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UK Budget 2016: CGT, stamp duty, more anti-avoidance and a boost for entrepreneurs

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By George it's a (sugar free) sweetener…

Against what he described as a backdrop of storm clouds gathering, George Osborne sought to deliver an upbeat Budget with a surprising amount of good news.

There are, as we have come to expect, a number of headline-grabbing measures, chief of which is likely to be the reduction of capital gains tax from 28% to 20% for higher rate taxpayers, as of 6 April 2016. This is, of course, subject to some caveats but that is no more than we have come to expect. Not just favouring individuals, we will see the corporation tax rate reduced to 17% by 2020, making the UK one of the most competitive jurisdictions in the EU from that perspective. Combined with the extension of entrepreneurs' relief to passive investments in unlisted businesses, this goes a good way to making the UK a very attractive place to do business.

How is this all to be paid for? This is especially interesting given that tax policy decisions only generate revenue from 2019/20, and indeed cost £960m and £470m respectively over the 2017/18 and 2018/19 tax years. The answer, which should come as no surprise, is in part by a further clampdown on avoidance. The much discussed GAAR is to be strengthened by the introduction of a penalty of up to 60% of any tax counteracted by it. Might this be to discourage those tempted to perform a little alchemy by converting income into capital, given the growing disparity in rates? Let us also not forget that, as of April 2017, longer term non-domiciled residents will be taxed on their worldwide income and gains (at least in relation to directly held assets), which seems likely to generate some revenue. While we await firm details of this, there was a helpful indication as to rebasing today.

We summarise the main measures below and also include the projected cost or benefit of each of the measures where this has been provided in the Budget papers.

Capital gains tax (CGT)

The applicable rate of CGT for all gains realised as of 6 April 2016 will be reduced to 20% from 28% for higher rate taxpayers and to 10% from 18% for basic rate taxpayers, though these lower rates will not apply to gains on residential property and carried interest. The exception for carried interest builds on the move to tax this as performance rather than investment related.

Meanwhile, for all those who do not benefit from principal private residence relief, the decision to leave the tax on gains on residential property at the old higher rates is a further disincentive to residential property investment. When allied with the higher rate of SDLT for second homes and the non-resident CGT charge, this is increasingly likely to distort the property market and discourage passive investors.

Practically, anyone contemplating a significant realisation event will wish to defer the disposal until after 6 April 2016 so as to benefit from the reduced rate.

Fiscal cost – £2,745m to 2021

Stamp duty land tax (SDLT)

Higher rate for second homes

The extra 3% SDLT charge for the purchase of second homes that was announced in the 2015 Autumn Statement has been confirmed.

Fiscal benefit – £3,735m to 2021

Tax rates for non-residential property

The Government is bringing the SDLT regime for non-residential and mixed use property into line with that for residential property by changing to a system under which different slices of value are charged at different rates. For non-residential and mixed used property, the rate applicable to the value between £150,000 and £250,000 will be 2% and the rate chargeable on value above £250,000 will be 5%. The new rates will apply to exchanges that occur after midnight on 16 March 2016, and contrast with current flat rates of 1% applicable where the purchase price is between £150,000 and £250,000 and 4% where it exceeds £250,000.

It remains to be seen what impact this will have on the market.

Fiscal benefit – £2,585m to 2021

Entrepreneurs' relief

The Chancellor's proposed changes to the entrepreneurs' relief regime give further encouragement to investors to leave traditional listed equity investments and funds and to invest directly in smaller companies, which the proliferation of crowd funding websites is making more accessible and attractive. Investing in smaller companies could now trigger income tax relief on investment through the enterprise investment scheme, an inheritance tax shelter during the holding period through business property relief and now a reduced rate of capital gains tax on disposal. Non-domiciled taxpayers may even want to combine this with business investment relief – leading to a very tax efficient package.

Long term investors

Entrepreneurs' relief, which provides for capital gains tax to be paid at 10% on up to £10m of gains from qualifying disposals, is currently available on the sale of company shares only where the shares are owned by an officer or employee of the company who owns at least 5% of its shares.

A new investors' relief will apply to all shares in unlisted companies where those shares were acquired as newly issued shares after 17 March 2016 and have been held for three years before the disposal. It appears that this will work alongside entrepreneurs' relief and have its own £10m lifetime allowance.

Fiscal cost – £120m to 2021

Associated disposals

Provision is made under the hideously complex entrepreneurs' relief regime for relief to be granted on associated disposals, where an individual disposes of a privately held asset at the same time as withdrawing from a business. This allows an individual to claim relief on the sale of an asset used in a business if at the same time he disposes of at least 5% of his interest in that business – for example, selling a barn at the same time as withdrawing from the farm partnership that uses the barn. However, many partnerships or shareholders' agreements contain commercial provisions that meant the relief as previously drafted was not available. Finance Bill 2016 will amend the regime to simplify the circumstances in which the relief is available and should prevent it from being denied by the provisions of a partnership or shareholders' agreement.

Fiscal cost – £185m to 2021

Joint ventures

The current definition of trading company for entrepreneurs' relief is problematic where a company participates in joint ventures as the activities of joint ventures are not attributed to the company participating in the venture, so that it may not itself be treated as trading.

A new definition will apply from 18 March 2015 under which a company will be treated as carrying on a proportion of the activities of its joint venture investments.

Fiscal cost – £165m to 2021

Non-UK domiciliaries

It had been hoped, although not realistically anticipated, that there would be further clarification in the Budget of the treatment of those non-domiciled taxpayers who will, with effect from 6 April 2017, be treated as deemed domiciled for income and capital gains as well as inheritance tax purposes once they have been resident for at least 15 out of the past 20 years. The only (but helpful) statement in the Budget document indicates that there will be automatic rebasing of offshore assets for those who become deemed domiciled on 6 April 2017. It is not however clear whether this applies to those who become deemed domiciled at a later time and we look forward to further clarification on this. It has also been stated that all legislation will be in Finance Bill 2017, which will hopefully give the opportunity to ensure that all the new provisions fit together properly before they are enacted, albeit that there may be little time for properly informed planning.

Income tax

Personal allowance

In a welcome move for all taxpayers, the Chancellor has extended the increases in the personal allowance. The rise to £11,000 for tax year 2016/17 will go ahead as planned, but the rise from 2017/18 will now be greater than trailed last summer, increasing to £11,500 (rather than £11,200).

Fiscal cost – £7,450m to 2021

Higher rate threshold

In a similar vein, the threshold for higher rate tax will increase to £45,000 for 2017/18 (up from £43,000 for tax year 2016/17).

Fiscal cost – £2,125m to 2021

Pensions

Savings in registered pension schemes

Despite the drama that has been playing out in the personal money pages over the last couple of months, the Treasury indicated over a week ago that radical reform to the pensions tax relief regime would not appear in this Budget.

Instead, the Chancellor has side-stepped the issue, at least for now.

The pension allowances for retirement savings held in registered pension schemes remain unchanged. With effect from 6 April 2016, the lifetime allowance will reduce to £1m and the tapering of the £40,000 annual allowance for earners with gross income over £150,000 will come into effect as planned.

The Chancellor did not announce any further changes to these allowances for future years. Pension salary sacrifice arrangements will remain untouched (see below). The Chancellor also confirmed that the ability to take up to 25% of retirement savings as a tax free cash lump sum remains intact.

Member contributions to registered pension schemes can therefore continue to be made on the basis of full tax relief up to the annual allowance (currently £40,000 for this tax year, ignoring any contributions made between 6 April 2015 and 9 July 2015) and including any unused annual allowances for the past three tax years. For those potentially affected by the tapering rules from 6 April 2016, it is still advisable to make the maximum contributions possible before 6 April 2016 and to utilise the 3 year carry forward rules if possible – from 6 April 2016, any unused part of the £50,000 annual allowance for tax year 2012/13 falls away.

Helpful adjustments were however announced to the flexible payments rules (which took effect from April 2015) to ensure that various forms of payment are consistently taxed: so that, for example, the tax treatment of serious ill-health lump sum payments will be aligned to that of death benefit payments.

Pensions advice

A welcome tax break was announced uplifting the amount of the exemption for employers to provide access to pensions advice free of income tax and National Insurance, from £150 to £500 from April 2017.
Other developments will also change the pension advisory landscape. The definition of what will constitute 'financial advice' is being reviewed to ensure consumers can get the advice they need. The pensions industry has been tasked with designing, funding and launching a new pensions dashboard from 2019, to help individuals view their pension savings across all their different schemes in one place. In addition, the delivery of publicly funded pensions guidance will also be restructured.

ISA

The surprise offering on the savings front came in the form of the new 'Lifetime ISA'.

Lifetime ISA

Although not the pensions ISA in the form which the Government consulted on last year, it is not far off. The key difference being that it does not affect the pension allowances and registered pension regime already in place.

From 6 April 2017, adults under age 40 can save up to £4,000 of post-tax earnings annually into a Lifetime ISA, which can be used for retirement savings or to purchase a first property. For every £4,000 invested annually, the Government will provide a £1,000 bonus into the Lifetime ISA, until age 50. If the savings are used to purchase a first home (up to a value of £450,000) they can be drawn 12 months after the opening of the account. Otherwise it will only be possible to withdraw funds after age 60, except in the case of ill health. If a member draws savings early (otherwise than to pay for a first property or due to ill-health), the bonus will have to be refunded and an exit charge of 5% will apply, though the Government is to consider whether early drawdown may apply for other life events and borrowing too.

New ISA allowances announced

Perhaps less radically (though of more immediate interest to older taxpayers!) a new, increased, overall ISA allowance from April 2017 of £20,000 (up from £15,240) was announced.

Fiscal cost – £1,940m to 2021

Employer-related issues

Termination payments

The current arrangements whereby a termination payment of up to £30,000 may be paid free of income tax and National Insurance contributions (both employer and employee) are preserved. From April 2018, however, the Government will be tightening up on these exemptions, so that payments are not manipulated to cover notice and bonuses that are otherwise taxable. Payments in excess of £30,000 will also, going forward, be subject to National Insurance contributions and not just income tax.

Salary sacrifice

These arrangements, which allow employees to give up salary for certain benefits, often on the basis of more favourable tax treatment than salary, are slated for reform. The Government intends to limit the range of benefits that can attract income tax and National Insurance savings, but salary sacrifice arrangements relating to pension savings, childcare and health related benefits (such as Cycle to Work) will be unaffected.

Corporation tax

Headline rate

Corporation tax, which had already been slated to reduce to 18% from 1 April 2020, will now reduce to 17% from that date.

Fiscal cost – £1,065m to 2021

h4.* Interest deductions*

Following consultation in 2015, the ability to deduct interest costs will be restricted to 30% of taxable profits.

Fiscal benefit – £3,965m to 2021

Hybrid mismatches

The Government will legislate to prevent hybrid mismatches. These are arrangements under financial instruments whereby payers may be able to deduct payments as interest, but payees receive them as exempt dividends, resulting in a loss of tax. Similar mismatches may arise where an entity is treated as transparent in one jurisdiction and opaque in another.

Fiscal benefit – £1,300m to 2021

Interest on royalties

Going forward, all royalties arising in the UK will be subject to the deduction of income tax at source unless the UK has explicitly given up its taxing rights under an international agreement. This legislation will widen the existing definition of royalties and be designed to prevent tax avoidance by establishing offshore holding structures.

Fiscal benefit – £735m to 2021

Further restrictions on bank losses

The proportion of a banking company's annual taxable profit that can be offset by pre-April 2015 carried forward losses is further reduced to 25% from April 2016.

Fiscal benefit – £2,005m to 2021

Small companies

The government has received the review of small companies by the Office of Tax Simplification (OTS) and agrees nearly all of its recommendations and that it should continue to develop a look-through taxation system and a new simple business model that protects the assets of the self-employed.

Substantial shareholdings exemption

There is to be a consultation on possible reform of the substantial shareholdings exemption.

Life insurance policies

Personal portfolio bonds

There is to be a consultation on the categories of assets that life insurance policyholders can select as investments without giving rise to an annual tax charge under the personal portfolio bond legislation. It is to be hoped that this will reduce the range of investments which currently trigger the penal charges applicable to such products.

Surrenders

The case of Joost Lobler v HMRC highlighted that mismanaging the surrender of a non-qualifying insurance bond could give rise to what the Tribunal referred to as 'an outrageously unfair result', namely that a tax charge of $560,000 arose when if the surrender had been managed differently, the charge would have only been $70,000. HMRC will consult on amending these rules.

Anti-avoidance

We have become used to a raft of anti-avoidance measures every year, and this Budget is no exception.

Increased civil penalties

The Chancellor confirmed that there will be enhanced civil penalties targeting offshore evaders, which will be determined by reference to the amount on which tax has not been paid. Alongside this, civil penalties, together with naming and shaming, will be introduced targeting those who enable offshore evasion. A key question must be what 'enable' means for these purposes.
Criminal offences

The Chancellor also confirmed the introduction of a new criminal offence under which liability will not depend on HMRC proving intention on the part of the taxpayer. This is aimed at the most serious cases of offshore evasion.

Requirements to correct

In addition to the civil and criminal measures for offshore evasion outlined above, there is to be a new requirement to correct offshore non-compliance. How this sits alongside the raft of existing requirements that (i) one must declare offshore monies and (ii) one is subject to penalties if one does not do so is not clear. Presumably the intention is to make the point beyond doubt.

Serial avoiders

Moving from a purely offshore focus, a special regime will apply to those identified as 'serial avoiders' – including those who regularly use tax avoidance schemes which are defeated. Sanctions will include the increasingly popular naming and shaming and – possibly more persuasively – restricting access to certain reliefs and exemptions. Given that a number of schemes rely on precisely those reliefs and exemptions, this may of itself reduce the ability of serial avoiders to engage in those schemes.

GAAR penalty

To date, the GAAR has acted as a deterrent to the most contrived forms of tax planning but has not, as far as we are aware, been used by HMRC. Indeed, it is understood that the intention thus far has been to seek to avoid using the GAAR in anything but the most egregious cases, with the result that its limits may never be tested.

Equally, the GAAR has never carried any sanction in addition to the sanction that the tax that ought to have been paid is to be paid. That has now changed with the Chancellor's Budget confirmation that in any case counteracted under the GAAR, a penalty of 60% of the tax due is to be levied. Given the introduction of accelerated payment notices and enhanced civil penalties, those engaged in aggressive tax planning which could be subject to the GAAR will wish to consider carefully the potential cost of penalties measured against the tax advantage offered by any planning they are contemplating. Of course, it remains to be seen if this change means that the GAAR will actually be deployed by HMRC going forwards.

Targeted Anti Avoidance Measures

In addition to strengthening the GAAR and enhancing civil and criminal penalties, the Budget saw the introduction of further targeted anti avoidance measures.

Disguised remuneration

Further to the introduction of the disguised remuneration provisions in 2011, a number of schemes based on loans to employees have been developed seeking to avoid the strict statutory provisions. With effect from 16 March 2016, schemes focussed on loans which will not be repaid are likely to fall within the ambit of disguised remuneration. Employers and employees who have made use of such planning since 2011 will wish to review the position and ensure they settle any loans before April 2019.

We have seen a number of instances where the disguised remuneration provisions apply in an unintended context, and it will be important to confirm that anyone who has received loans associated with employment is not accidentally within the ambit of the extension. If they are, they will wish to think about repaying loans in good time.

h4.* Loans to participators*

It was widely expected that measures would target taxpayers seeking to shelter earnings within close companies. This appears to be the focus of the increase in the tax rate that applies to close companies making loans to participators, which is increased to 32.5% as of 6 April 2016, bringing it into line with the higher rate of tax charged on dividend income.

Additional measures

A series of other noteworthy measures were announced in the Budget.

Asset managers performance linked rewards

Further to the changes to the taxation of carried interest which came into effect in July 2015 and generally treat carried interest as performance related and therefore taxable on the arising basis, notwithstanding any transfer to trusts or other planning that might have been put in place by non-domiciliaries, there was confirmation that legislation will be introduced to confirm when carried interest is subject to income tax. This is expected to apply where funds hold investments for less than four years, although an average holding period test should apply. No doubt some funds will wish to tweak their strategies where possible to ensure that they hold assets for more than four years.

Partnership taxation review

In stark contrast to jurisdictions such as the US, the UK has an uncodified series of provisions and extra statutory concessions which govern partnership taxation. In what could be a welcome clarification, there will be a consultation on how partnerships calculate their tax liabilities.

Estate duty

Around 2,000 people still own chattels that were exempted from estate duty, the pre-cursor to inheritance tax abolished in 1984, on the basis that they were of national importance. Estate duty remains payable at rates of up to 80% on the sale of such items. Prior to the Budget, on the death of the owner, those items could be re-exempted under inheritance tax rules and the tax on a subsequent sale would be reduced to 40%. However, from 16 March 2016, HMRC will be able to choose whether to charge the old (80%) estate duty rate, or the current (40%) inheritance tax rate.

Further, from Royal Assent (expected mid-June) where any items exempted from estate duty are lost (including by theft or fire), estate duty will be charged. Owners of such chattels should ensure that all losses are reported to HMRC in advance of that date to avoid an unnecessary charge. HMRC will have the power to waive such charges, where the loss was outside the owner's control.

Fiscal benefit – negligible

Offshore property developers

There is considerable focus in the Budget papers on non-resident developers of UK property. Legislation will be introduced 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. HMRC will also create a task force to focus on offshore property developers and this will target offshore structures used to avoid tax on profits and rental income from property development in the UK.

The basic effect of the new rules is to remove traditional residence and similar criteria from the income tax and corporation tax rules for persons engaged in UK property development and UK property dealing (so that UK profits-based taxation is effectively global in respect of trading profits derived from UK real estate).

The regime will also include anti-fragmentation rules (so that groups of related parties cannot avoid the creation of a relevant UK-related property trade by allocating different aspects of what is in substance a single activity to different otherwise non-taxable entities) and anti-enveloping rules (to be based upon a modified version of the existing disguised trading rules, so that sales of property trading companies will potentially be charged to UK tax on the basis that the value of their shares represents an underlying trading profit derived from UK real estate).

In the meantime the double tax treaties between the UK and Guernsey, Jersey and the Isle of Man have been amended to clarify that a building site can be treated as a permanent establishment.

And finally

Bad news for retiring footballers with the confirmation that testimonials will be subject to income tax, but with a £100,000 exemption.

Good news for the self-employed with the news that Class 2 NICs are to be scrapped, saving £2.80 a week.

And bad news for those who are eschewing alcohol (no increase in duty) in favour of soft drinks – the sugar tax comes in in April 2018!

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