

Tax First

Keeping tax professionals up-to-date*

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March 2010

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Welcome to the March issue of *Tax First*.

With the Chancellor's Budget pencilled in for March, there is obvious speculation around the likelihood of a 'voter-friendly' Budget in the run up to the May election. For PwC's insight and overview of the Budget, you can visit www.pwcbudget.co.uk.

In this March issue the [banking and capital markets](#) section looks at the recent announcement by the United States Internal Revenue Service (IRS) of a new initiative requiring certain companies to disclose specific information regarding uncertain tax positions as part of their tax return. We also highlight the discussion document published by HM Treasury and HM Revenue & Customs (HMRC) regarding the controlled foreign company (CFC) reforms.

The [finance and treasury](#) section outlines HMRC's views on capital distributions and dividends, with reference to the Tribunal finding in the *First Nationwide* case, and in our [indirect tax](#) section we flag up a potential opportunity for the recovery of VAT on business entertainment, following a decision by the Advocate General.

A recent ruling by the Court of Appeal has stated that a subsidiary whose shares have been pledged as security by its holding company is no longer a Companies Act 'subsidiary' of that holding company. We examine the implications of the case in question in our [legal](#) section.

The [risk](#) section centres around a change to the deadline for all six year income tax and corporation tax claims, whilst in our occasional [sustainability and climate change](#) section we outline the findings of PwC's new *Appetite for change* report – a global survey of business leader's views on climate change and carbon policy.

I hope you find this issue both interesting and informative; if you have any thoughts or comments on any of the topics covered, then please do contact me.

David Prosser
Tax partner
020 7804 5852

March 2010

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IRS proposes new tax return disclosure requirements for uncertain tax positions

The United States Internal Revenue Service (IRS) has recently announced a new initiative that will require certain companies to disclose specific information regarding uncertain tax positions as part of the tax return. IRS Announcement 2010-9, released on 26 January 2010, announces the development of a tax return schedule to facilitate the disclosure of information with respect to uncertain tax positions. As announced, the new disclosure requirement would apply to public and private companies with assets over \$10m that prepare their financial statements under FIN 48, or a similar accounting standard reflecting uncertain tax positions. The proposed effective date would be for returns filed after the release of the new tax return schedule. However, we understand that the IRS will provide that it will not apply to tax returns related to 2009. In the UK, taxpayers would usually resist attempts by HM Revenue & Customs (HMRC) to obtain similar tax information regarding the level of accounting provisions held for tax exposures.

Reform of the CFCs regime: published discussion document shows positive signs but sets practical conundrum

HM Treasury and HMRC have issued for consultation a 35-page discussion document on proposals for reforming the UK tax treatment of controlled foreign companies (CFCs). HM Treasury states that the proposals set out in the discussion document are intended to enhance the competitiveness of the UK, while providing adequate protection of the UK tax base. The discussion document sets out the framework of the new rules and proposals for how monetary assets and intellectual property could be treated.

Initial business reaction seems positive, but it may be challenging to get to a sensible workable solution that achieves all the objectives set out. HMRC invites comments by 20 April 2010.

The highlights of the proposed regime as outlined in the discussion document are as follows:

- The new regime will operate primarily on an entity basis. However, the rules will allow for certain income streams to be separately identified and taxed differently.
- The overall system, like the current system, will be exemption-based.
- A new test to replace the 'lower level of tax' test is being considered.
- There is a desire to exclude 'genuine trading activities' from the remit of the CFC regime via a redesigned motive test; and
- Intellectual property (IP) and monetary assets have been separately identified as a more difficult area with detailed discussion on both – including a Treasury exemption and a potential new tax charge for the transfer of IP offshore.

To view the recorded version of a recent PwC webcast that included discussion of these issues, please [click here](#)

Action to ensure manufactured payments received in repos are taxed includes retrospective element

A written ministerial statement was made to Parliament on 9 February 2010, announcing new legislation will be introduced with retrospective effect to deal with the corporation tax treatment of manufactured payments received by companies in the course of certain sale and

repurchase (repo) transactions. The legislation will have effect from 1 October 2007, the date when the affected repo legislation was introduced.

The aim is to put beyond doubt that manufactured payments received by a company in the course of a repo must be taken into account for corporation tax purposes to the extent that they are accounted for in accordance with generally accepted accounting practice (GAAP). HMRC published draft legislation and explanatory notes on 9 February 2010, which is intended to cure an existing defect with the repo rules and to prevent taxpayers from gaining any benefit – by design or inadvertently – from the imperfect law. HMRC reported that as much as £1 billion per annum of tax may be affected.

Foreign branch tax exemption possibility under consideration by HMT/HMRC

HM Treasury and HMRC have started to consult on the possible introduction of a foreign branch tax exemption, mentioned in the earlier foreign profits consultations and raised in the 9 December 2009 Pre-Budget Report. Key aspects include the need to align the foreign branch exemption with CFC proposals, the interaction of the foreign branch exemption with chargeable gains, which profits will be exempt and how to measure those profits, and any anti-abuse provisions.

For more information, please contact:

[Justin Woodhouse](#) on 020 7804 6750

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Dividend following capital reduction: accounting for, or disclosure of, uncertain tax positions

Companies should consider whether HM Revenue & Customs' (HMRC) views on dividends following a capital reduction give rise to an uncertain tax position that should be accounted for, or dealt with, by disclosure.

It is HMRC's view that under existing legislation a receipt ultimately sourced from a reserve created by a capital reduction is capital in nature in the hands of a UK recipient (despite judgment for the taxpayer in the *First Nationwide* case – you can read more in our article below). However, there now appears to be a prospect of an amendment to the law to ensure that dividends such as those paid out of reserves created from capital reductions would be treated as income. Until any announcement is made reflecting Ministerial approval of such legislation, particular care will be required.

[Click here for further information](#)

Capital distributions and dividends: HMRC's views and the Tribunal finding in the *First Nationwide* case

HMRC has started to consider arguments that in some circumstances distributions paid out of capital reserves, such as those created on a capital reduction, are capital in nature or may not even be 'dividends'.

However, in a recent case involving First Nationwide, the First-Tier Tribunal found that a distribution by a Cayman company out of its share premium account was a dividend for UK tax purposes and was also a distribution of profit rather than capital.

HMRC's developing views are of wide interest, not least

because the Finance Act 2009 dividend exemption regime does not apply to distributions 'of a capital nature'. The *First Nationwide* decision may be appealed, but in any event, at present, HMRC appears to consider that it is not necessarily conclusive.

[Click here for further information](#)

Government moves to support UK Islamic Finance Industry

The Treasury announced that it has introduced an order to clarify the regulatory treatment of corporate sukuk (Islamic investment instruments) within the UK. It is hoped that legal costs and obstacles for these investments have now been reduced.

[Click here for further information](#)

HMRC manual update - *Corporate Finance Manual – February 2010*

This manual has been updated to correct certain errors, bring guidance up-to-date and provide clarification that only certain interest on late payments is deductible as loan relationship debits. Information on tax avoidance and additional chapters on debt cap have also been added.

[Click here for further information](#)

For further information, please contact:

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[Jeremy Rayner](#) on 0161 245 2220



VAT recovery on business entertainment – potential opportunity

The Advocate General (AG) has expressed an opinion in a Dutch case concerning the input tax restriction on business entertaining. The AG indicated that where the input tax blocking provision does not closely define the nature of the specific goods and services on which input tax is blocked (such as general business entertaining), the legislation may be ultra vires (invalid).

As the UK blocking order in respect of business entertainment is drafted in similar terms to that in the Netherlands, there may be an opportunity for UK businesses to recover VAT on business entertaining. This will, of course, be dependent on whether the European Court of Justice (ECJ) follows the AG's opinion when giving its judgment in the case later this year.

Businesses should, therefore, determine how much VAT has been incurred on business expenditure since April 2006 (and possibly further back) and file a claim to protect their position.

Free samples-business promotions VAT opportunity

The ECJ has heard oral submissions in a case concerning the VAT treatment of sample goods given free of charge by the taxpayer in the course of promoting its business. For example, as part of its submission, the Commission has argued that:

- a 'sample' is an example of the quality and nature of goods given away to promote sales;
- member states may define 'gift of small value', set reasonable financial limits and limit the number or value of gifts which are acceptable within a given period;
- employee samples and gifts should not be aggregated per employer unless given to the employer to distribute; and
- the member states are permitted to restrict the relief from VAT on gifts as the UK has done.

It is clear from this case that there is some divergence between the member states regarding the scope of relief from VAT for samples and gifts. Should the ECJ follow the Commission's submissions, it appears the taxpayer may be successful in some aspects of its case; e.g. the series of samples point and samples sent to employees.

The outcome of this case could have significant implications for all businesses which use free samples as a business promotion strategy. All businesses that have accounted for VAT on samples and gifts should consider submitting or maintaining up-to-date claims pending the outcome of this case.

For further details on either of these two issues, please contact your usual PwC VAT advisor or [Michael Bailey](#) on 020 7804 3254.





Hold on to your subs!

Examining the *Enviroco v Farstad* case

The Court of Appeal has ruled that a subsidiary whose shares had been pledged as security by its holding company was no longer a Companies Act ‘subsidiary’ of that holding company, as the terms of the Scots law security required the registration of the bank as shareholder. The judgment has potential ramifications for companies in terms of the covenants in their borrowing agreements, other contractual obligations, and their employee share schemes depending on the nature of control a holding company has over its subsidiaries. There may also be tax implications, particularly in the interpretation of certain inheritance tax provisions.

The case concerned whether Enviroco Limited (Enviroco) had the benefit of an English law indemnity given in favour of companies within its group and considered the definition of ‘subsidiary’ in section 736 of the Companies Act 1985 (1985 Act). Enviroco’s parent, Asco Plc (Asco), had pledged its shares in Enviroco to a lender as security, the terms of which required legal title to the shares to be transferred to the lender – although the Scots law deed of pledge provided that Asco retained the voting rights. Enviroco argued it was a subsidiary within section 736(1)(c) of the 1985 Act because Asco was a member and controlled alone, via an agreement with other shareholders, a majority of the voting rights in Enviroco. The issue was whether Asco was, in fact, a member following the pledge over Enviroco’s shares. Enviroco argued that, by virtue of section 736(7) of the 1985 Act (which provides that rights attached to shares held by way of security are treated as held by the security provider in certain situations), the right for Asco to be registered as a member was a right

attached to the shares and so fell within the scope of the statutory definition of subsidiary.

The Court held that membership of a company was not a ‘right’ attached to the shares but rather “*a status derived from the entry of the shareholder’s name in the register of members*”. As the bank was registered as a member of Enviroco but Asco was not, Enviroco could not satisfy the 1985 Act definition of subsidiary and could not benefit from the indemnity.

Although the case relates to the 1985 Act, it will also apply to the equivalent provision in the Companies Act 2006 (section 1159). However, the case is limited in scope: in English law, legal title to the shares is seldom transferred to a lender on taking security. Instead, an equitable charge is usually created under which a lender reserves the right to become the registered shareholder on default events or enforcement.



Implications

The decision has highlighted potential implications for contracts and other statutory provisions which import the Companies Act definition of ‘subsidiary’. For example, a subsidiary could become detached from its group, triggering change of control provisions in a contract entitling the other party to terminate. Similarly, a parent company of a detached subsidiary may inadvertently be in a default under its borrowing documentation, and employee share option schemes may be affected where share options vest or lapse on an employer group company ceasing to be a subsidiary of a holding company.

In addition, there are certain provisions within tax legislation, notably relating to inheritance tax, which incorporate this Companies Act definition of ‘subsidiary’, and so the case may have tax implications in limited circumstances.

For the majority of subsidiaries, the holding company will hold a majority of the voting rights; where this is the case, an alternative Companies Act definition of ‘subsidiary’, which does not have membership as a condition, will apply. Nevertheless, care should be taken where Companies Act definitions are used when drafting documentation to ensure that the transfer of legal title to shares as security to a bank or its nominee does not break up the holding company and subsidiary company status.

Further information

Enviroco has applied for leave to appeal the decision.

For more information, please contact:

[Caroline Pearce](#) on 020 7804 5240



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'Six year' time limits reduced

With effect from 1 April 2010, the deadline for a number of income tax and corporation tax claims currently with 'six year' time limits will be reduced to four years. The legislation, contained within Schedule 39 Finance Act 2008, seeks to align all claims and elections across income tax, capital gains tax (CGT), corporation tax and VAT. The amendments in relation to VAT came into force on 1 April 2009.

For income tax and CGT purposes, five year and ten month claims become four year claims. The years most immediately affected are 2004/5 and 2005/6, where claims not already filed will need to be made by 31 March 2010 and 5 April 2010 respectively.

For corporation tax purposes, six year claims will be affected. For example, six year claims for say 31 December 2004 and 2005 will actually need to be made before 1 April 2010.

Transitional provisions may apply where an individual or trustee has not been given notice to file a return within one year of the end of the relevant year of assessment; in these cases the changes come into force on 1 April 2012. The transitional rules do not apply to 'discovery' situations: where income which ought to have been assessed has not been assessed, where an assessment has become insufficient or where any relief has become excessive. In these cases, the changes take effect from 1 April 2010.

The deadlines and conditions under which HM Revenue & Customs may raise assessments are also changing. Currently, the general time limit for assessments is six years, with an extended time limit of up to twenty years where negligent or fraudulent conduct can be proven. From 1 April 2010 this two-tiered approach becomes three-tiered as follows:

- General time limit 4 years
- Careless errors (analogous to 'negligence') 6 years
- Deliberate understatement (analogous to 'fraud') .. 20 years

This is a significant change as errors arising from careless errors will now only carry a maximum exposure of six years additional tax as opposed to twenty.

Finance Act 2009, Schedule 52 also contains potentially significant changes to claims in respect of error or mistake relief claims. In addition to the time limit being reduced from six years to four years, the provisions of S33 TMA 1970 and Para 51 Schedule 18 Finance Act 1998 have been extended to potentially nullify claims which may have previously been admitted. For example, a claim may be struck out where the claimant *"could have sought relief... within a period that has now expired"* and *"knew, or ought reasonably to have known....that such relief was available"*. This suggests that a level of subjectivity around the facts and competences of the taxpayer will be assessed as part of the claim and a potential area for disputes.

For more information, please contact:

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Sustainability and climate change focus: what's your appetite for change?

Business is looking to governments for leadership in establishing the behavioural change necessary to halt global warming – and it's a mixture of penalties and rewards that is most likely to encourage business to reduce its impact on the environment.

These are just two of the findings drawn from the most comprehensive survey of its kind yet conducted, and set out in PricewaterhouseCoopers' *Appetite for Change* report. The report takes a close look at attitudes in the international business community towards environmental regulation, legislation and taxes. In almost 700 interviews in 15 countries, executives shared their perspectives on issues such as the impact of climate change, the role of government, preferred environmental policy tools, and the essential ingredients for an effective global climate change deal.

Main tax insights

- Business leaders around the world recognise the need for meaningful emissions targets.
- Carbon taxes, emissions trading and incentives have widespread support in the business community.
- Businesses generally believe that existing environmental taxes, regulations and incentives are ineffective, inconsistent and unclear.
- Certainty and simplicity are the biggest challenges for carbon trading; for carbon taxes, the key issues are flexibility and the availability of incentives.
- Executives prefer the use of green taxes to fund environmental and low carbon programmes.
- Government action on climate change will increase the importance of regulatory compliance, reputation management and stakeholder relations.

Find out more and download a copy of the report at:

pwc.com/appetiteforchange



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- 1 Department for Work and Pensions (DWP) Pensions schemes: disclosure of information requirements – consultation period ends

Pensions Regulator draft revised guidance on pension scheme internal controls – consultation period ends
- 3 ICTA seminar: *The future of the UK tax system*, Holborn Bars, London

Pre-Budget Report: consultations on proposed pensions legislative changes – consultations end

HMRC: Draft legislation and explanatory notes for the proposed compliance checking framework so far as concerns excise duties – consultation ends
- 9 *IBC International Transfer Pricing Summit 2010*, Hilton London Paddington Hotel
- 10 DWP: Financial Assistance Scheme – draft guidance re transfer of scheme assets to government – consultation ends
- 16 Government review of the resolution arrangements for failing investment banks – consultation ends
- 18 ICTA Seminar, *Senior Accounting Officer*, Holborn Bars, London
- 31 Last chance to make common law EC Treaty claims for repayment of direct tax

April

- 1 Change bringing in four year deadlines for income tax and corporation tax claims

Consultation meeting on proposals for reform of the UK treaty clearance process in relation to relief from withholding tax on corporate interest

Corporation Tax Act 2010 and Taxation (International and Other Provisions) Act 2010 in force for accounting periods ending on or after 1 April

Changes to Bringing into Account of Gains or Losses (BAGL) Regulations to reflect impact of new 171A Taxation of Chargeable Gains Act 1992
 - 6 Changes to income tax rates take effect
 - 20 Proposals for controlled foreign company (CFC) reform – consultation ends
 - 27 Pensions Regulator consultation document *Record-keeping: measuring member data* – consultation ends
 - 28 HM Treasury: investment in the UK private rented sector – consultation ends

Deliberate wrongdoing by tax agents – consultation on draft legislation ends
- For full details of the ICTA seminars, please follow the link below:

[ICTA seminars, click here](#)



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