Clients&FriendsMemo

UK Budget 2014 – Key Tax Measures

20 March 2014

The Chancellor of the Exchequer's Budget, held on 19 March 2014, was notable for the number of provisions focusing on individual taxation measures and the continued encouragement of "fairness" within the UK tax system. These themes were perhaps unsurprising given that the Budget precedes by barely a year the UK's general election scheduled for May 2015 and the attention which continues to be paid by the UK media to failed tax avoidance schemes in which celebrities have participated.

Apart from personal taxation measures intended to be attractive to voters, the Budget is perhaps much less controversial than in previous years. Many of the detailed taxation provisions intended for inclusion in Finance Bill 2014 were foreshadowed in the Autumn Statement by the Chancellor of the Exchequer on 5th December 2013. Other taxation measures refine the UK tax system without introducing radical changes. A number of welcome announcements introduce remedial provisions to correct over-zealous, or poorly targeted, recent tax legislation. Amidst the good news there is, almost inevitably, a series of new anti-avoidance provisions, although the number of these is markedly smaller than in previous years.

In this Client and Friends Memo 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.

Selected Speed Read

Tax Avoidance: A smaller number of targeted anti-avoidance measures was proposed than in previous Budgets. These include new rules focusing on tax-motivated transfers of profits between group members, and details of both "Follower Notices" and "Accelerated Payment Notices". Provisions regarding "high risk" promoters of tax avoidance schemes, and a consultation in relation to certain of the DOTAS "hallmarks" are also confirmed.

Targeted Loss Buying Rules: Relaxation of newly introduced targeted loss buying anti-avoidance provisions to exclude research and development allowances.

Cadwalader, Wickersham & Taft LLP (Cadwalader) is a registered limited liability partnership established under the laws of the State of New York. The personal liability of our partners is limited to the extent provided in such laws. Additional information is available upon request or at www.cadwalader.com. A list of our partners, who are Solicitors or Registered Foreign Lawyers in England and Wales, is available for inspection at the above address. Regulated by the Solicitors Regulation Authority.

This memorandum has been prepared by Cadwalader for informational purposes only and does not constitute advertising or solicitation and should not be used or taken as legal advice. Those seeking legal advice should contact a member of the Firm or legal counsel licensed in their jurisdiction. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. Confidential information should not be sent to Cadwalader without first communicating directly with a member of the Firm about establishing an attorney-client relationship. ©2014 Cadwalader, Wickersham & Taft LLP. All rights reserved.

Solvency II-compliant instruments: Confirmation from the Government that it remains committed to ensuring that insurers' Solvency II-compliant instruments which are issued in debt form should be taxed as loan relationships, subject to the outcomes of the OECD's BEPS report.

UK-managed funds: The Government has confirmed that offshore non-UCITS funds which have a UK-based manager authorised by the Financial Conduct Authority will be able to provide management activities in the UK without being considered as UK resident for tax purposes.

* * * *

Tax Avoidance Measures

Themes and Interactions with the OECD BEPS Report: As with many previous Budgets of the current Government, tax avoidance is once again a theme which emerges from the Budget statement and accompanying HMRC releases. As noted above, the number of these provisions is smaller than in previous years, testament perhaps to the role being played by both the newly introduced UK general anti-abuse rule ("**GAAR**") in reducing the need for new anti-avoidance legislation and the expansive suite of targeted anti-abuse provisions currently on the UK statute book.

Nevertheless, it is notable that the Government did not lose the opportunity in the Budget to reiterate that it was committed to working with the G20 and OECD partners to take forward the action plan set out in the OECD's Base Erosion and Profit Shifting ("**BEPS**") report from 2013. Perhaps more surprisingly, the Government appears to have positioned certain anti-avoidance measures deliberately alongside the OCED BEPS report, as if to validate and endorse certain measures being taken against perceived UK anti-avoidance in the context of similar measures being loosely proposed by the OECD in the BEPS report.

Avoidance Arrangements using Artificial Profit Transfers: One such measure prevents groups of companies from transferring profits as part of tax avoidance arrangements. An anti-avoidance provision (to be introduced into legislation as section 695A of Corporation Tax Act 2009 ("**CTA 2009**")) was announced at the Autumn Statement in December 2013 to block avoidance schemes where tax deductions are claimed for payments between companies in the same group under derivatives (commonly a total return swap) linked to company profits. The new anti-avoidance provisions announced in the Budget complement the proposed section 695A CTA 2009, and apply to payments made on or after 19 March 2014. The new provisions apply where companies in a group enter into arrangements resulting in a payment from one group company to another group company of all, or a significant part of, the profits of the first company. Where the arrangements are motivated by tax avoidance, the paying company will be taxed as if the transfer of profits had not taken place. The tax counteraction might include adding back any sum deducted in respect of the transfer, or adding back any profits which have been diverted.

The measure announced in the Budget prevents the provisions of section 695A being avoided, counteracting other forms of profit transfer than just total return swaps. The new provision is accompanied by a technical note, in which HMRC state that some of the targeted arrangements “may also be potentially caught by other anti-avoidance provisions”. HMRC also state that “in practice, it is likely that any challenges would be run in parallel”, raising the possibility of numerous anti-avoidance provisions, including potentially the GAAR and case-law anti-avoidance arguments, being advanced at the same time.

Follower Notices and Accelerated Payment Notices: The Government has reiterated in Budget 2014 two previously announced measures – “Follower Notices” and “Accelerated Payment Notices” – which will require taxpayers to pay tax upfront in certain situations where there is an amount of tax subject to a dispute with HMRC. These measures are designed to address the cashflow advantage that accrues to a taxpayer where he or she retains tax that is the subject of a dispute with HMRC.

Follower Notices will apply in situations where the UK courts have determined that a tax motivated arrangement fails to achieve its objectives and there is an open enquiry or appeal in relation to the taxpayer in dispute with HMRC. The Follower Notice will inform the taxpayer that HMRC are of the opinion that, in accordance with the judicial decision which determines the arrangement previously in dispute, the tax liability is to be remitted to HMRC.

An Accelerated Payment Notice will apply where a tax avoidance scheme is covered by the Disclosure of Tax Avoidance Schemes (“**DOTAS**”) rules or where HMRC counteracts a tax motivated transaction under the GAAR following an opinion of the GAAR Advisory Panel that, in the panel’s opinion, the transaction arrangements are not a reasonable course of action. These announcements follow an initial consultation held during August and September 2013, announcements made in the Autumn Statement 2013 and a further consultation held during January and February 2014. Accordingly, whilst such announcements are not new, they will likely become significant in the on-going efforts to tackle tax avoidance at all levels within the UK economy.

That HMRC will only be able to issue a Follower Notice or an Accelerated Payment Notice where an enquiry notice or notice of assessment has been issued will likely be of little comfort to taxpayers. The Chancellor in his Budget speech noted that following such notices being issued, taxpayers would then be able to seek repayment of the tax through the usual means (being the courts). On a taxpayer being successful before the courts, the tax would be repaid with interest. Whilst this measure is therefore not fiscally positive (in that it is not intended to generate additional revenues for the Government), it is expected to bring forward £4 billion of tax receipts and affect some 65,000 avoidance cases.

Promoters of Tax Avoidance Schemes: The Chancellor reaffirmed the Government’s plans to “name and shame” high-risk promoters of tax avoidance schemes. Any such promoters (and their intermediaries) identified by HMRC as “high-risk” will be subject to increased information

gathering by HMRC. Clients of such promoters will be subject to a 20 year time limit for extended assessments whilst the promoter may be liable for fines of up to £1 million.

DOTAS regime: The Government also announced in the Budget a consultation in relation to certain of the DOTAS "hallmarks" (i.e., certain indicative features of a tax avoidance scheme). The consultation will consider introducing new hallmarks and strengthening the penalties for non-disclosure under the DOTAS regime. Any changes would likely be included in Finance Bill 2015 (i.e., released in draft form at the end of 2014).

Financial Taxation Measures

Changes to the UK Debt Cap Legislation: The Government has confirmed in the Budget that changes will be made to the UK debt cap rules, amending the definition of a group to ensure that group arrangements include companies or other bodies corporate without ordinary share capital, including companies limited by guarantee. The aim of these provisions, announced in the Autumn Statement, is to treat holdings and participations in or through companies without ordinary shares in the same way as shareholdings in companies which have issued ordinary share capital. The proposed changes in the legislation will apply with effect for periods of account of a worldwide group starting on or after 5 December 2013.

Loss Buying Rules: In Finance Act 2013 the Government introduced targeted loss buying anti-avoidance provisions under a new Part 14A of Corporation Tax Act 2010 ("**CTA 2010**"). The rules were focused on bringing the tax treatment of unrealised losses more closely into line with the current (and long standing) treatment of realised losses by restricting the set-off against other profits (including the set-off through group relief). HMRC have announced that the anti-loss buying rules within Part 14A, CTA 2010 have had a "more significant adverse impact" on research and development allowances ("**RDAs**") than was intended. The legislation enacted in Part 14A CTA 2010 is stated by the Government to have caught preliminary capital work which is undertaken by companies in furtherance of research and development, but which does not reach the point of being used in a trading activity before being sold on to a trading group. Absent the new rules in Finance Act 2013, the trading groups in question would have been able to claim RDAs. The Government has accepted in the Budget that the legislation announced in Finance Act 2013 has caused uncertainty in this area and therefore risks undermining capital investment in research and development activities. Accordingly, RDAs will be excluded from the Part 14A, CTA 2010 targeted loss buying rules enacted in Finance Act 2013. The change will have effect for qualifying changes occurring on or after 1 April 2014.

The Bank Levy and the Banking Code of Practice: A number of previously announced measures that are to be included in Finance Bill 2014 relate to changes to the UK bank levy. The rates applicable to short-term liabilities are to be increased from 0.130% to 0.156% and from 0.065% to 0.078% for long term equities and liabilities with effect from 1 January 2014. In addition, the bank levy definition of "Tier 1 Capital" is also to be aligned with the new Capital Requirements Directive with effect from 1 January 2014 and liabilities in respect of collateral that has been passed on to a central counterparty shall be excluded from the calculation of levy liabilities also with effect from January 2014.

A number of further changes which are scheduled to apply from January 2015 have been confirmed in the Budget, including limiting the protected deposit exclusion to amounts insured under a deposit protection scheme, the treatment of all derivatives as short-term, and restricting the relief available for a bank's "high quality liquid assets" to the rate applicable to long-term liabilities.

The Chancellor also announced the Government's intentions to consult on changes to the mechanism for the bank levy whereby banks would be allocated to different "bands" according to their chargeable equity and liabilities and charged in accordance with the rates for their relevant banding. It is intended that this would not increase the overall revenues generated by the bank levy but rather is intended to address various concerns whilst refining and improving the operation of the bank levy in practice. The consultation document in respect of the proposed "banding" is due to be released on 27 March 2014. Finally, with effect from the date of Royal Asset to the Finance Bill 2014 (expected to be July 2014), HMRC's powers to make legislation in relation to the bank levy are to be widened.

The Code of Practice on Taxation for Banks: A list of those banks that have unconditionally adopted the new and improved Code of Practice on Taxation for Banks (the "**Code of Practice**") was published with the Budget. As previously announced, Finance Bill 2014 provides for HMRC to publish a report on the operation of the Code of Practice with the first report covering the period 5 December 2013 to 31 March 2015, with future reports being prepared on an annual basis thereafter. More controversially, the report will include the names of banks that have and have not adopted the Code of Practice and may also include the names of any banks that are not, in HMRC's opinion, complying with the Code of Practice.

Solvency II compliant instruments: The Government has confirmed in the Budget that section 221 of Finance Act 2012 will be amended to ensure regulations can be made setting out the tax treatment of capital instruments that are compliant with the Solvency II Directive (2009/138/EC). In particular, the Government has stated its commitment to ensuring that insurers' Solvency II-compliant instruments which are issued in debt form should be taxed as loan relationships, subject to the outcomes of the OECD's BEPS report, thereby removing the uncertainty under current tax legislation concerning how these instruments are taxed.

UK management of offshore funds: The Budget has confirmed the Government's previously announced decision to enable offshore funds which are not within the scope of the Undertakings for Collective Investments in Transferable Securities IV Directive (UCITS funds) and which have a UK-based manager that is either an AIF Manager ("**AIFM**") authorised by the Financial Conduct Authority or a branch of an AIFM authorised in another member State to be able to provide management activities in the UK without being considered as UK resident for tax purposes. This announcement follows a consultation held during July to September 2013. This measure will further reinforce the UK's status as a centre for asset management activity and the certainty this announcement provides will be welcome news for alternative investment funds with UK management activities.

Corporate Taxation Measures

Controlled Foreign Companies: The Budget confirms that changes previously announced in the Autumn Statement 2013 regarding Controlled Foreign Companies ("CFCs") will be proceeding. The particular rules relate to situations where arrangements with a main purpose of transferring profits from existing intra-group lending out of the UK would otherwise give rise to a partial exemption for loan relationship credits. Arrangements to transfer external debt to the UK will also be dealt with by amendments to the CFC anti-avoidance rules.

Stamp Duty: Further to previous announcements and with effect from 28 April 2014, the Budget confirms that stamp duty and Stamp Duty Reserve Tax ("SDRT") will be abolished on shares in companies listed on "recognised growth markets". "Recognised growth markets" are those which are a "Recognised Stock Exchange" and either a majority of companies traded on that market have a market capitalisation of less than £170 million or the market's rules must require that issuers seeking admission demonstrate at least 20% compounded annual growth in revenue or employment in the three years preceding admission. Such markets include the Alternative Investment Market and the ICAP Securities & Derivatives Exchange. Reducing transaction costs on trades in such entities is intended to make participation in equity growth markets more attractive to investors, thereby assisting growing companies to raise equity financing.

* * * *

Please feel free to contact any of the following Cadwalader attorneys if you have any questions about this memo.

Adam Blakemore	+44 (0) 20 7170 8607	adam.blakemore@cwt.com
Catherine Richardson	+44 (0) 20 7170 8677	catherine.richardson@cwt.com