CLAUSE 24 AND SCHEDULE 3: AVOIDANCE INVOLVING TAX ARBITRAGE – DEDUCTION CASES

SUMMARY

1. Clauses 24 to 31and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply from 16 March 2005, to companies that use schemes involving certain types of hybrid entities or instruments, for UK tax avoidance purposes, but only if HM Revenue and Customs issue a notice to that company, directing that the legislation applies.

3. Clause 24 sets out the four conditions that must be satisfied in order for the legislation to apply to deductions.

4. Schedule 3 sets out the transactions that will result in a scheme becoming subject to the legislation as it applies to deductions (the deduction rules). It contains three sections: Schemes involving hybrid entities, schemes involving certain instruments that have hybrid effect and schemes between connected parties that involve additional types of instrument that have hybrid effect.

DETAILS OF THE CLAUSE

5. Subsection (1) provides that where it has reasonable grounds, the Commissioners of HMRC may issue a notice directing that the legislation applies.

6. Subsection (2) defines the companies who may be subject to the legislation and on whom a notice may be served – i.e. those within the charge to corporation tax.

7. Subsection (3) provides the first of the conditions (A) that must be satisfied before the deductions rules can have an effect which is that there is a "qualifying scheme". 'Scheme' and 'qualifying scheme' are defined in clause 30 (2) and Schedule 3 (9)

8. Subsection (4) provides the second condition (B) which is that there is or will be a tax deductible expense or other set-off.

9. Subsection (5) provides the third condition (C) which is that the purpose or one of the main purposes of the schemes is to achieve a "UK tax advantage". "UK tax advantage" is defined in clause 109.

10. Subsection (6) provides the fourth condition (D) which is that the tax advantage is not minimal.

11. Subsection (7) sets out the matters that may be covered by the notice issued by the Commissioners of HM Revenue and Customs.

12. Subsection (8) notes that a notice may cover several transactions that form part of the same scheme.

13. Subsection (9) introduces Schedule 3 which sets out the elements within a scheme that will make it a qualifying one for purpose of the legislation

DETAILS OF THE SCHEDULE

14. Paragraph 1 introduces the three Parts of the schedule under which a scheme is a "qualifying scheme".

15. Paragraph 2 provides that a scheme will be a qualifying scheme if at least one of the parties to it is a hybrid entity.

16. Paragraph 3 defines a hybrid entity.

17. Sub-paragraph (1) of paragraph 3 provides that definition as an entity which is recognised as a person, but whose profits are also taxable in the hands of another person.

18. Sub-paragraph (2) ensures that non UK-CFC apportionment does not result in an entity meeting this definition. (UK CFC apportionment is not subject to this rule anyway.

19. Sub-paragraph (3) defines the taxes which are relevant for this definition.

20. Paragraph 4 provides that a scheme will be a qualifying scheme, if it contains a hybrid instrument of the type specified in the subsequent four paragraphs (5, 6, 7 and 8). ie the scheme has a ‘hybrid effect’.

21. Paragraph 5 provides that a scheme will be a qualifying scheme if it contains an instrument that has an alterable characteristic.

22. Sub-paragraph (2) of paragraph 5 provides that an instrument is alterable if one of its “relevant characteristics” is that it can be altered by an election of any party to the instrument.

23. Sub-paragraph (3) specifies what is meant by “relevant characteristic”, which is one that, if altered, will, in turn, alter the taxation of the instrument because it is thereby taken into account as giving rise to income, or, as the case may be, capital or does not thereby fall to be taken into account as either income or capital.

24. Sub-paragraph (4) provides the terms on which an instrument will be regarded as giving rise to capital which is where any gain on its disposal would be a chargeable gain if the disposal was made by a person resident in the UK.

25. Paragraph 6 provides that a scheme will be a qualifying scheme if it contains shares subject to conversion.

26. Sub-paragraph (1) of paragraph 6 provides that shares are “subject to conversion” for these purposes if they are issued in convertible form or if they later become convertible.

27. Sub-paragraph (2) defines what is meant by “subject to conversion”, which is that the shares can be converted or exchanged for securities and that there was a reasonable expectation that this was likely to occur at “the relevant time”, as defined below.

28. Sub-paragraph (3) defines “the relevant time” as the time when the shares were issued or, as the case may be, the time when the rights attaching to the shares were amended.

29. Paragraph 7 provides that a scheme will be a qualifying scheme if it contains securities “subject to conversion”.

30. Subparagraph (1) of paragraph 7 provides that securities are "subject to conversion" for these purposes if they are issued in convertible form or if they later become convertible.

31. Sub-paragraph (2) defines what is meant by "subject to conversion" which is that the securities can be converted or exchanged for shares and that there was a reasonable expectation that this was likely to occur at "the relevant time".

32. Sub-paragraph (3) defines "the relevant time" as the time when the securities were issued or, as the case may be, the time when the rights attaching to the securities were amended.

33. Sub-paragraph (4) provides that for the purposes of the paragraph security has the same meaning as in Part 6 of ICTA.

34. Paragraph 8 provides that a scheme will be a qualifying scheme if it contains "debt instruments" that are treated as equity.

35. Sub-paragraph (1) of paragraph 8 provides that a debt instrument will be treated as equity for these purposes where it would be so treated under generally accepted accounting practice.

36. Sub-paragraph (2) defines a "debt instrument" as one which is, or would be if it were resident in the UK, a loan relationship of the company.

37. Paragraph 9 provides that a scheme will be a qualifying scheme, if it contains a hybrid instrument that has a hybrid effect of the type specified in the subsequent two paragraphs (10 and 11) and the scheme involves connected parties.

38. Paragraph 10 provides that a scheme will be a qualifying scheme if it includes shares that do not confer a "qualifying beneficial entitlement".

39. Sub-paragraph (1) of paragraph 10 provides that a scheme satisfies the requirements of the paragraph if it includes the issue of shares to a connected party and those shares are not excluded by virtue of sub-paragraph 2.

40. Sub-paragraph (2) excludes fully paid up ordinary shares that confer a "qualifying beneficial entitlement" at the time of issue and which will are expected to do so in subsequent periods.

41. Sub-paragraph (3) defines a “qualifying beneficial entitlement” as one which confers on the shareholder the right to both a “relevant proportion” of the profits and any assets available for distribution on a winding up of the company.

42. Sub-paragraph (4) defines ‘relevant proportion’ as the proportion of the company’s issued share capital represented by the shares in question.

43. Sub-paragraph (5) provides that, for these purposes, the Schedule 18 of ICTA definition of “equity holders” applies as it applies for S403C ICTA.

44. Paragraph 11 provides that a scheme will be a qualifying scheme if it contains a transfer of rights arising under a security.

45. Sub-paragraph (1) or paragraph 11 defines “transfer of rights” as the transfer of the right to receive payments under the security and the securing of any similar benefit for one or more persons.

46. Sub-paragraph (2) provides that a person receives a similar benefit where he receives a payment which would otherwise have arisen to the transferor.

47. Sub-paragraph (3) requires that some or all parties are connected in order for the scheme to qualify.

48. Sub-paragraph (4) requires that, following the transfer, at least half of the rights that remain are held by connected persons.

49. Sub-paragraph (5) provides that rights are to be valued at their market value in order to determine whether subparagraph (4) is satisfied.

50. Sub-paragraph (6) provides that “security” has the same meaning as in Part 6 of ICTA. It further provides, however, that it will also include an agreement under which a person receives an annuity or other annual payment for a period which is not contingent on the duration of a human life or lives.

51. Paragraph 12 provides that “connected person” for the purposes of paragraphs 9 to 11 is defined by S839 of ICTA.

BACKGROUND NOTES

52. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

53. The new legislation will apply only if a tax avoidance purpose is present and achieved and only if the Commissioners for HM Revenue and Customs issue a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

54. Draft Guidance on the application of the new rules was issued by the then Inland Revenue, now HM Revenue and Customs, on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

CLAUSE 25
AVOIDANCE INVOLVING TAX ARBITRAGE
RULES RELATING TO DEDUCTIONS

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply from 16 March 2005, to companies that use schemes involving certain types of hybrid entities or instruments, for UK tax avoidance purposes, but only if the Commissioners for HM Revenue and Customs (HMRC) issue a notice to that company, directing that the legislation applies.

3. Clause 25 sets out how the legislation applies to restrict the amount of the deduction allowable for corporation tax purposes (the deduction rules). The clause contains two rules that can reduce or deny deductions if the conditions of clause 25 are met.

DETAILS OF THE CLAUSE

4. Subsection (1) provides that the two rules will apply where the conditions of clause 24 are satisfied and the Commissioners for HM Revenue and Customs have issued a notice.

5. Subsection (2) provides that, where a notice is issued, the company is required to amend its self-assessment in accordance with the notice. This is subject to subsection (15) below.

6. Subsection (3) provides for the first condition for the application of the section (Rule A) which is that no deduction is allowed where the same expense is allowed for the purposes of any other tax

(except special taxes that apply to UK oil companies in addition to corporation tax).

7. Subsection (4) provides that Rule A applies where the amount in question would have been deducted or allowed twice but for the operation of “a rule” similar to that in subsection (3). The result is that a deduction may be disallowed in both the UK and in other territories.

8. Subsection (5) provides that ‘a rule’ for the purposes of subsection 4 means a UK tax rule or a similar foreign tax rule.

9. Subsection (6) provides the circumstances in which the second deduction rule, Rule B, has effect. The rule will apply where a transaction or series of transactions involves a payment which creates a deduction or allowance for the payer but the recipient is not liable to tax on the receipt or has his tax liability reduced as a result of the scheme.

10. Subsection (7) refines what is meant in subsection (6) by a person having his liability to tax reduced as a result of the scheme. It provides that this happens where the payee can set-off against his income an expense or relief arising out of the scheme.

11. Subsection (8) further refines what is meant by liable to tax for the purposes of Rule B. In order to fall under subsection (6) a person must be ordinarily liable to tax on their income but not liable to tax on the receipt received as a result of the transaction or series of transactions.

12. Subsection (9) provides that subsection (6) will not be satisfied where the recipient is not subject to tax because of a specified exemption from tax of the kind set out in subsection (10). This is designed to ensure that entities such as charities and pension funds, that are generally exempt from tax, are outwith the scope of this legislation.

13. Subsection (10) sets out the type of tax exemption that qualifies for the purposes of subsection (9) which is a statutory exemption which exempts a person from tax without providing that those income or gains are to treated of those of another person.

14. Subsection (11) provides that where Rule B applies the amount allowable as a deduction for the purposes of corporation tax is to be reduced in accordance with subsections (12) and (13).

15. Subsection (12) provides that, if the payee is not liable to tax on the receipt, none of the deduction is allowed.

16. Subsection (13) provides that, if the payee is partly liable to tax on the receipt, the deduction is reduced proportionately to correspond to the payee's liability.

17. Subsection (14) provides that in making or amending its self-assessment, a company may chose to make adjustments (as defined in subsection (16) with a view to counteracting a UK tax advantage.

18. Subsection (15) provides that if a company has made adjustments under subsection (14) and as a result has defeated the UK tax advantage that was a main purpose of the qualifying scheme, then because that UK advantage has not been achieved the deduction rules will not apply.

19. Subsection (16) defines a relevant reduction for the purposes of subsection (14) to include both reduced deductions and reduced set-offs.

20. Subsection (17) provides that any references in the clause to tax purposes, including those reference to foreign tax, have the same meaning as section 403D of ICTA.

21. Subsection (18) defines 'company tax return' for the purposes of this clause.

BACKGROUND NOTES

22. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

23. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if HM Revenue and Customs issues a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

24. Draft Guidance on the application of the new rules was issued by the then Inland Revenue, now HM Revenue and Customs, on 16 March 2005 and will be updated if issues give rise to particular uncertainty for business. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 26: AVOIDANCE INVOLVING TAX ARBITRAGE RECEIPTS CASES

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance of UK tax through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. Clause 26 defines the scope of the tax arbitrage rules as they apply to receipts ('the receipts rule'). The clause contains five conditions that must be satisfied before the receipts rules will have effect. The rules will not have effect unless the Commissioners for HM Revenue and Customs issue a notice.

DETAILS OF THE CLAUSE

3. Subsection (1) provides that HM Revenue and Customs may issue a notice requiring a company to take account of the arbitrage receipt rules. A notice may be issued if the Commissioners think, or have reasonable grounds to believe that the conditions below are satisfied.

4. Subsection (2) provides the first of the conditions (A) that must be satisfied before the receipts rules can have effect. That condition is that there is a scheme which includes the company on whom a notice may be served and another person who makes a payment to it. Scheme is defined in clause 30(1).

5. Subsection (3) provides the second condition (B), which is that a qualifying payment is made under the provision identified in condition (A). Qualifying payment is defined in 26 (11)

6. Subsection (4) provides the third condition (C), which is that the person making the payment is entitled to a tax deduction, either in the UK or another territory.

7. Subsection (5) provides that a deduction will not meet this condition if it is one that can be set against income arising as part of the scheme.

8. Subsection (6) provides for an exclusion from Condition C, for losses made by dealers in the ordinary course of their business, which would otherwise be caught. This covers the situation where a dealer cannot set all their deductions against income arising under the scheme as provided for in subsection (5) simply because a loss has arisen

9. Subsection (7) defines dealers for the purposes of the exclusion in 26(6). This includes any person for whom the receipts from share transactions is a trading receipt

10. Subsection (8) introduces the fourth condition (D) which is defined in the following clause

11. Subsection (9) defines condition (D), which is that the amount received by the company has not been taken into account in computing its own liability to corporation tax, or in computing the income portion of another company's corporation tax. This includes a charge under the avoidance involving financial arrangements rules provided by Clause 39 and Schedule 7 to this Bill. The effect of condition D is that a charge can only arise in respect of amounts that have not already been subject to tax.

12. Subsection (10) provides the fifth condition that must be satisfied, which is that a benefit arises from the fact that the receipt satisfies condition D.

13. Subsection (11) provides for the terms on which a notice may be issued by HM Revenue and Customs. The notice must inform the company that the Commissioners believe the conditions are satisfied and state which payment is subject to the notice. The notice must also specify the accounting period it effects and that clause 27 has effect (which brings an amount into charge).

14. Subsection (12) defines qualifying payment as one, which contributes to the capital of the company. A payment will contribute to the capital if the capital is increased as a result of the payment.

15. Subsection (13) defines a corresponding accounting period for the purposes of the receipts rules. This is any accounting period that overlap with the companies accounting period by at least one day

BACKGROUND NOTES

16. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

17. The new rule will apply only if the arrangements have been entered into to reduce UK tax and only if HM Revenue and Customs issues a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

18. There is no specific UK tax avoidance test in the case of receipts as unlike the legislation for deductions it is narrowly focused on a type of arrangement the benefit of which is known to be the avoidance of UK tax.

19. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 27: AVOIDANCE INVOLVING TAX ARBITRAGE RULE AS TO QUALIFYING PAYMENT

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments, for tax avoidance purposes, but only if the Commissioners of HM Revenue and Customs issue a notice directing that the legislation applies.

3. Clause 27 provides the effect of the tax arbitrage rules as they apply to receipts (the receipts rule). The clause requires that amounts that are subject to the rules be brought into charge in computing the income of the company that receives them.

DETAILS OF THE CLAUSE

4. Subsection (1) provides that the rule will not apply unless the conditions of clause 106 are satisfied and the Commissioners for HM Revenue and Customs have issued a notice.

5. Subsection (2) requires the company to apply the new rule when making or amending its self-assessment. The company must compute, (or where it has already made its return, it must recompute), its liability to Corporation tax as if the relevant amount received without taxation was in fact subject to tax under case VI of Schedule D (the miscellaneous receipts charging section).

6. Subsection (3) defines the amount to brought into charge. It also provides for the situation where part of a payment is subject to the receipts rules. Where a payment is partially subject to tax, or is only partially deductible in the hands of the payer then the charge under the receipts rules is limited to the remaining portion.

7. Subsection (4) defines the 'qualifying payment', which will be subject to tax, by using the definition already provided in clause 26. This is a payment, which contributed to the capital of the company. Contributes means the capital of the company is increased as a result of the payment.

BACKGROUND NOTES

8. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

9. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if the Commissioners for HM Revenue and Customs issue a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

10. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 28: AVOIDANCE INVOLVING TAX ARBITRAGE NOTICES UNDER SECTIONS 24 AND 26

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments, for the purposes of avoiding UK tax, but only if the Commissioners for HM Revenue and Customs issue a notice directing that the legislation applies.

3. Clause 28 provides the rules that determine when a notice may be issued by the Commissioners for HM Revenue and Customs to give effect to the arbitrage rules in clauses 24 and 26 and what the consequences of a notice may be.

DETAILS OF THE CLAUSE

4. Subsection (1) introduces the effect of a notice issued before a self assessment has been made

5. Subsection (2) provides that a company always has up to 90 days in which to make a self assessment or amendment that takes account of a notice, and covers the situation where it is about to make its self assessment.

6. Subsection (3) governs when a notice can be issued once a self assessment has been made. In such a case, the Commissioners may only issue a clause 24 or clause 26 notice if a notice of enquiry has been issued in respect of the return.

7. Subsection (4) introduces two requirements which must be satisfied in order for a notice to be issued after an enquiry has been concluded. These restrictions are provided by the following subsections.

8. Subsection (5) provides the first requirement which mirrors that already provided for reopening an enquiry under self assessment, which is that the Commissioners could not have been reasonably expected to realise that a notice was required on the basis of information made available before any enquiry was completed.

9. Subsection (6) defines when information is 'made available' to HM Revenue and Customs by reference to existing definitions for self assessment.

10. Subsection (7) provides the second requirement, which limits the application of the first requirement to cases where information had been requested by HM Revenue and Customs.

11. Subsection (8) permits a company to amend its return at any time within 90 days, following the receipt of a notice.

12. Subsection (9) prevents an enquiry being formally closed until the company has had up to 90 days in which to amend its return. The taxpayer may amend his return before the 90 days if they wish.

13. Subsection (10) prevents a discovery assessment being raised after an enquiry has closed, until the company has had up to 90 days in which to amend its return.

14. Subsection (11) makes it clear that subsections (2)(b) and (8) above do not prevent a return from becoming incorrect if the taxpayer fails to make an appropriate adjustment to the return within the 90 day time limits provided for in those subsections.

15. Subsection (12) provides the definitions of 'closure notice', company tax return', 'discovery assessment' and 'notice of enquiry', for the purposes of clause 28.

BACKGROUND NOTES

16. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

17. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if the Commissioners for HM Revenue and Customs issue a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

18. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 29: AVOIDANCE INVOLVING TAX ARBITRAGE AMENDMENTS RELATING TO COMPANY TAX RETURNS

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments, for the purposes of avoiding UK tax, but only if the Commissioners for HM Revenue and Customs issue a notice directing that the legislation applies.

3. Clause 29 makes certain amendments to self-assessment machinery, in consequence of the changes introduced by clauses 24 and 26.

DETAILS OF THE CLAUSE

4. Subsection (1) extends the range of matters that may be the subject of an enquiry into a corporation tax return, to include the question of whether a notice should be issued under either clause 24 or 26 (avoidance involving tax arbitrage).

5. Subsection (2) removes the two conditions that must normally be met before a corporation tax discovery assessment under paragraph 41 Schedule 18 FA 1998 may be made, in a case where a notice under either of clauses 24 or 26 has been issued. The restrictions on discovery assessments are not needed in view of the separately imposed restrictions on the notices issued under clauses 24 or 26.

BACKGROUND NOTES

6. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a

payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

7. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if the Commissioners for HM Revenue and Customs issue a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

8. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 30:AVOIDANCE INVOLVING TAX ARBITRAGE INTERPRETATION

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments, for the purposes of avoiding UK tax, but only if the Commissioners for HM Revenue and Customs issue a notice directing that the legislation applies.

3. Clause 30 provides the definitions of 'scheme' and 'tax advantage' for the purposes of the arbitrage rules. These definitions build on those used in other anti avoidance legislation.

DETAILS OF THE CLAUSE

4. Subsection (1) gives effect to the definitions in the following subsections for the purpose of the arbitrage rules.

5. Subsection (2) defines scheme for the purposes of the arbitrage rules:

6. Paragraph (a) of subsection (2) provides that scheme is defined as any scheme, arrangement or understanding of any kind. A scheme does not have to be legally enforceable and can consist of a single transaction.

7. Paragraph (b) of subsection (2) provides that a scheme shall exist notwithstanding the fact that different transactions within that scheme have different parties.

8. Paragraph (c) of subsection (2) includes within the definition of scheme, transactions that have been undertaken or amended as

consequence of the scheme and any transaction that would not have been entered into but for the scheme.

9. Subsection (3) defines a UK tax advantage for the purposes for the arbitrage rules. Paragraphs (a) to (c) of subsection (3) define advantage by reference to the effect that arises as a consequence of the scheme. Those consequences cover a relief or increased relief that arose from the use of the scheme, a repayment or increased repayment that arose from the use of the scheme or the avoidance or reduction of a charge to tax that arose from the use of the scheme.

10. Subsection (4) confirms that obtaining a tax credit for UK dividends is within the scope of 30(3)(a).

11. Subsection (5) provides additional definition for the terms 'avoidance' and 'reduction' which are used in the definition of 'UK tax advantage'. Avoidance or reduction of a charge to tax will occur if receipts have been made to arise in a non taxable way or a deduction has been contrived to reduce a charge to tax.

BACKGROUND NOTES

12. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

13. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if the Commissioners for HM Revenue and Customs issue a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

14. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.

EXPLANATORY NOTE

CLAUSE 31: AVOIDANCE INVOLVING TAX ARBITRAGE COMMENCEMENT

SUMMARY

1. Clauses 24 to 31 and Schedule 3 provide new rules to prevent avoidance through arbitrage. Arbitrage is the exploitation of differences between or within national tax codes. The clauses and schedule provide a set of circumstances in which deductions may be reduced or disallowed or under which receipts will be brought into charge.

2. The legislation will apply to companies that use schemes involving certain types of hybrid entities or instruments, for the purposes of UK tax avoidance, but only if the Commissioners for HM Revenue and Customs issue a notice directing that the legislation applies.

3. Clause 31 provides the commencement rules for the deductions rules (referred to here as the deduction case provisions) and the receipts rules (here referred to here as the receipts case provisions).

DETAILS OF THE CLAUSE

4. Subsection (1) provides the commencement date of accounting periods beginning on or after 16 Match 2005 for the deduction cases provisions.

5. Subsection (2) modifies the accounts periods of all companies for the purposes of the deduction cases provisions, where the accounting period straddles the commencement date. The clause splits the existing period into two for the purposes of applying the new legislation. The result is that deductions and reliefs arising on or after 16 March 2005 are within the scope of the deduction cases provisions if the Commissioners for HM Revenue and Customs issue a notice.

6. Subsection (3) provides an exemption from the deduction cases provisions for schemes that were in existence on 16 March 2005, do not include any connected parties and are unwound before 31 August 2005.

7. Subsection (4) provides the commencement date for the receipts cases provisions. This rule applies to all contributions to the capital of a company made on or after 16 March 2005.

8. Subsection (5) defines ‘deduction case provisions’ and ‘receipts case provisions’ for the purpose of deciding which provisions are covered by which commencement rules.

BACKGROUND NOTES

9. Arbitrage is the exploitation of differences between or within national tax systems. This can result, for example, in a tax deduction being given by both the UK and another country for the same expense (a double dip) or a deduction being given for a payment when tax on the corresponding receipt has been avoided. A significant number of disclosures under sections 306–319 of the Finance Act 2004 (the disclosure rules) identified arbitrage.

10. The new legislation will apply only if the arrangements have been entered into to reduce UK tax and only if the Commissioners for HM Revenue and Customs issues a notice directing a company to make or amend its self-assessment taking into account the rule. When it does apply, deductions forming part of an arbitrage scheme will be denied to the extent of the arbitrage and certain receipts will become taxable.

11. Draft Guidance on the application of the new rules was issued by the Inland Revenue on 16 March 2005 and was updated on 26 May 2005. HM Revenue and Customs will also give assistance on the application of the rule to specific cases.