Corporate Update

December 2007

EU Mergers Directive implementation

The Treasury has introduced more regulations to amend UK tax law to ensure that it implements the EU Directive on cross-border mergers of limited liability companies. This requires a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares between companies of different Member States within the EU.

Companies Act 2006 - postponement of implementation

The Companies Act 2006 was always going to take some time to implement; some provisions are already in place and functioning but the bulk of provisions were not due to come into effect until October 2008.

The Government has now announced that this deadline for implementation has been set back a year, to October 2009, to allow Companies House time to update its systems to cope with the changes. The few changes which do not affect Companies House may be brought in earlier, although the Government has not yet made a decision on this. These changes include matters such as trading disclosures and provisions relating to company directors, and the repeal of the restrictions on financial assistance given by private companies.

The changes being implemented in April 2008 are unaffected and will go ahead as planned – these include provisions relating to accounts and reports, audit and the removal of the obligation for private companies to have a company secretary.

EMI share option schemes - reminder

Company owners seeking to reward employees for performance should, where their company is independent, consider using Enterprise Management Incentive (EMI) options. These tax-advantaged share options have been available for some time but HMRC figures indicate that the take-up by companies is not as extensive as it might be.

EMI options are tax free – on grant and on exercise – so that only the capital gain which arises on final sale of the shares by the employee is taxable, and that is taxed as a capital gain and not as income.

This contrasts favourably with unapproved share options, which are generally subject to income tax and possibly national insurance on exercise of the option.

EMI options can be performance-linked, so that the employees' reward is directly related to their performance during the period between grant of the option and exercise of the option. Besides being flexible, EMI options do not need to be agreed in advance with HMRC and do not involve significant amounts of reporting to HMRC – although it is advisable to agree the option price with HMRC in advance, to minimise the risk of HMRC later arguing an increased value with the benefit of 20/20 hindsight.

HMRC investigation powers

Ever since the merger of the Inland Revenue and Customs & Excise (HMRC), the resulting HMRC has been steadily working to ensure that the whole organisation has the wider powers that used to be the exclusive province of Customs & Excise; the most recent round of consultation has now resulted in an article describing the criminal investigation powers now available to HMRC. Note that HMRC still cannot, on its own, bring a criminal prosecution – it still has to apply to the Revenue & Customs Prosecutions Office for permission to do so (different supervisory bodies exist for Northern Ireland and Scotland).

Pension contribution - employers' tax relief

Tax relief for employer contributions to registered pension schemes is now only available on a paid basis. This means that it will no longer be sufficient to make a provision in the accounts for pension contributions in order to claim tax relief on these amounts in that same period. The contributions need to be physically paid to the pension provider before the end of the period in order to claim tax relief in that period, otherwise relief can only be claimed in the later period in which the payment is actually made. This change is effective for all accounting periods ended on or after 1 April 2007.

Tax relief for salaries and bonuses accrued but unpaid at a period end is still available, provided that these costs are paid within 9 months of the period end.

Taper Relief for business assets

At the time of writing, no draft legislation is yet available giving more details of the changes to capital gains tax and, despite the efforts of The Times and The Sunday Times to prompt the Chancellor into action, no softening of those changes has been announced.

For any business owners considering succession issues, or contemplating a sale, it is likely that the period up until the beginning of April is the best opportunity to maximise tax relief on business assets to take advantage of the 10% maximum taper relief available on such assets until the changes take effect. Purchasers will also be aware of this, so negotiation on sales may prove more demanding than it might otherwise have done, with the vendor keen to ensure that some benefit of the taper relief is obtained while it still exists and the purchaser equally aware of this, and looking for perhaps a reduction in the price to reflect the additional value to the vendor of completing a sale by 5 April.

This opportunity to maximise taper relief is best used by those planning to sell their business assets soon in any event; there have been some suggestions that owners may be able to 'flip' their assets to take advantage of the current tax reliefs without entirely losing ownership of those assets, but we expect HMRC to be taking a closer-than-usual interest in such arrangements.

Owners of non-business assets (including listed company shares and property) should remember that their tax rate will decrease from 6 April, under the current proposed changes.

Value Added Tax:

Fund management services

In June 2007 the European Court of Justice (ECJ) gave judgment on whether fund management services provided to Investment Trust Companies (ITCs) should be exempt from VAT.

The good news is that having considered the ECJ judgment HMRC have withdrawn from the appeal and now accept that fund management services supplied to ITCs are exempt from VAT. However, HMRC do not interpret the ECJ decision as applying to any funds other than ITCs.

HMRC accept that for ITCs, services which are specific to, and essential for, their administration may be exempt if they form a distinct whole recognisable as a fund administration service. More generic management services, such as company secretarial services and accounting, remain taxable if they are not otherwise subsumed into a single composite supply of fund management services.

HMRC have confirmed that businesses may exempt fund management services supplied to ITCs, but HMRC cannot require this until such time as the UK law is amended. HMRC are expected to consult informally with key stakeholders in the coming weeks on possible legal changes in this regard.

There is a growing consensus of opinion that pension funds (being collective investment vehicles) should be treated under the same principles as ITCs and therefore fund management services provided to pensions funds should also be exempt. Probably not what fund managers wish to acknowledge, but this could result in a windfall for pension funds – VAT charged to pension funds is generally irrecoverable.

It is likely that a test case will be taken in the near future. Therefore, it would be prudent for any business that operates a pension scheme to consider, with the fund manager, submitting a protective claim to HMRC to avoid any potential refund going out of time.

Proposed modernisation of current legislation for financial and insurance services

Generally, financial and insurance services are exempt from VAT. This exemption has applied since 1977. However although there have been significant developments in the financial and insurance services field, VAT legislation has not kept pace with these developments. As a result, the VAT treatment of financial and insurance services has not been applied uniformly throughout the EU, which has resulted in more frequent referrals to the European Court of Justice to clarify the position.

The European Commission has therefore adopted a proposal to modernise and simplify the complex VAT rules for financial and insurance services and secure a level playing field in the EU market.

The proposal has three objectives:

1. To increase the legal certainty for all concerned, from the business sector to national tax administrations and thereby reduce their administrative burden in correctly applying the VAT provisions on their services.
2. To ensure a more consistent application of the tax and deliver a level playing field in the internal market, at least as far as VAT is concerned.
3. To allow businesses to manage better the impact of non-deductible VAT on their activities.

These objectives will be achieved by three measures contained in the proposal:

- Redefinition of the scope of the exempt services to ensure that the exemption better reflects the complexity and diversity of the modern industries. The proposal for a Directive is accompanied by a proposal for a Regulation which expands the definition of exempt services and will apply directly in all member states of the EU.
- Possibility for banking and insurance companies to opt to tax their services if they wish. Such an option to tax already exists in the VAT Directive but is currently at the discretion of member states and not widely used. Its limited availability today is potentially distortive and should therefore be equally accessible across the community. This will allow institutions to reduce their exposure to non-recoverable tax, in particular in business to business activities.
- Introduction of an industry specific exemption from VAT on cost sharing arrangements, including those which are cross border. This will enable institutions to pool their operations and to share costs between the group members without creating additional non-recoverable VAT.

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