FINANCE BILL 2017 – FIRST THOUGHTS

Robert Jamieson MA FCA CTA (Fellow) TEP

Wayfarers Barn, Steventon, Basingstoke, Hampshire RG25 3AY
Tel: 01256 782828 Fax: 01256 782076 Mob: 07801 932500
E-mail: robertianjamieson@hotmail.com

Contents	*Page No.*
Income tax rates and allowances for 2017/18	2
NICs for 2017/18	4
Trading and property allowances	6
Company car benefits	8
Optional remuneration arrangements	9
Assets made available to employees	12
Employer-financed pensions advice	13
Taxable benefits – time limit for making good	14
Legal expenses and employees	15
Termination payments	16
Pensions – two new restrictions	18
Deduction of income tax at source	19
EIS and SEIS – the ‘no pre-arranged exits’ requirement	20
Changes to the Social Investment Tax Relief (SITR) scheme	21
Business investment relief (BIR)	24
Annual CGT exemption	29
Assets appropriated to trading stock	30
Employee shareholder status abolished	32
Extending IHT to enveloped UK residential property	33
Deemed domicile – income tax, CGT and IHT	40
ATED in 2017	48
Corporation tax rates going forward	49
Another new capital allowance	50
Company tax loss relief reform	51
Corporate interest relief	56
Substantial shareholding exemption (SSE)	58
Transactions in UK land	61
Enablers – the new pariahs	62
Appendix: A problem with 2016/17 tax returns	64

© June 2017

mercer & hole
chartered accountants

www.mercerhole.co.uk

1. **Income tax rates and allowances for 2017/18**

(a) The basic, higher and additional rates of income tax for 2017/18 have been set at 20%, 40% and 45% respectively by Cl 2 FB 2017. This is the same as for 2016/17.

(b) S2(1) FA 2016 fixed the basic rate limit at £33,500. The threshold at which a taxpayer starts paying additional rate tax is unchanged. The income tax table therefore reads as follows for 2017/18:

	Rate	*Cumulative tax*
	%	£
0 – 33,500	20	6,700
33,500 – 150,000	40	53,300
Over 150,000	45	

By virtue of S3(1) FA 2016, the personal allowance has risen to £11,500. The point at which an individual is liable to higher rate income tax is £11,500 + £33,500 = £45,000. The represents an increase of just over 4.5% compared with the equivalent figure for 2016/17.

(c) The dividend tax rates for 2017/18 are:

(i) 7.5% (dividend ordinary rate);

(ii) 32.5% (dividend upper rate); and

(iii) 38.1% (dividend additional rate).

In addition, there is a dividend nil rate band for the first £5,000 of dividend income received. All these rates can be found in S8 ITA 2007. Following an announcement by the Chancellor on 8 March 2017, the dividend allowance reduces to £2,000 for 2018/19 onwards (Cl 5 FB 2017).

(d) The personal savings allowance for interest received remains at £1,000 in 2017/18 for basic rate taxpayers (ie. those who have no income chargeable at the higher or additional rates or their dividend equivalents). For taxpayers with income chargeable at the higher rate or its dividend equivalent, the personal savings allowance is £500. Taxpayers with income chargeable at the additional rate or its dividend equivalent are not entitled to any personal savings allowance. The personal savings allowance operates in conjunction with the 0% starting rate for savings income and the £5,000 starting rate limit, both of which continue on an unchanged basis.

(e) The trust rate, which applies to the income of discretionary and accumulation trusts above the standard rate band limit of £1,000, is 45% for 2017/18 and the dividend trust rate is 38.1%. Trustees are not entitled to benefit from either the dividend nil rate band or the personal savings allowance – both of these reliefs are only available for 'individuals'.

(f) The personal reliefs for 2017/18 are:

	£
Personal	11,500
Blind person's	2,320

These allowances continue to attract relief at the taxpayer's top marginal rate. The married couple's allowance was abolished 17 years ago. However, couples where at least one of the spouses (or civil partners) was born before 6 April 1935 can still claim the relief. This allowance, which is relieved at 10%, rises in line with inflation to £8,445 for 2017/18. The income limit for the married couple's allowance becomes £28,000 (also in line with inflation). If this limit is exceeded, the married couple's allowance is reduced by £1 for every £2 of excess income. This abatement can never take the married couple's allowance down to a figure of less than £3,260.

(g) By virtue of S35 ITA 2007, where an individual's 'adjusted net income' for 2017/18 exceeds £100,000, the personal allowance of £11,500 is withdrawn at the rate of £1 for every £2 of excess income. If relevant, the restriction is rounded down. Adjusted net income is defined in S58 ITA 2007 as an individual's total income less:

(i) trading losses;

(ii) allowable interest;

(iii) pension contributions paid gross;

(iv) the grossed up amount of pension contributions paid net; and

(v) the grossed up amount of Gift Aid donations.

Thus 45% taxpayers never receive a personal allowance nor do those in the upper echelons of the 40% tax bracket. The income cut-off figure for 2017/18 is £123,000. Note that this rule applies to high income taxpayers of all ages.

(h) In FA 2014, legislation was passed which allows individuals who are married (or in a civil partnership) to transfer 10% of the standard personal allowance for 2015/16 and subsequent tax years to their other half. The relevant details can be found in Ss55A – 55E ITA 2007. Thus, for example, a wife who has little or no income can transfer £1,150 in 2017/18 to her husband, subject to the requirement that he must not be liable to income tax at the higher or additional rate. In other words, the maximum tax benefit of what is known as the 'marriage allowance' is 20% x £1,150 = £230.

2. NICs for 2017/18

(a) *Class 1*

For 2017/18, the starting-point for the payment of Class 1 NICs by employees rises to £157 per week (£8,164 per annum). This figure is known as the 'primary threshold' and, several years ago, it was aligned with the level of the personal allowance so that the figure at which individuals began paying both income tax and Class 1 NICs was the same. However, following the unexpected £600 rise in the 2008/09 personal allowance after the start of that tax year (which was not matched with a corresponding step-up in the primary threshold) and the further inflation-beating increase for the 2009/10 allowance, it was decided to uncouple the two thresholds for the time being. Sadly, it does not look as though this gap is likely to close in the near future. The lower earnings limit for 2017/18 goes up to £113 per week (£5,876 per annum), and, although Class 1 NICs only become payable once earnings exceed the primary threshold, earnings between the lower earnings limit and the primary threshold protect an entitlement to basic state retirement benefits without incurring an NIC liability – family businesses, in particular, should consider whether they are taking full advantage of this rule.

(b) The upper earnings limit for 2017/18 increases to £866 per week (£45,000 per annum). The Class 1 percentage for standard-rated employees remains at 12%. Remember that the upper earnings limit is calculated by the taking the higher rate threshold and adding the personal allowance, ie. £33,500 + £11,500 = £45,000.

(c) Earnings in excess of the upper earnings limit are subject to a 2% charge on the employee.

(d) The employer rate for 2017/18 stays at 13.8% on all earnings in excess of the 'secondary threshold' which has now been harmonised with the primary threshold at £157 per week (£8,164 per annum).

(e) Class 1A

Fixed percentage – 13.8% (employers only). This relates to taxable benefits of employees.

(f) Class 1B

Fixed percentage – 13.8% (employers only). This relates to PAYE Settlement Agreements.

(g) Class 2

Flat rate – £2.85 per week. The small earnings exception is £6,025. However, on 18 March 2015, the then Chancellor announced that the Government intended to abolish Class 2 NICs during the next Parliament. This is going ahead.

(h) Class 3

Flat rate – £14.25 per week.

(i) Class 4

9% on trading profits between £8,164 and £45,000, together with an uncapped 2% payable on all profits above £45,000. The originally announced rate increase from 9% to 11% over the next two years, which was the *quid pro quo* for ending Class 2 NICs, was retracted by the Chancellor a few days later following pressure from the Prime Minister. A self-employed individual with business profits of £400,000 in 2017/18 will pay Class 4 NICs as follows:

			£		£
Upper profits limit			45,000		
Less: Lower profits limit			8,164		
	9%	x	£36,836	=	3,315
			£		
Business profits			400,000		
Less: Upper profits limit			45,000		
	2%	x	£355,000	=	7,100
					£10,415

(j) Employment Allowance

The Employment Allowance began three years ago. For 2017/18, eligible employers are able to reduce their employer Class 1 NICs by up to £3,000 for the tax year. The allowance operates on a FIFO basis. Most businesses and charities paying secondary Class 1 NICs on employees' and directors' earnings can claim the relief. However, with a group of companies, only one company is allowed to make a claim.

3. **Trading and property allowances**

(a) In his 2016 Budget, the previous Chancellor announced two new £1,000 allowances for trading and property income respectively, each to take effect from 6 April 2017. The aim of this measure is, in HM Treasury's words, 'to provide simplicity and certainty regarding income tax obligations on small amounts of income from providing goods, services, property or other assets'. The relief will help those who do a certain amount of selling on eBay or who rent out, say, parking spaces at home on sporting occasions such as Wimbledon.

(b) Cl 20 and Sch 6 FB 2017 insert a new Part 6A into ITTOIA 2005 which gives individuals full relief on trading and property income of up to an allowance of £1,000 in each case. Individuals with income of the requisite type which does not exceed their allowance will no longer have to declare and pay tax on such income. This eliminates the need for the recipients to determine their allowable expenses or to contact HMRC to declare the income.

(c) The new legislation also introduces a partial relief where the individual's income is above the level of the allowance. In that case, the individual can elect to pay tax using what might be described as the alternative method, ie. based on his receipts less the value of the allowance (instead of deducting his actual expenditure). The time limit for making this election is the first anniversary of the normal self-assessment filing date for the tax year for which the election is made, eg. 31 January 2020 for 2017/18.

(d) An individual can also elect, within the same time limit, not to be given full relief. In these circumstances, the tax result will be calculated using normal figures, ie. income received less expenses incurred. This option is likely to be adopted where there is a loss and the relevant income does not exceed £1,000.

(e) As far as the trading allowance of £1,000 is concerned, trades carried on in partnership do not count as a qualifying trade in the context of this relief. HM Treasury say that partnerships have been excluded 'to avoid adding extra complexity to the rules'.

(f) If an individual has more than one source of trading income, he can choose how to allocate his £1,000 allowance between the different sources. This will only be necessary where his aggregate trading income exceeds £1,000 and he has made an election to use £1,000 as his base cost. The obvious caveat is that he cannot, however, utilise this option as a means of creating a loss for any of his sources.

(g) Note also the anti-avoidance provisions which are intended to stop employers and close companies from trying to reclassify payments to members of staff or to shareholders (or to persons connected with them) in order to allow them to take advantage of this relief.

(h) In the context of the property allowance of £1,000, distributions from a Real Estate Investment Trust and income representing rent-a-room receipts do not qualify as income from an eligible property business.

(i) Any individual with a tax reduction in lieu of what are now non-deductible mortgage interest costs is excluded from relief under this provision.

(j) There are similar property anti-avoidance rules to those described in (g) above.

4. **Company car benefits**

(a) Car benefit

Where a car is made available to an employee by reason of his employment, the income tax charge is based on a percentage of the car's list price, graduated according to the level of the car's CO_2 emissions measured in grams per kilometre (g/km). For 2017/18, the table of percentages reads as follows:

CO_2 emissions in g/km	**Percentage of car's list price taxed**
0 – 50	9%
51 – 75	13%
76 – 94	17%
95 – 99	18%
100 – 104	19%
105 – 109	20%
110 – 114	21%
115 – 119	22%
120 – 124	23%
125 – 129	24%
130 – 134	25%
135 – 139	26%
140 – 144	27%
145 – 149	28%
150 – 154	29%
155 – 159	30%
160 – 164	31%
165 – 169	32%
170 – 174	33%
175 – 179	34%
180 – 184	35%
185 – 189	36%
190 or over	37%

Note: A 3% supplement is added to the appropriate percentage in respect of diesel cars, although this can never take the figure above 37%.

(b) Car fuel benefit

Under the car fuel regime introduced by FA 2002, where employees have private fuel paid for by their employer, the same percentage which applies to the car's list price for car benefit purposes is also applied to a statutory fuel figure known as a 'multiplier'. For 2017/18, this figure has risen by £400 to £22,600 (SI 2016/1174).

5. **Optional remuneration arrangements**

(a) The use of salary sacrifice arrangements in connection with the provision of benefits in kind allows many employees to pay less income tax and NICs than would have been the case if they had been remunerated entirely in cash. Employers may also achieve a saving through a lower NIC charge. In HM Treasury's words, 'the cost of (this) tax and NIC (saving) represents an exchequer cost which is borne by the majority of taxpayers'.

(b) In order to address this imbalance, the Government are limiting most of the available income tax and NIC advantages by imposing a notional cost on taxable benefits based on the value of any salary given up (where this is greater than the charge which would otherwise be due under the rules until now).

(c) Unfortunately, the legislation in Cl 8 and Sch 2 FB 2017 is rather widely drawn and has caused a good deal of uncertainty. The changes are not just restricted to salary sacrifice schemes but will have an impact on most flexible benefit arrangements. Employers will need to review, as a matter of urgency, their employee benefit position to see if they are affected by these 'optional remuneration' provisions.

(d) As mentioned, the legislation refers to 'optional remuneration arrangements' and therefore catches much more than a standard salary sacrifice. For example, an employee who decides to take a company car where a cash allowance is available will be taxed on the value of the allowance if this is higher than the taxable benefit of the car. This new charge will apply for both income tax and employer NIC purposes – it will not be relevant for employee NICs.

(e) Looking at the position in more detail, Para 1 Sch 2 FB 2017 inserts a new S69A ITEPA 2003 which introduces two definitions of 'optional remuneration arrangements':

   (i) 'Type A' – these are arrangements under which, in return for a benefit, the employee gives up the right (or a future right) to receive an amount of earnings from his employment; or

   (ii) 'Type B' – these occur where an employee agrees to be provided with a benefit rather than an amount of earnings.

(f) In these circumstances, the employee will normally be taxable on the 'amount foregone' (see new S69B ITEPA 2003) – this refers to the earnings given up under 'Type A' or 'Type B' arrangements. More precisely, the taxable value will be the higher of:

   (i) the existing taxable value of the benefit; or

   (ii) the salary foregone.

   In practice, it is imagined that (i) will seldom be the relevant figure.

(g) The Government have decided that the changes will not apply to employer pension scheme contributions, employer-financed pensions advice, employer-provided childcare, cycle-to-work schemes, ultra-low emission

vehicles, ie. those which emit CO_2 of 75g/km or less, and benefits related to the termination of an employment. These represent what HM Treasury call 'key policy areas . . . which the Government wish to continue supporting but which could fail without the use of salary sacrifice arrangements'. The full list is set out in new S228A ITEPA 2003 (as inserted by Para 49 Sch 2 FB 2017).

(h) The new regime takes effect from 6 April 2017, but grandfathering will ensure that arrangements in place before 6 April 2017 will be protected until at least 6 April 2018. For arrangements involving cars, vans, fuel, living accommodation and school fees, protection continues until 5 April 2021. It should be noted that this transitional protection will be lost from the date of any variation or renewal if the terms of a pre-6 April 2017 arrangement are varied or renewed on or after 6 April 2017. There are certain limited exclusions which do not count as a variation for this purpose. The detailed commencement and transitional provisions can be found in Para 62 Sch 2 FB 2017.

(i) The original legislation triggered numerous difficult questions and HMRC indicated that further guidance would be provided. This has now been published in the form of additional paragraphs to HMRC's Employment Income Manual. Typical queries, for example, included:

 (i) How will the transitional rules operate?

 (ii) How will the variation/renewal rules work?

 HMRC's views on these matters are set out in Illustrations 1, 2 and 3 below.

(j) Illustration 1

 Andrew Enterprises Ltd operates a flexible benefits scheme under which employees can give up the right to receive salary in return for free car parking near their workplace. If they decide to go ahead, employees have to sign up for a 12-month deal.

 An employee enters into a 12-month salary sacrifice arrangement starting on 1 March 2017. Because the arrangement starts before 6 April 2017, the employee's benefit in kind will continue to be tax-free until the end of the present contract, ie. up to 28 February 2018.

 The contract starting on 1 March 2018 will fall within the new rules.

(k) Illustration 2

 Boris agrees with his employer to vary his employment contract and so his salary is reduced by £1,000. At the same time, Boris' employer agrees to provide him with medical insurance which costs £800 for 12 months. The agreement is entered into by employer and employee on 1 April 2017. However, under the terms of this agreement, Boris' salary is not reduced until 1 June 2017 which is the date when his medical insurance cover starts.

 Although the arrangements do not come into effect until 1 June 2017, they were entered into before 6 April 2017. Therefore, the transitional rules will apply and Boris is not caught by the new regime until 6 April 2018.

(l) Illustration 3

Catherine has had a car made available to her by reason of her employment since 6 June 2016 under an optional remuneration arrangement which was set up to last for four years. The car has registered CO_2 emissions of 99g/km.

Unfortunately, due to a traffic accident in July 2018, Catherine's car was written off and a replacement vehicle was provided for the duration of the arrangement.

Since the variation in the arrangement was beyond Catherine's control, the revised legislation will not take effect on the date when the car is changed. The present arrangement will continue until 5 June 2020.

(m) The impact of the provisions in Sch 2 FB 2017 will depend on the particular benefits which are made available. It will clearly be greater on benefits with a low statutory value such as employer-owned living accommodation and on benefits covered by exemptions such as those for mobile phones, health screening, workplace gyms or parking.

(n) Unsurprisingly, the Chancellor's announcement has had a largely hostile reception. One senior member of a well-known accountancy firm commented:

'The denial of relief for the many basic rate taxpayers who benefit from salary sacrifice schemes sits oddly with a Government committed to helping those who are "just about managing". Salary sacrifice has been a great enabler, allowing lower paid employees to choose the benefits they want, something previously only possible for those nearer the boardroom.'

6. Assets made available to employees

(a) S205 ITEPA 2003 lays down a set of rules for calculating the taxable value of an asset provided to an employee (or a member of his family or household) which is available for his private use. The section applies to assets which do not have particular charging provisions elsewhere in ITEPA 2003 for assessing the quantum of the benefit in kind. Company cars, living accommodation and cheap or interest-free employer-provided loans have their own benefit-specific cash equivalent legislation, but, for other assets such as, say, the provision of a yacht, a 20% 'annual value' charge is set out in S205 ITEPA 2003.

(b) On a strict statutory interpretation of S205 ITEPA 2003, employees should be taxed as if the asset in question were made available to them for the whole tax year, even if it is only made available for part of the year or is shared with another member of staff. There is no provision in statute for apportioning a benefit, notwithstanding case law decisions such as *Westcott v Bryan (1969)*. HM Treasury have recently stated:

'This has the potential for unfair outcomes which cannot be corrected by simply publishing guidance.'

(c) Cl 11 FB 2017 introduces provisions which now detail the parameters for calculating adjusted cash equivalents to take account of days when the asset is not available for the employee's private use. This supersedes the guidance set out in Paras EIM21634 and EIM21635 of the Employment Income Manual which is not supported by legislation. The new regime takes effect for 2017/18 onwards.

(d) Looking at the amended legislation, Cl 11(2)(b) FB 2017 inserts new S205(1A) – (1D) ITEPA 2003 which defines the meaning of 'private use' and makes provision for deductions from the charge under certain circumstances which are spelled out in new Ss205A and 205B ITEPA 2003. The first of these sections provides for a deduction to be made for any day when the asset is unavailable for private use and explains the circumstances when such a deduction may apply (eg. if the asset is not in a fit condition for use or is undergoing repair or maintenance). S205B ITEPA 2003 allows for a reduction in the cost of the benefit when the asset is made available for the private use of more than one employee. This is to be achieved on a 'just and reasonable' basis.

7. Employer-financed pensions advice

(a) Cl 12 FB 2017 introduces a new income tax exemption where the cost of what is termed 'relevant pensions advice' is provided by an employer – see new S308C ITEPA 2003. This can either be paid for or alternatively reimbursed by the employer in respect of:

(i) an employee;

(ii) a former employee; or

(iii) a prospective employee.

The exemption is limited to the first £500 of benefit in any tax year.

(b) The legislation covers advice not just on pensions but also on general financial and tax issues relating to pensions which is intended to allow individuals, in HM Treasury's words, 'to make more informed decisions about saving for their retirement'. It replaces the more limited regulation which only applied to pensions advice and was capped at £150 per employee per tax year – see SI 2002/205.

(c) If an individual has two (or more) employments and both employers provide this benefit, the £500 exemption will apply separately to each one.

(d) The exemption is only in point if Condition A or Condition B is met. Condition A sets out availability conditions so that the 'relevant pensions advice' must be provided under a scheme which is open:

(i) to all the employees generally; or

(ii) generally to the employees at a particular location.

Thus this benefit cannot just be provided to, for example, members of the board of directors. Condition B allows the employer to provide advice to certain groups of employees on the grounds of age or ill-health without breaching the 'generally available' requirements of Condition A.

(e) The new regime takes effect for 2017/18 and subsequent tax years.

(f) This exemption was recommended as an outcome of the recent Financial Advice Market Review conducted by HM Treasury and the Financial Conduct Authority. It reflects the Government's acknowledgement that individuals aged 55 or over are making significant decisions on the application of their pension savings and may wish to seek advice. The review concluded that there is a particular advice gap in relation to pensions. The Government are keen to ensure that financial advice is affordable and accessible to consumers, especially those nearing retirement, and they want to encourage employers to provide advice to their staff in order to help them make informed choices about their available options.

8. **Taxable benefits – time limit for making good**

(a) In the context of benefits in kind, 'making good' refers to the situation where an employee makes a payment in return for the benefit which he has received. This payment has the effect of reducing the taxable value of the benefit on a pound-for-pound basis, often to zero, which therefore lowers the employee's taxable earnings. An employee might make good if the employer requires the employee to make a contribution towards the cost of the benefit or if the employee is seeking to reduce the tax due on the benefit.

(b) At present, there is a range of dates for making good – indeed, for some types of benefit, there is no date specified in the legislation. Employers have informed HMRC that the current regime causes difficulties and so they have asked for a greater degree of clarity.

(c) Cl 9 FB 2017 has set a date of 6 July following the end of the relevant tax year as the latest date for making good in relation to any benefits which are not accounted for in real time through PAYE (this practice is known as 'payrolling'). The taxable value of a benefit, together with the value on which Class 1A NICs are computed, will only be reduced if the benefit is made good by this date.

(d) The new measure has effect for 2017/18 and subsequent tax years. It does not amend the rules for making good on benefits which are payrolled.

9. **Legal expenses and employees**

(a) Cl 13 FB 2017 extends existing reliefs for employees (or former employees) who require legal advice or indemnity insurance which is funded by their employer. Hitherto, such costs have only been deductible from an employee's earnings if that person has had allegations made against them in their capacity as an employee – see, in this context, S346 ITEPA 2003. However, the new measure provides for equivalent deductions to be available in relation to proceedings where no such allegations have been made (or are expected to be made). This situation might arise where, for example, an employee is asked to give evidence before a public hearing at which he might require legal advice and support.

(b) There is a similar relief for individuals in receipt of a termination payment so that a deduction can now be given if the relevant legal costs are met by the employer. Previously, a deduction was only available if the individual had paid the costs himself. This was thought to be unfair.

(c) These amendments take effect for 2017/18 and subsequent tax years.

10. **Termination payments**

(a) There was disappointment when HMRC published their response to the consultation document entitled 'Simplification Of The Tax And National Insurance Treatment Of Termination Payments'. This document arose out of a review by the Office of Tax Simplification (OTS) which highlighted the complications of the current termination payment system with the consequential likelihood of mistakes being made by the various parties involved.

(b) The consultation document contained a number of proposals for amending the income tax and NIC treatment of termination payments. Following feedback received, the Government have decided to:

(i) retain the £30,000 income tax exemption;

(ii) continue with an unlimited employee NIC exemption;

(iii) make all payments in lieu of notice subject to income tax and NICs as earnings, regardless of whether they are contractual or not;

(iv) treat any other contractual payment (including amounts which employees would have received had they worked their notice period) as earnings subject to income tax and NICs;

(v) align the rules for income tax and NICs so that employer NICs will be due on termination payments in excess of £30,000;

(vi) remove the foreign service relief (which wholly or partly exempts non-contractual payments from income tax where the employee has worked abroad for a significant part of his period of service); and

(vii) make it clear that the exemption for injury payments does not extend to payments for injured feelings.

These changes take effect from 6 April 2018. The relevant legislation is set out in Cl 15 FB 2017.

(c) Expanding on some of the points above, it should be noted that FB 2017 splits an employee's termination payment into two categories: payments which can still benefit from the £30,000 threshold and payments which cannot. The employer has to identify the amount of basic pay which the employee would have received had he worked his notice period. This is the case even if the employee leaves his employment part way through the notice period. The resulting sum will be treated as earnings and will not be subject to the £30,000 exemption. Basic pay for this purpose excludes any overtime payment, bonus, commission and gratuities.

(d) All employees will be required to pay tax and Class 1 NICs on the amount of basic pay which they would have received if they had worked their notice period in full. This means that the income tax and NIC consequences will no longer depend on how the employment contract is drafted or on whether payments are structured to represent some other form of arrangement (eg. a payment for damages).

(e) One's initial feelings about these provisions are:

(i) annoyance that these amendments are likely to complicate the law rather than simplify it (which is what the OTS wanted);

(ii) regret that non-contractual payments in lieu of notice, which presently fall within the £30,000 exemption, will cease to do so;

(iii) surprise that the intention to impose employer NICs on termination payments in excess of the statutory limit will raise revenue for the Exchequer without there being any compensating adjustment to the – unaltered since 1988 – £30,000 threshold (the OTS suggested that any changes to the treatment of termination payments should be revenue-neutral);

(iv) concern that the introduction of NICs on termination payments over £30,000 will cause confusion among employers as regards when, and to what extent, such payments are chargeable or exempt; and

(v) unease that the imposition of NICs on termination payments may make employers more inclined to reduce termination packages in order to compensate for the additional employment costs.

Finally, it should be noted that, although professional bodies such as the CIOT called upon the Government to rethink their plan to abolish the foreign service relief which has worked well over many years to provide an exemption where all or part of an employee's duties were performed abroad, the withdrawal of the relief is still going ahead.

11. **Pensions – two new restrictions**

(a) Money purchase annual allowances

An individual's ability to make tax-deductible contributions to a registered pension scheme is subject to an annual allowance which, in recent years, has been set at £40,000. If the individual exceeds his annual allowance, the excess is subject to an annual allowance income tax charge which is levied at his marginal rate.

(b) The revised pension regime introduced in April 2015 gave individuals with savings in money purchase pension schemes much greater flexibility in how they take their benefits from age 55 onwards. As a result, it was decided that such individuals should be subject to a modified annual allowance test in respect of their money purchase pension savings: this is known as the money purchase annual allowance and was originally fixed at £10,000 per tax year.

(c) The purpose of this restricted money purchase annual allowance was twofold:

(i) to deter pension savers from diverting income such as a salary into their pension scheme, on which they receive tax relief, followed by a withdrawal of 25% on a tax-free basis; and

(ii) to limit the extent to which pension savers can gain a second round of tax relief by taking out their pension savings and then immediately reinvesting them (a technique known as 'recycling').

(d) Two years on, the Government believe that a money purchase annual allowance figure of £4,000 would be a fairer and more reasonable limit and so, following a short consultation period, the Chancellor announced that he would be reducing the money purchase annual allowance to £4,000 with effect from 6 April 2017 (Cl 16 FB 2017). As HMRC say:

'The reduction in allowance from £10,000 to £4,000 will limit the extent to which pension savings can be recycled to take advantage of tax relief, which is not within the spirit of the pension tax system.'

(e) There are no other changes being made as to how the money purchase annual allowance will operate. Remember that any unused money purchase annual allowance – unlike its £40,000 counterpart – *cannot* be carried forward for use in later tax years.

(f) Foreign pensions

Cl 17 and Sch 3 FB 2017 make a number of amendments to the rules for overseas pension schemes. One change in particular should be noted. S575 ITEPA 2003 has for many years allowed a special deduction of 10% in respect of foreign pension income paid to a UK-resident individual (so that only 90% of the income was brought into charge for UK tax purposes). Unfortunately, for 2017/18 onwards, this facility has been removed: 100%, rather than the previous 90%, of a foreign pension will now be taxable in these circumstances (Para 2 Sch 3 FB 2017).

12. Deduction of income tax at source

(a) It is estimated that, as a result of the introduction of the personal savings allowance in FA 2016 which took effect on 6 April 2016, some 95% of all taxpayers have no tax to pay on interest received. It will be recalled that, because of this decision, the previous Chancellor removed the obligation on the part of banks and building societies to deduct basic rate income tax at source from payments of interest on the same date.

(b) In the light of this and following further consultation, the Government have announced that, with effect from 6 April 2017, the deduction at source regime will also end for interest distributions made by:

(i) investment trusts;

(ii) open-ended investment companies; and

(iii) authorised unit trusts.

In addition, the requirement to deduct basic rate income tax at source has been dispensed with for interest paid to investors in peer-to-peer lending. Savers and investors will therefore receive these types of income gross – those with no tax to pay on their interest will no longer have to reclaim tax from HMRC.

(c) This widening of the gross interest rules is set out in Cl 21 and Sch 7 FB 2017.

13. **EIS and SEIS – the 'no pre-arranged exits' requirement**

(a) Cl 24 FB 2017 amends the EIS and SEIS legislation in order to allow companies which issue shares with rights for a future conversion into shares of a different class to qualify for these two reliefs. These amendments have effect for shares issued on or after 5 December 2016.

(b) Ss177 and 257CD ITA 2007 act, respectively, to deny relief under the EIS and SEIS rules if, in connection with an issue of shares, arrangements exist which provide for the disposal of shares of the company invested in. Where a company converts, or exchanges, one class of shares into, or for, another within a qualifying period (which is normally three years), this would be counted as a disposal. As a result, where such future rights or other similar arrangements exist at the time of the share issue, this will have the effect of preventing the company from being able to access relief under the two venture capital schemes.

(c) It is known that HMRC have been in discussion with industry members, advisers and other stakeholders about the issue of share conversion rights for some considerable time. The purpose of this consultation was to brief HMRC on the full implications of allowing companies to include share conversion rights in their Articles of Association and elsewhere.

(d) Companies often issue shares with these types of rights for good commercial reasons in order to enable them to simplify their share structures at some future date, for example, prior to a stock exchange listing or a private refinancing. The relaxation in Cl 24 FB 2017 is intended to allow companies to issue shares with these rights without limiting their access to the EIS or SEIS regimes. However, it should be emphasised that Cl 24 FB 2017 does not change the treatment which would apply if shares are converted or exchanged within the qualifying period. Provided that the conversion or exchange takes place outside the qualifying period, the fact that the company has always had the right to do this will no longer prejudice its entitlement to eligible EIS or SEIS status.

14. Changes to the Social Investment Tax Relief (SITR) scheme

(a) By virtue of FA 2014, individuals who make qualifying investments in certain types of social enterprise are able to benefit from SITR. This type of tax break works in a very similar way to the EIS regime. There are a number of conditions which must be satisfied by both the investor and the social enterprise in order for SITR to be available. Social enterprises are businesses with social objectives which trade in a variety of sectors – these include employment, healthcare, sport and leisure.

(b) Provided that the relevant requirements are met, the tax reliefs available for qualifying investments in social enterprises are as follows:

(i) Income tax relief

This is available to individuals who subscribe for shares or make debt investments in a qualifying social enterprise. Relief is given by way of an income tax reduction of 30% of the aggregate amount invested in the tax year (up to an annual maximum of £1,000,000). Relief can also be carried back to be claimed in the previous tax year.

(ii) CGT holdover relief

Payment of a CGT liability can be deferred if an amount equal to the gain is reinvested in qualifying shares or debt in a social enterprise. The investment must take place within a period of one year before to three years after the date on which the gain arose. The gain being deferred can derive from any kind of asset.

(iii) CGT disposal relief

Gains on the disposal of the social enterprise investment will be exempt from CGT as long as all the necessary conditions are fulfilled. The investment must have been held for a minimum three-year period and the income tax relief given at the time of the investment must not have been clawed back.

(c) Illustration 4

Florence sells quoted shares on 6 March 2016 for £175,000 and realises a chargeable gain of £72,000. If she makes a qualifying SITR investment of £30,000 on 24 April 2017, she can claim that a gain of £30,000 should be deferred until – usually – the SITR investment is disposed of. Florence will of course remain liable for CGT on the remaining chargeable gain of £72,000 – £30,000 = £42,000 in 2015/16.

(d) The following changes have been made to the SITR legislation by Cl 27 and Sch 8 FB 2017:

(i) The original five-year time limit for a qualifying SITR investment is being extended for a further two years, ie. up until 5 April 2021.

(ii) There is now a requirement that an investor who makes a SITR claim should be independent from the social enterprise. At the time

when the investment is made, he must hold no other shares or debentures in the social enterprise (or in any of its subsidiary companies). The only exception to this rule is if the existing investment is a 'risk finance investment' or a 'permitted subscriber' shareholding – see new S257LDA ITA 2007 for further details.

(iii) New S257LEA ITA 2007 introduces a 'no disqualifying arrangements' stipulation. This is a similar anti-abuse provision to that found in S178A ITA 2007 (for EIS relief). Arrangements are treated as 'disqualifying arrangements' if they are entered into with a main purpose of ensuring that any of the following tax reliefs are available in relation to the activities of a social enterprise:

- SITR;
- EIS relief;
- SEIS relief;
- VCT relief; and
- share loss relief.

(iv) Although the maximum SITR investment which is eligible for income tax relief in the hands of an individual is £1,000,000 per tax year, the maximum investment which any one social enterprise can receive used to be subject to a (much lower) overriding euro limit covering a three-year period – this has been replaced by a new limit of £1,500,000.

(v) Originally, the social enterprise had to have fewer than 500 full-time equivalent employees at the time when the investment was made. This limit has been halved.

(vi) There is a new requirement that the social enterprise must be in financial health at the time when the investment is made – see S257MIA ITA 2007.

(vii) There are a number of additional prohibited social enterprise activities:

- leasing (including letting ships on charter or other assets on hire);
- receiving royalties or licence fees;
- operating or managing nursing homes or residential care homes (see S257MQA ITA 2007);
- generating electricity, exporting electricity or making electricity generating capacity available;
- generating heat;
- generating any other form of energy; and

– producing gas or fuel.

(e) These changes all have effect from 6 April 2017 onwards.

15. **Business investment relief (BIR)**

(a) The legislation relating to BIR – this is a special relief which allows remittance basis taxpayers to remit their overseas income and gains to the UK tax-free as long as they use the money for the purpose of making a commercial investment in a company – was brought in by FA 2012 and can be found in Ss809VA – 809VO ITA 2007.

(b) With effect from 6 April 2012, there is deemed to be no remittance of foreign income or gains by a non-UK domiciled individual, provided that:

(i) a relevant event occurs; and

(ii) the individual makes a claim on or before the first anniversary of 31 January following the end of the tax year in which the income or gains would otherwise have been regarded as remitted to the UK (S809VA ITA 2007).

(c) A relevant event occurs if the money in question is:

(i) used by a person to make a qualifying investment (ie. directly); or

(ii) received in the UK in order to be used by someone else to make a qualifying investment (ie. indirectly).

The qualifying investment must be made by what is known as 'the relevant person' within 45 days of the money being received in the UK. By virtue of S809M ITA 2007, the investor can either be the non-UK domiciliary himself or else some other person mentioned in that section such as a trust of which he is a beneficiary or a close company in which he is a shareholder.

(d) It was originally provided that a qualifying BIR investment covered:

(i) the subscription of new shares or securities in; and

(ii) the making of loans to

a company (referred to in the legislation as 'the target company') (S809VC ITA 2007). In addition, at the time of the investment, the target company must meet Condition A and the investor must meet Condition B.

(e) Condition A is set out in S809VD ITA 2007 and originally specified that the target company must be either:

(i) an eligible trading company; or

(ii) an eligible stakeholder company; or

(iii) an eligible holding company.

There is no requirement that the company has to be incorporated in the UK.

(f) The company invested in must always be a private company, none of whose shares are listed on a recognised stock exchange. Investments in LLPs and other non-corporate structures are excluded.

(g) An eligible trading company is a company which is carrying on at least one commercial trade (see S809VE ITA 2007) or is preparing to do so within the next two years – this used to be the position, but a change is taking place. A couple of points should be noted:

(i) property businesses count as commercial trades – this includes property letting (both residential and commercial) as well as property development; and

(ii) the company's trading must represent at least 80% of its overall activities – this is similar to the test used for entrepreneurs' relief (it is understood that HMRC measure the percentage by reference to turnover alone).

(h) An eligible stakeholder company is one which exists wholly for the purpose of making investments in eligible trading companies, ie. it is effectively an investment company. There is no need to have a controlling interest. HMRC state that 'minor or incidental' non-qualifying activities can be ignored. A stakeholder company must hold all its investments directly – no intermediate holding company structures are allowed.

(i) The third permitted category is an eligible holding company. This is a 51% test and all the holding company's subsidiaries must be trading companies. In this context, the 80% test is applied to the group as a whole rather than on a company-by-company basis. Intermediate holding companies *are* permitted.

(j) Condition B is explained in S809VF ITA 2007. This section states that, at the time of the investment, the investor must not:

(i) have obtained a 'related benefit';

(ii) have become entitled to obtain a 'related benefit'; or

(iii) be expecting to obtain a 'related benefit'.

For this purpose, a benefit represents anything in money or money's worth which would not be provided in the ordinary course of business. This restriction will not be a problem for items such as director's fees or normal benefits in kind. Benefits are related if, broadly, they are directly or indirectly attributable to the making of the investment and would not have been available had the investment not been made.

(k) In summary, therefore, the following points about the form of the investment should be emphasised:

(i) There are no upper or lower limits on the amount of remittance basis income or gains which can be invested. Nor are there any restrictions on the size of the investment.

(ii) Relief is not restricted to UK-resident companies nor is there a stipulation that the business must be carried on wholly or mainly in the UK.

(iii) All types of trade are sanctioned – this regime is much more flexible than the SEIS, EIS and VCT legislation.

(iv) There is no embargo on the investor working for the company. It is quite in order for a non-UK domiciliary to invest money in his own company (or in a company owned by other members of his family).

(v) Any form of investment can qualify: ordinary shares, preference shares, loans etc.

(vi) As an alternative to investing directly, the individual can, if he wishes, make his investment via an offshore trust of which he is a beneficiary or a personal investment company in which he is a shareholder.

(l) BIR is clawed back (ie. there is deemed to be a remittance to the UK) where there is:

(i) a 'potentially chargeable event'; and

(ii) 'appropriate mitigation steps' are not taken within the 'relevant grace period' (S809VG ITA 2007).

(m) A potentially chargeable event occurs if:

(i) the target company ceases to be an eligible company (eg. because it obtains a stock exchange listing);

(ii) the investor disposes of all or part of the qualifying investment;

(iii) value is extracted from the company other than on a sale or in the ordinary course of business; or

(iv) the start-up requirement (see (g) above) is not met (S809VH ITA 2007).

(n) S809VI ITA 2007 explains the appropriate mitigation steps which must be taken, following a potentially chargeable event, in order to prevent the affected income or gains being treated as remitted to the UK. Where the potentially chargeable event is a disposal of all or part of the holding, the proceeds from the disposal must either be taken offshore or alternatively reinvested in another qualifying company. In any other case, the individual must dispose of the *entire* holding (or whatever part still belongs to him) and either take the proceeds offshore or else reinvest them. The relevant grace period is normally 45 days, although it can sometimes be longer (but see (p)(v) below).

(o) In 2015, the Government announced that they would be consulting on ways in which the BIR rules could be amended in order to increase the take-up. They made it clear that they wanted to expand the scope of the BIR by making it easier and more attractive for potential investors to bring their

money from overseas in order to put it into UK businesses. The changes set out in Cl 28 FB 2017 are the result. They widen the types of business in which an investment can be made and they modify the anti-avoidance legislation so that ITA 2007 does not discourage genuine investment. They also clarify parts of the rules which were previously unclear.

(p) The various amendments, which all come into force on 6 April 2017, are as follows:

(i) The wording of S809VC ITA 2007 has been altered so as to allow an investor to claim BIR on the acquisition of existing shares in a company, ie. shares no longer have to be subscribed for.

(ii) In S809VD ITA 2007, the start-up period for a company has been extended from two to five years. In addition, the revamped section provides for the introduction of a new eligible hybrid company. Such a company will be a combination of both a trading company and a stakeholder company – previously, an investment could only be made in a company which carried out one of these roles rather than a combination of both of them.

(iii) S809VE ITA 2007 clarifies the position in relation to corporate partners. Investment in LLPs and other forms of partnership was excluded from BIR *ab initio* – see (f) above. It has always been the Government's position that this exclusion encompassed corporate members of LLPs and other partnerships – indeed, HMRC are known to have refused claims, on a consistent basis, for BIR on investment in such corporate members. Feedback to the Government has suggested that the legislation is not completely clear in this respect. The amendment here addresses this concern by stating explicitly that a company which is a member of an LLP or a partner in a partnership is not to be regarded as carrying on the trade of the LLP/partnership. This means that, unless the target company is carrying on a commercial trade in its own right, it will not qualify for BIR.

(iv) As mentioned in (m) above, a potentially chargeable event occurs if value is extracted other than on a sale or in the ordinary course of business. This can be described as the 'extraction of value' rule. Hitherto, it has been breached if an investor receives any abnormal benefit, directly or indirectly, from the company in which he has invested or from any company associated with this company (these are called 'involved' companies), whether or not the benefit was connected with the investment. The revised wording removes the reference to an 'involved' company. In other words, the extraction of value rule will only be treated as having been breached if an abnormal benefit is received in circumstances directly or indirectly attributable to the investment – the fact that it comes from what was formerly described as an 'involved' company will no longer be automatically fatal.

(v) Where a company fails to satisfy the new five-year start-up time limit, the grace period allowed will be extended to two years from the date when the investor first became aware, or ought reasonably

to have become aware, that the company was what ITA 2007 calls 'non-operational'.

16. Annual CGT exemption

(a) The annual CGT exemption for individuals and personal representatives has been increased by £200 in line with inflation to £11,300 for 2017/18 (SI 2017/377). The exempt amount for most trusts is £5,650.

(b) There are no changes to any of the CGT rates (10%, 18%, 20% and 28%) nor to the maximum entrepreneurs' relief limit which therefore remains at £10,000,000 for 2017/18.

17. **Assets appropriated to trading stock**

(a) Where a chargeable asset acquired by a trader as a fixed asset or an investment is subsequently appropriated by him for use as trading stock, the general rule is that the trader is treated as having sold the asset for its market value at the time of the appropriation (S161(1) TCGA 1992). This gives rise to a chargeable gain or allowable loss and the amount brought into the trading accounts is the market value of the item in question.

(b) Collection difficulties might, however, arise, given that tax on any chargeable gain could become due and payable some time before there was an actual disposal of the asset. This is sometimes referred to as a 'dry' tax charge. In order to deal with the problem, traders are allowed to make an election under S161(3) TCGA 1992, as a result of which:

(i) no chargeable gain or allowable loss arises on the appropriation to trading stock; and

(ii) the market value of the asset in the trading accounts is reduced by the amount of the chargeable gain or increased by the amount of the allowable loss.

The effect of this election is that the trading results will now include the totality of any income profit or loss and any capital gain or loss accruing on the asset over the whole period of ownership.

(c) An election under S161(3) TCGA 1992 must be made:

(i) for CGT, by 12 months after 31 January next following the tax year containing the last day of the period of account in which the asset was appropriated to trading stock; and

(ii) for corporation tax, within two years of the end of the accounting period in which the asset was appropriated to trading stock.

(d) Illustration 5

John is a second-hand bookseller. He also collects antiquarian books as a hobby. In March 2004, he acquired a set of rare books for his personal collection at a cost of £26,500.

In January 2017, when the market value of the set was £70,000, he decided to offer it for sale through his business. John's CGT computation is:

	£
Market value on appropriation	70,000
Less: Cost	26,500
CHARGEABLE GAIN	£43,500

If John elects to roll the gain over into the value of the set in his trading accounts, no chargeable gain will arise. Instead, the cost of the set for the purpose of working out John's trading profit will be reduced to:

	£
Market value on appropriation	70,000
Less: Chargeable gain	43,500
COST OF SET IN TRADING ACCOUNTS	£26,500

On the assumption that the books were eventually sold for £74,700, John's trading profit will be £74,700 – £26,500 = £48,200. Depending on how quickly the books sold, John might well prefer to pay CGT rather than income tax on his appropriation profit. His CGT rate would presumably be 20% rather than a charge of 40% or 45% under income tax.

(e) However, what about the position where there is a loss? In that case, the effect of a S161(3) TCGA 1992 election is to convert an amount which is classified as an allowable loss while the asset was held as a fixed asset or an investment into a more flexible trading deduction. This is a widely recognised planning point which was often used by, for example, property developers during the recent property troubles.

(f) Unfortunately, the Chancellor has decided that this form of tax planning is a step too far. For appropriations into trading stock made on or after 8 March 2017, Cl 38 FB 2017 disallows the election facility where there is a loss in order to ensure that the loss retains the character which it had when it accrued. Elections can still be made where there is a gain.

18. **Employee shareholder status abolished**

(a) One of the few genuine surprises in the Chancellor's Autumn Statement on 23 November 2016 was the announcement that he had decided to end the favourable tax treatment for employee shareholder shares which had been introduced as recently as FA 2013.

(b) Employee shareholder status was originally intended to be a way of allowing small companies to grow rapidly without committing themselves to a large permanent workforce with full employment rights. Employers were allowed to grant their staff CGT-free shares worth up to £50,000 in return for the employees waiving their normal employment protection rights. Income tax and NICs were not chargeable on the first £2,000 of the share value received by the employee.

(c) Although tax advisers were initially somewhat sceptical about George Osborne's idea, it was in fact widely used – mainly by high-earning employees as a method of avoiding income tax and CGT. It attracted significant interest from private equity firms, given that the arrangement permitted participants in a management buy-out to avoid CGT on shareholdings of up to £50,000 when they subsequently exited from the company. HM Treasury's recognition of this fact was reflected in the decision last year to place a lifetime limit of £100,000 on the CGT exemption for an individual's disposal of employee shareholder shares on or after 17 March 2016 (S88 FA 2016).

(d) More drastic further action has now been taken. All the tax advantages for employee shareholder status have been removed for schemes launched on or after 1 December 2016 (Cl 45 and 46 FB 2017). However, although the Government have legislated to close the arrangement for new entrants, this does not affect shares which were issued in consideration of an employee shareholder agreement entered into prior to 1 December 2016 – they can still be sold free of CGT.

(e) Another point which should be noted is that, where a company buys back employee shareholder shares from an ex-employee and the shares were issued in consideration of an employee shareholder agreement entered into on or after 1 December 2016, the proceeds will no longer be treated as an automatic capital receipt, thus reversing the rule in S385A ITTOIA 2005 (Cl 47 FB 2017).

19. **Extending IHT to enveloped UK residential property**

(a) Background

Individuals who are not domiciled in the UK enjoy a significant IHT advantage over other taxpayers. UK domiciliaries are liable to IHT on the value of their worldwide assets, while those who are non-UK domiciled are only chargeable on property which is situated within the UK. This is the case, regardless of the individual's residence status.

(b) Any residential property in the UK directly owned by a non-UK domiciliary has always been within the charge to IHT. However, it has been standard practice for many years for non-UK domiciled individuals to hold such properties through an overseas company (or some similar vehicle). In these circumstances, the individual's property consists of a shareholding situated outside the UK which is therefore excluded from IHT. Enveloping properties in this way provides a tax advantage for non-UK domiciled individuals which is not available for anyone else.

(c) This technique has continued to be effective for IHT purposes, albeit at the potential cost of exposure to ATED which has applied since 2013. Indeed, the IHT benefit was a significant factor in discouraging de-enveloping when ATED was first introduced (along with the lack of both SDLT and rollover reliefs).

(d) The key change

The Government have decided to bring UK residential properties within the charge to IHT where they are held in an overseas structure. The new charge will apply both to individuals who are domiciled outside the UK and to trusts with settlors or beneficiaries who are non-UK domiciled. It comes into effect on 6 April 2017 and the relevant legislation is set out in Cl 44 and Sch 15 FB 2017. Para 1 Sch 15 FB 2017 inserts new Sch A1 IHTA 1984 (where all the material changes can be found).

(e) In order to implement this extended IHT charge, the Government have removed any UK residential property owned indirectly through an offshore vehicle from the definition of 'excluded property' in Ss6 and 48 IHTA 1984. It will make no difference whether the overseas structure is owned by an individual or a trust.

(f) By virtue of Para 2 Sch A1 IHTA 1984, shares in overseas companies which would be 'close' if they were UK-resident will no longer be excluded property if, and to the extent that, the value of any interest in the entity is attributable, directly or indirectly, to residential property in the UK. Similarly, where a non-UK domiciled individual is a member of an overseas partnership which holds residential property in the UK, such properties will also cease to be treated as excluded property for IHT purposes. Thus the normal IHT chargeable event rules will henceforth apply to assets which fall into these categories.

(g) Para 2(3) Sch A1 IHTA 1984 provides a very limited *de minimis* exemption from this new regime. Interests will be disregarded where the foreign domiciliary or trust holds a less than 5% interest (by value) in the overseas company or partnership.

(h) It should be emphasised that these FB 2017 changes only appertain to UK residential property. They do *not* affect any other UK situs assets owned by offshore entities.

(i) In this context, the Government are determined that the definition of UK residential property should be wide. There will be no monetary threshold below which the new charge will cease to apply. And there will be no special relief for an individual's main residence or for properties which are let out commercially.

(j) Properties affected

HM Treasury have stated:

'The legislation will need to define the types of property which will become liable to IHT. However, introducing a wholly new definition for IHT purposes could risk creating unnecessary complexity and uncertainty. The Government therefore intend that the new charge should be based as far as possible on other definitions of residential property which currently exist within tax legislation.'

The Government, after consultation, have decided to use the definition of 'residential property' found in the FA 2015 extension of CGT to non-UK residents, on the ground that this means amending the relevant definition less heavily than would be necessary if, for example, the definition applying for the ATED regime were to be adopted (Para 8 Sch A1 IHTA 1984).

(k) The FA 2015 definition covers a property which:

(i) is suitable for use as a dwelling; or

(ii) is in the process of being constructed or adapted for such use.

Land which is, or is intended to be, occupied or enjoyed with a dwelling as a garden or grounds (including any building or structure on such land) is taken to be part of that building.

(l) A building is not regarded as a dwelling if it is used as:

(i) residential accommodation for school pupils;

(ii) residential accommodation for members of the armed forces;

(iii) a home or other institution providing residential accommodation for children;

(iv) a home or other institution providing residential accommodation with personal care for persons in need of such care (eg. because of their age or disability);

(v) a hospital or hospice;

(vi) a prison or similar establishment;

(vii) a hotel, inn or similar establishment;

(viii) an institution (not falling within any of the above) which is the sole or main residence of its residents; or

(ix) purpose-built student accommodation or a student hall of residence.

A building which becomes temporarily unsuitable for use as a dwelling is treated as continuing to be suitable for such use, but there are exceptions (found in Sch B1 TCGA 1992) which apply where the property has been damaged or is undergoing major structural change – this includes partial or complete demolition.

(m) Change of use

In some cases, residential property might have previously been used for commercial purposes. The extended IHT charge needs to take account of such situations in order to determine the amount which will be liable to IHT in the event of a chargeable occasion. With non-UK resident CGT, there are rules which apply in these situations and which are designed to ensure that tax is charged on the basis of a 'just and reasonable' apportionment of the value of the property. A time-based approach is used. However, in the context of IHT, there are difficulties with such a procedure. Unlike CGT, IHT does not operate on the basis of annual tax years – instead, the charge represents a snapshot of an estate immediately before a chargeable event. An apportionment of value may not necessarily be the most appropriate course of action.

(n) Accordingly, in their 2016 consultation document, the Government planned to employ a two-year 'look-back' period so that, if the property had been residential during any part of that period, it would be caught. A number of representations pointed out that this went against the fundamental snapshot principle behind IHT and so this provision was reluctantly dropped. The position of the property at the time of the chargeable event is now all that is relevant.

(o) Duality of use

Although the above approach means that there will be no apportionments of value, there will still be a need for such an apportionment where a property has been used for both residential and commercial purposes, eg. a flat above shop premises. It would appear that this is going to be dealt with on a 'just and reasonable' basis.

(p) Valuation

As already mentioned, this IHT change is given effect by modifying the meaning of 'excluded property' so that the term will no longer cover shares or other forms of capital in an offshore entity which has an interest in UK residential property. It therefore follows that, when a chargeable event occurs, it is the value of the holding in the owning entity which is required, and not the value of the underlying property itself.

(q) Where the offshore entity owns more than just UK residential property (for example, foreign property or other types of asset), an adjustment will be

necessary in order to ensure that it is only the value deriving from the UK residential property interest which is taken into account.

(r) Deduction of debts

Where the owning entity only holds UK residential property, debts can be offset for IHT purposes in determining the value derived from the UK property. There is, however, a special attribution rule where there are liabilities and the owning entity additionally has other types of asset. In this case, it appears that, even if the debt is specifically secured on the UK residential property, the liability must be allocated across *all* the assets in proportion to their market values at the time of the chargeable event (Para 2(4) Sch A1 IHTA 1984) – see Illustration 6 below. The position with regard to any debts which, as an alternative, the foreign domiciliary or trust may have taken out in order to acquire the holding in the owning entity is not referred to in the legislation. In these circumstances, it seems that the normal rules relating to the deductibility of debts must apply.

(s) Illustration 6

Alastair is a UK-resident foreign domiciliary – he is not deemed domiciled. He owns all the shares in Cook Overseas Ltd (a New Zealand company). In turn, the company owns Cook Mews (a residential property in London worth £10,000,000) and a foreign share portfolio worth £90,000,000. The company borrowed £8,000,000 to finance the acquisition of Cook Mews – this is secured on the London property.

The legislation means that only one-tenth of £8,000,000, ie. £800,000, can be deducted in calculating the value attributable to the UK residential property.

(t) Relevant loans and collateral

In addition to the original extension of the scope of IHT where UK residential property is held within an overseas 'close' company or partnership, there will be an exposure to tax where:

(i) there is a 'relevant loan' (see (u) below); or

(ii) money or money's worth is used as security, collateral or a guarantee for this loan; or

(iii) the right or interest which a shareholder or partner holds is directly or indirectly attributable to the loan or to the collateral for it (Paras 3 and 4 Sch A1 IHTA 1984).

(u) The term 'relevant loan' refers to the situation where money or money's worth is made available (directly or indirectly) to finance:

(i) the acquisition of UK residential property by an individual, partnership or the trustees of a settlement; or

(ii) the maintenance or enhancement of the value of UK residential property which belongs to an individual, partnership or settlement; or

(iii) the acquisition by an individual or trustees of:

– a right or interest in an overseas 'close' company; or

– an interest in an overseas partnership,

provided that the funds are used for the acquisition, maintenance or enhancement of UK residential property.

Any loan can be a 'relevant loan' if it meets the applicable conditions – the term is not limited to loans between connected parties. These new charging provisions have the potential effectively to duplicate liabilities so that the amount subject to IHT could significantly exceed the actual value of the UK residential property! This anomaly is best explained by way of an example – see (v) below.

(v) Illustration 7

Joseph is a UK-resident foreign domiciliary – he is not deemed domiciled. He owns all the shares in Root Overseas Ltd (a New Zealand company). In turn, the company owns Root Manor (a residential property in Leeds worth £4,000,000) and a foreign share portfolio worth £6,000,000. The company borrowed £2,000,000 from a non-UK resident family discretionary settlement to finance the acquisition of Root Manor. The trust secured this loan on the share portfolio.

The following points should be noted:

(i) There is a qualifying interest in UK residential property. As a result, only four-tenths of the £2,000,000 mortgage (ie. £800,000) can be deducted from the worth of the Leeds property in ascertaining the value of Root Overseas Ltd which derives from this property. Therefore, Root has an asset value of £3,200,000 which will be subject to IHT should a chargeable event occur (such as his death).

(ii) The 'relevant loan' of £2,000,000 will constitute relevant property within the discretionary settlement and so will have to be taken into account for the purposes of 10-year anniversary and exit charges.

(iii) Although it is not entirely clear, there is a serious concern that the entire £6,000,000 of collateral provided for the loan is also caught by Sch A1 IHTA 1984 and so would fall within Joseph's estate.

This cannot be right. One hopes that, in due course, the legislation will be amended so that IHT can never be charged in these circumstances on an amount in excess of the UK residential property's value.

(w) Disposals and repayments

There are anti-avoidance provisions which apply where, on or after 6 April 2017, a UK residential property is sold, or a 'relevant loan' is repaid, within two years before a chargeable event for IHT purposes (Para 5 Sch A1 IHTA 1984). These catch:

(i) property which constitutes consideration in money or money's worth for the disposal of an overseas 'close' company or partnership through which there was an interest in a UK residential property or a 'relevant loan';

(ii) repayment of a 'relevant loan'; and

(iii) any property directly or indirectly representing (i) and (ii) above.

Para 5 Sch A1 IHTA 1984 appears only to apply to sales of interests in the foreign company or partnership, and not to disposals of the underlying property. Thus a company which sold its UK residential property and reinvested the proceeds in some other form of asset would not fall foul of the anti-avoidance legislation. Of course, during the two-year run-off period, the property will continue to be subject to IHT. Where there is a sale of the residential property, the two-year period runs from the date of the disposal and, where there is a loan repayment, the two-year period runs from the date of that repayment.

(x) More anti-avoidance

The Government are keen that the extension of IHT to enveloped property should not be circumvented. With this in mind, a specific targeted anti-avoidance rule (TAAR) has been introduced so that any 'arrangements' will be disregarded where their main purpose, or one of the main purposes, is to secure a 'tax advantage' by sidestepping the new provisions. 'Arrangements' are defined as including any scheme, transaction (or series of transactions), agreement or understanding (whether or not legally enforceable and whether or not entered into), together with any associated operations. The term 'tax advantage' covers:

(i) a relief or increased relief from tax;

(ii) a repayment or increased repayment of tax;

(iii) the avoidance or reduction of a charge to tax or an assessment to tax;

(iv) the deferral of a payment of tax or advancement of a repayment of tax; and

(v) the avoidance of an obligation to deduct or account for tax.

Given that the extension of IHT to enveloped property does not take effect until 6 April 2017, it might reasonably be assumed that the TAAR only applies to transactions entered into on or after 6 April 2017. This would appear to be the case.

(y) No transitional reliefs

Despite calls for a de-enveloping relief to allow existing structures to be unwound without triggering unexpected and/or onerous tax liabilities, the current position is that there will be no transitional reliefs. HM Treasury say that the Government can see that there might be a case for encouraging de-enveloping but, in the circumstances, they do not think that 'it would be

appropriate to provide any incentive to encourage individuals to exit from their structures at this time'. Many individuals and trustees holding UK residential property within offshore companies have been waiting to see whether there would be any de-enveloping relief before taking action. Unfortunately, it seems very unlikely that there will be such relief. It may now be time to consider collapsing structures which have become ineffective for tax purposes.

(z) Collection of tax

The Government recognise that HMRC will have some difficulty in identifying when a chargeable event has taken place and a liability to tax has arisen. In order to assist HMRC in this regard, there is to be an extension to the normal reporting obligations. Anyone with a legal interest in the property (including the directors of the company which holds the property) will have a responsibility to account for the tax. In addition, HMRC are to have an expanded power enabling them to prevent the sale of a property if there is an unpaid liability to IHT.

20. **Deemed domicile – income tax, CGT and IHT**

(a) Overview

In his Budget on 8 July 2015, the previous Chancellor proposed a major modification to the regime for taxing foreign domiciliaries who are resident in the UK. This amounted to a radical recasting of the existing rules and came as something of a surprise. Realising this, the Government announced that it would be necessary to allow those who were affected by the shake-up to make proper arrangements, with the result that the measures do not come into force until 6 April 2017.

(b) These notes examine the widening of the scope of deemed domicile as it applies for income tax, CGT and IHT. The relevant legislation is set out in:

(i) Cl 41 and Sch 13 FB 2017 (income tax and CGT); and

(ii) Cl 42 FB 2017 (IHT).

(c) The main changes in this regard can be summarised as follows:

(i) anyone born in the UK with a UK domicile of origin who is resident in the UK in a tax year (sometimes referred to as a 'formerly domiciled resident' (FDR)); and

(ii) anyone who has been resident in the UK for at least 15 out of the 20 immediately preceding tax years (sometimes referred to as a 'long-term resident')

will be deemed to be UK-domiciled for all tax purposes. It should be emphasised that these provisions apply for tax purposes only and will not affect an individual's domicile status under general principles. Furthermore, the circumstances of parents will not impact on children whose domicile position will be determined separately by reference to their own fact patterns.

(d) Individuals born in the UK with a UK domicile of origin

Looking at the position in more detail, FDRs who have subsequently acquired a foreign domicile of choice (or dependency) will in future be unable to access the remittance basis. For income tax and CGT purposes, such individuals will, when resident in the UK, be taxed in exactly the same way as anyone domiciled and resident here, ie. on their worldwide income and gains using the arising basis. And they will remain taxable on any remittance basis income and gains from prior years, remitted on or after 6 April 2017, as at present.

(e) In addition, the trust and company anti-avoidance codes will apply to the income and gains of foreign trusts and companies in exactly the same way as they do for anyone domiciled and resident here. Those affected:

(i) will have the income and gains of non-UK resident trusts – where they are settlors – attributed to them on the arising basis (a similar rule will apply to the income and gains of certain non-UK resident companies); and

(ii) will no longer be allowed to benefit from the special CGT reliefs for foreign domiciled beneficiaries of non-UK resident trusts (eg. the rebasing election introduced in FA 2008).

(f) Non-UK resident trustees will find themselves having to provide UK tax reporting information on foreign income and gains which hitherto has not been required. In some cases, they may not have UK advisers, but they will now need to take appropriate advice in order to understand the implications of the changes to the reporting requirements for the settlor and beneficiaries. Matters will become even more complicated if the settlor has a variable residence position (ie. he moves in and out of UK residence).

(g) As far as IHT is concerned, FDRs will also be caught by its charges, given that they will be treated as though they are domiciled in the UK. Furthermore, any trust of which the FDR is a settlor will be denied excluded property status for as long as the settlor remains resident in the UK. There is, however, one relaxation: there is a period of grace which means that the IHT provisions will only apply where the individual:

(i) is resident in the UK in the relevant tax year; and

(ii) was resident in the UK in at least one of the two preceding tax years.

This let-out has been introduced because there could potentially be such a severe impact on otherwise excluded property trusts that the Government are prepared to allow what is effectively a one-year moratorium.

(h) When determining the 10-year anniversary charge for such trusts under the new legislation, the general rules still apply. This means that, if the settlor is deemed to be domiciled in the UK for IHT purposes at the time of the 10-year anniversary, the charge will be calculated by taking the cumulative number of quarters in which he has been IHT-deemed domiciled as a fraction of the 40 total quarters in the 10-year period.

(i) Note that the Government have rejected calls for any 'grandfathering' provisions in relation to excluded property trusts established prior to 8 July 2015.

(j) Leaving the UK

From an income tax and CGT perspective, the question of domicile is normally irrelevant for non-UK residents. It only comes into play in the tax year when someone returns to the UK if, as a result, the provisions relating to temporary non-UK residence are thereby engaged (ie. because the returnee has been unable to satisfy the five-year requirement). Domicile does, however, continue to be important for IHT purposes for those non-UK residents who are domiciled in the UK or who are deemed to be domiciled here under the rules applying to:

(i) FDRs; or

(ii) long-term residents (this category is considered more fully below).

(k) An FDR will lose deemed domicile status in his first full tax year of non-UK residence, provided that he:

  (i) retains a foreign domicile under general law; and

  (ii) has not become deemed domiciled by virtue of long-term residence.

(l) As an individual's place of birth and domicile of origin are both unalterable facts, anyone born in the UK with a UK domicile of origin will always be an FDR if he re-establishes residence in the UK, no matter how many years he may have spent abroad and regardless of whether he has acquired a different domicile – see (m) below.

(m) Illustration 8

Edward was born in Wimbledon. His parents were married and his father had a domicile of origin in England and Wales. The family left the UK and settled permanently in New Zealand when Edward was four years of age.

The father established a domicile of choice in New Zealand, thereby giving Edward a domicile of dependency in the same jurisdiction. Edward retained this domicile (by choice) into adulthood, becoming successful at his work and wealthy. For local estate planning reasons, he settled substantial assets on trusts for the benefit of his family – he was now married with two children.

On 3 June 2017 (when Edward was aged 45), his firm asked him to accept a three-year posting to the UK to take the lead on a special project.

Despite Edward having lost all his connections with the UK, the FB 2017 provisions mean that, if he accepts the assignment, he will be an FDR on arrival and will be denied the benefits of his foreign domicile of choice. He will be taxed in exactly the same way as a UK-resident and UK-domiciled individual, ie. on his worldwide income and gains.

From the start of the second year of his UK residence (ie. on expiry of the IHT period of grace – see (g) above), Edward's worldwide assets, including the property in the various trusts which he has settled, will fall into the IHT net for the duration of his UK residence.

The tax implications of this, particularly the IHT exposure for the funds held on Edward's family trusts, may be sufficiently serious for him to decide to decline the positing to the UK.

(n) Long-term residents

With effect from 6 April 2017, foreign domiciliaries who have been UK-resident for at least 15 out of the last 20 tax years will be deemed to be domiciled in the UK for all tax purposes. There is, however, one transitional exception to this rule where:

  (i) the individual is not resident in the UK for the tax year in question; and

(ii) there is no tax year beginning after 5 April 2017 and preceding the tax year in question when he was UK-resident.

In other words, he has not been resident in the UK for 2017/18 onwards. Since non-UK residents never need to make use of the remittance basis, this exception will only be of importance for IHT purposes.

(o) There is one oddity about the provision described in (n) above. It can perhaps best be illustrated by a simple example. Imagine that an individual has been resident in the UK for 14 consecutive tax years on 5 April 2017. He leaves the UK on 1 November 2017. 2017/18 is his 15th year of UK-residence – remember that a split year counts as a year of residence. He has been resident for the 15 tax years immediately preceding 2018/19 and, although he is not UK-resident in 2018/19, there is a tax year beginning after 5 April 2017 which precedes 2018/19 in which he has been UK-resident. Therefore, the transitional exception is not available. It seems counter-intuitive that an individual can be deemed to be domiciled in the UK during a period when he was not in fact UK-resident!

(p) A non-UK domiciled individual who has less than £2,000 of unremitted foreign income and gains in a tax year is at present allowed automatic access to the remittance basis without any loss of allowances and without having to pay the remittance basis charge. The Government have confirmed that this will continue to be the case, even when the individual has been UK-resident for more than 15 years. It is understood that this decision is an entirely pragmatic one, given that the tax at stake is relatively small compared with the cost of collection. Talking of the remittance basis charge, the existing regime for those who have been resident in the UK for seven of the previous nine tax years (£30,000) and for 12 of the previous 14 tax years (£60,000) will remain in place. The £90,000 remittance basis charge (which took effect on 6 April 2015 for individuals who have been resident for 17 of the previous 20 tax years) will become obsolete on 6 April 2017.

(q) An individual could be deemed to be domiciled in the UK both as an FDR and as a long-term resident. Where the conditions for both are satisfied, the less favourable rules for FDRs take precedence.

(r) As previously mentioned, a UK-resident foreign domiciliary will be deemed to be domiciled in the UK (and therefore subject to tax on his worldwide income and gains) from the start of the tax year in which he has been UK-resident in 15 out of the immediately preceding 20 tax years. For these individuals, the remittance basis will therefore cease to apply (except as outlined in (p) above). It is important to appreciate that this change has required a reconsideration of the way in which relief is to be given for capital losses. Hitherto, a UK-resident foreign domiciliary who wishes to access the remittance basis has been able to choose either to forfeit entitlement to relief for foreign capital losses (so that he only claims relief for his UK losses) or to make a capital loss election. This election is irrevocable and has to be made within strict time limits. Making the election allows the individual to claim relief for all his capital losses, subject to provisions dictating the order of offset against his remitted and unremitted foreign gains and his UK gains (but in a generally unfavourable way). To adapt these provisions so that they operate effectively under the new regime, the following revisions have been proposed:

(i) When an individual becomes deemed domiciled, he will be treated in exactly the same way as someone who is UK-resident and UK-domiciled from that tax year onwards. He will therefore be able to offset his capital losses against his chargeable gains without having to distinguish between his UK and foreign disposals.

(ii) If this individual later loses his deemed domicile (through an extended period of non-UK residence) but then returns to the UK so that he is once again able to access the remittance basis, he will have the option of making the capital loss election afresh.

(s) Once a foreign domiciliary has become deemed domiciled as a long-term resident, his worldwide assets will be within the charge to IHT. Any transfers of value made by that individual will be governed by the same rules as apply to UK domiciliaries. For example:

(i) A gift to a child, whether of UK or foreign assets, will be a potentially exempt transfer (PET). A PET will fail and IHT may be payable if the donor dies within seven years of making the PET.

(ii) A transfer by a deemed domiciled individual to a trust (whether UK-resident or not) will be a chargeable lifetime transfer with an immediate 20% charge to tax to the extent that the amount settled exceeds his available IHT nil rate band. The trust property will fall within the relevant property regime and, if the settlor is able to benefit under the terms of the trust, the assets will form part of his estate by virtue of the gift with reservation rules.

(t) An important transitional provision – rebasing relief

A number of transitional provisions are being introduced for foreign-domiciled long-term residents. For some, the criteria are narrow, but, where they apply, they can be helpful (often surprisingly so). The special rebasing relief is probably the most important.

(u) Individuals who become deemed domiciled as long-term residents at the inception of these rules (ie. on 6 April 2017) will be able to calculate their gains on foreign asset disposals by reference to the value of the asset as at 5 April 2017. This rebasing relief is likely to be very valuable to those who meet the requisite conditions. In order for the individual to benefit:

(i) he must not have been born in the UK with a UK domicile of origin (in other words, he must not be an FDR);

(ii) he must not be domiciled in the UK under general law at any time during the tax year when the asset is disposed of;

(iii) he must have held the asset on 5 April 2017, with the disposal taking place after that date; and

(iv) the asset must have been a foreign situs one throughout the period from 16 March 2016 (or, if acquired later, the date of acquisition) to 5 April 2017.

With regard to (iv) above, an asset is not regarded as situated in the UK where it has been brought to the UK as a remittance and, throughout the period to 5 April 2017, one of the remittance exemptions in S809X ITA 2017 applies (eg. the personal effects rule or where the asset was brought into the UK for repair and restoration). Note that BIR does not count in this context as it is a relief which has to be claimed rather than an outright exemption.

(v) In addition, the individual concerned must be in the first wave of those acquiring deemed domicile status on 6 April 2017. The effect of this rule is to restrict access to the relief to individuals who have been resident in the UK in at least 15 out of the last 20 tax years up to 2016/17 and who remain UK-resident in 2017/18. He must also have paid the remittance basis charge at least once prior to 2017/18 (and so minors will never be able to benefit from rebasing relief even if all the other conditions are met).

(w) Rebasing relief is only available in respect of assets held directly by the individual. Despite representations, there will apparently be no rebasing for assets held by trusts or by companies.

(x) Where all the above requirements are satisfied and the asset is disposed of for a gain on or after 6 April 2017, the asset's base cost will be taken to be its market value as at 5 April 2017. This means that, where an asset has appreciated in value in the period up to 5 April 2017, the gain to that date will fall away and will never be subject to UK tax. The individual will only pay CGT on any subsequent increase in value.

(y) A rebasing relief election operates on an asset-by-asset basis, with the usual deadline of four years from the end of the relevant tax year (ie. the year in which the disposal took place). Once made, an election cannot be revoked.

(z) Cleansing of mixed funds

By virtue of Para 43 Sch 13 FB 2017, all non-UK domiciliaries who have claimed the remittance basis will, for a period of two years starting on 6 April 2017, be able to rearrange their bank accounts and separate the different component parts into:

(i) clean capital;

(ii) foreign income; and

(iii) foreign gains.

They can then make a tax-free remittance to the UK from their clean capital first. The existing mixed fund rules in S809R(4) ITA 2007 (which deem transfers from a mixed fund to be made in a certain order, depending on whether they are offshore transfers or remittances to the UK) are to be overridden on a temporary basis.

(aa) The key requirements for this relaxation are that:

(i) the transfer is a transfer of money made at any time during 2017/18 or 2018/19;

(ii) the transfer is made from an account which is a mixed fund (as defined in S809Q(6) ITA 2007);

(iii) the transfer is made into a different receiving account;

(iv) the transfer is nominated as a transfer for the purposes of these rules by the individual involved;

(v) at the time when the transfer is made, no other transfer had been so nominated from that mixed fund into the receiving account; and

(vi) the transfer is made by a 'qualifying individual', ie. an individual who has been taxed on the remittance basis in any tax year prior to 2017/18 and who is not an FDR.

(bb) Note that this relief does not apply to non-monetary assets such as a painting. Non-monetary assets do not qualify for cleansing. However, there is nothing to stop the individual from selling the painting during the two-year transitional window and separating out the sale proceeds in exactly the same way as he would do for other money.

(cc) Illustration 9

Maurice, a wealthy non-UK domiciliary who is now classified as a 'long-term resident', holds a substantial portfolio of foreign shares currently worth £2,000,000. This has been built up as follows:

(i) £1,000,000 of clean capital which he originally invested;

(ii) £500,000 of foreign income and gains which he subsequently added to the portfolio (eg. because shares were sold and the gains reinvested and because dividends were reinvested);

(iii) £100,000 which he inherited in 2016 (ie. clean capital) and added to the portfolio; and

(iv) £400,000 which represents his unrealised share gains.

If Maurice sells his share portfolio for £2,000,000 in 2017/18, any post-5 April 2017 element of the £400,000 gain will be taxed on him on an arising basis. But Maurice can then segregate the £400,000 realised on the sale, along with a further £1,100,000, and place the sum in a separate account. This will be treated as clean capital. It can be reinvested in anything which Maurice fancies (including UK shares) – any future income and gains will be taxed on Maurice on an arising basis. The remaining £500,000 (representing the foreign income and gains) should be moved to a separate account and should not be remitted. If and when it is reinvested, this should not be in UK shares, as this would constitute a remittance.

(dd) Conclusion

The important point to emphasise is that the magnitude of many of these changes is clear for all to see. Those who are going to become deemed domiciled and the trustees of non-UK resident trusts need urgently to review their position with specialist UK tax advisers. There are both pitfalls

and opportunities and the right advice is essential in determining what action should be taken.

21. **ATED in 2017**

(a) ATED is an annual tax payable by non-natural persons such as companies and corporate partnerships owning UK residential property valued at more than £500,000.

(b) The ATED chargeable period is linked to financial years, ie. it runs from 1 April in one year to 31 March in the next. The amount of tax charged is based on the value of the property on a particular date. The annual chargeable amounts are normally subject to indexation and, for the year to 31 March 2018, the relevant figures are:

Property value	£
More than £500,000 but not more than £1,000,000	3,500
More than £1,000,000 but not more than £2,000,000	7,050
More than £2,000,000 but not more than £5,000,000	23,550
More than £5,000,000 but not more than £10,000,000	54,950
More than £10,000,000 but not more than £20,000,000	110,100
More than £20,000,000	220,350

(c) The charge to ATED is handled by self-assessment, with owners needing to file a return each year based on an estimated value of their property. The ATED return is due on 30 April at the beginning of the relevant financial year. Any tax liability is also payable by the same date.

(d) In addition, a 28% ATED-related CGT charge applies to disposals of UK residential property where ATED has been payable at any time during the ownership period.

(e) There are a number of reliefs in relation to ATED and the ATED-related CGT charge for properties which:

(i) are let to a third party on a commercial basis (and are not occupied by anyone connected with the owner);

(ii) are being developed for resale by a property developer;

(iii) are used by a business to provide living accommodation for qualifying employees

and so on. These reliefs need to be claimed on an ATED Relief Declaration Return. Another important point is that charitable companies using a residential property for charitable purposes are exempt from the charge.

(f) The recent reductions in the valuation thresholds for ATED have brought a significant number of structures into the scope of the charge. Clients should be increasingly mindful of the requirement regularly to review their property holding arrangements in order to ensure that they are meeting all their tax compliance obligations.

22. **Corporation tax rates going forward**

(a) The rate of corporation tax for the financial year 2017 was set at 19% by S7(1) F(No2)A 2015. The profits of all companies – large, medium-sized and small – are nowadays taxed at the same rate.

(b) For the financial year 2020, the rate will fall to 17% (S46 FA 2016) – this replaces the 18% rate originally legislated in S7(2) F(No2)A 2015.

23. Another new capital allowance

(a) For expenditure incurred on or after 23 November 2016, Cl 52 FB 2017 has introduced a special 100% FYA for the cost of electric vehicle charging points. The charging point installed must be unused and cannot be second-hand. This short-term tax relief (see new S45EA CAA 2001) will run until 31 March 2019 (for corporation tax purposes) and until 5 April 2019 (for income tax purposes), but may be extended if HM Treasury see fit.

(b) The term 'electric vehicle' is defined as any road vehicle which is propelled by electrical power (whether or not it can also be propelled by another kind of power). And 'charging point' refers to a facility for charging such a vehicle.

(c) This capital allowance has been brought in for the purpose of supporting, in the words of HM Treasury, 'the development and installation of electric charge-point equipment' for electric vehicles in order to promote their wider uptake. It is intended to encourage the use of cleaner vehicles by making electric charging points a more common feature on the high street.

(d) The measure complements the 100% FYA for cars with low CO_2 emissions and for cars powered by natural gas, biogas or hydrogen.

(e) Detailed guidance on the operation of this relief will be published by HMRC later in the year.

24. **Company tax loss relief reform**

(a) In his Budget on 16 March 2016, the then Chancellor announced that there was to be a reform of the corporation tax rules governing the carry-forward of trading losses and certain other items with effect from 1 April 2017. This reform is of considerable significance to both single companies and groups.

(b) The losses included in this reform comprise:

(i) trading losses;

(ii) management expenses of investment companies;

(iii) non-trading loan relationship deficits;

(iv) UK property losses; and

(v) non-trading losses on intangible fixed assets.

The relevant legislation is found in Cl 29 and Sch 9 FB 2017. The main focus of these notes is on trading losses.

(c) The details of the Government's thinking were originally set out in a consultation document published in May 2016 which was entitled 'Reforms To Corporation Tax Loss Relief: Consultation On Delivery'.

(d) The Government say that this reform is in line with one of their key policy objectives, namely the 'modernising' of the tax system, in view of the fact that the existing rules on the carry-forward of company losses are 'not consistent with international best practice, overly restrictive and not reflective of the way in which businesses operate'.

(e) At the same time, the Government state that the absence of any restriction on the profits which can be relieved by carried forward losses can also have 'undesirable outcomes' for the Exchequer, in that businesses making substantial UK profits may not pay any corporation tax due to losses incurred from earlier activities. In response, one might argue that, however 'undesirable' this may be for the Exchequer, such a consequence is a perfectly logical one. The Government counter this line by pointing out that the majority of G7 countries have various forms of restriction in place for the carry-forward of losses.

(f) Considering the two main reforms, the first one is beneficial to the taxpayer, given that the new regime will allow greater flexibility in the way in which loss carry-forwards can be used. That is to say, trading losses, for example, no longer have to be carried forward against future profits from the same trade – they are able to be offset against other sources as well. On the other hand, the second one gives a cash flow advantage to the Government, in that the amount of losses being carried forward which can be utilised each year will, in some cases, be the subject of a restriction.

(g) Elaborating on the trading loss position in more detail, FB 2017 provides that:

(i) when corporate losses arise on or after 1 April 2017, they can be carried forward and set against other profits such as income from interest or property (alternatively, they can be surrendered to other group companies and set against their trading and non-trading profits); and

(ii) with effect from 1 April 2017, the amount of a company's profits which can be relieved by losses carried forward will be limited to a figure of 50%, subject to an annual allowance of £5,000,000 which will apply per company or per group (as the case may be).

The vast majority of businesses are going to be unaffected by the 50% restriction, given that it will only be the very largest companies or groups which have loss carry-forwards of more than £5,000,000.

(h) Note that relief for capital losses is completely unaffected by this reform.

(i) FB 2017 goes on to provide a comprehensive pro forma for the calculation of a company's trading loss position. The basic model works as follows:

(i) calculate the company's taxable profits after all reliefs (including in-year losses and group relief), but exclude:

– carried forward losses;

– carried back reliefs; and

– post-31 March 2017 carried forward losses to be claimed from other group companies;

(ii) allow up to £5,000,000 of these profits to be relieved in full by carried forward losses;

(iii) allow up to 50% of the remaining profits to be relieved by the remaining carried forward losses (note that pre-1 April 2017 losses do not have to be used in priority to later ones, as was originally going to be the case); and

(iv) if there are still profits which can be relieved within the 50% limit, allow them to be relieved by post-31 March 2017 carried forward losses which have been claimed from other group companies.

Carried back losses are *not* taken into account in calculating the amount of profits to which the 50% restriction applies. Instead, carry-back relief will be allowed and set against any profits which remain after this restriction has been applied.

(j) In relation to these new rules, there are three further matters which should be mentioned:

(i) A company is allowed to allocate in-year losses and group relief against its trading and non-trading profits as it sees fit. HMRC's initial proposal was that, where a company's profits were derived from both trading and non-trading sources, current year reliefs had

to be offset on a *pro rata* basis. The subsequent relaxation in FB 2017 is a welcome change.

(ii) In the case of a group of companies, the group will have absolute discretion as to how it should allocate its £5,000,000 limit between its members (and then within the chosen company or companies, between the different categories of profit). The meaning of the word 'group' for this purpose is based largely on the group relief definition.

(iii) Pre-1 April 2017 losses which are carried forward are always subject to the existing streaming rules, ie. they can only be carried forward against profits of the same trade.

(k) Illustration 10

Matthew Industries plc has total profits of £8,000,000 for the year ended 31 March 2019. This figure is made up of:

(i) trading profits amounting to £6,000,000; and

(ii) rental income and other non-trading profits amounting to £2,000,000.

The company has an in-year non-trading loan relationship deficit of £800,000.

Matthew Industries plc also has the following carry-forwards:

(i) pre-1 April 2017 trading losses of £10,000,000;

(ii) a pre-1 April 2017 non-trading loan relationship deficit of £600,000; and

(iii) a post-31 March 2017 UK property loss of £750,000.

Step 1

To begin with, calculate the amount of Matthew Industries plc's profit to which the 50% restriction will apply:

- The company's total profits for the accounting period, excluding any loss carry-forwards, are £8,000,000.
- The trading profits amount to £6,000,000 and the rental income and other non-trading profits are £2,000,000.
- The first relief is for the in-year non-trading loan relationship deficit of £800,000. This does not have to be offset on a *pro rata* basis, as was originally suggested – it can be deducted as the company sees fit. In this case, it is assumed that the non-trading loan relationship deficit is set against the rental income and other non-trading profits of £2,000,000, reducing this figure to £1,200,000.

- Matthew Industries plc, as a standalone company, is entitled to the full £5,000,000 allowance. It decides to allocate this entirely to its trading profits, meaning that, of the £10,000,000 trading loss carry-forward, one half has not been absorbed.

- The company's trading profits stand at £6,000,000 – £5,000,000 = £1,000,000. The rental income and other non-trading profits of £1,200,000 are not allocated any of the allowance.

Step 2

Allow up to 50% of the remaining profit to be relieved by losses carried forward, subject to the existing streaming rules:

- Matthew Industries plc's existing trading profits after Step 1 are £1,000,000. 50% of this comes to £500,000 and so the company can use a further £500,000 of its pre-1 April 2017 trading losses, reducing the loss carry-forward figure to £5,000,000 – £500,000 = £4,500,000. Remember that these losses, which predate 1 April 2017, cannot be set against any other sources of profit.

- The company's rental income and other non-trading profits after Step 1 stand at £1,200,000. 50% of this comes to £600,000. However, this is sufficient to absorb fully the pre-1 April 2017 non-trading loan relationship deficit of £600,000.

- The company has no capacity left within the 50% restriction to use any further losses. Thus no part of the post-31 March 2017 UK property loss of £750,000 can be utilised.

- Matthew Industries plc's remaining profits of £1,100,000 (£500,000 trading and £600,000 non-trading) will be subject to corporation tax at 19%.

- The company will carry forward the remaining pre-1 April 2017 trading losses of £4,500,000 and the post-31 March 2017 UK property loss of £750,000.

- In addition to the in-year non-trading loan relationship deficit of £800,000, the company has used £5,500,000 of its pre-1 April 2017 trading losses and all of its pre-1 April 2017 non-trading loan relationship deficit of £600,000.

(l) Finally, a number of other significant changes should be noted:

(i) On a cessation of trade, there is an improvement to the terminal loss relief rules in that brought forward losses can now be carried back and used – without the 50% restriction – against profits arising in the final 36 months of trading. This is subject to the proviso that they are not carried back to a period prior to 1 April 2017. Post-31 March 2017 losses in these circumstances can be set against the company's total profits, whereas the utilisation of any pre-1 April 2017 losses is restricted to profits of the same trade.

(ii) Another new constraint is being introduced to deal with the situation where a company's trade, having once flourished, has become small or negligible. Hitherto, such companies – other than on a change of ownership – have been able to continue to carry forward their accumulated trading losses, but the Government are concerned about the possibility of the trade being kept alive purely to enable the group to access its post-31 March 2017 losses. Accordingly, it is provided that the offset of any remaining trading losses in these circumstances should be limited to future profits from the same trade.

(iii) In order to counter what HMRC call 'loss buying', there is anti-avoidance legislation to the effect that, where a company suffers a major change in the nature or conduct of its trade within three years either side of a change of ownership, any unrelieved trading losses at the date of the ownership change are sterilised (see Ss673 and 674 CTA 2010). The Government are worried that, with the greater flexibility in the use of losses, the potential for 'loss buying' will increase. As a result, they have decided to widen the scope of these rules so that:

- the time period over which a major change in the acquired company's activities can occur goes up from three to five years; and

- on a change of ownership, any pre-acquisition losses in the acquired company cannot be group relieved for a period of five years.

25. **Corporate interest relief**

(a) On 22 October 2015, HM Treasury published a consultation paper on the Government's plans to restrict the tax-deductibility of corporate debt costs.

(b) The aim, according to HM Treasury, was to counter 'aggressive' tax avoidance, especially by large companies using cross-border debts to shift taxable profits between jurisdictions. Typically, this was achieved in one of three ways:

(i) by placing higher levels of third-party debt in high-tax countries;

(ii) by using intra-group loans to generate interest deductions which are higher than the group's actual third-party interest expense; or

(iii) by using third-party or intra-group financing to fund the generation of tax-exempt income.

(c) The idea for a restriction on debt relief was inspired by the OECD's Base Erosion Profit Shifting initiative. Most OECD countries allow interest expense to be deducted in calculating taxable business profits, but many jurisdictions also have rules to protect them against misuse. Hitherto, the UK has had two main protection mechanisms:

(i) The first is a transfer pricing provision which restricts tax relief for interest paid to an arm's length amount, although it should be noted that there is no check on whether the income or assets supporting that interest are themselves taxable.

(ii) The second is a 'large company' worldwide debt cap which acts as a backstop for excessive interest deductions.

There are also a number of TAARs to supplement the arm's length test referred to in (i) above.

(d) Despite this, the consultation paper admitted that 'significant planning opportunities can arise from both external and intra-group interest expenses'. Although a number of countries such as Australia, Germany, Italy, Japan and Spain currently have rules which provide what the consultation paper called 'a structural restriction on tax relief for interest expense', HM Treasury acknowledged that a general provision which restricted interest would represent a major change to the UK corporate tax regime, requiring 'careful consideration to ensure (that) any new rules work appropriately'.

(e) In his Budget last year, the previous Chancellor confirmed that the Government would be introducing legislation to limit the tax deductions which companies can claim for their interest expense. The rules, which are lengthy and complicated, can be found in Cl 31 and Sch 10 FB 2017. They take effect on 1 April 2017.

(f) The first point to appreciate is that there is a *de minimis* threshold which will allow all groups to deduct up to £2,000,000 of net interest expense in the UK per annum. Thus groups with an interest charge of £2,000,000 or less will be unaffected by the new regime.

(g) If a group's interest costs are greater than £2,000,000, a fixed ratio rule will restrict deductions for its net interest expense to 30% of the group's earnings before interest, taxes, depreciation and amortisation (EBITDA). In the UK, for 'depreciation' read 'capital allowances'.

(h) Alternatively, if a group ratio rule would produce a higher figure, it should be used. This is calculated as the ratio of the net interest expense for the worldwide group to the EBITDA for the worldwide group. Thus, if the net group interest expense is £3,600,000 and the group EBITDA comes to £8,000,000, the group ratio percentage is 45%. This will, however, be subject to a modified debt cap which is designed to ensure that the net interest deduction does not exceed the total net interest expense of the worldwide group.

(i) It should be noted that unrelieved interest can be carried forward.

26. **Substantial shareholding exemption (SSE)**

(a) An important exemption

Since FA 2002, many trading companies and groups have been able to obtain a capital gains exemption when selling their trading subsidiaries under the SSE. The somewhat unfortunate corollary is that no relief is available for capital losses arising on an SSE-qualifying disposal.

(b) For these purposes, 'substantial' means holding at least a 10% stake in the relevant company's ordinary share capital (plus other economic rights such as an entitlement to profits available for distribution). Thus, as well as disposals of trading subsidiaries, the SSE applies to sales of equity interests in joint ventures and other affiliated companies. There is no distinction drawn between disposals of a UK-resident company and an overseas company.

(c) The detailed rules are set out in Sch 7AC TCGA 1992. Hitherto, the main qualifying conditions for this relief have been the following:

(i) The investing company must be a sole trading company or a member of a trading group throughout a qualifying period which begins at the start of the relevant 12-month 'substantial shareholding' period (see (iii) below) and ends when the shareholding is sold.

(ii) Immediately after the disposal, the investing company must continue to be a trading company or a member of a trading group.

(iii) The relevant shareholding investment must qualify as a 'substantial shareholding' held in the investee company throughout a 12-month period starting no more than two years before the shares are disposed of. The purpose of this time limit was to allow subsequent disposals out of what was once a substantial shareholding to continue to qualify for exemption for a further 12 months, notwithstanding the fact that the 10% minimum threshold may no longer be satisfied.

(iv) The investee company must be a trading company or the holding company of a trading (sub-)group from the start of the 12-month 'substantial shareholding' period and ending with the disposal date.

(v) Immediately after the disposal, the investee company must be a trading company or a member of a trading group.

(vi) In practice, most disposals tended to meet the required conditions by reference to the 12 months immediately prior to the disposal date.

(d) The consultation last year

In 2016, the Government launched a consultation on a possible reform of the SSE. This followed discussions with stakeholders on the benefits to the competitiveness of the UK's tax regime in the event of a relaxation of some of the SSE's requirements. One of the areas considered was the

condition that both the company whose shares are being sold and the vending company/group had to be undertaking trading activities. It was pointed out that this stipulation has lessened the attractiveness of the UK as a holding company location, particularly for real estate investment which, for SSE purposes, is not generally regarded in this country as a trading operation.

(e) As a result, the Government have decided to proceed with several significant reforms in order to achieve their goal of making the SSE even more favourable – see Cl 39 FB 2017. These take effect for disposals made on or after 1 April 2017.

(f) Removal of investing company trading condition

As already mentioned, a serious cause of uncertainty in the existing rules is the requirement that the investing company is either a trading company or a member of a trading group. While it is normally reasonably straightforward to determine this status where the company making the disposal is not part of a group, this determination often has to be made in the context of what one commentator has called 'a large, complex and changing worldwide group of which the investing company is part'. The removal of this requirement by FB 2017 is therefore very welcome. Not only will it significantly reduce the compliance burden behind the judgment of whether an investing company meets the trading test, it will also simplify the regime itself. In addition, other restrictions such as the complications currently faced when a group disposes of its last trading subsidiary will disappear.

(g) Extension of 'substantial shareholding' period from two to six years

The original rules required the investing company to have held a shareholding of 10% or more of the ordinary share capital of the company whose shares are being sold for at least 12 months in the two years prior to the date of disposal. As illustrated in (c)(iii) above, this two-year requirement enabled an investing company to continue to qualify for SSE if it sold the shares in a fragmented fashion as long as, once the shareholding fell below 10%, the remaining shares were disposed of within a further 12 months.

(h) It is sometimes the case, particularly in a private equity exit scenario, that a disposal may have to be fragmented over a longer timescale, for example where the investing company's holding falls below 10% because the investee company is subject to an Initial Public Offering. By extending the period from two to six years, FB 2017 is seeking to alleviate this fragmentation problem.

(i) Removal of post-disposal investee company trading condition

Where the disposal is to an unconnected party, FB 2017 will no longer require the investee company to continue to be undertaking trading activities immediately after the disposal.

(j) Many share sales are undertaken under a contract where completion occurs some time after the contract has become unconditional (which is the point at which beneficial ownership of the shares is lost and the disposal is

made). In this situation, the investee company is presently required to meet the trading condition not just until the time of the contract becoming unconditional but – importantly – until after completion.

(k) In a third party sale, the vending company may not be in a position to determine with certainty the trading status of the company being sold and so the removal of this trading condition represents a welcome improvement in the SSE regime.

(l) Note that the trading requirement has been retained where the disposal is to a connected party, given that, in these circumstances, the investing company is likely to be able to influence whether the company invested in continues to trade.

(m) Broader exemption for companies owned by institutional investors

There were hopes that the Government might be persuaded to relax the rule that the company invested in had to be trading. This would be of particular benefit to organisations such as real estate funds and sovereign wealth funds which are involved in real estate investment as well as trading activities. These funds invariably carry a high level of liquid assets. As a result, they do not usually qualify for SSE treatment and so typically establish holding structures in other, ie. non-UK, jurisdictions.

(n) The broader exemption being introduced by Cl 40 FB 2017 goes some way towards meeting the needs of the funds sector. It specifies that a post-31 March 2017 gain on a substantial shareholding in any company (whether trading or not) will qualify for SSE relief where, immediately before the disposal, at least 80% of the disposing company's ordinary share capital is owned directly or indirectly by 'qualifying institutional investors', eg. life assurance companies, sovereign wealth funds or investment trusts.

27. **Transactions in UK land**

(a) The UK's tax system previously charged non-UK resident companies to corporation tax on their profits from a trade carried on through a permanent establishment. The income tax rules operated on broadly similar lines.

(b) In an attempt to ensure a level playing field between UK developers and those based in offshore jurisdictions, legislation introduced in Ss76 – 82 FA 2016 brought non-UK resident developers of UK property fully into UK tax on any profits arising from dealing in or developing land in the UK.

(c) The FA 2016 provisions excluded profits arising from contracts entered into before the relevant commencement date (5 July 2016). This was intended to ensure that the standard type of property contract (if made before 5 July 2016), ie. where the sale was committed on contract and the transfer which gave rise to the profit took place shortly afterwards, was not caught. However, the Government subsequently realised that some contracts were being entered into a long time before the transfer of the property and the recognition of the profit. It was never their intention to allow profits to escape a charge if they arose several months or even years after the contract was agreed.

(d) Cl 53 FB 2017 therefore changes the commencement date so that all profits recognised in the accounts on or after 8 March 2017 under generally accepted accounting practice are taxed, regardless of the date when the contract was signed.

28. **Enablers – the new pariahs**

(a) Cl 125 and Sch 27 FB 2017 introduce an important new penalty regime aimed at 'enablers' of defeated tax avoidance schemes. The legislation is targeting any person who 'enables' the use of what are referred to as 'abusive tax arrangements'.

(b) An enabler is defined as someone who satisfies any of the following tests, ie. he was:

(i) a designer of the arrangements;

(ii) a manager of the arrangements;

(iii) a person who marketed the arrangements;

(iv) an enabling participant in the arrangements (broadly, someone whose involvement was essential to their success); or

(v) a financial enabler in relation to the arrangements (broadly, someone who provided a financial product which allowed the taxpayer to participate in the arrangements).

These descriptions are all explained in more detail in the legislation.

(c) Tax planning is deemed to be 'abusive' for the purposes of FB 2017 if it represents arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances. This is nowadays referred to as a 'double reasonableness test'.

(d) Arrangements are held to have been 'defeated' when a final adjustment has been made to counteract all or any part of the intended tax advantage. In other words, the resulting tax charge can no longer be varied, on appeal or otherwise.

(e) The penalty charged in these circumstances is equal to the fee received by the enabler for his involvement with the defeated tax avoidance arrangements. Where a fee covers two or more transactions, it must be apportioned on a just and reasonable basis. Where the arrangements were entered into by multiple users, a penalty can only be levied if more than 50% of the arrangements have been defeated. Before any penalty is issued, HMRC must take account of any opinion given by the GAAR Advisory Panel in respect of the arrangements. Any penalty notice is appealable and the Court (or Tribunal) must also take account of any opinion given by the GAAR Advisory Panel and *may* consider the effect of guidance, statements and other material which was in the public domain, together with any evidence of established practice, at the relevant time.

(f) The penalty will apply to steps taken by an enabler in relation to arrangements entered into on or after the date of Royal Assent.

(g) The enablers' penalty is a key development in HMRC's war against what they see as artificial tax planning. And tax advisers are clearly in their sights. However, at the time when the original draft legislation was

published (5 December 2016), HMRC stated that advisers acting wholly within the spirit of the updated 'Professional Conduct In Relation To Taxation' (PCRT) would not normally be affected by this new code. HMRC will be publishing guidance on the penalty provision later this year and it is expected that they will reaffirm their statement that compliance with PCRT should take professional advisers outside the scope of the regime.

29. **Appendix**

A problem with 2016/17 tax returns

(a) It is well known that, for many years, an individual's personal allowance, together with any other deductions which go against his general income (eg. losses), were offset in a particular sequence. This sequence was:

(i) against non-savings income; then

(ii) against interest; and finally

(iii) against dividends.

This followed from S25(2) ITA 2007 which states that reliefs and allowances should be deducted 'in the way which will result in the greatest reduction in the taxpayer's liability to income tax'.

(b) However, the introduction of both the personal savings allowance and the dividend tax allowance in FA 2016 has significantly complicated the position for 2016/17 onwards.

(c) The personal savings allowance, which is effectively a form of nil rate band, stands at £1,000 for taxpayers who have no income subject to higher rate tax (or the dividend equivalent). In other words, the first £1,000 of interest received by such an individual is tax-free. An additional difficulty is the interaction of all this with the 0% starting rate band for savings income which has been £5,000 since 2015/16. It should be remembered that this 0% starting rate is only in point for recipients of interest whose non-savings income does not exceed their personal allowance plus a maximum of £5,000.

(d) The dividend tax allowance, which is another nil rate band, has been set at £5,000, but, unlike the personal savings allowance, it applies to all individuals in receipt of dividend income, regardless of their marginal tax rate.

(e) As a result, the order of set-off referred to in (a) above no longer holds good for some combinations of income, given the basic prerequisite that deductions must always be made in the most favourable way for the taxpayer. An illustration of this situation follows.

(f) Illustration 11

William has three sources of income for 2016/17:

	£
Business profits	5,400
Interest from gilt-edged securities	6,800
UK dividends	9,800

On the assumption that William's personal allowance of £11,000 is set first against his business profits and then against his interest, the income tax position is:

	£
Business profits	5,400
Less: PA (part)	5,400
	£Nil

	£
Interest	6,800
Less: PA (balance)	5,600
	£1,200

Given that no part of William's non-savings income is taxable, he is entitled to the 0% starting rate of up to £5,000 on his interest. In this case, all his remaining interest of £1,200 is therefore zero-rated.

William's dividend income of £9,800 is covered by his £5,000 dividend tax allowance, leaving £4,800 in the charge to tax at the dividend ordinary rate of 7.5%. This gives rise to a total income tax liability for 2016/17 of:

4,800 @ 7.5%	£360

However, this calculation does not produce the greatest reduction in William's liability to income tax. If, as an alternative, the personal allowance is set against his earned income (as before), but then only partly against the interest and partly against the dividends in order to maximise the benefit of:

(i) the 0% starting rate for savings income; and

(ii) the personal savings allowance,

William's tax position changes. His business profits are still tax-free, but, instead of using the balance of the personal allowance against William's gilt-edged interest, only £800 of the personal allowance is set against the interest. Thus:

	£
Interest	6,800
Less: PA (part)	800
	£6,000

This balance is then extinguished by a combination of the £5,000 0% starting rate and the personal savings allowance of £1,000.

William's dividend position is:

	£
Dividends	9,800
Less: PA (balance)	4,800
	£5,000

The remaining dividend income is covered by William's dividend tax allowance, leaving a nil income tax liability. This procedure has saved William a tax charge of £360.

(g) Unfortunately, the waters involving interest and dividends now become even murkier. For two groups of taxpayer, HMRC's online filing parameters (which all tax software providers must follow) are such that individuals falling into either of the categories in (h) below will be overcharged by up to £1,000 if their returns are filed online. The only solution for 2016/17 is that paper returns should be submitted. It is understood that this issue will be fixed for 2017/18.

(h) The taxpayers affected by this anomaly are:

(i) individuals with an income of over £32,000 made up from savings and non-savings sources of which the non-savings income is between £11,000 and £16,000 (Illustration 12); and

(ii) individuals with non-dividend income of between £27,000 and £32,000 which, together with dividends, takes their total income to more than £145,000 (Illustration 13).

(i) Illustration 12

For 2016/17, Gareth is in receipt of a state retirement pension of £11,000, together with bank and building society interest amounting to £27,000.

As usual, his personal allowance is set against his pension. Thus:

	£
Pension	11,000
Less: PA	11,000
	£Nil

Because Gareth's non-savings income does not exceed £11,000, he is entitled to take advantage of both the full 0% starting rate band of £5,000 and the £1,000 personal savings allowance. His taxable savings income is therefore £27,000 – £5,000 – £1,000 = £21,000. This is charged at 20%:

21,000 @ 20%	£4,200

However, in this case, the tax software will not apply the savings starting rate which means that there will be a charge of 20% (rather than 0%) on the income falling within the starting rate band. In other words, the HMRC calculation will show Gareth as owing tax of £5,200. This represents an

overpayment of £5,200 – £4,200 = £1,000 for 2016/17. In addition, there will be an adverse knock-on effect on his payments on account for 2017/18.

Thus Gareth must send in a paper return and this would conventionally have to be done by 31 October 2017. HMRC have, however, indicated that, in these circumstances, a return can be filed at any time up to 31 January 2018 without attracting the £100 late filing penalty, given that the taxpayer will have a reasonable excuse for the late submission. Notice that, if the return is inadvertently filed online, it will not be possible to amend the return online and resubmit it, as would normally be the case. This is because the tax software thinks that the filed return is in fact correct. A paper amendment must instead be sent to HMRC, supported by a tax calculation, with a covering letter explaining exactly what has happened.

(j) Illustration 13

In 2016/17, Charles has earnings of £28,000 and dividends amounting to £130,000.

Because of the level of Charles' income, he is not entitled to a personal allowance for this tax year. Therefore, his non-savings income is considered first. This income uses up £28,000 from the 20% basic rate band. Charles' dividends will therefore be taxed as follows:

	£
4,000 @ 0%	–
1,000 @ 0%	–
117,000 @ 32.5%	38,025
8,000 @ 38.1%	3,048
	£41,073

This tax must be added to the £5,600 charge on Charles' earnings, making a total of £5,600 + £41,073 = £46,673.

Unfortunately, in order to calculate tax on the dividends, the software for 2016/17 will treat the higher rate band between £32,000 and £150,000 as reduced by the full amount of the dividend tax allowance, whereas the correct reduction in this instance is £1,000. This pushes more dividends up into the 38.1% bracket. The tax on Charles' dividends will be wrongly computed as:

	£
113,000 @ 32.5%	36,725
12,000 @ 38.1%	4,572
	£41,297

Charles has been overcharged by the sum of £41,297 – £41,073 = £224. It will also be necessary for Charles to submit a paper return.

(k) It is important to appreciate that this state of affairs is not the fault of the tax software providers. Their software has to follow HMRC's parameters

because, if it does not, none of their online tax returns will be accepted. Sadly, they had no choice but to code their products to give an incorrect outcome.

.