Insight and analysis for the business tax community

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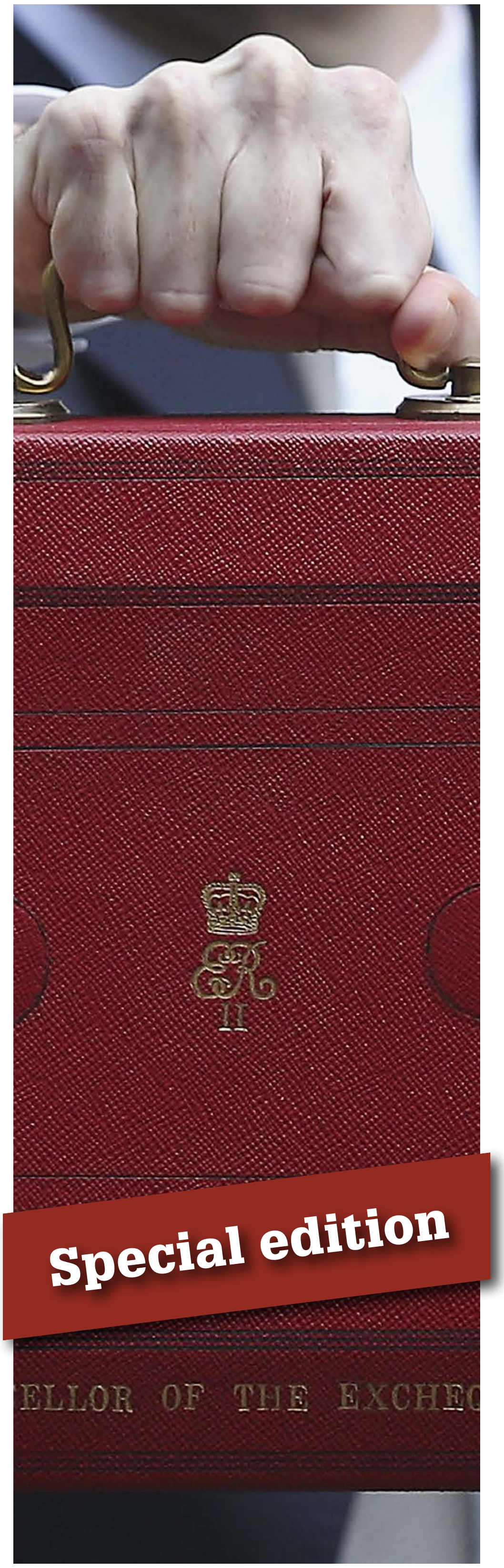

Special edition

Budget review

Your definitive guide to the Summer Budget

The big picture: Osborne unbound

Chris Sanger • Head of tax policy • EY

The latest in the war on non-compliance

James Bullock • Head of litigation and compliance • Pinsent Masons

A big Budget for big business

Dominic Robertson • Partner • Slaughter and May

Why it's a mixed bag for OMBs

David Whiscombe • Tax technical director • BKL Tax

The chancellor giveth but he also taketh away

Sue Laing • Partner • Boodle Hatfield

Economic view: pain still to come

John Hawksworth • Chief economist • PwC

ASK AN EXPERT

Earn-outs and deferred consideration

Lisa Stevenson • Founding partner • Parisi Tax

IN BRIEF

- Is *Anson* a source of relief or confusion?
- Reasonable excuse v special circumstances
- VAT recovery: zoo has lion's share of the argument

Contents

From the editor

What a blockbuster! The first Conservative Budget for 19 years sees 'Osborne unbound' (Chris Sanger, p 8). This was 'a reforming Budget' which sets out plans for a lower tax future 'but boosts the exchequer's coffers greatly in the short term'. It was also 'a surprisingly big Budget for big business' (Dominic Robertson, p 24). The unexpected announcement of further cuts to corporation tax is offset by a requirement for larger businesses to pay up early. And there is to be a tougher CFC regime, too. On the compliance and enforcement front, not much was genuinely new 'except for the rhetoric' (James Bullock, p 23). The promised £5bn clampdown on avoidance and evasion is expanded to tackle 'imbalances' in the tax system, such as dividend taxation. 'One wonders which of today's tax reliefs will be tomorrow's "distortions"' (David Whiscombe, p 24). Changes to the non-dom rules were widely expected, but the scale of reform surprised many. There were some popular measures for Middle England. As always though, 'the chancellor giveth but he also taketh away' (Sue Laing, p 25).

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News

Covering the key developments in tax

Business taxes

Summer Finance Bill

The Summer Budget on 8 July 2015 is to be followed by publication of the Finance Bill and explanatory notes on 15 July.

Cultural TV programmes

The Cultural Test (Television Programmes) (Amendment) Regulations, SI 2015/1449, change the cultural test for drama and documentary programmes with effect from 23 July 2015, bringing this into line with the cultural test for film which was introduced in 2007. The regulations also propose the same test for children's television programmes, following the new relief introduced by FA 2015. These cultural tests form part of qualification for the corporation tax reliefs in respect of television production development.

Responses on venture capital schemes consultation

Following consultation, the Summer Budget announced changes to take effect from royal assent to the Summer Finance Bill 2015, including: new limits on the period of eligibility for companies after receiving their first risk finance investment; a new cap of £20m for knowledge-intensive companies and £12m for other companies; and new rules to prevent EIS and VCT funds being used to acquire existing businesses. See www.bit.ly/1EEnfkr.

Personal taxes

Tax on performance linked rewards paid to asset managers

HMRC is consulting until 30 September 2015 on the introduction of specific rules to determine when performance related rewards paid to investment fund managers are properly taxable as capital gains, rather than as income. These proposals are not intended to change the existing CGT treatment of carried interest, for which new anti-avoidance legislation announced in the Summer Budget has effect from 8 July 2015. See www.bit.ly/1NQ8TmN.

Tax-free childcare scheme to launch in 2017

The government is to delay introduction of the tax-free childcare (TFC) scheme until early 2017, following victory in the Supreme Court against a legal challenge to its decision to deliver childcare accounts through National Savings and Investments. The scheme, first proposed in 2013, was originally expected to launch in the autumn of 2015. The legal action was brought by a small group of childcare voucher providers involved in the delivery of the scheme that tax-free childcare will eventually replace, leading the court to place a suspension on the development of the scheme. This has prevented key delivery steps from taking place.

People and firms

EY has promoted 95 new equity partners. For full list of names, see www.bit.ly/1RlR0lZ.

BDO has promoted nine new partners in the UK, including corporate tax adviser **Dan Brookes** as tax partner in its Yorkshire practice, formerly from EY.

Baker Tilly has appointed **Stephen Hunter** as tax partner for the North West region. He previously worked for KPMG for 20 years, where he was head of tax for the Lancashire, Cumbria & Merseyside region.

New Quadrant Partners, the London based boutique private client law firm, has appointed **Helen McGhee** (formerly Patton Squire Boggs) as a senior associate with the firm. McGhee is the winner of 'rising star' award at the 2015 *Taxation* awards.

Global real estate consultancy **JLL** has appointed **Steve Smith**, as head of capital allowances, and **Debra Feinson** in its UK capital allowances business. Both arrive from Sweett Group.

The **Oxford University Centre for Business Taxation at the Saïd Business School**, in conjunction with the university's faculty of law, has announced that a new part time Master's degree (MSc) in Taxation will commence in September 2016.

The **Public Accounts Committee** has announced its members: MPs **Richard Bacon**, **Harriett Baldwin**, **Deirdre Brock**, **Kevin Foster**, **Stewart Jackson**, **Clive Lewis**, **Nigel Mills**, **David Mowat**, **Teresa Pearce**, **Stephen Phillips**, **John Pugh**, **Nick Smith**, **Karin Smyth**, and **Anne-Marie Trevelyan**. As previously reported, Meg Hillier was elected as PAC chair on 17 June.

To publicise tax promotions, appointments and firm news, email *paul.stainforth@lexisnexis.co.uk*.

Indirect taxes

Landfill tax amending order

The Landfill Tax (Amendment) (No. 3) Regulations, SI 2015/1453, came into force on 2 July 2015. They update references in the principal regulations to reflect the fact that the Landfill Tax (Qualifying Fines) Order 2015 lapsed and was replaced by the Landfill Tax (Qualifying Fines) (No. 2) Order 2015 from 15 June 2015.

International

OECD calls for better use of environmental taxes

'Governments should make better use of environmental taxes' is the conclusion of the OECD's latest Global International Tax Dialogue (ITD) conference. Taxes are potentially among the most effective ways of cutting pollution and greenhouse gas emissions, but they are currently underused or designed in a suboptimal way, OECD secretary-general Angel Gurría said last week on publication of the report *Taxing Energy Use 2015*.

According to Gurría, 'current energy taxes are often too low – in particular for coal, which is sometimes not taxed at all; and they are incoherent, with different tax levels on energy types with similar environmental impacts. For example, in 39 out of the 41 countries surveyed, diesel is taxed at lower rates than gasoline, despite its greater environmental footprint. Recent work undertaken by the OECD demonstrates that taxes on energy use are less regressive than is commonly thought. The impact of current policies on competitiveness is very small or inexistent, meaning that a gradual increase in environmental taxation is compatible with a competitive economy.'

The ITD is a joint initiative of the OECD, EC, IMF, the World Bank, Inter-American Development Bank (IDB) and Inter-American Center of Tax Administrations (CIAT). The ITD facilitates international dialogue on tax policy and administration. In the lead up to COP21, 300 senior tax and environment policymakers, tax administrators and experts from more than 90 countries met in Paris this week to identify practical ways of harnessing the power of taxation as an environmental policy tool.

MEP debate on EC's action plan to reform corporate taxation

The EC corporate tax action plan, launched on 17 June 2015 (see *Tax Journal* news, issue 1268), was debated by the European Parliament on 24 June 2015. MEPs asked the EC to accelerate its work in order to deliver legislative proposals. There was a further debate on 2 July 2015 at a joint hearing held by the Economic and Monetary Affairs and Tax Rulings committees.

The action plan sets out various measures intended to tackle tax avoidance, secure sustainable tax revenues, and strengthen the European single market. To do this, the action plan proposes introducing a mandatory European common consolidated corporate tax base, and various proposals to close legislative loopholes, improve transfer pricing and implement stricter controls on preferential tax regimes.

Latest ECOFIN tax report

The EU Council of Economic and Financial Affairs (ECOFIN) has approved and published its report summarising the state of play of its work across all tax issues. The report notes that ECOFIN has started to work on the EC's proposal on the automatic exchange of information on tax rulings, although some member states have expressed their desire for further discussion on EU VAT fraud. Other topics covered include proposed changes to the Parent-Subsidiary Directive and Interest and Royalties Directive; standardising VAT return; the latest work on the financial transactions tax; other transparency measures; and areas of work to be taken forward for the second half of 2015 under the Luxembourg presidency of the EU Council. For report, see www.bit.ly/1Hktcnq.

Administration

OTS given permanent basis

The chancellor announced during his Summer Budget that the Office of Tax Simplification (OTS) would be put on a statutory footing in the Finance Bill 2016 with expanded role and capacity. Patrick Stevens, CIOT's tax policy director, said: 'This Budget puts the OTS on a permanent footing, and boy does it give them a lot to do. Pensions tax relief, inheritance tax and dividend taxation all have additional complications thrown in by this Budget. With the placing of the OTS on a statutory footing, we hope that it will be given more resources to continue its work and will have more ability to hold the government to account if its recommendations are not taken forward and to be involved in their implementation if they are.'

As its next two projects, the government has announced that the OTS will review the closer alignment of income tax and NICs; and review the taxation of small companies. Patrick Stevens commented: 'These are two important areas where there is a clear need for simplification. On small companies, in particular, we hope the OTS will be able to take a serious look at whether it is possible to simplify all tax and regulation matters for micro-businesses including income tax, NI, VAT and regulation.'

New HMRC taskforce targets wealthy in Northern Ireland

A new HMRC taskforce aims to recover £18m by targeting wealthy individuals in Northern Ireland who appear to be living beyond their means. HMRC is using Land Registry and Merchant Acquirer data to identify those with 'badges of wealth', such as large houses, aeroplanes, boats and undeclared offshore bank accounts which are not in keeping with the information they report to HMRC. HMRC's Ian McCafferty, leader of the taskforce, said: 'Our intelligence shows that people being targeted by this taskforce have no intention of playing by the rules and could end up facing a heavy fine or even a criminal conviction. Those who pay the tax they are supposed to have nothing to worry about.'

Time to pay arrangements affected by Greece

HM Treasury has announced that HMRC's 'time to pay' service will be available to help give breathing space to businesses which are experiencing cashflow difficulties and are unable to pay their tax liabilities as a result of events in Greece and the referendum result. HMRC has introduced a dedicated helpline for those affected (0300 330 8100). Further information and updates on the Greek situation can be viewed on HMRC's website at www.bit.ly/1g5pZTc.

Employment agencies' first quarterly reports due in August

Employment agencies that place more than one worker with a client and do not operate PAYE must make the first of their quarterly information returns (for the first quarter of the 2015/16 tax year, i.e. from 6 April to 5 July 2015) to HMRC by 5 August 2015 under the new rules introduced in April aimed at preventing false self-employment. Returns are due on the fifth day of the month following the end of each quarter.

Share scheme return online filing

PwC reports that, due to technical problems, companies trying to submit their annual share scheme returns online to HMRC since 3 July have not been able complete the submission process. HMRC has extended the deadline for filing annual returns that were due by 6 July by five working days from the date on which the online service is up and running again. This is not expected to happen until 13 July at the earliest. HMRC is therefore advising companies to try the service again on 13 July. PwC also reports that HMRC has said that its online technical problems did not affect the online share scheme registration system, the return template checking service or online EMI option grant notifications. However, HMRC has not yet confirmed how the automatic penalty process will work for those who were not able to file their returns by 6 July because of the technical problems.

HMRC restores recognised overseas pension schemes list

HMRC has republished the list of recognised overseas pension schemes, following its temporary suspension in June. The list contains schemes that have asked to be included and HMRC does not guarantee that all schemes listed will actually qualify for exemption from UK tax on transfers made to them. See www.bit.ly/1MjXJXa.

'Working together' goes digital

HMRC says it is in the process of moving away from face-to-face local meetings with agents and moving its 'working together' (WT) forum to a digital platform. HMRC says it wants 'to provide a better service for more agents through digital channels and services, learning from transforming our engagement with SMEs to digital which has had a huge degree of success both in terms of extending customer reach and improving satisfaction ratings'. In autumn 2014, HMRC says it conversed with tax agents to explore how it could work with them to move WT to a digital platform in order to:

- align with HMRC digital by default agenda;
- extend the reach of WT to the wider agent community;
- save resources for both HMRC and agents; and
- enable agents to discuss widespread issues with subject matter specialists.

Scotland: devolved powers

The Scotland Bill 2015/16 completed its committee stage on 6 July 2015. The Bill makes amendments to the Scotland Act 1998 and further devolves powers to Scotland in accordance with the recommendations of the Smith Commission, including arrangements for sharing of tax information to help the Scottish government decide on the Scottish rate of income tax later this year. See www.bit.ly/1CnJ6S4.

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Cases

Reporting the tax cases that matter

Personal taxes

Payment under compromise agreement

In ***Andrew Hill v HMRC*** [2015] UKFTT 295 (19 June), the FTT found that a payment made to an employee under a compromise agreement was an emolument.

Mr Hill had been working for General Motors (GM) when his employment had been transferred from GM to Saab City under the Transfer of Undertakings Regulations, SI 2006/246. Mr Hill had been unhappy with the transfer of his employment, in particular because he was now working a long way from home, in breach of his employment contract. He had raised a grievance and a compromise agreement had been entered into. The issue was whether the payment fell within ITEPA 2003 s 403 so that it was exempt (as below the £30,000 threshold).

Mr Hill contended that he had not been paid to agree to a change in the terms of his contract of employment, but for agreeing not to pursue a claim for damages in respect of a breach of those terms. The FTT held, however, that in both cases the effect of the agreement between the parties was that, in return for receiving a payment, he had accepted that he would work far away from home. Furthermore, the compromise agreement required Mr Hill to refund all or part of the payment, in the event that he ceased to be employed by Saab City within two years of the payment; and this supported the proposition that the payment was an emolument.

Why it matters: **Where the taxpayer's employment continued and he was paid because of a change in the conditions of his employment, the payment by his employers had to be treated as an emolument, regardless of the fact that it was made under a compromise agreement.**

VAT

Was the redemption of vouchers an exempt supply?

In ***Wilton Park, Secrets (Promotions) and others v HMRC*** [2015] UKUT 343 (1 July), the UT held that a commission charged by clubs, paid by exotic dancers on the redemption of vouchers that had been purchased by patrons, was for services which went beyond dealing with security for money.

The appellants operated table dancing clubs. The dancers were self-employed and paid a fee to gain entry to the clubs. Patrons that had run out of cash were able to purchase club vouchers to pay for the services of the dancers. The clubs charged the dancers a 20% commission on redemption of the vouchers.

The first question was whether the vouchers were 'security for money' (VATA 1994 Sch 9 Group 5 item 1) so that they were exempt from VAT. The UT held that the vouchers were given to the dancers by the patrons as 'a security for the money' that they wanted to pay and so were 'security for money'.

The second question was whether the services provided by the clubs in return for the commission were taxable supplies. The UT noted that, in the absence of comprehensive contractual documents, the rights and duties of the dancers had to be drawn from such documentation as did exist, together with the way the clubs conducted their business. The scope of the supply must be determined not only by the final step in the transaction (the presentation of the vouchers for payment), but also the whole scheme.

The benefit that the dancers derived from the vouchers was the right to be included in the scheme, which the clubs set up for patrons to be able to pay for entertainment at the club even though they had no cash. Furthermore, the clubs provided a bundle of services to the dancers, so that they could make the best use of the facilities. It would be artificial to split the voucher scheme from the other services provided by the clubs. Those services constituted a taxable supply.

Why it matters: **Although the transaction at issue was the redemption of a security, it did not fall within the scope of the exemption as the final step of the transaction should not be looked at in isolation but in the context of the business model operated by the parties.**

Joint application for reference to CJEU declined

In ***Capernwray Missionary Fellowship of Torchbearers v HMRC*** [2015] UKUT 368 (27 June), the UT, refusing the joint application of the parties, declined to make a reference to the CJEU.

This was a joint application by Capernwray and HMRC, for an order that a reference be made to the CJEU for a preliminary ruling. The FTT had dismissed Capernwray's appeal against HMRC's ruling that supplies in the course of construction of a conference hall used by Capernwray for its activities were not zero-rated.

The UT first noted that it was for the referring tribunal to determine whether it required the guidance of the CJEU. The fact that the parties were agreed that a reference should be made, whilst a factor that must be carefully considered, was not determinative of the need for a reference. Under TFEU art 267, a question should be referred to the CJEU only if a decision was necessary in order that the referring tribunal could give judgment. The UT therefore considered that for a reference to be made, it needed to be satisfied that a tribunal would not be able to resolve the relevant issues with complete confidence. Having reviewed each of the relevant issues, as well as the body of European jurisprudence relating to them, it concluded that that 'it was more likely than not' that the tribunal hearing the substantive appeal would be able with complete confidence to decide the answers.

Why it matters: **Even though both parties agreed that a reference to the CJEU was necessary, the UT turned down their application on the basis that there was a sufficient body of CJEU case law for a tribunal to decide the issues with confidence.**

Did the sale of a new building qualify for zero-rating?

In ***M Lennon & Co v HMRC*** [2015] UKFTT 296 (23 June), the FTT held that the sale of a new building, which included the façade of the original building, did not qualify for zero-rating in circumstances where the façade had not been retained to comply with planning permission.

M Lennon & Co appealed against HMRC's determination that a sale of residential property, which had been the object of extensive redevelopment, was an exempt supply, so that input tax attributable to that supply could not be recovered. Under VATA 1994 Sch 8 Group 5, the first grant by a person constructing a building is zero-rated, excluding a conversion, unless it falls within Note 18. This occurs when:

'(a) [the building] is demolished completely to ground level; or

'(b) the part remaining above ground level consists of no more than a façade, the retention of which is a condition or requirement of planning permission.'

The issue was therefore whether Note 18 applied. It was accepted that, given that the new building had been built within the blueprint of the original one, no planning consent had been required, so that Note 18(b) did not apply. The FTT accepted that there had been compelling safety reasons for not demolishing the front half façade of the property. However, this could not alter the fact that the property had not been 'demolished completely to ground level' so that Note 18(a) was not in play.

Our pick

Anson v HMRC
Profits from US LLCs and double tax relief

In ***Anson v HMRC*** [2015] UKSC 44 (1 July), the Supreme Court found that a member of a US limited liability company (LLC) was eligible for double tax relief in the UK on his share of the profits.

Mr Anson was resident but not domiciled in the UK for UK tax purposes. He was liable to UK income tax on foreign income remitted to the UK.

He was a member of an LLC, which was classified as a partnership for US tax purposes. He was therefore liable to US federal and state taxes on his share of the profits. Mr Anson remitted the balance to the UK, and was therefore liable to UK income tax on the amounts remitted, subject to double tax relief.

HMRC considered that Mr Anson was not entitled to double tax relief, on the basis that the income which had been taxed in the US was not his income but that of the LLC. Mr Anson contended that, even assuming that US tax was charged on the profits of the LLC and that he was liable to UK tax only on distributions made out of those profits, the US and UK tax were nevertheless charged on 'the same profits or income', within the meaning of the UK/US double tax treaty. He also argued that, as a matter of UK tax law, he was liable to tax in the UK on his share of the profits of the trade carried on by the LLC, which was the same income as had been taxed in the US.

The Supreme Court rejected the first ground, noting that the context of the treaty and its history did not suggest such a wide approach to the concept of income. However, in relation to the second ground, it found that Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits 'previously vested in the LLC'. His 'income arising' in the US was therefore his share of the profits, which was the income liable to tax both under US law and under UK law – to the extent that it was remitted to the UK. His liability to UK tax was therefore computed by reference to the same income as was taxed in the US and he qualified for double tax relief.

Why it matters: The classification of foreign entities and of the profits they generate continues to raise difficult questions. In this case, the FTT had found that the members of the LLC had an interest in the profits as they arose; therefore, the Supreme Court found that double tax relief was due. It remains to be seen whether HMRC will consider that this applies to all LLCs or only to a specific category of LLCs. (See also page 6.)

The remaining issue was whether HMRC should have exercised its discretion to treat Note 18(a) as satisfied, even though it was not satisfied as a matter of law. This was a matter of judicial review outside the jurisdiction of the FTT.

Why it matters: The retention of a front façade will take the sale of a building out of zero-rating, unless the purpose of the retention is compliance with planning consent. Retention for any other purpose will not satisfy the test.

Administration & appeals

Retrospective legislation lawful

In ***The Queen on the application of APVCO 19 and others v HMRC*** [2015] EWCA Civ 648 (30 June), the Court of Appeal found that retrospective legislation was lawful.

The appellants had implemented aggressive tax avoidance schemes designed to avoid SDLT. The question was whether retrospective legislation (amending FA 2003 s 45(1A)) targeting those schemes violated the European Convention on Human Rights (ECHR) Protocol 1 art 1 (A1P1) (protection of property) and art 6 (right to a fair trial).

The schemes had relied on sub-sale relief, which ensures that where successive transfers of rights relating to the purchase of a property (including options) are completed by a single property transfer, SDLT is chargeable only once on the property transfer. However, FA 2013 introduced an amendment, effective from 21 March 2012, that made it clear that the option arrangements entered into by the appellants had not constituted 'transfers of rights' and had therefore been subject to SDLT.

The first question was whether the amendments had the effect of depriving the appellant of any possession that they had at the date of the legislative changes. The Court of Appeal observed that, by the time the amendments had been made, the money that the appellants might have used to pay the tax was already the subject of an unresolved argument with HMRC. The appellants had therefore been deprived of an argument that they were not liable to pay the tax, but not of the tax itself. A1P1 was therefore not engaged; and even if A1P1 had applied, the retrospective amendments would have been lawful.

The government had published a protocol *Tackling tax avoidance* (March 2011), which had warned about the possibility of retrospective legislation in 'exceptional circumstances' to avoid 'significant losses to the exchequer'. The Court of Appeal pointed to the 'serial abuse' of the relevant provisions and concluded that the retrospective changes had been foreseeable and therefore lawful. Furthermore, the balance between the general interests of the community and the protection of the individual's fundamental rights had fallen 'heavily on the side of the public interest', making the changes proportionate. Finally, applying the decision of the European Court of Human Rights in *Ferrazzini* [2001] STC 1314, the Court of Appeal held that the dispute was not civil, so that art 6 was not engaged.

Why it matters: Since the publication of the protocol in 2011, the government has used retrospective legislation on several occasions, often provoking the anger of taxpayers. This case confirms that retrospective tax legislation can be lawful. It is therefore likely that the government will continue to use this powerful tool when the need and justification arise.

Also on taxjournal.com:

- ***Monica Bircham v HMRC*** [2015] UKFTT 293 (15 June): FTT confirmed correctness and validity of assessments and upheld penalties imposed for deliberately inflating tax repayment claims.
- ***Saudaçor – Sociedade Gestora de Recursos e Equipamentos de Saúde dos Açores SA v Fazenda Pública*** (C-174/14) (25 June): Advocate general considered that offshoot of a public body could not benefit from VAT exemption.
- ***Danesmoor v HMRC*** [2015] UKFTT 294 (15 June): FTT found that a company could not deduct input tax incurred on fees charged by advisers.
- ***North of England Zoological Society v HMRC*** [2015] UKFTT 287 (19 June): FTT found that a zoo was entitled to recover input tax in respect of animal related costs.
- ***Alistair Norman v HMRC*** [2015] UKFTT 0303 (22 June): FTT found that discovery assessment was valid and taxpayer was entitled to relief, so as not to be taxed twice on same transaction.
- ***Personal representatives of Mr Michael Wood (deceased) v HMRC*** [2015] UKFTT 282 (12 June): FTT found that HMRC could pursue assessments against a taxpayer who had died.

Cases reported by Cathya Djanogly (*cathya.djanogly@hotmail.com*).

In brief

Views on recent developments in tax

Anson: a source of relief or confusion?

A Supreme Court judgment brings good news for some individual investors, but creates uncertainty for UK corporation taxpayers.

The Supreme Court has decided that a UK resident individual who received distributions from a Delaware LLC would not suffer double (US and UK) taxation and was entitled under the UK/US double tax treaty to credit US tax borne by him on profits of the LLC against his UK income tax.

The keenly anticipated judgment in *Anson v HMRC* [2015] UKSC 44, which reverses the Court of Appeal, will come as a surprise to many. Long-standing HMRC practice has made clear that, for UK tax purposes, an LLC should be regarded as a taxable entity, and not as fiscally transparent. That view, and the technical underpinnings for it, have been rejected by the Supreme Court.

The decision will no doubt be welcomed by individuals who, like Mr Anson, hold investments in LLCs – a point that may be encountered, for example, when looking to award UK executives with equity incentives in a US group headed by an LLC. One work-around option here has been to consider converting the LLC into a Delaware LP (which HMRC has accepted is transparent). That expedient may now no longer be necessary.

For UK corporation taxpayers, the decision introduces some uncertainty. Corporate investors in LLCs who have treated receipts from the LLC as exempt distributions (rather than, say, trading income) will have to re-examine their position (though given the difference in headline corporate tax rates between the US and the UK, perhaps the UK tax bill for such investors will not be increased). Pension funds and other exempt investors may also have particular concerns. Well-known HMRC guidance allowing LLCs to be grouped may conceivably need to be revisited.

Fortunately, fears that the decision could have had an adverse impact on the transparency of other non-UK vehicles seem to have been allayed. The court expressly downplayed the importance of a member having a proprietary interest (as a UK lawyer would understand it) in an entity's assets in establishing income transparency – a point that, notwithstanding pragmatic HMRC guidance in this area, has always looked technically challenging when dealing with foreign entities that have separate legal personality (and which may be bodies corporate). Similarly, the decision does not go so far as to treat the LLC as a partnership, and seemingly does not affect the capital gains tax treatment of an LLC investor.

The question under the Treaty is whether the income taxed by the US is the same as the income taxed by the UK. In answering that, the court emphasised the role of Delaware law – the statute and the LLP agreement – as matters of fact for the first instance tribunal. A key point emerging from this was the distinction between profits and assets: while the assets of the business belonged to the LLC, that did not prevent a finding that the members had, as a matter of Delaware law, a contractual right to profits as they arose.

It is, however, not entirely clear whether provisions of Delaware statute (for instance, that profits and losses of an LLC shall be allocated among the members) weighed more or less heavily than the drafting of the LLC agreement itself (particularly the articles dealing with profit sharing and distributions). But it seems the possibility, at least, is raised of taxpayers drafting their LLC agreements (under favourable state law) to achieve transparency or opacity, as desired. The advent of such a 'de facto' check-the-box regime was one factor in the IRS introducing an elective regime in regulations in the US.

Whether HMRC will consider the time has now come for a UK check-the-box system – and how such a proposal might be viewed alongside the BEPS project's work on hybrid entities – remains to be seen. ■

Jonathan Cooklin (jonathan.cooklin@davispolk.com) and Dominic Foulkes (dominic.foulkes@davispolk.com), Davis Polk

For the case report, see page 5. A detailed article on the judgment is published on taxjournal.com and will be reproduced in next week's edition.

Optrak, reasonable excuse and special circumstances

When is an application to reduce penalties because of 'special circumstances' a better bet than 'reasonable excuse'?

There are lots of tribunal cases where HMRC has imposed a penalty for a failure to comply with the tax legislation and the taxpayer has claimed a reasonable excuse with varying degrees of success. The recent case of *Optrak Distribution Software Ltd v HMRC* [2015] UKFTT 0279 (TC) is such a case, but it contains some interesting (and unusual) features.

The case involved the late payment of PAYE liabilities but the precise details do not matter here. The taxpayer claimed that (for various reasons) the imposition of the penalty was unfair. However, the tribunal explained that:

'In the light of the Upper Tribunal's decision in *Hok*, we have no choice but to find that unfairness cannot be a ground on which to allow the appeal.'

The taxpayer then argued that the penalty was disproportionate and unduly onerous. The tribunal said that it had sympathy for the appellant's arguments, but explained that a penalty cannot be set aside for being disproportionate or unduly onerous either.

Whatever the merits of this particular case, these conclusions seem in stark contrast to the HMRC consultation paper on penalties issued on 2 February 2015 in which it expressed the 'underpinning' principle that penalties ought to be fair and proportionate.

It may be that there is nothing the tribunal can do about it, but this seems a bit off. I thought the whole idea was for the courts to protect the taxpayer from unfair, disproportionate and onerous impositions by the executive. (I am sure Magna Carta had something to say about that – and Montesquieu too.) In any event, having regard to its public statement one might have thought that HMRC's duty of care and management would have inhibited it from pursuing these arguments quite so vigorously.

Moving on, it may be remembered that there used to be an issue about postal delays – where the taxpayer posts a cheque for the tax in good time, but the payment does not reach HMRC until after the due date. That issue seems to have been resolved (at least there has been a series of cases on the subject) – but in the case of *Optrak*, the circumstances were slightly different. The company did not post a cheque to HMRC; it paid by bank transfer. There was a three day banking delay (unless 'faster payment' applies, which apparently HMRC does not use). The tribunal held that the taxpayer should have known the payment would have taken three days to reach HMRC, so it could not reasonably have been expected to have arrived earlier. This is an interesting variation on the postal delay cases.

Another point of interest was the possible application of 'special circumstances', which seems to be arising more regularly.

HMRC has power under FA 2009 Sch 56 para 9 to reduce a penalty because of 'special circumstances'. This is a discretion given to HMRC and cannot be reviewed by the courts unless the approach of HMRC was flawed – or if it should have been considered and HMRC failed to do so.

However, the special circumstances must be special to the particular taxpayer. It must be something more than the general circumstances which would apply to many taxpayers by virtue of the scheme of the provisions themselves.

There were no special circumstances which operated in the particular circumstances of *Optrak* and so no reduction on this ground was appropriate, but it is interesting that this issue is being raised increasingly by taxpayers as an alternative to a reasonable excuse. A reduction for special circumstances only applies where there is no reasonable excuse but the effect on the taxpayer may well be the same. ■

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Animal Magic applied to VAT

A recent tribunal decision on input tax recovery has implications for the exempt cultural sector.

Imagine the following day out, with children: a trip to the zoo, giving access to various animals in pens, a toilet block, a café cum shop situated either near the entrance or at the furthest extremity of the zoo, and a picnic/play park area. The café sells pizza slices, tea, coffee, fizzy drinks and bakewell tart. The merchandise includes named mugs and cuddly zebras and chimps. You view the toilet and café as a necessity, as otherwise the children will be unbearable and you will be desperate for a cup of tea.

Alternatively, imagine visiting Chester Zoo. You and the children are to stay more than four hours. You are making a day of it. There is a huge selection of animals to see, several varied and sophisticated cafés, and some boutiques with enticing themed merchandise. The café near the big cats serves tiger steaks. Near the giraffes, a café serves giraffe-leaf salad. The armadillos' neighbouring café serves armadillo-shaped pies. The whole thing is integrated, and the cafés are part of the experience – of the memories – and the learning process, and contribute to the overall enjoyment. The merchandise sales are similarly specific to the animal related experience.

Are these alternatives different for VAT? Well, following the decision in *North of England Zoological Society v HMRC* [2015] UKFTT 287 (TC) of the First-tier Tribunal, the answer may be in the VAT recovery position. Put simply, HMRC tried to limit VAT recovery on animal costs by saying that the only income to which these costs attributed value were admissions (exempt) and charges for animal encounter experiences (taxable). HMRC denied any link with the (significant taxable) café and merchandise turnover. It said that these were merely coincidental supplies, which visitors did not need to buy in order to enjoy the animals. This engaged the famous 'but for' test, which says that you cannot attribute a cost to a supply merely on the basis that the supply would not have happened but for the activity supported by that cost. The link has to be closer than that.

Chester Zoo, though, with boa-constrictor tenacity, argued that you could not analyse the holistic visitor experience like that. It was a complete day out, and all elements, and thus all costs, contributed to it. The animal costs gave a platform for all income generation. Thus, the café and merchandise turnover was more directly linked to the animals, rather than merely being a coincidental by-product.

That seems sensible, and different to the situation with the café/shop of my first example, which is provided for convenience/necessity and no more.

I wonder, though, about the attribution of the specific café costs. After all, where cafés are so integral to the entire visitor experience, surely these costs are equally attributable to the entire business, and not solely attributable to taxable supplies. But this provocative and extreme postulation is irrelevant, because that point never arose.

So, we now have a key decision which gives HMRC a dilemma. Should it appeal on the basis that the distinction is specious, or act the ostrich and argue that the decision applies only to the facts of Chester Zoo? To determine that choice, HMRC needs to consider the potential reaction of the entire exempt cultural sector. What if theatres and museums take this up, and add their bar and shop turnover into the mix when apportioning input tax on production costs? HMRC would then, I think, point out that the Court of Appeal (a far superior court to the FTT) said, in *Mayflower Theatre* [2007] EWCA Civ 116, that the merchandise sales, even when themed to go with the specific show, did not create a sufficient link with the production costs, and the appellant in that case did not even attempt to argue a link with bar sales. So HMRC holds some powerful cards to distinguish this recent zoo case from any other cultural venue.

But I feel that the zoo has the lion's share of the arguments. Bear in mind that a theatre bar trade is usually accepted by HMRC as being 'ancillary to primary purpose trade' (which is theatrical performance) and thus not subject to direct tax where a charity theatre is involved. This is of course a different test, but it seems to say something about the holistic 'day/evening out' argument which lends support to this recent decision. After all, feeding time for the penguins is not much different to feeding time for the children. ■

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Private equity changes

Budget changes mark the end of an era for the tax rules on carried interest.

The changes to the taxation of private equity carried interest bring to an end a basis of taxation agreed with HMRC as long ago as 1987 when the industry was in its infancy. This is one of a series of changes that have affected the way the industry has been taxed in recent Budgets and reflects the chancellor's progressive tightening of the tax regime and withdrawal of reliefs. Those affected will have to hope that other changes in the Budget will have a positive effect on the economy which feeds through into deal values. The worry will be is this the end of the road for tax on the private equity industry. ■

Alex Henderson, PwC

The big picture: Osborne unbound

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Those who had spent the run up to 8 July wondering how the chancellor was going to pull off the usual post-election tax grab, having previously placed a lock on his main revenue levers, will have been taken aback by the breadth of George Osborne's sweeping 'one nation' Budget. From further cuts on the corporation tax rate to deeper cuts in working age welfare benefits, the first Tory Budget for 18 years has gone for wide-ranging reform, but has also boosted the tax take to a remarkable extent.

The key headline message from the chancellor today was his commitment to eliminate the deficit and run an overall surplus to start paying down the debt. His prescription for achieving this boils down to the need for a further consolidation of some £37bn over the period of the current parliament. Having swiftly identified where this consolidation would come from (£12bn in welfare cuts, £5bn from clamping down on avoidance and the rest to come from the Autumn Spending review), George Osborne was free to turn his mind to reforming the tax system to further boost the UK's prospects for growth. And at heart of that reform lies Osborne's continued commitment to lower tax as the key to prosperity.

This is a reforming Budget that sets in place the elements for a lower tax future in the long term, but manages to boost the government's coffers greatly in the short term

What kind of Budget was this?

Conventional wisdom tells us that the first Budget after an election tends to be a cash grab, as the chancellor seeks to fill the exchequer's coffers, safe in the knowledge that his predations will be long forgotten by the time of the next election. This temptation is usually tempered with the chancellor's desire to be recognised for introducing more principled, reform minded changes that overhaul the system in pursuit of some wider ambition.

This chancellor has sought to have his cake and eat it. On the one hand, this was clearly a reform Budget, with Osborne free to pursue an agenda aimed at reforming the UK tax system in the long term direction of the low tax ideal. His reforming zeal extended to changing the taxation of banks and to opening up thinking completely on the future of pension tax relief. But some of the principled reforms have also produced significant increases in the tax take.

One example is the new tax regime for dividends, with its top tax rate of 38.1% – an easy number to remember? As the UK cuts corporation tax even further, despite already offering the lowest corporation tax rate in the G20, the incentive to incorporate in order to reduce tax increases. To head that risk off, the chancellor has changed the rules on dividend taxation, finally abolishing the imputation system and bringing in a 7.5% increase. This measure helps to support the principled reform to the main rate, but it brings in almost £9bn on its own over this parliament.

So was it all principled reform?

No, there were also some good old fashioned cash grabs. Prime examples here would be the acceleration of corporation tax payments for the most profitable companies and the 3.5 percentage point increase in insurance premium tax (raising £1.5bn by the end of 2020/21 and over £8bn over the parliament). The cash grab on corporation tax shouldn't impact companies' profit and loss accounts (since it's a shift from deferred tax to current tax) but, like the impact on the landlord of paying your rent in advance than arrears, will nevertheless boost the Treasury's coffers, to the tune of over £7bn.

Okay, so more conventionally, what did he do for business?

The most eye catching change was, of course, the reduction in the headline corporation tax rate from 20% to 19% and then 18%. This was something of a surprise and, at least in the short term, puts some clear water between the UK and the rest of the G20 (with the lowest of the rest being 20%, currently held by Russia, Turkey and Saudi Arabia). This change reinforces the message that Britain is open for business.

The other, far more heralded, announcement was the 'increase' in the annual investment allowance. The increase next year of the allowance from the previously announced £25,000 to £200,000 will be welcome, but is nevertheless far less than the £500,000 that we have currently. We also have the commitment that this will be 'permanent' – something I remember other chancellors saying about first year allowances that were changed pretty quickly nonetheless.

On the banks, the story was more mixed. The scorecard shows additional revenues over this parliament, with a new supplementary charge, much like that which applies to oil and gas. However, this is coupled with a reduction in the bank levy and, by 2021, the moving of the levy onto a territorial basis. Overall, this should provide a more sustainable, slightly lower burden on the banks after this parliament, but nevertheless increase the chancellor's funds in the meantime.

For the small and medium sized businesses, there was the £1,000 increase in the NICs employment allowance, although owner-managers will also be affected by tax on dividends.

So much for business, what about individuals?

On the personal tax front, this Budget ploughed the familiar furrow of increasing the personal allowance (up to £11,000), along with an increase in the higher rate threshold (to £43,000). It also saw the chancellor finally bring in the long cherished £1m allowance for inheritance tax. This was delivered through a rather convoluted reform, focused on the passing of a parent's main residence down to a child or lineal descendant, at some point in their life. Whilst this may limit the costs of reaching the £1m target, this must be an area ripe for review by the Office of Tax Simplification.

Against that, the further raid on the pension tax relief of the highest earners, included as a manifesto commitment, clawed back another sizeable sum (£4bn over the parliament) for the exchequer. Also on the downside was the new restriction on interest incurred in funding buy to let properties, something new but which nevertheless featured on Radio 4's *Money Box* programme in the week before the Budget.

At the same time, the chancellor closed by stealing Labour's clothes with the introduction of a national living wage for the over-25s – something that may have a wide impact on both employees and businesses.

Any other tax innovations?

The end of the last parliament promised new taxes, both with the diverted profits tax and the prospect of a new levy on tobacco companies. However, yesterday we saw what might be the turning of the tide, with the reduction of the bank levy and the idea of the tobacco levy being dropped. In contrast, hypothecation (i.e. the earmarking of funds from one particular tax to a particular spending programme), for long an anathema to the Treasury orthodoxy, makes a back-to-the-future appearance as vehicle excise duty is once again to be earmarked for the roads programme.

What about special groups like the non-doms?

They are less special than before. While recognising that completely abolishing the non-dom rules could damage the UK's competitiveness, the chancellor has sought to make it clear that the rules are only to provide a temporary relief from tax. He addressed what he sees as the unfairness of special treatment being handed down through the generations (hence the duration of non-dom status being reduced); and of some UK residents being able to avoid tax on their residential property by using offshore structures.

What else?

It wasn't all about the numbers. The chancellor also announced a 'business tax roadmap', to be delivered by the next Budget, as well as more spending on HMRC to tackle tax evasion, avoidance and aggressive tax planning by large businesses. This will raise £1.6bn and will include consultation on measures to promote further compliance and transparency, including the deployment of 'special measures' and a 'voluntary' code of conduct. We can expect to hear more soon on this.

How would you sum it all up?

On the one hand, this was a principled, reform-minded Budget, with significant long term tax cutting changes to some of the key elements of the system (including the corporation tax rate and personal allowances). Listening to the chancellor's speech and reading through the *Red Book*, there was a clear and coherent reform rationale running through the Budget. The first impression was very much one of a balanced approach.

However, standing back from the political theatre of it, and digging into the numbers, a different story starts to emerge. This was very much a tax raising Budget, with the tax take overall up by some £29bn over the parliament.

The chancellor clearly wanted to fill his coffers now, fresh from the election victory, but has done so in a manner that is widespread. The second chart (below) shows from where the increased revenue and the few cuts come.

So, this is a reforming Budget that sets in place the elements for a lower tax future in the long term, but manages to boost the government's coffers greatly in the short term. Quite an achievement.

Figure 1: Total exchequer impact of Summer Budget 2015 policy decisions

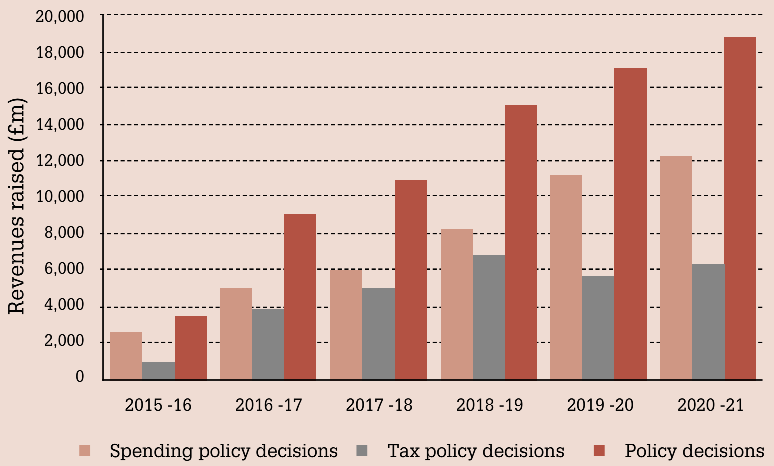
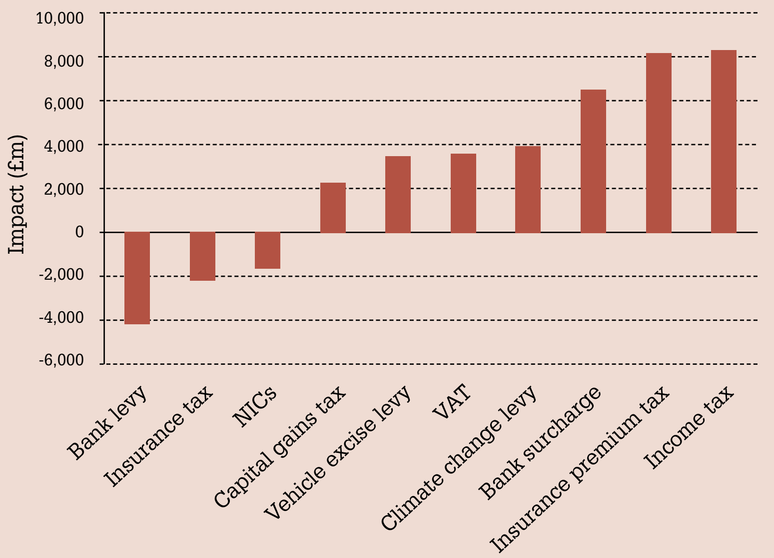


Figure 2: Budget impact on revenues



Summer Budget 2015
Your guide to the key measures

Key tax announcements

Key announcements that were new for Summer Budget 2015 include:

- reducing the main rate of corporation tax from 20% to 18% by 2020;
- a new permanent level of £200,000 for the annual investment allowance for capital allowances;
- CGT treatment for investment fund managers in respect of the full amounts received in respect of carried interest, taking effect from 8 July 2015;
- removing corporation tax relief for the cost of future acquisitions of goodwill and 'customer-related intangible assets' taking effect for accounting periods beginning on or after 8 July 2015, but not in respect of acquisitions made before 8 July 2015;
- changes to the bank levy to reduce the rate and restrict its scope to UK operations from 2021, and a new corporation tax surcharge of 8% for banks with effect from 1 January 2016;
- wide-ranging reform of the non-dom rules;
- wide-ranging changes to the taxation of dividends for individuals;
- further changes to pensions tax relief and consultation on wider reform;
- consultation on sanctions for serial avoiders and the introduction of measures to strengthen the GAAR, including a new penalty; and
- confirmation that the Summer Finance Bill will include measures for HMRC powers on direct recovery of tax debts.

Background

The chancellor of the exchequer, George Osborne, delivered his first all-Conservative Budget on Wednesday 8 July 2015. Against a backdrop of stable growth predictions and an upward trend in both employment and wage levels, the chancellor described this Budget as focusing on economic security, with the stated aim of the UK becoming a higher-wage, lower-tax, lower-welfare economy.

This first Budget of the new government can be divided into three broad categories:

- **stall-setting** – long term plans for the government's approach over the whole parliament, such as the election pledge to lock in tax rates; establishing the Office of Tax Simplification (OTS) as a permanent office of HM Treasury; setting its next targets as the alignment of income tax and NICs and the taxation of small businesses; and promises to publish tax roadmaps for:
  - tax administration for small businesses and individuals (by the end of 2015);
  - banking; and
  - business tax (by April 2016).
- **unpopular measures** (depending on your point of view) – measures that will either save money or raise revenue and which will be unpopular to some elements of the electorate, including:
  - sweeping changes to tax credits and other working benefits;
  - changes to reduce the tax benefits for buy-to-let individual landlords; and
  - wide-ranging changes to the taxation of dividends for individuals, which are expected to be a significant revenue raiser.
- **crowd-pleasers** (again depending on your point of view) – including:
  - continued focus on 'combatting tax evasion, avoidance and aggressive tax planning' with the aim of raising an additional £7.2bn a year;
  - some further bank bashing, with the introduction of a supplementary charge of 8% on banking profits;
  - a reduction in the headline rate of corporation tax to 18% by 2020;
  - increases to the personal allowance and higher rate tax thresholds, alongside the introduction of the national living wage; and
  - changes to the inheritance tax regime to remove many homes from the scope of inheritance tax.

Some advisers may have been rather alarmed by the rather cryptic and vague announcements of a review of company distributions in autumn 2015 and a consultation on 'new measures to increase compliance and tax transparency in relation to large business tax strategies'.

The Overview of Tax Legislation and Rates (OOTLAR) contains useful tables at the beginning of the document detailing proposed measures, the date of their announcement and the proposed means of implementation.

Business and enterprise

Corporation tax rates and payments

Legislation will be introduced in Summer Finance Bill 2015 to reduce the main rate of corporation tax for all non-ring fence profits to:

- 19% for financial years 2017, 2018 and 2019; and
- 18% for financial year 2020.

Draft legislation will be produced for a future finance bill to bring forward the instalment payment dates for companies with annual taxable profits in excess of £20m (with such threshold divided between group members), with effect for accounting periods starting on or after 1 April 2017. Affected companies will be required to pay corporation tax in quarterly instalments in the third, sixth, ninth and twelfth months of their accounting period.

See: *Summer Budget 2015*, paras 2.117, 2.118 and *TIIN: Corporation Tax Main rate*.

Intangible fixed assets: abolition of relief for purchased goodwill

In a major reform of the rules for taxing corporate intangibles, the government is removing corporation tax relief for the cost of future acquisitions of goodwill and 'customer-related intangible assets'. Companies will no longer be able to claim tax deductions for the amortisation or impairment of these assets, and debits arising on their realisation will no longer be relieved as trading losses. The change is described as reducing distortion, in that tax deductions for the amortisation of goodwill are available where a business is acquired via an asset purchase, but not where it is structured as an acquisition of shares.

Under current rules, companies can claim a tax deduction for the amortisation of expenditure on intangibles based on their treatment in the company's accounts. Accounting rules do not generally permit amortisation of goodwill, but a company can instead elect to take a fixed deduction for the cost of purchased goodwill at the rate of 4% per year. Tax deductions are also available for accounting debits arising as a result of an impairment review. Goodwill that is acquired after the new rules take effect will no longer be eligible for these deductions.

The rules will also be amended so that any debits arising on a realisation of goodwill will be relieved as non-trading debits rather than as trading losses. This is to limit how the debits can be relieved.

The new measures apply both to goodwill and to customer-related intangible assets. Customer-related intangible assets include customer information, customer relationships and unregistered trade marks. These are regarded as closely related to goodwill and so are included within the changes.

This is a significant change that removes one of the tax advantages for a buyer of structuring a business acquisition as a transfer of assets rather than of shares.

The measure applies to accounting periods beginning on or after 8 July 2015, but not in respect of acquisitions made before 8 July 2015.

See: *Summer Budget 2015*, para 2.124, and policy paper and draft legislation, *Corporation Tax: restriction of relief for business goodwill amortisation*.

CFC loss restriction

The controlled foreign company (CFC) legislation levies a charge on a UK company in relation to profits generated by its controlled foreign companies (CFCs) which have been diverted from the UK. Under the existing rules, certain UK tax losses, including brought forward, current year and group relieved losses and management expenses, can be used to reduce the amount of the CFC charge. This is achieved by deducting the tax value of the available losses from the CFC charge.

It was announced at *Summer Budget 2015* that TIOPA 2010, s 371UD, which provides for this offset of losses, will be repealed, so that the losses will no longer be available for use in this way.

This measure has immediate effect, applying to profits generated on or after 8 July 2015. For accounting periods which straddle this date, CFC profits should be apportioned on a just and reasonable basis to ensure that losses and management expenses can still be offset against profits arising prior to the commencement date. Interestingly, the apportionment is not carried out on a time apportionment basis, which could allow some degree of flexibility for companies which see seasonal fluctuations in profits.

In addition changes will be made to ensure that the rules that prevent tax avoidance using carried forward losses and were introduced by Finance Act 2015 will apply equally to avoidance or reduction of the CFC charge. This measure has effect for accounting periods which start on or after 8 July 2015. For straddle periods, the profits will be allocated between the before and after periods on a time apportionment basis unless that would be unjust or unfair.

See: *Summer Budget 2015*, para 2.177, *TIIN: Corporation Tax: Controlled Foreign Companies - loss restriction*.

Capital allowances: annual investment allowance

The annual investment allowance (AIA) for capital allowances purposes will be set at a new permanent level of £200,000 for qualifying investments in plant and machinery made on or after 1 January 2016.

The AIA was introduced in 2008 and since that time has been set, at different times, at five different levels, sometimes increasing and sometimes decreasing. It is currently £500,000 and was due to be reduced to £25,000 from 1 January 2016. Businesses will welcome the fact that the reduction will now be less dramatic, but will also be grateful for the AIA being set at a stable level as the fluctuations have led to considerable complexity in calculating allowances in the many accounting periods that have straddled a change.

See: *Summer Budget 2015*, para 2.120, and *TIIN: Annual investment allowance – permanent increase to £200,000*.

Research and development: universities and charities

The government will change the rules on research and development (R&D) tax credits for large companies so that the credits are not available to universities and charities. R&D tax credits (also known as ‘above the line’ credits) are replacing large company R&D relief and were not intended to apply to universities and charities. HMRC has received a number of claims from universities so is changing the legislation so that this will not be possible in future.

The measure affects a university’s or charity’s own independent research, and R&D they carry out as sub-contractors. It does not affect university spin-out companies.

The change applies to expenditure incurred from 1 August 2015. It will still be possible to make claims for expenditure incurred before this date.

See: *Summer Budget 2015*, para 2.121, and *TIIN: Corporation tax: R&D tax credits – universities and charities*.

Oil and gas taxation

The government has announced that it will broaden the application of the basin-wide investment and cluster area allowances to support investment on the UK Continental Shelf.

See: *Summer Budget 2015*, para 2.132.

Consortium relief

As previously announced at Autumn Statement 2014, all requirements relating to the location of the ‘link company’ for consortium claims to group relief will be removed for accounting periods beginning on or after 10 December 2014. Legislation was included in the original draft of Finance Bill 2015 but deferred to Summer Finance Bill 2015.

See: *Summer Budget 2015*, para 2.160 and *TIIN: Corporation Tax: simplifying ‘link company’ requirements for consortium claims*.

Future developments

- **Distributions:** the government will consult on the rules on company distributions in Autumn 2015, see: *Summer Budget 2015*, para 2.122.
- **Apprenticeships levy:** The government will introduce a levy on large UK employers to increase the number of apprenticeships. Details, such as the meaning of ‘large’, the rate of the levy and when it will start, have not been announced and are expected in the Spending Review. The chancellor’s speech suggested that there may be consultation with business on the details. It is expected that employers who appoint apprentices will be able to use some of the funds raised by the Apprenticeships Levy to support the apprenticeships. See: *Summer Budget 2015*, para 2.201.

Funds

Taxation of carried interest

Legislation will be included in Summer Finance Bill 2015 to ensure that all sums received by investment fund managers in respect of carried interest will be subject to capital gains tax.

Carried interest is broadly a right to participate in the profits of a fund where the fund has performed successfully. The government is concerned that fund managers are benefitting from arrangements that result in a low effective rate of capital gains tax on their carried interest, so they are not paying capital gains tax on their true economic profit. This is due to the application of Statement of Practice D12 (SP D12) which clarifies how the chargeable gains legislation applies to a disposal of a chargeable asset by a partnership. SP D12 operates to allow managers who receive carried interest effectively to share some of the base cost of the investors in the fund, with the result that the amount of the managers' chargeable gain is reduced. This is known as the base cost shift.

The measures announced in the *Summer Budget 2015* will apply to individuals who perform investment management services for a collective investment scheme through an arrangement involving one or more partnerships. The entire amount of any sums received by that individual in respect of carried interest under that arrangement will be subject to capital gains tax, regardless of the items notionally applied to satisfy the carried interest at the level of the partnership or other entity in the fund structure. A deduction will only be allowed for any consideration actually given in return for the carried interest rather than the amount that would be allowed under SP D12. Carried interest will be defined by reference to the disguised investment management fees legislation. The government has announced that the measure will not affect genuine investments in funds made on an arm's length basis, known as 'co-invest'.

The measures, which are likely to have a significant impact on fund managers, will have effect on all carried interest arising on or after 8 July 2015, whenever the arrangements were entered into. They do not include any grandfathering provisions, which is surprising as HMRC has known about and acknowledged this beneficial treatment for a while.

See: *Summer Budget 2015*, para 2.179, *TIIN: Investment managers Capital Gains Tax treatment of carried interest.*

Future developments in funds

The government announced at *Summer Budget 2015*:

- **Limited partnerships:** a consultation will be published on technical changes to limited partnership legislation in the context of the private equity and venture capital sector. No further information has been provided other than that the changes will enable private equity and venture capital funds to use the limited partnership structure more effectively. See: *Summer Budget 2015*, para 2.184.
- **Performance linked rewards paid to asset managers:** a consultation has been launched alongside *Summer Budget 2015* on the circumstances in which fund managers' performance linked rewards should benefit from capital gains treatment. There are currently no relevant tax rules specific to the asset management sector and applying normal investment/trading principles can be difficult. The consultation proposes statutory tests to clarify the position and to set out when performance fees arising to fund managers from their fund management activities may be treated as capital in nature. According to the consultation, the default rule will be that such fees will be charged to tax as income with capital treatment given in certain circumstances. Although private equity carried interest is expected to be taxed as capital gain, this is not certain and will be dependent on the investment strategy of the fund. The consultation closes on 30 September 2015. See: *Summer Budget 2015*, para 2.179 and consultation document: *Taxation of performance linked rewards paid to asset managers*.

Finance

Bank levy

In a much anticipated and lobbied for move, the chancellor announced that the bank levy, introduced in the wake of the credit crunch, will be reformed and reduced over the next six years.

Although only increased to its current rate in March Budget 2015, the main rate of the bank levy will fall from 0.21% to 0.18% with effect from 1 January 2016. It will then drop to 0.17% in 2017, 0.16% in 2018, 0.15% in 2019, 0.14% in 2020 and 0.10% in 2021. Proportionate and corresponding annual reductions will also be made to the half rate.

In a further reform, although the bank levy is currently calculated by reference to a bank's worldwide balance sheet, the government has announced that from 1 January 2021 it will be restricted to apply to UK operations only. The chancellor will hope that winding the bank levy down in this way will be enough to see major global banks (eg HSBC) decide to remain in the UK.

See: *Summer Budget 2015*, paras 1.201-1.204 and 2.127 and *TIIN: Bank Levy: rate reduction*.

In a separate but related development, the government has announced that a bank will be able to claim relief against the bank levy for any payments it has to make to the European Single Resolution Fund which forms part of the Single Resolution Mechanism (SRM). The SRM was set up after the financial crisis to establish an efficient 'resolution' process for European banks that encounter serious financial difficulties.

The new relief, which will be enacted by statutory instrument, will be available from 1 January 2016.

See: *Summer Budget 2015*, paras 1.205 and 2.128.

Bank corporation tax surcharge

It was not, however, all good news for banks. *Summer Budget 2015* includes proposals to introduce a new supplementary tax on banking sector profits intended to 'maintain a fair contribution from the banks'.

From 1 January 2016, an 8% surcharge – to be treated as an amount chargeable as if it were corporation tax – will be applied to a bank's corporation tax profit as calculated, crucially, before it has utilised any existing carried-forward losses and with any group relief surrendered from non-banking companies added back. Where a company's accounting period straddles 1 January 2016, the period will be split and the surcharge will apply to the profits of the notional period commencing on 1 January 2016.

The new provisions will also include a targeted anti-avoidance rule (TAAR).

Although the new surcharge will not apply to the first £25m of group profit, the government expects the surcharge to more than offset – by some £2bn in total – the reduction to the bank levy (outlined immediately above).

See: *Summer Budget 2015*, paras 1.201-1.204 and 2.126 and *TIIN: Bank Corporation Tax surcharge*.

Banking tax definitions

Summer Finance Bill 2015 will include provisions that change how 'banking companies' are defined for the purposes of the bank levy and bank loss-relief restriction legislation (CTA 2010 Pt 7A, announced at Autumn Statement 2014, included in FA 2015, and having effect for accounting periods beginning on or after 1 April 2015).

The definition of a banking company will be updated and aligned with recent changes to relevant regulatory standards, used by the Prudential Regulatory Authority and the Financial

Conduct Authority. There is no intention, however, for the amendments to materially impact the operation of the bank levy (or the bank loss-relief restriction).

The new definitions are back-dated and so take effect from 1 April 2014 (for the bank levy) and 1 April 2015 (for the loss restriction legislation).

See: *Summer Budget 2015*, para 2.130 and *TIIN: Updating bank definitions*.

Banks' compensation payments

As announced in March Budget 2015, and following consultation on the proposal by HM Treasury, Summer Finance Bill 2015 will include provisions to ensure that compensation expenses arising in relation to a bank's misconduct, management failures or mis-selling of products are not be allowable as a deduction in calculating the bank's profits for corporation tax purposes.

Before this change, large compensation payments made by banks in relation to, for example, the mis-selling of PPI and interest rate hedging products, were tax-deductible and, due to the huge figures involved, had a significant impact on UK corporation tax receipts after the financial crisis. The government considered that the existing rules were 'unsustainable' and that it was 'not acceptable that corporation tax receipts continue to be depressed by banks' past misconduct'. The new provisions are designed to address the anomaly and protect the exchequer.

The measures have immediate effect and so will apply to expenses incurred on or after 8 July 2015.

See: *Summer Budget 2015*, paras 1.206 and 2.129 and *TIIN: Restricting tax relief for banks compensation payments*.

Modernisation of the taxation of corporate debt and derivative contracts

In a welcome move, the government has confirmed that Summer Finance Bill 2015 will include the measures previously announced in Autumn Statement 2014, but omitted from Finance Bill 2015, to complete the latest efforts to update, simplify and rationalise the regimes for the taxation of loan relationships and derivative contracts.

The 'wide-ranging' changes include:

- with effect for accounting periods commencing on or after 1 January 2016, clarifying the relationship between tax and accounting – measures will include removing the 'fairly represent' requirement and basing the calculation of taxable loan relationship profits solely on accounting entries in a company's income statement (and so not in reserves or equity);
- with effect from the date Summer Finance Bill 2015 receives Royal Assent (although originally intended to apply from 1 April 2015), the addition of a new regime-wide anti-avoidance, 'main purpose', rule in each of the loan relationships and derivative contracts rules; and
- also from the date of Royal Assent of Summer Finance Bill 2015 (although it was originally intended to apply from 1 January 2015), a new 'corporate rescue' rule providing tax relief where loans are released in cases of debtor companies in financial distress with a view to ensuring their continued solvency.

With the exception of the changes to the operative dates, the proposals appear to be identical to those announced in Autumn Statement 2014. The government has, however, also announced that updates to the rules on the tax treatment of:

- FOREX hedging;
- convertible instruments; and
- property-based derivatives

will be introduced by secondary legislation during the course of 2015.

For background information, see: Consultation: *Modernising the taxation of corporate debt and derivative contracts* (6 June 2013), Draft Clauses & Explanatory Notes for Finance Bill 2015 (10 December 2015).

See: *Summer Budget 2015*, paras 2.123 and *TIIN: Corporation Tax: modernisation of the taxation of corporate debt and derivative contracts*.

Employment taxes

National insurance contributions

The following NICs announcements (to come into effect in April 2016) were made:

- following the introduction of a £2,000 NICs employment allowance in April 2014 (as announced in the *Budget 2013*), the government announced in *Summer Budget 2015* that the NICs employment allowance will be increased to £3,000. This allowance will enable an employer to hire four employees on the newly proposed national living wage of £7.20 per hour (effective from April 2016) without paying any NICs. As a result, up to 90,000 employers will see their employer NICs liability reduced to zero. See: *Summer Budget 2015*, paras 1.127 and 2.61; and
- companies where the director is the sole employee will no longer be able to claim the NICs employment allowance. See: *Summer Budget 2015*, paras 1.198 and 2.62.

Measures pre-announced

The following employment taxes measures were previously announced and will be implemented unchanged, or with the minor changes described:

- **statutory exemption for trivial benefits:** as previously announced in Autumn Statement 2014 and March Budget 2015, the statutory exemption for trivial benefits in kind costing less than £50 will be effective from April 2016 and will be introduced in Finance Bill 2016. For details of these measures, see *Summer Budget 2015*, para 2.161;
- **benefits in kind and expenses:** as previously announced in FA 2015 (following recommendations made by the OTS) the following measures will be effective, from the 2016/17 tax year:
  - abolition of the £8,500 threshold for benefits in kind;
  - allowing employers to voluntarily report and deduct tax on benefits in kind in real time; and
  - introduction of an exemption for qualifying business expenses.

  The draft regulations required to deliver these changes were released alongside *Summer Budget 2015*. See: *Summer Budget 2015*, para 2.161;
- **travel and subsistence expenses:** following a report by the OTS and as previously announced at *Budget 2014*, the government will review the rules underlying the tax treatment of travel and subsistence expenses. The consultation can be found here. The deadline for the review has been extended several times, the most recent of which extended stage 1 of the review until 1 May 2016. A discussion paper will be published shortly outlining a potential framework for the new rules. See: *Summer Budget 2015*, para 2.165;
- **ordinary commuting:** as previously announced in March Budget 2015, the government has published a consultation document detailing proposals to restrict tax relief for

ordinary commuting (in general home-to-work travel and subsistence expenses) for workers who are supplying personal services engaged through an intermediary (including umbrella companies, certain employment business and personal service companies) and who are working under the supervision, direction or control of any person. The proposed change is to ensure that individuals, whose relationship with their engager is such that they look and act as employees, cannot claim relief on the everyday cost of travelling to work, when employed through an intermediary. The consultation can be found here. The consultation is open for comments until 30 September 2015 and the changes will take effect from April 2016. See: *Summer Budget 2015*, para 2.182; and
- **NICs reform:** as previously announced at March Budget 2015, the government will consult in Autumn 2015 on the abolition of class 2 NICs and to reform class 4 NICs for the self-employed. See: *Summer Budget 2015*, paras 1.246 and 2.16.

Future developments

Pursuant to the *Summer Budget 2015*, the government has announced that it will:

- actively monitor the growth of salary sacrifice schemes that reduce employment taxes and their effect on tax receipts (see: *Summer Budget 2015*, paras 1.197 and 2.66);
- commission the OTS to review:
  - the closer alignment of income tax and NICs; and
  - the taxation of small companies.

  (The terms of reference for the OTS reviews on the closer alignment of income tax and NICs and the taxation of small companies will be published shortly. See: *Summer Budget 2015*, paras 1.245 and 2.158-2.159);
- consult on the tax and NICs treatment of termination payments, to make the system simpler and fairer. See: *Summer Budget 2015*, paras 1.246 and 2.164; and
- engage with stakeholders on how to improve the effectiveness of the existing intermediaries legislation (IR35) which is designed to protect against disguised employment. A discussion document will be published shortly as the government has admitted that IR35 (the current anti-avoidance legislation introduced to ensure that individuals choosing to work through their own limited company (but who would have been employees if they were providing their services directly) pay the same tax and NICs as employees) is 'not effective enough'. In addition, the government has asked HMRC to start a dialogue with business on how to improve the effectiveness of existing IR35 legislation. See: *Summer Budget 2015*, paras 1.180-1.181 and 2.182.

Incentivised investment

Venture capital schemes

Summer Budget 2015 announced further changes to the rules for enterprise investment schemes (EIS), seed enterprise investment schemes (SEIS) and venture capital trusts (VCT). Changes to the legislation governing these schemes were originally announced at March Budget 2015 but were deferred until after the general election. Since then, the government has analysed the responses to its consultation on this topic and made further amendments to the draft legislation.

The changes can be summarised as follows:

- **New measures in Summer Budget 2015:** new rules to prevent EIS and VCT funds from being used to acquire existing businesses, whether through a share purchase or asset sale;
- **Minor changes in Summer Budget 2015**:
  - new qualifying criteria to limit eligibility for companies receiving their first risk finance investment (SEIS, EIS or VCT). The limit will be 10 years after the first commercial sale took place for 'knowledge intensive' companies and 7 years (originally 12 years) for other qualifying companies (except where the total investment represents more than 50% of turnover averaged over the preceding five years);
  - a new cap on the total investment a company may receive under EIS and VCT at £20m for 'knowledge intensive' companies and £12m for other companies (originally £15m); and
  - an increase in the employee limit for 'knowledge intensive' companies to 500 employees (originally 499 employees).
- **Implemented measures**:
  - EIS and VCT will be amended to require all investments to be made with the intention to grow and develop a business, and require all investors to be 'independent' from the company at the time of the first share issue;
  - the removal of the requirement that 70% of SEIS money must be spent before EIS or VCT funding can be raised;
  - the establishment of a stakeholder forum to allow investors to raise queries and concerns about the operation and use of venture capital schemes;
  - as announced at the Autumn Statement 2014, the government will introduce a new digital process for companies and investors using SEIS, EIS and the Social Investment Tax Relief (SITR) by the end of 2016;
  - the government also intends to work with VCTs to develop a standard format for the annual VCT returns. This will be discussed at the new stakeholder forum.

These provisions will take effect from the date of Royal Assent of Summer Finance Bill 2015, subject to state aid approval, except for the 70% SEIS spending requirement which will take effect from 6 April 2015.

See: *Summer Budget 2015*, paras 2.71-2.72 and *TIIN: Income tax – amendments to tax-advantaged venture capital schemes.*

Real estate taxes

Restricting finance cost relief for individual landlords

The chancellor announced a number of measures which will impact on residential landlords in *Summer Budget 2015*. The most significant of these is a measure which will restrict the amount of income tax relief individual landlords can receive in respect of residential property finance costs (e.g. interest on mortgage payments). This measure will exclude those properties that meet all the criteria of a furnished holiday letting. The rationale for this measure is that the ability to use this relief puts individual landlords investing in a rental property at an advantage to ordinary homeowners and also to curb the rapid growth of buy-to-let mortgages.

Legislation will be introduced in Summer Finance Bill 2015 to restrict finance cost deductions on residential property income for individual landlords and to introduce a new tax reduction at the basic rate of income tax. Individuals will be able to claim a basic rate tax reduction from their income tax liability on the portion of finance costs not included in calculating the profit. Any excess finance costs may be carried forward to following years if the tax reduction has been limited to 20% of the profits of the property business in the tax year.

This measure will be phased in from April 2017 over 4 years. Relief will be calculated as follows:

Tax year	Deduction from property income	Basic rate deduction
2017/18	75% of finance costs	25%
2018/19	50% of finance costs	50%
2019/20	25% of finance costs	75%
2020/21	0% of finance costs	100%

The rationale behind this change is that the existing income tax relief puts individual landlords investing in a rental property at an advantage compared with ordinary homeowners. The measure is also intended to curb the rapid growth of buy-to-let mortgages.

See: *Summer Budget 2015*, paras 1.190-1.191 and 2.59; *TIIN: Restricting finance cost relief for individual landlords*; and *OOTLAR*, p 67.

Reform of wear and tear allowance

Currently a wear and tear allowance is permitted when residential landlords replace furnishings. This does not always allow the full cost of the replacement.

Summer Budget 2015 has announced a new relief to replace this allowance. From April 2016, residential landlords will be permitted to deduct the actual costs of replacing furnishings. Given the possibility of abuse of this relief, the details will not be finalised until after a technical consultation, expected to be published shortly, with a view to including legislation in Finance Bill 2016.

See: *Summer Budget 2015*, para 2.58.

Rent a room relief increase

Secondary legislation will be introduced to increase the level of rent-a room relief, which provides for tax-free income that can be received from renting out a room or rooms in an individual's only or main residential property, from £4,250 to £7,500 with effect from 6 April 2016.

See: *Summer Budget 2015*, para 2.60; *TIIN: Rent a Room relief increase*; *OOTLAR*, p 64.

SDLT and authorised property funds

As initially announced at Autumn Statement 2014, it has been confirmed that the government still intends to introduce a seeding relief for property authorised investment funds (PAIFs) and co-ownership authorised contractual schemes (CoACSs) and also to make changes to the SDLT treatment of CoACSs investing in property so that SDLT does not arise on transactions in units, subject to resolving potential tax avoidance issues. Provisions implementing these measures are intended to be included in Finance Bill 2016.

See: *Summer Budget 2015*, para 2.154.

Business rates review

Further to the announcement made at Autumn Statement 2014, the government is conducting a review of the structure of business rates and has now published an update outlining progress made to date on the review and setting out the government's proposed next steps. These include:

- consulting further with stakeholders on the proposed appeals system ahead of enabling legislation being considered in parliament in the Enterprise Bill;
- incorporating provisions on improved information sharing between the Valuation Office Agency and local authorities as part of the Enterprise Bill; and
- continuing to work across government to reduce the taxpayer burden of sharing the same information with multiple government bodies.

See: *Summer Budget 2015*, para 2.55.

Indirect taxes

VAT use and enjoyment rules

The government will extend VAT 'use and enjoyment' provisions from next year in order to ensure that all UK repairs made under UK insurance contracts will be liable to VAT in the UK. The government will also consider implementing a wider review of offshore based avoidance in VAT exempt business sectors, with a view to introducing additional use and enjoyment provisions for services such as advertising in the following year. These changes will be introduced in order to combat perceived VAT avoidance schemes, such as the scheme used by the taxpayer in *Ocean Finance* [2015] All ER (D) 298 (Jun) to avoid payment of VAT on advertising services.

See: *Summer Budget 2015*, para 2.136.

VAT refunds for shared services

As announced in March Budget 2015, the government will legislate in Finance Bill 2016 to enable eligible public bodies to reclaim VAT under the VATA 1994 s 33 VAT refund scheme for certain shared expenses.

See: *Summer Budget 2015*, para 2.137.

IPT standard rate increase

The standard rate of IPT will increase from 6% to 9.5%. It is predicted this increase will raise an additional £1bn in tax revenue per year.

The increased rate will have effect for insurers using the IPT cash accounting scheme with effect from 1 November 2015. For insurers using the special accounting scheme, there will be a 4 month concessionary period from 1 November 2015 to 29 February 2016. During this period premiums received before 1 November 2015 will remain liable to IPT at 6%. The new 9.5% rate will apply to all premiums received by insurers from 1 March 2016 regardless of when the policy was entered into. Provisions implementing these measures will be included in Summer Finance Bill 2015.

See: *Summer Budget 2015*, paras 1.209 and 2.133.

Private client

Income tax

Tax lock: The government will legislate to place a ceiling on the main rates of income tax, the standard and reduced rates of VAT and employer and employee (Class 1) national insurance contribution (NICs) rates. This follows the Conservatives' election pledge to fix the rates. The purpose of this measure is to ensure that these rates cannot rise above their 2015/16 levels. Specifically:

- the higher and additional rates of income tax applicable to earnings income in England, Wales and Northern Ireland and UK wide savings income (see ITA 2007 s 6(1)) will not increase above 20%, 40% and 45% for the duration of the current parliament;
- class 1 NICs rates payable by employers (13.8%) and employees (main rate 12%, additional rate 2%)(see Social

Security Contributions and Benefits Act 1992, s 8(2) and s 9(2)) will not be increased for the duration of this parliament;

- the upper earnings limit (UEL) for class 1 NICs (currently £815 per week) will not exceed the higher rate tax threshold (HRTT) – the UEL (reg 10(b) of the Social Security (Contributions) Regulations 2001) is the point at which employee's earnings no longer count toward contributory benefits and they start to pay NICs at 2% and the HRTT is the sum of the personal allowance (currently £10,600 and the basic rate limit (£31,785) equating to £42,385 (reg 11(2A)(b) of the Social Security (Contributions) Regulations 2001) in 2015/16;
- for the duration of this parliament, the standard rate under VATA 1994 s 2 can be no higher than 20% and the reduced rate under s 29A can be no higher than 5%.

These measures, for income tax and VAT, will have effect on the date that the Summer Finance Bill 2015 receives royal assent and for NICs after Royal Assent of the National Insurance Contributions Bill.

See: *Summer Budget 2015*, para 2.53; *TIIN: Tax lock: Income Tax, National Insurance contributions and VAT*; and *OOTLAR*, page 16.

Personal allowance: Legislation will be introduced in the Summer Finance Bill 2015 to set the personal allowance for 2016/17 at £11,000 and for 2017/18 at £11,200, and the basic rate limit for 2016/17 at £32,000 and for 2017/18 at £32,400 in accordance with the following table:

	2015/16	2016/17	2017/18
Personal allowance	10,600	11,000	11,200
Basic rate limit	31,785	32,000	32,400
Higher rate threshold	42,385	43,000	43,600

The NICs upper earnings/profit limits will remain aligned to the higher rate threshold and will therefore also increase for 2016/17 and 2017/18.

Note: the effect is that, from 2016/17, everyone, regardless of their date of birth, will be entitled to the same personal allowance.

See: *Summer Budget 2015*, para 2.54; *TIIN: Income Tax: personal allowance and basic rate limit for 2016 to 2017*; and *OOTLAR*, page 22.

Personal allowance indexation: With the objective that individuals working 30 hours a week at the national minimum wage will not pay income tax, legislation will be introduced in Summer Finance Bill 2015 to change the indexation of the personal allowance to increase in line with the annual equivalent of 30 hours a week (at the national minimum wage rate that individuals over the age of 21 are entitled to).

The change will only be effective when the personal allowance reaches £12,500.

See: *Summer Budget 2015*, para 2.55; *TIIN: Income Tax: personal allowance indexation*; and *OOTLAR*, page 19.

Higher rate threshold limit: The government proposes to increase the HRTT in accordance with the table under 'Personal Allowance' above.

The NICs UEL will also increase to remain aligned with the HRTT. See: *Summer Budget 2015*, para 2.56.

Dividend taxation: The government will abolish the dividend tax credit with effect from April 2016 and replace it with a new dividend tax allowance of £5,000 a year.

The new rates of tax on income above that allowance will be:

- basic rate taxpayers: 7.5%
- higher rate taxpayers: 32.5%
- additional rate taxpayers:38.1%

See: *Summer Budget 2015*, para 2.57.

Personal savings allowance: From 6 April 2016, a new personal savings allowance will reduce the tax payable by basic and higher rate taxpayers on interest earned on savings. Basic rate taxpayers will not have to pay tax on the first £1,000 of interest received on savings while higher rate taxpayers will not have to pay tax on the first £500 of interest received. Additional rate taxpayers are not eligible for the allowance.

Banks and building societies currently automatically deduct 20% income tax on non-ISA savings and the government has announced in Summer Budget 2015 that this practice will cease from 6 April 2016.

It has also been announced that the government will publish a consultation on whether changes are required to the deduction arrangements currently applicable to other savings income.

See: *Summer Budget 2015*, para 2.76.

Bad debt relief for peer-to-peer (P2P) industry

At Autumn Statement 2014, the chancellor announced a package of measures to support P2P and crowdfunding platforms by removing barriers to their growth. One of these measures was a new tax relief for lending through P2P platforms. This relief will operate so that, if a P2P loan is not repaid, the loss that the lender suffers on that loan will be set against the income that they receive on other P2P loans before that income is taxed.

HMRC published a technical note at March Budget 2015 setting out the proposed technical criteria for the relief including who should be able to benefit, when the relief can be obtained and the amount of relief to be made available. Draft legislation is expected later this year to be included in Finance Bill 2016.

See: *Summer Budget 2015*, para 2.74.

P2P withholding tax

At Autumn Statement 2014, the government also announced plans to introduce a withholding tax regime for income tax to apply across all P2P lending platforms from April 2017 so that P2P lending platforms would be required to withhold tax on interest earned at the basic rate.

The government will consult on these proposals with the industry over Summer 2015 to ensure that these proposals will work in practice. Legislation is expected to be introduced in Finance Bill 2016.

See: *Summer Budget 2015*, para 2.75.

Anniversary Games

Between 24 and 26 July 2015 at the Queen Elizabeth Olympic Park, the Sainsbury's Anniversary games will be held. This will attract not only UK athletes but others of international standing. The government will exempt from UK income tax, non-UK resident sports people on any income received as a result of their performance at the games. The exemption will also apply to a UK resident for whom this activity is performed in an 'overseas' part of the year.

See: *Summer Budget 2015*, para 2.69; *TIIN: 2015 London Anniversary Games*; and *OOTLAR,* page 77.

Individual savings accounts (ISAs)

Extending ISA eligibility: The government announced the introduction of the 'Innovative Finance ISA', for loans arranged via a peer to peer (P2P) platform to enable P2P loans to benefit from the tax advantages within an ISA.

As announced at Budget 2014 and Autumn Statement 2014, a consultation was published on 17 October 2014 and updated on 8 July 2015, on the proposed approach to including P2P loans as ISA qualifying investments. The government's aims are stated to be supporting savers, increasing the choice of investments to ISA investors and encouraging the growth of the P2P sector.

The government intends to use the proposed definition of 'relevant agreements' in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, article 36H for which P2P loans, including debt securities and equity offered via a crowdfunding platform, will be eligible for inclusion as ISA qualifying investments.

It's worth noting that the government has confirmed its intention for P2P loans to become a regulated activity although the Financial Conduct Authority has chosen not to include P2P platforms within the scope of the Financial Services Compensation Scheme. However, this decision is due to be reviewed in 2016.

See: *Autumn Statement 2014*, para 2.63; *March Budget 2015*, para 2.83; and *Summer Budget 2015*, para 2.77.

Making ISAs more flexible: The government will change the ISA rules to allow ISA savers to withdraw and replace money from their cash ISAs, within the tax year, without the replacement counting towards their annual ISA subscription limit.

The changes, which were announced at March Budget 2015 (para 2.85), will take effect on 6 April 2016 and will include cash held in stocks and shares ISAs. The changes will mean that ISA savers who need access to their ISA cash are not penalised if they then want to save more later in the tax year. ISA savers will need to replace any money withdrawn in the tax year the withdrawal was made, otherwise the replacement will count towards the following tax year's ISA subscription limit.

See: *Summer Budget 2015*, para 2.78.

Pensions

Taxation of pensions at death: As announced at Autumn Statement 2014, the government will reduce the 45% tax rate that applies on lump sums paid from the pension of someone who dies aged 75 and over to the marginal rate of the recipient from 2016/17.

From April 2015, lump sum death benefits paid from a registered pension scheme or non-UK pension scheme are taxed at 45% where the owner of the pension rights dies aged 75 or over. If the deceased was under the age of 75, from April 2015 these lump sum death benefits are not taxed unless they are paid out more than two years after the scheme administrator became aware of the death. The two-year rule does not apply to the pension protection lump sum death benefit of the annuity protection lump sum death benefit.

The government has confirmed that taxable lump sum death benefits will be subject to tax at the recipient's marginal rate of income tax. Where the recipient is, for example, a trust or a company and so does not have a marginal rate the 45% charge will continue to apply.

These measures will be legislated in Summer Finance Bill 2015, to be published on 15 July 2015 and will apply from April 2016.

See: *Summer Budget 2015*, para 2.79; and *OOTLAR*, page 57.

Unfunded employer financed retirement benefit schemes: The government will consult on tackling the use of unfunded EFRBS to obtain a tax advantage in relation to remuneration.

See: *Summer Budget 2015*, para 2.80.

Lifetime allowance for pension contributions: The government will reduce the Lifetime Allowance (LTA) for pension contributions from £1.25m to £1m from 6 April 2016. Transitional protection for pension rights already over £1m will be introduced alongside this reduction to ensure that the change is not retrospective. The LTA will be indexed annually in line with CPI from 6 April 2018. These measures will be legislated in Finance Bill 2016.

See: *Summer Budget 2015*, para 2.82.

Reduced annual allowance for top earners: The government will restrict the benefits of pensions tax relief for those with incomes, including pension contributions, above £150,000 by tapering away their Annual Allowance to a minimum of £10,000.

The measure will restrict pensions tax relief by introducing a tapered reduction in the amount of the annual allowance for individuals with income (including the value of any pension contributions) of over £150,000 and who have an income (excluding pension contributions) in excess of £110,000. In order to facilitate the taper, legislation will also be introduced to align pension input periods with the tax year as well as transitional rules to protect savers who might otherwise be affected by the alignment of their pension input periods.

These measures will be legislated in Summer Finance Bill 2015, to be published on 15 July 2015 and will come into effect from April 2016.

See: *Summer Budget 2015*, para 2.83; *OOTLAR*, page 60.

Pensions tax relief: The government will consult on whether and how to undertake a wider reform of pensions tax relief (PTR): *Strengthening the incentive to save: a consultation on pensions tax relief*.

PTR is designed to provide an incentive for individuals to defer their income until their retirement. However, the gross cost of PTR is significant. Including relief on both income tax and NICs, the government missed out on nearly £50bn of tax revenues in 2013/14. Consequently, the government is interested in considering suggestions on whether and how the current system of PTR could be reformed to strengthen the incentive to save for retirement.

The principles the government believes any reform should meet are:

- it should be simple and transparent;
- it should allow individuals to take personal responsibility for ensuring they have adequate savings for retirement;
- it should build on the early success of automatic enrolment in encouraging new people to save more; and
- it should be sustainable.

The consultation will close on 30 September 2015.

See: *Summer Budget 2015*, para 2.84.

Pensions Wise: The government is extending access to the successful Pension Wise advisory service to those aged 50 and above, and launching a new comprehensive nationwide marketing campaign. This will ensure more people can access high-quality, impartial guidance on making the most of the new pension flexibilities.

See: *Summer Budget 2015*, para 2.85.

Equitable Life payment scheme (ELPS): The ELPS will close to new claims on 31 December 2015. As part of this, the government will undertake a further effort to trace remaining policy holders due £50 or more.

The ELPS was set up by the government to make payments to Equitable Life policyholders who suffered financial losses as a result of government maladministration which occurred in the regulation of Equitable Life. Once Britain's oldest mutually – owned insurance company, Equitable Life was forced to close in 2000 after losing a £1.5bn court case, losing almost a million pension policyholders a total of £4.3bn.

The government will also make a further payment to Equitable Life policyholders on Pension Credit who received 22.4% of their relative loss. This payment will be for an additional 22.4% and will be made in early 2016.

See: *Summer Budget 2015*, paras 2.86–2.87.

Inheritance tax and trusts

Increased IHT nil rate band for main residence: The chancellor confirmed in his Budget speech the pre-announced proposal to introduce an additional IHT nil rate band (NRB) for the main residence. It will be available with effect from 6 April 2017 when a residence is passed on death to one or more direct descendants, such as children or grandchildren. Direct descendants include a step-child, adopted child or foster child. The extra allowance will be phased in as follows:

Tax year	Additional NRB
2017/18	£100,000
2018/19	£125,000
2019/20	£150,000
2020/21	£175,000

The basic NRB will now remain at £325,000 until 5 April 2021, and thereafter the two elements of the NRB will increase together in line with the consumer price index.

The main residence NRB will be transferable to a surviving spouse or civil partner, in the same way as the existing NRB. Hence the chancellor was able to claim that the effective IHT threshold for a couple will rise to £1m in 2020/21. It will be 'transferable' even where the first death occurs before 6 April 2017, and the second death occurs afterwards. It appears that where the family home has been left to the spouse or civil partner on the first death *at any time* before 6 April 2017, the additional NRB is effectively backdated.

The sting in the tail, which was not pre-announced, was that the additional NRB will be progressively withdrawn for estates valued at more than £2m. It will be tapered away by £1 for every £2 by which the net value of the estate exceeds £2m (after deducting liabilities but before reliefs and exemptions). This relief is therefore aimed squarely at the moderately wealthy, who hold a large proportion of their wealth in their home, and will be of little benefit to the very rich.

The proposals as outlined in the TIIN introduce some interesting details and raise a number of questions too.

The relief applies to the deceased's interest in a residential property which has been his or her residence *at some point* and is included in the estate at death. Where more than one residential property qualifies, the personal representatives will be able to choose which one should attract the additional NRB. Clearly the choice will be governed by the comparative values of the properties and who the beneficiaries are. Case law relating to CGT private residence relief on what constitutes a 'residence' will be persuasive.

It is not clear from the information available whether the residence in question must be the subject of a specific gift to direct descendants, or whether the value can be included as part of a residuary gift to them. If a specific gift is required, most people hoping to benefit from the relief will need to draft or re-draft their wills. If, as is more likely, a gift of residue will qualify, the calculation of the NRB could be complicated where other beneficiaries, such as an unmarried partner, take a share of the estate.

It has been argued that the proposal to focus the increased NRB on the family home will encourage people to retain their wealth in their home and this could have a detrimental effect on the property market. As a result, the government is proposing to include measures which preserve the relief even if the testator has downsized to a less valuable residence, or ceased to own a residence after 8 July 2015. The aim is to apply the additional NRB to the value of the former home. In recognition of the technical challenge inherent in such a solution, the government will publish a consultation on the proposals in September 2015.

As proposed, the additional NRB will only be available on death. It will not apply to lifetime transfers that become chargeable on death. This is a strange detail which will, if enacted, work against the downsizing principle as it will tend to deter parents from making lifetime gifts to their children for fear of being caught by the 'seven year rule.' They may downsize because they need a smaller home, but they will be encouraged to keep the excess proceeds to benefit from the additional NRB.

The published proposals do not address the potential issue of 'upsizing.' By singling out one particular asset for special relief, parents and grandparents will be encouraged, as far as practicable, to concentrate as much as they can afford in the value of their home, if only temporarily.

Initial legislation will be included in the new Finance Bill 2015, but the adjustments relating to downsizing and possibly other refinements will be deferred until Finance Bill 2016 after consultation.

See: *Summer Budget 2015*, paras 2.88 and 2.89; and *OOTLAR*, page 32.

Tax avoidance through multiple trusts: As announced at Autumn Statement 2014 and March Budget 2015, the government will introduce new rules to target tax avoidance through the use of multiple trusts and simplify the calculation of IHT on trusts rules, with the new rules to be introduced in a future Finance Bill.

The government had initially announced plans at Autumn Statement 2013 to allow just one nil rate band per individual, to be split across all relevant property trusts to simplify the calculation of IHT charges on relevant property trusts where property is settled into multiple trusts on the same day and by the same person with the value comprised in them not presently being aggregated when determining the rate at which IHT is charged. The purpose of the government's proposed future amendment is to prevent the leakage of IHT through the use of multiple trusts by the same settlor. There are no proposed changes following the legislation that was published in draft on 10 December 2014.

See: *Autumn Statement 2014*, para 2.73; *March Budget 2015*, para 2.95; and *Summer Budget 2015*, para 2.93.

IHT changes to support the new IHT digital service: The government will amend existing legislation dealing with interest to support the introduction of the new IHT digital service as part of its new digital and online services strategy for agents and taxpayers.

As announced at Autumn Statement 2014 and March Budget 2015, as part of the government's digital strategy to improve the process for customers and the administration of IHT, an online service will be provided in 2015/16 for the submission of IHT returns. The new rules will be introduced in the Summer Finance Bill 2015.

The amendments made by this clause are part of those changes and will ensure that the relevant provisions relating to late payment interest are updated and apply consistently when the new online service becomes available in 2015/16.

See: *Autumn Statement 2014*, para 2.74; *March Budget 2015*, para 2.92 and *Summer Budget 2015*, para 2.92.

Non-domiciliaries (non-doms)

At Summer Budget 2015 the government announced wide ranging reforms to the taxation of individuals domiciled outside the UK (non-doms). The changes relate to income tax, capital gains tax (CGT) and inheritance tax (IHT).

The changes to the taxation of non-doms will take effect on 6 April 2017 and will, broadly, be as follows:

- IHT will be payable on all UK residential property owned by resident or non-resident non-doms regardless of whether the property is held directly or indirectly through an offshore structure.
- Non-doms who have been resident in the UK for more than 15 of the past 20 tax years will be deemed to be domiciled in the UK for all tax purposes.
- Individuals who have a UK domicile of origin will no longer be able to claim non-dom status while they are resident in the UK.

See: *Summer Budget 2015*, paras 2.63, 2.64, 2.65, 2.90 and 2.91; and *Technical briefing on foreign domiciled persons/Inheritance Tax residential property changes*.

From 6 April 2008 a remittance basis charge (RBC) is payable if a non-dom is 18 or over, has to make a formal election to claim the remittance basis and is a long-term resident in the UK. The RBC is currently an annual charge but at Autumn Statement 2014 the government announced that it would consult on making the claim to pay the RBC apply for a minimum of three years to prevent non-doms from arranging their tax affairs so as to pay the charge occasionally. The consultation opened on 22 January 2015 and closed on 16 April 2015. The government has now confirmed that it will *not* introduce a minimum claim period for the RBC.

See: *Summer Budget 2015*, para 2.65.

Changes to the IHT treatment of enveloped UK residential property: The government announced that all UK residential property held directly or indirectly by non-doms will be subject to IHT from 6 April 2017.

Background: UK residential property can be held in many different structures. A common structure, even following the introduction of the Annual Tax on Enveloped Dwellings (ATED), is putting the company into an offshore company, whose shares are held by a non-dom or held by an offshore trust from which the non-dom can benefit (i.e. enveloping the property).

The principal benefit of such a structure is the IHT protection it affords by virtue of the non-dom effectively converting the UK residence to excluded property for IHT purposes. In the case of property held through an offshore company, the residence is protected from IHT on the death of the non-dom on the basis that non-doms are only subject to IHT on their UK situated assets and the shares in the offshore company are not located in the UK (i.e. the shares are excluded property). In the case of a trust, the trust will be holding the excluded property shares and so ten year and exit charges will not apply to the value of the UK residence.

References below to 'shares' are to the excluded property shares in the offshore company which owns the UK residential property.

The new IHT charge: In order to bring such UK residential properties within the scope of IHT, the government will amend the excluded property provisions. The changes will ensure that offshore companies and other structures cannot be considered excluded property if they derive their value directly or indirectly from UK residential property (and consequential amendments to the relevant property regime will be made).

The main features of the charge are:

- all UK residential property will be subject to the charge, whether the property is occupied or let;
- the charge will apply to UK residential property of any value;
- the charge will be imposed on the occasion of a chargeable event, including:
  - death of the shareholder, wherever resident;
  - a gift of the shares into trust;
  - the trust's ten year anniversary;
  - a distribution of the shares out of the trust;
  - death of the donor within 7 years of gifting the shares; and
  - death of the donor or settlor who benefits from the gifted UK property or shares in the 7 years prior to death;
- any borrowing taken out to purchase the UK residential property will be deductible when calculating the charge (although note the restrictions on deductibility of debt for IHT purposes);
- the same reliefs (e.g. the spouse exemption) will apply as if the shares were owned directly by the non-dom (although such reliefs may not be available if the shares are held by a trust); and
- the gift with reservation of benefit rules will apply similarly to the shares as they do to UK residential property held directly by non-doms and UK domiciled individuals.

Complications will arise in less straightforward situations, such as if the offshore company owns other assets (UK or foreign) or where groups of companies are in a structure. The government will consult on the detail of proposals to ensure only the value of UK residential property is brought within the new charge.

Interaction with the non-residents CGT charge on disposal of UK residential property and ATED: The same properties as those covered by the non-residents CGT legislation will be subject to the charge. Consequently, diversely held vehicles holding UK residential property will not be subject to the charge.

Furthermore, the IHT charge will be based on the ATED rules but with important differences:

- the new IHT charge will apply to UK residential property of any value (although the nil rate band may be available in the case of low value property) whereas ATED currently only applies to properties worth in excess of £1m; and
- there will be no exemption from the new IHT charge for let properties as there is with ATED.

Further points: The new charge does not affect UK domiciled individuals or trusts which are not excluded property trusts and also does not apply to assets other than UK residential property. Enforcement, liability and reporting obligations will be addressed through consultation. Anti-avoidance legislation in this area will be reviewed and any planning may come within the scope of the strengthened DOTAS (FA 2015, Sch 17) regulations.

This measure, like the introduction of ATED, is designed to encourage de-enveloping of UK residential property. However, de-enveloping may come with other tax costs which the government has said it will consider during the consultation process.

The changes are intended to be effective from 6 April 2017 through Finance Bill 2017, following a consultation to be published in early autumn and a later consultation on draft legislation.

See: *Summer Budget 2015*, para 2.90.

Deemed domicile for income tax, CGT and IHT: Individuals who have been resident in the UK for more than 15 of the past 20 tax years but are foreign domiciled under general law will be deemed domiciled for all tax purposes in the UK (the 15 year rule) from 6 April 2017.

Background: Currently an individual may be domiciled in the UK under general law or, for IHT purposes only, under the deemed domicile rules. There are two separate rules in IHTA 1984 s 267 that can apply deemed domiciled status for IHT:

- the individual was domiciled in the UK under general law at any point in the last three years (the three year rule);
- the individual has been resident in the UK for not less than 17 of the last 20 years (the 17 year rule).

In addition, IHTA 1984 s 267ZA allows someone who is married or in a civil partnership and not domiciled in the UK to elect to be treated as if they were domiciled in the UK (a domicile election).

The 3 year rule continues to attach a deemed UK domicile to an individual who has left the UK and taken sufficient steps to lose their UK general law domicile. The deemed domicile continues for three years after the general law domicile has been lost. This three year period does not refer to tax years.

The 17 year rule applies to individuals who have come to the UK and remained resident here for a prolonged period, but without otherwise acquiring a UK domicile under general law. It also continues to apply for three complete tax years to an individual who leaves the UK after acquiring a UK deemed domicile. This means that they can only lose their deemed domicile under the 17 year rule by being non-resident for four tax years (the 4 year rule).

Both the 3 year rule and the 17 year rule need to considered when an individual leaves the UK.

Where a double tax treaty in relation to UK IHT and a foreign equivalent has been entered into between the UK and a foreign territory, double tax relief for IHT may apply. The treaties with India, Pakistan, France and Italy were in place before 1975 during the estate duty era and have different rules to eliminate double taxation than more recent treaties and can, in some circumstances, override the 3 year rule and the 4 year rule.

The 15 year rule: The 15 year rule will apply as follows:

- The government will consult on whether split years of UK residence will count towards the 15 years or whether complete tax years of UK residence are required.
- From the 16th tax year of UK residence:
  - a non-dom will no longer be able to access the remittance basis of taxation and will be taxed on an arising basis on their worldwide personal income and gains; and
  - IHT will be paid on the non-dom's worldwide personal assets.
- The £90,000 RBC currently payable by a non-dom who wants to access the remittance basis and who has been resident in at least 17 of the last 20 tax years will cease to be relevant from 6 April 2017 since a non-dom will be taxed on an arising basis after 15 years. The £30,000 and £60,000 RBCs will remain.
- The government will consult on the need to retain a de minimis exemption beyond 15 years where total unremitted foreign income and gains are less than £2,000 per year (ITA 2007s 809D(2)).
- The new rules will be effective from 6 April 2017 irrespective of when someone arrived in the UK, and there will be no grandfathering rules for those already in the UK.
- The present rules will apply to those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled on 6 April 2017 under the 15 year rule.
- A non-dom who leaves the UK after becoming deemed domiciled under the 15 year rule has to spend more than five tax years outside the UK to lose their deemed domicile (the five year rule). This is consistent with the requirement to be non-resident for five years under the temporary non-residence rules.
- The government will also consult on whether other provisions need to be changed such as the domicile election and the effect of the change in relation to the old estate duty treaties.
- To ensure that UK domiciliaries (UK doms) and non-doms are treated the same under the new rules, UK doms who leave after 5 April 2017 having been here for over 15 years will also be subject to the 5 year rule even if they intend to emigrate permanently and settle in a particular place on the day of their departure. The government will consult on the detail of the various interactions between the 5 year rule and the existing 3 year and 4 year rule.
- If an individual spends more than five tax years abroad and then returns to the UK, while remaining non-dom under general law, the 15 year clock will restart. This will *not* apply to returning UK doms (who will be subject to different rules below).
- The deemed domicile of the long-term resident non-dom has no effect on the domicile status of the non-dom's children whose actual and deemed domicile position is looked at independently.
- Once deemed domiciled under the 15 year rule, non-doms will not be able to claim reliefs such as the remittance basis for overseas chargeable earnings under ITEPA 2003 s 22. There will be consultation on the employment-related securities provisions.
- Non-doms who have set up an offshore trust before becoming deemed domiciled in the UK under the 15 year rule will not be taxed on trust income and gains that are retained in the trust and such excluded property trusts will have the same IHT treatment as present (subject to the proposals referred to in *Changes to the IHT treatment of enveloped UK residential property*).
- Non-doms who are deemed domiciled in the UK under the 15 year rule will be taxed from 6 April 2017 on any benefits, capital or income received from any trusts on a worldwide basis. The government will consult on the necessary changes to the transfer of assets regime and CGT trust provisions.
- Transitional rules relating to trusts were introduced for non-doms in 2008 (e.g. rebasing provisions). The interaction of these rules with the new regime after the non-dom becomes deemed domiciled in the UK will be subject to consultation.

See: *Summer Budget 2015*, para 2.63, 2.64 and 2.91.

UK doms returning to the UK: The government will introduce a rule from 6 April 2017 which means that UK doms returning to live in the UK, having acquired a domicile of choice elsewhere, will be treated as UK domiciled (for all tax purposes) as soon as they become UK resident again. This measure applies to UK doms (i.e. those with a UK domicile of origin, not a UK domicile of choice) and 'UK doms' in this context refers to individuals with a UK domicile of origin only.

Background: A UK dom can acquire a domicile of choice in another country if they live abroad and have the intention to settle there permanently or indefinitely.Domicile is a matter of general law, and tax treatment has so far been determined by an individual's domicile position under general law (except in the case of IHT, where an individual can be deemed UK domiciled under IHTA 1984 s 267).

For IHT purposes, under IHTA 1984 s 267(1)(a), a person who had an actual UK domicile will remain UK domiciled for three years once a domicile of choice elsewhere has been established (the three year rule referred to above). The clock on the three years can start running as soon as an individual leaves the UK (if they also have the necessary intention to settle permanently elsewhere) or only once the decision has been taken not to return to the UK, which may happen many years after leaving the UK. Similarly, if a UK domicile of origin is revived at any stage, the three year rule will again come into effect.

Having acquired a domicile of choice elsewhere, a UK dom who returns to live in the UK can maintain that foreign domicile of choice, if they continue to have the intention of settling abroad. Acquiring and maintaining a domicile of choice outside the UK can enable the individual to undertake IHT planning (such as setting up excluded property trusts). This will no longer be possible under the changes being introduced.

Returning to the UK: A UK dom will from 6 April 2017 become UK domiciled as soon as they become UK resident again.

Leaving the UK again: A UK dom will lose their UK dom status again in the tax year after departure only if both of the following are satisfied:

- the UK dom did not spend more than 15 tax years here; and
- they did not acquire an actual domicile in the UK under general law when they were in the UK (i.e. their domicile of choice, as a matter of general law, remained in place).

If neither of these conditions are satisfied (i.e. the UK dom spent more than 15 tax years and became actually domiciled in the UK), the 3 year rule and 5 year rule both apply and UK domicile will only be lost on the later of those events.

On the other hand, if the UK dom has returned to the UK for more than 15 tax years but not become actually domiciled, the 5 year rule will apply. If the UK dom has become actually domiciled but came back to the UK for less than 15 years, the 3 year rule will come into effect again, and it will take another three years before they lose their UK dom status again.

Timing and scope of new measure: Although the new measure is framed by reference to the IHT rules, the rule will apply for all tax purposes.

This measure will apply to returning UK doms even if they returned prior to 6 April 2017. UK doms who leave after 5 April 2017 will be subject to the 5 year rule.

The measure will also affect trusts set up by UK doms (while they were non-doms) who become UK resident on or after 6 April 2017. The same tax rules apply for those trusts (for income tax, CGT and IHT purposes) as they would for any other UK dom.

As mentioned above, further consultation on the interaction of various deemed domicile rules for UK doms and non-doms will take place. The consultation will be published in the early autumn.

See: *Summer Budget 2015*, paras 2.63, 2.64 and 2.91.

Administration and anti-avoidance

Common Reporting Standard developments

The government will legislate to require financial intermediaries (including tax advisers) to notify their customers about the Common Reporting Standard (CRS), the penalties for evasion and the opportunities to disclose.

The CRS is a global standard for the automatic exchange of financial account information in tax matters, developed under the auspices of the Organisation for Economic Cooperation and Development (OECD). Under the CRS, jurisdictions obtain financial information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis.

HM Treasury will be given the power to make regulations to impose customer notification obligations on financial institutions, tax advisers and other professionals. This may include obligations to notify customers or clients of certain information relating to information HMRC will receive under international agreements to improve tax compliance, the law relating to offshore tax evasion and associated criminal and civil penalties, and opportunities that HMRC will make available to individuals to disclose their tax affairs. These measures will be legislated in Summer Finance Bill 2015 and are expected to take effect in early 2016.

See: *Summer Budget 2015*, para 2.168; and *OOTLAR*, page 112.

Additional resource to target non-compliance by wealthy individuals

In a continued crackdown on tax avoidance and evasion, the chancellor announced that the government will provide additional resource to HMRC to allow it to identify and tackle tax evasion and other non-compliance among wealthy individuals by extending HMRC's Customer Relationship Model to individuals with net wealth between £10–20m. The Customer Relationship Model, run by HMRC's High Net Worth Unit, currently only applies to individuals with wealth in excess of £20m.

It was announced that additional resource will also be committed to pursuing more criminal investigations against wealthy individuals evading tax. This is part of a wider plan to increase funding to HMRC by a total of over £60m by 2020/21 to allow HMRC to step up criminal investigations into serious and complex tax crime, focusing on wealthy individuals and corporates.

The government will also consult on enhancing the information reported to HMRC by wealthy individuals and trustees.

See: *Summer Budget 2015*, para 2.180.

Additional specialist personal tax (SPT) resource

The government will invest an additional £36m over five years from 2016 to tackle serious non-compliance by trusts, pension schemes and non-domiciled individuals.

See: *Summer Budget 2015*, para 2.181.

IR35 reform

The government has announced that it will engage with stakeholders on how to improve the effectiveness of existing intermediaries legislation (IR35).

See: *Summer Budget 2015*, para 2.183.

Interest on tax-related judgment debts

The rules on the rate of interest on tax-related debts owed to or by HMRC will be changed so that there is no longer a different rate if the debt follows a court action.

Under current rules, the interest rate on debts arising from court judgments is set by the Judgments Act 1838 and County Courts Act 1984 at 8%. This rate will be disapplied where the debt relates to a tax matter to which HMRC is a party. Instead, the late payment interest rate will apply where HMRC is the creditor, and the Bank of England base rate plus 2% (subject to future changes) will apply where HMRC is the debtor.

See: *Summer Budget 2015*, para 2.167 and *TIIN: Simplification of HMRC debtor and creditor interest rate*.

Large business tax compliance

The government is investing further resources into large business tax compliance, as part of its efforts to tackle tax evasion and avoidance. In addition it will legislate 'to improve transparency of tax strategies'. There will be a consultation on 'special measures' for businesses that persistently engage in aggressive tax planning, and a voluntary Code of Practice setting out the standards large businesses should meet in their dealings with HMRC.

See: *Summer Budget 2015*, paras 1.175 and 2.176.

HMRC information powers: tackling the hidden economy

HMRC will be empowered to acquire data from online intermediaries and electronic payment providers with the aim of finding those operating in the hidden economy. The government will consult on this measure with the intention of introducing legislation in FB 2016.

See *Summer Budget 2015*, para 2.172.

Disposal of stock other than in trade

Legislation will be included in Summer Finance Bill 2015 to ensure that the tax rules applying to transfers of trading stock or intangible fixed assets between related parties bring into account the correct value.

Market value rules that typically treat the transfers as taking place at market value can be overridden by the transfer pricing legislation so they do not apply. The proposed revisions, which have effect for transfers made on or after 8 July 2015, ensure that transactions between related parties that are subject to the transfer pricing legislation can still be further adjusted under the market value rules so that overall, disposals are brought into account for tax purposes at full open market value.

See: *Summer Budget 2015*, para 2.178, *TIIN: Corporation Tax and Income Tax: disposal of stock other than in trade*, and corporate intangibles and policy paper and draft legislation: *Disposal of stock other than in trade, and corporate intangibles*.

Measures pre-announced

The following anti-avoidance measures were previously announced:

- **Serial avoiders:** The government will publish a further consultation on sanctions for serial users of defeated tax avoidance schemes, following an earlier consultation on this topic that was published in January 2015. The proposed measures include a special reporting requirement, a surcharge, and 'naming and shaming' serial avoiders. In addition, the promoters of tax avoidance schemes (POTAS) regime, also known as the 'high-risk promoters' regime, would be widened by bringing in promoters whose schemes are regularly defeated. Legislation to implement these measures will be in Finance Bill 2016. See: *Summer Budget 2015*, para 2.174
- **GAAR penalty:** The government will consult on introducing a general anti-abuse rule (GAAR) penalty and new measures to strengthen the GAAR. A previous consultation on introducing a penalty where arrangements are counteracted under the GAAR was published in January 2015. The measures would be included in Finance Bill 2016. See: *Summer Budget 2015*, para 2.175
- **Direct recovery of debts:** Summer Finance Bill 2015 will include measures originally proposed in Budget 2014, to increase HMRC's powers to recover tax and tax credit debts directly from taxpayers' bank accounts. This measure has been widely criticised, and the government has promised that there will be 'robust safeguards' including a county court appeal process and a face-to-face visit to every taxpayer before they are subject to this form of debt recovery. Draft legislation was published in Finance Bill 2015 but was dropped as part of the 'wash up' to enact the Bill before the general election. The draft did not include a requirement for a face-to-face meeting and it remains to be seen whether this will be placed on a statutory footing. *See: Summer Budget 2015*, para 2.170.

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Government spending and revenue

Chart 1: Public sector spending 2015/16

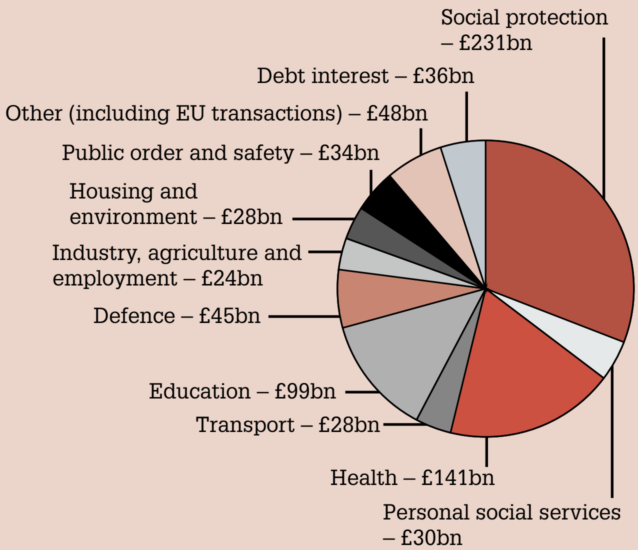
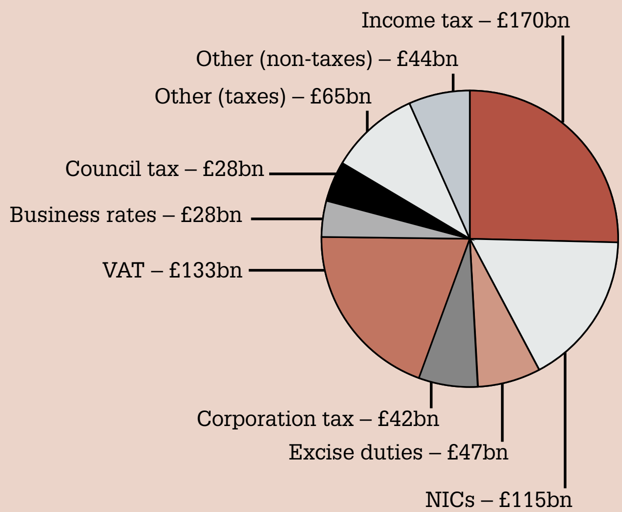


Chart 2: Public sector receipts 2015/16



Source: OBR 2015/16 estimates

Compliance and enforcement

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The war on non-compliance continues apace.

26 November 1996 was the last time that a chancellor presented the budget of a Conservative government – on that occasion Rt. Hon Kenneth Clarke MP. On 8 June 2015, Rt. Hon George Osborne (who is actually only Clarke's successor-but-two in the 18 years that have passed) stood up to do the same – not of course for the first time, but for the first time presenting a Conservative Budget. And the extent to which the Liberal Democrats in the coalition of 2010–15 had a significant influence over compliance and enforcement should not be forgotten. Back in March, following the coalition's last Budget (as it would turn out to be), the announcements about proposed new criminal powers were actually left to the Liberal Democrat chief secretary to the Treasury, Danny Alexander, to make the following day, complete with a bright yellow Budget box. That seems an eternity ago.

So to what extent has the tone changed? Well, apparently not much – although it appears that the Budget was very light on detail in relation to compliance and enforcement. We shall possibly have to wait and see what emerges over the next weeks and months – and of course in the Autumn Statement – which after all is less than five months away.

Within the first five minutes of his speech, the chancellor announced that he had 'found £5bn from tackling tax evasion, avoidance, planning and imbalances in the tax system'.

It would be interesting to see how the breakdown between these categories is made up, as there must be a limit to how much more the government can squeeze out of 'avoidance and evasion'.

Within the next five minutes we had heard some more specifics as the chancellor turned to 'combatting tax evasion, avoidance and aggressive tax planning'.

'We're boosting HMRC's capacity with three quarters of a billion pounds of investment to go after tax fraud, offshore trusts and the business of the hidden economy, tripling the number of wealthy evaders they pursue for prosecution – raising £7.2bn in extra tax'. Then, a minute or so later, he added: 'And we're going to add tough new penalties to our general anti-abuse rule, and name and shame serial users of failed tax avoidance schemes.'

But, after all that excitement, there was relatively little else. And a scour of the associated documents did not reveal very much either.

So what did we already know, what was not mentioned but is still expected – and what is genuinely new? In terms of what we already knew, the reference to penalties for the GAAR and the naming and shaming of avoiders (which had already been consulted upon) was announced in the March Budget for inclusion 'in a future Finance Bill'. Further provisions against serial avoiders which take this a stage further, will be the subject of a more detailed consultation, to be published over the summer. A special reporting requirement is also promised, as is a surcharge on those whose latest tax return is inaccurate as a result of a 'further defeated avoidance scheme'. There are also the naming and shaming proposals, a widening of the 'promoters of tax avoidance schemes regime' to include those whose schemes are regularly defeated, and a consultation on the detail of the proposed GAAR penalty. So we can expect a busy summer responding to consultations, followed by draft legislation in the Autumn Statement and – finally – inclusion of these provisions in the Finance Bill 2016.

One of the 'signature' features of the March Budget was the announcement of the abolition of the self-assessment system for individuals and small businesses; and its replacement with a system of 'digital tax accounts', under the banner of 'making taxes easier'. There was no reference to this in the chancellor's speech this time, but a reference was included – buried away (somewhat bizarrely) under the heading of 'Environment and energy taxes' – in HMRC's *Budget Overview*. This announced that the government will publish a 'roadmap' by the end of the year (presumably as part of the Autumn Statement), which will show the timetable for 'transforming tax administration' over the course of this Parliament. Discussions with 'key stakeholders and delivery partners' will begin over the summer. So, yes, the abolition of self-assessment will definitely be going ahead, but there is not much more detail yet. Watch this space.

We were also reassured that the proposals for closure of a 'single issue' on a closure notice are still alive and well; and that HMRC will respond 'during the summer' to the consultation exercise that took place over the winter. At that stage, we shall learn whether it has listened to representations encouraging it to match the power with a commensurate right on the part of taxpayers to apply to the tribunal for the closure of a single issue.

Following the consultation on the implementation of the common reporting standard (CRS) in the course of 2014, the results of which were published in March 2015, the forthcoming Finance Bill will include requirements on the part of financial institutions, tax advisers and other professionals to notify their customers about the CRS, the penalties for tax evasion that might result from it, and opportunities for disclosure.

The direct recovery of debts legislation (as amended following consultation, with the relevant draft legislation having been published for consultation around the last Autumn Statement) will also be included in the forthcoming Finance Bill. This will contain the necessary safeguards previously outlined following initial consultation; notably, a county court appeal process and a face-to-face visit for every debtor before they are subjected to this measure.

What was not mentioned but is still expected? The proposed new criminal offences of strict liability for offshore evasion, and the offence of 'corporate failure to prevent tax evasion', announced by the chief secretary in March, were the obvious 'elephants in the Budget'. The strict liability offence has appeared to do a 'disappearing act' once before in its gestation. As I noted (*Tax Journal*, 27 March 2015), the implementation of these provisions would 'presuppose that HMRC will have the funds to put behind them, particularly in terms of mounting criminal investigations, which are notoriously expensive and resource intensive'.

The answer to that is probably provided by one of the items in the 'genuinely new' category below. In short, we can expect a further – and more detailed – consultation over the summer or autumn (possibly as late as the autumn statement).

What is genuinely new? Not a great deal, is the answer – except for the rhetoric in the chancellor's speech, which suggested that the overall war on enforcement continues apace.

The announcement of a £750m investment in HMRC (presumably over the life of the parliament) to raise £7.2bn in extra tax was the signature announcement. Of this, £60m (by 2020/21) will be specifically targeted at 'serious and complex tax crime particularly focusing on wealthy individuals and corporates'. This, I suspect, provides the answer to the question as to what has happened to the two proposed new offences. There is the money earmarked to make them effective. The wishes of Margaret Hodge, late of the PAC (if not of Parliament itself), for more 'red blooded' prosecutions looks as if it might be granted.

HMRC's powers to acquire data from intermediaries and electronic payment providers will also be extended, so as to enable it to crack down further on the 'hidden economy'. Again, a fairly ambitious target of Finance Bill 2016 is set out for this, which again suggests a consultation over the summer.

Finally, £300m will be invested over the course of the parliament to tackle non-compliance by small and medium sized businesses, public bodies (an interesting target, and an increasing feature of HMRC's energies) and – unsurprisingly – 'affluent individuals'. The war on non-compliance by the 'mass affluent' looks set to be a feature of this Conservative government, as it was of the coalition. ■

The impact on multinationals

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A surprisingly 'big Budget' for big business.

Falling after the pre-election hoopla of diverted profits tax, and before the expected endorsement of a raft of BEPS-driven measures in Budget 2016, this Budget could easily have been a damp squib for multinationals. In fact, however, the chancellor's self-described 'big Budget' contained more than enough to keep life interesting for multinational groups, focused on four main areas.

First, rate and payment changes. For most groups, the headline news was the fall in the headline rate to 19% in 2017 and 18% in 2020. This is obviously welcome for corporate taxpayers – though it will further fuel the rather ill-informed argument, in the US and elsewhere, that the UK is becoming a 'tax haven'. The rate benefit will be partly offset by accelerating the times at which large businesses make their CT instalment payments. That single change is forecast to raise an astonishing £7.6bn in 2017/18 and 2018/19.

As so often, banks are effectively excluded from the benefit of reduced tax rates. The Budget announced a 'grand old Duke of York' policy on bank levy. Having marched the rate up from 0.05% in 2011 to 0.21% today, the government will gradually march it back down to 0.1% by 2021; and, at that point, it will also limit the bank levy to apply only to banks' UK balance sheets. This will be (more than) paid for through an 8% increase in banks' corporation tax rate, which will be imposed in full from 2016 onwards.

Second, a tougher CFC regime. Until the Budget, TIOPA 2010 s 371UD provided that profits apportioned to the UK under CFC rules could be set off against current and carried-forward UK losses, or sheltered using group relief. Describing this as an 'abuse', the chancellor announced that, from Budget day, any CFC charge will automatically trigger a cash tax liability, regardless of the UK company's loss position. This moves our CFC rules closer to being a (DPT-style) punitive regime. If the relevant activity was in fact carried out in the UK, then it would be taxed here with the ability to set off against losses; whereas, if it is diverted to a CFC, the apportioned profits will always trigger a cash tax charge. (For groups with carried-forward losses, it will also, incidentally, reduce the attractiveness of the UK's finance company partial exemption rules, as the partial exemption will inevitably result in additional cash taxes.)

Third, taxation of intangibles. The Budget amended the intangibles rules to deny future deductions for accounting amortisation of goodwill. This does not, however, apply to assets acquired before Budget day, or to assets which are acquired under a contract which had gone unconditional by Budget day. This change will, of course, make it still more attractive to structure business acquisitions as share deals rather than asset deals, particularly given the SSE benefits of share sales.

However, the Budget failed to provide the expected update on details of the narrower 'modified nexus' UK patent box, which was initially announced in November 2014 and which will be introduced from 2016. Further information will presumably be published over the next few months, but it is starting to look challenging to meet the OECD target of legislating for this in 2015.

Finally, the relationship with HMRC. One potentially significant change was tucked away in para 2.176 of the Budget document. This announced that the government was consulting on a 'voluntary code of practice defining the standards HMRC expects large businesses to meet in their relationship with HMRC.' This, of course, sounds rather similar to the banking code of practice adopted in 2009, which has had a major impact on many banks' approach to UK tax over the last few years. It will be interesting to see whether the consultation proposes a code that is restricted to governance and relationship matters, or whether (as with the banking code) it will require large businesses to comply with the 'spirit, as well as the letter, of tax law'. And, in light of banks' experience, businesses may wonder quite how 'voluntary' the code will be. Will HMRC have the power, say, to publish the names of large businesses which do not sign up to the code? ■

The effect on OMBs

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A mixed bag for owner-manager businesses.

Although it is the benefits cuts which have made the headlines, the Budget statement includes a number of changes particularly affecting owner-managed businesses, some welcome and some less so.

In parallel with cuts to tax credits, a new national living wage is introduced. Starting at £7.20 from April 2016, it will rise to £9 by 2020. It is estimated to cost employers, as a whole, 1% of profit; and it's compensated by a reduction in the rate of corporation tax to 19% in 2017 and to 18% in 2020. Large employers will also have to contribute to a training levy, which will provide a fund to assist financing apprenticeships. This looks like a modest but welcome transfer of training costs from small firms to larger ones. Smaller businesses, in particular, will also welcome the decision to retain the annual investment allowance at a permanent level of £200,000 per year. It means that for many businesses, all capital expenditure on plant and machinery will be fully relieved in the year of acquisition. Smaller organisations will also especially benefit from the increase in the employment allowance to £3,000 from April 2016 (equivalent to NIC on four full-time employees on the national living wage), though the allowance is withdrawn altogether from companies where the director is the sole employee.

HMRC has long been tetchy about 'tax-driven incorporation', especially of one-man businesses. Where two otherwise identical businesses are carried on, one as a company and one as a sole trader, the tax and NIC payable by the two can be very different. Imposing NIC on dividends is technically difficult, so Mr Osborne has solved his problem a different way. In future, dividends will carry no tax credit. There will be an annual exemption of £5,000; and dividends in excess of that amount will be taxed at 7.5%, 32.5% or 38.1%, depending on whether the shareholder is a basic, higher or additional rate taxpayer. It will not increase the tax payable by holders of modest portfolios of quoted shares; indeed, in many cases it will reduce it. But it will make trading through the medium of a company less attractive, though not terminally so, and is slightly compensated by the reduction in the rate of corporation tax to 19% from 2017 and to 18% from 2010. The change comes in from April 2016. Company owners may wish to consider taking accelerated dividends before then.

The pre-election Budget in March changed the rules on amortisation of intangible assets to deny relief for goodwill and similar assets acquired from related parties. So it is slightly odd that, just a few weeks later, the Summer Budget should now extend that denial to all acquisitions of such assets taking place after Budget Day, regardless of the identity of the person from whom the acquisition is made. Indeed, it seems even odder that it should have taken the government 13 years to have worked out that the intangible asset regime created what is now described as a 'distortion in the market' by affording more favourable tax treatment to the acquisition of assets than to that of shares. One wonders which of today's tax reliefs will be tomorrow's 'distortions'.

Private client

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The chancellor giveth, but he also taketh away.

Non-doms: The tax treatment of 'non-doms' (UK resident but domiciled abroad) has long been a bone of contention. Following fevered speculation before the election, it is unsurprising that this Budget targeted them – but the scale of reform was unexpected. All of these changes apply from April 2017.

Non-doms will lose the remittance basis for income tax/CGT and favourable IHT treatment after more than 15 out of 20 years of residence, regardless of when they first arrived in the UK. (At present, they only become deemed domiciled for IHT purposes after 17 years and can claim the remittance basis indefinitely, provided they pay the appropriate charge.) Under the new rules, they will pay tax on worldwide income and gains, including any benefits, capital or income received from trusts. Those with a UK domicile of origin will not be able to lose it easily. If they leave the UK and later return, they will be taxed as UK domiciled whatever their intention and general law domicile status.

More fundamentally, UK residential property held indirectly (for example, through a company or trust) will fall within the scope of IHT whether occupied or let – this means IHT on the death of a deemed domiciliary owning shares in an offshore company, on a gift or PET of those shares, and on ten year anniversaries of trusts holding them. This may sound the death knell for traditional planning, whereby a UK home is held through an offshore company/trust structure, but we await a consultation document which will be published after the summer recess.

These changes must prompt non-doms to re-assess their options post haste: they have just under two years to re-plan. Will those already in the UK stay here? Their tax bills have increased steadily since the introduction of ATED and the associated CGT charge on gains from property disposals (without any PPR exemption), so the loss of IHT protection for UK property held indirectly will call existing structures into question and make non-doms wonder whether, without the tax perks, it is really worth it. The benefits of owning foreign property directly or through an excluded property trust, will remain. However, that does not help those who wish to live here.

Ultra high net worth individuals: HNWIs were not targeted specifically in the Budget but the government is concerned about possible levels of tax evasion and non-compliance among wealthy individuals, so plans to extend the remit of the High Net Worth Unit. This unit 'looks after' individuals worth £20m+, which figure will now drop to £10m+. Another consultation is promised, on enhancing the information reported by wealthy individuals and trusts.

'Middle England': High earners and professionals may benefit from the new IHT main residence nil rate band, but will suffer from restrictions on tax relief for pensions contributions.

The new IHT allowance was widely trailed, but Budget papers reveal that this will be phased in over four years and won't start until 6 April 2017. It will also be restricted for net estates of £2m+.

The initial allowance is £100k in 2017/18, rising annually by £25k until reaching £175k in 2020/21, on top of the existing NRB (itself frozen at £325k until April 2021). It is transferable to a spouse or civil partner but will only reduce IHT on death, not other chargeable transfers. It applies specifically to a gift to direct descendants of a property which has been the deceased's residence; however, a concession, effective from Budget Day, will encompass taxpayers who downsize or sell property that would otherwise have qualified.

To finance the above, tax relief for pension contributions by additional rate taxpayers will taper down from £40,000 to £10,000, starting in April 2016. This is a major change for high earners in future, who will need to try and maximise relief in the current year.

Existing trusts: Trusts have not yet been rehabilitated, unfortunately, despite their use for non-tax reasons (e.g. asset protection, privacy and management continuity). From April 2016, the dividend tax credit will be replaced by a £5,000 tax free 'allowance'. Above that, dividends will bear tax at 7.5% or 32.5% (for basic and higher rate taxpayers), but at 38.1% for trusts taxed at the additional rate. Trustees will be worse off if they receive dividends over £25,250 p.a. However, trying to reduce the tax burden by appointing revocable interests in possession may prove fruitless, as higher rate taxpayers will be worse off if dividend income exceeds £21,700 p.a.

The previous proposals to outlaw pilot trust planning (setting up separate settlements to try to obtain multiple nil rate bands) will reappear in the July Finance Bill. If property is added on the same day to relevant property trusts, that will be aggregated in order to calculate the rate of IHT.

Pity the small landlord? Sharing your house is fine (rent a room relief will be increased by over 75% from next April to £7,500). However, from April 2017, individual buy-to-let landlords will only be able to deduct finance costs (principally interest) for basic, and not higher, rate income tax. This change will be phased in over four years, with the percentage of the finance costs available to be deducted against higher rate income gradually reducing from 75% in 2017 to 0% in 2020.

Economic view

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Less of a rollercoaster on spending, but still a lot of pain to come.

The chancellor stuck to his pre-election objective of eliminating the budget deficit before the end of this Parliament, but provided more concrete details of how he would achieve this. In particular, he opted for a smoother profile of real spending cuts over the next four years, which is sensible in allowing affected government departments, local authorities and households more time to adjust. But there is still a lot of pain to come.

The OBR's view of UK economic prospects has changed little since March. As the table shows, it still expects economic growth to proceed at a steady pace of around 2.3–2.4%, and still expects inflation to rise back gradually towards its 2% target over the next few years. Excluding the new measures announced in the July Budget, which the OBR judges will not have a material net impact on average economic growth over the period to 2020, its underlying public borrowing forecasts have not changed much since March. Tax receipts are projected to be a little stronger, but this is slightly outweighed in later years by higher public spending – due, in particular, to somewhat higher debt interest costs in the latest projections.

The chancellor's main strategic shift was to smooth out what the OBR had termed the 'rollercoaster' profile of planned spending cuts. Rather than being focused on 2016/17 and 2017/18, austerity will now continue until 2019/20, but at a more gradual pace than planned in March.

Welfare cuts totalling £12bn by 2019/20 will weigh heavily on lower income working age households, although a new national living wage will offset this for some workers by rising to £9 per hour by 2020. Unprotected government departments and local authorities will face a further Parliament on basic rations.

Restricting public pay growth to 1% per annum for the next four years may be needed to get the deficit down, but will pose challenges in attracting and retaining talent to the public sector over a period when private sector earnings are likely to be growing at around 3–4% per annum.

On the tax side, there was the usual complex mix of swings and roundabouts. The biggest giveaways related to cutting corporation tax to 18% by 2020, further increases in personal income tax allowances and extending inheritance tax relief for main residences.

These giveaways were more than outweighed, however, by a series of tax increases relating to dividend taxation, insurance premium tax and vehicle excise duty, as well as restrictions in pensions tax relief and a range of anti-avoidance measures. Overall, therefore, this was a tax-raising Budget, as indeed has been the norm for post-election Budgets since 1993. All chancellors like to get the bad news out of the way early in a parliament.

On the overall fiscal strategy, we clearly needed some further tightening to get the budget deficit down. It is good for financial and business confidence that we now have more detail as to how this will be achieved than we did before the election.

It is prudent for the chancellor to aim for a budget surplus by 2020, as a buffer against future economic shocks at a time when initial public debt levels are high due to the legacy of the financial crisis. But it may not be sensible to aim to run overall budget surpluses indefinitely, as this could unduly restrict the scope for the longer term public sector investment that Britain needs to strengthen its national infrastructure.

Comparison of key OBR forecasts at the time of the March and July 2015 Budgets

GDP growth (%, calendar years)	2015/16	2016/17	2017/18	2018/19	2019/20
Budget (March 2015)	2.5	2.3	2.3	2.3	2.4
Budget (July 2015)	2.4	2.3	2.4	2.4	2.4
CPI inflation (%, calendar years)					
Budget (March 2015)	0.2	1.2	1.7	1.9	2.0
Budget (July 2015)	0.1	1.1	1.6	1.8	1.9
Public sector net borrowing (£bn)*					
Budget (March 2015)	75	39	13	-5	-7
Budget (July 2015)	70	43	24	6	-10

*Excluding borrowing of public sector banks
Source: OBR

Ask an expert
Earn-outs and deferred consideration

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My clients (Anthony and Ben) are selling their shares in a design company for a mixture of cash at completion, deferred consideration (payable on the first anniversary) and earn-out consideration (of £4m payable over four years if certain revenue targets are met). Anthony will stay in the business, although he will no longer be a shareholder. Ben is neither an employee nor a director and will have no role in the business. Anthony qualifies for entrepreneurs' relief (ER) on the sale but Ben does not. How will they be taxed on the deferred consideration and the earn-out consideration, and how is it best to structure the earn-out?

The deferred consideration is a simple deferred payment of cash. For tax purposes, the payment is taxable in the year when the contract is made and the contingency is ignored (TCGA 1992 s 48). The sellers will therefore pay tax on the gain arising from this amount in respect of the tax year of sale. Anthony, who qualifies for ER, will pay tax at 10% and Ben will pay tax at 28%.

The tax on the deferred consideration will be reported in their self-assessment tax returns for this year (2015/16), along with the upfront cash consideration and, for Anthony, the earn-out element (see below). The tax will be payable by 31 January 2017. Ben could look at taking the deferred consideration in loan notes to defer his tax bill; however, he may decide not to on the basis that the deferred consideration will be paid out before the tax is due in any event. Anthony would not want loan notes as it suits him to crystallise the tax now while he has ER.

The tax treatment of the earn-out consideration is more complicated. Anthony and Ben may want to structure the earn-out differently, so that Anthony maximises his use of ER but Ben defers his tax bill.

Technically, where there is a sale for cash plus an earn-out, a seller has two transactions for CGT purposes; this assumes that the payment of the earn-out will be subject to CGT rather than income tax (see below):

- The first transaction is the sale of the shares. The consideration for that sale is the cash, plus the value of the right to the earn-out (under the principles laid down in *Marren v Ingles* [1980] STC 500). This means that without any planning Anthony would be taxed at 10% (and Ben at 28%) on the present day value of the earn-out right (as it is unascertainable). They would pay tax on this element on 31 January 2017.
- The second transaction is the disposal of the rights to the earn-out itself, which takes place when each slice of earn-out is paid. This transaction will not qualify for ER, because it is the sale of a *Marren v Ingles* right, not of shares or securities. Therefore, Anthony would pay tax at 28% (or whatever rate was then in force) on the difference between the value taxed in the year of sale and the amount received. That tax would be payable in respect of the year in which the earn-out paid out.

This gives an unfortunate result for Anthony, as he would want everything he receives to be taxed at 10%. Instead, the transaction could be structured (for Anthony) so that he pays CGT on the full maximum potential earn-out (i.e. the £4m) in respect of the year of sale; and then claims back any tax overpaid if the full earn-out amount is not achieved. The additional benefit of this is that the whole transaction takes place under the current tax regime, and so should not be susceptible to future changes in tax rates and reliefs. Assuming that Anthony wants to pay the full amount of tax in respect of the year of sale, the ways to achieve this are as follows:

- The earn-out element is expressed as a fixed sum of the full potential maximum (£4m) payable over four years; and Anthony gives representations that the earn-out targets will be met. To the extent they are not met, the buyer would have a claim and would receive liquidated damages. These would in effect be netted off against the amounts due to Anthony under the contract, resulting in the total amount paid being the same as under the original earn-out structure; or
- A series of small slices of fixed but deferred contingent consideration payments are created, linked to what would have been the earn-out structure.

Both of these routes would ensure that Anthony was not taxed on the present day value of the earn-out (as it would be fixed ascertainable amounts); instead, he would be taxed on the whole potential earn-out while he has ER. He would then be able to recover any overpaid tax, if the earn-out did not end up paying out in full.

Ben will instead prefer not to pay tax on any part of the earn-out before he receives the cash. This can be achieved by a more traditional earn-out right, where the earn-out is satisfied in loan notes. In structuring the earn-out this way, the CGT transaction for Ben on the disposal of the shares for loan notes would fall within TCGA 1992 s 138A, enabling him to benefit from the rollover provisions of TCGA 1992 s 135. This would allow the tax (at 28%) to be deferred until cash was realised when the loan notes are paid out.

Where shareholders have different requirements in this respect, it is possible with careful drafting to accommodate both.

There is always a risk that an earn-out could be taxed as employment income. This is most obvious where it is linked to shareholders remaining in employment during the earn-out period. In this case, only Anthony is required to stay in the business and Ben is not involved. On that basis, I think it would be difficult for HMRC to argue that Anthony's earn-out is employment income, when he is selling at the same time and for the same price as Ben, and Ben's earn-out is clearly share price.

HMRC has set out key indicators of when earn-out payments will be sale consideration in its *Employment Related Securities Manual* at ERSM110940. It is essential that Anthony is remunerated at market rates for the job that he does after completion. If there is any doubt about the capital nature of the earn-out, the sellers can obtain certainty by asking HMRC for a ruling in advance of the transaction. I would usually suggest that this application is made by the buyer.

What's ahead
Dates for your diary

July

14 **Cases:** *English Bridge Union Ltd v HMRC* [2014] UKFTT 181 (TC): UT hearing due on whether contract bridge is a sport for VAT purposes. *Patersons of Greenoakhill v HMRC* [2014] UKUT 225 (TC): hearing for permission to appeal to Court of Appeal due to begin.

15 **Finance Bill:** Publication date. **Consultations:** Comments due on Revenue Scotland consultation on Scottish landfill tax guidance for contaminated soils.

16 **Cases:** CJEU judgments due in *Larentia + Minerva* (C-108/14) on input tax recovery by holding companies; and *Mapfre Asistencia and Mapfre Warranty* (C-548/13) on supplies of insurance for VAT purposes. A-G Kokott opinion's due on *Hedqvist* (C-264/14) on VAT on transactions in virtual currency.

17 **Consultations:** Comments due on *Company ownership and control: register implementation.*

19 **NICs:** Class 1A NIC payments must reach HMRC if sent by post.

21 **Parliament:** House of Commons rises for summer recess.

22 **NICs:** Class 1A NIC payments must reach HMRC if made electronically. **Parliament:** House of Lords rises for summer recess.

23 **Regulations:** The Cultural Test (Television Programmes) (Amendment) Regulations, SI 2015/1449, come into force.

31 **VAT:** Transitional period for the retrospective concession on charities' direct mail ends. **Scottish taxes:** Deadline for submission of comments on draft guidance on determining the status of a 'Scottish taxpayer' for the purposes of the Scottish rate of income tax.

August

5 **Employment taxes:** Intermediaries quarterly return due for the first quarter of 2015/2016 (i.e. 6 April 2015 to 5 July 2015). Employment agencies that place more than one worker with a client and do not operate PAYE must make the first of their quarterly information returns to HMRC by this date under the new rules introduced in April aimed at preventing false self-employment.

For a 'what's ahead' which looks further ahead, see taxjournal.com (under the 'trackers' tab).

Coming soon in Tax Journal:

- The questions raised by *Anson*.
- Examining HMRC ten years on.

One minute with…

Dominic Stuttaford
Head of tax for Europe, Middle East, Asia and Brazil, Norton Rose Fulbright

How did you get into tax?
It was the penultimate stage in my training contract. I found it intellectually challenging and at the same time enjoyed the challenge of advising on a diverse range of transactions and matters. The range has never stopped increasing.

What's in your in-tray?
Continuing to build the international tax practice, both in Europe and more widely, most recently with hires in Amsterdam and Frankfurt. Our tax group has grown enormously in the last five years with Norton Rose Fulbright's expansion through combinations in Australia, Canada, South Africa and the United States, so part of my role is to work closely with colleagues around the world to provide an integrated global tax offering to our clients. This mirrors the increased focus on international tax matters from our clients.

What's the number one practical tax issue facing your clients?
Managing their tax risk across the multiple jurisdictions they operate in, not just in liability and financial terms but also in reputational terms. While some clients are affected more than others, all are conscious of the issue.

Aside from your immediate colleagues, whom in tax do you most admire and why?
Other than current and former Norton Rose Fulbright colleagues, anyone who can make complexity simple. One such person is Mr Justice Henderson. His judgments inspire immense respect.

What stood out for you in this week's Budget?
Among the raft of measures, two instantly stood out: the hike in the rate of IPT, and the restriction imposed on depreciation for goodwill. The latter in particular is hard to fathom out. While the availability of depreciation was a factor in deciding which way to buy a business, it was far from the only one, even while looking at the tax alone.

Where do you stand on the OECD's BEPS project?
Changes are inevitable, but they should be specific, well thought through and targeted. They should recognise that not all international tax structures are 'unfair' or wrong. It would also be helpful if we could see more concrete proposals, so that we have more certainty.

If you could make one change to UK tax law or practice, what would it be?
That there is less of it. I look back with nostalgia to the days when the *Yellow* and *Orange* books were half the size. Even for lawyers like us who enjoy the technical and intellectual challenge, the amount of material is daunting.

If I could have a second wish, it is for governments to address the mismatch between capital gains tax rates and the rate at which employment income is taxed.

Finally, you might not know this about me but…
Before settling down to married life with children, I went on a number of horse-safaris, which led to a number of terrifying encounters with lions, leopards and hippos. More recently life is restricted to riding on a Scottish beach, avoiding the seals.