Summer Budget 8th July 2015

Summary

Chancellor George Osborne has delivered the first Budget by a wholly Conservative government in almost 20 years. The March 2015 Budget provided some clues as to possible new measures and of course, the Conservative election manifesto contained a wide range of commitments to be introduced during the course of the current parliament.

The Chancellor said that this is a Budget for working families in a 'one-nation society'. In 'a big Budget for a country with big ambitions', he focused on how the government will continue with its deficit-reduction plans, whilst giving the promised support to 'hard-working families'. He said that whilst the deficit would be cut at the same pace as under the previous government, it would be a bold budget containing bold new measures.

As predicted, savings in welfare spending of around £12bn, and increases in revenue from tax avoidance and evasion to yield around £5bn made an early couple of headlines in the Chancellor's speech.

The welfare savings are to be funded by:

- ensuring those aged 18 to 21 who receive Universal Credit apply for an apprenticeship or traineeship, gain work-based skills, or go on a work placement 6 months after the start of their claim;
- subjecting benefit payments to a regional cap (£23,000 per year in London and £20,000 in other areas - cut from £26,000 a year);
- limiting child tax credits to two children for new claimants;
- working-age benefits, including tax credits and Local Housing Allowance, will be frozen for 4 years from 2016-17 and
- reducing rents for social housing by 1% a year for 4 years. Tenants on higher incomes (over £40,000 in London and over £30,000 outside London) will be required to pay market rate, or near market rate, rents.

With regards to tax avoidance and evasion, HMRC is to be given significant extra investment - some £60m between now and 2020 - for increased work on tackling evasion and non-compliance. It will be interesting to see how and where this money will be spent.

The Conservative manifesto pledged to introduce a new law within the first one hundred days of a Conservative government to prevent any rises in income tax, VAT or national insurance in the next parliament and it seems that this promise is now to be delivered. Broadly, a five-year 'tax lock' will guarantee no increases in income tax rates; no increases in VAT, nor an extension of its scope; and no increase in national insurance, nor an increase in its ceiling above the higher rate threshold. However, the Chancellor could still move the goalposts - there will still be plenty of scope to raise more revenue without increasing tax rates by widening the definitions of what is taxed, or by withdrawing tax reliefs.

This newsletter provides a summary of the key tax points from the July Budget, based on the documents released on 8 July 2015. It is possible that changes will be made between now and the publication of the draft legislation, which is due to be published on 15 July 2015. We will keep you informed of any significant developments.

Individuals

Tax rates and the personal allowance

Although the personal allowance for 2016-17 was set at £10,800 by the first Finance Act 2015, it has now been confirmed that it will rise from its current level of £10,600 to £11,000 for 2016-17. The government plans to increase the personal allowance to £12,500 by 2020.

The personal allowance will automatically increase in line with the equivalent of 30 hours a week at the national minimum wage for individuals over 21, once the personal allowance has reached £12,500. The Chancellor of the Exchequer will have a legal duty to consider the level of the national minimum wage in setting the personal allowance each year, until it reaches £12,500.

Increases to the personal allowance since 2010, when it was £6,475, mean that a typical taxpayer will be £905 a year better off in 2016-17.

The basic rate limit will be increased to £32,000 for 2016-17 and to £32,400 for 2017-18. As a result, the higher rate threshold will be £43,000 in 2016-17 and £43,600 in 2017-18.

National living wage

From April 2016, a new National Living Wage of £7.20 an hour for the over 25s will be introduced. This will rise to over £9 an hour by 2020.

Dividends

The dividend tax credit (which reduces the amount of tax paid on income from shares) is to be replaced with a new £5,000 tax-free dividend allowance for all taxpayers from April 2016.

Tax rates on dividend income will also be increased. The new rates of tax on dividend income above the allowance will be 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

Non-domiciled individual

Whilst the Chancellor stopped short of Labour's proposals to completely abolish non-dom status, he said that 'it is not fair that people live in this country for very long periods of their lives, benefit from our public services, and yet operate under different tax rules from everyone else.'

From April 2017 anybody who has been resident in the UK for more than 15 of the past 20 tax years will be deemed to be domiciled in the UK for tax purposes and will therefore be required to pay UK tax on their worldwide income. A technical consultation on the finer points of this change will be published later this year.

It is unclear how many individuals will be affected by the new rules. Those resident in the UK for more than seven years are currently required to either pay UK tax, or pay an annual charge that ranges from £30,000 to £90,000, depending on how long the individual has lived in the UK. The latest figures show that in 2012-13, some 5,080 paid the annual charge.

Inheritance tax on the family home

Currently, inheritance tax is charged at 40% on estates over the tax-free allowance of £325,000 per person. Married couples and civil partners can pass any unused allowance on to one another. From April 2017, each individual will be offered a family home allowance so they can pass their home on to their children or grandchildren tax-free after their death. This will be phased in from 2017-18. Broadly, the family home allowance will be added to the existing £325,000 IHT threshold, meaning the total tax-free allowance for a surviving spouse or civil partner will be up to £1 million in 2020-21. The new allowance will be tapered away from those leaving more than £2 million with the intention that those leaving more than £2.35m will not benefit from the new allowance. The tapering policy does, however, have a major flaw -where a home worth £175,000 is included in an estate with a value of between £2m and £2.35m, an effective rate of 60% will be payable.

Property income

Currently, individual landlords can deduct their costs - including mortgage interest - from their profits before they pay tax, giving them an advantage over other home buyers. Wealthier landlords receive tax relief at 40% and 45%. This tax relief will be restricted to 20% for all individuals by April 2020.

Landlords will be able to obtain relief as follows:

- in 2017-18 the deduction from property income (as is currently allowed) will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate tax reduction.
- in 2018-19, 50% finance costs deduction and 50% given as a basic rate tax reduction.
- in 2019-20, 25% finance costs deduction and 75% given as a basic rate tax reduction.
- from 2020-21 all financing costs incurred by a landlord will be given as a basic rate tax reduction.

In addition, from April 2016, the 'wear and tear allowance', which allows landlords to reduce the tax they pay (regardless of whether they replace furnishings in their property) will also be replaced by a new system that only allows them to get tax relief when they replace furnishings.

Rent-a-room relief

The rent-a-room relief limit is to be increased from the current level of £4,250 to £7,500 from April 2016. This means that from 6 April 2016 a person will be able to receive up to £7,500 tax-free income from renting out a room or rooms in their only or main residential property. The relief also covers bed & breakfast receipts as long as the rooms are in the landlord's main residence.

Tax-free childcare

From September 2017, working families with three and four year olds will receive 30 hours of free childcare - an increase from the 15 hours they are currently offered.

In addition, from 2017, parents will benefit from up to £5,000 worth of free childcare a year in a policy designed to help parents work. The government will also fund 15 hours a week of free childcare for all disadvantaged two-year-olds, worth £2,500 a year per child.

Taxation of lump sum death benefits

A change is being made to the pensions tax rules to reduce the tax charge that applies to taxable lump sum death benefits paid from registered pension schemes or non-UK pension schemes. Broadly, the rate of tax payable will be reduced from 45% to the recipient's marginal rate of income tax. This change will apply in relation to lump sums paid on or after 6 April 2016.

2015 Anniversary Games

Non-UK resident sportspeople will be exempt from UK income tax on any income received as a result of their performance at the 2015 Anniversary Games which are taking place at the Queen Elizabeth II Olympic Park and stadium between 24 and 26 July 2015.

Councillors' travel expenses

In relation to payments made on or after 6 April 2016, travel expenses paid to councillors by their local authority will be exempt from income tax and NICs.

Tax-advantaged venture capital schemes amendments

Amendments are to be made to the existing Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules. Broadly, the changes are as follows:

- The first measure specifies the age of a company that is eligible for investment under EIS and VCT. Companies must raise their first investment under EIS, VCT or other risk finance investment within 7 years of making their first commercial sale or 10 years if the company is a knowledge-intensive company. However, no age limit will apply to companies raising an investment where the amount of the investment is at least 50% of the company's annual turnover, averaged over the previous five years. The age limit will apply also to any business that has been owned previously by another company.
- In addition to the existing cap on annual investments of £5 million, there will be a new cap on the total amount of investments a company may raise under EIS, VCT or other risk finance investment, of £12 million or £20 million for knowledge-intensive companies (see below). Any risk finance investments used by a business previously owned by another company will count towards the total funding limit.
- If an individual subscribes for shares in a company and that individual already holds shares in the company, the new shares will not be eligible for EIS unless the individual has made a risk finance investment in the company before Royal Assent or the individual's shares in the company (excluding founders' shares) were a risk finance investment. A risk finance investment is an investment under EIS, SEIS or Social Investment Tax Relief.
- There will be a new requirement for the money to be used for the growth and development of the company (or subsidiary company).
- The rule prohibiting the use of money for the acquisition of shares will be extended to all investments made by VCTs on or after the operative date and will therefore apply to non-qualifying holdings.
- A new rule will prevent companies from using EIS and VCT investments to acquire a business.
- Higher limits are being introduced on total investment, age of company and number of employees to provide support for knowledge-intensive companies that are particularly likely to struggle to access finance. A knowledge-intensive company is a company:

  - whose costs of research and development or innovation are at least 15% of the company's operating costs in at least one of the previous three years, or at least 10% of the company's operating costs in each

of the previous three years and either
- which has created, is creating or is intending to create, intellectual property or
- which has employees with a relevant Masters or higher degree who are engaged in research and development or innovation and who comprise at least 20% of the company's total workforce.

For knowledge-intensive companies, the limit on employees will be raised from less than 250 to less than 500 employees.

- The following measures will be introduced with the intention of smoothing the interaction between SEIS and EIS:

  - companies will no longer need to use at least 70% of SEIS funds before raising funds under EIS or VCT respectively;
  - the EIS relief of investors in companies that redeem the shares of SEIS investors will no longer be reduced, so long as the SEIS relief on the redeemed shares is repaid;
  - the legislation will be amended to clarify that farming outside the UK is not an eligible activity for EIS, SEIS, VCT and Enterprise Management Incentives.

The measures will have effect from April 2014 for the change to the rule on redemption of shares of SEIS investors; 6 April 2015 for the provision removing the requirement for 70% of SEIS funds to be used before a company may raise funds under EIS or VCT; and Royal Assent for shares issued under EIS and for investments made by VCTs and for determining whether investments held by the VCT are to be regarded as qualifying holdings.

Possible pension reform

The Chancellor indicated that there are major changes afoot in the pension tax regime. Changes to the current regime may mean that in future, pension savings operate along similar lines to ISAs - where money is invested, the government makes top-ups to the investment, and the proceeds can eventually be taken out tax-free. There are no further details on this at present but a pension reform Green Paper is to be published for consultation, so we will be monitoring this area for further developments.

Investment managers Capital Gains Tax treatment of carried interest

Carried interest arises from an individual's participation in an investment vehicle, typically a partnership, and they will normally be charged to capital gains tax on the full amounts they receive in respect of that interest. In relation to all carried interest arising on or after 8 July 2015, whenever the arrangements were entered into, deductions will only be allowed in respect of sums actually given by the individuals as consideration for acquiring the right to that carried interest. This change will not affect genuine investments in funds made by managers on an arm's length basis (known as 'co-invest').

Businesses

Annual investment allowance

The annual investment allowance (AIA), which has previously been increased temporarily to £500,000 until 1 January 2016, will be set permanently at £200,000 from that date.

Broadly, the AIA allows businesses to deduct the full value of certain items, including equipment and machinery, up to a total value of £200,000 from their profits before tax. This helps them with cash flow because it means the full tax relief is given in the year that items are purchased, rather than over several years. Any businesses considering making large investment on items qualifying for the AIA should now consider the timing of such spending.

Personal service companies

The government is concerned that the IR35 rules are not effective enough and non-compliance in this area is estimated to cost over £400 million a year. The government has therefore asked HMRC to liaise with business on how to improve the effectiveness of existing IR35 legislation. We can expect to see further developments in this area.

Extending averaging for farmers

As announced in the Spring Budget, the averaging period for farmers will be extended from two years to five years from April 2016. A consultation on the measure has now been published.

Corporation Tax

Reduction in corporation tax rate

The main rate of corporation tax has already been cut from 28% in 2010 to its current rate of 20%. The Chancellor has announced that the main rate will now be cut further from 20% to 19% in 2017, and then to 18% in 2020, benefiting over a million businesses.

Business goodwill amortisation

Corporation tax relief for the cost of purchased goodwill will be restricted for acquisitions and disposals on or after 8 July 2015. This measure will be enacted in Summer Finance Bill 2015.

Research and development tax credits

Universities and charities will no longer be able to claim the research & development expenditure tax credit with effect from 1 August 2015. This corrects an anomaly in the legislation and restores the original policy intention. This measure will be enacted in Summer Finance Bill 2015.

Orchestra tax relief

The Government will go ahead with its proposed new tax relief for orchestras with effect from 1 April 2016. Corporation tax relief will be available at a rate of 25% on qualifying expenditure. This measure will be enacted in Finance Bill 2016.

National Insurance

Employment allowance

Businesses will have their employer national insurance bill cut by another £1,000 from April 2016, as the employment allowance rises from £2,000 to £3,000. This increase means that from April next year, businesses will be able to employ four people full time on the national living wage and pay no national insurance at all.

Also from April 2016, companies where the director is the sole employee will no longer be able to claim the employment allowance.

Abolition of Class 2 NICs and reform of Class 4

The government has confirmed that it will consult in autumn 2015 on abolishing Class 2 NICs and reforming Class 4 NICs for the self-employed.

VAT

VAT on services used and enjoyed in the UK

The VAT "use and enjoyment" provisions will apply so that from next year, all UK repairs made under UK insurance contracts are subject to UK VAT.

Also, the government will consider a wider review of off-shore based avoidance in VAT-exempt sectors, with a view to introducing additional "use and enjoyment" measures for services such as advertising in the following year.

VAT refunds for shared services

The Finance Bill 2016 will provide for refunds to eligible public bodies of VAT incurred on specified shared services.

Tax Simplification

Office for Tax Simplification

Legislation will be included in Finance Bill 2016 to put the Office for Tax Simplification (OTS) on a statutory basis and it will become a permanent office of HM Treasury.

The OTS are to review:

- the closer alignment of income tax and National Insurance contributions; and
- the taxation of small companies.

Taxation of employee benefits and expenses

A new statutory exemption for trivial benefits in kind costing less than £50 will be introduced with effect from April 2016. This was first announced at Autumn Statement 2014 as part of a package of measures intended to simplify the taxation and reporting of employee benefits and expenses. Although the other measures were included in Finance Act 2015, this measure has been held over for inclusion in Finance Bill 2016.

Simplified expenses

Finance Act 2013 introduced simpler rules that can be used by unincorporated businesses to claim relief for some business expenses. Legislation will be included in Finance Bill 2016 to amend those rules to ensure that partnerships can fully access the provisions in respect of the use of a home and where business premises are also a home.

Simplification of the treatment of termination payments

The government will consult on the tax and NICs treatment of termination payments with a view to making the rules simpler and fairer.

Reviewing the rules for tax relief on travel and subsistence expenses

A discussion paper will shortly be published outlining proposals for new rules for tax relief on travel and subsistence expenses.

HMRC debtor and creditor interest rate

Currently, different rates of interest apply to tax-related debt depending on whether or not it follows from court action. Legislation will be included in the Summer Finance Bill 2015 to ensure that rates of interest payable on tax-related debts to which HMRC is a party are all contained within tax legislation.

With effect for interest accruing on and after 8 July 2015, the government will set the rate of interest which applies on taxation-related debts payable under a court judgment or order by HMRC to a rate equal to the Bank of England base rate plus 2%; and it will apply the late payment interest rate of 3% to taxation-related debts owed to HMRC under a court judgment or order.