DIXON WILSON
CHARTERED ACCOUNTANTS

Summer Budget 2015 Update

23 July 2015

Note: This update was written on 23 July 2015. It is based on the government's proposals at that point in time which don't necessarily represent the final legislation. For that reason, no action should be taken based on this update without taking further advice.

INTRODUCTION

This overview highlights some of the key announcements made by the Chancellor in his Summer Budget 2015 speech which will affect our clients. It should be noted that many of the announcements are to apply at a later date (usually April 2016 or April 2017) and many are subject to consultation.

DIVIDEND INCOME

Significant changes to the taxation of dividends were announced. The government plans to abolish the 10% notional dividend tax credit from 6 April 2016 and replace this with a £5,000 Dividend Tax Allowance for all taxpayers. This allowance will be available in addition to the Personal Allowance.

Dividend tax rates are also changing: 7.5% will apply to the basic rate band, 32.5% to the higher rate band and 38.1% to the additional rate band. This compares to the current effective rates of 0%, 25% and 30.56%. The tax charged on dividend income will therefore increase for all taxpayers unless the income is covered by the Personal Allowance and/or the Dividend Tax Allowance.

With the changes not due to apply until next tax year, there is time to review current arrangements and implement measures to mitigate the tax rises. Options may include accelerating dividends so they are taxed in 2015/16, maximising the use of ISAs, and splitting dividend portfolios between spouses.

NON-UK DOMICILED INDIVIDUALS

The government announced major changes to the way that non-UK domiciled individuals will be taxed from April 2017.

LONG TERM RESIDENTS

Individuals will become deemed UK domiciled for all tax purposes if they have been resident in the UK for more than 15 out of the previous 20 year period. Once an individual has become 'deemed domiciled' in the UK, they will remain so for five years after leaving the UK.

The tax impact of becoming deemed domiciled in the UK is that the individual will no longer be able to claim the remittance basis and will instead be subject to UK tax on their worldwide income and gains as they arise, irrespective of whether they are remitted. UK inheritance tax (IHT) will also be payable on an individual's worldwide assets once they become deemed domiciled.

However, non-domiciled individuals will still be able to benefit from a preferential tax treatment with respect to offshore trusts. Where they have settled offshore trusts before becoming deemed UK domiciled they will not be taxed on overseas income and gains that are retained in the trust. Instead, from April 2017 such individuals will be taxed on any benefits, capital or income as they receive it from the trust. It is not currently clear how the existing rules for matching trust gains to capital payments will operate in these circumstances and these changes will be subject to consultation after the summer recess.

Trusts established before the individual becomes deemed domiciled will remain excluded property for IHT purposes. However, the government intends to bring all UK residential property within the scope of IHT. See the inheritance tax section below.

It is important to note that the proposed reforms do not abolish non-UK domiciled status, but merely bring in a new deemed UK-domicile status, which can be lost once an individual has been non-UK resident for at least five years. Furthermore, this change should have no impact on an individual's unremitted income and gains accrued while the individual claimed the remittance basis.

Those individuals who are non- UK domiciled and are not already caught by the existing IHT deemed domicile rules may wish to review their position with a view to potentially establishing new offshore arrangements before the reforms come into force.

INDIVIDUALS WITH A UK DOMICILE OF ORIGIN

From April 2017, rules will be introduced to restrict the eligibility to non-UK domiciled status for individuals with a UK domicile of origin. Broadly speaking this concerns individuals whose father was UK domiciled when they were born. Where such individuals have acquired a non-UK domicile of choice, they will immediately be treated as UK domiciled for tax purposes if they become UK resident. It will also affect trusts set up while such individuals were non-UK domiciled if they are UK resident on or after April 2017. In these circumstances, the trust will be subject to tax as if it were set up by any other UK domiciliary.

INHERITANCE TAX

MAIN RESIDENCE NIL-RATE BAND

The government plans to introduce a main residence nil-rate band which may be available when a residence is passed on death to direct descendants. This will be £100,000 in 2017 to 2018, £125,000 in 2018 to 2019, £150,000 in 2019 to 2020, and £175,000 in 2020 to 2021. It will then increase in line with CPI from 2021 to 2022 onwards. Any unused nil-rate band will be transferred to a surviving spouse or civil partner. It 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. There will also be a tapered withdrawal of the additional nil-rate band for estates with a net value of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold.

NIL-RATE BAND

The IHT nil-rate band is currently frozen at £325,000 until April 2018. The government plans to continue to keep the nil-rate band at £325,000 until April 2021.

IHT ON UK RESIDENTIAL PROPERTY

It is currently possible for UK residential property to be outside the scope of UK inheritance tax. An example of this would be if the property was owned by a non-UK company which was in turned owned by a non-UK domiciled individual or a trust settled by a non-UK domiciled individual. The government intends to amend the rules from April 2017 so that all UK residential property is within the scope of inheritance tax irrespective of the ownership. In particular this will include UK residential property held through non-UK companies, partnerships or other opaque vehicles and UK residential property held by non-UK domiciled individuals irrespective of their current or historic residence position. However, diversely held vehicles will not be affected. There will be no exemption for let properties or for low value properties. All types of chargeable events for IHT will be affected, for example the death of the individual, gifts within 7 years of death including gifts with reservation of benefit, settling assets on trust, 10 year anniversaries of trusts and distributions from trusts.

PENSIONS

Two main pension changes were announced. The first was a reduction to the annual allowance for 'high earners' - broadly those with net annual income of more than £110,000 and adjusted income (broadly income plus employee and employer pension contributions) of more than £150,000. The annual allowance, currently £40,000, will be tapered down to a minimum of £10,000, and will reduce by £1 for every £2 of adjusted income over £150,000. Tapering is due to be introduced with effect from 6 April 2016.

The second change is the aligning of pension input periods (PIPs) to the tax year. Again, this is due to take effect from 6 April 2016. However, there are transitional provisions that will apply for the current tax year. The transitional provisions split 2015/16 into two 'mini' tax years, one for the period from 6 April to the date of the summer budget on 8 July 2015, and the second from 9 July 2015 to 5 April 2016. Whilst the mechanics of the transitional provisions are quite complicated, the main point to be aware of is that many individuals who were a member of an existing pension scheme on 8 July 2015 are likely to be able to relieve additional pension contributions in the current tax year, sometimes up to twice the previous annual allowance. An increased annual allowance will usually apply if an individual (or their employer) has made pre-8 July 2015 contributions to their pension scheme.

There was a further minor change to the tax payable on pension lump-sum death benefits. The former 45% flat rate of tax that was payable in certain cases is being replaced with a tax rate equivalent to the beneficiary's marginal rate of income tax (i.e. 20%, 40% or 45%).

The government also announced that they would begin a consultation on wide-ranging and significant changes to the taxation of pensions, in particular on the way that pensions attract tax relief. In view of increasing life expectancy, there is concern that the current system may not be viable in the long-term. The consultation process is open until 30 September 2015, and we will have more information a few months after this date on the proposed changes that the government will seek to introduce.

It was confirmed that the Lifetime Allowance will reduce from £1.25 million to £1 million from 6 April 2016 and that transitional provisions will be introduced to ensure the change is not retrospective. The Lifetime Allowance will then be indexed annually in line with CPI from 6 April 2018.

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PROPERTY RENTAL

INCOME TAX RELIEF FOR FINANCE COSTS ATTRIBUTABLE TO RESIDENTIAL PROPERTY

The government intends to address the perceived unfairness that buy-to-let landlords have over owner occupiers by limiting income tax relief for finance costs to the basic rate. The proposal will affect individual landlords (including partnerships) who have taken out mortgages or loans to purchase residential property. Interest relief for commercial property is unaffected.

Currently all finance costs are deductible in computing an individual's taxable rental income. Under the proposals announced in the Budget, these would instead be restricted to relief at the basic rate of tax. This would only affect higher and additional rate payers where the relief for finance costs would be limited to 20%, instead of 40% or 45% respectively. The restriction will be phased in over 4 years, starting from April 2017.

It is not clear whether trustees will be affected by the changes, although this should be clarified when draft legislation is published. The changes do not affect UK companies subject to corporation tax, or non-resident companies subject to income tax where full relief for finance costs will continue to be available. This means that holding property through a corporate structure may be tax efficient for income tax purposes, particularly where profits do not need to be extracted immediately and be subject to tax in the shareholders' hands. Further changes to the taxation of residential property held in corporate vehicles may change this in the future.

WEAR AND TEAR ALLOWANCE

The wear and tear allowance for furnished residential property, which is currently set at 10% of gross rents, will be abolished and replaced with a renewals relief available to all residential landlords based on the actual costs of replacing furnishings. A technical consultation will be published over the summer with further details.

RENT-A-ROOM RELIEF

Rent-a-Room relief will be increased from £4,250 to £7,500 from April 2016.

BUSINESS TAXES

CORPORATION TAX RATE

It was announced that the main rate of corporation tax which fell to 20% from 1 April 2015 will fall further to 19% from 1 April 2017 and to 18% from 1 April 2020.

Financial forecasts and deferred tax calculations will need to be updated for the new rates.

ANNUAL INVESTMENT ALLOWANCE ('AIA')

The AIA which has been at the level of £500,000 since 1 April 2014 will reduce to a new permanent level of £200,000 with effect from 1 January 2016. Transitional rules will apply to accounting periods that span the effective date.

CORPORATION TAX PAYMENT DATES

The payment dates for the largest companies (those with taxable profits greater than £20 million) will be brought forward to the 3rd, 6th, 9th and 12th months of an accounting period (currently the 7th,10th,13th and 16th). For groups the £20 million limit is divided by the number of members of the worldwide group. This change is effective for accounting periods commencing on or after 1 April 2017.

RESTRICTION OF CORPORATION TAX RELIEF FOR BUSINESS GOODWILL AMORTISATION

Corporation tax relief for the amortisation of purchased intangible assets linked to business reputation and customer relationships will be withdrawn for purchases after 8 July 2015.

EMPLOYMENT ALLOWANCE

For the majority of employers the first £2,000 of employer's national insurance contributions each year is currently tax free. This will increase to £3,000 from April 2016. However this will be withdrawn completely for companies where the director is the sole employee.

OWNER MANAGED BUSINESSES

A number of measures announced in the Budget are designed to close the tax gap between operating as a company versus a sole trader (increase in dividend tax rates, restriction on corporation tax relief on goodwill, employment allowance).

The reforms will be of particular interest to owner-managed businesses with the choice of extracting profits by taking dividends or salary. Previous calculations will need to be revisited to establish the best approach going forwards, depending on the individual's circumstances.

ANTI-AVOIDANCE

COMMON REPORTING STANDARD ('CRS')

The CRS is a commitment to the automatic sharing of information with tax authorities in other jurisdictions. This is due to come into effect from January 2016, with the first reporting (of the 2016 data) expected to take place in September 2017. The government announced that they will legislate to require financial intermediaries (including tax advisers) to notify their customers about the CRS, the penalties for evasion and the opportunities to disclose.

HMRC DIRECT RECOVERY OF DEBTS

Direct Recovery of Debts will give HMRC powers to recover cash directly from bank accounts where there is tax due. Having widely consulted, these measures will be subject to more safeguards than were included in the original proposal including a county court appeal process and a face-to-face visit to every debtor before they are considered for debt recovery through this measure.

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