Smith & Williamson

Tax update

A round-up of recent issues

17 September 2019

1. Private client

1.1 Policy report recommends combining CGT and IT

An independent think-tank has published a report on reforming UK taxation (income tax and CGT), which the Shadow Chancellor is planning to look at carefully. The basic propositions are to tax all income and gains at the same rates, ultimately with NICs, to use a sliding rate scale rather than marginal rate bands, and the abolition of various reliefs. The estimate of additional tax revenue is significant.

The Institute for Public Policy Research, a progressive think-tank, has published a follow-up to its 2018 report *Prosperity and justice: A plan for the new economy*. This report, *Just tax: Reforming the taxation of income from wealth and work* models two of the proposals, setting out how they would work in practice, and the consequences. The aims are to raise more tax and increase economic justice. The report includes estimates of revenue raised, and considers potential behavioural impacts.

The first proposal is the reform of wealth taxation to match that of income from work. Under the new system, gains would be taxed at the same rates as employment income, and CGT reliefs would be abolished. Entrepreneurs' Relief, the CGT uplift on death, the bond exemptions (including for gilts) and miscellaneous reliefs such as tax-efficient investments would all be dispensed with. The annual exempt amount would be reduced sharply, possibly to £1,000, but a form of indexation allowance is proposed.

The second proposal, is that all income should be taxed together at the same rate, rather than distinguishing between earnings and dividends. Rate bands would be abolished, and replaced with one rate which applied to all income, but would increase on a sliding scale with the amount of income. The highest earners would pay 50% on the whole amount of their income. Ultimately, NICs would be incorporated. The report considers that 70-80% of taxpayers would be better off under this system.

The Shadow Chancellor, John McDonnell, commented on the report:

'Labour pledged at the last election to reverse Conservative cuts to capital gains tax rates.'

'We will look carefully at any proposals which seek to address the unfairness of those who work for their money paying higher taxes than those whose money does their work for them.'

www.ippr.org/research/publications/just-tax

https://labour.org.uk/press/john-mcdonnell-comments-capital-gains-ipprs-just-tax-report/

2. Trusts, estates and IHT

2.1 List of cultural gifts in lieu of tax published

Arts Council England has published details of the 46 cultural items received by the nation under the acceptance in lieu scheme in 2018/19, including manuscripts, paintings, and a chamber organ.

The acceptance in lieu scheme grants IHT reductions to taxpayers in exchange for transferring important cultural items or property to public ownership. Offers are assessed by a panel of experts against various criteria, and the tax reduction is based on a percentage of the gift's agreed value. Items are allocated to public collections in the UK, such as museums and galleries.

In the tax year 2018/19, 46 items were accepted of total value £58.6m. They include two leaves from the manuscript of *On the Origin of Species*, a historic manor house, and a chamber organ.

www.artscouncil.org.uk/publication/cultural-gifts-scheme-acceptance-lieu-annual-report-201819

www.accountancydaily.co/art-treasures-worth-ps58m-used-settle-tax

3. PAYE and employment

3.1 New loan charge review to report in November

The Treasury has announced that the new loan charge review will report by mid-November, and published the terms of reference. The loan charge is still in force, and HMRC has issued guidance on what taxpayers awaiting the outcome should do.

More details of the new independent review of the loan charge have been announced. Sir Amyas Morse, former Chief Executive of the National Audit Office, will lead the review, supported by staff from HMRC and the Treasury. He has been asked to report back by mid-November to allow certainty before the self-assessment deadline of 31 January.

The review will consider:

- 'whether the Loan Charge, as it applies to individuals who have directly entered into disguised remuneration schemes, is an appropriate response to the tax avoidance behaviour in question; and
- whether changes announced by the government in advance of, and since, the Loan Charge came into effect address any legitimate concerns that have been raised about the impact on individuals, including affordability for those affected.'

Taxpayer fairness and HMRC's ability to tackle tax avoidance effectively will also be taken into account.

The loan charge remains in force, and HMRC has issued guidance on what those affected in various ways should do in the interim.

www.gov.uk/government/publications/disguised-remuneration-independent-loan-charge-review

4. Business tax

4.1 New regulations to ensure hybrid capital instruments rules operate as intended

New regulations to amend the hybrid capital instruments rules in Finance Act 2019 have been laid before Parliament. These amendments will ensure the rules operate correctly where a loan relationship includes a change of control provision.

The regulations have been introduced following a consultation period, the results of which have now been published by HMRC. They widen the definition of a 'conversion event' in CTA 2009 to ensure that hybrid instruments that are essentially genuine debt instruments will fall within the coupon deductibility provisions. Alternative deadlines have been introduced for electing to treat a loan relationship as a hybrid capital instrument. For example, where a loan relationship meets the definition of 'hybrid capital instrument' by virtue of the changes introduced by these regulations, the deadline for the election is extended to 6 months after the regulations take effect. These regulations will come into force on 4 November 2019. The regulations will have retrospective effect.

SI 2019/1250: *www.legislation.gov.uk/uksi/2019/1250/made*

Consultation outcome: *www.gov.uk/government/consultations/draft-regulations-amendment-to-new-rules-on-taxation-of-hybrid-capital-instruments*

4.2 Report finds tax measures fail to tackle artificial foreign direct investment

The IMF has published some of the findings of a joint study on the rapid increase in global foreign direct investment (FDI). The research has found that international efforts to reduce tax base erosion have not effectively dealt with 'phantom', or artificially generated, FDI. Approximately 40% of FDI is reported to be redirected to low-tax economies to reduce corporate tax liabilities, rather than genuine investment.

The report, which has not yet been released in full, uses data from the OECD and IMF to distinguish between genuine FDI and 'phantom' FDI. Genuine FDI generates economic growth through cross-border transfers of capital and investment. Phantom FDI exists where cross-border financial investments between entities in the same group pass through empty corporate shells. FDI of this nature arises when a group shifts profits to a lower tax jurisdiction to reduce its overall tax liability. Of the estimated $40 trillion in total FDI, the report attributes $15 trillion to phantom FDI. Global measures to tackle these behaviours, such as the Base Erosion and Profit Shifting project and Common Reporting Standards, have not succeeded in changing this trend.

www.imf.org/external/pubs/ft/fandd/2019/09/the-rise-of-phantom-FDI-in-tax-havens-damgaard.htm

5. And finally

5.1 Chief Inspector Morse

After the Prime Minister's comments on the Loan Charge being a '*very, very difficult issue*' the Government has appointed an independent reviewer, Sir Amyas Morse, to review it (see article 3.1 above). This, then, will be in one sense a review of the review already carried out internally by HMRC and the Government. Oh dear!

The issue isn't whether disguised remuneration schemes should be tackled; it is, as Jesse Norman MP Financial Secretary to the Treasury put it, whether '*it is right to consider if the Loan Charge is the appropriate way of tackling them.'*

Well; we can help both Sir Amyas and the Treasury by answering that quickly and easily, now: no, it isn't.

Although this review sounds like real progress, and, candidly, looks as though it might offer some way out of the mess, it isn't tackling what really needs to happen. It seems reasonably likely that Sir Amyas will find that the Loan charge is to a greater or lesser degree inappropriate. Understandably, perhaps, he is not being invited to comment on any replacement. In truth, though, that is the very, very difficult issue;

not the current legislation. HMRC needs to come up with fresh thinking on the replacement urgently in line with Sir Amyas' tight deadline of November and we strongly suggest early and wide consultation on any draft legislation. Whatever happens, Sir Amyas must not be the means just to kick this down the road.

www.gov.uk/government/publications/disguised-remuneration-independent-loan-charge-review?utm_source=c82d686e-26a2-41c1-8be9-f1f269293904&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate

Glossary				
Organisations		***Courts***	***Taxes etc***	
ATT – Association of Tax Technicians	ICAEW - The Institute of Chartered Accountants in England and Wales	CA – Court of Appeal	ATED – Annual Tax on Enveloped Dwellings	NIC – National Insurance Contribution
CIOT – Chartered Institute of Taxation	ICAS - The Institute of Chartered Accountants of Scotland	CJEU - Court of Justice of the European Union	CGT – Capital Gains Tax	PAYE – Pay As You Earn
EU – European Union	OECD - Organisation for Economic Co-operation and Development	FTT – First-tier Tribunal	CT – Corporation Tax	R&D – Research & Development
EC – European Commission	OTS – Office of Tax Simplification	HC – High Court	IHT – Inheritance Tax	SDLT – Stamp Duty Land Tax
HMRC – HM Revenue & Customs	RS – Revenue Scotland	SC – Supreme Court	IT – Income Tax	VAT – Value Added Tax
HMT – HM Treasury		UT – Upper Tribunal		

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