

George Osborne's Season's Greetings or
Christmas Turkey?
Finance Bill 2011

OLSWANG



Introduction

The Government has recently published a number of tax policy updates and draft legislation to be contained in the Finance Bill 2011. Whilst much of this has been the subject of lengthy consultation processes and is therefore not surprising, the Government has released several new pieces of legislation and confirmed the precise approach it intends to take in several areas.

Highlights include a new 10% corporation tax rate for patent income, substantial reform of the corporation tax treatment of capital gains and controlled foreign companies, and a new exemption for foreign branch profits. Anti-avoidance provisions targeted at the splitting of supplies for VAT purposes and the use of employee benefit trusts to provide "disguised remuneration" have also been introduced.

The key changes are summarised briefly below with links to articles giving further details. Please contact us if any of these are of particular interest to you.

Overview

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1. Disguised remuneration using employee benefit trusts and real time PAYE reporting

Draft legislation was recently published which aims to counter arrangements including those using employee benefit trusts (EBTs) which avoid, defer or reduce income tax and/or national insurance contributions on benefits received by employees or their families. The legislation will take effect from 6 April 2011, but anti-forestalling charges will apply if, between 9 December 2010 and 5 April 2011, employees or their families receive certain benefits in a way which would be taxable under the new provisions if the legislation had applied at that time.

The draft legislation extends to a wide range of circumstances where employees or their families may potentially benefit from an EBT, even if in practice no real benefit is received. In particular, one potential effect of the draft legislation is to impose income tax and national insurance contributions charges at the time that an EBT trustee simply "earmarks" cash or shares for the purposes of granting or satisfying certain awards. Therefore, you should carefully review the wording and timing of arrangements with your company's EBT trustees for satisfying awards, in order to ensure that cash or shares in the EBT are not considered to be earmarked for these purposes.

We are actively involved in lobbying HM Revenue & Customs for clarity and change to the draft legislation and will provide updates on any developments. HM Revenue & Customs has also requested comments on the draft legislation and we would therefore hope that the position is clarified when the legislation is finalised. However, until any such clarification is given, care must be taken in relation to any instructions given to EBT trustees.

If you would like further details of the legislation, or if you would like us to advise on how best to deal with any instructions to EBT trustees then do let us know.

HMRC has also launched a consultation on the proposal to introduce a real time information system to collect information about tax and other deductions automatically each time an employer runs their payroll.

2. Controlled foreign companies ("CFCs") – legislating for interim improvements and consulting on full reform

The UK CFC regime is designed to prevent UK companies avoiding UK tax by diverting profits to subsidiaries which are based in low tax jurisdictions. It operates by taxing the UK parent company on its share of the profits of the CFC.

The Government is conducting a major overhaul of the CFC regime, to reduce the scope of the rules and improve the competitiveness of the UK tax regime for holding companies, which will not be complete until 2012. The Finance Bill 2011 introduces the first steps towards full CFC reform including the following main changes:

- Introducing an exemption for a CFC carrying on intra-group trading activities where there is minimal connection with the UK and little risk that UK profits have been artificially diverted;
- Introducing an exemption for a CFC with a main business of IP exploitation where the IP and the CFC have minimal connection with the UK;
- Increasing the de minimis exemption from £50,000 to £200,000 for groups including companies which are not small or medium sized enterprises;
- Introducing a grace period of up to three years for newly acquired foreign subsidiaries and certain companies which come within the scope of the CFC regime for the first time; and
- Extending the transitional rules for superior and non-local holding companies to ensure they continue to qualify for exemption under the exempt activities test until completion of the CFC reform in 2012.

These changes are broadly taxpayer friendly and should reduce the compliance burden pending full reform.

The Government is also consulting on wide-ranging changes to focus the UK's corporate tax system on taxing the profits from UK activity (rather than the worldwide income of a group). It is proposed that a CFC charge will only apply to overseas profits that have been artificially diverted from the UK. Exemptions will be used to minimise compliance burdens and focus attention on higher-risk entities. The consultation document focuses on monetary assets and IP and notes that targeted rules may be needed to address specific sectors including banking, insurance and real estate. The Government intends to publish further details in spring 2011.

[Click here](#) for more information on CFC reform

3. Taxation of foreign branch profits

UK trading companies with overseas operations will welcome the new optional corporation tax exemption for foreign branch profits. Profits of foreign branches of UK companies which opt into the exemption regime will no longer be subject to UK tax, thereby removing what was a clear tax disadvantage to operating a profitable overseas operation via a permanent establishment rather than via a foreign subsidiary.

A clear downside to opting in to the new exemption regime is that no relief can be claimed for foreign branch losses, so many companies, particularly those whose overseas branches are start-ups, may decide to remain within the current system. A transitional rule effectively defers the operation of the exemption for companies which have already claimed relief against UK tax for foreign branch losses, until the UK has recouped the tax relief granted in the previous six years for those losses. Where such losses exceed £50m, the UK will be able to claw back losses made more than six years before the election is made.

The foreign branch exemption for large and medium sized companies can apply to branches in low tax jurisdictions. A modified version of the CFC regime will protect against artificial diversion of profits to such branches. However, due to the risk of loss of tax through diversion of personal income, branches of small companies in a non-treaty country will be outside the exemption. Also, while capital gains attributed to foreign branches will generally be within the exemption, those of close companies will not be exempt.

[Click here](#) for more information on taxation of foreign branches

4. Corporation tax rates and capital allowances

As already announced, from 1 April 2011 the main rate of corporation tax will be reduced to 27% and the small companies' rate to 20%. The main rate will continue to fall by a further 1% in each of the following three years.

However, these rate reductions are accompanied by reductions in capital allowances. The rate of writing-down allowances on the main pool of plant and machinery expenditure will be reduced to 18% and that on the special rate pool to 8%, both with effect for chargeable periods ending on or after 1 April 2012 for corporation tax and 6 April 2012 for income tax. The annual investment allowance will be reduced to £25,000 (from £100,000) in respect of expenditure incurred from April 2012.

These changes are part of the same package of reforms as the phased reduction in the main rate of corporation tax and have been criticised as putting at a disadvantage manufacturing and other capital expenditure intensive businesses.

The Government has published draft legislation that will reduce the number of companies treated as associated with each other for the purposes of the small companies rate. This will be welcomed as companies associated with other companies have a lower threshold for payment of corporation tax at the main rate. Companies will no longer be treated as associated merely because their owners are related or are members of the same partnership but only where the relationship between the two companies is one of substantial commercial interdependence. The Treasury has been given the power to specify the factors which will determine whether substantial commercial interdependence exists.

5. Simplification of capital gains tax rules for companies

A number of measures have been introduced with the aim of simplifying certain aspects of the capital gains tax rules as they apply to companies.

Under current law, where a company leaves a group at a time when it holds an asset acquired within the past six years from another group member, the company is deemed to dispose of and immediately reacquire the asset. This can give rise to a taxable gain or an allowable loss for the company leaving the group. In future, the company's gain or loss on the deemed disposal will be attributed to the share disposal, as an adjustment to the seller's gain or loss. This will be generally welcomed as it enables the seller to take advantage of the substantial shareholdings exemption for this attributed gain on the disposal of the asset if the exemption applies to the gain on the share disposal. There will be an exception for certain disposals by non-UK residents of shares in UK resident companies to prevent taxable gains being moved outside the UK tax net.

The Government has not taken the opportunity to make similar changes to the degrouping rules applicable in other corporation tax regimes such as those for intangible assets, loan relationships and derivatives. It is understood that there is no current intention to do so, although changes may be considered in the future. The restriction of the change to assets within the chargeable gains regime limits the benefit of the change.

Complicated anti-avoidance provisions exist to counter the tax advantages obtained from transactions intended to artificially reduce chargeable gains or increase allowable losses in respect of disposals of assets. The complex provisions concerning intra-group transactions are to be replaced with a simple, purposive rule which will apply where the main purpose of such arrangements is to obtain a tax advantage. This will not necessarily result in greater certainty for taxpayers.

Changes are also proposed to the rules that restrict the use of capital losses where a change of ownership has occurred. The proposed changes relax certain restrictions so that, amongst other changes, losses that arise after a change of ownership are no longer restricted and pre-change losses, although still restricted, can be set against gains arising on a wider range of assets.

[Click here](#) for more information on the simplification of the capital gains tax rules for companies

6. VAT zero-rating: splitting of supplies

The Finance Bill 2011 contains amendments to withdraw VAT zero-rating from the supply of printed matter connected to the supply of a differently rated service by a different supplier where, had the printed matter and the service been supplied by a single supplier, the two supplies would have been treated as a single supply. Note that the change applies only where there is a supply of services (NB not goods) which are accompanied by printed materials.

The changes are designed to prevent a relatively standard way of circumventing the composite supply rules as set out in *Card Protection Plan*; namely that what, from an economic point of view, constitutes a single service by a supplier should not be artificially split. Where a person supplies a principal supply together with ancillary supplies, rather than multiple independent supplies, the ancillary supplies receive the same tax treatment as the principal supply. The supply of zero rated printed matter is the classic VAT supply which, when ancillary to a taxable or exempt supply, traders would rather treat as a separate stand-alone supply due to the obvious VAT savings.

Prior to this change taking effect, having different taxable persons making the supplies would generally achieve that aim. Notably, the Court of Appeal found that arrangements put in place by Telewest to split the supply of standard-rated television services by one group company from the supply of zero-rated television listing magazines by another were effective. The Court rejected HMRC's argument that Card Protection Plan could be extended to treat two suppliers as one. This legislation now seeks to achieve just that. From now on, unless traders can show that the printed matter is truly not "connected" to a differently-rated supply of services made by a different supplier, the intention of the legislator is that the new rules will have the effect of disapplying the zero rating. How the rules will work in practice, particularly when the elements of the composite supply are being made by unrelated parties (which would seem to fall within the ambit of the rules) remains to be seen.

The Government estimates that this measure alone, which would seem to be targeted specifically at arrangements similar to those in Telewest, will increase receipts by up to £100 million per year. The measure will take effect from Royal Assent, following consultation on the detail.

7. VAT on samples

The Finance Bill 2011 contains amendments to the VAT rules on samples designed to ensure that, where businesses provide free samples of their products for marketing purposes, none of the samples are liable to VAT. Previously the VAT exemption was limited to one sample per recipient. This change to the VAT rules should benefit businesses which use promotion samples such as music companies, video games developers and the fashion industry.

The change will come into force when Finance Bill 2011 receives Royal Assent. However, in September 2010 the ECJ in *EMI Group Ltd v Revenue and Customs Commissioners* ruled that the UK's limitation of the exception from VAT to one sample per recipient was incompatible with EC law, and so businesses who are affected may apply to HMRC for a refund of VAT immediately.

Further details are set out in our previous legal update which can be found by [clicking here](#).

Claims must be made within four years from the end of the accounting period in which the samples were supplied. Please contact us if we can help you with claims.

8. Intellectual property – the "Patent Box" regime

The Government has confirmed that it will introduce a 10% corporation tax rate for profits arising from patents in the form of a Patent Box. The Patent Box was originally a brainchild of the Labour government, first announced in 2009. The intention was to introduce a 10% corporation tax rate on royalties and other income derived from patents. This has now been endorsed by the Coalition Government who announced that the regime will come into effect in 2013, and will be applicable to all patents first commercialised after 29 November 2010.

It is thought by the Government that patents, as opposed to other intellectual property, have a strong link to the high-tech R&D and manufacturing activity that it is trying to encourage in the UK. However, given the more favourable regimes available in a number of overseas jurisdictions it is open to debate as to whether it is likely to achieve its aim.

[Click here](#) for our client update on the Patent Box dated 3rd December

9. Pensions

The Government has confirmed that with effect from 6 April 2011 the amount of tax relief available to individuals who contribute to a registered pension scheme will be significantly cut back by reducing the annual allowance to £50,000 (currently £255,000 for tax year 2010/11) and by reducing the lifetime allowance to £1.5m (currently £1.8m). Avoidance provisions will be targeted at excessive increases to pensions in payment that have the purpose of reducing or avoiding an annual allowance charge as well as provisions to target the use of trusts and other arrangements as a means of avoiding or deferring tax liabilities.

The Government has also announced that annuitisation will no longer be compulsory at age 75 but can be deferred beyond that age- a move which is designed to give individuals greater control over their own savings.

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