UK Budget 2016 - Swiss highlights

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The run-up to today's UK Budget was dominated by rumours of major changes to the taxation of pensions which did not materialise. Instead, there were announcements on CGT, SDLT, tax avoidance and evasion and the pending non-dom changes, not to mention the introduction of a sugar tax.

It may be that the Chancellor is fearful of too much criticism from his party, especially given the challenges it faces concerning the forthcoming EU referendum. Nevertheless, the Budget contained various announcements that, although not as headline-grabbing as in recent Budgets, will be of interest to clients of our Swiss offices and their advisers (and not just those with a sweet tooth).

Taxation of non-domiciliaries

As announced in the post-election Budget in July last year, there is to be a major reform to the taxation of non-UK domiciliaries ('non-doms') with effect from 6 April 2017. Today's Budget confirmed that individuals who have been UK resident for 15 out of 20 tax years will be deemed to be UK domiciled for all tax purposes – and will therefore be unable to claim the remittance basis. Individuals who were born in the UK and have a UK domicile of origin will also be deemed to be UK domiciled while they are resident in the UK, even if they have previously left the UK and managed to acquire a domicile of choice in another jurisdiction.

Although the broad scope of the changes was already clear, there are still a number of areas which remain to be clarified, particularly in relation to the treatment of non-UK resident trusts established by non-doms before becoming domiciled under the new rules. Unfortunately today's Budget announcement was also light on detail in this area. It confirmed that non-doms who have such a trust will not be taxed on income and gains retained in the trust, but did not give any clues as to how the proposed changes to the existing regime will work. Generally it appears that the government may have decided that it needs more time to consider the details of the changes, as it announced that all the non-dom reforms will be legislated in the Finance Bill 2017, rather than partly in 2016 and partly in 2017 as originally planned. At any rate, it is to be hoped that further details of the changes will be forthcoming soon, as we are finding that the lack of detail is making it difficult for clients to make plans.

In the meantime, there were a couple of helpful new announcements. Non-doms who become deemed domiciled in April 2017 will be able to treat the cost base of their non-UK assets as being the market value of the assets on 6 April 2017. Also, individuals who expect to become deemed domiciled under the 15 out of 20 year rule will be subject to transitional provisions relating to offshore funds, to provide certainty on how remittances to the UK from those funds will be taxed.

Not so very long ago it was accepted in the UK that there was a clear distinction between tax evasion (illegal) and tax avoidance (legal, albeit not popular with HMRC and open to challenge in the courts). It has been clear for a while that those days are gone. In addition to the now customary rhetoric about the government's crack-down on 'all forms of evasion and avoidance, and aggressive tax planning and compliance', Budget 2016 included a number of new measures which are expected to raise a total of £12 billion. Some of these are specifically targeted at multinational companies, but there are also several measures which are potentially relevant to international individuals.

AS ANNOUCED IN THE AUTUMN STATEMENT IN NOVEMBER 2015

(i) there is to be a new criminal offence for tax evasion, which will remove the need to prove intent for the most serious cases of failing to declare offshore income and capital gains;
(ii) civil penalties for deliberate offshore tax evasion will increase, including the introduction of a new penalty linked to the value of the asset on which tax was evaded and increased public naming of tax evaders;
(iii) new civil penalties are to be introduced for those who enable offshore tax evasion, including public naming of those who have enabled the evasion;
(iv) there is to be a new penalty of 60% of the tax due in all cases which are successfully tackled by the UK General Anti-Avoidance Rule (GAAR). There will also be small changes to the GAAR procedure to improve its ability to tackle marketed avoidance schemes.

These measures will be included in the Finance Bill 2016.

NEW MEASURES AND SANCTIONS

A significant new measure is that the government will also be introducing a new legal requirement to correct past offshore non-compliance within a defined period of time, with new (as yet unspecified) sanctions for those who fail to do so. This measure will be included in the Finance Bill 2017.

Although the Budget did not contain any mention of the Common Reporting Standard (CRS), anyone who may be affected by these measures and is within the scope of CRS would be well advised to come forward before it is fully up and running.

UK real estate

Recent Budgets have contained unwelcome announcements for foreign owners of UK real estate, including the introduction of the Annual Tax on Enveloped Dwellings ('ATED') and the gradual increase in its scope; the introduction of Non-Resident CGT ('NRCGT'); increases in rates of stamp duty land tax ('SDLT'); and the introduction of rules removing the IHT benefits of holding UK residential property via a non-UK envelope.

This Budget continues the trend and contains the following provisions, which will affect clients wishing to invest in UK real estate.

INCREASE IN RATES OF SDLT ON ACQUISITION OF COMMERCIAL PROPERTY.

The rates of SDLT payable on purchases of non-residential (or mixed) properties will change with effect from tomorrow.
For purchases of freehold properties, assignments of existing leases and upfront payments of premiums on new leases, a 'slice' system similar to that which was recently introduced for residential property, will apply. The top rate of tax has increased from 4% to 5%. The effect of the new charging provisions is that transactions worth less than £1.05m will pay the same SDLT or less compared to the current system, whilst those worth more than £1.05m will suffer an increased charge to SDLT.

Where SDLT is chargeable in relation to the rent on new leases, the top rate of tax has been increased from 1% to 2%. This change will affect transactions with a rent NPV of over £5m.

Where contracts have already been exchanged but transactions have not yet completed, purchasers can choose whether to apply the old or new rates.

INCREASE IN RATES OF SDLT ON ACQUISTION OF SECOND RESIDENTIAL PROPERTY.

From 1 April 2016, higher rates of 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% above the current SDLT rates for residential properties.

The changes do not affect individuals replacing their main residence and there are provisions for claiming a refund where there is a period of overlap or a gap of ownership of a main residence. Small shares in recently inherited properties will also be disregarded and will not count as a second home.

Purchases of additional properties by the trustees of trusts will be liable at the higher rates. Bare trusts will be looked through so as to determine the number of homes owned by a beneficiary, and trusts with mandatory beneficiaries will be tested based on the circumstances.

The changes are expected to affect 10% of residential property transactions.

IHT AND ENVELOPED PROPERTY

The Government confirmed that it will legislate to charge inheritance tax on all UK residential property indirectly held through an offshore structure from 6 April 2017.

This will remove the last remaining tax benefit of holding UK residential property through an offshore structure.

OFFSHORE PROPERTY DEVELOPERS

The UK government will introduce legislation in Finance Bill 2016 to ensure that offshore structures cannot be used to avoid UK tax on profits that are generated from developing UK property. This will take the form of specific legislation to tax trading profits derived from land in the UK. They will apply to both resident and non-resident business and will apply regardless of whether the developer has a 'permanent establishment' in the UK. Anti-avoidance rules will be put in place to counteract arrangements put in place between now and the date the legislation comes into force.

HMRC will also create a task force to focus on offshore property developers and will target offshore structures used to avoid tax on profits and rental income from property development in the UK.

Capital gains tax ('CGT')

DECREASE IN RATES

A rare piece of genuinely good news for UK taxpayers came with the announcement that rates of CGT are to be cut. At present the rates are 18% for basic rate taxpayers and 28% for higher and additional rate taxpayers. For gains accruing after 5 April 2016, the new rates will be 10% for basic rate payers and 20% for higher and additional rate taxpayers.

However, UK residential property owners need not get too excited since the new rates of tax will not apply on the disposal of residential property that does not qualify for principal private residence relief. Similarly, the rates chargeable in relation to NRCGT payable by companies (20%) and ATED related gains (28%) will not change.

VARIOUS CHANGES TO CGT ENTREPRENEURS RELIEF ('ER')

ER is a potentially valuable CGT relief for individuals and (in certain cases) trustees. It operates by applying a rate of CGT of 10% on 'qualifying business disposals' up to a lifetime limit per individual (currently £10m). Examples of qualifying business disposals include the sale of shares in a personal trading company and the transfer of the whole or part of a business by an individual. The changes contained in today's Budget include:

(i) EXTENSION TO LONG-TERM INVESTORS

To provide a financial incentive for individuals to invest in unlisted trading companies over the long term, ER will be extended to external investors in unlisted trading companies providing certain conditions are met (including the conditions that the shares in the unlisted trading company must have been issued on or after 17 March 2016 and that the shares have been held for a minimum period of three years at the date of disposal).

Anti-abuse provisions will also be introduced to ensure that the relief is only available where subscription for shares is for genuine commercial reasons (and not for tax avoidance purposes).

(ii) EMPLOYEE SHAREHOLDER SHARES

There will be a lifetime limit of £100,000 on the CGT exempt gains a person can make on the disposal of shares acquired under Employee Shareholder Agreements entered into after 16 March 2016.

(iii) ABUSE OF ER

Changes have also been announced to strengthen anti-abuse rules introduced by Finance Act 2015. These will specifically be targeted at the treatment of joint ventures and partnerships and relief on associated disposals.

Life insurance policies

The UK has a special tax regime for certain life insurance products. In broad terms, this regime offers tax deferral on income and gains realised on the assets held through the insurance wrapper and allows tax-free withdrawals of the initial premium to be withdrawn over time under the '5% rule'. However, partial surrenders in excess of the permitted limit are chargeable and can be disproportionately harshly taxed. The government's announcement today that it will change the current tax rules for part surrenders and part assignments to prevent excessive tax charges arising on these products is therefore good news. The government will consult later this year on alternatives to the current rules with a view to legislating in Finance Bill 2017.

Another piece of good news is that the government intends to consult later this year on changes to the class of assets that policyholders can choose to invest in without giving rise to an annual tax charge under the penal 'personal portfolio bond' rules. This is likely to be beneficial to, inter alia, individuals who are considering moving to the UK and have already invested in life insurance products which could fall foul of the current rules.

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