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## Nothing doing!

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Perhaps the surprise in this year's Budget was the complete lack of any surprises. None of HMRC's Budget Notes caused a sharp intake of breath, as everything seemed to have been thoroughly adumbrated in the pre-Budget report (PBR) last December or in one of the many long-running consultation exercises. (For an overview of the PBR measures for companies, see [Tax tweaks](#)).

Of course, there is still scope for some surprises yet: the Finance Bill will be published as this issue goes to print, and there has to be a general election within the next ten weeks or so.

Consequently, there is bound to be a post-election Budget and another Finance Bill, but, for now, let's have a look at the content of this year's first Budget.

### Corporation tax rates

Corporation tax rates for finance year 2010 (commencing 1 April 2010) remain the same: the main rate of corporation tax will be 28%, the small companies rate will be 21% and the marginal relief fraction will be 7/400.

In fact, the Budget Notes tell us the corporation tax main rates will be set for FY 2011 in Finance Act 2010, although it remains to be seen whether the promised increase in the small companies rate to 22% will materialise in 2011 or be postponed again (or maybe even cancelled).

### Bank payroll tax

This tax was announced at the PBR with a technical note and draft clauses, and covered in detail in my previous article. Briefly, this tax is payable by banking employers in respect of bonuses paid in excess of £25,000 to a relevant banking employee.

The rate of the tax is set at 50% of the excess of the bonus over £25,000. The tax paid by the employer is not deductible in arriving at their profits for corporation tax or income tax purposes, and the tax runs from 12.30pm on 9 December 2009 until 5 April 2010 (the chargeable period) for discretionary and contractual bonus awards.

The Finance Bill will include a number of changes from the original legislation, as follows.

- There is clarification of the point at which a bonus is deemed to have been awarded, in order to determine whether it arises during the chargeable period. A contractual obligation to pay a bonus arises when the amount of bonus is fixed, or can be fixed, without any person being able to exercise discretion. So if a bonus relates to, for example, an employee's performance later than the chargeable period, then any performance-related bonuses relating to periods after 5 April 2010 will not be subject to the bank payroll tax.
- A relevant banking employee is someone whose duties comprise of a banking employment (broadly, one where the duties relate to certain regulated activities under Financial Services and Markets Act 2000 or activities which consist of the lending of money or of dealing in currency) and who is either resident in the UK in the tax year 2009/10 or performs his or her duties wholly or partly in the UK. The Budget narrowed this slightly to exclude employees who spent less than 60 days in the UK in 2009/10.
- There is a narrowing of the scope of the definitions of a UK-resident bank, a relevant foreign bank, and banking groups. The definitions are highly technical and will not be described in detail.
- There are new provisions for the collection and management of the tax, including a requirement that all taxable companies must submit a return by 31 August 2010. It appears that nil returns will also be required, so that banking employers may have to formally state that they have not paid any bonuses to which the tax is applicable. There will be penalties for late or incorrect returns and payment of the tax will be made electronically.

This tax was widely heralded before the PBR announcement. Regardless of the effect on the banking industry, it was clearly welcomed by a lot of people who blamed the sector for the current global financial crisis.

### Capital distributions

The new regime for the taxation of distributions received by UK resident companies was introduced in FA 2009 (at CTA 2009, Part 9A). Under the pre-FA 2009 regime, a UK company was exempt from any distributions received from another UK company, but had to pay tax on distributions received from non-UK companies.

In theory, the exemption for UK distributions only applied to distributions that were of an income nature, but HMRC's practice was to treat most distributions from UK companies as income unless they fell within specific exceptions.

The introduction of the new regime in FA 2009 treated all income distributions from UK or non-UK companies as chargeable under CTA 2009, Part 9A, unless they fell within one of the many and widely drawn exempt classes. The expectation was that the new regime would therefore exempt almost all distributions, whether received from a UK or a non-UK company.

However, the new regime does not apply to distributions of a capital nature so the boundary between distributions of an income nature and those of a capital nature became important, as the latter are chargeable to corporation tax on chargeable gains.

The Government had not intended to change law or practice in this area in enacting Part 9A, and there was widespread commentary and concern about the accidental change when its effect was realised. This change was therefore presaged by a ministerial announcement on 24 February 2010.

The proposed amendment will simplify the distribution exemption regime by ensuring that Part 9A applies to all distributions, except for those relatively few that are specifically stated to be excluded from income and, hence, must be treated as capital distributions.

The legislation will be retroactive, but UK companies will be able to elect for the retrospection not to apply to them. However, the legislation will not be enacted until the next Parliament, so it will not appear in the first Finance Act of 2010.

### **REITs and stock dividends**

A real estate investment trust (REIT) is a UK-listed company that has mainly property rental income. The special nature of the REIT regime means that the shareholders are taxed on distributions from the REIT as though these were income from property, so the tax effect is the same as if they had invested directly in property themselves.

A UK REIT must distribute 90% of the profits of its property rental business by way of dividend for each accounting period.

Currently, if a REIT were to declare a stock dividend (a distribution where shareholders can either be paid cash or, instead, have further shares issued to them) this has not, hitherto, counted as a distribution for the purposes of the 90% rule.

This meant that, in effect, REITs were unable to pay stock dividends. This rule will now be amended so that stock dividends will be treated in the same way as cash dividends.

### **Loan relationships**

The Budget contained three proposals relating to the loan relationship rules.

The first relates to the worldwide debt cap, which was introduced in FA 2009 to guard against excessive debt funding of UK companies. If UK financing costs exceed the worldwide financing costs of a group, the legislation imposes a restriction on the amount of interest relief that the UK companies can claim.

The legislation applies to periods of account of a worldwide group that begin on or after 1 January 2010.

At the PBR, a number of amendments were announced to the legislation and further work has apparently brought to light the need for further changes, as follows.

- Generally speaking, securitisation companies and their results are excluded when computing the available amount and the actual UK financing costs and income of a group.
- A power will be added to the legislation for the making of regulations so that certain companies involved in capital markets arrangements incurring additional corporation tax liabilities as a result of the debt cap may be able to transfer that

liability to another company in the group.

- Certain arrangements which have the economic effect of loans and give rise to an interest-like return will now be taken into account for the gateway test
- An LLP will not be able to be the ultimate parent of a group of companies for the purposes of this legislation.
- Distributions of industrial and provident societies will not be treated as part of the financing expenses of such companies, even though such distributions are normally treated as interest for tax purposes.

The second measure relates to accounting standards. The IASB is currently making extensive changes to the accounting rules for financial instruments.

It is therefore intended that the FA 2010 will give the Treasury the power to amend the corporation tax rules for loan relationships and derivative contracts outside the normal Finance Bill timetable, where such changes are necessitated by the new accounting rules.

Finally, corporation tax and petroleum revenue tax will be brought within the harmonised interest regime introduced in FA 2009. It was always intended that this regime be phased in over a number of years, given the IT and operational requirements of the system. The dates from which this regime will apply to corporation tax and petroleum revenue tax will be set by Treasury orders.

### **Special tax regimes**

With regards to the North Sea fiscal regime, for companies with oil extraction and oil rights in the UK and on the UK continental shelf the main rate of corporation tax rate for ring-fence profits will remain at 30% for 2011, with a small profits rate of 19% and a marginal relief fraction of 11/400 for 2010.

As part of a package of measures in FA 2009 to support the UK oil and gas industry, there was a rollover relief where disposal proceeds are reinvested in new oil trade assets.

In respect of disposals made on or after 24 March 2010 this legislation will now apply in the group context, where the company making the new acquisition is not the company that made the original disposal.

The life insurance tax regime was also subject to a number of changes.

- The rules for the apportionment of income and gains are being amended to prevent the permanent deferral of profits of non-profit funds.
- There are also changes to the deficiency relief on a surrender of a policy by an individual on or after 6 April 2010, where those individuals are subject to the additional rate of tax from 2010/11.
- The Financial Services Compensation Scheme can intervene to protect policyholders of insurance policies or annuity contracts. Finance Bill 2010 will contain powers to ensure that, where such action is taken to protect policyholders, the tax treatment will be broadly the same as if there had been no intervention.

### **Anti-avoidance**

A number of anti-avoidance measures were covered in the Budget Notes, most of which had been brought forward at the PBR.

### ***Sale of lessor companies***

The anti-avoidance legislation at FA 2006, Sch 10 is intended to prevent certain tax-avoidance schemes involving the sales of lessor companies.

One of the measures imposes a tax charge on the vendor and a matching relief for the buyer, so that the tax benefit is taken from the selling group and returned to the buyer.

Some buyer groups were unable to use the full benefit of the matching relief, so draft legislation was published at PBR 2009 to provide an election for an alternative treatment, whereby the profits of the business are isolated following the sale of the company, as an alternative to the immediate charge on the vendor group.

Following consultation, there will be further changes to preserve the entitlement to capital allowances in some circumstances and to make the legislation fairer where the lessor is a controlled foreign company (CFC) or leases ships into tonnage tax.

Finally, there was a flaw in the legislation whereby certain consortium-owned companies could avoid the claw-back of the tax timing benefit. This flaw is being addressed.

The measures announced at PBR will be effective from 9 December 2009, as will any amendments now proposed to the draft legislation that will operate in favour of the taxpayer. Any newly proposed amendments in HMRC's favour will operate from Budget day, 24 March 2010.

### ***Risk transfer and double tax relief***

Legislation in Finance Bill 2010 will target overhedging/underhedging arrangements entered into by large multinational groups of companies in the financial sector. Measures were announced at the PBR relating to risk transfer schemes for financial instruments treated as loan relationships or derivative contracts for tax purposes.

In addition, a regulation-making power will also be included in FA 2010, so that the provisions can be extended to apply to other financial instruments used to get around the current legislation relating to loan relationships or derivative contracts.

Banks and financial institutions have been using avoidance schemes designed to ensure that they benefit from double tax relief where they have not suffered the cost of the foreign tax. These loopholes will be closed by legislation to be introduced in the Finance Bill.

### ***Transactions in securities***

Consultation on amending the transactions in securities legislation culminated in a consultation document and draft legislation published in July 2009.

The consultation also discussed the possibility of repealing the legislation completely for companies but the Budget Note only refers to individuals being affected by the

proposed changes, so the position for companies is uncertain.

The only comment about companies in the Budget Note is that certain corporate transactions such as dividend stripping at which the original legislation (enacted in 1960) was targeted, no longer represent avoidance opportunities.

However, the existing legislation on transactions in securities has been enacted in CTA 2010, Part 15 (effective from 1 April 2010), so it seems likely that changes made to the income tax provisions will be mirrored in the corporation tax provisions, unless a decision is taken to repeal the corporation tax provisions completely. We will have to wait for the draft legislation to see what legislation remains in place for companies.

The new rules will apply to tax advantages obtained on or after 24 March 2010. For the moment, therefore, all taxpayers are in the unsatisfactory position of being subject to new rules, but without any definitive idea of what those rules are.

Assuming that the new legislation looks largely like the draft legislation published last summer, the existing four circumstances will be replaced by tests that largely mirror the current circumstances D and E.

These circumstances applied where a person received tax-free consideration in a transaction in securities of a company under the control of five or fewer persons or not listed on the London Stock Exchange, and the consideration represented: the distributable reserves of a company; the future receipts of a company; or the stock of the company. This applied only to companies.

The new tests are very similar in their focus on tax-free consideration that represents the distributable reserves, etc. of a company.

But the tests now refer specifically to a transaction in securities of close companies, which is a similar but not identical test to the five or fewer persons requirement.

Not only is the concept of a close company better understood, it is also less discriminatory, as the previous legislation discriminated against companies listed on stock exchanges other than London's, which was clearly not compliant with the EC Treaty, for example.

The new legislation also includes a mechanism for measuring the potential tax advantage and makes it explicit that the advantage is only to be compared against a potential distribution of profits by the relevant companies.

The changes proposed in the July 2009 consultation document were a welcome simplification of a complex and largely out-dated set of rules. It will be interesting to see the next draft of the legislation in the Finance Bill and to review what is done for corporation tax.

### **For the future**

The *Economic and Fiscal Strategy Report and Financial Statement and Budget Report for Budget 2010* is on the [Treasury website](#). This has several interesting nuggets of information that were not mentioned in the Budget Notes.

- At paragraph 4.32, there is more detail of the patent box that was mentioned in the 2009 PBR. The intention is that there will be a 10% corporation tax rate on income from patents from April 2013. We are also promised consultation for the design of a practical and competitive regime for patents to support the UK's strengths in innovative industries.
- At paragraph 4.59, we are told that EU and EEA-resident companies engaged in UK consortia will be able to pass on relief for the losses of those consortia to their UK-resident subsidiaries. This appears to be a measure specifically designed to make the consortium relief rules compliant with the EC Treaty. At the same time, the consortium relief rules will be strengthened to ensure that access to the relief is given only in proper proportion to the member company's involvement in the consortium.
- Paragraphs 4.61 and 4.62 tell us that the on-going (and interminable) review of the CFC legislation will now be widened to include a review of foreign branch taxation. Legislation in both areas is expected for FA 2011.
- At paragraph 5.64 there is an announcement of a discussion document about the use of principles-based legislation to tackle avoidance schemes exploiting the different tax treatments of financial products within a group of companies.
- Paragraph 5.69 talks about possible measures to increase international tax transparency, with particular reference to the potential benefits to developing countries.

A current consultation document deals with the simplification of capital gains for groups of companies and responses are required by 17 May 2010.

The condoc can be found [here](#), and readers are strongly urged to have a look, as many of the proposals will be of very wide application.

HMRC held a workshop on 25 March 2010 to discuss some of the proposals and the reasoning behind them, but there is no indication as to when any proposals will be enacted. The only thing we know for sure is that there won't be anything in the forthcoming Finance Bill.

## Conclusions

As I said at the beginning for the article, there were no surprises in this Budget, although there is always the possibility of something unexpected in the Finance Bill.

In the meantime, we can of course expect an accelerated Finance Bill cycle, with typically inadequate debate about important measures, followed by a general election and at least another Finance Bill this year.

Ah well, at least we'll have something more to write about.

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