

# Sector commentaries

## Sector commentaries

### Financial Services Budget Briefing 2008

#### Major changes ahead for the funds industry... ...but little change for other Financial Services businesses

This year's Budget was billed as being uneventful, but there have been increasing calls for changes to the taxation of fund management, both from industry bodies and from the European Courts. A number of changes were also announced that will affect banks, life insurers and other financial institutions. Click on the links below to see our top five changes and summary of other measures affecting the financial services industry.

- **VAT: helpful and unhelpful changes for fund management**
- **Property Authorised Investment Funds**
- **Offshore funds regime**
- **Targeted anti-avoidance affecting financial services**
- **Changes to the Investment Manager Exemption (IME)**
- **Other measures announced today**

#### VAT: helpful and unhelpful changes for fund management

Of interest to: UK-based investment managers

As a consequence of the decision of the European Court of Justice in J P Morgan Claverhouse Investment Trust Plc (Case C-363/05), HM Revenue & Customs (HMRC) has announced changes to the scope of the VAT exemption available to fund managers. These changes will take effect in relation to supplies of services made on or after 1 October 2008. The exemption for the management of unit trust and open-ended investment companies will be extended to the management of closed-ended investment entities which invest in securities and whose shares are included in the UK Listing Authority main Official List and, additionally, to funds established outside the UK which are recognised as overseas schemes under sections 264, 270 and 272 of Financial Services and Markets Act 2000. At the same time, the exemption for the management of single property schemes has been removed. Draft legislation and guidance will be published on HMRC's website in April 2008.

**Our first reaction:** The Claverhouse case previously heralded the exemption for the management of investment trusts and the decision gave fund managers a directly enforceable right. This announcement extends the exemption to the management of Venture Capital Trusts and certain recognised overseas funds, for example, certain Luxembourg SICAVs and FCPs and Irish Open-ended Investment Companies. The extension of the exemption to include management of overseas funds is a particular sting in the tail for UK fund managers: UK VAT was never chargeable on supplies to such funds but the manager was able to recover its associated input VAT. Exemption will remove this associated VAT recovery, thereby increasing the costs of many UK fund managers. The addition of VAT to the management of single property schemes is similarly unwelcome, as it will increase the management costs of such schemes and reduce the investment returns achievable.

For more details contact: Marc Welby on 020 7893 3580 or at [marc.welby@bdo.co.uk](mailto:marc.welby@bdo.co.uk)

#### Property Authorised Investment Funds

Of interest to: Investors and fund management businesses

Regulations laid before Parliament today will legislate for Property Authorised Investment Funds (PAIFs). In essence these will be an open-ended equivalent of UK Real Estate Investment Trusts (UK-REITs). This elective regime will allow authorised funds investing mainly in property and related securities to elect for exemption within the fund for rental income, with streaming of distributions into property income, UK dividend income and other income to ensure the correct tax treatment in the hands of the ultimate investors. As for UK-REITs, restrictions apply as to the level of property business that must be undertaken and also on the ownership of the fund to stop tax avoidance.

**Our first reaction:** The new regime comes into effect on 6 April 2008. Given that the property market is not buoyant, there may however not be a rush by fund managers to launch new PAIFs initially. Furthermore, the existing UK-REIT regime has proved to be complex and similar considerations could hinder the development of PAIFs.

Contact: Malcolm Powell on 020 7893 2448 or at [malcolm.powell@bdo.co.uk](mailto:malcolm.powell@bdo.co.uk)

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### Offshore funds regime

Of interest to: Investors in non-UK funds and fund management businesses

The Government has announced a two stage revision of the offshore funds regime, deferring changes to the definition of 'offshore fund' pending further consultation until Finance Bill 2009. In the meantime the Government intends to grant powers to change the offshore funds regime in Finance Bill 2008.

**Our first reaction:** The ongoing consultation on changes to the offshore funds regime has highlighted a number of technical issues with the Government's suggested reforms but also considerable concern about how a new definition of 'offshore fund' would operate. As powers to change the existing law will not be available until the passing of this year's Finance Bill (in June or July) it is possible that secondary legislation may be made before Budget 2009, though the Government has kept the timeline for change open.

Contact: Malcolm Powell on 020 7893 2448 or at malcolm.powell@bdo.co.uk

### Targeted anti-avoidance affecting financial services

Of interest to: those entering into structured financial products

As a result of the Finance Act 2004 disclosure regime, immediate action is being taken to close a number of structured financial transactions aimed as disguising interest payments and achieving a tax advantage. HMRC have stated their intention to develop a principles-based approach to ensuring that all similar arrangements remain taxed as interest.

**Our first reaction:** The Government continues to close tax avoidance schemes as soon as possible after they are notified about them. Their intention to put in place a principles based approach to such schemes in Finance Bill 2009 is welcome, but may severely limit the ability to undertake tax planning for interest in the future.

Contact: Angela Foyle on 020 7893 2475 or at angela.foyle@bdo.co.uk

### Changes to the Investment Manager Exemption (IME)

Of interest to: UK based investment managers undertaking investment transactions on behalf of non-residents

The Government has announced two measures in relation to the IME. The first will ensure there will be a single list covering types of investment transactions that are within the scope of the IME. The second will ensure that tax can only be levied in relation to those transactions undertaken which fall outside the IME. Previously one transaction outside the list of allowable investment transactions could taint and bring into tax all transactions undertaken by the UK investment manager.

**Our first reaction:** This announcement follows the revision of Statement of Practice 1/90 last July and shows the Government's commitment to updating the tax regime in respect of UK management of non-resident funds.

Contact: Malcolm Powell on 020 7893 2448 or at malcolm.powell@bdo.co.uk

Click below for our commentary on related topics:  
Residence and domicile  
Entrepreneurs' Relief  
Enterprise Management Incentives/VCT changes  
Disclosure schemes: administrative changes

### Our comment on other measures announced today...

- **ISAs and other saving accounts**
- **Unclaimed assets in bank accounts**
- **Stamp duty on loan capital**
- **Changes to stamp duty on sukuk arrangements**
- **Funds of Alternative Investment Funds (FAIFs)**
- **Tax payments of Unauthorised Unit Trusts**
- **Other fund management matters**
- **Changes to taxation of life insurance companies**
- **Repeal of obsolete anti-avoidance provisions**

### ISAs and other saving accounts

Of interest to: ISA managers and other financial institutions

A number of administrative changes have been announced in relation to ISAs and other savings accounts. Quarterly statistical reports of ISA subscriptions will no longer be required. ISA managers

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will no longer be required to retain copies of signed application forms. Other financial institutions will not be required to retain signed copies of applications to receive interest gross.

**Our first reaction:** These changes will simplify the operation of the scheme and reduce administration for ISA managers, banks and building societies.

For more information on how this could affect your business please contact Angela Foyle on 020 7893 2475 or at [angela.foyle@bdo.co.uk](mailto:angela.foyle@bdo.co.uk)

### Unclaimed assets in bank accounts

Of interest to: banks and building societies

As part of the Government's Unclaimed Assets Scheme, changes are being made to reduce the administrative burden on banks and building societies in relation to deduction of tax on interest, reporting requirements and to remove a potential capital gains liability on transfer to the administrator of the scheme.

**Our first reaction:** These changes will simplify the operation of the scheme and reduce administration for banks and building societies.

For more information on how this could affect your business please contact Angela Foyle on 020 7893 2475 or at [angela.foyle@bdo.co.uk](mailto:angela.foyle@bdo.co.uk)

### Stamp duty on loan capital

Of interest to: Investors in debt securities on the capital markets

From Royal Assent, an exemption from ad valorem stamp duty will be available in respect of loan capital where the interest is determined by reference to the results of a business or, the value of any property if it is part of a capital market arrangement, and the right to interest is on limited recourse terms.

**Our first reaction:** This is a welcome change which removes a charge to tax on such arrangements.

For more information on how this could affect your business please contact Angela Foyle on 020 7893 2475 or at [angela.foyle@bdo.co.uk](mailto:angela.foyle@bdo.co.uk)

### Changes to stamp duty on sukuk arrangements

Of interest to: UK companies and individuals using alternative finance arrangements

Legislation will be introduced in Finance Act 2008 to classify alternative finance investment bonds as loan capital for stamp duty purposes. These products replicate the economic effect of debt securities and the measure will ensure that these instruments will benefit from the loan capital exemption from stamp duty.

**Our first reaction:** We await the legislation and note that today's announcement is consistent with the Government's willingness to introduce a level playing field with respect of sukuk finance.

For more information on how this could affect your business please contact Angela Foyle on 020 7893 2475 or at [angela.foyle@bdo.co.uk](mailto:angela.foyle@bdo.co.uk)

### Funds of Alternative Investment Funds (FAIFs)

Of interest to: investors and fund management businesses

The Government has now published draft regulations for the taxation of funds of FAIFs. This new elective regime will allow authorised funds to become funds of hedge funds and be exempt from tax on offshore income gains that would otherwise be chargeable inside the fund on realisation. Instead, the burden of taxation will pass to the investor, with the investor being taxed on gains realisation as if it were income.

**Our first reaction:** This follows earlier consultation by the Financial Services Authority (FSA) on establishing FAIFs. Responses to that consultation pointed out that tax hurdles remain a barrier to the effective establishment of such funds. These draft regulations would remove the tax issues within the fund but instead collect the same tax from the investor. The timing of the new regime depends on the timing of the FSA's changes to the regulatory regime to allow FAIFs.

For more information on how this could affect your business please contact Malcolm Powell on 020 7893 2448 or at [malcolm.powell@bdo.co.uk](mailto:malcolm.powell@bdo.co.uk)

### Tax payments of Unauthorised Unit Trusts

Of interest to: trustees and managers of unauthorised unit trusts

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The law will be altered to ensure that trustees of unauthorised unit trusts fall within the income tax self-assessment regime with payment dates falling on 31 January and 31 July.

**Our first reaction:** This change corrects an oversight in the tax law rewrite project and places unauthorised unit trusts back onto the same payment regime as existed before the passing of Income Tax Act 2007.

For more information on how this could affect your business please contact Malcolm Powell on 020 7893 2448 or at malcolm.powell@bdo.co.uk

### Other fund management matters

Of interest to: fund managers and investors

The Government's Budget statement also committed to continuing consultation on the reform of the Stamp Duty Reserve Tax (Schedule 19) charge on authorised funds, exploring whether authorised funds should become exempt from direct tax altogether (as part of the taxation of foreign profits consultation) and exploring changes to the investment trust rules to enable a wider range of investments.

**Our first reaction:** The first two of these comments provide reassurance that work will continue in relation to two existing consultations. The last follows discussion between the Association of Investment Companies and the Government on tax barriers that exist within the s.842 regime, especially in relation to investments in bonds.

For more information on how this could affect your business please contact Malcolm Powell on 020 7893 2448 or at malcolm.powell@bdo.co.uk

### Changes to taxation of life insurance companies

Of interest to: UK life companies and UK branches of overseas life companies

Finance Act 2007 introduced radical changes to the tax treatment of life insurance, companies. Not surprisingly various gaps and anomalies have been found in the legislation. The forthcoming Finance Act will therefore include further changes to the rules regarding the use of contingent loans and financial reinsurance, transfers of tax exempt business between Friendly Societies, the treatment of foreign currency assets and the treatment of structural assets.

In addition, specific rules will be introduced to cover the treatment of interest paid, in respect of a deposit back, following a reinsurance of a large block of business. The current rules give rise to unforeseen tax advantages where pension business is reinsured.

**Our first reaction:** These changes show the importance of ongoing dialogue between industry and HMRC. The proposals show that HMRC are open to the commercial needs of industry whilst remaining alert to blocking opportunistic tax planning.

For more information on how this could affect your business please contact Bernard Sweet on 020 7893 3442 or bernard.sweet@bdo.co.uk

### Repeal of obsolete anti-avoidance provisions

Of interest to: share dealers

The Government has announced the repeal of obsolete anti-avoidance provisions in relation to dividend buying and transactions in securities which had particular effect on share dealers, but has since been superceded by later legislation.

**Our first reaction:** These changes simplify the law but are likely to have little impact on share dealers.

For more information on how this could affect your business please contact Angela Foyle on 020 7893 2475 or at angela.foyle@bdo.co.uk

### Manufacturing - What has the Chancellor done for UK Manufacturing?

The renaissance of the UK manufacturing sector is one of the economy's success stories. Almost without notice, and certainly without acclaim, UK manufacturing has successfully taken on the competition both at home and in world markets. The recent report from BDO Stoy Hayward and the EEF highlighted the strategies underlying this success. These can be summarised as follows:

- Investment in people, knowledge and equipment so that the fundamental manufacturing proposition moves away from high volume, low margins to clever design solutions, quality products, and exceptional customer support.

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- Reduction in costs by appropriate investment in low cost overseas production and service facilities.
- Seeing the emerging countries not just as low cost competition, but as markets keen for quality goods and services.
- Fighting smart. Compete where there is the best chance of winning, which usually means niche opportunities, quality not volume, and an emphasis on service.
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Given this background, what has the Chancellor done to assist UK manufacturing?

Much of this course has been pre-announced. Some measures are very welcome, such as the extension of enhanced research and development tax relief to medium sized companies. (However we still wait EU approval of the scheme). We also welcome the reduction in the main rate of corporation tax from 30 per cent to 28 per cent. The more cash that manufacturing companies are allowed to retain and invest, the better, and in this respect we would have welcomed a general increase in capital allowances. Indeed, we note with regret, there was no U turn in relation to previously announced reductions in allowances and the increase in the small company corporation tax rate has been confirmed.

### **Issue: Encouraging innovation in the UK**

BDO Stoy Hayward response:  
We can only hope that the raising of the Capital Gains Tax (CGT) rate on business disposals, and the erosion of tax advantages for non-UK citizens is not going to discourage entrepreneurs from innovating in the UK. In our view both these moves could be a long-term mistake felt throughout the economy and in manufacturing in particular. The expansion in the Enterprise Investment Scheme is unlikely to add much by way of new investment capital.

### **Issue: Ever rising burden of compliance**

BDO Stoy Hayward response:  
It's already hard enough to establish overseas production and service operations, without having to worry about complex rules in the field of transfer pricing, double taxation, and controlled foreign companies. There was no sign in the Budget of any easing of the major rules. Indeed both the Chancellor and the Treasury web site mentioned tax simplification measures. We found plenty of minor changes but nothing that looked like real world simplification.

### **Issue: Good news for employers**

BDO Stoy Hayward response:  
In terms of taxes on employment, the good news is they did not go up. However, the increases in car tax, tobacco and alcohol will no doubt feed into the general feeling of price inflation and feed through to wage demands. We do however welcome the further encouragement of employee equity participation via the expansion in the EMI limits, albeit that the new 18 per cent rate of CGT makes such schemes less attractive than they once were. We also welcome further expansion of apprenticeship programmes with the aim of achieving material improvement in the UK skills base.

Overall, did Mr Darling provide much encouragement for the manufacturing sector? Not really. In our view the challenges remain the same and it's up to UK manufacturers to continue to pursue their successful strategies without significant further support from the Government.

Tom Lawton  
Head of Manufacturing  
BDO Stoy Hayward

## **Real Estate and Construction**

### **What did Darling say that affects your business?**

There are a number of significant issues raised in the 2008 Budget announcement specific to the Real Estate and Construction sector and we highlight below the key issues relevant to your business.

### **Issue: Stamp Duty Land Tax (SDLT)**

**Our first reaction:** Unsurprisingly, given the recent determination of HM Revenue and Customs (HMRC) to crack down on perceived SDLT avoidance, there are further targeted anti-avoidance measures although changes have also been announced to mitigate the adverse impact of previous budget challenges upon property investment partnerships.

Measures have been taken, with immediate effect, to block the use of certain arrangements involving Islamic finance in order to obtain an exemption from SDLT which was regarded as inappropriate by HMRC. Additionally, the rules on the withdrawal of 'Group Relief' are to be tightened to ensure that SDLT relief on a previous transfer of a property into a special purpose

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vehicle is clawed back in certain circumstances which HMRC consider offensive.

However, HMRC have acknowledged that previous legislation which would have had the effect of charging SDLT whenever there is a change in the interests of a property investment partnership were disproportionate and should not apply on a straightforward transfer of a property interest within the partnership. The change will be backdated to the commencement of the revised rules in July 2007. The relaxation of these rules is welcomed although the real estate sector will look at the details of the rules carefully to see whether SDLT arises on commercial transactions.

In a separate measure, previously announced new SDLT reliefs for zero-carbon homes are being extended to include zero-carbon flats.

In addition, for shared ownership residences such as where key workers are able to part-purchase and part-rent a flat from a housing association, SDLT will only arise in future when ownership exceeds 80 per cent.

Measures have been introduced with immediate effect to relax certain administrative burdens for both SDLT and Stamp Duty. For SDLT, the thresholds for notification of land transactions have been raised from the current £1,000 to £40,000, and for leases of seven years or more where the annual rent is more than £1,000 or other chargeable consideration is more than £40,000. This means many transactions which do not attract SDLT will not need to be notified. Nor will there be a requirement to submit SDLT returns (forms 'DLT 1' or certificates that no SDLT is due (forms 'DLT 60')) In addition, the £600 rule which applies to prevent manipulation of lease thresholds will be increased to £1,000 for non-residential property only, and will be removed for residential property.

### **Issue: Capital allowances**

**Our first reaction:** The 2008 Budget announced the introduction of legislation which will give effect to a number of changes previously announced in the Pre-Budget Report and the 2007 Budget:

- From April, writing down allowances of 10 per cent per annum are to be given on expenditure which qualifies for a new 'special rate pool'.
- Industrial buildings allowances and agricultural buildings allowances will be phased out over four

years, from 1 April 2008. Balancing adjustments will no longer apply on disposal.

- The rate of writing down allowances on long-life asset expenditure will increase from 6 per cent to 10 per cent from April 2008.
- Enterprise zone allowances will be withdrawn from April 2011. Enterprise zone allowances will not be subject to the phasing out rules applying to industrial buildings allowances.

The most significant change is the proposed decrease in writing down allowances from 25 per cent to 20 per cent with effect from 1 April 2008.

For more details on these changes visit our main Budget coverage .

### **Issue: Anti-avoidance**

#### **Our first reaction:**

#### **Taxation of income arising to UK residents from foreign trusts and partnerships**

Some UK resident individuals have attempted to avoid UK taxation on income which arises in the UK e.g. UK property trading income using a double Guernsey structure or an offshore trust above an Isle of Man company to hold the UK property. Promoters of such arrangements have argued that the Business Profits Article in the relevant double tax treaty exempts the income from UK tax not only in the hands of the trustees but also in the hands of the UK resident investor.

Our view has always been that the Business Profits Article does not exempt the income in the hands of the investor, and this has been confirmed by the Budget. The measure will have effect from 12 March 2008.

#### **Capital allowance buying and acceleration**

Legislation will be introduced to block an avoidance scheme whereby a profitable group could claim a balancing allowance by buying a loss making company whose assets eligible for capital allowances have a lower market value than the tax written down value, and then quickly selling on the trade of that company to a third party.

#### **Issue: Property authorised investment funds**

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**Our first reaction:** New regulations for authorised investment funds (AIFs) will be introduced with effect from 6 April 2008 which will enable property AIFs to elect for a tax treatment that will move the point of taxation on property income from the fund to its investors. The new regulations provide an open-ended fund alternative to the existing closed-ended UK-REITs.

The present market conditions will inevitably have created some reservations over the suitability of open-ended funds for investment in illiquid property assets but it is clearly sensible to remove some of the tax disadvantages that would have put PAIFs at a significant disadvantage compared to UK-REITs. These rules are, however, no substitute for extension of the UK-REIT regime to unlisted property companies which are already permitted in the US and Australian markets but are not permitted under the existing UK-REIT legislation.

### Issue: VAT – Option to tax land and buildings

**Our first reaction:** Legislation will be introduced allowing taxpayers to revoke an option to tax after 20 years. The earliest date an option to tax will be revocable will be 1 August 2009. In addition, a new rule will be introduced by which an option to tax will automatically lapse six years after the taxpayer ceased to have any interest in a property that they had previously opted to tax.

The legislation will also introduce changes intended to simplify the administration of the option to tax.

You can find detailed analysis issues including the much trailed Capital Gains Tax and non-domiciliary changes on our website by clicking here.

For more information on how we can help your business deal with the effects of current trends in the Real Estate and Construction sector, please click here to visit our website.

If you would like to discuss how the announcements made in the Budget affect your business, or indeed any tax issues, please contact Stephen Herring at [stephen.herring@bdo.co.uk](mailto:stephen.herring@bdo.co.uk)

Solly Benaim  
Head of Real Estate and Construction  
BDO Stoy Hayward LLP

### Retail sector commentary

The good news is that there were no major new tax changes nor significant additional spending, this was a consolidating Budget. However, there are a significant number of pre-announced changes which retail businesses, their owners and employees will have to deal with.

#### Corporate taxation announcements:

The headline corporation tax rate for large companies will be cut by 2 per cent to 28 per cent from 1 April 2008. However, for small companies, the headline rate is to rise from the current 20 per cent to 22 per cent from 1 April 2010.

The Treasury plan to recoup the cost of the cut in the headline tax rate for large companies by making a series of changes from 1 April 2008 to the capital allowance regime for expenditure on fixed assets. These include:

- Changes to the rates of writing down allowances (WDAs) from 25 per cent to 20 per cent on general plant and machinery expenditure and for long life assets from 6 per cent to 10 per cent.
- Restricting the rate of WDAs to 10 per cent for expenditure on both new and replacement 'integral fixtures' within buildings. This will include items such as electrical systems, air conditioning, heating, hot and cold water systems, lifts and escalators which will be found in many retail properties. This will require a change in all existing capital allowances systems.
- Removal of certain 'first year allowances' available to small or medium sized enterprises to be replaced by a 100 per cent annual investment allowance on the first £50,000 of expenditure for all companies.

For retailers who regularly incur expenditure on refurbishing or fitting out space, it is often efficient to agree a percentage with HMRC which may be applied for several years. All percentage agreements for any company will require review from April 2008 to establish what proportion applies to the new category of integral features at 10 per cent WDA. For many retailers the negative effective of these changes could significantly add to their tax burden such that it will outweigh the positive impact of the cut in the tax rate.

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The idea of a 'plastic bag' tax seems to have finally won through, although its implementation seems to depend on voluntary action in the meantime.

Personal taxation announcements:

The Chancellor provided as expected clarification of his pre-Budget announcements on changes to capital gains tax (CGT) and the taxation of non-domiciled individuals.

- The relaxation to the CGT rules is to be limited to the already-announced entrepreneurs' relief which gives a reduced rate of 10 per cent on qualifying business gains up to £1m. However, many owner managers and entrepreneurs seek to sell for substantially more than £1m and will pay significantly more CGT under the new regime.
- For the non-domiciled individuals, the central £30,000 levy and the loss of the personal allowances remain, albeit with a £2,000 minimum threshold.
- The controversial proposals on 'income shifting', that affect all family businesses, are also to go ahead but not until 2009 so there is time for more modifications to this administratively burdensome scheme.

Rupert Eastell  
Head of Retail  
BDO Stoy Hayward LLP

### **Budget briefing - a response from the TMT team**

Overall, the Budget Briefing will have little impact on TMT companies this year and there were no major surprises with the Chancellor adopting a very cautious approach following his recent run in with the business community. Some of the expected changes have been deferred – we will have to wait to hear about income shifting and taxation of foreign profits.

Disappointingly there is little in the way of new incentives to persuade other TMT companies to move their operations to the UK. In particular it had been hoped there would be further reductions in the corporation tax rates.

However, it's encouraging that the increase in R&D Tax Credits are being introduced, although the enhanced credits for SMEs and are still subject to EU approval.

The Chancellor has confirmed the proposed changes to the capital gains regime for individuals and the taxation of non-dom's will be introduced although there is a slight relaxation of the treatment of foreign income and gains for non-doms. He also confirmed he will not revisit the taxation of non-doms in the lifetime of this parliament and the next.

The Chancellor announced additions to the categories of assets qualifying for enhanced capital allowances and provision are being introduced for loss making companies to claim a refund in respect to this expenditure.

Although the Chancellor made a number of references in his speech to the importance of science and technology, most of the proposals were relatively small.

For more information on the Budget Briefing – please go to [www.bdo.co.uk](http://www.bdo.co.uk)

