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# Charter Tax Consulting Ltd

# Budget Announcement: 16 March 2016

# Client Summary Note

## Introduction

On 16 March 2016, the Chancellor delivered his 2016 Budget Statement. There were the usual comments in his speech about continuing the crackdown on tax avoidance, and indeed there are some changes that will be very significant for those affected, albeit such parties do not make up the majority of the voting public, of course.

What many voters will be pleased with, however, is the reduction in the capital gains tax rate (albeit this will not apply to gains on residential property) and also the relaxations to previously introduced – and somewhat unfair- restrictions on the availability of entrepreneurs' relief.

Companies will also be very pleased to hear that the Chancellor continues to be convinced that the way to a strong economy is to make our corporation tax system competitive and as such he has promised to further reduce the rate of corporation tax – down to 17% from 2020. He did, though, remind us in his speech that he will be using the diverted profits tax regime to ensure that companies here do in fact make sure the UK gets a fair share of their global profits and there are changes to certain rules affecting multi-nationals to make sure they play nicely.

In the run up to the Budget there was much speculation on whether the Chancellor will be changing the pension rules (again). However, the proposals never made the final cut but what we have instead is a new regime for a "Lifetime ISA", which may be of interest to the under 40's!

Although our non-dom clients may have hoped to hear further following the proposals given in recent budget statements, in fact there was nothing further at all said either on these changes, or the inheritance tax changes in relation to residential property owned by offshore entities. Being on the consultation group with HMRC, though, I think I am fairly safe to say that this is in no way an indication that Government have lost the political will to push these changes through!

Set out below is an initial summary of the key proposals in today's announcements, that may affect our clients, though naturally bespoke advice will always be required and action should not be taken on the basis of these notes alone.



As ever, we will be happy to assist our clients or contacts in relation to any of these issues, so please do contact us should you have any queries.


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## Capital Gains Tax – Rate Reduction!

In a welcome move, the Chancellor is cutting capital gains tax (CGT) rates from 6 April 2016. Currently taxpayers pay 18% on capital gains where their income and gains are within the basic rate band and 28% where the individual is a higher rate taxpayer. These rates will be reduced to 10% and 20% respectively.

However, this relief will not be available on disposals of residential property and "carried interests". This is a continued policy by the government seeking to discourage individuals from investing in residential property, and rather encourage them instead to invest in businesses (see also Long-Term Investors Entrepreneurs Relief). The new 20% upper rate of CGT will apply to trustees and personal representatives, but the old 28% will continue to apply for ATED-related chargeable gains.

## Entrepreneurs' Relief (ER)

Changes to the rules for ER were announced last year and took effect on 18 March 2015, as part of Finance Act 2015. These changes had a knock-on effect which meant that many individuals could no longer benefit from the relief despite having genuine commercial arrangements in place. The two areas of changes introduced but in fact regarded as quite unfair, and which will now be addressed in Finance Act 2016, will be the treatment of joint ventures and associated disposals.

### *Treatment of Joint Ventures and Partnerships*

The changes in FA 2015 meant that shareholders of a holding company of a trading group could no longer benefit from ER. FA 2016 will reverse this and backdate the revisions to 18 March 2015 so as not to penalise individuals who made disposals in the intervening period.

In effect the joint venture rules will be re-established but the test will now look at whether the shareholder had an effective 5% shareholding in the underlying joint venture trading company. For example, a 20% shareholder in a company which in turn has a 40% interest in the underlying joint venture trading company would no longer have qualified for ER following the FA 2015 change in rules. However, thanks to today's change in fact the shareholder would have an effective 8% interest (20% x 40%) and so could qualify for ER.

### *ER on Associated Disposals*

Again, changes in FA 2015 meant that parents selling businesses and assets used in business to their children could no longer qualify for ER from 18 March 2015. Changes in FA 2016 will reverse this from 18 March 2015 such that relief is available.

## New "Long-Term Investor" Entrepreneurs' Relief (ER)

In a further bid to encourage investment in small and growing companies, the Chancellor announced an extension of ER to independent investors. Under these new rules, individual subscribers to new shares issued on or after 17 March 2016 and held for three years from 6 April 2016 will be eligible for the relief. This will mean that gains will be taxed at the lower rate of 10% subject to a lifetime limit of £10m. Anti-avoidance measures will be introduced to prevent abuse of the tax relief.

## ISAs – An Alternative to Pensions?

In the run up to the Budget there was some speculation that there would be a wholesale change to the pension rules, such that in effect pensions became a lot more like ISAs. Fortunately these changes haven't made the final cut of the Budget but in fact the proposal we now have seems quite a useful alternative in many situations.

A new type of ISA will now be introduced, aimed at encouraging individuals to save for retirement or their first home. From 6 April 2017, anyone under 40 years old can open a Lifetime ISA and contribute up to £4,000 per annum. The Government will contribute a 25% bonus to the Lifetime ISA for all contributions made up to the age of 50, subject to certain restrictions. Growth or interest within the Lifetime ISA and drawing funds from it, either to buy your first house or after the age of 60 will also be tax free. The Government is considering various options with respect to this Lifetime ISA, including the ability to borrow against funds held within it, and other situations where the funds can be drawn without foregoing the government bonus.

The existing ISA regime will continue in parallel and indeed the annual investment limit on contributions to ISAs will increase from £15,240 to £20,000 from April 2017.

## Another Corporation Tax Reduction

Our Chancellor seems to have a genuine wish to encourage large businesses to set up in the UK and as such has announced that there would be a further cut to Corporation Tax rates from 1 April 2020; with a new reduced rate of **17%** for all companies. It had previously been announced in the Summer Budget that the rate would be 18% from this date.

This is the latest in a continuing trend of decreasing corporate tax rates, as we have seen rates fall from a main rate of 28% in 2010, to the current rate of 20%. Companies will benefit from a rate of 19% from 1 April 2017 until the new rate of 17% in 2020.

This further decrease to the new historic low for the UK means trading through a Limited Company is still an attractive structure, despite the changes to the dividend tax rules already announced from 5 April 2016.

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## SDLT – Commercial Property

At the end of 2014, the Chancellor changed the SDLT basis of calculation for residential property, such that it became progressive rather than on a stepped basis. However, for commercial property it remained on a stepped basis; nothing on sales of commercial property below £150,000, then 1% if the sale is between £150,001 - £250,000, 3% for sales between £250,001 - £500,000 and 4% for sales over £500,000. So, for a commercial property worth £499,999 you paid SDLT of £15,000 and for a commercial property worth £500,001 you paid £20,000, a marginal tax rate of 2,500%!!

Probably quite sensibly, the Chancellor has decided that commercial property SDLT should also now be calculated on a progressive basis. However, what he's also done at the same time is raise the amount of SDLT charged on properties above £150,000. The new progressive rates will now be as follows (from 17 March 2016):

| Transaction Value Band | Rate |
|---|---|
| £0 - £150,000 | 0% |
| £150,001 - £250,000 | 2% |
| £250,000 + | 5% |

For new leasehold transactions, SDLT is already charged at each rate on the portion of the net present value (NPV) of the rent which falls within each band. On and after 17 March 2016 a new 2% rate for rent paid under a non-residential lease will be introduced where the NPV of the rent is above £5 million.

The new rates bands and thresholds for rent paid under a lease are:

| Net present value of rent | Rate |
|---|---|
| £0 - £150,000 | 0% |
| £150,001 - £5,000,000 | 1% |
| £5,000,000 + | 2% |

As a transitional measure, where contracts have been exchanged but transactions have not completed before 17 March 2016 purchasers will have a choice of whether the old or new structure and rates apply.

Remember nowadays that Scotland has its own system of SDLT (known as Land & Buildings Transaction Tax) and as such this change does not apply in Scotland. This measure will apply in Wales until 1 April 2018, when SDLT will also be devolved to Wales.

## SDLT Higher Rate for Residential Property

As already announced, from 1 April 2016 higher rates of Stamp Duty Land Tax (SDLT) will be charged on purchases of "additional" residential properties, such as second homes and buy-to-let properties. The higher rates will be 3 percentage points above the current SDLT rates:

| Threshold | Existing SDLT rates | New additional property SDLT rates |
|---|---|---|
| £0 - £125k | 0% | 3% |
| £125k - £250k | 2% | 5% |
| £250k - £925k | 5% | 8% |
| £925k - £1.5m | 10% | 13% |
| £1.5m + | 12% | 15% |

In terms of how one defines an "additional" residential property, the proposal is that if, at the end of the day of the transaction, an individual owns 2 or more properties and has not replaced their main residence, the higher rates will apply.

Purchasers will have 36 months to claim a refund from the higher rates, in the event that there is a period of overlap or a gap in ownership of a main residence.

Properties purchased for under £40,000, caravans, mobile homes and houseboats will be excluded from the higher rates. Furthermore, small shares in recently inherited properties will not be considered when determining if the higher rates apply.

Companies purchasing residential property will be subject to the higher rates, including the first purchase of a residential property.

This measure will have effect for purchases which complete on and after 1 April 2016. Where contracts have been exchanged on or before 25 November 2015 but not completed until on and after 1 April 2016, the higher rates will not apply.

As for the commercial SDLT changes, this measure does not apply in Scotland and will apply in Wales until 1 April 2018, when SDLT will be devolved to Wales.

## Developers of UK land

Currently it is in principle possible for companies in certain treaty locations to develop and sell UK land/ property without falling within the charge to UK income or corporation tax. Long story short, if the developer is careful enough, it can avoid having a taxable "permanent establishment" in the UK and if the developer is in a treaty jurisdiction then giving priority of taxing rights on business profits to its home jurisdiction (and not the UK), then the UK can't tax the development profits. Certain such treaty jurisdictions (most notably Jersey, Guernsey and the Isle of Man) then in turn actually have a 0% home jurisdiction corporation tax rate for such development profits, so the developers can escape tax altogether.

For a long time now HMRC have not liked this sort of structuring, though perhaps surprisingly there has never been a challenge through the courts. Today, though, marked the start of a new regime for the taxation of property development profits that will seek to ensure that such profits are duly captured by the UK tax net.

The key change will be to remove the current territorial restriction in UK legislation so that the profits of a trade carried on by a company are subject to corporation tax on income where the trade comprises dealing in UK land, or developing UK land with a view to disposing of it, *regardless of the residence of the company carrying on the trade, regardless of where the trade is carried on and regardless of whether or not the trade is carried on through a Permanent Establishment (whether in the United Kingdom or elsewhere).*

The new rules will capture the profits of a trade (referred to in what follows as a 'UK property trade') carried on by a person in so far as the trade consists of:

- dealing in any estate, interest or right in or over land in the UK; or
- developing any land in the UK with a view to disposing of any estate, interest or right in or over the land. This will include redevelopment.

Normal corporation tax profit calculation rules will apply, with a suitable apportionment if the UK property trade is not the only activity of the foreign company.

In principle, this new charging regime will come into force with immediate effect, though in fact we will not have the legislation available until later this year, probably June 2016. Anti-avoidance rules will therefore apply to try and prevent forestalling of the new rules. However, effectively the new rules are only looking to capture profit from Budget Day onwards.

## Employee Shareholder Agreements

Back in 2013, the Chancellor decided to encourage a new type of share based payment for employees, where the employee takes on an "Employee Shareholder Agreement". Under this arrangement, employees could be provided with £2,000 of employee shares tax free and there was scope to receive gains of up to £50,000 tax free on a later sale of such shares.

However, one assumes that already too many employees have taken advantage of this route and made some rather nice gains as now HMRC will apply a lifetime cap on the amount of tax free gains you can make of £100,000.

## VAT and Online Sales

Currently, it is possible for an overseas business to sell goods on-line into the UK and while theoretically many of them should be registering for VAT in the UK, in practice this is very hard to enforce.

To try and tackle this problem, however, HMRC's powers to appoint a "VAT representative" for overseas traders who are regarded as a VAT risk will be increased – as "VAT representatives" are jointly and severally liable for the VAT due, along with the trader. There will also be increased powers for HMRC to require overseas businesses to provide a security deposit.

In addition, there is a proposal to make on-line marketplaces (such as ebay) responsible for the collection of the VAT.

The measure will have effect from Royal Assent to Finance Bill 2016.

## Corporation Tax Losses

Loss relief for companies is to become more flexible from 1 April 2017, with losses generated after this date being allowed to be offset against other income streams in the group, rather than having to be used against the same source of income, as the current rules allow.

For groups with profits of over £5 million, they will only be able to use losses to reduce their profits by a maximum of 50%.

## Loans to Participators

Loans to Directors/Participators have been subject to a tax charge of 25% for a number of years, and an increase in the rate of this tax is perhaps not unexpected given the change to the taxation of dividends announced in the summer budget.

This tax is payable by the company on the same date that its normal corporation tax liability is due, but has the benefit of being repayable once the loan from the company has been cleared or reduced.

The rate is to increase to 32.5% from 6 April 2016, meaning that the rate again mirrors the higher rate of dividend tax (as it did previously under the old dividend tax rules).

Loans can still be useful, as there is the benefit of the company paying the tax rather than the individual, and the tax is repayable to the company, however the Participator will often have to receive taxable income to enable the loan to be repaid. They can however be useful where a large withdrawal is required in one tax year, with the loan then being repaid out of income over a number of tax years.

There are other tax concerns of a loan however, such as avoiding a Benefit in Kind charge on a low interest loan. Advice should be sought to ensure Participators do not fall foul of these complex rules.

## Interest Deductibility

Large companies that have significant interest costs in the UK but associated to activities overseas, will have interest deductions restricted to either just 30% of UK earnings or will become based on the ratio of interest to earnings of the whole group. A threshold of £2 million of net UK interest will be introduced to ensure the largest companies are targeted.

## Anti-hybrid Rules

Measures are to be put in place to prevent complex structures that allow some multinationals to deduct the same expenses in more than one country, or receive a deduction for expenditure without the corresponding receipt being taxable.

Structures with Permanent Establishments or Dual Resident Companies could be affected, as could situations where the expenses and income are treated as different types of payment in different jurisdictions (e.g. finance cost in one jurisdiction and exempt investment income in the other).

The new rules will attempt to disallow the deduction in one of the entities where a double deduction would previously have been achieved, or to deny the claim for expenditure or tax the receipt where there is a mismatch of treatment.

Changes will come into force for payments made on or after 1 January 2017, so companies do have some time to reorganise their affairs.

## Royalties and Withholding Tax

Currently many (but not all) types of royalties paid by a UK resident to a non-UK resident attract a 20% withholding tax charge. However, this rate can be reduced by applicable double taxation treaties and is not charged on all categories of royalty payment. HMRC feel that the withholding tax regime should be extended and any use of double taxation treaties that is considered to be artificial should be prevented and announcements were therefore made today that this is an area on which the rules will now be tightened.

A number of changes have been announced to the way Royalty payments are charged to income tax for non-residents, and will increase the number of situations where a company is obliged to withhold tax on payments.

Changes to the definition of Intellectual Property Rights that are subject to withholding tax is set to change to align the definition with that of Rights which are subject to Income Tax, widening the net for payments requiring tax to be deducted at source and paid directly to HMRC.

In addition, the deemed source of royalties is to be amended to bring certain payments into the charge to income tax in the UK. Currently, income arising to a non-UK resident is not charged to UK tax if it is not from a UK source. A further provision will be added to treat royalties from a permanent establishment that a non-resident person has in the UK as a UK source of income. This will prevent UK permanent establishments from receiving an expense deduction from the payment of a royalty, while the recipient avoids a charge to UK income tax on the receipt.

These changes will not come into force until the Finance Bill receives Royal Assent.

A further amendment is to be made for arrangements entered into as part of a tax avoidance arrangement, and if the new provision applies, the payment must be made with the deduction of income tax, irrespective of the Double Taxation Agreement which may restrict the UK's right to tax the income. This change will effect payments made from 17 March 2016.

## IR35 legislation for Public Sector Workers

IR35 is the complex legislation that covers individuals who provide their services through an intermediary, usually their own Limited Company. The aim is to equalise the tax and national insurance paid under this arrangement to that of a normal employee. Interestingly, this new announcement only covers public sector workers, but this could highlight that a change will also be announced for private sector workers in due course. Perhaps the chancellor feels the government should get its own house in order first!

The new system will take the responsibility for deciding whether this legislation applies away from the individual, and responsibility will rest with the public sector agency that engages the individual.

A new digital tool will be developed to help decide the status of the individual, and this will also be available to those in the private sector.

## New £1,000 "Small Business" Allowance

From April 2017, taxpayers who make up to £1,000 from occasional jobs or small hobby businesses will not have to pay tax on this income. Similarly, £1,000 received from renting property will also be tax free. One wonders how many taxpayers put such things on their tax returns anyway…….