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UK Budget 2013 – Key Tax Measures

21 March 2013

The Chancellor of the Exchequer's fourth Budget, held on 20 March 2012, continued the prevailing taxation themes in recent Budgets of balancing between stimulus and business incentives on the one hand, and anti-avoidance initiatives on the other. However, perhaps more than recent Budgets, the balance this time seemed materially weighted towards anti-avoidance legislation and initiatives, with the stimulus package being quite narrowly focused towards the UK fund management industry. Allied with the sombre tone of the prevailing macro-economic news (including a revision of UK GDP growth down to 0.6 per cent. for 2013), the focus on counteracting tax avoidance and numerous damning comments from the Chancellor on tax avoiders and abusers contributed to a Budget which was devoid of much sunlight. In short, a Budget to match the notoriously gloomy UK weather experienced so far in 2013.

While an additional 1 per cent. reduction in the main rate of UK corporation tax from April 2015 will doubtless be welcomed by all sectors of UK industry, any dramatic stimulus measures to invigorate the UK's manufacturing and retail sectors (as advocated loudly by some commentators and economists) were absent from the Chancellor's Budget.

In this memorandum we have set out the details of a number of key changes in legislation and practice that we expect to be of interest to Cadwalader's clients and friends. These developments are briefly addressed in our "speed read" section which summarises the key points, each of which is expanded in the lengthier commentaries which follow.

Speed Read

Main rate of UK corporation tax: reduction of 1 per cent. in the main rate of UK corporation tax in April 2015, taking the main rate of UK corporation tax to 20 per cent.

UK Bank Levy: increase in the UK bank levy to a rate of 0.142 per cent. for short term chargeable liabilities, the sixth increase since the bank levy was introduced in 2011.

Additional Tier 1 CRD 4 compliant bank capital instruments: interest coupons on Additional Tier 1 debt capital instruments already in issue or yet to be issued will be deductible for the purposes of a bank computing its profits for corporation tax purposes.

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Revision to loan relationships and derivative contracts rules: consultation on a package of proposals to modernise the corporation tax rules governing the taxation of corporate debt and derivatives with a view to legislating in Finance Bill 2014 and Finance Bill 2015.

UK fund management stimulus package: a number of significant measures targeted at increasing the attractiveness of the UK as a centre for fund management, including abolishing the complex regime in Schedule 19 of Finance Act 1999 for stamp duty reserve tax charged on fund managers in respect of surrenders of units in funds such as open ended investment companies and unit trusts.

Numerous anti-avoidance measures: UK corporation tax "targeted loss buying" rules and "loss loophole closure" rules to be introduced in Finance Bill 2013. Retrospective changes to stamp duty land tax legislation relating to sub-sales following continued use of tax avoidance arrangements in this area. Proposed consultation on the "misuse" of the UK partnership tax rules commencing in Spring 2013.

Corporate Tax Competitiveness

As prominently announced in the Executive Summary of the UK Budget "[t]he Government's objective is to equip the UK to succeed in the global race, build a stronger economy and a fairer society and to support aspiration". As part of the programme of supply-side reform, the Chancellor has announced a further reduction of 1 per cent. in the main rate of UK corporation tax in April 2015, taking the main rate of UK corporation tax to 20 per cent. This will ensure that the UK main corporation tax will be (on current levels) the joint lowest level in the G20. The reductions in the main corporation tax rate are part of a co-ordinated strategy to improve UK tax competitiveness, particularly when placed alongside other tax-attractive jurisdictions in the EU such as Ireland, Luxembourg and the Netherlands. Other key components of the UK Government's strategy of increasing and retaining tax competitiveness have included a comprehensive reform of the UK controlled foreign companies ("**CFC**") legislation, the introduction of a UK "patent box" and, more controversially, ensuring that the UK has not joined the group of European Union Member States introducing a financial transaction tax under the enhanced cooperation procedure.[1]

As in the 2012 Autumn Statement delivered in December 2012, the additional 1 per cent. reduction in the main rate of corporation tax has been accompanied with a corresponding increase in the UK bank levy. Legislation will be introduced in Finance Bill 2013 to ensure that for periods falling wholly or partly after 1 January 2014, the bank levy rate applying to chargeable equity and long term chargeable liabilities will be increased from 0.0625 per cent. to 0.071 per cent., and the rate for short term chargeable liabilities will be increased from 0.130 per cent. to 0.142 per cent. This increase represents the sixth increase in the bank levy since its introduction in 2011. It also corresponds with the Government's stated intention to ensure that the bank levy should consistently raise at least £2.5 billion each year, and equally serves as

[1] For more details on the European Union Financial Transactions Tax, see: http://www.cadwalader.com/assets/client_friend/031113_-_RevisedProposalsEUFinancialTransactionsTax.pdf

useful political insurance for the Government against any potential allegations from the Opposition that reductions in the main rate of UK corporation tax represent a tax cut for the UK banking sector.

However, any direct correlation between the rate of the bank levy and the actions undertaken by individual banks to stimulate lending and credit liquidity to UK businesses, such as the Bank of England Funding for Lending Scheme launched in August 2012 continues to be absent. The bank levy remains a fairly blunt tool in tax policy terms, albeit currently a politically expedient one. Increases in the bank levy will certainly be felt by the UK banking sector at a time when bank balance sheets are being carefully managed and liquidity remains tight. With the introduction of an EU-wide financial transactions tax through the enhanced cooperation procedure (but not extending to the UK) now looking highly likely in 2014 (or at the latest, 2015), the Chancellor may find that any consequent increase in banking business in the City of London could leave him in the uncomfortable position of tacitly encouraging the long-term strategic location of banking activities to the UK while continuing the distinctly unfavourable corporation tax treatment for the banks when compared to other UK corporate sectors.

Financial Services

Bank Capital

One welcome announcement in the Budget was the confirmation that the Government will, following the conclusion of Capital Requirements Directive 4, legislate to "clarify" that interest coupons on banks' Additional Tier 1 debt capital instruments already in issue or yet to be issued will be deductible for the purposes of a bank computing its profits for corporation tax purposes. This announcement complements the written ministerial statement on 26 October 2012 that legislation would be introduced in Finance Bill 2013 to clarify that the interest coupon on a bank's Tier 2 debt capital instruments which is already in issue, or which is yet to be issued, will also be deductible for corporation tax purposes.

The Budget announcement regarding Additional Tier 1 will be warmly welcomed by the UK banking and financial institutions sector, particularly since statements made by HM Revenue & Customs ("**HMRC**") in a paper entitled "*The current tax treatment of Instruments designed to be compliant with Capital Requirements Directive 4*", published on the HMRC website on 26 June 2012, gave little comfort that HMRC were persuaded of the technical arguments as to why tax deductibility of Additional Tier 1 instruments should be preserved for going-concern and gone-concern instruments.

The developments regarding bank capital instruments are also complemented by regulations already made on 28 February 2013 ensuring that where a building society converts existing securities into Basel III-compliant 'core capital deferred shares', those shares will be taxed as

equivalent to shares (and not treated, for example, as loan capital for stamp duty purposes) with effect from 1 March 2013.[2]

Loan relationships and derivative contracts legislation

A surprise announcement in the Budget was the Government's proposal for a consultation on a package of measures to modernise the corporation tax rules governing the taxation of corporate debt and derivatives with a view to creating new legislation in Finance Bill 2014 and Finance Bill 2015. The stated intention of the Government is to include measures to "clarify and strengthen the structure of the current legislative regime and to update aspects of the detailed rules". Although the details of the changes are currently vague at best, the Budget makes additional references to the changes minimising the scope for abuse, reducing uncertainty, reducing administrative burdens and providing a simpler tax regime. The announcement is surprising as the loan relationships and derivative contracts codes were only very recently extensively rewritten into Corporation Tax Act 2009 following a project which lasted a number of years.

Funds and UK Fund Management

The Budget includes a number of significant measures targeted at increasing the attractiveness of the UK as a centre for fund management. Ensuring that the UK tax regime for fund management is "simple, fair and streamlined" has been placed centre-stage of an initiative aiming to improve the UK's competitive position as regards European and global fund management business.

These measures include:

- abolishing the complex and investor-unfriendly regime in Schedule 19 of Finance Act 1999 for stamp duty reserve tax charged on fund managers in respect of surrenders of units in funds such as open ended investment companies and unit trusts. Despite a number of HMRC initiatives (in 2007 and 2010) considering reform of the Schedule 19 regime, the tax charges created under the regime have continued to be burdensome and a clear disincentive to non-UK investors when evaluating UK funds alongside overseas fund structures. Representatives of the UK fund management industry and tax commentators have long argued that Schedule 19 was encouraging funds to locate outside the UK rather than in the UK. The Government's announcement of the abolition of Schedule 19 charges on funds will therefore be widely welcomed.
- extending the confirmation in section 363A of the Taxation (International and Other Provisions) Act 2010 ("**TIOPA**") to non-UCITS funds. Currently section 363A TIOPA 2010 provides that locating management functions of offshore UCITS funds in the UK will not place the fund at risk of being treated as being resident in the UK for UK tax purposes. The Budget sets out the Government's intention to broaden the scope of the provision to

[2] The Building Societies (Core Capital Deferred Shares) Regulations 2013 (SI 2013/ 460), made before the UK Parliament on 28 February 2013.

encompass non-UCITS foreign domiciled funds. This should provide substantial comfort to UK investment managers wishing to operate non-UCITS foreign domiciled funds under the Alternative Investment Fund Managers Directive.

- permitting UK domiciled bond funds to pay gross interest where they are marketed to non-UK residents (currently the managers of such funds are required with withhold basic rate income tax on interest distributions);
- making a number of minor changes to the white list of investment transactions for the purposes of the UK Investment Management Exemption, which is extensively relied upon in fund structuring and fund transactions generally.

Tax Avoidance

The theme of the Government's determination to confront and counteract tax avoidance is evident throughout the Budget documentation. If anything, the measured statement by the Exchequer Secretary to the Treasury in the Budget document "*Levelling the Tax Playing Field: Compliance Progress Report – March 2013*" that "[t]here is a strength of public feeling against tax avoidance and evasion" understates the current public and media rejection of tax avoidance as a socially acceptable and economically viable activity.

While the taxation profession, the UK financial services industry and UK business generally has gradually come to terms with the dynamics of the UK general anti-abuse rule (the "**GAAR**") to be introduced in Finance Bill 2013 (having effect from 1 April 2013), the Chancellor has introduced a series of stand-alone legislative changes and consultation initiatives which all target tax avoidance. In themselves, the detailed and intricate new anti-avoidance provisions are perhaps unsurprising. However, the timing of their proposed introduction, coterminous with the introduction of the GAAR, does raise questions of whether the GAAR will ever offer opportunities to simplify the UK tax system, as its proponents have claimed vigorously.

A number of avoidance arrangements, schemes and approaches are the subject of proposals and legislative changes In the Budget:

- *Corporation tax "targeted loss buying" rules*: The Government has announced the introduction of legislation to be enacted in Finance Bill 2013 to counteract what it considers to "prevent the growing practice of 'loss buying'" and circumvention of the longstanding loss restriction rules recently rewritten into Part 14 of the Corporation Tax Act 2010. Very broadly, this practice is where companies pass the potential to gain access to corporation tax loss relief to unconnected third parties, with the purchased losses then being relieved against profits unconnected with the activity from which they arose. Targeted anti-avoidance rules counteracting this form of loss buying are introduced with effect from 20 March 2013, with draft legislation being published by HMRC on 28 March 2013 for a short period of technical consultation.
- *Corporation tax "loss loophole closure" rules*: Government has proposed a number of specific restrictions on the availability of relief for losses. The restrictions relate to the surrender of losses for group relief and the treatment of losses in the event of a change of

company ownership. Three separate amendments to the relevant legislative provisions have been proposed, each of which aims to correct a perceived "loophole" in the legislation and thereby strengthen the UK loss rules in line with the "underlying policy principles" governing the tax treatment of corporate losses in the UK.

- *Stamp duty land tax ("SDLT") avoidance* – retrospective tax measures: In recent years, HMRC have increasingly focused efforts in combating the avoidance of SDLT through a number of approaches including litigation through the UK tax tribunals and courts and through targeted anti-avoidance legislation. Legislation was introduced in Finance Act 2012 to "put beyond doubt" that an SDLT avoidance scheme involving the sub-sale rules and an option to purchase land was ineffective. At the time of Budget 2012, the Government stated that it would use retrospective legislation to close down future SDLT avoidance schemes in the event that schemes and arrangements aiming to exploit perceived deficiencies in the SDLT legislation for tax avoidance purposes were found to be continuing.

  The Government has announced in the Budget that two specific SDLT avoidance schemes which abuse the sub-sale rules, and which have been used particularly (although not exclusively) in the context of residential property transactions, have been identified. Both schemes have therefore been closed retrospectively with effect from 21 March 2012 (being the date of Budget 2012).

- *"Misuse" of partnership rules*: The Budget contains a short description of a Government consultation on the "misuse" of the UK partnership tax rules. A previous announcement in this regard was made in the December 2012 Autumn Statement, although the announcement in the Budget adds greater clarity regarding the measures to be consulted on. These will include measures to: (a) remove the presumption of self-employment for limited liability partnership ("**LLP**") members, thereby tackling the perceived disguising of employment relationships through LLPs; and (b) to counteract certain profit and loss allocations by partnerships using a company, trust or similar vehicle in order to secure tax advantages which were not within the object of the relevant legislation when enacted by Parliament. Given the recent series of very high profile cases through the UK tax tribunals and courts concerning partnership arrangements, the enhanced Government and HMRC scrutiny in this area is unsurprising. The consultation document, and accompanying legislative proposals, will be published in Spring 2013, with the intention being for legislation to be introduced in Finance Bill 2014.

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