Special report
Draft Finance Bill 2013: points to watch

The draft Finance Bill 2013 clauses were published on 11 December 2013. The draft legislation and explanatory notes, which run to 1,074 pages, together with supplementary materials are available to view on the HMRC website (via www.lexisurl.com/draftFB2013). The draft measures are open to consultation until 6 February. In this feature, practitioners review the detail and identify some of the key points to watch.

Further ER enhancement to EMI share options

Peter Rayney
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Some welcome news – the qualifying period for entrepreneurs' relief in respect of EMI shares will now start from the date the option is granted.

The Budget 2012 announced that measures would be introduced in the FA 2013 to dispense with the 5% entrepreneurs' relief (ER) voting shareholding requirement for shares acquired under an EMI option after 5 April 2012 (where they were sold after 5 April 2013).

Under the original proposals, the employee option holders would only benefit from the 10% ER CGT rate where they have held their EMI shares for at least 12 months before they are sold. However, since the vast majority of EMI share options are only exercised immediately before a sale of the company, these proposals did not really 'hit the spot' since, in practice, employees would only hold their EMI shares for a very short period and could not therefore meet the 'one year' ownership requirement.

The government has listened to the various representations made over the summer and have revised the proposals. Under the revamped legislation the qualifying period for the EMI shares will now start from the date the option is granted. This will enable employee option holders to obtain the beneficial ER 10% CGT rate on a sale of their EMI shares (irrespective of the percentage held) provided their options were granted at least 12 months before the shares are sold.

The Finance Bill 2013 achieves this relaxation by inserting an additional set of qualifying ER conditions for EMI shares. These enable ER to be claimed on EMI shares where the option grant date falls before the 'beginning of the period of one year ending with the date of the disposal' provided the other ER 'trading' and 'employment/officer' tests are met throughout this period.

'Implementation' of the *Philips* judgment

David Milne QC
Barrister, Pump Court Tax Chambers

The draft 'Philips' clause does not fully implement the CJEU ruling in *Philips Electronics UK* (Case C-18/11), and is vulnerable to further challenge in an appropriate case.

The HMRC press release which came out with the draft clauses claimed that 'This measure will amend group relief legislation in order to conform to the CJEU ruling in *Philips*…' but the formal explanatory note to the clause itself is more circumspect and says merely that 'This clause derives from [the *Philips* decision]'. The fact is that the clause does *not* fully implement the *Philips* decision.

What the CJEU decided was that our group relief legislation was contrary to the fundamental principle of freedom of establishment, and could not be justified (and, for good measure, was disproportionate as well). As it stands, it provides that a non-UK company resident in another Member State in the EEA (in the *Philips* case, Holland) but with a permanent establishment/branch in the UK which is trading at a loss, can only set those UK losses against UK profits of a fellow group member resident in the UK if it is not legally possible to set any of those losses off against profits in other Member States. The UK argued that the provisions were justified by the need to ensure that the Anglo-Dutch group could not get double relief, once in the UK and once in Holland.

But both AG Kokott and the CJEU held that, in accordance with the principle of balanced allocation of taxing rights, losses made in the UK should be freely able to be set off against profits in the UK, and it was up to the Member State of residence (in the *Philips* case, Holland) to make its own rules for preventing double loss relief (should it so wish).

So the result was that the losses of the Dutch company made through its UK branch could be set off against UK group profits regardless of the tax position in Holland.

But this draft clause does not go quite that far. It limits the loss relief in the UK by providing that there is no relief to the extent that relief is actually given in another Member State. This is of course much more favourable than having to show – as under the current rules – that no part of the loss (however small) is even theoretically deductible in another Member State, *but* according to AG Kokott and the CJEU, when profits and losses made through activities in the UK are involved, they should be capable of being set off against each other regardless of what the tax position is in any other Member State.

So if the clause is enacted as currently drafted, it would be vulnerable to a further CJEU challenge on appropriate facts.

Bank regulatory capital instruments

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FA 2013 will confirm the debt treatment of banks' tier 2 regulatory capital instruments. However, some detailed issues are still outstanding. And the treatment of additional tier 1 debt remains doubtful.

Under new rules referred to as 'Basel III' (see www.lexisurl.com/basel3), introduced in the EU via the 'CRD IV' package of measures (see www.lexisurl.com/CRDIV), banks' regulatory capital must incorporate more extensive loss absorbency (so-called 'bail in') features. Typically, a debt instrument must be subject to mandatory write-off (in effect, release of the debt) or conversion to common equity on certain trigger events.

These requirements present a number of tax difficulties. In particular, HMRC's view (not all agree) is that interest paid

on such securities would be a non-deductible distribution – because the return is 'results dependent', and also potentially because it is excessive by reference to the 'principal secured'. Such equity-like features may also disturb tax groupings. (The loan capital exemption from stamp duty/SDRT might also be lost; but it may not be required anyway.)

HMRC has been consulting on these issues since mid-2011. The initial phase involved HMRC settling its views on the technical points. There have been concerns that in doing so, HMRC might upset the apple cart for existing regulatory capital instruments; it seems clear, though, that HMRC has no intention of doing that.

The issues having been identified, we have (for some time now) been waiting for policy decisions to be made. FA 2012 s 221 gave HM Treasury a wide-ranging power to make regulations in the area. Legislation in FB 2013 will now expressly provide that interest paid on banks' tier 2 securities (whenever issued) is not a distribution. As regards tax grouping, the legislation will also confirm that tier 2 securities are 'normal commercial loans' for CTA 2010 s 162 purposes.

Helpfully (and in a development from an earlier draft), the legislation will apply to any security falling within tier 2, even if it incorporates additional bells and whistles not strictly required for tier 2 compliance. (This may well assist with so-called contingent convertible or 'CoCo' securities.) 'Tier 2' is defined by reference to the *FSA Handbook*, and so gaps may remain for UK branches of non-UK banks or other cross-border scenarios.

One potential difficulty that remains for tier 2 instruments generally is that a mandatory write-off would likely crystallise taxable income for the issuer. Furthermore that possible tax liability (however remote) might correspondingly reduce the amount of regulatory capital that can be recognised up-front. Regulations may be needed to fix this.

Nothing has been said yet in policy terms about additional tier 1 instruments. It remains to be seen how significant this category is in practice, since it must have all the downside of common equity (including fully discretionary coupons) without any of the upside. Certainly the technical issues to be fixed would be more extensive: HMRC's view is that such instruments would not even qualify as loan relationships.

Overseas workday relief

Elizabeth Conway
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The abolition of the concept of 'ordinary residence' came relatively late in the evolution of the new statutory residence rules. Among its more interesting consequences are the changes now proposed to overseas workday relief (OWR).
Currently, OWR is only available to someone who is resident but not ordinarily resident (RNOR) in the UK. OWR enables an RNOR person to claim the remittance basis of taxation on earnings from a UK employment to the extent that those earnings are attributable (generally on a simple time apportionment basis) to days worked outside the UK. By contrast, someone who is resident and ordinarily resident in the UK (ROR), although he may be non-UK domiciled, can only claim the remittance basis in respect of earnings which are attributable to an employment carried out wholly outside the UK (and HMRC adopts a strict interpretation of what this means).

Under the proposed new rules OWR will be available to a person who is UK resident but non-UK domiciled for his first three tax years of residence in the UK. Take, for example, an overseas executive of a international organisation who decides to move to the UK given escalating tax rates in his own jurisdiction. He takes up residence in the UK and becomes an employee of a UK entity within the organisation. In all likelihood he will be internationally mobile and, at least in his early years in the UK, may be required to make frequent trips to his former country of residence. Under current rules all of his employment income is taxed in the UK on an arising basis even though he may be spending a considerable amount of his time working outside the UK. OWR is not available as, having moved to the UK to take up permanent residence here, he will be ordinarily resident from the time he arrives. Under the new rules, however, he will be able to avail himself of OWR which could be of significant value to him in his early years of residence here. Moreover, OWR will continue to be available, as now, to many short-term overseas secondees to the UK.

Corporate exit charges

David Yates
Barrister, Pump Court Tax Chambers

Watch out for the new 'exit charge payment plan'.
The Finance Bill 2013 makes changes to address *National Grid Indus BV* (CJEU Case C-371/10) and *Commission v Portugal* (CJEU Case C-38/11), where it was held that corporate exit charges, whilst justified, are disproportionate if they require immediate (rather than postponed) payment of tax.

The UK imposes a tax charge on a company ceasing to be UK resident in respect of TCGA assets (TCGA 1992 s 185), loan relationships, derivative contracts and intangible assets (CTA 2009 ss 333, 609 and 859). Deferment is currently available only for TCGA assets and intangible assets where the newly non-UK resident company remains a 75% subsidiary of another UK resident company.

The Bill introduces the 'exit charge payment plan' (ECPP) within TMA 1970. The key features are as follows:

- A company can apply for an ECPP within nine months of the migration accounting period but only where it has become resident in another EEA state.
- 'Deferred' tax remains 'due and payable' with interest running as normal but HMRC will not seek payment other than in accordance with the ECPP.
- Two payment methods can be chosen for an ECPP:
  - Standard instalment: six annual instalments. Earlier payment is triggered by a 'relevant event' (e.g. insolvency or ceasing to be resident in an EEA state).
  - Realisation: deferral until the earlier of (i) disposal (or 'trigger event' for non-TCGA assets) (ii) a 'relevant event' or (iii) ten years for TCGA assets, various instalment dates for non-TCGA assets based on the economic life of the asset concerned.

SDLT: leases simplification – substantial performance

Aaron Burchell
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A measure introduced to simplify the SDLT treatment of leases may only work in the most straightforward cases.

Currently where an agreement for lease is substantially performed before grant, the agreement is treated as a 'notional lease' beginning on the date of substantial performance. This typically triggers a requirement to file an SDLT return. When the actual lease is granted, the notional lease is treated as surrendered and a second return is required for the lease, with relief being available for any period of overlap.

The requirement to complete and file two separate returns can be a burden and so FA 2003 Sch 17A para 12A will be amended with the apparent intention that only one return will be required.

It remains the case that when the agreement for lease is substantially performed, the notional lease is deemed granted (and the return is required). Under the new rules however, when the lease is actually granted the notional and actual leases are treated as a single lease for a term beginning on the date of substantial performance and ending on termination of the actual lease. The actual grant is then generally disregarded. Except in straightforward situations it seems unlikely these rules will significantly lessen the compliance burden, because at the time of substantial performance not all the facts will be known. The date of completion may not be certain where a fit-out is to be carried out. The timing of future rent increases, relative to substantial performance, may also not be known (so too, the end date of the lease itself).

The new 'above the line' R&D credit

Diarmuid MacDougall
R&D network leader, PwC

In a welcome move, the draft Finance Bill introduces the new R&D credit from 1 April 2013 – earlier than previously proposed.

The credit is at a 9.1% rate and taxable. It is designed to be like a grant, accounted for against the cost of R&D, thereby reducing the costs R&D budget holders are responsible for with greater effect on investment decisions.

Crucially, it is payable to companies with no corporation tax (CT) liability so the cash benefit no longer depends on the tax profile of the business. However, the payable credit is restricted to the PAYE & NI within the staff cost in the company's R&D claim which could significantly restrict R&D claims involving foreign branches, external resource or large amounts of materials or software expenditure.

The credit is first offset against the company's own CT liability with any excess credit being limited to the PAYE & NI cap. The remaining excess is settled against the company's unpaid CT of other periods, may be surrendered to group companies or is paid to the company after deducting tax at the mainstream rate. However, this order favours companies with abundant CT (as the PAYE cap doesn't apply) over those with losses and may mean the ATL treatment isn't achieved so the legislation may have to change to overcome this.

Companies have the option to elect into the new ATL regime above or continue to claim the current super-deduction until accounting periods beginning on or after 1 April 2016 when the super-deduction scheme will be withdrawn.

Family pension plans

Paula Tallon
Managing director, Gabelle

Under a proposed change, the benefits of an employer making contributions to an employee family member's pension scheme will be lost.

Where an employer makes contributions under a registered pension scheme, ITEPA 2003 s 308 exempts the employee from income tax. The contributions are also excluded from earnings for the purposes of national insurance contributions (NICs).

The amount of pension contributions (made by or on behalf of an individual) that benefit from tax relief is limited to an annual allowance – currently £50,000 (reducing to £40,000 from 2014/15).

The introduction of the £50,000 limit led to the development of new arrangements (known as family pension plans) under which the employer pays pension contributions into a registered pension scheme for the benefit of an employee's family member, usually under a flexible remuneration package. These contributions do not count towards the employee's own annual allowance, but the contributions are exempt from income tax and NICs. Draft provisions in FB 2013 propose an amendment to s 308 such that the exemption, for 2013/14 and subsequent years will now only apply '*in respect of the employee*'. Therefore the benefits of an employer making contributions to an employee family member's pension scheme will be lost.

Employers with flexible benefit arrangements or other arrangements which pay contributions to pensions for family members should review the terms prior to the new provisions being enacted. There may be circumstances in which an employee's remuneration package will need to be renegotiated.

IR35 and intermediaries

Tracey Wright
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The government has announced that it had decided not to proceed with its proposals to tax persons who meet the definition of controlling persons. However, it has used the opportunity to amend the IR35 rules to make it clear that they cover 'office holders'.

HMRC announced in the Autumn Statement and through its response to the consultation (published on 11 December

2012) that it had decided not to proceed with the proposals to tax controlling persons at source even if engaged through an intermediary. HMRC view its new approach to policing IR35 along with measures introduced in the public sector (where departments have the right to seek assurance from highly paid off-payroll individuals that they are meeting their tax obligations) as sufficient to prevent the loss of tax/NIC through disguised employment.

However, as a result of the consultation, the government proposed legislation in the Finance Bill 2013 to put it beyond doubt that the IR35 legislation (at ITEPA 2003 Part 2 Chapter 8) applies to office holders as well as employees. This proposal is achieved by a change to ITEPA 2003 s 49(1)(c). This extends the application of IR35 both to where the worker is named as an office holder of the client (but paid by an intermediary) and also where the intermediary is named as the office holder of the client. The definition of 'office' in ITEPA 2003 s 5(3) will apply. Practitioners may have been working on the basis that the legislation always applied to office holders but the changes now put this beyond doubt. It is clear that a director or company secretary will be holding an office but the definition is wide enough to include other posts.

The above measures suggest that there will be no let-up in HMRC's focus on IR35 arrangements and reliance on the IR35 legislation.

Worldwide debt cap: group treasury companies

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A new anti-avoidance measure will narrow the scope of the group treasury company exemption to the worldwide debt cap and may impact the position of certain large groups from 1 January 2013

The proposed changes will require large groups with group treasury companies in the UK to assess whether:

- all or substantially all of the activities that those companies undertake throughout a period of account consist of treasury activities undertaken for the worldwide group of which they form part; and
- all or substantially all of the assets and liabilities of the companies relate to such activities.

If a group treasury company satisfies these new conditions, the company may elect, as it can today, for all of its financing income and expense amounts for the period to be excluded in computing the tested expense amount of the UK members of the worldwide group. The company's financing expense amount will therefore remain exempt from a disallowance under the worldwide debt cap, irrespective of whether it relates to the company's treasury activities. However, where either or both of these new conditions are not satisfied, the company's financing income and expense amounts must be streamed on a just and reasonable basis and those amounts will only be excluded for the purposes of the debt cap to the extent that they relate to treasury activities undertaken by the company for the worldwide group.

The government has announced that, when enacted, the changes will take effect in relation to periods of account beginning on or after 11 December 2012, thereby affecting groups with a calendar year end from 1 January 2013.

Exemptions for high value residential property

Marios Gregori
Tax partner, PKF

The government's original proposals for clamping down on SDLT avoidance on residential properties worth over £2m were harsh for some property developers but welcome new exemptions were announced in draft Finance Bill 2013.

The new exemptions apply where the property is:

- held by property development, rental or trading businesses including new businesses (provided it is not occupied by a connected person);
- run as a business (i.e. the property is open to the public on a commercial basis, or as a venue or for accommodation);
- held to provide employee accommodation;
- a farmhouse occupied by a working farmer on his or her farmland; or
- used for diplomatic purposes or government owned, or one that is conditionally exempt from inheritance tax (IHT).

These exemptions will apply to the 15% rate of SDLT for residential properties purchased by non-natural persons, the new annual residential property tax (ARPT) and the proposed capital gains tax charge on non-resident non-natural persons. In all cases, 'non-natural person' will mean companies, collective investment schemes and partnerships with a corporate member: trustees will be excluded.

The point to watch is that the exemptions will have to be claimed on each relevant return so there is still an administrative burden. Also, the exemptions apply from different dates for different taxes: from 1 April 2013 for ARPT, from 6 April 2013 for CGT, but for SDLT purposes, only where the effective date of the transaction is on or after the date of Royal Assent (probably in July 2013).

Amendments to TCGA 1992 s 13

Peter Jackson
Head of tax, Taylor Wessing

The proposed amendments to TCGA 1992 s 13 are in response to notice given by the European Commission that s 13 breaches statutory freedoms of establishment and movement of capital. It is not clear that the amendments as drafted will meet these concerns or promote greater certainty for taxpayers as to the operation of the regime.

Section 13 currently exempts attribution of capital gains to participators where the non-UK resident company disposes of an asset employed for the purposes of a trade carried on outside the UK. It's difficult to see how the proposed new exemption for gains arising on disposals of assets used for the purposes of 'economically significant activities' carried on through a permanent establishment outside the UK could apply in situations not covered by the existing exemption. Satisfaction of the economically significant activities test will be problematic for assets (including

investment assets) passively held for the purposes of a business. This is reinforced by the shoehorning of non-UK property held as furnished holiday accommodation into the existing exemption, perhaps recognising that the activity of commercial letting is unlikely to qualify for the new exemption.

A further exemption is proposed for gains accruing to a company on a disposal of any asset where 'it is shown' that none of the disposal, acquisition or holding of the asset by the company formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was avoidance of liability to capital gains tax or corporation tax. The omission of both IHT and SDLT mitigation is surprising, as is the lack of a restriction on the availability of exemptions to territories which have entered into a DTA with the UK that has a non-discrimination article. The requirement to 'show' the absence of tax avoidance at all points within the ownership cycle will be difficult in practice, particularly for companies with a diverse or multiple ownership history.

Changes to CFCs

Stella Amiss
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The proposed changes to CFCs do not, in general, affect the overall structure and content of the new regime.

The new controlled foreign companies (CFC) rules – a key plank in the government's strategy to attract business investment in the UK – are finally here, taking effect for accounting periods beginning on or after 1 January 2013.

These new rules – with wider reliefs, a broad financing exemption and reduced complexity (particularly for inbound investors) – support the commitment of delivering a modernised set of rules and a competitive environment for global business.

The recent draft Finance Bill included some proposed small amendments to the rules. All are narrowly focused changes so that the overall structure and content of the new regime remains unchanged. This demonstrates the government's ongoing commitment to reform.

The main change set out in the draft Finance Bill affects the way double tax relief will operate where a finance exemption is being used. As currently drafted this can result in a disproportionate restriction on the ability to credit withholding tax. However, we are hoping that the scope of the amendment will be narrowed before enactment – otherwise it could limit the ability of some groups (particularly those with a smaller global footprint) to access the simpler offshore financing that the reforms currently offer.

It should also be noted that the exempt territory rules have also been updated recently by statutory instrument. The introduction of eight 'good' territories is certainly a welcome move in helping to simplify the approach and the compliance burden.

Delivering on the introduction of CFC reform is positive for business. We are seeing new investments in the UK and look forward to this continuing.

The income tax relief cap

Nadine Elliott
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The cap could adversely affect early loss relief claims.

As the dust settles on the publication of the draft income tax relief cap legislation which will form part of Finance Bill 2013, the intricacies and difficulties presented by the cap are starting to be considered. Whilst the cap no longer applies to charity payments, it will still apply to other income tax reliefs, including loss relief, and will make professional advice for those affected even more important.

One of the loss reliefs on which the cap may have a particular detrimental effect is early trade losses relief. This relief is specifically aimed at those who have gone from employment to trying their hand at being their own boss. In today's economic climate, there are many former employees that enjoyed reasonable earnings finding themselves redundant and with little choice but to try and go it alone.

Early trade losses relief is particularly unforgiving in that it is an all or nothing relief. It is difficult to achieve relief against

Example of operation of income tax reliefs cap

Under the existing rules, taxable income would be calculated as follows:

	2011/12	2012/13	2013/14	2014/15	2015/16
	£	£	£	£	£
Business income/(loss)	–	–	–	(105,000)	20,000
Employment income	125,000	35,000	10,000	–	–
Early trade losses relief	(105,000)	–	–	–	–
Taxable income	**20,000**	**35,000**	**10,000**	**–**	**20,000**
Tax relief claimed	**40,495**	**–**	**–**	**–**	**–**

Under the new rules, the taxpayer's returns may look like this:

	2011/12	2012/13	2013/14	2014/15	2015/16
	£	£	£	£	£
Business income/(loss)	–	–	–	(105,000)	20,000
Employment income	125,000	35,000	10,000	–	–
Early trade losses relief (capped)	(50,000)	(35,000)	(10,000)	–	–
Loss relief carry forward	–	–	–	–	(10,000)
Taxable income	**75,000**	**–**	**–**	**–**	**10,000**
Tax relief claimed	**22,990**	**5,379**	**112**	**–**	**2,000***

*Estimated based on current tax rates.

the highest marginal rates of tax and the personal allowance withdrawal, made all the more difficult by the new cap.

For example, taking an individual who having had a particularly good year in 2011/12 with a large bonus finds himself redundant the following year. After trying unsuccessfully to find further permanent employment, he starts his own business in 2014/15. For the purposes of the example, the business becomes profitable in 2015/16. However, in reality, it may take several years, and further investment, before the loss making business becomes profitable. See the example above.

In this example, the cap reduces the overall tax relief (and therefore tax refund) on the same loss by £10,014. This is due to a combination of the loss of personal allowances and the effective tax rate at which the loss is relieved. Furthermore, there is a cash flow impact as some of the relief is deferred until future years. This represents a significant reduction in relief to someone at a point when they can ill afford it. It is doubtful that this was the intended target when the government was drafting the new cap, but individuals will be hit nevertheless.

Capital allowances

Tim Beresford
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The AIA limit is increased ten-fold from 1 January 2013, but care must be taken for chargeable periods which straddle that date.

Following the chancellor's Autumn Statement a welcome but unexpected inclusion in the Finance Bill 2013 will be the ten-fold temporary increase in the annual investment allowance (AIA) from £25,000 to £250,000. This change will be effective from 1 January 2013 and apply for two years.

On examining the operative provisions, however, it is clear that extreme care must be taken by taxpayers whose chargeable periods straddle either the start or end date of the increase when planning the timing of their expenditure.

This is because of some very complex transitional provisions. Consider an example of a company which has a 28 February year end and is planning to acquire a new piece of machinery in their year to 28 February 2015. Whilst the transitional provisions mean that the total AIA available to them in that year would be £212,500, if they waited until after the 1st January 2015 to acquire the machinery their AIA entitlement would be limited to just £4,167.

Whilst the AIA increase is still likely to provide a significant timing benefit to many businesses, probably a less welcome announcement to individuals was confirmation of proposals to limit certain income tax loss reliefs from April 2013.

The losses to be restricted will include capital allowances available to trades and property businesses. The reason given why the chosen losses were to be restricted was that they were otherwise uncapped (unlike EIS & VCT reliefs) and this was unsustainable in the current economic climate.

What does not fit with this reasoning, however, is why then the AIA with its much welcomed higher annual cap was still included within the restricted reliefs.

The statutory residence test: defining a home

Chris Tysoe
Manager, Grant Thornton

A new minimum presence test is introduced.

Perhaps the most significant change in the final draft legislation for the proposed statutory residence test (included within the draft clauses for the Finance Bill 2013), was the government's reconsideration of what constitutes a 'home' for these purposes.

Use of the term 'home' is prevalent throughout the test, but it is particularly significant for the purposes of the 'automatic residence test', where the existence of a UK home may act as a conclusive determinant for UK residence. However, it has raised much opinion and debate throughout the consultation process, with concerns that the lack of any conclusive definition could undermine the robustness of the test.

Significantly, the final draft test will arguably make it easier to be classed as UK resident.

In particular, a new 'minimum presence test', intended to remove holiday homes and occasional residences from consideration, means it is now necessary to disregard (for the purposes of this part of the test) any home at which an individual is present for fewer than 30 days in the tax year. This will apply to both homes in the UK and overseas.

Under previous versions of the test, an individual could not have met the test for being conclusively UK resident based on having a UK home if he or she owned a property overseas. However, it will now be important that an individual actually spends time in their overseas home, on at least 30 separate days in the year (consecutive or intermittent), for it to be considered a relevant factor.

The GAAR commencement rules

Heather Self
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The commencement rules for the GAAR have now been announced, and are less draconian than many had expected.

They are set out in clause 10 of the draft rule, with guidance in Chapter 6 of Part A. The GAAR will apply to any arrangements entered into after Royal Assent, and does not apply to any arrangements entered into before that date.

The rules for arrangements which straddle the commencement date are interesting. If the post-commencement steps are themselves abusive, the GAAR will apply, but only to any post-commencement tax advantage. If the post-commencement steps are not abusive in their own right, but are part of a broader abusive arrangement, HMRC cannot take this into account – the earlier steps will not 'taint' the later ones. But, in contrast, the taxpayer can take into account the overall arrangements in order to show that the post-commencement steps are not abusive. The examples in Chapter 6 of the draft guidance are helpful in illustrating the approach.

Historic planning is therefore safe from the GAAR (but may of course be attacked under existing rules). Those who think that they can continue to sell aggressive planning ideas right up to the

commencement date, in a 'buy now while stocks last' campaign, may see a glimmer of hope in the transitional rules, but run the risk that the government will introduce specific blocking legislation at short notice. The announcement of legislation against one such scheme on 21 December, barely two weeks after the Autumn Statement, shows that this risk is high.

Mortgage REITs: a brave new world?

Lara Hill
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While the Finance Bill changes to the REITs regime are welcome, it is disappointing that these do not include allowing REITs to invest in real estate mortgages as a tax exempt asset class.

Finance Bill 2013 amendments allow REITs to invest in property indirectly by acquiring shares in other REITs as part of the REIT's tax exempt property rental business. This change is welcome and demonstrates government's desire to increase the attractiveness of the regime. There was some expectation that government would take the opportunity to include real estate mortgages as another asset class which a REIT could acquire tax efficiently. It is disappointing that calls for widening the regime in this manner remain unheeded.

Unlike equity REITs which invest primarily in property, 'mortgage REITs' predominantly invest in debt instruments secured on commercial and residential property.

Mortgage REITs may provide a new source of much needed finance for the UK property sector, free up bank capital tied up in real estate lending and help stimulate the ailing economy. Given the current funding gap for UK property, securing alternative sources of property finance could be a vital part of the economic recovery. There are precedents for mortgage REITs in other countries, notably the US, which have proved popular investment vehicles in recent years.

Widening the 'tax exempt' asset class which REITs could acquire should not in principle be difficult and appropriate safeguards to protect investors / prevent abuse can be incorporated by drawing on existing models and international experience. The risk is that non-UK REITs would otherwise step into the breach, at a loss to UK industry and investors. Can we hope for the introduction of mortgage REITs in Finance Bill 2014?

SDLT and transfer of rights

John Christian
Partner, Pinsent Masons

Developers and others using sub-sales and similar structures should review the proposed changes to relief from SDLT on transfers of rights to check they do not affect current or proposed structures.

The transfers of rights relief in FA 2003 s 45 is often relevant in development and joint venture structures where sub-sales or similar transactions are involved.

The draft clauses substantially re-write the rules and the detail will need to be worked through on proposed transactions. The broad effect of the s 45 relief remains, so that an intermediate purchaser under a sub-sale or contract resulting from an assignment of rights is generally relieved from SDLT, though the relief now has to be claimed.

Specific changes have however been made to counter avoidance:

- a widely drawn provision denies transfer of rights relief where one of the main purposes of the intermediate purchaser is to obtain a 'tax advantage' from the arrangements. It is not clear whether 'tax advantage' may relate to any tax, rather than just SDLT. The definition of 'tax' in FA 2003 s 121 means SDLT except where the context requires. The recent debate between HMRC and the industry on the availability of group relief on hive-ups from acquired SPVs illustrates the difficulty that can arise in identifying what may be regarded as avoidance;
- a minimum consideration is imposed on transactions where the parties are connected, e.g. in some joint venture or partnering structures, or are not acting or arm's length terms. These rules may lead to issues where the sub-sale or assignment is completed at a lower price than the original contract, perhaps to reflect movement in market values or for other commercial reasons.

Long live the CSOP!

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The government's decision to retain the company share option plan (CSOP) has been universally welcomed. Proposed relaxations to the CSOP legislation could, once enacted, lead to increased take up amongst unlisted companies.

Significant concerns emerged during 2012 that the CSOP was to be scrapped as a result of the Office of Tax Simplification (OTS) review of HMRC approved employee share plans.

The future of the CSOP is, however, now much brighter. Not only has the government decided to retain the CSOP but it is also taking forward a number of changes recommended by the OTS which would make the CSOP available to more unlisted companies.

Unlisted companies have historically struggled to qualify for the CSOP as the option shares cannot be subject to restrictions. The proposed abolition of that prohibition means that unlisted companies should consider whether they will qualify once the changes are made. This will be of particular relevance to those companies which are not able to offer enterprise management incentives.

Note, however, that the proposed changes do not provide complete flexibility. For example, companies under the control of another company (e.g. many private equity backed companies) will still not be eligible. In addition, those companies with more than one class of share will still need to carefully analyse their position under the legislation.

If the CSOP is available, companies should also examine who might participate. Currently, if an employee holds 25% or more of a company's shares he cannot participate in a CSOP. That threshold is to be raised to 30% and so some substantial shareholders who could not previously benefit from a CSOP will soon be able to do so.

The proposed changes to the CSOP legislation can be reviewed at www.lexisurl.com/CSOP.