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Charter Tax Consulting Ltd

Budget Announcements 8 July 2015:

Client Summary Note

Introduction

On 8 July 2015, the Chancellor delivered his 2015 Budget Statement, the first "pure" Conservative Budget in nearly 20 years. Perhaps unsurprisingly, there was much to be said in the Budget on welfare cuts. It was always a given that the Chancellor will also need to find a way to raise taxes and so further tightening of anti-avoidance legislation came as no surprise.

What may surprise many non-dom clients, though, are the announcements to curtail the availability of the remittance basis of taxation for individuals living in the UK for more than 15 years.

Private landlords will also be particularly surprised as to the phased abolition of the ability for individual landlords to claim a tax deduction for their finance costs on buy to let properties.

There are, though, increases in the personal allowance and a "tax lock" promises no increase in the headline rates of taxation for the term of this Government. Families wishing to pass down the family home will also be grateful for the effective ability to do this for homes of up to £1m.

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.

Janet Paterson, FCA, CTA, AIIT, TEP
Director, For and on Behalf of
CHARTER TAX CONSULTING LIMITED
11 ST JAMES'S PLACE
LONDON SW1A 1NP
Janet.paterson@charter-tax.com

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Bad News for Non Dom's – New Deemed Domicile Rules

Individuals who are resident and domiciled in the UK are taxed on their worldwide income and gains. However, it has long been an attraction of the UK tax regime that non-doms can become UK resident and are able to pay tax under the "remittance" basis, whereby they are taxed, broadly, on their UK source income/ gains and their foreign income/ gains that are remitted to the UK – foreign income and gains kept abroad would not be taxed in the UK. To access the remittance basis, longer term UK resident non-doms need to pay an annual remittance basis charge.

The Government have acknowledged that this attractive basis of taxation for non-doms is helpful for our economy and as such there is a wish to keep it. However, it seems that Labour weren't the only party with some plans to curtail the regime, bowing to media pressure as to what is perceived to be "fair".

With this in mind, from 6 April 2017, two sets of changes will be brought in to the legislation applicable to non-doms:

(i) The 15 Year Deemed Domicile Rule

A new "deemed-domicile" rule is to be introduced for long-term residents who would otherwise remain foreign domiciled under general law. This will be a deeming rule for tax purposes only (not dissimilar from the current inheritance tax concept of deemed domicile) and will not affect the domicile position under general law, nor will it affect the domicile of the individual's children.

Under the new deemed domicile rule, individuals who have been UK resident for more than 15 of the past 20 tax years, but are foreign domiciled under general law, will be deemed domiciled for UK tax purposes. There will be consultation on whether split years of UK residence count towards the 15 years for this purpose not. So, in a non-dom's 16th tax year of UK residence, the remittance basis can no longer apply. Naturally this makes obsolete the increase in the remittance basis charge recently applied once a non-dom has been here for 17 tax years. Also, in effect it means that the deemed domicile rule for inheritance tax reduces from 17 years to 15.

The technical note released by Government advises that the new rules will be effective from 6 April 2017 irrespective of when someone arrived in the UK. It further confirms that there will be no special grandfathering rules for those already in the UK, although as a quid pro quo, for those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled under the 15 year rule on 6 April 2017, the present rules will apply.

In order for a non-dom to "reset the 15 year clock" they will need to be looking at being resident outside the UK for over 5 complete tax years. In effect, therefore, the deemed domicile rule for inheritance tax purposes is therefore further extended, and this extension will apply for non-doms (that are deemed domiciled) as well as for UK doms who then emigrate.

Interestingly, the technical note suggests that non doms who have set up an offshore trust before they become deemed domiciled here under the 15 year rule will not be taxed on trust income and gains that are retained in the trust; furthermore, such excluded property trusts will continue to have excluded property status for inheritance tax purposes (subject to the look through for UK residential property, also announced today). Benefits received from the trust would still be taxed, but this does potentially seem like quite a generous ability for non-doms to still have an effective tax deferral solution, even once they pass the 15 year rule. Potentially, therefore, this could be quite a saving grace for non-dom clients in a position to establish an excluded property trust offshore.

(ii) The returning UK dom rule.

There seems to be a political feeling that some people claim non-dom status when they shouldn't. Primarily, this is aimed at people who are born here but are currently able to claim non-dom status on account of their parentage. This will now be largely dealt with by the 15 year deemed domicile rule as outlined above.

The other area where the non-dom rules are perceived to operate unfairly is where someone was born here, goes to live abroad (and acquires a domicile of choice in their new country of residence) but then they return to the UK. In such cases, the Government wish to be able to deem such individuals to be domiciled here again for tax purposes.

Furthermore, individuals who were UK dom, live abroad so as to become a non-dom, then return to the UK will not benefit from any favourable tax treatment in respect of trusts set up while not domiciled here (whether inheritance tax treatment or otherwise).

There is, though, no suggestion by Government that it will harden further the ability for an individual to lose their UK domicile, once they have genuinely emigrated (subject to new deemed domicile rules which will now often mean that someone who was UK domiciled individual will need to be non-resident for 5 tax years before losing their UK domicile).

This measure will affect all returning UK doms from 6 April 2017, including those who returned prior to April 2017. The five year rule will affect UK doms leaving after 5 April 2017. It will also affect trusts set up while such individuals were not UK domiciled if they are UK resident on or after 6 April 2017. In these circumstances, an individual will be taxed on all income and gains arising in such trusts under the same rules as any other UK domiciliary. The IHT treatment of such trusts will also be the same as for UK tax payers who have never lost their UK domicile.

There will be a consultation period on these rules and legislation is expected in Finance Bill 2016 and naturally Charter Tax will plan to be a part of that process, so that it is able to give its clients the best possible advice.

IHT Changes for Non-Doms Owning UK Residential Property Through "Structures"

Under the current inheritance tax rules, inheritance tax applies to individuals domiciled (or deemed domiciled) in the UK, based on their world-wide assets (whether or not the individual lives in the UK). Non-doms are within the scope to UK inheritance tax only on their "UK situs" assets (i.e. including UK real estate).

So, for a non-dom wishing to own UK real estate, a common planning technique has always been to have the non-dom own the UK real estate through an offshore company. That way, for inheritance tax purposes, what the non-dom owns is shares in an offshore company – being a non-UK situs asset for inheritance tax purposes. A very simple (non-abusive) but effective planning for inheritance tax.

When the Government first brought in the "ATED" charge (Annual Tax on Enveloped Dwellings), the charge was based on the premise that taxpayers put high value residential property into offshore companies to avoid stamp duty land tax – because then in due course the client could sell the shares in the company, without an SDLT charge – rather than selling the property itself. At the time, all the representatives on the consultation groups dealing with HMRC on this pleaded with HMRC that if this was the point of the charge, it would miss its mark because in fact properties tend to be put in companies for inheritance tax planning reasons, not for SDLT planning reasons.

Well, it took a while, but HMRC seem to have finally agreed with what they were told in the consultation groups some years ago – UK properties are owned through offshore companies as routine inheritance tax planning. However, the Government have now decided that this is unfair as compared to individuals that are domiciled in the UK and there is now a wish to apply inheritance tax on UK residential property owned through offshore companies (or other opaque structures) on, seemingly, a "look-through" basis.

This "look through" could arise predominantly in one of the following situations:

i. A non-dom creates an offshore company as a vehicle to own UK residential property. Provided the non-dom is not here long enough to become deemed domiciled for inheritance tax purposes (which anyway would have happened once they were here for 17 tax years), then if the non-dom dies owning the shares in the offshore company, there is no inheritance tax charge. However, if they had owned the property directly, there would have been a charge. Likewise, if they gave the property away but died within 7 years of the gift, a charge would arise. Under the new rules, a charge to inheritance tax will, therefore, now arise should the individual die, even if they own the UK property through an offshore company.

ii. A non-dom settled an offshore trust. This would be an "excluded property trust", meaning that its assets are not within the charge to inheritance tax, unless it directly holds UK situs assets. If it directly holds UK situs assets (e.g. real estate) then such UK situs assets are within the charge to inheritance tax, meaning that there is a charge on putting the assets into the trust, on getting them out, if the settlor dies (if the trust is settlor interested) and also on every 10 year anniversary of the trust. Note that these charges would also all apply to a trust's entire assets, if the trust was settled by a UK domiciled individual. Common planning would be for the trust to therefore own the UK property through an offshore company, to avoid the inheritance tax charge. Under the new proposals, all these inheritance tax charges will still apply anyway, though only to the extent that the trust settled by the non-dom owns UK residential property, not on its assets generally.

The exact details of the implementation are as yet unknown. We have, though, been provided with a technical briefing, released today, to outline the Government's plans. Key points to note from this briefing are as follows:

- The briefing specifically refers to UK residential property so – as for the ATED regime – commercial property is unaffected. Indeed, the technical note suggests that the same definition of residential property as appears in the ATED rules, will be used for these new IHT rules. The Government have confirmed that there will be no extension of these rules to other classes of assets held by non-doms (….. anyone else feeling cynical about that?).

- It will not matter if the property is for the non-dom's own use or if it is let out (so, unlike the ATED regime, there will not be an exemption for landlords or developments).

- There will not be any minimum threshold to the new rules (unlike ATED, which started out having a £2m threshold – which has subsequently been reduced to £500k, from next year).

- The new regime doesn't appear to be limited to UK resident non-doms, it applies regardless of residence.

- Non-doms will be entitled to the same reliefs and exemptions as UK doms (though this may throw up complications as currently the spousal exemption for assets going to a non-dom spouse is limited). However, the Government has stated from the outset that the spousal exemption will not generally be available if the offshore company shares are held by trusts other than qualifying interest in possession trusts and the settlor is taxed on death under the reservation of benefit provisions. This could be a real bear trap for property owned in a trust/ company structure and some re-structuring will be needed in many cases.

- There will be exemptions for diversely held vehicles (funds) owning UK residential property, along the same lines as now exist for the extended capital gains tax charge.

The new charge is intended to apply from 6 April 2017, though a consultation process is promised on its implementation. Encouragingly, we are told that the government will consult on the details of these proposals *"so as to ensure that it is only the value of the UK residential property that is subject to tax (less any borrowings taken out to purchase such UK property)."* Also encouragingly, we understand that the Government *"will consider the costs associated with de-enveloping and any other concerns stakeholders may have during the course of the consultation regarding de-enveloping".* Naturally Charter Tax will fully commit itself to the consultation process, to be able to give best advice to its clients.

Inheritance Tax: Main Residence Nil-Rate Band

Currently each individual is entitled to a nil rate band for inheritance tax, of £325,000. An unused nil rate band can transfer to one's spouse on death, and so in effect a couple's combined nil rate band is £650,000. However, these days many family homes are well above that amount and as such it has become difficult for many families to pass down the family home to the next generation.

The Conservatives have previously alluded to an inheritance tax threshold of £1m. These proposals achieve that £1m threshold for situations where a family residence is passed to the next generation but without more generally increasing the inheritance tax threshold.

Proposals announced today will introduce an additional nil-rate band when a property that has been an individuals main residence at some point is passed on death to a direct descendant. This will be £100,000 in 2017-18, increasing gradually to £175,000 in 2020-21. It is then set to increase in line with Consumer Prices Index (CPI) from 2021-22 onwards. Any unused nil-rate band will be able to be transferred to a surviving spouse or civil partner.

The additional nil-rate band will also be available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets of an equivalent value, up to the value of the additional nil-rate band, are passed on death to direct descendants. This is provided that the deceased left that smaller residence, or assets of equivalent value, to direct descendants. However, the total amount available will not exceed the maximum available residence nil-rate band.

There will be a tapered withdrawal of the additional nil-rate band for estates with a net value of more than £2m. This will be at a withdrawal rate of £1 for every £2 over this threshold.

These measures are due to take effect for relevant transfers on death on or after 6 April 2017. They will apply to reduce the tax payable by an estate on death but not to reduce the tax payable on lifetime transfers that are chargeable as a result of death.

Carried Interest Gains

It is common practice for investment managers to have part of their performance package through a carried interest arrangement. It is accepted that such carried interest arrangements should be charged to capital gains tax rather than income tax (provided they are correctly structured). However, there is some planning in relation to such gains, when structured in investment partnerships who then undertake a "base cost shift", which has been regarded as unacceptable planning and will be stopped from 8 July 2015.

Buy To Let Investors – Restricting Tax Relief on Finance Costs

In a surprise move, the Chancellor has decided that it is "unfair" for individual landlords to receive a tax deduction for the finance costs of acquiring a buy to let property. The comparison was drawn to individuals who buy a property as their main residence, and who cannot obtain a tax deduction for finance costs on such a residence. The comparison seems to us to be debatable at best. Nevertheless, the tax deduction will therefore be withdrawn, on a phased basis, starting in April 2017.

Interestingly, though, the restriction only applies to individuals with buy to let properties. An obvious point to therefore consider will be whether the properties may be rolled into a corporate structure.

Properties regarded as furnished holiday lettings will be unaffected by these changes.

Taxation of Dividend Income

From April 2016, individuals will only be able to receive £5,000 of dividend income free of tax. Beyond this, a graduate tax rates will apply, up to a top rate of 38.1% will arise.

Owner managed businesses in particular be looking to review their dividend policies and their owner's remuneration structure.

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Corporation Tax Rate Reduction

The rate of Corporation Tax from 1 April 2016 is already set at 20%. This will reduce to 19% for the financial year beginning on 1 April 2017, and further still to 18% for the financial year starting 1 April 2020.

Restriction on Goodwill Amortisation costs

With immediate effect, where a business acquires another business, by way of an acquisition of the trade of that business (rather than buying the shares), then the resulting goodwill purchase cost (and the cost of related intangible assets) will not represent an allowable deduction for corporation tax purposes in the hands of the acquiring company. Until now, normally such a purchase could be allowed in accordance with the goodwill amortisation policy of the acquiring company. Going forward, relief will only be allowed should that trade then in turn be sold on.

This will make a massive difference to the way that many mergers and acquisitions are structured. The Government reasoning for the change appears to be that it is “unfair” that acquiring a business creates a deductible goodwill cost whereas acquiring shares in a target company does not.

Fortunately acquisitions made before 8 July 2015 are in effect grandfathered and the goodwill can still be written off in a tax efficient manner.

Pension Contributions

As promised in the Conservatives’ manifesto, the £40,000 Annual Allowance for pension contributions will be reduced for those with incomes of over £150,000 including personal and employer’s pension contributions and over £110,000 excluding pension contributions. For every £2 of income over £150,000 the Annual Allowance will be tapered by £1 to just £10,000 for those with incomes of £210,000 or more.

The tapering of the annual allowance will have effect from 6 April 2016, though legislation to align all pension input periods with the tax year and other transitional rules that may still have an impact. Fortunately, though, it seems that unused Annual Allowance from the previous three years can be carried forward in the normal way.

In better news, death benefits paid from pension schemes of those dying aged 75 or over - which are currently taxed at 45% - will, from 6 April 2016, instead be taxed at the recipient’s marginal rate of income tax.

Common Reporting Standard (CRS) -Disclosure

The Common Reporting Standard (CRS) will be a new international information exchange program, that will be upon us from next year. Under the CRS, financial institutions will be required to:

- identify accounts maintained for specified persons, that is, account holders who are tax resident in jurisdictions with which the UK has entered into an agreement to exchange information about a wide range of financial accounts and investments to help tackle tax evasion
- collect and report information in a specified manner on specified persons to HM Revenue and Customs (HMRC)

The March 2015 Budget announced that, in advance of the receipt of data under the Common Reporting Standard in 2017, the Government will offer a new time limited disclosure facility from 2016 to mid-2017 on less generous terms than existing facilities, which will now end later this year.

The Government have announced that they plan to require financial intermediaries, tax advisers and other professionals to notify their customers or clients of the impact of the new common reporting standard, and the accompanying disclosure facility opportunity, as well as the penalty regime for non-disclosure.

Direct Recovery of Debts Due to HMRC from Your Bank Account!

The idea has been around for a little while now that HMRC would like to be able to recover debts from non-paying "customers", direct from their bank account. It looks like it will now have its way. Debts over £1k due to HMRC will be able to be directly recovered by HMRC, so long as the taxpayer has at least £5k in their bank.

Acceptance of this new direct recovery procedure will, though, at least need to await Royal Assent.

Miscellaneous Changes:

- ***Annual Investment Allowance*** – will be permanently increased to £200,000.
- ***Insurance Premium Tax*** – is set to increase
- ***EIS/ SEIS/ VCT Schemes*** – will be subject to some amendments to dictate the age of the company that is eligible for investment, to cap the total investment allowed under its lifetime under these schemes, to stop such companies from using the funds for business acquisitions and to increase the rules around investor independence.

- ***Inheritance Tax 10 Year Charge on Trusts*** – measures will be introduced to "simplify" the calculation of trust charges by removing the need to include non-relevant property in the calculation. It also introduces new rules about adding property to more than one relevant property trust on the same day to protect inheritance tax revenues from the use of multiple trusts.
- ***Rent-a-room relief*** – will increase from £4,250 to £7,500 per annum.
- ***Controlled Foreign Companies*** - Anti-avoidance legislation will be introduced to prevent groups setting off various expenses/ losses against the CFC charge on profits of controlled foreign companies.

CONSULTATIONS are being made on:

- ***Employment Intermediaries and Tax Relief for Travel and Subsistence*** - Proposals to remove home-to-work travel and subsistence tax relief where a worker is employed through an employment intermediary.
- ***Income Tax: Extension of averaging period for farmers*** - possible extension of the averaging period for farmers' profits to 5 years.
- ***Tax Treatment of Sporting Testimonial Matches*** – Whether, and if so how, funds from sporting testimonial matches should be taxed.
- ***Taxation of Performance Linked Rewards Paid to Asset Managers*** – a full consultation is being launched to cover performance fees/ carried interest arrangements, etc.