Smith & Williamson

Autumn Budget 2018
Commentary

October 2018

Contents

1. Introduction

The Autumn 2018 Budget, which could be Chancellor Philip Hammond's last before the UK's scheduled departure from the European Union next year, proved reactive and non-reformist but did include a clutch of welcome commitments to back UK entrepreneurs.

Announcing yesterday (29 October) that "entrepreneurs must be at the heart of a dynamic economy," the Chancellor outlined plans to resist calls to scrap entrepreneurs' relief (albeit with changes to the qualifying period), raising the annual investment allowance to £1 million and cutting the business rates bill by a third for two years for retail properties where the rateable value is less than £51k.

Businesses owners needed the confidence that this government is on their side so these are positive moves. Growing tech companies will also take comfort from the fact that the heavily-trailed new digital services tax won't apply until they achieve revenues of more than £500m.

Our experts have pored over the rest of the detail and share their analysis here.

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30 october 2018

2. Income tax


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2. Income tax

Announcements on income tax were limited. The headline is that the Government will meet its manifesto promise on the personal allowance and higher rate threshold from 2019/20, a year earlier than expected.

Proposed restrictions to rent-a-room relief have also been abandoned.

2.1 Increases to personal allowance and higher rate threshold

The personal allowance and higher rate threshold will increase from 6 April 2019, bringing them to the levels promised in the 2015 Conservative manifesto.

The Government has brought forward its commitment to raise the income tax personal allowance and the 40% income tax threshold from 2020/21 to 2019/20. Consequently, the personal allowance for 2019/20 will increase to £12,500 (up from £11,850 in the current tax year) and the basic rate limit will rise from £34,000 to £37,500.

These thresholds will remain at the same levels for 2020/21. For future years, the personal allowance and higher rate threshold will increase in line with consumer price index (CPI).

Our comment: *The early introduction of these increases will be welcomed by many taxpayers.*

The Government's analysis states that the changes will result in 32 million individuals' tax bills being reduced in 2019/20 compared to 2015/16, and that the effect of the increase to the personal allowance will result in a typical basic rate taxpayer paying £1,205 less tax in 2018/19 than in 2010/11.

Not all taxpayers, however, will benefit from the increase to the personal allowance. Those on low incomes will not fully benefit from the increase, where their income is less than the personal allowance, or where the increase in after tax pay results in a reduction in their means tested benefits.

In addition, those with incomes above £100,000 will continue to see their personal allowances restricted for every £2 of income above this threshold. As the £100,000 limit has not changed despite increases in inflation, it is likely more people will fall into this category.

When will it apply? *This measure will apply from 6 April 2019.*

2.2 Proposed rent-a-room relief restriction withdrawn

Following a consultation on draft legislation, the Government has decided not to proceed with plans to include a shared occupancy test for rent-a-room relief.

Rent-a-room relief provides an income tax exemption for rents received by individuals who rent a room (or rooms) for residential purposes in their only or main residence. The exemption is currently £7,500.

The Government had previously announced that from 6 April 2019, it would introduce an additional 'shared occupancy' test for obtaining rent-a-room relief. The test would have required individuals to occupy the property at the same time as the tenant for at least some of the letting period.

The Government has decided that it will not go ahead with the introduction of this additional test in order to "maintain the simplicity of the system".

Our comment: *While the withdrawal of the legislation may be positive for those letting their homes to long term lodgers to ensure they do not lose the relief due to periods of absence from their main home, there remains uncertainty around the availability of rent-a-room relief in certain circumstances particularly where letting the whole of the property during a short term absence.*

Therefore, those letting their property through Airbnb and other such sites still need to carefully consider whether they are eligible for rent-a-room relief.

2.3 Voluntarily submitted tax returns to be given a statutory basis

HMRC's practice has always been to treat voluntary tax returns as if submitted in response to a statutory notice to file. Although saving additional administration work all round, the status of enquiry notices in such cases has been questioned, so legislating for the practice will give certainty for taxpayers and HMRC.

When a taxpayer submits a tax return without having been issued with a statutory notice to file, HMRC will nonetheless accept the return and process it as a 'voluntary' tax return. This effectively treats such returns as if submitted in response to a return notice.

HMRC has considered it has been able to do this under its discretionary collection and management powers.

There have been some recent legal challenges to this practice so legislation will be introduced, with retrospective effect, to put the practice onto a statutory basis. The intention is to remove any doubt for taxpayers that 'voluntary' tax returns have and will continue to be accepted as valid returns.

This will include returns submitted by individuals, partnerships, trusts and companies.

Our comment: *The self assessment regime requires a taxpayer to submit a tax return in response to a notice to file or to notify HMRC of a liability to tax. The latter generally leads to HMRC issuing a notice to file a return.*

There are some occasions where the tax liability is notified to HMRC by the submission of an unsolicited return form. Processing these as if in response to a notice to file a return saves time where the self assessment is accepted.

Problems have arisen when HMRC wants to enquire into such returns. This change will help clarify the position and avoid disputes over the validity of enquiry notices and related closure notices.

When will it apply? *It will apply retrospectively from the date Finance Bill 2018-19 receives Royal Assent to tax years 1996-97 onwards.*

3. Capital taxes

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A consultation has been announced into private residence relief, and anticipated changes include reducing the final period exemption from 18 months to 9 months from April 2020. There will also be changes to entrepreneurs' relief to tackle what HMRC perceive as misuse, including an increased minimum ownership period and more stringent conditions required to meet the 5% personal company test.

3.1 Changes to the definition of a 'personal company' for Entrepreneurs' Relief purposes

The definition of a personal company for Entrepreneurs' Relief (ER) purposes has been amended to require the entrepreneur to have a 5% interest in both the distributable profits and the net assets of the company.

ER applies on a disposal of shares in a company where the company is the 'personal company' of the individual making the disposal.

Previously, a personal company was defined as one in which the shareholder:

- is an office holder, director or employee of the company or group company; and
- holds at least 5% of the ordinary share capital and of the voting rights of the company.

The shareholder will now also need to hold a 5% interest in the distributable profits and the net assets of the company for the relief to be available on the gain.

Our comment: *ER is a valuable relief reducing the CGT rate from 20% to 10% on qualifying disposals. There were concerns in the run-up to the Budget that there would be restrictions to the availability of ER and some pressure groups had been calling for the relief to be abolished entirely. In this context, the commitment to maintaining the relief and the acknowledgement of its value in supporting the role that entrepreneurs play in the economy is heartening, albeit at the cost of a tightening of the rules. There was a perception that the relief was being accessed by those with voting rights that were disproportionate to their economic interest in the company. It is likely that this was only in limited situations and so the impact of this change is unlikely to be substantial. If the shares were acquired through exercise of an EMI option, they qualified as shares in a personal company even if the 5% interests were not met. It does not appear that this definition of personal company has been impacted by the above changes.*

When will it apply? *This change will apply to disposals on or after 29 October 2018.*

3.2 Restriction to availability of Entrepreneurs' Relief through a change to minimum qualifying period

The minimum period throughout which certain qualifying conditions must be met for an individual to be able to claim Entrepreneurs' Relief (ER) is to be extended from 12 to 24 months. Measures will be included to protect entrepreneurs whose businesses have already ceased by preserving the one year qualifying period for such businesses where cessation was before 29 October 2018.

ER is only available on the disposal of shares in a company where the company is the entrepreneur's personal company. The personal company conditions previously had to be met for a period of 12 months prior to the sale of the business. A business also currently has to be owned for at least 12 months before sale. These qualifying periods will now be extended to 24 months.

ER can also be claimed where a business has ceased to trade, provided that the qualifying conditions were met during the period prior to cessation and that the disposal takes place within 3 years of the company ceasing to trade. A specific protection will be included to apply the 12-month holding to businesses that ceased (or personal companies that ceased trading) prior to 29 October 2018, to avoid retrospectively penalising entrepreneurs who are in the process of winding up a company.

Our comment: *This is a further tightening of the ER rules, which will limit the availability of the relief for some entrepreneurs.*

Although the protection for those whose businesses have already ceased is welcome, this does not extend to those currently negotiating the sale of their business. Where such businesses have new shareholders, it will be necessary to complete these transactions before 6 April 2019 to ensure those shareholders don't lose entitlement to this valuable relief.

We would recommend that all entrepreneurs review their position to consider the availability of ER in the event of a short-term sale and whether or not any planning steps need to be taken now in anticipation of a sale in the medium to long-term.

When will it apply? *This change will apply to disposals made on or after 6 April 2019.*

3.3 Entrepreneurs' Relief where shareholding falls below the 5% qualifying threshold

An individual whose shareholding is diluted below the 5% qualifying threshold due to an issue of new shares will still be able to obtain Entrepreneurs' Relief (ER) on gains made up to the time of the dilution.

ER is only available on a sale of shares where an individual disposes of their 'personal company'. One of the definitions of personal company is one where the individual owns 5% of the ordinary share capital, voting rights and (after today's announcement) has a 5% interest in both the distributable profits and net assets.

Previously, entrepreneurs whose holdings fell below the 5% qualifying level because new shares were issued as part of a commercial fund raise lost the benefit of ER on their remaining shares.

The new rules will allow the entrepreneur to capture the ER on the growth in value of their shares up to the point of dilution. The relaxation will only be available where the dilution to the shareholding results from the issue of new shares to raise funds for genuine commercial reasons. This excludes, for example, the conversion of debt to equity or the exercise of employee share options.

Broadly, the entrepreneur elects to dispose of and then immediately reacquire the shares at their market value immediately prior to the dilution. ER is then available on the gain arising on this deemed disposal. Also, the entrepreneur can elect for the notional gain to be deferred until the shares are actually sold or otherwise disposed.

The time limit for making these elections will be 12 months after the 31 January following the end of the tax year in which the dilution occurs.

Our comment: *The concern around the rules as they stand is that they risk the entrepreneur choosing either to cease their involvement in the business or to avoid dilution by not undertaking the necessary fund raise. As such, the changes are vital to ensure the entrepreneur community remains involved with businesses as they look to scale up.*

The tight deadline for the elections, being based on the dilution event not the sale, means that entrepreneurs will need to be switched on in making the appropriate claims. Also, the fact that the elections are irrevocable means that they should consider detailed advice to ensure that the elections are appropriate.

When will it apply? *This will apply for shares held at the time of fundraising events that take place on or after 6 April 2019.*

3.4 Payments on account of capital gains tax following residential property disposals

Finance Bill 2018-19 will introduce a requirement for UK resident taxpayers to make a payment on account of capital gains tax (CGT) following a residential property disposal. New legislation will also replace the existing rules for reporting and payment of tax that apply to non-UK resident taxpayers. Budget 2018 has announced some tweaks to draft legislation published in July 2018.

Currently, CGT is typically due for payment by the 31 January following the end of the tax year in which a chargeable capital gain is realised. Non-residents, however, must report disposals of UK residential property via a non-resident CGT return and in many cases pay any tax due within 30 days of completion.

Under the new legislation, the draft proposals for which were published in July 2018, all taxpayers who are subject to CGT must file a tax return and make a payment on account of the tax within 30 days of completion. The payment on account will be self-assessed and will take into consideration unused losses and the person's annual exempt amount.

UK residents will not need to file a return or make a payment if:

- the gain on the disposal is not chargeable to CGT; or
- it arises from the disposal of a foreign residential property in a country covered by a CGT double taxation agreement; or
- it is foreign property and the gain arises to a person taxed on the remittance basis.

Following further consultation, Budget 2018 has announced the following changes to the legislation:

- a reasonable estimate of valuations will be allowed where these are not available before the reporting deadline;
- sales of non-UK properties by UK residents will be exempt from the rules; and
- non-UK resident companies will be exempt from the reporting requirement.

Our comment: *It is hoped that HMRC fully publicise the new rules so that taxpayers are sufficiently aware of their reporting requirements.*

Allowing the use of a reasonable estimate of a valuation appears to be a sensible amendment to the existing draft legislation. Taxpayers may have otherwise experienced difficulties in complying with the required 30 day deadline to report their capital gains.

It is assumed that non-UK resident companies will be exempt from the reporting requirements because gains made by non-UK resident companies will be subject to corporation tax from 6 April 2019.

When will it apply? *These changes will broadly apply from 6 April 2019 for non-UK residents (with a minor change applying from 6 April 2020) and from 6 April 2020 for UK residents.*

3.5 Consultation announced to reform specific elements of the private residence relief rules

Changes are expected to reduce the final period exemption from the current 18 months to 9 months and to restrict the availability of lettings relief.

A consultation has been announced into private residence relief (PRR) for CGT. The consultation is limited to the final period exemption and lettings relief.

PRR reduces the chargeable gain that accrues on an individual's only or main home. The relief applies during the period of ownership that the property was the main residence plus a final period exemption, even if the property is not the main residence for the owner at that time. This final period is currently 18 months but is expected to be restricted to 9 months. A longer period of 36 months exists for disabled persons and those in care homes, and this is not expected to change.

Lettings relief provides a further relief to cover a period of letting at the lowest of the following:

- the PRR available;
- the gain accruing during the let period; and
- £40,000.

As such, lettings relief is only ever available on the let of a former home and the maximum tax relief is £11,200 at current CGT rates. The relief is expected to be restricted so that it only applies where the owner of the property is in 'shared-occupancy' with a tenant.

Our comment: *Both of these changes reflect the Government's discouragement of landlords through taxation as a means of opening up the UK housing market. These new proposed changes to the CGT relief demonstrate this further by discouraging homeowners from retaining a property as they move up the housing ladder.*

The final period was 36 months prior to April 2014, which shows a real reduction in the relief over this relatively short period. While this clearly fits in with the prevailing attitude to landlords, the timing is perhaps somewhat surprising given the slowdown in the UK housing market. Many homeowners are not retaining their properties deliberately but rather because they are unable to find a buyer. It will be interesting to see if the UK housing market's performance over the next couple of years influences the final decision on the grace period at all or if, in fact, the proposals impact the housing market directly with sellers reducing prices to ensure a sale prior to the change.

Arguably, lettings relief has always been somewhat generous given no equivalent exists for pure buy-to-let properties. The intention of the relief was, however, to encourage home-owners to make use of the property through letting if they were unable to sell immediately. Again, given the current housing market, we may see more vacant housing stock. Homeowners will not want to enter into a 12 month rental agreement knowing that after 9 months they risk exposure to CGT. They will instead simply keep the empty property on the market.

The statement around 'shared-occupancy' would appear to be somewhat unnecessary as someone with a lodger in their home should not suffer a restriction to their PRR, making the availability of lettings relief superfluous in these circumstances. We await the consultation document to ascertain the specifics of the proposed reform for some clarity as to why this statement was thought necessary.

When will it apply? *Following a period of consultation, the change will apply for disposals after April 2020.*

3.6 Inheritance tax: residence nil rate band downsizing provisions to be adjusted

Amendments to the residence nil rate band (RNRB) legislation will be introduced to clarify the downsizing provisions and to provide certainty over when a person is defined as 'inheriting property'.

The RNRB was introduced from 6 April 2017 for taxpayers who wish to pass their main residence to their direct descendants on death. It applies an additional nil-rate band (NRB) on top of the standard NRB (currently £325,000), although it is tapered at £1 for every £2 that an estate exceeds £2million in value. The measure is being phased in over a number of years, bringing the combined available NRB to £500,000 from 6 April 2020.

Any unused RNRB can be transferred to a surviving spouse or civil partner so that the total NRB can be up to £1m if all conditions are satisfied. It is also available when a person downsizes or ceases to own a home on or after 8 July 2015, providing assets of an equivalent value are passed on to direct descendants.

The changes will tighten the legislation to ensure it fits with the original policy intent in two areas:

- it will ensure that the value of a residence inherited by an exempt beneficiary, for example, a surviving spouse inheriting a deceased partner's share of a property, is taken into account when calculating the relief under downsizing provisions; and
- where a property is gifted and the donor continues to occupy the property, it will only be treated as 'inherited property' for the purpose of the relief if it became immediately comprised in the direct descendant's estate as a result of the original gift.

Our comment: *The problem of how to apply the RNRB where a deceased person had either downsized or otherwise disposed of the main residence, for example on moving into residential care, was raised when the reforms were first announced. This announcement follows previous tweaks to the legislation to ensure clarity in its application. While the concept behind the relief is straightforward, quantifying it continues to be complicated and we remain of the view that a simple uplift in the NRB available to all taxpayers would be much simpler.*

When will it apply? *The changes will have effect for deaths applying on or after 29 October 2018.*

3.7 HMRC will confirm its established legal position of inheritance tax treatment of additions to trusts

HMRC will publish legislation to confirm what it states is its established legal position of the inheritance tax (IHT) treatment of additions to existing trusts. HMRC will also ensure that transfers between trusts are subject to additional excluded property tests.

Any non-UK property that is added to a trust by an individual who is not domiciled in the UK should remain outside the scope of UK IHT – it is regarded as 'excluded property'. Until now, however, there has been some uncertainty as to whether or not assets added to an existing trust once the individual has become UK domiciled (or deemed UK domiciled) should also be regarded as excluded property.

HMRC intends to publish legislation to confirm its current view. There is very little detail in the announcement but we assume this view is that an addition of assets to a trust originally settled by a non-UK domiciled settlor is not excluded property if the addition occurs when the individual is either UK domiciled under common law principles or is deemed-UK domiciled.

The legislation will apply to IHT charges arising on or after the date that Finance Bill 2019-20 receives Royal Assent, regardless of whether or not the additions were made prior to this date.

Our comment: *HMRC will also introduce legislation to ensure that transfers between trusts will be subject to additional excluded property tests.*

We expect that the proposed new legislation will address a decision in a recent tax case, Barclays Wealth Trustees (Jersey) Limited & Anor v HMRC [2017] EWCA Civ 1512, in which the Court of Appeal found that transfers of property between excluded property settlements after the settlor became deemed UK-domiciled did not cause the property to become subject to UK IHT.

There is little detail of how the proposed new legislation will apply and we await draft legislation from HMRC to provide further clarity.

When will it apply? *These changes will apply to IHT charges arising or transfers between trusts made on or after the date on which Finance Bill 2019-20 receives Royal Assent.*

4. Payroll and employee incentives

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As for last year, two of the main themes for employment taxes are off-payroll working in the private sector and the NIC treatment of termination payments.

The new off-payroll regime has been softened by excluding small organisations and postponed to April 2020.

Reform of the NIC treatment of terminations payments, hanging around from the draft NIC Bill in 2016, is postponed to April 2020 as well.

4.1 Changes to the taxation of contractors and Personal Service Companies will increase risk of PAYE and NIC exposure for many companies

From April 2020, medium and large private sector organisations will be responsible for assessing the employment status of any contractors whose services are provided under a contract with a Personal Service Company (PSC) or intermediary, accounting for any Pay As You Earn (PAYE) and employees' and employers' National Insurance Contributions (NICs) due.

From 6 April 2020, private sector organisations will potentially become liable for PAYE and employer NICs in respect of payments to contractors engaged through an intermediary company or a PSC. This is an extension of the so-called IR35 rules, so that the obligations to correctly operate PAYE and account for NICs will now fall on the engaging company in most circumstances. The rules will apply to all engagements that are in place on or after 6 April 2020 in medium and large organisations. Small companies will be exempt.

The organisation that makes payments to the contractor or intermediary will be responsible for determining the status of the contractor and assessing whether or not PAYE and NICs will apply even where there is no direct contract between the individual and the company making payments.

No details have yet been provided on where exactly responsibility will lie in more complex cases where there are multiple intermediaries in a chain between the end user of services and a contractor. Nor has there been any confirmation of what the definition of a small company will be for these purposes. A further consultation on the detailed operation of the reform will be published in the coming months.

Our comment: *It will be welcome news to the organisations affected that the changes have been delayed until 6 April 2020. Given the extent of the preparations required, however, many companies will already be considering their risk exposure and putting appropriate procedures in place. Significantly, the rules will apply to contractor arrangements already in place at 6 April 2020 as well as new arrangements; therefore, these rules will need to be considered when entering into or extending contracting arrangements over the coming year. For example, twelve-month contracts beginning on or after 6 April 2019 will be affected by the new rules.*

This measure will have a significant impact for all companies that do not meet the small company exemption. There will be increased administration required when taking on contractors, increased costs for engagers and decreased net income for contractors where the new rules are applicable. Even a single contractor can easily lead to tens of thousands of pounds of possible exposure, so interest and penalties for non-compliance could also be significant.

In advance of the changes, organisations will need to undertake a review of the contractor relationships already in place, to ensure they will be compliant come April 2020. It will also be necessary to design and implement processes both for assessing new contractor engagements and for reviewing existing engagements on an ongoing basis; HMRC will consider these processes when testing for non-compliance.

When will it apply? *The changes will come into effect from 6 April 2020.*

4.2 PAYE special arrangements for short term business visitors to the UK: An extension of the PAYE payment deadline and an increase in the UK workdays threshold

The payment deadline for settling employers' PAYE liabilities in respect of short term business visitors (STBVs) under a special arrangement will be moved back from 22 April to 31 May following the tax year-end. The number of UK workdays permitted for STBVs to be eligible for the special arrangement will be increased from 30 to 60.

The PAYE special arrangement is used by UK employers who host STBVs from overseas employers and whose earnings are not eligible for exemption from UK tax under a double taxation agreement. These STBVs commonly do not qualify for tax exemption because they are from an overseas branch of a UK company, or from a country with which the UK has not entered into a double taxation agreement.

The arrangement enables the employer to make one single PAYE payment for all STBVs, rather than through monthly payroll reporting for each STBV.

The extension of the payment deadline from 22 April to 31 May following the tax year-end will give more time for employers to collate the necessary information required to make the return. The increase in the UK workday limit from 30 to 60 will enable PAYE to be settled for more STBVs under the special arrangement.

Our comment: *The PAYE payment deadline extension will be welcome news for employers operating PAYE special arrangements, who will have longer to collate the requisite information and to calculate the amounts subject to PAYE.*

Also welcome is the relaxation of the eligibility criteria for STBVs by increasing the UK workdays limit to 60, as fewer STBVs will need to be reported through payroll on a monthly basis.

The above changes will increase the appeal of the PAYE special arrangement.

It is, however, disappointing for employers that the recommendations in the consultation to exempt STBVs from overseas branches of a UK company are not being taken forward.

When will it apply? *These changes will apply from 6 April 2020.*

4.3 Restriction of eligibility for National Insurance Contributions Employment Allowance

Access to the National Insurance (NICs) Employment Allowance will be restricted to employers with an employer NICs liability of below £100,000 in the previous tax year.

Currently, employers of all sizes may reduce their Class 1 NICs liability by £3,000 a year. This claim is available for one employer per group of companies.

From 6 April 2020, this relief will only apply to employers who had a NIC liability below £100,000 in the previous tax year.

Our comment: *While this will increase costs for larger employers, the amount of relief being withdrawn is unlikely to be significant for most affected employers.*

When will it apply? *This change will apply from 6 April 2020.*

4.4 Changes to the National Insurance treatment of termination payments delayed to 6 April 2020

The Chancellor announced the Government still intends bring in legislation broadly to align the National Insurance treatment of termination payments with the treatment that already applies for income tax. This change was initially proposed at Budget 2017, but its implementation was delayed and it will now come into effect from 6 April 2020.

From 6 April 2020, only the first £30,000 of any qualifying termination payment will be free from employer's National Insurance. Any excess over £30,000 will be subject to employer's National Insurance at the usual rate, but will remain free from employees' National Insurance.

Our comment: *This measure will increase the National Insurance costs for any employers paying termination payments of more than £30,000 to any one individual but will simplify the administration for all employers making termination payments.*

The complexity that exists in assessing whether or not a payment made at the end of an employment qualifies as a termination payment or is considered as any one of a range of other types of payment taxed as earnings will remain. It will be this technical distinction that employers will need to be aware of when making payments to employees ending their contracts.

When will it apply? *The changes will now apply where the employment contract is terminated on and after 6 April 2020.*

5. Business taxes

5. Business taxes

The Budget included relatively few new announcements on business taxes, the most significant being in relation to a new tax on the UK revenues of large digital businesses. The introduction of a digital services tax is in line with comments made by the Chancellor at the Conservative party conference.

Various changes to the capital allowances rates have also been announced with a temporary significant increase of the annual investment allowance.

5.1 A new Digital Services Tax will be introduced from April 2020

The Digital Services Tax (DST) will apply a 2% tax on certain revenues for large digital businesses.

It will only apply to revenues from intermediating sales, as opposed to the online sales themselves, and where value is derived from UK users.

Search engines, social media platforms and online marketplaces will be caught, whereas financial and payment services, provision of online content, sales of software or hardware, and TV and broadcasting services are not within scope.

The introduction of the DST is designed to ensure that digital businesses pay UK tax that reflects the value they derive from UK users.

The DST is targeted specifically at large businesses, and is designed to be a temporary measure pending a more comprehensive global solution. The DST includes the following features to support this intention:

- **two financial thresholds** - global revenues from in-scope activities must be at least £500m a year and the first £25m of relevant UK revenues are also not taxable.
- **safe harbour** - allowing businesses to elect to calculate their liability on an alternative basis, which will be of benefit to those with a very low profit margin.
- **review clause** - the DST will be subject to formal review in 2025.

DST will be an allowable expense for UK corporation tax purposes under ordinary principles.

A consultation on the design of the DPT is expected in the coming weeks, and will then be legislated for in the 2019/2020 Finance Bill.

Our comment: *It was widely anticipated that a tax on the digital economy would be announced, so the introduction of the DST is not a surprise. This measure pre-empts the OECD discussions centred around the 'Interim Report 2018' which has not provided a clear consensus to bridge the gap between the perceived advantage for digital businesses over traditional models.*

Businesses will be pleased that this only targets the largest businesses operating in specific sectors and with specific business models, rather than the digital economy as a whole. It will be interesting to see the consultation papers and further detail on the design in due course.

When will it apply? *To apply from April 2020*

5.2 Changes to capital allowances and a significant boost of the Annual Investment Allowance limit

A number of changes to capital allowances have been announced, the most significant being the temporary increase in the Annual Investment Allowance (AIA) to £1m. A new Structure and Buildings Allowance will be introduced, as well as a reduction in the allowance rate for the special rate pool.

The AIA will be increased from £200,000 to £1m for two years from 1 January 2019 to stimulate business investment.

In addition, a new allowance, the Structures and Buildings Allowance (SBA), was announced, which essentially provides for a 2% capital allowance on the cost of any new non-residential structures and buildings. The allowance will apply where all the contracts for the physical construction works are entered into on or after 29 October 2018.

The special rate of writing down allowances for qualifying plant and machinery will reduce from 8% to 6% from April 2019.

The Government will also update the Energy Technology List and the Water Technology List for the qualifying criteria to qualify for First Year Allowances.

Our comment: *The Government is keen to stimulate capital investment and improve the international competitiveness of the UK's tax system. These changes will provide significantly faster tax relief for qualifying investment and is a welcome change for businesses.*

When will it apply? *The AIA will increase from 1 January 2019. The SBA will apply from Budget Day for appropriate contracts. The special rate of writing down allowances for plant and machinery will apply form April 2019.*

5.3 Draft legislation on various corporate tax reform measures to be legislated with minor amendments

The Government confirmed that previously released draft legislation regarding the corporate interest restriction, the reform of corporation tax loss relief and the charging of non-UK resident corporate landlords to corporation tax rather than income tax will be included in Finance Bill 2018-19.

Amendments are being made to the existing corporate interest restriction rules to ensure the regime operates as intended, both now and after the introduction of the new accounting standard for leases, IFRS 16.The amendments to the corporation tax loss relief rules are also in order for the legislation to operate as intended, and in particular to prevent excessive relief for carried-forward losses.

From April 2020 non-UK resident companies that carry on a UK property business or have other UK property income will be brought within the charge to corporation tax rather than income tax, which is currently the case. Targeted anti-avoidance is to be introduced from 29 October 2018.

Whilst draft legislation covering these changes was published in the summer, some revisions have been made following periods of consultation.

Our comment: *The need for technical amendments to recently introduced legislation in order for it to operate as intended highlight the challenge of drafting complex tax rules to fit in with an already complex corporation tax regime.*

When will it apply? *Although some of the amendments to existing corporate interest restriction and loss relief legislation will have effect from 1 April 2017 when the rules commenced, others are effective from later dates between 1 January 2018 and 1 April 2019.*

The changes to the Corporate Interest Restriction rules as a result of the introduction of IFRS 16 will generally have effect for periods of account beginning on or after 1 January 2019, although certain amendments to the long funding lease rules will only have effect for leases entered into on or after 1 January 2019.

The changes for non-UK resident companies will have effect on and after 6 April 2020.

5.4 Corporate intangible fixed assets regime reform

The Government intends to reform the corporate intangibles fixed asset regime, following the policy consultation that was published in February 2018 to support intangible investment by UK companies.

The Government has announced that it intends to reform the intangible fixed asset regime following the consultation in Spring 2018. The consultation reviewed whether there was scope to make the regime more effective in supporting economic and business growth and if any targeted changes were required to encourage companies investing in intellectual property.

The regime was originally introduced to provide corporation tax relief for the amortisation of intangibles, making the UK an attractive location for holding intangible assets. The benefits of the regime, which is now 15 years old, were narrowed in 2015 to deny relief generally in relation to goodwill and other customer-related intangibles.

In Finance Bill 2018-2019, the Government intends to legislate:

- a relief for the cost of acquired goodwill in the acquisition of businesses with eligible intellectual property from April 2019;
- a reform to the de-grouping charge rules, which apply when a group sells a company that owns intangibles, to ensure that a de-grouping charge will not arise where the de-grouping is the result of a share disposal that qualifies for the Substantial Shareholding Exemption. This will take effect from 7 November 2018.

Our comment: *These provisions will be welcomed by those investing in intellectual property in the UK. This is a further indication of the UK's willingness to review and reform existing legislation to make the UK a more attractive location for investment in intellectual property-rich businesses.*

When will it apply? *The new tax relief will apply from April 2019 with the de-grouping reform to apply from 7 November 2018.*

5.5 Amendments proposed to the Diverted Profits Tax rules

Rules will be introduced in Finance Bill 2018-19 to close tax planning opportunities and make clarifications and modifications to the mechanics of the Diverted Profits Tax (DPT) legislation.

DPT was introduced to counter specific arrangements designed to erode the UK tax base, either by seeking to artificially avoid creating a UK permanent establishment that would bring a foreign company into the charge to UK corporation tax, or by using arrangements or entities which lack economic substance to artificially divert profits to low tax jurisdictions.

The government is proposing to:

- Close a tax planning opportunity whereby tax returns can be amended after the review period has ended and the DPT time limits have expired;
- Make clear that diverted profits will only be taxed under either the DPT or corporation tax rules, but not both; and
- Extend the review period during which HMRC and the company should work together to determine the extent of diverted profits and increase the period of time during which companies can amend their corporation tax returns for diverted profits.

Our comment: *These amendments have been introduced to clarify the DPT provisions as part of HMRC's mandate to tackle erosion of the UK tax base. The announcements do not come as particular surprise, especially given HMRC's recent interest in this area.*

When will it apply? *These measures will have effect on and after 29 October 2018.*

5.6 Restriction on use of corporate capital losses

Use of carried-forward capital losses to be restricted to 50% of capital gains from 1 April 2020.

The Government will legislate in Finance Bill 2019-20 to restrict companies' use of carried-forward capital losses to 50% of capital gains from 1 April 2020.

The measure will include an allowance that gives companies unrestricted use of up to £5 million capital or income losses each year.

A consultation paper was published on 29 October 2018 and draft legislation will be published in the summer. The measure will be subject to anti-avoidance rules that are to apply with immediate effect.

Our comment: *These capital loss restriction rules are being introduced to ensure that large companies pay tax when they make significant capital gains. This will bring the tax treatment of such corporate capital losses into line with the treatment of carried forward income losses and therefore brings forward tax revenues arising from gains arising in groups with large capital losses.*

When will it apply? *The change will apply from 1 April 2020*

5.7 Limit on R&D Tax Credit

A new limit will be introduced on the amount of payable tax credit that a company can claim under the R&D scheme for SMEs. The limit will be set at three times the company's total PAYE and National Insurance Contributions for the period.

There will be a limit on the tax credit payable under the R&D tax relief scheme for SMEs. The limit will be set at three times the company's total PAYE and National Insurance Contributions payment for the period.

If there is any loss that a company cannot surrender for a payable credit, the loss can be carried forward and used against future taxable profits.

The Government is entering into a period of consultation in respect of these changes before implementation in April 2020.

Our comment: *Prior to 2012, there was a limit in place that set the amount of credit payable to the PAYE and employer and employee National Insurance Contributions paid by the company during the period. To tackle perceived abuse of the R&D tax credit regime, HMRC now appears to be re-instating this limit but at a higher level. The limit may cause a problem where a company does not employ anyone directly, and therefore does not have PAYE/NIC liabilities.*

When will it apply? *The changes will have effect for accounting periods beginning on or after April 2020.*

5.8 Reform of Enterprise Investment Scheme rules for approved funds

The Government has proposed reforms to the Enterprise Investment Scheme (EIS) rules for approved funds from 6 April 2020. The rules will concentrate the focus of investment for approved EIS funds into Knowledge Intensive Companies, as well as permitting a longer time period within which monies raised can be deployed. The reforms also include changes for individual investors who will be able to set their income tax relief against liabilities in the year before the fund closes.

Following a policy consultation, the Government is seeking to reform the Enterprise Investment Scheme (EIS) rules and improve the current structure for approved EIS funds. The new approved EIS fund structure is intended to be rolled out in April 2020, at which point the current approved fund structure will be withdrawn.

The reforms will require approved funds to focus on investments in Knowledge Intensive Companies (KIC's) by requiring a minimum of 80% of funds raised to be invested in KIC's.

There will also be increased flexibility for fund managers, through increasing the time period within which fund capital must be deployed. The proposal is that approved funds will now have two years within which to deploy capital, with at least 50% of each raise to be invested within the first 12 months (with monies not yet invested held in cash). By way of comparison, the previous rules for approved EIS funds stipulated that 90% of each raise had to be deployed within the first 12 months.

In addition, investors will be allowed to set their relief against income tax liabilities in the year before the fund closes, whereas previously this was only permitted in the same year the fund closes.

Furthermore, HMRC has digitised the certificates and paperwork associated with these investments and eliminated the need for signed paper documents.

Our comment: *These reforms appear to be a welcome step for approved EIS fund managers and investors alike.*

The increased emphasis on investment in KIC's is of little surprise, whilst the relaxed time period for deploying capital will be beneficial for approved fund managers and their investment opportunities.

Investors should also benefit from the reforms by being able to claim relief earlier through offsetting their relief against income tax liabilities in the year before the fund closes.

The digitisation of the certificates and paperwork will also be welcomed for all parties involved through reducing the administrative burden previously involved with Venture Capital Schemes.

When will it apply? *The Government plans to publish draft legislation for consultation in Summer 2019. The changes will have effect from 6 April 2020.*

5.9 For businesses entering insolvency, HMRC will be made a preferred creditor for some taxes.

Some taxes collected and held by businesses on behalf of other taxpayers will instead be held in trust by the business to be paid to HMRC rather than be paid over to other creditors.

HMRC is to be made a preferred creditor to prevent taxes paid by employees and customers and held by insolvent businesses from being distributed to other creditors. The taxes to be held in trust will cover VAT, PAYE income tax, employee National Insurance Contributions and Construction Industry Scheme deductions. There is no change to the taxes paid directly by businesses, such as corporation tax and employer National Insurance Contributions. The change will, however, only be enacted in Finance Bill 2019-20.

Our comment: *This change will adversely affect all unsecured creditors of insolvent businesses; for example ordinary trade suppliers, who will now likely receive less in an insolvency process, as more value is transferred to HMRC as a preferred creditor.*

When will it apply? *The change will from 6 April 2020.*

6. VAT and indirect taxes

6. VAT and indirect taxes

There were not many new announcements for VAT. Highlights were the introduction of new anti-avoidance measures to target fraud and artificial transactions and the current VAT registration and deregistration thresholds to remain unchanged for a further 2 years.

6.1 VAT registration and deregistration thresholds to remain the same

The VAT registration and deregistration thresholds will remain the same for a further two years until April 2022.

The current taxable turnover registration threshold at £85,000 is the highest in the EU, where the average is far lower. The Office of Tax Simplification report published in 2017 recognised the distortions the threshold can cause and recommended a Government review. In the absence of clear guidance from a call for evidence, the registration threshold and the deregistration threshold (£83,000) will remain the same until 31 March 2022, which extends the two year period previously announced in last year's autumn Budget.

Our comment: *Although a high threshold can benefit smaller businesses who do not need to register for VAT, it is seen as creating a 'cliff-edge' and a bunching effect of businesses choosing to remain below the threshold, which limits their growth. Any reduction to the threshold will need to be implemented carefully, to ensure that it does not simply shift the cliff-edge effect to a lower level. Maintaining the threshold at the same level for four years is only seen as a temporary measure until the Government revisits the matter and provides a longer term solution.*

When will it apply? *There will be no change until April 2022.*

6.2 VAT anti-avoidance measures announced

Further measures are being introduced to combat VAT avoidance.

A number of new VAT measures have been announced as follows:

- **VAT grouping** - the definition of 'bought in services' from outside the UK will be amended to ensure that VAT under the reverse charge provisions is not avoided. The new measure will come into effect from 1 April 2019;
- **VAT and vouchers** – legislation will be brought in for vouchers issued on or after 1 January 2019, which will prevent non-taxation or double taxation where the vouchers are used in the UK and EU;
- **insolvencies** – from 6 April 2020, the Government will effectively become a preferential creditor;
- **unfulfilled supplies** – the Government will amend the rules from 1 March 2019 to bring all prepayments for goods and services into the scope of VAT where customers have been charged VAT and have not received the supply or a refund;
- **insurance** – this measure restricts the ability of UK service providers to recover VAT on supplies to off-shore brokers or insurers where the underlying contract is with a party in the UK. This will come into effect on 1 March 2019.

Our comment: *These announcements will not come as a surprise to businesses given recent communications from HMRC.*

When will it apply? *The measures will apply variously from 1 January 2019 to 1 April 2019, except for the changes concerning HMRC preference in insolvencies, which will come into effect from 6 April 2020.*

6.3 Stamp duty land tax surcharge for non-UK residents

A consultation will be launched in January 2019 on the potential implementation of a 1% stamp duty land tax (SDLT) surcharge for non-UK residents buying residential property in England and Northern Ireland.

UK resident and non-UK resident taxpayers currently pay the same rates of SDLT on purchases of residential property in England and Northern Ireland. The Government is proposing to introduce a 1% surcharge to increase the amount that would be payable by non-UK residents.

Any change will not automatically apply in Scotland or Wales. Responsibility for such taxes has been devolved to their respective governments, who have subsequently introduced a separate land and buildings transactions tax (Scotland) and a land transactions tax (Wales).

Our comment: *Little detail is currently available about how the proposal would work in practice. It will presumably be levied in addition to existing SDLT rates and surcharges, such as the existing 3% surcharge for purchasing a second residence. This would mean that a non-resident taxpayer purchasing a £1m property could in some circumstances pay almost twice as much SDLT as a UK-resident replacing a main residence. If the Government moves forward with this measure, it will be interesting to see if the change is replicated by the Welsh and Scottish governments, as they did following the introduction of the 3% surcharge for the purchase of additional residences.*

When will it apply? *These measures are subject to consultation with no fixed date for implementation.*

7. Glossary of terms

BEPS – base erosion profit share

EIS – Enterprise Investment Scheme

CGT – capital gains tax

CPI – consumer price index

EEA – European Economic Area

HMRC – HM Revenue and Customs

IHT – inheritance tax

ISA – individual savings account

NIC – national insurance contribution

OECD – Organisation for Economic Cooperation and Development

OBR - Office for Budget Responsibility

OTS – Office of Tax Simplification

PAYE – pay as you earn

VCT – Venture Capital Trust

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