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Explanatory Notes

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Clauses 1 to 81

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Explanatory notes

Introduction

1. These explanatory notes relate to the Finance (No. 2) Bill 2016 as introduced into Parliament on 24 March 2016. 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 need to be read in conjunction 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.

Clause 1: Income tax charge and rates for 2016-17

Summary

1. This clause provides for income tax and sets the main rates for 2016-17.

Details of the clause

2. Subsection (1) provides for income tax for 2016-17.

3. Subsection (2) sets the basic, additional and higher rates of income tax for 2016-17.

Background note

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

5. This section imposes a charge to income tax for the tax year 2016-17. It also provides the main rates of income tax for 2016-17: the 20% basic rate, the 40% higher rate and the 45% additional rate.

Clause 2: Basic rate limit for 2017-18

Summary

1. This clause sets the income tax basic rate limit for the 2017-18 tax year.

Details of the clause

2. Subsection (1) sets the amount of the basic rate limit for 2017-18 at £33,500.

Background note

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

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

5. Finance Act 2016 sets the basic rate limit at £33,500 for 2017-18.

Clause 3: Personal allowance for 2017-18

Summary

1. This clause sets the income tax personal allowance for the 2017-18 tax year.

Details of the clause

2. Subsection (1) sets the amount of the personal allowance for 2017-18 at £11,500.

Background note

3. An individual is entitled to a personal allowance for income tax. The government has an objective to raise the personal allowance to £12,500 by the end of this parliament.

4. This measure will increase the personal allowance for 2017-18 to £11,500.

Clause 4: Savings allowance, and savings nil rate etc

Summary

1. This clause introduces a new nil rate of tax for savings income (such as interest) within an individual's savings allowance. Each individual will have an annual savings allowance of £1,000, unless they have any higher-rate income for the year (in which case their allowance will be £500) or any additional-rate income (in which case their allowance will be nil). The clause will have effect for savings income paid or credited on and after 6 April 2016.

Details of the clause

2. Subsection (1) provides for amendments to Income Tax Act 2007 (ITA).

3. Subsection (2) adds the new savings nil rate to the rates of income tax listed in section 6 of ITA.

4. Subsection (3) amends section 7 of ITA to set the new savings nil rate.

5. Subsection (4) inserts new Section 12A into section 10 of ITA.

6. Subsection (5) introduces new Section 12A and new Section 12B of ITA.

Section 12A Savings income charged at the savings nil rate

7. New Section 12A provides the basis for calculating how much of an individual's savings income is eligible for the new savings nil rate, with reference to their savings allowance. The effect of subsection (1) of this new section is that the savings nil rate applies to an individual's savings income that is not covered by other allowances (such as the tax-free personal allowance) or the 0% starting rate for savings.

Section 12B Individual's entitlement to a savings allowance

8. New Section 12B determines an individual's savings allowance for a tax year - which may be £1,000, £500 or nil - with reference to whether they have any higher-rate or additional-rate income in the year. Subsection (8) of this new section defines higher-rate and additional-rate income for these purposes. This new section also enables HM Treasury to make regulations that change the amount of savings allowance, and includes provisions in relation to such regulations.

9. Subsection (6) of the clause provides that the income ordering rules at section 16 of ITA will apply for the purposes of determining the extent to which an individual's income is savings income, and therefore potentially eligible for the savings nil rate.

10. Subsection (7) amends section 17 of ITA (concerning repayment claims) to allow such claims to be made where tax has been paid on income that is chargeable at the savings nil

rate.

11. Subsection (8) amends sections 55B and 55C of ITA (concerning the transferable tax allowance for married couples and civil partners) to take account of the savings nil rate within the eligibility conditions for a tax reduction, where the other party to a marriage or civil partnership has elected to reduce their personal allowance.

12. Subsection (9) updates section 745 of ITA to clarify the exemption from income tax for income treated as arising to an individual as a result of certain transactions relating to the transfer of assets abroad. This amendment is consequential to the reduction of the starting rate of savings to 0% from April 2014.

13. Subsections 10 to 16 provide consequential amendments to ITA and other legislation to take into account the savings nil rate and savings allowance. Subsection (13) amends section 669 of the Income Tax (Trading and Other Income) Act 2005 to clarify the method for calculating a reduction in the residuary income of an estate, by removing an unnecessary reference to the starting rate for savings.

14. Subsections 17 to 21 provide for the commencement of the provisions within this clause and also set out powers for HM Treasury to amend, repeal or revoke other tax legislation in consequence of this clause.

Background note

15. At Budget 2015, the government announced the introduction of a new Personal Savings Allowance (PSA). This change enables most individuals to receive up to £1,000 of savings income (such as interest on a bank or building society account) tax-free each year. However, where an individual has any higher-rate income in the year, their PSA will be £500, and individuals with additional-rate income in the year will have a PSA of nil. The PSA provides a new nil rate for savings income in addition to the 0% starting rate for savings which has applied since 6 April 2014, and the tax-advantages that apply for ISA savings.

16. Alongside the PSA, banks, building societies and National Savings and Investments (NS&I) will cease to deduct income tax from the interest they pay on savings accounts.

17. Savings income is defined at section 18 of ITA and includes a number of different types of payments, such as interest; certain purchased life annuity payments; profits from deeply discounted securities; gains from certain contracts for life insurance and certain accrued income profits.

Clause 5 and schedule 1: Rates of tax on dividend income, and abolition of dividend tax credits etc

Summary

1. This clause introduces a new dividend allowance, which will apply to the first £5,000 of an individual's dividend income. The allowance will operate as a 0% tax rate inserted into the Income Tax Act 2007 (ITA 2007). The measure also introduces new rates for dividends received above the £5,000 allowance, and abolishes the dividend tax credit (along with consequential amendments). The new rules will apply from 6 April 2016.

Details of the clause

2. Subsection (1) provides for the amendments of ITA 2007.
3. Subsection (2) adds "the dividend nil rate" to the list of rates at which tax is charged.
4. Subsection (3) introduces a new 0% rate for dividend income, called "the dividend nil rate", and changes the dividend ordinary rate to 7.5% and the dividend higher rate to 38.1%.
5. Subsection (4) changes the dividend trust rate to 38.1%.
6. Subsection (5) introduces new section 13A into ITA 2007, which provides the rules for the new 0% rate.

New section 13A: Income charged at the dividend nil rate

7. New Section 13A(1) explains when the dividend nil rate will apply.
8. New Section 13A(2) identifies the dividend income to be charged at the dividend nil rate. Where an individual receives dividend income that would otherwise be chargeable at the dividend ordinary, upper or additional rate, and the income is less than or equal to £5,000, the dividend nil rate will apply to all of the dividend income. Where the dividend income is above £5,000, the lowest part of the dividend income will be chargeable at 0%, and anything received above £5,000 is taxed at the rate that would apply to that amount if the dividend nil rate did not exist.
9. Subsections (6) and (7) amend the conditions that apply to the transferable tax allowance for married couples and civil partners.
10. Subsection (8) adds "dividend nil rate" to the list of definitions for the purposes of the Income Tax Acts.
11. Subsection (9) amends section 7 of the Taxes Management Act 1970, which governs when a person must notify HMRC of a liability to tax. The amendments continue to ensure a person need not notify receipt of dividend income when they have no liability to tax on it.
12. Subsection (10) provides for commencement.

13. Subsection (11) introduces Schedule 1.

Details of the Schedule

14. Paragraph 1(1) amends the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005). It repeals the sections that entitle a UK resident (or eligible non-UK resident) person to a tax credit in respect of dividends received from UK resident and non-UK resident companies (sections 397 and 397A of ITTOIA 2005). Section 398 of ITTOIA 3005 increases a person's taxable income by the amount of the dividend tax credit and is repealed.

15. Paragraph 1(1) also repeals the sections in ITTOIA 2005 that treat tax as paid at the dividend ordinary rate on "non-qualifying distributions", stock dividends from UK resident and non-UK resident companies, and loans to participators that are released or written off, all of which are treated as distributions (sections 400, 414 and 421 of ITTOIA 2005).

16. Paragraph 1(2) repeals tax credits for certain distributions received by companies (or that are treated as the income of a company).

Further amendments in Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005)

17. Paragraphs 2 to 10, 13 to 20 and 55 make consequential amendments following the abolition of the dividend tax credit.

18. Paragraph 11 rewrites section 399 ITTOIA 2005. A non-UK resident person who receives a distribution from a UK resident company is treated as having paid tax on that distribution at the dividend ordinary rate. This amendment makes the consequential adjustments necessary following the abolition of the dividend tax credit. It also restores the meaning of the legislation to what it was before an inadvertent amendment was made under the Tax Law Rewrite project.

19. Paragraph 12 amends section 401of ITTOIA 2005, which provides relief where a person receives a distribution that is linked to an earlier distribution of a special type. The amendment introduces the concept of a "CD distribution", which means a distribution that is only a distribution because of section 1000(1) paragraphs C or D of the Corporation Tax Act 2010 (CTA 2010). The phrase "CD distribution" replaces "non-qualifying distribution", and accordingly "non-CD distribution" replaces the term "qualifying distribution" (see paragraph 26 below).

Further amendments in CTA 2010

20. Paragraphs 21, 24 to 29, 36, 38, 41 to 43 and 60 make consequential amendments following the abolition of the dividend tax credit.

21. Paragraphs 22 and 23 amend sections 279F and 279G of CTA 2010, which use the definition of "franked investment income" to determine when a company has ring fenced income. The concept of franked investment income is repealed (see paragraph 25 below), and a new definition introduced in its place.

22. Paragraphs 30 and 31 make similar amendment to sections 1070 and 1071 of CTA 2010, which deal with distributions made by a company carrying on mutual business.

23. Paragraphs 32 to 35 amend sections 1100 to 1106 of CTA 2010, which set out when a company must provide a certificate following a distribution. The amendments retain the

requirement for a certificate, but remove the obligation to show the dividend tax credit and make minor consequential adjustments.

24. Paragraph 37 replaces "qualifying distribution" with "non-CD distribution" in the definition of "new consideration".

25. Paragraph 39 repeals section 1126 of CTA 2010, the meaning of "franked investment income". This term was used to describe a dividend that had been "franked" with a dividend tax credit.

26. Paragraph 40 repeals section 1136 of CTA 2010, the meaning of "qualifying distribution". A qualifying distribution was one which qualified for a dividend tax credit, meaning a distribution under section 1000(1) but excluding paragraphs C and D.

Other Amendments

27. Paragraph 44 to 57, 59 and 61 to 65 make consequential amendments following the abolition of the dividend tax credit to a number of Acts.

Amendments to Corporation Tax Act 2009 (CTA 2009)

28. Paragraphs 58(1), (3) and (4) make consequential amendments following the abolition of the dividend tax credit.

29. Paragraph 58(2) amends section 1222 of CTA 2009, which deals with reductions in amounts deductible as management expenses. The amendments are similar to those described at paragraph 22 above.

Commencement

30. Paragraph 66 provides for commencement. Various commencement provisions are adapted to the different wording of each provision, but the changes in general apply from 6 April 2016.

Background note

31. The Chancellor announced at the Summer Budget 2015 that the way that dividends are taxed is to be reformed, with a new dividend allowance replacing the existing dividend tax credit. Schedule 1 repeals the dividend tax credit, and makes consequential adjustments. The clause introduces the new allowance

Clause 6: Structure of income tax rates

Summary

1. This clause separates the rates that apply to savings income from the main rates of income tax. It will also create a default rate of income tax on 'non-savings, non-dividends' income (i.e. employment income, pension income, property income and trading income) that will apply to, but is not limited to, trustees and non-resident taxpayers. The measure will take effect from the first tax year for which the Scottish government can set Scottish rates of income tax (anticipated to be the tax year 2017-18).

Details of the clause

2. Subsection (1) provides for amendments to Income Tax Act 2007.
3. Subsection (2) inserts a new Section 9A which provides a simple table overview to income tax rates outlined in Sections 10 to 15.
4. Subsection (3) inserts a new Section 6C which provides that Parliament may determine the default basic, higher and additional rates for each tax year.
5. Subsection (4) inserts a new Section 7A which provides that Parliament may determine the savings basic, higher and additional rates for each tax year.
6. Subsection (5) amends Section 6, subsection 3 so that income tax may be charged at the 'savings' rate and the 'default' rate alongside the other rates specified in the subsection.
7. Subsection (6) amends Section 10, subsection 2 so that it no longer applies to savings.
8. Subsection (8) amends Section 11 to provide that income tax is charged at the default rate for non-individuals, provided that it is not income from savings or dividends.
9. Subsection (9) inserts a new Section 11C which provides for income tax to be charged at the default rates for non-UK-resident individuals, provided that it is not income from savings or dividends or that any other provision provides that a different rate applies (for example, the Scottish rate).
10. Subsection (9) also inserts a new Section 11D, and subsection (10) amends Section 12, subsection 1, to provide for income tax on savings income to be charged at the savings rates.
11. Subsections (7), (11), (12) and (13) amend the new Section 12A to account for the introduction of the default rates.
12. Subsection (14) amends Section 17, subsection 1to provide that the section applies to tax paid at a rate greater than the starting rate for savings on income which is subject to the starting rates for savings.
13. Subsections (15) and (16) amend Sections 55B and 55C to provide for the introduction of the default rate and the savings rate.

14. Subsections (17) and (19) amend Sections 58, subsection 2, and 415, subsections 2 to provide for the adjusted net income or gift aid donations to be grossed up by the basic rate for UK-resident individuals that are not subject to Scottish rates, and by the default rate for non-individuals.

15. Subsection (18) amends Section 414, subsection 2 to provide that gift aid donations are treated as made after deduction of tax at the default rate for non-individuals.

16. Subsection (20) amends Section 828B, subsection 5 to provide that income from duties undertaken non-domiciled individuals is exempt from income tax unless it would be subject to the savings rate, in place of 'the starting rate for savings'.

17. Subsection (21) amends Section 989 to define the default and savings rates.

18. Subsection (22) amends Schedule 4 to include the default basic, higher and additional rates and the savings basic, higher and additional rates in the index.

Details of the clause

19. Subsection (23) makes minor amendments to Section 4, subsections 4 and 5 Taxation of Chargeable Gains Act 1992 to include the default and savings rates as rates at which income tax may be charged.

Background note

20. This measure meets the Government's commitment to ensure that the 'English Votes for English Laws' (EVEL) procedure can apply to the main rates of income tax.

21. In April 2017, the UK Government will devolve the power to set the rates and thresholds that apply to the 'non-savings, non-dividends' income of individuals resident in Scotland to the Scottish Government. The Scottish Parliament will have the final say on Scottish Income Tax.

22. The existing UK-wide main rates of income tax applied to 'non-savings, non-dividends' income will then no longer apply in Scotland. This clause separates out the 'main rates' of income tax that apply to 'non-savings, non-dividend income. This will ensure that the UK's 'main rates' of income tax on 'non-savings, non-dividends' income correspond to the rates that have been created in Scotland, ensuring that English Welsh and Northern Irish MPs can vote for these under the EVEL procedure. This will meet the Government's commitment to have an EVEL vote on income tax.

23. Income tax rates currently apply across the whole of the United Kingdom to non-savings, non-dividend income, dividend income and savings income. This clause amends the Income Tax Act 2007 (ITA) to separate savings income from non-savings, non-dividend income and introduce a default rate of income tax.

24. The rates which currently apply to savings (basic, higher and additional) will be renamed as:

- savings basic rate;

- savings higher rate;
- savings additional rate.

25. The main rates will apply to any individual that is:
    - resident in the United Kingdom;
    - not subject to Scottish income tax.
26. The main rates will apply to all of that individual's taxable income excluding income from:
    - Savings; or
    - Dividends.
27. A Default rate of income tax will be introduced into chapter 2 of part 2 of the ITA.
28. The Default rates will apply to any taxpayer who is
    - an individual that is not resident in the United Kingdom;
    - a non-individual.
29. The Default rates will apply to all of that taxpayer's taxable income excluding income from:
    - Savings; or
    - Dividends.
30. This clause will have effect on and after the tax year appointed by the Treasury under the Scotland Act 2016 being the first tax year for which the Scottish government will have the power to set rates and thresholds for non-savings income tax in respect of Scottish taxpayers. It is anticipated that this tax year will be 2017-18.

Clause 7: Taxable benefits: application of Chapters 5 to 7 of Part 3 of ITEPA

Summary

1. This clause introduces provisions to ensure that the concept of 'fair bargain' does not apply to certain taxable benefits in kind where the charge is based on tax rules specifying how the cash equivalent of that benefit should be calculated. This type of benefit includes beneficial loans, employer-provided living accommodation, and company cars and vans.

2. The legislation clarifies a number of statutory provisions within Part 3 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). There is no change to existing government policy.

Details of the clause

3. Subsection (1) provides for amendments to Part 3 of ITEPA.

4. Subsection (2) inserts new subsection 97(1A) which relates to living accommodation provided by reason of the employment to an employee or a member of their family or household. The effect of this is to ensure such provision is always to be treated as a benefit even where fair bargain applies.

5. Subsection (3) introduces new subsection 114(1A) in respect of cars, vans and related benefits within Chapter 6 of Part 3 ITEPA. This specifies that for the purposes of determining whether the conditions in subsection (1) apply, it is immaterial whether the terms on which the car or van is made available constitute fair bargain.

6. Subsection (4) inserts new section 117 which provides an extended definition of the meaning of "made available by reason of the employment". Subsections (1) and (2) set out the existing provisions. Subsection (3) introduces the circumstances under which provision of a car or van is not made available by reason of the employment. This relates to the hire of a vehicle on the same terms as a member of the public, from an employer whose normal business is to hire cars or vans.

7. Subsection (5) inserts new subsection 173(1A) in respect of employment-related loans. This specifies that for the purposes of determining whether a loan is employment-related, it is immaterial whether the terms of the loan constitute fair bargain.

Background note

8. Chapter 10 of Part 3 of ITEPA imposes a charge to tax where an employment-related benefit is provided to an employee or director by reason of their employment. For the purposes of this Chapter, something which is a 'fair bargain' between the employer and the employee is not a 'benefit'. Fair bargain applies where an employee has received goods or services from their employer at exactly the same cost, terms and conditions as a member of the public or

other independent third party dealing with the employer on an arms-length basis. When this occurs, there is no benefit in kind.

9. The government's policy intention is that the principle of 'fair bargain' does not apply to other benefits chargeable to income tax within Chapters 3 to 9 of Part 3 of ITEPA. For those benefits the amount of the taxable benefit is calculated by reference to the specific charging rules and any payments made by the employee are deducted from that charge.

10. As there has been some uncertainty about the application of fair bargain, legislation is included in Finance Bill 2016 to put this matter beyond doubt. It provides clarification for Chapters 5 to 7 of Part 3. Employees who work for an employer trading in the provision of hire cars to the public will be specifically excluded from the ambit of the legislation. In the circumstances where the employee hires a car from the employer at the same cost and under the same terms and conditions as any member of the public, the provision will not be treated as a benefit in kind.

11. HM Revenue and Customs have been unable to identify any circumstances under which fair bargain provisions might apply to Chapters 3, 4, 8 and 9 of Part 3 of ITEPA.

Clause 8: Cars: appropriate percentage for 2019-20 and subsequent tax years

Summary

1. The appropriate percentage is used to calculate the cash equivalent of the benefit charge for a car. This clause provides for changes to the appropriate percentage bands for cars (including those registered before 1 January 1998 and those without a registered CO2 emissions figure). The effect of the changes is to increase the level of chargeable benefit for taxing company cars for employees and the Class 1A National Insurance contributions (NICs) for employers. The changes have effect for the tax year 2019-20 and subsequent years.

Details of the clause

2. Subsection (1) introduces changes to Chapter 6 of Part 3 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 (taxable benefits: cars, vans and related benefits) which increase the appropriate percentage for cars for the tax year 2019-20 and subsequent tax years.

3. Subsection (2) introduces the changes to section 139 of ITEPA 2003 for cars with a registered CO2 emissions figure.

4. Subsection (3) provides new values for the appropriate percentages for cars with CO2 emissions not exceeding 50 grams per kilometer, for those with emissions between 51 grams and 75 grams per kilometre, and those with emissions exceeding 75 grams but below the relevant threshold (95 grams per kilometre). The relevant threshold is the approved CO2 emissions figure upon which all calculations and bandings for the appropriate percentage are based). Subsection (4) increases the appropriate percentage for the relevant threshold from 20% to 23%. The increases are outlined in the following table.

	Increase in appropriate percentage:	
CO2 emissions figure(grammes per kilometre)	from	to
0 - 50	13 %	16 %
51 - 75	16%	19%
76 - 94	19%	22%
95 (relevant threshold)	20%	23%

5. Subsection (5) introduces changes to the appropriate percentage bands applicable to section 140 ITEPA 2003 for cars without a CO2 emissions figure.

6. Subsection (6) provides the level of the appropriate percentage based on engine capacity for cars which produce CO2 emissions. For engines with a cylinder capacity of 1400 cc or less the appropriate percentage increases from 20% to 23%; and for those with a cylinder capacity of 1401 cc to 2000cc it increases from 31% to 34%.

7. Subsection (7) amends subsection 3(a) to increase the appropriate percentage for cars which cannot emit CO2 under any circumstances by being driven from 13% to 16%.

8. Subsection (8) provides the change to the appropriate percentages for cars first registered before 1 January 1998 under section 142(2). For cars with an internal combustion engine with a cylinder capacity of 1400cc or less the appropriate percentage is increased from 20% to 23%. For cars with an internal combustion engine with a cylinder capacity of 1401 cc to 2000 cc the appropriate percentage increases from 31% to 34%.

9. Subsection (9) provides that these changes have effect for the tax year 2019-20 and subsequent tax years.

Background note

10. Section 139 of ITEPA 2003 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 accessories) provides the level of chargeable benefit for company car tax for employees and Class 1A NICs for employers.

11. From 6 April 2019, the graduated table of bands for taxing the benefit of a company car will provide for a two percentage point increases for cars emitting more than 75 grammes of CO2 per kilometre to a maximum of 37% for cars emitting 200 grammes of CO2 per kilometre or more. There will be a 3 percentage point differential between the 0-50 and 51-75 grammes of CO2 per kilometre bands; and between 51-75 and 76-94 grammes of CO2 per kilometre bands.

12. This will continue to support the wider market for ultra-low emission vehicles (ULEVs) by maintaining lower taxation for ULEVs. At the same time, the increase in appropriate percentages ensures the tax system continues to support the sustainability of the public finances.

13. The Government is committed to legislating over two years in advance of the implementation date so that employers and employees can make informed choices about what type of vehicles they use and future tax implications.

14. Section 140 of ITEPA 2003 sets out the basis for calculating the appropriate percentage for cars without a CO2 emissions figure and all but the highest band have been increased.

15. Section 142 of ITEPA 2003 sets out the basis for calculating the appropriate percentage for cars registered before 1 January 1998 and these have been increased in line with the other changes

Clause 9: Cars which cannot emit CO2: appropriate percentage for 2017-18 and 2018-19

Summary

1. This clause modifies the appropriate percentage for cars without a registered CO2 emissions figure and provides the rate for cars which cannot produce emissions under any circumstances when driven. The changes have effect for the 2017-18 and 2018-19 tax years.

Details of the clause

2. Subsection (1) introduces a change to section 140(3)(a) of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 which increase the appropriate percentage from 7% to 9% for cars with no registered CO2 emissions figure which cannot under any circumstances emit CO2 by being driven.

3. Subsection (2) provides that the changes in subsection (1) have effect for the tax year 2017-18.

4. Subsection (3) introduces a change to section 140(3)(a) of ITEPA 2003 which increases the appropriate percentage for cars falling within this section from 9% to 13%.

5. Subsection (4) provides that the change in subsection (3) have effect for the tax year 2018-19.

Background note

6. Section 140 of ITEPA 2003 sets out the basis for calculating the appropriate percentage for cars without a CO2 emissions figure. Changes to the appropriate percentage for cars which have no registered CO2 emissions figure and which are also incapable of producing such emissions under any circumstances when being driven were not included in the Finance Act 2015 provisions in error.

7. Finance Act 2015 included changes to the appropriate percentage for calculating the cash equivalent of the taxable benefit of a car to apply to the years 2017-18 and 2018-19 and subsequent tax years. This clause rectifies that error.

Clause 10: Diesel cars: appropriate percentage

Summary

1. This clause has the effect of retaining the diesel supplement of 3 percentage points that was to be abolished with effect from 6 April 2016. The decision to retain the diesel supplement was announced at Autumn Statement 2015 and will be legislated in Finance Bill 2016. The provisions of the clause amend section 24 of the Finance Act 2014 so that section 141 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 continues to apply for 2016 -17 and subsequent tax years. Section 141 of ITEPA provides that the appropriate percentage for diesel cars is calculated by adding an additional 3 percentage points to what would otherwise be the appropriate percentage, up to an overall maximum of 37%.

Details of the clause

2. Subsection (1) repeals various subsections of section 24 of the Finance Act 2014. These would have repealed section 141 in its entirety and removed all references to that section from other provisions relating to the computation of the cash equivalent of the car benefit charge. The effect is that section 141 will continue to apply and will not be repealed from 6 April 2016.

3. Subsection (2) explains that those sections which would have been amended or omitted by section 24 of the Finance Act 2014 are in effect unchanged for the tax years 2016-17 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 registered on or after 1 January 1998. A chargeable car benefit arises when an employee is provided by an employer with a car that they can use for their private journeys. For most employees, the cash equivalent of the benefit is calculated by multiplying the appropriate percentage (set by the level of CO2 emissions of the car) by the list price of the car (including VAT and accessories). The cash equivalent of the benefit is treated as earnings of the employee's employment and is subject to income tax at the employee's marginal rate of tax. In addition, employers will pay Class 1A National Insurance contributions. The appropriate percentage for diesel cars ranges from 8% in 2015 -16, but this will increase to 10% from 6 April 2016 for 2016-17 to a maximum appropriate percentage of 37%.

5. Section 140 of ITEPA provides an appropriate percentage for those cars which do not have a CO2 emissions figure and is based on the engine capacity of the car.

6. Section 141 of ITEPA sets out the steps for calculating the appropriate percentage for diesel cars. It provides that for diesel cars, a supplement of 3 percentage points is added to the appropriate percentage calculated by reference to section 139 or 140 up to a maximum.

7. The government announced at Budget 2012 that the diesel supplement would be abolished in April 2016. This was legislated for in the Finance Act 2014.

8. At Autumn Statement 2015, the government announced the diesel supplement was to be retained until the point at which new EU-wide testing procedures come into effect. These procedures aim to ensure that diesel cars meet NO2 and other air quality standards even under strict real world driving conditions. Further provisions to remove the diesel supplement, to take effect from 6 April 2021, are currently expected to be made in a future Finance Bill.

Clause 11: Cash equivalent of benefit of a van

Summary

1. This clause introduces changes to the level of the van benefit charge for company vans which cannot in any circumstances emit CO2 by being driven (zero emission vans). In 2016-17 and 2017-18, the charge will remain at 20% of the full van benefit charge for vans which emit CO2. This is an amendment from 40% of the full charge in 2016-17 and 60% of the full charge in 2017-18. The charge for zero emission vans increases on a tapered basis from 2018-19 until 2022-23, when the full charge comes into effect. The amendment will come into effect on or after 6 April 2016.

Details of the clause

2. Subsection (1) introduces changes to section 155 of the Income Tax (Earnings and Pensions) Act 2003.

3. Subsection (2) extends to 2021-22 the period for which the cash equivalent for zero emission vans is a percentage of the cash equivalent of vans which emit CO2.

4. Subsection (3) replaces paragraphs (b) to (e) in subsection (1C). The charge for zero emission vans remains at 20% of the van benefit charge applying to vans which emit CO2, in 2016-17 and 2017-18. The charge increases subsequently in each year from 20% to 40% in 2018-19; to 60% in 2019-20; to 80% in 2020-21; to 90% in 2021-22; and to 100% in 2022-23. For vans which emit CO2, the full van benefit charge continues to apply. The cash equivalent of the van benefit charge remains £nil where the restricted private use condition is met.

5. Subsection (4) provides that these changes have effect for the tax year 2016-17 and subsequent tax years.

Background note

6. For tax years 2016-17 to 2021-22, the van benefit charge for zero emission vans will be a percentage of the van benefit charge applying to vans which emit CO2, as follows:

- 20% in 2016-17
- 20% in 2017-18
- 40% in 2018-19
- 60% in 2019-20
- 80% in 2020-21
- 90% in 2021-22.

7. From 2022-23, the van benefit charge for zero emissions vans is 100% of the van benefit charge for vans which emit CO_2.

8. The measure supports the uptake of cleaner goods vehicles by retaining the level of the van benefit charge for zero emission vans at 20% of the full charge for a further two years (2016-17 and 2017-18).

9. By tapering the subsequent increase in the van benefit charge for zero emission vans, there will still be an incentive to use zero emission vans so that their production will continue to be encouraged. At the same time, increasing the taxable benefit ensures the tax system continues to support the sustainability of public finances.

10. The government will review the support for zero emission vans at Budget 2018.

Clause 12 and Schedule 2: Sporting testimonial payments

Summary

1. This clause introduces the Schedule which provides income tax charging provisions for income from sporting testimonials for employed sportspersons which are not otherwise chargeable to tax as earnings from an employment. It provides for a new Section 226E in Chapter 12 Part 3 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA) to clarify that such income is to be treated as earnings from the linked employment or former employment.

2. Where there is either a contractual right or a customary expectation that an employee who is or has been a sportsperson receives a sporting testimonial, that income already falls within the charge to tax as earnings from the employment no matter who arranges the testimonial. Section 226E provides for a charge to tax in respect of income from sporting testimonials where no such right or expectation exists for an employed sportsperson.

3. The Schedule introduces a limited exemption from the charge to income tax being introduced under section 226E ITEPA. It provides for a new Section 306B in Chapter 9 Part 4 ITEPA which allows that up to £100,000 of the earnings from a sporting testimonial is not liable to income tax where certain conditions are met.

4. The Schedule also introduces a new Section 996A in Chapter 9 Part 22 Corporation Taxes Act (CTA) 2010 to provide for sporting testimonial payments and associated 'Pay as you Earn' payments to be deductible in calculating the profits chargeable to corporation tax.

5. The Schedule also confirms that sections 226E and 306B ITEPA and 996A CTA 2010 only have effect in relation to a relevant sporting testimonial payments made to an employed, or formerly employed, sportsperson where the sporting testimonial was made public on or after 25 November 2015, and only in respect of payments made out of the proceeds of events held on or after 6 April 2017.

Details of the clause

6. This clause introduces Schedule 2.

Details of the Schedule

7. Paragraph (1) inserts new Section 226E into ITEPA.

8. Subsection (1) provides that new Section 226E applies to individuals who are employed or were formerly employed as professional sportspersons. It does not apply in the context of self-employment as a professional sportsperson.

9. Subsection (2) defines "sporting testimonial" for the purposes of this legislation. Sporting

testimonials may relate to a single event, or may encompass a number of events involving the same 'controller' who will disburse the funds raised.

10. Subsection (3) defines the meaning of "relevant event or activity" by setting out a number of conditions in paragraphs (a) and (b). To be a relevant event or activity the purpose (at least in part) must be to raise funds for the individual (S) and the reason for it must be to recognise service by S as an employed professional sportsperson.

11. Subsections (4) and (5) together provide that an activity consisting solely of inviting and collecting donations will only be part of a sporting testimonial if it is one of a series of events with the same controller. Otherwise, if certain conditions are met, it will not be a sporting testimonial.

12. Subsection (5) says that the conditions are that any person collecting the donations must not be the employed (or formerly employed) sportsperson themselves. Neither can they be a person who is or has been the controller of any other relevant event or activity for the benefit of that sportsperson, or a person either connected with, or acting for or on behalf of that sportsperson or controller. The donations collected must not include any sums paid out of sums raised by any other relevant event or activity. These conditions are to ensure that fund-raising activities forming 'one off' donations that are not part of a sporting testimonial are not caught by section 226E.

13. Subsection (6) provides the meaning of a "sporting testimonial payment", which is defined as a payment, out of money raised for S or for their benefit, made by or on behalf of a 'controller' of a sporting testimonial to an employed (or formerly employed) sportsperson, a member of that sportsperson's family or household, to a 'prescribed person', at the sportsperson's order or otherwise for their benefit, provided that apart from section 226E it does not already constitute taxable earnings of S from an employment.

14. Subsection (7) says that a payment from a sporting testimonial is to be treated as earnings of the sportsperson from the employment, or former employment, with which it is most closely linked.

15. Subsection (8) explains how income from a sporting testimonial is to be treated if S has died. Anything done for the benefit of S's estate is to be regarded as done for S and a payment made to S's personal representatives is treated as a payment to S. Income from a testimonial arranged for the benefit of S's family would not be brought within this section as long as it is not paid to S's estate or to S's personal representatives.

16. Subsection (9) provides several definitions relating to this section. A 'controller' is a person who controls the distribution of payments to, or for the benefit of a sportsperson the money raised from a relevant event or activity forming part of a sporting testimonial. It also explains that payment made in forms other than money is included within the expression 'money' used throughout this section. Finally a 'prescribed person' is a person that has been 'prescribed' in regulations made by H M Treasury.

17. Paragraph (2) introduces new Section 306B into ITEPA.

18. New subsection (1) provides that new Section 306B applies to any sporting testimonial payments which are made out of money raised by a sporting testimonial and treated as earnings by virtue of section 226E. Any other sporting testimonial income will not qualify for the exemption provided by section 306B.

19. Subsection (2) provides that there will be no liability to income tax for payments to which section 306B applies.

20. Subsection (3) introduces the relevant conditions for the exemption to apply.

21. Subsection (4) says that section 306B only applies if the controller of the sporting testimonial is an independent person, and provided that S has not already benefitted from an exemption. It also provides that the section only applies to amounts payable from relevant activities or events that took place within a period of one year beginning with the day on which the first relevant event or activity took place (subject to the transitional provision at subsection (9)).

22. Subsection (5) provides for the maximum level of the exemption to be £100,000.

23. Subsection (6) provides that any part of the exempt amount can apply to sporting testimonial payments spread over several tax years with any amount unused being carried forward to the next tax year.

24. Subsection (7) limits the timing of the availability of the exemption where the professional sportsperson has died, to sporting testimonial payments made during the period of 24 months from the date of death.

25. Subsection (8) explains the meaning of 'independent person' as not being the sportsperson or a person connected with them, an employer or former employer of the sportsperson, or a person acting for, or on behalf of, any of these.

26. Subsection (9) is a transitional condition applicable to the condition at subsection (4). Where the first relevant activity or event in a series takes place before 6 April 2017, the exemption at subsection 5 only applies to payments made out of money raised by relevant activities or events that took place after 5 April 2017.

27. Subsection (11) confirms that the terms used in this section and the same expressions used in section 226E have the same meaning.

28. Paragraph (3) introduces new Section 996A into CTA 2010.

29. Subsection (1) provides that the section applies where a company is the controller of a sporting testimonial and makes a relevant sporting testimonial payment out of money raised by the sporting testimonial. The term "controller in relation to a sporting testimonial" is defined in subsection (9) of section 226E of ITEPA 2003.

30. Subsection (2) defines the term "relevant sporting testimonial payment" for the purposes of section 996A. A "sporting testimonial payment" is defined in subsection (6) of section 226E ITEPA.

31. Subsection (3) provides for a deduction from the company's total profits and details the amounts that constitute the allowable deduction.

32. Subsection (4) details how a deduction is given for the amount determined under subsection (3) and provides that the amount is deducted from the company's total profits for the accounting period in which the relevant sporting testimonial payment is made, and if required by a claim by the company, previous accounting periods.

33. Subsection (5) provides the time limit for making a claim under subsection (4)(b).

34. Subsection (6) provides the order for allowing deductions within an accounting period where a deduction is allowable for relevant sporting testimonial payments made in more than one accounting period.

35. Subsections (7) to (9) provides limits on the amount of the deduction that can be made for an accounting period.

36. Paragraph (4) provides that the new Sections introduced by this schedule only apply where a sporting testimonial has been announced on or after 25 November 2015 for income from events taking place on or after 6 April 2017. This means that for a testimonial year announced on or after 25 November 2015 with events taking place, say, between September 2016 and September 2017, only the payments from events taking place after 5 April 2017 can be taken into account for the exemption to apply. The payments for events taking place before 6 April 2017 will not be subject to the charge to tax under Section 226E.

Background note

37. The current tax treatment of income from sporting testimonials which take place where the employee has neither a contractual right or customary expectation to receive one has been identified as an extra statutory concession which goes beyond the strict statutory provisions.

38. Following consultation, the government announced at the Spending Review and Autumn Statement 2015 (paragraph 3.18), that they would legislate to put the tax treatment of sporting testimonial payments beyond doubt. This legislation is now included in the Finance Bill 2016.

39. Separate provisions are also included in Finance Bill 2016 for a limited income tax exemption, and for relief from corporation tax for deductions made under 'Pay as you Earn' regulations and National Insurance legislation as appropriate, from sporting testimonial payments made to or for employed or former employed sportspersons.

40. The government recognises that sporting testimonial payments are an important aspect in the transition from a career as a professional sportsperson to a new career or retirement, especially for those in the lower echelons of professional sport who might have had more modest incomes, or those who leave their sport through illness or injury.

41. As a result, the government have decided to introduce a 'one off' exemption. This schedule sets out the circumstances in which that exemption can apply. Where income from a sporting testimonial is neither contractual nor customary, an amount of up to a maximum of £100,000 will be exempt from Income tax.

42. The level of this exemption has increased from that announced at Autumn Statement 2015 of £50,000 to take into account representations made during the consultation on the draft legislation. Concerns were raised about the position of sportspersons retiring from their sport due to illness or injury and the retraining costs that can be incurred by them in moving to a new career.

Clause 13: Exemption for trivial benefits provided by employers

Summary

1. This clause introduces a statutory exemption from income tax for trivial benefits in kind (BiKs) provided by employers to employees. BiKs that qualify for the exemption will not incur a charge to income tax nor a liability for National Insurance contributions (NICs), and will not need to be reported to HM Revenue & Customs (HMRC). The exemption is capped at £300 a year where the employer is a close company and the BiK is provided to a director or other office holder of that company. The £300 annual cap also applies where BiKs are provided to an employee who is a member of the family or household of the director or other office holder of a close company. The change comes into effect on and after 6 April 2016.

Details of the clause

2. Subsection (1) provides for the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) to be amended.

3. Subsection (2) inserts new sections 323A to 323C into Chapter 11 of Part 4 of ITEPA 2003 (Miscellaneous Exemptions).

4. New subsection 323A(1) removes the liability to income tax for a BiK provided by, or on behalf of, an employer to an employee or a member of their family or household. It sets out that the income tax liability will only be removed if conditions A to D, set out in subsections (3), (4), (7) and (9), are all met. It also provides that where new subsection (2) applies an additional condition E, as set out in subsection (10), also has to be met.

5. New subsection 323A(2) sets out the circumstances when condition E also has to be met for the exemption to apply. These are where the BiK is provided by an employer that is a close company to an employee who is:

   - a director or other office holder of that company; or
   - a member of the family or household of the director or office holder.

6. New subsection 323A(3) defines Condition A which provides that the exemption applies only if the trivial BiK is not cash or a cash-voucher as defined in section 75 ITEPA 2003.

7. New subsection 323A(4) defines Condition B which provides that the exemption only applies if the cost of providing the BiK does not exceed £50.

8. New subsection 323A(5) defines “benefit cost” for the purposes of determining whether Condition B is met. This is either the cost of providing the BiK or the average cost of doing

so. It also sets out the circumstances in which average cost may be used.

9. New subsection 323A(6) sets out how the average cost per person of any BiK provided to more than one person should be calculated for determining whether Condition B is met.

10. New subsection 323A(7) defines Condition C which provides that the BiK cannot be provided as part of a contractual obligation or relevant salary sacrifice arrangements as defined in new subsection (8).

11. New subsection 323A(8) defines "relevant salary sacrifice arrangements" for the purposes of determining whether Condition C is met.

12. New subsection 323A(9) defines Condition D which provides that the exemption only applies if the BiK is given for a non-work reason, for example, a birthday or social event. It cannot be given in recognition of a job well done, or for any other work related reason.

13. New subsection 323A(10) defines Condition E which provides that in the case of a close company the exemption only applies where:

- the cost of providing the BiK to an employee as defined in subsection (2b); or
- the "benefit cost" allocated to an employee in respect of the BiK provided to a member of the employee's family or household who is not employed by the company;

does not exceed the employee's annual cap, known as the "available exempt amount".

14. New section 323B sets out the details of the annual cap that applies where the employer is a close company and the employee is a director or other office-holder of the employer or a member of the family or household of the director or other office-holder.

15. New subsection 323B(1) defines the meaning of "available exempt amount" for the purposes of new section 323A as the "annual exempt amount" less:

- the total cost of any BiKs that have already been treated as trivial in that tax year in accordance with new subsection 323B(3) and have been provided to the employee; and
- the total costs allocated to the employee in respect of trivial BiKs provided earlier in the tax year to a member of the employee's family or household.

16. New subsection 323B(2) sets the annual exempt amount for the purposes of new subsection 323B(1) at £300.

17. New subsection 323B(3) defines "eligible benefits" for the purposes of new subsection 323B(1).

18. New subsections 323B(4) and (5) set out how to allocate an amount to an employee in respect of a trivial BiK provided to a person who is not an employee but is a member of the employee's family or household. The allocated amount is calculated as the cost of the benefit divided by the number of persons who are:

- directors or other office-holders of the employer;
- employees of the employer and members of the family or household of the directors or office holders; or
- former employees of the employer who have been directors or other office-holders at any time when the employer was a close company; or
- former employees of the employer who are members of the family or household of someone who has been a director or other office-holder at any time when the employer was a close company.

19. New subsection 323B(6) defines the meaning of "benefit cost" for the purposes of new subsection 323B(1) as having the same meaning as in new section 323A.

20. New subsections 323C(1) to (3) provide an affirmative power for HM Treasury to amend by regulations the qualifying conditions in new section 323A, and to make any consequential changes to new section 323B.

21. Subsection (3) adds new sections 323A(4) and 323B(2) to the provisions listed in section 716 ITEPA 2003. Section 716 provides that sums of money specified in those provisions may be increased by an order from HM Treasury. This allows the amounts provided for in sections 323A(4) (cost of providing benefit) and 323B(2) (annual exempt amount) to be amended by Treasury order.

22. Subsection (4) amends section 717(4) to ensure that any regulations made under the new power in new section 323C(1) must be subject to the affirmative resolution procedure.

23. Subsection (5) provides that the exemption is effective from the start of the 2016-17 tax year.

Background note

24. This change has been introduced to provide an exemption from income tax for qualifying trivial benefits in kind where the cost of providing the benefit does not exceed £50. There are special provisions for directors or other office holders of close companies and employees of the same, who are members of their family or household. In these circumstances there is an annual exempt amount of £300.

25. The trivial benefits exemption replaces a concessionary practice, whereby an employer is required to agree with HMRC whether a benefit can be treated as trivial and so not reported to HMRC. A corresponding disregard will be introduced to remove any liability for Class 1 NICs for any qualifying non-cash vouchers provided under the exemption.

Clause 14: Travel expenses of workers providing services through intermediaries

Summary

1. This clause amends the provisions in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) allowing deductions from earnings made for travel and subsistence expenses, but only where a worker is engaged through an employment intermediary. The amended rules come into effect from 6 April 2016.

Details of the clause

Clause 14

2. This clause introduces two new sections (339A and 688B) into ITEPA and a new chapter (Chapter 3B) into Part 4 of the Income Tax (Pay As You Earn) Regulations 2003.

Section 339A

3. Subsection (1) inserts new section 339A into ITEPA.

4. Subsection (1) of section 339A sets out that the section will apply to workers who are personally providing services through an employment intermediary.

5. Subsection (2) of section 339A sets out that where this section applies each engagement a worker undertakes will be considered a separate employment for the purposes of the travel and subsistence rules in sections 338-339 of ITEPA .

6. Subsection (3) of section 339A sets out that the section will not apply when the worker (identified in subsection (1)) does not carry out their work in a manner that is subject to (or to the right of) the supervision, direction or control of another person. In such a case, as the section does not apply, the engagements of that worker will be not regarded as separate employments for the purposes of sections 338-339 of ITEPA.

7. Where the conditions in subsection (4) of section 339A are met, subsection (3) does not apply. As a consequence section 339A will apply even if the worker carries out their work in a manner that is not subject to supervision, direction or control. The condition in paragraph (c) is that the employment intermediary is not a managed services company. Therefore, where the employment intermediary is such a company, subsection (4) does not apply and the worker will need to consider whether they are subject to supervision, direction or control.

8. Where the conditions in subsection (5) of section 339A are met, section 339A does not apply. So each engagement is not regarded as a separate employment. This subsection does not apply where the employment intermediary is a managed service company.

9. Subsection (6) of section 339A sets out modifications to section 50(1)(b) and sections 51 to 53

of ITEPA for the purposes of determining whether the condition in subsection (4)(b) or (5)(b) is met.

10. Subsection (7) of section 339A makes provision for cases where a client or a relevant person provides the employment intermediary with a fraudulent document intended to mislead it into thinking that the manner in which the worker provides the service is not subject to the right of supervision, direction or control. In such a case subsection (8) applies.

11. Subsection (8) of section 339A provides that where the conditions set out in subsection (7) are met, it is the party who provides the fraudulent document which will be liable for the tax which was not deducted as a consequence of the actions of that person.

12. Subsection (9) of section 339A defines "relevant person" for the purposes of subsections (7) and (8).

13. Subsection (10) of section 339A provides that in determining whether the section applies where the parties have entered into arrangements in order to ensure this section does not apply those arrangements are to be disregarded for the purposes of this section.

14. Subsection (11) of section 339A provides a definition of "arrangements" "employment intermediary", "engagement" "excluded services" and "managed service company". The definition of managed service company for the purposes of this section is an extended definition to that in section 61B of ITEPA. As a consequence, for the purposes of section 339A a limited company can receive all of its remuneration as employment income and still be considered a managed service company.

15. Subsection (2) makes a consequential amendment to the definition of "managed service company" in section 688A(5) of ITEPA for the purposes of section 339A of ITEPA, to reflect the definition of that term in section 339A(11) of ITEPA. Section 688A of ITEPA gives the power to make secondary legislation to transfer the debts of a managed service company from that company to specified persons, including the directors of the company.

16. Subsection (3) inserts new section 688B into ITEPA.

17. This section gives HMRC the power to make provision in the Income Tax (Pay As You Earn) Regulations 2003 (the PAYE Regulations) for, or in connection with, the recovery from a director or officer of a company of debt owed as a result of section 339A not being operated correctly.

18. Subsection (4) inserts new regulations 97ZG to 97ZM into the PAYE Regulations.

19. 97ZG and 97ZH define a number of terms for the purposes of Chapter 3B, including "PAYE debt" and "relevant date".

20. Regulation 97ZI provides that where a company has not paid the relevant PAYE debt, by the relevant date, then HMRC may serve a personal liability notice on those who were directors of the company on the relevant date in respect of the relevant PAYE debt.

21. Regulation 97ZJ makes provision in respect of appeals against a personal liability notice served by HMRC under 97ZI.

22. Regulation 97ZK sets out the circumstances in which a personal liability notice can be withdrawn.

23. Regulation 97ZL provides that Part 6 of the Taxes Management Act 1970, which makes provision as to collection and recovery of sums due to HMRC, applies to personal liability notices.

24. Regulation 97ZM makes provision for cases where the amounts paid to HMRC under a personal liability notice exceed the aggregate of the relevant PAYE debt and the specified interest, including payment of interest.

Background note

25. The amendments to ITEPA 2003 have been introduced to ensure the tax system provides a focused relief for travel and subsistence expenses by preventing workers engaged through an employment intermediary, and their employers, from benefiting from relief for home-to-work travel expenses. It is an established principle in the UK tax system that people should not be able to claim relief on their regular commute from home-to-work, therefore this relief is not generally available to other workers

Clause 15: Taxable benefits: PAYE

Summary

1. This clause amends the Income Tax (Earnings and Pensions) Act (ITEPA) 2003, by extending existing powers to enable the Commissioners of HM Revenue & Customs (the Commissioners) to make regulations to collect income tax on vouchers and credit tokens through Pay As You Earn (PAYE).

Details of the clause

2. Clause 15 amends item 1ZA of the list of provisions set out in section 684(2) of ITEPA 2003. The reference in paragraph (a) to specific chapters of Part 3 of ITEPA 2003 is extended to include Chapter 4 of that Part.

Background note

3. Finance Act 2015 inserted item 1ZA in the list of provisions set out in section 684(2) of ITEPA 2003. This introduced new powers for the Commissioners to authorise employers to deduct (or repay) income tax through PAYE on the benefits of a specified kind that they provide to their employees ("payrolling").

4. The power enables the Commissioners to set out what benefits, falling to be charged to tax under any of Chapters 3 and 5 to 10 of the benefits code under Part 3 of ITEPA 2003, an employer can payroll.

5. At Budget 2015 the Chancellor announced that legislation would be introduced to allow employers to payroll vouchers and credit tokens, which are charged to tax under Chapter 4 of Part 3 of ITEPA 3003, from April 2017.

Clause 16 and Schedule 3: Employee share schemes

Summary

1. This clause and Schedule introduce several changes to simplify the tax rules and administrative processes for employee share schemes, including permitting late notification of tax-advantaged share schemes where the taxpayer had a reasonable excuse.

Details of the clause and Schedule

2. Clause 15 introduces Schedule 3.

3. Paragraph 1 amends section 534 Income Tax (Earnings and Pensions) Act 2003 (ITEPA), backdated to 1 October 2014. This amendment allows a company controlled by an Employee Ownership Trust to operate an Enterprise Management Incentive (EMI) scheme.

4. Paragraph 2 introduces amendments to Schedule 2 to ITEPA, which sets out the rules for Share Incentive Plans (SIP) by way of a new Part 10A. A SIP is a tax-advantaged share scheme which must be offered to all employees on a similar basis. A Schedule 2 SIP is one which meets criteria set out in Schedule 2 to ITEPA.

5. New Paragraph 85A within new Part 10A sets out certain events in consequence of which a scheme ceases to qualify as a Schedule 2 SIP. These disqualifying events enforce the principle that preferential shares in a SIP cannot be issued to select employees.

6. New sub-paragraph 85A(7) has the effect that any shares issued prior to the date of the disqualifying event will retain the SIP tax advantages.

7. Paragraphs 3 to 5 amend the rules in Schedules 2, 3 and 4 to ITEPA for SIP, Save As You Earn Option Schemes (SAYE) and Company Share Option Plans (CSOP) respectively. Currently, the rules relating to a SIP, SAYE or CSOP require HM Revenue and Customs (HMRC) to be notified of the scheme by a specified date. Late notification means that the tax advantages will be lost for earlier tax years and will only apply for future tax years. The changes introduce a reasonable excuse provision. If the company or share scheme organiser satisfies HMRC that they had a reasonable excuse for the late notification the tax advantage will not be lost. The provisions also provide a right of appeal against a decision of HMRC that the excuse was not reasonable and impose time limits for making the decision.

8. Paragraph 6 makes changes to Schedule 3 to ITEPA, which sets out the rules for SAYE. Paragraph 7 makes identical changes to Schedule 4 to ITEPA, which sets out the rules for CSOP. These changes provide for HMRC to publish guidance to specify acceptable ways in which a company could value share options by reference to the value at a time before the option was granted. These new provisions remove the need for specific HMRC agreement to the methodology.

9. Paragraph 8 introduces a change to paragraph 39 of Schedule 5 to ITEPA, which sets out the rules for EMI schemes. This will preserve tax advantages of an EMI where minority shareholders in an EMI scheme exercise so-called "tag-along" rights. These are rights in a

takeover to have their share options acquired by the offeror and exchanged for share options in the offeror company. This amendment is backdated to 17 July 2013.

10. Paragraph 9 repeals Part 4 of Schedule 7D to Taxation of Chargeable Gains Act 1992 and makes changes consequential to that repeal. This will ensure that a rights issue which takes place on or after 6 April 2016, in respect of shares received on exercise of an EMI share option, will be treated in the same way for share identification purposes as any other rights issues: the new shares will be treated as acquired at the same time as the original shares.

Background note

11. The clause and Schedule give effect to a number of changes to the rules for employment-related securities (ERS) and ERS options. They take further the government's response to the Office of Tax Simplification report on employee share schemes by simplifying and clarifying the law as well as making some minor technical corrections.

12. There are four types of tax-advantaged employee share schemes.

- Share Incentive Plan (SIP): An employee that obtains shares through a SIP and keeps them in the plan for 5 years will not pay Income Tax or National Insurance on their value. They will not pay Capital Gains Tax on shares they sell if they keep them in the plan until they sell them. An employer can give an employee a limited amount of free shares in a SIP in any tax year. Employees can also buy a limited number of shares to put in the SIP. Matching shares and dividend shares are also available.

- Save As You Earn (SAYE): SAYE is a savings-related share scheme where the employee can buy shares with their savings within the scheme for a fixed price. The interest and any bonus at the end of the scheme is tax-free. The employee does not pay Income Tax or National Insurance on the difference between what they pay for the shares and what they are worth, within certain parameters set out in the legislation.

- Company Share Option Plans (CSOP): In a CSOP an employee may have the option to buy up to £30,000 worth of shares at a fixed price. They do not pay Income Tax or National Insurance contributions on the difference between what they pay for the shares and what they are actually worth when the option is exercised.

- Enterprise Management Incentive (EMI): A company with assets of £30m or less that does not work in certain excluded activities may be able to offer EMIs. In EMIs an employee may be granted an option to buy shares worth up to £250,000 without paying Income Tax or National Insurance on the difference between what they pay for the shares and what they are worth when the option is exercised.

Clause 17 and schedule 3: Securities options

Summary

1. This clause deals with employment related securities options held outside one of the four types of tax-advantaged share schemes. From 6 April 2016 their acquisition or events such as exercise are charged to tax under the rules that deal with securities options, rather than those that deal with earnings.

Details of the clause

2. Subsections (1) and (2) amend section 418 Income Tax (Earnings and Pensions) Act 2003 (ITEPA). Under new sub-section 418(1A), the acquisition of an option, or a chargeable event within the meaning of section 477, (such as the exercise of the option), is now to be charged to tax solely under the rules that deal with securities options, and not under the rules that deal with earnings.

3. Section 227(4) is a list of provisions that confer exemption from liability to income tax in respect of earnings. Subsection (3) provides a minor consequential change by adding sub-section 418(1A) to this list.

Background note

4. This change has been introduced to put beyond doubt the tax treatment in non tax-advantaged schemes of Restricted Stock Units (RSUs). RSUs are arrangements particularly used by companies in the United States to incentivise their employees, including Internationally Mobile Employees (IMEs) over the long term via reward linked to shares and other securities. Under the existing legislation, there is uncertainty regarding whether, on the acquisition of shares under an RSU, the charge to tax is under part of the legislation that deals with income tax on *earnings* or the specific rules that deal with *securities options*. These changes make it clear that the charge to tax will arise under the rules relating to securities options. As a result of these changes the position in relation to National Insurance Contributions (NICs) will also be clarified. Employer's and Employee's NICs liabilities will arise from the RSU award for the period where the IME was subject to UK social security contributions.

Clause 18: Employment income provided through third parties

Summary

1. This clause amends the provisions in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) allowing deductions from earnings made for travel and subsistence expenses, but only where a worker is engaged through an employment intermediary. The amended rules come into effect from 6 April 2016.

Details of the clause

2. This clause introduces two new sections (339A and 688B) into ITEPA and a new chapter (Chapter 3B) into Part 4 of the Income Tax (Pay As You Earn) Regulations 2003.
3. Subsection (1) inserts new section 339A into ITEPA.
4. New subsection 339A(1) sets out that the section will apply to workers who are personally providing services through an employment intermediary.
5. New subsection 339A(2) sets out that where this section applies each engagement a worker undertakes will be considered a separate employment for the purposes of the travel and subsistence rules in sections 338-339 of ITEPA .
6. New subsection 339A(3) sets out that the section will not apply when the worker (identified in new subsection (1)) does not carry out their work in a manner that is subject to (or to the right of) the supervision, direction or control of another person. In such a case, as the section does not apply, the engagements of that worker will be not regarded as separate employments for the purposes of sections 338-339 of ITEPA.
7. Where the conditions in new subsection (4) of section 339A are met, new subsection (3) does not apply. As a consequence new section 339A will apply even if the worker carries out their work in a manner that is not subject to supervision, direction or control. The condition in paragraph (c) is that the employment intermediary is not a managed services company. Therefore, where the employment intermediary is such a company, subsection (4) does not apply and the worker will need to consider whether they are subject to supervision, direction or control.
8. Where the conditions in new subsection (5) of section 339A are met, new section 339A does not apply. So each engagement is not regarded as a separate employment. This subsection does not apply where the employment intermediary is a managed service company.
9. New subsection 339A(6) sets out modifications to section 50(1)(b) and sections 51 to 53 of ITEPA for the purposes of determining whether the condition in subsection (4)(b) or (5)(b) is met.
10. New subsection 339A(7) makes provision for cases where a client or a relevant person

provides the employment intermediary with a fraudulent document intended to mislead it into thinking that the manner in which the worker provides the service is not subject to the right of supervision, direction or control. In such a case new subsection (8) applies.

11. New subsection 339A(8) provides that where the conditions set out in new subsection (7) are met, it is the party who provides the fraudulent document which will be liable for the tax which was not deducted as a consequence of the actions of that person.

12. New subsection 339A(9) defines "relevant person" for the purposes of new subsections (7) and (8).

13. New subsection 339A(10) provides that in determining whether the section applies where the parties have entered into arrangements in order to ensure this section does not apply those arrangements are to be disregarded for the purposes of this section.

14. New subsection 339A(11) provides a definition of "arrangements" "employment intermediary", "engagement" "excluded services" and "managed service company". The definition of managed service company for the purposes of this section is an extended definition to that in section 61B of ITEPA. As a consequence, for the purposes of section 339A a limited company can receive all of its remuneration as employment income and still be considered a managed service company.

15. <u>Subsection (2)</u> makes a consequential amendment to the definition of "managed service company" in section 688A(5) of ITEPA for the purposes of new section 339A of ITEPA, to reflect the definition of that term in new section 339A(11) of ITEPA. Section 688A of ITEPA gives the power to make secondary legislation to transfer the debts of a managed service company from that company to specified persons, including the directors of the company.

16. <u>Subsection (3)</u> inserts new section 688B into ITEPA.

17. This section gives HMRC the power to make provision in the Income Tax (Pay As You Earn) Regulations 2003 (the PAYE Regulations) for, or in connection with, the recovery from a director or officer of a company of debt owed as a result of section 339A not being operated correctly.

18. <u>Subsection (4)</u> inserts a new Chapter 3B into the PAYE Regulations. This comprises new regulations 97ZG to 97ZM.

19. New regulations 97ZG and 97ZH define a number of terms for the purposes of Chapter 3B, including "PAYE debt" and "relevant date".

20. New regulation 97ZI provides that where a company has not paid the relevant PAYE debt, by the relevant date, then HMRC may serve a personal liability notice on those who were directors of the company on the relevant date in respect of the relevant PAYE debt.

21. New regulation 97ZJ makes provision in respect of appeals against a personal liability notice served by HMRC under 97ZI.

22. New regulation 97ZK sets out the circumstances in which a personal liability notice can be withdrawn.

23. New regulation 97ZL provides that Part 6 of the Taxes Management Act 1970, which

makes provision as to collection and recovery of sums due to HMRC, applies to personal liability notices.

24. New regulation 97ZM makes provision for cases where the amounts paid to HMRC under a personal liability notice exceed the aggregate of the relevant PAYE debt and the specified interest, including payment of interest.

25. Subsection (5) provides that the amendments to the PAYE regulation in subsection 94) are deemed to have been made by HM Revenue and Customs.

26. Subsection (6) provides that the new section 339(A) ITEPA 2003 which is introduced by subsection (1) has effect for 2016-17 and later years.

27. Subsection (7) provides that the new PAYE regulations introduced in subsection (4) apply to debts accounted for or paid on or after 6 April 2016.

Background note

28. The amendments to ITEPA 2003 have been introduced to ensure the tax system provides a focused relief for travel and subsistence expenses by preventing workers engaged through an employment intermediary, and their employers, from benefiting from relief for home-to-work travel expenses. It is an established principle in the UK tax system that people should not be able to claim relief on their regular commute from home-to-work, therefore this relief is not generally available to other workers

Clause 19 and Schedule 4: Standard lifetime allowance from 2016-17

Summary

1. This clause amends Finance Act (FA) 2004, as it relates to the lifetime allowance for UK tax relieved pension savings and provides for it to be increased in line with increases in the consumer prices index.

2. The Schedule introduces transitional provisions to protect pension savers affected by this reduction to the lifetime allowance and makes a number of consequential amendments to FA 2004 relating to the reduction in the lifetime allowance.

Details of the clause and schedule

Clause 19

3. Subsection (2) replaces sections 218(2) and (3) FA 2004 to provide for the standard lifetime allowance to be £1,000,000 for the tax year 2016 to 2017 onwards and replaces the power to make regulations at section 281(3) with a requirement for the Treasury to make regulations before the start of tax year 2018-19 and each subsequent tax year, specifying the amount of the standard lifetime allowance for the year. The amount of the standard lifetime allowance will be, where the consumer prices index (CPI) for the year to the previous September is higher than it was 12 months earlier, the standard lifetime allowance for the earlier year, increased by CPI, but rounded up to the nearest £100. If CPI is not higher in that 12 month period, then the standard lifetime allowance for the tax year will be same as the standard lifetime allowance for the previous tax year.

4. Subsection (3) inserts new subsections 5BC and 5BD into section 218 of FA 2004.

5. New subsection 5BC provides that where an individual has a lifetime allowance enhancement factor under sections 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), and the event giving rise to the lifetime enhancement factor occurs between 6 April 2014 and 5 April 2016, then in calculating the individual's lifetime allowance the lifetime allowance enhancement factor is multiplied by £1,250,000 if this is greater than the standard lifetime allowance at the time the benefit crystallisation event ("BCE") occurs.

6. New subsection 5BD provides the order of precedence where an individual has more than one lifetime allowance enhancement factor.

7. Subsection (4) inserts new subsection 5E into section 218 FA 2004, which provides for the reference to the standard lifetime allowance to be replaced by a figure of £1,250,000 where certain lump sum death benefits are paid (a 'benefit crystallisation event 7' occurs) on or after 6 April 2016 in respect of the death of the individual in either tax year 2014-15 or 2015-

16.

8. Subsection (6) inserts new subsection 3 into section 282 FA 2004. Subsection 3 provides that regulations made under the power in subsection 2D of section 218 FA 2004 are not subject to affirmative resolution procedures before the House of Commons.

9. Subsection (7) provides for the amendments made in subsections 2 to 4 of this clause to have effect for the tax year 2016-17 onwards.

10. Subsection (8) introduces the Schedule which contains provision for transitional protection from the lifetime allowance charge.

Schedule 4

Part 1: Fixed Protection 2016

11. Part 1 introduces a new type of transitional protection ("fixed protection 2016") for individuals who believe they may be affected by the reduction in the lifetime allowance from 6 April 2016.

12. Paragraphs 1 and 2 set out that individuals with fixed protection 2016 will have a protected lifetime allowance of £1.25 million and the general conditions of when this protection will apply. Individuals with any of fixed protection under paragraph 14 of Schedule 18 to FA 2011, fixed protection 2014 under paragraph 1 of Schedule 22 to FA 2013, primary protection or enhanced protection at any date on or after 6 April 2016 will not be able to hold fixed protection 2016 at that date, as these other transitional protections, if maintained, will always provide the individual with a higher protected lifetime allowance..

13. Paragraph 3 sets out certain events known as "protection-cessation events". Where any of these events occur on or after 6 April 2016, the individual will not be entitled to fixed protection 2016 from the date of the event. The events are:

   - where there is benefit accrual (as defined in paragraph 4);
   - where there is an impermissible transfer (as defined in paragraph 5);
   - where there is a transfer of sums or assets that is not a permitted transfer (as defined in paragraph 6);
   - where a new pension arrangement relating to the individual is made otherwise than in permitted circumstances (as defined in paragraph 7).

14. Subparagraph 4(1) provides definitions of benefit accrual for each type of arrangement and that for money purchase arrangements other than cash balance arrangements, any relevant contribution will mean there is benefit accrual.

15. Subparagraphs 4(2) and (3) provide 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.

16. Subparagraph 4(4) provides a definition of when a relevant contribution is paid.

17. Subparagraph 4(5) provides that increases in an individual's rights under an arrangement

are to be ignored for the purposes of determining whether benefit accrual has occurred if they don't exceed the relevant percentage in a tax year. This applies for defined benefits and cash balance arrangements as well as hybrid arrangements where the benefits to be provided may be defined benefits or cash balance benefits.

18. Subparagraph 4(6) provides that the relevant percentage is an annual rate of increase specified in the scheme rules (predecessor scheme rules if this is more favourable to the individual) as at 9 December 2015, plus any relevant statutory increase percentage as defined in paragraph 4(8) that may apply. Where there isn't a rate of increase specified in the scheme rules, the relevant percentage is either the annual percentage increase in the consumer prices index ('CPI') for September in the previous tax year, or if it is higher, the relevant statutory increase percentage.

19. Subparagraph 4(7) provides a definition of "predecessor arrangement" and "predecessor registered pension scheme".

20. Subparagraph 4(8) provides a definition of "relevant statutory increase percentage ".

21. Subparagraph 4(9) provides that paragraph 4(10) applies when the individual's rights are under a deferred annuity contract and that contract limits increases in rights to annual increases in the retail prices index (RPI).

22. Subparagraph 4(10) provides that where paragraph 4(9) applies, the relevant percentage in subparagraph (6)(b)(i), which allows for CPI increases, is replaced by the annual rate of increase in the value of the individual's rights during the tax year.

23. Subparagraph 4(11) provides further detail on the calculation of the annual increase in RPI for the purposes of paragraph 4(9).

24. Paragraph 5 defines impermissible transfers.

25. Paragraph 6 defines permitted transfers.

26. Paragraph 7 defines permitted circumstances.

27. Subparagraph 8(1) provides that paragraph 3 applies in relation to individuals who receive UK tax relief on pension savings in non-UK schemes, as if the non-UK scheme were a registered pension scheme, but that this is subject to sub-paragraphs (2) to (4).

28. Subparagraph 8(2) provides that where the individual has an arrangement under a non-UK pension scheme, then the definition of benefit accrual is set out in sub-paragraphs (3) and (4) for the purposes of paragraph 3(a), and paragraph 4(1) does not apply.

29. Subparagraph 8(3) provides that benefit accrual occurs at the end of the tax year where the pension input amount for a tax year is greater than nil.

30. Subparagraph 8(4) provides that there is also benefit accrual if an individual takes some or all of their benefits during a tax year and the pension input amount for the period up to the time the benefits were taken is greater than nil.

Part 2: Individual Protection 2016

31. Part 2 introduces a further type of transitional protection for those who think they may be affected by the reduction in the lifetime allowance from 6 April 2016. This is known as

individual protection 2016.

32. Paragraph 9 sets out who can rely on individual protection 2016, how their pension rights are valued and the level of protected lifetime allowance that they will be entitled to.

33. Subparagraph 9(1) provides that individuals can rely on individual protection 2016 if they have pension rights (their "relevant amount"), as defined in paragraph 9(4) of greater than £1 million on 5 April 2016 and they do not have primary protection as set out in paragraph 7 of Schedule 36 to FA2004, and they have a reference number issued by HMRC for the purposes of sub-paragraph 2.

34. Subparagraph 9(2) provides that where an individual has individual protection 2014 their standard lifetime allowance is the greater of their relevant amount (subject to an overall limit of £1.25 million) and the standard lifetime allowance at that time.

35. Subparagraph 9(3) provides a definition of relevant arrangement for the purposes of paragraph 9(1).

36. Subparagraph 9(4) defines the relevant amount as the sum of amounts A to D which are defined in paragraphs 10 to 13. This is the value on 5 April 2016 of the individual's pensions in payment plus their pension savings, not yet taken, that have benefited from UK tax relief.

37. Subparagraph 9(5) provides that where an individual who has notified HMRC that they intend to rely on individual protection 2016 has one of five specified existing protections, individual protection 2014 does not apply for so long as the existing protection continues to apply.

38. Subparagraphs 9(6) to (9) deal with the position where the pension rights of an individual with individual protection 2016 are subject to a pension debit, as a result of the sharing of the individual's pension rights following a divorce, on or after, 6 April 2016. In such a case, the individual's relevant amount is reduced by the amount of the debit. However, for individual protection 2016 purposes the amount of debit is reduced by 5 per cent for each complete tax year between 5 April 2016 and the date of the pension debit. The reduction is intended to reflect any increase in the individual's total pension rights between 5 April 2016 and the time of the pension debit. Where the individual's relevant amount is reduced below £1 million as a result of the pension debit, they will no longer be entitled to rely on individual protection 2016.

39. Paragraph 10 sets out how to calculate amount A, which is the value of the pensions that the individual was receiving on 6 April 2006 (A-day), which is the day when Finance Act 2004 including the lifetime allowance first applied from.

40. Subparagraphs 10(2) to (5) apply where a BCE has occurred, in respect of the individual on or before 5 April 2016, for example when an individual has taken some of their pension benefits. In this case Amount A is 25 times the annual rate of the pre A-day pension immediately before the BCE, multiplied by a factor of £1.25 million (the standard lifetime allowance for 2014-15) over the standard lifetime allowance at the date of the BCE. The factor is applied to take account of any change in the standard lifetime allowance since the BCE, so that that percentage of the standard lifetime allowance used up by the pre A-day pension is the same on 5 April 2016 as it was on the date of the BCE.

41. Subparagraphs 10(6) and (7) apply where no BCE has occurred in respect of the individual since A-day, in which case amount A is 25 times the annual rate at which the pre A-day pension is payable on 5 April 2016.

42. Subparagraphs 10(8) and (9) define expressions used in sub-paragraphs (2) to (7).

43. Paragraph 11 sets out how to calculate amount B, which is the value of any BCEs in respect of the individual occurring on or before 5 April 2016. Amount B is the aggregate of the value of each BCE, multiplied by a factor of £1.25 million (the standard lifetime allowance for 2015-16) over the standard lifetime allowance at the date of the BCE.

44. Paragraph 12 sets out how to calculate amount C, which is the value of any uncrystallised pension rights that the individual has in a registered pension scheme on 5 April 2016. Amount C is calculated In accordance with the method set out in section 212 of Finance Act 2004.

45. Paragraph 13 sets out how to calculate amount D, which is the value of any uncrystallised pension rights that the individual has under relieved non-UK pension schemes on 5 April 2016. To calculate amount D, it is assumed that there is a BCE in respect of those rights at that date and the amount that would have been crystallised in accordance with paragraph 14 of Schedule 36 to Finance Act 2004.

Part 3: Reference numbers

46. Part 3 sets out when a valid application for fixed protection 2016 or individual protection 2016 is made, and the issue by HM Revenue and Customs (HMRC) of a reference number that the individual can use to prove that they are entitled to that protection when they take any benefits on or after 6 April 2016.

47. Paragraph 14 makes provision for individuals to apply for a reference number, and the form of that application, for fixed protection 2016 and individual protection 2016, and for HMRC to issue a reference number.

48. Subparagraph 14(1) defines that an individual has a reference number for the purposes of fixed protection 2016 or individual protection 2016 if one has been issued by HMRC and it has not been withdrawn.

49. Subparagraph 14(2) defines the form of the reference number and when it will be issued.

50. Subparagraph 14(3) sets out what information is required in order for an application to be a valid application.

51. Subparagraph 14(4) requires HMRC to notify the individual if their application for a reference number for fixed protection 2016 or individual protection 2016 is unsuccessful or, in the case of individual protection 2016 the application was successful but a reference number is not being issued because the protection is dormant.

52. Subparagraph 14(5) defines the terms relevant arrangement, appropriate amount and transfer day for the purposes of paragraph sub-paragraph (3)(f)(iii).

53. Subparagraph 14(7) defines what is meant by "dormant basis" for the purposes of individual protection 2016, that is the application would have been successful but for the fact that the individual held another form of transitional protection at the time of the

application. Where an application is on a dormant basis, should the other protection become invalid, then the individual protection 2016 will cease to be dormant and a reference number will be issued.

54. Subparagraph 14(8) sets out the prior provisions which would result in the dormant basis.

55. Paragraph 15 sets out the circumstances in which HMRC may withdraw a reference number and requires HMRC to tell the individual the reasons for doing so.

56. Paragraph 16 provides for an appeal against the non-issue or the withdrawal of a reference number.

57. Paragraph 17 sets out the requirement for individuals who have a reference number, or a pending application for a reference number, for the purposes of fixed protection 2016 or individual protection 2016 to notify HMRC within 90 days if a protection-cessation event, as set out in paragraphs 3 to 8, occurs. Paragraph 17(3) sets out when an application is pending for the purposes of this paragraph, which is intended to cover the period between an application being submitted and a decision being made by HMRC, or where there is an appeal against a decision by HMRC.

58. Paragraph 18 sets out the requirement for individuals who have a reference number, or a pending application, for the purposes of individual protection 2016, to notify HMRC within 60 days if they receive a discharge notice related to a pension debit. Paragraph 18(3) defines what a discharge notice is.

59. Paragraph 19 provides for personal representatives of deceased individuals to be able to apply for fixed protection 2016 and individual protection 2016.

60. Paragraph 20 amends the table in section 98 of the Taxes Management Act 1970 (TMA70) to add paragraphs 17 and 18 of this Schedule to column 2 of the table. This means that where an individual fails to comply with the requirements in either paragraph 17 or 18, then the penalties as set out in section 98(1)(b) and (2) TMA70 apply, This includes a penalty of up to £300 where required information is not provided.

Part 4: Information

61. Part 4 sets out the information requirements in connection with fixed protection 2016 and individual protection 2016 through changes to existing secondary legislation.

62. Paragraph 21 sets out that individuals who have a reference number for the purposes of individual protection 2016 are required to preserve the documents that have been used in the calculation of their relevant amount, for 6 years from the date of application for the reference number.

63. Paragraphs 22 to 25 make various amendments to The Registered Pension Schemes (Provision of Information) Regulations 2006 (S.I. 2006/567) to include references to fixed protection 2016 and individual protection 2016. These changes ensure that where an individual relies on fixed protection 2016 or individual protection 2016 then similar information is required to be provided by the member to the scheme administrator and from the scheme administrator to HMRC as for the similar existing lifetime allowance protection regimes.

64. Paragraph 26 inserts new paragraph 14C into S.I. 2006/567 which sets out that, if the

member requests it and as long as the request is received by the scheme administrator before 6 April 2020, scheme administrators of registered pension schemes are required to provide information, to enable a member to calculate their relevant amount. . Scheme administrators may, if they so choose, provide this information for requests received after this date but there is no requirement to do so.

Part 5: Amendments in connection with protection of pre-6 April 2006 rights

65. Part 5 sets out changes to FA2004 in respect of primary protection and enhanced protection to ensure that certain individuals with one of these protections are able to receive the right amount of tax free lump sums intended by legislation.

66. Subparagraph 28(1) amends paragraph 2(10) of Schedule 29 to FA 2004 and applies where an individual has primary protection under paragraph 7 of Schedule 36 to FA2004 or enhanced protection under paragraph 12 of Schedule 36 to FA2004, but no lump sum protection. In these circumstances, if the member becomes entitled to a pension commencement lump sum after 6 April 2014, when making the adjustment to the relevant amount for a previous BCE that also occurred after 6 April 2014, where £1.5 million is greater than the standard lifetime allowance at the time of the previous BCE, PSLA (the standard lifetime allowance at the time of the earlier BCE) is treated as being £1.5 million.

67. Subparagraph 28(2) amends paragraph 28(3) of Schedule 36 to FA 2004 and applies where an individual has primary protection under paragraph 7 of Schedule 36 to FA 2004 with lump sum protection. If this applies, where more than one BCE occurs after 6 April 2012, and a further BCE occurs on or after 6 April 2014, the definition of PSLA for the purposes of revaluing the earlier BCEs is the greater of £1.8 million and the standard lifetime allowance at the time the individual became entitled to the lump sum.

Part 6: Interpretation and Regulations

68. Part 6 sets out the interpretation of expressions used in the Schedule and provides a power to make regulations amending Parts 1, 2 and 3 of the Schedule.

69. Paragraph 31 provides power to make changes to Parts 1, 2 and 3 of this Schedule by regulations. Such regulations may be retrospective providing they do not increase any person's liability to tax and do not have effect before 6 April 2016.

Background note

70. Individuals can save as much as they like in a registered pension scheme subject to overall limits on the amount of tax relief their pension savings can benefit from. These limits are the lifetime and annual allowances. The lifetime allowance is the maximum amount of pension and/or lump sum that an individual can take from pension schemes that benefit from UK tax relief, including any tax relieved savings the individual has in a relieved non-UK pension scheme.

71. When an individual becomes entitled to their pension benefits, these benefits are tested to see if they exceed the individual's lifetime allowance. If they do, the excess is subject to the lifetime allowance charge. The rate of the charge will depend on how the individual takes

their benefits. Any amount over the lifetime allowance taken as a lump sum is taxable at 55%, whilst any amount taken as a pension is taxable at 25%, and the income will be taxable at the individual's marginal rate.

72. The Government announced at March Budget 2015, and confirmed at Summer Budget 2015, that legislation would be introduced to reduce the standard lifetime allowance to £1 million for the tax year 2016 to 2017 onwards. It also announced that two transitional protections would be introduced to protect individuals from potentially retrospective tax charges arising from the reduction.

73. Clause 19 and Schedule 4restrict tax relief for pension savings by reducing the level of the lifetime allowance provided for in section 218 of FA2004.

74. The level of the standard lifetime allowance is reduced to £1 million with effect from 6 April 2016. Two new transitional protections 'fixed protection 2016' and 'individual protection 2016' come into force on the same date. Individuals with fixed protection 2016 have a lifetime allowance of the greater of £1.25 million and the standard lifetime allowance. Individuals with individual protection 2016 will have a lifetime allowance of the greater of the value of their pension savings at 5 April 2016, subject to an overall maximum of £1.25 million, and the standard lifetime allowance.

75. The Schedule also makes a number of consequential changes to the existing pensions legislation in FA2004.

Clause 20: Pensions bridging between retirement and state pension

Summary

1. This clause removes existing legislation at paragraph 2(4)(c) of Schedule 28 of the Finance Act 2004 regarding bridging pensions. In place of this provision, regulations will be made under paragraph 2(4)(h) of Schedule 28 in connection with bridging pensions to align pensions tax legislation with the Pensions Act 2014 and allow the payment of bridging pensions to continue as set out in current legislation.

Details of the clause

2. Subsection (1) provides that the clause amends paragraph 2 of Schedule 28 of the Finance Act 2004.

3. Subsection (2) omits sub-paragraph (4)(c) which sets out the current circumstances in which a scheme pension may be reduced when a bridging pension ceases to be paid.

4. Subsections (3) to (5) are consequential amendments to the omission of sub-paragraph (4)(c).

5. Subsection (6) provides for the amendments made by subsections (2) to (5) to be commenced by regulations made under paragraph 2(4)(h) and that pursuant to paragraph 2(8), will have effect from 6 April 2016.

Background note

6. A pension from a registered pension scheme is not normally allowed to be reduced when in payment. There are some exceptions to this rule, one of which is where a bridging pension is being paid. A bridging pension describes a pension that is higher at the outset and then reduced when the individual reaches state pension age.

7. The Department for Work and Pensions introduced a single tier state pension from 6 April 2016. This clause supports the Government's objective of promoting fairness in the tax system by ensuring that pension schemes can continue to pay a bridging pension up to a member's state pension age following the introduction of the single tier state pension.

8. HM Revenue and Customs will consult with industry representatives on the drafting of new regulations and to clarify the exact implications of the single tier state pension on the legislation relating to bridging pensions.

Clause 21: Dependants' scheme pensions

Summary

1. This clause introduces exceptions from the anti-avoidance calculations that must otherwise be carried out in respect of annual increases in dependants' scheme pensions where an individual who was entitled to a scheme pension, dies having reached age 75. The change has effect on or after 6 April 2016.

Details of the clause

2. Subsection 2 provides that application of the limits in paragraphs 16B and 16C of Schedule 28 to the Finance Act (FA) 2004 operates subject to the provisions of new paragraphs 16AA and 16AB of Schedule 28.

3. Subsection 3 inserts new paragraphs 16AA to 16AE of Schedule 28.

4. New paragraph16AA provides when the anti-avoidance calculations in paragraphs 16B and 16C of Schedule 28 do not apply.

5. New paragraph 16AA(a) provides that the calculations relating to dependants' scheme pensions in paragraphs 16B and 16C do not have to be carried out if, under the scheme, the only tests against the member's lifetime allowance were on unused funds in a money purchase arrangements when they reached age 75 (benefit crystallisation event 5B).

6. New paragraph 16AA(b) provides that the calculations relating to dependants' scheme pensions in paragraphs 16B and 16C do not have to be carried out if the member had enhanced protection at the time of their death.

7. New paragraph 16AB provides that the calculations relating to dependants' scheme pensions in paragraphs 16B and 16C do not have to be carried out while the total of the amounts payable from a scheme as dependants' scheme pensions in respect of a member are less than either the general limit as defined in new paragraph 16AC, or the personal limit as defined in new paragraph 16AD.

8. New paragraphs 16AC provides that the general limit for 2016-17 is £25,000 and a formula for it to be increased for future years.

9. New paragraph 16AD defines the personal limit as the total of the annual rate of the member's scheme pensions, both in payment and to which they were entitled but not yet in payment, in the year that they died. It also provides a formula for this to be increased for future years.

10. New paragraph 16AD(5) ignores the amount by which an individual's pension under a public service pension scheme had been reduced in their lifetime. This ensures the amount of the reduction is added back when determining the maximum rate of the dependants' scheme pensions.

11. New paragraph 16AE provides that the rate at which the personal limit and the general

limit should be increased is the highest of 5%, the annual increase in the retail prices index or the annual increase in the consumer prices index.

12. Subsection 4 amends paragraph 16B of Schedule 28 to allow for the value of tax free lump sums taken before death to be uprated when calculating the maximum dependants' scheme pension.

13. Subsection 5 amends paragraph 16C of Schedule 28 to make some minor corrections.

14. Subsection 5(c) amends the 'excepted circumstances' in paragraph 16C(4) so that increases to the rate of dependants' scheme pensions are authorised if that rate is the same as that of at least 20 other members of the pension scheme.

15. Subsection 6 provides that the amendments come into force on 6 April 2016. Subsections 6 and 7 also set out that the changes will apply to the calculations in paragraphs 16B and 16C of Schedule 28 where the last day of the post-death year and the last day of the 12 months in question respectively, falls on or after 6 April 2016.

Background note

16. This clause has been introduced to make the administration of dependants' scheme pensions simpler, and to support the Government's policy to reduce the administrative burden on UK industry.

17. If an individual who is a member of a registered pension scheme and in receipt of a scheme pension or prospectively entitled to a scheme pension dies with dependants, then dependants' scheme pensions may be payable.

18. If the individual started to take the pension from 6 April 2006 onwards and had reached age 75 at the time of their death, any dependants' scheme pensions have to be tested annually against the amount of the member's scheme pension, regardless of the size of the member's pension savings or the dependants' scheme pensions. Where a part of the dependants' pension is in excess of the permitted maximum for that year, the excess is taxed as an unauthorised payment. This ensures excessive amounts from the member's pension savings cannot be set aside to pay benefits for dependants in order to avoid the member paying a lifetime allowance charge.

19. This clause introduces exceptions from the tests of dependants' scheme pensions for low value pensions and where the risk of abuse is low.

Clause 22 and Schedule 5: Pension flexibility

Summary

1. This clause and Schedule amend Part 4 of Finance Act (FA) 2004. They make various minor changes to ensure that the pension flexibility changes introduced from 6 April 2015 operate as intended. They make changes to the tax rules for serious ill-health lump sums, charity lump sum death benefits, dependants' with drawdown pension funds and flexi-access drawdown funds where the dependant reaches age 23, trivial commutation lump sums and dependants' death benefits under cash balance arrangements. The changes will have effect on the day after Royal Assent to Finance Bill 2016.

Details of the clause and Schedule

Serious ill-health lump sums

2. Paragraph 1 amends the taxation of serious ill-health lump sums to remove the 45% charge and replace with a charge at the recipient's marginal rate, where the individual is over 75.

3. Paragraph 1(2) deletes section 205A of FA 2004 which had applied a 45% serious ill-health lump sum charge on taxable serious ill-health lump sums

4. Paragraphs 1(3) and (4) amend the definition of serious ill-health lump sum in paragraph 4 of Schedule 29 to FA 2004 (Schedule 29) to allow a lump sum to be paid out of unused funds in a drawdown fund.

5. Paragraph 2 amends section 636A of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 so that a taxable serious ill-health lump sum is taxed as a pension paid under a registered pension scheme, and therefore subject to the recipients marginal rate of tax.

6. Paragraph 3 contains minor and consequential amendments to FA 2004 and other Acts that flow from this new legislation.

7. Paragraph 4 provides that these changes apply to any serious ill-health lump sum paid from the day after this Schedule receives Royal Assent.

Charity lump sum death benefits

8. Paragraph 5 amends paragraph 18(1A) of Schedule 29 to allow payment of a charity lump sum death benefit from uncrystallised funds in respect of a member who had not reached age 75 at the time of their death.

Dependants' flexi-access drawdown funds

9. Paragraph 6 amends the conditions that must be met for a drawdown fund to be a dependants' flexi-access drawdown fund or a dependants' drawdown fund to enable dependants' with these type of funds who would currently have to use all of this fund before age 23, to be able to continue to access these funds as they wish after their 23rd birthday

10. Paragraph 6(2) amends paragraph 15 of Schedule 28 to FA 2004 (Schedule 28) to extend the

meaning of dependant in certain circumstances to include a child who has reached age23.

11. Paragraph 6(3) amends paragraph 20 of Schedule28 and paragraph 6(4) amends paragraph 21 of Schedule 28 to use the extended meaning of dependant for dependants' short-term annuities and dependants' income withdrawal respectively.

12. Paragraph 6(5) amends the meaning of dependants' drawdown pension fund in pargraph22 of schedule 28 so that a recipient may be a dependant under the extended meaning.

Trivial commutation lump sum

13. Paragraph 7(2) amends paragraph 7(1)(aa) of Schedule 29 to allow a scheme pension to be paid as an authorised payment where it is commuted to be a trivial commutation lump sum.

14. Paragraph 8 amends section 636B of ITEPA 2003 in respect of a lump sum paid out of uncrystallised rights.

15. Paragraph 8(2) inserts new subparagraph (aa) in section 636B(3) of ITEPA 2003 to ensure that only 75% of rights that have not been accessed (uncrystallised rights) are taxed, even when they are paid together with crystallised rights. This aligns the tax treatment with lump sums that are paid entirely out of uncrystallised rights.

Top-up of dependants' death benefits

16. Paragraph 10 inserts new sub-paragraph (2A) into paragraph 15 of Schedule 29. This allows employers to top up the amount of any shortfall in funds in a promised uncrystallised funds lump sum death benefit in a cash balance arrangement at the time of the member's death. The top up can only be made in respect of a shortfall at the time of the death.

Inheritance tax as respects cash alternatives to annuities for dependants etc

17. Paragraph 11 amends section 152 of the Inheritance Tax Act 1984 to provide that where an annuity is payable on death to a nominee, and some or all of the cost of the annuity could instead have been paid to a personal representative, those funds shall not form part of that person's chargeable estate for inheritance tax purposes.

Background note

18. Schedule 5makes changes to pensions tax rules to remove some unintended consequences that arose following the introduction of pension flexibility in the Taxation of Pensions Act 2014.

19. The changes were announced at Budget 2016. They relate to:

- Serious ill health lump sums
- Dependant's flexi-access drawdown benefits;
- Charity lump sum death benefits;
- Trivial commutation of money purchase scheme pensions in payment;
- Top-ups to dependants' death benefits.

20. The introduction of pension flexibility has meant that people are able to access part of their pension savings more easily and leave the remainder to a later date. These changes ensure that these particular payments can be paid and taxed as intended, as well as giving individuals more flexibility in how they want to use their pension funds.

Clause 23: Netherlands Benefit Act for Victims of Persecution 1940-1945

Summary

1. This clause exempts from income tax payments to individuals made by the Netherlands government under the 'Wet uitkeringen vervolgingsslachtoffers 1940 - 1945' (Wuv) scheme.

Details of the clause

2. Subsection (1) inserts new Section 642A to the Income Tax (Employment and Pensions) Act (ITEPA) 2003, which provides that any payments received by individuals under the Wuv scheme will be exempt from income tax.

Background note

3. The Netherlands' Wuv scheme makes payments to eligible individuals that were victims of persecution in Europe or Asia during the Second World War. In order to benefit from the scheme, recipients must either have had Dutch nationality, have been a Dutch subject or persecuted on Dutch territory and later acquired Dutch nationality.

4. Payments from the Netherlands government through the scheme are currently included in the calculation of an individual's income tax liability.

5. In April 2014, an Upper Tribunal Administrative Appeal Chamber ruled on a Housing Benefit claim, where a victim of National Socialist persecution who received payments from a Netherlands scheme contended that the failure to treat the payments in the same way as pensions and annuities from Germany or Austria amounted to unlawful discrimination.

6. This measure will therefore bring payments to victims of national-socialist and Japanese aggression, made through the scheme, into line with those made by the Federal Republic of Germany or Austria by removing the income tax liability of those payments.

7. The exemption from income tax of any such payment will apply from April 2016.

Clause 24: Fixed-rate deductions for use of home for business purposes

Summary

1. This clause introduces amendments to the simplified expenses provisions contained in the Income Tax (Trading and Other Income) Act (ITTOIA) 2005. The purpose of the amendments is to clarify how those provisions should be applied for partnerships in respect of the use of home and where business premises are also a home.

Details of the clause

2. Clause 24 introduces amendments to Chapter 5A, Part 2 of the Income Tax (Trading and Other Income) Act 2005 - sections 94H and 94I.

3. Subsections (3) and (6) amend subsections (1) and (5) of section 94H ITTOIA 2005 to ensure that, when considering a home used for the purposes of a trade, then the provision applies to a partner's home in the same way as it does to an individual's home.

4. Subsection (4) amends subsection (4) and Subsection (5) introduces new subsections (4A) and (4B) to section 94H to define qualifying work. The new subsections also ensure that where work is undertaken by more than one individual in the home, then any hour spent wholly and exclusively for the purposes of the trade is counted only once.

5. Subsection (7) introduces a new subsection (5A) to section 94H to ensure that, when a firm makes a claim to use a simplified expense deduction for a partner's home, it must consistently use the same rules for deductions for other partners' homes.

6. Subsections (8) and (9) amend section 94I(1)(b) to ensure that where premises are used, both as a home and as business premises, the provisions apply equally to situations where it is a partner that occupies the premises as a home.

7. Subsection (10) introduces a new subsection (6A) to section 94I. This is to ensure that where an individual or partnership has more than one premises, that are used both for business and as a home, then any claim to use the simplified expense deduction in respect of the expenses of these premises must be applied to all such premises.

8. Subsection (11) confirms that the amendments introduced by this clause will apply for the tax year 2016-17 and subsequent years.

Background note

9. The government is committed to making tax easier, quicker and simpler for small business. Simplified expenses was one of the measures introduced in 2013 as a consequence of a report by the Office of Tax Simplification and a formal consultation. It was always intended that the provisions would apply equally to most partnerships and individuals and the

purpose of these amendments is to clarify two of the provisions and thus ensure they are in line with the policy objectives.

10. These amendments have been introduced to ensure that partnerships can fully access the simplified expenses regime that was introduced by Finance Act 2013. They will also ensure that where an individual or partnership has more than one premises that are used both for business and as a home then any claim to use the simplified expense deduction in respect of the expenses of these premises must be applied to all such premises. These changes will come into effect for 2016 -17 and following years.

Clause 25: Averaging profits of farmers etc

Summary

1. This clause provides for an extension to the period over which an individual carrying on a qualifying trade of farming, market gardening, or intensive rearing of livestock or fish, can average fluctuating trading profits. For 2016 -17 and subsequent years they will be able to claim to average trading profits for income tax purposes over two or five consecutive tax years. The clause also removes marginal relief from the two-year averaging rules for farmers and creative artists, so that from 2016 -17 full two-year averaging relief will be available where the profits of one year are 75% or less of the profits of the other year.

Details of the clause

2. Subsection (2)(b) provides the definition of "qualifying trade, profession or vocation" for the purposes of new section 222A.

3. Subsection (3) inserts new section 222A into Chapter 16 of Part 2 of Income Tax (Trading and Other Income) Act (ITTOIA) 2005. This section sets out the circumstances in which a claim for five-year averaging may be made.

4. Subsection (1) of new section 222A provides that a claim for 5 year averaging may be made if the "volatility" condition is met.

5. Subsection (2) of new section 222A details the circumstances when the volatility condition is met because of a difference in the amount of the relevant profits being compared or because the relevant profits of one or more of the years is nil. For these purposes references to the relevant profits of a tax year being nil includes where the individual makes a loss, as detailed in section 221(5) of ITTOIA 2005.

6. Subsection (4) makes consequential changes to section 222 of ITTOIA 2005.

7. Subsections (5) amends section 223 of ITTOIA 2005. The effect of the amendments is to remove the marginal relief that was provided by that section, so that from 2016 to 2017 full two-year averaging relief will be available where the profits of one year are 75% or less of the profits of the other year.

8. Subsection (6) makes consequential changes to section 224 of ITTOIA.

9. Subsection (7) makes consequential changes to section 225 of ITTOIA.

10. Subsection (8) makes consequential changes to subsection (6) of section 31C of ITTOIA

11. Subsection (9) makes consequential changes to subsection (2d) of section 1025 of Income Tax Act 2007 (ITA2007)

12. Subsection (10) makes consequential changes to paragraph 3 of Schedule 1B of the Taxes Management Act (TMA) 1970.

13. Subsection (11) makes consequential changes to paragraph 4 of Schedule 1B of TMA 1970.

14. Subsection (12) provides for commencement. New section 222A of ITTOIA has effect from tax year 2016 -17 meaning that a five-year averaging claim with 2016 -17 as the final year would involve averaging the profits of the years 2012 -13 to 2016 -17. The amendments to the two-year averaging rules also have effect where the latest year is 2016 -17 or a subsequent year.

Background note

15. At Budget 2015, the government announced that it would extend the period for which self-employed farmers can average their profits for income tax purposes from two years to five years.

16. Following consultation, the government decided to retain the existing framework providing for averaging of fluctuating profits over two years and to provide an additional option of averaging over five years, for an individual carrying on a qualifying trade of farming. The changes take effect for the tax year 2016 -17 and subsequent years.

Clause 26: Relief for finance costs related to residential property businesses

Summary

1. This clause clarifies that the basic rate tax reduction is available to beneficiaries of deceased persons' estates. It also ensures that the basic rate tax reduction applies and is calculated as intended.

Details of the clause

2. Subsection (1) substitutes for section 274A and 274B of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005 new Sections 274A, 274AA, 274B and 274C.

3. New Section 274A explains when an individual is entitled to a basic rate tax reduction.

4. New Section 274A(1) provides that an individual is entitled to a basic rate tax reduction for a tax year if he has one or more relievable amounts for that year. A person would have more than one relievable amount where they have more than one property business.

5. New Sections 274A(2) and (3) provide that an individual has a relievable amount for a particular property business if he has any current-year amounts (including relating to estate income) and any brought-forward amount for that business, and the relievable amount is calculated as the total of those amounts.

6. New Section 274A(4) explains when an individual has a current-year amount for a property business and how that amount is calculated. A current-year amount exists where:

    a. an amount ("A") of costs of a dwelling-related loan would have been deductible in calculating the profits of a property business but for section 272A,

    b. an individual is liable to income tax on N% of the profits of the property business (an individual would generally be liable to income tax on less than 100 per cent of the profits of the property business where he is carrying on the business in partnership), and,

    c. that income tax liability does not relate to estate income.

7. The current-year amount is calculated as N% of the amount "A" of costs of the dwelling-related loan.

8. New Section 274A(5) explains when an individual has a current-year estate amount for a property business of a deceased person's estate and how that amount is calculated. An individual may have more than one current-year estate amount in respect of the same property business (for instance where a distribution includes amounts representing profits of the business for more than one tax year). A current-year estate amount exists where:

    a. an amount ("A") of costs of a dwelling-related loan would have been deductible in calculating the profits of a property business for a particular tax year but for section 272A,

b. the personal representatives are liable to income tax on N% of the profits of the property business (they would be liable to income tax on less than 100 per cent of the profits of the property business where they are carrying on the business in partnership),

c. the individual is liable to tax on estate income arising from an interest in the estate, and,

d. E% of the estate income is attributable to the profits of the property business for the tax year.

9. The current-year estate amount is calculated as E% of N% of the amount "A" of costs of the dwelling-related loan.

10. New Section 274A(6) makes reference to new Section 274AA(4) in order to establish whether an individual has a brought-forward amount.

11. New Section 274A(7) defines what is meant by "estate income" and "basic amount" for the purposes of new Sections 274A and 274AA.

12. New Section 274AA makes provision for how an individual's basic rate tax reduction is calculated.

13. New Section 274AA(1) provides that the section applies where an individual is entitled to the basic rate tax reduction under section 274A. It also clarifies that references to a relievable amount in this section refer to each relievable amount for each property business as defined in section 274A.

14. New Section 274AA(2) specifies that for each property business, the actual amount on which relief is to be given (subject to subsection 3) is L. L is the lower of:

    a. the relievable amount (this will be the current-year amount established in section 274A(4) in 2017-18, but may be the current-year amount plus any brought-forward amount in subsequent years), and,

    b. the profits of the property business for the year, after deduction of any losses brought forward under section 118 of Income Tax Act (ITA) 2007 ("the adjusted profits"), or, if less, the total of:

        i. the percentage of the adjusted profits of the property business on which the individual is liable to income tax (for example, where the business is operated in partnership), and

        ii. so much of the relievable amount as is estate income attributable to property income.

15. New Section 274AA(3) restricts the actual amount on which relief is to be given where the aggregate of L (across all the individual's property businesses) is greater than the individual's adjusted total income. This would occur where the person's property profits subject to tax fall partly within the personal allowance. Where this is the case, the actual amount on which relief is to be given is restricted to the adjusted total income and it is

apportioned between the individual's property businesses by reference to the value of L for each business.

16. New Section 274AA(4) calculates the brought-forward amount where the actual amount on which relief is to be given is lower than the relievable amount and it is calculated as the difference between those two amounts.

17. New Section 274AA(5) calculates the basic rate tax reduction as the actual amount on which relief is to be given multiplied by the basic rate of income tax for the year.

18. New Section 274AA(6) makes provision as to howan individual's adjusted total income is identified. It is the individual's net income of the year, excluding savings and dividends, then reduced by any allowances that the individual is entitled to for the tax year under Chapter 2 of Part 3 of the ITA 2007, for example, the personal allowance.

19. New Section 274B explains when trustees of a settlement with accumulated or discretionary income are entitled to a basic rate tax reduction.

20. New Section 274B(1) provides that the trustees are entitled to a basic rate tax reduction for a tax year if they have one or more relievable amounts for that year. Trustees would have more than one relievable amount where they have more than one property business, e.g. one carried on in partnership and another not.

21. New Sections 274B(2) and (3) provide that the trustees have a relievable amount for a particular property business if they have any current-year amount and any brought-forward amount for that business, and the relievable amount is calculated as the total of those amounts.

22. New Section 274B(4) explains when the trustees have a current-year amount for a property business and how that amount is calculated. A current-year amount exists where:

    a. an amount ("A") of costs of a dwelling-related loan would have been deductible in calculating the profits of a property business but for section 272A,

    b. the trustees are liable to income tax on N% of the profits of the property business (the trustees would generally be liable to income tax on less than 100 per cent of the profits of the property business where they are carrying on the business in partnership), and,

    c. the trustees' share of the profits is accumulated or discretionary income in relation to the trustees.

23. The current-year amount is calculated as N% of the amount "A" of costs of the dwelling-related loan.

24. New Section 274B(5) makes reference to new Section 274C(3) in order to establish whether an individual has a brought-forward amount.

25. New Section 274C makes provision for how the trustees' basic rate tax reduction is calculated.

26. New Section 274C(1) provides that the section applies where the trustees are entitled to the basic rate tax reduction under section 274B. It also clarifies that references to a relievable amount in this section refer to each relievable amount for each property business as defined in section 274B.

27. New Section 274C(2) specifies that the relief to be given (subject to subsection 3) is BR (the basic rate of income tax) multiplied by L. L is the lower of:

    a. the relievable amount (this will be the current-year amount established in section 274B(4) in 2017-18, but may be the current-year amount plus any brought-forward amount in subsequent years), and,

    b. the profits of the property business for the year, after deduction of any losses brought forward under section 118 of ITA 2007 ("the adjusted profits"), or, if less (for example, where the business is operated in partnership), the share of the adjusted profits:

        i. on which the trustees are liable to income tax, and,

        ii. which in relation to the trustees is accumulated or discretionary income.

28. New Section 274C(3) calculates the brought-forward amount where L is less than the relievable amount and it is calculated as the difference between those amounts.

Background note

29. Legislation was enacted in Finance (No.2) Act 2015 to restrict the deductions for finance costs relating to let residential properties and instead allow for a deduction from an individual's or, where relevant, trustees' income tax liability.

30. This clause:

    - puts beyond doubt that individual beneficiaries of deceased persons' estates are entitled to the basic rate tax reduction,
    - ensures that the adjusted total income restriction applies where the relevant finance costs or property profits are higher than that adjusted total income,
    - ensures that adjusted total income is a measure of the net taxable income after other reliefs,
    - ensures that any carried forward tax reduction is given in any subsequent year in which property income is received, even if there is no restriction on the deduction of finance costs in that year, for example, where the loan has been repaid.

Clause 27: Individual investment plans of deceased investors

Summary

1. This clause will allow regulations made by HM Treasury to provide that Individual Savings Accounts (ISA) can retain their tax-advantaged status following the death of the account holder.

Details of the clause

2. Subsection (1) adds new section 694A, concerning deceased investors, to Chapter 3 of Part 6 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). This Chapter enables HM Treasury to make regulations for the establishment and operation of individual investment plans, such as ISAs, and for the exemption from income tax of income arising from such plans.

Section 694A Deceased Investors

3. New section 694A(1) enables regulations to exempt from income tax the income of any person from 'administration-period investments' under a plan. It also allows regulations to exempt income from an estate that contains such investments. These provisions will allow regulations to exempt ISA income received by, for example, the personal representative of a deceased account holder or the beneficiary to whom that ISA income is distributed.

4. New sections 694A(2) and (3) modify the meanings of 'individual' and 'investor' for certain provisions within Chapter 3 of Part 6 of ITTOIA, when these apply to administration-period investments.

5. New sections 694A(4) and (5) define 'administration-period investments'.

6. New sections 694A(6) to (8) will allow regulations to set out when investments are administration-period investments, and allow these regulations to be framed with reference to the completion of the administration of an estate.

7. Subsection (2) of the clause amends section 151(2) of the Taxation of Chargeable Gains Act 1992 (TCGA), to allow regulations to be made which provide relief from capital gains tax in connection with individual investment plans (referred to in TCGA as 'personal equity plans'). The regulations correspond to those concerning income tax provided for by new section 694A of ITTOIA.

8. Subsection (3) amends section 62 of TCGA to allow regulations to be made which apply in place of section 62(4)(b) when an asset is acquired by a legatee in certain circumstances. Such regulations may, for example, make provision concerning the time that a legatee is treated as having acquired a former ISA asset, or the consideration the legatee is treated as having given for the asset, or both.

9. Subsection (4) makes consequential amendment to Finance Act 2011.

Background note

10. ISA tax advantages currently cease when an account holder dies. Autumn Statement 2015 included an announcement that these tax advantages would be extended into the administration of the ISA saver's estate. The effect of regulations made under this clause will be that, subject to certain time limits, personal representatives and beneficiaries or legatees should not face tax on any income or gains from investments retained in an ISA during the administration of a deceased saver's estate.

11. Since 6 April 2015, the surviving spouses or civil partners of ISA savers have benefited from an additional ISA allowance, equal to the value held in ISA when the deceased saver died. These changes will complement this additional allowance for surviving spouses and civil partners.

12. The government intend to use the powers within this clause to amend the Individual Savings Account Regulations 1998 (S.I. 1998/1870) during 2016 -17, following consultation.

Clause 28: EIS, SEIS and VCTs: exclusion of energy generation

Summary

1. This clause excludes all energy generating activities, including the production of gas or other fuel, from the tax-advantaged venture capital schemes - the Seed Enterprise Scheme (SEIS), the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) - for investments in companies made on or after 6 April 2016.

Details of the clause

2. Clause 28 removes all energy generating activities from the tax-advantaged venture capital schemes. It substitutes the existing subsidised renewable energy and reserve capacity exclusions with new broader exclusions that cover any form of energy generating activities and include all electricity generating and storage activities (including making capacity available), any activities generating heat and those producing gas or fuel.

3. These changes will take effect for the EIS, SEIS and VCTs in relation to shares or holdings issued on or after 6 April 2016.

Background note

4. The tax-advantaged venture capital schemes are intended to incentivise investment in smaller companies carrying on qualifying trades. A trade is qualifying if it is carried on commercially, with a view to profit, and if it does not consist to a substantial extent in "excluded activities".

5. The legislation listing the activities which are "excluded" for the purpose of the schemes can be found at sections 192 to 199 Income Tax Act 2007 (ITA) for the EIS (and the SEIS by virtue of section 257DA ITA). The equivalent VCT provisions are at sections 303 to 310 ITA.

6. Legislation already exists to exclude the subsidised generation of electricity or heat, the subsidised production of gas or other fuel and the provision of reserve electricity generating capacity.

7. The changes made by clause 28 follow previous amendments limiting the use of the venture capital schemes by those companies undertaking energy generating activities and supersede those made during the passage of the Finance (No.2) Act 2015. The new exclusions will apply to both non-renewable and renewable sources of energy generation and are without exception to whether a subsidy is received or to the nature of the company carrying on the activities.

8. It is intended that these energy generation activities will also be withdrawn from the Social Investment Tax Relief when this scheme is enlarged at a later date.

Clause 29: EIS and VCTs: definition of certain periods

Summary

1. This clause clarifies the method for determining certain periods used in determining if a company meets the permitted maximum age limit or if a company is a knowledge-intensive company for investments made under the Enterprise Investment Scheme (EIS) and by Venture Capital Trusts (VCTs).

Details of the clause

2. Subsection (1) amends section 175A(7) of the Income Tax Act (ITA) 2007 and inserts new subsections (7A) and (7B).

3. Subsection (2) amends section 252A(4) of ITA 2007 and inserts new subsection (4A).

4. Subsection (3) amends section 280C(8) of the Income Tax Act (ITA) 2007 and inserts new subsections (8A) and (8B).

5. Subsection (4) amends section 294A(7) of ITA 2007 and inserts new subsections (7A) and (7B).

6. Subsection (5) amends section 331A(5) of ITA 2007 and inserts new subsection (5A).

7. The changes made by subsections (1) to (5) ensure that the method to determine the end of the following two periods works as originally intended. The method is the same for all the provisions.

   - The five year period for the average turnover amount in sections 175A(7), 280C(8) and 294A(7); the average turnover amount is used to help determine if a company meets condition B of the permitted maximum age requirement.

   - The relevant three preceding years for the operating costs conditions in sections 252A(4) and 331A(5); a company must meet at least one of the operating costs conditions and at least one other condition in order to be a knowledge-intensive company.

8. The changes ensure that each period ends immediately before the beginning of an investee company’s last accounts filing period. The last accounts filing period begins immediately after the end of the company's most recent accounting period. The effect is to align the end of each period with the company's most recent accounting period before the relevant shares are issued.

9. The rule applies only if the end date falls within the 12 months before the relevant shares are issued. If the company's last accounts filing period begins more than 12 months before the issue of the relevant shares, the five year period and the relevant three years respectively end 12 months before the date of issue of the relevant shares. The effect of these changes is to ensure that the most recently filed accounts of a company are generally used

to determine the end date of the relevant period.

10. Example: A company whose first commercial sale was on 1 September 2008 wishes to raise money to fund expansion to enter a new product market. It is planning to issue shares on 1 June 2016. The company has never received a relevant investment and so the proposed investment will fall after the end of the company's initial investing period. However the company may still be eligible to raise money under the EIS or from a VCT if the total amount of relevant investments, including the proposed EIS/VCT investment, is at least 50% of the company's average annual turnover amount. The company has always made up its accounts to the 31 December. The average annual turnover amount is the turnovers of the company averaged over five years. The five year period ends on the day before the beginning of the company's last accounts filing period. As at 1 June 2016 the company's most recent accounts filing period ended on 30 September 2015, having started on 1 January 2015. The day before 1 January 2015 was 31 December 2014 and the five year period over which the company's turnovers must be averaged is 1 January 2010 to 31 December 2014.

11. Subsection (6) applies the new rules retrospectively, subject to clause 30. The method will therefore apply when considering if, for example, a company meets condition C of the permitted maximum age requirement under section 175A(5) or sections 280C(6) and 294A(5). In order to meet condition C a company must have met condition B of section 175A(4) or sections 280C(5) and 294A(4) at some earlier time. However a company may make an election under clause 30 to disapply the provisions of this clause.

12. The new method will apply to all companies that issue shares under the EIS or that receive a relevant investment from a VCT on or after 6 April 2016.

Background note

13. The EIS and VCT schemes encourage investment in small, higher risk, trading companies. Individual investors receive various tax reliefs if they invest directly in a qualifying company under the EIS or if they invest in a VCT which in turn invests in qualifying companies.

14. The changes introduced by this clause ensure that the test used for two separate provisions introduced by paragraphs 12 and 19 of Schedule 5 to, and by paragraphs 5, 11 and 20 of Schedule 6 to, the Finance (No. 2) Act 2015 works as originally intended.

15. The changes are being made retrospectively as they are likely to benefit most companies who will be able to use their existing accounts instead of drawing up accounts to a special date. However a company may elect under clause 29 to apply the rules introduced by Finance (No. 2) Act 2015, to apply to all shares issued and all relevant investments received between 18 November 2015 (the date of Royal Assent to Finance (No.2) Act 2015) and 5 April 2016 inclusive.

Clause 30: EIS and VCTs: election

Summary

1. This clause provides for companies receiving an investment under the Enterprise Investment Scheme (EIS) or from a Venture Capital Trust (VCT) to elect for the amendments made by clause 29 not to apply for investments made before 6 April 2016.

Details of the clause

2. Subsection (1) specifies the effect of a company making an election under this clause. If a company makes an election, the rules to determine the end of the following two periods, as introduced by Schedules 5 and 6 to Finance (No. 2) Act 2015, will remain unchanged for all investments made in the company up to and including 5 April 2016.

    - The five year period for the average turnover amount in sections 175A(7), 280C(8) and 294A(7) of the Income Tax Act (ITA) 2007; the average turnover amount is used to help determine if a company meets condition B of the permitted maximum age requirement.
    - The relevant three preceding years for the operating costs conditions in sections 252A(4) and 331A(5) of ITA 2007; a company must meet at least one of the operating costs conditions and at least one other condition in order to be a knowledge-intensive company.

3. Subsection (2) ensures that the provisions of clause 29 do not apply if the company has made an election. The effect is to ensure that the original method of determining the end of the periods specified in paragraph 1 above applies for all purposes for investments made in the company up to and including 5 April 2016.

4. Subsections (3) and (4) specify the processes a company must follow if it makes an election. If a company decides to make an election it must make the election in writing and a director of the company must sign and date the election. The election will apply to all investments received in the period from 18 November 2015 (the date of Royal Assent of Finance (No.2) Act 2015) and 5 April 2016. The company must:

    - State an election has been made if it submits an EIS compliance statement in relation to shares issued before 6 April 2016
    - Give a copy of the election to every VCT that makes an investment in the company before 6 April 2016.

5. Subsection (5) specifies that an election made under this section is irrevocable.

Background note

6. The EIS and VCT schemes encourage investment in small, higher risk, trading companies. Individual investors receive various tax reliefs if they invest directly in a qualifying company under the EIS or if they invest in a VCT which in turn invests in qualifying companies.

7. Clause 29 amends certain provisions in Parts 5 and 6 of ITA 2007 which were introduced by Schedules 5 and 6 to Finance (No.2) Act 2015. They ensure that a company can use accounts made up to the company's accounting date for the purpose of determining if the company meets certain conditions that will enable it to receive an EIS or VCT investment.

8. The changes made by clause 29 is likely to be beneficial to most companies and will take effect retrospectively. However it is possible that the original rules may be beneficial for certain companies. In such cases clause 30 enables a company to elect for the original rules to apply.

9. The effect of making an election is that the five year period for the average turnover amount and the three year period for the operating costs condition will always end 12 months before the date the shares are issued, for shares issued between 18 November 2015 and 5 April 2016 inclusive.

Clause 31: VCTs: requirements for giving approval

Summary

1. This clause amends rules introduced by Schedule 6 to Finance (No. 2) Act 2015 to clarify the non-qualifying investments a venture capital trust (VCT) may make for liquidity management purposes.

Details of the clause

2. Subsection (1) provides for amendment of section 274 of the Income Tax Act 2007 (ITA 2007).
3. Subsection (2) introduces a new condition to section 274(2), the non-qualifying investments condition. Any investments made by a VCT that are not qualifying holdings within Chapter 4 of Part 6 of ITA 2007 must be one of those specified in subsection (3A).
4. Subsection (3) makes minor and consequential amendments to section 274(3).
5. Subsection (4) inserts new subsection (3ZA) in section 274. Subsection (3ZA) excludes investments specified in subsection (3A) from the requirement to meet the investment limits condition, the maximum permitted age requirement and the no business acquisition condition. The investments specified in subsection (3A) are easily realisable short-term investments that may be made while the VCT is investigating new qualifying holding opportunities.
6. Subsection (5) makes a consequential amendment to subsection (3A).
7. Subsection (6) makes a consequential amendment to subsection (5)(c).
8. Subsection (7) specifies that the changes made will apply to investments made by VCTs on or after 6 April 2016.

Background note

9. The VCT scheme encourages approved listed companies to invest in small, higher risk trading companies by offering tax incentives to their individual investors.
10. All funds held by a VCT are tax-advantaged. However the VCT rules recognise that a VCT may not be able to hold all its funds in qualifying holdings at all times, for example after disposing of a holding. A VCT may hold no more than 30% of its funds in non-qualifying holdings at any time.
11. New rules were introduced by Schedule 6 to Finance (No. 2) Act 2015 to ensure that VCTs invest all their funds in accordance with the rules and introduced section 274(3A) which specified the only types of investments permitted for liquidity management purposes.
12. The amendments made by clause 31 put beyond doubt that VCTs may invest only in

qualifying holdings or the investments specified in section 274(3A).

Clause 32: Income tax relief for irrecoverable peer-to-peer loans

Summary

1. This clause introduces a new tax relief that will allow lenders subject to Income Tax on interest that they receive from peer to peer (P2P) loans to set losses from irrecoverable loans against other P2P interest that they receive. This tax relief will allow lenders to claim relief on P2P loans that become irrecoverable from 6 April 2015, and will apply automatically to set losses from P2P loans that become irrecoverable on or after 6 April 2016 against other P2P interest received through the same platform.

Details of the clause

2. Subsection 1 introduces new Chapter 1A to Income Tax Act (ITA) 2007.

Chapter 1A

3. Chapter 1A contains sections 412A to 412J which introduce the new tax relief.

Relief for irrecoverable peer-to-peer loans

4. Section 412A outlines the new tax relief and details what conditions must be met for the tax relief to apply.

5. Subsection 412A(1) outlines the conditions which must be met for an irrecoverable loan to be eligible for relief. This relief applies to loans that become irrecoverable on or after 6 April 2015.

6. Subsection 412A(2) states that a loan that becomes irrecoverable before 6 April 2016 will only be eligible for relief if the lender makes a claim to that relief. This means that if a claim is not made then the irrecoverable loan will not be eligible for relief under the Income Tax Acts.

7. This means that for a P2P loan that become irrecoverable between 6 April 2015 and 5 April 2016, if no claim is made the loss may be eligible for relief as a Capital Loss under Taxation of Chargeable Gains Act (TCGA) 1992, if it meets the relevant conditions.

8. From 6 April 2016 relief is given on irrecoverable P2P loans whether or not a claim is made. This means that a loss arising from a loan that becomes irrecoverable on or after 6 April 2016 will no longer be eligible for any relief under TCGA 1992.

9. Subsection 412A(3) states that this relief is only given against income received in the same tax year as the loan becomes irrecoverable.

10. Subsections 412A(4-6) state that relief for irrecoverable loans is only given against receipts of interest from other qualifying P2P loans held through the same platform.

11. Subsection 412A(7) outlines how the relief is given against income.

12. Subsection 412A(8) states that in a case where either loan security has been granted, or legal proceedings have been undertaken, then when considering whether the loan is "irrecoverable" for the purposes of this relief the presence of that security and the outcome of the proceedings will be disregarded.

Sideways relief

13. Section 412B allows lenders to make a claim for additional relief for irrecoverable loans against receipts of interest from P2P loans that are held through other P2P platforms.
14. Subsections 412B(1-2) restrict the maximum amount of relief available to be set sideways against interest received through other platforms to irrecoverable losses in excess of amounts which can be set against interest received through the same platform.
15. Subsections 412B(3-5) specify that sideways relief for irrecoverable P2P loans may only be set sideways against interest received on other qualifying P2P loans.
16. Subsection 412B(6) outlines how the relief is given against income.

Carry-forward relief

17. Section 412C allows lenders to make a claim for additional relief for irrecoverable loans against receipts of interest from P2P loans received in future tax years.
18. Subsection 412C(1) restricts the maximum amount of relief available to be carried forward to irrecoverable losses in excess of amounts which can be set against interest received through other P2P platforms in the same tax year.
19. Subsection 412C(2) states that relief may be carried forward for the nest four tax years following the year in which the loan becomes irrecoverable.
20. Subsections 412C(3-5) specify that sideways relief for irrecoverable P2P loans may only be carried forward against interest received on other qualifying P2P loans.
21. Subsection 412C(6) outlines how the relief is given against income.
22. Subsection 412D outlines how relief carried forward should be calculated.

Supplementary provisions

23. Section 412E outlines the treatment of any amount that the lender may recover in respect of a loan that has previously been treated as irrecoverable for the purposes of this relief.
24. Section 412F acts to treat loans that a lender acquires by way of assignment in the same way as loans that they make as the original lender.
25. Section 412G states that in the case of loans held by a nominee or bare trustee for a beneficiary these should be treated as being held by the beneficiary for the purposes of this relief.

Interaction with other reliefs

26. Section 412H states that if another form of income tax relief has been obtained in relation to the same loan, then the amount of relief available for the irrecoverable P2P loan will be restricted by the amount of the other relief.

Interpretation

27. Section 412I outlines the types of loan which may qualify for this relief. These will be loans that are defined as "article 36H agreements" in Chapter 6B of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013, are made on commercial terms and not for the purposes of obtaining a tax advantage.

28. Section 412J defines an operator for the purposes of this relief as a P2P platform who is either authorised by the Financial Conduct Authority to carry on the business of P2P lending, or who has been granted equivalent permissions by another territory within the European Economic Area.

Background note

29. This tax relief has been introduced to put the taxation of income received on P2P loans on a comparable basis to the taxation of income received from other economically similar forms of investment. P2P lending sites are in essence an intermediary service that connects investors with money to lend with individuals or small businesses that need to borrow. The lender invests a lump sum using the platform which is then lent in small sub-loans to a number of borrowers.

30. It is this breakdown of the investment into multiple small sub-loans spreading the risk of default across several borrowers which is the new aspect P2P lending brings to retail investment. The ability to lend directly to a diverse portfolio of borrowers gives an individual with a P2P portfolio access to diversified lending opportunities which were previously only available to retail investors via collective investment vehicles. Provision of these products is regulated by the Financial Conduct Authority. P2P loans that will be eligible for this relief are those loans that would be also available to retail investors, from a provider (platform) which is regulated by the Financial Conduct Authority.

31. This new tax relief will act to allow investors to set losses that they incur on loans that become irrecoverable against the interest they receive on loans that are repaid. This will result in the investor being taxed on the amount that they receive on their portfolio, in a similar manner to the way that they would be taxed if those loans were held through a collective investment vehicle.

Clause 33: Transactions in securities: company distributions

Summary

1. This measure introduces amendments to the Transactions in Securities rules in Part 13 of the Income Tax Act 2007 (ITA 2007). The changes clarify and improve a number of aspects of these rules. The amendments have effect for transactions occurring on or after 6 April 2016. Related changes are made by clause 34.

Details of the clause

2. Subsection (1) provides for the amendment of Part 13 of ITA 2007.

3. Subsection (2) amends section 684(1) of ITA 2007. From 6 April 2016 it will consider "the purpose of the transactions" in place of "the purpose of a person being party to a transaction". Section 684(1) will also apply to a tax advantage obtained by any person, not just the person who is a party to the transaction.

4. Subsection (3) clarifies that a repayment of share capital or share premium is a transaction in securities by adding it to the particular examples listed in the section. It also extends the definition of transaction in securities to include a distribution in respect of securities in a winding up.

5. Subsection (4) amends section 685 of ITA 2007 to say that the conditions are met where relevant consideration is received by a "relevant person", defined by new section 685(3A). It also introduces two further subsections into section 685.

6. New section 685(7A) replaces section 685(6), which is repealed. It will now be explicit that the assets of a company that are available for distribution are only disregarded where an amount is distributable solely because the laws of the country in which the company is incorporated allow it to be distributed.

7. New section 685(7B) provides that the assets of a company that are available for distribution include assets which can be distributed to the company by a subsidiary under the company's control.

8. Subsection (5) changes the way that the "fundamental change of ownership" rule applies. The new rule considers what the original shareholders of the company still hold after the transaction or transactions, rather than considering the new ownership structure.

9. Subsection (6) amends section 687 of ITA 2007 so that an income tax advantage can be obtained where a distribution could have been paid to an associate of the person. It also clarifies when to consider the value of a distribution that could have been paid.

10. Subsection (7) introduces the definition of "associate" to be used in section 687.

11. Subsection (8) provides that the amendments will apply to transactions occurring on or

after 6 April 2016 or, where there is a series of transactions, any one or more of the series occurs on or after that date.

12. Subsection (9) clarifies that the existing rules will apply to transactions occurring before 6 April 2016.

13. Subsection (10) explains that where HMRC have issued a clearance notice under section 701 of ITA 2007 in respect of a transaction before 6 April 2016, but the transaction occurs on or after 6 April 2016, the clearance will not be valid where the transaction ought to be counteracted only because of the amendments made by this clause.

Background note

14. The Transactions in Securities legislation in Part 13 of ITA 2007 counteracts the tax advantage where, as a result of one or more transactions in securities, a person receives as capital consideration something which might otherwise have been taxed as income, if the main purpose (or one of the main purposes) of the transaction or transactions, was to obtain that advantage.

15. These amendments are being made to rationalise the treatment of payments by companies to their members. The clause implements the announcement made by the Chancellor of the Exchequer in his statement of 25 November 2015.

Clause 34: Transactions in securities: procedure for counteraction of advantage

Summary

1. This measure amends Part 13 of the Income Tax Act 2007 (ITA 2007) to align the counteraction process for the Transactions in Securities legislation more closely with the process for compliance checks under self-assessment. The new procedure has effect for transactions occurring on or after 6 April 2016. Related changes are made by clause 33.

Details of the clause

2. Subsection (1) provides for the amendment of Part 13 of ITA 2007.
3. Subsection (2) changes the process required for an officer of HM Revenue and Customs (HMRC) to begin proceedings to counteract a tax advantage. The officer will serve a notice of enquiry in place of issuing a preliminary notification that a counteraction notice ought to be served.
4. Subsection (3) omits sections 696 and 697 of ITA 2007, which provided further procedural rules under the old counteraction provisions.
5. Subsections (4) and (5) amend section 698, the legislation that provides for a "counteraction notice" to be served, so that a notice can be issued following a notice of enquiry rather than a preliminary notice.
6. Subsection (6) introduces new section 698A into ITA 2007. This enables the recipient of an enquiry notice to apply to the tribunal to direct that the enquiry should be concluded. It also introduces a requirement for an enquiry to conclude either with the issue of a counteraction notice or a "no-counteraction notice" where no counteraction is required.
7. Subsection (7) amends section 684(4) so that it is subject to "no-counteraction notices". This replaces rules that consider when an officer determines that no further action is necessary or the tribunal determines that there is no prima facie case that section 684 applies.
8. Subsection (8) provides that the new procedure will apply to transactions occurring on or after 6 April 2016, or where there is a series of transactions, where any one or more of the transactions occurs on or after that date.
9. Subsection (9) makes clear that where the transaction occurs before 6 April 2016 the existing procedure will continue to apply.

Background note

10. The Transactions in Securities legislation in Part 13 of ITA 2007 counteracts the tax

advantage where, as a result of one or more transactions in securities, a person receives as capital consideration which might otherwise have been taxed as income, if the main purpose (or one of the main purposes) of the transaction or transactions was to obtain that advantage.

11. The compliance and counteraction part of rules were not updated in the light of the introduction of Self-Assessment. These changes improve and rationalise the counteraction rules.

Clause 35: Distributions in a winding up

Summary

1. This clause introduces a new Targeted Anti-Avoidance Rule (TAAR) that will apply to certain company distributions in respect of share capital in a winding-up. This TAAR will treat the distribution from a winding-up as if it were a distribution chargeable to Income Tax, where certain conditions are met. The TAAR applies to distributions made on or after 6 April 2016.

Details of the clause

2. Subsection (1) introduces new section 396B into the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

New section 396B: Distributions in a winding up

3. New section 396B(1) explains that a distribution in respect of shares in the winding up of a UK-resident company is a distribution if conditions A to D are met.

4. New section 396B(2) sets out condition A: the individual receiving the distribution must have held at least a 5% interest in the company immediately before the winding up.

5. New section 396B(3) sets out condition B: the company has to be a close company (as defined by section 439 of the Corporation Tax Act 2010), or to have been a close company at some point in the two years before the winding up began.

6. New section 396B(4) sets out condition C: that the person who receives the distribution is, at any time in the two years following the receipt, involved with the carrying on of a trade or activity that is similar to that of the trade or activity carried on by the company wound up (or its subsidiary). For this purpose the individual may carry on the trade directly, through a partnership, through a company in which he or she has at least a 5% interest, or through a person with whom he or she is connected.

7. New section 396B(5) and (6) sets out condition D: that it is reasonable to assume that the winding up forms part of arrangements designed to reduce the person's income tax liability. The legislation makes clear that condition D will address in particular the question whether the person continues in some way the same or a similar trade or activity.

8. New section 396B(7) provides an exemption from the TAAR where the distribution received by the individual does not exceed the Capital Gains Tax "base cost", or where it comprises only irredeemable shares, as would be the case in a "liquidation de-merger".

9. New section 396B(8) and (9) defines "arrangements", "effective 51% subsidiary" and "participator" as used in the section.

10. New section 396B(9) and (10) explains when a person has a 5% interest in a company by reference to ordinary share capital and voting rights.

New section 404A: Distributions In a winding up

11. Subsection (2) introduces new section 404A into Chapter 4 of Part 4 of ITTOIA, which mirrors the provisions of new section 396B for distributions in respect of shares from a non-UK resident company (treating the non-UK resident company as close if it would have been close had it been resident in the UK).

12. The new section refers to a "dividend" rather than a "distribution", reflecting differences in the way dividends and distributions from non-UK resident companies are taxed.

13. Subsection (3) provides for commencement.

Background note

14. This new TAAR is being introduced to rationalise and improve the tax treatment of payments to members from companies. It will help ensure that the treatment of what is received better reflects the nature of the payments.

Clause 36: Disguised investment management fees

Summary

1. This clause introduces amendments to the disguised investment management fee rules which apply to certain sums arising to individuals who perform investment management services.

Details of the clause

2. Clause 36 amends Chapter 5E of Part 13 of the Income Tax Act 2007 (ITA), which contains the Disguised Investment Management Fee Rules ("DMF Rules").

3. Subsection (2) amends section 809EZA(2) of ITA to make clear that the DMF Rules apply in certain situations. Firstly, section 809EZA(2)(a) is amended to ensure the DMF Rules apply to individuals who have performed or will, in the future, perform investment management services (i.e. there is no requirement that the individual performs investment management services in the year in which the sums arise). Secondly, section 809EZB(3)(b) is deleted to remove the requirement for a partnership in the arrangements (e.g. to be present in the investment scheme or management structure). Finally, section 809EZA(3)(c) is amended to make clear that the DMF Rules apply to sums arising from any investment scheme, not just a scheme in respect of which an individual performs investment management services.

4. Subsection (3) inserts a new subsection (7) into section 809EZA to make clear that the reference to collective investment scheme in section 809EZA(6) will include certain arrangements associated with the collective investment scheme. Subsection (7)(a) applies to arrangements which permit an external investor to participate in investments acquired by a collective investment scheme without participating in the scheme itself and would, for example, cover "managed accounts" and similar structures. Subsection (7)(b) applies to arrangements under which sums arise to an investment manager in respect of a collective investment scheme without arising from the scheme itself.

5. Subsection (4) amends the definition of "external investor" in section 809EZE such that it will only apply to investors who do not at any time perform, or are to perform, investment management services in respect of an investment scheme.

6. Sub-section (5) provides that these provisions will apply to all sums arising on or after 6 April 2016.

Background note

7. Managers of investment funds are rewarded in a variety of ways. Management Fees are charged to tax as income, and the DMF Rules in FA 2015 ensured that fee income could not be disguised as a form of capital receipt.

8. Managers also receive performance-based rewards, sometimes known as 'carried interest'. This is based on the performance of the funds that they manage and can take the form of a share in the fund's total return. Legislation in Finance (No. 2) Act 2015 ensured that where carried interest is taxable as a chargeable gain, the full amount would be taxable without reduction through arrangements such as 'base cost shift'. This legislation built on the DMF Rules.

9. Finance Bill 2016 contains further rules which will determine when carried interest should be taxed as income or as chargeable gains. Again, this builds on the architecture established for the DMF Rules.

10. As part of these changes the government has decided to make certain amendments to the DMF Rules.

Clause 37: Income-based carried Interest

Summary

1. This clause introduces a new test to determine whether performance-based rewards (or 'carried interest') paid to asset managers should be taxed as income or as chargeable gains. The new legislative test replaces the case law tests based around the 'badges of trade'.

Details of the clause

2. Clause 37amends Chapter 5E of Part 13 of the Income Tax Act 2007 (ITA), which contains the Disguised Investment Management Fee Rules ("DMF Rules").

3. Subsection (1) amends section 809EZB(1) of ITA, so that the exclusion from the DMF Rules for carried interest does not apply where the carried interest is "income-based carried interest", as defined in new Chapter 5F of Part 13. This has the effect of ensuring that carried interest which does not arise from long-term investment activity will be charged to income tax under the DMF Rules (where it is not already charged to tax as trading or employment income of the relevant individual).

4. Subsection (2) inserts new Chapter 5F into Part 13 of ITA. Chapter 5F consists of new sections 809FZA to 809FZZ inclusive.

5. New Section 809FZA provides an overview of the provisions in Chapter 5F.

6. Section 809FZA(7) puts beyond doubt that these rules do not affect the taxation of either the investment scheme itself or external investors in the scheme.

7. New Section 809FZB introduces the concept of the 'relevant proportion' of a sum of carried interest being classified as "income-based carried interest". The 'relevant proportion' is determined by the average time for which the fund giving rise to the carried interest holds its investments. It is then applied to the carried interest to determine what proportion is taxable as income.

8. New Section 809FZC explains how to calculate the average holding period for the purposes of the Chapter. Only those investments by reference to which the carried interest arises are included when determining the average holding period (see subsection (2)(b)). Where carried interest is calculated by reference to the "fund as a whole", this will include all investments made by the fund. Where carried interest is calculated by reference to the performance of a portfolio over a given period, the relevant investments will be those disposed of during that period and those which remain held at the close of the period.

9. Section 809FZC(3) explains that the average holding period calculation is made when the carried interest arises.

10. Section 809FZC(4) sets out the detail of the calculation of the average holding period. A weighted arithmetic mean is calculated, taking the sum total of all relevant investments multiplied by the length of time held, and dividing that total by the total value invested.

The value of the investment is determined as at the time it was made, and not at the time the carried interest is calculated.

11. For example. A fund holds three investments of £10,000, £8,000 and £6,000 and it holds them for 3, 4 and 5 years respectively. The calculation is (10,000x3)+(8000x4)+(6000x5), equals £92,000 which is then divided by £24,000 to give an average of 46 months.

12. Section 809FZC(5) directs that any intermediate holding structures are to be disregarded for the purposes of determining the average holding period.

13. The term "investment" is intended to have its normal, commercial meaning in the context of fund investment strategies and, when applied alongside the disregard of intermediate holding structures, will identify the assets a fund acquires in economic and commercial substance (and which investors in a fund would see as comprising the assets acquired in the course of that fund's strategy). For example, a fund described as a real estate fund will generally invest in land. It may acquire that land in various forms of "envelope" such as a company. However, the investments held by the fund will comprise land even if the acquisition of those investments is, for example, effected by way of share purchase or by taking control of a complex pre-existing holding structure comprising companies, partnerships and unit trusts. With a private equity fund, however, the investments made by that fund may generally comprise trading groups. Here the test would look to the fund's investment in the main holding company of that group (disregarding, for example, a Topco-Midco-Bidco acquisition structure) rather than requiring the fund to trace through the structure to specific trades carried on, and associated assets held, by members of that group.

14. The disregard of intermediate holding structures is intended to include other investment schemes such that, where a fund invests in another fund (the "underlying scheme"), when calculating the average holding period the investing fund will look to the investments held by the underlying scheme rather than its holding in that scheme. In this situation the "investment" held by the fund will not comprise the holding in the underlying scheme and the fund will be required to look through to the assets held by the underlying schemes it invests in. This approach is disapplied where the rules which apply to funds of funds (see section 809FZO) and secondary funds (see section 809FZP) are invoked.

15. Section 809FZC(6) explains how to determine the length of time for which an investment is held. If the investment is disposed of before the carried interest arises, the investment is treated as held for the time period it was owned by the fund. Otherwise the time period is taken as the time from which the investment is acquired to the time the carried interest arises.

16. Section 809FZC(7) makes clear that, in calculating the average holding period, any deferral of the carried interest is to be disregarded.

17. New Section 809FZD determines the circumstances when an investment is disposed of. The starting point is that there will be a disposal of an investment if there is a disposal for the purposes of the Taxation of Chargeable Gains Act 1992 (TCGA) (see subsection (1)), a disposal of an intermediate holding or intermediate holding structure (see subsection (2)), or a deemed disposal (see subsection (3)). A disposal of an intermediate holding, for example, would occur when a real estate fund holds a property in a corporate structure. If the fund sold 50% of its interest in that corporate holding structure, that would then trigger a part disposal of the underlying investment.

18. Section 809FZD(2) explains the circumstances in which there will be a deemed disposal. In essence, it involves a fund entering into arrangements to either (i) in substance, close its position in relation to an investment or (ii) no longer have any genuine economic exposure to the investment. There will only be a deemed disposal where it is reasonable to suppose that the arrangements in question were put in place to achieve that result. There will not be a deemed disposal, therefore, where a fund accidentally closes out a position by taking a reciprocal position. Regard must be had to all the circumstances in determining what it is reasonable to suppose (see section 809FZQ).

19. Section 809FZD(3) directs that, when a fund holds investments which comprise shares or securities in a company of the same class, a 'first in first out' basis is to be used in deciding which investments have been disposed of.

20. Section 809FZD(4) directs that section 116 of TCGA is to be disregarded for the purposes of this section 809FZD(1)(a). This means that sections 127 to 130 of TCGA will be able to apply to transactions involving qualifying corporate bonds.

21. New Section 809FZE sets out the rules governing part disposals. The part disposed of and the part retained are treated as two separate assets (subsection (1)). The value of each part is calculated in accordance with subsections (2) and (3).

22. New Section 809FZF sets out situations where the disposal of unwanted short-term investments is to be disregarded when calculating a fund's average hold period. In essence this applies where, to secure an investment which it intends to hold, a fund also has to acquire an investment or investments which it does not want to retain and which it intends to dispose of within a specified period. Where the fund does then dispose of the unwanted investment within the specified period (as determined under subsection (4)) that disposal is disregarded.

23. Section 809FZF(2) sets out the conditions that must be met for an investment to be an unwanted short term-investment.

24. Section 809FZF(3) lists the types of investment which, if they are unwanted short-term investments, can benefit from the disregard of disposals (being land, securities in unlisted companies, direct loans where the other investments comprise shares or other securities in unlisted companies, and direct loans which meet the conditions to be a "qualifying loan" under new section 809FZR(2)).

25. Section 809FZF(5) directs that the disregard of disposals under section 809FZF(1) is to cease if it becomes reasonable to suppose that 25% or more of the capital of the investment scheme will have been invested in unwanted short-term investments. This limits the amount of capital a fund can deploy over its lifetime in acquiring unwanted short-term investments the disposal of which is disregarded under this provision. The 25% limit is cumulative and does not "refresh" as unwanted short-term investments are disposed of.

26. New Section 809FZG sets out the treatment of derivative contracts. The value invested for the purposes of the weighted average holding period is determined by subsection (2) depending on the type of derivative contract in question. A substantial alteration to the terms of a derivative is treated as a disposal and new acquisition at the time of the alteration (subsection (5)).

27. New Section 809FZH sets out the treatment of instruments that hedge exchange gains and

losses, defined in subsection (2). Such instruments are not treated as investments for the purpose of this legislation (subsection (4)), and entering into such an instrument is not treated as a deemed disposal of the hedged asset(s) for these purposes (subsection (3)).

28. New Section 809FZI sets out the treatment of instruments that hedge interest rates, defined in subsection (2). Such instruments are not treated as investments for the purpose of this legislation (subsection (4)), and entering into such an instrument is not treated as a deemed disposal of the hedged asset(s) for these purposes (subsection (3)).

29. New Section 809FZJ applies where an investment scheme holds a controlling interest in a company. Subsection (1)(a) provides that any further investment by the scheme in the company is treated as being made at the time that the scheme acquired the controlling interest. Subsection (1)(b) provides that any disposal by the investment scheme after a controlling interest is acquired is not to be regarded as made until the scheme makes a disposal which takes the investment scheme's holding below a 40% interest (subsection (2))

30. Section 809FZJ(3) provides that in the context of "associated funds" the controlling and 40% interest thresholds are applied by aggregating the interests of those associated funds. This is designed to benefit funds comprised of multiple partnerships (or other entities) which invest together but are technically separate investment schemes. The definition of "associated funds" is set out in section 809FZZ.

31. New Section 809FZK sets out bespoke calculation rules for venture capital funds in respect of investments in companies which meet certain conditions. Subsection (1)(a) provides that any subsequent venture capital investment made by such a scheme is treated as being made at the time the scheme acquired a "relevant interest" in a company. Subsection (1)(b) provides that any disposal by a venture capital fund is not to be regarded as made until the scheme (i) makes a disposal which (with any previous disposals also taken into account) has the effect that the fund has disposed of more than 80% of its investment in the company (subsection (3)) or (ii) ceases to meet the "scheme director condition". Where the conditions are met, this will mean subsequent investments by a venture capital fund can effectively be "backdated" to the time the fund acquired a relevant interest. Similarly, any partial disposals will be treated as taking place when the fund makes a disposal which takes it below the 80% level described above. This is intended to avoid misrepresenting the average holding period for funds and investments which come within section 809FZK. This treatment will also reduce the compliance burden in respect of those investments, for example where funds make investments across multiple rounds of fundraising.

32. Section 809FZK(2) provides that a scheme will have a "relevant interest" where either (i) its venture capital investments (see subsection (7)) in the company give it a 5% interest or (ii) where those investments have a value (determined at the point of investment and not including any increase in value) of more than £1m. When testing both these thresholds the interests of "associated funds" are aggregated (see section 809FZK(10)).

33. Sections 809FZK(4) to (6) set out the definition of "venture capital fund". An investment scheme will be a venture capital fund if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) at least two-thirds of the investments made by the fund will be venture capital investments and (ii) at least two-thirds of the investments made by the fund will be held for at least 40 months. These two limbs are applied separately (i.e. it is not necessary that two-thirds of the investments will be venture capital investments held for at least 40 months) and tested by reference to the

total value invested by the scheme.

34. Section 809FZK(7) defines "venture capital investment" as an investment in a trading company or the holding company of a trading group which meets certain conditions. Firstly, the company must be unlisted and likely to remain so. This does not mean that there is no prospect the company will be floated on a stock market. In some situations a successful venture capital investment will be listed at some stage. Instead this test looks to whether the company is likely to be listed in the relatively near future, or whether firm plans are in place for it to be listed at some point. A vague expectation (or even desire) that the company might be listed at some point in the distant future if it is successful will not be sufficient. Secondly, at least 75% of the amount invested by the fund must be invested in newly issued shares or securities convertible into shares (i.e. it cannot be used to buy out other investors). Thirdly, the amounts invested by the fund must be used in a trade of the company or group to support its growth or the development of new products of services, and that trade must not have been carried on by a member of the group for more than 7 years. Finally, the "scheme director condition" must be met (see subsection (8)).

35. Section 809FZK(8) and (9) set out the "scheme director condition". In essence, the scheme, or one or more investment schemes acting together must be entitled to appoint a director of the company (or a company which controls the company) and that director must be entitled to exercise certain enhanced rights in respect of the company (as set out in subsection (9))

36. New Section 809FZL sets out bespoke calculation rules for significant equity stake funds in respect of investments in companies which meet certain conditions. Subsection (1)(a) provides that any subsequent investment made by such a scheme is treated as being made at the time the scheme acquired a significant equity stake in the company. Subsection (1)(b) provides that any disposal by a qualifying scheme (where it has held a significant equity stake investment in a company) is not to be regarded as made until the scheme (i) makes a disposal which takes the scheme's interest in the company below 15% (subsection (2)) or (ii) ceases to meet the "scheme director condition". As for the venture capital fund rules set out in section 809FZK, these rules will mean subsequent investments by a significant equity stake fund can effectively be "backdated" to the time the fund acquired a significant equity stake investment in a company. Similarly, any interim disposals will be treated as taking place when the fund makes a disposal which takes it below a 15% interest. This is intended to avoid misrepresenting the holding period of qualifying funds and investments while reducing the compliance burden implicit in tracking each subsequent investment and partial exit.

37. Section 809FZL(3) to (5) sets out the definition of "significant equity stake fund" (over which the venture capital fund rules in section 809FZK take priority). An investment scheme will be a significant equity stake fund if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) more than 50% of the investments made by the fund will be significant equity stake investments and (ii) more than 50% of the investments made by the fund will be held for at least 40 months. These two limbs are applied separately and tested by reference to the total value invested by the scheme.

38. Section 809FZL(6) defines "significant equity stake investment" as an investment in a trading company or the holding company of a trading group which meets certain conditions. Firstly, the company must be unlisted and likely to remain so. As for venture

capital funds, a vague expectation that the company might be listed at some point in the distant future if it is successful will not be sufficient to fail this limb. Secondly, the fund must have a 20% interest in the company. Thirdly, the "scheme director condition" must be met (as defined in section 809FZL(8) and (9)).

39. Section 809FZL(7) provides that in the context of "associated funds" the 20% and 15% interest thresholds are applied by aggregating the interests of those associated funds.

40. New Section 809FZM sets out bespoke calculation rules for controlling equity stake funds in respect of investments in companies which meet certain conditions. Where such a fund holds a 25% interest in a trading company or the holding company of a trading group, subsection (1)(a) provides that any subsequent investment made by such a scheme is treated as being made at the time the scheme acquired the 25% interest in the company, while subsection (1)(b) provides that any disposal by the investment scheme is not to be regarded as made until the scheme makes a disposal which takes the scheme's interest in the company below 25% (subsection (2)). These rules will mean subsequent investments by a controlling equity stake fund can effectively be "backdated" to the time the fund acquired a 25% interest in a company or group. Similarly, any interim disposals will be treated as taking place when the fund makes a disposal which takes it below a 25% interest.

41. Section 809FZM(3) to (5) sets out the definition of "controlling equity stake fund" (over which both the venture capital fund in section 809FZK, and the significant equity stake fund rules in section 809FZL take priority). An investment scheme will be a controlling equity stake fund if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) more than 50% of the investments made by the fund will be controlling interests in trading companies or holding companies of trading groups and (ii) more than 50% of the investments made by the fund will be held for at least 40 months. These two limbs are applied separately and tested by reference to the total value invested by the scheme.

42. Section 809FZM(6) provides that when testing if a fund has a controlling interest or an interest of any particular percentage in a company, any share capital held by an associated investment scheme is also brought into account.

43. New Section 809FZN sets out bespoke calculation rules for real estate funds where they hold a major interest in land. Major interest means the fee simple or a tenancy for a term certain exceeding 21 years and, in relation to Scotland, means the interest of the owner, or the lessee's interest under a lease for a period of not less than 20 years. Where such a fund holds a major interest, subsection (1)(a) provides that any subsequent investment made by such a scheme is treated as being made at the time the scheme acquired the major interest, while subsection (1)(b) provides that any disposal by the investment scheme is not to be regarded as made until the scheme makes a relevant disposal (see subsection (2)).

44. Section 809FZN(3) provides that where a fund holds a major interest in land and acquires a major interest in adjacent land, that is treated as an investment in the original land for the purposes of subsection (1)(a). For example, a fund could own a field, 'Blackacre' which it acquired on 1 June 2016. In January 2017 it acquires the adjacent field, 'Whiteacre'. Under these rules Whiteacre would be treated as acquired on 1 June 2016 for the purposes of calculating the fund's average holding period.

45. Section 809FZN(4) to (6) sets out the definition of "real estate fund". An investment scheme

will be a real estate fund if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) more than 50% of the investments made by the fund will be land and (ii) more than 50% of the investments made by the fund will be held for at least 40 months. These two limbs are applied separately and tested by reference to the total value invested by the scheme.

46. New Section 809FZO sets out specific rules for "funds of funds". Provided that the purpose of the fund in making an investment in another collective investment scheme (the "underlying scheme") is not to reduce the proportion of carried interest arising to any person, the requirement to disregard intermediate holdings and holding structures will not apply to an investment made by a fund in the underlying scheme. This means that the fund can treat its investment as comprising its interest in the underlying scheme: it will not need to look through to the underlying assets (subsections (1) and (2)).

47. Section 809FZO(3) sets out bespoke calculation rules where a fund of funds holds a significant interest in an underlying scheme. Subsection (3)(a) provides that any subsequent qualifying investment made by the fund of funds is treated as being made at the time the scheme acquired the significant investment in the underlying scheme, while subsection (3)(b) provides that any disposal by the fund of funds is not to be regarded as made until it makes a "relevant disposal".

48. Section 809FZO(4) defines "relevant disposal" as a disposal which means the fund of funds has disposed of at least 50% of its investment in the underlying scheme (looking at the greatest value invested by the fund of funds) (subsection (4)(a)). This is aimed at situations where the fund of funds disposes of its investment in the scheme (for example by way of sale to a secondary fund). A fund of funds will generally not be treated as making a disposal within section 809FZO(4)(a) where an underlying scheme constituted as a partnership sells investments (i.e. where such a fund of funds could be treated as making disposals of a fractional interest in those underlying assets under established practice governing the calculation of CGT). However, a relevant disposal will also be triggered under subsection 4(b) when the fund of fund's investment in the underlying scheme is worth less than the greater of £1 million or 5% of the total amount invested by the fund of funds in the scheme.

49. Section 809FZO(5) to (7) sets out the definition of "fund of funds". An investment scheme will be a fund of funds if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) substantially all of the investments made by the fund of funds will be in other collective investment schemes in which the fund of funds will hold less than a 50% interest (ii) more than 50% of the investments made by the fund will be held for at least 40 months and (iii) more than 75% of the total value invested in the fund of funds will come from external investors.

50. Section 809FZO(8) defines "significant investment" as an investment of at least £1 million of 5% of the total amounts raised or expected to be raised from external investors in the underlying scheme.

51. Section 809FZO(9) specifies when an investment by a fund of funds in an underlying scheme will be a qualifying investment for the purposes of subsection (3). These conditions are aimed at ensuring only a genuine fund of funds can benefit from the bespoke calculation rules set out in section 809FZO, and that they are not exploited to circumvent the average holding period test. The conditions are that: (i) the fund of funds must hold its

investment in the underlying scheme on the same terms as other investments made by external investors - the investment cannot be governed by different terms; (ii) the fund of funds must not hold more than 30% of the underlying scheme; (iii) the underlying scheme must not hold an investment in the fund of funds; (iv) the management teams of the two funds must be completely separate; and (v) the investment must not be part of arrangements which are designed to reward any person which provides investment management services to the underlying scheme (e.g. if the fund of funds is being used to disguise the average holding period of the underlying scheme by exploiting the treatment provided for in section 809FZO(1)).

52. New Section 809FZP sets out specific rules for "secondary funds". Provided that the purpose of the secondary fund in acquiring an investment in another collective investment scheme (the "underlying scheme") is not to reduce the proportion of carried interest arising to any person, the requirement to disregard intermediate holdings and holding structures will not apply to an investment acquired by a secondary fund in an underlying scheme. This means that the secondary fund can treat its investment as comprising its interest in the underlying scheme: it will not need to look through to the underlying assets (subsections (1) and (2)).

53. Section 809FZP(3) sets out bespoke calculation rules where a secondary fund holds a significant interest in an underlying scheme. Subsection (3)(a) provides that any subsequent qualifying investment made by the fund of funds is treated as being made at the time the scheme acquired the significant investment in the underlying scheme, while subsection (3)(b) provides that any disposal by the fund of funds is not to be regarded as made until it makes a "relevant disposal".

54. Section 809FZP(4) defines a "relevant disposal" as a disposal which means the secondary fund has disposed of at least 50% of its investment in the underlying scheme (looking at the greatest value invested by the fund of funds) (subsection (4)(a)). As for funds of funds, this is aimed at situations where the secondary fund disposes of its investment in the scheme (for example by way of sale to another secondary fund). A relevant disposal will also be triggered under subsection 4(b) when the secondary fund's investment in the underlying scheme is worth less than the greater of £1 million or 5% of the total amount invested by the fund of funds in the scheme..

55. Section 809FZP(5) to (7) sets out the definition of "secondary fund". An investment scheme will be a secondary fund if it is reasonable to suppose, as determined at the time it starts to make investments, that over the life of the fund (i) substantially all of its investments will be the acquisition of investments in other collective investment schemes (ii) more than 50% of the investments made by the fund will be held for at least 40 months and (iii) more than 75% of the total value invested in the secondary fund will come from external investors.

56. Section 809FZP(8) defines "significant investment" as an investment of at least £1 million of 5% of the total amounts raised or expected to be raised from external investors in the underlying scheme.

57. Section 809FZP(9) specifies when an investment by a secondary fund in an underlying scheme will be a qualifying investment for the purposes of subsection (3). These conditions are intended to ensure that only genuine secondary funds can benefit from the bespoke calculation rules set out in section 809FZP, and that they are not exploited to circumvent the average holding period test. The conditions are: (i) the investment acquired by the

secondary fund must have been made - in the hands of the original investor - on the same terms as other investments in the underlying scheme by external investors; (ii) those terms must not have been subject to significant chance; (iii) the secondary fund must not hold more than 30% of the underlying scheme; (iv) the underlying scheme must not hold an investment in the fund of funds; (v) the management teams of the two funds must be completely separate; and (vi) the investment must not be part of arrangements which are designed to reward any person which provides investment management services to the underlying scheme.

58. New Section 809FZQ treats carried interest arising from direct lending funds as chargeable to income tax, unless new section 809FZR applies.

59. New section 809FZR exempts certain direct lending funds from the scope of section 809FZQ. Where those conditions apply, the general rules of Chapter 5F will apply to the carried interest instead of section 809FZQ, although where certain loans are repaid in full or in part before maturity, the element repaid will be treated as having been held for 40 months.

60. New section 809FZS sets out the treatment of 'conditionally exempt carried interest'. Where certain conditions are met, that carried interest is conditionally taxed under the chargeable gains rules and not as income (subsection (1)). This prevents carried interest being charged to income tax under these rules in the early years of a fund's existence (when the calculation required by new section 809FZC will necessarily produce an average holding period of below 40 months) when the fund expects to hold the relevant investments for a period which would exceed four years.

61. Section 809FZS(2) to (8) sets out the required conditions. These are that: (i) the carried interest arises no later than four years after the fund first makes an investment or, where the fund uses a "realisation model" to calculate carried interest, ten years after the fund makes its first investment, (ii) the carried interest would be taxed as income by applying the new rules at the time the carried interest arises, but (iii) it is reasonable to suppose that, if the carried interest had arisen at a later time in the fund's life, it would be treated by the legislation as derived from assets that meet the test for being treated as long term investments. For these purposes, "realisation model" is defined by reference to section 809EZD of ITA, although the requirement for a performance hurdle in that section is ignored (see section 809FZZ(1)).

62. Section 809FZS(6) and (7) sets out the relevant time at which the carried interest is assumed to arise for the purposes of the test in subsections (2) to (5). This is the earliest of: (i) when the investment scheme will be wound up; (ii) the period of four years after the fund is expected to cease to make investments; (iii) the period of four years after the carried interest arose to the individual although, where a realisation model is used, this period is extended to 10 years; and (iv) the end of the period of four years from the end of the period by reference to which the carried interest was determined. In the context of a closed-ended fund which operates a "whole fund" carried interest on the realisation model the "period" by reference to which the carried interest will be determined will, broadly, run from the point commitments are first drawn down from investors until the point at which the last distribution is made.

63. New Section 809FZT sets out how 'conditionally exempt carried interest' is subsequently to be treated.

64. Section 809FZT(1) provides that conditionally exempt carried interest ceases to be exempt at the earliest of: (a) the time the scheme is wound up; (b) four years after the firm ceases to make investments; (c) four years from the day the carried interest arose to the individual (extended to 10 years where the fund uses a realisation model to calculate carried interest); (d) four years from the end of the period by reference to which the carried interest was calculated and (e) any time at which it is no longer reasonable to suppose that the carried interest would not be income-based carried interest if it arose at the relevant time (i.e. if it becomes apparent at any time that the carried interest will be chargeable to tax as income under these rules).

65. Section 809FZT(2) to (4) sets out the consequences of the conditionally exempt carried interest ceasing to be exempt. The carried interest is reviewed at that time to determine whether it should be taxed as income or capital. Any necessary tax adjustments are made, and where there is now to be a charge to income tax any capital gains tax paid in respect of the same carried interest is set off against that income tax.

66. New Section 809FZU provides that these rules do not apply to carried interest which arises in respect of an employment-related security within Part 7 of the Income Tax (Earnings and Pensions) Act 2003.

67. New Section 809FZV sets out how "loan to own" investments are to be treated. Where an investment scheme acquires impaired debt at a discount, with a view to securing ownership of assets on which the debt is secured or which are owned by a company which is the debtor under the debt, provided the investment scheme acquires ownership of these assets within three months, the debt and assets are to be treated as one asset.

68. New Section 809FZW puts in place an anti-avoidance rule to prevent manipulation of average holding periods or whether a scheme is a venture capital fund, significant equity stake fund, controlling equity stake fund, real estate fund, fund of funds or secondary fund.

69. New Section 809FZX provides the Treasury with a power to make regulations to vary how the average holding period is calculated, to amend what is and is not regarded as an investment, vary the time when an investment is made or disposed of and introduce anti-avoidance provisions or to remove or restrict the application of section 809FZU (employment-related securities).

70. New Section 809FZY defines what is meant by 'reasonable to suppose' for the purposes of Chapter 5F.

71. New Section 809FZZ provides definitions of various terms used in Chapter 5F. Subsection (4) provides that these provisions will apply to all sums of carried interest arising on or after 6 April 2016

Background note

72. Managers of investment funds are rewarded in a variety of ways. Management Fees are charged to tax as income, and legislation in FA 2015 ensured that fee income could not be disguised as a form of capital receipt.

73. Managers also receive performance-based rewards, sometimes known as 'carried interest'. This is based on the performance of the funds that they manage and can take the form of a

share in the fund's total return. Legislation in Finance (No. 2) Act 2015 ensured that where carried interest is taxable as a chargeable gain, the full amount would be taxable without reduction through arrangements such as 'base cost shift'.

74. In the 2015 Summer Budget the government also announced that it would consult on a new legislative test to determine when carried interest should be taxed as income or as chargeable gains. The intention is that this test should replace the current test, which is based on case law and is centred around the so-called 'badges of trade'. The case law underlying the test has mainly considered trades connected with areas such as manufacturing and retail. The test is more difficult to apply to a business such as asset management. The government has therefore decided to put in place a legislative test.

Clause 38: Income-based carried interest: persons coming to the UK

Summary

1. This clause introduces amendments to the disguised investment management fee rules which apply to certain sums arising to individuals who perform investment management services.

Details of the clause

2. Clause 38 amends Chapter 5E of Part 13 of the Income Tax Act 2007 (ITA), which contains the Disguised Investment Management Fee Rules ("DMF Rules").
3. Subsection (1) inserts new subsections (2A) to (2C) into 809EZA(2) of the DMF rules to modify the tax treatment of income-based carried interest where a person performing investment management services first comes to the UK.
4. New subsection (2A) of section 809EZA sets out the case, which is that a UK resident individual who meets various residence requirements is in receipt of income-based carried interest in a tax year. The residence requirements are that the individual has previously been non-UK resident for at least five consecutive tax years and receives the carried interest in the first, second, third or fourth tax year after becoming UK resident. It also a requirement that there has been no break in UK residence between arrival and the year of receipt of the income-based carried interest.
5. New subsection (2B) of section 809EZA sets out the consequences. Where "pre-arrival services" have been performed by the individual in the UK, the carried interest referable to those services is treated as profits of a trade carried on by the individual. Any carried interest referable to "pre-arrival services" performed by the individual outside the UK are treated as profits of a distinct and separate trade. The significance of this distinction is that if the manager is domiciled outside the UK, he or she will be fully chargeable to income tax on pre-arrival profits relating to the first trade, but will be potentially able to access the remittance basis in relation to pre-arrival profits of the second trade.
6. New subsection (2C) of section 809EZA defines pre-arrival services as investment management services performed before the individual became UK resident.
7. Subsection (2) provides that the amendment has effect in relation to carried interest arising on or after 6 April 2016.

Background note

8. Managers of investment funds are rewarded in a variety of ways. Management Fees are charged to tax as income, and the DMF Rules in FA 2015 ensured that fee income could not be disguised as a form of capital receipt.

9. Managers also receive performance-based rewards, sometimes known as 'carried interest'. This is based on the performance of the funds that they manage and can take the form of a share in the fund's total return. Legislation in Finance (No. 2) Act 2015 ensured that where carried interest is taxable as a chargeable gain, the full amount would be taxable without reduction through arrangements such as 'base cost shift'. This legislation built on the DMF Rules.

10. Finance Bill 2016 contains further rules which will determine when carried interest should be taxed as income or as chargeable gains. Again, this builds on the architecture established for the DMF Rules.

11. As part of these changes the government has decided to make certain amendments to the DMF Rules.

Clause 39 and Schedule 6: Deduction of income tax at source

Summary

1. This clause and Schedule amend Part 15 of the Income Tax Act 2007 (ITA) to remove the requirement upon deposit-takers (such as banks), building societies and other institutions to deduct sums representing income tax from the interest or other returns they pay on certain savings, investments and alternative finance arrangements. The changes have effect in relation to interest paid or credited on and after 6 April 2016.

Details of the clause and Schedule

2. Clause 39 introduces Schedule 6

3. Schedule 6amends Part 15 of ITA concerning the deduction of income tax at source.

Part 1: Abolition of duty to deduct tax from interest on certain investments

4. Paragraph 1 removes section 851 of ITA, which requires deposit-takers and building societies to deduct a sum representing income tax at the basic rate from the interest they pay on certain investments.

Part 2: Deduction of tax from yearly interest: exception for deposit-takers

5. Paragraph 2 amends section 876 of ITA to provide that the duty (under section 874 of ITA) to deduct a sum representing income tax from certain payments of yearly interest will not apply to interest paid by deposit-takers on 'relevant investments' (as defined in Chapter 2 of Part 15 of ITA).

Part 3: Amendments of or relating to Chapter 2 of Part 15 of ITA 2007

6. Part 3 of the Schedule amends or omits various provisions in, or relating to, Chapter 2 of Part 15 of ITA as a consequence of changes made elsewhere in this Schedule. These changes include the removal of the duty on deposit-takers and building societies to deduct sums representing income tax from certain interest payments. Following these amendments, Chapter 2 of Part 15 of ITA will apply to determine the scope of the exception (provided at section 876 of ITA) to the duty to deduct from certain payments of yearly interest.

7. Paragraphs 20 and 21 update section 564Q of ITA, consequential to other changes in this Schedule. These changes will also ensure that, where relevant, returns from alternative finance arrangements are treated in the same way as interest for the purposes of tax

deduction.

Part 4: Deduction of tax from UK Public Revenue Dividends

8. Part 4 of the Schedule amends section 877 and Chapter 5 of Part 15 of ITA, concerning deduction of tax from payments of public revenue dividends.

9. Paragraph 27 amends section 893 of ITA to ensure that interest payments on securities issued by National Savings and Investments (the National Savings Bank) are excluded from the duty to deduct tax set out in section 892 of ITA and makes consequential amendment to section 894 of ITA.

Part 5: Commencement

10. Part 5 of the Schedule sets out commencement provisions for these amendments.

Background note

11. Deposit-takers (such as banks) and building societies, currently deduct 20% from the account interest they pay, under the Tax Deduction Scheme for Interest (TDSI). Similarly, National Savings and Investments (NS&I) currently deducts sums representing income tax at the basic rate from the interest it pays on certain bonds. For these purposes, returns on certain alternative finance arrangements are treated in the same way as interest.

12. At Budget 2015, the government announced the introduction of a new Personal Savings Allowance (PSA) from 6 April 2016. Once the PSA is implemented, most individual savers will no longer be liable for tax on any of the savings interest they receive. The government therefore also announced that, alongside the introduction of the PSA, it would end the duty on banks, building societies and other institutions (including NS&I) to deduct sums representing income tax from account interest paid or credited to customers.

Clause 40: Deduction of income tax at source: tax avoidance

Summary

1. This clause amends the rules in Part 15 of the Income Tax Act (ITA) 2007 on the deduction of income tax from payments of royalties by inserting new section 917A. It introduces anti-avoidance rules to prevent the abuse of double taxation arrangements to avoid the duty to deduct income tax from royalty payments made to connected persons.

Details of the clause

2. Subsection (1) of the clause inserts new section 917A into Chapter 8 of Part 15 of ITA. Section 917A denies the benefit of double taxation arrangements where payments of royalties are made under tax avoidance arrangements.
3. Subsection (1) of new section 917A provides that the section applies where a person makes a payment of a royalty to a connected person under DTA tax avoidance arrangements. "DTA tax avoidance arrangements" are defined in subsection (4) of new section 917A.
4. Subsection (2) of new section 917A sets out the consequences of meeting these conditions. In such cases the person making the payment must deduct income tax from it regardless of any double taxation arrangements.
5. Subsection (3) of new section 917A prevents any income tax deducted by virtue of this section being set off against a company's tax liability under sections 967 or 968 of the Corporation Tax Act 2010.
6. Subsection (4) of new section 917A defines terms used in the section. In particular, the definition of "intellectual property royalty payment" sets out the payments to which the section applies.
7. Subsection (5) of new section 917A explains that for the purposes of the section, persons are connected if the participation condition is met as between them.
8. Subsection (6) of new section 917A applies section 148 of the Taxation (International and Other Provisions) Act 2010 to determine whether the participation condition is met.
9. Subsection (2) of the clause provides the commencement provisions.

Background note

10. Tax rules in ITA 2007 require the deduction of income tax from certain payments of royalties. The person making the payment is required to withhold an amount equivalent to income tax at the basic rate. This is commonly referred to as withholding tax. However, under double taxation treaties between the UK and a number of other territories the person receiving a payment of royalties may be able to reclaim any tax deducted and have future

payments made to them gross, that is, without any withholding by the person making the payment.

11. This measure addresses arrangements that seek to avoid the duty to deduct income tax at source from a payment of royalties through the abuse of double taxation treaties, where the payment is made to a person connected with the payer.

Clause 41: Charge for financial year 2017

Summary

1. This clause charges corporation tax (CT) for the financial year beginning 1 April 2017.

Details of the clause

2. Clause 41 charges CT for the financial year beginning 1 April 2017.

Background note

3. Parliament charges CT for each financial year. This clause charges CT for the financial year beginning 1 April 2017. The rate of CT for the financial year 2017 was set at 19% in section 7 of the Finance (No. 2) Act 2015.

Clause 42: Rate of corporation tax for financial year 2020

Summary

1. This clause sets the main rate of corporation tax (CT) at 17% for the financial year beginning 1 April 2020.

Details of the clause

2. Clause 42 sets the CT main rate for the financial year beginning 1 April 2020.

Background note

3. The CT main rate for financial year commencing 1 April 2020 was set at 18% in Finance (No.2) Act 2015. This clause replaces the 18% with an additional 1% cut to 17% for that Financial Year.

Clause 43: Abolition of vaccine research relief

Summary

1. Vaccine Research Relief (VRR) will be left to expire when its state aid clearance runs out on 31 March 2017.

Details of the clause

2. Subsection 1 introduces amendments to Corporation Tax Act (CTA) 2009.
3. Subsection 2 repeals chapter 7 of Part 13 CTA 2009.
4. Subsection 3 amends section 1039 CTA 2009 to omit references to vaccine research relief.
5. Subsection 4 removes a reference to vaccine research relief from section 1042 CTA 2009, which defines the meaning of research and development.
6. Subsection 5 amends legislation that provides for a cap on the total amount of aid provided for each research and development project. The subsection removes references to vaccine research relief from the aid cap provisions.
7. Subsections 6, 7, 8 and 9 provide further consequential amendments to other provisions.
8. Subsection 10 introduces amendments to Corporation Tax Act (CTA) 2010.
9. Subsection 11 amends legislation that governs how reliefs including vaccine research relief operate when the expenditure is incurred by a Northern Ireland company. This subsection removes the reference to vaccine research relief.
10. Subsection 12 omits a rule that governs how vaccine research relief is calculated in Northern Ireland cases.
11. Subsections 13 and 14 provide further consequential amendments to other provisions.
12. Subsection 15 provides that the amendments in this section have effect in relation to expenditure incurred on or after 1 April 2017

Background note

13. VRR was introduced in 2003 as an additional research and development tax relief for companies undertaking research in the fields of vaccines and treatments for tuberculosis, malaria and HIV/AIDS.
14. In 2011, VRR was first reduced, then withdrawn for small and medium sized enterprises. The relief is now only available to large firms and is claimed by fewer than 10 companies a year.
15. The low level of take-up of the relief suggests it does not have a significant impact on a company's research decisions. The government believes that direct spending programmes

like the recently announced Ross Fund offer a more effective and flexible approach to the production of medicines and vaccines.

16. As a result, VRR will be left to expire when its state aid clearance runs out on 31 March 2017.

Clause 44: Cap on R&D aid

Summary

1. The state aid cap rules for the Small and Medium Size Enterprise (SME) scheme include a formula which compares the amount of aid received by the SME with what it would have received under the large company relief. The amendments introduced by this measure update the references in the formula to ensure that the R&D Expenditure Credit (RDEC) becomes the comparator rather than the large company relief. This is because the RDEC is replacing the large company relief altogether from 1 April 2016.

Details of the clause

2. Subsection 1 introduces amendments to Corporation Tax Act (CTA) 2009.
3. Subsection 2 introduces amendments to section 1114 CTA 2009.
4. Subsection 2 (a) changes the formula in section 1114 CTA 2009. The need to multiply the notional figure with the main rate of corporation tax is removed from 1 April 2016; from that date the figure to be used comes from the notional RDEC claim.
5. Subsection 2 (b) changes the word 'relief' to 'R&D Expenditure Credit'. This change is needed because the RDEC is replacing the large company relief.
6. Subsection 3 amends section 1118 CTA 2009. The amendment has the effect that the notional figure which appears in the section 1114 CTA 2009 formula is to be calculated using the rules for the RDEC rather than the rules which apply to the large company relief
7. Subsection 4 provides that the amendments in this section have effect in relation to expenditure incurred on or after 1 April 2016.

Background note

8. By virtue of section 1044(9) CTA 2009 and Chapter 8 CTA 2009 Research and Development tax relief through the SME scheme cannot exceed €7.5million for any one company for any one project. An SME checks whether it has exceeded the €7.5 million aid cap by carrying out a calculation, the formula for which can be found in section 1114 CTA 2009. That formula compares the SME relief to any 'notional' claim which the SME could have made under the large company relief scheme.
9. From 1 April 2016 the large company relief is replaced by the RDEC so the references in the formula need to be updated.
10. Section 1118 CTA 2009 provides the rules by which the notional figure in the section 1114 CTA 2009 formula should be calculated. At present section 1118 CTA 2009 states that the 'notional' relief is based on the relief available within Chapter 5. Chapter 5 is where the large company relief rules are found and as mentioned above these rules do not apply to

expenditure incurred on or after 1 April 2016. This clause replaces the reference to 'Chapter 5' with a reference to 'chapter 6A of part 3 CTA 2009' to refer instead to the RDEC.

11. This clause also changes the formula in Section 1114 CTA 2009. This change reflects the fact that the large company relief has been replaced by the RDEC which mean that it is not necessary to multiply the credit by the main rate of corporation tax.

Clause 45 and Schedule 7: Loan relationships and derivative contracts

Summary

1. This clause introduces Schedule 7, which updates the rules governing the taxation of corporate debt ('loan relationships') and derivative contracts. Changes are being made in the Corporation Tax Act 2009 (CTA 2009) to address three situations where the interactions with accounting rules or other parts of the tax rules may lead to unintended and unfair outcomes. These three situations are:

   - notional finance costs that can arise on interest free loans and other loans on non-market terms;
   - credits that arise on reversal of debits which were previously denied for tax under the transfer pricing rules; and
   - amounts excluded from taxation under the transfer pricing rules where the loan or derivative is part of a hedging relationship intended to mitigate foreign currency risk.

2. The changes will take effect from 1 April 2016.

Details of the Schedule

Part 1: Loan relationships: non-market loans

3. Paragraph 2 introduces new section 446A to CTA 2009, concerning the treatment of interest-free loans and other loans on non-market terms.

4. New section 446A applies where a loan liability is initially recognised in the borrowing company's accounts at an amount less than the amount borrowed, and the accounting discount arising on inception is not brought into account. It will apply where the lender is an individual (or other non-corporate) or where there is a corporate lender which is resident in a non-qualifying territory.

5. Where this section applies, the debits resulting from the unwind of the discount over the term of the loan are restricted for tax purposes. Where the discount on inception is partly brought into account, the restriction applies to the part of the discount which is not brought into account (referred to as the 'relevant discount amount').

Part 2: Loan relationships and derivative contracts: transfer-pricing rules

6. Paragraph 3 amends section 446, which governs how amounts under a loan relationship are to be brought into account as a result of adjustments made under Part 4 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010). It inserts a new subsection (8) which excludes amounts from being taxed to the extent that they represent a reversal of, or otherwise correspond with, an amount for which a corporation tax deduction was previously restricted under this section as a result of the application of the transfer pricing provisions.

7. Paragraph 4 makes an equivalent amendment to section 693, which governs how amounts under a derivative contract are to be brought into account as a result of adjustments made under Part 4 of TIOPA 2010.

Part 3: Loan relationships and derivative contracts: exchange gains and losses

8. Paragraph 5 inserts new subsection 447(4A), concerned with debtor relationships not at arm's length. This limits the application of section 447 where the loan is matched. As a result, the amount of exchange gain or loss excluded by the section cannot exceed the exchange gain or loss arising on the unmatched element of the loan. This ensures that section 447 does not exclude any exchange gain or loss arising on the matched element of the loan.

9. Paragraph 6 makes a corresponding amendment to section 448, concerned with debtor relationships that are 'equity notes' under section 1015(6) of the Corporation Tax Act 2010.

10. Paragraphs 7 and 8 make corresponding amendments to each of sections 449 and 451, concerned with creditor relationships not at arm's length.

11. Paragraph 9 sets out the changes being made to section 452 dealing with the case where there is debt subject to a guarantee. Subsection 452(3) is amended so that subsections 452(4) and 452(5) will apply where either one company, or more than one company, has made a claim under section 192(1) TIOPA 2010, or is deemed to have done so.

12. Subsections 452(4) and 452(5) are also amended respectively in relation to the total amount of debits or credits that may be brought into account by any company which falls within section 452(3). This amount is to be determined by reference to the amount not brought into account by the issuing company, rather than by reference to the corresponding creditor relationship. This ensures that there is no potential of double counting of exchange gains and losses by the issuing company and the guarantee companies.

13. Paragraph 10 introduces new section 475B which sets out the circumstances in which a loan relationship is considered to be matched. A loan is matched to the extent to which either (i) the loan is in a matching relationship with another loan or derivative, or (ii) the exchange gains and losses on the loan are disregarded under regulations made under section 328(4).

14. Paragraph 11 makes corresponding amendments to section 694 in respect of derivative contracts not at arm's length. These mirror the treatment applied to loan relationships in that adjustments to contracts not entered into at arm's length are restricted to the extent

that the contract is unmatched.

Part 4: Commencement and transitional provisions

15. Paragraph 12 explains that this Schedule has effect for accounting periods beginning on or after 1 April 2016.

16. Where an accounting period straddles 1 April 2016, it is treated as two separate accounting periods for these purposes only. In this case the changes have effect for the accounting period that is treated as beginning on 1 April 2016

Background note

17. At Budget 2013, the government announced a consultation on a package of proposals to modernise the corporation tax rules governing the taxation of corporate debt and derivative contracts. The main changes made as a result of the consultation are contained in Schedule 7 to the Finance (No.2) Act 2015.

Non-market loans

18. As a result of recent changes to UK accounting standards, companies can now be required to recognise interest-free loans and other non-market loans in their accounts at a value lower than the actual amount of the loan. This discount unwinds progressively in later periods of accounts. This can create a notional interest cost in the accounts of the borrower which does not reflect any real interest paid. Normally there would also be an accounting credit entry arising for the borrower on inception of the loan. Following the wider changes made in Finance (No.2) Act 2015, these accounting credit entries may not be taxable.

19. In some cases this could result in a tax deduction for the borrower, but no matching UK tax liability for the lender. In particular, the accounting treatment can create an asymmetry where the lender is an individual or where interest is paid cross-border.

20. This measure therefore restores the borrower, in appropriate cases, to the position that would have arisen before the accounting changes. In particular, it restricts tax relief for the borrower’s notional interest expense where the borrower’s corresponding accounting credit entry on inception of the loan is not taxed.

Transfer pricing

21. Typically amounts of profits and losses arising from loan relationships and derivative contracts are brought into account for corporation tax in line with the company's accounts. However, the transfer pricing rules apply where the loan or derivative is not on arm's length terms and there is a potential tax advantage. In such a case, the profits and losses are to be calculated as if the loan or derivative had been on arm's length terms.

22. As a result of recent changes to UK accounting standards, there are now more occasions where companies can be required to recognise amounts in their financial statements which subsequently reverse. Where the transfer pricing rules apply, this can result in a restriction of corporation tax deductions for the amounts of debits, while the corresponding credits on reversal in subsequent periods could remain taxable.

23. This measure prevents that unintended outcome by ensuring that credits are not taxed to the extent that debits have been restricted under sections 446 or 693 as a result of the application of the transfer pricing provisions.

Exchange gains and losses

24. Sections 447, 449, 451 and 694 CTA 2009 operate to restrict amounts of exchange gains and losses brought into account for corporation tax on loans and derivatives in cases where the loan or derivative are not at arm's length. Section 448 operates in a similar way where the loan is an 'equity note' under section 1015(6) Corporation Tax Act 2010.

25. A particular concern has been identified with those provisions, as a result of which they can introduce a foreign currency exposure for corporation tax purposes even though none exists commercially or in the accounts.

26. This measure ensures that those provisions do not apply to the extent to which the loan or derivative in question is matched. Loans and derivatives are in a matching relationship when one is intended by the company to hedge foreign currency risk on the other.

27. In addition, the measure ensures that those provisions do not apply to the extent to which exchange gains and losses are disregarded under the Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) (known as the 'Disregard Regulations').

28. Section 452 defines the amount of exchange gains and losses that can be brought into account where a guarantor claim has been made under section 192(1) TIOPA 2010. This deems the guarantor company, and not the original debtor, as being party to the component of the debt not made at arm's length. The amendment to section 452 ensures there is no potential of double counting of exchange gains and losses by the issuing company and the guarantee companies.

Clause 46: Loans to participators etc: rate of tax

Summary

1. This clause specifically links the rates of tax charged by section 455 and section 464A Corporation Tax Act 2010 (CTA 2010) on loans or benefits conferred under arrangements made by close companies to their participators to the upper dividend rate. This increases the rate of tax charged by both sections from 25% to 32.5% from 6 April 2016.

Details of the clause

2. Subsection 1 sets the rate of section 455 tax for loans or advances made by close companies to participators at the dividend upper rate specified in section 8(2) of Income Tax Act 2007 (ITA07) for the tax year in which the loan or advance is made.

3. Subsection 3 sets the rate of section 464A tax for arrangements conferring a benefit on a participator at the dividend upper rate specified in section 8(2) of ITA 2007 for the tax year in which the benefit is conferred.

Commencement

4. Subsection 2 provides that the increased section 455 rate applies to loans made on or after 6 April 2016.

5. Subsection 4 provides that the increased section 464A rate applies to any benefits conferred on or after 6 April 2016.

Background note

6. The loans to participator rules charge tax on a close company (a company controlled by 5 or fewer participators - broadly shareholders) where it makes a loan or advance, or confers a benefit on a participator. The rules exist to deter extractions of value from close companies where those extractions are not subject to relevant personal taxes. If a loan or benefit is subsequently repaid to the company then the charge on the company is repaid.

7. The tax rate mirrors the dividend upper rate. To ensure this remains the case, given changes to dividend taxation, the rate is being specifically linked to the dividend upper rate. As dividend tax rates are increasing from April 2016, the loans to participators rates will therefore also increase. The new rates will ensure that section 455 and section 464A continue to meet their policy objective of deterring close companies from making loans or other arrangements which have the effect of minimizing the income tax burden of individuals.

Clause 47: Loans to participators etc: trustees of charitable trusts

Summary

1. This clause introduces a partial exemption from the loans to participator rules for certain charity transactions.

Details of the clause

2. Subsection 1 inserts new subsection 2A into section 456 Corporation Tax Act 2010 (CTA 2010).
3. New subsection 2A provides an exemption from the section 455 charge to tax for loans or advances to trustees of charitable trusts where the loan or advance is applied for the purposes of the charitable trust.
4. Subsection 2 provides that the exemption applies to loans or advances made on or after 25 November 2015.

Background note

5. The loans to participator rules exist to ensure that value is not extracted by individuals from close companies (broadly companies owned by 5 or fewer shareholders) in ways which minimise their personal taxes.
6. The rules applied to charities in relevant circumstances. Whilst 2013 changes to the rules did not bring charities within the rules for the first time, they raised awareness that certain financing transactions that charities entered into could be caught by the rules and this was brought to the government's attention.
7. The transactions in question do not meet the purpose of the loans to participator rules. The exemption will ensure that such loans are no longer caught, but at the same time it will provide that the charge can continue to apply to charity transactions which do meet the purpose of the rules.

Clause 48: Intangible fixed assets: pre-FA 2002 assets

Summary

1. This clause clarifies the rules for intangible fixed assets in Part 8 of the Corporation Tax Act 2009 (CTA 2009). The clause confirms that arrangements involving bodies such as partnerships or Limited Liability Partnerships (LLPs) cannot be used to move assets into the Part 8 rules in ways that were not intended by the legislation. Clause 49 makes a related change to the rules that establish the value to be taken into account on a transfer.

Details of the clause

2. Subsection (1) provides for amendments to sections 882, 894 and 895 of CTA 2009.

3. Subsection (2) inserts new subsections (5A) to (5D) into section 882 of CTA 2009. Section 882 is the provision that sets out the rules to determine whether assets fall within the Part 8 rules, or whether they remain within the pre 1 April 2002 rules.

4. New Section 882(5A) adds to section 882 the requirement that a 'participation condition' must also be considered when determining whether assets fall within the Part 8 rules, or whether they remain within the pre 1 April 2002 rules.

5. New Section 882(5B) applies section 882(5A) to a firm for the purposes of section 1259 of CTA 2009.

6. New Section 882(5C) sets out what is meant by 'section 1259 purposes'. Section 1259 of CTA 2009 determines how profits or losses of a partnership or LLP are computed when the partnership or LLP contains at least one member that is a company.

7. New Section 882(5D) brings in the 'participation condition' from section 148 of Taxation (International and Other Provisions) Act 2010.

8. Subsection (3) provides that new Sections 882(5A) to (5D) also apply for the purposes of sections 893 and 894 of CTA 2009.

9. Subsection (4) provides that new Sections 882(5A) to (5D) also apply for the purposes of sections 895 of CTA 2009.

10. Subsections (5) to (7) set out the time from when the changes apply. The new rules will apply to debits or credits arising in accounting periods beginning on or after 25 November 2015. For that purpose an accounting period is split into two notional accounting periods - one ending on 24 November 2015 and one beginning on 25 November 2015. The rules apply to debits and credits irrespective of when the relevant transfers of intangible fixed assets took place.

Background note

11. This clause confirms that the corporation tax regime for intangible fixed assets applies to those assets intended to be within its scope. Those rules, contained in Part 8 of CTA 2009, were introduced in FA 2002 to provide a modern set of tax rules for intangible assets. Broadly, the rules provide tax deductions for corporation tax that match the amounts amortised or written-off in the accounts year by year.

12. These rules only apply to assets created on or after 1 April 2002, or to assets acquired by a company from a third party after that date. Assets owned since before 1st April 2002 by a company or a party related to it should stay within the old rules, where relief for the cost of the asset is given when the asset is disposed of.

13. However, HMRC has identified arrangements that use bodies such as partnerships or LLPs to transfer assets in ways that aim to bring the assets within the new rules without an effective change of economic ownership.

14. HMRC does not consider that these arrangements work in the way that they are claimed to work. This measure widens the conditions that must be met for an asset to come within the Part 8 rules. This confirms that these arrangements are not effective to avoid the Part 8 commencement rules. A related change ensures that the correct value is used when assets which are within the Part 8 regime are transferred between companies and persons such as partnerships or LLPs.

Clause 49: Intangible fixed assets: transfers treated as at market value

Summary

1. This clause clarifies the rules for intangible fixed assets in Part 8 of the Corporation Tax Act 2009 (CTA 2009). The clause confirms that transfers of assets between companies and other bodies, such as partnerships or Limited Liability Partnerships (LLPs), in respect of which the participation condition is satisfied are brought into account at their market value. Clause 49makes a related change to the rules that establish whether intangible fixed assets come within the rules in Part 8 of CTA 2009, or whether they come within the rules that apply to pre 1 April 2002 assets.

Details of the clause

2. Subsection (1) amends section 845 of CTA 2009, which applies market value to transfers of intangible fixed assets between a company and a related party. It inserts new subsections (4A) to (4F) into section 845 of CTA 2009.

3. New Section 845(4A) enables section 845 to apply to transfers between companies and other bodies, such as partnerships or LLPs, in relation to whom the 'participation condition' is met.

4. New Section 845(4B) provides that references to a company in section 845(4A) also include a reference to a firm where a computation needs to be made for the purposes of section 1259 of CTA 2009.

5. New Section 845(4C) brings in the 'participation condition' from section 148 of Taxation (International and Other Provisions) Act 2010.

6. New Section 845(4D) sets out the circumstances in which subsection (4E) applies. These are that, for the purposes of section 1259, both a gain on disposal of intangible fixed assets is to be taken into account in computing profits and that references to a company in section 845(1) are to be read as references to a firm.

7. New Section 845(4E) provides that where those conditions apply, a gain on the disposal of those assets is brought within the rules of Part 8 of CTA 2009 as a 'chargeable realisation gain' and is therefore subject to the market value rule in section 845 of CTA 2009.

8. New Section 845(4F) sets out what is meant by 'section 1259 purposes'. Section 1259 of CTA 2009 determines how profits or losses of a partnership or an LLP are computed when the partnership or LLP contains at least one member that is a company.

9. Subsections (2) and (3) set out the commencement provision. The new rules will apply to transfers made on or after 25 November 2015, unless the transfer is made in consequence of a contract that was unconditional before that date.

Background note

10. This clause confirms that the corporation tax regime for intangible fixed assets applies to those assets intended to be within its scope. Those rules, contained in Part 8 of CTA 2009, were introduced in FA 2002 to provide a modern set of tax rules for intangible assets. Broadly, the rules provide tax deductions for corporation tax that match the amounts amortised or written-off in the accounts year by year.

11. These rules only apply to assets created on or after 1st April 2002, or to assets acquired by a company from a third party after that date. Assets owned since before 1st April 2002, by a company or a party related to it, should stay within the old rules where relief for the cost of the asset is given when the asset is disposed of.

12. However, HM Revenue and Customs (HMRC) has identified arrangements that use entities such as partnerships or LLPs to transfer assets in ways that aim to bring the assets within the new rules without an effective change of economic ownership. These arrangements also seek to disapply the rules that ensure that these transfers are brought into account at market value for tax purposes.

13. HMRC does not consider that these arrangements work in the way that they are claimed to work. This measure confirms that these arrangements are not effective in preventing the correct value being used when assets within the Part 8 regime are transferred between companies and other bodies such as partnerships or LLPs, where the participation condition is satisfied.

Clause 50 and Schedule 8: Tax relief for production of orchestral concerts

Summary

1. This clause and Schedule introduces a relief from corporation tax for qualifying orchestral concerts.

Details of the clause and Schedule

2. The clause brings in a Schedule which:

   - Introduces a new relief for orchestral concerts;
   - Provide for the consequential amendments to other parts of the Taxes Acts as a result of the new relief.
   - Provide for the commencement of the new orchestra relief.

Schedule 8: Part 1: Amendment of CTA 2009

3. Subsection 1 introduces Part 15D to Corporation Tax Act 2009 (CTA 2009).

Chapter 1

4. Chapter 1 contains sections 1217P to 1217PB which set out the overview of the relief and interpretation of "orchestral concert" and "production company".

5. Section 1217PA defines what is meant by "orchestral concert":

   - A concert by an orchestra, ensemble, group or band must consist wholly or mainly of instrumentalists who are the primary focus of the concert. For example, the instrumentalists are not just a backing band for a singer. Instrumentalists are not singers.
   - A concert will not be an 'orchestral concert' so not eligible for relief if It falls within the criteria set out at 1217PA(2) to (4). For example if a concert's main purpose is to advertise goods and services it will not qualify for relief.
   - A concert will not qualify for relief where the main purpose, or one of the main purposes is to advertise goods and services, or it includes a competition or contest, or the primary purpose is to make a recording.

6. Section 1217PB sets out the general rule that governs whether a company is a production company in relation to a qualifying concert.

   - The company must be actively engaged in decision-making, be responsible for putting on the concert from the start of the production process to the finish, and directly negotiate for and pay for rights, goods and services in relation to the concert. It must also employ and engage the performers.

- There can be only one production company in relation to a concert. Partnerships and co-productions are therefore not eligible for the relief.
- If there is more than one company that meets the conditions of a production company then it is that company most directly engaged in the activities set out in 1217PB(1) that is the production company. However if no company meets those conditions then there is no production company in relation to the concert.

Chapter 2

7. Chapter 2 sets out the taxation of activities of the production company.
8. Section 1217Q sets out how a company may make a claim for the additional deduction. A company that makes a claim for relief must treat each qualifying concert as a separate trade. A company is treated as beginning to carry on the separate trade when the pre-performance stage begins or, if earlier at the time of the first receipt by the company of any income from the production of the concert. Where a company makes an election in relation to a number of concerts in a series then that series is treated as a separate trade.
9. Section 1217QA sets out how a company may make an election for a concert series to be treated as a separate trade. The election must be in writing and is irrevocable once made. The election must also specify which of the concerts (if any) are not qualifying.
10. Section 1217QB sets out how the profits and losses of the separate orchestral trade are calculated for the first period of account and any subsequent periods.
11. Section 1217QC sets out what is income for the purposes of the calculation of the profits or losses of the separateorchestral trade. Income includes: receipts from the sale of tickets or of rights in the concert or concert series, royalties or other payments for use of other aspects of the concert or concert series, rights for merchandise and receipts by the company by way of any profit share agreements.
12. Section 1217QD sets out that for the purpose of the calculation of the profits or losses of the separate orchestral trade being the concert or the concert series. Costs incurred by the company will be those direct costs. Capital expenditure is treated as being of a revenue nature where it is on the creation of the concert or concert series.
13. Section 1217QE sets out the rules of when costs are taken to have been incurred for the purposes of the relief. For example that costs are incurred when they are represented in the state of completion of the work in progress or do not include any amount that has not been paid unless it is the subject of an unconditional obligation to pay.
14. Section 1217QF outlines the circumstances in which pre-trading expenditure, including expenditure on developing the concert or concert series before it was ‘green-lit’, may be treated as expenditure of the separate theatrical trade.
15. Section 1217QG provides that estimates at the balance sheet date for each period of account must be on a just and reasonable basis and must take into account all relevant

circumstances.

Chapter 3

16. Section 1217RA provides for how a company qualifies for relief.

    - A company must be the production company in relation to the concert and intends that the concert must be performed live before paying members of the general public, in other words the musicians must be present before the audience. However a concert may qualify if it is for genuine educational purposes (stating in a company's articles that it is set up for educational purposes is not sufficient evidence) and the production company is not associated, connected with, or has responsibility for, the beneficiaries of the concert.
    - There must be a minimum EEA expenditure (see 1217RB).
    - There must be a qualifying orchestral concert where the number of instrumentalists is at least 12 and none of those instruments played, or a minority, is electronically or directly amplified. Directly amplified instruments are those which are individually amplified rather than the use of separate, external microphones being used to pick up the overall sound of the concert generally.

17. Section 1217RB sets out the minimum European Economic Area expenditure required by the company to qualify for the relief. At least 25% of the qualifying core expenditure (see 1217RB) must be on goods or services that are provided from within the EEA.

18. Section 1217RC provides that core expenditure means expenditure on the activities directly involved in producing the concert or concert series. Examples of core expenditure which might qualify for a qualifying production company and its qualifying concert included costs of rehearsals and costs of commissioning new music specifically to be performed at a qualifying concert or concert series. Core expenditure will not include indirect expenditure such as marketing the concert or concert series, financing, associated finance costs, legal fees, accountancy fees or storage of instruments. Costs incurred on the actual performance of the concert and each individual concert within the concert series e.g. payments to musicians for their actual performances in the concert or concert series will not be eligible core expenditure. Development expenditure that precedes production will not be eligible if the production does not get 'green lit', in other words the production has permission and approval to proceed, (see also new section 1217QE for when costs are taken to have been incurred). The intention is to separate speculative expenditure from expenditure undertaken in the knowledge that the decision has been taken to go ahead with the production.

19. Section 1217RD sets out how a company may claim for the additional deduction. A company that makes a claim for relief must treat each qualifying concert or concert series as a separate trade. Claims are made in respect of an accounting period.

20. Section 1217RE provides that a company may claim an additional deduction based on its

qualifying expenditure. For the first period of account in which the separate orchestral trade is carried on, the additional deduction is the lesser of the amount of qualifying expenditure which is EEA expenditure, or 80% of the total amount of qualifying expenditure. For subsequent periods of account, the amount of additional deduction is the lesser of the amount of qualifying expenditure which is EEA expenditure or 80% of the total amount of qualifying expenditure minus any additional deductions given for previous periods.

21. Section 1217RF defines "qualifying expenditure" and also provides that where relief has been given for other creative reliefs that expenditure is excluded, for example, film tax relief, television tax relief, video games tax relief theatre tax relief.

22. Section 1217RF(1) also sets out that expenditure which is not otherwise relievable under other parts of the tax code, for example on entertainment, is not qualifying core expenditure. Furthermore where claims have been made on expenditure relating to the other creative reliefs (film, television, etc.) is not eligible for relief. This prevents a company claiming relief for the same expenditure under different regimes.

23. Section 1217RG provides that where a company qualifies for orchestra tax relief and has a surrenderable loss then that company may claim an orchestra tax credit for the period. The whole or part of the loss may be surrendered.

24. Section 1217RH defines a surrenderable loss and a relevant unused loss, and sets out how the available loss and any loss carried forward are to be calculated.

25. Section 1217RI provides that where a company is entitled to an orchestra tax credit for a period, and it claims that credit, the Commissioners for Her Majesty's Revenue and Customs will pay the credit to the company. However where there are any other outstanding liabilities of the company (such as outstanding corporation tax, VAT or PAYE) then the credit is first applied against those outstanding liabilities. If the company's tax return is enquired into the no payment of the credit needs to be made before enquiries are complete.

26. Section 1217RJ sets out that for state aid purposes the total amount of any orchestra tax credits for each undertaking must not exceed 50 million euros per year. "Undertaking" must be interpreted within the context of the General Block Exemption Regulation.

27. Section 1217RK Sets out that costs which remain unpaid by four months after the end of a period of account are ignored for that period.

28. Section 1217RL sets out that a company does not qualify for relief where the main or one of the main purposes of the arrangements is to claim the tax credit or otherwise benefit from the relief is to obtain a tax advantage.

29. Section 1217RM sets out that where a transaction is attributable to arrangements entered into otherwise than for genuine commercial reasons to inflate the amount of a claim then that transaction is disregarded when computing the additional deduction.

Chapter 4

30. Section 1217S sets out the application of the new section 1217SA to 1217SC.

31. Section 1217SA provides that losses made before the completion period of a separate trade are only available to be carried forward to be set against the profits of the separate

orchestral trade.

32. Section 1217SB provides for how losses are to be treated in the completion period.

33. Section 1217SC provides for how terminal losses are to be treated and the circumstances in which terminal losses can be transferred.

Chapter 5

34. Section 1217T sets out the conditions for claiming provisional relief, such as, a company is not entitled to relief in an interim accounting period unless it includes, in its company tax return for the period, a statement of the planned amount of EEA expenditure and that amount of expenditure meets the condition in 1217RB.

35. Section 1217TA allows for the claw-back of provisional relief where it subsequently appears the EEA condition will not be met. It sets out what a company must do if it no longer qualifies for relief and also what to do when it ceases to carry on the orchestral trade.

Chapter 6

36. Section 1217U sets out the interpretation of certain expressions within Part 15D.

Part 2: Consequential amendments

37. Paragraph 2 Sets out consequential amendments to ICTA

38. Paragraphs 3 to 6. Sets out the consequential amendments to FA1998 to accommodate orchestra tax relief

39. Paragraph 7. Sets out an amendment to CAA2001

40. Paragraph 8. Sets out an amendment to FA2007.

41. Paragraphs 9 to 11Sets out the necessary amendments to CTA 2009

42. Paragraph 12 Sets out amendments to FA2009

43. Paragraph 13 to 14.Sets out the amendments to CTA 2010 in respect of the Northern Ireland rate.

Part 3: Commencement

44. Paragraphs 16 to 17. Set out that all amendments made by the Schedule have effect in relation to accounting periods beginning on or after 1 April 2016. Where an accounting period straddles the 1 April date the profits of a trade are to be apportioned between a deemed accounting period ending on 31 March 2016 and one commencing on 1 April 2016 on a just and reasonable basis.

45. Paragraph 7 Sets out the separate commencement provisions in respect of the Corporation Tax (Northern Ireland) Act 2015.

Background note

46. The new tax relief for orchestral production will allow qualifying companies engaged in the production of concerts to claim an additional deduction in computing their taxable profits

and where that additional deduction results in a loss, to surrender those losses for a payable tax credit.

47. Both the additional deduction and the payable credit are calculated on the basis of EEA core expenditure up to a maximum of 80% of the total core expenditure by the qualifying company. The additional deduction is 100% of qualifying core expenditure and the payable tax credit is 25% of losses surrendered.

48. The credit is based on the company's qualifying expenditure on the production of a qualifying orchestral concert. This expenditure must be on activities directly involved in producing the concert, such as rehearsal costs. Qualifying expenditure will not include indirect costs such as financing, marketing and accountancy and legal fees.

49. At least 25% of the qualifying expenditure must be on goods or services that are provided for from within the EEA.

50. Concerts whose main purpose, or one of the main purposes, is to advertise goods and services, include a competition or the primary purpose is to make a recording will not qualify for relief.

51. The new relief is part of the government's support to the creative sector and aims to promote British culture in a sustainable way.

Clause 51: Television and video games tax relief: consequential amendments

Summary

1. This clause makes minor consequential amendments amending references to section 1218 Corporation Tax Act 2009 (CTA 2009) (meaning of 'company with investment business' and 'investment business) to section 1218B CTA 2009 in the Taxation of Capital Gains Act 1992 (TCGA 1992) and Corporation Tax Act 2010 (CTA 2010).

Part 1: Consequential amendments

2. This clause sets out consequential amendments to TCGA 1992 and CTA2010 amending the reference of section 1218 CTA 2009 to 1218B CTA 2009.

Clause 52: Banking companies: excluded entities

Summary

1. This clause amends the excluded entity test which forms part of the definition of a bank used in tax legislation ensuring that banking taxes are appropriately targeted.

Details of the clause

2. Subsection 1 introduces the amendment to section 133F Corporation Taxes Act (CTA) 2009, the amendment is effective from the introduction of section 133F on 8 July 2015.
3. Subsection 2 introduces new subsections (2A) and (2B) which amend the excluded entity test allowing an entity that would otherwise have fallen within the exclusion but for having a second line of business, to qualify as an excluded entity providing that this second line of business does not involve taking deposits and when considered in isolation would not result in it being both an IFPRU 730K investment firm and a Full Scope IFPRU investment firm.
4. Subsections 3 and 4 define at different points in time the meaning of the regulatory terms used in new subsection (2A).
5. Subsections 5 and 6 ensure that the above amendments apply from the introduction of section 133F in relation to corporate partners.
6. Subsections 7 to 9 introduce the same amendment to section 269BA CTA 2010. The amendment will apply from the introduction of section 269BA on 1 April 2015 for the purposes of the bank loss restriction and from 1 January 2016 for the purposes of the banking surcharge.
7. Subsections 10 to 13 introduce the same amendment to paragraph 73 of Schedule 19 to the Finance Act (FA) 2011. For the purposes of the bank levy the amendment will apply prospectively for any chargeable periods starting on or after Royal Assent.
8. Subsection 14 modifies the amendments to the excluded entities test in Schedule 19 to FA 2011 so that for the purposes of determining which groups and entities fall within the Code of Practice for the taxation of banks for the purposes of a relevant report the amendments within subsections 10 to 12 are deemed to always have applied.
9. Subsection 15 defines "relevant report" to apply this amendment to reporting periods ending on or after 1 April 2015.

Background note

10. The excluded entities test removes certain specified entities or certain entities that undertake a single specified activity, that would not commonly be considered to constitute banking, from the definition of a bank used in bank tax legislation.

11. The amendment extends the exclusion to allow an entity to undertake a second line of business. The "line of business" approach is similar to that taken in the first part of the excluded entity test where certain specified regulated activities are mentioned, such as asset management, CFD trading etc. Similarly, a second line of business encompasses a set of related products and/or services which together form a recognisable regulated activity, for example stockbroking. The exclusion will apply providing that this second line of business, when considered by itself, would not result in the entity being both an IFPRU 730K investment firm and a Full Scope IFPRU investment firm.

12. This approach provides that we continue to treat entities that carry on activities or lines of business that require them to be both an IFPRU 730K investment firm and a Full Scope IFPRU investment firm as investment banks for the purposes of the bank tax legislation contained in the Taxes Acts.

Clause 53: Banking companies: restriction on loss relief etc

Summary

1. This clause further restricts the proportion of a banking company's annual taxable profit that can be offset by brought forward losses to 25%. The further restriction will apply to accounting periods beginning on or after 1 April 2016.

Details of the clause

2. Subsection 1 introduces an amendment to the bank loss restriction rules in Chapter 3 of Part 7A of Corporation Tax Act 2010.

3. Subsections 2 - 4 change the proportion of a banking company's annual taxable profit that can be offset by brought forward deductions for trading losses, non-trading deficits from loan relationships and management expenses from 50% to 25%

4. Subsection 5 makes the change effective for accounting periods beginning on or after 1 April 2016

5. Subsection 6 ensures that where a period straddles the 1 April 2016 it is split into two periods: one ending 31 March 2016 and one beginning 1 April 2016. If the result of the straddling accounting period is a profit it is apportioned between the two periods; if the result is a loss It is apportioned between the two periods. The default apportionment method is time, unless that would give an unjust or unreasonable result.

Background note

6. The restriction of the use of carried forward losses by banking companies was introduced in response to the significant losses that banks had carried-forward from the financial crisis and subsequent misconduct scandals (e.g. PPI misselling) and the impact that these were having on corporation tax payments. In Budget 2016 the government announced the introduction of a general restriction on carried forward corporation tax losses that will come into effect from 1 April 2017. This amendment maintains the more restrictive treatment of losses incurred by banks during the financial crisis and subsequent misconduct scandals.

Clause 54: Reduction in rate of supplementary charge

Summary

1. This clause reduces the rate of Supplementary Charge from 20% to 10% on companies' adjusted ring fence profits. The reduced rate will have effect for accounting periods beginning on or after 1 January 2016. For accounting periods straddling this date, the rate will apply to profits apportioned to the part of the accounting period running from 1 January 2016.

Details of the clause

2. Subsections (1) and (4) amends Corporation Tax Act (CTA) 2010 to reduce the rate of Supplementary Charge from 20% to 10%.

3. Subsection (2) provides that the reduced rate applies to accounting periods beginning on or after 1 January 2016.

4. Subsection (3) makes further provisions where a company has an accounting period beginning before 1 January 2016 and ending on or after that date.

5. Subsection (4) provides that if an accounting period straddles 1 January 2016, this is to be treated as two separate accounting periods: one falling before 1 January 2016 and one falling on and after that date. Profits for the original accounting period are time-apportioned between the two periods in relation to the number of days in each.

6. Subsection (5) provides that the amount of the Supplementary Charge for a straddling period is equal to the sum of the separate amounts of Supplementary Charge for each of the separate periods mentioned in subsection (4).

Background note

7. Supplementary Charge 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 which are treated as a separate trade from the companies’ wider activities. This means that the ring fenced profits cannot be reduced by losses from other activities carried on by the company or from losses arising to other companies in the same group.

8. 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 but excluding any financing costs.

9. Supplementary Charge was introduced in 2002 at a rate of 10%. This was increased to 20% for accounting periods beginning on or after 1 January 2006 and to 32% for accounting periods beginning on or after 24 March 2011. It was reduced to 20% for accounting periods

beginning on or after 1 January 2015.

10. This reduction will help provide the right conditions for business investment to maximise the economic recovery of the UK's oil and gas resources.

Clause 55: Investment allowance: disqualifying conditions

Summary

1. This clause amends the investment allowance to update the conditions which disqualify expenditure, incurred on the acquisition of an asset in certain circumstances, from generating allowance. This will have effect for expenditure incurred on or after 16 March 2016.

Details of the clauses

2. Subsection 1 amends section 332D of Corporation Tax Act (CTA) 2010.

3. Subsection 2 clarifies which asset is the acquisition concerned, to which the disqualifying provisions are applied.

4. Subsections 3 and 4 insert leasing into the disqualifying conditions to reflect the introduction of leasing expenditure into the scope of the investment allowance by secondary legislation.

5. Subsection 5 inserts new subsections (5) to (10) which make clear that where investment allowance has been generated in respect of expenditure incurred before a field is determined, such expenditure is in the scope of the disqualifying conditions. The rules require that, when applying the disqualifying conditions to a situation where section 332CA applies, expenditure is to be taken to have been incurred when it was actually incurred, and not at the time of the determination. The amendments also provide clarity that leasing refers to the expenditure incurred by a company when an asset is leased to it.

6. Subsection 6 provides that these amendments have effect for determining whether expenditure incurred on or after 16 March 2016 is relievable for the purposes of the investment allowance.

Background note

7. In addition to ring fence corporation tax (RFCT), oil and gas companies are also subject to an additional tax, the supplementary charge (SC), on adjusted ring fence profits arising from oil-related activities. The rate of SC is currently 10 per cent.

8. Investment allowance was introduced in FA2015, and provides relief by reducing the amount of adjusted profits on which SC is due.

9. To ensure the legislation works as intended and protects the Exchequer, HMRC are updating the disqualifying conditions such that they are:

    - expanded following the extension of the allowance to include some leasing expenditure

- clarified as to the circumstances in which investment allowance can be generated when expenditure is incurred before a field is determined.

Clause 56: Investment allowance: power to expand meaning of "relevant income"

Summary

1. This clause amends the investment allowance to introduce a power to expand the meaning of relevant income, and to make amendments in consequence of or in connection with this expansion. The government intends to allow tariff income (payments by third parties for access to infrastructure) to activate the allowance. The power will have effect from Royal Assent but can have retrospective effect.

Details of the clause

2. Subsection 1 amends section332F of Corporation Tax Act (CTA) 2010.

3. Subsection 2 updates section 332F(2)(b) to reflect the expansion of the scope of relevant income .

4. Subsection 3 substitutes section 332F (3). The substituted subsection provides that the definition of relevant income for the investment allowance is now expanded to include production income and income of such other such description as may be prescribed by the Treasury by regulations. It further makes additional provisions relating to the regulations such that they can have retrospective effect, and can include amendments in consequence of, or in connection with the regulations.

Background note

5. In addition to ring fence corporation tax (RFCT), oil and gas companies are also subject to an additional tax, the supplementary charge (SC), on adjusted ring fence profits arising from oil-related activities. The rate of SC is currently 10%.

6. Investment allowance was introduced in Finance Act 2015, and provides relief by reducing the amount of adjusted profits on which SC is due.

7. When the investment allowance was introduced, allowances could only be activated by production income from an oil field. The government stated that it would look further at whether tariff income could be included as relevant income. The government now intends to allow tariff income to activate the allowance to encourage investment in infrastructure

Clause 57: Onshore allowance: disqualifying conditions

Summary

1. This clause amends the onshore allowance to update the conditions which disqualify expenditure, incurred on the acquisition of an asset in certain circumstances, from generating allowance. This will have effect for expenditure incurred on or after 16 March 2016.

Details of the clauses

2. Subsection 1 amends Corporation Tax Act (CTA) 2010.
3. Subsection 2 inserts new subsection (4A) which provides that in some circumstances capital expenditure is not relievable.
4. Subsection 3 inserts new section 356CAA which introduces further disqualifying conditions, any of which if met will prevent expenditure from being relievable on the acquisition of an asset, referred to as the "acquisition concerned".
5. The first disqualifying condition in new subsection (2) is that capital expenditure was incurred on an asset prior to the acquisition concerned which was relievable.
6. The second disqualifying condition in new subsections (3) to (7) is that previous expenditure on the acquisition of a licence and any related assets would have been relievable had the onshore allowance been in place at the time, and had it been incurred in relation to a qualifying site.
7. The third disqualifying condition in new subsections (8) to (10) is that capital expenditure which was incurred before the acquisition concerned either has become relievable following the transfer of expenditure to a specified site by reason of an election under section 356CB, or would be so relievable if such an election were made in respect of it.
8. Subsection 4 provides that these amendments have effect for determining whether expenditure incurred on or after 16 March 2016 is relievable for the purposes of the onshore allowance.

Background note

9. In addition to ring fence corporation tax (RFCT), oil and gas companies are also subject to an additional tax, the supplementary charge (SC), on adjusted ring fence profits arising from oil-related activities. The rate of SC is currently 10 per cent.
10. The onshore allowance was introduced in FA2014, and provides relief by reducing the amount of adjusted profits on which SC is due.

11. To ensure the legislation works as intended and protects the Exchequer, HMRC are updating the onshore allowance to include the disqualifying conditions relating to the acquisition of an asset, to provide parity with the other allowances.

Clause 58: Cluster area allowance: disqualifying conditions

Summary

1. This clause amends the cluster area allowance to update the conditions which disqualify expenditure, incurred on the acquisition of an asset in certain circumstances, from generating allowance. This will have effect for expenditure incurred on or after 16 March 2016.

Details of the clauses

2. Subsection 1 amends section 356JFA of Corporation Tax Act (CTA) 2010.

3. Subsections 2 and 3 insert leasing into the disqualifying conditions to reflect the introduction of leasing expenditure into the scope of the cluster area allowance by secondary legislation.

4. Subsection 4 inserts new subsection (5) to provide clarity that leasing refers to the expenditure incurred by a company when an asset is leased to it.

5. Subsection 5 provides that these amendments have effect for determining whether expenditure incurred on or after 16 March 2016 is relievable for the purposes of the cluster area allowance.

Background note

6. In addition to ring fence corporation tax (RFCT), oil and gas companies are also subject to an additional tax, the supplementary charge (SC), on adjusted ring fence profits arising from oil-related activities. The rate of SC is currently 10 %.

7. Cluster area allowance was introduced in FA2015, and provides relief by reducing the amount of adjusted profits on which SC is due.

8. To ensure the legislation works as intended and protects the Exchequer, HM Revenue and Customs are updating the disqualifying conditions such that they are expanded following the extension of the allowance to include some leasing expenditure.

Clause 59: Cluster area allowance: power to expand meaning of "relevant income"

Summary

1. This clause amends the cluster area allowance to introduce a power to expand the meaning of relevant income, and to make amendments in consequence of or in connection with this expansion. The government intends to allow tariff income (payments by third parties for access to infrastructure) to activate the allowance. The power will have effect from Royal Assent but can have retrospective effect.

Details of the clause

2. Subsection 1 amends section 356JH of Corporation Tax Act (CTA) 2010.

3. Subsection 2 updates section 356JH(2)(b) to reflect the expansion of the scope of relevant income .

4. Subsection 3 substitutes section 356JH (3). The substituted subsection provides that the definition of relevant income for the cluster area allowance is now expanded to include production income and income of such other such description as may be prescribed by the Treasury by regulations. It further makes additional provisions relating to the regulations such that they can have retrospective effect, and can include amendments in consequence of, or in connection with the regulations.

Background note

5. In addition to ring fence corporation tax (RFCT), oil and gas companies are also subject to an additional tax, the supplementary charge (SC), on adjusted ring fence profits arising from oil-related activities. The rate of SC is currently 10%.

6. Cluster area allowance was introduced in Finance Act 2015, and provides relief by reducing the amount of adjusted profits on which SC is due.

7. When the cluster area allowance was introduced, allowances could only be activated by production income from the cluster. The government now intends to allow tariff income to activate the allowance to encourage investment in infrastructure

Clause 60 and Schedule 9: Profits from the exploitation of patents etc

Summary

1. This clause amends the Patent Box legislation in Part 8A of Corporation Tax Act (CTA) 2010. The Patent Box provides a reduced rate of Corporation Tax on profits from patents and similar intellectual property (IP). The changes are to ensure compliance with the new international framework developed by OECD (see Chapter 4 of "Countering harmful Tax Practices More Effectively, Taking Into account Transparency and Substance", OECD, Paris, 2015).

2. The amended rules in new Chapters 2A and 2B of part 8A will require profit for the purpose of the Patent Box to be calculated at the level of an IP asset (for example a patent), or a product or a product family relying on an IP asset or assets. The profit will be adjusted to reflect the proportion of the development activity on the asset (or product, or product category) undertaken by the company itself. The measure will have effect for 'new entrant' companies to the Patent Box on or after 1 July 2016, and also for some IP assets acquired on or after 2 January 2016. The new rules are being phased in, with the current Patent Box rules applying to some companies and IP during a transitional period lasting until 2021. The new rules will apply to all companies and IP after 2021.

Details of the clause

3. Clause 60 introduces new Chapters 2A and 2B to CTA 2010.

4. Subsection 2(a) amends Section 357A to set out the circumstances in which new Chapter 2A or new Chapter 2B apply instead of the current provisions in Chapters 3 and 4, which set out how profits are to be calculated using the 'proportional split' and 'streaming' methods respectively. Chapters 3 and 4 continue to apply during the transitional period but only to companies which are not new entrants and which have no new IP.

5. Subsection 2(b) inserts the definition of a new entrant company for this purpose into section 357A.

6. Subsection (3) inserts the new Chapters.

7. New Chapter 2A contains sections 357BF to 357BN which set out the new rules in their default form. They apply to all accounting periods beginning on or after 1 July 2021 and to any company entering the Patent Box for the first time for an accounting period beginning on or after 1 July 2016 - a 'new entrant' (See also subsections (6) and (7) which provide that accounting periods straddling 1 July 2016 and 1 July 2021 are, for Patent Box purposes, to be split).

8. New Section 357BF provides the method of calculating the profit to which the reduced rate of Corporation Tax applies.

9. Subsection (2) sets out 9 steps to be followed in calculating the relevant IP profit or the relevant IP loss of the trade for the period

- Step 1 specifies that the company must separate its credits into two streams, those that are relevant IP income and those that are not. The definition of relevant IP income remains as in the current Patent Box rules at S357C;
- Step 2 divides the relevant IP income stream into sub-streams corresponding either to individual IP assets (such as patents) or to particular kinds of multi-IP items (products or product families);
- Step 3 allocates debits between the sub-streams;
- Step 4 deducts from each sub-stream the debits allocated at Step 3 and a routine return. These are calculated in the same way as under the current Patent Box rules;
- Step 5 deducts from each sub-stream the small claims figure where the company is eligible for, and has elected to use, small claims treatment. This is a simplified alternative to calculating the marketing assets return;
- Step 6 deducts from each sub-stream the marketing assets return where the company is not eligible for or has not elected for small claims treatment;
- Step 7 multiplies the figure for each sub-stream by the corresponding research and development (R&D) fraction, calculated at new section 357BM;
- Step 8 adds together the amounts of the sub-streams;
- Step 9 is the point at which a company includes in its relevant IP profits for the period any additional amount in respect of profits arising in the period where grant of a patent is pending when the patent is granted. The way in which this amount is calculated is set out at new section 357BN.

10. Subsection (5) defines multi-IP items as items incorporating more than one qualifying item (defined in line with the existing Patent Box rules) including provision for similar multi-IP items to be of the same kind (and therefore streamed together) if they are substantially the same, allowing tracking and tracing at the level of product categories or families.

11. Subsection (6) sets out when income may be allocated at Step 2 other than to an individual IP right sub-stream (for example to a sub-stream representing a particular patent or other IP asset). There are two cases. The first is where it is not reasonably practicable to apportion income between individual IP rights. The second is where the income can be so apportioned, but it would not be reasonably practicable to apply any of the later steps in the calculation. This allows a company to track and trace income to the level of a product (rather than an IP right) if it is not reasonably practicable for it to calculate its R&D fraction at the level of the IP right. As a consequence R&D expenditure is tracked in the same way (see new Section 357BM(1)).

12. New Section 357BG defines finance income, excluded in Step 1 of new Section 357BF. The

definition follows that in the current Patent Box rules (see S357CB).

13. New Sections 357BH to 357BHC define relevant IP income for the purpose of Step 1 in new Section 357BF. The definition follows that in the current Patent Box rules (see S357CC - S357CF).

14. New Section 357BI defines excluded debits for the purpose of Step 3 of new Section 357BF. The definition follows that in the current Patent Box rules (see S357CG(3)).

15. New Section 357BJ defines the routine return figure for Step 4 of new Section S357BF. The definition follows that in the current Patent Box rules (see S357DA(4)) but is modified to reflect its application to separate sub-streams.

16. New Sections 357BJA and 357BJB define routine and non-routine deductions for new Section 357BJ. The definitions follow those in the current Patent Box rules (see S357CJ and S357CK).

17. New Section 357BK sets out eligibility for small claims treatment. This is broadly in line with the current Patent Box rules in S357CL, but as the provisions now need to be applied where profit is calculated across a number of sub-streams, an additional simplifying condition is applied, requiring that the company only carries on one trade in the period.

18. New Section 357BKA provides rules for calculating the small claims figure for each sub-stream - the reduction in the sub-stream amount that takes the place of the marketing assets return. 75% of the qualifying residual profit (QRP) - defined in subsection (9) of new Section 357BK as the sum of the positive sub-stream amounts established after the deductions at Step 4 of section 357BF(2) - is compared to the small claims threshold.

    - If it is lower than that threshold, then the small claims figure is simply 25% of the amount of the sub-stream following Step 4 in S357BF;
    - Otherwise, the amount is obtained by distributing the small claims threshold between the different sub-stream figures following step 4 in proportion to those figures.

19. New Sections 357BL, 357BLA and 357BLB contain the provisions needed to calculate the marketing assets return figures for relevant IP income sub-streams. They follow the same principles as the current Patent Box rules (see S357CN - S357CP) but are modified to reflect their application to separate sub-streams.

20. New Sections 357BM to 357BMH contain the rules for calculating the R&D fractions that apply to the separate sub-streams. The R&D fraction is what is referred to in the OECD document as the "nexus fraction" or "nexus ratio".

21. New Section 357BMA defines the R&D fraction as the lesser of 1 and (D + S1) x 1.3 / (D + S1 + S2 + A) where the various terms represent different sorts of expenditure potentially incurred by the company on developing or acquiring the IP.

    - D is the company's qualifying expenditure on in-house relevant R&D;
    - S1 is the company's qualifying expenditure on relevant R&D subcontracted to unconnected persons;

- S2 is the company's qualifying expenditure on relevant R&D subcontracted to connected persons;
- A is the company's qualifying expenditure on acquiring relevant qualifying IP rights.

22. The multiplication by 1.3 applies a 30% "uplift" to the numerator, which is permitted by the OECD rules, increasing the fraction to allow for various circumstances in which substantive activity by the company would not contribute to qualifying expenditure, for example because of its group structure.

23. New Section 357BMB defines D, qualifying expenditure on R&D undertaken in-house. This is expenditure which is attributable to relevant R&D undertaken by the company and incurred on staffing costs, software or consumable items, externally provided workers or payments to the subjects of clinical trials. The definitions of these different types of expenditure follow those used in CTA2009 for the purposes of the R&D tax reliefs. Expenditure which must be included is that incurred in the relevant period - this is defined in new Section S357BMF.

24. 'Relevant research and development' is defined at new subsection (4) and (5). This is R&D which relates to the qualifying IP right or rights in question - not to the company's trade as a whole.

25. New Sections 357BMC and 357BMD define qualifying expenditure on R&D sub-contracted to unconnected and to connected persons. This is 65% of expenditure incurred making a payment within the relevant period to a sub-contractor with whom the company is not connected or is connected, as the case may be, the payment being attributable to relevant R&D. The 65% is the same as that used for the SME R&D tax relief and is intended to cover the cost of performing the R&D, excluding any element of profit or other non-qualifying cost.

26. New Section 357BME defines qualifying expenditure on acquisition of a relevant qualifying IP right, such as a patent, as expenditure incurred within the relevant period to acquire the right or rights or an exclusive licence to it or to them.

27. New Section 357BMF defines 'the relevant period' for the purpose of new sections 357BMB-357BME. This is the period from the 'relevant day' up to the end of the accounting period in question. The "relevant day" is 1 July 2013 if the accounting period began before 1 July 2021 and the company is a new entrant, or 1 July 2016 otherwise until 2036, after which the relevant period is simply the 20 year period leading up to the end of the current accounting period. In either case the company may elect to use an earlier date, allowing it to include earlier data in the R&D fraction if they are available at an appropriate level of detail. The company may go back no more than 20 years.

28. Subsection (7) defines when expenditure is taken to be incurred for the purpose of calculating the R&D fraction as when it is allowable as a deduction in computing corporation tax profits. There is a special provision at s1308 CTA2009 which applies here, allowing R&D expenditure that is brought into account in determining the value of an intangible asset to nevertheless be deductible.

29. New Section 357BMG makes special provision for cases where a new entrant has

insufficient data for the period 2013 to 2016 to enable it to calculate an R&D fraction in accordance with the usual rules. This is based on the transitional provision in paragraph 60 of Chapter 4 of the OECD document.

30. If the accounting period to which the sub-stream relates began on or after 1 July 2019 the company may make an election under subsection (2) of new Section 357BMG.

31. The effect of an election under subsection (2) is that, for the purposes of determining the R&D fraction for the sub-stream, the 'relevant period' will be treated as the period which runs from 1 July 2016 to the end of the accounting period concerned. This means that for accounting periods beginning on or after 1 July 2019, a new entrant will (where necessary) be able to calculate a R&D fraction even if it has no information about its expenditure from 1 July 2013 to 1 July 2016. (But new entrants will need to "track and trace" to individual IP/ multi-IP items from 1 July 2016).

32. If the accounting period to which the sub-stream relates began before 1 July 2019 the company may instead make an election under subsection (3) of new Section 357BMG. The effect of an election under subsection (3) is that, for the purpose of determining the R&D fraction for the sub-stream, sections 357BM to 357BME are to have effect with 3 modifications.

- The first modification is that any reference to "the relevant period" in sections 357BM to 357BME is to be read as a reference to the period of three years ending with the last day of the accounting period concerned. This means that if the accounting period concerned ended on, say, 10 July 2016 the company will have to take into account expenditure which was incurred between 11 July 2013 and 10 July 2016 (inclusive). If the accounting period concerned ended on, say, 10 July 2017 the company would instead have to take into account expenditure which was incurred between 11 July 2014 and 10 July 2017. Accordingly, for each subsequent accounting period one year's expenditure will drop off.

- The second modification has the effect of altering the definition of "relevant research and development" so that any expenditure on R&D which relates to the trade (rather than to the particular qualifying IP right) will be taken into account. This means that it will not matter that for the years during the three year period just described the company kept records about its "global" research and development expenditure but did not "track and trace".

- The third modification has the effect that any expenditure on acquiring qualifying IP rights will be taken into account. This means that it will not matter that during the three year period just described the company only kept records about its "global" expenditure on acquiring qualifying IP rights.

33. New Section 357BMH allows a company to elect to increase the R&D fraction for a sub-stream to reflect exceptional circumstances which mean the fraction does not correctly reflect the company's contribution to the intellectual property. This implements the principle referred to in the OECD framework as the 'rebuttable presumption'.

34. New Section 357BN allows a company to include profits arising before a right was granted

(for example, during a period when a patent had been applied for, but not granted). This is a general provision that requires the company to rework the calculation set out at new section 357BF taking account of the additional income. It is similar to existing S357CQ which applies in similar circumstances.

35. New Chapter 2B contains new Sections 357BO to 357BQ which apply the rules in new Chapter 2A, with modifications, for accounting periods beginning before 1 July 2021 for companies which are not new entrants and with a new qualifying IP right. This provides rules that apply during the transitional period for companies that have both preexisting and new IP.

36. The rules are based on streaming, so there is no option for the company's preexisting IP to be dealt with following the proportional split method

37. New Section 357BO sets out when the modified new Section 357BF applies.

38. Subsection 357BO(2) provides that for the purposes of sections 357BMF and BMG (which determine the relevant day, from which R&D expenditure must be included in the R&D fraction) the company is to be treated as if it were a new entrant. This means that the relevant day will be 1 July 2013 or such earlier day as the company may elect, but also that the company will be able to make elections under new Section 357BMG(2) or (3) as appropriate.

39. New Section 357BP defines a 'new qualifying IP right'. This includes IP rights granted to the company in respect of applications made on or after 1 July 2016. It also includes any IP (or any exclusive licence to IP) acquired by the company on or after 1 July 2016.

40. Subsections (8) and (9) define circumstances in which IP, or an exclusive licence to IP, acquired on or after 2 January is also treated as a new qualifying IP right. This is IP (or a licence) acquired from a connected person which is not within the charge to corporation tax nor liable to a foreign tax designated by the Treasury as similar to the UK Patent Box and where the main purpose or one of the main purposes of the transaction was the avoidance of tax.

41. Subsection (10) allows the Treasury to designate tax regimes similar to the UK patent Box.

42. New Section 357BQ sets out the modifications to Chapter 2A. These modifications make particular provisions for the case where a company which is not a new entrant has income from a "mixed" product (ie a product that reflects both "new" and 'old' IP rights). Such a company may apportion income between an old IP rights sub-stream (to which no R&D fraction is applied) and new qualifying IP rights sub-streams (to which a R&D fraction is applied).

43. If it is not reasonably practicable to make this apportionment there are a number of specific circumstances in which the company will have alternative options;

- If the value of the product is wholly or mainly attributable to old IP (ie the core IP in the product is unchanged), the company may put all of the income from the product in an old IP rights sub-stream (to which no R&D fraction is applied) - see subsection (8)(a) of new section 357BQ (as modified).

- If 80% or more of the items incorporated in the product relate to old IP, the company will also be able to put all of the income from the product in an old IP rights sub-stream - see subsection (8)(b) of new Section 357BQ (as modified).

- If less than 80% but 20% or more of the items incorporated in the product relate to old IP, the company may put that percentage of the income from the product into an old IP rights sub-stream and the remainder of the income in a product sub-stream (to which a R&D fraction will be applied) - see subsection (9) of section 357BF, as modified

44. If it is not reasonably practicable to make this apportionment but none of these circumstances apply, the default treatment is that all of the income is treated as arising from new IP, and an R&D fraction will be applied to it. So the profit from the "mixed" product is only treated as arising wholly from 'new' IP where the core IP has changed and less than 20% of the IP in the product is "old" IP.

45. Subsection (4) inserts Schedule 9 which contains consequential amendments.

46. Subsection (5) provides that the amendments have effect in relation to accounting periods beginning on or after 1 July 2016.

47. Subsections (6) and (7) address accounting periods that are split across either or both of 1 July 2016 and 1 July 2021. Where this is the case, the periods falling before those dates, and the periods on or after those dates, are treated as separate periods for Patent Box purposes.

48. If a company has an accounting period which straddles 1 July 2016 it will therefore have to determine the relevant IP profits for the notional accounting period which begins on 1 July 2016 using Part 8A as amended. It will use Part 8A as originally enacted to determine the relevant IP profits for the notional accounting period which ends on 30 June 2016.

49. Similarly, a non-new entrant company (see new subsection (11) of S357A) with an accounting period that straddles 1 July 2021 will apply section 357BF for the purpose of determining the relevant IP profits for the notional accounting period which begins on 1 July 2021 and will apply Chapter 2B, 3 or 4 to determine the relevant IP profits for the notional accounting period which ends on 30 June 2021.

50. If a company has an accounting period which straddles 1 July 2016 and has not yet elected into the Patent Box it will therefore have a choice. It will be able to make an election under section 357A in relation to the notional accounting period which ends on 30 June 2016 (in which case it will not be a new entrant) or it will be able to make an election under that section in relation to the notional accounting period which begins on that date (in which case it will be a new entrant).

51. Subsections (8) and (9) allow a company which had previously elected out of Patent Box for a period ending on or before 30 June 2016 to elect back in, overriding the normal rule which prevents this for 5 years.

52. Subsections (10) and (11) create a special rule in relation to relevant IP income of a non-new entrant company attributable to a new qualifying IP right acquired by the company within the period beginning with 2 January 2016 and ending with 30 June 2016.

53. The effect of new Section 357BP is that in certain circumstances such IP could be a "new qualifying IP right" (ie new IP). The effect of the special rule is that if the income accrued to

the company between 1 July 2016 and the end of the calendar year the income is to be treated for the purposes of Part 8A as not attributable to a new qualifying IP right. This means that income arising before the end of the calendar year is "grandfathered", as the OECD rules allow, even where the IP right was acquired from a connected person which did not benefit from an IP regime.

Details of the Schedule

54. Schedule 9 makes modifications to existing Chapters 3 and 4 which continue to apply to preexisting IP ("grandfathered" IP that existed before 1 July 2016) of a company that has no new IP.

55. In these circumstances the rules that apply are substantially the same as those currently in force. Unless the company makes a streaming election, or satisfies the requirements for mandatory streaming, the profits are calculated according to the rules in Chapter 3.

56. If it makes a streaming election, or satisfies the requirements for mandatory streaming, the profits are calculated according to the rules in Chapter 4.

Background note

57. The UK Patent Box gives companies a reduced rate of tax on their profits from patents and similar intellectual property (IP). It is intended to provide incentives for companies to patent IP developed in the UK and ensure new and existing patents are further developed and commercialised in the UK

58. The Organisation for Economic Cooperation and Development (OECD) has been coordinating a multinational effort to address Base Erosion and Profit Shifting (BEPS) - tax planning by multinational enterprises (MNEs) that exploits gaps and mismatches in tax rules to artificially shift profits to low tax locations where there is little or no economic activity. This has resulted in a new internationally harmonised framework for preferential IP regimes (like the UK's Patent Box). This framework is to apply from 1 July 2016.

59. The central point is that for a business to gain the benefit of a preferential regime, it should have conducted the substantial activities which generated the income benefiting from that regime. The agreed approach uses R&D expenditure as a proxy for substantial activity and links benefits to the requirement to have undertaken the R&D expenditure incurred to develop the IP. This is referred to as the nexus approach.

60. Following a consultation launched on 22 October 2015, in December 2015 draft legislation set out proposed modifications to the UK Patent Box to implement this new approach. The Government has considered views expressed in the consultation and this clause includes changes addressing points that were raised, including a clearer rule about when expenditure is treated as incurred for the purpose of the R&D fraction, the so-called "rebuttable presumption" allowed under the OECD framework and more flexible provisions for the grandfathering of "mixed" products (those that include both old and new IP).

61. The Government will consider further changes to the legislation to address, for example,

the specific cases of companies that engage in collaborative development (such as a cost-contribution arrangement) or the treatment when businesses with separate R&D histories combine (for example by acquisition of a trade).

Clause 61: Power to make regulations about the taxation of securitisation companies

Summary

1. This clause amends the regulation making power in section 624 of Corporation Tax Act (CTA) 2010 which concerns the taxation of securitisation companies, and the supplementary provisions set out in section 625 CTA 2010. The revised power to make regulations will be extended so that it also applies to the Income Tax Acts and will have effect on and after the date of Royal Assent.

Details of the clause

2. Subsection 1 provides for the amendment of section 624 of CTA 2010, which allows HM Treasury to make regulations about the taxation of securitisation companies.

3. Subsection 2 amends section 624(1) of CTA 2010, which currently permits regulations to be made concerning the application of the provisions of the Corporation Tax Acts only to a securitisation company. This amendment permits the regulations to concern the application of the wider "Taxes Acts", so including the provisions of the Income Tax Acts, to a securitisation company.

4. Subsection 3 is a consequential amendment of section 624(2) of CTA 2010, which allows regulations to be made to apply, disapply or modify normal tax rules in relation to securitisation companies.

5. Subsection 4 is a consequential amendment of section 624(9) to insert the definition of "Taxes Acts" for the purposes of section 624.

6. Subsection 5 amends section 625(3) so that the existing power to make regulations that have effect in relation to times before the regulations are made is not extended.

Background note

7. Securitisation is a means of raising debt finance on the capital markets through the issue of asset-backed securities. Securitisation companies are special purpose vehicles which issue securities to third party investors which are backed by assets transferred from another company. Such an arrangement is known as a "capital market arrangement" as defined in Schedule 2A to the Insolvency Act 1986.

8. A securitisation company typically acts as a conduit in which income flows arising from the securitised assets are channelled to the investor in the form of interest on the securities. It will normally retain only a small cash profit over the life of the securitisation. The application of International Accounting Standards from 2005 has led to increased volatility in the accounting profits of such companies. As a result the statutory accounts no longer form a suitable basis for calculating the securitisation company's tax liability.

9. The Taxation of Securitisation Regulations 2006 (Statutory Instrument 2006/3296) introduced new tax rules with effect for accounting periods beginning on or after 1 January 2007 for securitisation companies involved in the securitisation of financial assets. Such companies are taxed on their "retained profit" (the profit retained from their participation in the transaction) rather than the profit or loss shown in their statutory accounts.

10. Further regulations, The Taxation of Insurance Securitisation Companies Regulations (Statutory Instrument 2007/3402), were made to modify and extend the rules to apply to securitisation companies which are also insurance companies.

11. This clause extends the power to make regulations about the taxation of securitisation companies to permit regulations concerning the application of the wider "Taxes Acts" rather than just the "Corporation Tax Acts" as is currently the case.

12. This will permit changes to be made to regulations concerning the tax treatment of certain payments made by securitisation companies (known as "residual payments") in order to provide that no withholding tax liability arises upon any of such payments which may in limited circumstances constitute annual payments.

Clause 62 and Schedule 10: Hybrid and other mismatches

Summary

1. This clause and Schedule introduces new rules to counteract tax avoidance through hybrid and other mismatch arrangements which result in a deduction for various payments where there is no corresponding inclusion in ordinary income, or in double deductions from ordinary income. These new hybrid mismatch rules will effectively replace the existing anti-arbitrage rules in Part 6 of TIOPA 2010.

2. The new rules introduced by this Schedule deal concern hybrid mismatch arrangements. These mismatches can involve either double deductions for the same expense (double deduction mismatches), or deductions for an expense without any corresponding receipt being taxable (deduction/non-inclusion mismatches). Typically, such arrangements occur cross-border, as they seek to exploit the differences in tax treatment between two jurisdictions. However, in the case of hybrid financial instruments, mismatches can occur within jurisdictions, and these are within the scope of the rules.

3. Hybrid mismatch outcomes can arise from hybrid financial instruments, hybrid entities, dual resident companies and arrangements involving permanent establishments.

4. An example of a hybrid financial instrument would be one which allowed the payer to deduct a payment as interest, but allowed the payee to treat the receipt as an exempt dividend.

5. An example of a hybrid entity would be a partnership which is treated as transparent by one jurisdiction, but treated as opaque by another jurisdiction. The effect would be that one jurisdiction would apply its tax rules to the partnership, whilst the other would look through the partnership and apply its tax rules to the partners.

6. An example of a dual resident company would be a company that is treated as resident in one territory through its place of incorporation, and also resident in another territory through its central management and control. The effect would be that the company could obtain a deduction for an expense in both territories.

7. An example of an arrangement involving a permanent establishment would be where a permanent establishment is recognised by one jurisdiction but not recognised by another. The effect would be that one jurisdiction may apply its tax rules to that permanent establishment, whilst the other disregards the income or profits of the permanent establishment.

8. These new hybrid mismatch rules seek to neutralise the tax mismatch created by the hybrid arrangement by changing the tax treatment of either the payment or the receipt, depending

on the circumstances. The rules are designed to work whether both the countries affected by a cross-border hybrid arrangement have introduced hybrid mismatch rules, or just one. They do so by providing for a primary and a secondary response.

9. For example, in the case of double deductions involving hybrid entities, the primary response is for the parent company jurisdiction to deny a deduction to the parent company. If this does not occur (because the tax law in the country in which the parent company is resident does not provide for this), the secondary response is for the hybrid entity jurisdiction to deny the deduction to the hybrid entity.

10. In the case of deduction/non-inclusion, the primary response is to deny a deduction to the payer. If this does not occur, the secondary response is to bring the receipt into charge for the recipient.

11. In the case of deduction/non-inclusion where the payee is a hybrid entity, the primary response is to deny the deduction to the payer. If this does not occur, the secondary response Is to bring the receipt Into charge for the investor In the hybrid entity. If this also does not occur, the tertiary response is to bring the receipt into charge for the hybrid entity payee.

12. The new rules targets hybrid mismatches in the following circumstances:.

13. Deduction/non-inclusion outcomes involving:

- Hybrid Financial Instruments
- Hybrid Transfers
- Hybrid Entity Payers
- Hybrid Entity Payees
- Permanent Establishments

14. Double deduction outcomes involving:

- Hybrid Entity Payers
- Dual Resident Companies
- Permanent Establishments

15. The clause also includes rules to deter arrangements which attempt to circumvent the main hybrid mismatch rules by transferring a mismatch into a third jurisdiction - such arrangements are known as "imported" mismatches.

16. Chapter 1 provides an introduction to the legislation.

17. Chapter 2 provides a number of key definitions.

18. Chapters 3 to 11 deal with various types of mismatches. A common structure has been employed in those chapters, for ease of reference. Each chapter is divided into three parts,

as follows :

- Introduction: which sets out the scope of the chapter ;
- Application : which sets out the conditions which need to be met in order for the chapter to apply, and how to identify and measure particular mismatches, and
- Counteraction : which sets out how the mismatches that fall within that chapter are to be dealt with. Depending on the type of mismatch and the circumstances of the counterparties, the counteraction will either be the restriction or denial of a tax deduction, or the charging of an amount of income to tax.

Schedule 10

19. Paragraph 1 inserts new Part 6A into Taxation International and Other Provisions Act (TIOPA) 2010

Chapter 1 Introduction

20. New Chapter 1 provides an overview of the new rules for counteracting certain mismatches arising from arrangements involving hybrid entities, hybrid financial instruments, dual resident companies and permanent establishments.

21. New Section 259A sets out the structure of new Part 6A TIOPA 2010.

22. Subsection 1 explains that Part 6A is intended to counteract certain mismatches which fall into two categories : cases which involve a tax deduction but no corresponding taxable receipt (deduction/non-inclusion mismatches), and those which involve more than one tax deduction (double deduction mismatches).

23. Subsections 2 and 3 define deduction/non-inclusion mismatches and double deduction mismatches.

24. Subsection 4 provides that Part 6A will cover four types of mismatches : those involving financial instruments (including hybrid transfers), those involving hybrid entities, those involving permanent establishments and those involving dual resident companies.

25. Subsection 5 provides that the counteractions will be effected by making appropriate corporation tax adjustments.

26. Subsections 6 to 18 summarise the content of each Chapter in Part 6A.

27. Subsections 19 and 20 set out an order of priority for the application of the various Chapters of Part 6A.

Chapter 2 Key Definitions

28. New Chapter 2 sets out key definitions in relation to the hybrid rules.

29. New Section 259B sets out certain key definitions

30. Subsection 1 defines "tax" for the purposes of Part 6A as income tax, corporation tax on income, diverted profits tax, the CFC charge, foreign tax or a foreign CFC charge.

31. Subsection 2 defines foreign tax by reference to whether it is charged on income and corresponds to UK income or corporation tax.

32. Subsection 3 provides that provincial and state taxes are included within the definition of foreign tax.

33. Subsection 4 says that the meaning of "CFC", and "CFC charge" is the same as for Part 9A and gives a definition of a "foreign CFC charge"

34. New Section 259BA is about how to construe references to an equivalent provision to this Part under the law of a territory outside the UK

35. Subsections 1 and 2 provide that such a reference is one that it is reasonable to suppose is based on the OECD Final Report on Hybrid Mismatches published on 5th October 2015. This includes any replacement or supplementary publication.

36. Subsection 3 provides a definition of replacement or supplementary publication.

37. New Section 259BB defines the terms "payment", "payer", "payee" and "quasi-payment" and other key terms for the purposes of Part 6A.

38. Subsection 1 defines "payment" as any transfer of money or money's worth, for which a tax deduction can be claimed for a taxable period. Such deductions are referred to as "relevant deductions" and taxable periods are referred to as "payment periods".

39. Subsection 2 defines a "quasi-payment" for the purposes of Part 6A. Disregarding Part 6A or any equivalent non-UK law, a quasi-payment is made where the payer may deduct an amount from ordinary income in calculating taxable profits, and (based on the assumption in subsection (4)) it may reasonably be assumed that an amount of ordinary income arises to another person or persons as a result.

40. Subsection 3 provides that a quasi-payment does not arise if the deduction is a deemed deduction for tax purposes, and the circumstances that gave rise to the deduction do not include the creation of any economic rights between the counterparties.

41. Subsection 4 sets out the assumptions required to apply subsection (2), which are that it is the law of the payer's jurisdiction that determines whether an entity is a separate and distinct entity from the payer; that any person to whom amounts arise adopts the same accountancy approach as the payer; and that any payees or potential payees are tax resident and carrying on a business in the payer jurisdiction.

42. Subsection 5 provides that references to a quasi-payment, and to a quasi-payment being made, refer to the circumstances which give rise to the relevant deduction, in line with subsection (2).

43. Subsection 6 defines "Payee" in the case of payments within subsection (1) as either a person to whom a transfer has been made, or a person to whom an amount of ordinary income arises as a result of that payment.

44. In relation to quasi-payments within subsection (2), a payee is either a person to whom it would be reasonable to expect an amount of ordinary income to arise, or a person to whom ordinary income actually arises due to the quasi-payment.

45. Subsection 7 sets out the circumstances in which a payer can also be a payee with regard to quasi-payments. This can arise, for example, where the payer is a branch of the payee company.

46. Subsection 8 defines a "payer jurisdiction" as the territory in which the relevant deduction may be made.

47. Subsection 8 defines a "payee jurisdiction" as a territory in which the payee is either resident for tax purposes, or has a permanent establishment.

48. New Section 259BC sets out the basic rules relating to "ordinary income".

49. Subsection 2 defines ordinary income as income brought into account before any deductions when calculating taxable profits

50. Subsection 3 provides that amounts of income are not included as ordinary income if they are excluded, reduced or offset by an exemption, exclusion, relief or credit that either applies specifically to all or part of the income, or that arises from a payment or quasi-payment that generates that income.

51. Subsection 4 and 5 provide that if the relevant tax charged on profits is refunded in whole or in part, the income that is brought into account in calculating the taxable profit, or a proportional part of it, is not ordinary income.

52. Subsection 6 defines when an amount of relevant tax is refunded but provides that an amount of tax that is refunded as a result of qualifying loss relief is to be ignored.

53. Subsection 7 gives the meaning of qualifying loss relief

54. Subsection 8 provides that ordinary income is included in taxable profits when it is brought into account in calculating taxable profits.

55. Subsection 9 excludes a Controlled Foreign Company ("CFC") charge or a foreign CFC charge from the definition of "relevant tax", as they are dealt with separately in the following section.

56. New Section 259BD provides for amounts to be taken into account as ordinary income in relation to UK or foreign Controlled Foreign Company ("CFC") charges.

57. Subsection 2 provides that this section applies to a CFC, when certain amounts are not included in ordinary income, or, in relation to payments and quasi-payments linked to financial instruments or hybrid transfer arrangements, amounts are included but under-taxed. The section then considers to what extent those amounts have been taken into account in computing a CFC charge. These amounts are termed "the relevant income" of the CFC.

58. Subsection 3 sets out the three steps to be taken in determining whether the relevant income of that company is ordinary income of any other companies which are subject to a CFC

charge ("chargeable companies"). It does so by assessing whether and to what extent the relevant income has been taken into account in calculating the relevant chargeable profits which create a CFC charge for one or more chargeable companies.

59. Subsection 4 ensures that relevant income amounts can only be treated as ordinary income by one company, so that amounts that are ordinary income of a relevant chargeable company cannot also be ordinary income of the CFC.

60. Subsections 5 and 6 include apportioned CFC profits within the definition of "taxable profits" for the purposes of Part 6A.

61. Subsection 7 provides that tax charged on taxable profits includes a relevant charge charged by reference to relevant chargeable profits.

62. Subsection 8 defines an "under-taxed" amount as one where the highest rate of tax charged on that amount is less than the full marginal rate.

63. Subsection 9 defines "full marginal rate" and "credit for underlying tax".

64. Subsection 10 applies the definition of ordinary income in Section 259BC(3) in determining the extent to which an amount of relevant income is brought into account

65. Subsections 11 and 12 ensure that relevant income amounts are not counted twice when determining the ordinary income of a CFC and the relevant chargeable companies.

66. Subsection 13 provides definitions of "chargeable companies" , "chargeable profits" and "hybrid transfer arrangement".

67. New Section 259BE sets out definitions of "hybrid entity", "investor" and "investor jurisdiction".

68. Subsection 3 defines a "hybrid entity". An entity is a "hybrid entity" if it is a person for tax purposes in any territory, and either some or all of its income or profits are treated under the law of any territory as the income or profits of another person, or the entity is not regarded in one territory as a distinct and separate person from an entity or entities which are so regarded in another territory

69. Subsection 4 defines an "investor". An "investor" in a hybrid entity is either a person who is treated as having the income or profits of the hybrid entity, or a entity that is regarded as a distinct and separate person in one territory but not so regarded in another territory.

70. A territory in which an investor is within the charge to tax is an "investor jurisdiction"

71. New Section 259BF sets out a definition of "permanent establishment" for the purposes of this Part as either within the UK Corporation Tax Acts definition of a permanent establishment, or within any similar concept in any other territory.

Chapter 3 Hybrid and other mismatches from financial instruments

72. New Section 259C provides an overview of the Chapter 3 rules, which counteract hybrid or

otherwise impermissible deduction/non-inclusion mismatches.

73. New Section 259CA sets out four conditions (A to D) which need to be met in order for this Chapter to apply.

74. Subsection 2 sets out Condition A, which requires that a payment or quasi-payment is made in relation to a financial instrument.

75. Subsection 3 sets out Condition B which requires either the payer or the payee to be within the charge to corporation tax for the payment period.

76. Subsections 4 and 5 set out Condition C which asks whether it would be reasonable to assume a hybrid mismatch would occur, in the absence of this Chapter, Chapter 5, and Chapters 7 to 10, or any equivalent non-UK tax law.

77. Subsection 6 sets out Condition D which is met if the payer is also a payee (applies to quasi-payments only), the payer and payee are related, or if the financial instrument, or any arrangement connected with it, is a structured arrangement.

78. Subsection 7 defines a structured arrangement for this section.

79. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

80. New Section 259CB provides that there is a "hybrid or otherwise impermissible deduction/non-inclusion mismatch" if either or both of Cases 1 or 2 apply.

81. Subsection 2 provides for Case 1 to apply where deductions exceed the total payments or quasi-payments recognised as taxable income, and where the excess arises from the terms or other features of a financial instrument.

82. Subsection 3 provides that any other reason for an excess should be disregarded, and applies "relevant assumptions" to determine whether an excess could have arisen as a result of the terms or other features of a financial instrument.

83. Subsection 4 sets out the "relevant assumptions" to be applied in relation to this section. Those assumptions are that the payee does not benefit from any tax exclusion, immunity, exemption or relief ; that payments and quasi-payments are made in connection with a business carried on by the payee in the payee jurisdiction ; and, if the payee is not within the charge to tax in any territory, either as a company or as a permanent establishment, it is assumed that the payee is a company carrying on a business and is within the charge to tax in the UK

84. Subsection 5 provides for Case 2 to apply where payments or quasi-payments result in amounts being included as taxable income, but under-taxed as a result of the terms or features of a financial instrument. Such amounts are "under-taxed amounts."

85. Subsection 6 provides that any other reason for an undertaxed amount should be disregarded for the purposes of applying this section.

86. Subsection 7 defines a permitted taxable period for a payee.

87. Subsections 8, 9 and 10 define "undertaxed" taxable profits, "full marginal rate" and "credit

for underlying tax".

88. Subsection 11 sets the amount of a Case 1 mismatch amount as the excess that arises as a result of the hybrid financial instrument.

89. Subsection 12 sets the amount of a Case 2 mismatch amount by reference to a formula which takes into account the under-taxed amount, the full marginal tax rate and the actual tax rate applied.

90. Subsection 13 provides that where there is both a Case 1 and a Case 2 amount, the mismatch amount is the sum of the Case 1 and Case 2 amounts.

91. New Section 259CC provides the primary response : the counteraction if a payer is within the charge to corporation tax is that the relevant deduction is reduced by the mismatch amount.

92. New Section 259CD provides the secondary response: the counteraction if a payee is within the charge to corporation tax, and it is reasonable to suppose that the mismatch is not fully counteracted under section 259CC or any equivalent non-UK tax law. The amount calculated in accordance with subsection 3 is treated as income arising to the payee, or payees, for the counteraction period, and is charged to tax as income not otherwise charged to tax. This amount is "the relevant amount."

93. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.

94. Subsection 7 charges the relevant amount to tax under Chapter 8 Part 10 CTA 2009.

95. Subsection 8 defines the "counteraction period."

Chapter 4 Hybrid transfer deduction/non-inclusion mismatches

96. New Chapter 4 provides the detailed rules for countering certain mismatches arising from hybrid transfer arrangements.

97. New Section 259D provides an overview of Chapter 4.

98. New Section 259DA sets out the circumstances in which the Chapter applies.

99. Subsection 1 sets out five conditions (A to E) which need to be met for the hybrid transfer mismatch rules to apply. All five conditions need to be met in order for this Chapter to apply.

100. Subsection 2 sets out Condition A, which requires there to be a hybrid transfer arrangement in relation to an underlying instrument.

101. Subsection 3 sets out Condition B, which requires a payment or quasi-payment to be made in relation to that arrangement or instrument.

102. Subsection 4 sets out Condition C, which requires that either the payer or the payee is within the charge to corporation tax.

103. Subsection 5 sets out Condition D, which is that it is reasonable to assume that in the absence of Part 6A or any equivalent non-UK rules, there would be a hybrid transfer

deduction/non-inclusion mismatch.

104. Subsection 6 sets out Condition E, which is met if the payer is also a payee (applies to quasi-payments only), the payer and payee are related, or if the hybrid transfer arrangement is a structured arrangement.

105. Subsection 7 defines a structured arrangement for this section.

106. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

107. New Section 259DB provides definitions for "hybrid transfer arrangements" and related terms.

108. Subsections 2 and 3 define a "hybrid transfer arrangement" by reference to the transfer of an "underlying instrument" where either the "dual treatment" condition is met, or a "substitute payment" could be made.

109. Subsection 4 defines the "dual treatment" condition. The condition is met if, for the purposes of a tax charged on a person, the arrangement is treated as equivalent, in substance, to the lending of money at interest, and is not so treated for the purposes of a tax charged on another person.

110. Subsection 5 defines a "substitute payment". The definition covers, for example, a manufactured dividend.

111. Subsection 6 includes within the definition, circumstances where an arrangement involves a financial instrument effectively being replaced by a second financial instrument, so that the second instrument is treated as being transferred between the two parties.

112. New Section 259DC sets out two types of hybrid transfer deduction/non-inclusion mismatch which fall within Chapter 4 - denoted as Case 1 and Case 2.

113. Subsection 2 provides for Case 1 to apply where deductions exceed the total payments or quasi-payments recognised as taxable income, and where the excess is a result of either the dual treatment condition or substitute payment condition set out in subsection (7).

114. Subsection 3 provides that any other reason for an excess should be disregarded, and applies "relevant assumptions" to determine whether an excess could have arisen as a result of the dual treatment or substitute payment condition set out in subsection 7.

115. Subsection 4 sets out the "relevant assumptions" to be applied in relation to this section. Those assumptions are that the payee does not benefit from any tax exclusion, exemption or relief ; that payments and quasi-payments are made in connection with a business carried on by the payee in the payee jurisdiction ; and, if the payee is not within the charge to tax in any territory, either as a company or as a permanent establishment, it is assumed that the payee is a company carrying on a business and is within the charge to tax in the UK

116. Subsection 5 provides for Case 2 to apply where amounts are included as taxable income, but under-taxed, as a result of either the dual treatment condition or substitute payment condition being met as set out in subsection (7).

117. Subsection 6 provides that any other reason for an undertaxed amount should be disregarded for the purposes of applying this section.

118. Subsection 7 sets out whether the dual treatment condition is met, and the whether a payment or quasi-payment is a substitute payment, for the purposes of Case 1 and Case 2 above.

119. Subsection 8 disregards Case 1 and Case 2 mismatches which fall within the financial trader exclusion(see Section 259DD)

120. Subsection 9 sets out the time period for a payee, within which amounts of ordinary income can be considered - the "permitted taxable period". This period has to either begin within 12 months of the end of the payment period, or, if later, a claim for a longer period is made, and it is just and reasonable for there to be a longer period.

121. Subsections 10, 11 and 12 define "under-taxed", "full marginal rate" and "credit for underlying tax" for this Chapter.

122. Subsection 13 sets the amount of a Case 1 mismatch as the excess that arises as a result of the terms of the financial instrument.

123. Subsection 14 sets the amount of a Case 2 mismatch by reference to a formula which takes into account the under-taxed amount, the full marginal tax rate and the actual tax rate applied.

124. Subsection 15 provides that where there is both a Case 1 and a Case 2 amount, the mismatch amount is the sum of the Case 1 and Case 2 amounts.

125. New Section 259DD sets out the financial trader exclusion, which applies for substitute payments where the difference in treatment is the result of a person recognising both the underlying return and the substitute payment as trading income. Three conditions (A to C) have to be met for the exclusion to apply.

126. Condition A is that the excess or under-taxed amount arises from a substitute payment which is taxed on one person to reflect the underlying return, but taxed as trading income in the hands of a financial trader.

127. Condition B is that the financial trader brings such amounts into charge for tax.

128. Condition C is that if the underlying return were to be paid directly to the payee or payees, neither Chapter 3 nor any non-UK equivalent law would apply, and that the hybrid transfer arrangement is not a structured arrangement.

129. New Sections 259DE and 259DF set out the counteractions to be applied in relation to Chapter 4.

130. New Section 259DE provides the primary response : where the UK is the payer jurisdiction and the payer is liable to UK corporation tax, the relevant deduction is reduced by the mismatch amount.

131. New Section 259DF provides the secondary response : countering the hybrid mismatch arrangement where the UK is a payee jurisdiction, the payee is liable to UK corporation tax,

and it is reasonable to suppose that the mismatch is not fully counteracted under section 259DE or any equivalent non-UK tax law. The amount calculated in accordance with subsection 3 is treated as income arising to the payee, or payees, for the counteraction period, and is charged to tax as income not otherwise charged to tax. This amount is "the relevant amount."

132. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.

133. Subsection 7 charges the relevant amount to tax under Chapter 8 Part 10 CTA 2009.

134. Subsection 8 defines the "counteraction period."

Chapter 5 Hybrid deduction/non-inclusion mismatches

135. New Chapter 5 provides the detailed rules for countering certain mismatches arising from payments or quasi-payments where the payer is a hybrid entity, which result in a deduction with no matching inclusion of income.

136. New Section 259E provides an overview of the Chapter.

137. New Section 259EA sets out the five conditions (A to E) for the Chapter to apply.

138. Subsections 2 to 7 set out conditions A to E. All of these conditions must be met for the Chapter to apply.

139. Condition A requires a payment or quasi-payment to be made in connection with an arrangement.

140. Condition B requires that the payer is a hybrid entity.

141. Condition C requires either the hybrid payer or the payee to be within the charge to corporation tax.

142. Condition D requires that it is reasonable to assume that there would be a hybrid mismatch in the absence of Chapters 7 to 10, or any equivalent non-UK tax law.

143. Condition E which is met if the hybrid payer is also a payee (applies to quasi-payments only), the hybrid payer and payee are in the same control group, or if the arrangement is a structured arrangement.

144. Subsection 8 defines a structured arrangement for this section.

145. Subsection 9 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

146. New Section 259EB defines hybrid payer mismatches, and their quantum. There is a mismatch where a deduction exceeds the total amounts included in the ordinary income of the payees, and where some or all of the excess is as a result of the hybridity of the payer.

147. Subsection 2 provides that the size of the mismatch is determined by the extent to which it is caused by hybridity.

148. Subsection 3 provides that any other reason for an excess should be disregarded, and

applies "relevant assumptions" to determine whether an excess could have arisen as a result of the hybrid payer being a hybrid entity.

149. Subsection 4 sets out the "relevant assumptions" to be applied in relation to this section. Those assumptions are that the payee does not benefit from any tax exclusion, exemption or relief ; that payments and quasi-payments are made in connection with a business carried on by the payee in the payee jurisdiction ; and, if the payee is not within the charge to tax in any territory, either as a company or as a permanent establishment, it is assumed that the payee is a company carrying on a business and is within the charge to tax in the UK.

150. Subsection 5 defines a permitted taxable period of a payee.

151. New Section259EC provides the primary response : counteraction of hybrid payer mismatches where the UK is the payer jurisdiction.

152. Subsection 2 provides that the relevant deduction equal to the mismatch amount (the "restricted deduction") cannot be deducted unless it is deducted from dual inclusion income.

153. Subsection 3 provides that restricted deductions can be carried forward and set against dual inclusion income in future accounting periods.

154. Subsection 4 defines "dual inclusion income" as amounts which arise due to an arrangement, and which are included as ordinary income of the payer for tax purposes in the UK, and ordinary income for an investor for the purposes of tax charged in another territory, so that such amounts are brought into charge twice.

155. New Section259ED provides the secondary response: counteraction of hybrid payer mismatches where the payee is within the charge to corporation tax.

156. Subsection 1 applies the section where the payee is within the charge to corporation tax and it is reasonable to suppose that neither Section 259EC nor any non-UK equivalent to Section 259EC applies.

157. Subsection 2 determines whether, despite a non-UK tax law equivalent to Section 259EC, a mismatch still exists.

158. Subsection 3 defines "the relevant amount".

159. Subsection 4 provides that an amount equal to the relevant amount, less any dual inclusion income of the hybrid payer, is treated as income of the payee for that period.

160. Subsections 5, 6 and 7 allocate the relevant amount between multiple payees on a just and reasonable basis, and allocate the relevant proportion of any dual inclusion income of the hybrid payer on the same basis.

161. Subsection 8 provides that the amounts given by the calculation in subsections (4) and (5) are treated as income of the payee for the counteraction period and charged to tax under Chapter 8, Part 10 CTA 2009.

162. Subsection 9 defines the counteraction period and "dual inclusion income".

Chapter 6 Deduction/Non-Inclusion Mismatches relating to transfers by Permanent Establishments

163. New Section 259F provides an overview of this chapter, which deals with deduction/non-inclusion mismatches which involve deemed or actual payments by permanent establishments. Such deductions are counteracted by altering the corporation tax treatment of the multinational company.

164. New Section 259FA sets out the four conditions (A to D) which must be met for this chapter to apply.

165. Condition A is that the company is a multinational company, as defined in subsection 3.

166. Condition B is that in the PE jurisdiction an amount may be deducted from taxable income in the PE jurisdiction in respect of an actual or deemed transfer within the company from the PE jurisdiction to the parent jurisdiction.

167. Condition C is that the company is within the charge to corporation tax.

168. Condition D is that it is reasonable to suppose that no ordinary income arises in the parent jurisdiction as a result of the PE deduction, or that the PE deduction exceeds the amount of ordinary income that so arises.

169. Subsection 7 defines "the excessive PE deduction".

170. Subsection 8 defines a permitted taxable period.

171. New Section 259FB provides for counteraction where the UK is the PE jurisdiction.

172. Subsection 2 provides for that the excessive deduction may not be a tax deduction for the UK PE unless it is deducted from dual inclusion income.

173. Subsection 3 provides for amounts restricted by subsection 2 to be carried forward and deducted from dual inclusion income in future periods.

174. Subsection 4 defines "dual inclusion income" as ordinary income of the company in both the PE and the parent jurisdiction.

175. New Section 259FC provides for counteraction where the UK is the parent jurisdiction, the company is within the charge to corporation tax and it is reasonable to suppose that either no provision in the PE jurisdiction equivalent to Section 259FB applies, or if it does, the excessive deduction is not fully counteracted.

176. Subsection 2 determines whether the excessive PE deduction has been fully counteracted in the PE jurisdiction.

177. Subsection 3 determines "the relevant amount".

178. Subsection 4 provides that the relevant amount, less any dual inclusion income, is treated as income of the company for the counteraction period.

179. Subsection 5 provides that an amount treated as income is charged under Chapter 8, Part 10 CTA 2009.

180. Subsection 6 defines the "counteraction period" and "dual inclusion income".

Chapter 7 Hybrid payee deduction/non-inclusion mismatches

181. New Section 259G provides an overview of Chapter 7, which deals with mismatches in relation to hybrid entity payees. Mismatches are counteracted either by amending the corporation tax treatment of the payer, or by treating income as arising to an investor, or, where the hybrid entity is an LLP, by charging corporation tax on the limited liability partnership payees.

182. New Section 259GA sets out five conditions (A to E) which all have to be met for this Chapter to apply.

183. Condition A Is that there is a payment or quasi-payment linked to an arrangement.

184. Condition B is that a payee is a hybrid entity.

185. Condition C is that either the payer is within the charge to corporation tax during the payment period, or that an investor in a hybrid payee is within the charge to corporation tax within the payment period, or that a hybrid payee is a limited liability partnership.

186. Condition D is that is reasonable to assume that in the absence of Chapters 8 to 10, or any equivalent non-UK rules, there would be a hybrid payee deduction/non-inclusion mismatch.

187. Condition E is met if the payer is also a hybrid payee (applies to quasi-payments only), the payer and a hybrid payee, or an investor in a hybrid payee, are related, or if the arrangement is a structured arrangement.

188. Subsection 8 defines a structured arrangement for this section.

189. Subsection 9 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

190. New Section 259GB defines hybrid payee deduction/non-inclusion mismatches, and their quantum.

191. Subsection 1 provides that there is a mismatch where a deduction exceeds the total amounts included in the ordinary income of the payees, and where some or all of the excess is as a result of the hybridity of one or more of the payees.

192. Subsection 2 provides that the size of the mismatch is determined by the extent to which it is caused by hybridity.

193. Subsection 3 provides that any other reason for an excess should be disregarded, and applies "relevant assumptions" to determine whether an excess could have arisen as a result of the hybrid payee being a hybrid entity.

194. Subsection 4 sets out the "relevant assumptions" to be applied in relation to this section. These assumptions are that the payee does not benefit from any tax exclusion, exemption or relief ; that payments and quasi-payments are made in connection with a business carried on by the payee in the payee jurisdiction ; and, if the payee is not within the charge to tax in any territory, either as a company or as a permanent establishment, it is assumed that the

payee is a company carrying on a business and within the charge to tax in the UK

195. Subsection 5 defines a permitted taxable period for a payee.

196. New Section 259GC sets out the counteraction where the payer is within the charge to corporation tax. The relevant deduction of the payer must be reduced by an amount equal to the hybrid payee mismatch.

197. New Section 259GD sets out the counteraction where the investor is within the charge to corporation tax, and it is reasonable to suppose that Section 259GC does not apply, and that either no non-UK equivalent to Section 259GC applies, or that if it does, there is still a mismatch.

198. Subsection 2 determines whether a mismatch is fully counteracted by a non-UK equivalent of Section 259GC.

199. Subsection 3 determines the relevant amount.

200. Subsections 4 to 7 determine the counteraction if there is more than one investor in the hybrid payee.

201. Subsection 8 provides that amounts are charged under Chapter 8, Part 10 CTA 2009.

202. New Section 259GE sets out the counteraction where the hybrid payee is a limited liability partnership ("LLP").

203. Subsection 1 applies the section to a hybrid payee where it is reasonable to suppose that Sections 259GC and 259GD do not apply, and that either no non-UK tax law equivalent to those sections applies, or that if it does, but a mismatch still exists.

204. Subsection 2 determines whether a mismatch has been fully counteracted by the provisions set out in subsection 1.

205. Subsection 3 defines "the relevant amount."

206. Subsection 4 provides that if the hybrid payee is the only hybrid payee, an amount equal to the mismatch is treated as income arising to the hybrid payee on the last day of the payment period.

207. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis .

208. Subsection 7 provides that the amount given by the calculation in subsections (4) or (5) is treated as income of the hybrid payee and charged to tax under Chapter 8, Part 10 CTA 2009.

209. Subsection 8 disapplies section 863 ITTOIA 2005 and section1273 CTA 2009, which relate to the taxation of certain LLPs, so far as is necessary to apply the charge under subsection (7).

210. Subsection 9 disregards Section 259GE when considering whether the hybrid payee is within the charge to corporation tax in relation to the rest of the hybrid mismatch rules in Part 6A, apart from the anti-avoidance rules in Section 259M.

Chapter 8 Multinational Payee Deduction/Non-Inclusion Mismatches

211. New Section 259H provides an overview of the chapter, which deals with deduction/non-inclusion mismatches in relation to permanent establishments by altering the corporation tax treatment of the payer or a payee.

212. New Section 259HA sets out the five conditions (A to E) which all have to be met for this Chapter to apply.

213. Condition A is that there is a payment or quasi-payment linked to an arrangement.

214. Condition B is that the payee is a "multinational company" which is defined as a company resident for tax purposes in one territory ("the parent jurisdiction") and carries on a business through a permanent establishment in another territory ("the PE jurisdiction").

215. Condition C is that either the payer or the multinational company is within the charge to corporation tax.

216. Condition D is that it is reasonable to suppose, disregarding Chapters 8, 9 and 10 of Part 6A and any equivalent non-UK law, that there would be a deduction/non-inclusion mismatch.

217. Condition E is that the payer is also a payee (applies to quasi-payments only), the payer and the multinational company are related, or that the arrangement is a structured arrangement.

218. Subsection 10 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

219. New Section 259HB defines multinational payee deduction/non-inclusion mismatches and their quantum.

220. Subsection 3 provides that any other reason for an excess should be disregarded

221. Subsection 4 defines a "permitted period".

222. New Section 259HC sets out the counteraction when the payer is within the charge to corporation tax. The counteraction is that a relevant deduction for the payer is reduced by an amount equal to the multinational payee deduction/non-inclusion mismatch.

223. New Section 259HD sets out the counteraction when the multinational company is within the charge to corporation tax because the UK is the parent jurisdiction. The counteraction, which applies where it is reasonable to suppose that neither Section 259HC nor any non-UK equivalent applies (or does not fully counteract the mismatch), is that the payee's share of the relevant amount is treated as income of that payee not otherwise charged.

224. Subsection 2 determines whether a mismatch is fully counteracted.

225. Subsection 3 sets out "the relevant amount".

226. Subsection 4 provides that where the only payee is a multinational company, the whole of the relevant amount is treated as income arising to that company.

227. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.

228. Subsection 7 provides that amounts are charged under Chapter 8, Part 10 CTA 2009.

229. Subsection 8 sets out the counteraction period.

Chapter 9 Hybrid Entity Double Deduction Mismatches

230. New Section 259I provides an overview of Chapter 9, which deals with double deductions involving a hybrid entity.

231. New Section 259IA sets out three conditions (A to C), all of which need to be met for the Chapter to apply.

232. Condition A is that, disregarding Chapters 9 and 10, and any equivalent non-UK tax law, an amount could be deducted both from the ordinary income of a hybrid payer, and from the ordinary income of an investor in a different jurisdiction. This amount is the "hybrid entity double deduction amount".

233. Condition B is that either the hybrid entity or the investor is within the charge to corporation tax during the relevant deduction period.

234. Condition C is that the investor and the hybrid entity are related at any time during either the hybrid entity deduction period, or the investor deduction period. Alternatively, that there is a structured arrangement.

235. Subsection 7 defines a structured arrangement for this section.

236. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.

237. New Section 259IB sets out the counteraction where the investor is within the charge to corporation tax.

238. Subsection 2 provides that the hybrid entity double deduction amount can only be deducted from the dual inclusion income of the investor, so that the deduction can only be used to offset any dual inclusion income.

239. Subsection 3 allows for any investor's deduction that cannot be set against ordinary income to be carried forward to future accounting periods.

240. Subsection 4 allows for circumstances where investors will not have any future dual inclusion income. In those circumstances, the "stranded deduction" can be deducted from the investor's taxable total profits.

241. Subsection 5 allows for any unrelieved stranded deductions to be carried forward and set against future profits.

242. Subsections 6 and 7 provide that if it is reasonable to suppose that a hybrid entity double deduction amount is deducted from ordinary income (other than dual inclusion income) for any person for non-UK tax purposes, that amount is termed an "illegitimate overseas deduction" and any amounts that may be deducted by the investor for UK tax purposes is reduced by that amount. An amount equal to the illegitimate overseas deduction is deemed to have already been deducted in a previous accounting period, so that amount is no longer available for the current taxable period.

243. Subsection 8 defines "dual inclusion income" as an amount which is ordinary income for the investor in the UK, and also ordinary income for the hybrid entity in another territory, so that such amounts are brought into charge twice.

244. New Section 259IC sets out the counteraction where the hybrid entity is within the charge to corporation tax.

245. Subsection 1 applies this section where the hybrid entity is within the charge to corporation tax, and it is reasonable to suppose that either no non-UK provision equivalent to Section 259IB applies, or that if it does, a mismatch still remains, and the condition in subsection (2) is met.

246. Subsection 2 sets out the second counteraction condition. This requires that either the hybrid entity and any investor are either within the same control group, or that the hybrid entity or any investor are party to a structured arrangement.

247. Subsection 3 provides that the "restricted deduction" is either the hybrid entity double deduction amount, or the remaining amount after any non-UK law has been applied.

248. Subsection 4 provides that the restricted deduction can only be deducted from the dual inclusion income of the hybrid entity.

249. Subsection 5 provides for restricted deductions to be carried forward and set against dual inclusion income of later periods.

250. Subsection 6 allows for circumstances where the hybrid payer will not have any future dual inclusion income. In those circumstances, the "stranded deduction" can be deducted from total profits.

251. Subsection 7 allows for any unrelieved stranded deductions to be carried forward and set against future profits.

252. Subsections 8 and 9 provide that if it is reasonable to suppose that a hybrid entity double deduction amount ("the illegitimate overseas deduction") is deducted from ordinary income for any person for non-UK tax purposes, that amount is not dual inclusion income. As a result, amounts that may be deducted by the hybrid entity are reduced by that amount. An amount equal to the illegitimate overseas deduction is deemed to have already been deducted in a previous accounting period.

253. Subsection 10 defines "dual inclusion income".

Chapter 10 Dual Territory Company Double Deduction Cases

254. New Section 259J provides an overview of Chapter 10, which deals with double deductions arising from dual resident companies, or from a permanent establishment.

255. New Section 259JA sets out two conditions (A and B) which both have to be met for the Chapter to apply.

256. Condition A is that a company is a dual resident company, or a relevant multinational company.

257. Subsection 3 defines a dual resident company for the purposes of this Chapter.

258. Subsection 4 defines a relevant multinational company for the purposes of this Chapter.

259. Condition B is that it is reasonable to assume, in the absence of Chapter 10 and any non-UK equivalent, that an amount can be deducted for both UK and non-UK tax purposes. This amount is the "dual territory double deduction amount".

260. New Section 259JB sets out the counteraction to dual territory double deduction mismatches which arise due to a dual resident company, or because the UK is the parent jurisdiction of a relevant multinational company.

261. Subsection 2 provides that the dual territory double deduction amount can only be deducted from dual inclusion income.

262. Subsection 3 provides that any surplus mismatch can be carried forward to subsequent accounting periods, and set against dual inclusion income.

263. Subsection 4 allows for any stranded deduction to be set against taxable total income, if the company ceases to be dual resident.

264. Subsection 5 allows surplus stranded deductions to be carried forward.

265. Subsections 6 and 7 provide that if it is reasonable to suppose that a dual territory double deduction amount is deducted from ordinary income (other than dual inclusion income) of any person for non-UK tax purposes, that amount (the illegitimate overseas deduction) is deemed to have already been deducted in a previous accounting period. As a result, any dual territory double deduction amounts or stranded amounts that could otherwise be deducted in the UK are reduced by that amount.

266. Subsection 8 defines "dual inclusion income".

267. New Section 259JC applies where a double deduction which arises to a relevant multinational is not counteracted by Section 259JB.

268. Subsection 1 requires that the UK is the PE jurisdiction, and that either the parent jurisdiction has no equivalent to Section 259JB, or if it does, the double deduction is not fully counteracted.

269. Subsection 2 defines "the restricted deduction".

270. Subsection 3 provides that the restricted deduction can only be deducted from dual inclusion income for the period.

271. Subsection 4 provides for any unused restricted deduction to be carried forward and used against dual inclusion Income of subsequent periods

272. Subsection 5 allows for any stranded deduction to be set against total taxable income if the company ceases to be a relevant multinational company.

273. Subsection 6 allows for stranded deductions to be carried forward.

274. Subsections 7 and 8 provide that if it is reasonable to suppose that a dual territory double deduction amount is deducted from ordinary income (other than dual inclusion income) for any person for non-UK tax purposes, that amount (the illegitimate overseas deduction) is

deemed to have already been deducted in a previous accounting period. As a result, any dual territory double deduction amounts or stranded amounts that could otherwise be deducted in the UK are reduced by that amount.

275. Subsection 9 defines "dual inclusion income".

Chapter 11 Imported Mismatches

276. New Section 259K contains an overview of Chapter 11, which denies deductions in relation to imported mismatch payments or quasi-payments.

277. New Section 259KA sets out seven conditions (A to G) which all have to be met in order for this Chapter to apply.

278. Condition A is that the payment or quasi-payment is made under, or in connection with, an arrangement. Arrangements are termed "imported mismatch payments" and "imported mismatch arrangements".

279. Condition B is that the payer ("P") is within the charge to corporation tax.

280. Condition C is that the imported mismatch arrangement is part of a series of arrangements.

281. Subsection 5 defines a series of arrangements as a number of arrangements which are part of a wider, overall arrangement ("the over-arching arrangement").

282. Condition D is either that under another arrangement in the series, there is a payment or quasi-payment ("the mismatch payment") which it is reasonable to assume involves another hybrid mismatch - this can be any of the various mismatches detailed in the rest of Part 6A ; or that as a result of another arrangement, there will be an excessive PE deduction.

283. The "relevant mismatch" is defined in subsection 6 as the mismatch, amount or deduction which may arise as a result of the mismatch payment.

284. Subsection 7 defines a "dual territory double deduction" as an amount that can be deducted for tax purposes under the laws of two territories.

285. Condition E requires that it is reasonable to assume that Chapters 3 to 10, or any overseas equivalent, do not apply to the tax treatment of any person, or, where appropriate, to the tax treatment of the company in which an excessive PE deduction arises.

286. Condition F requires that it is reasonable to assume that Chapters 3 to 10, or any overseas equivalent provisions would apply if the payer (P) was a payer, a payee, or an investor. Alternatively, that such provisions would apply if an excessive PE deduction were to arise in relation to P.

287. Condition G is that either P and the payer, or a payee, are members of the same group, or that P and the company with the excessive PE deduction are members of the same group. Alternatively that either the imported mismatch arrangement, or the over-arching arrangement, is a structured arrangement.

288. Subsection 11 defines a structured arrangement for this section.

289. Subsection 12 provides that an arrangement may be a structured arrangement whether or

not there is also a commercial or other purpose.

290.New Section 259KB sets out the counteraction for an imported mismatch payment, which is the denial of relevant deductions.

291.Subsection 2 provides that a relevant deduction for P is reduced by the amount of the relevant mismatch.

292. Subsection 3 applies where there are one or more relevant payments in relation to the relevant mismatch - in which case, the deduction from P's ordinary income is reduced by P's share of the mismatch.

293.Subsections 4 and 5 determine the share of the relevant mismatch by reference to the extent to which the imported mismatch payment funds the mismatch, as opposed to being funded by the relevant payments. With regard to an excessive PE deduction, P's share of the mismatch is determined by reference to the extent to which the imported mismatch payment and relevant payments fund the actual transfer, or would have funded the deemed transfer.

294.Subsection 6 provides that in respect of deemed transfers, it is assumed that they would have been funded by the imported mismatch payment to the extent that it cannot be shown that they would have been funded by relevant payments.

295.Subsection 7 defines a relevant payment.

296.Subsection 8 sets out that in relation to formal court or tribunal proceedings, P will need to demonstrate that there are relevant payments in relation to the relevant mismatch, and demonstrate that a mismatch payment is funded by relevant payments rather than by an imported mismatch payment.

Chapter 12 Adjustments in light of subsequent events etc.

297.New Section 259L sets out the circumstances when it is possible for taxpayers to amend or correct the position where it is established that a reasonable supposition on which the application of Part 6A was based no longer applies.

298.Subsection 1 refers to cases where a reasonable supposition is mistaken, or is no longer reasonable, and allows for just and reasonable adjustments to correct the position.

299.Subsection 2 enables such adjustments to be made.

300.Subsection 3 provides that the normal UK time limits apply to this section.

301.Subsection 4 provides that no adjustment can be made on the basis that ordinary income arises after the payee's last permitted taxable period.

302.New Section 259LA provides for a deduction from taxable total profits in circumstances where ordinary income arises late.

303.Subsection 1 sets out the conditions which have to be met in order for Section 259LA to apply. Those conditions are that a relevant deduction has been reduced by the application of one or more of Chapters 3 to 8; that no other provision of Part 6A or any non-UK equivalent applies; and that an amount of ordinary income ("the late income") arises to a payee for a taxable period that is not a permitted taxable period ("the late period"). The ordinary income cannot arise as a result of the application of Part 6A or any non-UK equivalent.

304. Subsection 2 provides that an amount equal to the late income may be deducted from total taxable income of the payer for the period in which the payee's late period ends.

305. Subsection 3 provides for unused amounts to be carried forward.

306. Subsection 4 limits the total amount deductible from taxable total profits to the amount of the original counteraction.

307. Subsection 5 defines the "permitted taxable period"

Chapter 13 Anti-Avoidance

308. New Section 259M sets out anti-avoidance rules in relation to Part 6A. These targeted anti-avoidance rules are intended to prevent arrangements which seek to undermine the policy intent of Part 6A by circumventing the mechanical hybrid mismatch rules.

309. Subsection 1 sets out that the Chapter applies to relevant avoidance arrangements where any person within the charge to corporation tax (or who would be absent the arrangement) obtains a relevant tax advantage.

310. Subsection 2 provides for just and reasonable adjustments to cancel out the relevant tax advantage.

311. Subsection 3 explains how such adjustments may be made.

312. Subsection 4 defines "a relevant tax advantage" as one where a person avoids either a restricted deduction or an amount being charged as income due to the application of Part 6A or any equivalent non-UK provision.

313. Subsection 5 defines "relevant avoidance arrangements" as those where one of the main purposes is to obtain a relevant tax advantage.

314. Subsection 6 excludes arrangements where the relevant tax advantage can be reasonably regarded as consistent with the principles and policy objectives on which Part 6A, or any non-UK equivalent, are based.

315. Subsections 7 and 8 provide that the OECD Report on Hybrids (and any replacement or supplement) may, if appropriate, be considered when determining the underlying principles and policy objectives for the purposes of subsection 6.

Chapter 14 Interpretation

316. This chapter provides a number of definitions for the purposes of Part 6A.

317. New Section 259N provides a definition of "financial instrument".

318. Subsection 3(a) excludes hybrid transfer arrangements from the definition of financial instruments.

319. Subsection 3(b) excludes regulatory capital securities in relation to banking and insurance

(as defined by the Taxation of Regulatory Capital Securities Regulations 2013) from the definition of financial instruments, so that, subject to subsection 4, such securities are not within the scope of the new hybrid mismatch rules.

320. Subsection 4 provides that subsection 3(b) is subject to regulations made under section 221 of FA 2012. This will enable the new hybrid mismatch rules to be applied to any securities that are specified in those regulations.

321. New Section 259NA provides a definition of Control Groups.

322. New Section 259NB provides a definition of Related Persons.

323. New Section 259NC provides a definition of 50% and 25% investment.

324. New Section 259ND sets out the treatment of partnership members.

325. New Section 259NE sets out a number of definitions in relation to the hybrid mismatch rules.

Part 2 Consequential amendments

326. Part 2 sets out various amendments to other UK legislation, including the omission of Part 6, to take account of Part 6A.

327. Part 3 Commencement

328. This part provides the commencement provisions for Part 6A.

329. Paragraph 18 provides that, in relation to Chapters 3 to 5, 7 and 8, the rules will have effect for payments made on or after the commencement date, and for quasi-payments where the payment period begins on or after the commencement date.

330. Paragraph 19 provides that, in relation to Chapter 6, the rules will have effect for excessive PE deductions when the relevant PE period begins on or after the commencement date.

331. Paragraph 20 provides that, in relation to Chapter 9 and 10, the rules will have effect for accounting periods beginning on or after the commencement date.

332. Paragraph 21 provides that, in relation to Chapter 11, the rules will have effect for imported mismatch payments made on or after the commencement date, and for quasi-payments where the payment period begins on or after the commencement date.

333. Paragraph 22 provides for commencement in relation to various consequential amendments.

334. Paragraph 23 sets out the treatment in relation to Chapters 3 to 5, Chapters 7 and 8 and Chapter 11 where a payment period begins before the commencement date and ends on or after that date (straddling periods).

335. Paragraph 24 sets out the treatment in relation to Chapter 6 where a relevant PE period begins before and ends after the commencement date (straddling periods).

336. Paragraph 25 sets out the treatment in relation to Chapters 9 and 10 where a company has an accounting period that begins before the commencement date, and ends on or after that

date (straddling periods)

337. Paragraph 26 sets the commencement date as 1 January 2017.

Background note

338. Hybrid mismatch arrangements can be used to achieve double deductions or deduction/non-inclusion outcomes and erode the UK tax base. These new rules replace the arbitrage rules in Part 6 TIOPA 2010 and will ensure that deduction/non-inclusion and double deduction mismatch arrangements are counteracted. From 1st January 2017 the new provisions will put an end to multiple deductions for a single expense and for deductions in one country without a corresponding taxation in another.

339. It is expected that similar rules will be introduced by other jurisdictions, but in line with OECD recommendations the UK legislation contains provisions for counteraction in the UK where the other country does not counteract the mismatch with its own hybrid mismatch rules.

Clause 63: Insurance companies carrying on long-term business

Summary

1. This clause amends the corporation tax rules introduced by Finance Act (FA) 2012 so that they produce the appropriate policy result for the taxation of long-term business carried on by insurance companies. The amendments have effect for accounting periods beginning on or after the day on which the Act is passed.

Details of the clause

2. Subsection (2) provides that when calculating the I-E profit (or excess expense arising from a company's basic life assurance and general annuity business) a company's non-trading deficit from its loan relationships cannot be set against any minimum profits charge arising under section 93 of FA 2012.

3. Subsection (3) allows an excess of intangible fixed asset debits over credits to be a management expense of the period in which they arise rather than in the following period.

4. Subsection (4) provides that a trade loss arising from a company's basic life assurance and general annuity business is not reduced by the company's net position on derivatives contracts prior to being group relieved or set against other company profits.

Background note

5. FA 2012 introduced a new regime for the taxation of insurance companies carrying on long-term business.

6. HMRC and industry, working together, have identified areas where the legislation in its current form does not deliver the expected policy results. These amendments rectify that position.

7. The government intends to amend FA 2012 in Finance Bill 2016 to provide the necessary solutions.

Clause 64: Taking over payment obligations as lessee of plant or machinery

Summary

1. This clause tackles tax avoidance schemes that seek to generate non-taxable income in return for taking on liabilities under a lease that give rise to tax deductible amounts. It amends legislation for both corporation tax and income tax purposes.

Details of the clause

2. Subsection (1) introduces new Chapter 3 into Part 20 of Corporation Tax Act 2010 (CTA 2010).

3. Chapter 3 contains new section 894A of CTA 2010.

4. New section 894A(1) details the circumstances in which the section applies. Three conditions must be satisfied:

   - a company must agree to take over obligations under a lease of plant or machinery,
   - the assumption of those obligations results in tax deductible expenditure for the company, or a connected person,
   - consideration is payable to the company, or a connected person, for agreeing to take over the obligations.

5. New section 894A(2) provides that, in those circumstances, the consideration is treated as income of the company for corporation tax purposes received at the time of the agreement to take over the lease obligations.

6. New section 894A(3) disapplies section 894A(2) to the extent that the consideration is otherwise charged to tax as an amount of income, or is brought into account as income or in respect of the capital allowances of C, or a connected person.

7. New section 894A(4) clarifies that section 894A(1) may be satisfied regardless of how C takes over D's obligations under the lease.

8. New Section 894A(5) provides relevant definitions.

9. New Section 894A(6) and (7) ensures that any priority rule contained in the Taxes Acts, other than the General Anti-Abuse Rule in Part 5 of Finance Act 2013, has effect subject to new Section 894A. A priority rule is a rule, however expressed, whereby particular provisions have effect to the exclusion of, or otherwise in priority to, anything else.

10. New Section 894A(8) provides examples of priority rules.

11. Subsection (2) inserts new Section 809ZG into Chapter 6 of Part 13 of the Income Tax Act 2007.

12. New Section 809ZG replicates for persons chargeable to income tax the provisions of section 894ZA of CTA 2010, making necessary adjustments to refer to the appropriate taxes.

13. Subsection (3) sets out the commencement provision for both taxes. The new rules apply to agreements entered into on or after 25 November 2015.

Background note

14. HMRC has received disclosures of tax avoidance schemes that involve arrangements whereby non-taxable consideration is received when taking over tax deductible lease obligations. To the extent that such consideration is received, the person taking over those obligations incurs no real expenditure. The legislation addresses this form of avoidance by ensuring that all of the consideration payable to that person or connected persons is taxable as income.

Clause 65: Capital allowances: designated assisted areas

Summary

1. This clause changes the Enhanced Capital Allowances (ECA) scheme for expenditure on plant and machinery for use in designated assisted areas (DAA) within enterprise zones. It allows all DAAs to claim eight years of ECAs from the date they are designated or treated as designated.

Details of the clause

2. This clause amends section 45K - expenditure on plant and machinery used in designated areas - of the Capital Allowances Act 2001 by substituting "1 April 2012" with "the date on which the area is (or is treated as) designated under subsection (2)(a)".

Background note

3. Capital allowances allow the cost of capital assets to be written off against taxable profits. They take the place of depreciation charged in the commercial accounts, which is not allowed for tax.

4. Most businesses are entitled to a 100% allowance, the Annual Investment Allowance (AIA), for their investment in most plant or machinery (excluding cars) up to an annual limit, which from 1 January 2016 is £200,000 to 2020. For expenditure above that limit, writing-down allowances (WDA) are available, which are given at the main rate of 18% or the special rate of 8% per annum.

5. ECAs are available for expenditure on certain types of plant or machinery as an alternative to AIA and WDA. ECAs, currently available at a rate of 100%, accelerate the rate at which tax relief is available for capital spending and allow a greater proportion of the cost of an investment to qualify for tax relief against a business's taxable profits of the period in which the investment is made. 100% ECAs therefore provide business with a valuable tax-timing benefit.

6. ECAs for expenditure on plant and machinery for use in enterprise zones were introduced in Finance Act 2012 originally for a five year period to 31 March 2017 and it was subsequently extended to 31 March 2020. This measure amends the end date such that all DAAs will have eight years of ECA from the date they were so designated.

7. ECAs are part of a package of measures designed to encourage economic growth and investment in enterprise zones, including simplified planning and business rates discounts.

RESOLUTION 35

Clause 66: Capital allowances: anti-avoidance relating to disposals

Summary

1. This clause counters tax avoidance schemes which seek to reduce disposal values of plant or machinery for capital allowances purposes below the actual full value attributable to the disposal of those assets.

Details of the clause

2. Subsection (1) introduces the amendments to Chapter 17 of Part 2 of the Capital Allowances Act 2001.

3. Subsection (2) explains that section 213 CAA 2001 is to be amended as set out in subsections (3) and (4).

4. Subsection (3) amends section 213(1) to clarify that Chapter 17 applies to both parties to a relevant transaction - "S" (the transferor) as well as "B" (the transferee).

5. Subsection (4) inserts new Section 213(4) which defines the disposal values relevant for the purposes of Chapter 17 as being those arising from the different types of relevant transaction identified in section 213(1).

6. Subsection (5) explains that section 215 CAA 2001 is to be amended as set out in the three following subsections. Section 215 sets out when certain anti-avoidance rules apply for the purposes of Part 2 of CAA 2001 and, depending on the tax advantage sought by the arrangements, which other section within Chapter 17 will apply to counteract that tax advantage.

7. Subsection (6) amends section 215(1) in two respects. The first is to extend the section to the imposition of balancing charges, new or increased, as well as restriction of allowances. The second is to put beyond doubt the section applies potentially to either party to a relevant transaction.

8. Subsection (7) makes an amendment to section 215(4) to include as obtaining a tax advantage where a person seeks to avoid liability for all or part of a balancing charge.

9. Subsection (8) inserts new subsection (4A) into section 215. New subsection (4A) identifies the applicable section to counteract the tax advantage relating to disposal value of plant or machinery that is the subject of the relevant transaction as being section 218ZB CAA 2001. There are already two other applicable sections, referred to in section 215(5) and (6), being sections 217 and 218ZA CAA 2001. Those other applicable sections deal with instances where the tax advantage in question relates to allowances that B can claim on qualifying expenditure and the amount of the qualifying expenditure.

10. Subsection (9) inserts new Section 218ZB into Chapter 17 as the applicable section referred to in new Section 215(4A).

11. New Section 218ZB(1) provides for cancellation of the tax advantage in defined circumstances. These are that S would otherwise obtain a tax advantage in the form of a higher allowance or a reduced or no balancing charge as a consequence of a payment payable to any person where section 215 applies. The cancellation of the tax advantage takes the form of adjustment of the disposal value of the plant or machinery in a just and reasonable manner.

12. New Section 218ZB(2) provides that payment is to have a wide definition.

13. Subsection (10) adds section 218ZB to the list of sections about disposal values in section 66 CAA 2001.

14. Subsection (11) provides the amendments will have effect in relation to transactions within section 213(1) that take place on or after 25 November 2015.

Background note

15. This clause addresses a number of avoidance schemes that have been disclosed to HMRC. The fact pattern differs in each scheme. However, the common theme is that the amount to be taken into account under the scheme as disposal value for capital allowances purposes is significantly less than the actual value of the plant or machinery being disposed of. The difference is received, directly or indirectly, in such a way as to not form part of the disposal value and does not otherwise attract any actual tax liability. Consequently, the disposer receives capital allowances significantly in excess of the actual economic depreciation of the plant or machinery whilst it was being used for qualifying activities.

Clause 67: Trade and property business profits: money's worth

Summary

1. This clause confirms that trading income received in non-monetary form is fully brought into account in calculating taxable trading profits for income tax and corporation tax purposes. This will also apply to the calculation of taxable property income. The legislation operates with effect from Budget 2016 in relation to trading transactions occurring on or after 16th March 2016.

Details of the clause

2. Subsection (1) directs that the Income Tax (Trading and Other Income) Act (ITTOIA) 2005 is to be amended.

3. Subsection (2) inserts new Section 28A into Chapter 3 of Part 2 of ITTOIA.

4. New Section 28A(1) provides that new Section 28A(2) applies for the purpose of bringing into account money's worth arising in the course of a trade where certain conditions are met, where an amount would not otherwise be fully brought into account (but see also new Section 28A(3)).

5. New Section 28A(2) provides that if the money's worth would have been brought into account as a receipt if it arose as a sum of money, then the value of the money's worth is to be brought into account for the purposes of calculating the profits of the trade.

6. New Section 28A(3) provides that new Section 28A will not apply where another provision within Part 2 of ITTOIA expressly provides for the bringing into account as a receipt an amount in respect of money's worth.

7. Subsection (3) makes consequential changes to the reference table in section 272 of ITTOIA.

8. Subsection (4) directs that the Corporation Tax Act 2009 (CTA 2009) is to be amended.

9. Subsection (5) inserts new Section 49A into Chapter 3 of Part 3 of CTA 2009 and provides for the equivalent effect for the purposes of CTA 2009 that subsection (2) has for the purposes of ITTOIA.

10. Subsection (6) makes consequential changes to the Table in section 210(2) of CTA 2009.

11. Subsection (7) provides for commencement. The statutory rule will apply to transactions entered into on or after 16th March 2016.

Background note

12. The 1948 House of Lords decision in Gold Coast Selection Trust Ltd v Humphrey (30TC209)

established the principle that the value of trading income received in non-monetary form is taxable in full as trading income.

13. At Budget 2016 the government announced that it would introduce legislation with immediate effect to confirm existing law and practice in relation to trading and property income received in non-monetary form.

Clause 68: Replacement and alteration of tools

Summary

1. This clause repeals legislation providing tax relief for expenditure incurred by a business on replacement and alteration of trade tools. Relief under section 68 Corporation Tax Act 2009 (CTA2009) will not be available for expenditure incurred on or after 1 April 2016 and relief under section 68 Income Tax Trading and Other Income Act 2005 (ITTOIA 2005) will not be available for expenditure incurred on or after 6 April 2016.

Details of the clause

2. Subsection (1a) provides for repeal of section 68 of ITTOIA 2005.
3. Subsection (1b) provides for repeal of section 68 of CTA2009.
4. Subsection (2a) makes consequential changes to subsection (1) of section 56A of ITTOIA 2005.
5. Subsection (2b) makes consequential changes to subsection (2) of section 272 of ITTOIA 2005.
6. Subsection (3) makes consequential changes to subsection (2) of section 210 of CTA2009.
7. Subsections (4) and (5) provide for the repeal to take effect for expenditure incurred on or after 1 April 2016 and 6 April 2016 for corporation tax and income tax respectively.

Background note

8. At Budget 2016 the government announced that it would repeal legislation providing tax relief for expenditure incurred by a business on replacement and alteration of trade tools.
9. The allowance pre-dated the capital allowances regime and applied to expenditure incurred on replacing or altering implements, utensils and articles used in a business.
10. Alternative means of tax relief for this type expenditure are available to traders through the capital allowance regime and to residential landlords through replacement furniture relief.

Clause 69: Property business deductions: replacement of domestic items

Summary

1. This clause introduces a new deduction for capital expenditure incurred by a lessor on replacing domestic items, including furnishings, appliances and kitchenware, provided for the use of a lessee in a dwelling-house. The deduction has effect for expenditure incurred on or after 6 April 2016 for income tax and 1 April 2016 for corporation tax.

Details of clause

2. Subsection 1 introduces new Section 311A to Income Tax (Trading and Other Income) Act (ITTOIA) 2005.

3. Subsection 1 of new Section 311A of ITTOIA 2005 provides that the section applies if conditions A to D are met.

4. Subsections 2 to 5 set out conditions A to D:

   - Condition A is that a person ("P") carries on a property business that includes a dwelling-house.
   - Condition B is that P incurs expenditure on replacing a domestic item. The new item must be provided solely for the lessee for use in the dwelling-house and the old item must no longer be available for use in the dwelling-house.
   - Condition C is that the expenditure is of a capital nature and is incurred wholly and exclusively for the purposes of the property business.
   - Condition D is that no capital allowances are available in respect of the expenditure.

5. Subsection 6 provides for a deduction to be given for the expenditure when calculating the profits of the property business.

6. Subsection 7 prohibits a deduction in a tax year if the dwelling-house is qualifying furnished holiday accommodation within Chapter 6 of Part 3 of ITTOIA 2005 for that year.

7. Subsection 8 prohibits a deduction in a tax year if rent-a-room relief is claimed in respect of the dwelling-house for that year.

8. Subsection 9 provides that the amount of the deduction is the expenditure incurred on the replacement item, except where it is not the same or substantially the same as the old item. Where the replacement item is not the same or substantially the same as the old item, the deduction is limited to the amount of the expenditure that would have been incurred on an item that is the same or substantially the same.

9. Subsection 10 increases the deduction by any incidental capital expenditure incurred on disposing of the old item or purchasing the new item.

10. Subsection 11 provides for circumstances in which the old item is part-exchanged for the new item. The part-exchange value of the old item is treated as expenditure incurred on the new item and then the deduction is reduced by the same amount.

11. Subsection 12 applies in cases where the old item is not part-exchanged for the new item. It reduces the deduction by any disposal proceeds that P is entitled to receive for the old item, including where the proceeds are given in money's worth or where the proceeds are received by a person connected with P.

12. Subsection 13 clarifies that for the purpose of identifying the disposal proceeds for subsection (12), the consideration is only that relating to the old item and not for any money or money's worth given by P alongside the disposal of the old item.

13. Subsection 14 defines domestic item as an item for domestic use, including furniture, furnishings, household appliances and kitchenware, but excluding fixtures.

14. Subsection 15 defines the capital expenditure rule, the wholly and exclusively rule and lessee for the purpose of this section. Lessee for this purpose refers to a person that pays for the use of a dwelling-house, even where a formal lease does not exist.

15. Subsection 2 of the clause introduces new Section 250A to Corporation Tax Act (CTA) 2009.

16. Subsection 1 of new Section 250A of CTA 2009 provides that the section applies if conditions A to D are met.

17. Subsections 2 to 5 set out conditions A to D:

- Condition A is that a company ("C") carries on a property business that includes a dwelling-house.
- Condition B is that C incurs expenditure on replacing a domestic item. The new item must be provided solely for the lessee for use in the dwelling-house and the old item must no longer be available for use in the dwelling-house.
- Condition C is that the expenditure is of a capital nature and is incurred wholly and exclusively for the purposes of the property business.
- Condition D is that no capital allowances are available in respect of the expenditure.

18. Subsection 6 provides for a deduction to be given for the expenditure when calculating the profits of the property business.

19. Subsection 7 prohibits a deduction in an accounting period if the dwelling-house is qualifying furnished holiday accommodation within Chapter 6 of Part 4 of CTA 2009 for that accounting period.

20. Subsection 8 provides that the amount of the deduction is the expenditure incurred on the replacement item, except where it is not the same or substantially the same as the old item. Where the replacement item is not the same or substantially the same as the old item, the

deduction is limited to the amount of the expenditure that would have been incurred on an item that is the same or substantially the same.

21. Subsection 9 increases the deduction by any incidental capital expenditure incurred on disposing of the old item or purchasing the new item.

22. Subsection 10 provides for circumstances in which the old item is part-exchanged for the new item. The part-exchange value of the old item is treated as expenditure incurred on the new item and then the deduction is reduced by the same amount.

23. Subsection 11 applies in cases where the old item is not part-exchanged for the new item. It reduces the deduction by any disposal proceeds that C is entitled to receive for the old item, including where the proceeds are given in money's worth or where the proceeds are received by a person connected with C.

24. Subsection 12 clarifies that for the purpose of identifying the disposal proceeds for subsection (12), the consideration is only that relating to the old item and not for any money or money's worth given by C alongside the disposal of the old item.

25. Subsection 13 defines domestic item as an item for domestic use, including furniture, furnishings, household appliances and kitchenware, but excluding fixtures.

26. Subsection 14 defines the capital expenditure rule, the wholly and exclusively rule and lessee for the purpose of this section. Lessee for this purpose refers to a person that pays for the use of a dwelling-house, even where a formal lease does not exist.

27. Subsection 3 of the clause restricts capital losses that arise on replacement items by providing that deductions under section 311A of ITTOIA 2005 and section 250 of CTA 2009 are a capital allowance for the purpose of section 41 of Taxation of Chargeable Gains Act 1992.

28. Subsection 4 clarifies that in subsection (1)(b) of section 308 of ITTOIA 2005, the expenses allowable in connection with the provision of furniture must be of a revenue nature.

29. Subsection 5 inserts section 311A of ITTOIA 2005 into the list of provisions in section 322 of ITTOIA 2005 for which it matters whether a UK or overseas property business consists of or includes the commercial letting of furnished holiday accommodation.

30. Subsection 6 clarifies that in subsection (1)(b) of section 248 of CTA 2009, the expenses allowable in connection with the provision of furniture must be of a revenue nature.

31. Subsection 7 inserts section 250A of CTA 2009 into the list of provisions in section 264 of CTA 2009 for which it matters whether a UK or overseas property business consists of or includes the commercial letting of furnished holiday accommodation

32. Subsections 8 and 9 provides that the new deduction for the replacement of domestic items applies in relation to expenditure incurred on or after 1 April 2016 for corporation tax and on or after 6 April 2016 for income tax.

Background note

33. The clause has been introduced to give relief for the cost of replacing furnishings to a wider range of property businesses as well as a more consistent and fairer way of calculating

taxable profits.

34. This clause was announced at Summer Budget 2015. A consultation was held from 17 July 2015 to 9 October 2015 and a summary of responses to the consultation was published on 10 December 2015 alongside draft legislation.

Clause 70: Property business deductions: wear and tear allowance

Summary

1. This clause repeals the wear and tear allowance.

Details of the clause

2. Subsections 1 and 2 repeal the wear and tear allowance provisions in Income Tax (Trading and Other Income) Act 2005 for the tax year 2016-17 onwards.

3. Subsections 3 and 4 repeal the wear and tear allowance provisions in Corporation Tax Act 2009 for accounting periods beginning on or after 1 April 2016.

4. Subsection 5 applies for accounting periods that begin before 1 April 2016 but end after that date. The accounting period is treated as if it were two separate accounting periods for the purpose of subsection 3. The profits of the property business are apportioned between the two notional accounting periods on a time basis, unless that produces an unjust or unreasonable result.

Background note

5. The wear and tear allowance has been repealed and another clause has been introduced to give relief for the cost of replacing furnishings to a wider range of property businesses as well as a more consistent and fairer way of calculating taxable profits.

6. This measure was announced at Summer Budget 2015. A consultation was held from 17 July 2015 to 9 October 2015 and a summary of responses to the consultation was published on 10 December 2015 alongside draft legislation.

Clause 71: Transfer pricing: application of OECD principles

Summary

1. This clause updates the definition of "the transfer pricing guidelines" within the UK's transfer pricing legislation. It incorporates the amendments made to the 'Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' published in July 2010, as detailed in the Base Erosion and Profit Shifting (BEPS) Final Report published by the OECD on 5 October 2015. It also incorporates the authority for future changes to the definition to be made by secondary legislation.

Details of the clause

2. Subsection (1) of the clause introduces the changes to be made to subsection 164(4) of the Taxation (International and Other Provisions) Act 2010 which defines "the transfer pricing guidelines".

3. Subsection (1)(a) amends subsection 164(4)(a) TIOPA 2010 to update the definition of 'transfer pricing guidelines'. It revises the July 2010 transfer pricing guidelines approved by the OECD to incorporate the Profit Shifting (BEPS) Final Report published by the OECD on 5 October 2015.

4. Subsection (1)(b) amends subsection 164(4) TIOPA 2010 so that any future updates to the guidelines or a document approved and published in place of them may be designated by way of Treasury Order.

5. Subsection (2) inserts a new definition of 'OECD Transfer Pricing Guidelines' into subsection 357GE(1) of the Corporation Tax Act 2010. To ensure consistency, the current definition of 'OECD Transfer Pricing Guidelines' within 357GE(1) CTA10 is to be replaced and now defined by reference to subsection 164(4) TIOPA 2010.

6. Subsection (3) inserts the commencement provisions for the amendments at subsection (1). The amendments have effect for corporation tax purposes in relation to accounting periods beginning on or after 1 April 2016 and for income tax purposes in relation to the tax year 2016-2017 and subsequent tax years.

7. Subsection (4) inserts the commencement provisions for the amendment at subsection (2). It has effect for accounting periods beginning on or after 1 April 2016.

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 2013 OECD commenced a project, endorsed by G20 Finance Ministers, to address concerns regarding Base Erosion and Profit Shifting (BEPS) by multi-national enterprise (MNE) groups to minimise their tax burdens. That project resulted in the publication of a Final Report on 5 October 2015 which included amendments to the latest version of the OECD's transfer pricing guidelines published in July 2010.

Clause 72 and Schedules 11 and 12: Reduction in rate of capital gains tax

Summary

1. This clause and schedules reduce the basic rate of capital gains tax (CGT) from 18% to 10%, and the 28% rate to 20%, on most gains made by individuals, trustees and personal representatives. It also extends the 10% rate of CGT for gains qualifying for entrepreneurs' relief to include investors' relief.

2. Gains accruing on the disposal of interests in residential properties that do not qualify for private residence relief, and gains arising in respect of carried interest, remain subject to the 18% and 28% rates. ATED-related gains also remain subject to the 28% rate.

3. These changes take effect from 6 April 2016.

Details of the clause and schedules

4. Clause 72 amends the Taxation of Chargeable Gains Act (TCGA) 1992.

5. Subsection (2) amends section 4(1) to make clear that the rate of CGT for investors' relief is provided at section 169VC.

6. Subsection (3) amends section 4(2) to change the 18% rate of CGT to 10%, other than for higher rate gains.

7. Subsection (4) inserts new subsection (2A) into section 4 of TCGA 1992, which defines "higher rate gains".

8. Subsection (5) amends section 4(3) to change the 28% rate of CGT for trustees and personal representatives of a deceased person to 20%, other than for higher rate gains.

9. Subsections (6) and (7) amend sections 4(4) and 4(5) to change the 28% CGT rate of CGT for individuals to 20%, other than for higher rate gains.

10. Subsections (8) and (9) amend section 4(6) and inserts new subsection (6A) into section 4 of TCGA 1992. These ensure that the unused amount of an individual's income tax basic rate band is reduced by the amount of any gains that are taxed at the special CGT rate under entrepreneurs' relief or investors' relief. This limits or eliminates access to the lower rates of CGT (10% or 18%) where those reliefs are due.

11. Subsection (10) makes consequential provision.

12. Subsection (11) amends section 4(10) of TCGA 1992, which will be inserted by the Scotland Act 2016, to include a reference to new Section 4BA. This is necessary to ensure that Scottish taxpayers are treated in the same as way as other United Kingdom taxpayers.

13. Subsection (12) makes a consequential amendment to section 4A of TCGA 1992 to include a reference to the new Section 4BA.
14. Subsection (13) inserts new Sections 4BA and 4BB into TCGA 1992.
15. New Section 4BA provides special rules for calculating an individual's CGT liability when part of the individual's income tax basic rate band is unused. If the individual has gains from residential property or carried interest, the rules allow him or her to choose which chargeable gains are subject to the appropriate lower rate of CGT, up to the unused amount. For these purposes, the unused amount is reduced by the amount of any gains that are taxed at the special CGT rate under entrepreneurs' relief or investors' relief. Gains which are not charged at a lower rate are charged at the higher rate appropriate to their nature. This means that any unused basic rate band can be used in the most beneficial way to reduce CGT charged.
16. New Section 4BB defines that a "disposal of a residential property interest" is either a disposal of a UK residential property interest, which is defined in schedule B1 to TCGA 1992, or a "disposal of a non-UK residential property interest", which is defined in new schedule BA1 to TCGA 1992.
17. Subsections (14) and (15) insert section 57C, Schedule BA1 and Schedule 4ZZC into TCGA 1992 via Schedules 11[j2024s] and 12[j2024Zs], which also make further related amendments to TCGA 1992.
18. Subsection (16) provides that these amendments take effect for gains accruing on or after 6 April 2016.
19. Subsection (17) explains how subsection (1) of new Section 4BA of TCGA 1992 should be read until section 9(14) of the Wales Act 2014 takes effect. That provision deals with tax raising powers of the devolved Government of Wales.
20. Subsection (18) explains how subsection (1) of new Section 4BA of TCGA 1992 should be read until section 15(3) of the Scotland Act 2016 takes effect. That provision deals with tax raising powers of the devolved Government of Scotland.

Schedule 11: Capital Gains Tax: Disposals of non-UK residential property interests

21. Schedule 11makes various amendments to the TCGA 1992 and inserts a new Schedule BA1.
22. Paragraphs 2 and 3 make various amendments as a consequence of new Schedule BA1.
23. Paragraph 4 amends paragraph 1(4) of, and inserts subparagraph (4A) into, Schedule B1 to TCGA 1992. These change the date on which the "relevant ownership period" starts for the purposes of identifying a disposal of a UK residential property interest by UK residents so that it is the later of the date of acquisition or 31 March 1982.
24. Paragraph 5 introduces new Schedule BA1 to TCGA 1992, which defines the disposal of non-UK residential property interests.
25. Paragraph 1 of new Schedule BA1 defines a "disposal of a non-UK residential property

interest" as, broadly, the disposal of either an interest in non-UK land that has consisted of or included a dwelling at any time during the relevant ownership period or a disposal of a contract for an off-plan purchase.

26. Paragraph 2 of new Schedule BA1 defines an "interest in non-UK land".

27. Paragraph 3 of new Schedule BA1 provides that the grant of an option binding the grantor to sell an interest in UK land (a "call" option) is to be treated as the disposal of an interest in the land.

28. Paragraph 4 of new Schedule BA1 defines a "dwelling" for the purposes of the Schedule. It imports the definition in Schedule B1, subject to certain modifications.

Schedule 12: Disposal of residential property interests: Gains and losses

29. Schedule 12 makes various amendments to the TCGA 1992 and inserts a new Schedule 4ZZC.

30. Paragraph 2 amends section 57A in consequence of new Schedule 4ZZC to provide that where no ATED-related gain or loss accrues on a disposal after applying Schedule 4ZZA that does not prevent that Schedule being applied when applying Part 3 of new Schedule 4ZZC.

31. Paragraph 3 inserts new Section 57C into TCGA 1992, which introduces new Schedule 4ZZC. This schedule makes provision about the computation of residential property rate gains or losses.

32. Paragraph 4 makes provision in consequence of new Schedule 4ZZC.

33. Paragraph 5 inserts new Schedule 4ZZC into TCGA 1992.

34. New Schedule 4ZZC, Part 1 consists of paragraphs 1 and 2, which introduce the Schedule and define various terms.

35. New Schedule 4ZZC, Part 2 consists of paragraphs 3 to 6. This Part contains the rules for computing the amount of residential property interest (RPI) gain or loss in a case where the disposal does not involve a disposal that is chargeable to ATED-related CGT.

36. Paragraph 3 of new Schedule 4ZZC introduces Part 2.

37. Paragraph 4 of new Schedule 4ZZC provides that the RPI gain or loss is that proportion of the gain or loss over the period of ownership (since 31 March 1982) that reflects the amount of days in which the asset is used as a dwelling; and any mixed use on the same day is apportioned on a just and reasonable basis.

38. Paragraph 5 of new Schedule 4ZZC provides for the amount of gain or loss on the disposal that is not an RPI gain or loss.

39. Paragraph 6 of new Schedule 4ZZC applies Part 2 to disposals of contracts to purchase a dwelling off-plan.

40. New Schedule 4ZZC, Part 3 consists of paragraphs 7 to 20. This Part contains the rules for

computing the amount of RPI gain or loss in a case where the disposal either is, or involves, a disposal that is chargeable to ATED-related CGT.

41. Paragraph 7 of new Schedule 4ZZC introduces Part 3.

42. Paragraph 8 of new Schedule 4ZZC defines various terms for the purpose of Part 3.

43. Paragraph 9 of new Schedule 4ZZC provides that the amount of RPI gain or loss is the sum of the amounts determined under paragraphs 10 to 15.

44. Paragraph 10 of new Schedule 4ZZC provides that in a case where there is no rebasing for the purposes of ATED-related CGT, the amount of RPI gain or loss is that proportion of the gain or loss over the period of ownership (since 31 March 1982) that reflects the amount of days in which the asset is used as a dwelling and the days are not ATED chargeable days.

45. Paragraphs 11 to 14 of new Schedule 4ZZC provide that in a case where there is rebasing for the purposes of ATED-related CGT, the rebasing also applies for the purposes of the computation. The amount of RPI gain or loss is the sum of the RPI gain or loss that relates to the period up to the rebasing date and the RPI gain or loss from the rebasing date. The amount of RPI gain or loss in each case is that proportion of the gain or loss over the period of ownership to or from the rebasing date (as the case may be) that reflects the amount of days in which the asset is used as a dwelling and the days are not ATED chargeable days.

46. Paragraph 15 of new Schedule 4ZZC explains how rules relating to wasting assets and capital allowances should be taken into account when computing the RPI gain or loss that relates to the period from the rebasing date.

47. Paragraph 16 of new Schedule 4ZZC provides that the amount of gain or loss that is neither ATED-related nor a RPI gain or loss is the sum of the amounts determined in accordance with paragraphs 17 and 18.

48. Paragraph 17 of new Schedule 4ZZC contains provisions for computing gains and losses that are neither ATED-related nor RPI gains or losses when paragraph 10 applies.

49. Paragraph 18 of new Schedule 4ZZC contains provisions for computing gains and losses that are neither ATED-related nor RPI gains or losses when paragraph 11 applies.

50. Paragraph 19 of new Schedule 4ZZC provides that where part only of the land disposed of is a relevant high value disposal such that the gains that accrue on its disposal is wholly or in part chargeable to ATED-related CGT, the remaining part of the land is treated for Part 3 in the same way as if it formed part of the relevant high value disposal; and that any mixed use on the same day is apportioned on a just and reasonable basis.

51. Paragraph 20 of new Schedule 4ZZC applies Part 3 to disposals of contracts to purchase a dwelling off-plan.

Background note

52. Since June 2010 CGT has been charged at the following rates:

- 10% to the extent that the chargeable gains qualify for entrepreneurs' relief
- 18% where a person is a lower rate taxpayer

- 28% to the extent that the person is a higher rate taxpayer or the gains exceed the unused part of the individual's basic rate band
- 28% for trustees and personal representatives
- 28% for ATED-related chargeable gains accruing to any person (principally companies) so chargeable
- 20% for NRCGT gains accruing to a company on the disposal of UK residential property

53. A key government objective is to create a strong enterprise and investment culture. Cutting the rates of CGT to 10% and 20%, from 18% and 28%, for most assets is intended to incentivise individuals to provide the capital companies need to expand and create jobs. The retention of the 28% and 18% rates for residential property is intended to provide an incentive for individuals to invest in companies over property.

Clause 73: Entrepreneurs' relief: associated disposals

Summary

1. This clause changes the conditions which must be met in order for an individual to claim entrepreneurs' relief (ER) on a disposal of his or her personal assets (an "associated disposal"). These are assets which the claimant owns personally but which are used in a business carried on by a partnership of which he or she is a member, or by a company in which he or she is a shareholder. It will still be necessary for the claimant to withdraw from participation in the business by making a "material disposal" of either an interest in the partnership or shares in the company. However, under the new rules, the necessary "material disposal" may be to persons connected with the claimant, such as family members. Also, the requirement that the material disposal be of a certain minimum size may not apply if the claimant is disposing of all his or her interest in the partnership or shareholding. The new rules come into effect in relation to disposals on or after 18 March 2015.

Details of the clause

2. Subsection 1 amends section 169K of the Taxation of Chargeable Gains Act (TCGA) 1992.

3. Subsection (3) inserts new subsection (1ZA) into section 169K. Section 169K subsection (1ZA) contains a new alternative condition which, if met, will allow ER to be claimed on an associated disposal. The new condition applies if the "material disposal of business assets" associated with the disposal of personal assets is a disposal of the whole of the claimant's interest in a partnership. Where this is the case, the material disposal may be of less than a 5% interest in the assets of the partnership, providing the claimant has owned 5% or more for three years in the eight years preceding the disposal. The new condition also requires that, consistent with the original condition, no partnership purchase arrangements exist at the date of disposal.

4. Subsection (5) inserts new subsection (1AA) into section 169K. Section 169K subsection (1AA) amends the definition of "partnership purchase arrangements" which applies at the time of the material disposal. It ensures that the material disposal itself cannot be a partnership purchase arrangement and thereby prevent ER on an associated disposal. Certain other arrangements are also excluded from being partnership purchase arrangements: see subsection (12).

5. Subsection (7) inserts new subsection (3AA) into section 169K. Section 169K subsection (3AA) amends the definition of "partnership purchase arrangements" which applies at the time of the associated disposal. It ensures that, where the associated disposal takes place before the material disposal, any arrangements connected with the latter cannot be partnership purchase arrangements and thereby prevent ER on an associated disposal. Certain other arrangements are also excluded from being partnership purchase

arrangements: see subsection (12).

6. Subsection (9) inserts new subsection (3BA) into section 169K. Section 169K subsection (3BA) amends the definition of “share purchase arrangements” which applies at the time of the associated disposal. It ensures that, where the associated disposal takes place before the material disposal, any arrangements connected with the latter cannot be share purchase arrangements and thereby prevent ER on an associated disposal. Certain other arrangements are also excluded from being partnership purchase arrangements: see subsection (12).

7. Subsection (11) inserts new subsection (4A) into section 169K. It consists of a new condition which must be met in order for a disposal to be an associated disposal. The asset disposed of must have been owned by the claimant throughout the three years immediately preceding the disposal.

8. Subsection (12) inserts new subsection (6A) into section 169K. Section 169K subsection (6A) prevents arrangements entered into before both the material and associated disposals, and which are not connected with those disposals, from being partnership or share purchase arrangements. It ensures that pre-existing arrangements (unconnected to the material of associated disposal) for succession to a business, or ownership of shares in the event of retirement or death, will not prevent a claim to ER on an associated disposal.

9. Subsection (13) amends subsection (9) of section 169K. The amendment makes clear that, where it is necessary to determine partners' interests in the assets of certain partnerships, a partner's fractional entitlement to capital profits is to be treated as being his or her fractional interest in the assets.

Background note

10. This clause allows ER to be claimed in a number of commercial situations where relief ceased to be available as a result of the changes to section 169K TCGA 1992 introduced by section 41 of Finance Act (FA) 2015.

11. FA 2015 changes prevented certain abuses involving ER, but they also limited the availability of relief on some transactions where there was no abuse. The effect of the changes made by this clause are backdated to the introduction of FA 2015 changes in order to mitigate the disadvantage suffered by some as a result of the earlier changes.

Clause 74: Entrepreneurs' relief: disposal of goodwill

Summary

1. This clause changes the conditions which must be met in order for an individual to claim entrepreneurs' relief (ER) on a disposal of goodwill to a company. A claim will be possible where the claimant holds shares or voting rights in the acquiring company which are less than 5% of the company's total ordinary share capital or rights. A claim will also be possible where the claimant holds 5% or more shares or voting rights, providing he or she sells the whole of his or her holding to another company within a short time, and meets the maximum holding condition in respect of that other company. The new rules come into effect in relation to disposals of goodwill on or after 3 December 2014.

Details of the clause

2. Clause 74 amends section 169LA of the Taxation of Chargeable Gains Act (TCGA) 1992.

3. Subsection (2) changes the circumstances in which section 169LA subsection (4) TCGA 1992 applies to prevent a claim to ER. Section 169LA subsection (4) no longer applies when the claimant is a related party in relation to the acquiring company, but is not a retiring partner. These conditions are replaced by two new requirements, so that section 169LA subsection (4) instead applies if the claimant (referred to as P) holds 5% or more of either the company's shares or the voting rights in the company. If P holds less than 5% of both shares and voting rights, ER may be due. Shares and rights held by companies and trustees (but not individuals) connected with P are also taken into account in applying these new conditions.

4. Subsection (3) inserts new subsections (1A) to (1C) into section 169LA TCGA 1992.

5. Subsection (1A) of section 169LA disapplies subsection (4) - so that ER may be claimed - if the further conditions given in subsection (1B) are met.

6. Subsection (1B) of section 169LA sets down three conditions which, if met, result in ER being due on the gain which accrues when goodwill is transferred to a close company. Where the conditions are met, ER may be due despite the claimant holding 5% or more of the acquiring company's shares or voting rights.

7. Subsection (1C) of section 169LA defines terms used in the conditions set down in subsection (1B).

8. Subsection (4) of clause 74 removes the definitions of related party and retiring partner from section 169LA TCGA 1992. These are no longer required following the amendments made by this clause.

9. Subsections (5), (6), (7) and (8) make minor amendments to section 169LA TCGA 1992

consistent with removal of the definitions of related party and retiring partner.

Background note

10. This clause allows ER to be claimed in a number of commercial situations where relief ceased to be available as a result of the changes introduced by section 42 of the Finance Act 2015.

11. The Finance Act 2015 changes prevented certain abuses involving ER, but they also limited the availability of relief on some transactions where there was no abuse. The effect of the changes made by this clause are backdated to 3 December 2014, the effective date of the Finance Act 2015 changes, in order to mitigate the disadvantage suffered by some as a result of those earlier changes.

12. This clause ensures that relief is better targeted at entrepreneurs who sell their business and reduce their involvement in it.

Clause 75 and Schedule 13: Entrepreneurs' relief: "trading company" and "trading group"

Summary

1. This clause and Schedule change the meaning of "trading company" and "trading group" as those terms are used for the purposes of entrepreneurs' relief (ER) on capital gains tax. Under the new rules, activities carried on by a joint venture company may be treated as carried on by a company which holds shares in it (an "investing company"). This attribution of activities will take place if the ER claimant has an effective interest in the joint venture company of 5% or more. The effective interest is defined in terms of the claimant's directly and indirectly held shareholdings, and of the voting power he or she controls. Similarly, activities carried on by a company as a partner in a trading firm will be treated as trading activities of that company for ER purposes subject to two requirements. The first requirement is that the claimant has an effective share of the partnership of 5% or more. The second requirement is that the claimant controls 5% or more of the voting power in the firm's corporate partners. The new definitions apply in relation to disposals of shares which take place on or after 18 March 2015.

Details of the clause and Schedule

2. Clause 75 introduces Schedule 13which makes provisions concerning the meaning of "trading company" and "trading group" for the purposes of ER on capital gain tax.

Schedule 13: meaning of "trading company" and "trading group"

3. Paragraph 3 omits subsection (4A) of section 169S of Taxation of Chargeable Gains Act (TCGA) 1992. Subsection (4A) provides for the definitions of 'trading company' and 'trading group' for ER purposes to follow those in section 165A TCGA 1992, subject to modifications.

4. Paragraph 4 introduces new section 169SA to TCGA 1992. This new section signposts new definitions of 'trading company' and 'trading group' which apply for ER purposes and are contained in Schedule 7ZA TCGA 1992.

5. Paragraph 5 inserts new Schedule 7ZA to TCGA 1992.

Schedule 7ZA Part 1, TCGA 1992: Meaning of "Trading Company" and "Trading Group"

6. Schedule 7ZA, paragraph 1 states that, in specific provisions relating to ER, the phrases 'trading company' and 'trading group' have the same meaning as in section 165 TCGA 1992, subject to the modifications in Part 2 of the Schedule. In the same contexts, the phrase "trading activities" is to be interpreted in accordance with Part 3 of the Schedule, which

concerns activities carried on by members of partnerships.

7. Schedule 7ZA, paragraph 2 states that in all other provisions relating to ER, the phrases 'trading company' and 'trading group' have the same meaning as in section 165 TCGA 1992 but with subsections (7) and (12) of section 165A being disregarded. This means that activities of joint venture companies are not treated as being carried on by companies which hold their shares.

Schedule 7ZA: Part 2 TCGA 1992: Joint Venture Companies

8. Schedule 7ZA, Part 2 introduces rules for deciding when a proportion of the activities of a joint venture company (JVC) may be treated as being carried on by a company which holds its shares.

9. Schedule 7ZA, paragraph 3 states that for ER purposes a JVC's activities will only be attributed to a company which holds its shares if the individual claiming ER (referred to as P) passes two tests. The first test is the shareholding test (see paragraphs 5 to 8) and the second test is the voting rights test (see paragraphs 9 to 12).

10. Schedule 7ZA, paragraph 4 defines the term "investing company", which is used in Part 2 of the Schedule. An investing company is a company in which P owns shares directly, and which itself owns shares (directly or indirectly) in the JVC. This definition ensures that when applying the shareholding and voting rights tests we take account of all the interests P holds in the JVC, and not only the interests held via the company whose shares or securities P disposes of.

11. Schedule 7ZA, paragraph 5 expresses the shareholding test in its basic form. In summary, P must own at least 5% of JVC's ordinary shares, either directly or indirectly through investing companies. There is more detail of the test in paragraphs 6 to 8.

12. Schedule 7ZA, paragraph 6 explains how P's indirect holding in a JVC is to be determined for the purposes of the shareholding test in paragraph 5. P's holding through each investing company is computed independently using the further rules in paragraphs 7 and 8, and the percentages obtained added together. The total is P's "indirect shareholding percentage".

13. Schedule 7ZA, paragraphs 7 and 8 give detailed rules for computing the percentage of a JVC's shares which is indirectly owned by P through a particular investing company. P's fractional holding of shares in the investing company is multiplied by the fractional ownerships further down the structure. Note that fractional ownerships within the group of companies of which the investing company is a member are treated as 100%. For instance, P holds 20% of shares in investing company IC; IC holds 60% of shares in company Y, which holds 40% of shares in JVC. IC is grouped with Y, so P's indirect holding in JVC is 0.2 x 1.0 (not 0.6) x 0.4 x100% = 8%. Note also that the term "group of companies" takes it meaning from section 165A subsection (4) TCGA 1992.

14. Schedule 7ZA, paragraph 9 expresses the voting rights test in its basic form. It corresponds to the shareholding test in paragraphs 5 to 8. In summary, P must hold at least 5% of the voting rights in JVC, either directly or indirectly through one or more investing companies. There is more detail of the test in paragraphs 10 to 12.

15. Schedule 7ZA, paragraph 10 explains how P's indirect voting rights in a JVC is to be determined for the purposes of the voting rights test in paragraph 9. P's holding through

each investing company is computed independently using the further rules in paragraphs 11 and 12, and the percentages obtained added together. The total is P's “indirect voting rights percentage”.

16. Schedule 7ZA, paragraphs 11 and 12 give detailed rules for computing the percentage of voting rights in a JVC's shares which is indirectly owned by P through a particular investing company. The approach is the same as for computing P's “indirect shareholding percentage” (see paragraphs 7 and 8).

Schedule 7ZA: Part 3 TCGA 1992: Partnerships

17. Schedule 7ZA, paragraph 13 outlines how the activities of a company in its capacity as a member of a partnership are to be treated for the purposes of determining a claimant's eligibility for ER. In summary, the activities of a company as a member of a partnership are treated as non-trading activities unless the claimant (referred to as P) passes two tests in relation to the partnership. The first test is the profits and assets test (see paragraphs 15 to 20) and the second test is the voting rights test (see paragraphs 21 to 23). The activities of a corporate partner in that capacity are also treated as not being trading activities if the company has not been a member of the partnership for the “relevant period” specified in paragraph 25 (normally the year ending with P's disposal of shares).

18. Schedule 7ZA, paragraph 14 defines two terms used within Part 3 of Schedule 7ZA. A “direct interest company” is a company in which P owns shares directly, and which itself owns shares (directly or indirectly) in the JVC. This definition ensures that when applying the profits and assets test and voting rights test we take account of all relevant voting rights, and not only the rights held via the company whose shares or securities P disposes of. The direct interest company corresponds to the investing company in Part 2 of Schedule 7ZA (see paragraph 4). A “relevant corporate partner” is a company

- In which a direct interest company owns ordinary shares, directly or indirectly
- Is a member of a group of companies of which that direct interest company is a member and
- Is a member of the partnership being considered.

19. In this context, the term “group of companies” takes its meaning from section 165A subsection (4) TCGA 1992.

20. Schedule 7ZA, paragraph 15 introduces the profits and assets test mentioned in paragraph 13. P passes the test if he or she has an interest of at least 5% in the partnership throughout the “relevant period” specified in paragraph 25 (normally the year ending with P's disposal of shares). The interest may be directly held by P, or indirectly held through one or more direct interest companies. P's directly-held interest is the percentage share in the partnership's assets (if any) which P is treated as owning for tax purposes by virtue of being a partner in his or her own right. The nature of indirectly-held interests and how their sizes are computed are explained by paragraphs 16 to 20.

21. Schedule 7ZA, paragraphs 16 and 17 contain the rules for determining P's share of a partnership held through direct interest companies which are themselves members of the partnership. This is the second of the three components which count towards the profits and assets test. P's share through a particular direct interest company is the product of P's

fractional holding in that company's share capital and the lesser of -

- The fraction of the partnership's income profits in which the company has an interest and
- The fraction of the partnership's assets in which the company has an interest

22. For example, P owns 15% of a company's shares; the company is a partner in a firm and is entitled to 25% of the firm's profits but is treated for tax purposes as owning 10% of its assets. P's share in the partnership through the company is 0.15 x 0.1 (not 0.25) x 100 = 1.5%.
23. Schedule 7ZA, paragraphs 18 to 20 contain the rules for determining P's indirect share of a partnership. This is the third of the three components which count towards the profits and assets test. P has an indirect share in a partnership if a direct interest company holds shares directly or indirectly in a relevant corporate partner. P's indirect share through each relevant corporate partner is computed using the rules in paragraphs 19 and 20 and the results added together.
24. Schedule 7ZA, paragraph 19 contains rules for computing P's indirect share of a partnership through a particular direct investment company and a particular relevant corporate partner. P's share is the product of -
    - His or her fractional holding in the direct investment company
    - The fraction of the corporate partner's shares which is owned directly or indirectly by the direct investment company, and
    - The lesser of -
        - The fraction of the partnership's income profits in which the corporate partner has an interest and
        - The fraction of the partnership's assets in which the corporate partner has an interest
25. For example, P owns 20% of company DIC's shares. DIC owns 30% of relevant corporate partner CP, and CP is entitled to 25% of the firm's profits but is treated for tax purposes as owning 40% of its assets. P's indirect share in the partnership through DIC and CP is 0.2 x 0.4 (not 0.25) x 0.3 x 100% = 2.4%.
26. Schedule 7ZA, paragraph 20 explains how paragraph 19 applies where the direct interest company holds shares in the relevant corporate partner indirectly, that is to say through another company or companies. Fractional shareholdings between companies are multiplied together, but fractional ownerships within the group of companies of which the direct interest company is a member are treated as 100%. This corresponds to the rules in paragraphs 8 and 12 which apply to the shareholding and voting rights tests where joint venture companies are concerned.
27. Schedule 7ZA, paragraph 21, subparagraph 1 introduces the voting rights test mentioned in paragraph 13. In summary, the sum of the “direct voting rights percentage” and the “indirect voting rights percentage” held by the claimant P throughout a specified relevant period must be at least 5%.

28. Schedule 7ZA, paragraph 21, subparagraph 2 defines P's "direct voting rights percentage". It is the total of P's directly-held voting rights in direct interest companies which are members of the partnership. For the meaning of "direct interest company", see paragraph 14.

29. Schedule 7ZA, paragraph 21, subparagraph 3 defines P's "indirect voting rights percentage" by reference to each direct interest company and each relevant corporate partner. It is the total of voting rights in relevant corporate partners held indirectly by P through direct interest companies. For the meaning of these terms, see paragraph 14.

30. Schedule 7ZA, paragraphs 22 and 23 contain rules for computing P's indirect voting rights percentage in relation to a particular relevant corporate partner and a particular direct interest company. The rules correspond to those in paragraph 8 which apply for the purposes of the shareholding test where joint venture companies are concerned.

Schedule 7ZA: Part 4 TCGA 1992: Interpretation

31. Schedule 7ZA, paragraph 24, subparagraphs 2 and 3 explain how the provisions of the Schedule apply where the disposal which gives rise to the gain in respect of which ER is claimed is a disposal of trust business assets. In summary, these subparagraphs define P as any relevant beneficiary, but for the tests in paragraph 3 and paragraph 13, P is read as referring to all relevant beneficiaries as one body.

32. Schedule 7ZA, paragraph 25 defines the term "relevant period" used in the Schedule at paragraphs 5, 9, 13, 15 and 21.

Background note

33. This clause and Schedule allow ER to be claimed in a number of commercial situations where relief ceased to be available as a result of the changes to section 169S TCGA 1992 introduced by section 43 of the Finance Act 2015.

34. The Finance Act 2015 changes prevented certain abuses involving ER, but they also limited the availability of relief on some disposals of shares where the shareholder had made a genuine indirect investment in a trading business carried on by a joint venture company.

35. The changes made by this clause are backdated to the introduction of the Finance Act 2015 changes in order to reduce the unintended effects of the earlier changes.

36. The changes ensure that ER is better targeted at people who have a significant investment in a trading business.

Clause 76 and Schedule 14: Investors' Relief

Summary

1. This clause and schedule introduce investors' relief. This new relief applies a 10% rate of Capital Gains Tax (CGT) to gains accruing on the disposal of qualifying shares in an unlisted trading company held by individuals. Qualifying shares must have been newly issued to the individual on or after 17 March 2016, and have been held for a period of at least three years starting from 6 April 2016. Gains which qualify for the relief are subject to a lifetime limit of £10 million.

Details of the clause and Schedule

2. Clause 76 introduces Schedule 14, which makes various amendments to the Taxation of Chargeable Gains Act 1992 (TCGA).

Schedule 14: Investors' Relief

3. Paragraph 1 makes amendments to the titles of Part 5 TCGA and Chapter 1, Part 5 as a consequence of the introduction of investors' relief.

4. Paragraph 2 introduces a new Chapter 5 to Part 5 of the TGCA, made up of sections 169VA to 169VR.

5. New section 169VA introduces the new relief and briefly outlines the relevant legislation contained in the new Chapter.

6. New section 169VB defines three types of share which may be contained in a holding of shares immediately before a disposal of all or part of that holding:

   - "Qualifying shares": these are shares that meet the tests at subsection (2), paragraphs (a) to (h).
   - "Potentially qualifying shares": these are shares that meet tests at subsection (2), paragraphs (a) to (g), but do not pass the test at paragraph (h) because they have not been held for three years ending with the date of the disposal. They may become eligible for relief in future. The necessary three year holding period is extended where the shares in question were issued before 6 April 2016, so that no claim may be made in respect of a disposal made before 6 April 2019.
   - "Excluded shares": these are shares that can never qualify for investors' relief, for example they were purchased before commencement of the relief.

7. New section 169VC explains that investors' relief applies where an individual disposes of a holding of qualifying shares in a company. Where the disposal results in a gain, that gain is

subject to a 10% rate of CGT. The maximum amount of gain that qualifies for investors' relief is subject to a lifetime limit, which is given at new section 169VH, of £10 million. It also defines certain terms, or explains where those terms are defined.

8. New section 169VD applies when an individual disposes of shares from a holding but not all the shares in the holding are qualifying shares. In these cases, only the "appropriate part" of the gain which accrues on the disposal is relieved under section 169VC. For example, the holding immediately before the disposal may contain qualifying shares, potentially qualifying shares and excluded shares: without this provision, it is not possible to ascribe the gain or any part of it to qualifying shares comprised in the disposal. For the purposes of determining the appropriate part of the total gain, qualifying shares in a holding are treated as being disposed of in priority to other types of share.

9. New section 169VE introduces special rules in new sections 169VF and 169VG for determining the composition of a holding of shares from which there has been an earlier disposal. In order to determine the number of qualifying shares, potentially qualifying shares and excluded shares in the holding it is necessary to determine the number of each type disposed of on earlier occasions. Where there has been a claim to investors' relief on an earlier disposal, section 169VF applies to that disposal for this purpose; where there was no such claim, section 169VG applies.

10. New section 169VF sets out rules for identifying the types of share disposed of on a previous disposal from a holding when investors' relief was claimed in respect of that disposal. This is necessary in order to determine the composition of the holding immediately before any later disposal on which investors' relief is claimed. In summary, shares which were qualifying shares at the time of the earlier disposal are treated as having been disposed of first; then shares which were excluded shares at that time, and then shares which were potentially qualifying shares. The objective is to preserve the maximum potential investors' relief to be claimed on future disposals.

11. New section 169VG sets out rules for identifying the types of share disposed of on a previous disposal from a holding when investors' relief was not claimed in respect of that disposal. This is necessary in order to determine the composition of the holding immediately before any later disposal on which investors' relief is claimed. In summary, shares which were excluded shares at the time of the earlier disposal are treated as having been disposed of first; then shares which were potentially qualifying shares at that time, and then shares which were potentially shares. The objective is to preserve the maximum potential investors' relief to be claimed on future disposals.

12. New section 169VH provides for an upper limit on the total gains accruing to an individual during his or her lifetime which may be charged at the 10% rate of CGT under investors' relief. Relief can be claimed in respect of any number of gains accruing in tax year 2019-20 or later years, but the total gains eligible for investors' relief may not exceed £10 million.

13. New sections 169VI and 169VJ apply where, before a disposal, there has been a reorganisation of a company's share capital within section 126 TCGA and no new consideration was given for the new holding of shares. They provide rules for determining how many shares held after the reorganisation are qualifying, potentially qualifying or excluded shares for investors' relief purposes when they come to be disposed of. In summary, the new holding of shares after the reorganisation is treated as having the same proportions of the three types of share as the original holding before the reorganisation.

Where shares in the original holding had been subscribed for and held continuously by the claimant, the corresponding shares in the new holding are treated as having been likewise subscribed for and held for the same period.

14. New section 169VK applies where, before a disposal, an individual holds qualifying shares and there has been a reorganisation within section 126 TCGA, but consideration was given by the individual for new shares. It complements section 169VI by providing rules for characterising shares in the new holding which results from these reorganisations. Shares received for consideration given as part of the reorganisation are treated for investors' relief purposes as having been issued when they actually were issued, and not when the original shares from which they were derived were issued. Shares for which consideration was not given are collectively subject to the rules in new sections 169VI and 169VJ.

15. New section 169VL applies where one company has acquired the share capital of another company by means of a share exchange within section 135 TCGA. The rules in new sections 169VI and 169VK apply for the purposes of deciding whether the acquiring company's shares are qualifying shares, potentially qualifying shares or excluded shares. When applying those rules, the two companies concerned are treated as the same company and the share exchange is treated as a reorganisation of share capital for the purposes of new sections 169VI and 169VJ.

16. New section 169VM applies where there has been a scheme of reconstruction within section 136 TCGA. The rules in sections 169VI and 169VK apply for the purposes of characterising the shares held by a shareholder after the reconstruction. Section 136 provides for a shareholder to be treated as exchanging his original shares for his new holding of shares. When applying the rules in sections 169VI or 169VK, the two companies concerned are treated as the same company and the share exchange is treated as a reorganisation of share capital for the purposes of new sections 169VI and 169VJ.

17. New section 169VN modifies the definition of a qualifying share where shares are disposed of from a new holding which resulted from a reorganisation or reconstruction to which section 169VL or section 169VM applied. When determining whether a share in that new holding is a qualifying share on its disposal, some of the conditions in section 169VB subsection (2) must be applied twice, and met on each application.

18. The first application is to the original share (from which the share being disposed of is derived), in respect of the period from its issue to the reorganisation or reconstruction. The second application is to the share being disposed of, in respect of the period from the reorganisation or reconstruction to its disposal. Where there has been more than one reorganisation or reconstruction, the conditions are applied independently to each stage of the sequence, and must be met in respect of all of them.

19. New section 169VO allows a claimant to elect to disapply the normal tax treatment of a reorganisation of share capital or a share exchange. Where an election is made, for investors' relief purposes there is deemed to be disposal of the original shares and a gain eligible for relief is treated as accruing. This means that investors' relief is not lost where shares which would produce a relievable gain on a normal sale are exchanged for (or converted into) shares or securities which are not eligible for relief. The election is only effective if the original shares qualified for the relief at the time the reorganisation or exchange of shares occurred.

20. New section 169VP gives the meaning of "subscribes for" for the purposes of new Chapter 5. A person subscribes for shares if they are issued to that person for consideration consisting wholly of cash. Both the subscription and the issue must be for genuine commercial reasons and not for the avoidance of tax. "Tax" in this context is not limited to capital gains tax. This section also provides that, where shares are transferred between spouses or civil partners, the transferee is treated as having subscribed for and acquired the shares at the same time as the transferor did so.

21. New section 169VQ provides that "trading company" and "holding company of a trading group" take the meanings given by section 165A TCGA. It further provides that a company is not be regarded as ceasing to trade because it has gone into liquidation or receivership for genuine commercial reasons.

22. New section 169VR defines various terms used in the chapter.

23. Paragraph 3 of Schedule [jIRs] inserts new Schedule 7ZB into TCGA 1992. This new Schedule overrides the definitions of qualifying shares or potentially qualifying shares at section 169VB. Where the specified conditions are met, shares which would otherwise be qualifying shares or potentially qualifying shares at a given time are instead treated as excluded shares. This will be the case when, broadly, the shareholder has received value in some form from the company which issues the shares he has subscribed for. The value may be received at any time in the period starting one year before and (usually) ending three years after the shares are issued to him.

24. The purpose of these rules is to ensure that the cash subscribed for the shares serves genuinely to increase the funds available to the company and does not represent a recycling of the company's existing resources.

25. Paragraph 1 of new Schedule 7ZB outlines the circumstances in which shares are treated as excluded shares, notwithstanding that they would otherwise be qualifying shares or potentially qualifying shares. All receipts of value from the company during the specified “period of restriction” are aggregated, and if the total is not an amount of insignificant value then the shares subscribed for are treated as excluded shares. The meaning of “an amount of insignificant value” is given at paragraph 3 of Schedule 7ZB.

26. Paragraph 2 of new Schedule 7ZB specifies the circumstances in which an investor “receives value” from a company for the purposes of Schedule 7ZB. These take the form of actions by the company or persons connected with the company. They are based on the definitions which apply for the purposes of the enterprise investment scheme (EIS) in Chapter 6 of Part 5 of the Income Tax Act 2007.

27. Paragraph 3 of new Schedule 7ZB explains how the amount of any value received is established in each of the circumstances given in paragraph 2. This paragraph also explains what is meant by “an amount of insignificant value”.

28. Paragraphs 4 and 5 of new Schedule 7ZB provide for a receipt of value from a company not to result in the recipient's shares being treated as excluded shares provided further conditions are met. The conditions are, broadly, that the recipient restores an equal amount of value to the company, or otherwise effectively reverses the receipt. The share subscription itself cannot represent this “replacement value” given to the company

29. Paragraph 6 of new Schedule 7ZB defines various terms used in the Schedule.

Background note

30. Entrepreneurs' relief applies, subject to certain conditions, a 10% rate of CGT to gains accruing on qualifying business disposals. Certain disposals of shares are qualifying business disposals.

31. The new investor's relief complements entrepreneurs' relief. It extends the 10% rate of CGT to gains accruing on the disposal of certain qualifying shares held by investors in an unlisted company who have no connection with the company. The qualifying shares must:

    - Be new, having been acquired by the person making the disposal on subscription for new consideration.
    - Have been issued by the company on or after 6 April 2016.
    - Be in an unlisted trading company, or unlisted holding company of a trading group.
    - Have been held continually for a period of three years before disposal.

32. The gains qualifying for the relief are subject to a lifetime limit of £10 million for each claimant.

33. The government wants to create a strong enterprise and investment culture, and ensure that companies can access the capital they need to expand and create jobs. Extending the 10% rate of CGT to external investors in this way will provide a financial incentive for individuals to invest in unlisted trading companies over the long term.

Clause 77: Employee shareholder shares: limit on exemption

Summary

1. This clause places a lifetime limit of £100,000 on the Capital Gains Tax (CGT) exempt gains that a person can make on the disposal of shares acquired under Employee Shareholder Agreements entered into after 16 March 2016.

Details of the clause

2. Subsection 1 introduces an amendment to section 236B of the Taxation of Chargeable Gains Act (TCGA) 1992.

3. New subsections (1A), (1B), (1C) and (3A) of section 236B provide that in relation to Employee Shareholder shares issued as consideration for entering into Employee Shareholder Agreements after 16 March 2016 there will be a lifetime limit of £100,000 CGT exempt gains. Any gains which accrue on disposals of Employee Shareholder shares that were issued in respect of Employee Shareholder Agreements made on or before 16 March 2016 will not count towards the limit. Taxpayers will need to keep a record of CGT exempt gains which count towards the limit.

4. When Employee Shareholder shares issued as consideration for entering into Employee Shareholder Agreements after 16 March 2016 are disposed of, gains made in excess of the lifetime limit will be charged to CGT.

5. Subsection 4 introduces amendments to section 58 of TCGA 1992, which deals with disposals and acquisitions between spouses and civil partners. These amendments are a consequence of the new lifetime limit on CGT exempt gains on Employee Shareholder shares.

6. New subsections (3) and (4) and (5) of section 58 provide rules in relation to the transfers between spouses or civil partners of Employee Shareholder shares that have been issued as consideration for entering into Employee Shareholder Agreements. The rules ensure that no chargeable gain accrues to the Employee Shareholder (who is the transferor). If, assuming section 58 did not apply, a CGT exempt gain would accrue, then the disposal is treated as taking place for consideration which would result in that exempt gain. The effect is to limit the exemption to the gain that arises during the period that the Employee Shareholder holds the shares and to transfer the benefit of that exemption from the transferor to the transferee by increasing the transferee's allowable cost of the shares.

7. For shares that have been issued as consideration for entering into Employee Shareholder Agreements after 16 March 2016:

   - Where the whole of the transferor's lifetime allowance has been used up before the disposal, section 58 will apply as before: the transfer will be treated as if the shares were acquired from the transferor on a no-gain, no-loss basis. For example Mrs A owns shares worth £75,000 which cost £20,000. She has previously used up all her £100,000 lifetime CGT exemption on Employee Shareholder shares. She transfers these to Mr A. Mrs A has neither a gain nor a loss. The deemed cost to Mr A for any future disposal of those shares is £20,000.

- Where, if section 58 did not apply, the transferor's gain would be *less* than the balance remaining of his or her lifetime allowance, section 58 does not apply. The disposal is treated under normal TCGA rules as being for consideration of an amount equal to the market value of the shares transferred. For example Mrs B owns shares worth £75,000 which cost £5,000. She has previously used up £10,000 of her lifetime CGT exemption on Employee Shareholder shares, giving her £90,000 of unused exemption. She transfers these shares to Mr B. She has an exempt gain of £70,000 and keeps £20,000 of her exemption for future use. The deemed cost to Mr B for any future disposal of the shares is the market value, £75,000.

- Where, if section 58 did not apply, the transferor's gain would be *more* than the balance remaining of his or her lifetime allowance, then section 58 applies subject to the modifications given in new subsection (5). The disposal is treated as being for consideration which gives rise to a gain of an amount equal to the balance of the lifetime allowance. For example Ms X owns shares worth £75,000 which cost £5,000. She has previously used up £80,000 of her lifetime allowance, giving her £20,000 of unused exemption. She transfers these shares to her civil partner Ms Y. The consideration treated as received by Ms X is fixed at £25,000, giving her an exempt gain of £20,000: she will have no unused exemption left. The deemed cost to Ms Y for any future disposal of the shares is £25,000

Background note

8. Employee Shareholder status was introduced in 2013 and created a new class of employee (an "Employee Shareholder"). The policy intention of the introduction of Employee Shareholder Status was to reduce regulatory burdens on business, promote business and employment growth and increase the choices available to businesses and employees. To become an Employee Shareholder an individual gives up some statutory employment rights in exchange for free shares issued by the employer. Under the current law the tax treatment is that the first £2000 of free shares received by the Employee Shareholder are free of income tax and NIC and gains on the first £50,000 of shares received are free of CGT when sold.

9. This measure ensures that the advantages of Employee Shareholder Status are fair and proportionate and are not open to abuse.

Clause 78: Employee shareholder shares: disguised fees and carried interest

Summary

1. This clause amends the employer shareholder rules in the capital gains tax code that apply to the disposal of shares by certain employees where those shares were awarded to individuals providing investment management services. It is related to the changes made by clauses , and .

Details of the clause

2. Subsection (1) inserts new subsection (2A) into section 236B of the Taxation of Chargeable Gains Act 1992 (TCGA).

3. New section 236B(2A) of TCGA ensures that a gain on disposal of shares is not exempt under the employee shareholder rules where the proceeds of the disposal constitute either a disguised investment management fee under Chapter 5E of Part 13 of the Income Tax Act 2007 (ITA), or carried interest under section 809EZC of ITA.

4. Subsection (2) sets out the commencement condition. The new rules apply to relevant disposals of shares made on or after 6 April 2016.

Background note

5. Managers of investment funds are rewarded in a variety of ways. Management Fees are charged to tax as income, and legislation in FA 2015 ensured that fee income could not be disguised as a form of capital receipt.

6. Managers also receive performance-based rewards, sometimes known as 'carried interest'. This is based on the performance of the funds that they manage and can take the form of a share in the fund's total return. Legislation in Finance (No. 2) Act 2015 ensured that where carried interest is taxable as a chargeable gain, the full amount would be taxable without reduction through arrangements such as 'base cost shift'.

7. In the 2015 Summer Budget the government also announced that it would consult on a new legislative test to determine when carried interest should be taxed as income or as chargeable gains. The intention is that this test should replace the current test, which is based on case law and is centred around the so-called 'badges of trade'. The case law underlying the test has mainly considered trades connected with areas such as manufacturing and retail. The test is more difficult to apply to a business such as asset management. The government has therefore decided to put in place a legislative test

Clause 79: Disposals of UK residential property by non-residents etc

Summary

1. This clause amends capital gains tax (CGT) provisions in relation to disposals of UK residential property by non-residents. It corrects how to compute the amount of chargeable gain or loss that accrues on a disposal.

Details of the clause

2. Subsections (1) and (3) correct from 6 April 2015 paragraph 2(1) of Schedule 4ZZA to the Taxation of Chargeable Gains Act 1992 (TCGA 1992) to ensure that where paragraph 6A applies that paragraphs 3 and 4 don't also apply.

3. Subsections (2) and (4) correct from 26 November 2015 paragraph 17 of Schedule 4ZZB to TCGA 1992 to ensure that any notional pre-April 2013 gain or loss is identified as part of the balancing gain in all circumstances.

Background note

4. Since 6 April 2015, gains accruing on the disposal of UK residential property by non-resident persons are subject to CGT.

5. The gain accruing on the disposal of a residential property can, in certain circumstances, be divided into different components with each being chargeable under different rules to different persons at different rates. The components are, in priority order:

- First, the amount of post-April 2013, 2015 or 2016 (as the case may be) gain that is chargeable at 28% because the property is also chargeable to the annual tax on enveloped dwellings (ATED).
- Second, the amount of post-April 2015 gain that is chargeable on non-residents.
- Third, the amount of balancing gain that is neither of the first two components. This balancing gain is potentially chargeable under anti-avoidance rules that attribute gains accruing to non-UK resident companies to participators in the company and trusts to UK residents.

6. Schedules 4ZZA and 4ZZB to TCGA1992 aim to ensure there is neither double-counting nor under-counting.

Clause 80: NRCGT returns

Summary

1. This clause amends capital gains tax (CGT) provisions in relation to the making and delivery of returns in relation to disposals of UK residential property by non-residents (NRCGT). It provides for two circumstances when an NRCGT return is not required to be made and gives HM Treasury powers to add, amend or remove circumstances.

Details of the clause

2. This clause inserts new section 12ZBA into the Taxation Management Act 1970.

3. Subsection (1) of new section 12ZBA provides that a person is not required to make and deliver an NRCGT return, but may do so, in circumstances to which this section applies.

4. Subsection (2) prescribes two circumstances when an NRCGT is not required. The first is where a disposal is treated under the Taxation of Chargeable Gains Act 1992 as if neither a gain nor a loss accrues. The second is where an arm's length lease is granted to a person unconnected with the grantor for no premium; and so no chargeable gain accrues on the disposal.

5. Subsection (3) defines terms for the purpose of subsection (2).

6. Subsections (4) to (6) give HM Treasury the power to add, amend or remove circumstances by statutory instrument and set out the parliamentary process.

7. Subsection (7) ensures that late return penalties cannot apply where an NRCGT return is nevertheless made for either of the circumstances.

Background note

8. Since 6 April 2015, gains accruing on the disposal of UK residential property by non-resident persons are subject to CGT.

9. A non-resident person is currently required to notify HMRC when they dispose of a UK residential property interest by making and delivering an 'NRCGT return'. This includes circumstances when no CGT is due. An NRCGT return is required to be made within 30 days of the disposal being completed.

Clause 81: Addition of CGT to Provisional Collection of Taxes Act 1968

Summary

1. This clause amends the Provisional Collection of Taxes Act 1968 (PCTA 1968) to include capital gains tax.

Details of the clause

2. Clause 81 inserts capital gains tax into PCTA 1968 from Royal Assent.

Background note

3. PCTA 1968 gives temporary statutory force to resolutions of the House of Commons that 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.

4. Capital gains tax is ordinarily payable after the end of the tax year. Since 6 April 2015, non-resident persons disposing of UK residential property must (subject to certain exceptions) make a payment on account within 30 days of the property being conveyed.

5. At Autumn Statement 2015, the government announced the intention to extend payment on account of CGT to UK residents from April 2019.