Saffron

SAFFRON TAX PARTNERS LLP

Summer Budget 2015

A Private Client Perspective

The first Budget of any new Government is likely to contain surprises, and the proposals announced by George Osborne on 8 July certainly did not disappoint! Although some of the proposed changes had been anticipated by many commentators, including those surrounding Non-Doms and the restrictions for tax relief on pension contributions, others such as those relating to dividends and property were not widely anticipated.

Being a private client focused business, we have produced this summary of the major topics that we consider will be of concern to individuals and their advisers. In doing so, we have by necessity kept our comments brief. Furthermore, it is highly likely that at least some of the proposals will change as they pass through parliament and/or a consultation process. We will, of course, be monitoring developments closely, so please visit www.saffrontax.com for updates.

We hope that you find this guide helpful, and please do contact us, at info@saffrontax.com or through your usual Saffron contact, if you would like to discuss any aspect in further detail.

INCREASE IN PERSONAL ALLOWANCES AND THE BASIC & HIGHER RATE LIMITS

The personal allowances, previously set for 2016/17 at £10,800 and for 2017/18 at £11,000 by the first Finance Act 2015, have now been increased to £11,000 for 2016/17 and £11,200 for 2017/18 in the Summer Budget. There will also be an increase in the basic rate limit and the higher rate threshold, and the new limits will be as summarised below:

2015/16: Personal Allowance (£10,600); Basic Rate Limit (£31,785); Higher Rate Threshold (£42,385)

2016/17: Personal Allowance (£11,000); Basic Rate Limit (£32,000); Higher Rate Threshold (£43,000)

2017/18: Personal Allowance (£11,200); Basic Rate Limit (£32,400); Higher Rate Threshold (£43,600)

These changes are in line with the government's objective to increase the personal allowance to £12,500, and the higher rate tax threshold to £50,000, by the end of this parliament.

The National Insurance Contributions upper earnings/profit limits will remain aligned to the higher rate threshold.

The age related allowance for those born before 6 April 1938 had already been removed by the first Finance Act 2015 with effect from 2016/17, but for 2015/16 this remains at £10,660.

PERSONAL ALLOWANCE INDEXATION

The government proposes to introduce legislation to index link the personal allowance once it £12,500, to increase in line with the annual equivalent of 30 hours a week at the National Minimum Wage (at the adult rate applicable to those over 21 years of age).

This is in line with the government's objective of ensuring that individuals working 30 hours per week at the National Minimum Wage will not pay income tax.

NON-DOMS TO BECOME DEEMED-DOMICILED AFTER 15 YEARS

Current position

Until now non-doms have enjoyed a favourable basis of taxation, such that, in broad terms, they are taxed on foreign income and gains only when remitted to the UK. Presently a non-dom may elect to be taxed on this basis, but the cost of such an election is that a Remittance Basis Charge (RBC) is payable as follows:

- Resident in the UK for 7 out of the previous 9 years – £30,000
- Resident in the UK for 12 out of the previous 14 years – £60,000
- Resident in the UK for 17 out of the previous 20 years – £90,000

Such a charge needs to be paid for each tax year for which the non-dom wishes to make an election to be taxed on the remittance basis.

Regardless of whether or not an election is made, the non-dom is currently only liable to Inheritance Tax (IHT) on assets situated in the UK, unless he has been UK resident in 17 out of the last 20 years (including the current year), in which case his IHT exposure is on worldwide assets. Under these rules, to avoid such IHT exposure, the non-dom needed to become non-resident for 4 full tax years before returning to the UK.

New Proposals for Long Term UK Resident Non-Doms

The new rules will apply from 6 April 2017.

Non-doms who have been UK resident for more than 15 of the last 20 years will become “deemed domiciled” and be treated in the same way as UK domiciled individuals for all tax purposes. When this situation arises the “deemed domiciled” individual will:

- be subject to UK tax on his worldwide income and gains as they arise,
- not be able to claim the remittance basis of taxation, and
- be subject to UK Inheritance Tax on his worldwide assets

To lose this “deemed domiciled” status, the non-dom will need to leave the UK and become non-UK resident for at least 5 full tax years. During those 5 years he will still be treated as “deemed domiciled” for IHT purposes, but will be subject to UK tax only on UK income and gains and on UK residential property, as he would be as a non-UK resident.

Where, before becoming “deemed domiciled” under these new rules, a non-dom has set up an offshore trust, he will not be taxed on trust income and gains that are retained in the trust. The trust will continue to enjoy exemption from Inheritance Tax except in relation to UK assets held directly by the trustees and UK residential property, whether held directly or indirectly. However, such a long term resident individual will, from April 2017 be taxed on benefits received from the trust on a worldwide basis.

For non-doms who have been resident for only 7 out of the previous 9 years, or 12 out of the previous 14 years, the Remittance Basis Charge (RBC) still remains as before (i.e. £30,000 or £60,000). However the RBC for non-doms who have been resident for 17 out of the last 20 years will not apply, as they will be treated as “deemed domiciled” under the 15 year rule and the new rules will apply from 6 April 2017.

New Proposals for Individuals with a UK Domicile of Origin

When an individual is born he normally inherits the domicile status of his father at the time of birth. This domicile of origin may be replaced by the individual, after leaving the UK to live permanently in another country and thereby become a domiciliary of that country, and hence non-UK domiciled. Presently a UK domiciled individual, who leaves the UK permanently and acquires the domicile of another country, continues to be deemed UK domiciled and subject to UK Inheritance Tax for at least a further three years. Such an individual may subsequently (under current rules) return to the UK and become UK resident but retain their non-UK domicile.

With effect from April 2017, such a non-dom, whenever he returns to the UK and becomes UK resident will revert to having a UK domicile for all tax purposes. As a result, such an individual:

- will not benefit from the favourable treatment enjoyed by non-doms,

- If he is a beneficiary of a trust which he set up after losing his UK domicile and deemed domicile status, he will become subject to tax on the income and gains of the trust as they arise, and
- The trust assets will all become subject to UK Inheritance Tax (even the non-UK assets) after his return to the UK.

NON DOMS & IHT ON UK RESIDENTIAL PROPERTY

Presently, only UK assets held by non-doms (who are not deemed domiciled in the UK) are subject to IHT. To avoid such IHT exposure, non-doms often hold UK assets indirectly, e.g. via an offshore company, so that they hold shares in the offshore company (i.e. non-UK assets) rather than the UK property which is a UK asset. Even such shares in an offshore company would become subject to UK IHT, when the individual becomes deemed domiciled after having been resident in the UK in 17 out of the last 20 years. As such non-doms normally hold the shares in an offshore company via an offshore trust established by the non-dom before becoming deemed domiciled in the UK. Currently, non-UK assets held in such trusts are excluded property and not subject to IHT, even when the non-dom becomes deemed domiciled in the UK.

With effect from April 2017, the government proposes that all UK residential property held indirectly through an offshore company, partnership or other opaque vehicle by a non-dom or an offshore trust, will become subject to IHT. These changes are aimed at bringing all UK residential property of any value, even if the property is let, into charge for IHT purposes. The proposed changes do not bring into charge for IHT any other assets held indirectly by non-doms.

IHT will be imposed on the value of the UK residential property owned by the offshore company, less any borrowings taken out to purchase the UK property. It is intended that the same reliefs and charges will apply as if the property was held directly by the owner of the company. Where the company holds other assets in addition to the UK residential property, only the value of the residential property should be subject to tax under these proposals; UK commercial property or other UK assets are not within these new rules. Diversely held vehicles that hold UK residential property are to be exempt from this new charge to IHT.

The Annual Tax on Enveloped Dwellings (ATED) was in part to counter the IHT benefits afforded by the holding of UK residential properties through offshore companies. The new rules are now intended to remove the IHT benefits and as such non-doms may conclude that the costs of retaining the company outweigh any benefits, but some may wish to retain such structures for security reasons. However, for those looking to de-envelope properties from offshore structures, they should take independent advice, as it is clearly a complex area and may lead to unwelcome tax charges.

INHERITANCE TAX & TRUSTS

An additional Inheritance Tax nil-rate band for estates with main residences

There is to be an additional nil-rate band when a main residence is passed on death to children or grandchildren.

This measure will take effect for deaths on or after 6 April 2017 and be phased in, with the result that the additional nil-rate band will increase from £100,000 in 2017/2018 to £175,000 in 2020/2021. Thereafter it will increase in line with the Consumer Prices Index.

This additional nil-rate band is to be transferable between spouses/civil partners and it will apply where the surviving spouse/civil partner dies after 6 April 2017, irrespective of the date of death of the first spouse/civil partner to die.

The existing nil-rate band of £325,000 is to remain unchanged until the end of 2020/2021.

If the net value of the estate exceeds £2m, then the additional nil-rate band will be reduced by £1 for each £2 of value in excess of £2m. The legislation is to be included in the Summer Finance Bill.

There are to be measures to protect those who have downsized or sold their homes and the details of these measures are to be subject to Consultation and included in the 2016 Finance Bill.

Simplifying Inheritance Tax charges on trusts

There are to be some technical changes to simplify the Inheritance Tax computations for trusts. Thus, it will no longer be necessary to include non-relevant property when calculating ten year and exit Inheritance Tax charges; it will be possible for trustees to claim conditional exemption within two years of a ten year anniversary (rather than having to make the claim in advance of that date); the successive life interest of a spouse/civil partner will not be relevant property only if it is a qualifying interest in possession (this change will remedy a previous drafting defect); and appointments of property from Will trusts within three months of the death to the deceased's surviving spouse/civil partner will become eligible for retrospective Inheritance Tax treatment, thereby eliminating a trap for unwary executors/trustees.

New rules to prevent Inheritance Tax avoidance through the use of multiple trusts

Most trusts are subject to a separate Inheritance Tax charging regime with the result that, broadly speaking, the value of a trust in excess of the Inheritance Tax nil-rate band is taxed at 6% every ten years and pro rata exit charges are levied on capital distributions from the trust in between its ten year anniversaries.

It has been possible to reduce the Inheritance Tax charges on trusts by setting up multiple trusts (instead of a single trust) on different days, to which assets have later been settled on a single day. This opportunity is to be blocked by ensuring that "same day additions" to more than one trust are to be aggregated for the purposes of computing the ten year and exit charges.

These new rules will apply to trusts created on or after 10 December 2014 (when the draft legislation was first published) and to trusts created before that date to which property has subsequently been added. They will not, however, apply to a Will executed before 10 December 2014 if the testator dies before 6 April 2017.

PROPERTY TAXATION

Restricting Mortgage Interest Relief for Landlords

The amount of income tax relief landlords can claim on residential property finance costs is to be restricted to the basic rate of income tax. This will be phased in over 4 years from April 2017.

Finance costs include mortgage interest, interest on loans to buy furnishings and fees paid when taking out or repaying mortgages or loans.

The restriction will be phased in so that a proportion of the finance costs will be fully deductible, and the remaining proportion of the costs will be given tax relief at the basic rate only. The proposed restrictions are to apply as follows:

- In 2017/18, 75% of the finance costs will be fully deductible, with the remaining 25% allowed basic rate relief.
- In 2018/19, 50% of the costs will be fully deductible, and 50% allowed basic rate relief
- In 2019/20, 25% of the costs will be fully deductible, and 75% allowed basic rate relief
- From 2020/21, all finance costs will only be given relief at the basic rate of tax.

These restrictions do not apply to landlords of furnished holiday lettings.

Other changes to Property Taxation

Additional changes are to be introduced, with effect from April 2016, as follows:-

- An Increase in the level of Rent-a-Room relief from £4,250 to £7,500 per annum.

- Abolition of the 10% wear and tear allowance for furnished properties. Landlords will instead be entitled to deduct the actual cost of replacing furnishings.

PENSIONS

Restriction on tax relief

Restrictions are to be introduced on the amount of income tax relief a high earner may claim.

With effect from 6 April 2016, the annual allowance of £40,000 will be reduced by £1 for every £2 of income over £150,000 per annum, up to a maximum reduction of £30,000. Individuals with "adjusted income" in excess of £210,000 will only have an annual allowance of £10,000.

Adjusted income includes both their own and any employer's pension contributions.

All individuals still have the facility to carry forward any part of the annual allowance that remains unused for up to three full tax years. High earners should seek to utilise the higher annual allowance available for the current year in addition to unused allowances brought forward.

The annual allowance for pension contributions is measured by reference to a Pension Input Period (PIP). Currently, PIPs may or may not be the same as a tax year and as such, the government proposes to align PIPs to tax years with 2016/17 being the first tax year of alignment. Transitional arrangements will be in place to enable calculation of the annual pension allowance for 2015/16 by reference to PIPs.

Taxation of Lump Sum Death Benefits (for those over 75)

Presently a lump sum paid on the death of a scheme member who was over 75 years of age attracts a tax charge at 45%. From 2016/17, in such circumstances tax will be charged at the marginal rate of income tax of the recipient. This will of course benefit those paying tax at lower tax rates.

OTHER MEASURES

Changes to Dividend Taxation

The notional dividend tax credit is to be abolished from 6 April 2016, and replaced by a new Dividend Tax Allowance (DTA) of £5,000 a year. This change does not affect the position for shares held in ISAs and pension schemes.

The new rates of tax on dividend income will be as follows:

- No tax on the first £5,000 of dividend income
- 7.5% for basic rate taxpayers
- 32.5% for higher rate taxpayers
- 38.1% for additional rate taxpayers

The government have stated that these changes have been introduced, to reduce the incentive to incorporate, and remunerate through dividends rather than salary.

Annual Investment Allowance (AIA)

The AIA provides a 100% deduction for the cost of most plant and machinery, excluding cars, purchased by a business, up to an annual limit and is available to most businesses.

The Chancellor has now provided certainty of a permanent Annual Investment Allowance of £200,000 from 1 January 2016, when the allowance was due to be cut to £25,000. This means that businesses will be able to spend £200,000 on items of plant and machinery and write off the cost for tax purposes, immediately rather than over a period of time.

Presently the AIA qualifying expenditure incurred before 31 December 2015 has a limit of £500,000. As such businesses may wish to accelerate planned expenditure to take advantage of the higher allowance.

Where a business has a chargeable period which spans 1 January 2016, there are transitional rules for computing the maximum AIA for that period.

Carried Interest

Carried interest legislation was introduced with immediate effect to ensure that carried interest returns received by fund managers would be subject to capital gains tax with only limited deductions allowable.

The effect of the rule change will be to treat any amounts received from the carried interest partnership structure as being proceeds that are chargeable to capital gains tax, and to limit participant's base costs to amounts that they have actually paid to acquire their interests in the carried interest vehicle.

HMRC have also issued a consultation on the types of funds that should be able to issue carried interest which benefits from capital gains treatment, with a view to changing the law with effect from 6 April 2016 and limiting this to funds with a longer term investment strategy.

The effect of this change, as currently proposed, will be to tax carried interest in certain funds as income with only specified funds being entitled to issue carried interest benefiting from capital gains treatment.

Offshore Evasion of Tax

Subject to consultation, financial intermediaries, tax advisers and other professionals are to be obliged to notify their clients of HMRC's international information gathering powers, with a view to ensuring that clients are compliant in disclosing offshore tax liabilities.

Non-compliant taxpayers will be able to correct their tax affairs using a time-limited "disclosure facility" in early 2016, with the benefit of reduced penalties, although the terms will be less favourable than on previous occasions.

HMRC will then pursue anyone who continues to conceal their tax affairs, resulting in substantial penalties and, at worst, criminal charges.

Direct Recovery of Debts Payable to HMRC

This measure, which will have effect on or after the date of royal assent of the summer Finance Bill 2015, will enable HMRC to recover debts directly from cash held in the bank and building society accounts, including ISA's, of individuals and businesses who owe over £1,000 to HMRC.

The government claims that extra safeguards will be built into the system, and it will only be applied to people who "can pay but choose not to". Furthermore, HMRC will need to check that the recovery of the debt will not deplete the taxpayer's aggregate amount in the accounts to below £5,000.

Interest Rates on Tax-Related Judgement Debts Arising from Litigation

From 8 July 2015, new legislation will be introduced to simplify the way in which interest is calculated, where taxpayers are or have been involved in litigation with HMRC and a court judgement has created a tax-related debt to which HMRC is a party.

Where HMRC is the creditor, the new rate of interest will be the late payment interest rate (currently 3%). Where HMRC is the debtor, the new rate will be equal to the Bank of England base rate plus 2%.

This measure will provide taxpayers with more certainty as to the interest rate charged/applied.

Farmer's Averaging

It has been confirmed that from April 2016 averaging of farmer's profits will be extended from the present two years to five years. Details will be announced following a consultation period, which closes on 7 September 2015.

Tax treatment of income from sporting testimonials

Currently, the tax treatment of such payments is governed by HMRC guidance which broadly states that, where the right to a testimonial match forms part of the sportsperson's contract of employment, then the payment is subject to income tax and NIC. However where no such contractual entitlement exists, the payments are not deemed to be earnings but are gifts to demonstrate 'affection and regard for the personal qualities of the player.'

The government has published a consultation to review the existing rules, suggesting that existing guidance has departed from the current statutory position and that all proceeds from sporting testimonials should be taxable as earnings and consequently subject to income tax and possibly NIC. It is proposed the consultation will close on 2 September 2015.