Tolley's Tax Digest

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Including practical guidance on:

- business taxation;
- personal taxation;
- pensions; and
- revenue protection.

Practitioner's Guide to the Finance Act 2010

Powrie Appleby LLP

Tolley's Tax Digest

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1 Introduction

This year's Finance Act is, not surprisingly, much shorter than its predecessors, as it was a short, pre-election Bill. Notwithstanding that, FA 2010 still had 70 sections and 13 Schedules, and the entire debate of the Bill took around 3 hours. Hardly a triumph for Parliamentary democracy!

Of course, we anticipate a second Finance Bill shortly, following the General Election, and many of the intended provisions of that second Bill were detailed in the Budget Press Releases. Which of these will be enacted will be dependent on the complexion of the incoming Parliament.

For now, we turn our attention to the contents of the first Finance Act. The aim of this *Tax Digest* is to highlight those aspects of the new rules that the majority of tax advisers are likely to have to interpret for their clients, and any other areas of general interest that, whilst not so common in practice, may arise from time to time.

2 Business taxation

2.1 Rates of corporation tax

For the financial year 2011, the corporation tax rates remain unchanged at 21% for small companies and 28% for large companies. The Upper and Lower Relevant Maximum Amounts are unchanged at £300,000 and £1,500,000, respectively, as is the fraction used in calculating marginal rate, which is 7/400.

For ring fence profits (income and gains from oil extraction activities or oil rights in the UK and UK Continental Shelf), the rates continue to be 19% for small companies and 30% for large companies. The Upper and Lower Relevant Maximum Amounts are unchanged at £300,000 and £1,500,000 and the marginal relief fraction used for such profits is still 11/400.

2.2 Bank payroll tax

The Act introduces a new bank payroll tax, payable by banks in respect of bonus payments to relevant banking employees. The rate of this tax is 50% of the excess of any bonus over £25,000, and it applies to both contractual and discretionary bonuses which become due between 9 December 2009 (the date the tax was announced in the Pre-Budget Report) and 5 April 2010.

Whilst this may not be of wide application, advisers with banking clients or clients who are employed by banks should be aware that a 'bonus' can include money, money's worth, benefits or loans. The tax does not apply to regular salaries or benefits, to shares awarded under an approved SIP or to share options granted under an approved SAYE scheme. The tax also does not apply where there was already a contractual obligation to pay the bonus before 9 December 2009, or where the contractual obligation to pay the bonus arises after 5 April 2010.

The bank payroll tax cannot be taken into account when calculating profits or losses for income tax or corporation tax. That is, the banks do not get a tax deduction for this tax, so the whole 50% (over £25,000) is a cost to the employer.

The bank must submit a return to HMRC by 31 August 2010 and the tax is also due by this date. Late filing and late payment penalties apply.

2.3 Close companies: release of loans to participator

Where a close company makes a loan to a participator, and that loan is subsequently released or written off, the company is now denied a deduction for the release or writing off of the loan. Previously it was possible for a loan release to be tax deductible for corporation tax purposes, even though the release was treated as a distribution for the participator (effectively a tax deductible dividend).

This applies to loans released or written off after 24 March 2010. The income tax treatment for the person released from the loan remains the same.

2.4 Asset transfer to non-resident company: recovery of postponed charge

Under TCGA 1992 s 140, when a UK resident trading company transfers its non-UK trade and assets to a non-UK resident company in exchange for securities in the non-resident company, the gain was deferred until the disposal of any shares received on such a transaction. However, if the securities acquired on the transaction were loan notes or debentures, the later disposal of these was outside the scope of corporation tax on chargeable gains (by TCGA 1992 s 115), so that no deferred gain came back into charge.

FA 2010 amends TCGA 1992 s 140 for disposals after 6 January 2010, so that when the transferor company disposes of all or part of the securities received, a chargeable gain is deemed to accrue which is in addition to any actual gain or loss that accrues on the disposal of the securities. That way, the deferred gain comes back into charge even if it had not been rolled over into shares originally.

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2.5 Annual investment allowance

FA 2010 increases the annual investment allowance (AIA) from £50,000 to £100,000. Expenditure incurred which is in excess of the AIA threshold will continue to be dealt with under the normal capital allowances rules, and so subject to writing-down allowances of 20%, or at the 'special rate' of 10%.

The AIA is a 100% allowance on expenditure incurred on plant and machinery within the relevant provisions of Capital Allowances Act 2001, and was introduced by FA 2008 to replace first-year allowances. It is available to a 'qualifying person', namely an individual, a partnership of which all the members are individuals, or to a company, in relation to 'qualifying expenditure', broadly expenditure on plant and machinery incurred for the purposes of a 'qualifying activity' (see CAA 2001 Ch 2).

The details of the entitlement to AIA are set out in CAA 2001 ss 51A-51N.

The increase in the AIA will be effective from the 'relevant date', being 6 April 2010 for individuals and partnerships, and 1 April 2010 for companies. For those chargeable periods that would span the relevant date, so that both the previous AIA of £50,000 and the new AIA of £100,000 would be applicable, the AIA threshold will be calculated by reference to two notional chargeable periods, namely:

- from the start of the actual chargeable period up to the day before the relevant date (being either 31 March 2010 or 5 April 2010); and
- from the day of the relevant date to the end of the actual chargeable period.

The AIA threshold for the actual accounting period will then be calculated as a relevant proportion of the respective AIA thresholds based on the number of days in each notional chargeable period.

Example 1

ABC Ltd makes its accounts up to 31 December 2010. There are, therefore, two notional chargeable periods in respect of the AIA for the year to 31 December 2010, calculated as follows:

- 1 January 2010 – 31 March 2010 (90 days); and
- 1 April 2010 – 31 December 2010 (275 days).

The AIA available will therefore be calculated as follows:

90/365 x 50,000	=	12,329
275/365 x 100,000	=	75,342
		£87,671

Hence, the total AIA available to ABC Ltd for its accounting period ending 31 December 2010 is £87,671.

However, the amount of expenditure qualifying for AIA is restricted in these 'straddling periods', so that only a maximum of £50,000 expenditure incurred in the part of the chargeable period falling before 1 (or 5) April 2010 would qualify for the AIA. So, in the example above, although the AIA for the year is £87,671, no more than £50,000 incurred before 1 April 2010 would qualify for the AIA.

2.6 Company Share Option Plan (CSOP)

There is a new anti-avoidance measure, designed to tackle the 'geared growth' arrangements under CSOP schemes. Such arrangements can be used to deliver additional reward to employees in excess of the statutory limit of £30,000.

From 24 September 2010 shares of a CSOP can only relate to the company setting up the scheme or a company which controls the company setting up the scheme. The provision in ITEPA 2003 which allows the shares to be from a member of a consortium owning such companies will no longer apply.

For existing schemes involving consortia, there is a transitional period from 24 March 2010 to 23 September 2010. If the new requirements are not met at the end of the transitional period, any options granted after 24 September 2010 will not be treated as being approved.

In practice this means that all existing approved CSOP schemes need to be reviewed to establish whether they will lose their approved status.

2.7 Approved Share Incentive Plans

There is a new provision to disallow a corporation tax deduction for contributions to a Share Incentive Plan (SIP), if the payment is made as part of tax avoidance arrangements, ie where one of the main purposes of the company in making the payment is to obtain a corporation tax deduction. This new rule applies for payments made on or after 24 March 2010, and is designed to prevent abuse where payments were made as part of wider arrangements where the employees did not actually receive shares with any real value, so that

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the main reason for making the payment was the corporation tax deduction.

This may be a difficult measure to apply in practice as many businesses considering the merits of a SIP, when compared with alternative incentive schemes, will have taken into account the deductibility of the contribution when assessing which route would deliver the most value. We wait to see how HMRC will apply the legislation in practice.

The measure will also enable HMRC to withdraw approval of a SIP where there are transactions by the company which alter the share capital or rights attaching to SIP shares, with the effect of materially affecting the value of shares held in the SIP trust.

3 Personal taxation

3.1 Income tax rates and personal allowances for 2010/11

3.1.1 The 50% 'additional rate' of income tax

The 50% additional rate of income tax will take effect from 6 April 2010 on all taxpayers whose taxable income exceeds £150,000. There will also be a dividend additional rate of 42.5%, so that the effective rate of tax on dividends will increase to 36.11% of the dividend received, where the individual receiving the dividend is subject to the 50% income tax rate.

The trust tax rate will also increase from 40% to 50%.

All other rates and limits will remain the same as in 2009/10.

Starting rate for savings	10%	£0 - £2,440
Basic rate	20%	£0 - £37,400
Higher rate	40%	£37,400 - £150,000
Additional rate	50%	Over £150,000

3.1.2 Personal allowances

The personal allowances will also remain at the same levels as in 2009/10. However, the personal allowance will now be restricted for those higher rate taxpayers with adjusted net income of over £100,000. The restriction is £1 for every £2 that taxable income exceeds the £100,000 threshold. Once an individual's adjusted net income exceeds £112,950 there will be no personal allowances.

ITA 2007 s 58 defines adjusted net income as being the net income after adding back gross gift aid payments and gross pension contributions.

The restriction on the available personal allowance has given rise to an effective marginal income tax rate of 60% on the adjusted net income between £100,000 and £112,950.

Example 2

Mr A is a higher rate taxpayer in 2010/11 and has adjusted net income of £100,000.

Adjusted net income			£100,000
Personal allowance			£6,475
Taxable income			£93,525
Tax			
Basic rate	37,400	@20%	£7,480
Higher rate	56,125	@40%	£22,450
Tax charged			£29,930

Mr B is also a higher rate taxpayer in 2010/11 and has adjusted net income of £110,000.

Adjusted net income			£110,000
Personal allowance (see below)			£1,475
Taxable income			£108,525
Personal allowance			£6,475
Less (£110,000 - £100,000) /2			£5,000
Available personal allowance			£1,475
Tax			
Basic rate	37,400	@20%	£7,480
Higher rate	71,125	@40%	£28,450
Tax charged			£35,930

As you can see from the above example Mr B pays an additional £6,000 in tax on the extra £10,000 income he has received, in comparison to Mr A, which represents a marginal rate of 60%.

The same rules apply to taxpayers aged 65 and over. Any such taxpayers with adjusted net income of £100,000 will already have lost any age related allowances and they will now lose their standard personal allowances, as described above, with a restriction of £1 for every £2 that adjusted net income exceeds the £100,000 threshold.

3.2 Benefits in kind

3.2.1 Low emissions cars

For 2010/11, qualifying low emissions cars are defined as having CO_2 emissions up to 120g/km. The taxable benefits in kind charges for qualifying low emissions cars for 2010/11 are:

- for qualifying low emissions cars with CO_2 emissions of 75 g/km or less, the percentage used in calculating the benefit is 5% (a new rate introduced for lower emission vehicles); and
- for qualifying low emissions cars with CO_2 emissions above 75 g/km and up to 120 g/km, the percentage used to calculate the benefit is 10% (this rate applied for all cars with emissions up to 120 g/km in 2009/10).

3.2.2 Other cars

For cars that are not qualifying low emissions cars, the taxable benefits in kind charges for 2010/11 are:

- for cars that have CO_2 emissions of between 120 and 130 g/km, the percentage used to calculate the benefit is 15%; and
- for cars emitting 130 g/km or more, the percentage used to calculate the benefit is 15% plus one percentage point for each 5 g/km by which the CO_2 emissions figure exceeds 130 g/km, up to a maximum of 35%.

If a car cannot emit CO_2 emissions under any circumstances, there is now no taxable benefit for the tax years 2010/11–2014/15. Thereafter the percentage used to calculate the taxable benefit will be 9%.

All other car benefit rates remain unchanged and the provisions to increase the relevant percentage by 3% for diesel cars (capped at 35%) still apply.

The taxable benefit for a van is now £3,000 or nil if the van cannot emit CO_2 in any circumstances or the pre-existing conditions for restricted private use are met.

3.2.3 Subsidised meals

The exemption for subsidised meals provided by an employer still applies, but the benefit will become taxable if the arrangements are made pursuant to a salary sacrifice or if the employee receives the benefit instead of some other form of income. This change takes place from the 2011/12 tax year onwards.

3.3 Capital gains tax: Entrepreneurs' Relief

FA 2010 introduces a welcome doubling of the level of Entrepreneurs' Relief available on qualifying business disposals made on or after 6 April 2010. The relief (which effectively reduces the 18% rate of capital gains tax to a 10% rate of tax) is now available on the first £2 million of cumulative qualifying gains, rather than £1 million previously.

3.4 Inheritance tax

3.4.1 Inheritance tax rate bands

There has been no increase to the nil rate band of £325,000 for the 2010/11 tax year. FA 2007 had provided for an increase to £350,000. However, FA 2010 has now frozen the nil rate band threshold at £325,000 for the tax years 2010/11 to and including 2014/15 (subject, of course, to a possible change of Government).

The IHT rate remains at 40% on chargeable transfers that exceed the nil rate threshold.

3.4.2 Conversion or gifts of reversionary interests

FA 2010 ss 52 and 53 contain legislation to thwart planning that avoided the chargeable lifetime transfer charge that would otherwise become due upon settling large amounts on trust.

This type of planning involved the settlor retaining a reversionary interest at the time of making a settlement, which then enabled the taxpayer to claim that the reduction in their estate had been minimal (the reversionary interest being valuable in its own right for tax purposes). In time the reversionary interest itself could be given away as a Potentially Exempt Transfer (PET) or simply allowed to convert to an interest in possession, which would not be a chargeable event for IHT purposes.

IHTA 1984 s 81A has the effect of making the conversion of a reversionary interest into an interest in possession a disposition for IHT purposes. It also denies PET status to a gift of a reversionary interest, so the conversion gives rise to an immediate charge to IHT.

3.4.3 Termination of interests in possession

Prior to the changes introduced by FA 2010 if an interest in possession which arose after 22 March 2006 was terminated, there would be no chargeable transfer at all (either as a chargeable lifetime transfer or a PET), as it

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fell within a specific exemption. The new rules now ensure that, for terminations of such interests on or after 9 December 2009, a charge will arise based on the value of such an interest in possession. This transfer of value will no longer be eligible for treatment as a PET.

3.5 Stamp Duty Land Tax (SDLT)

3.5.1 Relief for first time buyers

The Act introduces an exemption from SDLT for 'first time buyers' for transactions of which the effective date is on or after 25 March 2010 but before 25 March 2012.

'First time buyers' are defined as individuals who have not previously been a purchaser of a major interest in land which consisted of or included residential property (either in the UK or abroad) and who are purchasing:

- a major interest in land;
- consisting entirely of residential property;
- which they intend to occupy as their only or main property; and
- the consideration is more than £125,000 but not more than £250,000.

The definition of a major interest in land for the purposes of this provision does not include either the grant of a lease for less than 21 years or the assignment of a lease with less than 21 years to run.

3.5.2 Rate for residential property for over £1 million

In order to fund the relief for first-time buyers there will be an increase in the top rate of SDLT on the purchase of residential property. For transactions for which the effective date is on or after 6 April 2011, and where the consideration paid for the property is more than £1,000,000 (including VAT, where appropriate), the chargeable rate for SDLT will be raised from 4% to 5%.

3.6 Losses

3.6.1 Sideways relief

A new anti-avoidance rule provides that a loss in a trade, profession or vocation that arises in connection with 'relevant tax avoidance arrangements' will be ring fenced, so that no sideways relief can be given in respect of the loss (that is, relief against other income or gains of the year of assessment). The losses will therefore only be available for use against future profits of the same trade, profession or vocation.

'Relevant tax avoidance arrangements' are defined as arrangements 'the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief or capital gains relief'. In short, this means that any such losses generated from arrangements entered into or committed unconditionally to before the relevant date, will no longer be available for use against general income under ITA 2007 ss 64(8) or 72(5), or against gains under TCGA 1992 s 261B.

Losses that derive wholly from qualifying film expenditure are specifically exempted from the changes.

The measure is backdated to the date of the original announcement of 21 October 2009.

3.6.2 Property loss relief

New anti-avoidance provisions have been introduced to stop the exploitation of losses generated by the annual investment allowance in property businesses (whether carried on alone or in partnership). The legislation becomes effective on or after 24 March 2010 and applies if:

- a person makes a loss in a UK property business or overseas property business;
- the loss has a capital allowances connection (see ITA 2007 s 123(2)); and
- the loss arises directly or indirectly in consequence of relevant tax avoidance arrangements.

Previously a person with a UK or overseas property business was entitled to offset so much of their loss that related to excess capital allowances against their general income. The changes mean that however much of that loss is related to both the Annual Investment Allowance and is the subject of a 'relevant tax avoidance arrangement' will no longer be available for relief against general income. A 'relevant tax avoidance arrangement' is defined as an arrangement 'the main purpose, or one of the main purposes, of which is being in the position of making use of the Annual Investment Allowance in the obtaining of a reduction in tax liability by means of property loss relief against general income'.

3.7 Non-domiciled individuals and the remittance basis

The 'remittance basis' is available to individuals who are resident, but neither ordinarily resident nor domiciled in the UK. In general, such individuals can claim only to be taxed on their foreign source income and gains when these are actually remitted to the UK. Several changes have been made to 'clarify' the legislation and to prevent abuse.

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3.7.1 Definition of a 'relevant person'

An individual who makes a claim to be taxed under the remittance basis will also be taxed on income and gains that are remitted to the UK by way of a 'relevant person'. The definition of a 'relevant person', in ITA 2007 s 809M, includes the non-domiciled person and certain relatives of the non-domiciled person. It also includes certain companies in which such persons are participators, specifically close companies and companies that would be close were they resident in the UK. Finally, the 51% subsidiary of a UK close company relevant person is also a relevant person.

Legislation was introduced to ensure that a relevant person now also includes a 51% subsidiary of a company which would be a close company if it were resident in the UK, where such persons as mentioned above are participators in the non-resident parent.

3.7.2 Foreign currency bank accounts

New rules are effective from 16 December 2009 to prevent the interaction of capital gains tax rules and the remittance basis of taxation from creating allowable capital losses on disposals from foreign currency bank accounts, which do not reflect a real economic loss.

Any foreign currency bank account not situated in the UK is an asset for capital gains tax purposes, so that a withdrawal or a disposal from the account will give rise to a chargeable gain or an allowable loss for capital gains tax purposes, based on the changes in the exchange rate of sterling against the foreign currency. However, under the remittance basis any foreign source income that is remitted to the UK from a foreign currency bank account is subject to income tax, and so is excluded from the CGT calculation.

The interaction of these rules means that, when foreign source income from a foreign currency bank account is withdrawn and remitted to the UK, it will give rise to an income tax charge and, since the income is excluded from the capital gains calculation on the disposal of the asset, a loss arises that does not reflect the true economic situation.

The new rule prevents an allowable loss arising for CGT purposes in these circumstances.

Example 3

Henry holds a FCBA into which he puts foreign source income of $20,000. The base cost for CGT purposes at this date is £15,000. At a later date Henry remits all the foreign source income to the UK when it has a value of £17,000. For income tax purposes the taxable amount remitted to the UK is £17,000 and under TCGA 1992 s 37 this amount is deducted from the consideration:

Consideration for disposal from FCBA	£17,000	
Less taxable under TCGA 1992 s 37	£17,000	
Net proceeds		Nil
Less cost of acquisition		£15,000
Loss		(£15,000)

As a result of the changes, this loss is disallowed.

3.8 Financial Services Compensation Scheme intervention in relation to insurance contracts

Legislation has been introduced that allows the Treasury, by means of statutory instrument, to make provision to address unintended tax consequences where there is relevant intervention by the Financial Services Compensation Scheme 'FSCS' to protect policyholders with insurance or annuity contracts and also insurers providing these contracts. The new rules are intended to ensure that if the FSCS takes action to protect policy holders, there will be broadly the same tax treatment as if no intervention had been necessary.

The relevant intervention is defined as securing continuity regarding the contracts, safeguarding policyholders, and the payment of compensation to the policyholder. Most importantly, the Treasury will have powers to introduce regulations to impose various taxes in respect of the insurance contracts. The relevant taxes are income tax, capital gains tax, corporation tax, inheritance tax, stamp duty land tax, stamp duty, stamp duty reserve tax and insurance premium tax.

The provisions come into effect from 8 April 2010, the date the Act received Royal Assent. Once regulations are made, they can apply to any period before this date, so long as they do not increase a person's liability to tax. The regulations may also amend, revoke or modify any existing legislation in respect of the contracts, and so can be considered to be quite far reaching.

3.9 Champions League final

The Government finally lays to rest the concerns of literally tens of overpaid young men with this provision that disregards the charge to tax of any non-resident and not ordinarily resident employee or contractor of

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an 'overseas team' on the occasion of the 2011 Champions League final. This legislation was a condition of the footballing body UEFA awarding the 2011 final to Wembley.

The concern was that any remuneration arising out of that game, as well as an appropriate proportion of each player's worldwide earnings for the year, would be subject to UK tax, almost certainly at a rate of 50%, given the largesse of footballers' earnings. The new legislation means that the payments will not now be subject to UK income tax.

The relevant phrase, contained within FA 2010 Sch 20 is 'That person *(an employee or contractor of an overseas team which competes in the 2011 Champions League final)* is not liable to income tax in respect of any income arising to the person which is related to duties or services performed by the person in the United Kingdom in connection with the final'.

It should be noted that this legislation is specific to the Champion's League final only and as such has created a disparity between how these particular sportsmen are taxed and the normal rules for sportspeople competing in the UK, for example at Wimbledon or at the Open. The new legislation also does not apply to players playing for a UK club that might reach the final, as such players will almost certainly be UK resident.

4 Pensions

4.1 High income excess relief charge

The high income excess relief charge will apply from 6 April 2011 for 'high-income' individuals. The charge will restrict tax relief to the basic rate of 20% on pension contributions for individuals earning over £180,000. Tax relief is tapered for individuals with income between £150,000 and £180,000. Anti-forestalling provisions (through 'the special annual allowance') apply for 2009/10 and 2010/11 (see below).

The proposed introduction of the 'high income excess relief charge' was announced in the 2009 Budget. Changes were then announced in the 2009 Pre-Budget Report and these, together with some further provisions, have now been included in FA 2010.

The extra tax arising from the restriction of tax relief on pension contributions will be collected through the Self Assessment tax return which, in practice, means that individuals falling into this category should notify HMRC of this if they are not already in the self assessment regime.

The high income excess relief charge will apply whether or not the individual, or the scheme administrator, is UK resident, ordinarily resident or UK domiciled.

4.1.1 Calculation of the charge: the income test

An individual will only be liable to the high income excess relief charge if their 'gross income' is £150,000 or more and their 'relevant income' is £130,000 or more in the tax year.

'Gross income' for these purposes broadly comprises income before deduction or relief for pension contributions and charitable donations and, for those in employment, includes the value of any pension benefit funded by the employer.

Whereas 'relevant income' for these purposes broadly comprises 'gross income' as calculated above less, for those in employment, the value of any pension benefit funded by the employer.

Example 4

Individual A has a salary of £115,000, no other sources of income, and receives a pension benefit from her employer of £40,000. As her relevant income is below the floor of £130,000 she is not affected by the restriction of tax relief on pension contributions, even though her gross income is over £150,000.

Example 5

Individual B has a salary of £160,000 and is a member of a defined contribution occupational pension scheme with 5% (£8,000) employee and 10% (£16,000) employer contributions. His relevant income is above the floor at £160,000 and his gross income is £176,000. He is therefore affected by the restriction of tax relief on the £24,000 of pension contributions made, and any tax due is payable under self assessment.

Comprehensive details on calculating 'gross income' and 'relevant income' are set out in FA 2004 ss 213C and 213D respectively (as amended by FA 2010).

4.1.2 Calculation of the charge: restriction of relief

Relief is clawed back by imposing the high income excess relief charge on an individual's 'total pension savings amount' at an 'appropriate percentage', so that

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the total relief for pension contributions does not exceed 20%.

The 'total pension savings amount' is broadly the total employee and employer pension contributions.

The 'appropriate percentage' is the marginal rate of relief an individual receives on the pension contributions they make (being the income tax that they would have paid if they had not made those contributions). It is possible for tax relief to be received at different rates on different tranches of pension contributions, and with the introduction of the 50% additional rate of income tax it could often be the case that those on gross incomes above £150,000 would be receiving pensions tax relief at more than one rate. For example, relief will be restricted by 30% on contributions which would have received tax relief at 50% and by 20% on contributions which would have received tax relief at 40%.

Example 6: Restricting relief to the basic rate

An individual has gross income of £180,000, and makes a £40,000 contribution into a personal pension:

- if he had not made that pension contribution, £10,000 of his additional income would have been taxed at 40%, and the remaining £30,000 of it at 50%;
- therefore, he receives 40% tax relief on the first £10,000 of contribution, and 50% on the remaining £30,000;
- in order to restrict relief accurately to the basic rate of 20%, a restriction of 20% is applied to the £10,000 receiving 40% marginal rate relief, and a restriction of 30% is applied to the remaining £30,000 of the contribution receiving 50% marginal rate relief; and
- this equates to a restriction of £11,000, with him still receiving basic rate relief of £8,000 (that is, 20%).

4.1.3 Tapering the relief

The high income excess relief charge will be tapered for individuals with gross income between £150,000 and £180,000. FA 2010 introduces a stepped taper so that the appropriate rate of high income excess relief charge is reduced by 1% for every £1,000 that gross income is less than the £180,000 threshold, but to no less than 0%. Overall, the result is that an individual with gross income of £150,000 will continue to get effective tax relief at 40%. The charge then gradually increases, so that an individual with gross income of £180,000 will be subject to the full high income excess relief charge and will only get effective tax relief at 20%.

The taper will apply both to pensions contributions made by the individual and to employer-funded contributions.

Example 7

An individual with a salary of £155,000, and with employer's pensions contributions made on his behalf of £10,000, has gross income of £165,000. This is £15,000 less than £180,000, so the high income excess relief rate is reduced by 15% (1% for every £1,000) to 15%. Therefore, the high income excess relief charge is £1,500 (£10,000 pension contribution, at 15%).

4.2 Defined benefit schemes

The high income excess relief charge is also imposed on a deemed contribution for defined benefit schemes.

The deemed contribution is intended to reflect the increase in the individual's rights / benefits, and is calculated as the aggregate amount of all contributions made in the tax year, by the individual, and the employer, and the value of any increased rights in respect of a registered pension scheme.

Detailed guidance on how to calculate the pension savings amount can be found in FA 2004 Pt 4 ss 213F–213N, as amended by FA 2010.

4.3 The special annual allowance charge

The 'special annual allowance charge' (SAAC) was introduced by FA 2009 as an anti-forestalling measure, in anticipation of the introduction of the 'high income excess relief charge'. The SAAC restricts tax relief for 'high income' individuals who dramatically increase their pension contributions in the tax years 2009/10 and 2010/11, in anticipation of the restriction of tax relief from 6 April 2011. FA 2010 made changes to the anti-forestalling rules, including the reduction of the anti-forestalling threshold for income from £150,000 or over to £130,000 or over. This change had been announced in the 2009 Pre-Budget Report.

In order to calculate whether pension contributions are in excess of the normal regular pension savings, the patterns of pension contributions for the previous two tax years are taken into account. The legislation looks

firstly at regular pension savings, ie savings paid at regular intervals up to quarterly, based on the individual's pre-22 April 2009 pattern. These are 'protected pension input amounts' and are not subject to the SAAC.

Each individual also has a 'special annual allowance'. This is usually £20,000, although there are circumstances where it can be up to £30,000. For example, where irregular contributions (ie less regular than quarterly) have been paid to another money purchase arrangement, the special annual allowance can be up to £30,000.

The special annual allowance is reduced by the protected pension input amounts. Where the protected pension input amounts equal or exceed the special annual allowance, the special annual allowance is reduced to nil.

The SAAC is charged at 20% and applies to pension savings in excess of the 'special annual allowance'.

Example 8

Belinda has relevant income of £158,000 in 2010-11 and makes pension contributions of £24,000 during the year, at £2,000 per month pursuant to an arrangement set up before 22 April 2009. Although her pension contributions are more than £20,000, they will not be subject to the SAAC because they only reflect her continuing, regular, pension savings. This is a protected pension input amount for the tax year.

Example 9

Christine has relevant income of £158,000 in 2009-2010 and has made irregular pension contributions of £15,000 in the year. Christine has no other pension input amounts for the year. Although her income exceeds the £150,000 threshold, and she has no protected pension inputs, her total contributions are less than the special annual allowance of £20,000, so she is not subject to the SAAC for 2009-10.

Example 10

Frank has relevant income of £150,000 in 2009-10 and makes pension contributions of £3,000 per month, pursuant to an arrangement set up before 22 April 2009. Although Frank's pension contributions are more than £20,000, they will not be subject to the SAAC because they only reflect his continuing, regular, pension savings, which is a protected pension input amount for the year.

Frank's special annual allowance is £20,000 but his special annual allowance for 2009-10 is reduced by the amount of his protected pension input amount for the same tax year. As Frank's protected pension input amount is £36,000 for 2009-10 (12 x £3,000) this has the effect of reducing his special annual allowance to nil for 2009-10.

If Frank makes a one-off extra contribution of £5,000 in 2009-10, this is not a protected pension input amount. As Frank's special annual allowance for 2009-10 is nil he is liable to a special annual allowance tax charge based on the whole of the £5,000 payment, the charge being £1,000 (£5,000 x 20%).

This is extremely complex legislation, with HMRC's guidance (in the Registered Pension Schemes Manual from 15100000 to 15109030) extending to over 75 pages.

5 Revenue protection

FA 2010 introduces a range of anti-avoidance provisions, some of which may only impact on those who undertake more complex tax mitigation strategies. Those of widest application are noted below.

5.1 Disclosure of tax avoidance schemes (DOTAS)

FA 2010 sets out the latest extension to the DOTAS regulations as part of the ongoing measures to target anti-avoidance schemes. It also provides for increased penalties for failure to comply. The amendments will be introduced by statutory instrument at a date to be announced, and which is expected to be later in 2010.

FA 2004 introduced the DOTAS rules that require 'promoters' and, in some cases the taxpayer, to provide details of notifiable tax schemes to HM Revenue and Customs. These rules are now being widened to impose a reporting obligation on other parties who may be involved in the marketing of such tax planning arrangements. The type of planning that is subject to the reporting obligations has not been changed, only those who are required to comply with the DOTAS rules.

5.1.1 Widening the scope of those required to disclose planning

The definition of a promoter has been expanded to include a person, an 'introducer' who makes a 'firm

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approach' to another person regarding a notifiable scheme.

A 'firm approach' in respect of a notifiable arrangement means a 'marketing contact' at a time when the proposed arrangements have been substantially designed. A person makes a 'marketing contact' if the person communicates details about the notifiable scheme to the third party with a view to that third party entering into transactions forming part of the proposed arrangements, and the information provided to the third party includes an explanation of a tax advantage that might be expected to be obtained from the proposed arrangements.

The new rules have the effect that 'introducers' have a duty to disclose tax avoidance schemes to HMRC, usually within five days of the firm approach to another person. Advisers should be aware that they may now fall within this category even though they do not widely market such tax planning arrangements. An introducer will be responsible for making the same disclosures as any other promoter, and will be subject to the same penalties for failure to do so.

5.1.2 Trigger date for disclosure

The new rules state that the date of a 'firm approach' is a trigger point for disclosure to HMRC regarding a scheme. Therefore a scheme will become notifiable when it is initially marketed, either by a promoter or by an introducer, and not just when first 'made available' to be implemented. Previously, it was only necessary to disclose a tax planning arrangement once sufficient details had been released to clients, that the scheme was available for implementation.

5.1.3 Promoters to provide client lists

Promoters will now be required to provide details of clients who have implemented a notifiable scheme to HMRC (reporting details on a quarterly basis). Promoters are already required to provide the scheme reference number (SRN) to all their clients or intermediaries (who themselves must pass the number on to the end user) who have undertaken the scheme.

In theory this is, therefore, not an additional layer of disclosure, as all such clients should have the DOTAS number on their tax return. However, it will enable HMRC to monitor which promoters are advising large numbers of clients, and how many clients are undertaking each planning arrangement, in advance of tax returns being submitted.

5.1.4 Penalties

The penalties for failure to disclose have also been increased dramatically. The penalties in the existing legislation stipulate that within the initial period, the penalty is a maximum of £5,000, followed by a daily penalty of up to £600 while the failure continues. Where a promoter fails to make a disclosure in time, the new rules impose the daily penalty from the date of the initial failure. However, once the new rules are implemented, there will also be a maximum penalty of £1million, if the maximum penalty on a daily basis 'appears inappropriately low'!

The level of the penalty will be decided by HMRC based on a number of contributing factors, including the extent to which there was a failure to comply, the frequency of such failures and the fiscal advantage gained by the promoter or introducer from the scheme, and should be an amount that would be an appropriate deterrent. The new legislation therefore extends HMRC's discretionary powers in respect of the penalties it can impose, although it is worth noting that the imposition of such an extreme penalty would be subject to mitigation if there is a reason for non-disclosure (such as an Opinion from Tax Counsel that the arrangements are not within the DOTAS regulations).

5.2 Transactions in securities

The transactions in securities legislation, which aims to negate any tax advantages arising from certain transactions in securities, has been in place for nearly 50 years. FA 2010 amends this legislation for both corporation tax payers and income tax payers. The new regimes will be discussed in detail in a forthcoming *Tax Digest*.

The corporation tax change is straightforward: Circumstance A, one of the four Circumstances in which a tax advantage could be counteracted under this legislation, is abolished by the repeal of CTA 2010 s 735, with effect from 1 April 2010. Circumstance A, at CTA 2010 s 735, applied where a company received an abnormal amount by way of dividend and the dividend was taken into account for the purposes of the 'shadow ACT' regime.

The income tax changes are more extensive, and amend ITA 2007 with effect from 24 March 2010. While the new rules are, in many ways, very different to their predecessors, the core of them is to replace the four previous Circumstances (A, C, D and E) with two new conditions, A and B, which between them broadly mirror the old Circumstances D and E.

The new provisions apply when a person is party to a transaction in securities, designed to obtain an income tax advantage, and, as a result of such a transaction, he receives 'relevant consideration' and actually obtains a

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tax advantage. Falling foul of these rules will generate a charge to income tax under ITTOIA 2005 s 427.

An income tax advantage is specifically measured by comparing the capital gains tax liability in respect of the relevant consideration with any income tax liability if the consideration had been received as a qualifying distribution, instead. However, the measure of the advantage is limited to the level of distributions the company could lawfully pay, so that there can be no tax advantage in respect of a company with no distributable reserves.

'Relevant consideration' is that which is received in connection with a distribution by a close company (subject to the exception below), including the transfer and realisation of assets (or the value of assets) which are available for distribution by way of dividend by the company. Consideration also includes share capital which represents the value of such assets, and consideration which is received in respect of future receipts of the company or is trading stock of the company.

There is an exception to the anti-avoidance provisions if there has been a fundamental change in ownership. A fundamental change in ownership occurs if, as a result of the transactions, at least 75% of the ordinary share capital – carrying an entitlement to at least 75% of the company's distributions and at least 75% of the voting rights – of the close company is held by a person who has not been connected with the original person within the period of two years before the first transaction.

Finally, the income tax rules now only apply to transactions in securities of close companies, rather than to the special class of companies that the previous rules applied to (and that the corporation tax rules continue to apply to).

Despite some simplification the rules in respect of transactions in securities remain a minefield for tax advisers and are best approached with caution.

5.3 Penalties for offshore tax evasion

As part of the new measures to combat offshore tax evasion the income tax penalty regime has been amended. Larger penalties will be introduced and will be applied to individuals and businesses that do not account for the full amount of tax liabilities arising from offshore income or capital gains. It is anticipated that the increased penalties will come into effect on or after 1 April 2011. Corporation tax is not covered by this legislation.

The new penalty regime will target individuals and businesses who fail to:

- notify HMRC of foreign income or gains;
- make a return in respect of foreign income and gains; or
- provide accurate disclosures or information in respect of their foreign income and gains.

The level of tax geared penalty will depend on the jurisdiction of:

- the source of income;
- where the asset is; or
- where the activities are wholly or mainly carried on.

The jurisdiction is a key factor as the level of penalty will be determined by any arrangements that the UK has with other territories to exchange information.

- Where there is the provision to automatically exchange information with the UK the maximum penalty will be 100% of the potential tax lost.
- Where there is a provision to exchange information with the UK, but it is not automatically done, the maximum penalty will be 150% of the potential tax lost
- Where there is no agreement in place to exchange information with the UK the maximum penalty will be 200% of the potential tax lost.

The penalties can then be mitigated according to the normal criteria.

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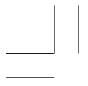
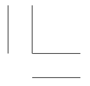
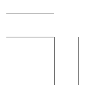
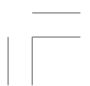

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