

- certain loans of money or assets by third parties to the employee;
- the earmarking of money or assets for the employee by a third party and in very limited cases by the employer; and
- the outright payments of money or transfers of assets to the employee by a third party;

where these are not otherwise charged to tax as earnings from the employment.

2. Schedule 2 also includes anti-forestalling rules which mean that certain events occurring on or after 9 December 2010 (the date on which the Schedule was published in draft form) but before 6 April 2011 will fall to be taxed on 6 April 2012 under the new rules. These rules are explained in the commentary on paragraphs 53 onwards of the Schedule.

DETAILS OF THE SCHEDULE

3. Paragraph 1 inserts new Part 7A into ITEPA.

4. New Part 7A has two Chapters.

5. Chapter 1 has the following structure:

- new section 554A states when Chapter 2, which deals with the treatment of relevant steps under Chapter 1 for income tax purposes, applies;
- new sections 554B to 554D specify what those relevant steps are;
• new sections 554E to 554X are exclusions; and

• new sections 554Y and 554Z define certain expressions for the purposes of new Part 7A.

6. Chapter 2 has the following structure:

• new sections 554Z1 to 554Z7 are the detailed rules on the treatment of relevant steps for employment income purposes;

• new sections 554Z8 to 554Z10 deal with the remittance basis; and

• new sections 554Z11 to 554Z14 deal with certain miscellaneous matters, which are explained in full in the commentary on those provisions.

CHAPTER 1 – APPLICATION ETC

Application

7. New section 554A (application of Chapter 2) sets out the circumstances in which Chapter 2 of Part 7A applies. It introduces the concept of “relevant steps” (taken in pursuance of, or connected to, “relevant arrangements”) the value of which, under Chapter 2, will count as employment income of the employee, or prospective or former employee, (“A”) of another person (“B”). Throughout the rest of the commentary on this Schedule, references to the “employee” and the “employer” include, unless otherwise stated, references to, respectively, a prospective or former employee and a prospective or former employer.

8. New section 554A(1)(b) defines “relevant arrangement” and new section 554A(1)(c) applies a condition that, in so far as the arrangement relates to A, it must be reasonable to suppose that, in essence, the arrangement is (wholly or partly) a means of providing rewards or recognition, or loans, in connection with A’s employment with the employer. Under new section 554A(6), it does not matter if at the time it is made the arrangement does not include certain details, such as the sum of money to be provided.

9. New section 554A(1)(d) requires that, for a tax charge under Chapter 2 of new Part 7A to apply, a relevant step must be taken by a “relevant third person” as defined in new section 554A(7). Relevant steps are defined in new section 554A(2) as steps taken under new sections 554B, 554C and 554D.

10. New section 554A(1)(e) contains a requirement that it must be reasonable to suppose that in essence either the “relevant step” is taken (wholly or partly) in pursuance of the relevant arrangement or it
and the relevant arrangement are connected in some other way either directly or indirectly. **New section 554A(11)** sets out further details on when such a connection exists. **New section 554A(12)** provides that in getting to the essence of the matter for the purposes of determining if the conditions in **new sections 554A(1)(c) and (e)** in particular are met, all relevant circumstances must be taken into account.

11. **New section 554A(4)** prevents Chapter 2 from applying to relevant steps within **new section 554B** taken on or after A’s death.

12. **New section 554A(5)** provides that references to A in **new sections 554A(1)(b) and (c)(ii)** include references to any person “linked” with A. That expression is defined for the purposes of new Part 7A in **new section 554Z**.

13. If B is a company which is a member of a group of companies, **new section 554A(8)** extends the meaning of “B” for the purposes of establishing who is, and is not, a relevant third person to include other companies in the group. In new Part 7A, “group of companies” has its corporation tax on chargeable gains meaning: **new section 554Y(5)**. If B is a limited liability partnership, **new section 554A(9)** extends the meaning of “B” to include wholly-owned subsidiaries of B within the meaning given by section 1159(2) of the Companies Act 2006.

14. **New section 554A(10)** disapplies the extensions to the definition of “B” in **new section 554A(8) and (9)** in cases where there is a connection between the relevant step and a tax avoidance arrangement. **New section 554Y(15)** sets out when, for the purposes of new Part 7A, a relevant step is connected to a tax avoidance arrangement.

Relevant steps

15. The charging provisions in Chapter 2 of new Part 7A do not apply unless a “relevant step” is taken: **new section 554A(1)(d)**. It is the value of the relevant step which counts as employment income: **new section 554Z1(1)**. The circumstances in which a relevant step is taken are set out in **new sections 554B to 554D**.

16. **New section 554B(1)(a)** (relevant steps: earmarking etc of sum of money or asset) provides that a relevant step occurs when a person (“P”) earmarks, however informally, a sum of money or asset held by or on behalf of P with a view to a later relevant step being taken in relation to that sum or asset or a sum or asset arising or deriving from it, by P or any other person, conditionally or otherwise. Under **new section 554B(1)(b) and (3)**, P also takes a relevant step if such a sum of money or asset starts to be held with that view.
17. New section 554B(2) provides that for the purposes of new section 554B(1) it does not matter whether:

- the details of the later relevant step have been worked out;
- any condition which would have to be met before the later relevant step is taken might never be met; or
- the employee (“A”) or a person linked with A has a legal right to have a relevant step taken in connection with the sum or asset (or a sum or asset arising or deriving from it).

18. New section 554B(4) and (5) provide that Part 7A will apply as if the employer of A (“B”) is to be regarded as a relevant third person within new section 554A(1) when B takes a step within new section 554B with a view to paying or securing payment of a contribution that meets the conditions in new section 554B(7).

19. New section 554B(6) provides that references to B in these subsections are to be taken as including references to other members of a group of companies to which B belongs.

20. New section 554B(7) provides that the contribution mentioned in new section 554B(4)(b) must be going to be used by a relevant third person to take a relevant step comprising the provision of retirement benefits but does not receive tax relief under any of the provisions in Part 4 of the Finance Act 2004 (FA 2004) and is not paid immediately after B took the relevant step.

21. New section 554B(8) provides definitions for the purposes of new section 554B(4) to (7).

22. New section 554C(1) (relevant steps: payment of sum, transfer of asset etc) provides that a person (“P”) takes a relevant step if P (a) pays a sum of money, transfers an asset, or grants a lease which is likely to have an effective duration exceeding 21 years, and (b) does so in favour of a “relevant person”.

23. New section 554C(2) defines “relevant person” in new section 554C(1). New section 554C(3) provides that references to the employee (“A”) in that definition include references to any person linked with A. Under new section 554Y(6), payment of a sum of money by way of a loan counts as payment of a sum of money for the purposes of new Part 7A.

24. P also takes a relevant step under new section 554C(1) if P (a) takes a step whereby a relevant person acquires securities, securities options or an interest in securities or (b) makes available a sum of money or asset for use as security to obtain a loan to a relevant person or
otherwise to secure the meeting of any liability or the performance of any undertaking in respect of a relevant person. Under new section 554C(5), it does not matter whether this is done in an informal way or if the relevant person has a legal right to use the sum of money or asset as security or actually does so.

25. New section 554C(6) to (9) set out conditions for determining the effective duration of a lease for the purposes of new section 554C(1).

26. New section 554D (relevant steps: making asset available) provides that a person (“P”) takes a relevant step if P makes available an asset to a “relevant person” in the circumstances set out in new section 554D(1) or (2).

27. “Relevant person” in new section 554D(1) and (2) is defined in new section 554D(5) and (6).

28. New section 554D(1)(a) applies if the asset is made available (within the meaning given by new section 554D(3)) for a relevant person to benefit from in a way which is substantially similar to that which would be the case were the asset transferred. New section 554D(7) describes factors that may be taken into account in determining whether new section 554D(1)(a) applies. If new section 554D(1)(a) does not apply, new section 554D(1)(b) applies where an asset is made available to a relevant person to benefit from at or after the end of the period of two years starting on the day the employee’s employment with their employer ceases. New section 554D(2) provides that where an asset is made available before the end of that period and P continues to make it available after the end of that period, a relevant step is taken at the end of that period.

Exclusions

29. New sections 554A to 554D are subject to the specific exclusions in new sections 554E to 554W.

30. New section 554E (exclusions: steps under certain schemes etc) provides, in particular, that Chapter 2 does not apply by reason of a relevant step under tax-advantaged employee share schemes under Chapters 6, 7, 8 and 9 of Part 7 of ITEPA, under registered pension schemes or the pension schemes of overseas governments for the benefit of their employees, under arrangements for the provision of excluded benefits as defined by section 393B(3) of ITEPA or under a holiday pay scheme within paragraph 12 of Part 10 of Schedule 3 to the Social Security (Contributions) Regulations 2001 (SI 2001/1004). In certain cases, the exclusion under this section ceases to apply as set out in new section 554E(6) and (7).
31. New section 554F (exclusions: commercial transactions) provides an exclusion from a charge under new Part 7A where the relevant step is an ordinary commercial transaction.

32. New section 554F(1) provides that Chapter 2 does not apply by reason of a relevant step which is a payment of a sum of money by way of a loan if the loan is a loan on ordinary commercial terms, as defined in section 176(2) and (3) of ITEPA, and the loan is not connected with a tax avoidance arrangement (as defined in new section 554Y(12) to (14)).

33. New section 554F(2) provides that Chapter 2 does not apply by reason of any other relevant step if the person taking the step does so in the course of a normal commercial transaction with the employee (“A”) which meets all the conditions in new section 554F(2)(a) to (d). New section 554F(5) provides that references to A in the section include references to any person linked with A.

34. New section 554G (exclusions: transactions under employee benefit packages) provides that Chapter 2 does not apply by reason of a relevant step if the step taken is (i) a transaction with the employee (“A”) under certain employee benefits packages described in new section 554G(1)(a) to (g) and (ii) not connected with a tax avoidance arrangement (as defined in new section 554Y(12) to (14)). New section 554G(7) provides that references to an employee (“A”) in the section include references to any person linked with A.

35. Where the relevant step is the payment of a sum of money by way of a loan, the exclusion in new section 554G does not apply if a package of employee benefits will be wholly or mainly conferred on directors or senior employees in receipt of higher levels or the highest levels of remuneration and (where the employer is part of a group) senior employees or those receiving the highest levels of remuneration in the group (new section 554G(1)(c)(ii)).

36. For other relevant steps, new section 554G(1)(d) provides that the exclusion in new section 554G does not apply unless the relevant step is part of the package of benefits available as part of the remuneration package for a substantial proportion of comparable employees of the employer.

37. New section 554H (exclusions: earmarking of deferred remuneration) excludes certain deferred remuneration arrangements from the scope of Chapter 2.

38. New section 554H(1) and (2) lay down the conditions which a deferred remuneration arrangement must meet if it is to come within new section 554H.
39. **New section 554H(3)** makes it clear that a deferred remuneration arrangement which meets the conditions in **new section 554H(1)** will still come within **new section 554H** if, in addition, it provides for the award of the deferred remuneration to be partly revoked if specified conditions are not met on or before the vesting date (defined in **new section 554H(1)(c)(i)**).

40. **New section 554H(4)** provides that Chapter 2 will not apply to the relevant step mentioned in **new section 554H(1)(g)**. Chapter 2 may nevertheless apply at a later date: see the commentary on **new section 554H(8)** onwards below.

41. **New section 554H(5)** defines the term “the earmarked deferred remuneration”.

42. **New section 554H(6)** and (7) deem a relevant step to have been taken at any time (the “relevant time”) that (broadly speaking) a sum of money or asset:

   - ceases to be earmarked for deferred remuneration (for example, because the remuneration is to be provided to the employee in some other way or its award has been revoked); but
   - remains within **new section 554B(1)(a) or (b)** (relevant steps: earmarking etc of sum of money or asset).

43. If the event mentioned in **new section 554H(7)** occurs, **new section 554H(7)** deems a relevant step within **new section 554B** to have been taken at the relevant time, the subject of which is:

   - the sum of money or asset which represented the earmarked deferred remuneration; and
   - a just and reasonable proportion of any relevant income (defined in **new section 554H(14)**).

44. **New section 554H(8)** deems a relevant step to have been taken at the end of the vesting date (under **new section 554H(9)**) unless, broadly, one of the two events described in **new section 554H(11) and (12)** has happened.

45. The event described in **new section 554H(11)** is that the earmarked deferred remuneration has become PAYE employment income.

46. The event described in **new section 554H(12)** is that the earmarked deferred remuneration has:

   - been revoked; and
• the sum of money or asset which represented the earmarked deferred remuneration has been taken beyond the scope of new sections 554B to 554D.

47. Where those events have not happened, new section 554H(9)(a) deems a relevant step within new section 554B to have been taken at the end of the vesting date the subject of which is:

• a sum of money of the notional PAYE amount (defined in new section 554H(10)); and

• a just and reasonable proportion of any relevant income (defined in new section 554H(14)).

48. If new section 554H(9)(a) deems a relevant step to have been taken, new section 554H(9)(b) provides that the charging provisions in Chapter 2 apply in relation to it (unless the employee has died and new section 554A(4) applies).

49. New section 554I (exclusions: introduction to sections 554J to 554L) introduces three sections relating to earmarking for employee share schemes and provides definitions for the purposes of those sections.

50. New sections 554J and 554K (exclusions: earmarking for employee share schemes (1) and (2)) provide that Chapter 2 will not apply by reason of a relevant step under new section 554B to shares earmarked to meet the requirements of an employee share scheme if the specified conditions are met.

51. New section 554J(1) provides that new section 554J applies where there is an arrangement under which (in respect of an employee’s employment with a company) an award of shares, or sum of money determined by reference to share value, is made, and the award is on deferred terms under which the shares or money are to be received by the employee on a specified vesting date, subject to specified conditions. It additionally provides that the vesting date is to be not more than five years after the award date, and that there is to be a reasonable chance that not all of the specified conditions will be met on or before the vesting date.

52. New section 554J(2) provides that, for the purposes of some of the requirements in new section 554J(1), any terms of the award dealing with events which happen after the employee’s death may be ignored.
53. **New section 554J(3)** provides that the deferred award terms may provide that the award can be partly revoked.

54. **New section 554J(4)** provides that Chapter 2 does not apply to a relevant step within **new section 554B** if the award is of relevant shares which are earmarked or otherwise start being held to meet the requirements of the employee share scheme mentioned in **new section 554J(1)**. It also provides that the number of relevant shares which are earmarked must not exceed the maximum number of relevant shares which might be expected to meet the award, and that there must be no connection between the relevant step and a tax avoidance arrangement.

55. **New section 554J(5)** provides that **new section 554J(6)** will apply if:

   - the award expected to be made as mentioned in **new section 554J(4)(a)(ii)** is not made before the end of the date which is three months after the end of the date on which the relevant step is taken; and

   - the shares continue to be held on the basis mentioned in **new section 554J(4)(a)**.

56. **New section 554J(6)** provides that new Part 7A will have effect as if a relevant step within **new section 554B** were taken at the date mentioned in **new section 554J(5)**, and the subject of that step is the shares which continue to be held on the basis mentioned in that subsection. It also provides that any relevant income (as defined in **new section 554J(4)(a)**) in relation to those shares will be treated as subject to a relevant step at that date.

57. **New section 554J(7)** provides that **new section 554J(8)** will apply if at any time (“the relevant time”) any of the earmarked shares cease to be held so as to meet the requirements of the relevant share scheme, but continue to be held on the basis of **new section 554B(1)(a) or (b)** (relevant steps: earmarking etc of sum of money or asset).

58. **New section 554J(8)** provides that new Part 7A will have effect as if a relevant step within **new section 554B** were taken at the relevant time, and the subject of that step is the shares mentioned in **new section 554J(7)** and any income in relation to those shares.

59. **New section 554J(9)** provides that **new section 554J(10)** will apply if a relevant step is taken in relation to an award which falls within **new section 554J(4)(a)(i)** or in relation to an expected award which falls within **new section 554J(4)(a)(ii)** before the end of the final award date.
60. New section 554J(10) provides that new Part 7A will have effect as if a relevant step within new section 554B were taken at the end of the vesting date, the subject of which is (a) earmarked shares to which none of new section 554J(11) to (13) apply and (b) any relevant income in relation to any of those shares.

61. New section 554J(11) to (13) set out the various conditions which must apply if earmarked shares are not to fall within new section 554J(10).

62. New section 554J(11) applies to earmarked shares if the employee receives the shares before the end of the vesting date, and the receipt of the shares by the employee gives rise to employment income which is chargeable to income tax or is exempt income.

63. New section 554J(12) applies to the payment of sums of money determined by reference to the market value of any relevant shares. It provides that earmarked shares fall within the subsection if the sum of money referred to in new section 554J(1)(a)(ii) is paid to the employee before the end of the vesting date, the payment of that sum of money gives rise to income which is chargeable to income tax or is exempt income, and either the payment is made out of the proceeds of the disposal of the shares, or, if it is paid from another source, then no further relevant step is or will be taken in relation to the shares or sum or money or asset arising or deriving from the shares.

64. New section 554J(13) applies where an award is revoked in whole or in part. It provides that earmarked shares fall within the subsection if before the end of the vesting date the award is revoked and no further relevant step is or will be taken in relation to the shares or to any sum or money or asset arising or deriving from the shares.

65. New section 554J(14) defines “relevant income” for the purposes of new section 554J(6)(a)(ii), (8)(a)(ii) and (10)(a)(ii).

66. New section 554K(1) provides that new section 554K applies where there is an arrangement under which (in respect of an employee’s employment with a company) a sum of money determined by reference to share value is to be made, and the award is on deferred terms under which the money is to be received by the employee if a specified exit event occurs. It additionally provides that the section only applies if there is a reasonable chance that the exit event will occur.

67. New section 554K(2) provides that an exit event occurs if relevant shares are admitted to trading on a stock exchange or all or a substantial proportion of the shares are sold to unconnected persons.
68. **New section 554K(3)** provides that, in deciding whether certain requirements of **new section 554K(1)** are met, any deferred award terms can be ignored if they relate to what happens if the employee dies before the exit event occurs.

69. **New section 554K(4)** provides that Chapter 2 does not apply to a relevant step within **new section 554B** if the subject of the relevant step is earmarked shares which are held to meet the requirements of a deferred award as set out in **new section 554K(1)**. It additionally provides that the shares must not be admitted to trading on a stock exchange, that the number of shares earmarked must be reasonable, and that there must be no connection with a tax avoidance arrangement.

70. **New section 554K(5)** provides that if a relevant step is taken, but no award is made within three months and the shares continue to be earmarked, then **new section 554K(6)** will apply.

71. If **new section 554K(6)** applies, it provides that a relevant step will be regarded as having been taken to which Chapter 2 does apply, in respect of the shares mentioned in **new section 554K(5)**.

72. **New section 554K(7)** provides that, if at any time the earmarked shares cease to be held on the basis set out in **new section 554K(4)**, but continue to be held on the basis set out in **new section 554B(1)(a)** or (b), then **new section 554K(8)** will apply.

73. If **new section 554K(8)** applies, it provides that a relevant step under **new section 554B** will be regarded as having been taken to which Chapter 2 does apply, in respect of the shares mentioned in **new section 554K(7)**.

74. **New section 554K(9)** provides that **new section 554K(10)** applies if the relevant step has been taken in respect of an award or an expected award, and the specified exit event occurs.

75. **New section 554K(10)** provides that Part 7A has effect as if a relevant step within **new section 554B** were taken at the end of the period specified in the subsection, the subject of the relevant step being (a) any earmarked shares to which **new section 554K(11)** does not apply and (b) any relevant income on those shares. It also provides that Chapter 2 is to apply to that relevant step.

76. **New section 554K(11)** applies to any earmarked shares if the sum of money in respect of which those shares were earmarked is paid to the employee before the end of the period specified in the subsection, the payment of the sum gives rise to employment income of the employee which is chargeable to income tax or is exempt income, and (broadly...
(speaking) the payment is made out of the proceeds of the disposal of the shares.

77. **New section 554K(12)** defines “exit period” for the purposes of new section 554K(11).

78. **New section 554K(13)** defines relevant income for the purposes of new section 554K(6)(a)(ii), (8)(a)(ii) and (10)(a)(ii).

79. **New section 554L (exclusions: employee share schemes (3))** is an exclusion whereby Chapter 2 will not apply to shares earmarked to meet the requirements of an employee share option scheme if the specified conditions are met. In this section, provisions are included to impose a charge under Chapter 2 where the purpose of the earmarking changes or the award in question is not made but the earmarking in relation to the employee does not come to an end.

80. **New section 554L(1)** provides that new section 554L applies where there is an arrangement under which, in respect of an employee’s employment with a company, the employee may be granted either a right to acquire shares or a sum of money determined by reference to share value, and the award is on deferred terms under which the shares or money are to be received by the employee on a specified vesting date, subject to specified conditions. It additionally provides that the vesting date is to be not more than five years after the grant date, and that there is to be a reasonable chance that not all of the specified conditions will be met on or before the vesting date.

81. **New section 554L(2)** provides that, for the purposes of some of the requirements in new section 554L(1), any terms of the grant dealing with events which happen after the employee dies may be ignored.

82. **New section 554L(3)** provides that the deferred grant terms may provide that the options can be exercised only in part.

83. **New section 554L(4)** provides that Chapter 2 does not apply to a relevant step within new section 554B if the subject of the step is relevant shares which are earmarked or otherwise start being held to meet the requirements of the grant of options mentioned in new section 554L(1). It also provides that the number of relevant shares which are earmarked must not exceed the maximum number which might be expected to meet the award, and that there must be no connection between the relevant step and a tax avoidance arrangement.

84. **New section 554L(5)** provides that, where a relevant step is taken in relation to an expected grant of a relevant share option, new section 554L(6) will apply if the grant is not made before the end of the date which is three months after the end of the date on which the
relevant step is taken, and the earmarked shares continue to be held on the basis mentioned in new section 554L(4)(a).

85. New section 554L(6) provides that Chapter 2 will apply as if a relevant step under new section 554B were taken at the end of the final grant date, and the subject of that step is the shares which continue to be held on the basis mentioned in that subsection. It also provides that any relevant income in relation to those shares will be treated as subject to a relevant step at that date.

86. New section 554L(7) provides that new section 554L(8) will apply if at any time (“the relevant time”) any of the earmarked shares cease to be held to meet the requirements of a relevant share option, but continue to be held on the basis of new section 554B(1)(a) or (b) (relevant steps: earmarking etc of sum of money or asset).

87. New section 554L(8) provides that new Part 7A will have effect as if a relevant step within new section 554B were taken at the relevant time, the subject of that step being the shares mentioned in new section 554L(7) and any income in relation to those shares.

88. New section 554L(9) provides that new section 554L(10) will apply if a relevant step is taken in relation to a grant of a relevant share option which falls within new section 554L(4)(a)(i) or in relation to an expected award before the final grant date.

89. New section 554L(10) provides that new Part 7A will have effect as if a relevant step within new section 554B were taken at the end of the final exercise date, the subject of which is (a) any of the shares to which none of new section 554L(11) to (14) apply and (b) any relevant income in relation to any of those shares.

90. New section 554L(11) to (14) set out the various conditions which must apply if earmarked shares are not to fall within new section 554L(10).

91. New section 554L(11) applies to earmarked shares if the options become exercisable, in whole or in part, before the end of the vesting date and the employee exercises the options in whole or in part before the end of the final vesting date, and the receipt of the shares which results gives rise to employment income which is chargeable to income tax or is exempt income.

92. New section 554L(12) applies to any earmarked shares if the relevant share option become exercisable, in whole or in part, before the end of the vesting date and as a result a sum of money is payable to the employee which either gives rise to employment income of the employee or is exempt income. It additionally provides that the payment must either represent the proceeds of the disposal of the
shares, or, if it is paid from another source, then no further relevant step is or will be taken in relation to the shares or sum or money or asset arising or deriving from the shares.

93. **New section 554L(13)** applies where before the end of the vesting date the share option ceases to be exercisable by the employee, in whole or in part, and no further relevant step is or will be taken in relation to the shares or to any sum or money or asset arising or deriving from the shares.

94. **New section 554L(14)** applies where the relevant share option lapses (in whole or in part), so that no further relevant step is or will be taken in relation to the shares or to any sum or money or asset arising or deriving from the shares, or in relation to the corresponding amount where the option has lapsed in part.

95. **New section 554L(15)** defines “the final exercise date” as the date which is five years after the grant date.

96. **New section 554L(16)** defines “relevant income” for the purposes of new section 554L(6)(a)(ii), (8)(a)(ii) and (10)(a)(ii).

97. **New section 554M** (exclusions: other cases involving employment-related securities etc) provides that, in some circumstances, Chapter 2 does not apply to relevant steps that involve employment-related securities.

98. **New section 554M(1) and (2)** provide that Chapter 2 does not apply to an acquisition of employment-related securities if that acquisition falls within section 425(2) of ITEPA, nor to an acquisition of employment-related securities options which falls within section 475(1) of that Act.

99. **New section 554M(3)** provides that terms used in **new section 554M(1) and (2)** have the same meanings as in Chapter 2 or 5 of Part 7 of ITEPA.

100. **New section 554M(4) and (5)** provide that Chapter 2 does not apply on the occurrence of certain events to which certain provisions in Part 7 of ITEPA apply. Those events take place when an amount counts as employment income under sections 426, 438 or 476, or by virtue of discharge of a notional loan for the purposes of section 446U or a disposal to which Chapter 3D of Part 7 applies.

101. Sections 421B(6), 421E(1), 474(1) and 477(2) of ITEPA disapply certain provisions of Part 7 of that Act, as do elections made under sections 430 and 431 of that Act to. **New section 554M(6)** similarly disapplies Chapter 2 in such cases.
102. Under certain circumstances, the exercise of a share option by A will give rise to employment income which either is subject to income tax in A’s hands or is exempt income. If a sum of money is paid by way of a loan made to A to exercise such an option, new section 554M(6) provides that Chapter 2 will not apply to the loan (unless there is a connection with a tax avoidance arrangement). New section 554M(9) to (11) restrict this exclusion; to the extent that the loan is not repaid by the end of the sixth day of the calendar month following the calendar month in which the loan is made, the exclusion will not be available.

103. New section 554N (exclusions: employee car ownership schemes) excludes from Chapter 2 certain relevant steps taken in relation to certain employee car ownership schemes (“ECOS”). New section 554N(1) sets out the detailed conditions which an ECOS must meet if it is to come within this exclusion – in particular, (i) a loan must be made to an employee which is used to buy a car under the arrangement and (ii) the arrangement must specify that the loan must be fully repaid by a date which is at most four years from the date on which the loan is made. New section 554N(2) specifies the relevant steps which will not give rise to a charge under Chapter 2 by virtue of the exclusion. New section 554N(3) and (4) restrict the exclusion; broadly speaking, to the extent that the loan is not repaid by the specified date, a relevant step under new section 554C is deemed to take place on that date and the charging provisions in Chapter 2 apply accordingly.

104. New section 554O (exclusions: employment income exemptions under Part 4) prevents new Part 7A from taxing benefits which would otherwise be exempt from income tax on employment income.

105. Part 4 of ITEPA includes “employment income exemptions”, which exempt certain benefits from the charge to tax on employment income completely. If an employment income exemption applies to the subject of a relevant step, new section 554O(1) disapplies Chapter 2.

106. New section 554O(2) and (3) provide for just and reasonable apportionments to be made in cases where the subject of the relevant step would only be covered in part by an employment income exemption (for example because the exemption is subject to a financial limit), confining the exclusion to the part of the benefit (provided by the relevant step) to which the employment income exemption applies.

107. For the purposes of this section, new section 554O(4) extends the definition of “employment income exemption” to include the exemption under section 271 of ITEPA (which does not exempt benefits from income tax completely). Section 271 exempts from
income tax in respect of earnings (a) the provision of certain removal benefits and (b) the payment or reimbursement of certain removal expenses.

108. New section 554P (exclusions: income arising from earmarked sum or asset) provides – broadly speaking – that, if Chapter 2 has applied because a sum of money or asset has been the subject of a relevant step under new section 554B in respect of an employee’s employment, then Chapter 2 does not also apply to income arising from that sum of money or asset when it is earmarked in respect of that employee’s employment.

109. New section 554P(1) sets the conditions which must be met if income is to come within new section 554P. New section 554P(2) sets the conditions which must be met if Chapter 2 is to be disapplied. New section 554P(3) and (4) contain an anti-avoidance provision directed against arrangements to increase the income sheltered by new section 554P.

110. New section 554Q (exclusions: acquisitions out of earmarked sums or assets) provides – broadly speaking – that, if Chapter 2 has applied because a sum of money or asset (“sum or asset S”) has been the subject of a relevant step under new section 554B in respect of an employee’s employment, then Chapter 2 does not also apply to a sum of money or asset (“sum or asset T”) which is wholly acquired out of sum or asset S when it is earmarked in respect of that employee’s employment.

111. New section 554Q(1) sets the conditions which must be met if sum or asset T is to come within new section 554Q.

112. In particular, if sum or asset T represents the proceeds from the disposal of sum or asset S, new section 554Q(2) makes it clear that the condition in new section 554Q(1)(b) will be met.

113. New section 554Q(3) sets the conditions which must be met if Chapter 2 is to be disapplied in relation to the earmarking of sum of asset T.

114. New section 554Q(4) and (5) contain an anti-avoidance provision directed against manipulation of the values of sum or asset S and sum or asset T.

115. New section 554Q(6) and (7) contain a supplementary exclusion which applies if Chapter 2 does not apply on the earmarking of sum or asset T by virtue of new section 554Q(3) and in other specified cases. The supplementary exclusion prevents the charging provisions in Chapter 2 from applying to a relevant step under new section 554C(1)(a) to (c) (payment of sum, transfer of asset, etc) which is
taken in relation to sum or asset S or sum or asset T solely for the purpose of the acquisition of sum or asset T.

116. New section 554R (exclusions: pension income chargeable under Part 9 etc) is the first of a group of sections concerned with retirement benefits.

117. New section 554R(1) gives Part 9 of ITEPA priority over new Part 7A. If:

- a relevant step is taken within new section 554C (relevant steps: payment of sum, transfer of asset etc) or new section 554D (relevant steps: making asset available); and
- the step is the provision of pension income which either (a) is chargeable to income tax under Part 9 or (b) is exempt income within the meaning of that Part;

then Chapter 2 does not apply by reason of that step.

118. In Part 9 of ITEPA, “pension income” and “exempt income” have the meanings given by section 566 of that Act.

119. New section 554R(2) directs that new sections 554S to 554W are to be applied, so far as applicable, sequentially.

120. New section 554S (exclusions: employee pension contributions) reduces the amount of employment income arising by virtue of new Part 7A in certain cases in which the employee has paid pension contributions to a relevant third person.

121. New section 554S(1) and (2) provide that the earmarking of sums or assets as described in new section 554B does not give rise to employment income by virtue of new Part 7A to the extent that those sums or assets arise or derive from excluded pension contributions paid by the employee (“A”) on or after 6 April 2011.

122. New section 554S(3) and (4) provide that the provision of sums and assets as benefits as described in new sections 554C and 554D does not give rise to employment income by virtue of new Part 7A to the extent that the sums and assets (a) are relevant benefits chargeable to tax under provisions other than new Part 7A and (b) arise or derive from excluded pension contributions paid by A.

123. New section 554S(5) provides that when determining for the purposes of new section 554S(1) to (4) the extent to which the sums and assets arise or derive from excluded pension contributions and the extent to which they do not apportionments are to be made on justly and reasonably.
124. New section 554S(6) defines “excluded pension contribution”.

125. New section 554S(7) provides other definitions.

126. New section 554T (exclusions: pre-6 April 2006 contributions to employer-financed retirement benefit schemes) ensures that, in certain specified circumstances, if an employer has paid a sum of money before 6 April 2006 to an employer-financed retirement benefits scheme (within the meaning of Chapter 2 of Part 6 of ITEPA) and an employee has been “taxed” in respect of this sum, then Chapter 2 will not apply to sums of money or assets arising or derived from this sum.

127. New section 554T(1) sets the conditions for the section to apply.

128. New section 554T(2) defines “taxed” for the purposes of new section 554T(1) by reference to paragraph 53(3) of Schedule 36 to FA 2004 (pension schemes etc: benefits taxable under Chapter 2 of Part 6 of ITEPA: contributions taxed pre-6 April 2006).

129. New section 554T(3) disapplies Chapter 2. As a result, benefits provided under the scheme will remain subject to tax under section 394 of ITEPA (relevant benefits provided under an employer-financed retirement benefit scheme) as reduced in accordance with the provisions in paragraphs 53 to 55 of Schedule 36 to FA 2004 or under Part 9 of ITEPA (pension income).

130. New section 554T(4) to (6) provide for just and reasonable apportionments to be made in order to confine new section 554T to sums of money or assets arising or derived from a taxed sum within new section 554T(1).

131. If B is a company which is a member of a group of companies, new section 554T(7) extends the meaning of contributions paid by B to include contributions paid by other group companies.

132. New section 554U (exclusions: purchases of annuities out of pension scheme rights) excludes from the charging provisions in Chapter 2 the capital value of annuities bought out of pre-6 April 2011 annuity rights. New section 554U(1) states when the section applies.

133. New section 554U(2) and (3) specify the relevant steps to which Chapter 2 does not apply. They focus on, respectively, the position of the purchaser of the annuity contract and the position of the insurance company selling it.

134. New section 554U(4) and (5) provide for just and reasonable apportionment if the annuity contract is purchased other than wholly
out of the employee’s rights to receive an annuity which accrued before 6 April 2011.

135. **New section 554U(6)** defines “annuity contract”, “insurance company” and “pre-6 April 2011 annuity rights”.

136. **New section 554V** (exclusions: certain retirement benefits etc) excludes from Chapter 2 certain lump sums paid from certain pension schemes where the lump sums are paid out of rights accruing before 6 April 2011.

137. **New section 554V(1)** states when the section applies; one of the conditions (**new section 554V(1)(d)**) is that the payment of the lump sum is a relevant step within **new section 554C**.

138. Under **new section 554V(2)**, Chapter 2 does not apply by reason of this relevant step. As a result, relevant benefits provided under the pension scheme will remain subject to tax under section 394 of ITEPA (relevant benefits provided under an employer-financed retirement benefit scheme) or under Part 9 of that Act (pension income).

139. **New section 554V(3) and (4)** provide for just and reasonable apportionment if the lump sum benefits are provided other than wholly out of the employee’s rights to receive the lump sum accrued before 6 April 2011.

140. **New section 554W** (exclusions: transfers between certain foreign pension schemes) ensures that, in certain specified circumstances, if tax relief has been given in relation to a foreign pension scheme, Chapter 2 will not apply to a transfer from that scheme to another foreign pension scheme.

141. **New section 554W(1)** deals with “section 390 schemes”, ie schemes in relation to which claims were accepted under section 390 of ITEPA. Section 390 was an exception, for non-domiciled employees with foreign employers, from the charge imposed by section 386 of ITEPA on payments to non-approved retirement benefits schemes. Sections 386 and 390 were repealed by the FA 2004 pensions legislation. Section 390 schemes are therefore a closed set.

142. Under **new section 554W(1)**, the section applies if rights which an employee (“A”) has under a section 390 scheme are transferred to another section 390 scheme or to an “overseas pension scheme” (within the meaning of Part 4 of FA 2004).

143. Under **new section 554W(2)**, the section also applies if two conditions are met.
144. The first condition is similar to new section 554W(1). It is that rights which A has under an overseas pension scheme are transferred to another overseas pension scheme: new section 554W(2)(a).

145. But not all such transfers will come within new section 554W(2). The second condition to be met is that some or all of the rights transferred are “section 390 scheme rights”: new section 554W(2)(b). “Section 390 scheme rights” are defined in new section 554W(12): broadly speaking, they are rights which (i) A has under an overseas pension scheme and (ii) stem from a section 390 scheme.

146. New section 554W(3) specifies the relevant steps to which Chapter 2 does not apply.

147. New section 554W(4) to (6) provide for just and reasonable apportionment in a case within new section 554W(2) if not all of the transferred rights are section 390 scheme rights.

148. New section 554W(7) to (10) provide for just and reasonable apportionments to be made in order to confine new section 554W to pre-6 April 2006 arrangements which have received tax relief.

149. If B is a company which is a member of a group of companies, new section 554W(11) extends the meaning of “B” and “contribution” to include contributions paid by other group companies.

150. New section 554X (power to exclude other relevant steps) enables the Commissioners for Her Majesty’s Revenue and Customs to make regulations adding to or broadening the exclusions from Chapter 2.

151. Under new section 554X(4), such regulations may be made with retrospective effect.

Interpretation

152. New section 554Y (interpretation: general) contains definitions for the purposes of new Part 7A.

153. New section 554Z (interpretation: linked persons) defines, for the purposes of new Part 7A, who is a person linked to the employee.

154. By virtue of section 718 of ITEPA, “connected” in new section 554Z(1)(a) has the meaning given by section 993 of the Income Tax Act 2007 (ITA); new section 554Y(2) extends this meaning for the purposes of new Part 7A.
CHAPTER 2 – TREATMENT OF RELEVANT STEP FOR INCOME TAX PURPOSES

Employment income

155. New section 554Z1 (value of relevant step to count as employment income) provides for the value of a relevant step under new sections 554B to 554D to count as employment income of the employee (“A”). New section 554Z1(1)(a) provides that the relevant step counts as employment income for the tax year in which A’s employment starts if the relevant step is taken before that time. New section 554Z1(1)(b) provides that in all other cases the relevant step counts as employment income for the tax year in which the relevant step is taken.

156. New section 554Z1(2) provides for a priority rule where a relevant step otherwise gives rise to (a) an amount which is treated as earnings under the benefits code or (b) any income from UK dividends to which Chapter 3 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) applies. In both cases new section 554Z1(1) applies instead of the provision in the benefits code or Chapter 3 of Part 4 of ITTOIA.

157. New section 554Z2 (value of relevant step) contains the general rules for determining the value of a relevant step. Those rules are subject to new sections 554Z3 to 554Z7 (new section 554Z1(7)).

158. New section 554Z2(1) provides that the value of a relevant step is the amount of the sum if the relevant step involves a sum of money.

159. New section 554Z2(2) provides that in any other case the value of a relevant step is the market value of the asset which is the subject of the relevant step at the time when the relevant step is taken (new section 554Z2(2)(a)), or (if higher) the cost of the relevant step as defined in new section 554Z2(6) (new section 554Z2(2)(b)).

160. “Market value”, in new Part 7A, has its capital gains tax meaning (see new section 554Y(5)). Under new section 554Z2(3), “market value”, in new section 554Z2(2)(a), is subject to sections 437 and 452 of ITEPA, both of which are concerned with the market value of certain employment-related securities.

161. New section 554Z3 deals with residence issues. Once the value of a relevant step has been determined, it requires that the tax year or years that value is “for” must be determined. For the purposes of new section 554Z3(1), new section 554Z3(2) applies the rules in sections 16(1) to (4) and 17(1) to (3) of ITEPA to determine the year the relevant step is for as though the value of the relevant step was general earnings covered by those provisions of ITEPA.
162. In a case where the value of a relevant step, or part of it, is “for” a tax year in which A is non-UK resident, new section 554Z3(3) applies new section 554Z3(4) to deduct from the value of the relevant step so much as is derived from duties performed outside the UK. Under new section 554Z3(5), that deduction is determined justly and reasonably.

163. New section 554Z3(6) provides that this section does not affect the tax year for which the value of the relevant step counts as employment income under new section 554Z1.

164. New section 554Z4 (overlap with earlier relevant step) provides for the value of a relevant step to be reduced by the value of an earlier relevant step (within the meaning given for the purposes of this section by new section 554Z4(3)) relating to the same employment if there is an overlap between the sum of money or asset which is the subject of the relevant steps. Under new section 554Z4(4), there is an overlap for the purposes of this section if:

- the sum of money subject to the relevant steps is the same sum of money or asset; or

- the sum or asset subject to a relevant step (defined as “sum or asset P”) essentially replaces the sum or asset of an earlier relevant step (defined as “sum or asset Q”).

165. If there is an overlap which covers the whole of sum or asset Q, new section 554Z4(2)(a) provides for the value of the relevant step (after taking account of any reductions under new sections 554Z3) to be reduced by the value of the earlier relevant step. But if the overlap covers only part of sum or asset Q, new section 554Z4(2)(b) provides that the value of the relevant step (after taking into account of any reductions under new sections 554Z3) is reduced by the part of the value of the earlier relevant step which corresponds to the part of sum or asset Q which overlaps sum or asset P. This reduction is determined justly and reasonably.

166. New section 554Z4(3) applies a priority order so that references to the value of the earlier relevant step in new section 554Z4(2) mean the value:

- after taking account of any reductions under new section 554Z3 or 554Z4; but

- before taking account of any reductions under new sections 554Z5 to 554Z7.

167. New section 554Z4(5) makes provision for cases where earlier relevant steps have already overlapped.
168. **New section 554Z5** (overlap with certain ITEPA charging provisions which also apply to a relevant step priority over a new Part 7A charge. **New section 554Z5(2)** reduces the value of a relevant step by the value of the income subject to those charging provisions. A reduction under **new section 554Z5** applies after any reductions under **new section 554Z3 or 554Z4**, and cannot reduce the value of a relevant step below nil.

169. **New section 554Z6** (exercise price of share options) allows a deduction from the value of the relevant step in some circumstances where under the terms of the relevant share option an amount has to be paid to exercise the share option.

170. **New section 554Z6(1)** sets out circumstances in which **new section 554Z6(3)** applies. It provides that it applies where the relevant step is within **new section 554B**, other than one treated as being taken by **new section 554L(6), (8) or (10)**. It also provides that the following conditions must apply: B must be a company, there must be an employee share scheme under which share options are granted, the subject of the relevant step must be relevant shares, the number must not exceed the maximum number of shares which might reasonably be needed, there must be no connection with a tax avoidance arrangement, and the employee must have to pay a sum of money to exercise the option.

171. **New section 554Z6(2)** sets out when **new section 554Z6(3)** applies in a case within **new section 554L(10)**.

172. **New section 554Z6(3)** provides that where the subsection applies, the value of the relevant step is to be reduced, but not below nil, by the amount of money that A would have to pay, or where the value was reduced under **new section 554Z3**, by a proportionately reduced amount.

173. **New section 554Z6(5)** provides that if the relevant step is taken in relation to the grant of a relevant share option, the grant is not before the end of the date (“the final grant date”) which is three months after the date on which the relevant step is taken, and at the final grant date earmarked shares continue to be held, then **new section 554Z6(7)** applies.

174. **New section 554Z6(6)** provides that **new section 554Z6(7)** also applies if, at any time after the taking of the relevant step, any of the earmarked shares cease to be held on the basis set out in **new section 554Z3(1)(e)**, but remain earmarked on the basis set out in **new section 554B(1)(a) or (b)**.
175. If new section 554Z6\((7)\) applies, it deems a relevant step within new section 554B to have been taken.

176. New section 554Z6\((8)\) defines “relevant shares”.

177. New section 554Z7 (cases where consideration given for relevant step) adjusts the value of certain relevant steps within new section 554C (relevant steps: payment of sum, transfer of asset etc) if consideration is given for the value of the relevant step in specified circumstances.

178. New section 554Z7\((1)\) sets the conditions for the value of the relevant step to be adjusted if an asset is transferred. It focuses on cases in which an employee (“A”) gives a person (“P”) consideration for the value of a relevant step by transferring an asset, before or around the time the relevant step is taken and otherwise than by way of loan, and the transfer is not connected with a tax avoidance arrangement. New section 554Z7\((3)\) expands on the meaning of tax avoidance arrangement for the purposes of new section 554Z7\((1)\).

179. New section 554Z7\((2)\) reduces the value of the relevant step by the market value of the asset at the time of its transfer (or, of the value of the relevant step was reduced under new section 554Z3, the proportion of the market value determined under new section 554Z7\((7)\)).

180. New section 554Z7\((5)\) sets the conditions for the value of the relevant step to be adjusted if a sum of money is paid. It focuses on cases in which A gives P consideration by paying a sum of money, at or before the time the relevant step is taken.

181. New section 554Z7\((6)\) reduces the value of the relevant step by the amount paid.

182. A reduction under new section 554Z7\((2)\) or (6) cannot reduce the value of the relevant step below nil.

183. New section 554Z7\((8)\) extends references to “A” in this section to include any person linked with A.

Remittance basis

184. New section 554Z8 (remittance basis: A is ordinarily UK resident) applies the remittance basis to the value of a relevant step (or part of it) if:

- section 809B, 809D or 809E of ITA (the remittance basis) applies to an employee (“A”) for “the relevant tax year”;
• A is ordinarily resident in the United Kingdom in the relevant tax year;
• A’s employment with the employer (“B”) is with a foreign employer; and
• the duties of that employment are performed wholly outside the United Kingdom.

185. New section 554Z8(1) sets out the conditions for new section 554Z8(2) to apply and new section 554Z8(1)(a) defines “the relevant tax year” for that purpose as the tax year which the relevant step, or part of it, is “for” as determined under new section 554Z5.

186. New section 554Z8(2) provides that A’s employment income by virtue of new section 554Z1, or the relevant part of it, is “taxable specific income” in a tax year if it is remitted to the UK in that year, and for this purpose new section 554Z8(3) provides that any income which is remitted before the start of A’s employment with B is treated as being remitted in the tax year in which the employment starts.

187. Where A has “associated employments” (defined in new section 554Z8(6)) for which the duties are not performed wholly outside the UK, new sections 554Z8(4) and (5) limit the amount of employment income to which new section 554Z8(2) applies to such an amount as is just and reasonable having regard to the factors listed in new sections 554Z8(5)(a) to (5)(d).

188. New section 554Z9 (remittance basis: A is not ordinarily resident) applies the remittance basis to the value of a relevant step (or part of it) if:
• section 809B, 809D or 809E of ITA (the remittance basis) applies to an employee (“A”) for “the relevant tax year”;
• A is not ordinarily resident in the United Kingdom in the relevant tax year; and
• the value of the relevant step, or a part of it, is not in respect of duties performed in the United Kingdom.

189. New section 554Z9(1) sets out the conditions for new section 554Z9(2) to apply and new section 554Z9(1)(a)(i) defines “the relevant tax year” for the purposes of the section as the tax year which the relevant step, or part of it, is “for” as determined under new section 554Z5.

190. New section 554Z9(2) provides that A’s employment income under new section 554Z1, or the relevant part of it, is “taxable specific
income” in a tax year if it is remitted to the UK in that year, and for this purpose new section 554Z9(3) provides that any income which is remitted before the start of A’s employment with B is treated as being remitted in the tax year in which the employment starts.

191. Under new section 554Z9(4), if it is necessary to determine the extent to which the value of the relevant step (or any part of it) is not in respect of duties performed in the United Kingdom, it is determined justly and reasonably.


193. In particular, new section 554Z10(1) applies new section 554Z10(2) where new sections 554Z8(1)(a) and 554Z9(1)(a) apply to only part of the value of a relevant step (labelled “the relevant part”). New section 554Z10(2) provides for a corresponding proportionate reduction of the relevant part where the value of the relevant step is reduced under new sections 554Z4 to 554Z7.

Supplementary

194. New section 554Z11 (relevant step taken after A’s death etc) deals with who is liable for the tax under Chapter 2 on relevant steps within new sections 554C and 554D (relevant steps: payment of sum, transfer of asset, making asset available etc) taken after the death of the employee.

195. New section 554Z12 (subsequent income tax liability) prevents the possibility of a double tax charge where:

- an event takes place after a relevant step;

- the later event would give rise to an income tax liability (other than under Chapter 2 of new Part 7A or Chapters 2 to 5 of Part 7 or Part 9) of the employee or any other person; and

- it is just and reasonable for new section 554Z12 to apply in order to prevent such a double tax charge.

196. New section 554Z13 permits an application for relief to be made where earmarking is not followed by a further relevant step.

197. New section 554Z13(1) specifies the conditions which must be met if the employee (“A”) or, if A has died, A’s personal representatives are to be able to apply to an officer of Revenue and Customs for relief.

198. Under new section 554Z13(1)(b) and (c), the conditions to be met include:
an event ("the relevant event") occurs which is not a relevant step in relation to "a relevant sum or asset" (defined in new section 554Z13(3)); and

by reason of the relevant event no further step is or will be taken in relation to any "relevant sum or asset".

199. New section 554Z13(2) makes it clear that "the avoidance of tax" in the definition of "tax avoidance arrangement" in new section 554Y includes the avoidance of tax by way of obtaining relief under new section 554Z13.

200. New section 554Z13(4) sets a deadline of four years for applying for the relief.

201. New section 554Z13(5) provides for relief to be given following an application under this section. The condition to be met is that an officer of Revenue and Customs is satisfied that the conditions in new section 554Z13(1) are met. The relief to be given is such relief (if any) as the officer considers just and reasonable in respect of income tax paid on the previously charged amount.

202. New section 554Z14 (location of employment duties) applies provisions relevant to the location of employment duties in sections 38, 39(1) and (2), 40 and 41 of ITEPA, with modifications to sections 38, 40 and 41.

203. Paragraphs 2 to 51 of the Schedule make other amendments to legislation required to give full effect to the provisions of new Part 7A.

Other amendments to ITEPA

204. Paragraphs 2 to 34 are concerned with ITEPA.

205. Paragraphs 3 to 7 make consequential amendments to sections 1, 3, 7, 10 and 13 of ITEPA to reflect the insertion of new Part 7A into that Act. For example, they bring amounts chargeable under new Part 7A within the definitions of "employment income" and "taxable specific income".

206. Paragraph 8 amends section 63 of ITEPA (the benefits code) to reflect the fact that a tax charge under new Part 7A applies instead of a charge under the benefits code in cases where a charge under both could accrue.

207. Paragraph 9 amends section 218 of ITEPA (exclusion of lower-paid employments from benefits code: calculation of earnings rate for tax year). Section 218 is in Chapter 11 of Part 3, which provides that the
certain tax charges under the benefits code do not apply in relation to lower-paid employments if certain conditions are met. Section 217 defines “lower-paid employment” and is reliant on section 218, under which the earnings rate for an employment is calculated. The amendment made by paragraph 9 provides that, in determining the earnings rate for the employment, it is necessary to take account of amounts which count as employment income for a year under new Part 7A.

208. Paragraph 10 amends section 222 of ITEPA (payments treated as earnings: payments by employer on account of tax where deduction not possible) to reflect the amendments made to sections 687A and 710 of that Act.

209. Paragraph 11 sets a signpost in section 227 of ITEPA (scope of exemptions to income tax under Part 4) to new section 554O(1) (which deals with application of the exemptions in Part 4 to new Part 7A).

210. Paragraphs 12 and 13 amend sections 271 and 287 of ITEPA (income tax exemptions: removal benefits and expenses) to reflect new section 554O (exclusions: employment income exemptions under Part 4).

211. Paragraph 14 amends section 394 of ITEPA (employer-financed retirement benefits: charge on benefits received), which establishes the tax charge on benefits provided under an employer-financed retirement benefits scheme, to provide that such a charge arises only to the extent that the benefit exceeds “other relevant income”. “Other relevant income” is defined as:

(a) “general earnings” (within the meaning given by section 7 of ITEPA) of the employee or former employee which are chargeable to income tax,

(b) an amount which counts as employment income of the employee or former employee under Chapter 2 of new Part 7A, or

(c) an amount which would be within paragraph (a) or (b) apart from the employee or former employee having been non-UK resident for any tax year.

212. This provision reduces the amount that would otherwise count as employment income under section 394(1) of ITEPA when some or all of the value of a relevant step taken under an employer-financed retirement benefit scheme is (i) “for” a tax year when A is resident outside the UK and (ii) in respect of duties performed outside the UK.
213. Paragraph 14 also amends section 394(5) of ITEPA to make it clear that section 394 does not prevent a tax charge arising in relation to a benefit either under Chapter 1 of Part 3 (general earnings) or under new Part 7A.

214. Paragraph 15 amends section 428 of ITEPA (restricted employer-related securities: amount of charge). Section 428(1) reduces, by amount CE, the taxable amount for the purposes of section 426 (restricted employer-related securities: charge on occurrence of chargeable event). Section 428(6) defines CE as comprising certain expenses incurred by the holder of the employment-related securities. Paragraph 15 inserts new section 428(6A), which provides that CE also includes any amount that has counted as employment income of the employee in respect of the employment under Chapter 2 of new Part 7A in relation to the employment-related securities, where the relevant step was taken before the chargeable event occurred.

215. Paragraph 16 inserts new paragraph (e) in section 431(3) of ITEPA (restricted employer-related securities: election for disapplication of Chapter 2 of Part 7). New paragraph (e) adds Chapter 2 of new Part 7A to the list of the relevant tax purposes for which an election under section 431 is to apply.

216. Paragraph 17 inserts new wording into section 437(1)(a) of ITEPA (convertible employer-related securities: market value) to add Chapter 2 of new Part 7A to the list of purposes for which the value of employment-related convertible securities is to be determined as if they were not convertible securities.

217. Paragraph 18 inserts new subsections (10) and (11) into section 441(9) of ITEPA (convertible employer-related securities: amount of gain realised). New section 441(10) provides that new section 441(11) applies if:

- before their acquisition, employment-related securities were the subject of a relevant step to which Chapter 2 of new Part 7A applied; and

- the amount mentioned in new section 441(11)(a) is higher than the amount mentioned in new section 441(11)(b).

218. New section 441(11) allows a reduction from the gain calculated under section 441 equal to the difference between the amount that counted as employment income of the employee in respect of the employment under Chapter 2 of new Part 7A (new section 441(11)(a)) and the market value of the employment-related securities without conversion rights at the time of the relevant step.
219. Paragraph 19 inserts a new paragraph (f) into section 446B(4) of ITEPA (employment-related securities with artificially depressed market value: charge on acquisition). New paragraph (f) adds Chapter 2 of new Part 7A to the list of tax liabilities which are not affected by section 446B.

220. Paragraph 20 inserts new subsections (4A) and (4B) into section 446C of ITEPA (employment-related securities with artificially depressed market value: amount of charge). New section 446C(4A) provides that new section 446C(4B) will apply if the employment-related securities were the subject of a relevant step before acquisition, and Chapter 2 applied by reason of that step. New section 446C(4B) provides that, if what would be the market value in accordance with section 446C(3) or (4) is lower than the amount that counted as employment income of the employee under Chapter 2 of new Part 7A, then market value should be used as the latter amount for section 446C.

221. Paragraph 21 inserts a new subsection (4) into section 446S of ITEPA (employment-related securities acquired for less than market value: notional loan), providing that that section is not affected by new section 554Z1(2).

222. Paragraph 22 inserts a new paragraph (f) into section 446T(3) (employment-related securities acquired for less than market value: amount of notional loan). Under that provision, if an amount has counted as employment income of the employee under Chapter 2 of new Part 7A in relation to employment-related securities, it is a deductible amount in calculating the notional loan for the purposes of section 446T.

223. Paragraph 23 inserts a new subsection (f) into section 446V of ITEPA (employment-related securities acquired for less than market value: charges under Chapter 3C of Part 4 to be additional to other charges). That provision adds Chapter 2 of new Part 7A to the list of tax liabilities which are not affected by a charge calculated under Chapter 3C.

224. Paragraph 24 inserts a new subsection (e) into section 452(2) of ITEPA (shares in research spin-out companies: market value on acquisition). That provision adds determining any amount that counts as employment income under Chapter 2 of new Part 7A to the list of relevant tax purposes for which the market value of the shares is to be calculated disregarding the effect on that market value of the intellectual property agreement.
225. Paragraph 25 inserts a **new subsection (d)** into section 480(5) of ITEPA (employment-related securities options: deductible amounts). Under that provision, if an amount has counted as employment income of the employee under Chapter 2 of Part 7A in relation to the employment-related securities option, it is a deductible amount for the purposes of section 478 of ITEPA.

226. Paragraph 26 includes **new section 567A** of ITEPA in the list, in section 567(5) of that Act, of deductions allowed from the amount of pension income charged to tax under Part 9 of that Act.

227. Paragraph 27 inserts **new section 567A** of ITEPA (cases in which Part 7A has applied to source of pension income).

228. New section 567A(1) provides that the section will apply if, broadly speaking, there is an amount of taxable pension income (“amount TPI”) flowing from rights which have already attracted a charge under Chapter 2 of new Part 7A.

229. New section 567A(2) allows a deduction from amount TPI. New section 567A(3) quantifies the deduction: it is the amount (“amount EI”) which counted as the employee’s employment income under Chapter 2.

230. New section 567A(4) allows surplus amount EI to be carried forward and deducted in future tax years.

231. New section 567A(5) and (6) provide for just and reasonable determinations to be made where part only of the sums and assets used to provide the pension flows from rights which have already attracted a charge under Chapter 2 of new Part 7A. In such a case, new section 567A(5) and (6) provide that only the corresponding amount of employment income previously charged to tax under Chapter 2 is deducted from amount TPI under new section 567A(2) and (3).

232. Paragraph 28 inserts a **new subsection (5)** into section 687 of ITEPA (PAYE: payments by intermediary). New section 687(5) provides that the section does not apply to the extent that a sum paid is employment income under Chapter 2 of new Part 7A.

233. Paragraph 29 inserts **new section 687A** of ITEPA (PAYE: payment of employment income under Part 7A). New section 687A provides that, where the subject of a relevant step which counts as employment income under new Part 7A is a sum of money, the employer of the employee is treated as making a payment of PAYE income for the purposes of PAYE regulations. As a result, the employer is responsible for operating PAYE rather than the relevant third person which took the relevant step. This will not apply, however, where the
relevant third person does in fact apply PAYE to the payment (new section 687A(4)). New section 687A(3) contains rules on when a payment is treated as made under new Part 7A for the purposes of PAYE and provides in particular that, where a relevant step is taken in relation to a prospective employee, the payment is to be treated as made on the first day of the employee’s employment.

234. Paragraph 30 amends section 689 of ITEPA (PAYE: employee of non-UK employer), which makes provision for the operation of PAYE where:

- an employee of a non-UK employer works for another person in the UK (“the relevant person”);
- the employee is paid by a person (“X”) other than the relevant person, such as their employer or an intermediary of their employer; and
- X is not under an obligation to operate PAYE.

235. In cases within section 689 of ITEPA, the obligation to operate PAYE falls on the relevant person. Paragraph 30 amends section 689 so that it applies to payments chargeable to tax under new Part 7A.

236. Paragraph 31 inserts new section 695A of ITEPA (PAYE: employment income under Part 7A). This deals with the value and timing for PAYE purposes of relevant steps that are not the payment of a sum of money and, similarly to new section 687A, requires the employer to operate PAYE unless the relevant third person which took the relevant step does so.

237. Paragraph 32 amends section 696 of ITEPA (PAYE: readily convertible assets) to provide that the section does not apply where the readily convertible asset is the subject of a relevant step (in which case new section 695A applies).

238. Paragraph 33 amends section 710 of ITEPA (PAYE: accounting for tax on notional payments). Section 710 requires employers to deduct PAYE in respect of notional payments from any payments that the employer actually makes. If the employer does not make actual payments which are sufficiently large to deduct PAYE from, the employer must account to HM Revenue & Customs for the tax which the employer is required, but unable, to deduct. Paragraph 33 adds payments dealt with by new section 687A to the list of payments which are notional payments. The amendment made by paragraph 10 is consequential to this. Section 222 of ITEPA (payments by employer on account of tax where deduction not possible) provides that any amount accounted for by an employer under section 710 is to
be treated as earnings from the employee’s employment for the purposes of income tax unless the employee makes good to the employer the amount accounted for. Paragraph 10 amends section 222 to reflect the addition of amounts dealt with by new section 687A to the list of notional payments.

239. Paragraph 34 amends section 716A of ITEPA (priority rule in relation to certain dividend income) to reflect the fact that a tax charge under new Part 7A applies instead of a charge under Chapter 3 of Part 4 of ITTOIA in cases where a tax charge under both could accrue.

Amendments to ITTOIA

240. Paragraphs 35 to 39 are concerned with ITTOIA.

241. Paragraphs 36 to 39 are concerned with Chapter 4 of Part 2 of ITTOIA, which contains rules restricting deductions from trade profits for the purposes of income tax. Sections 38 to 44 of ITTOIA deal with employee benefit contributions. Paragraphs 36 to 39 amend those rules to deal with the interactions with new Part 7A of ITEPA. In particular, paragraph 36 inserts new section 39(4) to provide that a relevant arrangement (or an arrangement connected to a relevant arrangement) under new Part 7A of ITEPA is an employee benefit scheme for the purposes of determining whether something is an employee benefit contribution; and paragraph 37(3) inserts new section 40(6A) to provide that qualifying benefits are provided by an employee benefit scheme if a relevant step is taken which gives rise to a tax charge under Chapter 2 of new Part 7A of ITEPA.

242. Paragraph 37(2) makes an additional amendment to section 40(5) of ITTOIA to make it clear that a payment or transfer under an employer-financed retirement benefits scheme only amounts to the provision of qualifying benefits if the payment or transfer gives rise to a tax charge under Chapter 2 of Part 6, or Part 9, of ITEPA, or is an excluded benefit under section 393B(3) of that Act.

243. Paragraph 38 makes various amendments to section 41 of ITTOIA to deal with the timing and amount of deductions that apply in relation to a qualifying benefit that consists of a relevant step.

Amendments to ITA

244. Paragraphs 40 to 43 are consequential on new sections 554Z8 to 554Z10. They make amendments to Chapter A1 of Part 14 of ITA, which provides for the remittance basis of the charge to income tax, to add necessary references to new Part 7A of ITEPA.
Amendments to the Corporation Tax Act (CTA) 2009

245. Paragraphs 44 to 48 are concerned with Chapter 1 of Part 20 of CTA 2009, which contains rules restricting deductions from income for the purposes of corporation tax. The amendments are equivalent to those made to ITTOIA by paragraphs 36 to 39 in relation to deductions from trade profits for income tax purposes.

Other amendments

246. Paragraph 49 amends the Taxation of Chargeable Gains Act 1992 (TCGA). Paragraph 49(2) amends section 119A of TCGA (increase in expenditure by reference to tax charged in relation to employment-related securities). The amendment applies where an amount counting as income under section 476 of ITEPA by virtue of the acquisition of securities pursuant to an employment-related securities option is reduced by an amount taxed under new Part 7A (by virtue of new subsection 480(5)(d) of ITEPA). The amendment ensures that the amount of the reduction is added back in calculating the enhancement expenditure under section 119A of TCGA.

247. Paragraph 49(3) inserts new section 119C of TCGA (section 119A: unremitted Part 7A income), which applies in a similar manner to section 119B of that Act (section 119A: unremitted foreign securities income) by ensuring that, where the remittance basis of taxation applies, the amount added back under section 119A excludes any part which has not been remitted to the United Kingdom.

248. Paragraph 50 extends the definition of “the employment income Parts of ITEPA 2003” in section 122(1) of the Social Security Contributions and Benefits Act 1992 and section 121(1) of the Social Security Contributions and Benefits Act (Northern Ireland) 1992 to include new Part 7A.

249. Paragraph 51 extends the regulation-making power in paragraph 3(6) of Schedule 34 to FA 2004 (non-UK pension schemes) to include provision in consequence of new Part 7A.

Commencement and transitional provision relating to Part 7A of ITEPA

250. Paragraph 52 provides that new Part 7A (as inserted by paragraph 1) has effect in relation to relevant steps which are taken on or after 6 April 2011; and the other amendments made by the Schedule have effect accordingly. Paragraph 52(2) makes paragraph 52(1) subject to paragraphs 53 onwards.

251. Paragraphs 53 and 54 contain anti-forestalling provisions which apply to certain relevant steps (“early steps”) which occur on or after 9 December 2010 but before 6 April 2011.
252. Paragraph 53 applies if:

- a relevant step within new section 554C(1)(a) (which relates to the payment of sums of money) is taken on or after 9 December 2010 but before 6 April 2011 – this step is labelled “the early step”;

- the early step would have been subject to the provisions in Chapter 2 of new Part 7A if the reference to 6 April 2011 in paragraph 47 had been a reference to 9 December 2010; and

- the early step is not chargeable to tax by virtue of Schedule 34 to FA 2004 (in whole or in part).

253. Paragraph 53(2) applies Chapter 2 of new Part 7A by reason of the early step and provides that the amendments made by the Schedule have effect accordingly.

254. Paragraph 53(3) provides for the early step to be treated as having been taken on 6 April 2012 in determining the tax year for which the relevant step counts as employment income of the employee (“A”) for the purposes of new section 554Z1(1). Paragraph 53(8) contains equivalent provision for the purposes of PAYE. Paragraph 53(3) also provides that, for all other purposes, the early step is treated as taken when it is actually taken.

255. Paragraph 53(4) permits arrangements caught by the anti-forestalling provision to be unwound. If the person to whom the payment was made (“Q”) repays to the person taking the early step any amount of the sum of money which was the subject of that step, then that amount is deducted from the amount counting as employment income of A by virtue of paragraph 53. Accordingly, a tax charge will not arise under Chapter 2 of new Part 7A in relation to an early step if Q repays in full before 6 April 2012 the sum which is the subject of the early step. Paragraph 53(4) also (a) provides for the making of any adjustments that need to be made to any assessment to tax because a repayment before 6 April 2012 has reduced the amount that counts as employment income in respect of an early step and (b) reinstates the effect of the Tax Acts as appropriate as if Chapter 2 of Part 7A has never applied in relation to the value of the early step.

256. Paragraph 53(5) makes further provision for the amount of any reduction under paragraph 53(4); and paragraph 53(6) provides that the overlap provisions in new section 554Z4 do not apply in relation to the early step and that in applying that section to any other relevant step (whenever taken) the early step is to be ignored.
257. Paragraph 53(9) and (10) makes provision dealing with the availability of business tax deductions in relation to early steps.

258. Paragraph 54(1) provides that paragraph 54 applies where the subject of the early step is a readily convertible asset which is made available on or after 9 December 2010 but before 6 April 2011 to be used to secure a payment of a sum of money. Further requirements for the application of paragraph 54 are set out in paragraph 54(1)(d) and (e).

259. Paragraph 54(3) defines the term “readily convertible asset” for the purposes of paragraph 54.

260. Paragraph 54(4) applies Chapter 2 of new Part 7A by reason of the early step and provides that the amendments made by this Schedule have effect accordingly.

261. Paragraph 54(5) provides for the early step to be treated as having been taken on 6 April 2012 in determining the tax year for which the relevant step counts as employment income of the employee (“A”) for the purposes of new section 554Z1(1). Paragraph 54(10) contains equivalent provision for the purposes of PAYE. Paragraph 54(5) also provides that, for all other purposes, the early step is treated as taken when it is actually taken.

262. Paragraph 54(6) provides for the amount which would otherwise count as employment income of the employee to be reduced to nil if the asset which is the subject of the early step is returned to the person who took the step before 6 April 2012 and the asset is no longer being used as security on that date. It also contains provisions equivalent to those in paragraph 53(4).

263. Paragraph 54(7) provides that the overlap provisions in new section 554Z4 do not apply in relation to the early step and that in applying that section to any other relevant step (whenever taken) the early step is to be ignored. Paragraph 54(8) and (9) deals with the application of new sections 554Z7 and 554Z11 in relation to early steps. Paragraph 54(11) and (12) contain equivalent provision to paragraph 53(9) and (10).

264. Paragraph 55 modifies the operation of new sections 554G, 554M and 554N in their application to the early step.

265. Paragraph 56 extends new section 554P (exclusions: income arising from earmarked sum or asset) to cover income arising from sums and assets that were earmarked before 6 April 2011. Paragraph 57 makes a similar extension to new section 554Q (exclusions: acquisitions out of earmarked sums or assets).
266. Paragraph 58 allows relief in cases where sums or assets earmarked before 6 April 2011 gave rise to earnings within section 62 of ITEPA on which the tax has been settled.

267. Paragraph 58(1) sets the conditions for relief to be given – broadly speaking, the paragraph applies if:

- a relevant step (“the chargeable step”) is taken within new section 554C or 554D (relevant steps: payment of sum, transfer of asset, making asset available etc) which gives rise to a Chapter 2 charge;

- a relevant step (“the pre-6 April 2011 step”) was taken within new section 554B (relevant steps: earmarking etc of sum of money or asset) before 6 April 2011 which would have given rise to a Chapter 2 charge if it had been taken after 5 April 2011; and

- the employer, the employee or both have agreed with HM Revenue & Customs that the pre-6 April 2011 step gave rise to taxable “earnings” within Chapter 1 of Part 3 of ITEPA for the tax year in which that step was taken; and

- tax has been settled on these earnings.

268. Paragraph 58(2) is the operative provision. It treats new section 554Z4 (overlap with earlier relevant step) as applying to the chargeable step as if the pre-6 April 2011 step had given rise to a Chapter 2 charge.

Other commencement provision

269. Paragraphs 59 to 62 make commencement provision.

Power to make provision dealing with interactions etc

270. Paragraph 63 enables the Treasury to make provision dealing with the interaction between (a) new Part 7A and (b) any other provision of the Tax Acts or any enactment relating to capital gains tax or inheritance tax.

BACKGROUND NOTE

271. The June 2010 Budget announced that legislation would be introduced from April 2011 to tackle arrangements using trusts and other vehicles to reward employees which seek to avoid, defer or reduce tax liabilities.
272. The Government also confirmed that the scope of the legislation would include employer financed retirement benefit schemes, in order to protect revenues and in keeping with the restriction of pensions tax relief through the reduced annual and lifetime allowances announced on 14 October 2010. These restrictions on pensions tax relief are included separately in Schedules 17 and 18.
EXPLANATORY NOTE

CLAUSE 27: TAINTED CHARITY DONATIONS

SUMMARY

1. Clause 27 introduces Schedule 3 which brings in a new anti-avoidance rule to prevent the abuse of the tax reliefs available to donors to charity with effect from 1 April 2011. The rule ensures that the usual tax reliefs are not available where donors enter into arrangements to obtain a financial advantage from the charity (or someone else involved in the arrangement) in return for their donation. The Schedule disapplies some (but not all) of the rules in respect of substantial donors to charity transactions at sections 549 to 557 of the Income Tax Act 2007 (ITA) and sections 502 to 510 of the Corporation Tax Act (CTA) 2010 up to and including 31 March 2013. After that date the substantial donors to charity legislation is largely repealed.

DETAILS OF THE SCHEDULE

2. The Schedule consists of five parts: Parts 1, 2 and 3 of the Schedule apply the new rule to donations made by persons who would otherwise be entitled to income tax reliefs, corporation tax reliefs or capital gains tax reliefs respectively on their donation to a charity. Part 4 details the consequential amendments to be made including the repeal of the substantial donors to charity legislation. Part 5 details sets out when the new rule starts and includes transitional provisions.

3. Paragraph 1 inserts new Chapter 8 in Part 13 of ITA.

4. New section 809ZH introduces new Chapter 8 which applies the new rule to donations made by persons who would otherwise be entitled to income tax reliefs. New section 809ZH(2) refers the reader to the relevant sections in the Taxation of Chargeable Gains Act 1992 (TCGA) and CTA 2010 where this new rule appears (see Parts 2 and 3 of this Schedule).

5. New section 809ZI sets out a number of definitions of terms used later in Chapter 8.

6. New sections 809ZI(1) and (2) define a “relievable charity donation” to which the new rule applies. New section 809ZI(3) specifies the scope of the new rule. New section 809ZI(4) sets out the list of relieving provisions to which the new rule applies. New section 809ZI(5) extends the scope of the new rule to income arising under a UK settlement.
7. New section 809ZJ introduces the definition of a “tainted donation”. A relievable charity donation will be a tainted donation where it satisfies all three of the following conditions:

- Condition A – the donor or a person connected with the donor enters into arrangements, and it is reasonable to assume that the donations and the arrangements would not have been made or entered into independently of each other. New section 809ZJ(4) sets out the time periods during which the test considers a person’s connection to the donor;

- Condition B – the donor or a person connected with the donor enters into the arrangements with the main purpose (or one of the main purposes) of obtaining a financial advantage directly or indirectly from the charity that received the donation (or a connected charity) for the donor or a person connected with the donor. Such a person is referred to as a “potentially advantaged person”; and

- Condition C – the donor is not a qualifying company that is wholly-owned by a charity (or charities) or a relevant housing provider linked with the charity to which the donation is made. The condition means that wholly-owned trading companies of charities, which generally donate their profits to their parent charity each year, and relevant housing providers that often donate to linked charities within a housing group, will not be caught by the new rule.

8. New section 809ZJ(7) defines the terms under which a relevant housing provider is linked with a charity.

9. New section 809ZJ(8) defines a qualifying company and ensures that a donor or a connected person cannot take themselves outside the scope of Condition C by transferring to a charity a trade or business that the donor or a connected person carried on. This subsection also defines a relevant housing provider.

10. New section 809ZJ(9) defines a company that is wholly owned by a charity and extends this definition to include Community Amateur Sports Clubs (CASCs).

11. New section 809ZJ(10) disappplies the new rule where the financial advantage is one listed at new section 809ZL. Generally these financial advantages are those where the advantage received is accounted for under existing legislation. For example where a donor, in respect of a donation of money made under the Gift Aid scheme, obtains a financial advantage from a charity that is within the values defined by the Gift Aid benefit rules in Chapter 2 of Part 8 of ITA or Chapter 2 of Part 6 of CTA 2010, the financial advantage is ignored.
12. **New section 809ZK** expands on the concept of a “financial advantage” in Condition B of new section 809ZJ. This section describes certain circumstances in which a financial advantage is deemed to arise, but it does not replace the test in Condition B which seeks to determine whether obtaining the financial advantage is the main purpose (or one of the main purposes) of entering the arrangement.

13. **New sections 809ZK(2) and (3)** apply a test where a donor or a person connected with the donor (Person “X”) enters into arrangements which include a transaction to which they and another person (Person “Y”) are parties. Person Y may be the charity or any other person that is part of the arrangement and provides the financial advantage to Person X in connection with the donation to the charity, whether an individual or a corporate entity. The test compares what each of the parties gets from the transaction with what they would be prepared to agree if the transaction were at arm’s length. If Person X receives more than would be expected from an arm’s length transaction, or Person Y receives less, or the transaction would not have happened at all, then Person X will have obtained a financial advantage from a charity.

14. **New section 809ZK(4)** makes it clear that the circumstances described in new sections 809ZK(2) and (3) are not an exhaustive definition of a financial advantage for the purposes of Condition B.

15. **New section 809ZK(5)** provides examples of the types of transaction to which this section applies. The list is not exhaustive.

16. **New section 809ZL(1)** specifies situations in which certain financial advantages are to be ignored. These are where:

   - a person who receives a financial advantage applies it for charitable purposes only;

   - the financial advantage received on a donation under Gift Aid is within the limits set by Chapter 2 of Part 8 of ITA or Chapter 2 of Part 6 of CTA 2010. This ensures that the Gift Aid benefit rules continue to apply, and take priority over, the new rule in respect of donations of money made under the Gift Aid scheme;

   - the benefits are already taken into account in computing the relief due on gifts of shares, securities and real property to charities etc or for gifts of trading stock.

17. **New section 809ZM** disallows income tax relief which would have been available on the donation if the new anti-avoidance rule did not apply. Where more than one donation forms part of the arrangement, none of the donations, referred to as “associated donations”, will be
eligible for tax reliefs regardless of whether these other donations are “tainted” in their own right.

18. **New section 809ZM(4)** defines a number of terms. In particular, a donation made by a qualifying charity-owned company, or relevant housing provider linked with the charity to which the donation is made, is not an “associated donation”. This means that the new anti-avoidance rule does not affect subsidiaries of charities that make donations to the parent charity, for example trading subsidiaries that gift their profits to the parent charity.

19. **New sections 809ZM(5) to (8)** ensure that, even where income tax relief is not available as a result of this section, the donation remains a qualifying donation in the hands of the charity for the purposes of the tax reliefs defined in these subsections. For example, a charity may still claim a repayment of tax if the donation was made under the Gift Aid scheme and the donor must still have paid sufficient income tax or capital gains tax to cover the Gift Aid repayment to the charity. If they have not paid enough tax to cover the donation then HM Revenue & Customs (HMRC) may recover the tax paid to the charity from the donor. A tainted donation would not be a qualifying donation in the hands of an individual donor for the purposes of computing their adjusted net income.

20. **New section 809ZN** provides for a new tax charge to apply where a donor has made a tainted donation which would otherwise have been a qualifying donation for Gift Aid.

21. The tax charge is equal to the value of the Gift Aid repayment that the charity can claim in respect of the donation, whether the charity made such a claim or not. **New section 809ZN(4)** provides a list of people on whom the tax charge will fall, which includes the donor and the charity receiving the donation.

22. However, **new section 809ZN(5)** ensures that a charity can only become liable to the new tax charge if it was a party to the relevant arrangements and the charity knew, at the time it entered into those arrangements, that they were arrangements for the donor or a person connected with the donor to obtain an advantage directly or indirectly from the charity.

23. **New section 809ZN(6)** ensures that a double charge to tax in respect of a tainted donation cannot arise. It disapplies the new tax charge where the repayment resulting from the tainted donation is made to HMRC under any other provision of the Tax Acts.

24. **New section 809ZO** mirrors new section 809ZN by providing for a new tax charge to apply where a tainted donation has been made through a trust. The people on whom the tax charge may fall includes the settlor of a settlor-interested trust and any beneficiary of the
settlement (whether or not the settlement is settlor-interested) who is party to the arrangements.

25. **New section 809ZP** defines a “connected charity” for the purposes of the tests contained in new section 809ZJ. Arrangements that rely upon a number of donations to connected charities are caught by the new rule.

26. **New section 809ZQ** defines a connected person for the purpose of the new rule relying principally on the existing definition in section 993 ITA with some updating in line with new anti-avoidance legislation.

27. New section 809ZR provides further minor definitions and extends the new rule to community amateur sports clubs (CASCs) within the meaning of section 658(6) of CTA 2010.


29. **New section 939A** introduces new Part 21C of CTA 2010 which applies the new rule to donations made by persons who would otherwise be entitled to corporation tax reliefs. **New section 939A(2)** refers the reader to the relevant sections in ITA and TCGA where this new rule appears (see Parts 1 and 3 of this Schedule).

30. **New section 939B** sets out a number of definitions of terms used later in Part 21C of CTA 2010. **New sections 939B(1) and (2)** define a “relievable charity donation” to which the new rule applies.

31. **New section 939B(3)** specifies the scope of the new rule.

32. **New section 939B(4)** sets out the list of relieving provisions to which the new rule applies.

33. **New section 939B(5)** extends the scope of the new rule to income arising under a UK settlement.

34. **New section 939C** introduces the definition of a “tainted donation”. A relievable charity donation will be a tainted donation where it satisfies all three of the following conditions:

- **Condition A** – the donor or a person connected with the donor enters into arrangements, and it is reasonable to assume that the donations and the arrangements would not have been made or entered into independently of each other. **New section 939C(4)** sets out the time periods during which the test considers a person’s connection to the donor;
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- Condition B – the donor or a person connected with the donor enters into the arrangements with the main purpose (or one of the main purposes) of obtaining a financial advantage directly or indirectly from the charity that received the donation (or a connected charity) for the donor or a person connected with the donor. Such a person is referred to as a “potentially advantaged person”; and

- Condition C – the donor is not a qualifying company that is wholly-owned by a charity (or charities) or a relevant housing provider linked with the charity to which the donation is made. The condition means that wholly-owned trading companies of charities, which generally donate their profits to their parent charity each year, and relevant housing providers that often donate to linked charities within a housing group will not be caught by the new rule.

35. New section 939C(7) defines the terms under which a relevant housing provider is linked with a charity. New section 939C(8) defines a qualifying company and ensures that a donor or a connected person cannot take themselves outside the scope of Condition C by transferring to a charity a trade or business that the donor or a person connected with the donor carried on. This subsection also defines a relevant housing provider. New section 939C(9) defines a company that is wholly owned by a charity and extends this definition to include CASCs.

36. New section 939C(10) disapplies the new rule where the financial advantage is one listed at new section 939E. Generally these financial advantages are those where the advantage received is accounted for under existing legislation. For example, where a donor, in respect of a donation of money made under the Gift Aid scheme, obtains a financial advantage from a charity that is within the values defined by the Gift Aid benefit rules in Chapter 2 of Part 8 of ITA or Chapter 2 of Part 6 of CTA 2010, the financial advantage is ignored.

37. New section 939D expands on the concept of a “financial advantage” in Condition B at new section 939C. This section describes certain circumstances in which a financial advantage is deemed to arise, but it does not replace the test in Condition B which seeks to determine whether obtaining the financial advantage is the main purpose (or one of the main purposes) of entering the arrangement.

38. New sections 939D(2) and (3) apply a test where a donor or a person connected with the donor (Person “X”) enters into arrangements which include a transaction to which they and another person (Person “Y”) are parties. Person Y may be the charity or any other person that is part of the arrangement and provides the financial advantage to Person X in connection with the donation to the charity, whether an
individual or a corporate entity. The test compares what each of the parties gets from the transaction with what they would be prepared to agree if the transaction were at arm’s length. If Person X receives more than would be expected from an arm’s length transaction, or Person Y receives less, or the transaction would not have happened at all, then Person X will have obtained a financial advantage from a charity.

39. **New section 939D(4)** makes it clear that the circumstances described in new sections 939D(2) and (3) are not an exhaustive definition of a financial advantage for the purposes of Condition B.

40. **New section 939D(5)** provides examples of the types of transaction to which this section applies. The list is not exhaustive.

41. **New section 939E(1)** specifies situations in which certain financial advantages are to be ignored. These are where:

- a person who receives a financial advantage applies it for charitable purposes only;

- the financial advantage received on a donation under Gift Aid is within the limits set by Chapter 2 of Part 8 of ITA or Chapter 2 of Part 6 of CTA 2010. This ensures that the Gift Aid benefit rules continue to apply, and take priority over, the new rule in respect of donations of money made under the Gift Aid scheme;

- the benefits are already taken into account in computing the relief due on gifts of shares, securities and real property to charities etc or for gifts of trading stock...

42. **New section 939F** disallows corporation tax relief which would have been available on a donation if the new anti-avoidance rule did not apply. Where more than one donation forms part of the arrangement, none of the donations, referred to as “associated donations”, will be eligible for tax reliefs regardless of whether these other donations are “tainted” in their own right.

43. **New section 939F(4)** defines a number of terms. In particular, a donation made by a qualifying charity-owned company, or relevant housing provider linked with the charity to which the donation is made, is not an “associated donation”. This means that the new anti-avoidance rule does not affect subsidiaries of charities that make donations to the parent charity, for example trading subsidiaries that gift their profits to the parent charity.

44. **New section 939G** defines a “connected charity” for the purposes of the tests contained in new section 939C. Arrangements that rely upon
a number of donations to connected charities are caught by the new rules.

45. **New section 939H** defines a connected person for the purpose of the new rule, relying principally on the existing definition at section 1122 CTA 2010 with some updating in line with new anti avoidance legislation.

46. **New section 939I** provides further minor definitions and extends the new rule to CASCs within the meaning of section 658(6) of CTA 2010.

47. **Paragraph 3 of the Schedule inserts new section 257A into TCGA.**

48. **New section 257A** applies the new rule to chargeable gains by removing the relief available on the disposal of chargeable assets to a charity in section 257 where the donation, or any associated donation, is a tainted donation.

49. **Paragraphs 4 to 12 and 14 to 22 of the Schedule make a number of consequential amendments to various provisions of the Taxes Acts to ensure relief is denied where Parts 1, 2 or 3 of this Schedule applies.**

50. **Paragraphs 13 and 23 of the Schedule repeal the existing substantial donors to charity legislation in respect of charitable trusts and charitable companies respectively. The repeals will take effect from the dates as specified in paragraph 27.**

51. **Paragraphs 24 to 26 of the Schedule make a number of further consequential amendments to the Corporation Tax Act 2010.**

52. **Paragraph 27 of the Schedule specifies that the provisions in the Schedule take effect in respect of donations made on or after 1 April 2011.**

53. **Paragraph 27(2) provides for repeal of the existing substantial donors legislation from April 2013. Paragraph 27(3) ensures that contractual obligations entered into before 1 April 2013 continue to be caught by the substantial donors to charity legislation. Otherwise such transactions would escape the scope of both the existing and the new rules where a donation was made before 1 April 2011 but payment deferred until on or after that date. However where such a contract is varied on or after 1 April 2013 the substantial donors rule will not apply therefore bringing an end to the existing rules.**

54. **Paragraph 28 targets the new rule at arrangements which may have been made before 1 April 2011. The effect of this is that the new rules may determine that a donation made on or after 1 April 2011 is tainted, even where the arrangements whose main purpose, or one of
whose main purposes, is to obtain a financial advantage from the charity, were made before 1 April 2011.

55. **Paragraph 29(1)** brings to an end the concept of any new “substantial donors” for the purposes of the substantial donors to charity legislation in respect of donations made to a charitable trust on or after 1 April 2011.

56. **Paragraphs 29(2) to 29(6)** introduce a transitional provision which disapplies the substantial donors legislation in certain circumstances. Where the conditions are met, a payment by a charitable trust made on or after 1 April 2011 to one of its existing substantial donors that would otherwise be caught under the substantial donor rule, will no longer be treated as non-charitable expenditure.

57. Where a transaction takes place between a substantial donor and a charity that would normally be caught under the substantial donors to charity legislation, no tax charge will arise where it is reasonable to assume that the donations and transactions were independent of each other. The effect of this provision is to leave within the charge to tax under the substantial donor provisions only those transactions where the donation and substantial donor transaction are part of the same arrangement.

58. **Paragraph 30** replicates for charitable companies the transitional provisions contained in **Paragraph 29** for charitable trusts. **Paragraph 30(1)** brings to an end the concept of any new “substantial donors” for the purposes of the substantial donors to charity legislation in respect of donations made to a charitable company on or after 1 April 2011.

59. **Paragraphs 30(2) to 30(6)** introduce a transitional provision which disapplies the substantial donors to charity legislation in certain circumstances. Where the conditions are met, a payment by a charitable company made on or after 1 April 2011 to one of its existing substantial donors that would otherwise be caught under the substantial donor rule, will no longer be treated as non-charitable expenditure.

60. **Paragraph 31** ensures that references to a “relevant housing provider” in Scotland remain valid following introduction of the Housing (Scotland) Act 2010, which has yet to come into force.

**BACKGROUND NOTE**

61. The changes made by Schedule 3 replace large parts of the “transactions with substantial donors” legislation in respect of donations made on or after 1 April 2011, and repeals that legislation
from 1 April 2013 (with some exceptions). The new rule is based on a purpose test which considers the reason why the donor or someone connected with the donor entered into arrangements with a charity, and to what extent those arrangements were to obtain a financial advantage from a charity.

62. Only those donors who enter into arrangements to obtain a financial advantage from a charity need to consider whether the new rule applies to their donation. This purpose test, combined with the preservation of the Gift Aid benefit rules in respect of donations of money made under the Gift Aid scheme, will ensure that the vast majority of donors do not need to consider these new rules. Similarly, where any benefit has been taken into account in calculating the relief due for donations to charity of shares, securities and real property, or trading stock, the new rules provided by this schedule do not need to be considered.

63. The new anti-avoidance rule introduces the concept of a “tainted charity donation”. Three Conditions, A, B and C, must be met for a donation to be a tainted charity donation. Where the conditions are satisfied, the donor loses any tax relief that they would have been entitled to claim, had the donation not been tainted. An additional charge to tax may also arise where the donation would have been eligible for relief under the Gift Aid scheme (for individual donors only).

64. Condition A is that a donation and arrangements entered into between the donor and another party in respect of the donation, are connected to each other. If a donation is made and there are no arrangements in place, or any arrangements that are entered into are unconnected to the donation, that donation will not satisfy Condition A and therefore will not be a tainted charity donation. If however the donor and another person do enter into an arrangement and there is a connection between the donation and the terms of the arrangement, the donor will need to consider Condition B.

65. Condition B examines the donor’s purpose in entering into the arrangement that is within Condition A. If the main purpose, or one of the main purposes of the arrangement, is for the donor (or someone connected to the donor) to receive a financial advantage directly or indirectly from the charity the donation is caught by Condition B. If Condition B is satisfied, the donor will need to consider Condition C.

66. Condition C excludes donations from “qualifying charity-owned companies” and “relevant housing providers” (who make donations to linked charities) from being treated as tainted donations even where they could otherwise be caught by conditions A and B. For the purposes of qualifying charity owned companies, this condition is restricted and does not apply where a person who stands to obtain a
financial advantage from the arrangement was previously in control of the charity owned company at the relevant time.

Example 1

A conservation charity offers donors who make donations of £5,000 or more a special membership package called gold membership, which entitles the member to a benefits package consisting of an opportunity to attend an event at which an ‘expert’ will talk about conservation issues, plus 12 monthly newsletters and a charity branded mug.

In this example the donation will not be caught by the new tainted charity donation legislation. The donation of £5,000 and the receipt of a benefits package as a result may be arrangements caught by Condition A of the new legislation. If the circumstances are such as to suggest the donation would have been made without the benefits package, Condition A will not apply. However, these packages are designed to incentivise the donor to make a larger donation and, if the donation was made in order to obtain the benefits package, Condition A of the new legislation would apply. It would then be necessary to consider if the donor receives a financial advantage from the arrangement (Condition B). The legislation gives examples of circumstances in which a financial advantage can arise; however a financial advantage is ignored if it falls within the Gift Aid benefit limits. In this example, it is extremely likely that the value of the financial advantage will fall within those limits (as the packages are normally designed with the Gift Aid benefit limits in mind). If, of course, the sort of expert advice received as part of the benefits package could not be received by a person without making a donation of £5,000 the donation would not be a tax relievable donation in the first place and merely a payment for services from the conservation charity.

Example 2

A donor donates £100,000 to a hospital (a charity) in recognition of the excellent treatment received by his son during his stay. The hospital subsequently writes to thank the donor for the unexpected donation.

In this example the donation will not be caught by the new tainted donation legislation. There was no arrangement in place for the hospital to provide any services in connection with the donation, so Condition A of the new legislation does not apply. Even if his son (or any other person connected to the donor) were to receive further ongoing treatment at the hospital, a lack of an arrangement means that the donation will not be caught. The making of a donation is not in itself an arrangement and this legislation clearly refers to both concepts separately. In this example, there is a donation, but there are no arrangements and the hospital may spend the donation as it sees fit. It is not under any obligation to provide the donor (or any member of his family) with specific medical treatment.

However, the position would be different if the donor had agreed with the hospital that in return for a Gift Aid donation of £100,000 the hospital would
provide treatment that would ordinarily cost £125,000. In this instance, the first principles of the Gift Aid legislation would apply and the Gift Aid benefit rules would determine that the £100,000 was not in fact a gift and therefore no tax relief would be available. There would not be any need to consider these new rules in this instance. However, if the donor entered into an artificial avoidance arrangement in order to distance himself from the Gift Aid donation (or the return of the benefit), the Gift Aid benefit rules may not operate in this way. The new tainted donation legislation could then apply.

Condition A would apply because the donor would have entered into an arrangement (now more complicated and contrived than the original scenario) in connection with their donation. Condition B would also apply because the main purpose of the donor in entering the arrangement is to obtain a financial advantage from the hospital (there being no other reason to enter into such a complicated arrangement). The clear financial advantage would arise from the fact that the donor has received services valued at £125,000 at a cost of £100,000. The donor is not a qualifying charity owned company or relevant housing provider so Condition C would apply. The donation would be tainted and the tax relief denied.

Example 3

A US resident donor lives and works in the UK (receiving UK-source income subject to UK tax) and decides he wants to make a £10,000 donation, tax effectively, to a charitable organisation in the US. The donor is linked to the US organisation to which the donation is to ultimately be made. The donor arranges to make his donation to an agency charity recognised by HMRC and, on making the donation, applies Gift Aid so the agency receives £12,500 (£10,000 donation plus a £2,500 Gift Aid repayment) to distribute on the donor’s behalf. The donor instructs the agency charity to pass the funds to the US organisation that undertakes charitable activities, and the US organisation spends the charitable funds on charitable activities.

In this example the donation will not be caught by the new tainted donation legislation. The donor enters into arrangements with the agency charity to confirm that his donation, once made, will be routed on to the US charitable organisation. The donation would not have been made to the agency charity in the absence of this arrangement so Condition A is clearly satisfied. The main purpose for entering the arrangement is to increase the funds of the US charitable organisation (a financial advantage) and this organisation is linked to the donor. At first glance it would appear that Condition B is satisfied. However, the legislation provides for certain financial advantages to be ignored. Where the body that receives the financial advantage (in this case the US charitable organisation) applies the financial advantage for charitable purposes only, the financial advantage is to be ignored. In this example, the donation is not therefore ‘tainted’.
Example 4

Mr A is a trustee of two charities, Charity B and Charity C. Charity B is responsible for running a college and Charity C provides financial support for the college. Mr A also controls Company D which runs a leisure facility (swimming pool, gym, squash) which is used by the students of the college during school hours and fee paying members of the public outside school hours. Company D wants to expand the leisure facility to allow opening to the public in the day and to provide more up-market facilities i.e. this is a wholly commercial development. To fund this, Company D offers interest free loan stock. Mr A makes a Gift Aid donation of £100,000 to Charity B. Company D issues interest free loan stock of £125,000. Charity B subscribes for £125,000 of the loan stock and requests it be issued in the name of Charity C.

In this example the donation will be caught by the new tainted donation legislation. There is an arrangement in place that, in connection with the donation, the charity will provide an interest free loan (by buying loan stock) to a company connected with the donor and the donation would not have been made and the arrangements would not have been entered into independently of one another. Therefore, Condition A of the new legislation will be satisfied. The main purpose of entering into the arrangement is for the donor to obtain a financial advantage (in this instance, an interest free loan for his company) and therefore Condition B is satisfied. The donor is not a charity owned company or relevant housing authority so Condition C is satisfied and the donation is therefore a tainted charity donation and the relief is denied.

67. Where a donation is tainted, no tax relief is due to the donor. Where the donation, if it were not a tainted donation, would have been a qualifying donation under the Gift Aid scheme, an income tax charge will arise on the repayment of tax due to the charity. The donor, a connected person or any other potentially advantaged person, in relation to the tainted donation, or the charity is liable to the tax charge. However no charge will arise on the charity unless, exceptionally, the charity was party to, and fully aware of the arrangements.

68. There will be no liability to income tax where the repayment is repaid under some other provision, for example if the charity is charged to tax on non-charitable expenditure in relation to the donation.

69. The current substantial donors to charity rules will initially remain largely in place when the new anti-avoidance rule is introduced. However, no new “substantial donors” will arise from 1 April 2011. Substantial donor transactions with donors who were already substantial donors before 1 April 2011 will continue to be chargeable to tax under the substantial donors to charity rules up to and including 31 March 2013 after which date the substantial donor legislation is repealed, subject to the transitional provisions. The substantial donors legislation cannot be repealed in full from 1 April 2011
because transactions carried out on or after 1 April 2011, where the
donation was made before 1 April 2011, would otherwise be free
from a tax charge because the new anti-avoidance rule applies only to
donations made on or after that date.

70. A transitional provision has been introduced that relaxes the
substantial donors to charity rules in relation to certain transactions
on or after 1 April 2011. Where a pre-existing substantial donor
enters into a transaction caught by the substantial donors to charity
rules, but that transaction is not “tainted” then no charge to tax will
arise. A substantial donor transaction is “tainted” if it is made as part
of an arrangement that would not have occurred independently of the
associated donation. The effect of the provision is to ensure that
transactions that would not have formed part of an arrangement under
the new anti-avoidance rule will not attract a tax charge under the
substantial donors to charity rules. Charities will therefore need to
monitor only those transactions with existing substantial donors
where the donations and arrangements were not independent of each
other and even then, only for two years rather than the five years
under the current substantial donors to charity legislation.

71. This Schedule provides for the repeal of the existing substantial donor
rules, in respect of transactions taking place on or after 1 April 2013,
subject to a specific exclusion. The current substantial donors to
charity legislation will continue to apply after 1 April 2013 if a
substantial donor enters into a contract before 1 April 2013 and a
transaction under that contract is entered into on or after 1 April 2013.
The effect of this is to ensure that ongoing payments made under a
contract that is caught by the substantial donors to charity legislation
continue to be caught by those rules. However, if the terms of the
contract are varied on or after 1 April 2013 the substantial donors to
charity legislation will no longer apply and the situation will fall to be
considered under the new rule. Therefore, this situation should only
apply to a very small minority of substantial donors.

Example 5

Donor A donated £30,000 to charity B on 1 May 2010 which means that donor
A is a substantial donor of charity B. Under the existing substantial donors to
charity legislation the charity would need to monitor any transactions it enters
into with donor A for five years after the tax year 2010/11 (i.e. to 30 April
2016). A person connected with donor A enters into a transaction with charity
B in June 2012; for example, donor A's son is employed by charity B after a
recruitment process, to fill a vacancy that had arisen in the charity and
receiving remuneration at a rate that is commensurate to the work they are
carrying out. Under the substantial donors to charity legislation this would be
treated as a caught transaction and charity B would be charged to tax in
respect of the value of the remuneration paid. However, the new rule
introduces transitional provisions which mean that the transaction will only
continue to be caught (between 1 April 2011 and 31 March 2013 inclusive) if the donation by donor A and the transaction entered into between charity B and donor A's son, would not have taken place independently of one another. From the facts in this scenario, it is clear that there is no link between the donation and the transaction. Charity B had a vacancy that it needed to fill, the donation did not lead to donor A's son being given the job and the remuneration received reflects the value of the job being carried out. Therefore, the substantial donors to charity legislation will not apply to this transaction.

However, if donor A's son were employed (between April 2011 and March 2013) because of the donation (regardless of whether the remuneration was well above what would be expected for the work they were doing) it could not be argued that the donation and the transaction were entered into independently of one another, and the transitional provision would not relieve a charge under the substantial donors legislation.

If the transaction were caught under the existing substantial donors to charity legislation, because the contract for employment was entered into before 1 April 2013 and would create ongoing obligations on the part of the charity to pay the remuneration, those payments would continue to be non-charitable expenditure of the charity under the existing legislation. However, if the terms of that contract are varied on or after 1 April 2013 (e.g. to ensure that the remuneration is consistent with the market rate for that type of work) then future payments will no longer be caught under the substantial donors to charity legislation.
EXPLANATORY NOTE

CLAUSE 28 SCHEDULE 4: AMOUNTS NOT FULLY RECOGNISED FOR ACCOUNTING PURPOSES

SUMMARY

1. Clause 28 and Schedule 4 amend the corporation tax rules on loan relationships and derivative contracts that apply to amounts that are not fully recognised, or are ‘derecognised’, for accounting purposes. Under the current rules, where a company derecognises a loan or derivative and its associated cash flows in accordance with generally accepted accounting practice (GAAP), in specified circumstances amounts are brought into account for tax purposes as if the accounts had in fact recognised them. The amendments to these rules change the basis on which the legislation operates. For accounting periods beginning on or after 6 December 2010, in relation to loan relationships and derivative contracts, derecognition in accounts is overridden for tax purposes, and losses arising from derecognition are not allowable, where a company is party to tax avoidance arrangements.

DETAILS OF THE SCHEDULE

2. Paragraph 1 provides for the loan relationships rules in Part 5 of the Corporation Tax Act (CTA) 2009 to be amended. The rules in question are sections 311 and 312 of CTA 2009 under which amounts that are not fully recognised under GAAP are taxed as if they were fully recognised, where certain conditions are met.

3. Section 311 of CTA 2009 currently applies where a company is party to a creditor loan relationship (that is, holds a loan as a financial asset) and is also:

- party to a debtor loan relationship (a financial liability);
- has received a capital contribution;
- has issued securities; or
- acquires or varies a capital interest in another company or partnership

and as a result of the application of GAAP, amounts are not fully recognised in respect of the creditor loan relationship and the debtor
loan relationship, capital contribution, securities, or capital interest in question. In such cases section 312 of CTA 2009 applies.

4. **Paragraph 2** amends section 311 of CTA. It inserts **new section 311 (2)(b)** which applies where amounts are not fully recognised as a result of tax avoidance arrangements to which the company is at any time party, and it removes the current conditions in section 311 which require section 312 to be applied.

5. **New section 311(7)** defines “tax avoidance arrangements” as arrangements that have the obtaining of a tax advantage as their main purpose or one of their main purposes.

6. **New section 311(8)** defines “arrangements” broadly to include all arrangements, schemes and understandings of any kind.

7. **New section 311(9)** ensures that the rule in section 311 cannot be avoided where the company is party to repo and stock lending arrangements.

8. **Paragraph 3** amends section 312 of CTA 2009 to reflect the changes to section 311 of CTA. The effect of section 312 remains that where section 311 applies, for tax purposes credits arise on the creditor relationship as if amounts had been recognised in the accounts, but **new section 312(3)(a)** provides that no debits are to be recognised for tax purposes on the creditor relationship. Where there is a debtor loan relationship that corresponds to the creditor loan relationship, the rule remains that debits are recognised for tax purposes, but only up to the amount of the credits on the creditor relationship.

9. **Paragraph 4** amends section 440 of CTA, the introductory section to Chapter 15 of Part 5 of CTA, which deals with tax avoidance provisions that apply for the purposes of Part 5 of CTA, by inserting a reference to a **new section 455A** of CTA.

10. **Paragraph 5** inserts **new section 455A**. This applies where the company is party to tax avoidance arrangements, which are defined in the same way as in section 311 of CTA, and provides that no debit is to be brought into account, either under Part 5 of CTA 2009 or under any other corporation tax provision, if an amount is derecognised in accordance with GAAP as a result of those arrangements. As with section 311, the rule cannot be avoided where the company is party to repo and stock lending arrangements.

11. **Paragraph 6** amends section 464 of CTA, which deals with the priority of the loan relationships rules for corporation tax purposes.

12. **Paragraph 7** provides for equivalent changes to be made to rules in Part 7 of CTA 2009. The rules in question are sections 599A and
599B of CTA which require that amounts that are not fully recognised under GAAP are be taxed as if they were fully recognised, where certain conditions are met.

13. Section 599A of CTA 2009 currently applies where a company is party to a derivative contract and

- has received a capital contribution, or
- has issued securities, or
- acquires or varies a capital interest in another company or partnership

and as a result of the application of GAAP, amounts are not fully recognised in respect of the derivative contract and the capital contribution, securities, or capital interest in question. In such cases section 599B of CTA 2009 applies.

14. Paragraph 8 amends section 599A of CTA. It inserts new section 599A(2)(b) which applies where amounts are not fully recognised as a result of tax avoidance arrangements to which the company is at any time party, and it removes the current conditions in section 599A which require section 599B to be applied. The effect of section 599B remains that where section 599A applies, for tax purposes credits arise on the derivative contracts as if amounts had been recognised in the accounts.

15. New section 599A(7) defines “tax avoidance arrangements” as arrangements that have the obtaining of a tax advantage as their main purpose or one of their main purposes.

16. New section 599A(8) defines “arrangements” broadly to include all arrangements, schemes and understandings of any kind.

17. New section 599A(9) provides that the rule cannot be avoided where the company is party to repo and stock lending arrangements.

18. Paragraph 9 amends section 599B of CTA 2009 by inserting new section 599B(2A) which provides that no debits are to be recognised for tax purposes on the derivative contract. In addition new section 599B(4) requires that where the fair value of the derivative contract is greater than its accounts value at the start of the accounting period in which avoidance arrangements come into being, the difference is to be taxed as a credit in that period. This ensures that any uplift in the value of the derivative contract cannot escape the anti-avoidance rule by virtue of the fact that the avoidance arrangements came into being in a later period.
19. **Paragraph 10** amends section 689 of CTA, the introductory section to Chapter 11 of Part 7 of CTA, which deals with tax avoidance provisions that apply for the purposes of Part 7 of CTA, by inserting a reference to a **new section 698A** of CTA.

20. **Paragraph 11** inserts **new section 698A**. This applies where the company is party to tax avoidance arrangements, which are defined in the same way as in section 599A of CTA, and provides that no debit is to be brought into account, either under Part 7 of CTA 2009 or under any other corporation tax provision, if an amount is derecognised in accordance with GAAP as a result of those arrangements. As with section 599A, the rule cannot be avoided where the company is party to repo and stock lending arrangements.

21. **Paragraph 12** repeals parts of the Schedules to Finance Acts (FA) 2009 and 2010 that introduced certain of the current provisions.

22. **Paragraph 13** sets out the commencement provisions. The changes have effect for periods of account beginning on or after 6 December 2010, except for new section 599B(4) of CTA 2009 which has effect only for tax avoidance arrangements to which the company becomes party on or after 23 March 2011. An accounting period beginning before and ending on or after 6 December 2010 is treated as if it were two separate periods, with the latter period starting on that date. The new rules apply with effect from the start of that later period.

**BACKGROUND NOTE**

23. The corporation tax rules that apply to loan relationships and derivative contracts are based on the principle that amounts brought into account for tax purposes as credits and debits under those rules are those that, in accordance with GAAP, are recognised in determining a company’s profit or loss for the period.

24. In certain circumstances, where a company holds a loan or derivative that is matched with another financial instrument issued by it, GAAP may permit or require the loan or derivative, or amounts arising in respect of it, not to be recognised in determining the company’s accounting profits or losses for the period. For example, a company may have made a loan or hold securities from which it receives income in the form of interest, and issued fixed rate preference shares under which matching amounts are paid as dividends. While the interest income and dividend expense match each other economically, following the accounting treatment in such a case gives rise to a tax advantage, since interest is normally fully taxable and the dividends are not deductible.
25. The resulting asymmetry between the accounting and the tax treatment has been exploited in tax avoidance schemes. Legislation was first introduced in FA 2006 to counter avoidance of this type, and has been amended in subsequent Finance Acts as new schemes based on derecognition have come to light. Rather than continue to make additions to the legislation in response to new examples of such avoidance, these amendments create a general rule that taxable amounts arising on loan relationships and derivative contracts are to be computed as if all profits and losses on derecognised financial instruments were fully recognised for accounting purposes, where the company is party to tax avoidance arrangements. In addition, a company is denied a tax deduction under the rules on loan relationships and derivative contracts for a loss on derecognition, again where the company is party to tax avoidance arrangements.
EXPLANATORY NOTE

CLAUSE 29: LOAN RELATIONSHIPS INVOLVING CONNECTED DEBTOR AND CREDITOR

SUMMARY

1. Clause 29 responds to schemes which have attempted to circumvent section 418 and section 419 of the Corporation Tax Act (CTA) 2009 (loan relationships involving connected debtor or creditor). The rule in section 418 was introduced in the Finance Act 2008 to block schemes that involved the provision of intra-group finance through the use of convertible securities. In these schemes the debtor company seeks to bring into account larger debits than the creditor’s credits as a result of the adopting of differing accounting methods in relation to the securities.

DETAILS OF THE CLAUSE

2. Subsection (1) extends the circumstances to which section 418 of CTA can apply to include cases where a company connected with the creditor company is or may become entitled or required to acquire shares in any company.

3. Subsection (2) clarifies that the amounts taken into account under the loan relationship rules in determining the chargeable profits of a controlled foreign company are treated as “brought into account” for the purposes of section 418.

4. Subsection (3) and (4) contain the commencement rules. The amendments apply to any loan relationship to which a company is party on or after 6 December 2010, but will not apply to amounts that relate to a time before that day.

BACKGROUND NOTE

5. In the Finance Act 2008, the Government acted to block a scheme that involved the raising of intra-group finance through the issue of convertible securities (a loan that may be converted into shares of the issuing company). The debtor company claimed for tax purposes larger debits than the credits on which the creditor company was chargeable. The legislative response was to require the creditor company to bring in additional credits equal to this excess.

6. The rule was amended in the Finance Act 2009 in response to disclosure of new schemes that sought to circumvent the legislation.

7. These further amendments ensure that the legislation applies where a company connected with the creditor company is entitled to receive...
the shares; and also puts beyond doubt that it applies where one or more of the parties to the loan is a controlled foreign company.
EXPLANATORY NOTE

CLAUSE 30 SCHEDULE 5: GROUP MISMATCH SCHEMES

SUMMARY

1. The purpose of clause 30 and Schedule 5 is to ensure that groups of companies cannot use loan relationships or derivative contracts to reduce their tax liability purely as a result of asymmetries in the way different members bring amounts into account under Part 5 or 7 of Corporation Tax Act 2009.

2. The legislation is structured as a stand-alone Schedule covering both loan relationships and derivative contracts in Corporation Tax Act 2010 (CTA). This follows the model of the legislation on risk transfer schemes in Part 21A of CTA. For that reason the legislation is placed immediately after that legislation as Part 21B.

DETAILS OF THE CLAUSE

3. New section 938A CTA sets out the operative rule if a company is at any time in an accounting period party to a group mismatch scheme (GMS) and is a member of the scheme group. “Scheme losses and profits” made by the company in that period are not to be brought into account as debits or credits for the purposes of Part 5 (loan relationships) and Part 7 (derivative contracts) Corporation Tax Act 2009 or under any other corporation tax provision.

4. New section 938B CTA defines GMS. A scheme is a GMS if the parties to the scheme include members of the same group (referred to as the “scheme group”) and either of two Conditions is met:

   • The first Condition (Condition A) is that when the company enters into the scheme it is practically certain to produce a “relevant tax advantage” (RTA), which is defined in new section 938D, of £2m or more.

   • The second Condition (Condition B) is that the purpose, or one of the main purposes, of any member of the scheme group in entering into the scheme is to obtain the chance of securing a RTA, and at the time the scheme is entered into the expected value of the scheme is a positive amount. In determining whether the value of a scheme is positive it is necessary to take into account both the likelihood of any RTA or relevant tax disadvantage (RTD) arising and also the amount of the RTA and RTD. That is, the expected tax value of the scheme, taking into account both the amount of any tax
advantage/disadvantage and the chance of it arising, must be positive for the group and negative for the Exchequer.

5. The tests under Conditions A and B are both carried out at the outset of the scheme. Hindsight cannot be used to determine whether the scheme is a GMS. Because the tests are carried out by reference to a company’s initial purpose in being party to a scheme or what at the outset that scheme is practically certain to achieve, it is possible that a scheme that in fact does not ultimately produce a RTA may still be a GMS. For the same reason it is also possible that a scheme that happens to produce a RTA may not be a GMS.

New section 938C

6. New section 938C defines “scheme loss” and “scheme profit” as a loss or profit made by a company in an accounting period in relation to a group mismatch scheme (as defined in new section 938B) if the loss or profit:

- arises from a transaction, or series of transactions, that forms part of the scheme (new section 938C(1)(a)),

- is, or is included in, an amount that is brought into account as a debit or credit for the purposes of Part 5 or 7 of CTA 2009 (new section 938C(1)(b)),

- and meets either of the asymmetry conditions in new section 938C (2) or (5) (new section 938C(1)(c)).

7. The asymmetry condition in new section 938C(2) is that the loss or profit affects the amount of any RTA secured by the scheme.

8. RTA is defined in new section 938D to mean an “economic profit” that is made by the scheme group over the scheme period that arises as a result of asymmetries in the way that different members of the scheme group bring, or do not bring, debits and credits into account under Part 5 or Part 7 of CTA 2009.

9. The requirement that the profit arises from asymmetries means that losses or profits on genuine third party loans or derivatives that might be part of a scheme (e.g. a loss arising from interest on money borrowed from a third party that is used to fund a scheme) cannot be scheme losses or profits. These losses or profits cannot affect the amount of any RTA because they cannot produce intragroup asymmetries. For instance, if a group company brings debits into account in respect of money it has borrowed from an unrelated company (and those debits reduce its liability to corporation tax), the absence of corresponding credits in any other member of the group is not the consequence of asymmetries in the way that the other
members of that group bring, or do not bring, amounts into account under Part 5 or 7 of CTA 2009.

10. The scheme period may fall wholly within the company’s accounting period (AP) – and that AP may be coterminous with all other members of the scheme group that are party to the scheme. If so, it will be obvious at the end of the AP whether the scheme has produced a RTA for the group: there will (or would on the tax capacity assumption in new section 938G) be a real economic profit arising to it as a result of asymmetries in the way different companies bring amounts into account for the purposes of Part 5 or Part 7 of CTA 2009. If there is a RTA then any amounts (both losses and profits) that affect its amount will be disregarded, thus eliminating the RTA.

11. Where the scheme period extends beyond the end of a company’s AP it may not be clear at the end of that AP whether the scheme is one that over its full length will secure a RTA or how much any RTA will be. If so, new section 938C(3) provides that any loss or profit will be treated as meeting the first asymmetry condition if there is a chance that the scheme will secure a RTA and the loss or profit would affect its amount.

12. The scheme period may have begun before the start of a company’s AP but ended before the end of that AP. If so, then any scheme losses and profits arising to the company in earlier periods will have been disregarded as a result of new section 938C(3) and new section 938A. In the AP in which the scheme ends it will be possible to ascertain if the scheme has produced a RTA overall. If it has produced a RTA overall then the losses or profits that arise in the final AP that affect the amount of the RTA (either by an increase or decrease) will also be disregarded.

13. In the AP in which the scheme ends it may become apparent that the scheme did not produce a RTA after all – in which case new section 938C(5) will apply: see paragraph 16 below.

14. New section 938C(4) applies where a loss or profit affects, or may affect, the amount of any RTA but not all of the loss or profit affects or may affect it. In such a case just the part of the loss or profit that does or may affect the RTA is treated as a scheme loss or profit.

15. New section 938C(4) would apply (for instance) if part of a loan relationship loss arising to a debtor company is referable to a transaction with a third party – for instance, part of the profit corresponding to the debtor’s loss may have been allocated to an unconnected member of a partnership in which all other partners are all associated with the debtor, or because the loan gives rise to
expenses payable to a third party as well as to amounts referable to other group members. In such a case the part of the loss that is referable to the third party cannot be a scheme loss because it cannot affect the amount of any RTA.

16. The second asymmetry condition in new section 938C(5) applies if it becomes clear that a scheme will not (despite the fact that it is a GMS) produce a RTA. In this case, neither new section 938C(2) nor (3) can apply because it is no longer possible for the scheme to affect the amount of any RTA; it follows that it can no longer produce scheme losses or profits. If nothing were said to deal with this situation, then although scheme losses may have been disregarded in earlier APs as a result of the rule in new section 938C(3), then any later profit that prevents the scheme from producing a RTA overall would not be a scheme profit and so would be taxed. New section 938C(5) ensures that any such amount is treated as a scheme profit and is not taxed.

17. New section 938C(5) would not apply if the later profit merely reduced the amount of the RTA. For instance, a profit that partially reverses a timing advantage, but not so as to eliminate the RTA, would be a scheme profit and so be disregarded by virtue of the rule in new section 938C(2).

18. In theory a scheme originally meeting Condition A or B could produce a tax disadvantage. This would be a question of fact – the evidential burden would be on the scheme group to demonstrate that such a scheme was a GMS from the outset. That is, to demonstrate that, despite the scheme being one that was practically certain to produce a RTA, or it being the main purpose of a group member to obtain the chance of securing such an advantage, the scheme achieved the opposite. If so, new section 938C(5) would mean that amounts that gave rise to the tax disadvantage would be left out of account, thus eliminating the disadvantage but without creating any advantage.

New section 938D

19. New section 938D defines the term “relevant tax advantage” as an “economic profit” (see new section 938F) that is made by the scheme group over the whole scheme period, and arises because of asymmetries in the way different members of the scheme group bring, or do not bring, amounts into account as debits and credits under the loan relationships or derivative contracts rules.

20. “Relevant tax disadvantage” is defined in the same way as relevant tax advantage, except that references to “economic profit” are replaced by references to an “economic loss”.
21. The economic profit or loss must be one that is made by the scheme group (not an individual company – see also new section 938F(2)); determined over the whole scheme period (see new section 938D(6) and new section 938B(8)); and be of a more than negligible amount.

22. “Asymmetries” is defined to include in particular asymmetries in timing and quantification.

23. New section 938D(5) makes clear that an economic profit includes an increase in an economic profit and a decrease in an economic loss. This ensures, for instance, that arrangements involving partnerships where not all of the partners are group members (so that overall the scheme does affect the pre-tax profit or loss of the group, albeit that elements of the scheme do not) may be within the scope of the rule; as may schemes that involve the payment of loan relationship or derivative contract expenses to third parties. But it does not include profits that are negligible.

24. New section 938D(6) defines scheme period to mean the period during which the scheme has effect.

New section 938E

25. Group is defined in new section 938E in a way similar to the definition in section 400C of CTA 2009 and 937K of CTA, that is, as being company A and any other company that is party to the scheme 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 five conditions is met.

26. 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 938E(9).

27. The second condition is that company A and company B are connected. Section 466 of CTA 2009 applies for the purposes of establishing connection.

28. 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.

29. 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.

30. 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.
31. The “consolidation condition” is that the financial results of any two companies are:

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

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 United Kingdom.

New section 938F

32. New section 938F provides that any reference to an economic profit or loss made by the scheme group over the scheme period is to a profit or loss being made by members of the scheme group taken together and taking into account the following matters:

- Profits and losses made as a result of the operation of the Corporation Tax Acts.
- Any adjustments required to reflect the time value of money.

33. In determining the amount of an economic profit or loss made by the group over the scheme period, amounts are only to be taken into account to the extent that they relate to the times when the relevant company is party to the scheme.

New section 938G

34. New section 938G makes clear that in determining whether a scheme is a GMS it is assumed that each member of the relevant group that is a party to the scheme obtains the full tax benefit of any loss made in relation to a loan relationship or derivative contract over the scheme period. Similarly it is assumed that each such company incurs the full tax cost of any profit made from a loan relationship or derivative contract over the scheme period.

35. This ensures that the tax advantage must arise as a result of structurally asymmetrical tax treatment of the transactions and not because of circumstantial matters such as losses that might be available to shelter profits from the loan relationship or derivative contract.
New section 938H

36. **New section 938H** defines “scheme” as including all arrangements, schemes and understandings of any type whether or not legally enforceable, and whether involving a single transaction or series of transactions.

New sections 938I and 938J

37. **New sections 938I and 938J** ensure that the group mismatch rules can apply to transactions that are treated as a loan relationship by just one party – the borrower under a repo or structured finance arrangement. Where the “advance” under such arrangements has been received by a company from a member of the same group then the test of whether amounts corresponding to the debtor company’s debits have been taxed symmetrically is carried out not just by reference to Part 5 of CTA 2009 but any other provision of the Corporation Tax Acts under which amounts may be subject to the charge to tax on income. In any such cases the group mismatch rules are to apply as if those amounts were, or were not, brought into account under Part 5 of CTA 2009. The “Corporation Tax Acts” means the enactments relating to the taxation of the income and chargeable gains of companies and of company distributions (including provisions relating to income tax).

New sections 938K

38. **New section 938K** clarifies that references to amounts being brought into account, or not brought into account, under Part 5 or 7 of CTA 2009 include amounts that are brought into account under Part 3 of CTA 2009 by virtue of section 297 or section 573 of CTA 2009.

New sections 938L

39. **New section 938L** puts beyond doubt that references in the Part to amounts not being brought into account by a company under Part 5 or 7 of CTA 2009 do not include amounts that are not brought into account by virtue of the company not being UK resident or an election made under section 18A of CTA 2009 for the profits of an overseas permanent establishment of a UK company to be excluded from corporation tax.

40. The exclusion for overseas companies will not extend to a UK permanent establishment of an overseas company that enters into loan relationships or derivative contracts in the course of its UK trade. The profits of the permanent establishment must be calculated on arm’s length principles. If the UK permanent establishment fails to bring into account credits on its intragroup loan relationships or derivative contracts the failure will not be result of the company not being UK resident.
New section 938M

41. **New section 938M** ensures that the legislation applies properly where one or more of the companies that is party to the GMS is a controlled foreign company for the purposes of Chapter 4 of Part 17 of ICTA.

New section 938N

42. **New section 938N** is a scope or boundary provision. It ensures that in determining whether any amounts are brought into account apart from the group mismatch rules (and so might give rise to a RTA), certain provisions are to be treated as of no effect. The provisions are:

- section 441 of CTA 2009 (loan relationships for unallowable purpose)
- section 690 CTA 2009 (derivative contracts for unallowable purposes)
- Part 4 of TIOPA (transfer pricing).
- Part 6 of TIOPA (tax arbitrage).

43. It follows that the group mismatch rules are applied in priority to these specified provisions.

44. Paragraph 5 of the Schedule makes consequential amendments to the transfer pricing and tax arbitrage rules to reinforce the priority of the group mismatch rules.

45. Paragraph 6 of the Schedule deals with commencement. The legislation will have effect in relation to schemes whenever entered into but so that the only amounts disregarded under new section 938A are scheme losses and profits made on or after commencement day.

46. Where a scheme is entered into before the date of Royal Assent, the only amounts to be disregarded in relation to that scheme following Royal Assent are scheme losses. This is intended to deter groups from entering into schemes before Royal Assent with the expectation of initially obtaining relief for scheme losses (relating to times before the Finance Act is passed) whilst avoiding a tax charge on “scheme profits” that relate to times after the Act is passed.
47. Paragraphs 7 and 8 of the Schedule signal the repeals that will be consequential upon the introduction of the legislation. Section 418 and section 453 of CTA 2009 will be repealed with effect in relation to loan relationships to which a company is party on or after commencement day, but not so as to affect the taxation of amounts that relate to any time before that day.

BACKGROUND NOTE

48. Group mismatch schemes use intragroup loans or derivatives to give rise to tax deductions that are not matched by corresponding taxable receipts. The schemes take a variety of different forms. As a simple example, a company B takes an interest-bearing loan from another group company A in circumstances where B’s accounting treatment accrues the associated finance cost but A’s accounting treatment does not.

49. The tax rules for loans and derivatives are based on the accounting profits and losses of each company arrived at by applying generally accepted accounting practice.

50. So although the transaction is economically neutral over the group as a whole, B achieves a tax deduction for the finance cost whereas A is not chargeable on a corresponding amount. Consequently the transaction reduces the overall corporation tax liability for the group.

51. The above scheme involves accounting asymmetries. Other group mismatch schemes have relied on tax overrides of accounting rules to produce tax asymmetries.

52. The aim of the legislation is to counter tax advantages that arise from group mismatch schemes, by providing that debits and credits that would otherwise arise from such schemes will not be brought into account for corporation tax purposes if they would affect the amount of the tax advantage.
EXPLANATORY NOTE

CLAUSE 31: COMPANY CEASING TO BE A MEMBER OF A GROUP: AVAILABILITY OF RELIEF

SUMMARY

1. Clause 31 amends an aspect of the degrouping charge rules in the corporation tax regime for chargeable gains. The changes ensure that corporation tax cannot be avoided by a series of transactions undertaken within a group prior to a disposal that are intended to escape the existing degrouping charge.

DETAILS OF THE CLAUSE

2. Subsection (1) amends the main degrouping charge provisions in section 179 of the Taxation of Chargeable Gains Act 1992 (‘TCGA’).

3. Subsection (2) introduces an additional circumstance in which a later degrouping charge may arise, that is where after a company leaves a group and 179(2) applied when it left the original group. Section 179(2) of TCGA may apply where companies that have transferred an asset between them in the previous six years leave the group at the same time. Section 179(2A) reappplies the degrouping charge if the companies join a second group that is connected with the original group when the transferee company leaves the second group. The additional circumstance is where the two groups cease to be connected. For these purposes the connection between the groups is established by looking at the control of the two groups. The detailed rules regarding the meaning of connection are in section 179(2B) of TCGA.

4. Subsection (3) introduces new subsection 179(2AA) of TCGA, which applies section 179 at the time of the specified event set out in subsection (2A), such that a degrouping charge may arise at that point. New subsection 179(2AA)(c) ensures that this charge cannot itself be subject to the associated companies exception.

5. Subsection (4) makes a minor consequential amendment to section 179(2B) of TCGA, which defines when there is a connection between the first and second group for the purposes of subsection (2A).
BACKGROUND NOTE

6. The changes introduced by this clause aim to ensure that tax cannot be avoided on chargeable gains arising from asset disposals.
EXPLANATORY NOTE

CLAUSE 32 SCHEDULE 6: LEASING BUSINESSES

SUMMARY

1. Clause 32 and Schedule 6 make changes to the sale of lessor company provisions in Part 9 of the Corporation Taxes Act (CTA) 2010 to ensure that the legislation continues to protect the Exchequer from a risk that tax could be lost following a sale of a lessor company. The provisions have immediate effect to prevent a risk of forestalling.

DETAILS OF THE SCHEDULE

2. Paragraph 2 substitutes references to "plant or machinery falling within subsection (7)" for references to "qualifying leased plant or machinery" in section 387 of CTA 2010.

3. Subparagraph (4) substitutes new section 387(7) to (10).

4. New section 387(7) identifies assets that have been leased out under a plant or machinery lease during the 12 months ending with the relevant day where the lessor was or is the relevant company or a "qualifying associate" of the relevant company. It excludes from these assets leased out background plant or machinery and plant or machinery leased out by a qualifying associate only to the relevant company.

5. New section 387(8) and (9) provide definitions for the purposes of section 384(7). Plant or machinery is leased out if it is subject to a plant or machinery lease. An "associate" of the relevant company is a person who is connected with the relevant company. This is extended if the relevant company is a consortium company or a qualifying 75% subsidiary of a company owned by a consortium to include any member of the consortium and any person connected with the member. A person is a qualifying associate if the person is an associate at the start of the relevant day or at any earlier time in the past 12 months.

6. New section 387(10) defines the past 12 months as the 12 months ending with the relevant day.

8. Paragraph 5 substitutes "plant or machinery falling within section 387 (7)" for "qualifying leased plant or machinery" in section 391 of CTA 2010.

9. Paragraph 6 makes changes to section 398G of CTA 2010 which deals with transfers of plant or machinery by a company that has elected out of the charge. Section 948 of CTA 2010 continues to be disapplied. In addition whenever the company A is required to bring a disposal value into account, the ascribed value is substituted for the disposal value where the ascribed value would give a higher figure. It makes section 265 of the Capital Allowances Act 2001 (CAA) subject to this requirement.


11. Paragraph 9 amends section 403(2)(b) of CTA 2010 by substituting new section 403(2)(b) and inserting new section 403(3) and 403(4). These new provisions identify that part of the unrelieved qualifying expenditure that relates to relevant new expenditure. Relevant new expenditure is defined as expenditure attributable to acquiring plant or machinery on the relevant day except plant or machinery acquired from an associated company, and expenditure incurred on the relevant day but where the plant or machinery was acquired by the company before that day.

12. New section 403(4) defines "acquired" for the purposes of new section 403(3) to include being “brought into use or made available for use for the first time for the purposes of the business” and extends "acquired or incurred" to include anything treated as "acquired or incurred".

13. Paragraphs 10 to 15 make changes to the corresponding provisions in Chapter 4 of Part 9 of CTA 2010 which deal with a business carried on by a company in partnership.

14. Paragraph 11 makes changes to section 410 of CTA 2010. It replaces “qualifying leased plant or machinery” with “plant or machinery falling within subsection (6)’’.

15. Sub-paragraph (4) substitutes new section 410(6) and (7) as provisions identifying plant or machinery that has been leased out by the partnership or a qualifying associate that is not an excluded lease of background plant or machinery and excluding an asset leased out by a qualifying associate only to the partnership.

16. New section 410(7) defines "associate" as a partner of the partnership or a person who is connected with a partner of the partnership. An
associate is a “qualifying associate” if the person is an associate on the relevant day or at any earlier time in the past 12 months.

17. **New section 410(8)** extends “associate” where a corporate partner is owned by a consortium or is a qualifying 75% subsidiary of a company owned by a consortium to include any member of the consortium and any person connected with such a member.

18. **New section 410(9)** defines the past 12 months as the 12 months ending with the relevant day.

19. **Paragraphs 12 and 13** substitute "ascribed value" for "market value" in sections 412 and 413 of CTA 2010.

20. **Paragraph 14** substitutes "plant or machinery falling within section 410(6)" for "qualifying leased plant or machinery" in section 414 of CTA 2010.

21. **Paragraph 15** makes changes to section 421(6)(b) and inserts new section 421(6A) and (6B). These new provisions identify that part of the unrelieved qualifying expenditure that relates to relevant new expenditure. Relevant new expenditure is defined as expenditure attributable to acquiring plant or machinery on the relevant day except plant or machinery acquired from a qualifying company, and expenditure incurred on the relevant day but where the plant or machinery was acquired by the partnership before that day.

22. **New section 421(6B)** defines "acquired" for the purposes of new subsection (6A) to include being “brought into use or made available for use for the first time for the purposes of the business” and extends "acquired or incurred" to include anything treated as "acquired or incurred".

23. **Paragraphs 16 to 19** extend the provisions in section 435 – the anti-avoidance provisions. These provisions permit an adjustment to be made in certain circumstances when balance sheet figures that influence the effect of the legislation have been manipulated.

24. **Paragraph 17** introduces question C into section 434(2) of CTA 2010 which is the question of the amount of any disposal value to be substituted where there is a disposal by a company that has elected out of the charge.

25. **Paragraph 18** inserts new section 435(1A) which sets out the various amounts that might be adjusted. It enables adjustments to be made to the relevant plant or machinery value, the value of plant or machinery falling within section 387(7) or 410(6) of CTA 2010, the amount of income in the period, and the amount of the PM and/or TWDV figures in the formula PM-TWDV. It also covers the disposal value to
be brought into account when there is a disposal by a company that has elected out of the charge. New section 435(1A)(g) makes clear that adjustments can be made to underlying amounts.

26. Sub-paragraphs (4) and (5) amend section 435(2) and 435(3) of CTA 2010 to reflect the increase in the scope to make adjustments to figures other than balance sheet figures and sub-paragraph (6) changes the heading of the section to reflect the increase in the scope of possible adjustments.

27. Paragraph 19 inserts new section 436(7) into CTA 2010, which makes clear that the provisions apply to leasing businesses carried on by companies in partnership.

28. Paragraphs 20 to 22 introduce and define "the ascribed value of plant or machinery" which replaces "market value" in section 437(9) of CTA 2010.

29. New sections 437A, 437B and 437C of CTA 2010 determine the ascribed value of plant or machinery. Where the asset is subject to a lease and the relevant company or partnership is the lessor the ascribed value is generally the higher of the market value of the plant or machinery and the present value of the lease. There is an exception with regard to certain equipment lessors in new section 437A(4).

30. New section 437B of CTA 2010 provides that market value is the value of the asset disposed of by an absolute owner and free from any encumbrances. The present value of the lease is determined in accordance with new section 437C of CTA 2010 as being the sum of the present value of the amounts payable under the lease and any residual amount.

31. New section 437A(4) ensures that certain equipment lessors within section 174 of CAA 2001 are required to calculate the present value of the lease.

32. New section 437B determines the market value – the value of the asset disposed of by an absolute owner and free from any encumbrances. Where the asset is a fixture a just and reasonable apportionment should be made to determine what amount of the value of the relevant land is attributable to the fixture.

33. New section 437C sets out the present value of the amounts payable under the lease which is determined using the interest rate implicit in the lease on the basis of normal commercial criteria and generally accepted accounting practice (where applicable) or, if this is not possible, using an interest-rate determined by reference to LIBOR plus one per cent. The calculation covers amounts payable under the current lease and amounts payable where there is an option to extend the lease after the expiry of the initial term and it is reasonably certain
that the lease will be extended. Charges for services or qualifying UK or foreign tax to be paid by the lessor are excluded. The residual amount has the same meaning as given in section 70YE of CAA. Where the lease also relates to assets that are not plant or machinery a just and reasonable apportionment should be made.

34. Paragraphs 23 to 26 deal with consequential amendments.

35. Paragraph 23 substitutes “falls within section 387(7) of CTA 2010 (if the business is carried on otherwise than in partnership) or within section 410(6) of that Act (if the business is carried on in partnership)” for "qualifying leased plant or machinery" in section 267A of CAA.

36. Paragraph 24 inserts new section 948(6)(za) into CTA 2010 to reflect the modifications to section 398G.

37. Paragraph 25 substitutes the higher of ascribed value and disposal value for "market value" in section 950 of CTA 2010, the ascribed value being substituted if the disposal value that would be required to be brought into account is lower.

38. Paragraph 26 amends the index of defined expressions in Schedule 4 to CTA 2010 to add "ascribed value" and remove "market value".

39. Paragraph 27 deals with commencement. Where amendments have effect in relation to events requiring a disposal value to be brought into account or transfers or successions take place, the amendments have effect where the event, transfer or succession takes place on or after 23 March 2011. Where amendments have effect in relation to the scope of the sale of lessor company legislation or the calculation of the income amount, the amendments have effect where the relevant day is on or after 23 March 2011.

BACKGROUND NOTE

40. The sale of lessor company legislation was introduced in Finance Act 2006 to address a risk that tax would be lost on the deferred profits of the lessor company after it changes hands.

41. The changes introduced here ensure that the legislation identifies the appropriate companies and that it brings in a charge that reflects accurately the deferred tax position of the company.

42. An option to elect out of the charge was introduced in December 2009 in response to the difficult financial climate of the time. As a consequence of an election the business is subject to a number of restrictions including modifications to the way in which disposals of
plant or machinery assets are dealt with. The amendments substitute a value that more accurately reflects the value of the asset to the company.

43. Clause 54 makes provisions concerning the election out of the sale of lessor company charge.
EXPLANATORY NOTE

CLAUSE 33: LONG FUNDING FINANCE LEASES

SUMMARY

1. HM Revenue & Customs have received a disclosure of a tax avoidance scheme which has the claimed effect of giving to a lessee of plant or machinery tax relief of up to twice the actual cost. Clause 33 puts beyond doubt that the disclosed, or similar, arrangements cannot result in relief available in excess of cost incurred.

DETAILS OF THE CLAUSE

Section 70C of CAA 2001

2. Subsection (2) of the clause inserts new subsections (4A), (4B) and (4C) into section 70C of the Capital Allowances Act 2001 (CAA), which provides how to calculate the amount of capital expenditure for a lessee under a long funding finance lease.

3. New section 70C(4A) is the main operational part of the new subsections. It provides for the purposes of subsection 70C(4) (which defines “commencement PVMLP” (present value of minimum lease payments), an amount which is included in capital expenditure of the lessee) that the present value of a “relievable amount” is to be excluded from commencement PVMLP.

4. New section 70C(4B) provides that an amount is a “relievable amount” if three conditions are met.

5. New section 70C(4B)(a) contains the first condition. This is that as a result of an arrangement being in place the lessee, or a person connected with the lessee, has guaranteed all or part of the residual amount (the residual value of the leased asset as determined at the commencement of the lease). Residual amount for a lessee is defined in section 70YE(3).

6. New section 70C(4B)(b) contains the second condition. This is that the amount must be within the minimum lease payments, as defined in section 70YE(1), because of the arrangement.

7. New section 70C(4B)(c) contains the third condition. This is that it is reasonable to assume that, were the amount to be incurred, relief would be available as a result. It further provides that relief in this
context does not include relief under section 70C or section 70E where relief under those two sections is available because the amount is within minimum lease payments.

8. **New section 70C(4C)** contains further provisions relating to **new section 70C(4B)(c)**, identifying two matters that are not to be taken into account in determining whether relief would be available as a result of incurring the amount. It excludes these matters from the decision process in new section 70C(4B)(c) as to whether it is a reasonable assumption that relief would be available as a result of the amount being incurred.

9. **New section 70C(4C)(a)** identifies the first matter to be excluded in that decision process. This is any part of the arrangement except for that which relates to the guarantee of all or part of the residual amount.

10. **New section 70C(4C)(b)** identifies the second matter that is to be excluded from the decision process. This is any other arrangements which may be either
    - connected with the arrangement, or
    - form part of a set of arrangements which includes the arrangement.

*Section 70D of CAA 2001*

11. **Subsection (3)** inserts **new sections 70D(1A) and (1B)** into CAA. This section provides in specified circumstances for:
    - additional capital allowances for the lessee under a long funding finance lease, where:
      - the lessor incurs additional expenditure on plant or machinery; and
      - there is consequently an increase in the present value of the minimum lease payments of the lessee.

12. **New subsection 70D(1A)** provides that if any increase in the minimum lease payments is attributable to a “relievable” amount then it is to be ignored for the purposes of section 70D(1)(d) (increase in the present value of the minimum lease payments as a consequence of the additional expenditure by the lessor).

13. **New subsection 70D(1B)** provides for new sections 70C(4B) and 70C(4C) (see 4 to 10 above) to be used for the purposes of determining whether or not new section 70D(1A) applies.
Section 70E of CAA 2001

14. **Subsection (4)** amends section 70E of CAA, which is concerned with disposal events and disposal values for a lessee under a long funding lease. It inserts the words “other than any relievable payment” into section 70E(2C)(b). It restricts, in the case of a long funding finance lease, the “qualifying amount” (QA) used in the formula for disposal value in section 70E(2A). The restriction is that a payment under a guarantee of a residual amount does not include a “relievable payment”. Residual amount is defined in section 70YE(3).

15. **Subsection (5)** of the clause inserts new section 70E(2DA) into CAA for the purposes of defining when a payment is a “relievable payment”.

16. **New section 70E(2DA)** is identical to new section 70C(4B) (see 4 to 7 above) except in two respects:
   
a) some references in the new section 70C(4B) to “amount” are replaced in new section 70E(2DA) by references to “payment”, and
   
b) new section 70E(2DA) excludes from the meaning of relief that “would be available as a result of making the payment”, any relief which only arises under section 70E, section 70C or section 70D where relief under those sections is available because the payment is within minimum lease payments.

17. **New section 70E(2DA)(c)** contains the test of “reasonable to assume” that relief would be available as a result of making the payment except for the exclusions in new sections 70C, 70D and 70E.

18. **Subsection (5)** also inserts new section 70E(2DB) which applies for the purposes of new section 70E(2DA)(c) (reasonable to assume relief is available as a result of making the payment).

19. **New section 70E(2DB)(a)** provides that for those purposes relief has the meaning given in section 70C. Section 70C(9) provides that relief can be relief by way of an allowance under CAA or a deduction in computing profits for corporation tax or income tax purposes or a deduction from total profits or total income for corporation tax or income tax purposes.

20. **New section 70E(2DB)(b)** provides for the purposes of new section 70E(2DA)(c) that new section 70C(4C) applies in the same way that it applies for new section 70C(4B)(c). So, for the purposes of new section 70E(2DA)(c), no account is to be taken of certain matters in deciding whether a payment is a relievable payment (see 8 to 10 above as to what the excluded matters are).
Commencement

21. **Subsection (6)** provides that the amendments made by subsections (2) and (3) apply to arrangements entered into on or after 9 March 2011.

22. **Subsection (7)** provides that the amendments made by subsections (4) and (5) apply to payments made on or after 9 March 2011 regardless as to when the arrangement under which the payment is made was entered into.

**BACKGROUND NOTE**

23. The long funding lease rules were introduced into CAA, and other relevant areas of the Tax Acts, by Schedule 8 of Finance Act 2006.

24. These rules provide that, where the relevant conditions are satisfied, the lessee, rather than the lessor, is entitled to claim capital allowances in respect of expenditure on leased plant or machinery which is the subject of a long funding lease.

25. For these purposes, in the case of a long funding finance lease, section 70C of CAA determines the lessee’s capital expenditure for capital allowances purposes. The rules in section 70E of CAA deal with disposal events and disposal values and contains provisions for both long funding finance leases and long funding operating leases.

26. In the case of a long funding finance lease, any guarantee given by the lessee, or a person connected with the lessee, of all or any part of the residual value of the plant or machinery at the end of the lease (the “residual amount” - see section 70YE(3) of CAA), is included in the calculation of the lessee’s capital expenditure. Similarly any payment made under that guarantee is taken into account in arriving at the disposal value at the end of the lease.

27. The disclosed scheme includes an arrangement which it is claimed acts as a guarantee but would also result in the lessee acquiring the asset from the lessor at the end of the lease. The claimed tax effects of these arrangements are:

   - The lessee is entitled to include the residual amount “guaranteed” by the arrangement in calculating capital expenditure at the commencement of the lease under section 70C.
   - When payment is made under the arrangement:
     - that payment will effectively reduce the disposal value under section 70E, and
o that payment will fall to be treated as qualifying expenditure for capital allowance purposes a second time, having already been taken into the calculation of capital expenditure under section 70C and no adjustment having been made subsequently under section 70E.
EXPLANATORY NOTE

CLAUSE 34 SCHEDULE 7: INVESTMENT COMPANIES

SUMMARY

1. Clause 34 and Schedule 7 ensure that investment companies cannot generate tax deductible foreign exchange losses by changing their functional currency.

2. A company’s functional currency is the currency of the primary economic environment in which the company operates. This may be sterling or another currency.

3. An investment company may elect for a currency other than its functional currency to be designated for tax purposes.

DETAILS OF THE SCHEDULE

4. Paragraph 1 inserts a new subsection (1A) into section 6 of the Corporation Tax Act (CTA) 2010.

5. New subsection (1A) ensures that section 6 applies to UK resident investment companies that prepare their accounts in a currency other than sterling and make an election under new subsection (9A) for sterling to be the company’s designated currency for tax purposes. Where no election is made section 6 applies, as previously, to UK resident investment companies that prepare their accounts in a currency other than sterling and identify a functional currency other than sterling.

6. Paragraph 2 inserts a new subsection (1A) into section 7 of CTA 2010.

7. New subsection (1A) ensures that section 7 applies to UK resident investment companies that prepare their accounts in one currency and make an election under new subsection (9A) for a different non-sterling currency to be the company’s designated currency for tax purposes. Where no election has been made new section 7 applies, as previously, to UK resident investment companies that prepare their accounts in one currency but identify another non-sterling currency as the functional currency.

New section 9A allows a UK resident investment company to make an election to designate a currency for tax purposes different from that of its accounts.

New section 9A(1) sets out that the designated currency of a UK resident investment company is the currency which the company elects to be the designated currency.

New section 9A(2) explains that a UK resident investment company may only make an election for a designated currency if, at the time the election is made, the designated currency meets one of two conditions (A and B). In the case of a newly incorporated company, the company can make an election at any time in the period beginning with the date of the company’s incorporation and ending immediately before its first accounting period.

New section 9A(3) provides that where a newly incorporated company makes an election under new subsection (2)(b) but at the start date of its first accounting period fails to meet either condition A or condition B, the election is void.

New section 9A(4) sets out condition A for the purposes of new subsection (2)(a). This is that a significant proportion of a company’s assets and liabilities are denominated in the designated currency.

New section 9A(5) sets out condition B for the purposes of new subsection (2)(b). This is that the currency is the functional currency of another company and the two companies meet the consolidation condition.

New section 9A(6) sets out the consolidation condition for the purposes of new subsection (2)(a) and section (5). This is that the financial results of the UK resident investment company (X) are required to be consolidated into accounts prepared under acceptable accounting practice by the other company (Y). If no financial statements are prepared in accordance with acceptable accounting practice then company X is deemed to be part of Y’s group if X would be part of Y’s group if such financial statements were prepared.

New section 9A(7) sets out the definitions of “financial statements of the group”, “Y’s group” and “acceptable accounting practice” for new subsection (6)(a) and (6)(b).

New section 9A(8) explains that for a period of account a currency is the designated currency of a company where the election has effect throughout the period.
18. **New section 9B** sets out the period for which an election under new section 9A has effect.

19. **New section 9B(1)** sets out that an election under new section 9A has effect from the beginning of the first period of account following that in which the election is made.

20. **New section 9B(2)** provides that where a newly incorporated company makes an election under new section 9A(2)(b) the election has effect from the date of the company’s incorporation.

21. **New section 9B(3)** explains that an election under new section 9A has effect until the end of the first period of account in which the company makes another election or a revocation event occurs.

22. **New section 9B(4)** explains that a revocation event, other than where new section 9B(5) applies, occurs where a company does not have a significant proportion of its assets and liabilities in the designated elected currency or where it no longer meets the consolidation condition in new section 9A(6).

23. **New Section 9B(5)** sets out that where a newly incorporated company makes an election under new section 9A(2)(b) a revocation event occurs in its first accounting period only if at the beginning of that accounting period a significant proportion of the company’s assets and liabilities are denominated in the elective currency but later in the accounting period that is not the case.

24. **Paragraph 4** inserts **new section 17(3A)** into CTA 2010 to define an “investment company” in Chapter 4 of Part 2 of CTA 2010.

25. **Paragraph 5** inserts **new section 328(2A)** into CTA 2009.

26. **New section 328(2A)** ensures that any foreign exchange gains or losses that arise in the first period of account under a new functional currency from a loan relationship held by a company with investment business are not to be brought into account. This applies both where the change takes place due to a change of functional currency for accounting purposes and where it takes place due to a change in the designated currency.

27. **Paragraph 6** inserts **new section 606(2A)** into CTA 2009.

28. **New section 606(2A)** ensures that any foreign exchange gains or losses that arise in the first period of account under a new functional currency from a derivative contract held by a company with investment business are not to be brought into account. This applies both where the change takes place due to a change of functional
currency for accounting purposes and where it takes place due to a change in the designated currency.

29. Paragraph 7 provides that the new rules apply in relation to periods of account beginning on or after 1 April 2011. However, elections of designated currency may be made (or revoked) by notice in writing to an officer of HM Revenue & Customs at any time on or after 9 December 2010.

**BACKGROUND NOTE**

30. The current tax rules relating to foreign currency accounting are in Chapter 4 of Part 2 of CTA 2010. The basic rule is that income and chargeable gains are to be calculated and expressed in sterling. However, the starting point is the accounts, expressed in the functional currency of the company. Where a company uses a currency for accounting purposes that is not sterling, the profits and losses are still computed and adjusted in the functional currency of the company and are then translated into sterling for tax purposes at an appropriate rate of exchange.

31. Where a company holds a loan relationship or derivative contract that is denominated in a currency other than the functional currency of the company, foreign exchange gains and losses may arise on translation of that loan relationship or derivative contract into the functional currency of the company.

32. Under the new rules, UK resident investment companies can elect for a designated currency to be used for tax purposes, other than the functional currency used in the accounts. Such an election is valid only to the extent that the designated currency reflects the assets and liabilities held by the company or where the designated currency is the same as the ultimate parent company of the group to which the company belongs.

33. The new rules mean that when a UK resident investment company changes its functional currency any foreign exchange gains or losses that arise with respect to loan relationships or derivative contracts in the first period of account under the new currency are not brought into account. This applies equally to changes of functional currency for accounting purposes and changes of functional currency through a change of designated currency.
EXPLANATORY NOTE

CLAUSE 35 SCHEDULE 8: REDUCTION IN CHILDCARE RELIEF FOR HIGHER EARNERS

SUMMARY

1. Clause 35 introduces Schedule 8 which provides for restrictions to the level of tax relief for employer-supported childcare for higher earners who join employer-supported childcare schemes on or after 6 April 2011.

2. The effect of this will be that the monetary value of tax relief received by higher rate and additional rate taxpayers will equal that available to basic rate taxpayers.

DETAILS OF THE SCHEDULE

Childcare vouchers

3. Paragraph 2 of the Schedule amends section 270A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which relates to the provision of employer-supported childcare through childcare vouchers.

4. Paragraph 2(3) inserts a new subsection (5C) which provides for new condition D.

5. Paragraph 2(5) inserts new section 270A(6ZA) which provides for the monetary level of the tax exemption to depend on the level of employment income identified for the relevant year according to condition D.

6. Paragraph 3 of the Schedule inserts new section 270B to provide definitions of “relevant earnings amount” and “required time”.

7. New section 270B(1) defines the “relevant earnings amount”.

8. New section 270B(2) provides that where the employment begins during the tax year, the amount of the assessed relevant earnings is time-apportioned to give a notional annual figure on which to base the monetary value of the relief.

9. New section 270B(4) provides a definition of “excluded amounts”, which, for example, include contributions to a registered pension scheme, and deductions under payroll giving.
10. New section 270B(5) provides a definition of “the required time” for making the estimate of earnings. This is normally at the beginning of the tax year, but where an employee joins an employer-supported childcare scheme during the year, it is the point at which they join.

11. New section 270B(6) provides for recognition of the point at which an employee joins a scheme.

12. New section 270B(7) provides an order-making power to amend new section 270B.

Childcare provided otherwise than at the employer’s premises etc

13. Paragraph 4 of the Schedule amends section 318A of ITEPA which provides for other forms of employer-supported childcare with the exception of workplace nurseries. This complements the changes in respect of childcare vouchers in sections 270A and 270B of ITEPA.

14. Paragraph 4(3) inserts a new subsection (5C) which provides for new condition D.

15. Paragraph 4(5) inserts new section 318A(6A) which provides for the monetary level of the tax exemption to depend on the level of employment income identified for the relevant year according to condition D.

16. Paragraph 5 of the Schedule inserts new section 318AA to provide definitions for the meaning of “relevant earnings amount” and “required time”. These provisions mirror, for the purposes of childcare provided otherwise that at the employer’s premises, the provisions for childcare vouchers.

17. New section 318AA(1) defines the “relevant earnings amount”.

18. New section 318AA(2) provides that where the employment begins during the tax year, the amount of the assessed relevant earnings is time-apportioned to give a notional annual figure on which to base the monetary value of the relief.

19. New section 318AA(3) cross-references the meaning of “relevant earnings” to that provided in new section 270B(3). Similarly, new section 318AA(4) cross-references what are “excluded amounts” to the provisions in new section 270B(4).

20. New section 318AA(5) provides a definition of “the required time” for making the estimate of earnings. This is normally at the beginning of the tax year, but where an employee joins an employer-supported childcare scheme during the year, it is the point at which they join.
21. New section 318AA(6) provides for recognition of the point at which an employee joins a scheme.

22. New section 318AA(7) provides an order-making power to amend new section 318AA.

23. Paragraph 6 makes consequential changes to section 318D.

Commencement and transitional provisions

24. Paragraph 7 provides that the Schedule has effect for the tax year 2011-12 and subsequent tax years. Paragraph 8(1) has the effect that new qualifying condition D in sections 270B and 318AA have no effect if the employee joined an employer-supported childcare scheme before 6 April 2011 and has not ceased that employment after 6 April 2011. It also provides that if an employee can still be regarded as a continuing member of an employer-supported childcare scheme when not receiving either childcare vouchers or other care, as long as the lack of provision does not exceed a continuous period of 52 weeks.

25. Paragraph 8(2) provides for when an employee is taken to join a scheme for the purposes of paragraph 8(1) of the Schedule.

26. Paragraph 9 provides that the order-making power exercisable under section 318D still has effect.

BACKGROUND NOTE

27. Relief for employer-supported childcare in the form of the provision of childcare vouchers or care other than in a workplace nursery was originally introduced in the tax year 2005-06. It is currently subject to a tax exemption and a corresponding NICs disregard of £55 per week. Approximately 450,000 parents currently qualify for the relief.

28. At present, higher rate taxpayers benefit from double the amount of income tax relief that basic rate taxpayers receive, and individuals who pay the 50% additional tax rate benefit even more. Around a third of the funding for employer-supported childcare goes to parents who pay tax at a higher rate. This is badly targeted, and it is unfair that those on higher incomes should benefit disproportionately in this way.

29. This reform equalises the income tax relief available at the same rate as that for basic rate taxpayers. It applies to all individuals joining employer-supported childcare schemes on or after 6 April 2011. Employees who were members of schemes before that date retain their current levels of relief.
30. The Government recognises that this support is highly prized by parents and helps to encourage parents into the workforce by making childcare more affordable. The reform allows the Government to keep this relief available, while making it fairer, more progressive and better targeted.
EXPLANATORY NOTE

CLAUSE 36: CHILDCARE: SALARY SACRIFICE ETC AND THE NATIONAL MINIMUM WAGE

SUMMARY

1. Clause 36 amends sections 270A and 318A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which set out the conditions for tax exemptions for employment income in respect of childcare vouchers and other childcare (sometimes referred to as directly contracted childcare) respectively. It makes no changes to section 318 of the Act, which applies to workplace nurseries provided by an employer.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for amendments to section 270A of ITEPA.

3. New section 270A(5A) provides that Condition C in section 270A(5) (“vouchers are provided under a scheme that is open to employees generally or generally to those at a particular location”) will be met even if the scheme is not open to relevant low-paid employees.

4. New section 270A(5B) defines various terms, that is “relevant salary sacrifice arrangements”, “relevant flexible remuneration arrangements” and “relevant low-paid employees”. A relevant low-paid employee is one who, if participating in a salary sacrifice or flexible remuneration arrangement, would have their earnings depressed below the level of the national minimum wage.

5. Subsection (2) of the clause provides for similar amendments to section 318A of ITEPA so that Condition C in section 318A(5) will be met even if the scheme is not open to relevant low-paid employees. New section 318A(5B) defines the same terms as described above.

6. Subsection (3) of the clause provides for the amendments to have effect for the tax year 2005-06 (when sections 270A and 318A of ITEPA first came into effect) and subsequent tax years.

BACKGROUND NOTE

7. One of the existing conditions for tax relief is that the employer’s scheme has to be open to the employer’s employees generally or generally to those at a particular location.
8. The vast majority of employer-supported childcare schemes are delivered through salary sacrifice or flexible remuneration arrangements. In salary sacrifice arrangements, employees forego part of their salary in order to gain a benefit, and in flexible remuneration arrangements, the employee agrees to be provided with a benefit rather than receive some other description of employment income.

9. Many employers do not allow employees who cannot participate in salary sacrifice or flexible remuneration arrangements for legal reasons (e.g. employees with employment earnings at or near the national minimum wage (NMW)) to become members of their childcare scheme. Employers do, of course, have the option of paying the benefit on top of salary (that is, a ‘salary plus’ arrangement), which would not disturb those earning at or near NMW levels.

10. We are aware that, in most cases, individuals with earnings at or near the NMW will have financial support for childcare costs available in the form of the childcare element of the Working Tax Credit. From April 2011 this offers lower income families up to 70 per cent of their childcare costs to a maximum limit of £175 per week for one child, and £300 per week for families with more than one child.

11. As a result, it has been decided to amend the qualifying conditions for the tax relief so that employees with earnings at or near the NMW can be excluded from employer-supported childcare schemes because of the alternative availability of the childcare element of the Working Tax Credit.

12. The amendment is being made for the tax year 2005-06 and subsequent tax years in order to remove any outstanding tax liability for schemes that did not meet all of the conditions set out in existing legislation.
EXPLANATORY NOTE

CLAUSE 37: ACCOMMODATION EXPENSES OF MPs

SUMMARY

1. Clause 37 amends section 292 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). This section exempts from income tax a payment in respect of accommodation expenses made by the Independent Parliamentary Standards Authority (IPSA) to a member of the House of Commons. This clause will allow the exemption to also apply to payments in respect of accommodation expenses made to another person on the authorisation of the Member of Parliament (MP).

DETAILS OF THE CLAUSE

2. Subsection (1) amends section 292 of ITEPA by inserting a new subsection (5) after subsection (4).

3. New section 292(5) provides that payments made to a member of the House of Commons in respect of accommodation expenses also includes a payment made to another person at the direction of the MP.

4. Subsection (2) provides that the amendment has retrospective effect and applies in relation to payments made by IPSA on or after 1 November 2010.

BACKGROUND NOTE

5. Section 292 of ITEPA was amended by Schedule 4 to the Finance (No. 2) Act 2010 following the introduction of a new scheme for paying the expenses of MPs. IPSA developed the new scheme under which MPs have been paid their expenses since the Parliamentary election on 6 May 2010. Prior to that date, MPs’ expenses were paid by the House of Commons authorities.

6. The amended section 292 of ITEPA exempts from income tax accommodation expenses paid by IPSA to MPs in respect of expenses necessarily incurred on overnight accommodation that is required for the performance of the MP’s parliamentary duties in Westminster or their constituency.

7. As currently worded, the legislation exempts a payment of accommodation expenses in so far as it is “made to a member of the
House of Commons”. The proposed amendment to section 292 will allow the exemption to apply to payments made by IPSA, on the authorisation of the MP, to another person (for example to a landlord).

8. This follows IPSA’s introduction of a minor simplification to the way it pays MPs’ accommodation expenses. From 1 November 2010 IPSA will make payments in respect of MPs’ rental charges direct to landlords where authorised to do so by the claimant MP.
EXPLANATORY NOTE

CLAUSE 38: EXPERTS SECONDED TO EUROPEAN UNION BODIES

SUMMARY

1. Clause 38 introduces a tax relief for subsistence allowances paid to seconded experts by a relevant body of the European Union (EU). The relevant EU bodies are listed. The clause also provides an order-making power for further EU bodies to be added to the list.

DETAILS OF THE CLAUSE


3. New section 304A(1) ensures that there is no income tax charge on subsistence allowances paid by a relevant EU body to a person who is seconded to the body by their employers because of their expertise in matters relating to the subject matter of the functions of the EU body.

4. New section 304A(2) lists the relevant EU bodies covered by this legislation.

5. New section 304A(2)(d) provides an order-making power for HM Treasury to add any other body established by an EU instrument as a relevant EU body.

6. Subsection (2) provides that the exemption applies in relation to subsistence allowances paid for any period commencing on or after 1 January 2011.

BACKGROUND NOTE

7. The European Banking Authority (EBA), a body of the European Union, was established in London on 1 January 2011. The aim of the EBA is to upgrade the quality and consistency of national supervision, strengthening oversight of cross-border groups and establishing a European single rule book applicable to all financial institutions in the internal market.

8. There are currently two other EU bodies located in the UK. They are the European Medicines Agency (EMA) and the European Police College (CEPOL). CEPOL was established in 2005 and European Medicines Agency (EMA) was established in 1993 (initially as the
European Agency for the Evaluation of Medicinal Products, which subsequently changed its name in 2004 to the EMA).

9. Under current legislation, subsistence allowances paid to experts seconded to a body of the EU located in the UK are subject to income tax and National Insurance Contributions. The seconded worker may be entitled to a matching deduction under the temporary workplace rules if the period of secondment is less than two years; in such cases the effect would be that the worker would not pay tax on the payments. However, as secondments to EU bodies are likely to be longer than two years, most seconded experts will not benefit from such a deduction. Therefore, there is a potential to create a disparity between EU bodies located in the UK and EU bodies located in some other member States, leaving those on secondment to bodies in the UK at a disadvantage.

10. Changing the legislation to exempt these allowances from income tax helps maintain a level playing field with EU bodies located in other member States and ensure that the bodies located in the UK can attract high-quality experts.

11. The exemption applies for all subsistence allowances paid in respect of any period beginning on or after 1 January 2011.
EXPLANATORY NOTE

CLAUSE 39: EMPLOYMENT INCOME: EXEMPTION FOR FEES RELATING TO MONITORING SCHEMES

SUMMARY

1. Clause 39 introduces a tax relief for registration fees for joining the Protection of Vulnerable Groups Scheme (PVGS) in Scotland where these fees are paid or reimbursed by an employer. The clause also provides an order-making power for a tax relief to be introduced for future corresponding schemes which cover England and Wales, and Northern Ireland.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts new section 326A into the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which provides a relief for fees relating to monitoring schemes relating to vulnerable persons.

3. New section 326A(1) ensures that there is no tax charge on an employee in relation to the reimbursement or payment of the employee’s registration fee for joining the PVGS in Scotland.

4. New section 326A(2) provides an order-making power to extend the relief to fees for corresponding schemes in England and Wales and Northern Ireland.

5. Subsection (2) provides that the relief applies for the tax year 2010-11 and subsequent tax years.

BACKGROUND NOTE

6. Following the Bichard Enquiry into the Soham murders, the Scottish Executive decided to introduce a scheme with the object of monitoring all those carrying out regulated work with children and vulnerable adults. Similar schemes are also being considered for England and Wales and Northern Ireland.

7. Under Scotland’s PVGS, it will be an offence for any individual who has been barred from working with children or vulnerable adults to take up regulated work, and it will also be an offence for an employer to employ such an individual to carry out regulated work as defined under the Protection of Vulnerable Groups (Scotland) Act 1997. Any fees paid or reimbursed by an employer for registering under the
PVGS would normally be subject to income tax as a benefit-in-kind or expenses payment treated as earnings, and this clause removes the tax liability.

8. The PVGS was launched on 28 February 2011.
EXPLANATORY NOTE

CLAUSE 40: INDIVIDUAL INVESTMENT PLANS FOR CHILDREN

SUMMARY

1. Clause 40 provides HM Treasury with additional regulation-making powers and makes other provision in relation to individual investment plans, such as Individual Savings Accounts. It is designed to provide for the establishment, operation and tax exemption of investment plans for children, such as the Junior ISA tax-free children’s savings account that was announced by the Government on 26 October 2010.

DETAILS OF THE CLAUSE

2. Subsection (1) specifies that this clause amends Chapter 3 of Part 6 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005). Part 6 of ITTOIA 2005 concerns income which is exempt from charges to income tax. Chapter 3 of Part 6 enables HM Treasury to make regulations for the establishment and operation of individual investment plans, and for the tax exemption of income arising from such plans. Individual Savings Accounts (ISAs) are the only current example of individual investment plans governed by regulations made under Chapter 3 of Part 6 of ITTOIA 2005.

3. Subsection (2) inserts a new subsection (1A) into section 694 of ITTOIA 2005. Section 694 of ITTOIA 2005 concerns income from individual investment plans and enables HM Treasury to make regulations (investment plan regulations) exempting all or part of this income from income tax. The new section 694(1A) provides that income which is treated by the operation of section 629 of ITTOIA 2005 as being the income of an individual can be made exempt from a charge to income tax by investment plan regulations. Section 629 forms part of the income tax legislation contained in Chapter 5 of Part 5 of ITTOIA 2005 relating to settlements and provides that, in certain circumstances, income arising from a payment made by a parent to, or for the benefit of, their child is to be treated as income arising to that parent. The Government intends to provide in investment plan regulations that income arising from any sum paid by a parent into their child’s Junior ISA will not be taxed as the income of that parent under section 629 of ITTOIA 2005.

4. Subsection (3) inserts a new section 695A into ITTOIA 2005. This provides HM Treasury with regulation-making powers in addition to those currently contained in Chapter 3 of Part 6 of ITTOIA 2005 and makes other provision necessary for the establishment and administration of individual investment plans for children, such as Junior ISAs.
5. New section 695A(1) introduces the concept of a ‘child plan’, which the Government intends will encompass Junior ISAs. It provides that the new section 695A will apply in relation to such plans.

6. New section 695A(2) and (3) extend HM Treasury’s regulation-making powers at Chapter 3 of Part 6 of ITTOIA 2005 in relation to individual investment plans. This is to enable investment plan regulations to be made providing for the establishment of child plans, such as Junior ISAs.

7. New section 695A(2)(a) enables investment plan regulations to be made specifying who may make investments for a child under a child plan. The Government intends to provide in regulations that any person who so wishes will be able to contribute to a child’s Junior ISA.

8. New section 695A(2)(b) sets out that investment plan regulations may be made preventing withdrawals from a child plan other than in specified circumstances. The Government intends to provide in regulations that investments held in a Junior ISA may not be withdrawn until the account holder’s 18th birthday, other than in specified circumstances, such as where the child is terminally ill.

9. New section 695A(2)(c) enables investment plan regulations to be made specifying who can provide instructions to plan managers in relation to child plans held by children under the age of 16.

10. New section 695A(3)(a) and (b) enables investment plan regulations to be made preventing investments in a child plan being assigned or used as security, or being passed to a third party on the bankruptcy of a child who holds a child plan.

11. New section 695A(3)(c) enables investment plan regulations to be made providing that contracts entered into by a child between the ages of 16 and 18 years have effect as if these contracts had been made by an 18 year old. The Government intends to provide in regulations that a Junior ISA holder may provide instructions in relation to the management of their account from the date of their 16th birthday. Where a Junior ISA is held by a child whose parent is younger than 18 years old, that parent may give instructions in relation to their child’s account from the date of their own 16th birthday.

12. New section 695A(4) provides that where child plan investments are made for a child by another person, those investments are treated as having been made by the child for the purposes of investment plan regulations.

14. Subsection (4) of the clause amends section 699 of ITTOIA 2005, which concerns non-entitlement to exemption from income tax in relation to individual investment plans. Section 699 of ITTOIA 2005 allows investment plan regulations to specify circumstances in which an investor in an individual investment plan is not, or ceases to be, exempt from income tax in relation to income from their plan. It also contains regulation-making powers concerning the collection of tax due from an investor and an investor’s liability for penalties in certain circumstances. Subsection (4) of the clause provides that, for the purposes of the regulation-making power at section 699 of ITTOIA 2005, an ‘investor’ includes any person entitled to a tax exemption provided by investment plan regulations made under the new section 694(1A) of ITTOIA 2005 (see subsection (2) at paragraph 3 above). Therefore, the effect of subsection (4) is to enable investment plan regulations made under section 699 of ITTOIA 2005 to apply in relation to a parent who has paid amounts into their child’s Junior ISA.

15. Subsection (5) achieves the same effect as subsection (4) in relation to section 701 of ITTOIA 2005. Section 701 of ITTOIA 2005 enables investment plan regulations to be made covering certain general and supplementary matters, such as the establishment and administration of investment plans, the administration of income tax in relation to such plans and the application of income tax legislation to such plans. Subsection (5) provides that, for the purposes of the regulation-making power at section 701 of ITTOIA 2005, an ‘investor’ includes any person entitled to a tax exemption provided by investment plan regulations made by virtue of the new section 694(1A) of ITTOIA 2005 (see subsection (2) at paragraph 3 above). Therefore, the effect of subsection (5) is to enable investment plan regulations made under section 701 of ITTOIA 2005 to apply in relation to a parent who has paid amounts into their child’s Junior ISA.

16. Subsection (6) amends section 151(2) of the Taxation of Chargeable Gains Act 1992 (TCGA 1992). Section 151(1) of TCGA 1992 enables regulations to be made by HM Treasury providing relief from capital gains tax on gains accruing to an individual under an individual investment plan. Section 151(2) of TCGA 1992 sets out that certain provisions of Chapter 3 of Part 6 of ITTOIA 2005 apply in relation to regulations made under section 151(1) as they apply to investment plan regulations. Subsection (6) modifies section 151(2) of TCGA 1992 to take account of changes set out in subsections (1) to (5) of this clause. Therefore, subsection (6)(a) updates references within section 151(2) of TCGA 1992 to take into account new subsection 694(1A) of ITTOIA 2005 (see subsection (2) at paragraph 3 above).
18. Subsection (6)(b) inserts new paragraphs (a) to (d) into section 151(2) of TCGA 1992. New section 151(2)(a) of TCGA 1992 restates an existing provision concerning the application of certain provisions of Chapter 3 of Part 6 of ITTOIA 2005 to regulations made under section 151(1) of TCGA 1992. New section 151(2)(b) and (c) is designed to ensure that new section 695A (see subsection (3) at paragraphs 4-13 above) works correctly in relation to child plan investments.

19. New section 151(2)(d) reflects the fact that the certain provisions of this clause, as introduced by subsections (4) and (5) (see paragraphs 14 and 15 above) are relevant to income tax only, and therefore have no significance for capital gains tax.

20. The effect of subsection (6) is that gains from Junior ISA investments can be made exempt from capital gains tax by regulations made under section 151(1) of TCGA 1992. This includes investments made for a child by another person, which can be treated, for the purposes of regulations exempting investment plan gains from capital gains tax, as if they had been made by the child.

BACKGROUND NOTE

21. The Financial Secretary to the Treasury announced on 26 October 2010 that Junior ISAs would be established as tax-free children’s savings accounts. The announcement can be found at: http://www.hm-treasury.gov.uk/press_57_10.htm.

22. The detailed account rules and processes for Junior ISAs will be set out in regulations to be made under powers in Chapter 3 of Part 6 of ITTOIA 2005, as extended by this clause. The Government published draft Junior ISA regulations on 31 March 2011. It is expected that Junior ISA accounts will be available from autumn 2011.
EXPLANATORY NOTE

CLAUSE 41: GIFT AID: INCREASE OF LIMITS ON TOTAL VALUE OF BENEFITS ASSOCIATED WITH GIFTS

SUMMARY

1. Clause 41 increases the limit on the maximum value of benefits a charity or a community amateur sports club (CASC) may provide to an individual or corporate donor under Gift Aid from £500 to £2,500.

DETAILS OF THE CLAUSE

2. Subsection (1) increases the limit on the value of benefits that a charity or CASC may provide to a donor from £500 to £2,500, where a donation is made by an individual under Gift Aid.

3. Subsection (2) increases the limit on the value of benefits that a charity or CASC may provide to a donor from £500 to £2,500, where a donation is made by a company under Gift Aid.

4. Subsection (3) repeals section 60(1) of Finance Act 2007, which had increased the maximum value of benefits that a charity or CASC may return to an individual donor under Gift Aid from £250 to £500.

5. Subsections (4) and 5 apply the new benefit level to donations made:
   - by individual donors on or after 6 April 2011, and
   - by corporate donors on or after 1 April 2011.

BACKGROUND NOTE

6. The Gift Aid rules for individual and corporate donors allow charities and CASCs to provide a low level of benefits to their donors without affecting the donor’s eligibility to tax relief on the donation.

7. The value of the benefits allowed depends on the amount of the donation and the value of the benefits provided as a proportion of the amount of the donation. The maximum benefit allowed is:
   - for donations under £100: 25% of the gross value of the donation;
   - for donations between £100 and £1,000: £25; and
8. In addition to the limits set out above, the total value of benefits received by a donor from the same charity or CASC in one tax year may not exceed £500.

9. Clause 41 increases the maximum value of benefits received from a charity or CASC in a tax year from £500 to £2,500.

10. The 5% limit on the value of benefits provided as a proportion of the donation, for donations over £1,000, remains in place.
EXPLANATORY NOTE

CLAUSE 42: ENTERPRISE INVESTMENT SCHEME: AMOUNT OF RELIEF

SUMMARY

1. Clause 42 increases from 20 per cent to 30 per cent the rate of income tax relief to which investors are entitled when they subscribe under the Enterprise Investment Scheme (EIS) for shares in qualifying companies. The new rate applies to shares issued on or after 6 April 2011.

DETAILS OF THE CLAUSE


3. Subsections (3), (4) and (8) make consequential amendments to provisions which withdraw relief already given when the conditions of the EIS are later broken. They ensure that when this happens, relief is only withdrawn at the rate originally given, rather than at the new, higher rate.

4. Subsection (6) provides for HM Treasury, by order, to appoint when the section will come into force, so that the increased level of relief will not be available until the change receives State aid approval.

5. Subsection (7) provides that, once the section comes into force, the increased rate of relief will apply to the tax year 2011-12 and to subsequent years, that is, to shares issued on or after 6 April 2011.

BACKGROUND NOTE

6. The Enterprise Investment Scheme (EIS) is designed to encourage investment into small, higher risk trading companies by offering tax incentives to individual investors in qualifying companies.

7. The income tax relief available under the EIS is a reduction of tax liability calculated as the product of a rate and the amount subscribed for shares.

8. The Chancellor announced in his Budget on 23 March 2011 that, subject to State aid approval, the rate of income tax relief would be increased for shares issued on or after 6 April 2011.
9. A number of other changes were announced which will be the subject of further consultation, with the aim of implementation in Finance Bill 2012.
EXPLANATORY NOTE

CLAUSE 43: RELIEF FOR EXPENDITURE ON R&D BY SMES

SUMMARY

1. Clause 43 amends Part 13 of the Corporation Tax Act 2009 (CTA 2009) to increase the rate of the additional deduction given to companies that are small or medium enterprises (SMEs) for expenditure on research and development (R&D) and to reduce the rate of the further deduction given for R&D expenditure on drugs and vaccines.

DETAILS OF THE CLAUSE

2. Subsection (3) of the clause increases the rate of the additional deduction provided by section 1044 CTA 2009 from 75 per cent to 100 per cent.

3. Subsection (4) increases the rate of relief given where the R&D expenditure is pre-trading expenditure.

4. Subsection (5) similarly increases the rate of the additional deduction where relief is taken as payable tax credit.

5. Subsection (6) reduces the rate at which losses may be surrendered for payable tax credit from 14 per cent to 12.5 per cent, so that the value of the payable tax credit remains within limits set by the European Commission.

6. Subsections (8) – (11) reduce the rate of the further deduction given for R&D expenditure on drugs and vaccines to 20 per cent.

7. Subsection (12) provides that the section comes into force from a day to be appointed by the Treasury by order. This provision ensures that the increased level of relief will not be given until the changes receive State aid approval.

8. Subsection (13) provides that the changes made by the section then have effect for expenditure incurred on or after 1 April 2011.

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 (“vaccine research relief” or VRR) was introduced in 2003 for
expenditure on R&D into vaccines and medicines for strains of TB, malaria and AIDS/ HIV prevalent in the developing world.

10. The SME R&D relief currently gives an additional deduction equal to 75 per cent of qualifying expenditure. This, combined with the normal 100 per cent deduction for such expenditure, gives a total of 175 per cent.

11. Losses arising from the 175 per cent deduction can be surrendered by a loss making company in return for a payment at a rate of 14 per cent, giving relief of 24.5 per cent in all (175 per cent x 14 per cent = 24.5 per cent).

12. The rate of the additional deduction is to be increased to 100 per cent for expenditure incurred on or after 1 April 2011. The rate at which losses can be surrendered will be reduced to 12.5 per cent giving relief of 25 per cent in all (200 per cent x 12.5 per cent = 25 per cent).

13. To prevent total relief exceeding the Commission’s guidelines, from the same date, the rate of vaccine research relief will be reduced for SME companies.
EXPLANATORY NOTE

CLAUSE 44 SCHEDULE 9: VALUE SHIFTING

SUMMARY

1. Clause 44 and Schedule 9 simplify the current rules that apply where the capital gains proceeds on the disposal are reduced because the value of an asset has been reduced. The complex rules that apply in following transactions involving companies are replaced by a new targeted anti-avoidance rule that applies to disposals of shares or securities by companies on or after the passing of the Act. Where the rule does apply, it acts to adjust the disposal consideration to counter any tax advantage of the transactions.

DETAILS OF THE SCHEDULE

2. Paragraph 1 amends the current value shifting rule in section 30 of the Taxation of Chargeable Gains Act 1992 (TCGA) to remove the parts that relate to transactions within groups and make its operation subject to section 31 onwards in relation to a disposal by a company of shares in another company. As a result, section 30 will no longer apply to such a disposal for the purposes of corporation tax.

3. Paragraph 2 removes the existing rules that modify section 30 at sections 31 to 34 and replaces them with a new section 31 of TCGA. This is a self contained rule applying to disposals of shares or securities for the purposes of corporation tax.

4. New section 31(1) applies the rule where arrangements have been made that have reduced the value of shares or securities and the purpose of those arrangements was to obtain a tax advantage. It also applies where it is the value of a “relevant asset” that has been reduced. The rule does not apply where the arrangements consist solely of making an “exempt distribution”.

5. New section 31(2) provides for the consideration received on a disposal to be adjusted by an amount that is just and reasonable in the light of the arrangements and any charge to or relief from corporation tax arises as a consequence of the arrangements.

6. New section 31(3) defines a “relevant asset” and ensures that the rule applies where the tax advantage is obtained by any person.

7. New section 31(4) modifies the rule in the case where the disposal of shares or securities occurs before their acquisition so as to apply where their value is increased.
8. New section 31(5) clarifies the interaction of the rule with section 29 of TCGA to ensure that a capital gains disposal will result where shares are issued by a company whose value has previously been reduced by arrangements within the scope of this subsection.

9. New section 31(6) sets out the arrangements within the scope of new section 31(5).

10. New section 31(7) provides definitions of “arrangement”, “exempt distribution”, “group”, “securities” and “tax advantage” for the purposes of the section.

11. Paragraph 3 of the Schedule introduces a time limit into the depreciatory transaction rule in section 176 of TCGA. An adjustment under that section may be made where a disposal takes place up to six years following a depreciatory transaction.

12. Paragraph 4 amends the degrouping charge rules in Section 179 of TCGA to allow such a charge to be adjusted by this new rule.

13. Paragraph 5 makes a number of minor repeals that are consequential to the repeal of Sections 31 to 34 of TCGA made by paragraph 2 of the Schedule.

14. Paragraph 6 sets out the commencement provision. The changes will apply to disposals made on or after the date that Finance Bill 2011 receives Royal Assent including deemed disposals resulting from the degrouping charge in section 179 of TCGA. The current section 31A has the effect of applying Section 30 to create a separate charge some time after a disposal of shares and will continue to apply in the case of disposals that took place before Royal Assent.

**BACKGROUND NOTE**

15. The changes introduced by Schedule 9 follow extensive consultation by HM Treasury and HM Revenue & Customs aimed at simplifying the group aspects of the corporation tax chargeable gains regime. The existing values shifting rules as they apply to groups of companies were identified as being particularly complex and uncertain in effect, leading to additional compliance costs.

16. The revised legislation will reduce compliance costs for companies by simplifying the rules that apply to adjust disposal consideration where the value of shares or securities has been reduced.

17. The complex mechanical rules that currently apply to restrict the operation of section 30 of TCGA will be replaced by a simple rule targeting tax motivated transactions.
EXPLANATORY NOTE

CLAUSE 45 AND SCHEDULE 10: COMPANY CEASING TO BE MEMBER OF GROUP

SUMMARY

1. Clause 45 and Schedule 10 simplify certain aspects of the rules for the calculation of degrouping charges in the corporation tax regimes for chargeable gains and intangible fixed assets. Schedule 10 also addresses interactions between the chargeable gains degrouping charge rules and the exemption for disposals of substantial shareholdings.

DETAILS OF THE SCHEDULE

2. Paragraph 1 ensures that the operation of section 139 of the Taxation of Chargeable Gains Act 1992 (TCGA) to certain corporate reconstructions is not affected where the revised rules mean that a degrouping charge is treated as increasing the consideration on a share disposal. Section 139 of TCGA only applies where a person disposing of a company's business receives no part of the consideration for the disposal. Where the degrouping charge results in additional consideration being deemed to be received this is disregarded for the purposes of section 139.

3. Paragraph 2 removes the provision that otherwise prevents a degrouping charge being subject to an election to transfer any resulting gain or loss to another company in the same group under section 171A of TCGA. Previously such transfers were dealt with under section 179A, which is being repealed.

4. Paragraph 3 amends the main degrouping charge provisions at section 179 of TCGA.

5. Paragraph 3(2) ensures that a degrouping charge can only arise in respect of an asset transferred between two companies at a time when both are members of the same group. Paragraph 3(5) makes a consequential change in section 179(2A)(a) for the same reason.

6. Paragraph 3(4) amends the “associated companies exception” in section 179(2) of TCGA, which prevents a degrouping charge arising where two associated companies leave a group together, and an asset has previously been transferred between those associated companies. The new exception applies where two companies are part of the same sub-group at all times from when the asset is transferred until immediately after they leave the original group.
7. Paragraph 3(6) introduces new rules at new sections 179(3A) to (3H) of TCGA which provide a new mechanism for bringing into account a degrouping charge where it arises on a company leaving a group as a result of a disposal of shares by a group company within the charge to corporation tax including where that disposal is otherwise disregarded for capital gains purposes. In such cases, any degrouping gain or loss will instead result in an adjustment to the chargeable gain or allowable loss that arises on the share disposal, or will subsequently arise on a new holding of shares or securities.

8. New section 179(3A) disapplies the normal operation of the degrouping charge in the circumstances mentioned above. The normal operation is preserved for certain degrouping charges that are not exempt under the rules for Real Estate Investment Trusts (REITs).

9. New section 179(3B) applies the new mechanism to companies within the charge to corporation tax and to persons charged to tax as members of a non-resident company by section 13 of TCGA.

10. New section 179(3C) provides that section 127, which treats certain transactions as involving any disposal, is disregarded for the purposes of the new mechanism.

11. New section 179(3D) provides that the degrouping gain or loss will result in an adjustment to the chargeable gain or allowable loss of the group company making a share disposal.

12. New section 179(3E) provides for where the operation of section 127 means that there is no immediate disposal. The degrouping gain or loss will accrue on a future disposal of the asset received in exchange for the shares. Normally this will be achieved by adjusting the allowable cost of the asset received in the exchange. Where a degrouping gain exceeds the allowable cost of the asset then the excess will result in a separate gain accruing at the time the asset is sold.

13. New section 179(3F) applies where a company leaves the group as a result of more than one group company making a share disposal. In those circumstances the adjustment will be shared equally or, if they so elect, as the companies wish.

14. New section 179(3G) sets out the requirements for an election under new section 179(3F).

15. New section 179(3H) applies where a company leaves a group as a result of a company making a disposal of more than one class of shares. In those circumstances the company may allocate the adjustment between each class of shares as it wishes.

16. Paragraphs 3(7) to (10) apply the new mechanism to situations where a degrouping charge does not arise immediately at the point a company
leaves a group, but only where certain other conditions are no longer met.

17. Paragraph 3(11) changes the time a degrouping charge accrues in cases where a company leaves a group (other than through a disposal of shares) where that charge arises because a condition is no longer met. This change is to allow the procedure for transferring gains and losses in groups in section 171A of TCGA to apply.

18. Paragraph 3(12) defines “associated companies” for the purposes of section 179(3). This reflects the changes made to the exception to the charge in section 179(2).

19. Paragraph 3(13) provides a definition of “chargeable asset” for the purposes of the section as a whole that takes account of the application of the Substantial Shareholding Exemption to the new charging mechanism. The definition was previously in section 179(1A).

20. Paragraph 4 provides a new procedure for claiming a reduction in a degrouping charge set out in new section 179ZA of TCGA.

21. New section 179ZA(2) allows a claim to be made for the reduction of the amount by which a degrouping charge is taken into account in calculating a gain on a disposal of shares under section 179(3C).

22. New section 179ZA(3) allows a similar claim in the case of a charge that arises on the company leaving the group.

23. New section 179ZA(4) provides that the effect of the claim is that the gain is reduced by an amount that is just and reasonable.

24. New section 179ZA(5) provides that when deciding on the amount of an adjustment particular consideration should be taken of the transactions by which the company leaving the group acquired the asset.

25. New section 179ZA(6) ensures that any reduction in the gain as a result of a claim is reflected in the cost of the asset for tax purposes.

26. Paragraph 6(1) introduces amendments to the Substantial Shareholding Exemption in Schedule 7AC to TCGA that will allow the exemption to apply in situations involving the disposal of part of a group’s trading activity that has been transferred to another company in the group.

27. Paragraph 6(2) inserts a new paragraph 15A into Schedule 7AC which treats the minimum 12 month substantial shareholding requirement as having been met for the period that assets were used for a trade conducted by the group before being transferred to the company being disposed of.
28. Paragraph 6(3) amends paragraph 19 of Schedule 7AC. Where the new paragraph 15A applies the company being disposed of may be treated as having been a trading company for periods within the 12 months prior to the disposal. This applies where it was not a trading company at the time but the assets transferred to it were used for the purposes of the trade the company carried on at the time of the disposal.

29. Paragraph 7 amends the exception to the degrouping charge under the Intangible Fixed Assets rules in line with the changes to the capital gains at paragraph 3(4) of this Schedule.

30. Paragraph 9 is the commencement provision. The changes to the degrouping charge will apply to companies leaving groups on or after the date that the Finance Bill receives Royal Assent. Changes to the Substantial Shareholding Exemption have effect in relation to disposals of shares on or after that date.

**BACKGROUND NOTE**

31. The changes introduced by this clause follow extensive consultation by HM Treasury and HM Revenue & Customs aimed at simplifying the group aspects of the corporation tax chargeable gains regime.
EXPLANATORY NOTE

CLAUSE 46 SCHEDULE 11: PRE-ENTRY LOSSES

SUMMARY

1. Clause 46 and Schedule 11 simplify the current rules that apply to restrict the circumstances in which capital losses of a company that joins a group can be set against gains. In particular, the use of losses that arise after a company joins a group will no longer be restricted. Losses that are restricted may be used against gains arising on assets used in the same business that the company conducted before joining the group rather than, as now, only against gains on assets used in the same trade.

DETAILS OF THE SCHEDULE

2. Paragraph 3 amends the definition of a “pre-entry loss” for the purposes of Schedule 7A to the Taxation of Chargeable Gains Act 1992 (TCGA) so that it only applies to the losses of a company that accrue before it becomes a member of a group.

3. Paragraphs 3 and 4 remove from Schedule 7A all of those parts that restrict the capital losses of a company that accrue after it becomes a member of a group.

4. Paragraph 5 amends paragraph 6(2) of Schedule 7A. This provides a procedure by which, in certain circumstances, a company can elect whether it is restricted “pre-entry losses” or other losses have been allowed against gains. The change reflects the more limited circumstances in which a loss may be restricted.

5. Paragraph 6(2) and (3) extend the circumstances in which a restricted loss may be used to include setting off against gains arising on assets used in any trade or business that was carried on by the company before it joined the group. After the company joins the group, it is not necessary that the trade or business continues to be carried on by that company; it may be carried on by any company within the same group as the company that incurred the loss. A new paragraph 7(1A) is inserted into Schedule 7A that sets out the conditions to be met. New paragraph 7(1B) provides a definition of “group company” for this purpose.

6. Paragraph 6(3) also inserts into Schedule 7A a new paragraph 7(1C) which sets out clearly the rule that once a loss has become subject to restriction under the Schedule then the same restriction continues to apply should the company subsequently join another group.
7. Paragraph 6(6) amends paragraph 7 of Schedule 7A to set out a definition of “pre-entry asset”, the gains on which may be have restricted losses deducted. The definition previously depended on the rules for restricting losses that accrue after the company join the group, which have been repealed.

8. Paragraph 7 amends paragraph 8 of Schedule 7A which applies to the use of restricted losses where there has been a major change in the activity of a company after it joins a group. The changes take account of the extension of the use of restricted losses to gains on assets used for a continuing business, rather than just a continuing trade.

9. Paragraph 11 sets out the commencement provision. The new rules apply to the deduction on or after the day that the Finance Bill receives Royal Assent of any loss that has accrued before a company joined a group.

10. Paragraph 12 is a transitional provision. Where a loss on the disposal of an asset after a company joined a group is subject to restriction under the current rule, then it will be treated as one that arose before the company joined the group for the purposes of the amended rules.

**BACKGROUND NOTE**

11. The changes introduced by this clause follow extensive consultation by HM Treasury and HM Revenue & Customs aimed at simplifying the group aspects of the corporation tax chargeable gains regime.

12. The revisions to Schedule 7A to TCGA will reduce compliance costs by simplifying the rules that apply to restrict the use of losses when a company joins a group.

13. The amended rules will apply a restriction only to losses that have been realised before the company joins the group and will also allow restricted losses to be used against gains in a continuing business rather than only against those in a continuing trade.

14. The existing scope of the restrictions is no longer required because the tax motivated acquisition of companies with losses is addressed by a targeted anti-avoidance rule at section 184A of TCGA.
EXPLANATORY NOTE

CLAUSE 47 SCHEDULE 12: CONTROLLED FOREIGN COMPANIES

SUMMARY

1. Clause 47 and Schedule 12 introduce a number of changes to the controlled foreign company (CFC) rules:
   - an exemption for certain intra-group activities where there is limited connection with the UK;
   - an exemption for CFCs whose main business is the exploitation of intellectual property (IP) where both the IP and the CFC have minimal connection with the UK;
   - an exemption which runs for three years for foreign subsidiaries that, as a consequence of an acquisition or a reorganisation come within the scope of the CFC regime;
   - an exemption for CFCs with a low level of profits, with an accounts based limit of £200,000 profits per annum, as an alternative to the existing £50,000 limit based on chargeable tax profits; and
   - extension of the transitional rules for holding companies until July 2012.

2. The changes have effect for accounting periods beginning on or after 1 January 2011, other than the extension of the transitional rules, which is deemed always to have had effect.

DETAILS OF THE CLAUSE

3. The clause introduces Schedule 12.

DETAILS OF THE SCHEDULE

Part 1 - Exemptions for companies with limited UK connection

4. Part 1 of Schedule 12 introduces two new exemptions to the CFC regime. The first applies to a CFC which carries on trading activities where there are limited business connections with the UK, regardless of the extent of intra-group transactions. The second applies to a CFC with a main business of IP exploitation where the IP and the CFC have minimal connection with the UK, again regardless of the extent of intra-group transactions. A CFC that does not fully meet the
conditions for either exemption may apply to HM Revenue & Customs (HMRC) for a reduction of the full CFC charge to reflect the extent to which the conditions have been satisfied.

5. Paragraph 1 amends Section 748(1) of the Income and Corporation Taxes Act 1988 (ICTA), which lists the circumstances in which the CFC charging provision in section 747 of ICTA do not apply. The paragraph inserts references to the two new exemptions introduced for companies with a limited UK connection – one for trading companies, and another for companies exploiting IP. The paragraph also makes a minor clarification to section 748(1)(b).

6. Paragraph 2 introduces a new section 751AB of ICTA, which allows a reduction in a CFC charge in circumstances where the conditions of the new exemptions are not met in full. The new exemptions themselves are included in Schedule 25 (see later in this note).

7. New section 751AB(1) restricts application of the section to any UK company which would be subject to a CFC apportionment under section 747 because of a failure by the CFC to meet all the conditions of either of the new exemptions.

8. New section 751AB(2) gives the circumstances in which failure to meet the conditions of the exemptions enable an application to be made under this section to reduce the CFC apportionment. For the trading company exemption, those circumstances are either that the level of UK connected income exceeds 10 per cent but does not exceed 50 per cent, and/or where the combined finance and IP income of the CFC exceeds five per cent of gross income but the relevant IP income of the CFC does not exceed five per cent of gross income. For the IP company exemption, the circumstances are where the finance income exceeds five per cent of the gross income.

9. New section 751AB(3) provides for the UK company to apply to HMRC to reduce the apportioned CFC profits to an amount specified by the company, the “specified amount”.

10. New section 751AB(4) provides that if the Commissioners grant the application, then the chargeable profits are treated as reduced to the specified amount, and the related creditable tax is reduced accordingly, on a just and reasonable basis.

11. New section 751AB(5) sets the conditions under which an application may be granted. The specified amount cannot be less than “the relevant amount” (defined by new section 751AB(6)), and no previous adjustment under section 751A or section 751AC can have been agreed in respect of the same accounting period for the CFC.
12. **New section 751AB(6)** defines “the relevant amount”. For a CFC that fails the new trading company exemption, “the relevant amount” is the excess finance and IP income (defined by **new section 751AB(7)**) to which is added, if the “UK connection” condition is failed, the part of the CFC’s net chargeable profits (as defined by **new section 751AB(12)**) that, in broad terms, arise from UK transactions or which does not represent the net economic value arising from the activity in the territory (defined in **new section 751AB(8)**). For a CFC that fails the new IP company exemption, “the relevant amount” is the amount of finance income in excess of five per cent of the CFC’s gross income, but ignoring negligible amounts.

13. **New section 751AB(7)** defines “the excess finance and IP income” for the relevant accounting period as the excess of the combined income from those sources over five per cent of its total gross income, but treating a negligible amount as nil.

14. **New section 751AB(8)** identifies the net chargeable profits to be excluded from “the relevant amount”. Broadly, these are profits which represent economic value added by “qualifying work” carried out by individuals in the territory of residence or, alternatively, profits which are not attributable to transactions with persons within the charge to UK income or corporation tax.

15. **New section 751AB(9)** defines “qualifying work” as work done in the CFC’s territory by individuals working there for the CFC. Individuals working for the CFC in the territory include both its own employees and other individuals directed by the company to perform duties on its behalf in the territory. This definition is provided by section 751A(9), which is applied by **new section 751AB(11)**.

16. **New section 751AB(10)** provides that in applying new section 751AB(8), transactions with non-UK companies within the charge to corporation tax are taken into account only to the extent that they are undertaken with the UK permanent establishment (such as a branch or agency).

17. **New section 751AB(11)** applies some existing CFC provisions to the new ones. These are some of the provisions at section 751A for reducing the chargeable profits of certain activities of EEA business establishments, and the residence rules in paragraph 5 of Schedule 25.

18. **New section 751AB(12)** defines various terms used within section 751AB.

19. **Paragraph 3** provides for the conditions for the two new exemptions to be included in Schedule 25 to ICTA as **new Parts 2A and 2B**.
new conditions in Part 2A (new paragraphs 12B to 12G) relate to the exemption for trading companies with limited connection to the UK. The new conditions in Part 2B (new paragraphs 12H to 12N) relate to the exemption for companies exploiting intellectual property with a limited UK connection.

20. New paragraph 12B summarises the requirements imposed on the CFC which need to be met in order for the CFC to satisfy the new trading company exemption. The requirements are in respect to the CFC’s:

(a) business establishment;

(b) business activities;

(c) UK connection; and

(d) finance income and expenditure.

The detailed conditions are set out in the subsequent paragraphs.

21. New paragraph 12C provides that the business establishment condition is met if the CFC has a business establishment in its territory of residence. This condition is the same as that which currently applies as part of the exempt activities test in the existing CFC rules.

22. New paragraph 12D(1) sets out the business activities condition which requires that the CFC’s business cannot include to a substantial extent non-exempt activities. These activities are listed in new paragraph 12D(2) and cover various investment activities and, specifically, insurance activity by a non-insurance group. The scope of the list is similar to that which applies to the exempt activities test. Provision is made for a banking business not to fail this condition simply as a result of carrying on listed activities which constitute investment business. New paragraphs 12D(3) and (4) defines various terms used in the list in new paragraph 12D(2).

23. New paragraph 12E(1) requires that the CFC does not have a significant UK connection during the CFC’s accounting period. Under new paragraph 12E(2) there is a significant UK connection if either of two conditions (A or B) is met.

24. New paragraph 12E(3) sets out the first condition (A); that the CFC has a significant UK connection if more than 10 per cent of its gross income in that period is UK-connected and new paragraph 12E(4) does not apply.
25. New paragraph 12E(4) applies if the CFC has sufficient staff based outside the UK to manage the CFC’s business, its profits do not exceed 10 per cent of its relevant operating expenses, and its UK-connected income for the period does not exceed 50 per cent of its gross income.

26. New paragraph 12E(5) sets out the second condition (B); that more than 50 per cent of the CFC’s related-party business expenditure in that period is UK-connected and that the CFC has been involved in a scheme or arrangement which has a main purpose of achieving a reduction in UK corporation tax or in a CFC tax charge.

27. New paragraph 12E(6) and (7) explains or defines various terms used in the preceding sub-paragraphs, while new paragraph 12E(8) explains how transactions with UK branches are to be dealt with for the purposes of the paragraph.

28. New paragraph 12F(1) and (2) sets out the finance and IP income condition, which is that the sum of both elements cannot exceed five per cent of the CFC’s gross income for the accounting period. Finance income is defined in new paragraph 12F(3), (5) and (6) as amounts arising from a financial asset as defined by UK generally accepted accounting practice (UK GAAP) plus any amounts that would be recognised as income under the loan relationship disguised interest rules. Relevant IP income is defined by new paragraph 12F(4) as royalties and receipts of a similar nature arising from intellectual property. New paragraph 12F(7) defines terms used in the preceding paragraph, including the existing definition for IP in paragraph 9(1A).

29. New paragraph 12G defines gross income so as to exclude distributions which would be exempt under the UK dividend exemption legislation (Part 9A of the Corporation Tax Act (CTA) 2009) and chargeable gains, but to include income accruing to a settlement of which the CFC is a settlor or a beneficiary, and income accruing to a partnership of which the CFC is a partner.

30. New paragraph 12H(1) and (2) sets out the five requirements to be satisfied if the new exemption for CFCs exploiting IP with limited UK connection provided by Part 2B of the Schedule is to apply. The requirements relate to the CFC’s:

a) business establishment;

b) intellectual property business;

c) other business activities;

d) UK connection; and
e) finance income.

31. **New paragraph 12J** sets out the “business establishment” requirement. This is the same as for the new trading company exemption in Paragraph 12C.

32. **New paragraph 12J(1)** sets out the “intellectual property business” requirement which is that the CFC’s main business throughout the accounting period must be exploitation of IP which has no relevant UK connection. **New paragraph 12J(2)** disregards, for this purpose, IP with a UK connection if it forms an insignificant part of the main business. **New paragraph 12J(3)** defines a UK connection by reference to whether the IP has been held in the UK within the last six years, or whether any activities to create, maintain or enhance the IP have been carried on by a person related to the company (C) and within the charge to UK income or corporation tax.

33. **New paragraph 12K(1)** sets out the “other business activities” requirement, which is either that the CFC carries on no activities otherwise than in the course of its main business or, if the CFC carries on any other activities, that those activities meet the “secondary activities” condition set out in **new paragraph 12K(2)**. This condition requires that either such other activities do not constitute a substantial part of the whole business, or that they are activities which would meet all the conditions of the new trading exemption in Part 2A, or of the exempt activities conditions in section 748(1)(b) and Part 2A of Schedule 25 to ICTA 1988.

34. **New paragraph 12L(1)** sets out the “UK connection” requirement, which is that the CFC has no significant connection with the UK during the accounting period. This condition is distinct from the requirements of new paragraph 12J, which tests whether the IP itself has a UK connection.

35. **New paragraph 12L(2)** provides that there is a significant connection if:

   (a) a substantial proportion of the CFC’s gross income for the period is income from the exploitation of IP where the income derives from persons within the charge to UK income or corporation tax; or

   (b) the CFC incurs expenditure (other than incidental or insignificant expenditure) with a related person within the charge to UK income or corporation tax on R&D or on creating, developing or maintaining the relevant IP.

36. **New paragraph 12L(3)** defines various terms used in the other sub-paragraphs.
37. New paragraph 12M provides that the finance income requirement is met if no more than five per cent of the CFC’s gross income consists of finance income as defined by paragraph 12F(3).

38. New paragraph 12N defines various terms which are used within new Part 2B of Schedule 25 including when a person is “related” to a CFC, “intellectual property”, and in the context of the requirement that a company is within the charge to corporation tax, how this applies to a company within the charge only because it has a UK permanent establishment.

Part 2 – Amendment of small chargeable profits exemption

39. Part 2 of the Schedule provides an alternative form of the current exemption provided by section 748 of ICTA for CFCs with a low level of profits – the de minimis exemption. The current de minimis threshold of £50,000 per annum based on chargeable profits is retained. For accounting periods beginning on or after 1 January 2011, a CFC meeting the conditions of either the new or the existing exemption is exempt for the relevant accounting period. The new de minimis exemption has a threshold of £200,000 per annum and is based upon accounting profits, rather than a UK tax calculation. Specific anti-avoidance rules are also introduced in respect of the new exemption.

40. Paragraph 4 of the Schedule makes a number of amendments to section 748 of ICTA.

41. New section 748(1)(da) provides the new de minimis exemption and sets a “relevant profits” threshold of £200,000. The limit relates to a 12 month accounting period and is reduced proportionally for shorter periods.

42. New section 748 (3A) defines “relevant profits” for an accounting period as the sum of the CFC’s profits for that period calculated in accordance with generally accepted accounting practice (defined at section 1127 of CTA 2010), adjusted to exclude exempt distributions, capital gains or losses, but to include trust and partnership income. These adjustments are to ensure consistency with the rest of the CFC regime.

43. New section 748(3B) defines or interprets various terms for the purpose of “relevant profits”. Exempt distributions are defined by reference to the exempt distribution rules in Part 9A of CTA 2009, while income from trusts and partnerships is to be allocated on a just and reasonable basis.

44. New section 748(3C) requires transfer pricing adjustments to be considered in relation to the £200,000 threshold for the new
exemption. This is achieved by applying the transfer pricing rules in Part 4 of the Taxation (International and Other Provisions) Act 2010 (TIOPA), but is subject to new section 748(3D).

45. New section 748(3D) provides that if the transfer pricing adjustment resulting from subsection (3C) would be less than £50,000, no such adjustment is required when calculating the “relevant profits” of the CFC for the period.

46. Paragraph 5 inserts a new section 748ZA which provides an anti-avoidance measure in respect of the new de minimis exemption. This is intended to ensure that groups do not take advantage of the new exemption by entering into certain tax planning arrangements (schemes), such as profit fragmentation. Exemption under section 748(da) is not available to a CFC that is the subject of such a scheme.

47. New section 748ZA(1) provides that the new de minimis exemption does not apply to a CFC in respect of an accounting period if at any time before the end of that period, a scheme is entered in which meets any one of three conditions, A, B or C.

48. New section 748ZA(2) sets out the first condition (A). Condition A is that the CFC in question is party to a scheme where the main purpose, or one of the main purposes, of any party to the scheme is to ensure that the new de minimis exemption applies to the CFC.

49. New section 748ZA(3) sets out the second condition (B). Condition B is that the scheme shifts profits to a CFC from another company, and that the main purpose, or one of the main purposes of any party to the scheme is to ensure that the new de minimis exemption applies to one or more CFCs for one or more accounting periods. Condition B is designed to ensure that the CFC to which the profits are shifted does not qualify for the new de minimis exemption. The company from which the profits are shifted is within condition A if it is also a CFC. New section 748ZA(4) sets out what is meant by the shifting of profits.

50. New section 748ZA(5) sets out the third condition (C). Condition C requires that in computing the CFC’s chargeable profits, there must be no adjustment as a consequence of either section 418 (loan relationships involving connected debtor and creditor where debits exceed credits) or Part 21B of CTA 2010 (group mismatch schemes).

51. New section 748ZA(6) gives the meaning of “scheme” and “apportionment” for the purposes of the section.
Part 3 – Temporary exemption following reorganisation etc

52. **Part 3** introduces a new temporary period of exemption in relation to certain acquisitions and reorganisations. The approach taken is to exempt foreign subsidiaries whose accounting periods end within a set exempt period. The start of the exempt period is determined by the date on which the company becomes subject to the UK CFC rules. The end of the exempt period is either 24 months after the end of the first exempt accounting period (in practice an exempt period of up to three years) or an earlier time if the company enters into certain types of arrangement (early termination events). The temporary period of exemption is achieved by amending section 748 and inserting a new **Part 3A** into Schedule 25 to ICTA. **New section 751AC** enables the CFC charge which arises because of an early termination event to be reduced by reference to the tax effect of the change that brought about the termination. The section 751AC mechanism is broadly similar to the section 751AB mechanism for trading and IP companies.

53. **Paragraph 6** of the Schedule amends section 748 of ICTA by adding **new subsection (1)(f)** which provides for a new exemption for accounting periods that end within an exempt period as defined in Part 3A.

54. **Paragraph 7** provides for the addition of **new section 751AC** which permits a reduction in the chargeable profits of a CFC in circumstances where the temporary exemption period has been terminated.

55. **New section 751AC(1)** sets out the conditions under which an application can be made by a UK resident company which would otherwise suffer an apportionment of the full chargeable profits of the relevant CFC. It refers to the termination events set out in new paragraph 15F(2), but specifically excludes terminations in relation to acquisition vehicles (new paragraph 15F(3)(b)).

56. **New section 751AC(2)** enables a UK company to make an application to the Commissioners to reduce the CFC’s chargeable profits to a specified amount.

57. **New section 751AC(3)** provides that if the Commissioners grant the application, the chargeable profits are treated as reduced to the specified amount, and the related creditable tax is reduced accordingly, on a just and reasonable basis.

58. **New section 751AC(4)** permits the Commissioners to grant the application only if they are satisfied that the specified amount is not be less than the relevant amount, and that they have not previously
granted an application under section 751A or section 751AB. This prevents overlapping applications in respect of the same profits.

59. **New section 751AC(5)** defines “the relevant amount” as the amount (if any) of the chargeable profits as it is just and reasonable to regard as referable to any relevant transactions – both the transaction which brought the exempt period to an end and any subsequent transactions.

60. **New section 751AC(6)** states that the definition of “relevant transaction” is provided by **new paragraph 15E** of Schedule 25 to ICTA.

61. **Paragraph 8** of the Schedule inserts new **Part 3A** into Schedule 25 to ICTA which sets out the detailed conditions for the new temporary exemption period.

62. **New paragraph 15A** applies Part 3A for the purposes of the new temporary period of exemption in section 748(1)(f).

63. **New paragraph 15B** determines when the exempt period relating to the new exemption begins. The exempt period begins when a company becomes a CFC, subject to its meeting the requirements of either **new paragraph 15C** or **new paragraph 15D**.

64. **New paragraph 15C(1)** sets out the following requirements:

   (a) the company has not previously been controlled by a UK resident person or persons;

   (b) no part of its business or its assets were previously carried on or owned by a company under such control and related to the CFC;

   (c) the new CFC meets one of four conditions (A, B, C or D); and

   (d) a “disqualifying relevant transaction” does not occur.

65. **New paragraph 15C(2)** sets out condition A, which is that the company was in existence before the relevant time, but was not a member of a UK controlled group. The “relevant time” here and in the rest of new paragraph 15C means the time at which the company becomes a CFC. This covers the acquisition of overseas subsidiaries by a UK controlled group.

66. **New paragraph 15C(3)** sets out condition B, which is that the company is controlled by a UK resident company at the relevant time, but that the controlling company was not a UK resident before the relevant time. This covers holding companies moving into the UK and therefore bringing their overseas subsidiaries within the scope of the UK CFC rules for the first time.
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67. **New paragraph 15C(4)** sets out condition C, which covers circumstances in which the company remains in the same group, but control of the company is passed from a non-UK resident parent to a UK resident intermediate holding company, as part of a group reorganisation.

68. **New paragraph 15C(5)** sets out condition D, which is that the company is a CFC when formed, and is formed for controlling one or more companies where an exempt period is expected to begin in relation to that or those companies when the CFC begins to control it or them. This covers companies which have been set up as acquisition vehicles in preparation for acquiring other companies which should themselves qualify for the new temporary exemption.

69. **New paragraph 15D** sets out alternative requirements to new paragraph 15C. The requirements are that the relevant time occurs after 23 March 2011, that the company was not a CFC during its accounting period which includes that date, that immediately before the relevant time the company was not UK controlled, and that at the relevant time the company is controlled by a UK resident company which is the group’s ultimate parent. The same anti-avoidance rules concerning disqualifying transactions that apply for new paragraph 15C also apply for new paragraph 15D.

70. Within these conditions, a foreign subsidiary that is not under UK control on Budget Day can qualify for the temporary exemption if its ultimate parent later becomes UK resident, regardless of whether it has been under UK control and a CFC at some earlier time.

71. **New paragraph 15E(1)** deals with “disqualifying relevant transactions” and “relevant transactions” for the purposes of the conditions for the new temporary exemption set by paragraphs 15C and 15D.

72. **New paragraph 15E(2)** defines a “disqualifying relevant transaction” as either a relevant transaction which occurs at the relevant time (including transactions in relation to agreements entered into before that time) or a relevant transaction which occurs on or after 9 December 2010 if it is part of an avoidance scheme designed to exploit this new exemption.

73. **New paragraph 15E(3)** defines a “relevant transaction” as one in which the company makes a loan or advance to a related person within the charge to UK tax – arrangements which are commonly known as “upstream” loans. The term also covers changes in such arrangements in relation to the amount or terms of the loan. Arrangements put into place before the start of the exempt period are also caught. Negligible amounts are disregarded. The definition also
includes other transactions defined at new paragraph 15E(4) which achieve a reduction in UK tax – which has the meaning set out in new paragraph 15E(5) and 15E(6).

74. **New paragraph 15E(4)** brings within the scope of “relevant transactions” any transactions referable to non-exempt (typically investment) activities carried on by the CFC which are reflected in the profits of the CFC (other than where the result of a transaction is negligible in value) and which achieve a reduction in UK tax.

75. **New paragraph 15E(5)** sets out that one or more transactions achieve a reduction in UK tax if, in the absence of the transactions, any person either would have been liable for more UK tax, or would have been entitled to less UK tax relief.

76. **New paragraph 15E(6)** defines various terms used in the preceding paragraph, including “avoidance scheme”.

77. **New paragraph 15F(1)** provides that an exempt period ends immediately after the period of 24 months following the end of the CFC’s accounting period in which the exempt period started, unless there is an early termination.

78. **New paragraph 15F(2)** provides that in the case of an early termination event, the period of exemption ends before the date set by new paragraph 15F(1), ending instead immediately before that event.

79. **New paragraph 15F(3)** defines an early termination event as either a “relevant transaction” as defined in new paragraph 15E(3) or when an acquisition vehicle engages in activities other than simply holding shares in its subsidiaries.

80. **New paragraph 15G** contains various definitions of terms within Part 3A.

**Part 4 – Holding companies – extension of transitional provision**

81. **Part 4** extends the transitional holding company provision by amending Part 2 of Schedule 16 to the Finance Act (FA) 2009.

82. **Paragraph 10** of the Schedule amends Part 2 to extend the transitional period until 1 July 2012, with the result that there is now a three year transitional period from 2009 until 2012.

**Part 5 – Minor and consequential amendments**

83. **Part 5** makes a number of minor and consequential amendments.
Paragraph 10 of the Schedule provides for consequential amendments to reflect the fact that the application mechanism for section 751A, section 751AA, new section 751AB and new section 751AC work in broadly the same way. These amendments are required to ensure that the links between these four sections and the rest of the CFC regime work correctly.

Paragraph 11 of the Schedule amends section 751A of ICTA to ensure that applications cannot be made under this section if applications have previously been granted in relation to either of two new application mechanisms (new sections 751AB and 751AC). In practice this means that a successful application under new section 751AB or new section 751AC precludes a company from also making an application under section 751A.

Paragraph 12 of the Schedule amends section 751B so that the application, information and appeal powers which apply to section 751A and section 751AA also apply to new sections 751AB and 751AC. In addition, section 751B(9) is amended to set the time limits for applications under new sections 751AB and 751AC, and to apply those time limits to applications under section 751A and section 751AA.

The minimum period for an application to be made under those sections is the usual period within which a corporation tax self-assessment return may be amended, that is up to 12 months after the filing date (which itself is generally 12 months after the end of the accounting period). However, if an enquiry is opened into the company tax return, the scope of the enquiry includes the application of the CFC rules to that company, and the return is amended at the end of that enquiry as a consequence of those rules, then the time limit for making an application is extended to the earlier of 30 days from the date the amendment was notified and 30 days from the final determination of any appeal against that amendment.

Paragraph 13 of the Schedule provides for minor consequential amendments.

Part 6 – Commencement

Part 6 deals with the commencement provisions for the Schedule.

Paragraph 14 of the Schedule provides for the extension of the transitional provision for holding companies to be treated as always having had effect. The other new and amended provisions have effect for accounting periods of a CFC beginning on or after 1 January 2011.
91. These changes to the CFC rules will be introduced in Finance (No.3) Bill as a first step towards full reform of the CFC regime in 2012.

92. This measure supports the Government’s objective to deliver a more competitive corporate tax system. These changes are designed to make the current CFC rules easier to operate and, where possible, to increase competitiveness.

93. The main objectives are to:

- modernise aspects of the rules so as to exempt commercially justified activities that both business and HMRC agree do not erode the UK tax base; and

- introduce other changes that will help UK businesses that wish to undertake overseas acquisitions and reorganisations and non-UK businesses that want to invest or locate in the UK.

94. The Government published a note entitled the *Aim and scope of the CFC interim improvements* on 27 July 2010, which outlined the detailed objectives and informal consultation was undertaken from July to October 2010.

95. The Government published detailed proposals for reform on 29 November 2010 as part of the Corporate Tax Reform document. All documents are available on the HM Treasury website.
EXPLANATORY NOTE

CLAUSE 48 SCHEDULE 13: PROFITS OF FOREIGN PERMANENT ESTABLISHMENTS ETC

1. Clause 48 and Schedule 13 give an optional exemption from corporation tax for profits arising from foreign permanent establishments of a UK company. If profits are exempt from corporation tax under these provisions, losses will be excluded to the extent that they arise from foreign permanent establishments. Profits and losses will be treated in this way only when the company has made an election for these rules to apply to it. Once a company has made this election, foreign permanent establishment profits will be exempt and losses will be cancelled from the commencement of the next accounting period, subject to a transitional rule.

2. A company has a permanent establishment when it trades in another state through a branch or other fixed place of business, or through an agent, other than an independent agent.

DETAILS OF THE CLAUSE


DETAILS OF THE SCHEDULE

PART 1 – AMENDMENTS OF CTA 2009

Section 18A of CTA 2009


5. New section 18A provides that profits or losses that are attributable to a foreign permanent establishment are to be left out of account in computing the chargeable profits of a company that has elected for the section to apply.

6. New section 18A(1) requires ‘exemption adjustments’ to be made in calculating the profits of a company in a ‘relevant accounting period’. It applies only where the company has elected for the section to apply.

7. New section 18A(2) defines ‘the exemption adjustments’ as those adjustments appropriate to secure the result that any profits or losses
that are attributable to a foreign permanent establishment are left out of account in computing the company’s chargeable profits.

8. **New section 18A(3)** defines a ‘relevant accounting period’ as any period to which the election applies. **New section 18F** provides that such periods are those which follow the one in which an election is made for the section to apply.

9. **New section 18A(4)** defines the term ‘foreign permanent establishments amount’, which is used in new section 18A(2) to refer to the exempt profits or losses. The foreign permanent establishments amount is made up by aggregating ‘relevant profits amounts’ and ‘relevant losses amounts’ – these terms are defined in **new section 18A(6) and (7)**.

10. **New section 18A(5)** defines the term ‘relevant foreign territory’ as any foreign territory where the company is carrying on or has at any time carried on business through a foreign permanent establishment.

11. **New section 18A(6)** defines a ‘relevant profits amount’ in relation to a foreign territory in an accounting period. Where a treaty between the UK and the foreign territory is a full treaty (as defined in **new section 18R**), the relevant profits amount is defined by reference to that treaty.

12. Where there is not a full treaty, the relevant profits amount is defined by reference to the 2010 version of the Organisation for Economic Co-operation and Development (OECD) Model Convention (see **new section 18S**).

13. In either case, the relevant profits amount is the amount which would be attributable to the permanent establishment in the foreign territory for the purpose of arriving at the amount for which credit would be allowed under the UK’s credit regime for tax paid under the law of that territory.

14. **New section 18A(7)** defines a ‘relevant losses amount’ in relation to a foreign territory in an accounting period. While new section 18A(6) is itself concerned with profits, the rules and principles applied under that subsection may lead to the calculation of a loss. Where a loss results, that is a relevant losses amount.

15. As with profits, the relevant losses amount is defined by reference to the actual treaty in place if that is a full treaty, or by reference to the OECD Model Convention if it is not.

16. There are some full treaties that provide for taxation by the foreign territory in respect of certain profits without any requirement that they are attributable to any permanent establishment in that territory. Foreign tax so paid will in general be eligible for credit relief, but
new section 18A(8) and (9) includes the profits in respect of which such tax is paid within a relevant profits amount only to the extent that the profits are attributable to a permanent establishment in the territory. Relevant losses amounts are calculated in an equivalent way.

17. Most treaties provide for an attribution of profits to a permanent establishment to be made by both contracting states, so that any credit allowed against foreign tax is computed by reference to the same profits as those by reference to which the foreign tax was computed. However, some treaties do not provide for attribution on the part of the state of residence and do not contain any provision for the credit against foreign tax to be so computed by reference to the same profits as those by reference to which the foreign tax was computed. In such cases new section 18A(10) requires relevant profits and relevant losses amounts to be calculated as if there were such provision.

Section 18B of CTA 2009

18. New section 18B provides for the application of new section 18A where gains arise on assets. These may be chargeable gains, or gains that are taken into account in the computation of income.

19. New section 18B(1) provides for the making of exemption adjustments in relation to gains arising on the disposal of an asset, or on any other occasion when a gain or loss in respect of an asset is realised. This removes the effect of any gain or loss that is included in the foreign permanent establishments amount. In particular, exemption adjustments under section 18A may increase a gain or a loss: for example, if a gain of 100 arises in respect of an asset, but a loss of 50 has been included in a foreign permanent establishments amount, then the exemption adjustment increases the gain to 150, reflecting the loss attributable to a foreign permanent establishment.

20. Most treaties provide for taxation by each contracting state in respect of gains arising on immovable property in that state, irrespective of whether the property is used for the purposes of business carried on by a permanent establishment. There is therefore no attribution of such gains to any permanent establishment for credit relief purposes, even where they are used for such a purpose. New section 18B(2) provides for gains or losses on immovable property to be included in relevant profits or losses amounts to the extent that the property has been so used.

21. New section 18B(3) determines the extent to which gains attributed to a foreign permanent establishment in earlier accounting periods may be taken into account for the purposes of new section 18A. Credit relief may sometimes be given against corporation tax due in respect of a gain arising in an accounting period for foreign tax paid in
respect of an earlier accounting period. For example, the alienation of an asset from a permanent establishment is generally an occasion of charge, but a corporation tax charge might arise in a later period when the asset is disposed of.

22. In such a case, the earlier gain or loss can be taken into account in the calculation of a relevant profits or losses amount, but only to the extent that the foreign tax was paid in respect of an accounting period for which the company had elected for new section 18A to have effect. This prevents the application of new section 18A to foreign gains or losses realised before exemption takes effect for a company. Where foreign tax is paid in respect of an accounting period before exemption takes effect that foreign tax can still be given credit for in computing corporation tax liability in the same way as before the new exemption was introduced.

Section 18C of CTA 2009

23. New section 18C explains how plant and machinery allowances and other claims or elections are to be made for the purposes of new section 18A.

24. New section 18C(1) provides that notional plant and machinery allowances and charges are to be taken into account automatically in any calculation of profits or losses attributable to the permanent establishment for all accounting periods after an election has been made. Just for the purpose of establishing these notional plant and machinery allowances or charges, the Capital Allowances Act 2001 (‘CAA 2001’) is assumed to apply as if the separate branch activity provided for by new section 15(2A)(a) CAA 2001 was a qualifying activity for capital allowances purposes, provided that it would be a qualifying activity but for the effect of an election made under new section 18A CTA 2009 and new section 15(2A)(b) CAA 2001.

25. New section 18C(2) applies where a capital allowances disposal event arises solely as a result of the company making an election under new section 18A CTA 2009 and where the disposal value of the plant or machinery is the tax-written down value (the “transition value”) under new section 62A CAA 2001. For the purposes of calculating the notional plant and machinery allowances and charges under new section 18C(1), the qualifying expenditure attributable to the permanent establishment in relation to the same plant and machinery starting to be used for the separate activity provided for by new section 15(2A)(a) CAA 2001 is also its tax-written down value (the “transition” value).

26. New 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 new section 18A, if any capital allowance (other than a notional allowance provided for by new section 18C(1)) 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. This prevents new section 18A from having the effect that any such leasing profits or losses are left out of account in calculating the company’s taxable profits.

27. New section 18C(4) gives the meaning of a “plant or machinery lease” and “lessor” for the purpose of new section 18C(3), by reference to section 70K CAA 2001.

28. New subsection (5) provides that all other claims and elections are assumed to have been made in determining for the purposes of new section 18A the credit to be allowed under the Taxation (International and Other Provisions Act (‘TIOPA 2010’) and thus in calculating any profits or losses for the purposes of new section 18A.

Section 18D of CTA 2009

29. New section 18D(1) provides that, where the condition at new section 18D(2) is met, profits or losses referable to any transaction between a person who is UK resident and a permanent establishment to which the Schedule applies are to be excluded from any relevant profits or relevant losses amount.

30. The condition at new section 18D(2) is that there would be an obligation under Part 15 of Income Tax Act 2007 (‘ITA 2007’) on the UK resident to deduct income tax from payments in respect of the transaction if the payments were made to a company resident in the territory of the permanent establishment, having regard to any claim that could have been made in accordance with double taxation arrangements between that territory and the UK.

31. New section 18D(3) provides that this exclusion does not apply if the company is a bank (within section 1120 of Corporation Tax Act 2010 (‘CTA 2010’)), unless the transaction is part of arrangements with a main purpose of avoidance of an obligation to deduct income tax.

Section 18E of CTA 2009

32. New section 18E describes how the costs of employee share acquisitions are taken into account in determining the relevant profits or losses amounts of the exempt foreign permanent establishment.

33. New section 18E(1) requires that any relief under Chapters 2 or 3 of Part 12 of CTA 2009 is taken into account in determining the relevant profits or losses amounts in a relevant territory of the exempt foreign permanent establishment to the extent they are linked to it.
34. **New section 18E(2)** provides that the extent of relief linked to a territory is calculated on a just and reasonable basis to the extent the work of the employees contributes to the business there.

*Section 18F of CTA 2009*

35. **New section 18F** makes any election under section 18A effective for all accounting periods following that in which it is made. The election becomes irrevocable at the start of the first accounting period to which it applies.

*Section 18G of CTA 2009*

36. **New section 18G** provides that certain permanent establishment profits will not be exempt in specified circumstances.

37. **New section 18G(1)** gives effect to the section if the lower level of tax test is met in relation to a permanent establishment by which a company carries on, or has carried on, business in a foreign territory (see **new section 18G(4)** regarding the test itself).

38. **New section 18G(2)** provides that if there is an adjusted relevant profits amount in relation to the foreign territory, the relevant profits amount is taken to be nil. There are two exceptions to this rule in **new section 18G(6)**. **New section 18I** may also apply to make only a proportionate reduction in the amount.

39. **New section 18G(3)** provides that “adjusted” in relation to the relevant profits amount or the relevant losses amount is what those amounts would be if chargeable gains and allowable losses were disregarded.

40. **New section 18G(4)** defines what is meant by the lower level of tax test in **new section 18G(1)**. A foreign permanent establishment meets the test for this purpose if the foreign tax paid in respect of its profits is less than 75 per cent of the corporation tax that would be payable on those same profits if they were chargeable to corporation tax (ignoring any credit allowed for foreign tax). This is a notional calculation of the tax that would be payable if the corporation tax were charged on the adjusted relevant profits at the average rate applicable for the accounting period, without any relief for losses, group relief etc.

41. **New section 18G(5)** gives the meaning of “a relevant treaty provision” for the lower level of tax test as provision in double taxation arrangements having effect in relation to the territory or, if there are no such arrangements, provision made by the OECD model (see **new section 18S**).
42. **New section 18G(6)** gives two circumstances in which new section 18G will not apply. The first is where the adjusted relevant profits amount is less than the "entry limit" defined in **new section 18G(7)**. The second is where the motive test as defined in **new section 18H** is met.

43. **New section 18G(7)** defines the entry limit as £200,000. This limit is reduced proportionately if the accounting period is less than 12 months.

*Section 18H of CTA 2009*

44. **New section 18H** sets out the motive test. Where a company meets the conditions set out in this section the rule in new section 18G will not apply. This motive test is in similar terms to the motive test in the controlled foreign companies legislation (section 748 of, and Schedule 25 to, Income and Corporation Taxes Act 1988 (‘ICTA’)).

45. **New section 18H(2)** provides that condition A is met where the reduction in UK tax achieved by any relevant transaction is minimal or the achievement of that reduction was not the main purpose or one of the main purposes of the transaction.

46. The meaning of “relevant transaction” is given by **new section 18H(3)**.

47. **New section 18H(4)** provides that transactions achieve a “reduction in United Kingdom tax” if, had they not been carried out, any person would have been liable to more UK tax or would have been entitled to less relief or a smaller repayment of such tax. In applying the subsection, the effect of **new section 18G(2)** is ignored.

48. **New section 18H(5)** provides that it is a main purpose of a transaction to achieve a reduction in UK tax if that is a main purpose of the company or the person who has an interest in the company at any time during the relevant accounting period.

49. **New section 18H(6) to (9)** gives condition B. The condition is satisfied where it was not the main reason or one of the main reasons for the company carrying on business through a permanent establishment to achieve a reduction in UK tax by a diversion of profits from the UK.

50. **New section 18H(7) and (8)** specifies that a permanent establishment achieves a reduction in UK tax where it is reasonable to suppose that if the business was not carried on through that or any other permanent establishment, or any related company, the whole or a substantial part of the receipts reflected in its profits would have been received (not through any permanent establishment) by the company that established it or another person resident in the UK who would
thereby have been liable for a greater amount of UK tax or would been entitled to less or no relief from or a smaller or no repayment of UK tax.

51. The meaning of “related” in new section 18H(8) is given in new section 18H(9).

52. New section 18H(10) to (13) defines a number of terms used in the section.

Section 18I of CTA 2009

53. New section 18I provides for a proportionate reduction of the relevant profits amount in certain cases, where the amount would otherwise be taken to be nil under new section 18G(2).

54. New section 18I(1) states that this section applies if condition B of the motive test at new section 18H is met but condition A is not.

55. New section 18I(2) provides that where this is the case the reduction under new section 18G(2) will be by an amount which it is just and reasonable to regard as referable to “tainted relevant transactions”.

56. New section 18I(3) defines “tainted relevant transactions” as those which achieve a reduction in UK tax and in relation to which the main purpose test at new section 18H(2)(b) is not met.

Section 18J of CTA 2009

57. New section 18J gives the rules for determining whether there is a total opening negative amount at the start of the first accounting period to which the election applies. A total opening negative amount includes any loss arising in a company’s foreign permanent establishments during the six-year period ending at the end of the accounting period in which the election is made unless it is reduced or eliminated by a subsequent profit arising from the foreign permanent establishments in that period.

58. New section 18J(1) introduces the rules in this section and those following that apply when an election for exemption has been made and there is a total opening negative amount at the start of the first accounting period to which the election applies.

59. New section 18J(2) gives the steps for determining whether a “total opening negative amount” exists.

60. Step 1 takes the earliest negative adjusted foreign permanent establishments amount arising in an affected prior accounting period. This negative amount is carried forward to the following period (step 2), where it is either increased by another negative adjusted foreign
permanent establishments amount, or reduced (or eliminated) by a positive foreign permanent establishments amount, but not so as to cause the result to be positive. This process continues through each affected prior accounting period. If (after the application of step 3) there is a negative amount for the last such period, the “total opening negative amount” is determined as the amount of this negative amount (expressed as a positive quantity).

61. **New section 18J(3)** defines “affected prior accounting period” as the accounting period in which the election for exemption is made and any accounting period ending less than 6 years before the end of that accounting period.

62. **New section 18J(4)** defines “adjusted foreign permanent establishments amount” as the foreign permanent establishments amount but without reference to chargeable gains or allowable losses.

**Section 18K of CTA 2009**

63. **New section 18K** provides for the reduction of the “opening negative amount” where it is matched by subsequent aggregate relevant profits amounts.

64. **New section 18K(1)** provides for the opening negative amount to be reduced by the aggregate relevant profits amount (if any) in the accounting period after that in which the election is made and in successive accounting periods until it is extinguished.

65. **New section 18K(2)** provides that when an opening negative amount is reduced by an aggregate relevant profits amount the aggregate relevant profits amount for the accounting period is not exempt.

66. **New section 18K(3)** provides that, in the last accounting period when the opening negative amount can be matched by an aggregate relevant profits amount, exemption is disapplied only to the extent of the opening negative amount at the start of that accounting period.

67. **New section 18K(4)** allows the company to specify in its tax return for the period when the opening negative amount is used up which part of the aggregate relevant profits amount the exemption from UK tax applies to.

68. **New section 18K(5)** defines ‘aggregate relevant profits amount’.

69. **New section 18K(6)** subjects **new section 18K** to **new section 18L**.

**Section 18L of CTA 2009**

70. **New section 18L** gives details of an election for streaming the opening negative amount of the foreign permanent establishments of
a particular territory. If such an election is made, the transitional rule is applied separately to losses in a particular territory so that they do not delay the application of exemption to other territories which would otherwise have no or a shorter transitional period.

71. New section 18L(1) provides that if a streaming election is made new sections 18M and 18N have effect instead of new section 18K.

72. New section 18L(2) explains that the streaming election has to be made at the same time as the election for exemption, must state that sections 18M and 18N are to have effect in relation to the company and must specify which territories are to be streamed.

73. New sections 18L(3) and 18L(4) provide that the streaming election becomes irrevocable at the start of the first exempt period.

74. New section 18L(5) states that a streaming election only has effect if a company specifies in its tax return for the first accounting period to which the election for exemption applies how much of the opening negative amount is to be streamed for each territory.

75. New section 18L(6) provides that the amount that can be streamed to a territory is what the opening negative amount of the company would be if the territory were the only territory in which the company has carried on business through a permanent establishment.

Section 18M of CTA 2009

76. New section 18M provides for the reduction of the streamed “opening negative amount” where it is matched against subsequent aggregate relevant profits amounts for the territory.

77. New section 18M(1) provides for the streamed opening negative amount of the territory to be reduced by the aggregate relevant profits amount (if any) of the territory in the accounting period after that in which the election is made and in successive accounting periods until it is extinguished, but not below nil.

78. New section 18M(2) provides that, when an opening negative amount is reduced by an aggregate relevant profits amount, the aggregate relevant profits amount is not exempt.

79. New section 18M(3) explains that, in the last accounting period when the streamed opening negative amount can be matched by an aggregate relevant profits amount, exemption is disapplied only to the extent of the streamed opening negative amount at the start of that accounting period.

80. New section 18M(4) allows the company to specify in its tax return for the period when the streamed opening negative amount is used up,
to which part of the aggregate relevant profits amount the exemption from UK tax applies.

Section 18N of CTA 2009

81. New section 18N provides for the unstreamed “residual opening negative amount” to be reduced where it is matched by subsequent aggregate relevant profits amounts.

82. New section 18N(1) provides for the residual opening negative amount of the territory to be reduced by the residual aggregate relevant profits amount (if any) in the accounting period after that in which the election is made and in successive accounting periods until it is extinguished.

83. New section 18N(2) defines the residual opening negative amount of a company when a streaming election has effect as the total opening negative amount of the company less the total streamed opening negative amounts.

84. New section 18N(3) defines the residual aggregate relevant profits amount as so much of any relevant profits amount of the company as is not reduced by any streamed negative amount.

85. New section 18N(4) provides that, when a residual opening negative amount is reduced by an residual aggregate relevant profits amount the aggregate relevant profits amount is not exempt.

86. New section 18N(5) explains that, in the last accounting period in which the residual opening negative amount can be reduced by matching it with a residual aggregate relevant profits amount, exemption is disapplied only to the extent of the residual opening negative amount at the start of that accounting period.

87. New section 18N(6) allows the company to specify in its tax return for the period when the residual opening negative amount is used up, to which part of the residual aggregate relevant profits amount the exemption from UK tax applies.

Section 18O of CTA 2009

88. New section 18O sets out how the transitional rules apply when a business or part of a business carried on through a foreign permanent establishment is transferred to a connected company’s foreign permanent establishment.

89. New section 18O(1) provides for the section to apply if the effect of the transfer of business from a foreign permanent establishment to a connected company’s foreign permanent establishment is to lessen the overall effect of the new sections 18K to 18N on profits that are
exempt under section 18A, compared with what the position would be had the business at all material times been carried on by the transferee company.

90. **New section 18O(2)** makes such adjustment as are necessary to the effects of sections 18K to 18N as are necessary to negate the advantage referred to in subsection (1). Where appropriate, adjustments may be made to the application of these sections to both transferor and transferee.

*Section 18P of CTA 2009*

91. **New section 18P** sets out exclusions and restrictions in relation to new section 18A.

92. **New section 18P(1)** restricts the application of new section 18A in the case of a small company (see new section 18S) to permanent establishments in full treaty territories (see new section 18R).

93. **New section 18P(2)** provides that those profits of a close company that are derived from chargeable gains are not relevant profits or losses amounts for the purposes of new section 18A.

*Section 18Q of CTA 2009*

94. **New section 18Q** contains provisions relating to insurance business.

95. **New section 18Q(1)** provides that profits and losses arising from basic life assurance and general annuity business are to be excluded from relevant profits and relevant losses amounts and thereby excluded from exemption within the regime.

96. **New section 18Q(2)(a)** provides that in establishing the investment return of the business carried on through the permanent establishment in accordance with section 432E of ICTA, that section will apply by reference to the surplus of the permanent establishment and not the surplus of the company.

97. **New section 18Q(2)(b)** removes the alternative method of establishing the investment return within section 432E(3) of ICTA.

98. **New section 18Q(3)** provides that any income amounts deemed, or treated, as brought into account as an increase in the value of non linked assets, shall not be regarded as attributable to a foreign permanent establishment.

99. **New section 18Q(4)** provides that an election under section 107(4) of Finance Act (‘FA’) 2000 shall be ignored for the purposes of new Chapter 3A. Section 107 of FA 2000 was repealed by Finance Act
2007, so the impact of ignoring its effect is limited to determining a company’s opening negative amount.

Section 18R of CTA 2009

100. New section 18R contains definitions in relation to the term “full treaty territory”.

101. New section 18R(1) defines a full treaty territory as one with which the UK has entered into double taxation arrangements (see new section 18S) that include a relevant non-discrimination provision.

102. New section 18R(2) defines a relevant non-discrimination provision as one providing that the taxation of a permanent establishment of a contracting state is not to be less favourably levied in the other contracting state than the taxation of enterprises of the other state engaged in the same activities.

Section 18S of CTA 2009

103. Section 18S contains further definitions for the purposes of Chapter 3A. The definition of ‘the OECD model’ refers to the most recent publication of the OECD Model Tax Convention and allows the definition to be updated if necessary by Treasury order.

104. Paragraph 5 adds a new subsection (c) to section 775(4) CTA 2009, which disapplies the section in a case where new section 18A applies to the company for the accounting period and the asset has at any time been used for the purposes of a foreign permanent establishment.

105. Paragraph 6 introduces new section 776A of CTA 2009, which applies in a case where section 775(4)(c) applies (see the entry for paragraph 5 above), but where the asset has not been used exclusively for the purposes of a foreign permanent establishment.

106. If the asset is used wholly for a foreign permanent establishment, the effect of the new section 775(4)(c) is to treat the transfer as taking place at market value, rather than the tax neutral value. Subsection (2) of section 776A applies a transfer value between the tax neutral value and the market value, according to what is appropriate having regard to the operation of new section 18A.

107. Paragraph 7 enables Part 10 CTA 2009 to be taken into account in computing relevant profits and losses amounts for the purposes of section 18A.

108. Paragraphs 8 and 9 have the effect that statutory deductions may be given in respect of the cost of provision of an employee share scheme, despite the operation of section 18A.
109. **Paragraph 10** updates the index of defined expressions used in CTA 2009.

PART 2- AMENDMENTS OF OTHER ACTS

**ICTA**

110. **Paragraph 11** amends part of the controlled foreign company (‘CFC’) legislation. Paragraph 4(1) of Schedule 24 to ICTA requires an assumption to be made that a CFC makes all available beneficial claims and elections. This paragraph amends this rule so that a CFC is assumed not to have made an election under new section 18A of CTA 2009. This is because such an election would typically eliminate the whole of a CFC’s chargeable profits, undermining the effect of the CFC legislation.

111. **Paragraph 12** clarifies the way that a no gain / loss disposal value is calculated for the purposes of the Taxation of Chargeable Gains Act 1992 (‘TCGA 1992’) when a gain or loss is taken into account in calculating a relevant profits or losses amount for the purposes of new section 18A CTA 2009. The disposal value is that value which, taking into account the effect of new section 18A, secures neither a gain nor a loss for the person making the disposal.

**CAA 2001**

112. **Paragraph 13** provides that CAA 2001 is to be amended.

113. **Paragraph 14** inserts new subsection (2A) into section 15.

114. **New section 15(2A)** provides that where a company carries on a business through permanent establishments outside of the UK and an election is made under new section 18A of CTA 2009 then from the beginning of the first accounting period after the election is made the business carried on in the permanent establishment is to be treated as a separate activity the profits and gains of which are not chargeable to tax.

115. **Paragraph 15** inserts new item 6A into the Table in section 61 providing the disposal value where there is a disposal to which new section 62A applies.


117. **New section 62A** gives a new disposal value rule in relation to plant and machinery assets used in the overseas permanent establishment which is subject to a particular plant and machinery disposal event at the beginning of the first period after the election is made. The new rule provides that disposals will be made at tax-written down value (that is, an amount which gives rise to neither a balancing allowance
nor a balancing charge) for the majority of cases. Where new section 62A does not apply disposals will be at market value.

118. **New subsection (1)** provides that the section only applies when an election under new section 18A CTA 2009 has effect and brings about a disposal event solely as a result of section 15(2A) (the business in the exempt foreign territory being treated as a separate activity).

119. **New subsection (2)** provides for the disposal to be the transition value where new section 62A applies.

120. **New subsection (3)** provides that the transition value is the tax-written down value (that is, an amount which gives rise to neither a balancing allowance nor a balancing charge).

121. **New subsection (4)** gives the circumstances where new section 62A does not apply.

122. **New subsection (5)** explains what constitutes a “group of assets” for the purpose of new subsection (4)(a).

123. **New subsection (6)** gives the meaning of “relevant preceding accounting period” for the purpose of new subsection (4)(a).

**ITA 2007**

124. **Paragraph 17** provides for amendments to be made to ITA 2007.

125. **Paragraph 18** extends section 879(1) of ITA 2007 (interest paid on advances from banks). This ensures that the duty under section 874 of ITA to deduct a sum representing income tax from certain payments of interest is also disapplied in the case of interest attributable to a permanent establishment of a bank which would be within the charge to corporation tax as respects that interest apart from new section 18A of CTA 2009.

**Manufactured dividends on UK shares: Real Estate Investment Trusts**

126. **Paragraph 19** modifies the rules in section 918 of ITA 2007 which apply to manufactured dividends on UK shares relating to Real Estate Investment Trusts (UK REITs). The broad effect is that manufactured dividends paid or received by “an exempted permanent establishment” of a UK company are treated in the same way as manufactured dividends paid or received by a non-UK resident.

127. Section 973 of ITA allows regulations to be made for the assessment, collection and recovery of income tax from a dividend paid by a UK REIT, or by the parent company of a group UK REIT, in respect of profits or gains of a property rental business. Section 918 of ITA
provides for the regulations made under section 973 also to apply to certain manufactured dividends representative of such dividends that are paid under arrangements for the transfer of shares.

128. Section 918 of ITA provides for the regulations made under section 973 of ITA 2007 to apply to payments of manufactured dividends made by UK residents or by non-UK residents in the course of a trade carried on through a branch or agency in the UK. It allows regulations to be made where the payer is non-UK resident and does not pay the manufactured dividend in the course of a trade carried on through a branch or agency in the UK and the recipient is a UK resident or a non-UK resident who receives the manufactured dividend for the purposes of a trade carried on through a branch or agency in the UK.

129. The amendments to section 918 of ITA 2007 apply where the manufactured dividend is paid or received by a UK resident company as part of a trade carried on through a foreign permanent establishment in respect of which an election is made under new section 18A of CTA 2009 (“an exempted permanent establishment”). They mean that such a manufactured dividend is treated in the same way as a manufactured dividend paid or received by a non-UK resident otherwise than in the course of a trade carried on through a branch or agency in the UK.

Section 918 of ITA

130. New section 918(3A) of ITA 2007 means that the regulations under section 973 of ITA do not apply to a manufactured dividend paid by a UK resident company in the course of a trade carried on through an exempted permanent establishment.

131. Section 918(4) of ITA is amended so that regulations made under it would apply to a manufactured dividend paid by a UK resident company in the course of a trade carried on through an exempted permanent establishment.

132. New section 918(5A) of ITA 2007 means that regulations made under section 918(4) would not apply to a manufactured dividend received by a UK resident company for the purposes of a trade carried on by an exempted permanent establishment.

Manufactured interest on UK securities

133. Paragraphs 20 and 21 modify the rules applicable to manufactured interest on UK securities in sections 919 and 920 of ITA 2007. The broad effect is that manufactured interest paid or received by “an exempted permanent establishment” of a UK company is treated in the same way as manufactured interest paid or received by a non-UK resident.
134. Sections 919 and 920 of ITA 2007 provide for income tax to be deducted from certain payments and receipts of manufactured interest. Manufactured interest is an amount representative of interest on UK securities that is paid under an arrangement for the transfer of the securities.

135. Section 919 of ITA 2007 provides for the deduction of sums representing income tax from payments of manufactured interest made by UK residents and non-UK residents trading through a branch or agency in the UK. Section 920 of ITA provides for UK residents and non-UK residents trading through a branch or agency to account for income tax on manufactured interest received where the payer is non-UK resident and does not make the payment in the course of a trade carried on through a branch or agency in the UK.

136. The amendments to sections 919 and 920 of ITA 2007 apply where the manufactured interest is paid or received by a UK resident company as part of a trade carried on through a foreign permanent establishment in respect of which an election is made under new section 18A of CTA 2009 (“an exempted permanent establishment”). They mean that such manufactured interest is treated in the same way as manufactured interest paid or received by a non-UK resident otherwise than in the course of a trade carried on through a branch or agency in the UK.

**Section 919 of ITA**

137. New section 919(1A) of ITA 2007 removes the obligation to deduct tax if manufactured interest is paid by a UK resident company in the course of a trade carried on through an exempted permanent establishment.

**Section 920 of ITA**

138. New section 920(1A) of ITA 2007 means that manufactured interest paid by a UK resident company in the course of a trade carried on through an exempted permanent establishment may be subject to a charge on the recipient.

139. New section 920(2A) of ITA 2007 removes the obligation for a UK resident company to account for tax where the manufactured interest is received for the purposes of a trade carried on through an exempted permanent establishment.

140. Section 920(3) of ITA 2007 determines the amount of income tax to be accounted for on the basis of the tax which would have been deducted from a payment of manufactured interest by a UK resident. It is amended to make it clear that it is assumed that that payment is not made by that UK resident in the course of a trade carried on through an exempted permanent establishment.
Manufactured overseas dividends

141. Paragraphs 22 and 23 modify the rules applicable to manufactured overseas dividends (MODs) in sections 922 and 923 of ITA 2007. Their broad effect is that MODs paid or received by “an exempted permanent establishment” of a UK company are treated in the same way as MODs paid or received by a non-UK resident.

142. Sections 922 and 923 of ITA 2007 provide for tax to be deducted from certain payments and receipts of MODs. A MOD is a payment which is representative of an overseas dividend which is made under an arrangement for the transfer of overseas securities.

143. Section 922 of ITA 2007 provides for the deduction of tax from payments of MODs made by UK residents and non-UK residents trading through a branch or agency in the UK. Section 923 of ITA provides for the deduction of tax from MODs received by UK residents and non-UK residents trading through a branch or agency in the UK, where the payer is a non-UK resident and does not make the payment in the course of a trade carried on through a branch or agency in the UK.

144. The amendments to sections 922 and 923 of ITA 2007 apply where the MODs are paid or received by a UK resident company as part of a trade carried on through a foreign permanent establishment in respect of which an election is made under new section 18A of CTA 2009 (“an exempted permanent establishment”). They mean that such MODs are treated in the same way as MODs paid or received by a non-UK resident otherwise than in the course of a trade carried on through a branch or agency in the UK.

Section 922 of ITA

145. New section 922(1A) of ITA 2007 removes the obligation for a UK resident company to deduct tax if it pays a MOD in the course of a trade carried on through an exempted permanent establishment.

Section 923 of ITA

146. New section 923(1A) of ITA 2007 has the effect that MODs paid in the course of a trade carried on by an exempted permanent establishment may be subject to a charge on the recipient.

147. New section 923(2A) of ITA 2007 removes the obligation for a UK resident company to account for tax if it receives a MOD for the purposes of a trade carried on through an exempted permanent establishment.

148. Section 923(3) of ITA 2007 determines the tax to be accounted for under section 923 on the basis of the tax which would have been
deducted from a MOD paid by a UK resident. It is amended to make clear that it shall be assumed that the payment is not made by that UK resident in the course of a trade carried on through an exempted permanent establishment.

**TIOPA**

149. Paragraph 24 provides for TIOPA 2010 to be amended.

150. Paragraph 25 causes to be left out of account for credit relief purposes any foreign tax paid in respect of profits that are included in a relevant profits or losses amount. In particular, this will prevent any such tax being taken into account as unrelieved foreign tax on profits of an overseas permanent establishment (section 72 TIOPA).

151. Paragraph 26 substitutes a new section 43 of TIOPA. That section applies for determining how much of a UK resident company’s profits which are, or would be, chargeable to corporation tax are attributable to a foreign permanent establishment for the purposes of applying a limit on credit imposed by section 42(2) of TIOPA.

152. The existing section 43 of TIOPA applies ‘with the necessary modifications’ the whole of the provisions (Chapter 4 of Part 2 of CTA 2009) which apply for the purpose of determining the profits attributable to a foreign permanent establishment of a non-UK resident company in the UK. This section is repealed and replaced with a new section 43.

**Section 43 of TIOPA**

153. New section 43(1) of TIOPA provides that the new section applies for the purposes of establishing for the purposes of section 42(2) of TIOPA the amounts of the profits that are to be attributed to the foreign permanent establishments of UK resident companies.

154. New section 43(2) sets out the basis for establishing the amount of profits to be attributed to the permanent establishment, namely that the permanent establishment is a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the company of which it is a permanent establishment.

155. New section 43(3)(a) requires the assumption that the permanent establishment has the same credit rating as the company of which it is part.

156. New section 43(3)(b) requires the assumption that the permanent establishment has the equity and loan capital it would have on an allocation made in accordance with subsection (4).
157. New section 43(4) provides for an allocation on a just and equitable basis of the company’s capital amongst the permanent establishments through which it carries on business outside the UK and the entity which the company would be those permanent establishments were distinct and separate entities from the company.

158. New section 43(5) provides that the assumption in new section 43(3)(b) is subject to the provisions of a full double taxation treaty in force between the UK and the state in which the permanent establishment is situated.

159. New section 43(6) provides that new section 43(3)(b) to (5) prevails over any allotment of equity or loan capital to a permanent establishment in the books and records of the company.

160. New section 43(7) provides that in applying new section 43(2), “free assets” of an insurance company are to be attributed to its permanent establishment in accordance with the approach set out in that subsection.

161. New section 43(8) confers a power on the Commissioners for HMRC to make provision as to the meaning of free assets. Paragraph 35 of this Schedule gives effect to the same meaning as is given by existing regulations made for the purposes of non-resident insurance companies, until such time as regulations are made under the power given in this subsection.

162. Paragraph 27 amends the definition of “overseas permanent establishment” in TIOPA, for consistency with this Schedule. In particular, the change gives effect to the definition given in the OECD Model Convention in cases where there is no full treaty (see new section 18R) with the territory. As in new section 18S the definition of ‘the OECD model’ refers to the most recent publication of the OECD Model Tax Convention and allows the definition to be updated if necessary by Treasury order.

163. Paragraphs 28 and 29 make consequential changes to the worldwide debt cap (Part 7 of TIOPA 2010 (tax Treatment of Financing Costs and Income), to exclude amounts that are made exempt under section 18A from being taken into account as debt or as finance income or expense.

164. Paragraph 28 excludes from the calculation of net debt of a company so much of a company’s debt as is attributed to a permanent establishment for the purpose of calculating profits or losses that are made exempt under section 18A.

165. Paragraph 29 similarly excludes from the debt cap definition of a financing expense or income amount any income or expense that is taken into account in the calculation of an exempt profit or loss.
PART 3 – COMMENCEMENT AND TRANSITIONAL PROVISIONS

166. **Paragraph 30** gives effect to the Schedule from the day on which the Act is passed.

167. **Paragraphs 31 and 32** apply in relation to condition B of the motive test for the anti-diversion rule (see section 18H (6)) in certain circumstances where the business of the permanent establishment was previously carried on throughout a period of 12 months up to the day before the Schedule comes into effect (“the pre-commencement year”).

168. **Paragraph 31 (1)** applies to a company’s first relevant accounting period, or one beginning less than 12 months after the start of the first relevant accounting period of the company if the company carried on the business through the permanent establishment throughout the pre-commencement year.

169. **Sub-paragraph (2)** allows condition B of the motive test to be assumed to be met subject to the three provisos at subsection (2)(a) – (c). These give assurance as to the absence of a main reason in carrying on the business through the permanent establishment to achieve a reduction in United Kingdom tax by diversion of profits.

170. **Sub-paragraph (2)(a)** requires that the gross income attributable to the permanent establishment for the relevant accounting period is no more than 10% greater than the level of gross income for the period of 12 months immediately preceding the relevant accounting period. If the relevant accounting period is shorter than 12 months the comparison will be with the appropriate proportion of the income for the 12 months immediately preceding the first relevant accounting period.

171. **Sub-paragraph (2)(b)** further requires that there has been no major change in the nature or conduct of the business (see subsection (3)) over the period starting from the start of the pre-commencement year up to the end of the relevant accounting period (“the relevant period”).

172. **Sub-paragraph (2)(c)** further requires that, in the relevant accounting period, no asset attributable to the permanent establishment was previously owned and no part of the business carried on through the permanent establishment was previously carried on by a controlled foreign company to which section 747(3) applied for any accounting period ending within the relevant period. This includes where an apportionment of chargeable profits and creditable tax (if any) under section 747(3) would have been made but for an agreement made or undertaking given.
Sub-paragraph (3) specifies that “major change in the nature or conduct of the business” for sub-paragraph (2) includes major changes in the type of property dealt in, or services or facilities provided in the business as well as in customers, outlets or markets of the business.

Sub-paragraph (4) specifies that “change” in sub-paragraph (3) includes a change which is achieved gradually as a result of a series of transfers.

Paragraph 32 (1) applies to a company’s first relevant accounting period or one beginning less than 12 months after the start of the first relevant accounting period of the company if the business of the permanent establishment was previously carried on through a non-UK resident company (“company B”) controlled by the company of which the permanent establishment is part (“company A”) and was so carried on throughout the pre-commencement year.

Sub-paragraph (2) allows condition B of the motive test to be assumed to be met subject to the four provisos at subsection (2)(a) – (d).

Sub-paragraph (2)(a) requires that the gross income attributable to the permanent establishment for the relevant accounting period is no more than 10% greater than the level of gross income of the business for the period of 12 months immediately preceding the relevant accounting period. If the relevant accounting period is shorter than 12 months the comparison will be with the appropriate fraction in relation to the immediately preceding 12 month period.

Sub-paragraph (2)(b) further requires that there has been no major change in the nature or conduct of the business (see subsection (3)) over the period starting from the start of the pre-commencement year up to the end of the relevant accounting period (“the relevant period”).

Sub-paragraph (2)(c) further requires that the company that previously carried on the business was not one to which section 747(3) applied for any accounting period ending within the relevant period. This includes where an apportionment of chargeable profits and creditable tax (if any) under section 747(3) would have been made but for an agreement made or undertaking given.

Sub-paragraph (2)(d) further requires that, in the relevant accounting period, no asset attributable to the permanent establishment was previously owned and no part of the business carried on through the permanent establishment was previously carried on by a controlled foreign company to which section 747(3) applied for any accounting period ending within the relevant period. This includes where an apportionment of chargeable profits and creditable tax (if any) under
section 747(3) would have been made but for an agreement made or undertaking given.

181. **Sub-paragraph (3)** applies sub-paragraphs (3) and (4) (on “major change”) of paragraph 31 to subparagraph (2).

182. **Sub-paragraph (4)** applies the meaning of “control” at section 1124 CTA 2010 to this paragraph.

183. **Paragraph 33** extends the definition of “affected prior accounting period” for the purposes of section 18J(2) where there is a relevant losses amount over £50 million in relation to a relevant foreign territory for an earlier accounting period beginning no more than 6 years before the commencement date given in paragraph 30 of this Schedule. In that case, the definition covers that period and every later one which would not otherwise be an affected prior accounting period.

184. **Paragraph 34** provides additional rules for how far back a business must look to see if the plant or machinery has been used other than in a foreign permanent establishment in determining whether the transfer at transition to exemption is at tax-written down value under new section 62A CAA 2001.

Where qualifying expenditure on plant and machinery does not exceed £50 million the “relevant preceding accounting period” will not include an accounting period ending more than 12 months before than the commencement date given in paragraph 30 of this Schedule.

It further extends the definition of “relevant preceding accounting period” where the qualifying expenditure exceeds £50 million to any accounting period beginning not more than 6 years before the commencement date mentioned in paragraph 30 above.

185. **Paragraph 35** gives a definition used in section 43 TIOPA (as substituted by paragraph 26 of this Schedule).

**BACKGROUND**

186. Branch exemption and distribution exemption (introduced in 2009) together have the effect that profits earned through foreign operations of UK resident companies will not generally be taxed in the UK except by reason of the controlled foreign company (CFC) rules or other rules intended to prevent the artificial diversion of profits from the UK.

187. This legislation invokes treaty principles to establish the measure of profits, including chargeable gains, for exemption. Treaties require the profits attributable to a foreign permanent establishment to be identified and it is that identified amount which is eligible for
exemption. If the amount attributable to the foreign permanent establishment is a loss, this is also excluded from the calculation of the profits of a company chargeable to Corporation Tax. The same principles are used for chargeable gains.

188. An anti-diversion rule prevents branch exemption from being used to avoid taxation on the amount of profits arising in a UK resident company. There are also rules to prevent any new incentive occurring to use branches to sidestep deduction at source rules and to ensure that capital allowances are taken into account in the branch profits calculation to an appropriate extent. A further rule applies on transition to exemption to ensure a coherent approach to loss relief and profits exemption.
EXPLANATORY NOTE

CLAUSE 49: MEANING OF “INVESTMENT TRUST”

SUMMARY

1. Chapter 4 of Part 24 of the Corporation Tax Act (CTA) 2010 sets out the meaning of “investment trust” for the purposes of the Corporation Tax Acts. Clause 49 amends the CTA 2010 to provide a new definition of “investment trust”. It also provides a power for the Treasury to make regulations about the circumstances in which the Commissioners for Her Majesty’s Revenue and Customs (“the Commissioners”) may approve applications from a company to be an investment trust.

DETAILS OF THE CLAUSE

2. Subsection (2) substitutes a new section 1158 of CTA 2010 which provides that to be an “investment trust” a company must, in relation to an accounting period, meet specified conditions and be approved for that period by the Commissioners.

3. Subsection (3) substitutes a new section 1159 of CTA 2010 which provides powers for the Treasury to make regulations specifying the circumstances in which a company can be approved as an investment trust and the process by which approval can be given or refused. This section also specifies that the first regulations made using this power must be made under the affirmative resolution procedure; subsequent regulations are subject to the negative resolution procedure.

4. Subsections (4) and (5) omit the remaining sections in Chapter 4 of Part 24 of CTA 2010 and provide for commencement of the amendments made by this section by Order of the Treasury.

BACKGROUND NOTE

5. An intention to reform the legislative framework for investment trusts was announced at the June 2010 Budget. A consultation document and subsequently a summary of responses, containing draft primary legislation, were published on 27 July and 9 December 2010 respectively.

6. A company which invests its funds with the aim of spreading investment risk and giving members of the company the benefit of the
results of management of its funds can be approved as an “investment trust” if it meets certain conditions.

7. The main benefit of approval as an investment trust is exemption from corporation tax on chargeable gains. Investors, who may be subject to tax on chargeable gains when they dispose of their interests, are therefore not subject to a double layer of taxation.

8. The purpose of clause 49 is to provide a revised definition of “investment trust” for the purposes of the Corporation Tax Acts.

9. The clause includes powers enabling HM Treasury to make regulations to provide a regime under which a company may be approved as an investment trust by the Commissioners and the process by which approvals are granted or refused.
EXPLANATORY NOTE

CLAUSE 50: POWER TO MAKE PROVISION ABOUT TREATMENT OF TRANSACTIONS

SUMMARY

1. Clause 50 inserts a new Chapter 3A into the Corporation Tax Act 2010 (CTA 2010) to provide a power for the Treasury to make regulations about the treatment of specified transactions of investment trusts for the purposes of the Corporation Tax Acts.

DETAILS OF THE CLAUSE

2. The clause inserts a new section 622A into CTA 2010.

3. The new section provides a power to make regulations which may provide that specified transactions are not to be treated as being trading transactions.

4. New section 622A(3) specifies that the first set of regulations under this power cannot be made unless a draft has been approved by the House of Commons.

BACKGROUND NOTE

5. An intention to reform the legislative framework for investment trusts was announced at the June 2010 Budget. A consultation document and subsequently a summary of responses, containing draft primary legislation, were published on 27 July and 9 December 2010 respectively.

6. Clause 50 enables the Treasury to provide certainty about the tax treatment of transactions made by investment trusts by providing that they are not treated as trading transactions.

7. Provisions excluding certain transactions from being treated as trading transactions already exist for authorised investment funds.
EXPLANATORY NOTE

CLAUSE 51: TAXABLE BENEFITS: CALCULATING THE APPROPRIATE PERCENTAGE FOR CARS

SUMMARY

1. Clause 51 relates to taxable benefits on company cars. With effect from 6 April 2013, it modifies the current appropriate percentage bands and carbon dioxide (CO₂) emissions thresholds by revising the relevant threshold down to 95g CO₂ per kilometre, rather than 100g.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for a change to the level of the relevant threshold in section 139 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (as amended by section 59 of the Finance Act 2010 with effect from 6 April 2012).

3. Subsection (2) provides that this amendment has effect for 2013-14 and subsequent tax years.

BACKGROUND NOTE

4. Section 139 of ITEPA sets out the basis for calculating the appropriate percentage for cars with CO₂ 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.

5. From 6 April 2012, the graduated table of company car tax bands will provide for a 0 per cent band for zero emission cars, a 5 per cent band for ultra low emissions cars (1-75g CO₂ per km emissions), a new 10 per cent band for other low emissions cars (76g-100g CO₂ per km emissions) with a 1 per cent increase for each rise in emissions of 5g CO₂ per km from 6 April 2012 to a maximum of 35 per cent.

6. The effect of clause 51 is to change the 10 per cent band for low emissions cars to 76-95g CO₂ per km from 6 April 2013. The rule under which there is a 1 per cent increase in the appropriate percentage for each rise in emissions of 5g CO₂ per km above 100g CO₂ to a maximum of 35 per cent will apply instead to each rise in emissions of 5g CO₂ per km above 95g CO₂.
7. On average, the level of CO₂ 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 52 SCHEDULE 14: FURNISHED HOLIDAY LETTINGS

SUMMARY

1. Clause 52 and Schedule 14 make three changes to the special rules for the tax treatment of income from the commercial letting of furnished holiday accommodation, extending the rules, restricting tax relief for losses and tightening qualifying criteria.

2. The first change extends the special rules to the letting of property outside the UK but in the European Economic Area (EEA).

3. The second change removes:
   - income tax relief for losses against general income and for terminal losses; and
   - corporation tax relief for losses against total profits.

4. The third change extends the length of the periods for which accommodation must be available to be let and is actually let if it is to qualify as holiday accommodation.

5. The first and second changes take effect for income tax from 2011-12 and for corporation tax from accounting periods beginning on or after 1 April 2011.

6. The third change takes effect for income tax from 2012-13 and for corporation tax from accounting periods beginning on or after 1 April 2012.

DETAILS OF THE SCHEDULE

Part 1: Income tax

7. Paragraph 1 amends the rules in Finance Act 2004 about relief for pension contributions and amends the definition of “relevant UK earnings” in section 189(2) of that Act so that it includes income from an EEA furnished holiday lettings (FHL) business.

8. An “EEA furnished holiday lettings business” consists of the commercial letting of furnished holiday accommodation carried on in one or more EEA countries excluding the UK (new section 189(6A)).

Details of the revised section 322 of ITTOIA

10. This section introduces the rules about the commercial letting of furnished holiday accommodation. Paragraph 2(2) extends the section so that it applies to an EEA furnished holiday lettings business (new section 322(2A)).

Details of the revised sections 325 and 326 and the new section 326A of ITTOIA

11. Paragraphs 2(3) and (4) amend sections 325 and 326 to increase the lengths of the periods used to determine whether accommodation is “qualifying holiday accommodation”. During a tax year the accommodation must be available for commercial letting for at least 210 days (instead of 140) and must be commercially let for at least 105 days (instead of 70). New section 326(7) ensures that an averaging election has to be made separately for properties in the UK and for properties in the EEA.

12. Paragraph 2(5) introduces new section 326A which allows a “period of grace”. Once a property qualifies as holiday accommodation in one tax year the owner may elect to treat the property as continuing to qualify for up to two later years even though it does not meet the “letting condition” (based on 105 days) in the later years. The election may only be made if an averaging election under section 326 has not been made in respect of the same year. The election has to be made in the first tax year in which the letting condition is not met.

Details of the new sections 328A and 328B of ITTOIA

13. Paragraph 2(8) introduces new sections 328A and 328B. These sections require that in some circumstances separate calculations are made of the income from:

- EEA furnished holiday lettings; and
- other overseas property lettings.

14. They are the equivalents for EEA furnished holiday lettings to the rules for UK furnished holiday lettings in sections 327 and 328 of ITTOIA.

Details of the revised section 117 of ITA

16. This section introduces the rules about losses from property businesses. Paragraph 3(2) introduces new section 117(2A) which extends the section so that it applies to an EEA furnished holiday lettings business.

Details of the revised section 127 of ITA

17. Revised section 127 treats a “UK furnished holiday lettings business” as a trade for the purposes of loss relief. Paragraph 3(3) removes relief for losses against general income (sections 64 to 82 of ITA) and for terminal losses (sections 89 to 95 of ITA).

Details of the new section 127ZA of ITA

18. Paragraph 3(4) introduces new section 127ZA which treats an “EEA furnished holiday lettings business”, defined in new section 127ZA(2), as a trade for the purposes of loss relief. It is the equivalent of section 127 for UK furnished holiday lettings businesses.

Details of the revised section 836 of ITA

19. Section 836 provides that income from property held jointly by married couples or civil partners living together is treated as arising in equal shares. There is an exception to this general rule for income from a furnished holiday lettings in the UK. Paragraph 3(5) inserts another exception, exception DA in new section 836(3), for income from EEA furnished holiday lettings.

Commencement

20. Paragraphs 4 to 6 give details of commencement for income tax. Paragraph 4 sets out the date from which the changes take effect with the exception of those in paragraphs 5 and 6. Paragraph 5 sets out the date from which the changes to the lengths of the periods used to determine whether accommodation is “qualifying holiday accommodation” are effective and paragraph 6 makes particular reference to the “period of grace” commencement.

Part 2: Corporation tax

Details of the revised section 264 of CTA 2009

22. Revised section 264 introduces the rules about the commercial letting of furnished holiday accommodation. Paragraph 7(2) extends the section so that it applies to an EEA furnished holiday lettings business (new section 264(2A)).

Details of the revised sections 267 and 268 and the new section 268A of CTA 2009

23. Paragraphs 7(3) and (4) amend sections 267 and 268 to increase the length of the periods used to determine whether accommodation is “qualifying holiday accommodation”. During an accounting period the accommodation must be available for commercial letting for at least 210 days (instead of 140) and must be commercially let for at least 105 days (instead of 70). New section 268(7) ensures that an averaging election has to be made separately for properties in the UK and for properties in the EEA.

24. Paragraph 7(5) introduces new section 268A which allows a “period of grace”. Once a property qualifies as holiday accommodation in one accounting period year the company may elect to treat the property as continuing to qualify for up to two more later accounting periods even though it does not meet the “letting condition” (based on 105 days) in the later periods. The election may only be made if an averaging election under section 268 has not been made in respect of the same year. The election has to be made in the first accounting period in which the letting condition is not met.

Details of the new section 269A of CTA 2009

25. Paragraph 7(7) introduces new section 269A which requires that in some circumstances separate calculations are made of the income from:

- EEA furnished holiday lettings; and
- other overseas property lettings.

26. This is the equivalent for EEA furnished holiday lettings to the rules for UK furnished holiday lettings in section 269 of CTA 2009.


Details of the revised section 65 of CTA 2010

28. This section treats a “UK furnished holiday lettings business” as a trade for the purposes of loss relief. Paragraph 8(2) removes the relief for losses against total profits (sections 37 to 44 of CTA 2010).
Details of the new section 67A of CTA 2010

29. Paragraph 8(3) introduces new section 67A. This section treats an “EEA furnished holiday lettings business” as a trade for the purposes of loss relief. It is the equivalent of section 65 for UK furnished holiday lettings businesses.

Commencement

30. Paragraphs 9 to 11 give details of commencement for corporation tax. Paragraph 9 sets out the date from which the changes take effect with the exception of those in paragraphs 10 and 11. Paragraph 10 sets out the date from which the changes to the lengths of the periods used to determine whether accommodation is “qualifying holiday accommodation” are effective and paragraph 11 makes particular reference to the “period of grace” commencement.

Part 3: Capital allowances


Details of the new section 13B of CAA

32. Paragraph 12(2) introduces new section 13B which provides a rule that where a person carrying on a property business of any of the four types listed in section 15(1)(a) to (d), uses plant or machinery in rotation between different types of property business, whilst still retaining ownership, that person is treated as if the plant or machinery was first acquired at the date it started to be re-used for the first property business after ceasing to be used in the second property business. The amount of qualifying expenditure is treated as the market value of the plant or machinery or the amount of the original expenditure if lower.

33. Paragraph 12(3) amends section 15(1) to cover the four types of property businesses that are qualifying activities for capital allowances purposes, following the extending of the special rules to the letting of property outside the UK but in the EEA.

34. Paragraphs 12(4) to (17) make consequential amendments following the changes made to section 15 of CAA.

Part 4: Chargeable gains

Details of the revised section 241 of TCGA

36. Paragraph 14(2) amends the rules in section 241 about the commercial letting of furnished holiday accommodation so that it specifically applies to a UK furnished holiday lettings business. It also removes an obsolete reference to capital gains tax retirement relief, which ceased to be available in 2003.

Details of the new section 241A of TCGA

37. Paragraph 14(3) introduces new section 241A which sets out the rules about commercial letting of furnished holiday accommodation as they apply to an EEA furnished holiday lettings business. The rules are the equivalents for EEA furnished holiday lettings to the rules for UK furnished holiday lettings in revised section 241.

38. Paragraphs 15 to 17 set out the dates from which the changes to TCGA take effect. It may be necessary to treat an EEA furnished holiday lettings business as a trade before those dates if maximum capital gains relief is to be available. Paragraph 17 allows this by treating new section 241A as having been in force at all material times from 1 January 1994.

BACKGROUND NOTE

39. The furnished holiday lettings (FHL) legislation applies to properties that are used to provide commercial furnished holiday lettings. Income from FHL, although income from property, qualifies for certain specified tax treatments for trades, providing certain conditions are met. The tax treatments cover income tax, corporation tax, capital allowances and chargeable gains. Individuals, partnerships and companies are all covered by the regime.

40. Originally the FHL legislation applied only where the letting in question was carried on in the UK. As this limitation may not have complied with EU law, as an interim measure, the previous government announced in 2009 that HMRC would apply the rules to all qualifying properties in the EEA. The FHL rules would then beabolished from 2010-11.

41. The Government announced in the June Budget that it would not repeal the FHL rules, because of the adverse effect this would have on UK businesses and the UK tourism industry. Instead, it undertook to consult on proposals that would ensure the regime was compliant with European law in a way that was fiscally responsible, whilst at the same time allowing properties let as commercial businesses to continue to benefit from favourable treatment.
42. These proposals were as follows:

43. To formalise within legislation that FHL in both the UK and the EEA would be eligible as qualifying FHL within the (revised) special tax rules;

44. The minimum period over which a qualifying property has to be available for letting to the public in the relevant period would be increased from 140 days to 210 and the minimum period over which a qualifying property has to be actually let to the public in the relevant period would be increased from 70 days to 105 days in a year.

45. The relevant period is normally the tax year for individuals and partnerships or the accounting period for companies;

46. Losses made in a qualifying UK or EEA furnished holiday lettings business can only be set against income from the same UK or EEA furnished holiday lettings business;

47. The Government has carefully considered the responses to the consultation. Changes to the original proposals are reflected in Schedule 14, as well as those proposals which have remained unchanged following consultation.

48. Following consultation on the draft Finance Bill clauses amendments have been made to the date from which the period of grace provisions apply.
EXPLANATORY NOTE

CLAUSE 53: LEASES AND CHANGES TO ACCOUNTING STANDARDS

SUMMARY

1. Clause 53 ensures that businesses which account for lease transactions using a new form of leasing accounting standard will be treated for tax purposes as if the changes to the leasing accounting standard had not taken place.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that the clause applies to changes in a leasing accounting standard occurring on or after 1 January 2011.


4. Subsection (3) provides that the clause will not apply to a change in a leasing accounting standard if it is a change to UK Generally Accepted Accounting Practice (UK GAAP) that permits or requires businesses to account for a lease, or a transaction accounted for as a lease, in a manner equivalent to that provided for by the International Financial Reporting Standard for Small and Medium-sized Entities issued by the International Accounting Standards Board (but ignoring any change which may be made to the leasing section of that Standard). As a consequence, should the draft Financial Reporting Standard for Medium-sized Entities proposed by the UK Accounting Standards Board on 29 October 2010 be issued and include such an equivalent lease section then this will not constitute a change in a leasing accounting standard under this clause.

5. Subsection (4) ensures that the clause will also apply to a change in a leasing accounting standard adopted for periods of account falling wholly or partly before the change in the leasing accounting standard occurs or before the clause is enacted. This recognises the uncertainty both as to when changes to a leasing accounting standard may occur and whether persons may be permitted to adopt the changes before any mandatory start date.

6. Subsection (5) requires that any change in a leasing accounting standard is ignored when considering whether something has been determined or done in accordance with or by reference to generally accepted accounting practice. Similarly any change in a leasing accounting standard is ignored when considering whether accounts
have been prepared or not prepared in accordance with International Accounting Standards or UK GAAP.

7. **Subsection (6)** provides that for the purposes of this clause the meaning of generally accepted accounting practice and related expressions usually applicable for the Tax Acts is determined by reference to subsection (5) to such practice before any leasing accounting standard change.

8. **Subsection (7)** introduces the concepts of new standards and old standards (defined in subsection (11)). It applies subsection (8) or (9) as a consequence of a person first preparing accounts (or being required to prepare accounts) in accordance with new standards. Subsection (8) will apply where the person prepared accounts in accordance with old standards in the previous period of account. Subsection (9) will apply in all other cases, for example, where a new company uses a new standard in its first period of account.

9. **Subsection (8)** requires a person to use their old standard for the purpose of the Taxes Act. For example, if immediately prior to using a new standard a company was using International Accounting Standards then their old leasing standard will be International Accounting Standards disregarding any changes to lease accounting standards.

10. **Subsection (9)** requires a person to use the old standard that corresponds to their new standard for the purpose of the Taxes Acts. For example, if a sole trader business uses UK GAAP (incorporating changes to a leasing accounting standard) then the corresponding old standard will be UK GAAP disregarding the changes to the leasing accounting standard.

11. **Subsection (10)** defines for the purposes of subsection (9) what corresponding old standards are.

12. **Subsection (11)** provides relevant definitions for the purposes of this clause.

13. **Subsection (12)** provides that the clause applies where there is a change to a leasing accounting standard occurring on or after 1 January 2011 and ensures that it applies to any period, including any period falling wholly or partly before the clause is enacted. This recognises the uncertainty both as to when changes to a leasing accounting standard may occur and whether persons may adopt the changes before any mandatory start date.
BACKGROUND NOTE

14. A significant part of the corporation tax and income tax code for leases is based on accounting definitions, particularly the distinction between finance leases and operating leases, and the resulting entries in accounts prepared in accordance with either UK GAAP or International Accounting Standards.

15. Fundamental changes to lease accounting, in particular the removal of the distinction between finance leases and operating leases, within International Accounting Standards are expected during 2011. UK GAAP may also introduce similar fundamental changes to lease accounting during 2013. If these changes go ahead as planned the current tax rules will not work as originally intended, or in some situations not work at all.

16. Clause 53 prescribes which version of the accounting standards a business must use when determining and computing lease entries for tax purposes in order to ensure current tax law is maintained and operates as originally intended. Businesses which account for lease transactions using a new form of leasing accounting standard will for tax purposes be treated as if the changes to the leasing accounting standard had not taken place.
EXPLANATORY NOTE

CLAUSE 54: LEASING COMPANIES: WITHDRAWAL OF ELECTION

SUMMARY

1. Clause 54 makes changes to the sale of lessor company provisions in Part 9 of the Corporation Taxes Act (CTA) 2010 to withdraw the option to elect out of the charge as it is no longer needed and has been abused. The provisions have immediate effect to prevent a risk of forestalling.

DETAILS OF THE CLAUSE

2. Clause 54 withdraws the option to elect out of the charge when the relevant day falls on or after 23 March 2011 by inserting “before 23 March 2011” in section 398A(1)(a) of CTA 2010.

BACKGROUND NOTE

3. The sale of lessor company legislation was introduced in Finance Act (FA) 2006 to address a risk that tax would be lost on the deferred profits of the lessor company after it changes hands.

4. The option to elect out of the charge was introduced in FA 2010 in response to the difficulties experienced by groups wishing to sell lessor companies during the recent economic crisis.

5. Schedule 6 makes further changes to the sale of lessor company provisions.
EXPLANATORY NOTE

CLAUSE 55: COMPANIES WITH SMALL PROFITS: ASSOCIATED COMPANIES

SUMMARY

1. Clause 55 amends corporation tax small profits rate legislation to ensure that companies are not held to be associated through an attribution of rights, solely by virtue of relationships between individuals but rather only where the level of commercial interdependence between the companies themselves makes it appropriate to do so.

DETAILS OF THE CLAUSE

2. Subsection (1) replaces the wording of section 27 of the Corporation Tax Act (CTA) 2010.

3. New section 27(1) provides that when considering whether two companies are under common control and thus associated, section 27 applies only when the relationship between the two companies is not one of substantial commercial interdependence.

4. New section 27(2) impacts upon section 451 of CTA 2010. Where the control tests at section 450 of CTA 2010 are being applied to a person, in order to establish whether two companies are associated, those tests are limited where there is no substantial commercial interdependence between the companies. Where substantial commercial interdependence is not present, the person to whom the control tests are being applied is deemed not to have any associates. This means that rights held by another are not attributable to him under sections 451(4) and (5) of CTA 2010.

5. New section 27(3) provides that HM Treasury may, by order, prescribe factors that should be taken into account when determining whether, for the purposes of this section, substantial commercial interdependence exists between companies.

6. Subsection (2) sets out that new section 27 has effect for accounting periods ending on or after 1 April 2011.

7. Subsection (3) allows a company to elect for new section 27 to apply only to its accounting periods that commence after 1 April 2011.
8. **Subsection (4)** sets out the timeframe in which an election under subsection (3) must be made.

9. **Subsection (5)** allows the first order made under the power provided by section 27(3) to have effect for accounting periods ending on or after 1 April 2011.

**BACKGROUND NOTE**

10. In establishing who controls a company and whether two companies are under common control and thus associated, sections 450 and 451 of CTA 2010 currently automatically attribute to an individual all the rights and powers held by his or her associates.

11. HM Revenue & Customs (HMRC) extra statutory concession (ESC) C9, however, separately limits such attribution between relatives (apart from spouses and minor children) solely to circumstances where substantial commercial interdependence exists between the companies.

12. Clause 55 places the treatment currently afforded by longstanding ESC C9 on to a statutory footing and extends it to all associates.

13. The proposed change has been arrived at through consultation over the last two years between HM Treasury and HMRC official and representatives from business, the accountancy profession and the Law Society.
EXPLANATORY NOTE

CLAUSE 56: INSURANCE COMPANIES: APPORTIONMENT OF AMOUNTS BROUGHT INTO ACCOUNT

SUMMARY


DETAILS OF THE CLAUSE

2. Subsection (1) amends the definition of D in subsection (9) of section 432C of ICTA.

3. Subsection (2) provides that the amendment in subsection (1) has effect for periods of account beginning on or after 1 January 2011.

4. Subsection (3) provides that where for the purposes of section 432CA of ICTA an applicable appropriate period ends before 1 January 2011 the amendment in subsection (1) has effect in applying section 432C to that period of account.

BACKGROUND NOTE

5. Where a life insurance company carries on more than one category of long term business it is necessary to apportion the income and gains brought into account in its regulatory return between those categories of business.

6. Finance Act 2007 introduced new rules which treat Overseas Life Assurance Business, ISA Business, CTF Business, Pension Business and Life Reinsurance Business as a single category, Gross Roll Up Business (GRB) for tax purposes. As a consequence section 432C, which is used to determine:

- the amount to be allocated to the company’s life assurance business, as opposed to its Permanent Health Insurance (PHI) business; and

- the amount to be allocated to the company’s GRB business as opposed to its BLAGAB (Basic Life and General Annuity Business),

was rewritten.
7. As a result of that rewriting the total mean linked asset values of BLAGAB and PHI are to be deducted from the total of BLAGAB and PHI liabilities, rather than the mean liabilities of each category of business being reduced only by the mean linked asset values of the same category of business. This was an inadvertent change to the operation of section 432. The amendment reverses that change.
EXPLANATORY NOTE

CLAUSE 57: TONNAGE TAX: CAPITAL ALLOWANCES IN RESPECT OF SHIP LEASING

SUMMARY

1. Clause 57 amends the capital allowances treatment of ships leased to companies that have elected to have their corporation tax profits from qualifying activities calculated under the Tonnage Tax legislation. It brings the rate of writing down allowances available on the first £40 million of expenditure on a ship into line with the rate available on a ship used by a company that has not elected for Tonnage Tax. The clause amends various provisions of Schedule 22 to Finance Act (FA) 2000.

DETAILS OF THE CLAUSE

2. Subsection (2)(a) amends paragraph 94(3)(a) of Schedule 22 to FA 2000 so that the writing-down allowances on the first £40 million of expenditure on a ship will be at a rate to be determined by a new sub-paragraph (3A), rather than at a fixed rate of 20 per cent.

3. Subsection (2)(b) amends paragraph 94(3)(b) so that writing-down allowances on the next £40 million of expenditure on a ship are at the ‘special rate’ set out in section 104D(1) of the Capital Allowances Act 2001. As the special rate is currently 10 per cent there is no immediate change. However the rate in paragraph 94(3)(b) will automatically rise or fall in line with changes to the special rate.

4. Subsection (2)(c) introduces new paragraph 94(3A). Paragraph 94(3A) provides that the rate of writing-down allowances on the first £40 million of expenditure on ships that are not long life assets will be at the main rate for capital allowances, whilst the rate of writing-down allowances on the first £40 million of expenditure on ships that are long life assets will be at the special rate.

5. Subsection (2)(d) and (e) introduces new paragraph 94(4A) and amends the existing pools in paragraph 94(4) from a 20 per cent and a 10 per cent pool to a main rate and a special rate pool. The first £40 million of expenditure on a ship that is not a long life asset will be allocated to the tonnage tax (main rate) pool. The first £40 million of expenditure on a ship that is a long life asset will be allocated to the tonnage tax (special rate) pool together with the next £40 million of expenditure on the ship. Subsections (3) to (5) make consequential amendments.
6. **Subsection (6)** amends paragraph 99, which deals with the situation where the ship is leased to a company that ceases to be in Tonnage Tax. The intention is that, when the ship ceases to be used by a company in Tonnage Tax, the lessor will be placed in the same position for capital allowance purposes as if the ship not been leased to a company in Tonnage Tax and the available writing down allowances had been claimed each year.

7. **Subsection (8)** provides that these amendments have effect in relation to chargeable periods ending on or after 1 January 2011. These provisions have retrospective effect.

8. **Subsection (9)** is a transitional rule. The legislation does not affect expenditure where the lessor incurred the expenditure on the ship before 1 January 2011

**BACKGROUND NOTE**

9. There are restrictions on the amount of writing down allowances that a lessor can claim where it leases a ship to a company that has elected to have its corporation tax profits calculated using the rules of Tonnage Tax. The lessor can claim writing down allowances at the main rate of 20 per cent on the first £40 million of expenditure on a ship; and at the rate of 10 per cent on the next £40 million of expenditure. Expenditure over £80 million on a ship leased to a company in Tonnage Tax does not qualify for writing down allowances.

10. From 1 January 2011, where a ship is not used by a company in Tonnage tax, the writing down allowances will be at the special rate, currently 10 per cent, where the ship is a long life asset.

11. The changes provide for an equivalent treatment for the first £40 million of expenditure on ships leased to companies that have elected for Tonnage Tax.
EXPLANATORY NOTE

CLAUSE 58: TRANSFER PRICING: APPLICATION OF OECD PRINCIPLES

SUMMARY

1. Clause 58 updates the definition of “transfer pricing guidelines” within the UK’s transfer pricing legislation to refer to the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by OECD for publication in July 2010.

2. It also extends the power to make future changes to the definition by secondary legislation to include replacement of the existing version of the OECD Transfer Pricing Guidelines.

3. The changes apply, for corporation tax purposes, for accounting periods beginning on or after 1 April 2011, and, for income tax purposes, for the tax year 2011-12 and subsequent tax years.

DETAILS OF THE CLAUSE


5. New subsection (4)(a) defines the “transfer pricing guidelines” as the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the OECD on 22 July 2010.

6. New subsection (4)(b) allows for future changes to the definition of “transfer pricing guidelines” where updates or replacement versions of the OECD transfer pricing guidelines are published to be made by secondary legislation.

7. Subsection (2) provides that the new subsection (4)(a) and (4)(b) have effect, for corporation tax purposes, for accounting periods beginning on or after 1 April 2011 and, for income tax purposes, for the tax year 2011-12 and subsequent tax years.

BACKGROUND NOTE

8. Transfer prices are the prices that connected parties use when they conduct business with each other.
9. UK transfer pricing rules are based on the internationally agreed arm’s length principle. Guidance on applying the arm’s length principle is set out in the OECD’s transfer pricing guidelines, which are referred to in UK transfer pricing legislation. They are available from the OECD website (www.oecd.org).

10. In July 2010, following an extensive period of consultation, the OECD published revised and updated guidelines on applying the arm’s length principle. These provide greater practical guidance and reflect changes of emphasis based on experience gained since the guidelines were originally published in 1995.
EXPLANATORY NOTE

CLAUSE 59: OFFSHORE FUNDS

SUMMARY

1. Clause 59 inserts a new section 363A into the Taxation (International and Other Provisions) Act 2010 to treat certain offshore funds as not being resident in the United Kingdom (UK), in cases where they otherwise might be resident by virtue of having a UK resident fund manager.

DETAILS OF THE CLAUSE

2. New section 363A(1) defines the offshore funds within the scope of the legislation. These are funds that are authorised under article 5 of the UCITS IV directive and are treated as tax resident in the Member State where they are authorised.

3. New section 363A(2) provides that where a fund so defined is a body corporate then it will be treated as not being resident in the UK for tax purposes.

4. New section 363A(3) provides that where a fund so defined is treated as if it were a company for the purposes of tax on chargeable gains then the deemed company will be treated as not being resident in the UK for the purposes of the Taxation of Chargeable Gains Act 1992.

BACKGROUND NOTE

5. The UCITS IV directive provides that an investment fund authorised under the provisions of Article 5 of that directive may have a manager which is not resident in the same State as that in which the fund is established and regulated.

6. Clause 59 ensures that the affected offshore funds and their investors will not be subject to any tax consequences in the UK as a result of having a UK resident management company.

EXPLANATORY NOTE

CLAUSE 60: INDEX-LINKED GILT-EDGED SECURITIES

SUMMARY

1. Clause 60 amends the corporation tax definition of an index-linked gilt-edged security. The current definition provides that an index-linked gilt-edged security is one where the payments are wholly or partly determined by reference to the retail prices index (RPI). This is changed so that an index-linked gilt-edged security is one where the payments are determined, wholly or partly, by reference to an index of prices published by the Statistics Board.

DETAILS OF THE SCHEDULE

2. Subsection (1) amends section 399 of the Corporation Tax Act (CTA) 2009 by substituting new subsection 399(4). The amendment replaces the current definition of an index-linked gilt-edged security which refers to the RPI with a new definition which refers to an index of prices published by the Statistics Board.

3. Subsection (2) substitutes the word ‘relevant’ for ‘retail’ wherever it appears in sections 400 and 400A of CTA 2009. Subsection (3) makes consequential amendments.

4. Subsection 4 provides that the amendments have effect from the date of Royal Assent.

BACKGROUND NOTE

5. In July 2010, the Minister for Pensions announced that, from 2011, the “general level of prices” for determining the statutory minimum percentage increase for the revaluation and indexation of private sector occupational pensions, Pension Protection Fund compensation and Financial Assistance Scheme payments is the consumer prices index (CPI).

6. As a result, for those pension funds whose trust deeds refer to the “general level of prices” for the revaluation of deferred pensions and the indexation of pensions in payment, the CPI applies as the statutory minimum increase rather than the retail prices index (RPI).

7. At present, there is not a reliable government estimate of the number, or size, of pension schemes that are affected. A number of pension
schemes are required explicitly by their trust deeds to revalue deferred pensions or uprate pensions in payment by reference to the RPI regardless of the Government’s definition of the “general level of prices”. However, some reports suggest that a significant number of pension funds are directly affected by the decision.
EXPLANATORY NOTE

CLAUSE 61: PRT: AREAS TREATED AS CONTINUING TO BE OIL FIELDS

SUMMARY

1. Clause 61 corrects a defect in existing legislation that governs whether assets have been decommissioned.

DETAILS OF THE CLAUSE

2. Subsection (1) amends existing legislation which provides that the Board must have regard to any obligations to decommission qualifying assets which arise under the law applicable to the relevant area. It provides that the Board must instead have regard to any obligations which arise under the law applicable to those qualifying assets.

3. Subsection (2) provides that the amendment made by subsection (1) has effect in relation to chargeable periods that begin after 30 June 2009.

BACKGROUND NOTE

4. Paragraphs 6 and 7 of Schedule 1 to the Oil Taxation Act 1975 seek to ensure that companies can obtain relief for decommissioning costs for petroleum revenue tax (PRT) purposes after a licence granted by the Department of Energy and Climate Change has expired.

5. Paragraph 6 achieves part of this by deeming an area which has ceased to be an oil field or part of such a field as continuing to be the oil field or part of such field. This treatment ceases in several situations, and in particular at the end of the second chargeable period that falls after the chargeable period in which the area is decommissioned.

6. Paragraph 7 determines whether an area is decommissioned and provides that a relevant area is decommissioned if all qualifying assets of the relevant area are decommissioned.

7. Where a UK offshore decommissioning regime does not apply to qualifying assets of the relevant area, those assets are decommissioned if the Board are satisfied that they have been decommissioned.
8. The legislation provides that in reaching their decision the Board must have regard to any obligations to decommission the qualifying assets which arise under the law applicable to the relevant area (whether the law of any part of the UK or of any other state or territory), including any obligations imposed by an authority having functions under that law in respect of such decommissioning.

9. ‘Relevant area’ as defined in the legislation is necessarily within the UK Continental Shelf (UKCS), being an area for which either the Secretary of State or the Department of Commerce for Northern Ireland is the appropriate authority. However the legislation referred to in paragraph 8 above is only brought into play if a UK offshore decommissioning regime does not apply to qualifying assets of the relevant area, and so the asset is outside the UKCS. That being the case the requirement to have regard to the law applicable to the relevant area is inappropriate.

10. Clause 61 makes the necessary correction and applies as from the introduction of the existing legislation.
EXPLANATORY NOTE

CLAUSE 62: INTANGIBLE FIXED ASSETS: OIL LICENCES

SUMMARY

1. Clause 62 amends the corporate intangible fixed asset (IFA) rules in Part 8 of Corporation Tax Act 2009 (CTA 2009). The clause ensures that the scope of the IFA regime excludes all goodwill and any intangible asset which relates to, derives from or is connected with an oil licence or an interest in an oil licence. The Government has become aware that some companies have interpreted accountancy practice in such a way that goodwill is recognised on the acquisition of an oil licence or an interest in an oil licence. This interpretation may bring this goodwill within the scope of the IFA regime, which conflicts with what was intended when the legislation was introduced by Finance Act 2002. This clause has effect from 23 March 2011. It denies relief under the IFA regime for accounting periods beginning on or after that date and deems, for the purposes of this legislation, a new accounting period to start on that date.

DETAILS OF THE CLAUSE

2. Section 2 inserts new subsection (1A) into section 809 CTA 2009. New subsection (1A) extends the reference to an oil licence or an interest in an oil licence in subsection (1) to include all goodwill and any intangible asset which relates to, derives from or is connected with an oil licence or an interest in an oil licence.

3. Subsection (5) provides for the amendments made by the clause to have effect in relation to accounting periods beginning on or after 23 March 2011, and that in relation to those accounting periods the amendments are treated as always having had effect. The amendments therefore also apply for the purposes of calculating the future tax consequences of past transactions.

4. Subsection (6) provides that where an accounting period starts before 23 March 2011 and ends on or after that date, then for the purpose of applying the amendments, the period from 23 March 2011 to the end of the accounting period is treated as a separate accounting period.
BACKGROUND NOTE

5. Finance Act 2002 introduced a new corporation tax regime for intangible fixed assets, including goodwill.

6. A number of assets are excluded from the IFA regime. These specific exclusions include oil licences and other rights over land.

7. Some companies have interpreted accountancy practice in such a way that goodwill is recognised on the acquisition of an oil licence or an interest in an oil licence. In doing this these companies consider that the amounts they write off the value of the goodwill are allowable deductions, under the IFA rules, in computing profits for tax purposes.

8. Clause 62 amends the IFA rules to ensure that all goodwill and any intangible asset which relates to, derives from or is connected with an oil licence or an interest in an oil licence is excluded from the scope of the IFA regime.
EXPLANATORY NOTE

CLAUSE 63: REDUCTION OF SUPPLEMENTARY CHARGE FOR CERTAIN NEW OIL FIELDS

SUMMARY

1. Clause 63 makes two changes to the field allowance legislation.

2. The first change amends the time at which the initial licensee is to hold a field allowance. Where production income occurs in the same accounting period as that in which development authorisation is given the change enables the field allowance to be activated in that period.

3. The second change amends the definition of “new oil field” for the purposes of the field allowance. This enables certain previously decommissioned fields to be treated as new oil fields for field allowance purposes.

4. Both changes have retrospective effect as from the introduction of the field allowance legislation.

DETAILS OF THE CLAUSE

5. Subsection (1) amends the time at which the initial licensee is to hold a field allowance.

   a. New section 350(1) provides that a “new oil field” is an oil field which is a qualifying oil field, and whose development in whole or in part is first authorised on or after 22 April 2009.
   b. New section 350(2) provides that where all relevant assets of an oil field have been decommissioned, any authorisation of development of that field which occurs before that decommissioning is ignored.
   c. New section 350(3) applies provisions from paragraph 7 Schedule 1 to the Oil Taxation Act 1975 [which relate to whether an oil field is decommissioned] to determine whether relevant assets have been decommissioned.
   d. New section 350(4) defines a “relevant asset” of an oil field.
7. Subsection (3) amends the definition of “authorisation day” in section 357 of CTA 2010.

8. Subsection (4) provides that the new section 350 and the amendment to section 357 have effect for accounting periods ending on or after 1 April 2010.

9. Subsection (5) provides that corresponding amendments having effect for accounting periods ending on or after 22 April 2009 are treated as having been made in Schedule 44 to the Finance Act 2009.

BACKGROUND NOTE

10. The field allowance reduces a company’s ring fence profits on which the supplementary charge is due. The field allowance recognises that some new fields are particularly challenging and that the full application of the supplementary charge might result in the field not being developed. The allowance applies to new oil fields, being an oil field which is a qualifying oil field and whose development is first authorised on or after 22 April 2009.

11. Where a new oil field is developed quickly and commences production in the same accounting period as that in which development is authorised the field allowance has previously not been available for that accounting period. This result was unintended and the clause ensures the allowance is available for that accounting period.

12. Where an oil field has previously been decommissioned a licensee may want to redevelop the field, and there is no policy reason for treating that field differently from a new field for field allowance purposes. This clause delivers that result.

13. Clause 63 applies with retrospective effect as from the introduction of the field allowance legislation.
EXPLANATORY NOTE

CLAUSE 64 SCHEDULE 15: CHARGEABLE GAINS: OIL ACTIVITIES

SUMMARY

1. Clause 64 and Schedule 15 amend the oil chargeable gains licence swaps legislation and extend the scope of the ring fence reinvestment legislation to exploration, appraisal and development expenditure.

2. Schedule 15 enables the licence swaps legislation to work as originally intended when, under swap arrangements, economic benefits and liabilities pass at a time other than the day on which the arrangements are entered into. It also ensures that where expenditure is effectively reimbursed the additional base cost sits with the correct company for chargeable gains purposes.

3. Schedule 15 also enables expenditure on exploration, appraisal and development to be treated as expenditure on new assets for the purpose of the ring fence reinvestment legislation.

DETAILS OF THE SCHEDULE

Part 1: Licence swaps

4. Paragraph 1 amends section 195A of the Taxation of Chargeable Gains Act 1992 (TCGA) to reflect the introduction of section 195F of TCGA.

5. Paragraph 2 introduces new section 195F of TCGA which provides that where a company effectively reimburses expenditure under a licence-consideration swap or mixed-consideration swap, that company is treated as incurring enhancement expenditure for chargeable gains purposes.

6. Paragraph 3 amends section 196 of TCGA including consequential amendments.

7. Paragraph 3(4) amends the definition of “non-licence consideration” and paragraph 3(5) replaces the existing section 196(5B) of TCGA with section 196(5B) to (5F).

   a. Section 196(5C) provides that any determination of the consideration given for disposal A or disposal B, of the non-licence consideration or of the value of a licence comprised in
disposal A or disposal B is to be made as at the time the swap arrangements are entered into, subject to subsections (5D) to (5F).

b. **Section 196(5D)** provides that subsections (5E) and (5F) apply if the swap arrangements provide for economic benefits and liabilities to pass at a time (called “the effective time”) other than the day on which the arrangements are entered into.

c. **Section 196(5E)** provides that any determination of the following matters is to be made as at the effective time: consideration given for disposal A or disposal B; the non-licence consideration; or the value of a licence comprised in disposal A or disposal B.

d. **Section 196(5F)** amends the amount of the non-licence consideration if the swap arrangements provide for it to be increased to reflect the period between the effective time and the time it is payable.

8. **Paragraph 4** provides that Part 1 of the Schedule has effect in relation to disposals made on or after 23 March 2011.

**Part 2: Reinvestment of ring fence assets**

9. **Paragraph 5** introduces new section 198I (exploration, appraisal and development expenditure) into TCGA.

a. **Section 198I(1)** treats the incurring of ring fence exploration, appraisal and development expenditure as the acquisition of assets for the purposes of the ring fence reinvestment legislation in sections 198A to 198H.

b. **Section 198I(2)** makes similar provision for sections 152, 153, 175 and 198(1) for the purpose of determining whether a disposal and acquisition qualify for rollover relief or section 153 relief.

c. **Section 198I(3)** provides that section 198C is to have effect in relation to exploration, appraisal and development expenditure, but with the exception that a declaration under section 198C does not have effect also as a declaration under section 153A.

d. **Section 198I(4)** provides that exploration, appraisal and development expenditure in section 198I means expenditure on oil and gas exploration, appraisal and development activities which is treated as such under generally accepted accounting practice.
e. Section 198I(5) provides that this section affects sections 152, 153, 175 and 198(1) only for the purposes of sections 198A to 198H.

f. Section 198I(6) defines “oil asset” and “ring fence trade” for the purposes of section 198I.

10. Paragraph 6 provides that the amendment made by Part 2 of the Schedule has effect in relation to disposals made on or after 24 March 2010, whenever the deemed acquisition takes place.

**BACKGROUND NOTE**

*Part 1: Licence swaps*

11. Finance Act (FA) 2009 introduced legislation which provides that no chargeable gains arise on the swap of UK/UK Continental Shelf licences in some circumstances. The clause addresses some circumstances in which non-licence consideration is involved.

12. A licence swap agreement usually includes provision for various payments to be made between the parties, which are typically treated as adjustments to the consideration. The existing legislation does not remove the chargeable gains liability that may arise in respect of the receipt of such payments. The clause removes some of those receipts from the scope of taxation on chargeable gains, and also ensures that where expenditure is effectively reimbursed the additional base cost sits with the correct company for chargeable gains purposes.

*Part 2: Reinvestment of ring fence assets*

13. FA 2009 introduced reinvestment relief which provides that no chargeable gain arises in some circumstances where disposal proceeds are reinvested in new oil trade assets and the disposal and acquisition qualify for rollover relief.

14. Expenditure incurred on exploration, appraisal and development activities is not included within the prescribed classes of assets for rollover relief purposes and does not permit a claim for reinvestment relief.

15. However, the clause treats the incurring of expenditure on exploration, appraisal and development activities as the acquisition of assets for the purposes of ring fence reinvestment relief.
EXPLANATORY NOTE

CLAUSE 65 SCHEDULE 16: BENEFITS UNDER PENSION SCHEMES

SUMMARY

1. Clause 65 and Schedule 16 amend Part 4 of the Finance Act (FA) 2004 as it relates to certain tax rules relating to registered pension schemes that apply to individuals reaching the age of 75.

2. From 6 April 2011 the effective requirement to buy an annuity by the age of 75 will be removed and the alternatively secured pension rules repealed. Individuals will be able to leave their pension funds invested in a drawdown arrangement and to make withdrawals throughout their retirement, subject to an annual cap. The maximum withdrawal of income that an individual will be able to make from most drawdown funds on reaching minimum pension age will be capped at 100 per cent of the equivalent annuity that could have been bought with the fund value. This maximum capped amount will be determined at least every three years until the end of the year in which the member reaches the age of 75, after which reviews to determine the maximum capped withdrawal will be carried out annually.

3. Individuals able to demonstrate that they have a secure pension income for life of at least £20,000 a year will have full access to their drawdown funds without any annual cap. All withdrawals from drawdown funds will be subject to tax as pension income. An individual making a withdrawal from a drawdown pension fund during a period when they are resident outside the UK for a period of less than five full tax years will be liable for UK income tax on that withdrawal for the tax year in which they become UK resident again.

4. Any new pension savings by an individual after he or she has demonstrated that their secure lifetime pension income is at least £20,000 a year will be liable to the annual allowance charge on all pension input amounts. Most of the rules preventing registered pension schemes from paying lump sum benefits after the member has reached the age of 75 are being removed. The tax rate for all lump sum death benefits is set at 55 per cent, apart from death benefits for those who die before age 75 without having taken a pension, which will remain tax free.

5. With effect from 6 April 2011, inheritance tax (IHT) will not typically apply to drawdown pension funds remaining under a registered pension scheme, including when the individual dies after reaching the age of 75. Also with effect from 6 April 2011, IHT anti-avoidance charges that apply to registered pension schemes and Qualifying Non UK Pension (QNUP) Schemes where the scheme
member omits to take their retirement entitlements (e.g. a failure to buy an annuity) will be removed. These changes will also apply to superannuation funds that are occupational pension schemes by virtue of section 615(3) of the Income and Corporation Taxes Act 1988 (ICTA).

DETAILS OF THE SCHEDULE

6. **Part 1** makes changes to the rules applicable at age 75 and at death

7. **Paragraph 1** makes amendments to section 165 of FA 2004.

8. **Paragraphs 1(2)** amends the pension rules to remove the distinction between the types of pension that can be paid before and after reaching the age of 75. It also replaces the concepts of “unsecured” and “alternatively secured” pensions with the concept of a “drawdown” pension and caps the amount that can be paid out of such a pension at 100 per cent of the equivalent annuity that could have been bought with the fund value unless the conditions set out in **new section 165(3A)** are met.

9. **Paragraph 1(3)** inserts new section 165(3A) and (3B) into FA 2004. These two subsections set out the criteria that have to be met for a member of a registered pension scheme not to be subject to a cap on their drawdown pension. The member must make a declaration to the scheme administrator that he or she meets the “flexible drawdown conditions” and the scheme administrator must accept the declaration. To meet the flexible drawdown conditions:

   - the member must have a minimum pension income for the tax year;
   - there must not be any contributions paid in respect of a member’s money purchase arrangement under a registered pension scheme during the tax year; and
   - where the member has a defined benefits or cash balance arrangement under the scheme, he or she must have stopped being an active member before making the declaration.

More details of the minimum income requirement are given in new paragraph 14A of Schedule 28 to FA 2004, inserted by paragraph 10 of this Schedule.

10. **Paragraph 2** introduces the amendments made to Part 1 of Schedule 28 to FA 2004 by paragraphs 3 to 10.

11. **Paragraph 3** amends paragraph 4 of Schedule 28 to FA 2004 to replace the definition of “unsecured pension” with a definition of “drawdown pension”.
12. Paragraph 4 amends the definition of “short-term annuity” in paragraph 6 to Schedule 28 to FA 2004. A short-term annuity is a form of drawdown pension. The amendments provide that payments under a short-term annuity do not have to end when the member reaches the age of 75 and make other consequential changes to the definition so it refers to drawdown pension rather than to unsecured pension.

13. Paragraph 5 amends the definition of “income withdrawal” in paragraph 7 of Schedule 28 to FA 2004 so it refers to drawdown pension rather than to unsecured or alternatively secured pensions.

14. Paragraph 6(1) to (3), (5) and (6) amends paragraph 8 of Schedule 28 to FA 2004 to replace the definition of “an unsecured pension fund” with a definition of “a drawdown pension fund”.

15. Paragraph 6(4) omits the rule requiring relevant uncrystallised funds to be treated as having been designated as available for payment of a drawdown pension immediately before age 75.

16. Paragraph 7(1), (2) and (4) amends paragraph 9(1) of Schedule 28 to FA 2004 to replace the definition of “unsecured pension year” with a definition of “drawdown pension year”.

17. Paragraph 7(3) provides that drawdown pension under an arrangement relating to the member may carry on after the member reaches the age of 75.

18. Paragraph 8(1) to (6) and (8) to (11) amends paragraph 10 of Schedule 28 to FA 2004 and defines how the basis amount is generally determined for a member who has not reached the age of 75. This is needed in order to work out the amount of drawdown pension that may be paid in each drawdown pension year in accordance with the substituted pension rule 5 in section 165 of FA 2004. The maximum amount that the member may withdraw in accordance with pension rule 5 is determined at least every three years.

19. Paragraph 8(7) provides that, where the fund value determining the basis amount falls, despite there having been an additional fund designation during the drawdown pension year, the reduction in the maximum amount that the member may withdraw in accordance with pension rule 5 is not applied until the following drawdown pension year.

20. Paragraph 8(12) provides that none of the rules in connection with the basis amount for a drawdown pension year apply to a drawdown pension arrangement to which the cap on withdrawals imposed by pension rule 5 does not apply because new section 165(3A) of FA 2004 applies.

22. **New paragraph 10A(1)** provides that new paragraph 10A applies if the drawdown pension year begins after the member has reached the age of 75.

23. **New paragraph 10A(2)** provides how the basis amount is determined for the purposes of working out the amount of drawdown pension that can be paid in each drawdown pension year.

24. **New paragraph 10A(3) to (5)** provides how to determine the date on which the sums and assets held for the purposes of the drawdown pension arrangement are valued in order to calculate the basis amount.

25. **New paragraph 10A(6) to (8)** provides how and when the basis amount is re-calculated when the member adds more sums and assets to his or her drawdown pension fund.

26. **New paragraph 10A(9) and (10)** provides cross-references to definitions in other paragraphs of Schedule 28 to FA 2004.

27. **New paragraph 10A(11)** provides that none of the rules in connection with the basis amount for a drawdown pension year apply to a drawdown pension arrangement to which the cap on withdrawals imposed by pension rule 5 in section 165 of FA 2004 does not apply because new section 165(3A) of FA 2004 applies.

28. **New paragraph 10B(1)** provides that new paragraph 10B applies to members who have reached the age of 75.

29. **New paragraph 10B(2)** provides a right for the member to notify the scheme administrator that he or she wishes the drawdown pension year for one of the member’s drawdown pension arrangements under the scheme to begin on the same day as another of the member’s drawdown pension arrangements under that scheme (including when this other arrangement is a dependants’ drawdown pension arrangement relating to that individual).

30. **New paragraph 10B(3)** provides that the scheme administrator has discretion to comply with the wish of the member and, if it does, the drawdown pension year brought to an end prematurely shall be treated as if it were a drawdown pension year for the purposes of operating pension rule 5 in section 165 of FA 2004. The next year will start on the following day and henceforth the drawdown pension year for that arrangement will begin on the anniversary of when the next year began.
31. New paragraph 10B(4) provides that the scheme administrator may bring a drawdown pension year to a premature end at the wish of the member once only per drawdown pension arrangement.

32. Paragraph 10 inserts new paragraphs 14A to 14E into Schedule 28 to FA 2004. These paragraphs define how and when the minimum income requirement is satisfied.

33. New paragraph 14A provides that the member meets the minimum income requirement when he or she has at least £20,000 of “relevant income”, defines relevant income and describes sources of pension income that do not count as relevant pension income.

34. New paragraph 14B provides a power to vary the amount of the minimum income threshold by Treasury Order. It also provides a regulation making power to change the description of payments that count towards the minimum income threshold and provide that certain types of payment will not be taken into account when determining whether the minimum income threshold is met.

35. New paragraph 14C defines “relevant day” for the purposes of new section 165(3B)(a) of FA 2004. Where no previous declaration has been made, the relevant day is when the member makes that first declaration. Where a previous declaration has been made the relevant day is when the member first actually became eligible to receive flexible withdrawals from a drawdown pension fund.

36. New paragraph 14D defines “relevant contributions” for the purposes of new section 165(3B)(b) of FA 2004.

37. New paragraph 14E provides for the requirements of a valid declaration that the member meets the flexible drawdown conditions to be set out in regulations. The declaration is accepted for the purposes of new section 165(3A)(c) of FA 2004 if the scheme administrator is satisfied that the person meets the flexible drawdown condition.

38. Paragraph 11 changes the pension death benefit rules in section 167 of FA 2004 by amending pension death benefit rules 3 and 4 and deleting pension death benefit rules 5 and 6. This removes the distinction between the type of pension death benefits that can be paid before and after the age of 75. It also replaces the concepts of “dependants’ unsecured” and “dependants’ alternatively secured” pensions with “dependants’ drawdown pension” and caps the amount that can be paid out of a dependants’ drawdown pension at 100 per cent of the equivalent annuity that could have been bought with the fund value.

39. Paragraph 11(3) inserts new section 167(2A) and (2B) into FA 2004 and sets out the rules for when the 100 per cent cap in respect of a
dependants’ drawdown pension arrangement does not need to be applied.

40. Paragraph 12 introduces the amendments made to Part 2 of Schedule 28 to FA 2004 (pension death benefit rules) by paragraphs 13 to 15. Paragraphs 16 to 20 make further amendments to Part 2 of Schedule 28 to FA 2004.

41. Paragraph 13 amends a number of definitions so they refer to dependants’ drawdown pension rather than to dependants’ unsecured pension.

42. Paragraph 14 amends the definition of dependants’ short-term annuity in paragraph 20 of Schedule 28 to FA 2004. A dependants’ short-term annuity is a form of dependants’ drawdown pension. The amendments provide that payments under a dependant’s short-term annuity payments may carry on after the member reaches the age of 75.

43. Paragraphs 15 and 16 amend a number of definitions so they refer to dependants’ drawdown pension fund instead of dependants’ unsecured pension fund.

44. Paragraph 17 amends a number of definitions so they refer to a dependant’s drawdown pensions rather than to unsecured pensions.

45. Paragraph 18 amends paragraph 24 of Schedule 28 to FA 2004 setting out how the “basis amount” is determined for the purposes of working out the amount of dependants’ drawdown pension that can be paid in each drawdown pension year where the dependant has not reached the age of 75. The maximum amount that may be withdrawn is determined at least every three years until the end of the year in which the dependant reaches the age of 75, after which reviews to determine the maximum capped withdrawal are carried out annually.


47. New paragraph 24A(1) provides that new paragraph 24A applies if the dependant has reached the age of 75.

48. New paragraph 24A(2) provides how the “basis amount” is determined for the purposes of working out the amount of dependants’ drawdown pension that can be paid in each drawdown pension year where the dependant has reached the age of 75. The maximum amount that may be withdrawn is determined annually.

49. New paragraph 24A(3) provides how to determine the date on which the sums and assets held for the purposes of the drawdown pension arrangement are valued in order to calculate the basis amount.
50. **New paragraph 24A(4) to (6)** provides how and when the basis amount is re-calculated when the member adds more sums and assets to his or her drawdown pension fund.

51. **New paragraph 24A(7) and (8)** provides cross-references to definitions in other paragraphs of Schedule 28 to FA 2004.

52. **New paragraph 24A(9)** provides that none of the rules in connection with the basis amount for a drawdown pension year apply to a drawdown pension arrangement to which the cap on withdrawals imposed by pension rule 5 in section 165 of FA 2004 does not apply because **new section 167(2A) of FA 2004 applies**.

53. **New paragraph 24B(1)** provides that paragraph 24B applies if the dependant has reached the age of 75.

54. **New paragraph 24B(2)** provides a right for the dependant to notify the scheme administrator that he or she wishes the drawdown pension year for one of the dependant’s drawdown pension arrangements under the scheme to begin on the same day as another of the dependant’s drawdown pension arrangements under that scheme (including when this other arrangement is a dependants’ drawdown pension arrangement relating to that individual).

55. **New paragraph 24B(3)** provides that the scheme administrator has discretion to comply with the wish of the dependant and if it does, the drawdown pension year brought to an end prematurely shall be treated as if it were a drawdown pension year for the purposes of operating pension rule 5 in section 165 of FA 2004. The next year will start on the following day and henceforth, the drawdown pension year for that arrangement will begin on the anniversary of when the next year began.

56. **New paragraph 24B(4)** provides that the scheme administrator may bring a drawdown pension year to a premature end at the wish of the dependant once only per drawdown pension arrangement.

57. **Paragraph 20** inserts new paragraphs 24C to 24G into Schedule 28 to FA 2004. These paragraphs set out rules for when withdrawals of income from a dependants’ drawdown pension fund are not limited to 100 per cent of the “basis amount”. These are similar to the rules applying to the original member’s drawdown pension fund as provided under the amendments made by paragraph 10 of this Schedule.

59. Paragraph 21(2) provides that foreign pensions within Part 9 of ITEPA include among other things annuities and income withdrawals under overseas pension schemes.

60. Paragraph 21(3) makes a consequential change to section 575(1) of ITEPA.

61. Paragraph 21(4) inserts new section 576A into ITEPA.

62. New section 576A(1) provides that a withdrawal from a flexible drawdown pension fund under a relevant non-UK scheme during a year of non-residence is to be treated as pension income for the tax year in which the individual returns to the UK.

63. New section 576A(2) provides that the section applies only when the individual did not satisfy the residence requirements for a temporary period and prescribes what counts as temporary non-residence.

64. New section 576A(3) defines the residence requirements for the purposes of new section 576A(2).

65. New section 576A(4) provides that, when an individual is chargeable to tax on the remittance basis and both withdraws an amount from a flexible drawdown pension fund and remits this to the UK during a period of temporary non-residence, the remittance will be treated as if it were actually remitted in the year in which the individual returns to the UK.

66. New section 576A(5) and (6) provides that the section does not apply unless the withdrawal from a flexible drawdown pension fund is referable to either the individual’s UK tax-relieved fund or his or her relevant transfer fund. A member’s UK tax-relieved fund is created by the accumulation of pension rights supported by UK tax relief. A member’s relevant transfer fund is created by the transfer to the relevant non-UK scheme from a registered pension scheme or from another relevant non-UK scheme.

67. New section 576A(7) provides that no double taxation relief arrangements prevent a charge to tax under section 575 of ITEPA from arising by virtue of new section 576A.

68. New section 576A(8) provides definitions for the purposes of the section.

69. Paragraph 22(1) introduces amendments to Chapter 5A of Part 9 of ITEPA (pensions under registered pension schemes).

70. Paragraph 22(2) makes a consequential change to section 579B of ITEPA (taxable pension income).
71. Paragraph 22(3) inserts new section 579CA into ITEPA.

72. New section 579CA(1) provides that a withdrawal from a flexible drawdown pension fund under a registered pension scheme during a year of non-residence is to be treated as pension income for the tax year in which the individual returns to the UK.

73. New section 579CA(2) provides that the section applies only when the individual did not satisfy the residence requirements for a temporary period and prescribes what counts as temporary non-residence.

74. New section 579CA(3) defines the residence requirements for the purposes of new section 579CA(2).

75. New section 579CA(4) provides that no double taxation relief arrangements prevent a charge to tax under section 579B of ITEPA from arising by virtue of new section 579CA.

76. New section 579CA(5) provides definitions for the purposes of the section.

77. Paragraph 22(4) inserts new section 579D into ITEPA. New section 579D provides definitions for the purposes of Chapter 5A of Part 9 of ITEPA.

78. Paragraph 23 introduces the amendments made to the pension commencement lump sum rules in paragraphs 1 to 3A of Schedule 29 to FA 2004 by paragraphs 24 to 27 and the other amendments of Part 1 of Schedule 29 to FA 2004 made by paragraphs 28 to 31.

79. Paragraph 24(1), (2) and (4) amends paragraph 1 of Schedule 29 to FA 2004 to provide that a pension commencement lump sum may be paid when the member becomes entitled to it when aged 75 or over. A member is treated as becoming entitled to a pension commencement lump sum when the member becomes entitled to the relevant pension which the lump sum is paid in connection with.

80. Paragraph 24(3) inserts new paragraph 1(3A) into Schedule 29 to FA 2004. It has effect when a member becomes entitled to a pension commencement lump sum before reaching the age of 75 but the lump sum is not paid until after the member has reached that age. In these circumstances only, the requirement in paragraph 1(1)(b) of Schedule 29 that the member has not used up all of their lifetime allowance is modified so that it is applied when the member became entitled to the lump sum, not when it is paid. This enables the member to receive a tax free pension commencement lump sum if there was lifetime allowance available when he or she became entitled to the lump sum before reaching the age of 75 even if all of the member’s lifetime allowance has subsequently been exhausted.
81. Paragraph 25 provides that one of the two calculations (to determine “the available portion”) needed to determine the maximum tax free pension commencement lump sum payable is determined without reference to any lifetime allowance used up by a new benefit crystallisation event 5B, but takes into account events which would have been benefit crystallisation events if the event or payment had occurred before the member reached the age of 75. New benefit crystallisation event 5B is inserted in section 216 of FA 2004 by paragraph 43 of the Schedule. The concept of the available portion broadly limits the value of tax free lump sums that an individual may receive over a lifetime to one quarter of the lifetime allowance.

82. Paragraph 26 amends the calculation in paragraph 3 of Schedule 29 to FA 2004 and provides how the applicable amount is determined when a member becomes entitled to a relevant pension after reaching the age of 75. The concept of the applicable amount limits the tax free pension commencement lump sum to an amount that is broadly no more than one quarter of the value of the individual’s pension rights. The legislation being amended here expresses the value of the pension rights in terms of the amount crystallised by the rights to the pension and lump sum for the purposes of the lifetime allowance. Once a member has reached the age of 75 the lifetime allowance is generally no longer relevant so, in this case, paragraph 26 amends paragraph 3 of Schedule 29 to provide that the applicable amount is to be determined by reference to the amount that would have been crystallised by that event were it to have been a benefit crystallisation event (but was not because the member was aged 75 or over). The permitted maximum pension commencement lump sum is the lower of the available portion and the applicable amount due to paragraph 2(5) of Schedule 29 to FA 2004.

83. Paragraph 27(1) and (2) amends paragraph 3A of Schedule 29 to FA 2004 (rules on recycling of pension commencement lump sums).

84. Paragraph 27(3) inserts new paragraph 3A(4A) into Schedule 29 to FA 2004 and provides that paragraph 3A of that Schedule does not apply in relation to pension commencement lump sums recycled into contributions paid on or after the member reaching the age of 75. Such contributions are not relieviable pension contributions under section 188 of FA 2004.

85. Paragraph 27(4) amends paragraph 3A(5) of Schedule 29 to FA 2004 so that if the entitlement to the pension commencement lump sum arises when the member is aged 75 or more, the appropriate amount is the amount of the lump sum paid.

86. Paragraph 28 amends paragraph 4 of Schedule 29 to FA 2004 so that a serious ill-health lump sum may be paid when the member is aged 75 or over.
87. **Paragraph 29** amends paragraph 7(1)(e) of Schedule 29 to FA 2004 so that a trivial commutation lump sum may be paid when the member is aged 75 or over.

88. **Paragraph 30** amends paragraph 10(1) of Schedule 29 to FA 2004 so that a winding-up lump sum may be paid when the member is aged 75 or over.

89. **Paragraph 31** amends paragraph 12 of Schedule 29 to FA 2004 to provide that none of the specific lifetime allowance charge rules affecting a member on reaching the age of 75 affect when a member, who has reached that age, is treated as having lifetime allowance available for the purposes of the pension commencement lump sum, the serious ill-health lump sum, the trivial commutation lump sum or the winding up lump sum.

90. **Paragraph 32** introduces amendments made to Part 2 of Schedule 29 to FA 2004 by paragraphs 33 to 39 of this Schedule.

91. **Paragraph 33** amends paragraph 13 of Schedule 29 to FA 2004 so that a defined benefits lump sum may be paid when the member is aged 75 or over and, on the member’s death after the age of 75, removes the condition that the lump sum has to be paid within two years of the scheme administrator learning of the member’s death.

92. **Paragraph 34(1)** introduces amendments to paragraph 14 of Schedule 29 to FA 2004 (pension protection lump sum benefits).

93. **Paragraph 34(2)** amends paragraph 14(1) of Schedule 29 to FA 2004 so a defined benefits lump sum death benefit may be paid when the member is aged 75 or over.

94. **Paragraph 34(3)** sets out how the pension protection limit is determined when the member became entitled at age 75 or over to the pension or annuity in respect of which a pension protection lump sum is paid. The pension protection limit is determined by deducting the pension payments made from the value of the pension rights when the member became entitled it. Paragraph 14 of Schedule 29 to FA 2004 expresses the value of the pension rights in terms of the amount crystallised by the rights to a pension for the purposes of the lifetime allowance. Once a member has reached the age of 75 the lifetime allowance is generally no longer relevant so, in this case, paragraph 34 amends paragraph 14 of Schedule 29 to FA 2004 to provide that the pension protection limit is determined by reference to the amount that would have been crystallised by the member becoming entitled to the pension were it to have been a benefit crystallisation event (but was not because the member was at that time aged 75 or over). The pension protection limit is the maximum amount that may be paid as a pension protection lump sum death benefit. It is liable to the special lump sum death benefits charge under section 206 of FA 2004.
95. Paragraph 35 amends paragraph 15 of Schedule 29 to FA 2004 so that an uncrystallised funds lump sum death benefit may be paid when the member is aged 75 or over and, on the member’s death after the age of 75, removes the condition that the lump sum has to be paid within two years of the scheme administrator learning of the member’s death.

96. Paragraph 36(1) introduces amendments to paragraph 16 of Schedule 29 to FA 2004 (annuity protection lump sum death benefit).

97. Paragraph 36(2) amends paragraph 16(1) of Schedule 29 to FA 2004 so that an annuity protection lump sum death benefit may be paid when the member is aged 75 or over.

98. Paragraph 36(3) provides how the annuity protection limit is determined when the member became entitled at age 75 or over to the pension or annuity in respect of which an annuity protection lump sum is paid. The annuity protection limit is determined by deducting the pension payments made from the value of the pension rights when the member became entitled it. Paragraph 16 of Schedule 29 to FA 2004 expresses the value of the pension rights in terms of the amount crystallised by the rights to a pension for the purposes of the lifetime allowance. Once a member has reached the age of 75 the lifetime allowance is generally no longer relevant so, in this case, paragraph 37(3) provides that the annuity protection limit is to be determined by reference to the amount that would have been crystallised by the member becoming entitled to the pension or annuity were it to have been a benefit crystallisation event (but was not because the member was at that time aged 75 or over). The annuity protection limit is the maximum amount that may be paid as an annuity protection lump sum death benefit. It is liable to the special lump sum death benefits charge under section 206 of FA 2004.

99. Paragraph 37(1) introduces amendments to paragraph 17 of Schedule 29 to FA 2004 so that a drawdown pension fund lump sum death benefit can be paid, rather than an unsecured pension fund lump sum death benefit.

100. Paragraph 37(2) to (6) provides for a drawdown pension fund lump sum death benefit to be paid, rather than an unsecured pension fund lump sum death benefit.

101. Paragraph 38(1) introduces amendments to paragraph 18 of Schedule 29 to FA 2004 (charity lump sum death benefit).

102. Paragraph 38(2) amends paragraph 18(1) of Schedule 29 to FA 2004 so that a charity lump sum death benefit may be paid tax free from a drawdown pension fund whether or not the member has reached the
age of 75. The payment can only be made when the member has no dependants and it is paid to a charity nominated by the member.

103. Paragraph 38(3) inserts new paragraph 18(1A) into Schedule 29 to FA 2004. New paragraph 18(1A) provides that a tax free lump sum may be paid to a charity out of funds relating to a member who dies without dependants after reaching the age of 75 without using some or all of the fund to provide a pension.

104. Paragraph 38(4) amends paragraph 18(2) of Schedule 29 to FA 2004 so that a charity lump sum death benefit may be paid tax free from a dependants’ drawdown pension fund whether or not the dependant has reached the age of 75. The payment can only be made when there are no other dependants of the member and it is paid to a charity nominated by either the member or dependant.

105. Paragraph 38(5) amends paragraph 18(4) of Schedule 29 to FA 2004 so that there is a cap on the amount of the charity lump sum death benefit at the value of the sums and assets in the drawdown pension fund immediately before the payment is made.

106. Paragraph 39 amends paragraph 20(1) of Schedule 29 to FA 2004 so that a trivial commutation lump sum death benefit may be paid when the member is aged 75 or over.

107. Paragraph 40 inserts new section 205A into FA 2004 and provides for a serious ill-health lump sum charge. Serious ill-health lump sums are defined in paragraph 4 of Schedule 29 to FA 2004. The charge under new section 205A will arise where a serious ill-health lump sum is paid to a member who is aged 75 or over. The scheme administrator will be liable to the charge at a rate of 55 per cent on the gross amount of the lump sum. Serious ill-health lump sums are tax free when paid to a member who has not yet reached the age of 75.

108. Paragraph 41 amends section 206 of FA 2004 which contains the special lump sum death benefits charge rules so they cover a drawdown pension fund rather than an unsecured pension fund and adds two new occasions on which the special lump sum death benefits charge arises. It also changes the rate of charge to 55 per cent.

109. Paragraph 42 makes consequential amendments to section 636A ITEPA in respect of serious ill-health lump sums, defined benefits lump sum death benefits and uncrystallised funds lump sum death benefits. These terms are defined in paragraphs 4, 13 and 15 of Schedule 29 to FA 2004.

110. Paragraph 43 provides for a new benefit crystallisation event 5B, which occurs when a member, with remaining unused funds held for
the purposes of a money purchase arrangement relating to the member, reaches the age of 75.

111. Paragraph 44(1) introduces amendments to Schedule 32 to FA 2004. Schedule 32 provides supplementary provision in connection with benefit crystallisation events and the lifetime allowance charge.

112. Paragraph 44(2) inserts new paragraph 14A in Schedule 32 to FA 2004. New paragraph 14A defines “remaining unused funds” for the purposes of benefit crystallisation event 5B in section 216 of FA 2004.

113. Paragraph 44(3) inserts new paragraph 15A into Schedule 32 to FA 2004. New paragraph 15A provides that where a member becomes entitled to a pension commencement lump sum in respect of a money purchase arrangement before the age of 75 but it is not paid until after, it is not treated as a benefit crystallisation event 6.

114. Paragraph 45 inserts new section 227A into FA 2004. This provides that, where a member enters flexible drawdown, any subsequent pension input amounts in respect of a registered pension scheme of which they are an active member are subject to the annual allowance charge in full, without the benefit of the annual allowance.


116. Paragraph 47(1) introduces the amendments made to section 12 of IHTA by the rest of the paragraph.

117. Paragraph 47(2) inserts a new subsection into section 12 of IHTA. New section 12(2ZA) provides that the IHT charges for omissions (for example, failure to buy an annuity) in relation to registered pension schemes, qualifying non-UK pensions as defined at section 271A of IHTA and superannuation schemes within section 615(3) of ICTA will no longer apply.

118. Paragraph 47(3) provides for the removal of sections 12(2A) to (2E) of IHTA. Sections 12(2A) to (2D) currently provide for IHT charges in the event of omissions by members of registered pension schemes, qualifying non-UK pensions as defined at section 271A of IHTA and superannuation schemes within section 615(3) of ICTA. Section 12(2E) currently prevents a double charge arising under section 3(1) or 3(3) and sections 151A to E of IHTA. As the latter charges are being removed by this measure the charge under section 3(1) is reinstated.

119. Paragraph 48 provides for the removal of sections 151A to 151E of IHTA. These changes remove the IHT charge that can currently apply to alternatively secured pensions.
120. Part 2 makes consequential amendments

121. Paragraph 49 introduces consequential amendments to IHTA.

122. Paragraph 50 provides for the removal of the term “registered” from section 12(2F)(b) of IHTA. and for the removal of terms from section 12(2G) of IHTA which are currently contained in sections 12(2A) to 12(2E) of IHTA but which are removed by paragraph 47(3) of this schedule.

123. Paragraph 51 provides for the removal from section 151 of IHTA of any references to sections which are removed as mentioned in the preceding paragraph.

124. Paragraph 52 provides for the removal of section 200(1A) of IHTA and any reference thereto in section 200(1) of IHTA. This subsection currently makes the scheme administrator liable for the tax chargeable under sections 151A to 151C of IHTA.

125. Paragraph 53 provides for the removal of section 210(2) and (3) of IHTA. These subsections currently set out who is liable for charges under section 151B and section 151D of IHTA which are removed by paragraph 48 of this Schedule.

126. Paragraph 54(1) to (6) provides for the inheritance tax rules governing the delivery of accounts as currently set out in section 216 of IHTA to be amended to reflect the removal of charges by this Schedule.

127. Paragraph 55 provides for the inheritance tax rules governing the due date and payment, as currently set out in section 226(4) of IHTA to be amended to reflect the removal of charges by this Schedule.

128. Paragraph 56 provides for the inheritance tax rules governing interest due on amounts brought into charge, as currently set out in section 233(1)(c) of IHTA, to be amended to reflect the removal of charges by this Schedule.

129. Paragraph 57 provides for the removal of the definition of the term “scheme administrator” from section 272 of IHTA, the necessity for which is removed by virtue of this Schedule.

130. Paragraphs 58 and 59 are consequential changes required to apply the limit on withdrawals from a drawdown pension fund insofar as the sums and assets in the fund represent Protected Rights. The limits on withdrawals imposed by pension rule 5 in section 165 of FA 2004 and by pension death benefit rule 4 in section 167 of that Act cannot be disapplied in relation to Protected Rights.
131. Paragraph 60 makes consequential changes to prevent there being an obligation on a registered pension scheme to operate PAYE on pension income that is taxable in the year of return by virtue of new section 579CA of ITEPA.

132. Paragraph 61 makes consequential changes to definitions used in ITEPA.


134. Paragraph 63 amends section 164(2)(b) of FA 2004 so as to extend the regulation making power contained in section 164(1)(f) of FA 2004. Provision may be made in regulations that payments that have been prescribed as authorised payments using this power may be subject to the ill-health lump sum charge.

135. Paragraph 64 replaces a reference to unsecured pension in section 165 of FA 2004 with a reference to drawdown pension.

136. Paragraph 65 amends section 168(1) of FA 2004 to provide for a drawdown pension fund lump sum death benefit to be a specified category of authorised lump sum death benefit.

137. Paragraph 66 amends section 169(1D) of FA 2004 to provide a power to make regulations enabling transfers of sums or assets made out of a drawdown pension fund to a new arrangement to be treated as if they were sums or assets held under the old arrangement to the extent provided for. The paragraph also replaces references to unsecured pensions and alternatively secured pensions with references to drawdown pensions.

138. Paragraph 67(1) to (4) amends the provisions in section 172B of FA 2004 in respect of increases in rights of connected persons on death to remove references to unsecured and alternatively secured pension funds and substitute with references to drawdown pension funds.

139. Paragraph 68 omits section 172BA of FA 2004 so that the rules on increases in rights on death arising from alternatively secured pension funds cease to have effect.

140. Paragraph 69 omits section 181A of FA 2004 so that the rules setting minimum levels of payments out of alternatively secured pensions cease to have effect.

141. Paragraphs 70 to 72 amend sections 182, 211 and 212 of FA 2004 to remove references to unsecured and alternatively secured pension funds and substitute with references to drawdown pension funds.
Paragraph 73 replaces references to unsecured pension in section 216 of FA 2004 with references to drawdown pension.

Paragraph 74 amends the definition of scheme chargeable payment in section 241 of FA 2004 to omit the cross reference to section 181A of FA 2004 which concerns minimum withdrawals from alternatively secured pensions.

Paragraph 75 deletes the cross references to sections 172BA and 181A of FA 2004 from section 268(6) of FA 2004.

Paragraph 76 removes the reference in section 273A of FA 2004 to the liability of insurance companies to pay the special lump sum death benefits charge in respect of an unsecured pension fund lump sum death benefit and substitutes a reference to a drawdown pension fund lump sum death benefit.

Paragraph 77 amends the general index in section 280(2) of FA 2004 to reflect changes provided for in the Schedule.

Paragraph 78 repeals certain provisions from Schedule 28 to FA 2004.

Paragraph 79 provides consequential amendments to paragraphs 1, 3 and 15 of Schedule 29 to FA 2004 (Authorised Lump Sums).

Paragraph 80 replaces references to unsecured pension in Schedule 32 to FA 2004 with references to drawdown pension.

Paragraph 81(1) introduces consequential amendments to Schedule 34 to FA 2004 (non-UK schemes: application of certain charges).

Paragraph 81(2) and (4) provides that the serious ill-health lump sum charge is one of the member payment charges applying to members of relevant non-UK schemes by virtue of Schedule 34 to FA 2004 and that the member of the relevant non-UK scheme is the person liable for the tax arising in respect of such lump sums.

Paragraph 81(3) inserts new paragraph 4A into Schedule 34 to FA 2004. New paragraph 4A modifies certain of the provisions of FA 2004 inserted or revised by this Schedule for the purposes of determining whether a member of a relevant non-UK scheme meets the flexible drawdown conditions.

Paragraph 81(5) makes a consequential repeal of provisions relating to alternatively secured pension arrangements under a relevant non-UK scheme.

Paragraph 82(1) introduces amendments to Schedule 36 to FA 2004 (transitional provisions and savings).
155. **Paragraph 82(2)** provides how to determine the value of a person’s pre-commencement rights in respect of a flexible drawdown arrangement. This is needed in order to determine the lifetime allowance treated as used up by pension rights existing before 6 April 2006 in order to ascertain whether there is any liability to the lifetime allowance charge due to a benefit crystallisation event after that date.

156. **Paragraph 82(3)** makes consequential changes to paragraph 28 of Schedule 36 to FA 2004.

157. **Paragraph 82(4)** makes consequential changes to paragraph 29 of Schedule 36 to FA 2004 in connection with transitionally protected rights to a pension commencement lump sum of more than £375,000. The changes firstly address the conversion of unsecured pension funds into drawdown pension funds on 6 April 2011 and secondly the removal of the rule preventing pension commencement lump sums from being paid to a member who has reached the age of 75.

158. **Paragraph 82(5)** makes consequential changes to paragraph 34 of Schedule 36 to FA 2004 in connection with transitionally protected rights to receive a lump sum worth more than 25% of the total rights under the scheme to deal with cases where the member becomes entitled to the pension after reaching the age of 75.

159. **Paragraph 82(6)** makes consequential changes to paragraph 36 of Schedule 36 to FA 2004.


161. **Paragraph 84** makes consequential repeals.

162. **Part 3** makes commencement and transitional provision.

163. **Paragraph 85** provides for the new rules to take effect on and after 6 April 2011.

164. **Paragraph 86** provides that a person who immediately before 6 April 2011 was entitled to unsecured pension or alternatively secured pension is treated from this date as entitled to drawdown pension.

165. **Paragraph 87** provides that where the legislation stipulates that a short term annuity has to be bought out of the assets in a drawdown pension fund that this includes annuities bought out of assets in an unsecured pension fund before 6 April 2011.

166. **Paragraph 88** provides that where the legislation stipulates that sums or assets have been designated as available for payment out of the funds of a drawdown pension, that this includes sums or assets
designated as available for an unsecured pension or alternatively secured pension fund before 6 April 2011.

167. **Paragraph 89** provides that where a member was entitled to an unsecured pension, the start of the next pension year for their drawdown pension will be the anniversary of the start of the unsecured pension year which includes 6 April 2011 and that the unsecured pension year in which 5 April 2011 falls is called the last unsecured pension year.

168. **Paragraph 90** sets out rules for working out the maximum amount that members who had unsecured pension fund arrangements and were under the age of 75 before 6 April 2011 can draw from a drawdown pension fund. It provides that the current withdrawal limits under pension rules 5 in section 165 of FA 2004 and under pension rule 4 of section 167 of FA 2004 are preserved until the first drawdown pension year to start after the relevant date as is the ability to re-determine the basis amount only every five years before age 75. The relevant date is the earlier of:

- the date on which the last reference period to begin before 6 April 2011 ends in accordance with the rules in Schedule 28 to FA 2004 disregarding amendments made by this Schedule; and

- the end of the drawdown pension year in which there is a recognised transfer to another scheme.

169. **Paragraph 91** sets out rules for working out the maximum amount that members who had unsecured pension fund arrangements and who reached the age of 75 on or after 22 June 2010 and before 6 April 2011 can draw from a drawdown pension fund in the drawdown pension year which includes 6 April 2011. The transitional rules affecting these members in Finance (No.2) Act 2010 are repealed by **paragraph 84(e)** of this Schedule.

170. **Paragraph 92** sets out rules for individuals who have reached the age of 75 before 22 June 2010 and who immediately before 6 April 2011 had an unsecured pension because their whereabouts were unknown to the scheme administrator. It provides that in these circumstances, there is a new drawdown pension year starting either:

- on 6 April 2011 if the scheme administrator ascertained their whereabouts before that date but the six month period of grace has not yet elapsed and the sums and assets have not all been used to provide an annuity or scheme pension and so remain held for the purposes of the unsecured pension fund on 5 April 2011; or

- on the date on which the scheme administrator ascertains their whereabouts after 5 April 2011.
Annual reviews and withdrawals capped at 100 per cent of the basis amount apply to these formerly untraceable members from the first day of the start of this drawdown pension year on or after 6 April 2011.

171. Paragraph 93(1) provides that this paragraph applies to members who immediately before 6 April 2011 were entitled to an alternatively secured pension.

172. Paragraph 93(2) to (5) provides that a member’s or dependant’s first drawdown pension year will be treated as having started on the first day of an alternatively secured pension scheme year which began on or after 7 April 2010. As a consequence:

- the member or dependant may take income withdrawals for that year of up to 100% of the basis amount at the start of the year in accordance with pension rule 5 of section 165 of FA 2004 and pension rule 4 of section 167 of FA 2004 as amended by this Schedule, and
- section 181A of FA 2004 (minimum level of payment from an alternatively secured pension, repealed by paragraph 69 of this Schedule) will not apply.

173. Paragraphs 94 to 100 make provisions for dependants of members with unsecured or alternatively secured pensions equivalent to the changes described above in relation to paragraphs 86 to 91 and paragraph 93 of this Schedule.

174. Paragraph 101 provides that the amendments in relation to pension commencement lump sums apply to lump sums to which the member became entitled on or after 6 April 2011.

175. Paragraph 102 provides that the amendments in relation to lump sums other than pension commencement lump sums and lump sum death benefits apply to lump sums paid on or after 6 April 2011.

176. Paragraph 103 provides that the amendments to lump sum death benefit rules apply to lump sums paid in respect of deaths on or after 6 April 2011.

177. Paragraph 104 provides that the changes to the benefit crystallisation event rules apply to benefit crystallisation events occurring on or after 6 April 2011.

178. Paragraph 105 provides that the amendments to the IHT charges under section 12 of IHTA shall have effect in respect of dispositions made or treated as being made on or after 6 April 2011.

179. Paragraph 106 provides that the amendments to the IHT charges under section 151 of IHTA and related administrative arrangements,
as outlined in paragraphs 48 and 51 to 57, shall have effect in relation to deaths occurring on or after 6 April 2011.

180. Paragraph 107 makes provision for how the consequential repeals in paragraph 84 are to have effect.

181. Paragraph 108 extends the regulation making power in section 282 of FA 2004 and provides that regulations made during the 2011-12 tax year in connection with amendments made by this Schedule may have retrospective effect even if they increase an individual’s liability to tax.

182. Paragraph 109 provides that payments may be made by registered pension schemes that are authorised member payments by virtue of this Schedule even if the pension scheme rules prohibit such a payment.

BACKGROUND NOTE

183. Schedule 16 removes the effective requirement for members of registered pension schemes to buy an annuity by the age of 75 following an announcement by the Government that it intended to remove this requirement. A consultation document Removing the requirement to annuitise by age 75 was published on 15 July 2010, inviting views on the issues around the precise design of the new rules required to do so. The formal consultation concluded on 10 September 2010.

184. The current tax rules require that tax-relieved pension savings must be used to secure an income by age 75. This requirement is intended to ensure that pension savings accumulated with the help of tax relief are used to provide an income on retirement.

185. Most members of defined contribution (DC) schemes secure a retirement income by buying an annuity. Up until now, the options for members of DC schemes who do not wish to buy an annuity have been limited to:

- before age 75, an unsecured pension arrangement (USP) which enables individuals to leave their pension fund invested while drawing down an income; and

- after age 75, an alternatively secured pension arrangement (ASP) which is similar to USP but with a lower maximum drawdown limit.

186. Under the new rules, the concepts of USP and ASP will disappear and there will be a single alternative to an annuity, a drawdown pension. The maximum withdrawal of income that an individual may make from most drawdown funds will be capped at 100 per cent of
the equivalent annuity that could have been bought with the fund value. However, individuals who can demonstrate that they have secure pension income for life of at least £20,000 will have unrestricted access to receive their drawdown fund as pension income.

187. Transitional rules were legislated in section 6 of and Schedule 3 to F(No.2)A 2010. These rules modify how certain rules relating to registered pension schemes apply to individuals reaching age 75 on or after 22 June 2010, the date of the June Budget when the changes were announced.
EXPLANATORY NOTE

CLAUSE 66 SCHEDULE 17: ANNUAL ALLOWANCE CHARGE

SUMMARY

1. Clause 66 and Schedule 17 amend Part 4 of Finance Act (FA) 2004 as it relates to the annual allowance charge.

2. The level of the annual allowance for determining whether the annual allowance charge is applicable is lowered to £50,000 for pension input periods from 2011-12 and the rate of the annual allowance charge is changed to the “appropriate rate” from 2011-12. This Schedule also amends the way in which the pension input amount is valued for defined benefit and cash balance arrangements.

3. From 2011-12, the annual allowance charge applies in the year pension benefits are drawn except where the benefits are in the form of a serious or severe ill-health lump sum and also applies to those who have enhanced protection under paragraph 12 of Schedule 36 to FA 2004.

4. This Schedule introduces transitional provisions for the annual allowance for 2011-12 and provisions for the carry forward of unused annual allowance for a period of up to three years to 2011-12 and following years.

5. From 2011-12 individuals can elect for their pension scheme to pay their annual allowance charge out of their pension benefits. The election is subject to certain qualifying conditions and exceptions.

DETAILS OF THE SCHEDULE

6. Paragraph 2(1) amends section 227 of FA 2004 as follows.

7. Paragraph 2(2) omits section 227(2) and (3) which deals with an individual’s liability to the annual allowance charge.

8. Paragraph 2(3) provides that the annual allowance charge is to be at “the appropriate rate”.

9. Paragraph 2(4) inserts new section 227(4A), 227(4B) and 227(4C) as set out below.

10. New section 227(4A) sets out how to calculate “the appropriate rate” and links the rate of the annual allowance charge to the top slice of an
individual’s income so that it reflects the rate of relief that was given on the pension saving.

11. **New section 227(4B)** defines reduced net income, as used in working out the “the appropriate rate” to be used for the annual allowance charge.

12. **New section 227(4C)** provides that where the basic and higher rate bands are increased, the new increased band applies for the purposes of working out “the appropriate rate”.

13. **Paragraph 2(5)** removes current section 227(5A) and (5B) which provides a power to make orders to vary the rate of the annual allowance charge and for there to be different rates in different circumstances.

14. **Paragraph 2(6)** inserts new sections 238ZA to 238ZE which provide for who is liable to the annual allowance charge.

15. **Paragraph 3** amends section 228 of FA 2004 to set the level of the annual allowance to £50,000 from 2011-12 and provides the power to amend the annual allowance by Treasury Order in future tax years.

16. **Paragraph 4** inserts **new section 228A** in FA 2004. This provides for any unused annual allowance for the three years preceding the current year to be added to the annual allowance for the current year for determining whether an annual allowance charge is applicable for the current year. Unused annual allowance is only available for carry forward where it arises during a tax year in which the individual is a member of a registered pension scheme but applies to a tax year even if the pension input amount for that year is nil. The earlier year’s unused allowance is to be set off against the current year before that of the later year.

17. **Paragraph 5(1) to (4)** amends section 229 of FA 2004 and provides for the pension input amount to be treated as nil under an arrangement in a tax year where the individual satisfies the severe ill-health condition. The condition is that the individual is unable to work again in any gainful capacity before reaching pensionable age otherwise than to an insignificant extent or becomes entitled to a serious ill-health lump sum under the arrangement or becomes entitled to a tax-free benefit provided as compensation to a member of the armed forces by reason of illness or injury.

18. **Paragraph 6(1) and (2)** amends section 230(4) of FA 2004 to provide for the measure of the opening rights of a cash balance arrangement to be by reference to the previous closing value of the individual’s rights under the arrangement for the previous pension input period.
19. Paragraph 6(3) inserts new section 230(5A), (5B) and (5C) as set out below.

20. New section 230(5A) provides that the pension input amount in connection with a cash balance arrangement does not include minimum payments or amounts recovered under section 8 of the Pension Schemes Act 1993 (PSA 1993) or section 4 of the Pension Schemes (Northern Ireland) Act 1993 (PSNIA 1993).

21. New section 230(5B) provides for the pension input amount for an arrangement to be treated as nil in a tax year where the individual is a deferred member of a cash balance arrangement, or a deferred member for part of the year and a pensioner member for the remainder, and the value of their relevant rights in that arrangement does not increase by more than the relevant percentage.

22. New section 230(5C) provides the definitions of guaranteed minimum pension, predecessor arrangement, predecessor registered pension scheme, the relevant percentage, the relevant rights of the individual and specified, for the purpose of the new section 230(5A) and (5B).

23. Paragraph 7 substitutes section 231(3) of FA 2004 to provide for the opening value of the individual’s rights under a cash balance arrangement to be increased by the annual percentage increase (if any) in the consumer prices index for September in the previous tax year.

24. Paragraph 8(1) to (9) amends section 232 of FA 2004 to provide for the closing value of the individual’s rights under a cash balance arrangement to be adjusted. The amount of the adjustment is calculated by reference to the amount of the annual rate of the pension that has been reduced or increased by:

- a transfer in or out;
- a reduction or increase in pension;
- a surrender of rights; or
- a benefit crystallisation event.

25. Any consequential adjustment made to the individual’s rights as a result of the scheme paying the individual’s annual allowance charge is to be subtracted from the closing value if it is not otherwise taken into account.

26. Paragraph 9(1) provides for the amendment of section 234 of FA 2004 as set out below.
27. Paragraph 9(2) amends section 234(4) and provides for the opening value of a defined benefit arrangement to be adjusted by a factor of 16 when working out the pension input amount. It provides for the opening value of the individual’s rights under the arrangement to be measured by reference to the previous closing value of those rights for the previous pension input period.

28. Paragraph 9(3) amends section 234(5) and provides for the closing value of a defined benefit arrangement to be adjusted by a factor of 16 when working out the pension input amount.

29. Paragraph 9(4) inserts into section 234 new section 234(5A), (5B) and (5C) as set out below.

30. New section 234(5A) provides that the pension input amount in connection with a defined benefit arrangement does not include minimum payments or amounts recovered under section 8 of PSA 1993 or section 4 of PSNIA 1993.

31. New section 234(5B) provides for the pension input amount for an arrangement to be treated as nil in a tax year where the individual is a deferred member of a defined benefit arrangement. The treatment also applies if the individual is a deferred member for part of the year and a pensioner member for the remainder. In either case the value of their relevant rights in that arrangement does not increase by more than the relevant percentage.

32. New section 234(5C) provides the definitions of guaranteed minimum pension, predecessor arrangement, predecessor registered pension scheme, the relevant percentage, the relevant rights of the individual and specified, for the purpose of the new section 234(5A) and (5B).

33. Paragraph 9(5) inserts a reference to new section 236A into section 234(6) so that it supplements section 234.

34. Paragraph 10(1) to (3) amends section 235 of FA 2004 and provides for the opening value of the individual’s rights under a defined benefit arrangement to be increased by the annual percentage increase (if any) in the consumer prices index for September in the previous tax year.

35. Paragraph 11(1) to (7) amends section 236 of FA 2004 to provide for the closing value of the individual’s rights under a defined benefit arrangement to be adjusted. The adjustment is calculated by reference to the amount of the annual rate of the pension that has been reduced or increased by:

- a transfer in or out;
- a pension reduction;
• a surrender made in return for any other entitlement; or
• a benefit crystallisation event.

36. Any consequential adjustment made to the individual’s rights as a result of the scheme paying the individual’s annual allowance charge is to be subtracted from the closing value if it is not otherwise taken into account.

37. Paragraph 12 inserts new section 236A in FA 2004 which provides for the opening and closing values of an individual’s annual rights in an arrangement to be based on the cash equivalent value where the individual enters into a scheme for making a post-entitlement enhancement the main purpose of which is to avoid or reduce a liability to the annual allowance charge.

38. Paragraph 13 substitutes the reference to section 236 in section 237(5) of FA 2004 with a reference to new section 236A to provide for that section to be taken into account in calculating the pension input amount in respect of hybrid arrangements.


40. New section 237A(1) and (2) provides for an individual’s liability to the annual allowance charge.

41. New section 237B(1) to (3) provides for an individual to give notice to the scheme administrator for the individual’s annual allowance charge calculated by reference to the individual’s marginal rate of tax (“the relevant rate”) to be paid from their pension benefits. This is allowed where the individual has an annual allowance charge of more than £2,000 and the aggregate of the individual’s pension input amounts for arrangements within that pension scheme exceeds the annual allowance. The individual can only give notice for the scheme to pay an amount up to the amount by which the individual’s aggregate pension input amount exceeds the annual allowance for that scheme.

42. New section 237B(4) provides the definition of the “relevant rate” for the purposes of new section 237B(3).

43. New section 237B(5) provides that, subject to subsection (6), the notice must be given by the individual by 31 July of the year following the end of the tax year in which the annual allowance charge arises. For example, where an individual exceeds the annual allowance in the tax year 2012-13, the notice must be given by July 2014. The notice must be given in the manner and form prescribed in regulations. The notice may be amended in accordance with
provision made by regulations made by HM Revenue and Customs (HMRC), but cannot be revoked.

44. **New section 237B(6)** provides that any notice given in the year in which an individual becomes entitled to all the remaining benefits under the scheme, or in relation to whom benefit crystallisation event 5,5A or 5B occurred, must be given before the date on which the individual becomes entitled to those benefits or the benefit crystallisation event occurred.

45. **New section 237B(7)** provides that once the notice is received by the scheme administrator, the scheme administrator and the individual are jointly and severally liable to pay the amount of the annual allowance charge specified in the notice. This subsection is subject to the provisions of the new section 237C (which provides for exceptions), the new section 237D (which provides for discharge of the scheme administrator’s liability) and any amendments made to the notice.

46. **New section 237B(8)** provides that the scheme administrator is jointly and severally liable on receipt of the notice whether or not the individual and the scheme administrator are resident, ordinarily resident or domiciled in the United Kingdom.

47. **New section 237B(9)** provides for individuals who transfer all their pension benefits to another pension scheme and have exceeded the annual allowance in the transferring scheme to give notice to the receiving scheme to meet their annual allowance charge.

48. **New section 237B(10)** provides a power for the Treasury to make regulations modifying the provisions of the section where there is a transfer of sums and assets from the pension scheme to another registered pension scheme.

49. **New section 237B(11)** provides a power for the Treasury to make an order increasing the £2,000 limit in subsection (1).

50. **New section 237C(1)** provides an exception for a scheme which has already entered the assessment period for the Pension Protection Fund (PPF), or does so after the individual has given notice but before the scheme has been able to process the payment, so that the scheme administrator is not jointly and severally liable to pay the amount of the annual allowance charge specified in the notice.

51. **New section 237C(2)** provides that the scheme administrator is not liable to pay any amount of the individual’s annual allowance charge that would result in a reduction to the individual’s benefits below the amount of the statutory Guaranteed Minimum Pension.
52. New section 237C(3) provides a power for the Treasury to make regulations to specify other circumstances when the scheme administrator is not jointly and severally liable to pay the amount of the annual allowance charge specified in the notice.

53. New section 237D(1) to (5) provides that the scheme administrator may apply to HMRC for the discharge of the scheme administrator’s liability to pay an individual’s annual allowance charge from their pension benefits. The scheme administrator must demonstrate that to do so would be to the substantial detriment of the interests of the pension schemes’ members or that it would not be just and reasonable for the scheme administrator to do so. It is for HMRC to decide whether or not to discharge the scheme administrator’s liability and they must notify the scheme administrator of their decision. If the scheme administrator’s liability under a notice is discharged, the individual remains liable for the amount of the annual allowance charge which is the subject of that notice.

54. New section 237D(6) provides a power for the Treasury to make regulations altering the grounds on which an application for the discharge of the scheme administrator’s liability can be made.

55. New section 237D(7) provides a power for HMRC to make regulations supplementing the section and to set time limits for making any application.

56. New section 237E(1) and (2) provides that where the scheme administrator pays the annual allowance charge in respect of an individual, consequential adjustment must be made to the individual’s entitlement to benefits under the scheme on a just and reasonable basis having regard to normal actuarial practice. Any consequential adjustment cannot reduce the individual’s pension rights below the amount that would provide the individual with their Guaranteed Minimum Pension.

57. Paragraph 15(1) amends section 238 of FA 2004 as follows.

58. Paragraph 15(2) provides for the first pension input period to end on a nominated date before the anniversary of the commencement date or, if there is no nominated date, the first 5 April following the anniversary of the commencement date or 5 April if that is the commencement date.

59. Paragraph 15(3) inserts new section 238(4A) to provide that the nominated date for the purposes of the date on which a pension input period ends cannot be before the date on which the nomination is made.
60. **Paragraph 15(4)** provides for pension input periods other than the first pension input period to end on the nominated date falling within the year following the last pension input period; or, if there is no nominated date, the day before the anniversary of the date on which that period ended.

61. **Paragraph 15(5)** provides that the final pension input period for an arrangement is the pension input period in which the individual becomes entitled to all the benefits to which they are entitled under the arrangement.

62. **Paragraph 16** inserts **new section 238A** in **FA 2004** to provide an order making power for the Treasury to make provision about the annual allowance charge, including modifications to sections 227 to 238 of FA 2004.

63. **Paragraph 17** inserts **new subsections (7A) and (7B)** into section 254 of FA 2004. New section 254(7A) requires the scheme administrator to return the annual allowance charge specified in a notice given by an individual in the return form for the quarter ending 31 December of the year following the end of the tax year in which the annual allowance charge arises. For example, where an individual exceeds the annual allowance charge in the year 2012-13, the scheme administrator must account for the annual allowance charge in the return for the quarter ending 31 December 2014.

64. **New section 254(7B)** applies where the notice has been amended and requires that any additional tax to which the scheme administrator becomes liable is to be charged in the later of:

   - the period specified in subsection (7A); and
   - the period in which the scheme administrator receives notice of the amendment.

65. **Paragraph 18** inserts a reference to liability to the annual allowance charge into section 255 which contains a regulation-making power enabling provision to be made concerning assessments.

66. **Paragraph 19** applies the appeal provisions in section 269 of FA 2004 to decisions taken by HMRC in relation to discharging the scheme administrator’s liability in accordance with new section 237D.

67. **Paragraph 20** inserts into section 279(1) of FA 2004 definitions of the consumer prices index and pensionable age. The definition of pensionable age is the state pension age as given by the rules in paragraph 1 of Schedule 4 to the Pensions Act 1995 and paragraph 1 of Schedule 2 to the Pensions (Northern Ireland) Order 1995.
Paragraph 21 inserts into section 280(2) of FA 2004 a reference to the definitions of the consumer prices index and pensionable age in section 279(1).

Paragraph 22 amends section 282(1A) of FA 2004 which lists orders which must be made using the affirmative procedure. The reference to section 227(5A) which provides a power to make orders to vary the rate of the annual allowance is removed. In its place there is a reference to the new power contained in section 237B(11) to increase the £2,000 threshold for giving the scheme administrator a notice under that section. References to sections 228(2) and 238A are inserted so that an order modifying the provisions relating to the annual allowance or varying the annual allowance which has the effect of increasing a person’s liability to tax must be made under the affirmative procedure.

Paragraph 23 (1) amends Schedule 34 to FA 2004 as follows.

Paragraph 23(2) makes consequential changes to paragraph 8(1) of Schedule 34 to FA 2004 to enable the application of joint liability of the annual allowance charge to apply to non-UK pension schemes.

Paragraph 23(3) inserts new paragraphs 9A and 9B into Schedule 34 to FA 2004 as follows.

New paragraph 9A provides for the carry forward of unused annual allowance by a member of an overseas pension scheme from years in which they were a member of a currently relieved non-UK pension scheme whether or not they were resident in the UK at the time the contributions were made or benefit accrual arose.

New paragraph 9B provides for the carry forward of unused annual allowance by a member of a registered pension scheme from years in which they were a member of a currently relieved non-UK pension scheme whether or not they were resident in the UK at the time the contributions were made or the benefit arose.

Paragraph 23(4) makes consequential changes to paragraph 12(1) of Schedule 34 to FA 2004 to enable the application of joint liability of the annual allowance charge to apply to non-UK pension schemes.

Paragraph 24 removes paragraph 49 of Schedule 36 to FA 2004 which disapplies the annual allowance charge for individuals with enhanced protection.

Paragraph 25 removes material which becomes redundant because the rules it introduced are repealed.
78. Paragraph 26 provides that the Schedule has effect from 2011-12 and for pension input periods that end in 2011-12.

79. Paragraph 27(1) and (2) provides for transitional provisions to apply in arriving at the amount of the annual allowance charge for 2011-12, where a pension input period ends in 2011-12 and begins before 14 October 2010 and the total input amount for that tax year exceeds £50,000.

80. Paragraph 27(3) provides for there to be two separate pension input periods for 2011-12, a “pre-announcement” and a “post-announcement” period, where the pension input period ends in 2011-12 and begins before 14 October 2010. Any other pension input period which ends in 2011-12 is a “post-announcement” period.

81. Paragraph 27(4) and (5) sets out how to calculate the post-announcement periods’ total by aggregating the pension input amount for each post-announcement period and then deducting £50,000.

82. Paragraph 27(6) and (7) sets out how to calculate the individual’s pre-announcement periods’ total. The pre-announcement periods’ total is:

- the aggregate pension input amount for each pre-announcement period with the value of any rights under a defined benefit arrangement calculated using a factor of 10; minus

- the difference between £255,000 and the lesser of £50,000 and the aggregate of the pension input periods for each post-announcement period.

83. Paragraph 27(8) to (10) sets out how to calculate the amount of the annual allowance charge for 2011-12 by totalling the post-announcement and pre-announcement periods’ totals and deducting the annual allowance for the tax year as increased by the carry forward of unused annual allowance under new section 227A of FA2004.

84. Paragraph 28 provides that where the transitional provisions apply to the pension input amount for 2011-12 under paragraph 23, the carry forward amount for that year under the new section 227A of FA 2004 is to be calculated as if the annual allowance for that year were £50,000.

85. Paragraph 29(1) provides for paragraph 28 to have effect in determining the amount of unused annual allowance available for carry forward to the years 2011-12, 2012-13 and 2013-14.
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86. Paragraph 29(2) to (3) provides that certain assumptions are to be made when applying new section 227A to the years 2011-12, 2012-13 and 2013-14. The assumptions are:

- that the annual allowance for 2008-09, 2009-10 and 2010-11 was £50,000; and

- that the amendments made by the Schedule apply.

87. Paragraph 30 provides for contributions paid during 2009-10 and 2010-11 which are repaid as a contributions lump sum under the anti-forestalling rules in paragraph 15 of Schedule 35 to FA 2009 to be deducted when determining the pension input amount for the annual allowance for the arrangement in respect of those years.

88. Paragraph 31 provides that any notice given by an individual to a scheme administrator in relation to an annual allowance charge for 2011-12 must be made by 31 December 2013.

89. Paragraph 32 requires the scheme administrator to return any annual allowance charge for 2011-12 in the return form for the period ending 31 March 2014.

90. Paragraph 33 provides for expressions used in Part 2 of Schedule 1 to have the same meaning as the same expressions used in Part 4 of FA 2004.

BACKGROUND NOTE

91. Schedule 17 restricts tax relief for pension savings by reducing the level of the annual allowance provided for in section 227 of FA 2004. This section limits the amount of tax relief given on annual pension savings made by or in respect of an individual.

92. It follows an informal consultation which concluded on 27 August 2010 following an announcement by the Government that it was considering an alternative approach to restricting pensions tax relief, involving reform of existing allowances. A discussion document on the subject “Restriction of pensions tax relief: a discussion document on the alternative approach” was published in July, inviting views on a range of issues around the precise design of any such regime.

93. The annual allowance is reduced to £50,000 and the rate of charge is linked to the individual’s top slice of income. The new level of annual allowance and rate of charge comes into force from 2011/12.
Schedule 17 also provides for the payment of an individual’s annual allowance charge for 2011-12 and following years by the individual’s pension scheme out of their pension benefits.

These changes follow an announcement by the Government on October 2010 that it was considering options to enable individuals to meet the annual allowance charge out of their pension benefits, rather than current income. An informal consultation concluded on 7 January 2011. With the lowering of the annual allowance from £255,000 to £50,000 from 2011-12, the Government published a discussion document on the subject “Options to meet high annual allowance charges from pension benefits: a discussion document” in November 2010 inviting views on two broad options: payment from pension benefits at the point the charge arises; or payment at the point the pension benefit crystallises. The main purpose of this exercise was to establish which of the two broad options better met the Government’s objectives, and how it would work in practice.
EXPLANATORY NOTE

CLAUSE 67 SCHEDULE 18: LIFETIME ALLOWANCE CHARGE

SUMMARY

1. Clause 67 and Schedule 18 amend Part 4 of the Finance Act (FA) 2004 as it relates to the lifetime allowance charge.

2. The level of the lifetime allowance for determining whether the lifetime allowance charge is applicable is lowered to £1,500,000 from 2012-13 onwards. The Schedule introduces transitional provisions which provide protection from the lifetime allowance charge for those who may already have built up pension savings on the expectation that the lifetime allowance would remain at the current level of £1,800,000.

DETAILS OF THE SCHEDULE


4. Paragraph 2(2) provides for the lifetime allowance to be £1,500,000 for the year 2012-13 onwards and provides the power to increase the lifetime allowance by Treasury Order in future tax years.

5. Paragraph 2(3) inserts new sections 218(5A),(5B) and (5C) into section 218 as follows.

6. New section 218(5A) provides for the standard lifetime allowance to be replaced by a figure of £1,800,000 when calculating the enhancement factor where the individual is relying on protection under section 220, 222, 223 or 224 of FA 2004 (which apply a lifetime enhancement factor in respect of pension credits, relevant overseas individuals and transfers from recognised overseas pension schemes). The substitution in respect of sections 220, 222, 223 and 224 of FA 2004 relates only to events taking place before 6 April 2012.

7. New section 218(5B) provides for the references to the standard lifetime allowance in section 218(4) to be replaced by a figure of £1,800,000 where the individual is relying on primary protection under paragraph 7 of Schedule 36 to FA 2004.

8. New section 218(5C) provides for the reference to the standard lifetime allowance to be replaced by a figure of £1,800,000 where a benefit crystallisation event 7 occurs on or after 6 April 2012 because of the payment of a lump sum death benefit in respect the death of the individual before 6 April 2012.
9. **Paragraph 3** introduces amendments of Schedule 29 to FA 2004 (authorised lump sums) as set out below.

10. **Paragraph 4** sets the quantum of a trivial commutation lump sum at £18,000 and provides the power to increase the amount of the lump sum in future years by Treasury Order.

11. **Paragraph 5** sets the quantum of a winding-up lump sum at £18,000 and provides the power to increase the amount of the lump sum in future years by Treasury Order.

12. **Paragraph 6** sets the quantum of a trivial commutation lump sum death benefit at £18,000 and provides the power to increase the amount of the lump sum in future years by Treasury Order.

13. **Paragraph 7** sets the quantum of a winding-up lump sum death benefit at £18,000 and provides the power to increase the amount of the lump sum in future years by Treasury Order.

14. **Paragraph 8** introduces amendments of Schedule 36 to FA 2004 as set out below.

15. **Paragraph 9** substitutes the “underpinned lifetime allowance” for the “standard lifetime allowance” in paragraph 16(3) of Schedule 36 when determining the “post commencement earnings limit” for calculating the relevant benefit accrual for those relying on enhanced protection. The “underpinned lifetime allowance” is the greater of the standard lifetime allowance and £1,800,000.

16. **Paragraph 10** amends paragraph 28(3) of Schedule 36 so that the enhancement factor for those relying on primary protection is determined using the “underpinned lifetime allowance”.

17. **Paragraph 11** amends paragraph 34(2) of Schedule 36 so that the enhancement factor for those individuals entitled to a lump sum exceeding 25 per cent at 5 April 2006 but who do not have enhanced or primary protection is calculated using the “underpinned lifetime allowance”.


19. **Paragraph 13** provides that Part 1 of the Schedule shall have effect for the tax year 2012-13 onwards.
20. **Paragraph 14(1)** provides for transitional protection against the lifetime allowance charge from 6 April 2012 for those who do not have either primary or enhanced protection.

21. **Paragraph 14(2)** provides a power for HM Revenue & Customs to make regulations specifying how a notice of intention to rely on the transitional protection should be given.

22. **Paragraph 14(3)** provides for the “underpinned lifetime allowance” rather than the standard lifetime allowance to be used for those who are relying on the new transitional protection when applying the provisions of Part 4 of FA 2004. The underpinned lifetime allowance is the greater of the standard lifetime allowance and £1,800,000.

23. **Paragraph 14(4)** provides for the transitional protection to be lost if:
   - there is a benefit accrual;
   - there is an impermissible transfer;
   - there is a transfer of sums and assets that is not a permitted transfer; or
   - a new arrangement relating to the individual is made otherwise than in permitted circumstances

24. **Paragraph 14(5)** sets out when benefit accrual occurs for a money purchase arrangement other than a cash balance arrangement, for a cash balance or defined benefits arrangement and for a hybrid arrangement for the purposes of paragraph 14(4)(a).

25. **Paragraph 14(6) and (7)** provides how to determine the increase in the value of the individual’s rights under a cash balance or defined benefit arrangement and a hybrid arrangement under which cash balance or defined benefits may be provided.

26. **Paragraph 14(8) to (11)** provides the definition of impermissible transfers, permitted transfers, permitted circumstances and relevant contribution.

27. **Paragraph 14(12)** provides for benefit accrual not to be taken into account in respect of cash balance and defined benefits arrangements if the accrual is less than the relevant percentage.

28. **Paragraph 14(13)** provides the definition of relevant percentage as the annual rate of increase specified in the scheme rules (or predecessor scheme rules if this is more favourable to the individual) as at 9 December 2010, if there is one, or the annual percentage increase in the consumer prices index for September in the previous tax year.
29. Paragraph 14(14) provides the definition of predecessor arrangement and predecessor registered pension scheme.

30. Paragraph 14(15) provides that regulations made under paragraph 14(2), to specify how the notice of intention to rely on the transitional protection is to be given, may include supplementary or incidental provision.

31. Paragraph 14(16) and (17) provides that regulations made in respect of the transitional protection are to be made under statutory instrument and are to be subject to negative resolution.

32. Paragraph 14(18) provides for expressions used in paragraph 14 to have the same meaning as the same expressions used in Part 4 of FA 2004.

**BACKGROUND NOTE**

33. Schedule 18 restricts tax relief for pension savings by reducing the level of the lifetime allowance provided for in section 218 of FA 2004 which limits the total amount of tax relief given on an individual’s pension savings.

34. It follows a consultation on reducing the lifetime allowance which concluded on 27 August 2010 and formed part of the Summary of Responses document on the ‘Restriction of pensions tax relief: a discussion document on the alternative approach’ published on 14 October 2010 which announced the reduction.

35. This level of the lifetime allowance is reduced to £1,500,000 with effect from 6 April 2012. A new transitional protection comes into force on the same date.
EXPLANATORY NOTE

CLAUSE 68: BORROWING BY SECTION 67 PENSION SCHEME

SUMMARY

1. Clause 68 removes the tax charge on borrowing that is used to fund the cost of establishing, managing and administering a pension scheme established under section 67 of the Pensions Act 2008. The change has effect on and after 6 April 2011.

DETAILS OF THE CLAUSE

2. Under section 182 of the Finance Act (FA) 2004, a pension scheme registered under section 153 of FA 2004 is not authorised to borrow amounts where the total outstanding borrowing exceeds half of the value of the sums or assets of the scheme. Unauthorised borrowing results in a tax charge arising which is payable by the scheme administrator.

3. Subsection (1) provides that section 182 of FA 2004 does not make any borrowing unauthorised if that borrowing is used to fund the costs of establishing, administering or managing a pension scheme set up under section 67 of the Pensions Act 2008. The National Employment Savings Trust (NEST) has been set up under section 67.

4. Subsection (2) provides that any calculation of the amount of borrowing by NEST for the purposes of sections 182 and 183 FA 2004 should not include any amounts previously borrowed that were used to fund the costs of establishing, administering or managing NEST.

5. Subsection (3) ensures that, for the purposes of this section, the definition of establishment, administering and managing does not include investment.

BACKGROUND NOTE

6. NEST will be a registered pension scheme. It will be self-financing but the initial cost of setting up NEST will be funded by loans. As the borrowing will be repaid out of charges on members the tax rules on pension scheme borrowing will apply.

7. An unintended tax charge would arise on the borrowing used to fund the cost of setting up NEST. The changes in this section ensure that
the tax charge is removed. This means that the tax outcome for the cost of funding NEST is the same as for other similar pension schemes where the cost of establishment has been funded by the sponsoring employers or by the pension providers, without incurring unauthorised borrowing.
EXPLANATORY NOTE

CLAUSE 69: EXEMPTION FROM TAX ON INTEREST ON UNPAID RELEVANT CONTRIBUTIONS

SUMMARY

1. Clause 69 exempts from tax any interest that the Pensions Regulator may, at its discretion, require an employer to pay because the employer pays pension contributions late under the employer compliance provisions in the Pensions Act 2008 and the Pensions (No.2) Act (Northern Ireland) 2008.

DETAILS OF THE CLAUSE

2. Subsection (2) adds unpaid relevant contributions to the list of exemptions from the income tax charge on interest included in section 369(3)(e) of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

3. Subsection (3) inserts new section 753A into ITTOIA. New section 753A(1) provides that there is no liability to income tax on interest that is paid to comply with a compliance notice or unpaid contributions notice issued by the Pensions Regulator in respect of unpaid pension contributions.

BACKGROUND NOTE

4. Interest that the Pensions Regulator may require an employer to pay on late paid pension contributions is paid directly to the employee’s pension account. The employee does not have access to that interest until he or she comes to take benefits from that pension scheme but would, without this exemption, be liable to tax on that interest payment.

5. The interest is intended to compensate the employee for lost investment growth as the contributions are paid late to their pension account. As the investment growth in the pension scheme would be tax-free, this new section 753A(1) of ITTOIA exempts the tax charge on the interest.
EXPLANATORY NOTE

CLAUSE 70: POWER TO MAKE FURTHER PROVISION ABOUT SECTION 67 PENSION SCHEME

SUMMARY

1. Clause 70 gives HM Treasury a power to make regulations for and in connection with the application of tax to a pension scheme established under section 67 of the Pensions Act 2008 or any person in connection with such a scheme.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that HM Treasury may make regulations for and in connection with the application of the taxes listed in subsection (3). The regulations can make provision only in connection with the application of taxes to a pension scheme established under section 67 of the Pensions Act 2008. The National Employment Savings Trust (NEST) has been set up under section 67.

3. Subsection (2) provides that the provision made by the regulations may impose the relevant taxes as well as provide exemptions or reliefs from them.

4. Subsection (4) allows the regulations to apply retrospectively but only if they do not increase a person’s tax liability.

5. Subsection (5) provides that the regulations can amend any primary or secondary legislation and make consequential, supplementary and transitional provision.

6. Subsection (7) provides that regulations under this power are to be made under the negative resolution procedure.

BACKGROUND NOTE

7. NEST will be a registered pension scheme. Generous tax reliefs are provided for “registered pension schemes” so there are rules on what can happen to pension savings under a registered pension scheme and how the assets supporting the fund are treated. Tax charges of up to 70 per cent may arise where the rules are not followed.

8. When the pensions tax rules were introduced a pension scheme like NEST had not been envisaged. So NEST, or the members of NEST, may be subject to unintended tax charges.
9. Regulations containing tax provisions may be needed to prevent these unintended tax charges arising.
EXPLANATORY NOTE

CLAUSE 71: TAX PROVISION CONSEQUENTIAL ON PART 1 OF PENSIONS ACT 2008 ETC

SUMMARY


DETAILS OF THE CLAUSE

2. Subsection (1) provides that HM Treasury may make regulations in relation to the taxes listed in subsection (3). The regulations can make provision only as a consequence of measures in Part 1 of the Pensions Act 2008 or in Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.

3. Subsection (2) provides that the provision made by the regulations may impose the relevant taxes as well as provide exemptions or reliefs from them.

4. Subsection (4) allows the regulations to apply retrospectively but only if they do not increase a person’s tax liability.

5. Subsection (6) provides that the regulations can amend any primary or secondary legislation and make consequential, supplementary and transitional provision.

6. Subsection (8) provides that regulations under this power are to be made under the negative resolution procedure.

BACKGROUND NOTE

7. The pension schemes that meet the employer duty provisions in Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008 from 2012 must be registered for tax purposes.

8. Generous tax reliefs are provided for “registered pension schemes” so there are rules on what can happen to pension savings under a registered pension scheme and how the assets supporting the fund are treated. Tax charges of up to 70 per cent may arise where the rules are not followed.
9. Tax provisions may be needed to prevent unintended tax charges arising as a result of the interaction of the tax rules for registered pension schemes and provisions in Part 1 of the Pensions Act 2008 or Part 1 of the Pensions (No.2) Act (Northern Ireland) 2008.

10. Some changes to tax legislation have been made already and this power to make regulations enables any further necessary changes to be made to the tax rules once those Pensions Acts provisions take effect. However, the power is also there to make any tax provision required as a result of the interaction of the tax rules and the Pensions Acts provisions. The aim is to ensure that all registered pension schemes fit within the existing pensions tax framework.
EXPLANATORY NOTE

CLAUSE 72 SCHEDULE 19: THE BANK LEVY

SUMMARY

1. Clause 72 and Schedule 19 impose a new tax, the bank levy, which applies in relation to periods of account ending on or after 1 January 2011. The Schedule identifies who will be liable to pay the tax and how the tax is to be administered.

DETAILS OF THE SCHEDULE

Part 1

2. Part 1, which contains paragraphs 1 to 3, introduces the bank levy and identifies what is contained in Parts 2 to 9 of the Schedule.

Part 2

3. Part 2 of Schedule 19 covers the charging of the bank levy.

4. Paragraph 4 identifies the groups that, at the end of their periods of account (called “chargeable periods”), are within the bank levy and contains a number of definitions. It also sets out the applicable accounting frameworks for determining which entities are members of those groups. The definitions of the groups that are within the bank levy are to be found in paragraphs 8 to 11 of the Schedule.

5. Paragraph 5 provides for certain stand alone entities to be within the charge to the bank levy.

6. Paragraph 6 sets out the steps to be followed in order to ascertain the amount of the bank levy. The steps show how the allowance of £20 billion is to be applied and how the bank levy charge is calculated for long and short chargeable periods. Part 6 of the Schedule provides details of how to identify the entity responsible for payment of the bank levy.

7. Paragraph 7 provides rules for dealing with chargeable periods where some or all of the chargeable period falls before 1 January 2012. It provides for different rates to be applied for the part of the chargeable period falling between 1 January 2011 and 28 February 2011 and for the period falling between 1 March 2011 and 30 April 2011, and for the period falling between 1 May 2011 and 31 December 2011. Periods that fall wholly before 1 January 2011 are to be ignored.
8. **Part 3** of the Schedule identifies the groups that are covered by the bank levy.

9. **Paragraphs 8 to 11** define the terms “UK banking group”, “building society group”, “foreign banking group” and “relevant non-banking group”.

10. **Paragraph 12** defines a “banking group” as being one where one of conditions A, B, C or D is met and the exempt activities test is not met. Condition A is set out in paragraph 12(2); Condition B is set out in paragraph 12(3) and 12(6); Condition C is set out in paragraph 12(4) and (8) and Condition D is set out in paragraph 12(5), 12(6) and 12(8).

11. **Paragraph 12(6)** provides the rule for Condition B and Condition D that the top trading entity must only have investment entities between it and the ultimate parent entity.

12. **Paragraph 12(7) and (9)** contains definitions of terms used in the paragraph.

13. **Paragraph 12(8)** applies where either the non–resident parent entity for Condition C or the non-resident top trading entity for Condition D would be a UK resident bank where, if they were UK resident and carried on their activities in the UK they would be required to be an authorised person for purposes of the Financial Services and Markets Act 2000 with the necessary permission to carry out those activities and where those activities consist wholly or mainly of any of the relevant activities described in the provisions mentioned in paragraph 78(b) to (f), if those activities were carried on in the UK, and as a result of carrying on those activities, they would be a BIPRU 730k firm and a full scope BIPRU investment firm. It also contains a similar rule if either entity is a member of a non-UK resident partnership.

14. **Paragraph 13** defines the “exempt activities test” referred to in paragraph 12. For the exempt activities test to be met at least 90 per cent of the group’s trading income for the chargeable period must derive from exempt activities, or 50 per cent of the group’s trading income for that chargeable period must derive from non-financial trading activities.

15. **Paragraph 13(2) and (3)** explains how the trading income of the relevant group is to be ascertained.

16. **Paragraph 13(4)** provides definitions of the various terms used in this paragraph.
**Part 4**

17. **Part 4** of the Schedule defines the equity and liabilities on which the bank levy is charged.

18. **Paragraph 14** defines the terms “assets”, “equity” and “liabilities”.

19. **Paragraph 15** in conjunction with paragraphs 16 and 43 sets out how the chargeable equity and liabilities of a UK banking group or building society group are to be determined.

20. **Paragraph 16** explains the circumstances in which certain assets and certain liabilities that are recognised in the consolidated financial statements can be netted off against each other.

21. **Paragraph 16(4), (5) and (6)** provides definitions of terms used in paragraph 16(1) to (3) which explains that to qualify for such netting, the liabilities and assets in question must be between a group member and a third party and that there must be a legally enforceable agreement in place which allows, where a netting event occurs (the termination of the arrangements as a result of the bankruptcy or insolvency of one of the parties), for any amounts owed to be set off against any amounts due such that there is one single net sum either due to or payable by the group member to settle all of the liabilities and assets in question that are covered by the agreement.

22. **Paragraph 16(3)** allows net settlement assets to be netted off against any net settlement liabilities to the extent of those liabilities (but not below nil) and subject to the rule in paragraph 16(7).

23. **Paragraph 16(7)** determines that the net settlement assets should be set against long term net settlement liabilities and short term net settlement liabilities on a proportionate basis.

24. **Paragraph 17(1) and (2)** determine the chargeable equity and liabilities of a foreign banking group. The chargeable equity and liabilities will be the sum of all Type A, B, C and D equity and liabilities.

25. **Paragraph 17(3)** defines Type A equity and liabilities as being the chargeable equity and liabilities of a relevant UK sub-group.

26. **Paragraph 17(4) and (5)** defines the term “relevant UK sub-group”.

27. **Paragraph 17(6)**, in conjunction with sub-paragraphs (7) and (8) and paragraphs 18 and 43, explains how the relevant UK sub-group’s chargeable equity and liabilities (Type A equity and liabilities) are determined and provides for the reduction in the chargeable equity.
and liabilities by the relevant balance sheet value of high quality liquid assets (defined in paragraph 69), but only where those assets have not already reduced chargeable liabilities under the netting provisions.

28. **Paragraph 17(7) and (8)** explains how certain lending transactions with certain collateral underlying (such as reverse repos) may reduce chargeable equities and liabilities, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

29. **Paragraph 17(9)** defines the accounts to be used to determine the Type A equity and liabilities.

30. **Paragraph 17(10) and (11)** defines Type B and Type C equity and liabilities and paragraph 17(12) to (14) in conjunction with paragraphs 18 and 43 explains how the Type B and C equity and liabilities are calculated. They also provide for the reduction in the chargeable equity and liabilities by the relevant balance sheet value of high quality liquid assets, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

31. **Paragraph 17(13) and (14)** also explains how certain lending transactions with certain collateral underlying (such as reverse repos) may reduce chargeable equities and liabilities, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

32. **Paragraph 17(15)** defines the accounts to be used to determine the Type B and C equity and liabilities.

33. **Paragraph 17(16)** explains that when deducting high quality liquid assets from chargeable equity and liabilities (see paragraph 17(6)(c) and (12)(c)) for the purpose of calculating Type A, Type B and Type C equity and liabilities, long term equity and liabilities are reduced before short term liabilities.

34. **Paragraph 17(17)** defines Type D equity and liabilities.

35. **Paragraph 17(18) and (19)** allows for smaller Type A, B, C and D equity and liabilities as at the end of the chargeable period to be left out of the aggregation provided that the Type A, B, C or D equity and liabilities are less than £50 million and the sum of all such equity and liabilities that are left out is not greater than £200 million in a chargeable period.

36. **Paragraph 18** provides further rules that explain how the Type A, Type B and Type C equity and liabilities in a foreign banking group are to be calculated.
37. **Paragraph 18(2)** defines the term “relevant member” as being any relevant UK sub-group (as defined in paragraph 17(4) and (5)), any UK resident entity not within the relevant UK sub-group (paragraph 17(10)) and any non UK resident entity that is a subsidiary of a UK entity that is within the charge to the levy but is not a member of a relevant UK sub-group (paragraph 17(11)).

38. **Paragraph 18(3) to (6)** allows any equity that would normally be removed in consolidation procedures under International Accounting Standards (IAS) or UK Generally Accepted Accounting Practice (UK GAAP), as the case may be, to be left out from a relevant member’s computation of chargeable equity and liabilities where that relevant member is the member of a larger UK sub group that does not prepare consolidated accounts.

39. **Paragraph 18(7)** allows any liabilities of relevant members to other relevant members or to any UK permanent establishment of a foreign bank (within paragraph 17(17) provided they correspond to assets of the UK permanent establishment) to be left out of the Type A, Type B and Type C equity and chargeable liabilities.

40. **Paragraph 18(8) to (14)** explains the circumstances in which certain assets of a relevant member (as defined in paragraph 18(9)) can be netted off against certain liabilities of that member when calculating Type A, Type B and Type C equity and chargeable liabilities (see commentary above on the provisions of paragraph 16 for further explanation of how the netting works).

41. **Paragraph 18(11)** allows for net settlement assets to be netted off against net settlement liabilities to the extent of those liabilities (but not below nil) and subject to the rule in paragraph 18(15).

42. **Paragraph 18(15)** determines that the net settlement assets should be set against long term net settlement liabilities and short term net settlement liabilities on a proportionate basis.

43. **Paragraph 19(1) and (2)** determines the chargeable equity and liabilities of a relevant non-banking group. The chargeable equity and liabilities will be the sum of all Type A, B, C and D equity and liabilities.

44. **Paragraph 19(3)** defines Type A equity and liabilities as the chargeable equity and liabilities of a relevant UK banking sub-group.

45. **Paragraph 19(4) and (5)** defines what a “relevant UK banking sub-group” is.

46. **Paragraph 19(6)** in conjunction with paragraph 19(8) and paragraphs 20 and 43 explains how the relevant UK banking
sub-group’s chargeable equity and liabilities (Type A equity and liabilities) are determined.

47. **Paragraph 19(6)** also provides for the reduction in the chargeable equity and liabilities by the relevant balance sheet value of high quality liquid assets, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

48. **Paragraph 19(7) and (8)** explains how certain lending transactions with certain collateral underlying (such as reverse repos) may reduce chargeable equities and liabilities, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

49. **Paragraph 19(9)** defines the accounts to be used to determine the Type A equity and liabilities.

50. **Paragraph 19(10) and (11)** defines Type B and Type C equity and liabilities and **paragraph 19(12) to (14)** in conjunction with paragraphs 20 and 43 explains how the Type B and C equity and liabilities are calculated.

51. **Paragraph 19(12)** also provides for the reduction in the chargeable equity and liabilities by the relevant balance sheet value of high quality liquid assets, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

52. **Paragraph 19(13) and (14)** explains how certain lending transactions with certain collateral underlying (such as reverse repos) may reduce chargeable equities and liabilities, but only where those assets have not already reduced chargeable liabilities under the netting provisions.

53. **Paragraph 19(15)** defines the accounts to be used to determine the Type B and C equity and liabilities.

54. **Paragraph 19(16)** explains that when deducting high quality liquid assets from chargeable equity and liabilities (see paragraph 19(6)(c) and 19(12)(c)) for the purpose calculating Type A, Type B and Type C, long term equity and liabilities are reduced before short term liabilities.

55. **Paragraph 19(17)** defines Type D equity and liabilities.

56. **Paragraph 19(18) and (19)** allows for smaller Type A, B, C and D equity and liabilities to be left out of the aggregation provided that the Type A, B, C or D equity and liabilities are less that £50 million and the sum of all such equity and liabilities that are left out is not greater than £200 million in a chargeable period.
57. Paragraph 20 explains how the Type A, Type B and Type C equity and liabilities in a relevant non-banking group as outlined within paragraph 19 are to be calculated.

58. Paragraph 20(2) defines the term “relevant member” as being any relevant UK banking sub-group (as defined in paragraph 19(4) and (5)), any UK resident bank not within the relevant UK banking sub-group (paragraph 19(10)) and any UK or non-UK resident entity that is a subsidiary of a UK entity that is within the charge to the levy but is not a member of a relevant UK banking sub-group (paragraph 19(11)).

59. Paragraph 20(3) to (6) allows any equity that would normally be removed in consolidation procedures under IAS or UK GAAP, as the case may be, to be left out from a relevant member’s chargeable equity and liabilities where that relevant member is a member of a larger UK banking sub-group that does not prepare consolidated accounts.

60. Paragraph 20(7) allows any liabilities between relevant members or between relevant members and any UK permanent establishment of a relevant foreign bank (within paragraph 19(17) and where the liability corresponds to an asset of the permanent establishment for the purposes of this Schedule) to be left out of the Type A, Type B and Type C equity and chargeable liabilities computations.

61. Paragraph 20(8) to (14) explain the circumstances in which certain assets of a relevant member (as defined in paragraph 20(9)) can be netted off against certain liabilities when calculating Type A, Type B and Type C chargeable equity and liabilities (see commentary above on the provisions of paragraph 16 for an explanation of how the netting works).

62. Paragraph 20(11) allows for net settlement assets to be netted off against net settlement liabilities to the extent of those liabilities are subject to the rule in paragraph 20(15).

63. Paragraph 20(15) determines that the net settlement assets should be set against long term net settlement liabilities and short term net settlement liabilities on a proportionate basis.

64. Paragraph 21 in conjunction with paragraphs 22 and 43 explains how to determine the chargeable equity and liabilities of UK banks and building societies that are not part of a group (see paragraph 5 of the Schedule). The chargeable equity and liabilities are to be determined from the amounts disclosed in its financial statements (prepared under IAS or UK GAAP) or, where no accounts are prepared, on the amounts which would have been disclosed if financial statements (under IAS) had been prepared for the chargeable period.
65. **Paragraph 22** explains the circumstances in which certain assets of a bank or a building society that is not part of a group can be netted off against certain liabilities (see commentary above on the provisions of paragraph 16 for an explanation of how the netting works).

66. **Paragraph 22(3)** allows net settlement assets to be netted off against any net settlement liabilities to the extent of those liabilities (but not below nil) and subject to the rule in paragraph 22(7).

67. **Paragraph 22(7)** determines that the net settlement assets should be set against long term net settlement liabilities and short term net settlement liabilities on a proportionate basis.

68. **Paragraph 23** explains how to determine the chargeable equity and liabilities of a UK permanent establishment of a relevant foreign bank that is not part of a wider group. Its chargeable equity and liabilities are the amounts allocated to it under the allocation process outlined in paragraph 24.

69. **Paragraph 24** in conjunction with paragraphs 25, 26 and 27 sets out the steps to be followed in order to allocate chargeable equity and liabilities to a UK permanent establishment of a relevant foreign bank.

70. **Paragraph 24(1)** sets out six steps detailing the process to be followed to allocate the equity and liabilities to a UK permanent establishment of a relevant foreign bank:

   - step 1 requires the assets of the foreign bank of which the UK permanent establishment is a part to be calculated in conjunction with paragraph 25;
   - step 2 first requires the assets of the UK permanent establishment to be calculated (see paragraph 26) and secondly, a determination of the proportion that these assets bear to those of the foreign bank as a whole (i.e. the assets from step 2 as a proportion of the assets from step 1);
   - step 3 requires the foreign bank’s chargeable equity and liabilities for the period to be determined (see paragraph 27);
   - step 4 requires the chargeable equity and liabilities as determined at step 3 to be attributed to the UK permanent establishment in the same proportion as determined at step 2;
   - step 5 requires long term equity and liabilities to be identified from the chargeable equity and liabilities attributed at step 4; and
   - step 6 feeds the amount of long term equity and liabilities and the balance, the short term liabilities, into paragraph 6(2) in order to determine the amount of bank levy that will apply.

71. **Paragraph 24(2)** provides that the first three steps in paragraph 24(1) are to be based upon amounts that are recognised in financial
72. **Paragraph 25** explains how the netting process works when determining the assets of a foreign bank (step 1 – paragraph 24(1)) and the UK permanent establishment’s assets (step 2 – paragraph 24(1)).

73. **Paragraph 25(1) to (3)** explains that to qualify for such netting, the liabilities and assets in question must be between the foreign bank and an entity which is neither a relevant member (paragraph 18(9) or 20(9)) nor a UK permanent establishment of another foreign bank in the same group (within paragraph 17(17) or 19(17)).

74. **Paragraph 25(4)** allows for such net settlement liabilities to be netted off against any net settlement assets up to the extent of the net settlement assets in determining the foreign bank’s assets in step 1 (of paragraph 24(1)).

75. **Paragraph 25(5) to (6)** explains how netting applies to the UK permanent establishment’s assets (step 2 – paragraph 24). The UK permanent establishment’s assets that qualified for netting at entity level are to be reduced by the same proportion that the foreign bank’s assets were netted-down in step 1 (of paragraph 24).

76. **Paragraph 25(7)** explains how netting applies when determining the foreign bank’s equity and liabilities (step 3 of paragraph 24(1)). Paragraph 25(7) allows for net settlement assets to be netted off against net settlement liabilities to the extent of those net settlement liabilities and subject to the rule in paragraph 25(12).

77. **Paragraph 25(8) to (10)** defines the terms used in paragraph 25(1) to (7) and paragraph 25(11) defines terms used in paragraph 25(5).

78. **Paragraph 25(12)** determines that the net settlement assets should be set against long term net settlement liabilities and short term net settlement liabilities on a proportionate basis.

79. **Paragraph 26** sets out how the assets of a UK permanent establishment are to be calculated (step 2 of paragraph 24(1)), using the legislation at sections 21 to 28 of the Corporation Tax Act (CTA) 2009.

80. **Paragraph 26(4) to (7)** explains that the assets of the UK permanent establishment will not include any assets that represent loans to any group member that is a UK bank or UK permanent establishment of a foreign bank which is a deposit-taker regulated by the Financial Services Authority (FSA) and where the UK permanent establishment would be recognised in financial statements if accounts had been prepared for the foreign bank using IAS or UK GAAP (if that is what the bank prepares its financial statements under).
is acting as an agent or intermediary for the group member borrowing bank.

81. **Paragraph 27** in conjunction with paragraphs 25(7) and 43 explains how the equity and liabilities of the relevant foreign bank are determined (step 3 of paragraph 24(1)).

82. **Paragraph 27(2) to (4)** explains how the equity and liabilities of the relevant foreign bank are reduced for excluded liabilities, netting and high quality liquid assets.

83. **Paragraph 27(5)** explains that liabilities (as defined by paragraph 18(2) or 20(2)) that relate to other relevant members and liabilities (as defined by paragraph 17(17) or 19(17)) that relate to UK permanent establishments of foreign bank group members can be left out of equities and liabilities.

84. **Paragraph 28** provides that “excluded equity and liabilities” are the items more specifically defined in paragraphs 29 to 39. HM Treasury has the power to add, repeal or amend the types of excluded equity and liabilities. This power is subject to the affirmative resolution procedure.

85. **Paragraph 29** defines “protected deposits” and explains how these are to be calculated.

86. **Paragraph 29(2) to (10)** explains how protected deposits are calculated for the purposes of determining excluded liabilities.

87. **Paragraph 30** explains that tier one capital equity and liabilities are excluded equity and liabilities and provides definitions.

88. **Paragraph 31** provides that “sovereign repo liabilities” are excluded equity and liabilities and provides definitions.

89. **Paragraph 32** provides that “sovereign stock-lending liabilities” are excluded equity and liabilities and provides definitions.

90. **Paragraph 33** provides that “relevant insurance liabilities” are excluded equity and liabilities; it defines the term and explains how such liabilities are determined.

91. **Paragraph 34** provides that liabilities representing revaluation reserves relating to relevant property, plant and equipment liabilities are excluded; it defines the terms and explains how such liabilities are determined.

92. **Paragraph 35** provides that “relevant tax liabilities” are excluded equity and liabilities and defines these liabilities as being any
amounts of current tax or deferred tax liabilities as defined in IAS or UK GAAP, or an amount of bank levy.

93. **Paragraph 36** provides that “relevant retirement benefit liabilities” are excluded equity and liabilities and identifies how these liabilities are to be determined.

94. **Paragraph 37** sets out that “Financial services compensation scheme liabilities” and liabilities for comparable foreign schemes are excluded equity and liabilities.

95. **Paragraph 38** explains that liabilities representing clients’ money (as defined by the paragraph) held by an authorised person (as defined) are excluded equity and liabilities.

96. **Paragraph 39** provides that liabilities relating to currency notes in circulation are excluded equity and liabilities.

*Part 5*

97. **Part 5** of the Schedule sets out supplementary provisions.

98. **Paragraph 40** provides rules to determine the chargeable period for entities that do not prepare financial statements.

99. **Paragraph 41** defines “consolidated financial statements” and “financial statements”.

100. **Paragraphs 42 and 43** explain how joint ventures are dealt with for the bank levy.

101. **Paragraph 42** brings into the bank levy charge joint venture liabilities for foreign banking groups and relevant non-banking groups in certain circumstances that otherwise would not have been included.

102. **Paragraph 43** provides relief from a double charge of the bank levy on the liabilities of a joint venture where certain conditions are met. **Paragraph 43(5) to (7)** sets out the conditions.

103. **Paragraph 44** provides the rule for determining the residence of any company or partnership for the purposes of the bank levy.

104. **Paragraph 45** provides that the bank levy and any other amounts paid or received in respect of meeting or reimbursing the bank levy are not taken into account in determining the profit or loss for corporation tax or income tax purposes of any member of the relevant group.

105. **Paragraph 46** sets out the anti-avoidance rule for the bank levy.
106. Paragraph 46(1) provides a purpose test that will be applied to determine whether the anti-avoidance rule applies to the arrangements entered into.

107. Paragraph 46(2) defines “relevant arrangements”.

108. Paragraph 46(3) applies paragraph 46(4) where an effect of relevant arrangements is that the bank levy is not charged or assessed as it otherwise would have been if the relevant arrangements were absent.

109. Paragraph 46(4) allows the bank levy to be charged as it would have been ignoring the effect of the relevant arrangements.

110. Paragraph 46(5) and (6) prevents paragraph 46(4) from ignoring the effect of relevant arrangements that are described in paragraph 46(7) to (12). This means that these arrangements may reduce the amount of bank levy charged or assessed.

111. Paragraph 46(7) applies to relevant arrangements that change the funding profile of the group or entity on an ongoing basis by increasing excluded equity and liabilities.

112. Paragraph 46(8) applies to relevant arrangements that change the funding profile of the group or entity on an ongoing basis by increasing long term equity and liabilities.

113. Paragraph 46(9) applies to relevant arrangements that change the funding profile of the group or entity on an ongoing basis by decreasing short term equity and liabilities, where there is no corresponding increase in funding or size of the financial obligations other than excluded or long term equity and liabilities. For the purposes of determining whether these conditions are met it does not matter whether the funding or financial obligations in question are recognised in the relevant financial statements.

114. Paragraph 46(10) applies to relevant arrangements that change the funding profile of the group or entity on an ongoing basis by decreasing long term equity and liabilities, where there is no corresponding increase in funding or size of the financial obligations other than excluded equity and liabilities. For the purposes of determining whether these conditions are met it does not matter whether the funding or financial obligations in question are recognised in the relevant financial statements.

115. Paragraph 46(11) applies to arrangements which comprise a net settlement agreement within paragraph 16, 18, 20, 22 or 25.

116. Paragraph 46(12) applies to arrangements where the effect is to increase the amount of high quality liquid assets held on an ongoing basis.
117. Paragraph 46(13) and (14) explains the meaning of the terms “relevant group” and “relevant member” in this Part, in respect of foreign banking groups and relevant non-banking groups.

118. Paragraph 47 amends the definition of “tax advantage” at section 1139 of the Corporation Tax Act 2010 to include reference to the bank levy.

Part 6

119. Part 6 of the Schedule deals with the collection and management of the bank levy.

120. Paragraph 48 sets out that Her Majesty’s Revenue & Customs (HMRC) will be responsible for collection and management of the bank levy.

121. Paragraph 49 explains that for groups a single “responsible member” will return and pay the bank levy for a chargeable period through the corporation tax system, with the bank levy being chargeable as if it were corporation tax. The process for establishing the “responsible member” is set out at paragraphs 53 and 54 of the Schedule.

122. Paragraph 49(3) explains how to determine the accounting period for which the bank levy is to be chargeable as if it were corporation tax.

123. Paragraph 49(4) provides rules for determining the proportion of bank levy that is chargeable in any other accounting period where there is more than one accounting period that relates to a single chargeable period.

124. Paragraph 50 explains that banks and building societies that are not part of groups (see paragraph 5) are also liable to pay the bank levy through the corporation tax system and determines the accounting period for which the bank levy will be chargeable.

125. Paragraph 50(2) explains how to determine the accounting period for which the bank levy is to be chargeable as if it were corporation tax.

126. Paragraph 50(3) provides rules for determining the proportion of bank levy that is chargeable in any other accounting period, where there is more than one accounting period that relates to a single chargeable period.

127. Paragraph 51 provides that the bank levy will be treated for all purposes of the Taxes Acts as if it were corporation tax.

128. Paragraph 52 provides that all relevant members of the relevant group will be jointly and severally liable for the bank levy liability (and any interest and penalties connected with this liability) of the responsible
member save for certain specified entities set out in paragraph 52(6). For bank and building society groups those members will be all group members that are within the charge to corporation tax. For non-banking groups it will be only those members whose equity and liabilities are within the ambit of the bank levy and who are also within the charge to corporation tax at the end of the chargeable period.

129. Paragraph 52(6) sets out two exceptions to the general rules set out above in respect of securitisation companies (as defined by the paragraph) and certain covered bond limited liability partnerships (as defined by the paragraph), which will not be joint and severally liable for the responsible member’s bank levy and any related interest and penalty liability. HM Treasury has the power to prescribe by order other entities that will be excluded from the joint and several liability for the bank levy. Such an order may have limited retrospective effect – see paragraph 52(9).

130. Paragraphs 53 and 54 explain how the responsible member for a group for a chargeable period is established. This is through either the group nominating an entity to be the responsible member and that entity fulfilling certain conditions, the legislation providing that an entity is to be the responsible member, or otherwise by HMRC determining an entity to be the responsible member for the chargeable period.

131. Paragraph 53(3) sets out the requirements and conditions that need to be met when a group nominates an entity to be the responsible member.

132. Paragraph 53(4) to (6) sets out who the responsible member is (subject to certain conditions being met) in situations where the requirements in paragraph 53(3) are not met including where there has been no nomination made for a chargeable period.

133. Paragraph 53(7) sets out the circumstances in which HMRC will determine who the responsible member is for a chargeable period (that is where the provisions of paragraph 53(3) and 53(4) to (6) respectively do not establish a responsible member for that chargeable period).

134. Paragraph 53(8) prevents HMRC from determining a “securitisation company” or certain covered bond limited liability partnerships (as defined at paragraph 52(6)) as responsible member.

135. Paragraph 54 provides additional rules setting out how the nomination process works including the circumstances in which HMRC may reject a nomination and the time limit for doing so.
FINANCE (No. 3) BILL

RESOLUTION 40

CLAUSE 72

SCHEDULE 19

136. Paragraph 55 amends the Provisional Collection of Taxes Act 1968 to include a reference to bank levy.

137. Paragraphs 56 to 58 set out the consequential amendments that are being made to the Taxes Management Act 1970 (TMA) in respect of the bank levy.

138. Paragraph 57 extends the regulation making powers in section 59E of TMA to apply in respect of the bank levy. These powers allow HM Treasury to make regulations in respect of matters such as the due and payable dates for corporation tax and permit HM Treasury to provide for these dates to be earlier than the date provided for in section 59D of TMA (the general rule that sets out when corporation tax is due). The Corporation Tax Instalment Payment Regulations 1998 (SI 1998/3175) are made under this power. The paragraph also provides additional regulation making powers which will permit HM Treasury, amongst other matters, to make regulations to make provision for determining the extent to which the payments are to be treated as payments of bank levy.

139. Paragraph 58 provides that bank levy can be included in arrangements for paying tax on behalf of group members (group payment arrangements).

140. Paragraphs 59 to 63 set out certain consequential amendments that are required to Schedule 18 to the Finance Act (FA) 1998.

141. Paragraphs 59 and 60 ensure that for the purposes of Schedule 18 to FA 1998, bank levy is treated as if it were corporation tax.

142. Paragraph 61 allows HMRC to publish, from time to time, its requirements as to the information, accounts and reports that are required to be submitted in respect of the bank levy as part of the corporation tax return.

143. Paragraph 62 amends paragraph 8 of Schedule 18 to FA 1998 to include the bank levy. Paragraph 8 of Schedule 18 sets out how the tax payable for an accounting period is calculated.

144. Paragraph 63 amends paragraph 11 of Schedule 18 (which limits the accounts to be supplied as part of the corporation tax return to those required under the Companies Act) by inserting new sub-paragraph (2). This sub-paragraph provides that paragraph 11(1) does not apply to any accounts, information or documents that are required to be submitted as part of the return in support of the bank levy charge.

145. Paragraph 64 sets out the transitional rules for chargeable periods that start on or before the day on which Finance (No.3) Bill receives Royal Assent.
FINANCE (No. 3) BILL

RESOLUTION 40

CLAUSE 72

SCHEDULE 19

146. Paragraph 64(2) to (8) provide amendments to the rules for nominating the responsible member for chargeable periods that start on or before the date the Act is passed.

Part 7

147. Part 7 of the Schedule explains how double taxation relief is to be dealt with.

148. Paragraphs 65 and 66 respectively give HM Treasury power to make orders giving effect to agreements, and to make regulations to provide for relief from double taxation from equivalent foreign levies.

149. Paragraph 65 explains how double taxation relief is to be given in accordance with any arrangement that HM Treasury has entered into with a foreign territory to provide relief from double taxation in relation to the bank levy.

150. Paragraph 65(2) to (10) provides further details of how this process will operate.

151. Paragraph 66 gives HM Treasury the power to make regulations to allow double taxation relief in certain circumstances.

152. Paragraphs 66(2) to (7) provide further details of how this process will operate.

153. Paragraph 67 allows HMRC to provide to an authorised officer of a foreign territory the facts necessary to permit that territory to give effect to its own double taxation relief in respect of an equivalent foreign levy.

154. Paragraph 68 amends the Constitutional Reform and Governance Act 2010 so that the arrangements referred to in paragraph 65 to afford double taxation relief from the bank levy are not required to be laid before Parliament.

Part 8

155. Part 8 of the Schedule provides definition of terms used.

156. Paragraph 69(1) identifies the terms that are defined in the Schedule and paragraph 69(2) identifies the terms that are defined within the FSA handbook.

157. Paragraph 70 sets out what activities constitute “asset management activities” for the purpose of determining what is an excluded entity and in turn whether an entity is a UK resident bank or a relevant foreign bank and also for the purposes of determining a group’s level of “exempt activities” for the purposes of paragraph 13(4).
158. Paragraph 71 explains the “capital resources condition” that is used in determining whether an entity is a UK resident bank (paragraph 79(1)(e)) or a relevant foreign bank (paragraph 77(1)(e)).

159. Paragraph 72 defines an “excluded entity” for the purposes of determining whether an entity is a UK resident bank or a relevant foreign bank.

160. Paragraphs 73 and 74 define “long term equity and liabilities” and the further test required to demonstrate that liabilities between members of the same relevant group are ultimately funded by the relevant group through equity, excluded liabilities or long term debt in order to satisfy an Officer of HM Revenue and Customs that such liabilities are long-term for the purposes of the bank levy.

161. Paragraph 75 provides that any non-protected deposits (i.e. those that are not treated as excluded liabilities by paragraph 29) otherwise than those from financial institutions and financial traders are “long term liabilities” and provides further definitions of “deposit” and “depositor”.

162. Paragraph 77 defines a “relevant foreign bank”.

163. Paragraph 78 defines “relevant regulated activities” which are used in determining whether an entity is a “UK resident bank” (paragraph 79) or a “relevant foreign bank” (paragraph 77).

164. Paragraph 79 defines a “UK resident bank”.

165. Paragraph 80 provides a power to allow HM Treasury to make changes to specific areas of this schedule that arise as a consequence of changes to the Financial Services Authority Handbook, the statutory instrument in respect of regulated activities or to accounting standards. These amendments may take effect with limited retrospection as set out in paragraph 80(2).

**BACKGROUND NOTE**

166. The Chancellor of the Exchequer announced in the June 2010 Budget the introduction of a bank levy to apply to 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.

167. This was followed by a formal consultation between 13 July 2010 and 5 October 2010. The Government announced its proposals on the final design of the Bank Levy in a Consultation Response Document on 21 October 2010.
168. Draft legislation, supported by a Technical Note and an Explanatory Note were published on 21 October 2010 and following further consultation on these draft clauses the legislation dealing with the Bank Levy was published as part of the draft Finance Bill 2011 on 9 December 2010.

169. A further version of the draft legislation, incorporating some small amendments together with the changes to the bank levy rates announced by the Government on 08 February 2011 and in the Budget on 23 March 2011 was published on 31 March 2011. This explanatory note accompanies that legislation.
EXPLANATORY NOTE

CLAUSE 73: BUSINESS SAMPLES

SUMMARY

1. Clause 73 makes changes to provisions relating to the VAT treatment of samples of goods given away by businesses. It extends the VAT relief available to a business which provides an individual person or business with a succession of identical, or not significantly different, free samples of its products for marketing purposes. The existing provisions restrict relief to the first sample.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for amendments to paragraph 5 of Schedule 4 to the VAT Act 1994 which sets out the VAT consequences which follow when a business transfers or otherwise disposes of goods which form part of its assets.

3. Subsection (2) amends paragraph 2(b) of Schedule 4. It substitutes a reference to the provision of a sample otherwise than for a consideration for the reference to a “gift” of a sample in order to differentiate between samples and gifts.

4. Subsection (3) deletes paragraph 5(3) of Schedule 4 which restricts VAT relief to the first sample given to a person or business and therefore extends the relief to second and subsequent samples.

BACKGROUND NOTE

5. The EU Principal VAT Directive requires that, when goods on which input tax has been reclaimed are disposed of for no consideration, VAT normally becomes due. However, there is an exception in the case of business samples.

6. In the UK the relief for business samples is provided for by paragraph 5 of Schedule 4, but this is currently restricted to the first sample of a product (a good) supplied to each business or individual.

7. In the EMI case (C-581/08), the European Court of Justice found that the UK’s blanket restriction of relief to the first sample given away was not compatible with the VAT Directive and, accordingly, the UK is required to change Schedule 4 to give effect to the judgment.
EXPLANATORY NOTE

CLAUSE 74: ZERO-RATING: SPLITTING OF SUPPLIES

SUMMARY

1. Clause 74 makes changes to the zero-rate for printed matter. The zero-rate is amended to exclude a supply of printed matter connected with a supply of services made by a different supplier. The supplies of printed matter and services are “connected” if, had they been made by a single supplier, they would have been treated as a single standard rated, reduced rated or exempt supply, of services.

DETAILS OF THE CLAUSE

2. Subsection (1) provides that the clause amends Group 3 of Schedule 8 to the VAT Act 1994, which contains the zero-rate for supplies of printed matter.

3. Subsection (2) amends the Note to Group 3, which excludes specified supplies from the scope of the zero-rate. The amendment enables additional Notes to be added containing further exclusions.

4. Subsection (3) inserts new Notes (2) and (3) into Group 3.

5. Note (2) provides that supplies of printed matter connected with supplies of services made by a different supplier are excluded from the scope of the zero-rate.

6. Note (3) provides that for the purposes of Note (2) supplies are “connected” if, had the two supplies had been made by a single supplier, they would have been treated as a single supply of services that would have been either taxable (other than zero rated) or exempt.

BACKGROUND NOTE

7. Clause 74 prevents tax avoidance schemes designed to obtain a tax treatment that would apply if separate supplies were being made, when in substance the business is making a single supply. In particular such schemes aim to attribute a value for tax purposes to something for which no charge is being made commercially.

8. European and domestic judgments have stated in clear terms that supplies that comprise a single service from an economic point of view should not be artificially split.
EXPLANATORY NOTE

CLAUSE 75: ACADEMIES

SUMMARY

1. Clause 75 creates a new refund scheme to enable academies to recover the VAT incurred on goods and services used in the provision of free education. Academies are schools in England that enter into Academy arrangements with the Secretary of State under section 1 of the Academies Act 2010 or has entered into an agreement with the Secretary of State under section 482 of the Education Act 1996.

DETAILS OF THE CLAUSE

2. Subsection (1) establishes the special refund scheme for academies by inserting new section 33B in Part 2 of the VAT Act 1994 (VATA).

3. Subsection (1) of new section 33B defines the scope of the special refund scheme.

4. Subsection (1)(a) provides that the special refund scheme applies to VAT incurred by the proprietor of the academy on any supply, acquisition or import of goods or services.

5. Subsection (1)(b) provides that the special refund scheme does not cover VAT incurred in relation to any business activity undertaken by the academy. Therefore, the special refund scheme only covers VAT incurred on non-business activities, primarily the provision of free education.

6. Subsection (2) enables the Commissioners for HM Revenue and Customs (HMRC) to make provision as to how and when a claim is made.

7. Subsection (3) allows four years for claiming a refund from the date of incurring the VAT. This puts this special refund scheme for non-business VAT in line with the rules for reclaiming VAT incurred against business activities.

8. Subsection (4) allows HMRC to shorten the period in which a VAT refund for non-business activities may be claimed.

9. Subsections (5) and (6) refer to VAT on goods and services incurred by the academy that are used for both business and non-business activities. The VAT incurred relating to business activities can be
reclaimed through the normal VAT rules. These subsections allow the element of the VAT relating to non-business activities to be reclaimed.

10. Subsection (7) puts this special refund scheme in line with normal VAT rules by excluding any VAT specified in a Treasury Order made under section 25(7) of VATA from a refund claim.

11. Subsection (8) defines the terms “Academy” and “proprietor” for the purposes of the special refund scheme.

12. Subsections (2)-(5) of the clause make consequential amendments to VATA:

- allowing the repayment supplement to be paid to an academy if HMRC is late in making a refund (subsection (2));

- excluding any VAT that has already been repaid under section 90 of VATA where a resolution under the Provisional Collection of Taxes Act 1968 has failed (subsection (3));

- allowing non-business VAT to be reclaimed by excluding VAT claimed under the special refund regime from the VAT exemption in Group 14 of Schedule 9 to VATA, which exempts supplies of goods in respect of which input VAT cannot be recovered (subsection (4)).

13. Subsection (5) provides that the clause will have effect in relation to supplies, acquisitions or imports on and after 1 April 2011.

BACKGROUND NOTE

14. VAT can ordinarily only be recovered on expenditure relating to taxable business activities. The provision of free education is a non-business activity. Schools under local authority control have their non-business VAT refunded through the special refund scheme for local authorities found in section 33 of VATA. Academies cannot access this scheme because they are not under local authority control.

15. Section 33B is being created to enable academies to recover VAT incurred in the provision of free education. This is in order to maintain the level of funding for a school leaving local authority control to become an academy and to ensure newly created academies are treated in the same way.

16. The majority of academies will be VAT registered and so any refund will be made via the normal VAT return system. Any academies not VAT registered will make a separate claim along the lines of the procedure currently used by non-VAT registered parish councils.
EXPLANATORY NOTE

CLAUSE 76: RELIEF FROM VAT ON IMPORTED GOODS OF LOW VALUE

SUMMARY

1. Clause 76 reduces the value of goods that may be imported VAT free from outside the European Union (EU) including the Channel Islands from £18 to £15, with effect for imports on or after 1 November 2011.

DETAILS OF THE CLAUSE

2. Subsection (1) amends Item 8 of Group 8 of Schedule 2 to the Value Added Tax (Imported Goods) Relief Order 1984 (S.I. 1984/746) which provides VAT relief on the importation of certain goods.

BACKGROUND NOTE

3. Low Value Consignment Relief (LVCR) is a relief prescribed by EU Law, under Article 23 of Council Directive 2009/132, which exempts low value consignments imported from outside the EU from import VAT.

4. The Directive requires the exemption to be set at a minimum of €10 (£9) but gives Member States the option of setting the limit at up to €22 (£20).

5. Since 1995 the limit has been set at £18.

6. In recent years the cost to the Exchequer of the relief has been growing as the value of internet shopping from non-EU jurisdictions has increased, particularly for low value products.

7. This measure is the first step towards preventing LVCR from being exploited for a purpose, and on a scale, for which it was never intended. The Government has also announced it will pursue discussions with the European Commission to explore ways of limiting the application of the relief and will, if necessary, return to the issue of the appropriate threshold for LVCR in Budget 2012 with a view to reducing it further.
EXPLANATORY NOTE

CLAUSE 77 SCHEDULE 20: SUPPLIES OF COMMODITIES TO BE USED IN PRODUCING ELECTRICITY

SUMMARY

1. Clause 77 introduces Schedule 20 which removes the exemption from climate change levy (CCL) for supplies of fossil fuels used to generate electricity and provide for new rates, known as carbon price support rates, to be charged on such supplies. It also provides for the Commissioners for HM Revenue and Customs (“the Commissioners”) to make regulations to give effect to the new provisions, and makes a number of consequential changes to Schedule 6 to the Finance Act 2000 (“Schedule 6”). The Schedule also contains a provision to prevent forestalling.

DETAILS OF THE SCHEDULE

2. Paragraph 1 provides for the amendment of Schedule 6.

3. Paragraph 2 inserts three new sub-paragraphs into paragraph 6 of Schedule 6:
   - **Sub-paragraph (1A)** provides that, in relation to a supply of gas that falls within sub-paragraph (1B) but not sub-paragraph (1C), CCL is chargeable on that supply even if it is made by a person who is not a regulated gas utility. It also provides that the reference to “utility” in paragraph 40(2)(b) of Schedule 6 is to be read as including an unregulated gas supplier.
   - **Sub-paragraph (1B)** provides that a supply falls within the sub-paragraph if it is a supply of any gas to a person to be used in producing electricity.
   - **Sub-paragraph (1C)** provides that a supply of gas to a station that is either a fully or partly exempt station under the Combined Heat and Power Quality Assurance programme falls within the paragraph.

4. Paragraph 3 amends paragraph 14 of Schedule 6 so that the exemption in that paragraph applies only to the supply of electricity.

5. Paragraph 4 inserts a new sub-paragraph (2A) into paragraph 21 of Schedule 6 to clarify that the provisions in that paragraph regarding double charges to CCL do not apply to taxable commodities subject to the new carbon price support rates set out in new paragraph 42A of Schedule 6.
6. **Paragraph 5** inserts a new sub-paragraph (1B) into paragraph 42 of Schedule 6 to provide that the CCL rates set out in paragraph 42(1) do not apply to a supply that is subject to the new carbon price support rates.

7. **Paragraph 6** inserts a new paragraph 42A into Schedule 6:
   - **New paragraph 42A(1)** provides that the new paragraph applies if a supply is subject to the new carbon price support rates.
   - **New paragraph 42A(2)** provides that a supply of fossil fuels that is to be used to generate electricity is subject to the new carbon price support rates, unless it is a supply covered by sub-paragraph (3).
   - **New paragraph 42A(3)** provides that a supply of fossil fuels to a station that is either a fully or partly exempt station under the Combined Heat and Power Quality Assurance programme is not liable to the carbon price support rates.
   - **New paragraph 42A(4)** provides that the amount of levy payable is calculated by applying the relevant carbon price support rate to the supply and, in relation to fractions of units of fossil fuels, is payable on the appropriate fraction.
   - **New paragraph 42A(5)** sets out the carbon price support rates for the three taxable commodities (gas, petroleum gas or other gaseous hydrocarbon in a liquid state and other taxable commodities, excluding electricity).
   - **New paragraph 42A(6) and (7)** provides for the Commissioners to make regulations to give effect to the paragraph which may, in particular, determine whether a supply is subject to the carbon price support rates.

8. **Paragraph 7** amends paragraph 101 of Schedule 6 to provide for a penalty to apply where a person incorrectly claims to receive supplies at the carbon price support rates.

9. **Paragraph 8** provides that the changes provided for by paragraphs 1 to 7 of the Schedule will come into effect for supplies, other than for supplies of gas in a gaseous state, treated as taking place on or after 1 April 2013. In the case of a supply of gas in a gaseous state that is not treated as taking place before 23 March 2011, the amendments made by paragraphs 1 to 7 of the Schedule have effect in relation to gas actually supplied on or after 1 April 2013.

10. **Paragraph 9** provides for special time of supply rules for supplies taking place between 23 March 2011 and 1 April 2013 of taxable commodities (other than of gas in a gaseous state) that will become
liable to the carbon price support rates on and after 1 April 2013. These are designed to prevent avoidance of tax. The paragraph also sets out when invoicing or payment in advance is acceptable.

**BACKGROUND NOTE**

11. The June 2010 Budget announced that HM Treasury and HM Revenue and Customs would publish proposals to reform CCL to provide more certainty and support to the carbon price and to encourage investment in low-carbon electricity.

12. Currently, in most cases, fossil fuels used to generate electricity are exempt from CCL. In its proposals to introduce a carbon price support mechanism, published in a consultation paper on 16 December 2010, the Government proposed to remove these CCL exemptions and to tax these commodities at rates that take account of the average carbon content of each commodity. The Government proposed that these rates would be known as the ‘CCL carbon price support rates’ and be set at different levels from the existing CCL rates for fossils fuels.

13. Oils are not subject to CCL but fuel duty is payable at a rebated rate at the point the oil leaves the refinery. Currently, the duty can be reclaimed in full by the electricity generator but, as part of the Government’s proposals for a carbon price floor, the Government indicated that it would reduce the amount of fuel duty that can be reclaimed and to base the amount that can be reclaimed on the carbon content of the oils.


15. Clause 77 and Schedule 20 introduce most of the primary legislative changes to CCL required to introduce a carbon price floor. The Government will consider the CCL treatment of supplies of fossil fuels to combined heat and power stations and generation stations with carbon capture and storage technology. If the Government decides to introduce measures for these supplies it will introduce any required amendments to CCL in Finance Bill 2012. Secondary legislation provided for by the Schedule will be introduced in 2012 to deal with the more detailed administrative arrangements. Separate secondary legislation will also be introduced to adjust the amount of fuel duty that can be reclaimed by those generating electricity using oils.
EXPLANATORY NOTE

CLAUSE 78: NORTHERN IRELAND GAS SUPPLIES

SUMMARY

1. Clause 78 removes the climate change levy (CCL) exemption for gas supplied in Northern Ireland with effect from 1 April 2011 and makes provision for a rate of CCL that is 65 per cent lower than the main gas rate to apply to supplies of gas in Northern Ireland during the period 1 April 2011 to 31 October 2013. This means the rate is £0.00059 per kilowatt hour from 1 April 2011 to 31 March 2012 and £0.00062 per kilowatt hour from 1 April 2012. From 1 November 2013, the full CCL rate for supplies of gas will apply.

DETAILS OF THE CLAUSE

2. Subsection (1) removes paragraph 11A (exemption for Northern Ireland gas supplies) of Schedule 6 to the Finance Act (FA) 2000.

3. Subsection (2) sets out the conditions for subsection (3) to apply.

4. Subsection (3) modifies paragraph 42 of Schedule 6 to FA 2000 (amount payable by way of levy) to:

(a) set the lower rate for the period 1 April 2011 to 31 March 2012 and from 1 April 2012 onwards; and

(b) fulfil the requirement of the EU State aid General block exemption Regulation (Commission Regulation (EC) No.800/2008) (which permits the granting of a lower rate) that the legislation providing for the aid must contain an express reference to that Regulation.

5. Subsection (4) removes section 105(2) of FA 2001 which is now redundant.

6. Subsections (5) and (6) specify when the provisions take effect.

BACKGROUND NOTE

7. Natural gas did not arrive in Northern Ireland until 1996 and, at the introduction of CCL in 2001; energy consumption was dominated by oil, coal and electricity. An exemption from CCL was introduced to support the fledgling gas industry by encouraging business energy
consumers to switch to natural gas from coal and oil, contributing to reductions in the carbon emissions of Northern Ireland.

8. The UK secured State aid approval for the exemption, initially for five years and then for a further five years from 2006. The current approval expires on 31 March 2011.

9. The exemption is permitted by derogation from Directive 2003/96: Restructuring the Community framework for the taxation of energy products and electricity. This is the Directive that sets a framework for the way in which EU member States tax energy products. The derogation from the Directive expires on 31 October 2013.

10. The derogation makes it clear that total or partial exemptions or reductions for natural gas are intended to be temporary. 31 months is the maximum period for which the UK is able to secure further State aid clearance for such a relief in Northern Ireland after the current State aid approval expires. Following consultation with the Commission, the Government has concluded that it is unlikely that a full exemption could be re-approved under the current Community guidelines on State Aid for Environmental Protection issued in 2008.

11. The Government has therefore decided not to seek a further period of State aid approval for the exemption. The lower rate is being introduced in recognition of the environmental, economic and social benefits a gas supply infrastructure brings to Northern Ireland.

12. Applying a lower rate of tax rather than an exemption is still a State aid. However, provided the lower rate is set at least at the minimum rate for gas prescribed by Directive 2003/96 the UK is permitted to use Commission Regulation (EC) No 800/2008 which simplifies the clearance process for State aid schemes.
EXPLANATORY NOTE

CLAUSE 79: POWER TO SUSPEND EXEMPTION FOR TRANSPORT SUPPLIES

SUMMARY

1. Clause 79 gives HM Treasury the power to suspend by order parts of the exemption from the climate change levy (CCL) for taxable commodities used in certain forms of transport, from 1 April 2011. To ensure that the power cannot be used indefinitely and for other purposes in the future, this power to suspend lapses after 31 March 2012. The clause also gives the Treasury the power to revoke parts of the suspension using secondary legislation (with retrospective effect).

DETAILS OF THE CLAUSE

2. **Subsection (1)** grants HM Treasury the power by order to provide that paragraph 12 of Schedule 6 to the Finance Act 2000 (and any reference to that paragraph in the schedule), does not apply in relation to any supply of a taxable commodity, which is made on or after 1 April 2011 and which is specifically described in the order.

3. **Subsection (2)** provides that a revocation order may have retrospective effect.

4. **Subsection (3)** defines a “revocation order” as one that revokes the whole or any part of the suspension order as mentioned in subsection (1).

5. **Subsection (4)** provides that a suspension order cannot be made after 31 March 2012.

6. **Subsections (5) and (6)** specify that an order made under this section is to be made by statutory instrument under the negative procedure of the House of Commons.

7. **Subsection (7)** defines when a supply of a taxable commodity is “made” for purposes of the clause.

BACKGROUND NOTE

8. CCL is a tax on the non-domestic (i.e. business and public sector) use of energy (gas, electricity, liquefied petroleum gas and solid fuels), and is aimed at promoting energy efficiency.

9. Since the start of the tax in 2001, supplies of energy products used in certain forms of transport (mainly rail) have been exempt from CCL. The purpose of the exemption is to incentivise one of the least polluting modes of public transport (rail travel).
10. The exemption is a State aid, and the current approval expires on 31 March 2011. The Government has been in dialogue with the European Commission since last summer with a view to renewing the approval for the exemption. As a result of the discussions, most of the exemption can continue without formal State aid approval, including public passenger rail services where the operator holds a public service obligation (PSO) and heritage rail services.

11. The Government does, however, need to obtain a further period of State aid approval from the Commission for supplies of taxable commodities used by electrified rail freight train operators and operators of public passenger rail services that do not hold a PSO. The Government cannot allow the exemption as it applies to these operations to continue after 31 March 2011 without obtaining State aid re-approval, as to do so would be a breach of its obligations under European law. Clause 79 therefore introduces a power to suspend parts of the transport exemption. This power will be used only if the relevant State aid re-approval remains outstanding at 1 April 2011.

12. Clause 79 also enables HM Treasury to re-instate either or both parts of the exemption using secondary legislation if State aid re-approval for either or both parts is subsequently received, with retrospective effect, if the terms of the approval permit.
EXPLANATORY NOTE

CLAUSE 80: POWER TO SUSPEND EXEMPTION FOR SUPPLIES USED IN RECYCLING PROCESSES

SUMMARY

1. Clause 60 gives HM Treasury the power to suspend by order all or part of the exemption from the climate change levy (CCL) for taxable commodities used in recycling processes from 1 April 2011. This power cannot be exercised after 31 March 2012. The clause also gives HM Treasury the power to revoke all or part of the suspension using secondary legislation with retrospective effect.

DETAILS OF THE CLAUSE

2. Subsections (1) and (2) grant HM Treasury the power by order to suspend the operation of paragraph 18A of Schedule 6 to the Finance Act 2000 (and any reference to that paragraph in the Schedule) in relation to supplies of taxable commodities made on or after 1 April 2011. The suspension may apply generally, or in relation to supplies made for the purposes of a particular recycling process.

3. Subsection (3) provides that any revocation order that is made may have retrospective effect.

4. Subsection (4) defines a “revocation order” as one that revokes all or part of the suspension order as mentioned in subsection (1).

5. Subsection (5) provides that a suspension order cannot be made after 31 March 2012.

6. Subsections (6) and (7) provide that an order under this section is to be made by statutory instrument subject to the negative procedure of the House of Commons.

7. Subsection (8) defines when a supply is “made” for the purposes of the clause.

BACKGROUND NOTE

8. CCL is a tax on the non-domestic (i.e. business and public sector) use of energy (gas, electricity, liquefied petroleum gas and solid fuels), and is aimed at promoting energy efficiency.

9. The purpose of the recycling exemption is to prevent a market distortion between the primary production of metals and more environmentally-
friendly recycling processes. The beneficiaries of the exemption are firms that recycle aluminium and steel. (The exemption for lead recycling has been revoked with effect from 1 April 2011 as there is no longer any primary production of lead in the UK.)

10. The exemption is a State aid, and the current approval expires on 31 March 2011. The Government has been in dialogue with the European Commission since last summer, with a view to renewing the approval for the recycling of aluminium and steel. The Government cannot allow the exemption to continue after 31 March 2011 without obtaining re-approval from the Commission as to do so would be a breach of the UK’s obligations under European law. The Commission has not yet made its final decision and a decision will not be made by 1 April.

11. Clause 80 therefore gives HM Treasury the power to suspend all or part of the CCL exemption for recycling processes by order from 1 April 2011. To ensure that the power cannot be used indefinitely and for other purposes in the future, the power to suspend the exemption lapses after 31 March 2012.

12. Clause 80 also enables HM Treasury to re-instate either or both parts of the exemption using secondary legislation if State aid re-approval for either or both parts is subsequently received, with retrospective effect, if the terms of the approval permit.
EXPLANATORY NOTE

CLAUSE 81: TRANSITIONAL TAX CREDIT

SUMMARY

1. Clause 81 amends section 30A of the Finance Act 2001 to extend the powers of the Commissioners for HM Revenue & Customs (“the Commissioners”) to make provision by regulations for a tax credit scheme in Northern Ireland (known as the aggregates levy credit scheme (ALCS)).

DETAILS OF THE CLAUSE

2. Subsection (1) amends, as provided for in the subsequent subsections, the provision allowing a transitional tax credit in Northern Ireland.

3. Subsection (2) substitutes a period prescribed in regulations for the time limits laid down in section 30A(2) of the Finance Act 2001.

4. Subsection (3) repeals the provision that allows the starting date for a tax credit in Northern Ireland to be earlier than the date on which section 30A of Finance Act 2001 came into force.

5. Subsection (4) removes the restriction that the Commissioners may only make provision for a tax credit for a person operating a site in respect of which he holds an aggregates levy credit certificate.

BACKGROUND NOTE

6. Under the Aggregates Levy (Northern Ireland Tax Credit) Regulations 2004, registered operators in Northern Ireland could qualify for a credit from the levy of 80 per cent upon condition that they entered into an aggregates levy credit agreement with the Commissioners and were in compliance with a code of practice for environmental improvement for quarrying administered by the Department of the Environment in Northern Ireland. The issue of an aggregates levy credit certificate provided such operators with evidence of entitlement for a credit from the levy.

7. This tax credit scheme, the ALCS, was introduced in 2004 in recognition of the particular conditions of the Northern Ireland aggregates market and the extra costs of making the environmental improvements required under the Code of Practice. The scheme received State aid approval from the European Commission from 1 April 2004 until 31 March 2011.
On 9 September 2010 the European General Court annulled the decision of the European Commission that the ALCS was an approvable State aid. *The Aggregates Levy (Northern Ireland Tax Credit) (Revocation) Regulations 2010* accordingly revoked the earlier regulations, suspending the ALCS with effect from 1 December 2010.

The Government has confirmed its continued support for the ALCS, and intends to apply for State aid approval to reintroduce the scheme at the earliest date possible. The European Commission has initiated a full formal investigation as to whether the tax credit allowed from 1 April 2004 to 30 November 2010 constituted an approvable State aid, and this process means there will be a delay before State aid approval for the reintroduction of the scheme can be considered.

The period during which the Commissioners may make regulations for a transitional tax credit in Northern Ireland ends after 31 March 2011. To enable the Commissioners to make regulations to reintroduce the ALCS after this date therefore requires an amendment to Finance Act 2001.

Restrictions on the persons to whom the Commissioners may grant relief are being lifted in case it should be necessary to amend the scope of the ALCS in order to comply with European law.
EXPLANATORY NOTE

CLAUSE 82 SCHEDULE 21: PREVENTION OF AVOIDANCE

SUMMARY

1. Clause 82 introduces Schedule 21 which makes changes to three areas of Stamp Duty Land Tax (SDLT) legislation. The Schedule introduces an additional exception in the sub-sales rules, narrows the definition of a “financial institution” for the purposes of the alternative property finance reliefs and also changes the rules for exchanges of land from imposing market value to effectively imposing at least market value.

DETAILS OF THE SCHEDULE

2. Paragraph 2 amends section 45(3) of the Finance Act (FA) 2003 extending the exception from the sub-sales rules to all of the alternative property finance reliefs at sections 71A to 73 of that Act.

3. Paragraph 3(1) removes all the current definitions of “financial institution” from the alternative property finance reliefs. Replacement definitions are provided by paragraph 3(2) which inserts a new section 73BA into FA 2003. The new section 73BA imports the definition of “financial institution” from section 564B of the Income Tax Act 2007 but excludes section 564B(1)(d) which refers to the holders of a Consumer Credit Licence.

4. Paragraph 4 amends the rules on exchanges of interests in land at paragraph 5 of Schedule 4 to FA 2003. Paragraph 5(3) of that Schedule determines what the chargeable consideration is when an exchange involves a major interest in land; broadly speaking, it is the market value of the interest in land that is acquired. Paragraph 4(2) replaces the parts of paragraph 5(3) of Schedule 4 to FA 2003 which describe what the chargeable consideration should be with new provisions which state that the chargeable consideration should the greater of two amounts: (i) what the chargeable consideration would have been under the old rules (now moved to the new paragraph 5(3A)); and (ii) what the chargeable consideration would be in the absence of the rules for exchanges.

5. Paragraph 5 is the commencement provision for paragraphs 2 and 4.

6. Paragraph 6 is the commencement provision for paragraph 3.

7. Very broadly, the new rules come into effect at the beginning of March 24 2011 except that arrangements entered into earlier fall under the old rules unless they are altered after commencement.
BACKGROUND NOTE

8. Schedule 21 makes three changes to ensure or put beyond doubt that certain SDLT avoidance schemes are ineffective.

9. The first change makes clear that the sub-sales rules and the alternative property finance reliefs cannot be combined to remove all SDLT charges on the purchase of an interest in land.

10. The second change ensures that the alternative property finance reliefs cannot be abused by purchasers setting themselves up as a “financial institution” by acquiring a Consumer Credit Licence.

11. The third change relates to the rules on exchanges of land. Before SDLT was introduced in 2003, stamp duty was only payable on exchanges of land to the extent that there was an equalisation payment. The SDLT exchanges rules were introduced to ensure that exchanges were appropriately taxed by imposing a charge on the market value of the interest acquired. The change to these rules ensures that SDLT avoidance will not be possible by the manipulation of the market value of the interest acquired.
EXPLANATORY NOTE

CLAUSE 83 SCHEDULE 22: TRANSFERS INVOLVING MULTIPLE DWELLINGS

SUMMARY

1. Clause 83 and Schedule 22 introduce a new relief for stamp duty land tax (SDLT), which reduces the amount of tax payable on a transaction, or linked transactions, which include interests in multiple dwellings.

DETAILS OF THE CLAUSE

2. Clause 83 introduces Schedule 22.

DETAILS OF THE SCHEDULE

3. Paragraph 2 inserts new section 58D of Finance Act (FA) 2003, which introduces new Schedule 6B and provides that relief under that Schedule must be claimed in a land transaction return or an amendment of such a return.


5. Paragraph 1 of new Schedule 6B sets out the arrangement of the Schedule.

6. Paragraph 2 of new Schedule 6B sets out the transactions (“relevant transactions”), the subject-matter of which consists of interests in dwellings or interests in dwellings and other property, to which relief under the Schedule applies. Sub-paragraph (4) excludes certain transactions to which other exemptions or reliefs apply. Sub-paragraph (6) excludes superior interests in dwellings subject to a lease of 21 years or more from consideration in determining whether a transaction is a “relevant transaction”.

7. Paragraph 3 of new Schedule 6B defines key terms used in the Schedule.

8. Paragraph 4 of new Schedule 6B sets the amount of tax chargeable in respect of a transaction to which relief under the Schedule applies.
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9. Paragraph 5 of new Schedule 6B provides rules to establish the appropriate percentage(s) from tables A and B in section 55 of FA 2003 which is/are to be used in calculating the amount of tax chargeable under paragraph 4.

10. Paragraph 6 of new Schedule 6B provides for a further return and payment of additional tax if an event occurs which, if it had occurred immediately before the effective date of the transaction to which relief applied, would have resulted in more tax being payable. This applies within three years of the effective date of a transaction or, if earlier, before the interest in the building or part of the building is disposed of to a person not connected with the original purchaser.

11. Paragraph 7 of new Schedule 6B provides rules to establish what constitutes a dwelling for the purposes of relief under Schedule 6B. Sub-paragraph (5) extends relief 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.

12. Paragraph 4 of the main Schedule prevents a claim to disadvantaged areas relief for any transaction for which relief under new Schedule 6B is claimed.

13. Paragraph 5 of the main Schedule amends section 87 of FA 2003 to set the date from which interest on unpaid tax runs in the case of a further return under paragraph 6 of new Schedule 6B.

14. Paragraph 6 of the main Schedule makes consequential amendments in Schedule 5 to FA 2003, which deals with the amount of tax chargeable on rent.

15. Paragraph 7 of the main Schedule amends Schedule 10 to FA 2003 to allow Her Majesty’s Revenue & Customs to enquire into an earlier return when enquiring into a further return under paragraph 6 of new Schedule 6B, even if the normal enquiry period in respect of the earlier return has expired.

16. Paragraph 8 of the main Schedule amends Schedule 15 to FA 2003 (partnerships) to provide for the application of relief under new Schedule 6B to partnership transactions.

17. Paragraph 9 of the main Schedule provides for commencement.
BACKGROUND NOTE

18. Clause 83 and Schedule 22 are designed to strengthen demand for residential property. They will reduce a barrier to investment in residential property, promoting the supply of private rented housing. They do so by reducing the amount of SDLT payable on a purchase of multiple dwellings, so that it is closer to that charged when purchasing those properties singly.

19. The measure was included in the consultation *Investment in the UK private rented sector*, launched by the previous government on 3 February 2010. The Government responded in September 2010 but no further work was carried out on this policy at that time. The Government has now decided to bring forward this measure, to strengthen demand for residential property.

20. The measure takes the form of a relief which must be claimed in a land transaction return (or an amendment to such a return). Where a transaction, or a scheme, arrangement or series of linked transactions, includes multiple dwellings, the rate of tax charged in respect of those dwellings is determined by the mean consideration: that is, the total consideration attributable to the dwellings, divided by the number of dwellings.

21. Particular provision is made for “off-plan” purchases where construction or adaptation of a dwelling has not yet commenced and for a further return and payment of additional tax where the number of dwellings changes after the effective date of the transaction.

22. The measure has effect for land transactions where the effective date is on or after the date of Royal Assent to the Finance Bill and which are not linked to any transactions before that date (except certain options and rights of pre-emption). 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 84: INTERESTS IN COLLECTIVE INVESTMENT SCHEMES

SUMMARY

1. Clause 84 amends the stamp duty reserve tax (SDRT) regime for collective investment schemes (known as ‘Schedule 19’). It extends the circumstances in which investments in underlying schemes should be classed as exempt investments for Schedule 19 purposes. It replaces the old definition of when such investments are exempt with a new one that has a wider scope.

DETAILS OF THE CLAUSE

2. Subsection (2)(a) amends section 99(5B) of the Finance Act (FA) 1986. It amends paragraph (b) of that subsection, removing the old exemption and providing that an interest under a collective investment scheme is exempt unless the new section 99(5C) applies to the scheme.

3. Subsection (2)(b) also amends section 99(5B). It removes the last part of that subsection that followed paragraph (d) and contained certain definitions.

4. Subsection (3) inserts two new subsections into section 99 of the Finance Act 1986, namely new sections 99(5C) and 99(5D). New section 99(5C) contains a condition for it to apply to a collective investment scheme. New Section 99(5D) defines the term “collective investment scheme” for these purposes.

BACKGROUND NOTE

5. Formal consultation on the reform of Schedule 19 was launched in November 2007. It was agreed that major reform of Schedule 19 should not proceed but informal consultation on the details of the Schedule 19 regime continued. This change arises from that work.

6. Clause 84 extends the situations in which fund managers can treat an interest in an underlying scheme as an exempt investment. Interests in the underlying scheme will be exempt investments where, broadly speaking, it is not significantly invested in UK shares.
EXPLANATORY NOTE

CLAUSE 85: SECURITY FOR PAYMENT OF PAYE

SUMMARY

1. Clause 85 provides HM Revenue & Customs (HMRC) with a power to make secondary legislation to require from a person security for PAYE deductions due to HMRC and that a failure to provide security will be an offence which will be penalised by a fine.

DETAILS OF THE CLAUSE

2. Subsection (2) provides that a new item 4B is inserted into section 684(2) of ITEPA (under which the Income Tax (Pay As You Earn) Regulations 2003 (SI 2003/2682) (“PAYE regulations”) are made). This provides that, in specified circumstances, a person may be required to give security or further security for amounts of PAYE due to HMRC. The effect is that HMRC may make regulations about requiring security for PAYE and other matters in connection with that requirement.

3. Subsection (3) inserts a new subsection (4A) into section 684 of ITEPA. This provides that a person who fails to comply with a requirement in PAYE regulations to give security commits an offence if the failure continues for a specified period. The specified period will be set out in the regulations. A person guilty of that offence is liable, if convicted to a fine not exceeding level 5 on the standard scale (currently £5,000).

BACKGROUND NOTE

4. The Review of Powers, Deterrents and Safeguards was set up to review cross-tax legislation in the light of the creation of the single department of HMRC.

5. The administrative rules inherited from the predecessor departments of Inland Revenue and HM Customs and Excise were not aligned, which confused taxpayers and hampered HMRC’s effectiveness, particularly where several taxes were involved.

6. HMRC currently requires some businesses owing or likely to owe taxes and duties to provide security, before being approved or to ensure payments are met. A facility to require security exists for most of the indirect taxes, but it is most commonly used for VAT where the
taxpayer has a poor payment record. It is also used for “phoenix traders” where a business accrues a VAT debt, goes into liquidation or administration and then sets up again, usually with the same directors and runs up further VAT debts.

7. The most common form of security is a cash deposit held by HMRC or paid into a joint HMRC/taxpayer interest bearing banking facility. Taxpayers may make withdrawals from these accounts but only with HMRC approval. Security can also be a third party guarantee provided by an approved financial institution, normally a bank.

8. There is currently no similar obligation to require a security within PAYE or national insurance legislation. As a result, some businesses which have been required to provide a VAT security then persistently account to HMRC for PAYE and/or National Insurance Contributions late.

9. New penalties for late payment to HMRC of PAYE were introduced in the Finance Act 2009 and will come into effect on 6th April 2010. These were designed to penalise late payment of PAYE: in contrast this clause is designed as a preventative measure in order to protect PAYE revenue.

10. Clause 85 is therefore intended to enable HMRC to require a security in respect of PAYE. It will be restricted so that it applies only to cases of serious non-compliance where it is considered that PAYE is seriously at risk. Similar amendments will be made to National Insurance regulations to achieve the same effect. The effect will be that HMRC will be able to require security for any one of VAT, PAYE and NICs, or potentially for all.

11. The clause will come into force on the date that Finance Bill 2011 receives Royal Assent, but regulations must be made before any securities can be required. HMRC intends to make regulations in order for this measure to come into effect on 6th April 2012. The regulations and the accompanying operational guidance will be published for comment prior to implementation.

12. This measure will not affect those who are genuinely seeking HMRC’s help through the Business Payment Support Scheme, and it is in line with Government’s wider objectives of coming down hard on those who are obtaining financial gain from withholding their tax obligations.

13. A consultation document was published in December 2010 alongside the draft Finance Bill. It included draft regulations. A response document is published with this Bill.
EXPLANATORY NOTE

CLAUSE 86 SCHEDULES 23 AND 24: DATA-GATHERING POWERS

SUMMARY


DETAILS OF SCHEDULE 23

Part 1: Power to obtain data

2. Paragraph 1 provides that an officer of HMRC may issue a “data-holder notice” to a relevant data-holder requiring the provision of relevant data. The categories of data-holder are specified in Part 2 of the Schedule. The data that may be required is to be specified in Treasury regulations.

3. Paragraph 2 explains the purpose for which the power may be used. It may be used not only for collecting data for the purposes of risk assessment, but also for obtaining third-party data in connection with specific tax checks. But it cannot be used for the purpose of checking the tax position of the data-holder (for which the powers in Schedule 36 to FA 2008 are available) except to the limited extent specified in paragraph 14(3)(a) of this Schedule. That exception applies where it is not known whether or not the person to whom the notice is sent is the taxpayer.

4. Paragraph 3 requires the notice to specify the data that can be required. In place of a range of provisions in the source legislation restricting the age of the data that may be specified, the common rule here is that only data that an officer has reason to believe may be relevant to a chargeable or other period ending within the last four years may be specified.

5. Paragraph 4 enables HMRC to specify in the notice (or in a document referred to in the notice) the means and form in which the data must be provided and the address to which the data must be sent.

6. Only documents in the data-holder’s possession or power need be provided. If the notice requires the data to be provided by making
documents available for inspection the paragraph provides rules about specifying the location and timing of the inspection.

7. **Paragraph 5** enables HMRC to ask the tribunal to formally approve the issue of a data-holder notice at a hearing without notice being given to the data-holder (an ‘ex-parte’ hearing). The effect of issuing a tribunal approved notice is that the data-holder may not appeal against the notice itself.

8. The procedures to be followed in a case where HMRC applies for tribunal approval of a proposed notice are set out. The tribunal may decide to set aside some of the normal rules if following them might prejudice any purpose for which the data are required.

9. No appeal is possible against a tribunal decision under paragraph 5.

10. **Paragraph 6** says that HMRC may make copies of or make extracts from any document provided in response to a notice.

11. **Paragraph 7** says that HMRC may retain any document provided in response to a notice for a reasonable period and if requested must give the data-holder a copy. The retention of a document is not regarded as breaking any lien claimed on the document and HMRC must compensate the owner if a document is lost or damaged.

**Part 2: Relevant data-holders**

12. **Paragraph 8** explains that paragraphs 9 to 27 set out who are the data-holders to whom this Schedule applies. Each paragraph or group of paragraphs sets out a particular category of data-holder. The paragraphs below set out where in the Taxes Acts these references were previously found. The provisions apply to persons who previously fell within a category, but no longer do so.

13. **Paragraphs 9 to 11** are based on the data-holders in sections 15, 15A, 16 and 16A of the Taxes Management Act 1970 (TMA) and number 1 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008. **Paragraph 11** reflects the extension of section 15 of TMA to certain overseas employments by section 15A (relocated from section 24 of FA 1974 by paragraph 14 of Schedule 7 to the Tax (International and Other Provisions) Act 2010 (TIOPA)).

14. **Paragraph 12** is based on the data-holders in sections 17 and 18 of TMA.

15. **Paragraph 13** is based on the data-holders in section 13 of TMA.

16. **Paragraph 14** is based on a number of provisions in TMA and the Corporation Tax Act (CTA) 2010. The connection between them is
that HMRC is simply trying to establish who is the beneficial owner of some shares or securities or beneficially entitled to a particular specified payment. The limited scope of the information that may be required is set out in sub-paragraph (3).

17. Paragraph 14(1)(a) is based on the data-holders in sections 21(5), 24(1) and 26 of TMA and sections 31(1), 465(1), 728, 1102(2) and 1109(4) of CTA 2010.

18. Paragraph 14(1)(b) is based on the data-holders in sections 21(4) and 24(2) of TMA. The provision improves HMRC’s ability to establish beneficial ownership where there is a chain of nominee holders.

19. Paragraph 14(1)(c) is based on the data-holders in section 1046(5) to (7) of CTA 2010.

20. Paragraph 14(1)(d) is based on the data-holders in section 1097 of CTA 2010.

21. Section 24(3), (3ZA) and (3ZB) TMA (the latter two subsections were inserted by paragraph 4 of Schedule 8 TIOPA 2010) provides a limited carve-out for banks. A bank currently does not have to provide information under section 24 if the person beneficially entitled to the income from securities is not resident in the UK except in cases where arrangements for relieving double taxation are in place with the territory in which the person is resident. There is no good reason to continue to treat banks any differently from other financial institutions and with the growth in the number of tax treaties the scope of the exception is limited. Furthermore, it is possible that the information could be required under either section 13 or 21 of TMA. Accordingly there is no equivalent of section 24(3), (3ZA) and (3ZB) in this Schedule.

22. Paragraph 15 is based on the data-holders in section 21(4A) of TMA.

23. Paragraph 16 is based on the data-holders in section 18A(1), (3) and (6) of TMA.

24. Paragraph 17 is based on the data-holders in section 18A(2) of TMA. To avoid disputes over the meaning of the term ‘register’ a new definition is inserted.

25. Paragraph 18 is based on the data-holders in section 19 of TMA. The scope is widened to include a person who markets property to potential tenants, searches for tenants or provides similar services.

26. Paragraph 19 is based on the data-holders in sections 21, 24, 25(1) to (5) and 26 of TMA and number 8 in the Table of involved third
parties in paragraph 61A of Schedule 36 to FA 2008. The source provisions are complex and there is some overlap between them. The new provision is much simpler. It is made clear that data-holders include those involved in registration or administration in respect of securities transactions.

27. Paragraph 20 is based on the data-holders in section 25(6) and (7) of TMA.

28. Paragraph 21 is based on the data-holders in number 4 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008.

29. Paragraph 22 is based on the data-holders in numbers 2 and 3 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008.

30. Paragraph 23 is based on the data-holders in number 9 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008.

31. Paragraph 24 is based on the data-holders in numbers 5, 6 and 7 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008.

32. Paragraph 25 is based on the data-holders in numbers 10, 11 and 12 in the Table of involved third parties in paragraph 61A of Schedule 36 to FA 2008.

33. Paragraph 26 is based on the data-holders in section 27 of TMA and section 647 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). It includes beneficiaries as well as settlors and trustees although there was some doubt as to the scope of the old term “a party to a settlement”.

34. Paragraph 27 provides that all charities (as defined in paragraph 1(1) of Schedule 6 to FA 2010) are data-holders. Data can already be obtained from charities constituted as trusts because they are settlements. This provision ensures that data can also be obtained from charitable companies.

Part 3: Appeals against data-holder notices

35. Paragraph 28 provides that a person receiving a notice may appeal on any of the grounds listed, subject to two exceptions. The first exception is in respect of relevant data that form part of the data-holder’s statutory records (defined in paragraph 46). The second exception is where the tribunal has approved the giving of the notice.

36. Paragraph 29 sets out the procedure to follow for an appeal against a notice. On an appeal referred to the tribunal, the tribunal is given
wide powers to vary a requirement in a notice and to set new a
deadline to comply. A decision by a tribunal is final. The general
rules in Part 5 of TMA relating to appeals apply to appeals against
data-holder notices.

Part 4: Penalties

37. Paragraph 30 provides for an initial fixed penalty of £300 for failing
to comply with a notice. Failing to comply includes disposing of a
document that is required by a notice or that the data-holder has been
told will be required. The provisions are similar to those applying to
information notices under Schedule 36 to FA 2008.

38. Paragraph 31 provides for a daily penalty of up to £60 for a failure
that continues after the award of an initial penalty. An alternative
increased penalty may be imposed by the tribunal (see paragraph 38
of the Schedule).

39. Paragraph 32 provides for a penalty on the data-holder of up to
£3,000 for deliberately or carelessly providing inaccurate information
or documents. The penalty applies if the data-holder submits
information or a document knowing about an inaccuracy attributable
to another person and fails to tell HMRC at the time. It also applies in
cases where an inaccuracy comes to light later and the data-holder
does not then take reasonable steps to tell HMRC.

40. Paragraph 33 provides that no late-filing penalty arises under
paragraph 30 or 31 if the notice was complied with within further
time allowed by HMRC.

41. Paragraph 34 provides that no late-filing penalty arises under
paragraph 30 or 31 if the data-holder satisfies HMRC or the tribunal
that there is a reasonable excuse for the failure. The paragraph sets
out some rules about what constitutes a reasonable excuse in the same
terms as paragraph 45 of Schedule 36 to FA 2008.

42. Paragraph 35 provides the rules for the assessment of penalties by
HMRC. They are the same as those applying to the assessment of
penalties under Schedule 36 to FA 2008 in paragraph 46 of that
Schedule.

43. Paragraph 36 provides that a data-holder may appeal against a
decision of HMRC to impose a penalty.

44. Paragraph 37 sets out the procedure for an appeal against a penalty.
The provisions are the same as those applying to appeals against
penalties in paragraph 48 of Schedule 36 to FA 2008.
45. Paragraph 38 provides that HMRC may apply to the tribunal for a daily penalty of more than £60 if the notice is still not complied with within 30 days of a daily penalty within paragraph 31 being notified to the data-holder. Subject to the tribunal’s own rules, the data-holder may attend the hearing at which a penalty is sought.

46. HMRC would proceed under this paragraph in cases where it is not expected that a daily penalty of up to £60 will encourage compliance. The tribunal would be entitled to impose a daily penalty of up to £1,000 in place of a continuing penalty under paragraph 31.

47. Paragraph 39 provides that HMRC must notify the data-holder of the amount of the daily penalty imposed under paragraph 38 and the date from which it applies.

48. Paragraph 40 provides that any penalty under this Schedule is payable within 30 days of the date that it is notified or, if appealed, the date on which the appeal is determined or withdrawn. Penalties are treated like income tax for enforcement purposes.

49. Paragraph 41 provides that the Treasury may make regulations to change the fixed and maximum penalty levels in this Schedule if there is a change in the value of money.

50. Paragraph 42 provides that no penalty may be charged under this Schedule for anything in respect of which the data-holder has been convicted of an offence.

Part 5: Miscellaneous provision and interpretation

51. Paragraph 43 provides that various machinery provisions of TMA (for example about the service of documents) apply to this Schedule.

52. Paragraph 44 provides that regulations specifying relevant data under paragraph 1(3) of the Schedule are to be made by statutory instrument. The first such set of regulations needs to be approved by Parliament under the affirmative procedure. Subsequent regulations will use the negative procedure.

53. Paragraph 45 lists the taxes to which the Schedule applies. In contrast to the source legislation for the various categories of data-holder, the Schedule applies to most of the taxes and duties administered by HMRC. “Relevant foreign tax” is included for the first time.

54. Paragraph 46 defines “statutory records”. This is relevant to whether an appeal may be made against a requirement in a notice (see the note above relating to paragraph 28 of the Schedule).

55. Paragraph 47 gives the meanings of terms used in this Schedule.
56. Paragraphs 48 and 49 explain what is meant by “providing data” and “carrying on a business”.

57. Paragraph 50 provides that the Schedule applies to the Crown (including Government departments), but not to Her Majesty in a private capacity.

Part 6: Consequential provisions

58. Paragraphs 51 to 64 list the provisions that are being repealed or amended as a result of the modernised powers in this Schedule. In some cases the provisions being repealed have been rewritten in CTA 2010 or relocated by TIOPA. It is necessary to repeal both the original and rewritten provisions because the repealed provisions are still in force for periods before 1 April 2010 by virtue of the terms of section 1184 of CTA 2010 or section 381 of TIOPA.

59. It should be noted that section 76 of TMA is repealed rather than simply amended to change the references to section 13 of TMA.

Part 7: Application of this Schedule

60. Paragraph 65 provides for this Schedule to have effect from 1 April 2012. In relation to a notice issued before that date under any provision repealed by this Schedule, the old rules (eg in relation to penalties) continue to apply.

DETAILS OF SCHEDULE 24

61. Paragraph 2 amends paragraph 5 of Schedule 36 to FA 2008. The effect is that all of the information powers in Schedule 36 may now be used to obtain information in relation to relevant foreign tax of a territory outside the UK.

62. Paragraph 3 amends paragraph 40A of Schedule 36. This introduces a new category for which a penalty may be charged: where a person knowingly provides information containing an inaccuracy but does not notify HMRC at the time.

63. Paragraph 4 inserts new paragraphs 49A to 49C into Schedule 36. These allow for a daily penalty to be charged which is greater than that chargeable under paragraph 40 of Schedule 36. This applies where there is a continuing failure to comply with a notice under paragraph 5 of Schedule 36. Such an increased penalty must be approved by the tribunal and the person involved must be given prior warning and may attend the hearing. New paragraphs 49B and 49C are administrative provisions about notification and payment of the
penalty. The provision of an increased daily penalty corresponds to that introduced for Schedule 23.

64. Paragraph 5 amends paragraph 50 of Schedule 36 to clarify the relevant date for the purpose of charging a tax-related penalty.

BACKGROUND NOTE

65. The Review of Powers, Deterrents and Safeguards was set up to review cross-tax legislation in the light of the creation of the single department of HM Revenue and Customs.

66. The Review has already produced modernised and aligned information powers in Schedule 36 to FA 2008 for taxpayers, third parties and “involved third parties”.

67. The latest phase of the Review’s work is to modernise and align the more specialist information powers which apply to certain third parties and which in some cases allow for the provision of bulk information. These parties are now called data-holders. This phrase also covers the involved third parties, so Schedule 23 brings the information powers for this category of persons out of Schedule 36 into a new schedule. All these similar types of data-holder are now in a single Schedule. The change in name does not change the information powers on involved third parties.

68. The Review published a consultation document called *Bulk and specialist information powers* on 9 July 2009. A response document was published on 9 December 2009. A second consultation document, with draft legislation, was issued on 9 December 2010 and a response to that is published alongside this Bill.

69. Schedule 24 makes amendments to Schedule 36 to FA 2008 to clarify matters and allow for new penalties. By extending Schedule 36 to tax of other countries it reflects international obligations.

70. Some of Schedule 24 has effect on and after the date that the Finance (No.3) Bill receives Royal Assent. Other paragraphs only affect inaccuracies and failures on or after 1 April 2012.
EXPLANATORY NOTE

CLAUSE 87 SCHEDULE 25: MUTUAL ASSISTANCE FOR RECOVERY OF TAXES ETC

SUMMARY

1. This Bill includes provisions implementing the following European Community legislation: Council Directive 2010/24/EU covering mutual assistance arrangements between member States. This Directive was cleared by the Commons EU Scrutiny Committee on 25 November 2009 and the Lords EU Scrutiny Committee on 4 December 2009. A Transposition Note setting out how the Government will transpose into UK law the main elements of this Directive is annexed to this Explanatory Note.

2. Clause 87 and Schedule 25 enable the UK to implement the new mutual assistance recovery Directive (MARD) agreed by EU Finance Ministers during 2010. Under this Directive EU member States can provide each other with assistance in the recovery of tax debts and duties, which includes service of documents and exchanging information in connection with the recovery of claims.

DETAILS OF THE CLAUSE

3. Subsection (1) explains that Schedule 25 is designed to give effect to Council Directive 2010/24/EU, the new EU mutual assistance Directive.

4. Subsection (2) provides for the Treasury to make regulations in order to give effect to any amendments or extensions of the new Directive, to any EU instrument covering mutual assistance that replaces the new Directive, and to any later amendments or extensions to any such EU instrument.

5. Subsection (3) provides that any such regulations may amend, repeal or replace Schedule 25 and any other enactment designed to give effect to an EU instrument concerning mutual assistance.

6. Subsection (4) provides that regulations made under subsection (2) cannot cover matters within the legislative competence of the Scottish Parliament or Northern Ireland Assembly.
DETAILS OF THE SCHEDULE

7. Paragraph 2 sets out the matters that are dealt with by HM Revenue and Customs (HMRC). Sub-paragraph (1) states that HMRC are competent to deal with all matters under MARD and sub-paragraph (2) provides that HMRC is the Central Liaison Office for the United Kingdom for all purposes other than excluded matters.

8. Paragraph 2(3) sets out that excluded matters are outbound requests for assistance with a devolved tax, and inbound requests for assistance with agricultural levies where that assistance requires steps to be taken in Scotland.

9. Paragraph 2(4) explains the meaning of “devolved tax” for the purpose of this legislation.

10. Paragraph 3 provides a gateway to allow information to be shared to facilitate compliance with the MARD.

11. Paragraph 3(1) permits a public authority, or anyone acting on their behalf, to disclose information if it is for the purpose of MARD.

12. Paragraph 3(4) explains that sub-paragraph (1) does not apply to a disclosure relating to any excluded matter.

13. Paragraph 4 details the circumstances when information shared under paragraph 3 can be shared further and creates an offence for the wrongful disclosure of the information. This offence mirrors the offence of wrongful disclosure HMRC staff are subject to under section 19 of the Commissioners for Revenue and Customs Act 2005.

14. Paragraph 5 provides a defence for a person charged under paragraph 4. It is that the person believed that the disclosure was lawful. The paragraph goes on to set out the penalties for an offence and the detail of the paragraph’s application in different parts of the UK.

15. Paragraph 6 explains the procedure for enforcing foreign claims in the UK. Sub-paragraph (7) states that any legal provisions relating to the same UK claim apply, with any necessary adaptations, to the foreign claim. Sub-paragraph (8) explains that the provisions covered by sub-paragraph (7) particularly include those relating to penalties and interest on unpaid amounts.

16. Paragraph 7 sets out who the “relevant UK authority” is.

17. Paragraph 8 covers corresponding UK claims. Sub-paragraph (1) provides that, where possible, the UK should match foreign claims to a UK tax, duty or levy and seek to recover the foreign claim as such a UK debt would be recovered. Sub-paragraph (2) provides that where
the relevant UK authority concludes there is no similar UK claim then income tax provisions apply to recover the foreign claim.

18. Paragraph 9 permits the relevant UK authority to set out in regulations any differences in treatment, or adaptations, for a foreign claim to the UK equivalent tax, levy or duty.

19. Paragraph 10 provides the Treasury with a regulation-making power to cover procedural or other supplementary matters in order to give effect to MARD.

20. Paragraph 11 deals with the procedures to apply where a claim is contested.

21. Paragraph 11(1) to (3) states that enforcement action must be suspended if the person can show that action to dispute the claim has been, or will soon be, taken in the member State where the debt arose.

22. Paragraph 11(4) states that enforcement action does not need to be suspended where such action can continue for a disputed equivalent UK debt.

23. Paragraph 11(5) lifts the suspension on enforcement action where the debtor does not begin or progress action to dispute the claim reasonably quickly.

24. Paragraph 12 states that enforcement action must not be taken or continued if a final decision on the foreign claim has been given in the taxpayer’s favour by a court, tribunal or other competent body in the applicant member State. Sub-paragraph (2) explains that a final decision is one against which an appeal cannot be made or can no longer be made. Sub-paragraph (3) explains that where such a decision has been given for part of the foreign claim enforcement action must not be taken or continued for that part.

25. Paragraph 13 provides that the debtor cannot dispute the foreign liability with the UK enforcement agency except to draw attention to any decision as set out in paragraph 12 that affects the claim.

26. Paragraph 14 states that, for the purpose of taking enforcement proceedings, a request made by an applicant authority is taken to be properly made in accordance with MARD unless the contrary is proved.

27. Paragraph 17 sets out a number of repeals and consequential amendments. Sub-paragraph (2) states that any outstanding requests made under the current mutual assistance Directive are to be treated as if they had been made under MARD when that comes into force. Sub-paragraph (3) preserves the current legislation as far as it relates
to excluded matters, so inbound requests for assistance with agricultural levies where that assistance is to be given in Scotland.

28. Paragraph 18 updates the rules about the mutual assistance arrangements with Andorra with effect from 1 January 2012.

29. Paragraph 19 states that the Schedule applies to the recovery of sums becoming due at any time, whether before or after Finance Act 2011 is passed.

BACKGROUND NOTE

30. This legislation replaces and repeals the existing UK legislation implementing the current mutual assistance Directive as it relates to national and local taxes in England and Wales, and agricultural levies in England, Wales and Northern Ireland. European rules governing mutual assistance were originally introduced in 1976 and consolidated in the 2008 codified Directive following a number of revisions. The new Directive modernises and expands the scope of mutual assistance, and comes into force on 1 January 2012.

31. Discussions are ongoing between member States and the Commission on the content of the EC Implementing Regulation, which will be directly applicable in all member States and will cover some of the detail regarding implementation, organisation and administration included in the Directive, plus a number of further such provisions.

32. Member States are required to implement the Directive by 31 December 2011. Apart from these Finance Bill provisions, regulations will be needed to cover the detailed rules and administration matters not included in the EC Implementing Regulation. Additional legislation will be needed to implement the provisions for Scotland and Northern Ireland in relation to devolved taxes. So the Directive itself will be introduced into UK law through a combination of the EU Implementing Regulation and UK primary and secondary legislation.
## Transposition Note: Council Directive 2010/24/EU

Transposition Note setting out how clause 87 of, and Schedule 25 to, Finance Bill 2011 implement this Directive. This legislation will be supplemented by both a directly applicable EU Implementing Regulation and UK secondary legislation later this year.

### The Directive

Council Directive 2010/24/EU of 16 March 2010 is concerned with mutual assistance across member States in the recovery of claims. The Directive covers national and local taxes, duties and levies, and under its provisions member States may provide each other with assistance in the recovery of tax debts and exchange information in connection with the recovery of claims. The Directive takes effect on 1 January 2012.

### Introduction

This Directive replaces Council Directive 2008/55/EC which itself updated Directive 76/308/EC (as amended by Directive No. 2001/44/EC). The 2008 Directive sets out the current provisions concerning mutual assistance. These are transposed at section 134 of and Schedule 39 to Finance Act 2002 and by the Recovery of Duties and Taxes Etc. in Other Member States (Corresponding UK Claims, Procedure and Supplementary) Regulations 2004 (SI 2004/674). The new Directive aims to set out the rules more clearly to promote wider information exchange quickly and efficiently between member States. The Directive no longer prescribes what should be translated into domestic law and how, but rather sets out the rules that should be applied and then leaves it to each member State to decide how to transpose these into its national laws in order to comply with its provisions. The significant changes to existing provisions are made in Article 2 of the Directive on scope, Article 4 on organisation, Article 6 on exchange of information without request, Article 21 on the use of standard forms, and Article 23 on the wider use of information across member States. There is no requirement under the new Directive to correspond taxes or duties, although member States are expected to use national recovery powers for a similar tax or duty. If no such tax or duty exists then the powers in relation to the recovery of income tax should be used. The remaining Articles provide the supporting framework for operating mutual assistance across member States, but make no substantial changes, particularly in the areas of enforcing foreign claims and dealing with contested claims. Responsibility for implementing the Directive in the UK lies with HM Revenue & Customs under the direction of HM Treasury.

<table>
<thead>
<tr>
<th>Articles</th>
<th>Objective</th>
<th>Implementation</th>
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<tr>
<td>Article 2</td>
<td>Extends the scope of the rules to all taxes and duties levied by or on behalf of the member State’s territorial or administrative subdivisions, including local authorities.</td>
<td>Subsection (1) of clause 87 and paragraph 7 of Schedule 25 set out that effect is given to the Directive by the Schedule and that HMRC, DEFRA, the Welsh Ministers and the Northern Ireland Department of Agriculture and Rural Development will deal with the relevant claims under the Directive.</td>
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<td>Article 4</td>
<td>Introduces the concepts of a “competent authority”, “central liaison office”, “liaison office”, and “liaison department” and sets out their roles.</td>
<td>Paragraph 2 of Schedule 25 states that the Commissioners are a competent authority for the purposes of this Directive, and that HMRC is the central liaison office. The remaining detail of this Article will be covered by an EU Implementing Regulation and under domestic regulations provided for by paragraph 10 of the Schedule, if necessary.</td>
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<td>Article 6</td>
<td>Provides that member States may spontaneously provide information on refunds to other member States.</td>
<td>This will be covered in regulations provided for by paragraph 10 of Schedule 25.</td>
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| Article 11 | Sets out the conditions governing a request for recovery. It states that the applicant authority must apply appropriate recovery procedures before sending a request for recovery to another member State, except where
- there are no assets or little prospect of securing payment in the applicant State,
- the applicant State has specific information indicating the debtor has assets in the requested State, or
- taking recovery action in the applicant State would lead to disproportionate | This is covered in part at paragraph 6 of Schedule 25; the remainder will be covered in regulations provided for by paragraph 10 of Schedule 25. |
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<th>Article</th>
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<tr>
<td>Article 13</td>
<td>Provides, among other matters, that the requested member State should use its powers and procedures to recover the claim for a similar tax or duty, and where this is not possible that it uses the provisions for tax levied on personal income.</td>
<td>This Article is covered in part by paragraph 8 of Schedule 25 and further by an EU Implementing Regulation.</td>
</tr>
<tr>
<td>Article 14</td>
<td>Provides that disputes must be dealt with by the applicant State, who must keep the requested State informed. Disputes regarding the enforcement action taken by the requested State should be dealt with by that State in accordance with its laws and regulations. Recovery action should be suspended on any disputed element of the debt, although the applicant authority can ask the requested authority to recover a contested claim where the requested State’s laws permit it. If it later transpires that the underlying debt was not due then the applicant State is liable for reimbursing any sums recovered plus any compensation due in accordance with the laws of the requested member State.</td>
<td>This Article is covered in part by paragraphs 11 and 12 of Schedule 25. Other elements will be covered in regulations provided for by paragraph 10 of Schedule 25.</td>
</tr>
<tr>
<td>Article 15</td>
<td>Requires the applicant State to inform the requested State if the recovery request is amended or withdrawn, and the reasons. If the amendment is as a result of a decision following a dispute, then a new enforcement instrument must be issued. Recovery or precautionary measures, if already initiated, can then be continued on the basis of the revised instrument, unless the amendment of the request is due to the invalidity of the original instrument.</td>
<td>This Article is covered in part by paragraphs 11 and 12 of Schedule 25. Other elements will be covered in an EU Implementing Regulation.</td>
</tr>
<tr>
<td>Article 21</td>
<td>Provides that all requests and information exchanged under the Directive should be sent by electronic means, using a standard form, unless this is impractical for technical</td>
<td>This Article will be covered by an EU Implementing Regulation and under domestic regulations provided for by paragraph 10 of Schedule 25.</td>
</tr>
<tr>
<td>Article 23</td>
<td>Introduces provision concerning disclosure and details how information communicated between member States should be protected and used by other member States, the Commission, or other agencies within a member State. Information provided under the Directive may be used for applying enforcement and precautionary measures for claims covered by the Directive and for the assessment and enforcement of social security contributions.</td>
<td>This Article has been legislated in part by paragraphs 2 to 5 of Schedule 25 (HMRC functions, exchange of information and onward disclosure). The penalty provisions for unlawful disclosure can only apply within UK. Information can only be passed more widely around EU if agreed by the providing member State.</td>
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</table>
EXPLANATORY NOTE

CLAUSE 88: AMENDMENTS OF SECTION 1 OF THE PROVISIONAL COLLECTION OF TAXES ACT 1968

SUMMARY

1. Clause 88 amends the Provisional Collection of Taxes Act 1968 (PCTA) to ensure that it continues to enable the Government to collect taxes on a provisional basis after the move to sessions beginning in the spring, and ending in the following spring.

DETAILS OF THE CLAUSE

2. Subsection (3) substitutes a new section 1(3) of PCTA, which provides that the maximum period for which a PCTA resolution can have statutory effect is seven months.

3. Subsections (4) and (5) make amendments to the effect that a PCTA resolution ceases to have statutory force at the end of a session unless proceedings on a Bill containing a clause corresponding to the resolution have begun but are not completed, and are to be resumed in the next session.

4. Subsection (5) also inserts new section 1(5B) of PCTA whose effect is that the resolution ceases to have statutory force if the Bill is not reintroduced in the first 30 sitting days of the new session (this mirrors section 1(4) of PCTA, which provides that the resolution ceases to have statutory effect unless, within thirty sitting days after it is passed, the Bill reaches second reading).

5. Subsection (7) inserts new section 1(9) of PCTA, whose effect is that where a resolution has had statutory effect in a session, another resolution may be given the same effect in the same session, but only if the later resolution is passed in a different calendar year.

6. Subsection (10) provides that the amendments to PCTA do not apply in relation to resolutions passed before the day appointed for the clause’s coming into force (this does not alter the effect of the amendment made by subsection (7), which applies whether the earlier resolution is passed before, on or after the appointed day).

BACKGROUND NOTE

7. The PCTA gives temporary statutory force to resolutions of the House of Commons which renew, vary or abolish certain taxes and duties. The principal practical application of this is to allow the Government to collect taxes on a provisional basis between Budget day (or a day after Budget), and the coming into operation of the
Finance Act. These resolutions currently lose statutory effect when Parliament is prorogued.

The new parliamentary timetable

8. The parliamentary timetable will be changed so that sessions will end in the spring rather than the autumn. This will not occur in 2011, so there will be a long first session until spring 2012, when the new timetable will be implemented.

9. It is likely that under the new timetable, sessions will end between Budget day and Royal Assent to the Finance Bill, and this would mean that PCTA resolutions passed after the Budget would (by virtue of the prorogation) lose their statutory force before their substance is enshrined in statute. These changes are being introduced to address this.
EXPLANATORY NOTE

CLAUSE 89: SPECIFIED INVESTMENTS

SUMMARY

1. Clause 89 addresses the unintended tax consequences of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010 (SI 2010/86) (‘the first order’) which came into force on 24 February 2010. The first order made changes to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (‘the RAO’). The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2011 (SI 2011/133) (‘the second order’) corrected the unintended effects of the first order with effect from 16 February 2011. This clause provides that for tax purposes the second order is treated as if it has effect from the date of the first order (24 February 2010), to correct the unintended tax consequences from this earlier date. To prevent any potential adverse retrospective effect, a person may opt within 30 days of this clause coming into effect for this clause not to apply,

DETAILS OF THE CLAUSE

2. Subsection (1) provides that for all tax purposes the first order applies as if the second order had come into force immediately after the first order on 24 February 2010. The first order and the second order are defined in subsection (4) to mean, respectively, the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010 (SI 2010/86) and the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2011 (SI 2011/133).

3. Subsection (2) provides that a person may elect for this treatment not to apply to them. Subsection (3) provides that the election must be made in writing within 30 days of the Royal Assent to the Finance Bill.

4. Subsection (5) ensures that treating the second order as having commenced, for tax purposes, immediately after the first order has no other effect on the commencement of the second order.

BACKGROUND NOTE

5. This measure corrects the unintended tax consequences of the coming into force of amendments made to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (‘the RAO’) in February
2010 by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010 (the ‘first order’).

6. The first order was supposed to align the regulatory treatment of sharia-compliant securities providing an interest-like return with that of conventional bonds or asset-backed securities to which they are economically equivalent, by creating a new regulatory category for them.

7. However the first order inadvertently excluded some conventional securities from both their existing, and the new, regulatory category. Such instruments would then not qualify for the stamp duty loan capital exemption in section 79(4) of Finance Act 1986. And companies issuing such instruments might no longer qualify for the special corporation tax regime for securitisation companies (contained in the Taxation of Securitisation Companies Regulations 2006 (SI 2006/3296)).

8. A Written Ministerial Statement issued on 19 November 2010 confirmed that the Government would reverse the unintended regulatory and tax consequences of the first order.

9. A second order (The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2011) corrected future regulatory and tax treatment of instruments issued on or after 16 February 2011, as well as to instruments already in existence at that date.

10. However the second order could not alter the tax treatment applying to instruments between 24 February 2010 when the first order came into force and 16 February 2011.

11. This measure now achieves this result. It has retrospective effect: for tax purposes, the second order is treated as if it had applied from 24 February 2010. This re-establishes the stamp duty loan capital exemption and qualification for the securitisation companies regime for the period to 16 February 2011.

12. An election out of this treatment may be made, so that no one need be adversely affected by this retrospective effect.
EXPLANATORY NOTE

CLAUSE 90: MACHINE GAMES DUTY

SUMMARY

1. Clause 90 enables HM Revenue and Customs (HMRC) to incur expenditure in preparing for the introduction of the new machine games duty (MGD) before it is formally provided for in law.

DETAILS OF THE CLAUSE

2. Clause 90 allows HMRC to incur expenditure in preparing for the introduction of a new duty to be charged in respect of games played on machines.

BACKGROUND NOTE

3. The Government has announced that it intends to replace amusement machine licence duty with a new duty payable on the profits from games played on machines. Supplies in relation to the playing of games on machines which are liable to MGD will also become exempt from VAT. It is the intention to introduce the main provisions for MGD in Finance Bill 2012.
EXPLANATORY NOTE

CLAUSE 91 SCHEDULE 26: REDUNDANT RELIEFS

SUMMARY

1. Clause 91 introduces Schedule 26 which repeals certain obsolete reliefs. Part 1 covers those reliefs within income tax and corporation tax and Part 2 covers exemptions from stamp duty.

DETAILS OF THE SCHEDULE

2. Paragraph 1 repeals section 35 of, and Schedule 5 to, Finance (No.2) Act 1997 which provided transitional relief to charities on the withdrawal, in 1999, of repayable tax credits on distributions, and makes further consequential amendments.

3. Paragraph 2 repeals section 48 of Finance Act (FA) 1998 which allows donors to claim Gift Aid on smaller gifts of money to charities for relief in poor countries than was otherwise allowed under the Gift Aid rules at the time, and makes further consequential amendments.

4. Paragraph 3 repeals section 38 of FA 2000 which provides a 10 per cent supplement on donations made between 6 April 2000 and 5 April 2004 under the payroll deduction scheme, and makes further consequential amendments.

5. Paragraph 4 repeals section 691 of ITTOIA 2005 which deals with National Savings Bank ordinary account interest.

6. Paragraph 5 repeals section 45 of FA 1944 which provides for exemption from stamp duty for certain assignments by seamen.

7. Paragraph 6 repeals section 31 of FA 1953 which provides for exemption from stamp duty for instruments relating to National Savings.

8. Paragraph 7 repeals paragraph 24(b) of Schedule 13 to FA 1999 as well as all references to that paragraph elsewhere in the Act. This provision provides for exemption from stamp duty on instruments for the sale or transfer of ships or vessels.

BACKGROUND NOTE

9. The Office of Tax Simplification established by the Chancellor of the Exchequer in July 2010 carried out a review of reliefs, allowances
and exemptions. The above reliefs were included as part of that review and have now been identified for repeal as the provisions are obsolete.
EXPLANATORY NOTE

CLAUSES 92 & 93: FINAL PROVISIONS

CLAUSE 92: INTERPRETATION

1. Clause 92 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 93: SHORT TITLE

2. Clause 93 provides for the Bill to be known as the “Finance Act 2011” upon Royal Assent.