Summer Budget Alert 2015

Building a better working world

Introduction

Listening to the Chancellor's Budget, one was left with a view that this was a Chancellor set on reform. We saw reforms to the corporate tax system, both in terms of rate reductions and payment times, banking taxation (with increases in the burden for the next six years followed by reductions in the next Parliament), and the income tax system (with a new tax regime for dividends and restriction on pensions relief). We even saw changes to some forgotten taxes like Vehicle Excise Duty and Insurance Premium Tax.

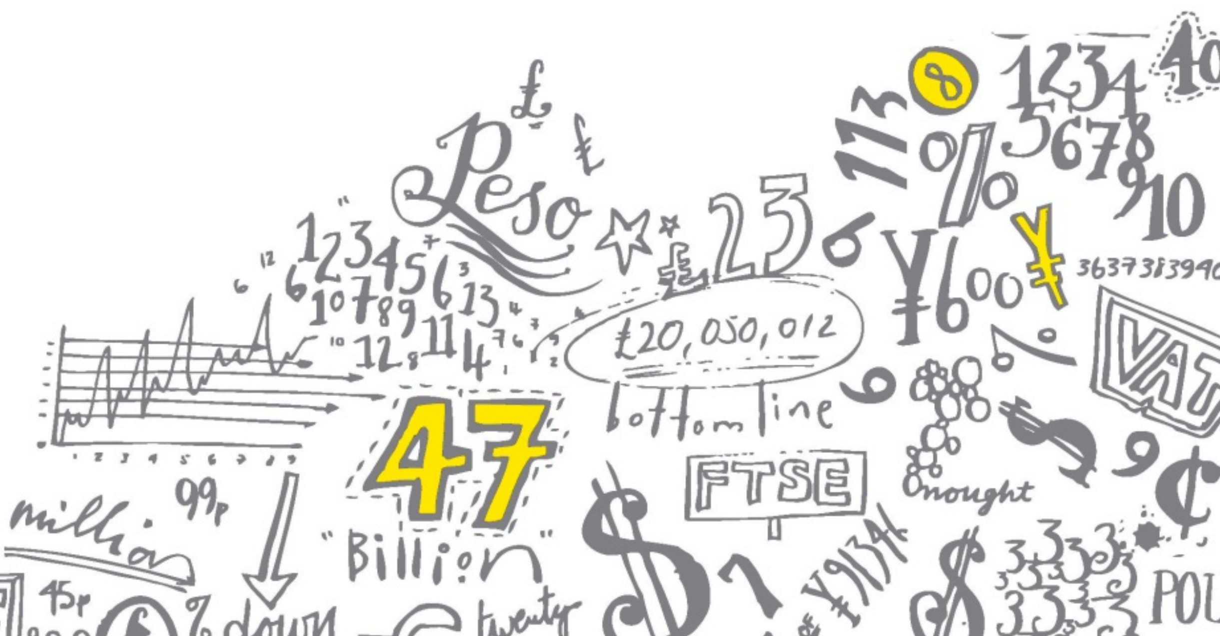
The sheer volume of changes, which span from fundamental reform through to cash grabs, leads to a confusing picture from this Budget. But one thing is clear – the tax lock has not stopped the Chancellor from increasing the overall tax burden. Over the six years, the tax changes alone raise an additional £29bn, more than the total amount raised in one year from either business rates or council tax. But even this pales compared to the cuts in spending, which amount to almost £46bn, giving a grand total of almost £75bn.

The Chancellor has also promised a plethora of consultation documents, some of which we saw today and others will appear over the summer. Some of these will be very 'green', such as on the potential reform of pensions to be taxed like ISAs, whilst others are more definitive. Beyond the summer we are promised a Business Tax Roadmap for Budget 2016, once the Government knows more about the recommendations coming from the OECD/G20 project on Base Erosion and Profit Shifting and has concluded on Business Rates reform.

In addition to the changes in policy, we also saw additional funds being given to HMRC to tackle tax avoidance and compliance, with the Chancellor booking £1.6bn from enhanced compliance activities. This includes the introduction of a 'special measures' regime to tackle businesses that persistently adopt highly aggressive behaviours including around tax planning and a voluntary Code of Practice defining the standards HMRC expects large businesses to meet in their relationship with HMRC. This is complemented by measures aimed at small and mid-sized businesses, public bodies and affluent individuals, raising over £2bn.

All in all, the Chancellor delivered a surprising array of policies and reforms. Taxes have clearly risen but the impact is hard to see at first. However, that impact is something we will definitely feel over the rest of this Parliament.

This report provides insight and analysis around the key measures announced by the Chancellor beginning with the tax triple lock followed by developments around business taxation.



Business taxation

The tax triple lock

Legislation will be included in the summer Finance Bill and National Insurance Contributions Bill to prevent the rates of income tax or class 1 national insurance contributions (for employers and employees) from being increased. It will stipulate that the upper earnings limit for national insurance contributions cannot exceed the threshold for the higher rate of income tax.

Legislation will also be included that prevents the standard rate or reduced rates of VAT from being increased beyond 20% and 5%, respectively. Furthermore, under the triple lock, the scope of supplies of goods and services subject to the reduced and zero rate of VAT cannot be decreased.

The triple lock applies for the duration of this Parliament and will have effect from Royal Assent of the summer Finance Bill, except for the national insurance elements that will have effect from Royal Assent of the National Insurance Contributions Bill.

The triple lock will not apply to Scotland in respect of income tax on non-savings income.

Main rate of corporation tax reduced to 18% in 2020

The main rate of corporation tax, which applies to all companies subject to corporation tax except for those within the oil and gas ring fence, will be reduced to 19% from 1 April 2017 and 18% from 1 April 2020. It is proposed that these changes will be included in the summer Finance Bill so they will be substantively enacted from the date that the Bill clears the House of Commons, expected to be after the summer recess. This means that the new rates should be reflected under IFRS in deferred tax calculations from that date.

The reduction in corporation tax is to be welcomed and helps the UK maintain the competitiveness of its tax system. However, it will potentially have an adverse impact on the controlled foreign company (CFC) status of subsidiaries of certain non-UK parented groups.

The change increases the differential between corporation tax and diverted profits tax, currently charged at 25%. The drop in the corporation tax rate below the basic rate of income tax will also mean that life insurance companies will no longer pay the same rate on all their profits.

Corporation tax payment dates brought forward

The instalment payment dates for corporation tax for companies with annual taxable profits of £20mn or more will be brought forward. Companies will be required to pay corporation tax in quarterly instalments in the third, sixth, ninth and twelfth months of their accounting period. For groups, the £20mn threshold for each company will be divided by the number of companies in the group. The measure will apply to accounting periods starting on or after 1 April 2017 and the Government will publish draft legislation in the autumn.

Currently, companies subject to quarterly instalments pay them during the seventh, ninth, twelfth and fifteenth months following the start of a twelve month accounting period, so the new rules will accelerate payments by about three or four months.

Loan relationship and derivative contract reform

It has been confirmed that the summer Finance Bill will include changes to the loan relationships and derivative contract rules which follow from the consultation by HMRC launched in the summer of 2013.

The key purpose of the changes is to align the tax treatment of corporate debt and derivatives more closely to the amounts going through a company's profit and loss account. Unlike the current rules, amounts will only be taxed when they are recognised in the profit and loss account, and not when they are recognised in other financial statements such as the statements of other comprehensive income or changes in equity. Also, the override of the accounting treatment where it does not 'fairly represent' profits and losses will be removed.

The majority of changes will have effect from accounting periods commencing on or after

1 January 2016. However, there are two exceptions to this commencement date.

Firstly, new 'principles-based' targeted anti-avoidance rules, seeking to counter arrangements that are entered into with a main purpose of achieving a tax advantage under the loan relationship or derivative contract rules, will be introduced for arrangements entered into on or after the date that the summer Finance Bill receives Royal Assent. The introduction of this rule, called the ‘Regime TAAR’, will enable the repeal of some of the existing detailed anti-avoidance rules on loan relationships and derivative contracts from the same date. However, the current rules disallowing deductions in relation to an 'unallowable purpose' will remain.

Secondly, new rules enhancing the tax reliefs available on the restructuring of debts of a company which is in financial distress are also to be introduced from the date that the summer Finance Bill receives Royal Assent. This is later than the date of 1 January 2015 first mooted for this law change. The proposed changes deal with situations where a company in financial distress releases its debt, or a proportion thereof, or modifies the terms of its debt. The change seeks to ensure that credits arising in these circumstances are not brought within the charge to tax with a view to ensuring the company’s continued solvency.

Restriction on using losses against controlled foreign company charges

Groups will no longer be able to use their UK losses to offset a CFC charge. Broadly, a CFC charge arises in the UK where profits are diverted to a CFC in a low tax jurisdiction. Where they apply, a CFC charge is suffered by any UK company that holds a relevant interest in the CFC.

From 8 July 2015, these imputed profits can no longer be reduced by the losses of UK companies, whether the losses are brought forward or from the current year, or losses surrendered as group relief from elsewhere in the group. For CFCs with an accounting period that straddles 8 July 2015, the rules will apply to profits treated as accruing from that date on a just and reasonable apportionment.

In addition, the rules introduced in Finance Act 2015, which restricted losses in cases involving tax avoidance, will be amended to make clear that they also apply to transactions involving CFCs.

New market value override on disposal of trading stock and intangible fixed assets

Transfer pricing provisions will no longer have priority in relation to transfers of trading stock or intangible fixed assets between related or connected parties made on or after 8 July 2015.

Prior to the announcement in the Summer Budget, the provisions relating to intragroup disposals of stock and intangibles contained specific requirements to treat such transactions as taking place at market value. However, these provisions were subject to transfer pricing and therefore the specific overrides did not apply where transfer pricing did. This provided opportunities for the recipient not to be taxed on the market value of the trading stock or intangible fixed assets transferred provided the consideration received was market value (and therefore could not be adjusted under transfer pricing principles).

The proposed revisions ensure that transactions between related parties can be subject to further adjustment under the specific market value override provisions detailed in the trading stock and intangible asset regimes. The intended effect is that the market value of the transfer will therefore be brought into charge.

New restrictions on corporation tax relief for business goodwill amortisation

Tax relief will no longer be available for the amortisation of goodwill or customer-related intangible assets in relation to any acquisition made on or after 8 July 2015 (unless the acquisition is pursuant to an unconditional obligation existing prior to that date). This applies whether or not the expenditure is written off in accordance with generally accepted accounting principles (GAAP) or via the 4% election.

This will potentially have a significant impact on the effective cash tax rate applicable to businesses acquired into the UK either from a third party or intragroup. However, IFRS 3 requires the separate identification of more intangible assets than was common under UK GAAP which should mean that there is a general reduction in the quantum of goodwill recognised on business acquisitions. Furthermore, the impact will be mitigated by the reductions in the headline rate of corporation tax also announced in the Summer Budget.

Any debits arising on the realisation of such goodwill or customer-related intangible assets on or after 8 July 2015 will also now be treated, in all circumstances, as non-trading in nature. Bearing in mind the restrictions recently introduced on the ability to utilise carried forward losses, the effect of this new change is that there will be limited ways in which such debts can be utilised.

A key question is how broadly goodwill and customer-related intangible assets will be defined. Interestingly, the wording in the documents released in the Summer Budget is the same as that used in the Autumn Statement 2014 which announced a restriction on relief in the context of incorporation of a business. The definition that was ultimately enacted in the context of such incorporations was very broad and included intangible fixed assets that consisted of information which relates to customers or potential customers of a business, a relationship (whether contractual or not) that the transferor has with one or more customers of a business together with an unregistered trademark or other sign used in the course of a business.

Increase in the permanent level of the annual investment allowance

The permanent level of the annual investment allowance (AIA) will increase to £200,000 a year from 1 January 2016. Although the rate is currently £500,000 a year, it was due to fall to £25,000 at that date.

The AIA applies to all businesses investing in plant and machinery and provides for a 100% write-off of the investment against tax. Where the AIA is exceeded, the excess qualifies for normal capital allowances. For businesses with a period that straddles 1 January 2016, transitional rules apportion the AIA across the period.

The permanent increase of the AIA to a generous limit provides welcome certainty for small businesses planning their future investment.

Research and development expenditure credit for higher education and charities

Under the previous research and development (R&D) tax enhanced deduction regime, institutions of higher education and charities were unable to file an R&D tax claim. When the research & development expenditure credit (RDEC) scheme was introduced for expenditure incurred from 1 April 2013, an unintended consequence was that it allowed institutions of higher education and charities to benefit from the RDEC and claim the repayable credit.

It has been announced that the anomaly will be addressed within the legislation so that institutions of higher education and charities will no longer be able to claim RDEC. This will be effective for all expenditure incurred from 1 August 2015.

We understand that HMRC will continue to process existing claims received from these organisations and will continue to receive claims for expenditure incurred up to 1 August 2015. This was previously an uncertain area and it is good to see that HMRC has acknowledged the efforts by institutions of higher education and charities for the work they have already undertaken to ensure compliance to the existing rules by not amending this retrospectively.

Taxation of banks

It has been announced that the rate of the bank levy will be reduced from the current 0.21% to 0.1% by 2021. In addition, from 2021, the taxable base for bank levy will be redefined to exclude non-UK balance sheets. We see this as a response to pressure from UK parented banks concerned about the imposition of the levy on their global balance sheets; and from overseas parented banks for which the levy, at current rates, represents a disincentive to operate in the UK.

Countering the reduction in bank levy, a new bank corporation tax surcharge of 8% will be introduced with effect from 1 January 2016. The bank corporation tax surcharge has a £25mn annual allowance to exclude many smaller banks and building societies. However, for those that are in scope, the surcharge will be charged separately from corporation tax and the taxable profits for the purposes of the surcharge will not be capable of being reduced by pre-January 2016 losses or group relief from non-banking companies. For banks with an accounting period that straddles 1 January 2016, a notional accounting period whose profits will be subject the surcharge will be treated as starting on that date.

As a result of these measures, the burden of bank taxation will now fall more on profits than on balance sheets. As such the changes will adversely affect banks which make significant profits in the UK, so will be subject to the surcharge, but have balance sheets below the bank levy threshold. The timing mismatch between the reduction in the bank levy and the introduction of the bank corporation tax surcharge also means that for the time being, the tax burden on the banking sector as a whole has increased further. According to HM Treasury figures, the cuts in the bank levy are intended to outweigh the corporation tax surcharge in the long term. However, this depends on the validity of the assumptions used, particularly in respect of predicting banks' profitability.

Finally, with effect from 8 July 2015, certain compensation payments incurred by banking groups and building societies will be treated as non-deductible for corporation tax purposes. This follows an announcement in the March 2015 budget and a consultation process which closed on 29 May 2015.

UK oil and gas

Despite name-checking the UK oil and gas industry in his speech today, the Chancellor had no new oil and gas measures in his Summer Budget. Instead, the intention to extend the scope of the new investment allowance – an allowance which reduces a company's profits which are liable to supplementary charge – beyond simply applying to capital expenditure was reaffirmed. Secondary legislation will be introduced later this year to effect this. The legislation will ensure it also applies, for example, to the long-term leasing of production assets. The expected date of the draft legislation has slipped to late summer or autumn.

Introduction of stamp duty land tax seeding relief

As previously announced, subject to the resolution of potential avoidance issues, a new stamp duty land tax (SDLT) seeding relief for property authorised investment funds (PAIFs) and co-ownership authorised contractual schemes (CoACSs) will be introduced. There will also be changes to the SDLT treatment of CoACSs investing in property so that SDLT does not arise on the redemption, issue or transfer of units in CoACSs. The legislation is expected in Finance Bill 2016.

These changes are welcome as the current charge to SDLT where property is transferred to a PAIF or CoACS has inhibited the launch of new funds.

Interim findings on business rates and introduction of relief for local newspapers

The Government has published its interim findings as to how the business rates system is administered. The Government asked for views as to how property is valued, how often property is valued, how business rates bills are set, how business rates are collected and how information about ratepayers and business rates is collected and used. Its interim findings on these points are accompanied by a note as to how the Government proposes to respond to businesses' calls for clearer billing, better sharing of information and a more efficient appeals system.

This work is separate to the fiscally-neutral review of the future structure of business rates which will report by Budget 2016.

At the same time, the Chancellor announced a consultation on the introduction of a business rates relief for local newspapers. The Government wants to understand better the challenges currently faced by local newspapers occupying property in their local areas and whether a relief on their business rates bills could help support them. This is a joint consultation by the Department for Culture Media and Sport and the Department for Communities and Local Government and responses are requested by 30 September.

Further reform to be considered

The Government has announced the following publications over the coming year:

- A business tax roadmap to be published by April 2016, setting out its plans for business taxes over the rest of the Parliament.
- A consultation on the rules for company distributions in autumn 2015.

Indirect taxation

VAT

The Government will apply the VAT 'use and enjoyment' provisions to tax UK repairs made under UK insurance contracts from next year, as a means of tackling perceived avoidance and VAT planning measures. Under current rules, repair services carried out in the UK for insurers are typically subject to VAT according to the location of the insurer, rather than either the location of the insured person or where those repair services are carried out, which can result in a VAT advantage.

This change will form part of a wider review of perceived tax avoidance by insurers and financial services businesses. The measure is a direct response to UK litigation in the *WHA* case, which was decided by the Supreme Court in HMRC's favour. This case involved an insurer establishing operations in Gibraltar to reduce irrecoverable VAT on insurance claims related costs.

In addition to levying VAT on repair costs, the Government also announced that it will consider a wider review of the scope of 'use and enjoyment' provisions to cover advertising services with a view to implementation in 2017. This measure may well be a response to ongoing litigation in the *Ocean Finance* case in which a UK loan broker established a Jersey entity to purchase advertising services. By doing so, these costs did not carry VAT.

Although these moves are in response to tax planning arrangements, all businesses will need to determine whether these changes will impact their VAT obligations. Depending on how these changes are implemented, it is possible that the drive to reduce VAT planning arrangements will create unforeseen complications for all businesses purchasing the affected services.

Insurance premium tax

The standard rate of insurance premium tax (IPT) will increase from 6% to 9.5% with effect from 1 November 2015. This brings the UK rate closer to the IPT rates of other European countries.

Insurers may suffer the cost of additional tax or, alternatively, the cost will need to be passed onto the market at a time when, in another Budget announcement, the Financial Conduct Authority has been asked to consider how consumers can be encouraged to shop around for insurance. The increase will add approximately £35 per year to the average cost of insuring two cars.

Insurers will also need to pay particular attention to the transitional rules regarding policies and premium payments that cross over 1 November 2015 as the rules are complex.

Vehicle excise duty

Cars registered on or after 1 April 2017 will be subject to a new vehicle excise duty (VED) banding system. The new banding system will introduce a first year rate which will vary according to the carbon dioxide emissions of the vehicle. It will introduce a flat standard rate of £140 for all cars where the emission of carbon dioxide is more than 1 gram per kilometre. Cars emitting zero grams of carbon dioxide per kilometre will have a standard rate of nil applied.

An additional supplement of £310 per year will be payable on cars with a list price above £40,000, for the first five years in which the standard rate is paid.

The new VED system appears to incentivise purchasers to buy more environmentally friendly cars. All of the revenue raised from VED in England will be spent on the English Strategic Road Network from 2020/21.

Alcohol duties

The UK is currently in discussion with the European Commission and EU Member States on potential reforms to the relevant EU law which will give each Member State the flexibility to support small cider producers through the duty regime. In addition to these discussions, the Government is investigating if any alternative solutions could apply. The current duty exemption for small cider producers will not change until an alternative replacement scheme is established.

The Government will also introduce a new mobile taskforce in an effort to combat illicit trade in alcohol.

Tobacco duties

Following consultation, the Government has decided not to proceed with the introduction of a tobacco levy.

Measures have been announced to help combat illicit trade in tobacco in the UK and reduce illicit tobacco products entering the UK from Europe and will expand its Fiscal Crime Liaison Officer network. Furthermore, the Government will increase the number of criminal investigation teams working in HMRC by 50% as well as recruiting additional Crown Prosecution Service staff.

The Government will also introduce a new registration scheme to help combat illicit trade in raw tobacco.

Climate change levy

The climate change levy (CCL) exemption for renewable electricity will be removed for electricity generated on or after 1 August 2015, affecting renewable electricity generators and suppliers of renewable electricity to industrial/commercial and public sector consumers. There will be a transitional period effective from 1 August 2015 where the exemption can still be applied to electricity generated prior to that date – assuming the licenced supplier holds sufficient renewable levy exemption certificates (LECs) that relate to that electricity supplied under a renewable contract to the consumers. The duration of this period will be confirmed following consultation. This measure is not expected to have an impact on wholesale electricity traders who will continue to be exempt from CCL, but it is expected to affect business customers on a 'green tariff' where the licenced supplier will no longer be able to price the package without CCL based on the position with respect to LECs.

Whilst the Government states that this measure is not expected to have a significant macroeconomic impact, it forecasts additional revenues of £3.9bn over the course of this Parliament. Licensed suppliers of renewable electricity to the affected sectors will have to review pricing plans in existing long term renewable source contracts to fully understand the financial impact of this measure for their business.

Aggregates levy

The Government has reinstated most of the exemptions from aggregates levy, which were suspended on 1 April 2014.

This follows the European Commission's announcement on 27 March 2015 that the aggregates levy regime, including its exemptions, is lawful (with the exception of part of the shale exemption).

Any businesses which have paid the levy on materials covered by a suspended exemption, which was subsequently found by the Commission to be lawful, will be able to claim a refund. Businesses which are no longer required to be registered for the levy following the reinstatement of an exemption will be able to deregister.

Air passenger duty

The Government has published a discussion paper considering various options including devolving air passenger duty (APD) within the English regions, varying APD rates across English airports and also providing aid to English regional airports. This is set against the background of APD devolution to Northern Ireland, Scotland and possibly also Wales with a concern that significantly lower APD rates in Scotland or Wales could draw passengers and airlines away from nearby English regional airports.

This proposal significantly increases the compliance burden for airline operators who will need to administer multiple APD rates within the same country with extensive systems changes and re-pricing of flights. At the moment, there are 6 possible APD rates but this proposal could lead to over 20 different rates.

Other Budget announcements

The following measures have been previously announced:

- Certain non-departmental public bodies will become eligible for VAT refunds
- The design of the new horserace betting right (to replace the current horserace betting levy) is expected to be completed later this year
- A reduced rate of fuel duty will be introduced for aqua-methanol.

Personal taxation

Personal allowance and higher rate threshold

For 2016/17 the personal allowance will increase by a further £200 over previously announced levels to £11,000. The personal allowance will then increase to £11,200 in 2017/18.

The basic rate limit for 2016/17 will be increased to £32,000 and to £32,400 for 2017/18. These combined changes will increase the higher rate threshold above which individuals pay income tax at 40% to £43,000 for 2016/17 and £43,600 for 2017/18.

The Chancellor has reiterated that the changes are part of a goal to increase the personal allowance to £12,500 and to increase the higher rate threshold to £50,000 by the end of the decade.

The Government has confirmed a Conservative manifesto commitment of linking future increases in the personal allowance, once it has reached £12,500, to increases in the national minimum wage. In future, the personal allowance will always exceed the amount which an individual on the national minimum wage could earn in 30 hours a week.

The previously announced personal savings allowance will also be introduced from 6 April 2016.

Dividends

Fundamental changes have been announced to the taxation of dividends. From April 2016, the dividend tax credit will be abolished and a tax-free annual dividend allowance of £5,000 will be introduced. The dividend tax rates will also be amended to 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. The combination of these two changes means that many basic rate taxpayers and individuals who receive significant dividend income will pay more tax under this new regime.

Dividends received in ISAs and pensions will continue to be tax-free.

New domicile rules introduced

As widely expected, the Chancellor has made significant changes to the so called 'non-dom' rules which allow individuals living in the UK to shelter their overseas income and gains from tax.

The Chancellor has not abolished the regime (recognising its important role and the contribution of 'non-doms' to the UK) but rather has made it a temporary relief from tax. At present, an individual normally acquires his or her domicile status from their father. This means an individual can be a non-dom even if they have never set foot outside the UK. Equally, at present a national from overseas could live in the UK for many years and still be a non-dom.

The Chancellor has announced the following significant structural changes which will be introduced from 6 April 2017, irrespective of when the individual arrived in the UK:

- 'Returning UK dom rule' - An individual who has a UK domicile of origin at birth will revert to this domicile whenever they are resident in the UK.
- '15 year rule' - If an individual who is non-domiciled under general law lives in the UK for more than 15 out of 20 tax years they will be treated as domiciled in the UK for all tax purposes, including inheritance tax. The general law positon will remain the same and, therefore, any children's domicile status will not be impacted by their parent's deemed domicile position, and vice versa.

There will be no grandfathering provisions in this regard.

These reforms will mean that the recently introduced £90,000 remittance basis charge, due after 17 years of residency out of the previous 20, will be redundant.

There will be a consultation after the summer recess to obtain views on how best to deliver these reforms; this will include the following areas:

- Whether the current de minimis exemption, where total unremitted income and gains are below £2,000, will be extended to still apply after 15 years.
- The interaction of the 15 year rule with certain provisions, such as:
  - Split year treatment under the statutory residence test (in terms of counting years).
  - Employment related securities provisions.
  - Various regulations governing the taxation of offshore trusts, including the transfer of assets regime and capital gains tax provisions.
- Introduction of a new 'five year rule' whereby individuals will remain deemed domiciled for five years after leaving the UK. This would only affect individuals leaving after 5 April 2017.
- For the 'Returning UK dom' rule, how to restrict the individual from being able to benefit from any favourable tax position for trusts set up whilst non-resident and non-domiciled in the UK.

It is encouraging that the Chancellor has recognised the contribution made by non-doms, and certain refinements were not unexpected. However, the new 15 year rule takes the current remittance basis option away from long-term non-dom residents and puts them on an even footing with UK doms.

The previous proposals, which were subject to consultation, to require a claim for the remittance basis to last for a minimum of three tax years, will not proceed.

Inheritance tax on non-domiciled individuals holding UK residential property

The Chancellor announced new inheritance tax (IHT) rules in respect of UK residential property held indirectly by non-UK domiciled individuals (e.g. via a non-UK company or held in an excluded property trust). With effect from 6 April 2017, all UK residential property will come into charge for IHT whether it is held directly or indirectly by foreign domiciled persons. Therefore, even where such property is held by say, an offshore company, it will still be subject to IHT on a relevant event, for example, the death of the individual.

The new rules will apply to all UK residential property, whatever its value and regardless of whether it is let or occupied by the non-domiciled individual and their family.

The Government will consult on the detail behind the changes and also on the draft legislation prior to its inclusion in the 2017 Finance Bill. However, the intention is to include only the value of the UK property (less any borrowings taken out to purchase the property) and to ensure that offshore companies or similar structures that derive their value from other assets, UK and non-UK, will still be treated as excluded property for inheritance tax purposes.

Since 2012, there have been substantial changes to the tax treatment of UK residential property and this announcement further adds to the number of provisions that need to be considered when purchasing such property.

Inheritance tax: main residence nil rate band and existing nil rate band

The Chancellor has confirmed his intention to introduce an additional, transferable nil rate band for IHT for the transfer on death of a residence to a direct descendent. A direct descendant means a child (including step-child, adopted child or foster child) and their lineal descendants. The additional relief will only be available on one property which must have been the deceased person's residence at some point during their life. Executors may elect which property should qualify where there is more than one in the estate.

The nil rate band, above which individuals pay IHT at death at 40%, is currently £325,000 and it was today announced this limit will remain in place until 2020/21. The unused proportion of this nil rate band can be transferred to a surviving spouse on death. In 2017/18, individuals will be entitled to an additional main residence nil rate band of £100,000, this rises to £125,000 in 2018/19, £150,000 in 2019/20 and in 2020/21 the allowance will be £175,000. The allowance will then rise with CPI from 2021/22 onwards.

Any unused proportion of the additional nil rate band will also be transferable to a spouse on death. By 2020/21, this will allow a married couple (or civil partners) to pass a home with a value of up to £1mn on to direct descendants without paying IHT.

For those with a net estate worth in excess of £2mn, the relief will be tapered by £1 for every £2 the net value exceeds that amount.

The Government recognises that this relief might act as an incentive for the older generation to remain in homes bigger than they need. To counteract this, those who downsize or sell their home after 8 July 2015 will effectively be able to 'bank' the additional nil rate band for use against the remaining value of their estate where they pass a smaller home or equivalent value assets to a direct descendant. Precise details will be subject to a consultation to be published in September 2015.

While the relief will increase the number of homes which can be passed tax-free to the next generation, the detail, particularly around the relief for those who sell or downsize, adds further complexity. Since for many taxpayers their most valuable asset will be their property, it is a pity the Chancellor has not chosen to keep the relief simple by instead extending the nil rate band for all assets.

Changes to property taxation

The Chancellor has announced three changes which will affect individuals who let residential properties or rooms in their own home. These will not affect furnished holiday lets.

Restricting finance cost relief

Individuals who receive rental income on residential properties (whether in the UK or overseas) and incur finance costs, such as mortgage interest will no longer be able to deduct finance costs from their property income to calculate taxable profits. Instead they will be able to take only a basic rate deduction from their income tax liability. The restriction will be phased in over four years starting in 2017/18.

Wear and tear allowance

Currently, by claiming wear and tear allowance, landlords of furnished properties can deduct 10% of their rent from their profit to account for wear and tear, irrespective of their expenditure on furnishings etc. From April 2016, the Government will replace this allowance with a new system that enables all landlords of residential property to only deduct costs they actually incur. A consultation will be published on the detail.

Rent-a-room relief

Where individuals rent out a room in their own home, they are currently not taxable on the income received if it is £4,250 or less. This limit has been frozen since 1997 and so, to reflect increasing market rents, this relief will be raised to £7,500 from 6 April 2016.

Investment managers: capital gains tax treatment of carried interest

The Chancellor announced that new legislation will be introduced to change the way that carried interest payments relating to capital gains will be taxed. The changes are aimed at ensuring that when calculating taxable gains, participants in carried interest schemes are taxed on their 'true, economic gain' and only receive deductions for consideration actually paid. Provisions will be made to ensure that credit is given for employment income tax charges.

Based on the initial comments from HMRC, these changes appear to target the use of Base Cost Shift planning in the payment of carried interest.

The new measures will have effect on all carried interest arising on or after 8 July 2015, whenever the arrangements were entered into.

Consultation on the taxation of performance linked rewards paid to asset managers

The Government has today released a consultation document on the taxation of performance linked rewards paid to asset managers. The Government is concerned that some asset managers have reassessed the activities of the funds they manage such that they are treated as investing for tax purposes rather than trading. The subsequent payment of performance reward from these funds (usually as carried interest) then receives capital gains treatment rather than attracting higher rates of tax under income tax treatment.

Comments on proposed legislative definitions of long-term investment activities for the purposes of carried interest are requested by 30 September 2015. Two options are proposed. The first is based on a list of specific activities that will constitute long-term investment activities which is to be updated as new forms of investment activity are developed. The second is based purely on the average length of time for which the fund holds investments.

In this consultation, together with the disguised fee income legislation introduced by in the Finance Act 2015, the Government is seeking to charge what it considers to be income to income tax rather than at the lower capital gains tax rate.

Limited partnership consultation

A consultation on technical changes to the limited partnership legislation that will enable private equity and venture capital investment funds to use the structure more effectively will be issued.

Changes to venture capital scheme rules

Following a consultation launched in July 2014, the Government has announced further refinements to the rules for venture capital schemes to be included in summer Finance Bill 2015 and to take effect from Royal Assent. These will be subject to State Aid approval.

The new legislation will introduce the following measures:

- All investments must be made with the intention to grow and develop a business
- Investors will be required to be ‘independent’ from the company at the time of the first share issue
- New qualifying criteria limiting relief will apply for ‘knowledge intensive’ companies within 10 years of their first commercial sale, and for other qualifying companies within seven years of their first commercial sale
- A cap for total investments into knowledge intensive companies will be introduced at £20mn as previously announced, whilst the cap for other qualifying companies will be introduced at a lower limit of £12mn
- An increase to the employee limit for knowledge intensive companies to 499 employees, as previously announced
- New rules to prevent enterprise investment scheme (EIS) and venture capital trust (VCT) funds being used to acquire existing businesses
- As previously announced in Budget 2015, the requirement that 70% of the funds raised under SEIS must have been spent before EIS and VCT funding can be raised will be removed for qualifying investments made on or after 6 April 2015.

The Government has also stated that it will continue to monitor the use of venture capital schemes for investments in community energy organisations benefiting from subsidies for the generation of renewable energy. This follows restrictions introduced in Finance Act 2015 excluding some such companies from venture capital schemes from 6 April 2015.

This represents additional complexity to an already labyrinthine area. However, the new limits and levels of investment for ‘knowledge intensive’ companies will be beneficial for encouraging investments in companies which qualify.

Inheritance tax charges and trusts

New rules which apply where property has been added to more than one trust on the same day, such that the value of this property is aggregated when calculating IHT charges for each trust, will now be included in the summer Finance Bill. This had previously been expected in the pre-election Finance Act 2015 but was deferred.

The rules are designed to prevent the use of multiple trusts, often known as ‘pilot trusts’ as an IHT planning strategy. This planning was often used for will trusts and there will be a period of grace so the rules do not apply to transfers on deaths before 6 April 2017, provided the will was executed before 10 December 2014. Otherwise, the new rules will apply to all charges arising on or after the date of Royal Assent for the summer Finance Bill in respect of trusts created on or after 10 December 2014. The provisions will also apply to trusts created before 10 December 2014 where value is added after this date other than on death.

In addition, further provisions regarding the passing of a life interest to a spouse or civil partner and the administration and calculation of IHT charges for trusts will be included in the summer Finance Bill.

Peer-to-peer lending ISAs

The Government today published its response to consultation on including peer-to-peer loans in ISAs. The intention is to introduce a new type of ISA for peer-to-peer loans – the Innovative Finance ISA – alongside cash ISAs and stocks and shares ISAs.

The Government intends to publish draft legislation for technical consultation later this year, with a view to legislating to allow peer-to-peer loans to be held in an ISA from 6 April 2016.

Changes to the taxation of pensions

The summer Finance Bill will include a provision to restrict tax relief on pension contributions for individuals who have taxable income over £110,000 and taxable income plus pension inputs over £150,000. From April 2016 the annual allowance for those individuals affected will be reduced by £1 for every £2 of income over £150,000 with a maximum reduction of £30,000 once income reaches £210,000. A similar reduction will apply to the alternative annual allowance for individuals who are subject to the money purchase annual allowance as a result of having accessed their pension savings flexibly.

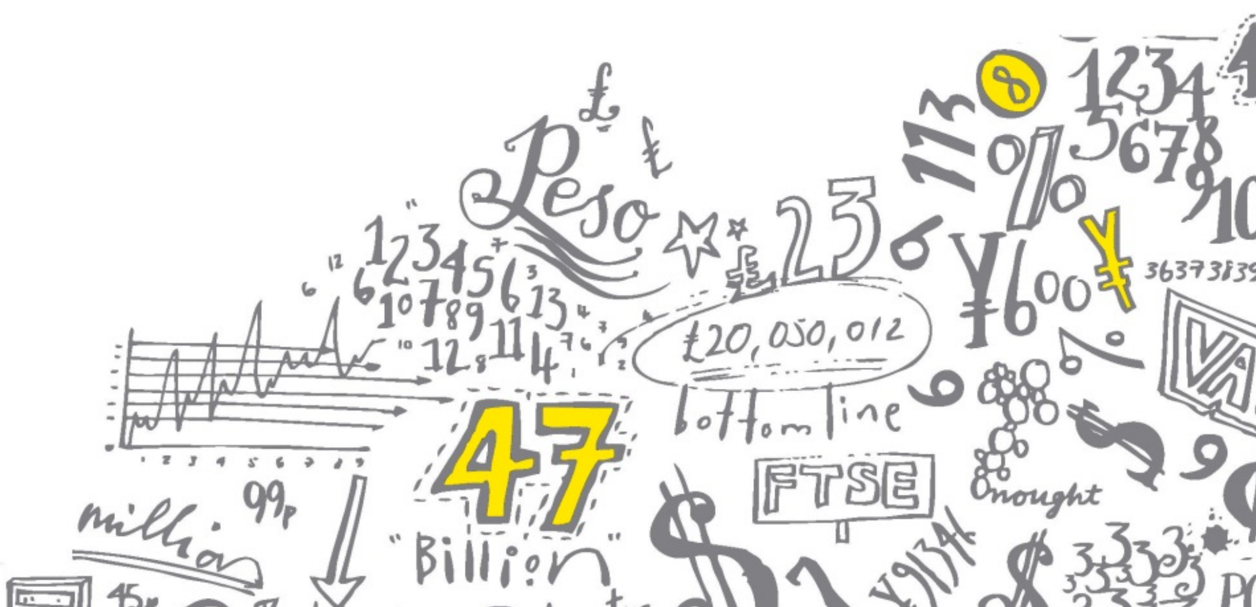
Currently, the annual allowance applies to pension contributions made in each 'pension input period' which does not always align with the tax year. All pension input periods will be aligned with the tax year from 6 April 2016 with transitional rules being introduced from 8 July 2015 to protect pension savings already made from retrospective charges.

The Government has also published a consultation document related to wider reform of tax relief on pensions. The aim of the consultation is to explore possible changes to the pension tax relief regime with the aim of encouraging individuals to save for their retirement. The consultation will remain open until the end of September 2015.

The following previously announced pension changes have been confirmed:

- The reduction in the lifetime allowance for pension savings from £1.25mn to £1mn with effect from April 2016, with transitional protection regimes to be introduced
- The reduction in the lump sum death benefits tax charge on pension funds transferred on deaths after age 75 from a 45% flat rate to the beneficiaries' marginal rates of income tax

following consultation, the previously announced implementation of a secondary annuities market has been delayed until 2017. Further plans related to this will be announced in autumn 2015.



Employment taxation

Amendments to the national insurance contributions employment allowance

The existing employment allowance of £2,000 will be increased to £3,000 with effect from April 2016. However, companies where the Director is the sole employee will no longer be able to claim the employment allowance.

Employment intermediaries – travel and subsistence expenses

HMRC has published a consultation document setting out their proposals for amending the rules for tax relief on travel and subsistence for those working through employment intermediaries.

The proposals add to the changes already made in Finance Act 2015 and seek to remove the tax relief where any party to the arrangement can (or has the right to) supervise, control or direct the manner in which the worker provides their services. They will apply to agency arrangements, personal service companies and umbrella companies.

The proposals also include provisions for the transfer of liability to the engager if any PAYE/NIC debt arises from the misuse of the legislation.

These proposals could have a significant impact on how businesses engage with contractors, agencies and umbrella businesses, particularly given the potential for the transfer of liability.

The consultation closes on 30 September 2015.

Extension to employer supported childcare schemes

With the delay in the implementation of Tax-Free childcare, the Government is holding open the existing employment supported childcare scheme (childcare vouchers) to new entrants until Tax-Free childcare is launched in September 2017.

Parents who wish to remain in Employer Supported Childcare after Tax-Free Childcare is launched will be able to, whilst their employer continues to offer the voucher scheme.

Salary sacrifice arrangements

The Chancellor has announced that the Government will actively monitor the growth of salary sacrifice arrangements and their effect on tax and national insurance receipts. These schemes have become increasingly popular in recent years because they can facilitate a reduction in income tax and national insurance for some employees and employers, prompting Government concern that the cost to the taxpayer is increasing.

Changes to salary sacrifice schemes attracted much press attention in the run up to this Budget, with some sources predicting that the Chancellor would remove the relief from national insurance for pension contributions made by way of salary sacrifice. However, having proposed measures to counter travel and subsistence sacrifice arrangements with regard to employees working for employment intermediaries, the Chancellor appears to have taken a 'watching brief' with regard to the broader use of these schemes.

Introduction of statutory exemption for trivial benefits in kind

The introduction of a statutory exemption for trivial benefits in kind costing less than £50 was planned for April 2015 but was delayed in the March 2015 Budget. The exemption has now been confirmed as applicable from April 2016.

Additional consultations

Following recommendations by the Office of Tax Simplification:

- Travel and subsistence – the Government will hold a consultation to review the rules underlying the tax treatment of travel and subsistence expenses. It has advised that a discussion paper will be published shortly.
- Termination payments – the Government will hold a consultation on the simplification of the tax and national insurance contribution treatment of termination payments.
- Class 2 and 4 – the Government will hold a consultation on the abolition of Class 2 national insurance contributions and

reforming Class 4 national insurance contributions.

The Government has engaged the OTS to consider the following:

- Closer alignment of income tax and national insurance contributions for small companies – the terms of reference will be published shortly.

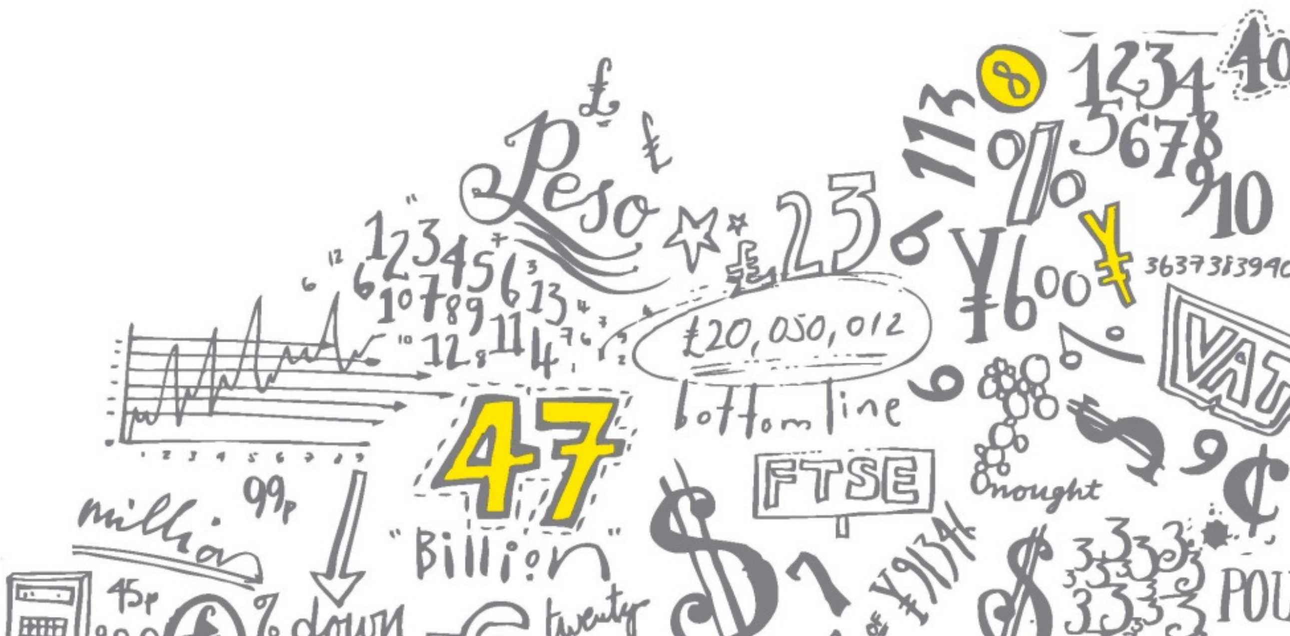
The Government will engage with stakeholders on the following:

- IR35 – the Government will engage stakeholders this year to discuss ways to improve the effectiveness of existing intermediaries' legislation. A discussion document will be published shortly.

Draft legislation issued for technical consultation:

- Finance Act 2015 included measures that are to apply from 2016/17 in respect of the abolition of the £8,500 threshold for benefits in kind and voluntary payrolling of benefits. An exemption for qualifying business expenses was also introduced.

  The payrolling of benefits will include all benefits in kind other than accommodation, beneficial loans and credit tokens and vouchers. The announcement includes reference to the introduction of additional reporting requirements from April 2017 for employers payrolling cars.



Tax administration

A tougher HMRC large business strategy

HMRC's current relationship management approach to dealing with large business taxpayers goes back to 2006 and is based on promoting open, collaborative and transparent working relationships. Enhanced compliance measures for large businesses announced today target those businesses that HMRC sees undertaking aggressive tax planning or refusing to engage with HMRC collaboratively and transparently.

Specific proposals/measures include:

- A 'special measures' regime on which the Government is continuing to consult as part of its wider serial avoiders consultation. This would require enhanced disclosure and provision of documentation by those HMRC identifies as engaged in persistent tax avoidance, and may also involve restricted access to certain reliefs while the taxpayer is subject to the special measures.
- Further consultation on measures to deal with 'serial avoiders' including surcharges on returns that are incorrect as the result of the use of avoidance schemes that fail.
- A mandatory requirement for large businesses to publish their tax strategy, making their approach to tax planning and relationship with HMRC open to the public. Many large companies already have a tax strategy, but the requirement for this to be published is new.
- A voluntary Code of Practice setting out standards HMRC expects of large business in their relationship with HMRC.

Together with the additional compliance resource for large business also announced on 8 July 2015, this announcement signals a toughening of HMRC's approach to large businesses, both by linking the proposed serial avoiders measures directly with large businesses, and by further shifts from carrot to stick.

Tackling tax avoidance and evasion

Consultations on serial avoiders and general anti-abuse rule penalties

As noted above with regard to HMRC's Large Business Strategy, the Government will publish a consultation, ahead of introducing legislation in Finance Bill 2016, in relation to serial avoiders who persistently enter into tax avoidance schemes which are found to be ineffective. This will include developing further measures to 'name and shame' those defined as serial avoiders. The scope of the Promoters of Tax Avoidance Schemes regime would be widened by bringing in promoters whose schemes are regularly defeated.

The Government will also publish a consultation to consider the detail of introducing a general anti-abuse rule (GAAR) penalty as well as considering new measures to strengthen the GAAR further. Legislation will be included in Finance Bill 2016.

Both consultations will build on the consultation, 'Strengthening Sanctions for Tax Avoidance', published on 30 January 2015.

Additional HMRC resources

The Summer Budget includes a package of additional HMRC resources aimed, by 2020/21, at raising an additional £2.8bn a year from tackling avoidance and evasion. Over the life of this Parliament the Government has committed to spend an additional £800mn in this area.

Specific proposals/measures include:

- An undisclosed number of additional staff from April 2016 to tackle non-compliance by large businesses
- 1,300 additional staff being deployed from April 2016 to tackle non-compliance by mid-sized businesses, public bodies and affluent individuals
- 200 additional staff from April 2016 in the Specialist Personal Tax teams dealing with employment taxes, inheritance tax, capital gains tax, pensions, trusts and estates
- An extension of the Customer Relationship Manager (CRM) focus on wealthy

individuals to cover those with £10mn to £20mn of assets

- An additional 135 staff for criminal investigations into suspected tax fraud and a threefold increase in the number of criminal prosecutions carried out by HMRC

In tandem with these announcements, HM Treasury has provided assurances to the Office for Budget Responsibility that over and above this additional resource, the Government is committed to providing HMRC with the funding it needs to maintain its current level of compliance performance.

The measures proposed show that the new Government intends continuing to bolster HMRC's operational compliance activity against avoidance and evasion.

Other tax administration measures

- Direct recovery of debts: The summer Finance Bill will set out HMRC's powers to recover tax and tax credit debts from debtor's bank, building society accounts with the inclusion of funds held within ISAs. The measure will include the already notified safeguards and will have effect on and after the date of Royal Assent of the summer Finance Bill.
- HMRC tax enquiries: closure rules. A response will be available this summer to the consultation on new HMRC powers to achieve early resolution and closure of one or more aspects of a tax enquiry whilst leaving others open. The mechanism for introducing this requirement suggests that there may be a permanent power which could be reused by HMRC in the future.
- Requirement for financial intermediaries to notify their customers of certain developments in the Government's offshore tax evasion strategy. Financial intermediaries, including those who may be aware of, or may have given advice in respect of, an offshore account, will need to notify their customers about the introduction of the common reporting standard, the time-limited disclosure opportunity opening in 2016 and the tougher penalties for tax evasion. An informal consultation will be held prior to introducing regulations.
- Business tax roadmap: A roadmap will be published by the end of 2015 showing how the Government will reform tax administration for individuals and small businesses over this Parliament.
- New information powers to enable HMRC to acquire information from online intermediaries and electronic payment providers to help identify people trading who are not declaring their profits for tax purposes.

Office of Tax Simplification

The Government has confirmed that it will include measures to establish the Office of Tax Simplification (OTS) on a statutory basis in Finance Bill 2016. The OTS will be commissioned to review the closer alignment of income tax and national insurance contributions and to review the taxation of small companies.

HMRC debtor and creditor interest rates

Legislation will be included in the summer Finance Bill to amend the interest rate payable in tax litigation cases where HMRC is either a debtor or creditor. The new provision replaces judgment interest (at 8%) with the much lower late payment interest rate on amounts payable to HMRC (currently 3%) and bank base rate +2% for amounts payable by HMRC. The changes will apply to interest accruing on or after 8 July 2015 and will apply to new and pre-existing judgment debts.

The new policy will need to be considered, particularly where matters are being appealed to higher courts. A recent example is the Court of Appeal VAT judgment in the case of *Littlewoods* which confirmed a taxpayer's ability to claim compound interest on refunds in cases of HMRC error. HMRC is appealing the *Littlewoods* decision but in the meantime taxpayers may have been tempted to pursue a summary judgment. If successful, this would have allowed the taxpayers to accrue interest at 8% if they did not pursue immediate payment, pending Littlewoods being considered by the Supreme Court. The new measure, while simplifying the rates of interest in relation to HMRC will also make pursuing summary judgment against HMRC on an interim basis less attractive.

EY ITEM Club comments

The Chancellor used the Budget to set out the framework for his new surplus target and the way in which he plans to achieve this. Although this target is very ambitious, he does not plan to meet it until 2019/20. This means that government spending will increase over the next three financial years, partly financed by the Royal Bank of Scotland and other asset sales. It means that the adjustment, though painful, will be spread out over a much longer period.

The details of the departmental spending effects will be agreed in the forthcoming spending review, but this relaxation will make these negotiations a lot easier than looked likely on the basis of the last Budget. Also, the Chancellor is planning to increase taxes after all, notably vehicle excise duty and insurance premium tax. Each of these will raise about £1.5bn per annum by the end of the decade and, of course, fall on households. Like the near-term relaxation in the spending envelope, this adds to the money available for departmental spending, which is a hefty £24bn higher in 2017/18 than envisaged in March. In sum, over this Parliament, departmental spending is £83.3bn or 5% higher than previously envisaged.

Nevertheless, departmental cash spending remains flat until the end of the Parliament, meaning real savings of £18bn still have to be found. That is less than half the £42bn we were looking at in March, but will fall disproportionately upon areas that are not protected.

The Chancellor gave us a blow-by-blow account of the £12bn cuts to welfare spending. As expected, the axe largely fell on in work benefits, but the leeway given by pushing the target date back to 2019/20 meant that they are not as severe as they would otherwise have been. The disabled, as well as current recipients of Employment Support Allowance and family tax credits will be shielded. Near-term, the main effect is due to the lowering of the income threshold for tax credits and work allowances in Universal Credit, which save £3.6bn next year. The freezing of working age benefits, tax credits and housing allowances then saves another £3.9bn by 2019/20.

Over time, the increase in the national living wage should provide a cushion for those in work or able to find work. An increase from £7.20 to £9 an hour over four years may not seem much, but is an increase of 25%. Small businesses that find their wage costs rising as a result will in turn be helped by lower NICs and corporation tax. The ambition of raising the personal tax allowance should also help to cushion these effects for those in work. However, the increase from £10,600 to £11,000 announced in the Budget for next April was insignificant compared to the takeaway on tax credits.

The Chancellor's surplus target remains very challenging, with a £37bn dose of fiscal medicine still to be administered. Government surpluses must be matched by private or overseas sector deficits, so someone must be persuaded to borrow more if this is to be achieved. Historically, Government surpluses are rather rare, and have only occurred when companies have been heavily borrowing to invest. The last time we saw one was at the height of the dot-com boom, and this vanished as soon as companies started to tighten their belts after the bust. The business-friendly Budget, with its emphasis on investment and productivity, should help encourage CFOs to loosen the purse strings. But failing that, with households reluctant to borrow and the outlook for exports remaining poor, the adjustment must come from a slowdown in the economy and import growth.

Households have done very well this year from low inflation and the robust labour market, with real incomes up 4.5% in the year to the first quarter and we would be surprised if the OBR's growth forecast for this year (2.4%) was not exceeded. Further out, however, there is a huge degree of uncertainty around the forecasts. The OBR has effectively assumed that the higher living wage will do little damage to employment levels and will largely offset the impact on household incomes of the very large cuts to welfare spending. They may well be right, although there is a risk that the damage to household incomes and, therefore, consumer spending turns out to be greater. It is not clear that this summer's sunshine is strong enough to facilitate the extensive roof repairs the Chancellor has in mind.

Further information

For further information on any of the issues raised here, please contact one of the following or your usual EY contact:

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