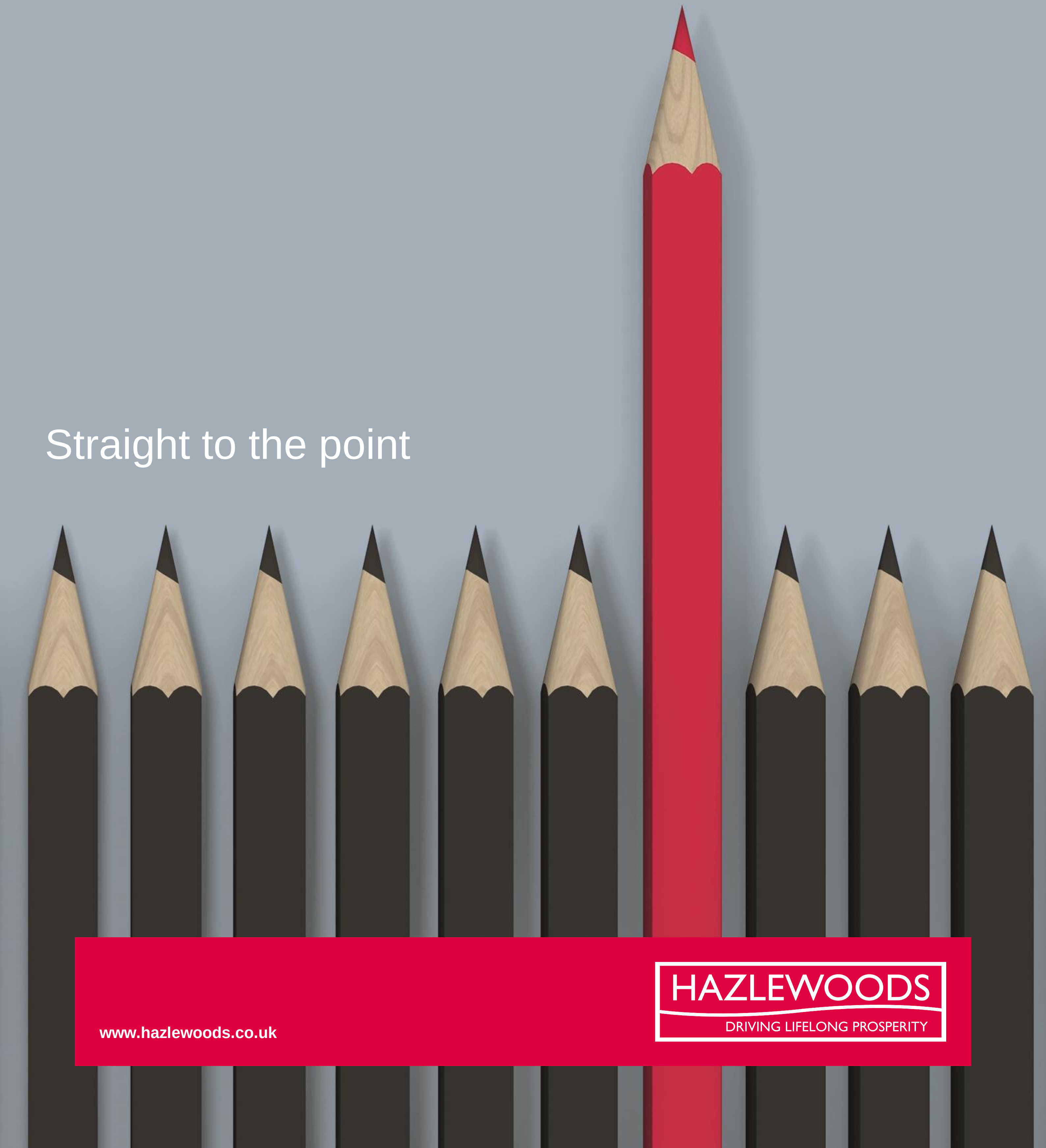
Budget 2016 analysis

March 2016



Straight to the point

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HAZLEWOODS
DRIVING LIFELONG PROSPERITY

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Introduction

GEORGE BACKS THE NEXT GENERATION

No, this is not the Chancellor's tip for Cheltenham Festival, but instead it was the focus of his Budget, something he mentioned a mere sixteen times throughout his speech.

George Osborne was able to make some pretty confident statements, including the fact that the Office for Budget Responsibility is predicting that the UK will be the fastest growing major economy in the world, whilst employment rates are currently the highest in the UK's history. Add to this the fact that our deficit has reduced by two thirds from when he took over and you can understand why he was in a buoyant mood.

There were a lot of tax announcements made during his 64 minute speech, most of which were a surprise, which makes a change from previous Budgets where the bulk of the detail has been leaked in advance.

One of the biggest surprises was the reduction in the capital gains tax rates, from a main rate of 28% to 20% and on the lower rate from 18% to 10%. Unfortunately, for buy to let investors, the joy was short lived when the Chancellor announced there would be an 8% surcharge for residential property sales and for carried interest which affects Private Equity executives.

Corporation tax is to be lowered even further than originally predicted, with a commitment to a 17% rate by 2020.

Inevitably, there was his regular attack on large corporates, tax avoidance and evasion, with a range of measures seeking to bring in an extra £12bn in revenue by the end of the parliament.

Those measures include an increase in the tax charge on loans to shareholders from 25% to 32.5% and a restriction on the interest deductibility to 30% of the profits. For larger companies with profits over £5m the use of brought forward trading losses will be restricted to 50% of the profits of the later year.

Beer, cider and scotch whiskey rates were frozen, as was fuel duty, which was widely tipped to be set for an increase, whilst the attack on smokers continues with a further 2% increase.

In an attempt to reduce the risk of childhood obesity, George is going to introduce a "sugar tax" from April 2018, chargeable on the manufacturers. The measure is expected to bring in £520m and all monies raised will be spent on school sports.

To assist the next generation to save for retirement, a pension ISA is to be available for those aged between 18 and 40, whereby up to £4,000 can be put in per year, which will be matched by 25% of the amount contributed, by the government. Is the start of the end of pensions? The Chancellor did confirm that the lump sum tax free amount will remain, which was a relief to many.

With his monies now firmly on the Next Generation, the hope is that he's onto a winner, but only time will tell.

Corporation tax

The Chancellor announced a mixed bag of measures making significant changes to the taxation of companies. Some good, some bad.

THE MAIN RATE

It was previously announced that the main rate of corporation tax (CT) would fall to 18% from 1 April 2020, but he has gone one step further and will reduce the rate to 17%.

TAX ON DIRECTORS' LOAN ACCOUNTS

Under current rules, where a close company (broadly, a company with five or fewer owners) loans money to an individual associated with the company, typically a shareholding director, then a tax charge of 25% is due on the balance of the loan at the company year end. From 6 April 2016, loans made after this date will be charged at an increased rate of 32.5%. As is currently the case, once the loan has been repaid, the tax paid may be reclaimed from HMRC.

Legislation will also be introduced to provide an exemption from this charge where loans are made to charity.

REPEAL OF THE RENEWALS ALLOWANCE

Previously, the cost of replacement or alteration of tools and small equipment was a deductible costs against profits of a business. This measure will mean that expenditure of this type will be treated on the same footing as acquisitions of any type of equipment, essentially subject to the capital allowances regime. Further detail has not yet been released but this could have a detrimental affect on businesses unable to claim capital allowances, such as corporate or non-corporate residential landlords, although a previously announced provision to allow a deduction for replacement furnishings may mitigate the impact.

REFORM OF CORPORATE LOSS RELIEF

From 1 April 2017, a positive change is that brought forward losses will be available to set against any type of profit, and by any company in the same group. However, loss relief will be restricted for larger companies, so that only 50% of profits above £5m may be relieved. The £5m threshold will apply to whole groups as well as stand alone companies.

CHANGE TO QUARTERLY INSTALMENT DATES

Summer Budget 2015 announced a change to bring forward the quarterly payment dates applicable to large companies by four months. This measure has been delayed by two years to accounting periods ending on or after 1 April 2019 to give businesses time to adapt.

LOW EMISSION CARS

First Year Allowances of 100% for low emission cars (<50g/km CO_2) is to be extended from 2018 to 2021. The main rate of capital allowances will fall to 8% for cars with emissions of 110 g/km CO_2, down from the previous 130 g/km CO_2 with effect from 1 April 2018.

Corporation tax continued

ANTI-AVOIDANCE

A number of measures have been introduced to combat what is perceived by parliament as the artificial reduction of profits, especially where there is an overseas connection. Legislation will place additional obligations to tax royalty payments at source when paid by UK companies, combat the exploitation of so called “hybrid-mismatches” (broadly where rules in different jurisdiction cause costs to be allowable in one country, but exempt as income in another), and update transfer pricing regulations, in particular focusing on a new rule to limit interest relief to 30% of a group’s EBITDA (Earnings before interest, tax, depreciation and amortisation), subject to a £2m de minimis threshold.

DISGUISED REMUNERATION

Not content with just accelerated payment notices, follower notices and the introduction of the common reporting standard, there will be a renewed attack on individuals who received loans from structures such as employee benefit trusts which remain unpaid at 5 April 2019. It is parliament’s intention that these measures will put beyond doubt that the loans are subject to tax under the disguised remuneration provisions

Employment taxes

TAX-FREE CHILDCARE

There was a minor update on Tax-Free Childcare, which is set to be introduced in early 2017 and will replace the existing Employer Supported Childcare scheme (childcare vouchers). We now know that there will be a phased roll out of the new scheme, with the youngest children being eligible first and all families becoming eligible by the end of 2017.

The existing childcare vouchers scheme will remain open to new entrants until April 2018 rather than being closed when the new scheme is launched. This gives families a little longer to decide whether or not they will be better off staying in the existing scheme or moving over to the new one.

As a reminder, the new scheme allows parents to save up for childcare using a new account, where every £8 saved by the parents is topped up by £2 from HMRC. This allows parents to save up to £10,000 per year (£8,000 from the parents and £2,000 from the government) for each child.

TERMINATION PAYMENTS

There is to be a tightening of the rules on termination payments, which the government has identified as an area open to manipulation by employers. It was confirmed that the £30,000 exemption for termination payments will remain, but that the scope of the exemption will be reduced.

Payments in excess of the £30,000 are already subject to income tax. It was announced that from April 2018 they will be subject to employer's (but not employee's) national insurance contributions (NICs) too.

SALARY SACRIFICE

Not unexpectedly, it was announced that the government is considering limiting the range of benefits that attract tax relief as part of a salary sacrifice arrangement. Salary sacrifice works by allowing employees to trade a deduction in their gross pay for a range of benefits, saving income tax and NICs. If the benefits are taxable and subsequently declared on P11Ds, the income tax and employer's NICs are clawed back, but the employee's NICs are not, which can resulting in significant savings.

The government's intention is that salary sacrifice for pensions, childcare and health-related benefits such as cycle to work should not be affected, but we can expect changes for other arrangements, such as accommodation and company cars.

Individuals

PERSONAL TAX

Not a huge amount of change in the Budget relating to general personal tax matters which is not necessarily a surprise given the revolutionary changes to dividends and saving rates announced in the 2015 Summer Budget.

The government previously committed to raising the personal allowance to £12,500 over this parliament and they made a move in this direction in the 2016 Budget by increasing it to £11,500 for 2017/18. The personal allowance was already set to rise to £11,000 for 2016/17 and that is still the case.

In addition the Chancellor has reiterated his wish to remove more people from the higher rate tax band. The higher rate band will increase from £32,000 in 2016/17 to £33,500 in 2017/18. This taken with the personal allowance rising will mean that in 2017/18 an individual will be able to earn £45,000 without paying higher rate tax. This is set to benefit 28.9 million individual taxpayers.

For the self-employed the announcement of the withdrawal of Class 2 NICs will have been welcome. This will have effect from April 2018 and will save individuals that currently pay these contributions approximately £150 per year.

The most exciting announcement on income tax was the introduction of two new allowances. There will be a £1,000 allowance for trading income and another £1,000 for property income. This will mean that individuals with property or trading income below £1,000 will not need to submit tax returns. The aim is for fewer people to need to be in the system ahead of tax 'going digital'.

Individuals with trading or property income over £1,000 will have the choice of calculating their profits in the normal way (deducting the relevant expenses) or simply knocking off the allowance in the same way as under rent a room relief.

ISA LIMIT RISES AND NEW LIFETIME ISA FOR UNDER 40S

ISA SAVING LIMIT

The annual ISA savings limit is rising from £15,240 to £20,000 for all adults from April 2017.

NEW LIFETIME ISAS

Those between the age of 18 and 40 will be able to save up to £4,000 per year in a lifetime ISA from April 2017 until they turn 50. To this the government will add a 25% bonus so that those who save the maximum each year will receive a state top up of £1,000. The fund is expected to be more flexible than a pension and it is possible to withdraw funds from the ISA at any time before reaching 60 but this will mean losing the government bonus and paying a 5% charge.

The ISA funds can be used by first time buyers for a home worth up to £450,000. The ISA accounts are limited to one per person so a couple can both receive the bonus when buying together. It can also be taken as a tax free retirement fund at the age of 60.

NON-DOMICILED INDIVIDUALS

Proposals had already been made to bring in significant changes to the deemed domicile rules for UK taxation with effect from 6 April 2017. Broadly, individuals who have been resident for 15 of the last 20 years, or are resident and have a domicile of origin in the UK, will be treated as if they are domiciled for all UK taxes.

Budget 2016 confirms that affected individuals will be able to rebase their non-UK assets to market value at 6 April 2017. All non-domiciled reforms will be legislated in Finance Bill 2017.

Capital Gains Tax

In his Budget speech today the Chancellor continued a long standing tradition of tinkering with the taxation of capital gains. On this occasion it was rather more than tinkering and leaves the UK with a system of capital gains tax that aims to encourage investment in businesses.

The headline grabbing measure was a reduction in the rates of capital gains tax taking the maximum rate down from 28% to 20% and the lower rate from 18% to 10%. Those with buy to let properties and second homes need not get too excited however, as the measure will not apply to residential properties. The new rates will also be disapplied for gains on “carried interests” held by private equity executives.

ENTREPRENEURS’ RELIEF

Entrepreneurs’ relief (ER) was introduced in 2008 and allows individuals to benefit from a 10% rate of capital gains tax (CGT) on the disposal of certain business assets. It has proved to be a very generous and popular relief, perhaps too popular, as the rules have been significantly tightened in recent years.

Amongst a raft of changes was the announcement that from 3 December 2014 the disposal of goodwill to a connected company would no longer qualify for ER, effectively ending the possibility of claiming it, in respect of goodwill on business incorporations.

The March 2015 Budget restricted ER in respect of ‘associated disposals’ of privately held assets used in a business to those accompanied by a disposal of at least a 5% shareholding or 5% partnership share.

Changes were also brought in that effectively removed the availability of ER on the disposal of shares in joint venture companies and corporate partners.

There has been much criticism of these legislative tweaks due to their impact on genuine commercial transactions. Anti avoidance provisions designed to stop people circumventing the new rules have meant that disposals of goodwill to a third party, where the consideration includes even a very small stake in the acquiring entity, have been problematic, as have disposals of privately held business assets where the accompanying business disposal is to family members.

In response to this criticism, the Chancellor has tweaked the rules again, recognising that this is necessary to reverse what were essentially unintended consequences of the original provisions; the changes will be backdated.

BACKDATED TO 3 DECEMBER 2014

It will be possible to claim ER on the disposal of goodwill to a close company (broadly one controlled by five or fewer) where the claimant holds or acquires shares in the acquiring company, as long as that shareholding is less than 5%. This opens up the possibility of disposing an unincorporated business to a third party, receiving both cash and a small amount of equity as consideration and still claiming ER.

A further welcome measure is the decision to allow ER on incorporation where this is undertaken as part of arrangements for the sale of the business to an independent owner.

Capital Gains Tax continued

BACKDATED TO 18 MARCH 2015

The anti avoidance provisions are to be amended so that ER should now be available on the 'associated disposal' of a privately held business asset when the accompanying disposal of shares or partnership interest is to a family member.

Another positive announcement, for family businesses in particular, was that the 5% minimum disposal requirement will be relaxed for 'associated disposals' where the claimant disposes of the whole of their interest and has previously held a larger stake.

The rules on ER for joint venture companies and corporate partners have also been softened. Legislation is to be introduced so that a company which holds shares in a trading company will be treated as carrying on a proportion of the activities of that company, corresponding to its fractional shareholding in it. So an individual who has an indirect holding of at least 5% in the joint venture company and effectively controls at least 5% of the voting rights may potentially qualify for ER.

For corporate partners, the rules will apply if the individual making the disposal is entitled to at least 5% of the partnership's assets and profits and controls at least 5% of the voting rights in the corporate partner.

The full effect of these measures won't be known until the draft legislation is released, but they open up the possibility of a claim to ER for a range of commercial transactions where it was previously unavailable.

NEW INVESTORS ENTREPRENEURS' RELIEF

In addition to this fundamental change the generous provisions of entrepreneurs' relief (ER) were extended. Currently the 10% rate is only available to taxpayers who have for at least twelve months held a 5% holding in an unquoted trading company of which they are either an employee or director. The revised "investor" relief will simply require that the taxpayer subscribes for shares, rather than acquiring them from another shareholder, and holds them for at least three years. The rationale for this seems to be a desire to encourage investment into these companies. This is a separate £10m lifetime limit, meaning that individuals will be able to make gains of up to £20m (£10m as an employee and £10m as an investor) and benefit from the 10% rate.

To some degree this seems to cut across the Enterprise Investment Scheme (EIS) which has for many years been the main incentive for taxpayers looking to invest in smaller and riskier private companies. It is worth noting that EIS has been the subject of much anti-avoidance regulation over the years and is unpopular with our European colleagues. The introduction of this extension to ER might just be a prelude to the demise of that much maligned regime.

EMPLOYEE SHAREHOLDER STATUS

Another development is of interest to those who are looking to incentivise their employees through the recently introduced Employee Shareholder Status. This scheme, sometimes know as "shares for rights" gave an opportunity for participants to enjoy an unlimited exemption from capital gains tax. The exemption has now been capped at £100,000 for awards made after 16 March 2016. The scheme, which was slow to gain acceptance but has become more popular in recent times, will now perhaps play a more conventional role in the employee share schemes market.

Business rates

SMALL BUSINESS RATE RELIEF

This has been doubled and made permanent from 1 April 2017. There will be 100% relief for eligible properties with rateable values up to £12,000 with the relief tapering to 0% for eligible properties with rateable values up to £15,000. This means 600,000 small businesses will pay no business rates at all i.e. one-third of all business properties will benefit. A further 50,000 businesses will benefit from tapered relief.

RISE IN BUSINESS RATES THRESHOLD MULTIPLIER

The standard multiplier threshold will increase from £18,000 to £51,000 for business properties outside of Greater London. This total is multiplied by the current standard multiplier supplement. This is then adjusted to reflect future years inflation which will use the Consumer Prices Index from April 2020 rather than the current Retail Price Index.

Rateable values are based on a ratings list from 2010 which is due to be updated in 2017.

Stamp Duty Land Tax (SDLT)

The Chancellor has enjoyed fiddling about with SDLT in recent years, overhauling the residential SDLT system in his 2014 Autumn Statement and announcing the new additional rate for second homes in the 2015 Autumn Statement.

The latter announcement was formalised in the 2016 Budget. An additional 3% will be charged on the purchase of second homes and buy to let properties from 1 April 2016. If, at the end of the day of the transaction, the purchaser owns two or more properties and has not replaced their main residence, then the extra tax will be charged.

If there is an overlap in the ownership of two main properties then the purchaser will have 36 months to sell the previous property and claim a refund.

For companies, the additional SDLT rate will apply to all purchases of residential property, not just on subsequent purchases. HMRC had consulted on exemptions for companies with large property portfolios (over 15 properties) but Osborne confirmed in his Budget speech that this would not be the case and all companies would be subject to the additional charge.

On non-residential property there were also changes. It had seemed odd that back in 2014 the residential SDLT system was completely revamped from a cliff-edge structure to a progressive banding method whilst the taxation of non-residential property stayed the same. This has now been aligned from 17 March 2016 with the following new rates for purchases:

- £0-£150,000 – 0%
- £150,000 - £250,000 – 2%
- Over £250,000 – 5%

The SDLT on leases on commercial property was already taxed on a marginal 'slice' basis but an additional rate has now been introduced for leases which have a net present value on the rent of over £5,000,000. These leases will now be subject to a 2% SDLT rate.

Sugar tax

A sugar tax will be imposed on soft drink producers in two bands according to the level of sugar content from April 2018. It will not be imposed on milk based drinks or fruit juices.

The £520 million raised each year will be used to offer more sports activities in both primary and secondary schools and expanding breakfast clubs in up to 1,600 schools from September 2017.

VAT

VAT REGISTRATION AND DEREGISTRATION

The government will increase the VAT registration threshold in line with inflation to £83,000 from 1 April 2016. This will save around 2,000 small businesses from having to register for VAT by the end of the 2016-17 financial year.

The deregistration threshold increases from £80,000 to £81,000.

TACKLING VAT EVASION BY OVERSEAS SELLERS

The government is taking firm action to protect the UK market from unfair online competition. Some overseas traders from beyond the EU avoid paying UK VAT, undercutting online and high street retailers and abusing the trust of UK consumers who purchase goods via online marketplaces.

The Finance Bill 2016 will contain provisions that will help to protect consumers and level the playing field for businesses. HMRC will be able to require non-compliant overseas traders to appoint a tax representative in the UK, will have greater flexibility in respect of seeking a security and will be able to inform online marketplaces of the traders who have not complied. If traders continue to evade VAT and no action is taken to prevent the fraud, then the online marketplace can be made jointly and severally liable for the unpaid VAT of an overseas business that sells goods in the UK via the online marketplace's website.

The government will also introduce a due diligence scheme for the fulfilment houses where overseas traders store their goods in the UK. This will make it harder for VAT evading firms to trade. Fulfilment houses will need to meet "fit and proper" standards in order to operate. They will have an obligation to register and maintain accurate records once online registration opens in 2018. They will also have to provide evidence of the due diligence they have undertaken to ensure overseas clients are following VAT rules. The UK has already raised this issue with the EU and international partners, and the EU and OECD's current work programmes include further work to help combat this fraud, including looking at alternative mechanisms for the collection of VAT.

TACKLING MARKETED TAX AVOIDANCE

The government will:

- consider the case for clarifying what constitutes reasonable care in avoidance penalty cases;
- consider options to address the issue of those who "enable" tax avoidance schemes; and
- consult during the summer on updating the VAT Disclosure of Schemes Regime (VADR),

including by extending coverage to other indirect taxes and by alignment with the Disclosure of Tax Avoidance Schemes (DOTAS) regime.

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