

2 December 2004

## PROTECTING TAX REVENUES

A package of measures aimed at tackling tax fraud and avoidance was announced by the Chancellor today. The reforms will protect revenue for investment in public services and ensure that an unfair burden does not fall on the vast majority of taxpayers who pay their fair share.

A number of the measures have been informed by the disclosure rules introduced in Finance Act 2004. These provide early warning of avoidance schemes, thereby enabling the Government and revenue departments to respond to avoidance in the most effective manner, whether by means of legislation or litigation, without creating unnecessary burdens for compliant taxpayers. The revenue departments will continue to analyse disclosures received and further action will be taken as and when appropriate.

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### DETAILS

#### **Tax and National Insurance Contributions avoidance: employee remuneration**

A number of avoidance schemes that seek to sidestep the rules that deal with rewards paid to employees in the form of shares and other securities are being stopped with effect from today. Employers are using these schemes to avoid paying the proper amount of income tax and National Insurance Contributions, particularly in relation to large bonuses in the City.

The measures will:

- extend the definition of securities to include certain insurance contracts;
- tighten the rules relating to securities that have restrictions or rights of conversion placed on them; and
- expand the provisions relating to benefits from employment-related securities.

A technical note published today gives further details of these measures and is available from the Inland Revenue website.

Further to this announcement, the Paymaster General has today made a written statement to Parliament. This outlines the Government's approach to dealing with any future attempts to frustrate its intention that employers and employees should pay the proper amount of tax and National Insurance Contributions on rewards from employment. Where the Government becomes aware of arrangements that attempt to frustrate this intention it will introduce legislation to close them down, where necessary from today.

This will have no effect on the vast majority of employers and employees who organise their affairs in a straightforward and ordinary way. In particular, genuine employee share schemes and share option plans will not be affected.

This written statement is available on the Inland Revenue and Treasury websites.

### **Financial Avoidance**

A number of financial avoidance schemes that have come to light as a result of the new disclosure rules are being closed with effect from today. The measures will:

- block schemes used by companies to avoid tax on debt securities by manipulating "repo" and stock lending arrangements; and
- close down a scheme to avoid income tax involving corporate bonds which have had their interest payments removed ("stripped corporate bonds").

Details of the proposed legislation are available on the Inland Revenue website.

### **Controlled Foreign Company rules**

The Controlled Foreign Company (CFC) rules provide an important defence against those seeking to avoid tax by the artificial diversion of profits from the UK. Genuine overseas business is protected from the effect of the rules by a number of exemptions (including the Excluded Countries Exemption). Measures are being introduced to stop a number of avoidance schemes with effect from today and to provide protection against possible future avoidance. These will:

- ensure that profits are identified in a way consistent with UK taxation principles;

- prevent the artificial reduction of UK tax due by the use of the rules providing relief from double taxation where income passes through a CFC;
- prevent groups with several subsidiaries manipulating profits between them by using the Excluded Countries Exemption; and
- deny the benefit of the Excluded Countries Exemption where this is being exploited as part of a scheme for tax avoidance.

Further details are available on the Inland Revenue website.

### **Double Taxation Relief**

Avoidance schemes that have been identified using the new disclosure rules are being closed with effect from today. These schemes seek to exploit the double taxation relief and annual payment rules to increase the amount of relief due. The Government continues to keep this area under review.

A technical note published today sets out legislative proposals to clarify the way credit is given for foreign taxes paid against trade receipts. The purpose of the note is to encourage dialogue on practical approaches to determine the correct measure of profit against which credit is due.

Details of the proposed changes are available on the Inland Revenue website.

### **Tax avoidance using film and partnership reliefs**

Measures are being introduced with effect from today to end abuse of tax reliefs for UK film production and ensure that the reliefs operate as intended. These will:

- prevent the accelerated relief for qualifying British films being claimed more than once on any film ('double dipping');
- stop structures which use the film reliefs to defer tax beyond 15 years;
- prevent companies from converting a tax deferral into an outright tax gain by exiting from a film tax deferral arrangement; and
- prevent partnerships from getting loss relief for money not really at risk.

Details of these measures including the commencement provisions are on the Inland Revenue website.

In addition, the Government will introduce legislation to make the accelerated deductions claimed under the film tax reliefs clearer and easier to enforce.

In light of the steps taken against film tax avoidance both today and in recent years, and of the development of the new tax credit for low budget British films, the Government will consult with the UK Film Council and the industry in a review of the tax relief that is used by large budget British films. The Government appreciates the need for certainty, given the long lead times for film production. The review will therefore be taken forward on a short time-scale to the end of January 2005, and the Government invites comments from relevant parties on that basis. The need for certainty will also be taken into account in any changes that may arise as the result of this review.

### **Capital Gains: uncommercial use of options to avoid tax**

Draft legislation published today counters certain tax avoidance schemes involving options to acquire or dispose of assets. The options are exercised at uncommercial prices to avoid tax on capital gains or to create or augment capital losses. The new rules will apply in relation to options exercised on or after today.

Further details, including draft legislation, are available on the Inland Revenue website.

### **Life insurance companies**

A number of loopholes being exploited by life insurance companies are being closed. New measures will:

- from today, ensure that the rules on certain transfers of business from one life insurance company to another cannot be used to reduce taxable trading profits artificially;
- for accounting periods ending on or after today, clarify the circumstances in which companies can treat amounts as 'notional' and therefore exclude them from their computations of taxable trading profits;
- for periods of account beginning on or after 1 January 2005, clarify the circumstances in which companies can use additional revenue accounts to obtain a more favourable tax apportionment of their investment return; and
- update the tax treatment of income and gains attributable to assets not needed to pay policyholder benefits.

Draft legislation is on the Inland Revenue website.

## **Preventing VAT avoidance through off-shore insurance schemes**

Legislation is being introduced to block from tomorrow an offshore scheme that seeks to avoid VAT incurred in settling UK insurance claims. This change will only affect certain non-EU businesses in the finance and insurance sectors that incur UK VAT in the course of making exempt financial and insurance supplies to customers that are also outside the EU. Under EU VAT law, there is no right to reclaim this VAT. This change puts the UK legislation on this point beyond doubt.

A copy of the statutory instrument implementing this change is on the HM Customs and Excise website.

## **Ensuring fair input VAT recovery on supplying shares**

Legislation is being introduced today to ensure fair VAT recovery on supplying shares.

With effect from tomorrow, businesses will be prevented from unfairly recovering VAT on the cost of services used to make an incidental financial supply (such as an issue or other supply of shares) to a customer in the EU by mixing these costs with costs related to supplies for which VAT is recoverable. Businesses will now be required in all cases to apportion the VAT based on the use to which the costs are put. The costs covered include professional fees (legal fees, accountants' fees etc), and the costs of an associate listing on the Stock Exchange.

Further information can be found in the information sheet 09/04 on the HM Customs and Excise website today.

## **Alcohol strategy**

Further details are announced today of the Government's alcohol fraud strategy, including an update on plans for the implementation of duty stamps for spirits. Building on detailed work with the spirits industry, and in light of encouraging signs that HM Customs and Excise are making progress in tackling spirits fraud, the Government is proposing measures, including the adoption of proposals made by the industry, to ensure that duty stamps are an effective and proportionate response to spirits fraud.

Further information is available in a business brief published by HM Customs and Excise today and available on the Customs website.