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CHARTERED ACCOUNTANTS

2016 BUDGET UPDATE

Introduction

Budget 2016 contained several surprises, with perhaps the most notable highlight being the reduction in capital gains tax rates for individuals and trustees.

The potential uproar over planned changes to tax relief on pensions led the Chancellor to abandon any major reform of the existing rules in this Budget, whilst paving the way for future changes by introducing the new 'Lifetime ISA'.

Individuals

Capital gains tax rates

From 6 April 2016, the higher rate of capital gains tax will reduce from 28% to 20%. The lower rate will reduce from 18% to 10%. The new rates apply to disposals made by both individuals and trustees.

The new rates do however exclude taxable gains on residential property and the receipt of carried interest, both of which will continue to be taxed at the old rates. The rate applicable to ATED-related chargeable gains also remains unchanged at 28%.

This change means individuals and trustees should consider delaying any proposed disposals to take advantage of the lower rates.

'Investors' Relief'

The Chancellor effectively increased the availability of Entrepreneurs' Relief ('ER') by introducing a new relief for 'long-term' external investments in unlisted trading companies, with a 10% rate applying to a lifetime limit of £10 million of gains.

The lifetime limit is separate to the existing ER lifetime limit. The relief will only apply to capital gains made on shares subscribed for by individuals (other than employees and officers of the company) from 17 March 2016, which are held for a continuous period of three years from 6 April 2016.

Entrepreneurs' Relief – other changes

Several other minor changes were made to ER. These include slightly extending the availability of ER on 'associated disposals', joint ventures and corporate partners, and disposals of goodwill.

The government will also review the definition of a trading company for ER purposes to ensure that the relief operates as intended.

Company distributions

Although not announced as part of Budget 2016, it is worth noting that in December 2015 the government announced a tightening of the rules surrounding distributions from companies on winding up. This included amendments to the existing 'Transactions in Securities' anti-avoidance rules. It also included a new anti-avoidance rule which can apply where an individual receives a distribution on the winding up of a company, but then sometime in the next two years is involved in a similar trade or activity to that which was carried out by the company.

Where these anti-avoidance rules apply, the distribution will be treated as income rather than capital for tax purposes. This means that Entrepreneurs' Relief (including the new Investors' Relief) and the new lower capital gains tax rates are irrelevant and the distribution is taxed at the rates applicable to dividend income which are increasing from 6 April 2016 to 7.5%, 32.5% and 38.1%.

Employee shareholder gains

Employees who have acquired shares on or after 17 March 2016 under the 'employee shareholder' arrangements will be subject to a lifetime cap of £100,000 of gains eligible for exemption. There was previously no cap on the capital gains that could be relieved under these provisions, and any gains on shares acquired prior to the operative date continue to be uncapped.

This is a significant change to the treatment of employee shareholder shares and we expect this will result in the use of these shares reducing.

ISAs

The annual ISA subscription limit is to be increased to £20,000 from 6 April 2017.

Also from 6 April 2017, a new 'Lifetime ISA' will be available to anyone under the age of 40. Individuals can save up to £4,000 each year in the new Lifetime ISA and will receive a government top-up of 25% of their annual savings. Savings that attract government contributions can continue to be made up to the age of 50, and can either be used to purchase a first home (value capped at £450,000), or can be extracted tax-free in retirement (from age 60).

If an individual needs to access the Lifetime ISA funds for other purposes they can do so at any time, minus the government's contribution and a 5% 'access fee'. The government will consider whether savers should be able to borrow from the Lifetime ISA without losing their accrued government contributions.

Existing Help to Buy ISAs will be eligible for transfer to the new Lifetime ISA from 2017/18 onwards.

Pensions

The government published the outcome to the consultation document 'Strengthening the Incentive to Save' alongside the Budget. It was felt that the lack of consensus among respondents discouraged any fundamental changes to tax relief on pensions at present. The significant changes to pensions that were explored in the consultation document have therefore been put on hold and, following the previously announced reductions to the annual and lifetime allowances, no further revisions were made.

Tax-free allowances

Two new tax-free allowances will be introduced from 6 April 2017 in the amount of £1,000 each. These allowances can be set against income from property and income from trading.

The allowances are targeted at users of the 'sharing economy', for example those who occasionally rent out their home or sell small numbers of goods online with a view to a profit. Individuals who choose to claim the relief must pay tax on the gross income they receive less the £1,000 allowance. Alternatively, if the allowance is not claimed then taxpayers may continue to deduct any relevant expenses in calculating their net profit subject to tax.

Class 2 NICs

These will be abolished with effect from 6 April 2018 onwards. Entitlement to contributory benefits for self-employed individuals will be based on class 4 NICs from 2018/19 onwards.

Non-UK domiciled individuals

It was expected that the response to the non-dom consultation document would be published alongside the Budget. Unfortunately this response was not released and very little clarification was provided in respect of many of the continuing uncertainties, in particular the tax position of distributions from excluded property trusts post-6 April 2017. We now understand that the consultation document response, along with the relevant draft legislation, should be published by 23 May 2016.

There were however a couple of updates. The government confirmed their intention that non-doms who become deemed-domiciled in April 2017 can treat the tax base cost of their non-UK assets as being the market value on 6 April 2017 for capital gains tax purposes. In addition, individuals who expect to become deemed UK domicile under the 15 out of 20 year rule will be subject to 'transitional provisions' with regards to offshore funds to provide certainty on how amounts remitted to the UK will be taxed. This is a potentially significant change to the existing rules.

We await further detail on both of these points.

Employment

Intermediaries legislation

Individuals working for the public sector through personal service companies will no longer be able to decide if they should be on or off the payroll of the public service body. Liability to pay the correct taxes and NICs will shift from the intermediary to the public sector body/agency, which could result in strong resistance to contracting with intermediaries. It is anticipated that this shift in liability from the intermediary may extend to non-public sector businesses in future.

Salary sacrifice

The government is considering limiting benefits that attract income tax and NIC advantages through salary sacrifice schemes. At present the government does not intend to limit the benefit that such schemes confer with regard to pension saving, childcare, and health-related benefits such as Cycle to Work.

Termination payments

From 6 April 2018 termination payments over and above the £30,000 exemption will be subject to employer's class 1 NICs.

The eligibility criteria for the £30,000 exemption will be tightened as part of the 2017 Finance Bill. The intention is that all types of payments in lieu of notice (PILONs) will become taxable along with some damages payments which would currently be eligible for the exemption. The government intends to launch a technical consultation on the changes in due course.

Companies

Corporation tax rates

The main rate of corporation tax will be reduced to 17% by April 2020. It had previously been announced that the rate would reduce to 18% from April 2020

Loans to participators

There will, however, be an increase in the tax charged on loans to participators in close companies (known as 's455 tax'), from the current rate of 25% to the higher rate of 32.5% for loans made from April 2016 onwards. This mirrors the increased higher tax rate on dividends from April 2016.

Losses

Currently losses carried forward by a company can only be used by that company, and can only be used to relieve certain types of profits. For example trading losses carried forward can only be used against future profits arising from the same trade. From 1 April 2017 businesses will be able to offset carried forward losses against profits of other companies in the group, or against different types of profits within that company.

This change will make carried forward losses significantly more flexible. The effect will not be immediate however as the new rules will only apply to losses incurred from April 2017.

Also from 1 April 2017, restrictions will be introduced to limit corporate loss relief claims for profits in excess of £5 million, such that these companies will only be able to offset a maximum of 50% of their profits using brought forward unrelieved losses. It is unclear at this stage how the £5 million profit threshold will be applied, but we would hope that the restriction would only apply to the excess of profits over the threshold.

Interest deductions

The government has also announced that it will cap the amount of relief for interest to 30% of taxable UK earnings, or based on the net interest to earnings ratio for the worldwide group. This will apply to most companies with a net interest expense in excess of £2 million; once again we do not yet have the detail of how the rules will be implemented. The purpose is to avoid multinationals shifting profits to low-tax jurisdictions through excessive interest deductions in the UK company.

Stamp Duty Land Tax (SDLT)

Residential property

The Chancellor previously announced that increased rates of SDLT would apply to individuals who already own an interest in residential property anywhere in the world, who purchase an additional interest in a UK residential property. Companies will also be liable to the higher rates even if it is the company's first purchase of residential property. The new rates apply to transactions that complete on or after 1 April 2016.

The SDLT rate will increase by 3% for each band apart from £0 to £40,000. If a main residence is replaced but there is an overlap in ownership of the old and new properties, the higher rates of SDLT must still be paid but the difference can then be reclaimed. The Budget announced that the maximum permitted overlap period for claiming a refund on the higher rates would be 36 months rather than 18 months as originally proposed.

The government confirmed that the planned exemption for investors with high numbers of residential properties will not now be implemented, meaning that the higher rates of SDLT will apply to all individuals, companies, and certain trustees.

Non-residential property

SDLT charged on freehold and lease premium transactions for non-residential property will be reformed, such that the SDLT is calculated by reference to three 'slices' (£0-£150K at 0%, £150-250K at 2% and £250K+ at 5%), rather than the old 'slab' system. These new rates apply to transactions that complete on or after 17 March 2016. There will be transitional provisions for contracts which have exchanged, but not completed, before this date.

The government will also introduce a new 2% rate for non-residential leasehold rent transactions where the net present value is over £5 million.

Anti-avoidance

Disguised remuneration

The government has brought forward a package of reforms to tackle the use of disguised remuneration avoidance schemes, including a targeted anti-avoidance provision connected to Employee Benefit Trusts and the abolition of relief for investment returns within these schemes. Furthermore, a new charge will be introduced on loans made through disguised remuneration schemes that remain outstanding as at 5 April 2019.

Trading and developing – UK land

The Budget announced a crack-down on the use of offshore structures used for UK property development and that HMRC will create a task-force to focus on offshore property developers to achieve 'long term improvement in taxpayer compliance'. The change to the rules will bring UK property dealing or development profits within the scope of UK corporation tax irrespective of whether the company carrying out the activity is resident in the UK or has a permanent establishment in the UK.

Royalty withholding tax

Income tax is currently withheld at source from payments made to non-residents in respect of certain royalty payments. Withholding tax requirements will be extended to cover all royalty payments made in respect of intangible assets, for example trademarks and brand names. This will apply to all payments connected with the activities of a business liable for tax in the UK.

The government will also introduce a domestic law to prevent our tax treaties being abused by royalty payments being routed through third countries to gain a tax advantage. This will apply where royalty payments are made to a connected person as part of arrangements to obtain a tax advantage through a double taxation agreement.

Both of these measures are intended to prevent multinational profits being transferred out of the UK to low-tax jurisdictions.

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