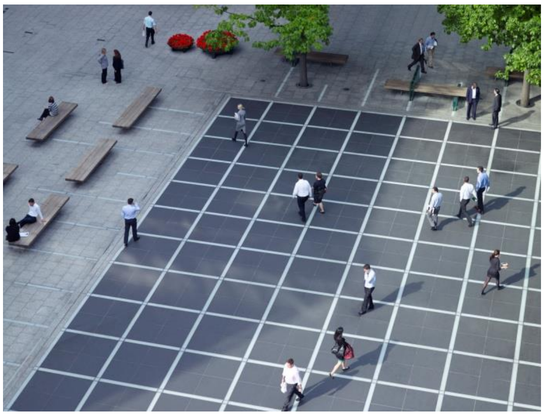
Tax Talk

Special Edition
UK Budget 2016



Welcome to the second Special Budget edition of Tax Talk for 2016. This time we devote the issue to George Osborne's eighth budget, and in particular the tax issues that might be of particular interest to Isle of Man residents. As usual, if you would like to discuss any of the matters raised please do not hesitate to contact either Kevin, Andrew or Phil.

In this Edition:

Overview

George Osborne, the UK Chancellor, delivered his eighth Budget to the UK Parliament on 16 March 2016.

With the impending UK referendum on EU membership as a backdrop, the Chancellor was looking to deliver a balanced, if unspectacular budget. Like a roaring log fire, one that made people feel comfortable and content.

His speech was prefaced with warnings about the state of the global economy and strong rhetoric on how to deal with the challenges ahead:

"Financial markets are turbulent. Productivity growth across the west is too low. And the outlook for the global economy is weak. It makes for a dangerous cocktail of risks. But one that Britain is well-prepared to handle, if we act now so we don't pay later…In this Budget we choose to put stability first…In this Budget we choose the long term…We choose to put the next generation first."

The backdrop to the actual announcements in the budget were similarly downbeat. Growth and GDP forecasts revised down. The outlook for global economy being "materially weaker" and the UK is "not immune" to slowdown elsewhere. Debt targets to be missed.

There were more positive notes. The Chancellor commented that the UK is still forecast to grow faster than any other major Western economy. A million jobs are forecast to be created by 2020 and there is underlying low inflation. The deficit as a share of GDP projected to fall and Public finances still projected to achieve a £10.4bn surplus in 2019-2020.

As ever, George Osborne had to walk a tightrope in the Budget with all of the 'winners' being counter balanced by 'losers'. In choosing his losers he's followed some familiar themes.

For large corporates the news is definitely mixed. There is an extra 1% off the rate of Corporation Tax, with the promise of more to come, but further restrictions on tax deductions such as interest and losses some of which take effect more or less immediately.

Buy-to let investors, private equity investors and banks have all been targeted in recent budgets and the Chancellor returned to them again.

Closer to home, measures have been announced to tackle the use of certain offshore property structures to avoid UK tax on trading profits arising from developing land and property in the UK.

Mr Osborne is continuing to drive for the UK to be highly competitive on tax rates in order to attract new business and stimulate the economy - a strategy identical to our own in the IoM. However, if a low tax environment is to prevail, then everyone must pay their fair share.

The difficulty the Chancellor had was that in order to shower cash on particular parts of the economy he had to take it from somewhere else, and that meant in practice either upping certain taxes, or restricting reliefs. So what did he do?

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Offshore Property Developers

New rules will be introduced to tackle the issue of property developers who use offshore structures to avoid UK tax on their profits from trading in property in the UK. The Government is seeking to ensure that profits arising from property trading in the UK are taxed in the UK. In the past it has been possible to avoid UK tax where the developer is non UK resident and does not have a 'permanent establishment' in the UK. The key change will be to remove the current territorial restriction in UK legislation so that the UK has the right to charge tax regardless of the residence of the company carrying on the trade, and regardless of whether the trade is carried on through a permanent establishment, whether that be in the UK or elsewhere.

The change will mean an amendment to the UK/Isle of Man Tax Treaty. This is an old pre OECD model treaty and the UK Government felt that it was necessary to negotiate an amendment so as to ensure the position on taxing rights was beyond doubt.

HMRC have published a detailed Technical Note on the subject which is available online and this requests that comments are invited on the issues raised in the document, to be received by 29 April. The new measures are planned to come into effect from the report stage of the Finance Bill 2016 and will apply to disposals that occur on or after the date the legislation is introduced to Parliament at Report Stage, probably in June 2016. Anti-Avoidance will however be in place effective from Budget date.

Mr Teare has commented that he doubted that the change would have much impact in the IoM but whether that is the case remains to be seen.

BEPS and anti-avoidance

Progress in the OECD BEPS project which we have reported on many times before, sees the Chancellor making further moves towards action being taken to continue the modernisation of UK tax rules in accordance with BEPS and to ensure they are applied to multinationals.

Transfer Pricing

Changes to the transfer pricing rules, announced by the OECD last October as part of the BEPS process, will be incorporated into UK law for accounting periods beginning on or after 1 April 2016.

Interest Relief

Action Point 4 of the BEPS project seeks to target a broad range of what it describes as 'excessive' interest and other financial payments paid by companies to overseas group members in order to reduce their tax liability. Mr Osborne has announced that over the next 5 years he will raise around £8 billion from large multinationals by changing the rules on interest relief. Although there is no draft legislation yet, and a consultation is expected, the plan is that, from 1 April 2017, the amount of relief for interest paid will be restricted to 30% of taxable earnings in the UK, or, based on the net interest to earnings ratio for the worldwide group.

Hybrid Arrangements

In accordance with the recommendations of Action 2 of the BEPS project, draft legislation was published in December 2015 to tackle the use of 'Hybrid arrangements'. The 2016 budget has seen an extension of these proposals which seek to tackle aggressive tax planning where, within a multinational group, either one party gets a tax deduction for a payment while the other party does not have a taxable receipt, or there is more than one tax deduction for the same expense. The rules will come into effect from 1 January 2017.

Royalty Payments

Changes will be made to the rules on withholding tax on royalty payments to counter tax avoidance where multinationals use intragroup royalty payments to shift profits from the UK to low or no-tax jurisdictions.

Currently the Income Tax Acts require the deduction of income tax equivalent to the basic rate of tax from 'certain' payments of royalties and other income arising from intellectual property. This is commonly referred to as withholding tax. The new rules mean that where a payment of a royalty or similar is made to a connected person as part of arrangements, the purpose of which is to obtain a tax advantage by virtue of a provision of a Double Tax Agreement, then tax must be withheld from the payment. This will include payments made in respect of trademarks, brand names, patents and copyrights and those made under obligations with a UK permanent establishment.

Open for Business and Creating Opportunities

The Chancellor has introduced changes which he hopes will be seen as backing business and drive productivity, growth and entrepreneurship, part of his 'Business Tax Roadmap' which sets out his plans for business taxes to 2020.

The changes include:

- Cutting the rate of Corporation Tax from 1 April 2020 down from the expected 18% to 17% which means that the UK will have the lowest tax rates in the G20 and will ensure a strongly competitive business environment;
- Reforms to Business Rates, which can often be a very high fixed cost for an early stage business;
- The extension of Entrepreneur's Relief to long term investors in unlisted businesses;
- From April 2017 two new £1,000 tax – free allowances will be available for individuals. One for selling goods or providing services, and one relating to income from property you own;
- The personal allowance which for 2016/17 is £11,000 will rise to £11,500 for 2017/18. (As compared to £10,500 for 2016/17 in the IOM);
- The abolition, from April 2018, of Class 2 NIC contributions made by the self-employed. Although only a fairly small weekly sum for the individuals concerned, Mr Teare has said that if the Island had not revised the reciprocal social security arrangements with the UK, this small change would have cost around £250,000;
- The reduction of capital gains tax from 18% to 10% and 28% to 18% for basic and higher rates respectively for disposals made after 6 April 2016. The existing rates will continue to apply for certain interest transactions and for chargeable gains made on residential property.

Buy to Let

Having said all of the above however, there is one area that Mr Osborne seems not to be encouraging and that is the buy to let market. The SDLT rates are, with effect from 1 April 2016, all increased by 3% above the standard rates where the purchase is of second properties.

This is coupled with capital gains tax remaining at its existing 18% and 28% rates for profits on the sale of residential properties, and the changes to interest deductions which will be available to offset in income from property accounts.

Pensions and Savings

The radical reforms to pensions taxation that were touted ahead of the budget failed to materialise. Instead the Chancellor surprised us with a new Lifetime ISA for the under 40's for savings up to £4,000 per annum. He has pledged to give 25% of the amount saved in this ISA meaning an additional contribution of up to £1,000 is made by the Government. The new ISA has been dubbed the Pensions ISA and sounds fantastic for under 40's, but it does also have a small tax windfall effect for the Chancellor as contributions into the ISA are out of taxed income as opposed to normal pension contributions which receive tax relief when they are made.

The fact that Mr Osborne has chosen not to scrap relief on traditional pension contributions as had been expected, and has now introduced another ISA where individuals can roll up their savings in a tax free vehicle with a tax free exit might suggest that he has opted for a middle ground solution. This is an area of great interest for the IoM as we consider our own pension system and how it will sit alongside the UK regime.

Corporate Losses

Subject to consultation the Chancellor plans, with effect from April 2017, to modernise and reform corporate loss relief rules to make their use more flexible.

It is expected that losses will be able to be offset against other income sources in future and not just profits from the source from which the loss arose. In addition they will be available for offset against the profits of other group companies.

There will however be a restriction such that companies will only be able to set off losses against up to 50% of their profits above £5million. Banks will only be able to set off up to 25 % and there is speculation that these new tax raising measures will put even more pressure on banks at an already difficult time for them.

Disguised Remuneration and EBT's

The Government has announced its intention to shut down Disguised Remuneration schemes. This announcement will be significant for many of those with Employee Benefit Trusts [EBTs] and similar arrangements, particularly where funds have been used to lend money to an employee.

A package of measures will be introduced over time, starting with measures in Finance Act 2016. These include tackling historic pre 2011 loans by introducing a new tax charge on 5 April 2019 on any which are still outstanding at that date. Investment returns made by the Employee benefit trust (EBT) will also be treated as taxable employment income and the PAYE regulations will be amended so that any PAYE tax found to be due can be recovered directly from the employee.

Non-Doms

Although major changes were announced to the taxation of UK non-doms back in 2015, there were, and still are, some areas that require further clarification. Thankfully a little more light has been shed on the situation this week when two areas were clarified.

It was confirmed that non-doms who have a non-UK resident trust set up before becoming deemed domiciled in the UK will not be taxed on income and gains retained in the trust.

In addition non-doms who become deemed domiciled in April 2017 will be able to treat the base cost of their non-UK based assets, as being the market value of that asset on 6 April 2017.

Indirect taxes

VAT revenue sharing arrangement

Although not part of the UK budget, this is a significant recent announcement that sets out the split of VAT revenue between the UK and the Isle of Man and gives the Isle of Man more certainty on its tax receipts to allow it to budget.

Minister Teare said: 'The new formula, which is largely based around final expenditure by households, is intended to give the Isle of Man the revenue due to it from the consumption of goods and services in the island whether purchased on or off the island, including via the internet.'

The good news is that under the new deal, the Island's share of VAT will increase by £2.7m for 2013/14, £7m for 2014/15 and an extra £11.8m in the current year. An extra £21.5m.

Online suppliers

This year's Budget featured little in the way of significant indirect tax changes. The most significant measure is action to level the playing field between UK suppliers and non-EU online suppliers which the Government perceives as avoiding paying UK VAT on UK sales of goods.

This is aimed at protecting the UK market from unfair online competition where it perceives overseas traders from beyond the EU are avoiding paying UK VAT, undercutting online and high street retailers and abusing the trust of UK consumers who purchase goods via online marketplaces.

The measures will include powers to require non-compliant overseas traders to appoint a tax representative in the UK. HMRC will be also able to inform online marketplaces of the traders who have not complied. If traders continue to evade VAT and no action is taken to prevent the fraud, then online marketplaces can be made liable for the VAT.

Being part of the UK VAT system, locally based traders should benefit from this measure to level the playing field against non EU competition.

VAT Thresholds

From 1 April 2016 the VAT registration threshold will be increased from £82,000 to £83,000 and the deregistration threshold from £80,000 to £81,000.

Charities

In a specific nod to the Isle of Man, there will be legislation to ensure that locally based charities subject to the jurisdiction of the High Court of the Isle of Man are capable of qualifying for UK VAT charity reliefs in the same way as UK charities. This clarifies any uncertainty that there may have been.

Museums and Galleries

To encourage people to engage with the arts and culture, the government will broaden the eligibility criteria for the VAT refund scheme for museums and galleries and will enable support to a wider range of free museums from across the UK.

Insurance Premium Tax

From 1 November 2015, the standard rate of Insurance Premium Tax increased to 9.5% from 6%. The standard rate of IPT will be increased again from 9.5% to 10% with effect from 1 October.

Gaming Duty

Finally, there will also be reform to the treatment of 'freeplays' in Remote Gaming Duty to bring it into line with General Betting Duty, to come into effect from 1 August 2017. The intention is to ensure that when a person uses a freeplay to participate in gaming these will have a value for calculating the operator's dutiable profit, but free plays given as prizes will not reduce that profit.

Stamp Taxes

The budget announced significant changes to stamp duty on commercial property to bring the treatment in line with changes to residential property which were introduced in December 2014. While changing from a 'slab' system to a progressive structure will be welcomed, reducing distortion around the bands, the top rate rising to 5% could cause headaches for the higher end of the market.

Properties over £1.05m will experience a substantial increase in the rate of stamp duty, which could subsequently slow transaction levels. The chancellor expects to raise £0.5bn from this move, but it will be interesting to see whether he meets this target given the fiscal drag caused by increased tax.

Sugar Tax

A new 'soft drinks industry levy' will be introduced from April 2018. It is targeted at producers and importers of soft drinks that contain more than 5g of added sugar per 100 millilitres with an even higher rate for those containing over 8g. This new measure is expected to raise £520m.

The stuff that matters

Good news for Motorists with fuel duty frozen for the sixth year in a row. Welcome news also for responsible drinkers. Beer, cider, and spirits duties to be frozen and an inflation rise in duties on wine adding about 4p to a bottle.

Perennial bad news for smokers. Excise duties on tobacco to rise by 2% above inflation.

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