



16 March 2005

STAMP DUTY LAND TAX: RAISING THE THRESHOLD FOR RESIDENTIAL TRANSACTIONS

Who is likely to be affected?

1. Anyone who enters into a land transaction relating to residential property where the chargeable consideration exceeds £60,000 but does not exceed £120,000.

General description of the measure

2. The measure raises the threshold for Stamp Duty Land Tax on residential transactions from £60,000 to £120,000.

Operative date

3. Any land transaction the 'effective date' of which (see below) is on or after 17 March 2005.

Current law and proposed revisions

4. Stamp Duty Land Tax is charged, at varying rates, on the consideration given for a land transaction. At present no tax is payable on transactions in residential property if the consideration does not exceed £60,000 and tax is payable at 1% if the consideration exceeds £60,000 but does not exceed £250,000.

5. This measure raises the threshold to £120,000. So tax will not be payable on transactions in residential property if the consideration does not exceed £120,000 and tax will be payable at 1% if the consideration exceeds £120,000 but does not exceed £250,000.

6. There is no change to the charge on residential transactions where the consideration exceeds £120,000. There is no change to the higher threshold of £150,000 for residential transactions in designated disadvantaged areas.

7. This change takes effect for transactions the 'effective date' of which is on or after 17 March 2005. The effective date of a transaction is normally the date of completion. However the effective date may be earlier than completion if a contract

is 'substantially performed'. Most residential contracts will not be 'substantially performed' in advance of completion.

8. When Stamp Duty Land Tax replaced stamp duty on land transactions on 1 December 2003 some contracts relating to land transactions remained outside Stamp Duty Land Tax, so that documents relating to those transactions remained subject to stamp duty. Although it is unlikely that many such contracts relate to transactions in residential property the threshold under stamp duty is also raised to £120,000.

Further advice

9. If you have any questions about this change, please contact Crispin Taylor on 020 7147 2793 or by e-mail at Crispin.Taylor@ir.gsi.gov.uk Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 02

16 March 2005

RETENTION OF ISA LIMITS

Who is likely to be affected?

1. All ISA savers and providers.

General description of the measure

2. The current ISA limits of £7000 maximum and £3000 for cash will be retained until 5 April 2010. The existing ISA limits were due to fall from £7000 maximum and £3000 in cash to £5000 maximum and £1000 in cash from 6 April 2006.

Operative date

3. The measure will take effect from 6 April 2006.

Current law and proposed revisions

4. The current ISA limits are set out in regulation 4(2) of the Individual Savings Account Regulations 1998. These state that the maximum limit will be £7000, of which £3000 can be in cash, until end of tax year 2005/6 and £5000 and £1000 respectively for tax year 2006/7 onwards.
5. The retention of the existing limits will mean a change to this regulation to delay changes to the limits until the end of the tax year 2009/10.

Further advice

6. If you have any questions about this change, please contact David Ensor at Capital and Savings on 020 7147 2835 or email at david.ensor@ir.gsi.gov.uk Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 03

16 March 2005

ISA AND CHILD TRUST FUNDS: ALL FSA AUTHORISED OR REGULATED RETAIL INVESTMENT SCHEMES WILL BE QUALIFYING INVESTMENTS

Who is likely to be affected?

1. The providers of FSA authorised collective investment schemes and Individual Saving Account (ISA) and Child Trust Fund (CTF) account holders who invest in them.

General description of the measure

2. This announcement means that the Government will extend the ISA and CTF qualifying investment rules to include all retail collective investment schemes authorised by the FSA, both UCITS and non-UCITS retail schemes, provided they do not restrict savers ability to access their savings. Schemes applying the 'limited redemption' rule, introduced by the FSA, will not be eligible.

3. In addition to enable similar overseas schemes to compete within the ISA and CTF markets we shall extend the ISA and CTF to any similar overseas non-UCITS retail scheme, provided it is regulated by the FSA.

4. As now any collective investment scheme allowed into the ISA will also be subject to a 'cash-like' test, to limit those promising cash-like returns on investment to the cash component of the ISA.

5. The legislation for the ISA and CTF currently limits the types of collective investment scheme that can be held within an ISA or CTF account to certain types of retail investment scheme authorised by the FSA or schemes authorised in another European country that satisfy the EU UCITS Directive rules.

6. The UK schemes are all defined by reference to the relevant FSA sourcebook for collective investment schemes. There are currently two FSA sourcebooks in operation:

- the old FSA sourcebook for collective investment schemes, the CIS Sourcebook, which will cease to apply in February 2007; and

- the new FSA sourcebook, the COLL Sourcebook.

7. Under the CIS sourcebook four different types of scheme could qualify for the ISA and CTF – the UCITS scheme, warrant schemes, securities schemes or a fund of fund scheme that invests in other UCITS, warrants or securities schemes.

8. Under the COLL sourcebook that will replace the CIS sourcebook in 2007 only two types of retail scheme will remain:

- 'UCITS' schemes, which are very similar in nature to the CIS sourcebook UCITS scheme; and
- 'non-UCITS retail' schemes, which have slightly more relaxed investment rules and allows schemes to invest in a wider range of investment products than the UCITS scheme, such as real property.

9. Currently only the COLL UCITS scheme is allowed into the ISA, and it is intended that they will also be allowed into the CTF.

10. Existing Fund of Fund schemes that qualify for the ISA and CTF under the CIS sourcebook, may not necessarily fall within the definition of a COLL UCITS. In addition, with the extension of the stocks and shares ISA component to include stakeholder products and life insurance from April 2005, it no longer makes sense to exclude authorised collective investment schemes that invest in certain types of investment product, such as real property.

Operative date

11. The measure will take effect from 6 April 2006 at the latest.

Current law and proposed revisions

12. The current ISA qualifying investment rules are set out in regulations 7 and 8 of the Individual Savings Account Regulations 1998. Regulation 7 (2) lists the types of investments allowed within the stocks and shares component of the ISA and regulation 7(15) sets out the cash-like test that will be applied to authorised collective investment products. Products failing the test will be eligible investments for the cash component in Regulation 8.

13. The current CTF qualifying investment rules are set out in regulation 12 of the Child Trust Fund Regulations 2004.

14. Extending the list of qualifying investments to include COLL sourcebook UCITS and non-UCITS retail schemes will mean adding these to regulation 7 with effect from April 2006 and applying Regulation 7(15) to those products for ISA purposes. For the CTF this means adding these products to regulation 12.

Further advice

15. If you have any questions about this change, please contact David Ensor at Capital and Savings, on 020 7147 2835 or email at david.ensor@ir.gsi.gov.uk

Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

RESEARCH INSTITUTION SPINOUT COMPANIES

Who is likely to be affected?

1. Employees of Research Institutions (RI) who acquire or have acquired employment-related shares in spinout companies into which the RI transfers Intellectual Property (IP). As the nature of the IP can be very wide-ranging it is unlikely it will favour or impact on a particular business sector/activity. Given the nature and purpose of spinout companies, it is most likely that the spinout companies affected will be small in size, with less than 50 employees.

General description of the measure

2. Universities, public-sector research establishments (PSREs) and entities such as NHS Trusts and The Ministry of Defence own IP created by their employees. Such entities have unique IP sharing policies (sometimes called “employee incentive or compensation schemes”) that allow researchers, who have helped create the IP, to benefit when it is subsequently exploited.

3. The form and timing of this reward varies. It may be cash representing a share of royalties received by the institution from licensing or selling the IP. Alternatively, it could be a transfer of value to researchers via their ownership of shares in a spinout company set up to further develop the IP to the point where it can be exploited commercially.

4. Whatever form the reward takes it is subject to PAYE and National Insurance Contributions (NICs) at the time it flows to the employee. Where shares are concerned, this point can be very early on in the life of a spinout, and it can be difficult to value the extent of the reward, leading to difficulties in payment of tax and NICs. This uncertainty has had a negative impact on the creation of new spinout companies. This measure will help to provide the flexibility the sector needs to resume spinout activity by ignoring the value of the IP on transfer to the spinout company.

5. For spinouts that were set up before the operative date, there will be an opportunity to elect that income tax and NICs liabilities will not be payable unless and until the company is successful.

Operative date

6. The main legislation will be effective from 2 December 2004. Spinouts set up before that date who wish to elect for the charge to income tax and NIC to be calculated at a later date must do so no later than 15 October 2005.

Current law and proposed revisions

7. The Finance Act 2003 reform of the taxation of employee share remuneration brought the tax treatment of this employment reward into sharp focus and created uncertainty for spinouts. This contributed to a significant reduction in the number of new spinouts. Legislation will be introduced to remove this uncertainty and allow universities and other PSREs to make decisions on the formation and structuring of spinouts based on commercial factors rather than on the basis of the tax consequences of certain company structures.

8. The legislation will disregard the value of the IP on transfer from the research institution to the spinout company for the purpose of the rules that tax employment-related securities held by researchers, thereby removing the barrier to spinouts posed by a tax charge at the time of the transfer.

Further advice

9. If you have any questions about this Note, please contact Hasmukh Dodia on 020 7147 2839. A Final Regulatory Impact Assessment (RIA) and a summary of the Consultation Representations on this measure have been published today. These and information about other Budget measures are available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

SIMPLIFICATION OF THE TAXATION OF PENSIONS

Who is likely to be affected?

1. Pension scheme savers, employers, insurance companies, occupational and personal pension schemes and their advisers and Independent Financial Advisers.

General description of the measure

2. The simplified tax regime for pensions comes into effect on 6 April 2006. From that date there will be a single set of tax rules for all registered pension schemes. The relevant legislation is contained in Finance Act 2004.

3. These new measures build on those in Finance Act 2004, providing additional flexibility for schemes and individuals, clarifying aspects of the new rules, smoothing the transition from the current to the new regime and introducing further anti-avoidance and compliance rules.

Operative date

4. 6 April 2006.

Current law and proposed revisions

5. Currently pensions are governed by various different tax regimes that limit the amount an individual can contribute to a pension scheme and the consequent benefits a scheme can pay out. Simplification will replace the existing tax regimes with a single universal regime for tax-privileged pension savings. The numerous controls in the current regimes will be replaced by 2 key controls in the new regime:

- the lifetime allowance; and
- the annual allowance.

6. The new measures fall into four main areas:

- benefits and contributions;
- lifetime allowance;

- unauthorised payments; and
- transitional issues.

7. The new measures were announced in the Inland Revenue Technical Note published on 16 February. Additionally, there will be a measure to ensure that the provision on modification of scheme rules will operate so that schemes will have until 6 April 2011 to make changes to their rules and there will be an order making power to extend this time limit. There will also be a number of further minor and technical provisions.

Consultation on Pension Commencement Lump Sums and Scheme Pensions

8. Representations have been received that if a member decides to take a scheme pension a larger lump sum may be generated if the member decides to remove all escalation and dependants' pensions. Conversely with the purchase of a lifetime annuity the lump sum is capped at 25% of the fund and the member then decides how much of the residual fund should provide dependants' pensions and escalation.

9. The Government will be consulting on how this mismatch might be addressed and we will make an announcement by the 2005 PBR of any intention to change these rules in Finance Bill 2006.

10. The basic principles of the simplified regime of valuing scheme pensions at 20:1 for the purposes of testing against the lifetime allowance and paying 25% of a money purchase arrangement as a lump sum are not at issue here.

Further advice

11. If you have any questions about these changes, please contact the Pensions helpline on 0115 974 1600 or go to the Technical Note on the Inland Revenue website at www.inlandrevenue.gov.uk/pensionschemes/pensions-simplification-tn.pdf An appendix to the Regulatory Impact Assessment, *Simplifying the taxation of Pensions*, published in April 2004 is also published today. This confirms that the additional measures do not affect the costs or impacts as set out in the original Regulatory Impact Assessment.

12. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

PENSION PROTECTION FUND

Who is likely to be affected?

1. Members of defined benefit occupational pension schemes and their sponsoring employers.

General description of the measure

2. The Government legislated in the Pensions Act 2004 to create the Pension Protection Fund (PPF), which will be able to assume responsibility for defined benefit occupational pension schemes (and other pension schemes with defined benefit elements) whose sponsoring employers have become insolvent, leaving insufficient assets in the scheme. The PPF will pay compensation to the members of these schemes in lieu of the benefits that would have been payable by the schemes. The PPF will not be a pension scheme, but will be given tax treatment equivalent to that of a tax-privileged pension scheme.

Operative date

3. The tax treatment will apply from 6 April 2005.

Current law and proposed revisions

4. Pension schemes that are “approved” by the Inland Revenue have various tax privileges. The schemes are exempt from tax on their investment income and capital gains. Tax relief is allowed on contributions to the schemes, whether from members or employers. Lump sums paid to members or their dependants are (within certain limits) exempt from tax.

5. Under the new simplified tax regime for pension schemes, which takes effect from 6 April 2006, these tax privileges will be provided to “registered” pension schemes. Existing approved schemes will become registered schemes.

6. The PPF will be a body corporate, which means that it will ordinarily be liable to pay corporation tax on its income and gains. It will be funded by statutory levies on eligible schemes, for which tax relief will not necessarily be given. As the PPF will not be a pension scheme, it would not be able to pay tax-free lump sums.

7. Legislation will put the PPF on the same tax footing as tax-privileged pension schemes. Up to 5 April 2006, the PPF will benefit from the tax treatment of an approved occupational pension scheme. After that date, the PPF will benefit from the tax treatment of a registered pension scheme. Tax relief will be allowed for payment of the statutory levies to the PPF, for example where a sponsoring employer provides a scheme with funding for the levy payments.

Further advice

8. If you have any questions about this change, please contact Mark Bravery on 020 7147 2860. Information about the impact of the PPF on business can be found in the Regulatory Impact Assessment for the Pensions Bill 2004, published at www.dwp.gov.uk/resourcecentre/ria Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 07

16 March 2005

REFORM OF TAXATION OF COLLECTIVE INVESTMENT SCHEMES

Who is likely to be affected?

1. Providers of, and investors in, Authorised Investment Funds (AIFs), i.e. Authorised Unit Trusts (AUTs) and Authorised Open-ended Investment Companies (OEICs). Some of the changes affect all unit trusts, one affects only Qualified Investor Schemes (QIS), and one affects investors in a void PEP, ISA or CTF account.

General description of the measures

2. The measures include some minor changes to the tax rules for potentially chargeable capital gains arising to:

- certain unauthorised unit trusts (UUTs) where the fund manager holds units in the fund temporarily;
- certain UUTs with life assurance companies as unit holders; and
- investors in accumulation units in a unit trust or accumulation shares in an OEIC

3. Other changes simplify the deduction at source rules for interest paid on accounts no longer within the PEP/ISA rules (void accounts), clarify the tax arrangements for AUTs that issue multiple classes of units and correct two cross-references in the offshore funds legislation relating to loan relationships and permanent establishments.

4. The package includes powers to make regulations to reform the tax treatment of AIFs and their investors. The main changes will:

- allow funds to make both interest and dividend payments in a distribution period;
- extend the circumstances in which interest distributions can be made gross; and
- provide for different tax rules for investors with a significant stake in funds that are QIS

Operative date

5. In the main, Budget Day 2005, apart from the reforms to be provided in regulations. The operative date for these will be set in the regulations, which will be published in draft for discussion later in the year.

Current law

6. The current regime subjects AIF income to corporation tax at a rate equal to the lower rate of income tax (currently 20%) and exempts their chargeable gains from tax. Management expenses are allowable in arriving at the amount distributable to investors. Subject to meeting a daily investment test (bond fund test), distributions are either yearly interest or dividends. Interest distributions are deducted to arrive at the fund's tax liability.

7. Individuals generally receive interest distributions net of lower rate tax, which can be set against tax due, or reclaimed in the same way as tax on bank interest. Unit holders within the charge to corporation tax and non-residents generally receive them gross. Dividend distributions are treated in the same way as ordinary dividends, except that for corporation tax purposes dividends are split between a part attributable to UK dividends and that attributable to other income.

8. If an AIF is held within a PEP/ISA or CTF, interest distributions are generally paid gross. If the account is void, e.g. because the investor dies, interest is payable net of tax. If that does not happen, the AIF manager must account for that tax.

Proposed Revisions

9. It is proposed to change the chargeable gains rules as follows to:

- give statutory effect to Extra Statutory Concession D17 - exemption from tax on chargeable gains where the manager temporarily holds units in the capacity of manager;
- allow a life assurance company/friendly society to hold units in a UUT without the UUT losing chargeable gains exemption if the units are referable to a category of the company's business where chargeable gains are exempt from corporation tax; and
- give effect to an Inland Revenue practice allowing amounts reinvested in accumulation units/shares as a deduction on disposal of the units or shares

10. The first two changes will apply from 2005/06, the third will apply in relation to disposals of accumulation units/shares on or after today (16 March 2005).

11. Administrative arrangements when a PEP, ISA or CTF account is void are being simplified. From 6 April 2005 responsibility to account for income tax will move to the investor, or the executors where the investor has died.

12. Since 1 April 2004, when the FSA introduced its new rulebook (COLL), AUTs can use multiple classes of units in the same way as OEICs can issue multiple share classes. Non-discrimination rules similar to those in the OEIC rules are being introduced for AUTs that issue more than one class of unit.

13. Finance Bill 2005 will include powers to change the regime in regulations to:

- define and consolidate the existing tax rules in regulations;
- allow changes in response to future FSA changes, or to counter avoidance;
- change the existing distribution rules; and

- permit different tax treatment to be applied to different unit/share holders in funds that are QIS

14. Further discussions with interested parties are planned before publishing draft regulations. This will include discussions on design issues, start dates and will take account of the time funds may need to adapt their systems. Among other things, any regulations under these powers will deal with:

Distributions: AIFs can invest in a mix of assets including equities and bonds but the 'bond fund' rules prevent them from making distributions fully reflecting that mix. The daily 'bond fund' test will therefore be removed and funds will be able to make interest and dividend distributions in the same period in proportion to the interest and other income received. Funds will be able to elect to distribute profits only as dividends. The rules determining who can receive interest distributions gross will be aligned with the gross payment rules for bank interest but this will not affect deductibility of such distributions when calculating an AIF's income chargeable to corporation tax.

Substantial ownership rule: The AIF regime provides tax benefits to investors who pool their investments, handing over management to independent fund managers. The QIS regime allows a new degree of flexibility in investment strategy. As access to a QIS can be limited, this flexibility offers greater scope for potential exploitation of the AIF tax regime. To counter this the Finance Bill will include a power to make regulations to tax unit/share holders differently if they own a substantial portion of a QIS. We will also consider the case for a purposive anti-avoidance test for QIS. For other investment funds work will continue on the suitability of either a purposive test or other potential measures. For the QIS rule the investor will need to take units/shares owned by connected parties and associates into account when deciding what proportion of the fund they own – similar to the control test for close companies. Certain kinds of investor such as pension funds, charities, companies carrying on life insurance and nominees acting on behalf of investors will be excluded from this rule.

This rule for QIS will apply to the investor, so the tax treatment of the QIS will remain as for other AIFs. However, where an investor owns a substantial portion of a QIS, any annual increase in the value of their units/shares will be chargeable as income under self-assessment. Unrealised gains at the time the rule starts will be held over and treated as chargeable gains when the units are sold.

Property: AIFs can now invest up to 100% in property. Furthermore, HM Treasury and Inland Revenue today published “**UK Real Estate Investment Trusts: a discussion paper**” to consider reform to the taxation of the property investment market in the UK. Many of the issues in that paper are relevant to AIFs and regulations to deal with the tax treatment of property-owning AIFs will be drafted once the Government's position on UK-REITs has been finalised.

Further advice

15. If you have any questions about these changes, please contact Michael Swan on 020 7147 2608 or Stephanie Allistone on 020 7147 2560. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 08

16 March 2005

ALTERNATIVE FINANCE ARRANGEMENTS

Who is likely to be affected?

1. Individuals and companies who wish to invest or borrow money under arrangements that do not involve the receipt or payment of interest.
2. Individuals who wish to use such arrangements for the purchase of property.
3. Banks and building societies who wish to offer alternative finance products and who will have to apply the rules for deduction of tax at source.

General description of the measure

4. This measure will ensure that certain financial arrangements that replicate the effect of investments or loans at interest are taxed no more or less favourably than equivalent arrangements which do give rise to interest.
5. The changes to the Stamp Duty Land Tax (SDLT) regime will extend the reliefs introduced in Finance Act 2003 to a wider range of alternative property finance arrangements.
6. The change will facilitate the use of alternative financial products including for example those developed to be Shari'a compliant.

Operative date

7. The changes relating to borrowing and investing will apply to arrangements entered into on or after 6 April 2005.
8. The changes to the SDLT regime will apply from Royal Assent to the Finance Bill.

Current law and proposed revisions

9. Current tax law contains no specific rules to deal with finance arrangements that are structured so that they do not involve the payment or receipt of interest. This can lead to problems such as the return on an investment being characterised as a distribution for tax purposes.

10. The exception to this is alternative property finance, where sections 72 and 73 Finance Act 2003 offer relief on additional payments of SDLT for alternative property finance structures that involve more than one transaction for SDLT purposes.

11. The new provision will provide a level playing field for tax between equivalent financial products whether or not these involve the payment or receipt of interest. This will include application of the rules for deduction of tax at source.

12. The changes to alternative property finance arrangements will allow a wider range of property finance structures to have relief from more than one SDLT charge and will make section 72 relief more easily available in Scotland.

Further advice

13. If you have any questions about these changes, please contact Chris Kerr on 020 7147 2619. For changes concerning alternative property finance please contact Adam McMordie on 020 7147 2798. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 09

16 March 2005

STAMP DUTY LAND TAX: COMMERCIAL DISADVANTAGED AREAS RELIEF

Who is likely to be affected?

1. Purchasers entering into a commercial land transaction in Enterprise Areas, which are wards designated as qualifying for the 'disadvantaged area relief' exemption from stamp duty land tax. Land transactions include the transfer of freehold and the grant, assignment or assignation of a lease.

General description of the measure

2. Disadvantaged areas relief will not be available for non-residential land transactions with an effective date after today.

Operative date

3. The operative date is for transactions with an effective date after 16 March 2005. However the relief is preserved for the completion or substantial performance of contracts entered into on or before 16 March 2005, provided that there is no variation or assignment of the contract or sub-sale of the property and that the transaction is not the exercise of an option or right of pre-emption.

Current law and proposed revisions

4. Schedule 6 Finance Act 2003 provides for a relief from stamp duty land tax for non-residential transactions in land situated in designated 'disadvantaged areas'. There is no tax charge where non-residential land is wholly within a disadvantaged area. Where non-residential land is partly inside and partly outside a disadvantaged area the consideration is apportioned so that only that part attributable to the land outside the disadvantaged area is charged to tax.

5. After today Schedule 6 will no longer provide an exemption for non-residential transactions. However the relief is preserved for the completion or substantial performance of contracts entered into on or before 16 March 2005, provided that there is no variation or assignment of the contract or sub-sale of the property and that the transaction is not the exercise of an option or right of pre-emption.

6. Disadvantaged areas relief on residential transactions, which provides a higher residential threshold of £150,000, is unaffected.

7. Transactions outside disadvantaged areas are unaffected.

Further advice

8. If you have any questions about this change, please contact Crispin Taylor on 020 7147 2793 or Keith Brown on 020 7147 2790. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

MODERNISING THE TAX SYSTEM FOR TRUSTS

Who is likely to be affected?

1. Trustees, beneficiaries and settlors of trusts.

General description of the measure

2. A package of measures to modernise the tax system for trusts. Two of these (a standard rate band for trustees who pay tax at the rate applicable to trusts and a new tax regime for certain trusts with vulnerable beneficiaries) are being introduced and a further discussion paper is being issued today to consider the details of a number of other simplifying proposals.

Operative date

3. The regime for certain trusts with vulnerable beneficiaries is backdated to 6 April 2004; the standard rate band comes into effect from 6 April 2005; and other measures are likely to be introduced from 6 April 2006.

Current law and proposed revisions

4. In his 2004 Budget, the Chancellor announced that the tax rate applicable to trusts (RAT) would be raised to 40% to combat tax avoidance. He also announced that there would be new measures to prevent this change increasing burdens on certain trusts that have vulnerable beneficiaries.

5. Two measures were announced – a new tax regime for certain trusts with vulnerable beneficiaries, and a standard rate band of £500 for all trusts paying tax at the rate applicable to trusts. Legislation giving full details of these measures will be published in the Finance Bill.

6. A number of other proposals were put forward at Budget 2004. These included a set of common definitions and tests for trusts, and the streaming of income through trusts. These measures will simplify the taxation of trusts and were widely supported during consultation last year. However, during subsequent consultation, respondents also raised a number of concerns about some of the

detailed aspects of the proposals. A summary of the findings of this consultation has been published today.

7. Therefore, the Inland Revenue will carry out further development work on these measures and a discussion paper has been published today. It is intended that draft legislation will be published for consultation later this year, prior to the measures being included in next year's Finance Bill.

Further advice

8. If you have any questions about this change, please contact Roger Willoughby on 0131 777 4143 or Doug Stoneham on 020 7147 2761. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

STAMP DUTY AND STAMP DUTY RESERVE TAX: EXTENSION OF RELIEFS FOR INTERMEDIARIES AND REPURCHASES/STOCK LENDING

Who is likely to be affected?

1. Intermediaries who are members of a specified Multilateral Trading Facility (MTF) as defined by the EU Markets in Financial Instruments Directive (MiFID) - Directive 2004/39/EC.

General description of the measure

2. To extend Stamp Duty /Stamp Duty Reserve Tax (SDRT) relief for intermediaries and for repurchase/stock lending to members of a MTF that meets the MiFID definition.

Operative date

3. This measure will apply from Royal Assent to the Finance Bill.

Current law and proposed revisions

4. The reliefs, introduced in 1997, are currently only available to members of an EEA exchange, a recognised foreign exchange, or any market that is not a recognised exchange but is prescribed by order under section 118(3) Financial Services and Markets Act 2000.

5. The measures will allow the Treasury to designate specified MTFs as being, in effect, a “recognised exchange” for the purposes of Stamp Duty and SDRT intermediary and repurchase/stock lending reliefs.

Further advice

6. If you have any questions about this change, please contact Gareth Hills on 020 7147 2802. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

STAMP DUTY RESERVE TAX: DEMUTUALISATION OF INSURANCE COMPANIES

Who is likely to be affected?

1. Mutually owned insurance companies that restructure on demutualisation.

General description of the measure

2. A stamp duty relief was introduced in 1997 to remove all stamp duty and stamp duty reserve tax (SDRT) charges when an insurance company demutualises. This measure will ensure that the relief continues to apply as originally intended.

Operative date

3. The measure will apply from Royal Assent to the Finance Bill.

Current law and proposed revisions

4. Subject to certain conditions, the relief introduced in 1997 removed all stamp duty and SDRT charges when a mutually owned insurance company restructures and moves its investments to a new company on demutualisation.
5. Following changes that have been made to the stamp duty and SDRT legislation since 1997, this new measure will ensure that the transfer of investments in collective investment schemes from the mutual to the new company will continue to qualify for relief.

Further advice

6. If you have any questions about this change, please contact Ian Burton on 020 7147 2788. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

INTERNATIONAL ACCOUNTING STANDARDS (IAS): THE TAX IMPLICATIONS

Who is likely to be affected?

1. Large companies.

General description of the measure

2. A number of technical amendments are being made to the legislation included in the 2004 Finance Act and in regulations made in December 2004. They reflect recent developments in both IAS and UK Generally Accepted Accounting Practice (GAAP) and correct some errors and omissions in the 2004 legislation.
3. The Government also proposes to extend and widen the moratorium allowing securitisation special purpose companies to be taxed as if they had continued to use UK GAAP as it stands at 31 December 2004. A power to make regulations setting out a permanent scheme of taxation for these companies will also be included in the Finance Bill.
4. An anti-avoidance measure will also be introduced to prevent companies frustrating the announcement made by the Government at Pre-Budget report that transitional adjustments would be deferred until 2006 at the earliest.

Operative date

5. These changes will generally have effect for periods beginning on or after 1 January 2005, the earliest date from which companies are permitted to use IAS to draw up their accounts. The anti-avoidance measure will apply from 14 December 2004.

Proposed revisions

6. Securitisation companies are special purpose vehicles (SPVs) involved in structures under which at least one such company is used to issue securities or commercial paper into the market which are backed by charged assets, the cash flows from which are used to meet liabilities under the securities. Such SPVs are

usually "bankruptcy remote" so that they are insulated from any insolvency risks within the group (the "sponsoring group") that transferred the assets into the structure. Often there is more than one SPV in a chain of companies ending with an issuer SPV, or an SPV may be used to "warehouse" assets prior to transfer into a structure involving an issuer SPV.

7. The effect of IAS and revised UK GAAP (especially IAS 39 and FRS 26) on the profits and hence the tax of SPVs is still the subject of debate among accountants. But SPVs are peculiarly dependent on an appropriate rating of the debt, in particular one that is higher than the rating of the sponsoring group, because the higher rating means a lower cost of finance. But if rating agencies are unsure of the potential tax liabilities of an SPV they may be unwilling to grant a rating or may wish to downgrade ratings previously granted to SPVs that were set up before the recent accounting changes came into effect.

8. In order to avoid disruption to the markets, at PBR draft legislation was published containing a provision (the "moratorium") that allows SPVs in a defined category to continue to use UK GAAP as it stood on 31 December 2004 for another year for the purpose of computing their taxable profits, even where they make the transition to preparing accounts under IAS or revised UK GAAP. Following subsequent discussions between the Inland Revenue and representatives of the securitisation industry, the Finance Bill will contain legislation that modifies the moratorium so that it:

- applies for all accounting periods beginning in 2005; and
- widens the class of SPVs to which it applies.

9. In addition the Finance Bill will contain a power to make regulations to establish a permanent regime for securitisation SPVs.

10. A number of other amendments and additions are being made to the legislation enacted in Finance Act 2004 on IAS. Many were included in draft legislation published at the Pre-Budget Report 2004, but there have been some changes to that legislation as a result of consultation. The changes include:

- removing releases of debt as part of a debt/equity swap from a charge to tax;
- restoring the rule formerly in section 85(3)(c) Finance Act 1996 that applies where a company acquires debt owed by a connected company from a third party. But the new rule will charge tax on the debtor company as if it had been released from repaying more than the amount paid by the acquiring company, unless the acquiring company had brought credits into account. In that case the credits will reduce the amount treated as released;
- ensuring that a debit for a valuation change not related to impairment is still allowed where the debit represents an exchange loss;
- ensuring that the exemption for reversal of unallowed debits for valuation changes applies to debits disallowed under the pre-2005 rules or bad debt deductions in the case of money debts which are not loan relationships, and that these rules apply to general provisions for bad debt;
- limiting debits and credits in relation to impairment of money debts which are not loan relationships to trading debts;

- repealing paragraph 6B and 6C(2) Schedule 9 FA 1996 which are redundant;
- amending the definition of exchange gains and losses in the loan relationships and derivative contracts legislation to make it clear how it operates where fair value accounting is used;
- applying section 94A FA 1996 (bifurcation of embedded derivatives) only where it is required for accounting purposes. This means it is not used where a company accounts for an asset “at fair value through profit and loss”, and where a company continues to use UK GAAP as it stood before FRS 25 and FRS 26 apply. But those companies will be allowed to elect into the bifurcation rules;
- amending the changes of accounting basis rules in the Intangible Fixed Assets regime in Schedule 29 FA 2002 so that any credit is capped at the level of net debits previously given. This rule will apply to capacity at Lloyd’s as well as to other assets; and
- introducing new rules into the Intangibles regime to clarify what happens where an asset such as goodwill is disaggregated into several assets on a change of accounting basis, and where separate assets are aggregated.

11. In addition regulations will be made amending Part 9 Schedule 26 FA 2002 (derivative contracts) to continue the process of providing a comprehensive tax code for, in particular, embedded derivatives. The Order will:

- restore paragraph 45H Schedule 26 which deals with the adjustments to base cost of shares where debt is converted into shares;
- modify paragraph 45J so that it applies with suitable adaptations where an exchangeable security was issued before the issuing company was required to bifurcate the security; and
- allow companies to elect to follow for tax purposes the accounting treatment of derivatives embedded in a contract that is not a loan relationship.

12. Regulations will also be made when the Finance Act receives Royal Assent to amend the Disregard regulations. In particular:

- The closing date for elections out of regulations 7, 8 and 9 will be extended to 1 July 2005.
- transitional amounts in relation to derivative contracts to which regulations 7, 8 or 9 apply will be included in the Disregard regulations and not in the Change of Accounting Basis regulations;
- the definition of “exchange gains and losses” will mirror the changes to paragraph 54(2) Schedule 26 FA 2002 mentioned above.

13. Regulations will also be made when the Finance Act receives Royal Assent to amend the Change of Accounting Basis regulations. In particular:

- an error in the regulations about “held-to-maturity” assets will be corrected. The “greater than 10%” rule will become “less than 10%” as always intended;
- the reference to regulation 4 derivative contracts will be removed; and
- the exception for securities falling within section 94A will be removed, and modifications to the way credits and debits on such securities are brought into account will be included in the Disregard regulations.

14. The Government announced at the 2004 PBR that IAS transitional adjustments would be deferred until 2006 at the earliest. An anti-avoidance measure will be introduced to prevent companies crystallising losses in advance of transition to IAS. It will provide that where:

- a company takes steps on or after 14 December to realise a loss which results in a debit in a period ending before transition;
- those steps were not carried out in the normal course of the company's business but with the sole or main purpose of bringing the debit into account;
- had those steps not been taken and the asset still been held at the transition date; and
- the asset had the same value as at the date the loss arose;

then a debit would have arisen on transition which would have been deferred under the Loan Relationship and Derivative Contracts (Change of Accounting Practice) Regulations, then the debit in respect of the loss realised will be deferred under those regulations.

15. The measure will contain a rule to prevent groups of companies getting round it by fragmenting steps between different companies.

Further advice

16. If you have any questions about these changes, please contact Richard Thomas on 020 7147 2558 or richard.thomas@ir.gsi.gov.uk or Sue Davies on 020 7147 2565 or sue.davies@ir.gsi.gov.uk Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

LLOYD'S REGULATIONS

Who is likely to be affected?

1. Members of Lloyd's and managing agents of Lloyd's syndicates.

General description of the measure

2. Amendments to the powers for making Regulations relating to Lloyd's underwriters.

Operative date

3. The measure will apply to Regulations made after the passing of the 2005 Finance Bill.

Current law and proposed revisions

4. Tax rules for Lloyd's underwriters are set out in Finance Act 1993 and Finance Act 1994. Underwriters are taxed according to their share of the profits or losses of syndicates of which they are members. In order to facilitate the assessment and collection of tax from underwriters, Lloyd's managing agents are required to make returns to the Inland Revenue of syndicate profits and losses, computed for tax purposes.

5. The legislation allows Regulations to be made on a range of matters, including the assessment and collection of tax. This measure amends these Regulation-making powers, primarily in order to permit the repeal of Schedule 19 of Finance Act 1993 and its replacement with Regulations made by Statutory Instrument. This will allow greater flexibility when amending and modernising the current procedures, for example by allowing for electronic filing of syndicate returns and by applying self assessment principles to the determination of syndicate profits.

Further advice

6. If you have any questions about this change, please contact Tony Sadler on 020 7147 2616. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

EXTENSION OF LOW BUDGET FILM TAX RELIEF

Who is likely to be affected?

1. Those producing or investing in films with total production expenditure of up to £15 million which are certified as qualifying British Films under provisions in Schedule 1 of the Films Act 1985.

General description of the measure

2. This measure extends the tax relief for low budget films until 31 March 2006.

3. Low budget tax relief is currently provided in section 48 of Finance (No.2) Act 1997 and is due to expire on 1 July 2005.

Operative date

4. Legislation in the 2005 Finance Act will extend the low budget tax relief from 2 July 2005 until 31 March 2006. It will also contain a power to substitute a later date. This allows for the timetable if necessary to obtain formal State Aid clearance.

5. This extension will enable films to qualify for current tax relief where:

- the first day of principal photography is before 1 April 2006 ; and
- the film is completed before 1 January 2007

Relief for acquisition will continue to be available for films which meet these conditions and which are acquired before 1 October 2007.

Current law and proposed revisions

6. Low budget film tax relief was introduced by section 48 of Finance (No.2) Act 1997 and was originally intended to expire on 1 July 2000. It was extended by Finance Acts 1999 and 2001 and is currently due to expire on 1 July 2005.

7. The current film tax reliefs are at sections 40A to 43 Finance (No.2) Act 1992, section 48 Finance (No.2) Act 1997 and sections 99 to 101 Finance Act 2002.

Without the film reliefs, expenditure on producing or buying a film would be capital expenditure, eligible for capital allowances. The film reliefs treat such expenditure as revenue expenditure and give rules as to how this expenditure can be written off.

8. The provisions in F(No.2)A 92 allow expenditure on the production or acquisition of a qualifying British film, which would otherwise be on capital account, to be treated as a revenue expense and either matched against income from the same film or written off over three years. Section 48 F(No.2)A 97 allows production or acquisition expenditure on a low budget qualifying British film to be written off immediately, rather than over three years.

Further advice

9. If you have any questions about this change, please contact Craig Mason on 020 7147 2599. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

COUNTERING FILM TAX AVOIDANCE

Who is likely to be affected?

1. The measures will affect those producing or investing in films using financial structures described in the Inland Revenue's Technical Note issued on 2 December 2004. It will also apply to individuals in Limited Partnerships, Limited Liability Partnerships, or any other partnerships where the partner does not spend a significant amount of time working in the trade.

General description of the measure

2. As announced in the 2004 Pre-Budget Report, the measures counter tax-avoidance schemes which seek to:

- obtain relief more than once on expenditure on any qualifying film;
- use film reliefs alongside arrangements to defer tax for more than 15 years;
- enable companies using 'exit' schemes intended to convert the deferral of tax into a permanent tax advantage; and
- enable partnerships to get loss relief for money not really at risk.

3. A change is also being made to align some of the rules on relief for large budget films with the rules for small budget films.

Operative date

4. The measures will be effective from the date of the announcement in the Pre-Budget Report (2 December 2004) but the terms of the commencement will be different for the different types of scheme being countered.

5. For schemes seeking to claim relief more than once on any film, the legislation will apply in general to claims made on or after 2 December 2004, except where the film was in production at that date.

6. For schemes seeking to defer tax for more than 15 years the legislation will come into effect for claims made on or after 2 December 2004, except where, before that date, the claimant has entered into an unconditional agreement guaranteeing income arising from the film in respect of which the claim is made.

7. For schemes enabling groups of companies to exit from tax deferral schemes, the legislation will apply to any exits and disposals of film rights out of those groups on or after 2 December 2004.

8. For schemes enabling partners to obtain loss relief for money that is not really at risk, the legislation will apply to partnership contributions made on or after 2 December 2004 and to agreements and arrangements made on or after that date in respect of contributions made earlier.

9. The measure aligning the rules for relief on large budget films with the rules for small budget films will apply to all films starting principal photography on or after 2 December 2004.

Current law and proposed revisions

10. The current film tax reliefs are at sections 40A to 43 Finance (No.2) Act 1992, section 48 Finance (No.2) Act 1997 and sections 99 to 101 Finance Act 2002. Without the film reliefs, expenditure on producing or buying a film would be capital expenditure, eligible for capital allowances. The film reliefs treat such expenditure as revenue expenditure and give rules as to how this expenditure can be written off.

11. The provisions in F(No.2)A 92 allow expenditure on the production or acquisition of a qualifying British film, which would otherwise be on capital account, to be treated as a revenue expense and either matched against income from the same film or written off over three years. Section 48 F(No.2)A 97 allows production or acquisition expenditure on a low budget qualifying British film to be written off immediately it is completed or acquired. Partners of Film Partnerships which invest money in films can get relief for trading losses under section 380 ICTA 1988, or under section 381 ICTA 1988 for the early years of a trade, or under section 72 Finance Act 1991 against their capital gains.

12. The provisions to counter multiple claims to relief will allow only one person to claim relief under section 42 or section 48 in respect of any one film, either for production expenditure or for acquisition expenditure, but not both.

13. The provisions to counter deferral beyond 15 years will, in cases where there is a guaranteed stream of income, restrict the relief in the proportion that 15 years bears to the length of the income stream.

14. The provisions to prevent groups of companies turning the tax deferral into a tax gain will require the companies to bring in the value of the film rights not yet brought into the tax charge as a trading receipt at the time of the exit event.

15. The provision to counter partnership abuse will prevent partners obtaining loss relief in excess of their capital contribution for which they are fully at risk, and also prevent such non-risk contributions from being counted when computing the exit charge under section 119 FA 2004 ('Exit charge for individuals benefited by film relief').

16. The measure aligning relief under section 42 with that under section 48 will ensure that the maximum amount of relief will be restricted to the amount incurred before the film was completed and payable within 4 months of completion.

Further advice

17. If you have any questions about these changes, please contact Graham Dean on 020 7147 2568. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

DISCLOSURE RULES: STAMP DUTY LAND TAX AND COMMERCIAL PROPERTY

Who is likely to be affected?

1. Accountants and lawyers who devise and market certain tax schemes and arrangements and clients who use them. Property companies and others who devise their own schemes in-house.

General description of the measure

2. These additional disclosure rules are designed to provide the Inland Revenue with information about schemes and arrangements intended to avoid Stamp Duty Land Tax (SDLT) on commercial property transactions in the UK. The information will enable risk assessment and, where appropriate, counteraction.

Operative date

3. Schemes and arrangements made available or implemented on or after 1 July 2005.

Current law and proposed revisions

4. Finance Act 2004 provides for promoters or users of schemes or arrangements, a main benefit of which might be expected to be a tax advantage, to disclose details of that scheme or arrangements to the Inland Revenue. The Act applies to all the direct taxes. However, regulations narrow the scope of the existing disclosure requirements to schemes and arrangements involving employment or the use of certain financial products where the tax advantage concerns income tax, corporation tax or capital gains tax.

5. The new rules will ensure promoters or users provide details to the Inland Revenue of schemes and arrangements whose use might be expected to provide, as a main benefit of using the scheme, an SDLT advantage concerning property which:

- is not residential property (as defined in section 116 FA 2003); and

- which has a market value of at least £5 million.

6. The Inland Revenue will not issue a reference number for such schemes and a promoter will have no obligation to convey a reference number to a client. Consequently, in most cases users of a scheme will have no obligation to provide the Inland Revenue with information. But in some circumstances the users themselves will be required to provide information about the scheme. This is where:

- the promoter is offshore;
- the user has devised the scheme in-house; or
- the promoter is a lawyer who cannot make a full disclosure without revealing legally privileged material.

In the last case the client can choose to waive the right to privilege and allow the lawyer to make the disclosure.

7. Further details will be included in draft regulations that will be published shortly, together with a partial Regulatory Impact Assessment, on the Inland Revenue website.

Further advice

8. If you have any questions about this change, please contact David Easton on 020 7147 2148 or Crispin Taylor on 020 7147 2793. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

AVOIDANCE THROUGH ARBITRAGE

Who is likely to be affected?

1. Legislation is introduced with effect from today to counter tax avoidance using arbitrage schemes that involve hybrid entities or hybrid instruments.
2. The legislation potentially applies to any person subject to corporation tax but, as it is targeted against highly contrived avoidance structures, it will not apply to most companies nor to the majority of transactions undertaken by companies.
3. In general it will apply where an arbitrage scheme using a hybrid entity or instrument results in:
 - A double deduction for the same expense
 - A UK deduction for the payer in circumstances where the recipient is not taxed on the receipt because, for example, a tax credit has eliminated liability to tax
 - Amounts being received by a company in a way that would not otherwise be taxable in the UK.

The hybrid entity or instrument will usually have been used deliberately to achieve one of these results.

4. The legislation will not normally apply if the recipient of the payment is a pension fund or other exempt body or if the recipient is not taxed on any of their profits. It will also not apply in the case of a permanent establishment solely because its expenses and receipts are recognised in two countries.

General description of the measure

5. Arbitrage is the exploitation of differences between or within national tax codes. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided.

6. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments (as detailed below) for tax avoidance purposes, but only if the Inland Revenue issues a notice directing that the legislation applies. If a notice is issued, a company must make or amend its self-assessment taking into account the legislation. The legislation will deny relief for deductions forming part of an arbitrage scheme and certain receipts will become taxable.

7. The Inland Revenue will give assistance under the established Code of Practice 10 procedures on the application of the legislation to specific cases. Detailed draft guidance on the application of the legislation is also available on the Inland Revenue's website from today at www.inlandrevenue.gov.uk.

Operative date

8. Legislation will apply to deductions and receipts arising or accruing on or after Budget Day. However, in order to allow companies to unwind arrangements with third parties, the legislation will not apply to schemes involving deductions that:

- do not involve connected parties, and
- are in place on or before 16 March 2005 and are terminated by 1 July 2005.

Proposed Provisions

9. The new legislation will apply in two situations. These are where:

- deductions are claimed by or allowed to a company in computing their profits or gains for corporation tax purposes; or
- amounts are received by a company in a way that would not otherwise be taxable.

The legislation deals with each situation separately.

Deductions

10. There are four conditions that will need to be satisfied before the Inland Revenue can issue a notice directing that the legislation should apply. These are:

- the company is a party to a scheme that involves a hybrid entity or a hybrid instrument (a "qualifying scheme");
- the qualifying scheme results in a UK tax advantage;
- the main purpose, or one of the main purposes, in adopting the qualifying scheme was the obtaining of the UK tax advantage; and
- the amount of the UK tax advantage is not minimal.

11. A **hybrid entity** is an entity that is recognised as a taxable person under one tax code, but whose profits, gains or losses are also within the scope of the same or another tax code for one or more other persons. This may be because, for example, two countries treat the same entity differently in their respective tax codes with one, say, treating it as a company taxable on its own income and the other

seeing it as a partnership with its partners taxable themselves on their shares of its income.

12. Hybrid entities do not include a permanent establishment the income of which is treated under a different tax code as the profits or gains of the same person i.e. the company of which it is a part.

13. A **hybrid instrument** is, for the purposes of the legislation, an instrument that contains one or more characteristics specified in the legislation. There are two sets of characteristics. The first applies to schemes involving instruments between any parties and the second applies only to schemes involving instruments between connected parties.

14. For all schemes, an instrument is a hybrid instrument when it has one or more of the following characteristics:

- the tax treatment of the instrument in the hands of the payer or recipient can be varied by an election;
- it is a share with a reasonable expectation of being converted into a security or a security with a reasonable expectation of being converted into a share;
- the UK gives a deduction for payments arising from or accruing under the instrument and the instrument is recognised as equity under generally accepted accounting practices.

15. In addition to the above characteristics, for those schemes involving instruments between connected parties, an instrument is a hybrid instrument if it has one or more of the following characteristics:

- it involves shares other than ordinary share capital
- it involves an instrument that splits income from its underlying principal and connected parties hold the split rights.

16. A **UK tax advantage** includes the types of tax advantage listed in Section 709(1) ICTA1988.

17. Where the legislation applies, a deduction for corporation tax purposes will be denied if and to the extent that:

- more than one deduction or an amount otherwise allowed for tax purposes is available for the same expense, whether in the UK or elsewhere, and the income accruing or arising under the scheme is only taxed once; or
- a deduction is available to the payer but the person receiving or entitled to receive payments is not liable to tax under that transaction or would be liable but for a deduction or relief derived from the scheme.

Receipts

18. The legislation applies more narrowly to receipts that seek to benefit from arbitrage. If the Inland Revenue issues a notice directing that the legislation should apply, there are four conditions that have to be satisfied:

- a company has entered into a scheme under which it receives an amount on which it is not liable to tax;
- that amount may to any extent be deducted from or allowed against taxable income of the person making the payment;
- the mismatch in tax treatment is a reasonable expectation of the parties to the provision; and
- the payment constitutes a contribution to the capital of the company (a “qualifying payment”).

19. Where all these conditions are satisfied, the amount received by the company will be treated as income chargeable to tax, unless it is already the subject of a charge to tax.

Notices

20. When the conditions for the application of the legislation are triggered, the Inland Revenue will issue a notice directing that the legislation should apply and indicating its view of the adjustment that should be made in the company’s self-assessment. Notices will not be issued without the approval of the Inland Revenue’s Head Office. The company must then either self assess (or amend an existing self-assessment) on that basis, or on such other basis as it sees fit, if it believes that the legislation should apply in a different way.

21. Where a company does not agree with the Inland Revenue’s view of the application of the legislation and therefore self assesses on a different basis, the issue will be resolved in the normal way through a self-assessment enquiry and the appeals procedures. An appeal can challenge whether the conditions required to trigger the legislation were met or what the effect of applying the legislation should be.

22. Even after the end of the enquiry period the Inland Revenue may still issue a notice. This will apply either where the failure to issue a notice was due to the fraudulent or negligent conduct of the taxpayer or certain other associated persons, or where the Inland Revenue could not reasonably have been expected to realise that a notice should have been issued based on the information available to it.

Penalties

23. No penalty is due if a notice was not issued before a return was made as in such circumstances the return cannot be incorrect. Once a notice has been issued directing that the legislation applies, penalties can arise if the taxpayer fraudulently or negligently fails to take account of the legislation. No penalty would arise, however, where the taxpayer takes a reasonable view that the legislation did not apply and accordingly takes no account of it in their return.

Further advice

24. Additional detailed draft guidance on the application of the legislation and definitions of all the terms used above is available today on the Inland Revenue's web-site: www.inlandrevenue.gov.uk The Inland Revenue would welcome comments on the draft guidance including areas where additional guidance would help.

25. The Inland Revenue will consider requests for advice about the legislation in specific cases, in accordance with established procedures set out in the Inland Revenue's Code of Practice 10. Where possible, we will confirm that no notice will be issued in respect of the disclosed transactions.

26. Comments on guidance and requests for advice should be sent to:

Andrew Hoar or Ken Almand
Revenue Policy (International)
3rd Floor (Central)
1 Parliament Street
London
SW1A 2BQ

Andrew.Hoar@ir.gsi.gov.uk

020 7147 2719

Ken.Almand@ir.gsi.gov.uk

020 7147 2650

16 March 2005

DOUBLE TAXATION RELIEF FOR TRADE RECEIPTS

Who is likely to be affected?

1. As announced at PBR in a Technical Note, and in the Paymaster General's Statement of 10 February, legislation will clarify the amount of double taxation relief (DTR) that is to be given when foreign tax is paid on income that is a trade receipt for UK tax purposes or on other income that is computed in a similar way for UK tax purposes (such as rents from foreign properties).

2. The legislation will therefore mainly affect those companies, individuals and partnerships who receive such income and who have previously calculated their DTR claims on a basis contrary to the Inland Revenue's published view.

General description of the measure

3. The purpose of DTR is to prevent the imposition of UK taxes resulting in double taxation on the same income, so credit should never exceed the amount of UK tax due in respect of the income that gave rise to the foreign tax payment.

4. Where tax is charged on the basis of a calculation of profits, it is necessary to determine the proportion of those profits that is properly attributable to the transactions that gave rise to the foreign tax, while excluding profits from other transactions that are independent of the foreign tax.

5. In practice, this means attributing expenses and profits or losses from related transactions to an item or items of income that represent trade receipts, in order to arrive at a figure of profit or loss attributable to the income in question. The proposed legislation determines the expenses and related transactions that should be taken into account, and those which should be excluded.

Expenses

6. The expenses to be taken into account are those incurred directly in earning an item of income, for example, brokerage fees on a share transaction by a financial trader, and indirect expenses such as general overheads. Direct expenses should be deducted from the income to which they relate, but indirect expenses are to be allocated on a just and reasonable basis.

7. In some trades where income is derived from an asset, changes in value of the asset are taken into account in calculating trade profits. In such a case income derived from the asset should be aggregated with gains or losses from the asset for the purposes of calculating the limit on DTR. For example, dividend income received in the context of a financial trade should be aggregated with gains or losses (whether realised or unrealised) from the same shareholding. The guidance published today gives more detail of how this works and addresses the issue of income earned in the course of derivatives trading.

8. Where arrangements are set up to place the expenses incurred in earning the income into other companies so as to avoid a restriction on DTR under this legislation, then it may be necessary to consider the expenses incurred in those other companies.

Aggregation of Financial Transactions

9. In practice it will not usually be possible to subdivide trade profits between each class of share, bond or other income bearing asset, including derivatives, held as part of a financial trade.

10. Therefore, the legislation will allow results to be aggregated, so that for example more than one class of shareholding is considered together. Any approximate result based upon aggregation will be acceptable only if all information that is available, or that can reasonably be made available, is used. However, if it can be shown that any given method of approximation is not likely to be materially different from a more precise but more resource-intensive method, such an approximation will be acceptable.

Transitional Rule

11. There is a transitional rule for the period from 16 March 2005 to 31 December 2005, which applies to foreign tax paid in respect of dividend income. For this type of foreign tax payment, nothing in this legislation will deny credit relief for more than half of the foreign tax paid by any person in respect of dividends received in this period.

Manufactured Overseas Dividends (MODs)

12. MOD set-off rules should be applied wholly independently of the limitation on DTR determined by the profit arising from a transaction.

Royalties

13. All foreign royalties derived from the same intangible asset are treated as a single item of foreign income with a single tax payment.

Operative date

14. All the above changes will be effective from today for companies and from 6 April for individuals.

Guidance

15. Detailed guidance on this measure is published today on the Inland Revenue website.

Further advice

16. If you have any questions about this change, please contact Andrew Page on 020 7147 2680. Further information about this and other Budget measures are available at www.inlandrevenue.gov.uk

16 March 2005

DOUBLE TAXATION RELIEF ANTI-AVOIDANCE

Who is likely to be affected?

1. Anti-avoidance legislation is introduced with effect from today to provide a generic response to counter highly contrived schemes or arrangements that give rise to excessive double taxation relief (DTR) claims. Other legislation announced today sets out the basis on which claims to DTR should be computed generally for trading and similar income (REV 19).
2. Most companies, individuals and partnerships do not use schemes or arrangements to create excessive DTR claims so they will not be affected by this anti-avoidance legislation.
3. Any company, individual or partnership that enters into such a scheme or arrangement to claim DTR with tax avoidance as one of their main purposes may be affected if the scheme or arrangement falls within one of the five prescribed circumstances described below. The legislation will only apply where the Inland Revenue issue a notice to direct that it does and the total of the credit claimed for foreign tax in any one year, including that claimed by any connected persons, is not minimal. Further, the legislation will only apply to claims for underlying tax relief in limited circumstances. The legislation is described in more detail from paragraph 5 below.
4. Separate legislation is also being introduced today to target two known avoidance schemes exploiting the legislation for relief of underlying foreign taxes. The first scheme seeks to circumvent the controlled foreign company (CFC) legislation and the second to obtain credit for underlying foreign tax on income treated as dividends in the UK, but for which the foreign payer gets a deduction as interest. Further detail of these provisions is given from paragraph 15 below.

General description of the anti-avoidance measure

5. This anti-avoidance legislation will apply only if at least one of five circumstances specified in legislation applies. These circumstances and other aspects of the legislation are explained in greater detail in draft Inland Revenue

guidance published today. Where the legislation applies, it cancels the increase in DTR that results from the scheme or arrangement.

6. Where the conditions for the legislation to apply are met, the Inland Revenue will issue a notice directing the taxpayer to self assess their tax liabilities taking into account the legislation. The notice will also give the Inland Revenue's view of what effect the legislation should have on the self-assessment.

Operative date

7. For most purposes the legislation will take effect from Budget Day. This legislation also gives effect to the announcement made on 10 February 2005 that claims would be denied in respect of income acquired for the purposes of securing excessive DTR (such as "dividend buying" where extra income is deliberately bought and the DTR claimed to be due is more than the UK tax due on that income).

Legislation

8. Where a taxpayer claims relief for foreign tax as part of a scheme or arrangement with tax avoidance as its main purpose or one of its main purposes, and where the scheme or arrangement falls within the prescribed circumstances described below, then the DTR claim will be limited so as to cancel the effect of the scheme or arrangement.

9. The prescribed circumstances in which the legislation will apply are where one or more of the following are true:

- the foreign tax is not properly attributable to the source from which the income is derived
- the payer of the foreign tax and any person associated with the transactions have not together suffered the full cost of the foreign tax
- a claim or election that could have been made and which would have reduced the foreign tax credit eligible for relief was not made, or a claim or an election that was made increased the amount of relief
- the foreign tax credit reduces the tax payable to less than would have been due if the transaction had not occurred
- the income subject to foreign tax was acquired as consideration for a tax deductible payment

10. In the case of underlying tax, the legislation will apply only where, had the foreign company that paid the foreign tax been UK resident and made a claim for credit for that foreign tax, the legislation would have applied to the foreign company. This means that tax avoidance would have been one of the main purposes and the scheme or arrangement would have fallen within at least one of the five prescribed circumstances.

11. When the legislation applies, the Inland Revenue will issue a notice directing that it does. The taxpayer must take their own view on how the legislation should apply and self-assess, or amend an existing self-assessment, in the normal way.

12. In the event that a taxpayer does not agree with the Inland Revenue's view of the application of the legislation, the issue will be resolved in the normal way through the self-assessment enquiry and appeals procedures. An appeal can challenge whether the conditions required to trigger the legislation were met or what the effect of applying the legislation should be.

'Discovery' notices

13. When the period in which the Inland Revenue may enquire into a return has closed, it may issue a notice in certain circumstances. This will apply either where the inability of the Inland Revenue to issue a notice was due to the fraudulent or negligent conduct of the taxpayer or certain other associated persons, or where the Inland Revenue could not reasonably have been expected to realise that a notice should have been issued based on the information available to it.

Penalties

14. No penalty is due if a notice is not issued before a return was made as in such circumstances the return cannot be incorrect. Once a notice has been made directing that the legislation applies, penalties can arise if the taxpayer fraudulently or negligently fails to take account of the legislation within a period of 90 days from the issue of the notice. No penalty would arise, however, where the taxpayer takes a reasonable and tenable view that the legislation did not apply and accordingly takes no account of it in their return.

Targeted Action on Underlying Tax Schemes

15. Where a foreign jurisdiction taxes companies on a consolidated basis, Section 803A ICTA treats all group companies in that jurisdiction as a single entity. Avoidance schemes notified under the avoidance disclosure regime have sought to exploit this legislation to circumvent the controlled foreign company (CFC) legislation. Consequently, changes will be made with effect from today to the operation of this provision to limit its scope so that it does not apply to a CFC for which exemption is available under the acceptable distribution policy (ADP) test.

16. Further disclosures have concerned schemes that seek to make use of the fact that certain payments may be characterised as interest for tax purposes in another jurisdiction but as a dividend under UK law. The payer obtains a tax deduction for the payment in the other jurisdiction, but in the UK credit for underlying tax is given against the receipt.

17. With effect from today no underlying tax relief will be given if a tax deduction is given in another jurisdiction calculated by reference to the amount of the dividend.

18. More detailed guidance on these underlying tax changes is available on the Inland Revenue website from today at www.inlandrevenue.gov.uk

Further advice

19. If you have any questions about either the anti-avoidance legislation or the specific underlying tax changes, please contact Andrew Page on 020 7147 2680. Further information about these and other Budget measures are available at www.inlandrevenue.gov.uk

16 March 2005

LIFE INSURANCE COMPANIES

Who is likely to be affected?

1. These measures affect life insurance companies.

General description of the measure

2. Measures relating to life insurance companies were announced in the PBR 2004 when draft Finance Bill clauses and regulations were published. As a result of consultation undertaken since PBR, the proposed legislation to implement some of these measures has been significantly revised so that the measures more closely meets the policy objectives. The measures to be included in the Finance Bill will:

- prevent certain transfers of business from one life insurance company to another artificially reducing taxable trading profits, in particular where the transferred liabilities exceed the transferred assets or the transferee's long-term fund holds shares in the transferor. The relevant measures will apply to all transfers of business on or after 2 December 2004;
- clarify the circumstances in which companies can treat receipts as "notional" and therefore exclude them from their returns of taxable trading profits. The relevant measure will apply to accounting periods ending on or after 2 December 2004;
- clarify the circumstances in which companies can use additional revenue accounts ("sub-funds") to obtain a more favourable tax apportionment of their investment return. The relevant measure will apply to accounting periods beginning on or after 1 January 2005; and
- provide for the updating of the tax treatment of income and gains attributable to assets not needed to pay policyholder benefits and ensure that, for accounting periods beginning on or after 1 January 2005, such income and gains will be taxed at normal corporation tax rates.

Operative date

3. See above.

Current law and proposed revisions

4. A full explanatory note was published at the time of the PBR announcement describing the proposed changes.

5. In the light of representations received from the industry, changes have been made to the proposals.

6. The changes relating to transfers of business are as follows:

- under the original proposals there is a deemed trading receipt where transferred liabilities exceed assets; an excess of assets over liabilities is excluded from the computation of trading profits. In comparing assets and liabilities, debts will now be taken into account only if they are more than the excess of the value of transferred assets over the amount shown in the revenue account;
- the original proposals provided that the measure of liabilities used in this comparison could not be reduced by reinsurance. That measure now can be reduced where the reinsurance was entered into by the transferor, the liabilities were so reduced before transfer and the reduction was reflected in computations of the transferor's trading profits; and
- where business is transferred from one insurance company to another whose long-term insurance fund wholly or partly owns it, the amount of the reduction in the value of the transferee's shareholding in the transferor will give rise to a trading receipt. This will now be reduced by the value of any assets transferred from the transferor's shareholder fund that itself constitutes a trading receipt.

7. The proposals about excess assets (the "inherited estate") were included in draft regulations at PBR. On 10 December the Government announced that the proposals would be included in the Finance Bill instead. Since then there has been a consultation exercise with the industry to refine the proposals. The outcome of that consultation is that the Finance Bill will contain an amendment to existing regulation making powers. This will enable the apportionment rules applicable to life assurance companies to be modified in a way that achieves the Government's object in bringing forward the original proposals. The regulations when made will apply to accounting periods beginning on or after 1 January 2005.

8. The proposals about sub-funds will be amended to deal with a case not covered by the draft legislation. This is where a non-profit fund is embedded within a with-profits fund. In that case the with-profits fund will be treated as consisting only of those parts which are not included in the non-profit fund.

Further advice

9. If you have any questions about these changes, please contact Richard Thomas on 020 7147 2558 or Robert Peel on 020 7147 2614. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 22

16 March 2005

FINANCIAL AVOIDANCE

Who is likely to be affected?

1. Persons liable to income tax or corporation tax who enter into avoidance arrangements which involve a financial product.

General description of the measure

2. This measure blocks a number of avoidance schemes which have been disclosed to the Revenue under the disclosure rules introduced in Finance Act 2004.

3. The following schemes are blocked:

- a) Avoidance of income tax by individuals using stripped corporate bonds.
- b) Avoidance of tax by companies acquiring debt securities by way of stock loans or sale and repurchase (repo) agreements.
- c) Exploitation by companies of a hole in the loss buying rules for non-trading loan relationship losses.
- d) Generation of artificial capital losses by companies using capital redemption bonds.
- e) Conversion by companies of interest-like income into either a capital gain or a tax nothing using shares or derivatives over shares.
- f) Exploitation of the group continuity rules for loan relationships and derivative contracts to convert income into capital or take advantage of different accounting methods used by different group companies.
- g) Rent factoring schemes which attempt to get around the Finance Act 2000 anti-avoidance rules by arranging deals which slightly exceed the 15-year rule.
- h) Schemes which exploit the relief available to companies for annual payments as charges on income.

4. In addition, the measure will also put it beyond doubt that an income tax scheme involving a stock loan of gilts which is said to result in a double deduction under the manufactured interest and Accrued Income Scheme rules will not work.

5. Announcements were made in respect of the first two schemes on 2 December 2004, and in respect of the third and fourth schemes on 10 February 2005 (see News release 03/05).

Operative date

6. The changes apply to schemes (a) and (b) above from 2 December 2004, and apply to schemes (c) and (d) from 10 February 2005.

7. The changes apply to scheme (e) in relation to profits accruing on or after Budget day.

8. The changes apply to scheme (f) in cases where a company ceases to be a member of a group on or after Budget day.

9. The changes apply to scheme (g) for arrangements entered into on or after Budget day. In addition, for interposed lease cases where the finance arrangement was entered into after 20 March 2000 but before 16 March 2005 and to which the rent factoring rules did not apply, no deduction will be available for rent paid which relates to a period after 16 March 2005.

10. The changes apply to scheme (h) in respect of payments made on or after Budget day.

11. The clarification of the rules for income tax relief on manufactured interest will apply to payments made on or after Budget day.

12. The other measures apply to profits accruing on or after Budget day.

Current law and proposed revisions

13. In outline, the proposed changes will block the schemes as follows:

a) Strips of corporate bonds will be brought within the Relevant Discounted Securities regime so that profits accruing will be taxed as income in the same way as applies to gilt strips.

b) The loan relationships rules will be amended to ensure that all profits, and not just interest, in respect of debt securities acquired by stock loan or repo are brought into tax.

c) The loss buying rules will be amended to ensure that non-trading loan relationship losses cannot be carried forward beyond the date of a change of ownership which is accompanied by one of the events listed in section 768B(1) ICTA 1988.

- d) Generation of artificial capital losses on capital redemption bonds will be prevented by bringing such bonds within the scope of the loan relationships rules for companies, which means that no allowable loss can arise in respect of those bonds.
- e) Conversion of income into capital or into a tax nothing will be stopped by:
- bringing certain shares within the ambit of the loan relationship rules;
 - ensuring that all derivatives over shares are within the derivative contracts rules, unless the contract is used to hedge an asset to which the chargeable gains rules apply; and
 - extending the scope of the income charge under the loan relationships rules on simple money debts to include discount and profits relating to interest.
- f) Exploitation of the group continuity rules will be stopped by adding a de-grouping charge on similar lines to that which exists for the equivalent capital gains and intangibles fixed assets rule for intra-group transfers. It will also be made explicit that where an asset is transferred between two group companies which have different accounting methods, no profits can fall out of charge. Finally, the loan relationships arm's length rule will be amended to ensure it interacts properly with the group continuity rule so that there are no cases where neither rule applies.
- g) The 15-year exception for rent factoring schemes will be abolished.
- h) Annuities and annual payments (other than donations to charity and payments falling within section 587B ICTA) will no longer be treated as charges on income, so that relief will fall to be given under the management expenses regime which has its own anti-avoidance rule.

Further advice

14. If you have any questions about these changes, please contact Chris Kerr on 020 7147 2619 or Richard Thomas on 020 7147 2558. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

CORPORATE INTANGIBLE ASSETS

Who is likely to be affected?

1. Companies (and their related parties) acquiring or disposing of intangible fixed assets.

General description of the measure

2. A number of amendments to the corporate intangible assets legislation in Schedule 29 to the Finance Act 2002 ("Schedule 29") are being introduced. These comprise:

- an amendment of the related party rules to ensure that they achieve their intended effect;
- amendment of the market value rules to ensure that:
 - other tax provisions, concerned with company distributions and employment income, work as intended; and
 - the market value rules and capital gains tax gifts relief rules interact correctly; and
- the addition of a further class of asset (payment entitlement under the single payment scheme for farmers) to those which are not eligible to be replacement assets for the purposes of capital gains rollover relief (or hold-over relief in the case of depreciating assets) when acquired by companies.

3. In addition, the power in section 86 of the Finance Act 1993, which permits further classes to be added by way of Treasury order to the list of assets which can qualify for capital gains rollover relief is being amended. The amendment will ensure that if any further classes are added, then any necessary consequential amendments to Schedule 29 may be made under this power.

Operative date

4. The first two changes detailed above (affecting the related party and market value rules) apply with effect from Budget Day – see paragraphs 6 and 8 below. The third change (concerning payment entitlement under the single payment scheme) will apply to acquisitions of payment entitlement on or after 22 March 2005.

The amendment described in paragraph 3 above will apply to orders made on or after the passing of the Finance Act 2005.

Current law and proposed revisions

Related party rules

5. In broad terms, relief under Schedule 29 is available for intangible fixed assets created on or after 1 April 2002 when the Schedule came into force, or (if created earlier) transferred between unrelated parties on or after that date. Thus assets created before 1 April 2002 and transferred between 'related parties' on or after this date are normally excluded. These excluded assets are termed 'existing assets'.

6. This measure stops a recently disclosed avoidance scheme that exploits a loophole in the related party rules. It amends the related party rules to ensure that a participator (or associate of a participator) in a company that controls, or has a major interest in, another close company will be a related party of the second company. This change will take effect in relation to transfers of assets, and to debits or credits to be brought into account, on or after Budget Day. For the purpose of bringing into account debits and credits under Schedule 29 on or after Budget Day, the amended rules are deemed to have been part of the Schedule as originally enacted.

Market value rules

7. The 'market value' rules ensure that, in many circumstances, transfers of intangible assets between related parties are deemed to take place at market value rather than the price agreed between the parties. This applies for all purposes of "the Taxes Acts" (as defined in paragraph 142 of Schedule 29) as regards both the transferor and the transferee. The purpose of these rules is to prevent related parties from gaining a tax advantage by agreeing an artificially high or low price for an intangible asset.

8. For transfers of assets made on or after Budget Day this measure ensures the market value rule works as intended by limiting its effect in two circumstances:

- where an intangible asset is transferred from a company to a related party at under-value or to a company from a related party at over-value, the measure will ensure that Schedule 29 will not prevent taxable distribution or employment income from arising; and
- where capital gains tax gifts relief is claimed on an intangible asset gifted to a related party company, the measure will ensure that the company's acquisition cost for the purposes of Schedule 29 is the market value less the amount of the held-over gain.

Payment entitlement under the single payment scheme

9. A new class of assets, consisting of payment entitlement under the single payment scheme for farmers, will shortly be added to the classes of qualifying

assets listed in section 155 of the Taxation of Chargeable Gains Act 1992 ('TCGA')¹. A consequential change to Schedule 29 is needed as a result of this addition. The change ensures that companies cannot claim relief under section 152, 153 or 154 TCGA (rollover and hold-over relief) where the new asset (within the meaning given by section 152) falls within the new class. This is because in the hands of companies these assets will be within Schedule 29 and not within the charge to corporation tax on capital gains.

10. The amendment to Section 86 of the Finance Act 1993 is concerned with possible future additions by Treasury order to the classes of assets listed in section 155 TCGA. The amendment will obviate the need for further consequential changes to be made to Schedule 29 by primary legislation. Instead such consequential changes may be made by the Treasury order concerned.

Further advice

11. If you have any questions about this change, please contact Richard Hopwood on 020 7147 2589. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

¹ The Finance Act 1993, Section 86(2) (Single Payment Scheme) Order 2005 SI2005/409

16 March 2005

CHARGEABLE GAINS: TRUSTEES' CHANGE OF RESIDENCE

Who is likely to be affected?

1. Those likely to be affected are:
 - trustees of settlements who:
 - at some time in a tax year, are resident or ordinarily resident in the UK and not also resident for tax treaty purposes in a territory outside the UK, and
 - at a different time in the same tax year, are either resident or ordinarily resident in the UK but resident for tax treaty purposes in a territory outside the UK, or neither resident nor ordinarily resident in the UK; and
 - certain UK-resident or ordinarily resident settlors or beneficiaries of settlements whose trustees fall into the category described above.

General description of the measure

2. The measure will ensure that trustees of settlements cannot exploit the terms of certain double taxation agreements (DTAs) to avoid being within the charge to UK tax in respect of chargeable gains if, at some time in the tax year when the gain in question arises, they are resident in the UK and not simultaneously resident in a territory outside the UK for tax treaty purposes.

Operative date

3. The measure has effect in relation to disposals of settled property by trustees on or after today.

Current law and proposed revisions

4. For capital gains tax (CGT) purposes, the trustees of a settlement are treated as being a single and continuing body of persons, distinct from the persons who are trustees. The body is treated as being resident and ordinarily resident in the UK unless the trust is administered outside the UK (except in certain circumstances where it is administered in the UK by professional trustees) and the trustees, or a majority of them, are neither resident nor ordinarily resident in the UK.

5. Trustees who are resident or ordinarily resident in the UK for any part of a tax year are chargeable to CGT in respect of any chargeable gains arising to them in the year (subject to what is said about DTAs in paragraph 6 below). However, in certain circumstances, section 77(1) of the Taxation of Chargeable Gains Act 1992 (TCGA) provides that the trustees of a settlement in which a UK-resident or ordinarily resident settlor has an interest are not chargeable to CGT in respect of any such chargeable gains which are referable to property originating from the settlor. Instead, chargeable gains of an amount calculated by reference to those gains are treated as arising to the settlor. The settlor is able to obtain reimbursement from the trustees for any CGT paid in consequence.

6. Where trustees dispose of settled property during a part of a tax year when they are resident in a territory outside the UK, their liability to UK CGT may be subject to the terms of a DTA with the territory in question. Some trustees have sought to exploit this situation by disposing of assets when they are resident in a territory where no, or only a small, liability to tax will arise in respect of the gains in question. If the terms of the relevant DTA prevent the UK from taxing the capital gains, no charge to UK tax can arise.

7. The new measure will ensure that liability to tax on chargeable gains cannot be avoided in this way. It will provide that nothing in any DTA can be read as preventing the UK having taxing rights over any chargeable gains which arise to the trustees of a settlement on the disposal of settled property in any case where the disposal is made in a tax year in which the trustees are at some time resident or ordinarily resident in the UK and not simultaneously treated for tax treaty purposes as being resident in a territory outside the UK.

8. REV 10 *Modernising the Tax System for Trusts* announces a special tax regime which may apply in relation to settlements having vulnerable beneficiaries in circumstances where a claim is made for the tax year concerned. Where that regime applies for a tax year in relation to a beneficiary who is resident or ordinarily resident in the UK, the beneficiary will, in effect, be regarded for the purposes of section 77(1) TCGA as though he or she were a settlor of the settlement. If the trustees exploit the terms of a DTA in the way described in paragraph 6 above the beneficiary may be affected by the new measure announced in this Note. Where this happens, the beneficiary will be able to obtain reimbursement from the trustees for any CGT charged on him or her as a result of the application of the measure.

9. Where a liability to tax also arises in the foreign territory concerned in respect of any chargeable gains affected by this measure, an appropriate amount of relief from double taxation will be available in accordance with the normal rules.

10. The measure does not affect the treatment of chargeable gains which arise to the trustees of a settlement on the disposal of settled property in a tax year throughout which they are neither resident nor ordinarily resident in the UK.

Further advice

11. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Mark Abani on 020 7147 2765 or mark.abani@ir.gsi.gov.uk will deal with more detailed enquiries. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

CHARGEABLE GAINS: TEMPORARY NON-RESIDENTS

Who is likely to be affected?

1. Individuals who:
 - return to the UK having been temporarily neither resident nor ordinarily resident in the UK; or
 - are resident or ordinarily resident in the UK but have been temporarily treated for tax treaty purposes as resident in a territory outside the UK.

General description of the measure

2. The measure will ensure that individuals are not able to exploit the terms of any Double Taxation Agreement (DTA) to secure that capital gains arising to them while they are temporarily outside the charge to UK tax escape being charged to capital gains tax (CGT) under the rules for temporary non-residents which were introduced by the Finance Act 1998.

Operative date

3. The measure has effect from today. The detailed commencement effects are described in paragraphs 14, 15 and 18 to 20 below.

Current law and proposed revisions

4. Section 2(1) of the Taxation of Chargeable Gains Act 1992 (TCGA) provides that individuals are chargeable to CGT in respect of capital gains arising to them in any tax year during any part of which they are resident in the UK or during which they are ordinarily resident in the UK.
5. Section 10A TCGA provides that individuals who, throughout a period encompassing fewer than five complete tax years, are neither resident nor ordinarily resident in the UK may be chargeable to CGT in the tax year of their return as though all the capital gains and losses which arose to them during the "intervening tax years" (that is, the tax years between the tax year of departure and the tax year of return) had instead arisen to them in the tax year of return. Section 10A applies in

relation to an individual only if certain “residence requirements” are satisfied for each of at least four of the seven tax years immediately preceding the tax year of departure. An individual satisfies the residence requirements for a tax year if he or she is resident in the UK during any part of the year or ordinarily resident in the UK during the year.

6. In any case where section 10A has effect in relation to an individual and foreign tax has been paid in respect of any of the gains which are brought within the charge to CGT, an appropriate amount of relief from double taxation will be available in the UK or in the territory of temporary residence, in accordance with the normal rules.

7. Where individuals have realised gains during an intervening tax year, the Inland Revenue has accepted the view that their liability to CGT in their tax year of return in respect of those gains was subject to the terms of the DTA between the UK and the territory in which they were resident for tax purposes when the gains arose. Some individuals have sought to exploit this situation by disposing of assets when they are resident in a territory where no, or only a small, liability to tax will arise in respect of the gains in question on the basis that the terms of the relevant DTA prevent the UK from taxing the capital gains, so no charge to UK tax can arise under section 10A.

8. However, the Inland Revenue now considers that those DTAs do not preclude a tax charge under section 10A in these circumstances. The Government is therefore acting to provide certainty and put the matter beyond doubt by announcing this measure.

9. The new measure also remedies a weakness in the definition of the “residence requirements” in section 10A so that it will not be possible for an individual to avoid a charge to CGT under that provision by arranging to be resident for tax treaty purposes in a territory outside the UK while simultaneously being resident or ordinarily resident in the UK. In such a case, under the law as it stands at present, section 10A cannot have any effect in relation to capital gains realised during a temporary period of such “Treaty non-residence” because the individual has, as a matter of fact, not ceased to be resident or ordinarily resident in the UK.

Main changes

10. The main changes made by new measure will confirm the Revenue’s revised view of the law mentioned in paragraph 8 above and rectify the problems mentioned in paragraphs 7 and 9 above.

11. First, the measure will secure that nothing in the terms of any DTA can be read as having effect to prevent a tax charge arising under section 10A in respect of any chargeable gains which are treated by that provision as arising to any individual in his or her tax year of return. As explained in paragraph 6 above, relief is given in the usual way in respect of any foreign tax paid in respect of the gains.

12. Second, the measure will provide that, for the purposes of determining whether an individual satisfies the residence requirements for a tax year for the

purposes of section 10A, any time at which the individual is resident or ordinarily resident in the UK but is also Treaty non-resident will be treated as a time when he or she is neither resident nor ordinarily resident in the UK.

13. The provision described in paragraph 12 above will not, however, have effect to postpone a charge to CGT in respect of any chargeable gains which arise to the individual under section 13 TCGA (which has effect to attribute gains arising to offshore companies to UK-based participators in certain cases) or any of sections 86, 87 and 89(2) TCGA (which have effect to attribute gains of offshore trusts to UK-based settlors or beneficiaries in certain circumstances) in a tax year which becomes an intervening tax year solely on account of this change to the rules.

14. The provisions mentioned in paragraphs 11 and 12 above will have effect in any case where the tax year of departure is, or (on the assumption that the provision mentioned in paragraph 12 above had always had effect) would be, 2005-06 or a later year.

15. Those provisions will also have effect in any case where the tax year of departure is, or (on that assumption) would be, 2004-05 and there is a time in that year on or after today at which the individual concerned is resident or ordinarily resident in the UK and not Treaty non-resident.

16. For the purposes of this note, an individual is “Treaty non-resident” at any time at which there exist “double taxation relief arrangements” (as defined in section 288(1) TCGA) for the purposes of which he or she falls to be regarded as resident in a territory outside the UK.

Minor changes

17. The measure also makes some minor changes to the rules in section 10A which determine, in the case of a capital gain arising to an individual on the disposal of an asset in an intervening tax year, whether the gain is to be treated as arising to him or her in the tax year of return:

- the rule in subsection (3)(a) concerning the individual’s residence status at the time when he or she acquired the asset is to be modified so as to cater additionally for cases where, at that time, the individual was resident or ordinarily resident in the UK but Treaty non-resident;
- the meaning of “relevant disposal” in subsection (8) is to be modified to provide that a disposal of an asset is a relevant disposal if the person making the disposal acquired the asset at a time when that person was resident or ordinarily resident in the UK and was not Treaty non-resident; and
- the list of CGT “rollover relief” provisions in subsection (3)(d) is to be expanded to include reference to section 153(1)(b) TCGA, which is a provision that provides rollover relief on the replacement of business assets.

18. The provision mentioned in the first bullet in paragraph 17 above will have the same commencement effect as the provisions described in paragraphs 11 and 12 above.

19. The provision mentioned in the second bullet in paragraph 17 above will have effect for the purposes of determining whether a disposal of an asset is a relevant disposal in any case in which the person making the disposal acquired the asset on or after today.

20. The provision mentioned in the third bullet in paragraph 17 above will have effect in relation to relevant disposals made on or after today.

Further advice

21. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Mark Abani on 020 7147 2765 or mark.abani@ir.gsi.gov.uk will deal with more detailed enquiries. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

CHARGEABLE GAINS: LOCATION OF ASSETS ETC

Who is likely to be affected?

1. Those likely to be affected are:
 - individuals who are resident or ordinarily resident, but not domiciled, in the UK; and
 - persons neither resident nor ordinarily resident in the UK who are carrying on a trade, profession or vocation through a branch, agency or permanent establishment in the UK.

General description of the measure

2. The main effect of the new measure will be to amend the statutory provisions which determine where certain assets are located for the purposes of tax on chargeable gains. In some cases the new rules will provide that assets (broadly, ones which are related to the UK, such as bearer shares in UK companies, but which may in certain circumstances be regarded as located outside the UK under current law) are treated as being located in the UK for such purposes. The measure also makes some minor changes to provisions which apply where a non-resident company is carrying on a trade in the UK through a permanent establishment in the UK.

Operative date

3. The main amendments to the rules will have effect to determine whether, at any time falling on or after today, any assets affected by the changes are located in the UK at the time concerned. In certain cases, the revised rules will determine where assets of a particular description are located at any such time. The minor changes also take effect from today, as described in paragraph 9 below.

Current law and proposed revisions

Main changes

4. In most circumstances, a person resident or ordinarily resident in the UK who realises a chargeable gain on disposing of an asset is liable to UK tax on the gain regardless of where the asset is situated. Special rules apply, however:

- where an individual is resident or ordinarily resident, but not domiciled, in the UK. Such a person does not incur any liability to UK tax in relation to chargeable gains arising to him or her on disposals of assets situated outside the UK unless amounts in respect of such gains are received in the UK; and
- where a person is neither resident nor ordinarily resident in the UK, but carries on a trade, profession or vocation in the UK through a branch or agency or permanent establishment. A UK tax liability arises on, for example, any chargeable gains the person realises on disposals of assets situated in the UK which were used for the purposes of the trade before the time the gain arose.

5. Section 275 of the Taxation of Chargeable Gains Act 1992 (TCGA) provides rules which determine the location of certain assets for the purposes of that Act. These determine, for example, that registered shares and securities are generally situated where the register is situated (or where the principal register is situated, if there is more than one). This is subject to the proviso that shares or securities issued by a municipal or governmental authority, or by a body created by any such authority, are situated in the country of the authority in question. But the rules in section 275 do not provide a comprehensive code for determining the location of all types of asset for TCGA purposes. Where section 275 has no effect, the location is determined by common law.

6. In some circumstances, people have taken advantage of the absence of a specific rule to secure that the asset they dispose of is not treated as being situated in the UK for TCGA purposes, even where it derives most, or all, of its value from the UK. For example, it may be possible for a UK-resident but non-UK domiciled individual to arrange for a disposal of bearer shares in a UK company to take place outside the UK. Under common law the shares disposed of will be situated where the bearer instrument is present at the time of the disposal.

7. The new measure will provide specific rules for certain assets which are not currently within the scope of section 275. The changes will have effect to provide that:

- all shares in, and debentures of, companies incorporated in the UK, whether registered or not, will be treated as situated in the UK, subject to the proviso mentioned at paragraph 5 above relating to municipal or governmental authorities;
- the scope of the existing rules in section 275 which apply in relation to securities will be extended so that they apply in relation to debentures – this means, for example, that, subject to the proviso relating to municipal or governmental

authorities, all registered debentures (rather than just those which are securities) of a company which is not incorporated in the UK will be treated as being situated where they are registered or, if there is more than one register, where the principal register is situated;

- membership rights in a company which has no share capital will be treated in the same way as shares and debentures;
- any question as to where, for TCGA purposes, assets which are rights under the law of a territory outside the UK that correspond to patents, trade marks or registered designs are located, or whether licences or other rights in respect of such corresponding rights are situated in the UK, will be determined in the same way as the corresponding question is determined in relation to patents, trade marks and registered designs;
- any question as to whether, for TCGA purposes, assets which are rights under the law of a territory outside the UK that correspond to copyright, design rights, or franchises are situated in the UK, or whether licences or other rights in respect of such corresponding rights are so situated, will be determined in the same way as the corresponding question is determined in relation to copyright, design rights and franchises;
- any intangible asset falling within the description which follows whose location is not otherwise determined by a specific TCGA rule will be treated as situated in the UK at all times for TCGA purposes if it is subject to UK law at the time of its creation. For this purpose, an “intangible asset” is a thing in action (such as a contract or a right to sue) or other intangible or incorporeal property, or anything which under the law of a country or territory outside the United Kingdom corresponds to, or is similar to, a thing in action or other such property. And such an asset is subject to UK law at any time when any right or interest which comprises the asset or forms part of it is governed by, or otherwise subject to, or enforceable under, the law of any part of the UK;
- any such intangible assets that are options or futures which are not subject to UK law at the time of their creation will be treated as situated in the UK at all times if they can be satisfied (wholly or in part) by delivery of an asset which is situated in the UK, or if any part of the underlying subject matter is shares in, or debentures of, a company incorporated in the UK which are yet to be issued. This rule will have effect to “look through” any number of options or futures which are not subject to UK law to an underlying subject matter which includes, or comprises, something other than an option or future which is not subject to UK law. The rule will not apply, however, in relation to options or futures which can be settled only in cash (such as financial futures over the FTSE 100 index), rather than by delivery of any underlying subject matter; and
- where an asset whose location is determined by a TCGA provision is co-owned by two or more persons (whether jointly or in common), the location for TCGA purposes of the interest in that asset which is held by a co-owner will be the same as the location of the asset would be if that person were to own it wholly.

The question as to whether such an interest in an asset is situated in the United Kingdom for TCGA purposes will be determined in the same way.

8. The changes will have a knock-on effect in relation to those provisions of the accrued income scheme (AIS) which use the rules in section 275 to determine whether securities are situated in the UK for their purposes. The provisions in question appear in sections 715 and 723 of the Income and Corporation Taxes Act 1988. These sections ensure that the AIS does not apply to a non-resident (unless trading in the UK through a branch of agency) in respect of securities situated in the UK, and allow relief from a charge where the proceeds from a transfer of securities situated outside the UK cannot be remitted to the UK because of the laws of the territory in which those securities are situated.

Minor changes

9. The measure also updates some statutory cross-references in the TCGA in certain provisions which apply where a non-resident company trades through a permanent establishment in the UK. The amendments make some consequential changes which were overlooked when section 10B, which makes provision in such cases, was introduced in the Finance Act 2003 to replace section 10(3). To be specific:

- the reference to “section 10” in the rules relating to losses in section 16(3) is to be replaced by “section 10 or 10B” with effect for accounting periods ending on or after today; and
- the references to “section 10(3)” in the rules relating to groups of companies in section 179A(12) and in the substantial shareholdings rules in paragraph 3(2) of Schedule 7AC are to be changed to “section 10B” with effect from today.

Further advice

10. If you have any questions about these changes, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Colin Weston on 020 7147 2764 or colin.weston@ir.gsi.gov.uk will deal with more detailed enquiries. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 27

16 March 2005

GIFT AID AND ADMISSIONS

Who is likely to be affected?

1. Charities who normally charge the public for the right of admission to view property preserved, maintained, kept or created by a charity in relation to their charitable work who grant visitors free or reduced rate admission in return for a donation. The measure will not affect charities where admission is normally free to the public and any donation is made on a voluntary basis.

General description of the measure

2. As announced in the 2004 Pre-Budget Report, this measure will stop charities simply reclassifying admission fees as donations on which Gift Aid can be claimed and will instead restore the key principle of Gift Aid, to promote additional giving to charity. The measure will also extend the types of charities that can benefit from the exemption which currently allows certain charities to offer free admission to donors without that being treated as a benefit when deciding whether Gift Aid applies.

Operative date

3. For admissions on or after 6 April 2006.

Current law and proposed revisions

4. Gift Aid is a scheme that enables individuals to make tax effective donations to charity. Gift Aid donations are treated as having been made after the deduction of income tax at the basic rate. As charities are exempt from tax on that income, they are entitled to reclaim an amount equal to the basic rate of tax suffered on the donation. This means that charities benefit from an additional 28 pence for every pound given. The donor must have paid enough tax to cover the amount repaid to the charity and must make it clear to the charity that they want Gift Aid to apply.

5. The scheme contains rules determining the maximum level of benefit a donor can receive in return for making a donation. Broadly, benefits are restricted to 25% of the donation, up to a maximum of £250 in any year. If the maximum level is exceeded, the donation will not be treated as a Gift Aid donation.

6. Currently certain heritage and conservation charities can offer free admission to donors in return for a donation to allow them to view the work of the Charity, without the admission being considered a benefit for Gift Aid purposes. From April 2006 we will broaden the scope of the exemption to apply where any type of charity grants to the public the right to pay to view property preserved, maintained, kept or created by a charity in relation to their charitable work.

7. Where the conditions in paragraph 6 are met and, instead of paying the admission charge, the visitor makes a donation, the new rules provide two alternative situations where the Gift Aid may apply.

- The first is where a right of admission given in return for the gift is valid for a period of at least one year for all times that the general public can gain admission. The number of visits within this twelve-month period should not be restricted.
- The second situation is where the right of admission is for less than one year. The gift must be at least 10% more than the amount that any member of the public would have to pay to gain the same right of admission. So a donation giving a right of admission for one day would need to be at least 10% more than a member of the public would pay for a ticket giving admission for a day. If there is not a comparable ticket the value of the right of admission will not be disregarded in determining whether the benefits received in consequence of the gift exceed those allowed by the normal Gift Aid rules.

8. Where the new rules are met by the charity, the whole of the gift will be eligible for Gift Aid.

Further advice

9. If you have any questions about this change, please contact Adrian Cooper on 020 7147 2782, or the charities helpline on 0845 302 0203. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

TAX AND CIVIL PARTNERS

Who is likely to be affected?

1. Same-sex couples.

General description of the measure

2. The measure paves the way for changes to all existing tax legislation, both primary and secondary, so that civil partners formed as a result of the Civil Partnership Act 2004 (CPA) will be treated the same as married couples for tax purposes. It gives the Inland Revenue the power to introduce regulations to effect those changes.

Operative date

3. The tax changes will take effect from 5 December 2005 – the date the CPA comes into force.

Current law and proposed revisions

4. Married and unmarried couples are usually treated differently for tax purposes. For example a husband and wife are protected from tax charges that might otherwise arise if they transfer assets between them. This protection is not available to unmarried couples. On the other hand, there are situations where husband or wives can be taxed on certain benefits that are provided for their spouse but if the persons concerned are unmarried that is not the case. There are, in addition, limited circumstances in which unmarried couples are treated as if they were married.

5. The CPA creates an entirely new legal status of civil partner, giving same-sex couples in the UK the opportunity of acquiring a legal status for their relationship. Couples who enter into a civil partnership will gain a package of rights and responsibilities reflecting those already available to a married couple.

6. For tax purposes, the Government has announced that civil partners will be treated the same as married couples. Therefore, from the start of the civil

partnership scheme, tax charges and reliefs and anti-avoidance rules will apply equally to married couples and civil partners, and those treated as such.

7. Full details will be published with the regulations. The key areas affected include:

Inheritance Tax (IHT)

8. Transfers between married couples in lifetime or on death are generally exempt from IHT without limit. On a par with married couples, civil partners will be able to make gifts or bequests to their partners with the benefit of IHT exemption.

9. There will be consequential changes elsewhere in the IHT code to extend to civil partners other provisions currently applying to spouses. For example, IHT anti-avoidance provisions that apply to marriage will be applied to civil partnerships.

Capital Gains Tax (CGT)

10. CGT will apply in relation to civil partners as it applies in relation to married couples. In particular:

- Private Residence Relief. Only one property owned by a couple, whether that property is owned solely or jointly, may be treated as the principal private residence of either of them at any time for CGT purposes and thus qualify for private residence relief;
- transfers of assets between persons who are civil partners who are living together will be on a no-gain no-loss basis, and thus not attract an immediate CGT charge; and
- civil partners will be “connected persons” in the same way as husbands and wives. They will also be connected with certain other persons, such as close relatives of their civil partner, in the same way as husbands and wives. Furthermore, where one partner settles property into a settlement under which the other partner can benefit, the settlor may be liable to CGT by reference to capital gains realised by the trustees if the relevant conditions as to the residence of the settlor, and certain other conditions, are met.

ISAs

11. There are two minor areas where the ISA rules will be amended to cover a civil partner: firstly the eligibility of a spouse of a Crown employee serving overseas to subscribe to an ISA; and secondly the ability of a husband or wife to subscribe to an ISA account on behalf of their spouse who lacks the mental capacity to operate their own ISA account.

Bank and building society interest paid to individuals

12. Banks and building societies are required by law to deduct tax at the lower rate (20%) before paying interest to savers, unless they have authority to pay the

interest gross, that is, without tax taken off. The category of people who can sign a gross registration declaration (on form R85) on behalf of a person who lacks the mental capacity to operate their own bank or building society account will be extended to include civil partners.

Pension Schemes (other than state)

13. The current pension tax legislation will be amended so that references to husband, wife, ex-husband, ex-wife, spouse, ex-spouse, surviving spouse, widow, widower will include civil partner, former civil partner and surviving civil partner under the terms of the CPA. Changes will also be made to the pension tax simplification legislation that takes effect from 6 April 2006 to account for the terms of the CPA.

Settlements

14. Anti-avoidance legislation will be extended to include civil partners in the same way as spouses. The anti-avoidance Settlements legislation prevents people avoiding tax by transferring their income to other people who pay less tax. There are special rules for husbands and wives and these will be extended to civil partners.

Beneficial Ownership - Sections 282A and 282B ICTA 1988

15. Married couples frequently own property jointly and the Inland Revenue treats them as though the property is held equally so any income arising is taxed 50/50. However, if the couple are not in fact entitled to half the income each, they can elect to have income from property they hold jointly taxed on a basis other than 50/50. Civil partners will be treated in exactly the same way.

Company Control Tests

16. Section 416 of the Income and Corporation Taxes Act provides various tests for identifying who controls a company. It also deems a company to be under the control of a person if it is controlled by an associate of that person. The term "associate" is defined in section 417 and includes husband or wife. The definition of "associate" will also include civil partner.

Stamp Duty and Stamp Duty Land Tax (SDLT)

17. There is currently an exemption from stamp duty and SDLT for transactions carried out in connection with divorce such as a transfer of shares or the transfer of the marital home from joint ownership into the sole ownership of one of the ex-spouses. There will be a similar exemption for transactions carried out in connection with the dissolution of a civil partnership.

Transfer of assets abroad

18. Civil partners will be treated in the same way as married persons under the transfer of assets abroad legislation in sections 739-746 ICTA 1988. This legislation aims to prevent individuals avoiding income tax by means of the transfer of assets.

It applies where, as a result of a transfer and/or any associated operations, income becomes payable to persons resident or domiciled outside the UK.

19. The legislation provides that an income tax charge may arise on the husband or wife of an individual who makes a transfer of assets, where the spouse is involved in the transfer or associated operations. This will in future apply equally to civil partners.

20. In addition, we will extend to civil partners the practice of not normally seeking to tax under section 739 UK domiciled individuals in relation to income of their non-domiciled husband or wife, where that spouse would be outside the section 739 charge because of his or her entitlement to the remittance basis.

Married couple's allowance

21. Married couple's allowance is currently available to married couples where one of the spouses was born before 6 April 1935. Civil partners will have similar rights so that from the date that the registration scheme commences, civil partnerships and also new marriages meeting the age criteria will have an allowance based on the income of the highest earner. There will be no change to the arrangements for existing marriages.

Blind person's allowance

22. The Blind Person's Allowance (BPA) contains a provision that any unused allowance (because the person does not have sufficient income) can be transferred to their spouse. Surplus BPA will also be transferable to a civil partner.

Further advice

23. If you have any questions about these proposals, please contact Mark Taylor on 020 7147 2386 or Sara Woollard 020 7147 2380. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

EXTENSION OF TAX EXEMPTION ON OUTPLACEMENT COUNSELLING AND TRAINING EXPENSES TO PART-TIME EMPLOYEES

Who is likely to be affected?

1. Part-time employees provided with outplacement counselling services and retraining course expenses by their employer when they lose their job.

General description of the measure

2. This measure will allow both part and full-time employees to receive tax free outplacement counselling and retraining expenses when they lose their job. Currently a tax exemption is only available to employees who work full-time.
3. It also extends the duration of the retraining course covered by the exemption from one year to two and removes the condition that the course has to be full-time or substantially full-time.

Operative date

4. From 6 April 2005.

Current law and proposed revisions

5. Sections 310 and 311 of the Income Tax (Earnings and Pensions) Act 2003 allow an employer to provide outplacement counselling and retraining courses for employees who lose their jobs without the employee incurring an income tax charge. One of the conditions for this exemption is that the employee must work full-time, another is that any course undertaken should last no more than a year.
6. The proposed revision extends the current exemption to include part-time workers and that any course undertaken can last up to a maximum of two years.

Further advice

7. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

COMPANY CAR AND FUEL BENEFIT TAX

Who is likely to be affected?

1. Employees provided with a car that is available for their private use and free private fuel where provided; and employers who bear Class 1A National Insurance on the taxable benefit of a provided car and fuel.

General description of the measure

2. The measure:

- sets the company car fuel figure for 2005/06;
- simplifies the current alternative fuel discounts for company cars; and
- sets the company car tax charge for 2007/08;

Operative date

3. 6 April 2005 – company car fuel multiplier

6 April 2006 – simplification of the current alternative fuel discount

6 April 2007 – company car tax.

Current law and proposed revisions

Company car fuel

4. An additional taxable benefit arises if the employee receives free fuel for the company car for their private use. The taxable benefit calculation was reformed in April 2003 to align the charge with the environmental principles of the company car tax system. Since April 2003 the fuel benefit charge has been calculated by applying the company car tax appropriate percentage to a set figure. In 2004/05 the figure was £14,400.

5. For 2005/06 the figure for the company car fuel benefit charge will be frozen at £14,400.

Simplification to current alternative fuel discounts

6. Cars that are capable of running on alternative fuel such as LPG, CNG or battery-propelled cars, currently enjoy a discount from the equivalent company car percentage. There are different calculations of the discounts for bi-fuel gas and petrol cars depending on whether they are manufactured or converted to run on gas as well as petrol before or after the type approval.

7. The current discounts are:

- cost of conversion disregarded plus 1% discount for bi-fuel gas and petrol cars converted after type approval;
- 1% discount plus an additional 1% for each 20g/km the car's emissions fall below the level of CO₂ qualifying for the minimum petrol percentage charge for bi-fuel gas and petrol cars manufactured or converted before type approval;
- 2% discount plus an additional 1% for each 20g/km the car's emissions fall below the level of CO₂ qualifying for the minimum petrol percentage charge for hybrid petrol and electric cars; and
- 6% discount for electric-only cars.

8. For 2006/07 the discounts for cars that run on alternative fuels will be simplified to:

- cost of conversion disregarded for bi-fuel gas and petrol cars converted after type approval, no additional percentage discount;
- 2% discount for bi-fuel gas and petrol cars manufactured or converted before type approval;
- 3% discount for hybrid electric and petrol cars; and
- the 6% discount for electric-only cars will be maintained.

Company car tax

9. Where a car is made available for an employee's private use a taxable benefit arises. Company car tax was reformed in April 2002 and is now calculated by applying a percentage to the list price of the car. The percentage is related to the CO₂ emissions of the car and ranges from 15% to 35% (in 1% increments) for a petrol car. Diesel cars that do not meet Euro IV emissions standards attract a 3% supplement on the petrol percentages (capped at 35%). The 2004 Pre-Budget Report announced that from April 2006, the waiver of the 3% supplement for diesel cars meeting Euro IV standards will be withdrawn for all cars registered from 1 January 2006.

10. The CO₂ emissions qualifying for the minimum petrol percentage charge have been set as follows:

2005/06	140 grams per kilometre of CO ₂
2006/07	140 grams per kilometre of CO ₂

11. For 2007/08 the level of CO₂ emissions qualifying for the minimum petroleum percentage (15%) will be frozen at 140 grams per kilometre of CO₂.

Further advice

12. If you have any questions about this change, please contact the Employer Helpline on 0845 7143 143 or your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

COMPUTER AND BICYCLE EXEMPTIONS

Who is likely to be affected?

1. Employees who purchase a computer or bicycle that has previously been loaned to them or another employee by their employer. Employers who loan and subsequently sell computers or bicycles to their employees.

General description of the measure

2. To change the benefit in kind rules on employer-provided computers and bicycles to ensure that no tax charge arises where employees buy previously loaned computers or bicycles from their employer at market value.

Operative date

3. 6 April 2005.

Current law and proposed revisions

4. Computers and bicycles loaned to employees by their employer are exempt from the tax charge on the benefit arising. For computers the exemption applies to the first £500 of annual benefit.

5. The Government-sponsored Home Computer Initiative (HCI) encourages employers to set up computer loan schemes allowing employees to take advantage of the exemption for computers and generally envisages that employees will buy computers from their employer after the loan period ends (typically 3 years) at market value. Currently if the employee decides to buy the computer (or bicycle) at the end of the loan period for market value a tax charge may still arise because section 206 (3) (5) Income Tax (Earnings and Pensions) Act 2003 (ITEPA) provides for an alternative basis of valuation where ownership of an asset that has previously been provided as a benefit in kind transfers to an employee.

6. This measure will disapply the alternative basis of valuation for computers and bicycles that have benefited from the exemption at S.320 or S.244 ITEPA. This will mean that where ownership of a computer or bicycle that has previously been loaned to an employee is transferred to an employee the valuation rule which

applies in deciding whether any benefit arises at transfer will always be the market value rule in S.206 (2).

Further advice

7. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details, or the Employer helpline on 0845 7143 143. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

Budget 2005



REV 32

16 March 2005

PAYMENTS MADE BY EMPLOYERS TO EMPLOYEES WHEN IN FULL-TIME ATTENDANCE AT UNIVERSITIES AND TECHNICAL COLLEGES

Who is likely to be affected?

1. Employees who receive payments from their employers whilst they are in full-time education and the employers who make such payments.

General description of the measure

2. Updating and modernising the Statement of Practice 4/86 (SP 4/86) - "Payments Made By Employers To Employees When In Full-Time Attendance At Universities And Technical Colleges" and introducing a change to National Insurance Contributions (NICs) regulations to align NICs treatment with that of tax. The main changes are:

- payments of up to £15,000 (previously £7,000) for an academic year can be paid free of tax to an employee for periods of attendance on a full-time educational course at a recognised educational establishment;
- further simplification to remove the link to amounts paid by public awarding bodies; and
- introducing a new NICs regulation so that these types of payments (up to £15,000) can also be paid free of Class 1 NICs. Previously Class 1 NICs would have been exempted if the payments were made under a training contract, but would have been liable if done so under an employment contract.

Operative date

3. The tax treatment will start for payments made for the 2005-06 academic year, commencing 1 September 2005.

4. The NICs treatment will start for payments made for the 2005-06 academic year, commencing 1 September 2005 as set out in NICs regulations laid on 16 March 2005.

Current law and proposed revisions

5. The current SP 4/86 "Scholarship And Apprenticeship Schemes At Universities And Technical Colleges" sets out the circumstances when payments made by an employer to an employee for periods of attendance on a full-time course can be exempted from income tax. The SP states that:

- the employee must be attending a full-time course at a recognised educational establishment, for at least twenty weeks a year;
- the payments can cover lodging allowance, subsistence and travelling allowances, but exclude any university fees or fees payable by the employee;
- the payments do not exceed the higher of £7,000 or an amount, which an individual in similar personal circumstances would have received as a grant from a public awarding body (e.g. studentship from one of the research councils).

6. Most of the conditions and limitations remain the same, but the revised Statement of Practice:

- raises the limit from £7,000 to £15,000;
- has simpler language and layout, for example, clarifying that this measure is linked to an academic year;
- removes the link to amounts paid by awarding bodies;
- will be reviewed annually.

7. SPs are not used for NICs, but the opportunity has been taken to bring the NICs and tax treatment into line for payments made to employees in these circumstances with new NICs regulations.

8. Any payments made after 16 March 2005 that relate to the 2004-05 academic year should be paid under the SP4/86 conditions that existed prior to the 16 March 2005 update.

Further advice

9. A copy of the updated SP and NICs regulations are published today on the Inland Revenue Budget 2005 website. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

TAX TREATMENT OF ARMED FORCES PENSION, COMPENSATION AND EARLY DEPARTURE PAYMENT SCHEMES BENEFITS

Who is likely to be affected?

1. Recipients of benefits payable under new Armed Forces Pension, Compensation and Early Departure Payments Schemes.

General description of the measure

2. Adjustment to existing legislation to ensure that existing tax exemption applicable to certain benefits payable under current arrangements will also apply to comparable benefits payable under new schemes. This will make sure that beneficiaries under the new schemes will be in the same tax position as those receiving benefits under the existing schemes.
3. Also exempts from a charge to income tax, lump sum in-service compensation payments, paid through the Armed Forces Compensation Scheme (AFCS).

Operative date

4. New schemes will pay benefits from 6 April 2005; tax exemption will, where appropriate, apply from the same date.

Current law and proposed revisions

5. Current legislation provides tax-exemption for pensions and other benefits granted on account of medical unfitness attributed to or aggravated by service in the Armed Forces.
6. Adjustments to the Income Tax (Earnings and Pensions) Act 2003 will be necessary to replicate the current tax treatment in relation to equivalent benefits payable under the new schemes.

Further advice

7. If you have any questions about this change, please contact your local Inland Revenue Enquiry Office: see the Telephone Directory for details. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk

16 March 2005

CAPITAL ALLOWANCES: RENOVATION OF BUSINESS PREMISES IN DISADVANTAGED AREAS

Who is likely to be affected?

1. Any individual or company, who incurs capital expenditure on bringing qualifying business premises (owned or let) back into business use.

General description of the measure

2. The scheme will enable people or companies, who own or lease property that has been vacant for a year or more in one of the designated disadvantaged areas of the UK, to claim immediate, full tax relief on their capital spending on the conversion or renovation of the property, in order to bring it back into business use.

Operative date

3. The scheme will apply once state aid approval has been granted.

Current law and proposed revisions

4. In broad terms, capital allowances enable the cost of capital assets to be written-off against a business's taxable profits. Generally, different classes of assets qualify for allowances at different rates. Two of the main rates are:

- 25 per cent a year on the "reducing balance" basis for most plant and machinery expenditure (with a 40 per cent first-year capital allowance for expenditure by small and medium-sized enterprises on most plant and machinery); and
- 4 per cent a year on the "straight-line" basis for expenditure on industrial and agricultural buildings and certain hotels.

5. The proposed new Business Premises Renovation Allowance (BPRA) scheme will provide 100 per cent first-year capital allowances for capital expenditure on renovating or converting vacant business properties in the designated disadvantaged areas. Thus, BPRA would provide an enhanced rate of allowance for expenditure that currently qualifies for plant and machinery, industrial buildings or agricultural buildings allowances, and a new relief for expenditure on commercial

buildings (such as offices and shops), which do not currently qualify for any capital allowances.

Further advice

6. If you have any questions about this change, please contact an Inland Revenue Policy Official on 020 7147 2541. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk and more information about this scheme is available at:
www.inlandrevenue.gov.uk/pbr2004/sup_cap_allowance.pdf

RING FENCE CORPORATION TAX AND SUPPLEMENTARY CHARGE INSTALMENT PAYMENTS FOR OIL COMPANIES

Who is likely to be affected?

1. Oil companies that have tax to pay on profits or gains from extracting oil or gas in the UK or on the UK continental shelf, or from rights to such oil or gas ("ring fence profits").

General description of the measure

2. Corporation tax and supplementary charge payable by oil companies on their ring fence profits is to be paid by way of three equal instalments rather than quarterly instalments as at present. There will be transitional arrangements for the first accounting period ending after 30 June 2005 which will leave the amount due in respect of the first two quarterly instalments unchanged but require the remainder of the estimated liability for that accounting period to be paid on the third instalment date.

Operative date

3. The new rules will apply to the tax liability of companies with ring fence profits in respect of accounting periods ending after 30 June 2005. For companies with calendar year accounting periods the first instalment affected will be that due on 14 January 2006.

Current law and proposed revisions

4. Oil companies with ring fence profits currently pay all their corporation tax (including that payable on their ring fence profits) and supplementary charge under the general system for the payment of corporation tax by quarterly instalments for large companies. For a company with a 12-month accounting period tax is therefore paid in four equal instalments in the seventh, tenth, thirteenth and sixteenth months following the start of the accounting period.
5. In future companies with ring fence profits will need to estimate separately the corporation tax and supplementary charge due on their ring fence profits and pay

that tax by way of three instalments rather than four. The corporation tax due on their other profits will continue to be paid by quarterly instalments.

Due date for instalments of tax on ring fence profits

6. For accounting periods ending after 30 June 2005 the due date for instalments of tax on ring fence profits will be as follows:

- 1st instalment - 6 months and 13 days from the start of the accounting period;
- 2nd instalment - 3 months from the first instalment due date; and
- 3rd instalment - 14 days from the end of the accounting period

Amounts to be paid on due dates

7. For the first accounting period ending after 30 June 2005 the amount of corporation tax and supplementary charge liability on ring fence profits to be paid on the relevant instalment dates will be -

- 1st instalment - one quarter of estimated liability for the period (as at present);
- 2nd instalment - one quarter of estimated liability for the period (as at present);
- and
- 3rd instalment - balance of estimated liability for the period

8. For subsequent accounting periods the amount of corporation tax and supplementary charge liability on ring fence profits to be paid on the relevant instalment dates will be –

- 1st instalment - one third of estimated liability for the period;
- 2nd instalment - one third of estimated liability for the period; and
- 3rd instalment - balance of estimated liability for the period

9. For accounting periods of less than 12 months the final instalment will be due 14 days from the end of the accounting period. Earlier instalments will only be due if the dates for those instalments fall earlier than the date for the final instalment.

10. Rules for the payment of interest and penalties will follow the rules that apply at present for quarterly instalments.

11. The new rules for instalment payments will be contained in regulations entitled 'The Corporation Tax (Instalment Payments)(Amendment) Regulations 2005' which will be laid before the House of Commons shortly.

Further advice

12. If you have any questions about this change, please contact Ruth Bulteel, IR Energy Group, on 020 7438 6466. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

STAMP DUTY LAND TAX: ANTI-AVOIDANCE AND OTHER PROVISIONS

Who is likely to be affected?

1. Property vendors and purchasers who use avoidance schemes to avoid stamp duty land tax.

General description of the measure

2. This measure blocks a number of stamp duty land tax avoidance schemes. These schemes cover:

- Use of group relief (paragraph 4a below);
- Use of acquisition relief (paragraph 4b);
- Grants of leases by bare trustees to their principal (paragraph 4c);
- Certain variations of leases to remove restrictive covenants (paragraph 4d);
- Use of repayable loans or deposits as consideration (paragraph 4e);
- Reduction of market value by encumbrance (paragraph 4f);
- Use of 'sub-sale relief' in alternative finance transactions (paragraph 4g); and
- Use of partnerships (paragraph 4h).

Operative date

3. For all provisions land transactions with an effective date of 17 March 2005 or later. However, transactions effected in pursuance of contracts entered into on or before 16 March 2005 will not be affected by the provisions, unless:

- there is a variation of the contract, or an assignment of rights under the contract, after 16 March 2005;
- the transaction is effected in consequence of the exercise after 16 March 2005 of any option, right of pre-emption or similar right; or
- after 16 March 2005 there is any assignment, sub-sale or similar transaction in respect of all or part of the subject matter, as a result of which a person other than the contracting purchaser becomes entitled to call for a conveyance.

Current law and proposed revisions

4. The provisions are as follows:

(a) changes to the group relief provisions in Part 1 of Schedule 7 Finance Act 2003. At present group relief is clawed back if the transferee company ceases to be a member of the same group as the transferor company within three years of the transfer. This is subject to various let-outs, for example where the transferor leaves the group in certain circumstances. The new provisions will provide that, additionally:

- where there is a change of control of the transferee company and group relief is not clawed back; and
- group relief claimed by the transferee company will be clawed back if the company is not in a group relationship with a previous transferor which transferred the property within three years of the change of control and a claim to group relief was made at that time.

Example

A transfers to B, which transfers to C, which transfers to D, all with the benefit of group relief and within a three-year period. Still, in that three-year period D ceases to be a member of the same group as C. The group relief on the C–D transfer is clawed back unless one of the let-outs applies, for example because C has left the group. Under the new rules, if one of the let-outs does apply then group relief is nevertheless clawed back if D has ceased to be a member of the same group as A.

(b) changes to the acquisition relief provisions in Part 3 of Schedule 7 Finance Act 2003. The legislation currently refers to an ‘undertaking’. The new provisions require that the ‘undertaking’ must be a trade and must not be a trade consisting wholly or mainly in land transactions;

(c) changes to the provisions on transactions by or with bare trustees, so far as they affect the grant of new leases. The provisions of paragraph 3 of Schedule 16 Finance Act 2003 (which provide that the acts and property of a bare trustee are attributed to the beneficiary) will not apply to the grant of a lease. In other words, the fact that one of the parties to a lease is a bare trustee will be ignored in determining the charge on the grant of a new lease;

(d) at present the variation of a lease to reduce the rent is treated as the acquisition of a chargeable interest by the tenant. This will be extended to include any variation of a lease where the tenant gives chargeable consideration other than rent;

(e) changes to the rules on contingent consideration to provide that where consideration is in the form of a ‘loan’ or ‘deposit’ the contingency of repayment is ignored;

- (f) changes to the charge on the sale element of a sale and lease-back (or lease and lease-back) transaction. At present (because the transaction is an exchange) the charge is on the market value of the freehold or head lease. There will be a new rule that requires that market value be determined ignoring any effect of the lease back, or of a prior agreement to lease back;
- (g) a change to the interaction between sections 45 and 73 Finance Act 2003, so that 'sub-sale relief' under the last sentence of section 45(3) is not available where the sale to the ultimate purchaser is a 'second transaction' which benefits from relief under section 73.

Example

A financial institution buys land and sells it on to an individual. On the sale to the individual the conditions for relief in section 73 are satisfied. Under the new rules, no 'sub-sale relief' is available on the initial purchase by the financial institution.

- (h) changes will be made to the charge on partnership transactions so that there will be a charge where land is transferred into a partnership and the transferor takes money out of the partnership within three years.

Further advice

5. If you have any questions about these changes, please contact Crispin Taylor on 020 7147 2793. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk



16 March 2005

LANDLORD'S ENERGY SAVING ALLOWANCE

Who is likely to be affected?

1. Individual landlords (and other landlords who pay income tax) who let residential property.

General description of the measure

2. The scope of the Landlord's Energy Saving Allowance (LESA) will be extended to include solid wall insulation.

Operative date

3. 7 April 2005.

Current law and proposed revisions

4. Under section 31A, Income and Corporation Taxes Act 1988 (if enacted, clause 312, Income Tax (Trading and Other Income) (ITTOI) Bill from 6 April 2005), landlords who pay income tax may claim a deduction, the LESA, against profits for expenditure to install loft insulation or cavity wall insulation in dwelling houses which they let. The maximum amount which may be claimed is limited to £1,500 per building.

5. Regulations will be made under clause 312(5)(c) ITTOI Bill to enable landlords also to claim the allowance for expenditure to install solid wall insulation in dwelling houses which they let.

Further advice

6. If you have any questions about this change, please contact your local Inland Revenue Enquiry centre: see the Telephone Directory for details. Information about Budget measures is available on the Inland Revenue website at www.inlandrevenue.gov.uk