CUSTOMS AND EXCISE RESOLUTION 58 | FINANCE BILL 2003 CLAUSE 190

EXPLANATORY NOTES

CLAUSE 190: CLIMATE CHANGE LEVY (CCL): ELECTRICITY FROM RENEWABLE SOURCES ETC

SUMMARY

1. Clause 190 provides for the levy accounting requirements to ensure that a supplier of exempt renewable source electricity or exempt combined heat and power (CHP) electricity accounts for the levy on the difference where, at the end of a 2-year averaging period, the sales of such electricity to final consumers exceed the amount the supplier has purchased or generated (i.e. there is a deficit).

DETAILS OF THE CLAUSE

2. Subsection (1) announces the amendment of Schedule 6 to the Finance Act 2000 (c. 17) (climate change levy) as follows.

3. Subsection (2) substitutes sub-paragraphs (6) to (8) of paragraph 20 *(exemption under 19: averaging periods)* with a new sub-paragraph (6). This provides for levy to be accounted for on the difference whenever an averaging period for renewable source electricity ends with a deficit.

4. Subsection (3) substitutes sub-paragraphs (6) to (8) of paragraph 20B *(exemption under 20A: averaging periods)* with a new sub-paragraph (6). This provides for levy to be accounted for on the difference whenever an averaging period for CHP electricity ends with a deficit.

5. Subsection (4) provides that the measure has effect for relevant averaging periods for renewable source electricity that end on or after 31 March 2003.

6. Subsection (5) has effect for relevant averaging periods that end on or after 1 April 2003 following the introduction of the CCL exemption for indirect supplies of CHP-generated electricity.

BACKGROUND

7. Paragraphs 20 and 20B of Schedule 6 to the Finance Act 2000 cover the rules for balancing and averaging periods in relation to supplies of renewable source and CHP generated electricity. This mechanism exists because some renewable source generation and CHP generation are

unpredictable. It enables energy suppliers to balance their purchases and production with supplies of renewable source or CHP generated electricity over a maximum averaging period of two years. If at the end of an averaging period supplies exceed purchases and production of renewable source electricity or CHP electricity, the supplier must account for levy on the debit balance at that time.

8. This clause properly amends the typographical mistakes in the original legislation and gives proper effect to the exemptions.

EXPLANATORY NOTES

CLAUSE 191: HIGHER RATE OF TAX: DIVIDED COMPANIES

SUMMARY

1. Clause 191 amends the applicable insurance premium tax (IPT) legislation so as to bring cells or divisions of Protected Cell Companies (PCCs) and similar companies within the ambit of the IPT higher rate as if they were separate corporate persons and so within the "connected persons" definition in the legislation. This will prevent this type of company from being used to avoid the higher rate of IPT. The clause defines this type of company as a divided company.

DETAILS OF THE CLAUSE

2. Paragraph (1) inserts a new paragraph 3A into Schedule 6A to the Finance Act 1994.

3. Subparagraph 3A(1) provides that an insurance contract, provided by a divided company, in relation to a motor car or a motor cycle will be liable to the higher rate of IPT where, if any division of the divided company was a separate person, the supplier of the car or motor cycle would be connected to it.

4. Subparagraph 3A(2) similarly provides that an insurance contract, provided by a divided company, in relation to a domestic appliance will be liable to the higher rate of IPT where, if any division of the divided company was a separate person, the supplier of the domestic appliance would be connected to it.

5. Subparagraph 3A(3) provides that where the insurance is provided free of charge it will not liable to the higher rate of IPT.

6. Subparagraph 3A(4) limits the application of subparagraph 3A(1) to insurance provided by a divided company which is attributable to a risk relating to a motor car or motor cycle supplied by a supplier with whom the division would, if it was a separate person, be connected.

7. Subparagraph 3A(5) limits the application of subparagraph 3A(2) to insurance provided by a divided company which is attributable to a risk relating to a domestic appliance supplied by a supplier with whom the division would, if it was a separate person, be connected.

8. Subparagraph 3A(6) defines a divided company. The characteristics of a divided company are; that it has segregated assets and liabilities; and that creditors of the company will only have a claim against particular assets of the company. A division of a divided company is an identifiable part of the company where the assets and liabilities have been so segregated.

9. Subparagraph 3A(7) provides that "free of charge" has the same meaning as in paragraphs 2 and 3 of Schedule 6A to the Finance Act 1994.

10. Subparagraph 3A(8) provides that all other expressions used in this paragraph have the same meaning as in paragraphs 2 and 3 of Schedule 6A to the Finance Act 1994.

11. Paragraph (2) provides that this clause shall take effect from Royal Assent.

BACKGROUND

12. Protected Cell Companies (PCCs) ordinarily have within them units called cells. These cells can be owned and run independently of each other and their assets and liabilities are segregated from the assets and liabilities of other cells and from any non-cellular assets (while in principle the assets of a PCC can be entirely non-cellular, it is the cellular nature of these companies that is likely to be utilised for commercial purposes, including tax avoidance).

13. Because similar types of company that exist in various parts of the world are not universally described as "protected cell companies", in order to ensure that the relevant use of such companies is caught by this legislation, the draft clause uses the phrase "divided company".

14. Higher rate IPT was introduced in 1997 to counter the tax distortion arising from contract restructuring in the motor, domestic appliance and travel sectors. In the case of the motor and domestic

appliance (but not travel) sectors liability to the higher rate is based on the insurance being sold or provided by a supplier of relevant goods (motor cars, motor cycles or domestic appliances) or by a person connected to them (eg a broker or insurer).

15. The definition of connected persons in the higher rate IPT legislation, in the case of companies, depends on whether another person has a controlling interest in the company. Because of the cellular structure of PCCs, a person can wholly own a cell of a PCC but, despite this, may only have a minority interest in the PCC overall. Thus PCCs can be used to avoid the higher rate of IPT.

16. This clause seeks to redress the balance by making insurance supplied by a PCC liable to the higher rate of IPT if any cell of a PCC would, if it was a separate person, be connected to a supplier of relevant goods.

BOARD OF INLAND REVENUE **FINANCE BILL 2003**
RESOLUTION 60 **CLAUSE 192**
SCHEDULE 40

EXPLANATORY NOTE

CLAUSE 192 AND SCHEDULE 40: COMPANIES ACQUIRING THEIR OWN SHARES

SUMMARY

1. Due to changes in company law, listed companies will be able to acquire shares in themselves ("own shares"), hold and dispose of them. Own shares held in this way are often called "treasury shares". This clause and schedule treat own shares held without cancellation as if they are cancelled for tax purposes, and as newly issued shares if they are subsequently sold.

DETAILS OF THE CLAUSE

2. Subsection 1 explains that this clause applies where a company acquires its own shares by any means including by purchase or by issue to it of bonus shares. It is effective for income, corporation, capital gains and inheritance tax purposes.

3. Subsection 2 provides that on acquisition of own shares by a company, those shares do not become an asset.

4. Subsection 3 provides that although own shares are acquired or held by a company, the company is not treated as a member of itself. This is so even if the shares are entered in the company's register of members.

5. Subsection 4 is subject to Subsection 5. It requires that the issued share capital is reduced by the nominal value of own shares acquired by the company and treats those shares as cancelled. If, as a matter of fact, the own shares including bonus shares held by a company are subsequently cancelled, that cancellation is ignored and accordingly there is no disposal of an asset or allowable loss for chargeable gains tax purposes.

6. Subsection 5 treats own shares which are bonus shares issued to the company as not having been issued. Therefore, they cannot be treated as issued share capital and cannot be treated as cancelled on acquisition for the purposes of subsection (4).

7. Subsection (6) applies where, as a matter of fact, a company holds any of its own shares at a time when it issues bonus shares in respect of those shares or any class of them. In such circumstances, subsection (6) provides for the company's holding of its own shares to be taken into account in determining whether the issuing of the bonus shares constitutes a "reorganisation" of the company's share capital for the purposes of sections 126 to 131 of the Taxation of Chargeable Gains Act 1992 (TCGA).

8. This ensures that the bonus shares must be issued on a pro rata basis to all the holders of the company's shares (or of the shares comprised in the class of shares in question) if the "same asset" provision in section 127 of the TCGA is to apply. The "same asset" provision secures that the acquisition of the bonus shares by the shareholders concerned is not treated as a separate acquisition for the purposes of tax on chargeable gains. It provides that the bonus shares are instead treated as though they were acquired at the same time as the shares in respect of which they were issued and that they are treated as part of the same holding.

9. Subsection (7) makes it clear that the reference in subsection (6) to the application of section 126 of the TCGA is strictly limited to its application in relation to reorganisations of a company's share capital.

10. Subsection 8 is about the disposal to a person by a company of its own shares. On disposal

a. they are no longer treated as cancelled and bonus shares treated as not having been issued under Subsection 5 are treated as having been issued and not treated as cancelled. All these shares are "relevant shares",

b. the disposal of the relevant shares by the company to that person is not treated as a disposal by the company but is treated as a new issue of shares at that time,

c. the person is treated as having subscribed for the relevant shares just as if they had been new shares,

d. the amount subscribed for the shares is treated as the amount or value payable (the consideration) for them on disposal by the company,

e. if the consideration does not exceed the nominal value of the shares, the amount of share capital is treated as that amount of consideration. For example, £1 shares sold for £0.75 will have share capital for tax purposes of £0.75, not £1,

f. if the consideration exceeds the nominal value of the shares, those shares are treated as if they had been issued at a premium of that excess. Therefore, the nominal value will represent an amount of share capital and the excess the amount of premium. This is the same tax treatment as that provided for genuinely "new" shares issued at a premium.

11. Subsection 9 excludes from these provisions own shares purchased and sold by share dealers where they are taken into account in computing the profits of the business.

12. Subsection 10 introduces Schedule 40.

13. Subsection 11 defines "bonus shares" and "Taxes Acts". It also explains that the provisions are relevant only to companies which have a share capital.

14. Subsection 12 provide for the provisions to become effective for shares acquired on or after an appointed day.

DETAILS OF THE SCHEDULE

15. Paragraph 1 provides for an exception to the rules within clause 192 for venture capital trusts (VCTs). It inserts two new sub-paragraphs into Schedule 15B to the Taxes Act 1988 (ICTA 1988). New sub-paragraph (10) of Schedule 15B ICTA 1988) prevents an individual being eligible for income tax relief on subscription for shares which by virtue of subsection 8 of clause 192 would otherwise be treated as newly issued shares.

16. New sub-paragraph (11) requires the VCT to inform the individual at the time of issue of the shares to which sub-paragraph (10) above applies that he is not eligible for the income tax relief as provided by Part 1 of schedule 15B ICTA 1988 in respect of those shares. The company must also give an officer of the Board of Inland Revenue a copy of that notice no later than three months after the issue of those shares.

17. Paragraph 2 amends section 66 Finance Act 1986 (stamp duty on company's purchase of own shares).

18. Sub-paragraph (a) provides that ad valorem stamp duty shall apply to a return made to the Registrar of Companies showing a company's purchase of own shares to be held without cancellation.

19. Sub-paragraph (b) provides that a return subsequently made showing that treasury shares have been cancelled shall be subject to fixed duty of £5.

20. Sub-paragraph (c) applies the section to a return made under section 169(1) or (1B) of the Companies Act 1985.

21. Paragraph 3 exempts from stamp duty reserve tax an agreement to transfer treasury shares.

22. Paragraph 4 amends section 92 of the Finance Act 1986 to cancel any stamp duty reserve tax charge arising from an agreement under which a company purchases its own shares provided that a return has been made in accordance with the Companies Act and the return has been duly stamped.

23. Paragraph 5 amends paragraph 1 schedule 13 to the Finance Act 1999 and provides that an instrument whereby a company purchases its own shares shall be exempt from stamp duty. An instrument transferring a company's own shares shall be subject to fixed stamp duty of £5. Stamp duty of 1.5% is chargeable if the own shares held by the company are transferred to a person whose business is issuing depository receipts, or providing a clearance service.

BACKGROUND

24. Under The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003, listed companies will be allowed to purchase and hold their own shares. Shares held in this way are often referred to as "treasury shares". Subsequently, they may sell them, transfer them to an employee shares scheme or cancel them. This change to company law and the proposed consequential tax treatment were the subject of consultation documents published by the DTI in 1998 and 2001. The general proposals underlying the tax provisions outlined in this clause and schedule received widespread approval.

25. This clause and schedule provide for purchases of own shares to be treated in the same way for tax purposes, whether or not they are immediately cancelled or held by the company. This is a practical necessity to give clear and certain tax treatment because it may not be known at the time of own share purchase whether any of the shares are subsequently going to be cancelled.

26. The new rules make no changes to the tax treatment of own shares purchased and immediately cancelled. For example, in these circumstances, such shares are not acquired by the company for the purposes of the Taxation of Chargeable Gains Act, and they cease to exist on cancellation.

27. While own shares are held by a company, they are treated as no longer in issue for tax purposes, and when the company sells them, or transfers them to an employee share scheme, they are treated as a new issue.

28. Venture Capital Trusts (VCTs) are companies quoted on the Stock Exchange and approved for the purpose by the Inland Revenue. Individuals who subscribe for new shares in a VCT are entitled to income tax relief at 20% on investments up to £100,000 per tax year. The VCT on invests this money in smaller, higher risk trading companies.

BOARD OF INLAND REVENUE **FINANCE BILL 2003**
RESOLUTION 61 **CLAUSE 193**
SCHEDULE 41

EXPLANATORY NOTE

CLAUSE 193 AND SCHEDULE 41: COMPANIES IN ADMINISTRATION

SUMMARY

1. This clause and its Schedule make changes to the tax rules for companies in liquidation and administration. These changes are necessary as a result of changes to insolvency law made by the Enterprise Act 2002.

DETAILS OF THE CLAUSE AND SCHEDULE

2. Clause 193 is the paving section introducing the Schedule.

3. Paragraph 1 of the Schedule makes changes to the rules for corporation tax accounting periods for companies that go into administration (including those which go into administration from liquidation). It does so by amending section 12 of the Taxes Act - paragraph 1(1)

4. Sub-paragraph (2) provides, inserting a new paragraph (da) into section 12(3), that an accounting period ends when a company ceases to be in administration.

5. Sub-paragraph (3) defines, inserting a new section 12(5A), the circumstances that will be taken as ‘ceasing to be in administration’ for the purposes of sub-paragraph (2).

6. Sub-paragraph (4) ensures that a new accounting period begins when a company moves out of liquidation into administration. It amends section 12(7) accordingly.

7. Sub-paragraph (5) inserts a new subsection (7ZA) into section 12. This ensures that a new accounting period begins when a company goes into administration. It also dissapplies section 12(7) for companies that move from liquidation to administration.

8. Sub-paragraph (6) makes a minor drafting change to section 12(7A) (insurance companies accounting period ends with business transfer) to take into account the new subsection.

9. Paragraph 2 of the Schedule amends the rules defining and governing the proper officer of a company for tax purposes, and amends section 108 Taxes Management Act (TMA) 1970 (paragraph 2(1)).

10. Sub-paragraph (2) widens the scope of section 108(3)(a) TMA 1970, which defines the proper officer of a company for tax purposes. It ensures that if an administrator has been appointed for the company, he or she will be the proper officer.

11. Sub-paragraph (3) inserts a new subsection (4) into section 108 TMA 1970. This subsection provides that where more than one administrator is appointed for the company, notice may be given to the Inland Revenue specifying which of them should be regarded as the proper officer. If no such notice is given, the Revenue may regard any or all of the administrators as the proper officer.

12. Paragraph 3 inserts a new section 342A into ICTA 1988, to provide rules designed to speed up the completion of an administration by enabling the early payment of corporation tax liabilities.

13. Subsection (1) of new section 342A defines the relevant event for these purposes as being the date the administrator sends a notice to the registrar of companies that it is intended to dissolve the company. It also extends this to any equivalent action under corresponding insolvency procedures. The company's 'final year' is defined as the financial year (running from 1 April to 31 March) in which the relevant event occurs, and the 'penultimate year' as the financial year preceding the final year.

14. Subsection (2) of new section 342A provides that where a company is to be dissolved at the end of a period of administration, then the corporation tax rates, limits and fractions used for the financial year in which the application for dissolution is made should be taken as those applicable for the previous financial year. This ensures that the corporation tax due on the company's final accounting period can be settled before the administrator disposes of all the assets of the company.

15. Subsection (3) of new section 342A effectively overrides the effects of subsection (2) where the rates of tax etc for the final financial

year are known when the tax affairs for the relevant accounting period are settled.

16. Subsection (4) of new section 342A provides that where a company is eligible for certain payments of interest from the Inland Revenue in respect of its final accounting period, then these will not be taxable when they do not exceed £2,000.

17. Subsection (5) of new section 342A defines a company's final accounting period, as the last period before an application for dissolution under the administration rules.

18. Subsection (6) of new section 342A provides that, while a company is in administration, corporation tax assessments may be made before the end of the accounting periods to which they relate.

19. Subsection (7) of new section 342A provides that an administrator may make an assumption as to the point at which he will make an application for dissolution under the new administration rules.

20. Subsection (8) of new section 342A provides that if an assumption has been made as to the date of the relevant event, and that assumption proves to be incorrect, then actions up until that date remain undisturbed, and a new accounting period commences. It will then be possible for the administrator to make a further assumption as to the relevant date.

21. Subsection (9) of new section 342A applies subsections (7) and (9) of section 342 ICTA 1988, with appropriate amendments, to this section. These subsections define the method of determining the relevant rates of corporation tax, and provide an assessment mechanism to give effect to this section.

22. Subsection (10) of new section 342A is a technical provision, which will only apply when rates of corporation tax etc for a financial year are fixed late in the year, or after the year.

23. Paragraph 4 makes changes to paragraph 6A of Schedule 9 to FA 1996, which provides special rules governing the tax treatment of loan relationships (loans and other debts) between connected parties, where the creditor has become insolvent.

24. Sub-paragraph (2) replaces, by amending paragraph 6A(1), the concept of a company 'having gone into insolvent liquidation' with the

concept of 'being in insolvent liquidation'. It also replaces the concept of 'having an administration order in force' to 'being in insolvent administration'. Additionally, it converts the foreign equivalent test from being tied to a specific momentary event to an ongoing period.

25. Sub-paragraph (3) replaces, by amending paragraph 6A(2), the reference to events occurring 'after a liquidation has started' with a reference to events occurring 'while a liquidation is occurring'. Also, it replaces the concept of an administration order being in force with a company being in administration.

26. Sub-paragraph (4) replaces paragraph 6A(3) with a new sub-paragraph (3) and a sub-paragraph (3A). They define the time when a company is in insolvent liquidation or insolvent administration.

27. Paragraph 5 provides for the commencement of this schedule.

28. Sub-paragraph (1) provides that paragraphs 1 to 3 start for all companies on the date that section 248 of the Enterprise Act 2002 comes into force.

29. Sub-paragraph (2) provides that paragraph 4 has effect for companies which are in insolvent liquidation or administration on Budget Day, or go into insolvent liquidation or administration after Budget Day.

BACKGROUND

30. The Enterprise Act received Royal Assent on 7 November 2002. Among other things, it provided a new regime for companies in administration.

31. In particular it provided that:
- companies could go into administration without an order of the court;
- companies could move from liquidation into administration;
- administrators could distribute all of the assets of the company to its creditors, with no obligation to move into liquidation;

- that administration could result in the company being dissolved without the company going into liquidation, or any other procedure.

32. The provisions in this Schedule are designed to ensure that the way companies in administration are taxed remains appropriate to the new and altered procedures available to companies.

EXPLANATORY NOTE

CLAUSE 194 AND REPEAL SCHEDULE 43: EXCHANGE OF INFORMATION BETWEEN TAX AUTHORITIES OF MEMBER STATES

SUMMARY

1. Clause 194 and repeal Schedule 43 consolidate and update existing legislation relating to assistance offered to tax authorities in other European Union Member States. The new legislation includes a power to amend certain legislative references within the clause and the definition of "the mutual assistance provisions" in section 48(1B) of the VAT Act 1994 by Statutory Instrument to cater for future legislative changes to information exchange arrangements.

2. With the increased interest in information exchange and greater use of EU agreements, the government is drawing together scattered legislation in this area, and making it more flexible in order to cater more easily for future legislative changes. The wording in subsections (1) – (4) is essentially the same as the legislation that is to be repealed. Subsection (5) allows for amendments to subsections (1) to (4) to be introduced by Treasury Order. Subsection (6) covers amendments arising from the introduction of the clause and updated legal references and allows for amendments to the definition of "the mutual assistance provisions" in s48(1B) VAT Act 1994 to be introduced by Treasury Order.

DETAILS OF THE CLAUSE

3. Subsection (1) replaces, with minor amendments, Section 77(1) Finance Act 1978. It ensures that there are no legislative barriers to tax authorities supplying information required to be disclosed by specified European legislation. The authorities concerned are defined later in subparagraph (4) as HM Customs and Excise and the Inland Revenue.

4. Subsection (2) replaces, with minor amendments, Section 77(2) Finance Act 1978. In keeping with the previous legislation it prevents the UK tax authorities from supplying information unless they are satisfied that the information will be treated confidentially and at least to the same standard as in the UK.

5. Subsection (3) replaces, with minor amendments, Section 77(3) Finance Act 1978. It prevents the UK tax authorities from allowing the use

of information provided under the specified legislation for anything other than taxation or legal proceedings relating to a breach of tax laws.

6. Subsection (4) replaces section 17(2) of Finance Act 1980. It defines the terms used and the relevant European legislation referred to.

7. Subsection (5) allows for amendments to be made to subsections (1) to (4) by Treasury Order in response to changing European legislation.

8. Subsection (6) replaces references in section 48 subsection (1B) of the VAT Act consequent to the introduction of the new clause. It also allows for future amendments to be made to the definition of “the mutual assistance provisions” in that subsection by Treasury Order in order to be able to respond to changing European legislation.

9. The legislation governing exchange of information between the UK and other EC member states is currently found in s77 Finance Act 1978; subsections (2), (2A) and (3) of s17 Finance Act 1980 (as amended); and s22 Finance Act 1993.

BACKGROUND

10. The Mutual Assistance Directive is the main European legislative instrument dealing with mutual assistance for direct and indirect taxes. It was originally introduced in 1977 and has subsequently been amended to cover VAT and Excise duties.

11. A new Regulation covering all VAT administrative co-operation matters is planned. This will require consequential amendments to certain references in current UK legislation. In addition, a Directive amending the Mutual Assistance Directive to remove the reference to VAT and to extend its scope to IPT is imminent. The power to amend legislative references and definitions by Statutory Instrument will enable amendments to be made to update UK primary legislation as and when necessary outside the constraints of the Finance Bill timetable.

BOARD OF INLAND REVENUE RESOLUTION: PROCEDURE (EXCHANGE OF INFORMATION BETWEEN UNITED KINGDOM AND OTHER STATES OR TERRITORIES) (b)

FINANCE BILL 2003 CLAUSE 195

EXPLANATORY NOTE

CLAUSE 195: ARRANGEMENTS FOR MUTUAL EXCHANGE OF TAX INFORMATION

SUMMARY

1. This clause makes a minor amendment to existing powers to exchange information under Double Taxation Agreements and Tax Information Exchange Agreements.

DETAILS OF THE CLAUSE

2. Subsection (1) changes the wording governing the exchange of information under the UK's bilateral international treaties from that "necessary for the carrying out of" the laws of the UK and its treaty partner to that "forseeably relevant to the administration and enforcement of" such laws.

3. Subsection (2) sets out the existing tax provisions that will be affected by the amendment.

4. Subsection (3) provides that in the case of arrangements already made under the existing provisions, references to exchange of information "necessary for the carrying out of" the laws of the territories includes information forseeably relevant to the administration and enforcement of those laws.

BACKGROUND

5. The United Kingdom regularly exchanges tax information with other countries and territories – amongst other things to counter international tax avoidance and evasion. Such exchanges are generally facilitated by bilateral double taxation agreements (DTAs) or (where, for example, the other country or territory has no tax

system) Tax Information Exchange Agreements (TIEAs). The United Kingdom has not to date entered into any TIEAs, but the Government expects to do so during the coming year.

6. The UK has been at the forefront of work within the Organisation for Economic Co-operation and Development (OECD), to promote effective exchange of information as a key defence against international tax avoidance and evasion. This work has involved the development of modern standards for information exchange.

7. In practice, the UK is already in line with the modern standards being developed, not least because it was long ago recognised in the UK that, in its context, a broad interpretation of "necessary" was required to give effect to the intentions of the treaty signatories. The government wishes nonetheless to reflect these developments explicitly in the UK's bilateral DTAs and TIEAs. To do so requires minor changes to the wording used in the legislation that enables the UK to exchange information under these agreements. Clause 195 provides the required modifications although, in practice, the change will not alter the type or scope of information that is exchanged at present.

8. The amendment will affect exchange of information in respect of agreements relating to income tax, capital gains tax, corporation tax and inheritance tax.

CLAUSE 196: SAVINGS INCOME: COMMUNITY OBLIGATIONS AND INTERNATIONAL ARRANGEMENTS

SUMMARY

1. The clause enables the Inland Revenue to implement a scheme to help counter cross-border tax evasion by individuals on their savings income. The scheme will require paying agents to report details of savings income payments to certain non-residents. The Inland Revenue will exchange this information with the tax authorities of specified other countries. Information that the Inland Revenue receives in return will enable it to ensure that savings income earned abroad by United Kingdom (UK) residents is properly reported and taxed.

2. The scheme will enable the UK to implement the European Union (EU) Directive on the Taxation of Savings, when it is adopted. The details of the scheme will be set out in regulations.

DETAILS OF THE CLAUSE

3. Subsection (1) sets out the purpose of the clause and enables the Treasury to make regulations.

4. Subsection (2) provides for regulations to require paying agents to obtain and verify information about the residence and identity of relevant payees and to report it to the Inland Revenue together with information about savings income payments.

5. Subsection (3) provides for regulations allowing the inspection of books, documents and other records of paying agents.

6. Subsection (4) provides for regulations that will allow the Inland Revenue to combine notices under the scheme with notices under the existing reporting arrangements for those who pay interest.

7. Subsection (5) provides for regulations to specify the time at or within which and the manner in which the requirements of the regulations – for example, the form in which the information must be provided – are to be met.

8. Subsection (6) provides for regulations to impose penalties for failing to comply with the requirements of the scheme, including applying any provisions of the Taxes Management Act 1970 dealing with penalties. Paying agents who fail to comply with a notice, or negligently or fraudulently provide incorrect information, would be liable to penalties under section 98 Taxes Management Act 1970.

9. Subsection (7) defines paying agent and specifies that it can include public officers and Government departments.

10. Subsection (8) defines the circumstances in which a paying agent makes a savings income payment.

11. Subsection (9) defines savings income.

12. Subsection (10) defines relevant payee, and limits the territories covered by the scheme to member States and other specified countries or territories with which the United Kingdom has an arrangement with a view to ensuring the effective taxation of savings income.

13. Subsection (11) provides that regulations may make different provision to cover different cases, and deal with supplementary, incidental, consequential or transitional matters.

14. Subsection (12) provides that regulations are exercisable by statutory instrument.

15. Subsection (13) provides that the statutory instrument shall be laid before the House of Commons only, and be subject to the negative procedure.

16. Subsection (14) provides definitions.

BOARD OF INLAND REVENUE RESOLUTION: PROCEDURE (SAVINGS INCOME)

FINANCE BILL 2003 CLAUSE 196

BACKGROUND NOTE

17. The Government is committed to fostering co-operation between tax authorities and using exchange of information as widely as possible to counter cross-border tax evasion on savings income. This principle was endorsed by the European Council meeting in Feira in June 2000. The principle is also the basis of the EU Directive on the Taxation of Savings, which is currently being considered by the European Council.

18. Under the Directive, businesses and public bodies that pay interest or other savings income to, or collect savings income for, individuals resident in the EU, will have to report details of the payments and the payees to the Inland Revenue. The Inland Revenue will then provide this information to the tax authority of the payees.

19. Similarly, tax authorities in other member States will provide the Inland Revenue with information on UK resident payees who receive savings income from paying agents established in their jurisdictions.

20. As an alternative to exchanging information about cross-border payments, three EU countries (Austria, Belgium and Luxembourg) will, for a transitional period, impose a withholding tax. UK residents receiving interest from these countries may request that tax is not withheld by either:

    - authorising the paying agent to report information about the savings income payments made; or

    - presenting the paying agent with a certificate drawn up by the Inland Revenue.

21. The detailed rules of the scheme will be set out in regulations. The regulations will be subject to consultation after the text of the Directive has been published.

22. The scheme will build on the current reporting arrangements, which require UK businesses and public bodies to provide information to the Inland Revenue about interest payments they make. These arrangements are in sections 17 and 18 Taxes Management Act 1970 and the Income Tax (Interest Payments) (Information Powers) Regulations 1992 (SI 1992/15).

23. As currently drafted, the Directive requires member States to have legislation and guidance in place by 1 January 2004. The Directive itself will not take effect before 1 January 2005. This date is subject to the condition that agreements with certain third countries and arrangements with relevant dependent and associated territories of member States are in place and take effect from the same date. However, the provisions for obtaining and verifying information about the residence and identity of relevant payees will apply differently, depending on whether the relevant payee entered into contractual relations with the paying agent before or after 1 January 2004.

BOARD OF INLAND REVENUE | **FINANCE BILL 2003**
RESOLUTION 62 | **CLAUSE 197**
SCHEDULE 42

EXPLANATORY NOTE

CLAUSE 197 AND SCHEDULE 42 CONTROLLED FOREIGN COMPANIES: EXEMPT ACTIVITIES TEST

SUMMARY

1. This Clause and the Schedule it introduces, protect the UK tax base by closing a loophole in the Controlled Foreign Company “CFC” rules that are designed to prevent UK multinationals from diverting profits to low tax regimes. It will put a stop to the use of arrangements that are, or could be used to exploit one of the exemptions from the CFC rules by circumventing a restriction that applies only to certain types of business which derive more than half their receipts from connected parties. This change closes the loophole by extending this particular restriction in the "Exempt Activities Test" so that it also applies to receipts derived from business carried on with UK persons.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for Schedule 42 amending the rules for exempt activities contained in Part 2 of Schedule 5 to the Taxes Act to have effect.

3. Subsection (2) brings the amendments made to Schedule 25 into effect for CFCs whose accounting periods begin on or after the 27 November 2002.

4. Subsection (3) confirms that the terms 'CFC' and 'accounting period' have the same meanings as in the main body of the CFC legislation.

5. Subsection (4) gives effect to the Clause from 27 November 2002.

DETAILS OF THE SCHEDULE

6. Paragraph 1 of Schedule 42 provides for the amendments to the legislation concerning the Exempt Activities Test (Part 2 of Schedule 25 to the Taxes Act).

7. Sub-paragraph (1) of Paragraph 2 provides for the amendments to Paragraph 6 of Schedule 25 (meaning of "exempt activities").

8. Sub-paragraph (2) amends the list of sub-paragraphs identified in sub-paragraph (1)(c) of Paragraph 6 of Schedule 25 with which a CFC whose main business is wholesale, distributive, financial or service business must comply in order to benefit from the Exempt Activities Test, by specifying those sub-paragraphs individually, instead of by reference to a range, as that approach no longer remained appropriate following the insertion of sub-paragraph (2B).

9. Sub-paragraph (3) extends the list of persons within sub-paragraph (2A) of Paragraph 6 (from whom less than 50% of the receipts of a CFC must be derived if its main business is wholesale, distributive, financial or service) to include three new classes of persons. Those three classes are, respectively: unconnected UK-resident companies, the UK branches of unconnected non-UK companies and unconnected individuals who are habitually resident in the UK. However this extension is disapplied if new sub-paragraph (2B) of paragraph 6, inserted by sub-paragraph (4) of this paragraph below, applies. "Habitually resident" takes its ordinary meaning and is derived from parallel terminology in the Second EC Non-life Insurance Directive.

10. Sub-paragraph (4) inserts two new sub-paragraphs, (2B) and (2C) into Paragraph 6.

11. Where new sub-paragraph (2B) applies, the extension of the list of persons specified in new sub-paragraph (2A) of Paragraph 6 is disregarded if

    - the main business of the CFC is either "long term insurance" (other than "protection business") or

- "large risk" insurance carried on by a CFC, which is a member of an "insurance group".

New paragraph 11A of Schedule 25, inserted by paragraph 4 of this Schedule, gives definitions of terms used in this sub-paragraph.

12. New sub-paragraph (2C) confirms that when applying paragraph (b) of sub-paragraph (2) of paragraph 6 to the UK branch or agency of a non-UK unconnected company; only gross trading receipts deriving from contracts or arrangements relating to that branch or agency are to be taken into account.

13. Sub-paragraph (5) corrects a cross-reference in sub-paragraph (4C) of Paragraph 6. Sub-paragraph (4C) defines a "25 per cent assessable interest" for the purposes of sub-paragraph (2A)(b) (which lists the persons from whom less than 50% of the receipts must be received if the CFC exemption is to apply). The correct reference should be to sub-paragraph (2A)(b) and not (2)(b) as currently provided.

14. Sub-paragraph (1) of Paragraph 3 of Schedule 42 provides for the amendment of Paragraph 11 of Schedule 25, which explains the meaning of "wholesale, distributive, financial or service business".

15. Sub-paragraph (2) replaces the provision in sub-paragraph (3) of paragraph 11, which currently excludes UK-source interest in the hands of companies within paragraph (c) of sub-paragraph (1) of paragraph 11 (banking and similar concerns) from being treated as derived from connected persons within the meaning of sub-paragraph (2A) of paragraph 6. The new provision reflects the extension of the list of persons caught, introduced by sub-paragraph (3) of paragraph 2 above.

16. Sub-paragraph (3) adds a new test that has to be satisfied by banking and similar concerns independently of the "capitalisation test" imposed by sub-paragraph (3) of paragraph 11. Failure to meet this new test will also result in such concern being conclusively presumed to have failed the Exempt Activity Test. This new test reflects the extension of the list of persons caught by sub-paragraph (2A) of paragraph 6 introduced by sub-paragraph (3) of paragraph 2 above. A banking or similar concern will fail the additional test if

more than 10 per cent of its gross trading receipts are receipts (other than interest) and are derived from, UK-resident companies, the UK branches of non UK companies and individuals who are habitually resident in the UK (whether or not these persons are connected with the CFC). In parallel with the clarification in new sub-paragraph (2C) above about the application of paragraph (b) of sub-paragraph (2) of paragraph 6 to the UK branch or agency of a non-UK unconnected company; only gross trading receipts deriving from contracts or arrangements relating to such a branch or agency are to be taken into account for the purposes of the new test.

17. Paragraph 4 inserts into Schedule 25 new paragraphs 11A and 11B which provide interpretation rules for the purpose of paragraph 6(2B), inserted by sub-paragraph (4) of Paragraph (2) above, which excludes CFCs carrying on most “long term insurance” or “large risk insurance” as part of an insurance group.

18. Sub-paragraph (2) of New Paragraph 11A defines a "contract of long term insurance" (as introduced by new sub-paragraph (2B) of paragraph 6) as one which is within Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. This is a standard definition used in many places elsewhere in the Tax Acts.

19. Sub-paragraph (3) defines "protection business" to mean the insurance or reinsurance of long term insurance contracts which do not have a significant investment element. This will be primarily term assurance policies and permanent health insurance policies. The definition is modelled on paragraph (b)(iii) and (iv) of the definition of “qualifying contract of insurance” in Article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, which at present distinguishes those policies which do not come within the Conduct of Business rules in the FSA’s Handbook. Paragraph 11B(3)(a) identifies the relevant policies as

- all contracts which have no surrender value; and
- all contracts for which a single premium is paid which will be greater than any surrender value.

This second definition does not mean that policies whose surrender value happens to have fallen below the amount of the single premium, because for example the policy is linked to the value of assets and that value has declined, fall to be treated as protection business.

20. Sub-paragraph (3)(b) of New Paragraph 11B provides that contracts which can be converted to a form which no longer falls within the two identified classes in sub-paragraph (3)(a) will not constitute “protection business”.

21. Sub-paragraph (4) defines "insurance group" for the purposes of excluding CFCs whose main business is insuring or reinsuring "large risks" from the new clause. The definition is the one given in section 255A(5) of the Companies Act 1985 but with a modification as if Part 7 of that Act applied to Northern Ireland and as if references in that Act extended to companies defined in Article 3 of the Companies (Northern Ireland) Order 1986. However this definition does not include insurance groups that fall within sub-paragraph (5) of this paragraph below.

22. Sub-paragraph (5) restricts the definition of "insurance group" introduced by sub-paragraph (4) to exclude an insurance subgroup within a non insurance group. The restriction prevents an insurance subgroup from qualifying if it is part of a larger group and the ultimate parent of that larger group is not itself the parent of an insurance group. These terms are also to be applied as if Part 7 of the Companies Act 1985 were subject to the same modifications in relation to Northern Ireland as are mentioned in sub-paragraph (4) above.

23. Sub-paragraph (6) makes clear that a CFC is to be regarded as a "member of an insurance group" if it is the parent, or a subsidiary of a parent, of an insurance group as defined by sub paragraph (4).

24. Sub-paragraph (7) provides a test for determining whether insuring or reinsuring "large risks" (as defined in paragraph 11B introduced by sub-paragraph 8 below) is the CFC's main business. The test is met where its main business is the effecting or carrying out of insurance contracts and 50% or more of its receipts are derived from insuring or (reinsuring) large risks.

25. Sub-paragraph (8) provides definitions of "contract of insurance" and "contract of long-term insurance" for the purposes of paragraph 11A.

26. A New Paragraph 11B defines what is meant by "large risks" for the purposes of excluding insurance groups insuring such risks from the provisions of this Clause.

27. Sub-paragraph (1) of paragraph 11B defines those classes of insurance risk from the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 which will be accepted as large risks. This definition is the same as that used in the Financial Services and Markets Act 2000 (Law Applicable to Contracts of Insurance) Regulations 2001 (SI 2001/2635) and that in turn is derived from the definition in Article 5 of the 1st EC Non-Life Directive. They are:

28. In paragraph (a) of sub-paragraph (1), all cases of the following risks:
    - Railway rolling stock
    - Aircraft
    - Ships
    - Goods in transit
    - Aircraft liability
    - Liability of ships.

29. In paragraph (b), all cases of the following risks where the policies relate to a business carried on by the policy holder:
    - Credit
    - Suretyship.

30. In paragraph (c), all cases of the following risks where the policy holder carries on a business which is not a small or medium sized enterprise, as defined in sub-paragraph (2):
    - Land (motor) vehicles
    - Fire and natural forces
    - Damage to property
    - Motor vehicle liability
    - General liability

- Miscellaneous financial loss.

31. Sub-paragraph (2) sets out three criteria, two of which must be exceeded if the policies identified in paragraph (c) of sub-paragraph (1) are to qualify as "large risk". The criteria provide a threshold for a balance sheet total (6.2 million euros), turnover (12.8 million euros) and number of employees (250) respectively. These annual limits are reduced if the policyholders financial year is in fact less than a calendar year. These terms used in setting the limits are themselves defined in sub-paragraph (3) by reference to the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.

32. Sub-paragraph (4) requires a group drawing up consolidated accounts (as defined in EC directive 83/349) to use those accounts for the purposes of the large risks tests. Sub-paragraph (5) requires the aggregate of all the amounts referable to all the members to be used where the policyholder is a joint venture consisting of several members.

33. Sub-paragraph (6) defines "business", as used in sub-paragraphs (1) and (2), to include any trade, profession or other activity.

34. Sub-paragraph (7) provides that the basis for converting into Euros amounts expressed in accounts drawn up in currencies other than euros is to be the relevant London closing exchange rate for the last day of the period to which those accounts relate.

35. Sub-paragraph (8) provides definitions of 'euro' and 'financial year' for the purposes of the large risk exclusion only.

BACKGROUND

36. A CFC is a company which is not resident in the UK (but which is controlled by persons who are) and which is subject to a level of taxation of less than three quarters of that which it would have been subject to had it been resident in the UK.

37. The CFC rules stop UK companies reducing their UK tax liabilities by diverting profits to foreign companies, which they control and which are situated in low tax regimes. The rules work by, broadly, charging UK parent companies of CFCs on an amount equal to the profits that would otherwise avoid tax.

38. There are a number of specific exemptions from the CFC rules that exclude subsidiaries that are not set up to avoid tax. A CFC is exempt from the CFC rules if it satisfies the Excluded Activities Test (EAT). This test exempts companies carrying out a genuine commercial activity that is "effectively managed" in their territory of residence. However the EAT is not intended to be available where the business activities are easily moved from one country to another or between associates. In such cases, other exemptions have to be considered on their merits.

39. One such restriction applies to deny exemption under the EAT for certain types of business where more than half the receipts are derived from connected parties.

40. Some retail and banking groups have managed to avoid this restriction and so brought themselves within the strict terms of the exemption by arranging for their CFCs to provide services to their UK retail customers in way that means the legislation does not bite as intended. UK tax that would otherwise be due is therefore lost.

41. This clause closes that loophole by extending the restriction on business between "connected parties" to include business carried on with UK persons. The rules however have two industry specific modifications so as not to disrupt arrangements which have not been designed to exploit the loophole.

42. The first of these modifications relates to banking groups. Banks are already able to benefit from an exception for interest received from UK sources. However some financial businesses are very similar to investment businesses and moneybox companies for whom exemption by way of the EAT would be inappropriate. Banks must already satisfy a stricter business identification rule if they are to gain exemption. The new rules include a second restriction to address the special position of these businesses in the light of the changes now being made.

43. The second modification applies to insurance groups. Insurance companies that insure large risks or offer long term life assurance (other than, broadly investment business) are not part of the mischief at which the clause is aimed. These two classes of insurance business have therefore been specifically excluded.

BOARD OF INLAND REVENUE **FINANCE BILL 2003**
CLAUSE 198

EXPLANATORY NOTE

CLAUSE 198: APPLICATION OF CFC PROVISIONS TO HONG KONG AND MACAO COMPANIES

SUMMARY

1. This clause allows eligible companies in Hong Kong and Macao to continue to claim exemption from a CFC charge by virtue of the Exempt Activities Test. The change applies retrospectively so that the position of companies affected will remain as always intended.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts three new sub-paragraphs in Part 2 (exempt activities) of Schedule 25 to the Taxes Act, at the end of paragraph 5, after sub-paragraph (2), containing special rules for determining a CFC's territory of residence for the purpose of the exempt activities test.

3. New sub-paragraph (3) of Paragraph 5 requires that references to the "territory of residence" of a controlled foreign company which is presumed by virtue of section 749(5) to be in a territory where it is subject to a lower level of taxation and is effectively managed in and liable to tax in one of the special administrative regions of China shall be treated as references to that region for the purposes only of applying the Exempt Activities Test.

4. New sub-paragraph (4) defines "special administrative region" to mean either the Hong Kong or Macao special administrative region, as appropriate.

5. New sub-paragraph (5) makes clear that where the identification of a territory of residence is governed by the new rules introduced by new sub-paragraph (3) the new rules take precedence over the existing identification rules in sub-paragraph (2) of Schedule 5.

6. <u>Subsection (2)</u> applies the clause retrospectively to the date each special administrative region came into being, ie to 1 July 1997 and 20 December 1999 for Hong Kong and Macao respectively.

BACKGROUND

7. A CFC is a company which is not resident in the UK (but which is controlled by persons who are) and which is subject to a level of taxation of less than three quarters of that which it would have been subject to had it been resident in the UK.

8. The CFC rules stop UK companies reducing their UK tax liabilities by diverting profits to foreign companies, which they control and which are situated in low tax regimes. The rules work by, broadly, charging UK parent companies of CFCs on an amount equal to the profits that would otherwise avoid tax.

9. There are a number of specific exemptions from the CFC rules that exclude subsidiaries that are not set up to avoid tax. The Exempt Activities Test "EAT" exempts companies carrying out a genuine commercial activity that is "effectively managed" in their territory of residence.

10. However it was far from clear that these regions were capable of meeting the special tests applying to a CFC's territory of residence for the purposes of the EAT. This result was not anticipated.

11. This clause therefore puts this beyond doubt by allowing companies in those regions to continue to be eligible for exemption to the extent that they would otherwise meet the requirements of the Exempt Activities Test. This change is being made retrospectively to the date to the formation of each SAR so that the position of companies affected will remain as always intended.

BOARD OF INLAND REVENUE **FINANCE BILL 2003**
RESOLUTION 63 **CLAUSE 199**

EXPLANATORY NOTE

CLAUSE 199: DEDUCTION OF TAX FROM INTEREST: RECOGNISED CLEARING HOUSES ETC

SUMMARY

1. This clause allows recognised clearing houses and recognised investment exchanges to make annual interest payments without deduction of tax at source in the course of providing central counterparty clearing services.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the amendment of section 349 of the Income and Corporation Taxes Act 1988.

3. Subsection (2) adds two paragraphs to subsection 349(3) to remove the obligation to deduct tax at source in the two cases where annual interest payments may be made during the provision of central counterparty clearing services. The inserted paragraph 349(3)(j) applies in relation to interest paid on margin or collateral deposited with the central counterparty. The inserted paragraph 349(3)(k) applies in relation to price differentials (which are deemed to be interest by section 730A) on repo contracts cleared by the central counterparty.

4. Subsection (3) inserts definitions of “central counterparty clearing service”, “recognised clearing house” and “recognised investment exchange” into subsection 349(6).

5. Subsection (4) applies the section to payments made on or after 14 April 2003.

BACKGROUND

6. Certain recognised clearing houses and recognised investment exchanges (which are recognised under the Financial Services and Markets Act 2000) provide central counterparty clearing services to users of their facilities. A central counterparty clearing service is one in which the central counterparty (the clearing house or investment exchange) stands in the middle of the contractual chain between the buyer and the seller of an investment in order to protect either party from the default of the other, and ensure the performance of the contract.

7. In order to provide this service and to protect its own position, the central counterparty will hold margin or collateral deposited by the parties to the contract. Interest may be paid on this money and, if it is annual interest, income tax would need to be deducted at source under section 349(2) of the Income and Corporation Taxes Act 1988, unless other provisions applied. The new paragraph 349(3)(j) removes that obligation.

8. Central counterparty clearing services may also be provided in the same way to persons who enter into sale and repurchase agreements (repos) in securities. A repo is a contract in which one person sells a security to another person and agrees to buy the security back at a later date at a price agreed at the outset, which may be higher or lower than the price of the original sale. Repos are subject to special tax rules (set out in section 730A of the Income and Corporation Taxes Act 1988) under which the difference in the price between the original sale and the subsequent repurchase is treated for tax purposes as an interest payment. If the repurchase takes place more than 364 days after the original sale, that price differential will be an annual interest payment and income tax would need to be deducted at source under section 349(2), unless other provisions applied. The new paragraph 349(3)(k) removes that obligation.