20 March 2014

Tax Measures in the 2014 UK Budget

UK government continues to support growth and build on economic recovery.

On 19 March, UK Chancellor of the Exchequer, George Osborne, released the UK's 2014 budget. From a business tax perspective, the budget contained few surprises, reflecting the government's policy of consulting on significant tax changes in advance. The government continues to drive tax cuts to help businesses grow and to encourage global competitiveness, with corporation tax reducing to 21% from April 2014 and to 20% from April 2015. This will give the UK the joint lowest rate of corporate income tax in the G20 (the group of finance ministers and central bank governors from 20 major economies) by April 2015.

Alongside this policy is a focus on fairness, with the government concentrating on reducing tax avoidance and evasion. The government has introduced 34 separate measures to address tax avoidance since 2010, and, although the rate of change is slowing, there are several provisions in the 2014 budget to address tax avoidance techniques of which the government has become aware.

It is acknowledged that one aspect of tax competitiveness is simplicity, and the government has committed to continue its work to produce a clear and logical tax structure with transparency and certainty. Work will be undertaken to investigate ways to minimise the statutory differences between accounting profits and taxable profits.

Business Taxes

One of the most fundamental changes to affect businesses is the expected overhaul of the tax treatment of members of a UK limited liability partnership (LLP). Currently, such members are taxed as partners, broadly resulting in tax transparency and payment of income tax by self-assessment as a self-employed person, rather than through payroll as an employee.

Although notice of the intended changes was given in March 2013, the scope of the changes was vastly increased in December 2013, and the proposed changes will now catch a much wider range of LLP members. Amongst other things, members who are caught must, from April 2014, be taxed as if they were employees. This includes the need for LLPs to account to HM Revenue & Customs (HMRC) for employer's national insurance contributions (NICs) as well as to deduct income tax on a current basis.

In brief summary, members in LLPs will be treated as employees (for tax purposes only—they will not benefit from the employment law rights available for employees) if

- at least 80% of their expected remuneration is fixed or variable otherwise than by reference to the profits of the LLP as a whole (disguised remuneration);
- they do not have significant influence over the affairs of the LLP (a mere right to vote is insufficient); and
- they have contributed less than 25% of their disguised remuneration as capital to the LLP.

Accompanying these changes are anti-avoidance provisions to prevent abuse through the allocation of profits and losses of partnerships where the partners include both companies and individuals.

It had been hoped that the introduction of the new rules would be postponed to give businesses time to adapt to the major changes that were announced in December 2013. However, the Chancellor has made it clear that the changes will take effect from 6 April 2014. Firms are now left with very little time to organise their affairs and restructure if necessary. Firms will need to take care not to fall foul of specific or general anti-avoidance provisions, and careful thought will need to be given in particular to UK LLPs that operate as part of a wider global firm. This task is somewhat complicated by the announcement that further “minor” amendments will be made before the draft legislation released in March 2014 is finalised, as no details of those changes are yet available. The Finance Bill will be released on 27 March, so if the changes are not released prior to that, businesses will have only nine days to adapt.

A positive development, however, is the government’s announcement that it will publish a draft manual on partnership taxation principles for comment in April 2014. This announcement follows a review of partnership taxation—a notoriously complex area—by the Office of Tax Simplification. The government will also proceed with some simplification of a few areas of partnership taxation.

There are also some measures designed to help business and encourage investment. These include a doubling (from £250,000 to £500,000) of the expenditure on plant and machinery qualifying for the annual investment allowance, which permits a 100% upfront deduction for such expenditure, from April 2014. The availability of this enhanced allowance is extended from the current period expiring in December 2014 to cover expenditure incurred to December 2015.

Tackling Tax Avoidance

The UK government strongly supports and plays an active role in the work of the Organisation for Economic Co-operation and Development, the European Union, and the G20 to tackle aggressive tax planning and to counter base erosion and profit shifting (BEPS). In connection with this, the government has released a position paper on the UK’s priorities for countering BEPS.

In the position paper, the government recognises the need for tax systems to produce adaptable solutions addressing the modern economy and delivering neutrality between different businesses. This necessitates a dual approach in revising international tax concepts and domestic tax provisions.

Areas of focus include the following:

- The digital economy, which is closely linked with the modernisation of the permanent establishment and transfer pricing principles and should focus on how value is created, but which the UK believes would not benefit from a separate regime for businesses operating in the digital economy[1]
- Global advancement of permanent establishment concepts, focusing on the threshold at which a presence in a country is sufficient to trigger taxes there and preventing artificial splitting of operations within a group
- An update of the transfer pricing rules to reflect true value creation and prevent separation of profits from economic activities, for example, by allocations of economic risks and capital
- Encouraging jurisdictions to adopt measures that prevent “treaty shopping”, to adopt controlled foreign corporation (CFC) rules, to prevent harmful tax practices that distort tax competition, and to adopt greater exchanges of tax information with other countries

On the domestic side, various provisions are to be introduced in the continued drive to reduce—or to discourage taxpayers from—tax avoidance. These will include the following:

- An obligation to pay on demand disputed taxes arising from avoidance schemes if another taxpayer suffers a litigation defeat on the same scheme or face penalties for failure to do so

1. The OECD’s draft discussion paper on the digital economy is due for release on 24 March 2014.

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- An accelerated obligation to pay disputed taxes relating to schemes that were notified to HMRC under the disclosure of tax avoidance schemes rules or schemes that are subject to counteraction under the general anti-abuse rules (following an opinion of the independent General Anti-Abuse Rule Advisory Panel that the arrangements in question were not a reasonable course of action), pending resolution of any dispute with HMRC over such taxes, to remove the cash flow advantages of entering such schemes
- Provisions to counteract contrived schemes that permit companies to reduce their corporation tax bill by transferring profits (through the use of a total return swap or otherwise) to other group members
- A measure to prevent avoidance of CFC charges arising by transferring profits from intragroup lending outside the UK and/or the transfer of external debt to the UK

Energy sector

The government continues to support the UK's energy sector with some new reliefs. These include the following:

- Extending the exemption from capital gains tax on disposal of shares in a company (the substantial shareholding exemption) to disposals of companies that have acquired oil and gas exploration and appraisal activity assets from other group companies in certain circumstances
- Permitting tax-free reinvestment for pre-trading companies into the UK and UK Continental Shelf of proceeds from the disposal of assets used in oil and gas exploration and appraised activities
- Providing accelerated tax relief for expenditure on a successful application for planning permission as expenditure on mineral exploration and access, permitting relief at 25%, rather than the 10% relief available for expenditure on mineral assets
- From 2015, replacing the ultra-high pressure high temperature cluster field allowance with a new allowance removing at least 62.5% of qualifying profits from the ring fence profits subject to the supplemental charge
- The instruction of an "onshore allowance"[2]

In addition, the government has committed to consult with industry to ensure the oil and gas tax regime encourages exploration, reduces decommissioning costs, and accommodates the maturing oil and gas basin.

Employment and Employee Incentives

While there are no fundamental tax changes to employment tax rates, a number of changes are proposed to simplify tax rules and administration. These include the requirement to file all employee share schemes with HMRC online from April 2014. Few details are available, and the online filing deadlines and processes are not yet finalised.

The tax treatment of internationally mobile employees is complex, particularly when they receive share-based awards. The government has acknowledged the need for simplification in this area, but the bulk of the changes (and details) are to be deferred until April 2015.

As was originally announced at the Autumn Statement 2013, measures will be introduced to counteract certain dual contract arrangements that are used by non-UK-domiciled UK resident individuals and that are designed to artificially divide employment duties between the duties of a UK employment (taxed as the income arises) and overseas employment (taxed only on remittance to the UK) in order to obtain a tax advantage. The effect of this measure would be, broadly, to deny remittance-based taxation to the income that arises to such individuals with respect to their overseas employment duties. The final legislation will be clarified to ensure that, amongst other things, the measure is limited to arrangements involving tax avoidance and that genuine noncontrolling directorships or directorships held under certain regulatory requirements would not be caught by this measure.

2. For further information, read our 6 December 2013 LawFlash, "Tax Measures in UK Chancellor's 2013 Autumn Statement", available at http://www.morganlewis.com/pubs/Tax_LF_TaxMeasuresUKChancellorsAutumnStatement2013_06dec13.

Stamp Duties

As previously announced, stamp duty and stamp duty reserve tax (SDRT) (generally charged at 0.5% of the consideration) will be abolished on sales of shares in growth markets from 28 April 2014. This will include shares listed on AIM.

In addition, SDRT charged on fund managers when investors surrender units in UK unit trusts and open-ended investment companies (OEICs) will be abolished from 30 March 2014. This measure is designed to make the UK a more attractive domicile for such collective investment schemes. This is coupled with a minor change to prevent non-*pro rata in specie* redemptions of units in unit trusts and interests in OEICs qualifying for the current exemption from SDRT that applies to *in specie* redemptions.

Personal Taxes

The UK government announced a number of changes to personal taxation that are broadly designed to assist those with low and middle incomes and to encourage savings. These include an increase of the tax-free personal allowance from 6 April 2015. In addition, from 6 April 2015, the UK government is expected to abolish the current 10% starting tax rate for savings income and to increase the starting tax rate limit for such savings to £5,000.

A number of measures relating to taxation of pensions were announced in the 2014 budget. These measures form part of an extensive set of measures designed to reform the current system of pension taxation. The initial changes are aimed at improving the flexibility in terms of accessing pension funds and changing the way in which withdrawals from pension funds are taxed. The government intends to consult on further proposals for reforms that are intended to change the current structure of pension benefits and the administration of pension schemes.

UK Residential Property

Currently, acquisitions of UK residential property valued at more than £2 million are subject to a 15% stamp duty land tax (SDLT). From 20 April 2014, this SDLT charge will be extended so that properties with values starting at £500,000 would be caught by the same SDLT charge. Transitional rules are expected to apply with respect to certain contracts entered into before 20 March 2014 but completed on or after that date.

As a linked measure, the application of annual tax on enveloped dwellings (ATED) to UK residential property is also expected to be broadened. In particular, from 1 April 2015, an annual charge of £7,000 would apply to affected residential properties with values falling between £1 million and £2 million. An additional annual charge of £3,500 would apply to affected residential properties falling within the value bracket between £500,000 and £1 million from 1 April 2016.

Currently, disposals of high-value UK residential property held through non-natural persons (e.g., companies, partnerships that have companies as their members, and collective investment schemes) are subject to a 28% capital gains tax charge (CGT) on any gain. As a result of the extension of the SDLT and ATED measures set out above, non-natural persons disposing of such properties that fall within the extended ATED bands (as referred to above) would also be subject to the CGT charge. The full CGT charge applying to any gain resulting from the disposal of affected properties with values between £1 million and £2 million is expected to take effect from 6 April 2015. For affected residential properties falling within the value bracket between £500,000 and £1 million, the CGT charge will take effect from 6 April 2016.

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