

FINANCE (No.2) BILL 2006

LOBBY NOTES

PART 1

EXCISE DUTIES

Tobacco products duty

Clause 1 provides for an increase in the rates of excise duty on tobacco products (cigarettes, cigars, hand-rolling tobacco and other smoking tobacco and chewing tobacco) with effect from 6pm on 22 March 2006.

Clause 2 imposes a duty on tobacco manufacturers not to facilitate smuggling. Tobacco manufacturers will be required to conduct their businesses in such a way as to avoid, so far as is reasonably practicable, supplying cigarettes or hand-rolling tobacco to those likely to smuggle, or to those likely to re-supply to those likely to smuggle, that product into the United Kingdom. Any failure to comply with this obligation may render a tobacco manufacturer liable to a penalty.

Alcoholic liquor duties

Clause 3 provides for an increase in the rate of excise duty charged on beer to take effect at midnight on Sunday 26 March 2006.

Clause 4 provides for an increase in the rate of excise duty charged on still wine and still made-wine to take effect at midnight on Sunday 26 March 2006. The rates for sparkling wine and sparkling made-wine included in this clause are unchanged from last year, as duty on sparkling wine is frozen.

Clause 5 causes a number of sections of the Alcoholic Liquor Duties Act 1979 (ALDA 1979) to cease to have effect. Some of the sections are entirely obsolete and others are no longer deemed to have practical utility due to changes in the methods employed by the Commissioners to assure the revenue.

Hydrocarbon oil duties

Clause 6 consolidates adjustments made by certain statutory instruments affecting the liabilities to duty under the Hydrocarbon Oil Duties Act 1979, and provides that those statutory instruments shall cease to have effect. These changes will come into effect at Royal Assent.

Clause 7 amends the rates of duty and rates of rebate applicable to products charged to duty under the Hydrocarbon Oil Duties Act 1979. Duty rates for

hydrocarbon oils used as road fuels will be increased in line with inflation, and effective rates of duty (that is, the relevant duty minus the relevant rebate) for non-road fuels will be increased by the same cash amount of 1.25 pence per litre. Other increases similarly maintain current differentials compared with the rates for the main road fuels, except in the case of road fuel gas other than natural gas, where the differential is being reduced by the equivalent of 1 penny per litre. These changes come into effect on 1 September 2006.

Clause 8 introduces a new power to enable HM Treasury to amend Schedule 1 to the Hydrocarbon Oil Duties Act 1979 by way of statutory instrument. Vehicles falling within the Schedule are excepted vehicles for the purposes of the Act and, unlike road vehicles, are entitled to run on rebated heavy oil. This power will come into effect on Royal Assent.

Betting and gaming duties

Clause 9 amends the charging provision for general betting duty in section 2(2) of the Betting and Gaming Duties Act 1981 to specifically exclude any bets that are made on a gaming machine and are charged with value added tax.

Clause 10 will increase the gaming duty bands in line with inflation for accounting periods starting on or after 1 April 2006.

Amusement machine licence duty

Clause 11 amends the definition of “gaming machine” in the Betting and Gaming Duties Act 1981.

Clause 12 provides for amendment to the description of gaming machine categories and rates of duty for the purposes of amusement machine licence duty in the Betting and Gaming Duties Act 1981. It also makes consequential amendments removing references to non-gaming machines.

Vehicle excise duty

Clause 13 provides for changes in the rates of vehicle excise duty by amendment of the Vehicle Excise and Registration Act 1994 (“VERA”). Changes to the rates took effect on 23 March 2006 in relation to all licences taken out on and from that date.

Clause 14 amends section 61B of the Vehicle Excise and Registration Act 1994 to extend the Secretary of State's regulation making powers in respect of reduced pollution certificates.

Clause 15 introduces a new section 7C into the Vehicle Excise and Registration Act 1994 (“the 1994 Act”). The new section gives the Secretary

of State power to make regulations which provide for the recovery of supplements payable under Continuous Registration by summary warrant procedure in Scotland.

PART 2

VALUE ADDED TAX

Gaming machines

Clause 16 updates the definition of gaming machines for valuation purposes in section 23 of the Value Added Tax Act 1994 (“the VAT Act”) in line with the Value Added Tax (Betting, Gaming And Lotteries) Order 2005 (SI No. 2005/3328) which took effect from 6 December 2005.

Land

Clause 17 empowers HM Treasury to substitute by Statutory Instrument a new Schedule 10 to the Value Added Tax (VAT) Act 1994 (buildings and land) for the purpose of rewriting the Schedule (with amendments) into language that is clearer and easier to use. It includes powers to make related provision or savings, such as granting taxpayers new appeal rights relating to Schedule 10; and to repeal certain redundant provisions.

Imported works of art etc

Clause 18 implements changes to the valuation for Value Added Tax (VAT) purposes of certain importations of works of art, antiques and collector’s pieces from outside the EC. Where such goods have been entered to a temporary importation regime and sold by auction while within it, any commissions payable to the auctioneer will in future be excluded from the value of the goods for VAT where the goods are then finally imported into the European Union. (This is preparatory to the commissions being taxed under the rules governing normal domestic supplies.)

Avoidance and fraud

Clause 19 provides for the introduction of a change of accounting procedure (reverse charge) whereby the Value Added Tax (VAT)-registered customer, rather than the seller, accounts for and pays the VAT on the supply of certain goods of a kind used in Missing Trader Intra-Community (MTIC) fraud. The clause provides powers for HM Treasury to specify by Order the goods to which the reverse charge will apply and certain excepted supplies. A business purchasing more than £1000 of goods subject to the reverse charge in any one month will be required to include their value in its taxable turnover for VAT

registration purposes. The clause will apply to supplies made on or after a date to be appointed by the Treasury.

Clause 20 clarifies the scope of the existing power for HM Revenue and Customs officers to enter premises and inspect goods for Value Added Tax (VAT) purposes. It specifically provides that the power to inspect goods includes the right to mark the goods or their packaging for the purposes of indicating that they have been inspected, and to record any information relating to the goods by electronic means.

Clause 21 introduces a new power for HM Revenue and Customs (HMRC) to direct individual businesses to keep specified records relating to specified goods, in addition to the current records that are required to be kept for Value Added Tax (VAT) purposes. HMRC will only be able to exercise this power where they have reasonable grounds to believe that the records might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid. The clause includes a specific penalty for failing to comply with a record keeping direction, and a right of appeal against any such penalty or against the issue of a direction.

Clause 22 allows HM Treasury to amend Schedule 10A to the Value Added Tax (VAT) Act 1994 by affirmative resolution order to specify circumstances in which the supply of credit vouchers is not to be disregarded for VAT purposes.

PART 3

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 1

INCOME TAX AND CORPORATION TAX: CHARGE AND RATE BANDS

Income tax

Clause 23 imposes the income tax charge for 2006-07, and sets the starting, basic, and higher rates of tax at 10 per cent, 22 per cent, and 40 per cent respectively.

Corporation tax

Clause 24 charges corporation tax for the financial year beginning 1 April 2007 and sets the main rate at 30 per cent (no change from the previous year).

Clause 25 sets the small companies' rate of corporation tax for the financial year beginning 1 April 2006 at 19 per cent, and sets the fraction used in calculating marginal relief from the main rate at eleven four-hundredths.

Clause 26 provides for the abolition of the corporation tax starting rate and non-corporate distribution rate.

CHAPTER 2

RELIEFS FOR BUSINESS

Group relief

Clause 27 and Schedule 1 provide for an extension to the rules that give relief for losses and other amounts within groups of companies (group relief). Schedule 1 sets out the conditions to be met for foreign losses to be relievable as group relief in the UK. It also sets out how the amount relievable is to be computed and the compliance obligations of the UK claimant company. These rules will apply from 1 April 2006.

Research and development

Clause 28 and Schedule 2 expand the expenditure qualifying for research and development (R&D) reliefs to include payments to volunteers participating in clinical trials.

Clause 29 and Schedule 3 are designed to align the claims process and time limits for enhanced deductions under the research and development (R&D) and vaccines research relief scheme. As a result all claims to these reliefs will need to be made in a company tax return within 12 months of the return filing date.

Capital allowances

Clause 30 increases for one year the rate of first-year capital allowances for spending by small businesses on most plant and machinery. The rate is increased from 40 per cent to 50 per cent. The increased allowances apply to spending on or after 1 April 2006 for businesses within the charge to corporation tax and on or after 6 April 2006 for businesses within the charge to income tax.

CHAPTER 3

FILMS AND SOUND RECORDINGS

Introductory

Clause 31 defines, for the purposes of Chapter 3, the term “film”, and sets out when a series of films is to be treated as a single film, and when a film is treated as having been completed.

Clause 32 defines the meaning of “film production company” for the purposes of Chapter 3. It ensures that there can only be one film production company in relation to any particular film and sets out the activities that must be undertaken by a film production company to for it to meet the definition. It also sets out how to identify the film production company where a film is to be treated as a national film by virtue of a co-production treaty or the European Convention on Cinematographic Co-production.

Clause 33 defines the terms “production expenditure”, “core expenditure” and “limited-budget film” for the purposes of Chapter 3. It also ensures that arm’s length prices are used for core expenditure when determining whether a film is a limited-budget film or not.

Clause 34 defines the terms “production expenditure”, “core expenditure” and “limited-budget film” for the purposes of Chapter 3. It also ensures that arm’s length prices are used for core expenditure when determining whether a film is a limited-budget film or not.

Clause 35 defines United Kingdom expenditure for the purposes of Chapter 3 as expenditure on services performed, or goods supplied, in the UK. It requires that there shall be a fair and reasonable apportionment where expenditure is part UK and part non-UK. And it allows HM Treasury to amend the definition by regulations subject to the affirmative procedure of the House of Commons.

Clause 36 defines the terms “qualifying co-production” and “qualifying co-producer” for the purposes of Chapter 3.

Taxation of activities of film production company

Clause 37 and Schedule 4 introduces Schedule 4 that determines how film production companies are to compute their profits and gains for tax purposes. It applies the schedule in relation to films that begin principal photography on or after 1 April 2006.

Film tax relief

Clause 38 sets out the three conditions that films need to meet in order to qualify for film tax relief.

Clause 39 imposes the first condition for film tax relief; that a film must be intended for theatrical release, and provides definitions to enable this to be determined.

Clause 40 imposes the second condition for film tax relief; that a film must be certified as a British film under Schedule 1 to the Films Act 1985.

Clause 41 imposes the third condition for film tax relief; that not less than 25 per cent of the core production expenditure on the film must be UK expenditure. HM Treasury may vary this minimum percentage of UK expenditure by regulations made by affirmative resolution of the House of Commons.

Clause 42 and Schedule 5 introduces Schedule 5, which sets out how film tax relief is to operate.

Film losses

Clause 43 restricts the way in which a film production company can use trading losses, allowing it only carry them forward while the film is in production.

Clause 44 enables a film production company to use its losses (including those brought forward from earlier periods) more widely in the period during which the film is completed or abandoned.

Clause 45 allows any losses remaining, when the trade of the film production company making a film that qualifies for film tax relief ceases, to be transferred to another similar trade of the same company, or within the same group.

Films: withdrawal of existing reliefs

Clause 46 sets out how, and when, the current basic treatment of expenditure on the production or acquisition of films and of preliminary expenditure on film production, and the special relief for British films, is to be disapplied for corporation tax purposes.

Clause 47 sets out how, and when, the current basic treatment of expenditure on the production or acquisition of films and of preliminary expenditure on

film production, and the special relief for British films, is to be disapplied for income tax purposes.

Corporation tax treatment of sound recordings

Clause 48 with clauses 49 and 50 puts Extra-Statutory Concession (ESC) B54 on a statutory basis. It ensures that expenditure on the production or acquisition of the original master version of a sound recording is treated as expenditure of a revenue nature. Similarly, receipts from disposal of the master version, rights in it or monies derived from the original master version are treated as revenue receipts for corporation tax purposes and are brought into account in calculating the profits for the accounting period in which they are received.

Clause 49 with clauses 48 and 50 puts Extra-Statutory Concession (ESC) B54 on a statutory basis. It establishes the way in which expenditure on the original master version of a sound recording is allocated to accounting periods for the computation of taxable profits.

Clause 50 with clauses 48 and 49 puts Extra-Statutory Concession (ESC) B54 on a statutory basis. It provides interpretations and definitions of the terms “sound recording”, “original master version” and “relevant” period for those sections.

Supplementary provisions

Clause 51 makes changes to Schedule 29 to the Finance Act 2002 to modify the exclusion of films so far as acquisition expenditure is concerned, so that films acquired as intangible fixed assets will be dealt with by the specials regime set out in that Schedule for the taxation of gains and losses from intangible fixed assets.

Clause 52 gives HM Treasury the ability to make regulations providing for the tax treatment of films that commence principal photography before 1 April 2006, but that are not completed by 1 January 2007.

Clause 53 allows HM Treasury, by order, to appoint a day when Chapter 3 shall come into force and to amend key dates when specific elements of it are to take effect.

CHAPTER 4

CHARITIES

Clause 54 imposes restrictions on the transactions that a charity can participate in with a substantial donor that benefit from tax exemption or relief. Where a

charity participates in such transactions the clause will act to restrict tax exemption or relief granted to the charity.

Clause 55 amends a mechanism that restricts tax reliefs granted to charities where the charity incurs non-charitable expenditure.

Clause 56 will remove the risk that charities with trades that are only partly primary purpose, or are not mainly carried on by the beneficiaries of the charity, could, if the non-charitable part of the trade is large, lose tax relief on the profits of the whole of the trade.

Clause 57 enables subsidiary companies that are wholly owned by one or more charities to donate their profits to those charities and obtain tax relief for the donation using company gift aid. The measure comes into effect for payments made to charities on or after 1 April 2006.

Clause 58 extends to all companies' provisions that restrict the benefits that a close company can receive in return for a donation of money to charity that is eligible for tax relief. (A close company is a company controlled by five or fewer participators or by its directors). The clause also extends rules preventing relief where a donation is subject to repayment, or is part of a scheme involving the acquisition of property by the charity.

CHAPTER 5

PERSONAL TAXATION

Cars

Clause 59 provides that the lower threshold for company car tax rates will be reduced by 5g/km from 140g/km to 135g/km from 2008/09. It also provides for the introduction of a new 10 per cent band for cars with CO₂ emissions of 120g/km or below, also from 2008/09.

Mobile telephones and computers

Clause 60 replaces the exemption for employer provided mobile telephones in section 319 Income Tax (Earnings and Pensions) Act 2003. It provides that no tax will be due when employers make only one mobile telephone available for private use and removes the availability to family or household tax-free.

Clause 61 repeals the exemption for computer equipment made available to employees for private use with effect from 6 April 2006.

Eye care

Clause 62 exempts from a tax charge the provision by employers of eye care tests and/or corrective glasses for Visual Display Units (VDU) use to their employees. It also exempts from tax the provision of a non-cash voucher or credit-token used to facilitate the provision of such eye care tests and corrective glasses.

Vouchers and tokens

Clause 63 provides a regulation making power to allow the Treasury to provide by regulations for exemption from tax where a voucher or credit-token is used to provide a benefit in kind that would otherwise be exempt from tax.

Holocaust victims

Clause 64 exempts from tax, payments made by UK and foreign banks and building societies to Holocaust victims or their heirs for dormant accounts. The clause defines the victims as ‘victims of National-Socialist persecution’. It also replaces Extra Statutory Concession A100 exempting such payments made by UK banks and building societies under the “Restore UK” initiative. The exemption will cover payments made at any time on or after 6 April 1996.

CHAPTER 6

THE LONDON OLYMPIC GAMES AND PARALYMPIC GAMES

Clause 65 provides for the London Organising Committee of the Olympic Games Ltd (LOCOG) to be exempt from corporation tax with retrospective effect from 22 October 2004. It also provides powers for Treasury regulations to be made to apply the exemption, as appropriate, to a wholly owned subsidiary of LOCOG, and to make regulations to make further provision in relation to LOCOG and another person where LOCOG is acting in concert with a third party.

Clause 66 makes supplementary provision to clause 65.

Clause 67 provides powers for regulations to be made in relation to the tax treatment of the International Olympic Committee (IOC) and certain persons owned or controlled by the IOC.

Clause 68 provides powers for regulations to be made in relation to the tax treatment of non-United Kingdom resident athletes and other non-resident persons temporarily in the UK to carry out Olympic-related business.

CHAPTER 7

CHARGEABLE GAINS

Capital losses

Clause 69 amends the definition of an allowable capital loss for corporation tax purposes to exclude losses generated by a company as part of a tax avoidance scheme. It has effect in relation to disposals of assets made by a company on or after 5 December 2005. It is part of a package of three targeted anti-avoidance measures announced in the Pre-Budget Report (PBR) on 5 December 2005. On that date, HM Revenue and Customs published draft clauses, guidance material and a statement setting out the principles on which these rules are founded. The draft clauses and guidance were subject to a period of consultation until 6 February 2006.

Clause 70 introduces a new targeted anti-avoidance rule designed to prevent companies being bought and sold primarily in order to allow one group of companies to access the capital losses that were suffered by another company or group. It has effect in relation to tax advantages sought by a company in respect of assets disposed of on or after 5 December 2005. It is part of a package of three targeted anti-avoidance measures announced in the Pre-Budget Report on 5 December 2005. On that date, HM Revenue and Customs published draft clauses, guidance material and a statement setting out the principles on which these rules are founded. The draft clauses and guidance were subject to consultation until 6 February 2006.

Clause 71 prevents the use of a company's capital losses in tax avoidance schemes intended to reduce the income profits chargeable to corporation tax. The rules have effect in relation to chargeable gains accruing on any disposal that is made on or after 5 December 2005. This clause is part of a package of three targeted anti-avoidance measures announced in the Pre-Budget Report (PBR) on 5 December 2005. On that date, HM Revenue and Customs published draft clauses, guidance material and a statement setting out the principles on which these rules are founded.

Clause 72 repeals section 106 of the Taxation of Capital Gains Act 1992 ("TCGA"). This was an anti-avoidance measure to prevent companies or groups of companies gaining a tax advantage by selling and repurchasing shares within a short period of time.

Insurance policies and annuities

Clause 73 amends provisions in the Taxation of Chargeable Gains Act 1992 (TCGA) which relate to capital gains and losses arising on disposals of rights conferred by certain types of insurance policies and annuity contracts. The

main effect of the amendments is to clarify how the rules apply in relation to capital redemption policies. The amendments take effect in relation to disposals made on or after 5 December 2005.

Capital gains tax

Clause 74 counters certain schemes to avoid capital gains tax by amending the Taxation of Chargeable Gains Act 1992 (TCGA) so that, in certain circumstances, the “bed and breakfasting” rules do not identify “securities” (including shares or other assets that cannot be separately identified), that have been disposed of, with identical assets acquired within the following thirty days. The amendment applies if the person who makes the disposal is not resident in the United Kingdom for tax purposes at the time of the acquisition, and takes effect in relation to acquisitions made on or after 22 March 2006, irrespective of the time of the disposal.

CHAPTER 8

AVOIDANCE: MISCELLANEOUS

Film partnerships

Clause 75 is an anti-avoidance measure that applies to individuals who pay interest on a loan used to buy into a partnership carrying on a film-related trade (a “film partnership”). It restricts relief to 40 per cent of the interest paid where the individual’s loan is secured on an investment in another partnership (an “investment partnership”) in which the individual’s right to a share of the taxable income is disproportionately low compared to their capital contribution to that partnership.

Financial instruments

Clause 76 and Schedule 6 close a number of loopholes and block a number of avoidance schemes disclosed under Part 7 Finance Act (“FA”) 2004 and elsewhere. They all exploit legislation relating to financial products and arrangements of the types for which disclosure of schemes is required. The main categories of affected schemes are ones which:

- create contrived losses by the purchase and sale of the rights to distributions on shares;
- avoid tax on interest using stock lending or similar arrangements;
- exploit accounting rules which result in profits on loan relationships being de-recognised;
- attempt to get around the ‘shares as debt rules’ using the ‘outstanding third party obligations’ and ‘redeemable shares’ conditions;
- avoid tax on intra-group loans by passing value representing interest on the loan to a third group company in non-taxable form;

- exploit the group continuity rules for loan relationships and derivative contracts;
- avoid tax on loan relationships using arrangements where a debt can only be settled by the issue of shares.

Intangible fixed assets

Clause 77 makes changes to the legislation that deals with companies' intangible fixed assets (Schedule 29 Finance Act (FA) 2002). The legislation is aimed at avoidance schemes designed to obtain relief under Schedule 29 for the value of companies' 'existing assets', which were not intended to be within the scope of the Schedule. Schedule 29 specifically excludes the assets held by companies at the commencement of the new intangibles regime (1 April 2002) unless and until those assets are acquired by an unrelated party after that date.

International matters

Clause 78 provides for changes to the controlled foreign company (CFC) rules. These rules are designed to prevent UK companies from diverting profits to low tax regimes. Following changes in Finance Act 2002, UK resident companies which are deemed to be non-resident as a result of the operation of a double taxation treaty from 1 April 2002 remain subject to the CFC legislation, but companies which became non-resident in the same way before that date are not so treated. It has become clear that non-resident companies not subject to the CFC legislation are being used for avoidance. Clause 78 prevents this by bringing non-resident companies currently outside the scope of the CFC rules back within them if a specified event occurs on or after 22 March 2006.

Clause 79 and Schedule 7 amend the anti-avoidance legislation on transfer of assets abroad. These provisions are directed at individuals ordinarily resident in the UK who avoid income tax through transfers of assets that result in income becoming payable to a person abroad. The amendments were announced in the Chancellor's 2005 Pre-Budget Report, and are to take effect from 5 December 2005. These changes have been introduced to clarify how key elements of this legislation are intended to apply, and ensure it works effectively. In particular they revise the terms of the test allowing exemption from an income tax charge in cases not involving a tax avoidance purpose.

Pre-owned assets

Clause 80 amends legislation charging income tax on the benefit of enjoying "pre-owned assets". Its effect is that an existing exemption from the charge will not apply where the chargeable person disposes of an asset, continues to enjoy it, and is given an "interest in possession" in it. The income tax charge will apply in such circumstances on and after 5 December 2005 or, if later, from the time at which these circumstances first arise. However, the clause

also provides that the chargeable person can elect that the asset will not give rise to an income tax charge but will instead be charged in due course to inheritance tax.

CHAPTER 9

MISCELLANEOUS PROVISIONS

Leasing of plant or machinery

Clause 81 and Schedule 8 introduce a new regime for the taxation of long funding leases of plant or machinery. **Schedule 9** makes miscellaneous amendments relating to the new regime for the taxation of long funding leases of plant or machinery, which is introduced by clause 81 and Schedule 8.

Sale of lessors

Clause 82 and Schedule 10 introduces Schedule 10. The Schedule applies to companies carrying on a business of leasing plant or machinery on their own or in partnership. The provisions apply where there is a change of ownership of a company or a change in the arrangements for sharing partnership profits.

Clause 83 introduces new section 785ZA and 785ZB into ICTA 1988 and new section 261A into CAA 2001. It restricts the use of losses arising from a leasing business carried on by a company in partnership where there are unusual profit sharing arrangements.

Clause 84 inserts a new section 228K into the Capital Allowances Act (CAA) 2001. The new section 228K determines the disposal value to be used when a piece of plant or machinery subject to a lease is sold and the right to all or some of the income from the lease is retained.

Clause 85 inserts a new section 267A into the Capital Allowances Act (CAA) 2001 which restricts the effect of an election under section 266 where the transferor and transferee are both carrying on a business of leasing plant or machinery. The restriction applies for corporation tax purposes only.

Insurance companies and policy holders

Clause 86 and Schedule 11 make four changes to the taxation of companies carrying on life assurance business by:

- ensuring that losses cannot be created or profits reduced by paying bonuses etc out of untaxed surplus transferred to a company on a demutualization;
- preventing the potentially indefinite deferral of taxation on investment return in non-profit companies;

- deeming the amendments to the rules for apportionment of income and gains in relation to a company's "inherited estate" made by time-limited statutory instruments to have been made instead by the current Bill thus making permanent the effect of the amendments;
- removing unintended charges to tax where there is a transfer of business (which includes a demutualization).

Clause 87 allows insurance companies and friendly societies to agree certain types of variation in the terms of life insurance policies with their holders without attracting undesirable tax consequences for the policyholders. Such variations are those, which alter the basis used for determining the benefits secured by the policy.

Settlements

Clause 88 and Schedule 12 provide for legislation in the Taxation of Chargeable Gains Act 1992 (TCGA) relating to settlements to be amended, and for related minor and consequential amendments to be made to provisions of the TCGA and of other Acts. The principal amendments, with effect from 6 April 2006, provide a definition of settlor for most TCGA purposes, modify the rules that determine when a settlement is settlor-interested, and allow an election for a sub-fund of a settlement to be treated as a separate settlement; and from 6 April 2007 different rules will apply to determine the residence status of trustees for TCGA purposes.

Clause 89 and Schedule 13 provide for legislation in the Income and Corporation Taxes Act 1988 (ICTA) and the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) relating to trustees and settlements to be amended, and for related minor and consequential amendments. The principal amendments provide, with effect from 6 April 2006, for an increase in the standard rate band from £500 to £1000; a definition of 'settlor'; some new rules for settlor-interested trusts; a new regime for sub-funds to be treated as separate trusts; and for a common charging mechanism for certain receipts. A new trustee residence test applies from 6 April 2007.

Clause 90 amends legislation in the Income and Corporation Taxes Act 1988 (ICTA) relating to the special trust rates of tax. The effect of the clause is to exclude income arising from service charges held on trust by certain social landlords from being taxed at the special trust rates. The income will instead be chargeable at no more than the basic rate of tax. The changes will take effect from 6th April 2006.

Investment reliefs

Clause 91 and Schedule 14 make a number of amendments to the Enterprise Investment Scheme (EIS), the Venture Capital Trust (VCT) scheme and the Corporate Venturing Scheme (CVS).

Employment-related securities

Clause 92 amends section 420 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The changes strengthen parts of the income tax legislation relating to employment related securities to counter avoidance schemes, which use options over shares and securities to deliver employment reward.

Clause 93 amends the rules on Corporation Tax (CT) relief, introduced in Schedule 23 to Finance Act 2003, for shares acquired under Enterprise Management Incentive (EMI) options. The amendment will provide the intended CT relief where the shares acquired from the exercise of discounted options are restricted or convertible shares.

PAYE

Clause 94 amends sections 222, 684 and 710 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The changes provide for PAYE to be applicable prospectively on retrospective notional payments of employment income.

Alternative finance arrangements

Clause 95 is part of a measure that extends the legislation on alternative finance arrangements enacted in Finance Act (“FA”) 2005. It provides for an agency-style alternative finance arrangement, which is economically equivalent to a deposit at interest, to be taxed in the same way as a conventional deposit.

Clause 96 is part of a measure that extends the legislation on alternative finance arrangements enacted in Finance Act (“FA”) 2005. It provides for a partnership-style alternative finance arrangement, used to finance the purchase of property or other asset, to be taxed in a similar way to conventional arrangements.

Clause 97 provides for low-cost alternative finance arrangements within sections 47 and 47A Finance Act (“FA”) 2005 made by employers to employees to be taxed as a benefit in kind in the same way as conventional low-interest loans to employees.

Clause 98 allows for arrangements similar to alternative finance arrangements within Chapter 5 of Part 2 Finance Act (“FA”) 2005, which equate in substance

to a loan or deposit but do not give rise to the payment or receipt of interest, to be brought into the existing legislation by Treasury Order.

Nuclear decommissioning

Clause 99 amends section 29 of the Energy Act 2004. The amendments provided in this clause will preserve the intended effect of section 29 that accounting entries made by certain publicly owned companies in the British Nuclear Fuels Group, arising from the recognition of the Nuclear Decommissioning Authority taking responsibility for nuclear decommissioning and cleaning-up, should not be brought into account for corporation tax purposes.

Clause 100 amends section 30 of the Energy Act 2004. The amendments provided in this clause will preserve the intended effect of section 30 that certain accounting entries made by the Nuclear Decommissioning Authority on taking responsibility for nuclear decommissioning and cleaning-up should not be brought into account for corporation tax purposes.

Accounting practice

Clause 101 extends the temporary regime under which securitisation companies remain on old UK Generally Accepted Accounting Practice (GAAP) for tax purposes for a further year to cover periods of account ending before 1 January 2008. This gives further time for discussion with the sector in order to develop a permanent regime. It also makes some changes to the temporary regime and provides for the removal of certain regulatory powers.

Clause 102 and Schedule 15 provide a relief to enable certain taxable adjustments arising in the first period of account ending on or after 22 June 2005 to be spread for income tax and corporation tax purposes over between three and six years. The relief is to be available for adjustments which arise from a change in accounting policy required to comply with the interpretation of UK generally accepted accounting practice announced in Abstract 40 issued by the Urgent Issues Task Force of the Accounting Standards Board on 10 March 2005.

PART 4

REAL ESTATE INVESTMENT TRUSTS

Introduction

Clause 103 together with clauses 104 to 146 and Schedules 16 and 17, introduces a new regime in the UK for Real Estate Investment Trusts.

Clause 104 and Schedule 16 defines “property rental business” for the purpose of the regime that applies to Real Estate Investment Trusts. Schedule 16 provides details of various types of property business and classes of income, which are excluded from the remit of a “property rental business” for these purposes.

Clause 105 defines various terms used in the remainder of the legislation relating to Real Estate Investment Trusts.

Clause 106 sets out the conditions for giving notice to join the regime, and the conditions that a company must fulfil in order to join and remain in the Real Estate Investment Trust regime.

Clause 107 provides details of the conditions that a company must satisfy in relation to the type of business that it carries out in order to be eligible for the Real Estate Investment Trust regime.

Clause 108 provides details on the proportion of a company’s business that must be qualifying property rental business by reference to profits and assets in order to qualify for the Real Estate Investment Trust regime.

Entering Real Estate Investment Trust Regime

Clause 109 sets out the mechanism through which a company can inform HM Revenue & Customs that it wishes to opt for the Real Estate Investment Trust legislation to apply.

Clause 110 provides that the company will be subject to the legislation applicable to the Real Estate Investment Trust regime until a termination event occurs.

Clause 111 describes what happens for tax purposes to the existing business of a company when it enters the Real Estate Investment Trust regime.

Clause 112 sets out the amount and nature of the charge levied when a company first enters the Real Estate Investment Trust regime. The charge is 2 per cent of the value of the company’s assets that transfer to the tax-exempt property rental business.

Assets &c

Clause 113 provides a separation for tax purposes between the pre-conversion company, the post-conversion company, and the tax-exempt business and non tax-exempt business during the time of application of Real Estate Investment Trust legislation to the company.

Clause 114 provides powers to impose a tax charge on the Real Estate Investment Trust if it pays out distributions to investors with 10 per cent or more of the company's dividends, share capital or voting rights.

Clause 115 provides an interest cover ratio that a Real Estate Investment Trust must meet if it is to avoid the imposition of a tax charge. The clause provides for the tax charge itself to be set out in regulations.

Clause 116 provides the Treasury with a regulation-making power to deal with minor or inadvertent breaches of some of the Real Estate Investment Trust regime membership conditions, as an alternative to requiring the company to leave the regime.

Clause 117 describes the consequences when a Real Estate Investment Trust tries to obtain a tax advantage. It allows for the cancellation of the tax advantage and for the imposition of an additional charge to tax equal to the advantage sought.

Clause 118 deals with the treatment of cash arising from the disposal of an asset used in the tax-exempt business. Where these funds are not immediately reinvested in an asset of the tax-exempt business and are instead invested in short term funds, debits or credits arising from any resulting loan relationships fall to be relieved or taxed as part of the non tax-exempt business.

Profits

Clause 119 sets out the exemption from corporation tax that applies to the property rental business of a Real Estate Investment Trust and the rate of tax applicable to other activities.

Clause 120 provides the mechanism for the calculation of profits of the tax-exempt business of a Real Estate Investment Trust.

Clause 121 provides that a distribution from the tax-exempt profits of a Real Estate Investment Trust will be taxable under Schedule A (in the case of a shareholder chargeable to corporation tax) and as profits of a UK property business (in the case of a shareholder chargeable to income tax).

Clause 122 provides powers to set out the detailed requirements concerning deduction of basic rate income tax from distributions of profits of the tax-exempt business of a Real Estate Investment Trust.

Clause 123 sets out how a Real Estate Investment Trust identifies which of its distributions are treated as paid out of profits of its tax-exempt property rental income.

Capital gains

Clause 124 sets out rules for exempting from corporation tax some or all of the gain on the disposal of an asset that has been used at some time for the purposes of the tax-exempt business of a Real Estate Investment Trust.

Clause 125 applies where an asset is transferred from the tax-exempt business to the non tax-exempt business of a Real Estate Investment Trust. The transfer will be treated as a disposal by the tax-exempt business for a consideration equal to the market value of the asset as defined for chargeable gains purposes. The sale and reacquisition will take place at tax written-down value for capital allowances purposes.

Clause 126 deals with the transfer of an asset from the non tax-exempt business to the tax-exempt business of a Real Estate Investment Trust. The transfer will be treated as a disposal by the non tax-exempt business for a consideration equal to the market value of the asset for chargeable gains purposes. The transfer will take place at tax written-down value for capital allowances purposes.

Clause 127 provides that the capital gains provisions in clauses 124 to 126 of the Real Estate Investment Trust regime are to be interpreted together with the provisions of the Taxation of Chargeable Gains Act 1992.

Leaving Real Estate Investment Trust Regime

Clause 128 sets out how a company that is a Real Estate Investment Trust can give notice to HM Revenue and Customs that it wants to leave the Real Estate Investment Trust regime.

Clause 129 sets out the circumstances in which HM Revenue and Customs can issue a notice to a Real Estate Investment Trust that the regime will cease to apply to it. Such a notice can only be given if the Real Estate Investment Trust has repeatedly failed to meet certain conditions of the regime or been involved in tax avoidance.

Clause 130 provides for the Real Estate Investment Trust regime to cease to apply to a company automatically when it breaches certain conditions of the regime.

Clause 131 describes what happens for tax purposes to the tax-exempt business that was carried on by the company while it was a Real Estate Investment Trust.

Clause 132 sets out rules that apply if a company leaves the Real Estate Investment Trust regime within ten years of entering it. Where the company

disposes of an asset that was part of the tax-exempt business within a period of two years after leaving the regime, any deemed disposals that applied to that asset on entry to or exit from the regime, or on transfers out of the ring fence, are ignored in working out the gain on disposal.

Clause 133 sets out rules for when the Real Estate Investment Trust regime ceases to apply to a company if it leaves the regime early as the result of breaching one of the conditions the company has to meet to remain in the regime. It allows HM Revenue and Customs to determine a different cessation date than would normally apply to companies leaving the regime because they failed one of those conditions.

Groups

Clause 134 and Schedule 17 defines the group of companies that can join the regime to become a Group Real Estate Investment Trust, which is broadly a group as defined for taxation of chargeable gains purposes. The clause also introduces the schedule to the Bill that contains the modifications to the single-company Real Estate Investment Trust rules so they can apply to groups of companies.

Clause 135 provides that, in relation to a single company which has elected into the Real Estate Investment Trust regime (rather than a group of companies), the normal capital gains group rules which enable a transfer of assets between members of the group at no gain/ no loss will not apply between the tax-exempt and non tax-exempt parts of the company.

Clause 136 sets out the concept that the tax-exempt and non tax-exempt parts of the members of a Group Real Estate Investment Trust form two separate deemed groups, a tax-exempt group and a non tax-exempt group. In addition, the group that existed before joining the Real Estate Investment Trust regime and the group that exists after leaving the regime are also treated for tax purposes as separate from the tax-exempt and non tax-exempt groups that exist while the group is in the regime. The clause also sets out the application of various grouping provisions to a group that has elected into the regime.

Miscellaneous

Clause 137 applies to shares in Real Estate Investment Trusts held by an insurance company as part of its long term insurance fund. For the purposes of taxation of chargeable gains, the insurance company is deemed to have sold the shares and immediately reacquired them at market value at the end of each accounting period.

Clause 138 allows provision to be made in regulations to accommodate joint ventures in which a Real Estate Investment Trust is an investor being included within the Real Estate Investment Trust regime.

Clause 139 applies the provisions of the manufactured payments regime to distributions paid out of the tax-exempt profits of a Real Estate Investment Trust.

Clause 140 provides for penalties in cases where a Real Estate Investment Trust fails to comply with certain provisions of the legislation.

Clause 141 clarifies that, where the Real Estate Investment Trust legislation refers to a deemed disposal and re-acquisition for market value, on any subsequent disposal of the relevant asset, that market value shall be used as the cost of acquisition of the asset.

Clause 142 provides a definition of various terms used in the Real Estate Investment Trust provisions.

Clause 143 sets aside the rules applying to company reconstruction in section 139 Taxation of Chargeable Gains Act 1992 (TCGA) where the arrangements involve entering or leaving the Real Estate Investment Trust regime.

Clause 144 repeals the legislation relating to Housing Investment Trusts.

General

Clause 145 provides a general description of how the powers to make regulations provided in relation to the Real Estate Investment Trust provisions can be used.

Clause 146 clause sets out when a company can first enter the Real Estate Investment Trust regime (accounting periods beginning on or after 1 January 2007), and sets the date for repeal of the Housing Investment Trust legislation as the date the Bill receives Royal Assent.

PART 5

OIL

New basis for determining market value

Clause 147 and Schedule 18 provide for changes to the way oil disposed of at arm's length is valued for tax purposes. The changes will take effect from 1 July 2006.

Clause 148 provides commencement provisions for the measures outlined in the clause: “New basis for determining the market value of oil.”

Attribution of blended crude oil

Clause 149 provides powers for the Commissioners for HM Revenue and Customs to make regulations for determining to which fields, and in what proportions, blended oil is attributable for oil pricing for tax purposes.

Nomination scheme

Clause 150 provides for changes to the way oil disposed of is valued for tax purposes. The changes will take effect from 1 July 2006.

Clause 151 provides for changes to the way oil disposed of is valued for tax purposes. The changes will take effect from 1 July 2006.

Clause 152 provides for an excess of nominated proceeds to be brought into charge for the purposes of ring fence corporation tax and supplementary charge. The change will take effect from 1 July 2006.

Ring fence trades

Clause 153 provides for an increase in the supplementary charge in respect of ring fence trades from 10 per cent to 20 per cent.

Clause 154 provides for a company to elect for capital expenditure in respect of a ring fence trade, incurred in the year ended 31 December 2005, to be treated as being incurred on the first day of the company’s first accounting period beginning on or after 1 January 2006.

Clause 155 and Schedule 19 introduces a new supplement, which extends and replaces the existing exploration expenditure supplement (EES). The Ring Fence Expenditure Supplement (RFES) will help those companies exploring for oil or gas or in the development phase, in the UK or on the UK Continental Shelf, which do not yet have any taxable income against which to set their exploration, appraisal and development costs and capital allowances. The RFES increases the value of unused expenditure carried forward from one period to another by a compound 6 per cent per annum. It applies to all unrelieved expenditure from 1 January 2006.

PART 6

INHERITANCE TAX

Future rates and bands

Clause 156 provides for stepped increases in the inheritance tax threshold to £312,000 in 2008-09 and £325,000 in 2009-10 and maintains the tax rate at 40 per cent for each tax year on chargeable amounts in excess of these tax-free amounts.

Trusts

Clause 157 and Schedule 20 align the inheritance tax (IHT) rules for assets held in trust. So far as new trusts are concerned (created on or after 22 March 2006), it continues the current special treatment:

- for “interest-in-possession” trusts created on intestacy and straightforward interest-in-possession trusts created by will; and
- for “accumulation and maintenance trusts” to trusts created on the death of a parent where beneficiaries will take the trust assets at age 18.

Trusts for “disabled persons” will also continue to enjoy special treatment, as will existing regular premium life insurance policies written into trust. The IHT treatment for trusts which do not come within these rules will be aligned with the mainstream IHT rules for trusts. The clause and Schedule provide transitional arrangements for existing trusts.

Clause 158 provides that such property will no longer be excluded property where a person domiciled in the UK has acquired an “interest in possession” in it as a result of a money transaction. The amendments apply to all transfers or other chargeable occasions on or after 5 December 2005 in relation to interests acquired on or after that date.

PART 7

PENSIONS

Clause 159 and Schedule 21 remove tax advantages for self-directed registered pension schemes on investments in residential or tangible moveable property (together these are “taxable property”). The provisions provide for tax charges to arise on pension scheme members and administrators when the pension scheme acquires, holds, improves or disposes of taxable property

unless the taxable property is acquired or held through a genuinely diverse commercial vehicle.

Clause 160 provides an anti-avoidance rule that counters the use of tax-free lump sums from registered pension schemes to fund further tax-relieved pension contributions.

Clause 161 and Schedule 22 make changes and additions to the Inheritance Tax Act 1984 (IHTA) to clarify how Inheritance Tax (IHT) is applied to members of registered pension schemes on and after 6 April 2006 when the new tax rules for pension schemes take effect. These provisions cover two aspects. One legislates a 1992 HM Revenue and Customs concessionary practice that provides an IHT exemption in certain circumstances for pension scheme members who die under the age of 75 and also extends the exemption to payments made to charity. The other sets out how IHT is charged where a person dies over the age of 75 with funds in an alternatively secured pension (ASP).

Clause 162 and Schedule 23 make changes and additions to the Pensions Tax Simplification legislation introduced in Part 4 of the Finance Act (FA) 2004. The Pensions Tax Simplification legislation, including the changes made under this clause and Schedule, takes effect from 6 April 2006. The changes include measures that give schemes, employers and pension savers additional flexibility, measures dealing with the transition to the new regime, and measures to prevent abuse of the new rules.

PART 8

STAMP TAXES

Stamp duty and stamp duty land tax: thresholds

Clause 163 raises the threshold for stamp duty land tax on residential transactions from £120,000 to £125,000, and raises the threshold for stamp duty on documents effecting land transactions from £120,000 to £125,000.

Stamp duty land tax

Clause 164 and Schedule 24 make further provision for the stamp duty land tax treatment of transactions between partners and partnerships and transactions in partnership interests.

Clause 165 and Schedule 25 make further provision for the stamp duty land tax treatment of leases.

Clause 166 prevents a charge to stamp duty land tax arising when trust property is reallocated between beneficiaries.

Clause 167 repeals section 64A Finance Act ('FA') 2003 (initial transfers of assets to trustees of unit trust scheme) and makes provision for the stamp duty land tax treatment of transfers of assets to the trustees of a unit trust scheme.

Clause 168 makes further provision for relief from stamp duty land tax on the demutualisation of an insurance company. The clause ensures that the transfer of business on demutualisation (a) does not of itself give rise to a recovery of group relief where property-owning subsidiaries are transferred and (b) does not of itself constitute 'arrangements' so that group relief is not available.

Clause 169 extends the current reliefs from stamp duty land tax for alternative financing transactions to persons other than individuals.

Stamp duty

Clause 170 amends the stamp duty reconstruction and acquisition reliefs. It removes the requirement that the acquiring company must have its registered office in the United Kingdom. It also changes the rules requiring that the proportion of shares held by each shareholder must remain unaltered. It provides that relief may apply when shareholdings are matched as nearly as is possible when precise matching cannot be achieved for practical reasons.

PART 9

MISCELLANEOUS PROVISIONS

Landfill tax

Clause 171 increases the standard rate of landfill tax from £18 per tonne to £21 per tonne on relevant waste disposals at authorised landfill sites made, or treated as made, on or after 1 April 2006.

Climate change levy

Clause 172 increases the rates of climate change levy, in line with current inflation, with effect from 1 April 2007.

Clause 173 will remove the temporary half rate of climate change levy (CCL) for energy used by the horticulture sector, from 1 April 2006. This reduced rate was only ever intended to last 5 years, and state aid clearance for it expires on 31 March 2006. However, businesses in the horticulture sector are now eligible to enter a climate change agreement and receive an 80 per cent

reduction in CCL rates in return for signing a binding agreement to reduce energy use and/or emissions.

International tax arrangements

Clause 174 provides for international agreements about mutual assistance in the enforcement of taxes, covering exchange of information, assistance in tax collection and the service of documents. This clause replaces a variety of different existing provisions concerning international agreements for the exchange of tax information, all of which will be repealed. The clause has effect from Royal Assent.

Clause 175 adapts the powers available to HM Revenue and Customs to obtain information for the purposes of a liability to income tax, corporation tax and capital gains tax so that they may be used to obtain information in respect of a liability to any foreign tax included in agreements provided for in clause 174. These provisions mirror the existing information powers relating to international agreements for the exchange of tax information, which will be repealed. Clause 175 has effect from Royal Assent.

Clause 176 enables foreign tax debts arising from the international agreements provided for in clause 174 to be recovered in the UK. The details of the way in which recovery will work will be set out in regulations. Clause 176 has effect from Royal Assent.

Clause 177 aligns the Parliamentary procedures applying to Orders in Council that give effect to agreements concerning the avoidance of double taxation with the procedures applying to Orders made under clause 174. The clause has effect from Royal Assent.

Disclosure of information

Clause 178 provides a criminal sanction for the wrongful disclosure of HM Revenue and Customs information, which has been passed to the Gambling Commission, or other specified persons or bodies, in accordance with information sharing provisions in the Gambling Act 2005. Clause 178 will take effect from Royal Assent.

PART 10

SUPPLEMENTARY PROVISIONS

Clause 179 provides for the repeals contained in Schedule 26 to the Bill to have effect. It also gives effect to the Notes in the Schedule that set out the commencement provisions and savings applying to the repeals.

Clause 180 provides for the use of abbreviations for a variety of Acts. For example, it provides for the use of “ICTA” as an abbreviation for the Income and Corporation Taxes Act 1988 (c.1).

Clause 181 provides for the Bill to be known as the “Finance Act 2006” upon enactment.