BUDGET BRIEFING

October 2018

A Spin Of The Wheel?

The Chancellor delivered the first Monday Budget since 1962. Furthermore, in a move which can only have been motivated by a wish to inconvenience those responsible for the preparation of their Firms' Budget releases, he started his speech much later than usual at 3.30pm.

The 'end of austerity', we were told, is upon us at last. The Chancellor clearly felt obliged to give us some evidence of this by committing to more spending than had been anticipated. The massive pledge of £20.5 billion extra NHS spending per year was supplemented by further pledges on defence, counter-terrorism, Universal Credit, roads, housing and even trees. One of the reasons he was able to do this was that borrowing had come in £11.6 billion less than had been forecast in Spring, partly due to underspends on other projects and partly due to tax receipts having proved more robust than had been expected. But how realistic is it to suppose that the spending commitments can be met without specific measures being taken?

The figures provided to back up the spending make it only too apparent that the Chancellor is assuming that tax receipts will rise as the economy grows, without any requirement for specific tax raising measures. The assumed growth in the economy is based on the Office for Budget Responsibility's forecast of 1.5% per year. These forecasts are subject to very clear caveats on the part of the OBR, and in particular the fact that they have been estimated on the assumption that Brexit negotiations will lead to an orderly transition to a new long-term relationship.

'When concrete agreement on the relationship between the UK and EU is reached, we will adjust our Brexit assumptions as necessary.'

In other words, if we get a bad Brexit, the OBR will need to downgrade its growth forecasts, which will in turn invalidate the assumptions about tax receipts. This would mean that the receipts would not match the spending commitments, which will then require the shortfall to be funded by significant tax increases or additional borrowing. So it seems that the Chancellor has spun the wheel, gambling on a favourable Brexit deal to meet the cost of the massive pledges on spending. The UK economy is presently growing at approximately half the speed of the Eurozone, and is further behind against the US economy. These Budget figures require a significant investment of optimism.

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RAWLINSON & HUNTER

For the tax enthusiast, there were a couple of headlines but as usual there was a lot buried in the detail. Some of the points to highlight include:

- The introduction of a Digital Services Tax ('Google Tax') from April 2020, targeted at profitable businesses with worldwide digital revenues in excess of £500m.
- Further tinkering with SDLT, including the possible introduction of a 1% surcharge imposed on non-resident buyers of residential property in England and Northern Ireland.
- The acceleration by one year of the increase in the personal allowance to £12,500 and the higher rate tax threshold to £50,000.
- Curtailing the use of personal service companies ('IR35') in the private sector by moving responsibility to the payer or agency for applying payroll taxes. This follows successful implementation of the same rules in the public sector. This will take effect from April 2020.
- Changes to certain aspects of Capital Gains Tax, including the qualification rules and ownership period for Entrepreneurs' Relief and aspects of the Principal Private Residence Relief.

The above points and some of the other changes of note announced in the Budget are commented upon in more depth in the main body of this Briefing.

The real test of how balanced this Budget is will come when it is known what shape Brexit will eventually take. A lot of today's generous spending announcements are predicated on the achievement of a favourable outcome to the negotiations with our EU neighbours, which seems at this point to be something of a gamble…..

A. Personal Taxation

Rates and Allowances

The government's previously stated intention was to raise the personal allowance to £12,500 and the higher rate threshold to £50,000 by April 2020. However, in the 2018 Budget the Chancellor was able to fulfil this commitment one year earlier with the changes instead taking effect from 6 April 2019. It has also been confirmed that these thresholds will remain at the same level for the year ending 5 April 2021.

The basic rate threshold will increase from £34,500 in the current tax year to £37,500 for the two years ending 5 April 2021. The additional rate threshold of Income Tax is unchanged at £150,000 for 2019/20.

Good news was provided by the absence of changes to the pension tax reliefs which pre-Budget speculation had suggested may be reduced in order to fund previously announced increases to government spending. In the event, the only pension change was a relatively minor increase in the lifetime allowance for pension savings to £1,055,000 for 2019/20.

The existing £20,000 ISA allowance for adults is unchanged for 2019/20 and the subscription limit for Junior ISAs is to increase to £4,368 for 2019/20.

The annual exempt amount for Capital Gains Tax for 2019/20 will be £12,000 (an increase of £300 from the previous year).

Entrepreneurs' Relief

Entrepreneurs' Relief enables individuals selling certain business assets and shareholdings to benefit from a 10% Capital Gains Tax rate on a lifetime amount of capital gains of £10 million. It was introduced in April 2008 with the idea that only true entrepreneurs would benefit from the relief. However, due to the wide encompassing rules, the relief attracted use from a much larger group of people than originally intended.

Since its introduction, there have been a number of changes to the applicability of the relief to help close some of the loopholes in the system. However, according to some, the relief continues to be 'misused'. In 2017/18 HMRC estimated that the relief cost £2.7 billion in lost taxes. Whilst this figure does not take into account all other taxes that entrepreneurs pay when setting up their business in the UK, there were calls made to the government to scrap the

relief entirely.

The Chancellor, however, recognises that withdrawing the relief completely would discourage entrepreneurs from setting up businesses in the UK, and with the UK ‘being open for business’ this would be hugely detrimental to the UK economy.

Following the Spring 2018 consultation, the Chancellor announced two changes to the application of Entrepreneurs’ Relief, making qualifying for the relief stricter. The two changes announced are:

1) From 6 April 2019, the minimum qualifying ownership period will be extended from 12 months to 24 months.

   With this change, the government expects to generate an extra £5m in tax revenue in 2019/20 rising to an additional £90m in 2023/24.

2) From 29 October 2018 shareholders must be entitled to at least 5% of the distributable profits and net assets available for distribution upon winding up, as well as the share capital and voting rights, in order to qualify for the relief.

   This change is expected to generate an extra £5m in tax revenue in 2019/20 rising to £15m in 2023/24.

Given that the second change is effective now, anyone potentially affected by it who was planning to rely on Entrepreneurs’ Relief in the immediate future will now need to review their deal and either amend it or factor in a higher tax cost.

Whilst these changes may have been unexpected by some, the government believe that they will not impact on 95% of those individuals who claim the relief. However, some commentators have warned that these changes could have effects on employees who have share options and later become shareholders in the business.

These changes show that care will need to be taken by individuals who were looking to rely on Entrepreneurs’ Relief.

Main Residence Exemption for Capital Gains Tax

Lettings Relief

The main residence exemption that applies on the disposal of a taxpayer’s only or main home is a familiar concept to most. Where a property has only been the taxpayer’s only or main home for part of the period of ownership but the property has been let, the tax relief is reduced resulting in part of the gain being chargeable to Capital Gains Tax. However, there is currently a separate ‘Lettings Relief’ available which further exempts a proportion of the gain. This provides for a valuable additional tax relief albeit restricted to the lower of the amount of main residence relief available in respect of the period of letting and £40,000.

The government has announced its intention to reform ‘Lettings Relief’ so that it will only apply in circumstances where the owner of the property is in shared occupancy with the tenant. Currently, the relief applies to any property which has been the taxpayer’s only or main home at any time and has been let without the owner being in occupation. The change will take effect from April 2020.

Final Period Exemption

In a move designed to further restrict the exemption available on property gains, it was announced that owners will only be allowed a grace period of 9 months in which to sell their former main home in order for the gain to be completely exempt from tax. The grace period currently extends to 18 months although this was as long as 36 months for disposals before 6 April 2014. Arguably, the ‘old’ 36 month period was overly generous but the proposed 9 month grace period is quite short and may well result in a number of property disposals coming within the charge to Capital Gains Tax.

There is no change proposed to the existing 36 month final period exemption available to disabled people or to those in a care home.

The government is to consult on both of these changes.

Income Tax: Rent-a-Room Relief - Shared Occupancy Test

Rent-a-room relief provides Income Tax relief for those letting out furnished accommodation. It was introduced to encourage individuals to make spare capacity in their homes available for rent, with the aim of increasing the quantity and variety of low-cost rented accommodation. The relief gives an exemption from Income Tax on profits of up to

£7,500 p.a. (per person).

The Autumn 2017 Budget suggested that legislation would be introduced in Finance Bill 2018-19 to provide an additional test of 'shared occupancy' that would have to be met in order for a taxpayer to be eligible for rent-a-room relief.

The proposed 'shared occupancy' test would have provided that the individual, or a member of their household, in receipt of income must have a 'shared occupancy' (a physical presence for all or part of the period of the rental), with the individual whose occupation of the furnished accommodation is generating receipts.

The perceived intention was to deny relief to those who let their main residence for a short period of time when demand is high (such as Wimbledon Tennis Championships fortnight) so that relief is only available to those who let rooms to tenants on a long term basis.

However, following consultation on draft legislation, to maintain the simplicity of the system, the government has confirmed that it will not include legislation for the 'shared occupancy test' in Finance Bill 2018-19.

Inheritance Tax

Readers may recall that the 2015 Budget introduced a new residence nil rate band, available from 6 April 2017. It is an additional nil rate band available when a residence is passed on death to a direct descendant. Children, step children, adopted children and foster children, and their lineal descendants, are included in the definition of direct descendant, together with spouses and civil partners. The amount of residence nil rate band Is currently £125,000, rising to £150,000 from 6 April 2019 and £175,000 from 6 April 2020. The residence nil rate band is tapered away for estates with a net value of more than £2 million.

The residence nil rate band is also available when a person downsizes or ceases to own a home on or after 8 July 2015 and assets are passed on death to direct descendants. A downsizing addition of nil rate band amount is allowed, subject to certain conditions. The downsizing addition is limited by reference to the proportion of value inherited by direct descendants.

Any unused residence nil rate band can be transferred to a surviving spouse or civil partner.

The principle of allowing at least part of the value of the family home to pass tax free to younger generations is commendable, but the legislation is complex.

Two technical changes to the legislation were announced in Budget 2018.

Firstly, any part of a residence that is inherited by an exempt beneficiary will be taken into account in calculating the downsizing addition.

Secondly, where a residence forms part of a person's estate because of a gift with reservation of benefit, (that is, a gift in which the donor retained an interest) the residence will only be treated as inherited by a direct descendant if the property became immediately comprised in the direct descendant's estate as a result of the original gift.

The operation of this relief is highly complex, as will be understood from the above, and specific advice should be sought.

B. Employment and Self-Employment Taxes

Off-payroll working in the private sector

In the 2016 Budget, the government announced that it would introduce legislation intended to apply to workers who provide services to public sector organisations through intermediary companies, and this legislation was enacted in April 2017. It has now been announced that similar legislation will be introduced, to apply to workers who provide services via intermediaries to organisations in the private sector.

The 2017 rules were introduced to combat widespread non-compliance with the IR35 rules (or 'off-payroll working rules') that were introduced in 2000. Under the IR35 rules, a worker who provides services to an organisation through an intermediary, and who would have been treated as an employee if they had provided the same services to the organisation directly, would have to pay virtually the same amount of Income tax and NIC as they would have done had the organisation actually employed them directly.

Since the introduction of the new rules in April 2017, the responsibility for assessing the worker's position has shifted from the worker themselves to the public sector end user. Accordingly, public sector bodies who offer work to individuals who provide services through an intermediary are required to decide whether that individual would be treated as their employee but for the existence of the intermediary. The worker is required to provide information to the public sector organisation to help them reach their decision. If the off-payroll working rules apply, the public sector organisation responsible for paying the intermediary must deduct tax and National Insurance (NI) from the payments they make, make the appropriate employer NI payments, and report the taxes deducted to HMRC through Real Time Information (RTI).

Right from the point at which the new legislation was introduced, it has been thought that the extension of the off-payroll working rules beyond the public sector to the private sector would only be a matter of time, and a consultation on precisely such an extension was held over the summer this year. Today's announcement confirms that the off-payroll working rules will be introduced to large and medium sized businesses in the private sector with effect from April 2020. Small business will be exempt from these provisions. Individuals who work for small businesses in the private sector through intermediaries will therefore continue, at least for the short term, to self-assess their position and decide whether IR35 applies to them. However, an extension of these provisions to smaller businesses in future certainly cannot be ruled out

Employment Allowance reform

The National Insurance (NI) Employment Allowance was introduced in April 2014. The measure was intended to support growth for businesses and charities by reducing the cost to them of taking on employees. The Employment Allowance originally reduced the employer NI bill for business and charities by up to £2,000 but the reduction increased to £3,000 with effect from April 2016.

The Chancellor today announced that access to the Employment Allowance will be limited to businesses and charities who have an employer NI bill of less than £100,000 per annum. The aim of this measure is to ensure that the support is targeted at smaller businesses which need help the most, and it is estimated that over 90% of the businesses who currently benefit from the Employment Allowance will continue to receive it.

The changes will take effect from April 2020.

National Insurance Contributions Bill

The Chancellor re-confirmed today that, as previously announced last month, the government has decided not to abolish Class 2 National Insurance Contributions (NICs). The abolition of Class 2 NICs was originally announced as part of a series of proposals that were set out in a draft NICs Bill published in December 2016.

However, the government still intends to implement two of the reforms that were originally put forward in the December 2016 NICs Bill.

The first of these is the reform of the taxation of certain types of termination payments to which NICs do not currently apply. Under the new proposals, termination payments in excess of £30,000 which are subject to Income Tax will also be subject to employer NICs.

It is also intended that employee and employer NICs will be applied to all income from sporting testimonials, unless the testimonial events are neither contractual nor customary. A £100,000 exemption will apply to non-contractual and non-customary one-off testimonials, or events in a single testimonial year. Where NICs are required to be paid, the independent testimonial committee organising the event or testimonial season will be required to operate the employer and employee NICs in respect of any taxable amounts paid.

It is intended that legislation to implement these measures will take effect from April 2020.

C. Trusts and Charities Taxation

Trusts Consultation

The government reaffirmed their commitment to publishing their much anticipated consultation document on the taxation of trusts. Originally announced in the Autumn 2017 Budget, the government are seeking to make the taxation of trusts simpler, fairer and more transparent. It was announced in 2017 that the consultation would be published in

2018 so it remains to be seen whether this will be pushed back to 2019 as no mention of timing was made in today's announcement.

It should, perhaps, also be noted that a number of consultation papers regarding the taxation of both UK and offshore trusts have been published, only to be discarded, in recent years. Most private client advisers would welcome a more straightforward and transparent taxation regime for trusts and we look forward to its publication in due course.

Additions to Trusts

It was announced in the Budget that legislation will be introduced in Finance Bill 2019-20 to reflect 'HMRC's established legal position' on the Inheritance Tax treatment of additions to existing trusts. It is uncertain precisely which circumstances are to be affected, but it seems to be targeted at additions of assets to existing trusts by UK domiciled persons (or foreign domiciled but 'deemed domiciled' persons) who were not UK domiciled when the trusts were established. The new law will clarify that the additions will not be treated as exempt excluded property unless additional tests are satisfied. The provisions will have effect for IHT charging events which occur after the date on which Finance Bill 2019-20 receives Royal Assent, whether or not the additions were made before or after that date.

There has for some time been uncertainty as to the status of assets held on excluded property trusts (created by foreign domiciled settlors) which are subsequently transferred to new trusts or other pre-existing trusts, when the transfer occurs at a time when the settlor has become UK domiciled or deemed domiciled. HMRC suffered a reversal in the Court of Appeal in the case Barclays Wealth Trustees (Jersey) and another v Revenue and Customs Commissioners in 2017, and it seems likely that whatever is now proposed is intended to reverse the implications of that decision. However, it is not currently clear what the new provisions will apply to. Until it is clear, trustees should be extremely wary of exercising a power of appointment or advancement to transfer settled assets which are presently exempt excluded property to another trust, whether new or in existence before the settlor became UK domiciled or deemed domiciled.

Charity Taxes

The government have announced a number of measures in recent years to simplify the administrative burden on charities and have continued this theme in today's budget. Amongst the measures announced to take effect from 6 April 2019 are:-

- An increase in the small trading tax exemption limits

  Income from trading activities that are part of the charity's primary purpose is exempt from tax. Income from all other trading activities is exempt from tax only if it falls below certain limits, known as the small trading tax exemption.

  The government today announced an increase in these limits from £5,000 to £8,000 (where the charity's total turnover is under £20,000) and from £50,000 to £80,000 (where the charity's total turnover exceeds £200,000).

  If these limits are exceeded, the entire amount of non-primary purpose trading income is taxable.

- An increase in the individual donation limit under the Gift Aid Small Donations Scheme

  As it is often impractical for small charities that receive cash donations to obtain a Gift Aid declaration from every donor, Gift Aid may be claimed on cash donations up to £20 made by any individual without obtaining a Gift Aid declaration. In today's budget it was announced this limit will increase to £30 from 6 April 2019.

  The overall maximum donations limit of £8,000 per tax year which a charity can claim under this scheme will continue to apply.

- A relaxation in the frequency with which letters must be sent to donors under the Retail Gift Aid Scheme

  Under the Retail Gift Aid Scheme, charities may claim Gift Aid on goods donated by individuals for sale in their retail outlets. Under the scheme, the charity must write to the donor annually to inform them of the proceeds raised from the sale of goods they have donated.

  This requirement was relaxed in today's budget for those donors whose goods raise less than £20 per year. From 6 April 2019, the charity will be required only to write a letter to inform the donor every three years.

Whilst these changes will be welcomed, their impact is unlikely to be significant. In the policy paper for the first of these measures, it is stated that it will have an impact on around 50 charities. The second measure should, perhaps, have been coupled with an increase to the overall donations limit of £8,000 and the third measure could make it more onerous for charities to keep a track of donors to whom it applies.

D. Stamp Duty Land Tax

Some minor, but nonetheless welcome, changes to SDLT were announced:

For first-time home buyers, the relief available for purchases of property up to £500,000 is extended from 29 October 2018 to include purchases through shared ownership schemes where the buyer did not elect to pay SDLT on the market value of the property, but instead paid SDLT in stages through a 'staircasing' arrangement. In addition, perhaps to forestall criticism from those who bought properties under such arrangements only a short time before the introduction of the relief, those who have purchased eligible properties since 22 November 2017 will be able to obtain relief retrospectively.

Again, perhaps responding to industry criticism, the window of opportunity for claiming back the 3% SDLT surcharge paid on a new home where the former home had not been sold at the date of purchase has been extended. Previously, if the sale of the former home took place more than 12 months after the new home was purchased, the buyer only had 3 months to reclaim the 3% surcharge. This has now been extended to 12 months for sales of former homes taking place on or after 29 October 2019. This is a sensible extension, as the 3 month period may have inadvertently been missed.

Finally, the government is to consult on the introduction of a further 1% SDLT surcharge for non-residents buying residential property in England and Northern Ireland.

Despite the additional reliefs announced, the UK continues to have one of the highest and most complex property tax regimes in the world.

E. Property Taxes

Corporation Tax: UK property income of non-UK resident companies

Under the current law that applies to the UK property business income of a non-UK resident company, profits are subject to Income Tax. However, as announced in the Autumn 2017 Budget, the 2018 Budget has confirmed that income received from UK property by non-UK resident companies will be chargeable to Corporation Tax rather than Income Tax from April 2020.

This measure will deliver more equal tax treatment for UK and non-UK resident companies in receipt of similar income, and take steps to stop those who have been trying to use this difference to reduce their tax bill on UK property through offshore ownership. In many circumstances, the change will increase the UK tax arising on property income received by non-resident companies due to the restrictions on interest deductions and loss relief under the Corporation Tax rules.

As a result of extending the scope of Corporation Tax to a non-UK resident company that carries on a UK property business, a number of supplementary and consequential amendments are made to the tax provisions.

For example, as part of these changes, a non-UK resident company will not have a disposal event for capital allowances purposes and will not need to notify its chargeability to Corporation Tax in cases where its only UK income source is its UK property business, provided that UK tax deducted at source from its rental income fully satisfies its liability to Corporation Tax on the profits of that business.

There are also a number of transitional provisions, the most relevant being that a non-UK resident company can carry forward any existing Income Tax losses to be offset against future UK property business profits chargeable to Corporation Tax.

The government confirmed that the issue of filing of tax returns by non-UK resident companies that invest in UK

property only through large transparent collective investment funds, and the reporting obligations of those funds, remains under discussion.

Extension of UK Capital Gains Tax and UK Corporation Tax to non-residents on non-residential UK property and indirectly held property

Non-UK resident persons, including individuals, companies and Trusts, are currently subject to UK Capital Gains Tax on disposals of directly held interests in UK residential properties. However, the government announced in last year's Budget that, from 6 April 2019, UK Capital Gains Tax and Corporation Tax would be extended to non-UK residents who dispose of all types of UK immovable property. Following a period of public consultation which ended in February 2018, the final legislation has now been published to be included in Finance Bill 2018-19 and will take effect as planned for disposals occurring on or after 6 April 2019.

The new rules will apply to non-resident individuals, trusts or companies who make direct or "indirect" disposals of UK land, not just of UK residential property. The extension of the rules will tax non-residents on gains realised on direct holdings of all types of UK property, as well as on indirect interests -i.e. selling shares in a company that derives 75% or more of its value from UK land. The new tax rules are expected to raise only as much as £105m additional revenue for the Exchequer by 2023/24, a small part of the overall Capital Gains Tax revenue.

ATED-related Capital Gains Tax, which can currently apply in addition to the charge on residential property, will be abolished from 6 April 2019.

Non-resident companies will be able to claim relief for losses arising on direct or indirect UK land interests, subject to the normal Corporation Tax rules for loss relief.

Similarly, for individuals and trusts, Capital Gains Tax losses on UK land will be available and can be claimed in accordance with existing rules for non-resident Capital Gains Tax losses.

As previously announced, the tax payer may elect to calculate the gain or loss on a disposal using either the original acquisition cost of the asset or using the value of the asset at commencement of the rules in April 2019, i.e. providing a "rebasing" of the asset at the date of commencement of the new regime. It has been confirmed that both calculation options will be available for both direct and indirect disposals. However, where opting for the original cost basis for an indirect disposal, any loss arising will not be allowable.

It has been clarified that the indirect disposal rules will apply where a person makes a disposal of an entity that derives 75% or more of its gross asset value from UK land. Where a number of entities are disposed of in one arrangement, their assets and those of subsidiaries will be aggregated to establish whether the test is met.

There is relief for minority investors (those who, together with connected persons, hold less than a 25% interest), who will be exempt from the charge. However, that 25% interest test applies both at the date of disposal and for the two years prior to disposal.

This exemption will not however be available for non-residents investing in "UK property rich" collective investment vehicles.

Collective Investment Schemes and Alternative Investment Funds will be treated as if they were companies and so chargeable to Corporation Tax. The legislation also brings within the charge for the first time disposals of interests in residential property held by diversely held companies, widely held funds not previously included, and life assurance companies. A further Technical Note is expected to be published on 7 November 2018 containing further rules applicable specifically to funds.

On the one hand, there will be commercial exemptions such as a trading exemption where a property rich entity is trading before and after the disposal and the land is used in the trade. This is intended to apply in scenarios where, for example, a non-UK resident disposes of shares in a retailer which owns a significant retail property portfolio.

On the other hand, strong anti-avoidance measures will be enforced to preserve existing anti-avoidance rules for capital gains together with the creation of new specific anti-avoidance rules to counteract abuse of the indirect disposal provisions. Anti-avoidance measures which were introduced in Autumn Budget 2017 to target arrangements relying on

provisions in Double Tax Treaties in order to escape the UK tax charge on non-UK residents will be written explicitly into the new legislation. There will also be provisions to enforce the charge to tax against UK resident companies in the same group as a non-UK resident company which defaults on its obligations.

F. Anti-Avoidance

The government's attempt to tackle offshore tax avoidance and evasion continues apace. The government has stated that since 2010 it has secured and protected over £185 billion of tax that would otherwise have gone unpaid and introduced over 100 measures to crack down further on avoidance, evasion, aggressive tax planning and what it terms 'unfair outcomes'. This Budget is no different.

International Disclosure Rules

The government has announced that it is enacting new legislation to allow the introduction of international disclosure rules about offshore structures that could avoid tax or could be misused to evade tax. The measure involves giving powers to HM Treasury to require disclosure of information about certain cross border tax arrangements to HMRC by persons who participate in such arrangements. The powers include penalties for non-compliance. This is for the purpose of securing compliance of the UK Government with international tax provisions. It also implements EU directives regarding mandatory automatic exchange of information in the field of taxation in relation to cross-border arrangements and the Organisation for Economic Co-operation and Development (OECD) model mandatory disclosure rules if the government decides to adopt those rules.

Offshore Tax Compliance Strategy

The government will also publish an updated offshore tax compliance strategy. In the government's view this will build on the substantial progress the UK has made in tackling offshore tax evasion and non-compliance since its previous strategy was published in 2014.

Extension of Assessment Time Limit

Another notable example of the government's stated commitment to tackle offshore tax avoidance and evasion is a measure, now included in the draft Finance Bill, to extend the time limit by which HMRC can assess a tax liability where the loss of tax relates to an offshore matter, or perhaps more significantly, to an offshore transfer.

Normally, HMRC can only assess a tax liability if it has arisen in a tax year ending in the previous four years. This time limitation is extended to six years where the taxpayer has been careless, and to 20 years where the behaviour giving rise to the liability was deliberate.

However, the draft legislation, if enacted as currently proposed, will extend HMRC's powers to assess a liability relating to an offshore matter or offshore transfer up to 12 years after the end of the tax year, even where there is no carelessness or deliberate intention to evade tax on the part of the taxpayer. This therefore represents a massive extension of HMRC's existing powers. The time limit for both onshore and offshore cases will remain at 20 years where there is deliberate behaviour by the taxpayer to evade tax.

The wording of the draft legislation to include not just non-UK income, assets and activities but also income or disposal proceeds received in a territory outside the UK or transferred to a territory outside the UK, emphasises how ordinary taxpayers who receive and transfer funds offshore for a variety of legitimate family, investment and commercial reasons will be potentially caught by this new legislation.

While the government's attempt to continue to crack down on tax evasion is commendable, it is questionable how effective and proportionate HMRC will be in the use of their proposed new powers and lamentable that many ordinary taxpayers will have much less short-term certainty in their tax affairs. There is perhaps some reassurance that, based on the draft provisions, HMRC will not be allowed to raise an assessment where it has received information from another tax authority under automatic exchange of information agreements such that it should have been aware of the lost tax but has failed to raise an assessment within a reasonable length of time. What is a reasonable length of time for HMRC to raise an assessment is open to question.

Moreover, the government appears to have attempted to limit the retrospective nature of the draft provisions by limiting their scope in the case of Income Tax and Capital Gains Tax to 2013/14 and subsequent tax years in the case of

careless behaviour, and to 2015/16 and subsequent tax years in other cases and in the case of Inheritance Tax to chargeable transfers taking place on or after 1 April 2013 in the case of careless behaviour and after 1 April 2015 in other cases. This is a welcome development in the context of giving compliant taxpayers a degree of certainty in their historic tax affairs.

G. Business Taxes

Capital allowances

Structures and Buildings Allowance

Since the withdrawal of the Industrial Buildings Allowance in 2011, no immediate tax relief has been available for structural expenditure on buildings. This resulted in an unwelcome dichotomy between the tax relief available on capital expenditure on plant and machinery as compared to commercial buildings.

Therefore, the introduction of a 2% per annum straightline deduction for the construction or renovations costs of commercial buildings and structures used for a qualifying activity marks a positive development in the UK's capital allowances scheme.

The relief is available on expenditure incurred under build or renovation contracts entered into after 29 October 2018 and relief is available when the property comes into use.

Relief is given over 50 years and the unclaimed balance can pass on to new owners. All claims are based on the initial construction costs and balancing allowances/ charges do not arise on disposal, which marks a departure from normal capital allowance computational rules.

Annual Investment Allowance

In a welcome move and in response to longstanding calls from the British Chambers of Commerce, a temporary increase to the AIA from £200,000 per annum to £1m per annum has been introduced from 1 January 2019 – 31 December 2021.

The AIA provides a 100% deduction in the year of expenditure for most main and special rate pool capital expenditure, with a notable exception being cars. Businesses will benefit from a significant acceleration in the timing of tax relief and this is expected to incentivise businesses to invest in plant and machinery.

The AIA available in accounting periods straddling the period of the temporary increase will be pro-rated.

Special rate pool

The writing down allowance available on the tax written down value of the special rate pool will reduce from 8% per annum to 6% per annum from April 2019, extending the period over which tax relief is available.

Special rate pool expenditure includes assets such as integral features in buildings like air conditioning and lighting systems. Such assets tend to be long term in nature and the government has introduced this reduction to more closely mirror the period over which such fixed assets are depreciated in the accounts.

The immediate impact of this reduction will be tempered by the temporary increase in the AIA.

Enhanced capital allowances

Enhanced capital allowances allow for a 100% first year allowance and tax credits for loss making companies in respect of expenditure on certain environmentally friendly plant, although they have only been beneficial to a small number of businesses.

From April 2020, expenditure on energy and water efficient technology (as set out on the Energy Technology List and Water Technology List) will cease to qualify for enhanced capital allowances.

Whilst this withdrawal may seem at odds with the government's environmental commitments, savings from this measure are intended to fund the Industrial Energy Transformation Fund, which the government consider will more effectively promote energy efficiency.

However, this is by no means a widespread withdrawal of enhanced capital allowances. In a move designed to further the UK's electric car infrastructure and encourage the uptake of electric cars, the government extended the availability of enhanced capital allowances on electric vehicle charge points to March 2023.

Clarification of capital allowances for costs of altering land

With effect from 29 October 2018, it was clarified that expenditure incurred on the alteration of land for the purpose of

installing plant and machinery is only eligible for capital allowances to the extent that the item being installed is eligible for capital allowances.

Expenditure on altering land for the installation of assets ineligible for capital allowances will typically relate to buildings, which may now qualify for the new Structures and Buildings Allowance.

Domestic Corporate Tax

1. Corporate Capital Loss Restriction

Following the introduction of a 50% restriction on the carry forward of corporate income losses arising from 1 April 2017, subject to an annual £5 million cap per group, the government is proposing a consultation on applying a similar regime to capital losses. The aim is to align the tax treatment of corporate income losses and capital losses.

The intention is that from 1 April 2020:

a. The amount of capital gains that can be relieved by carried forward capital losses will be limited to 50%; and

b. The £5 million group cap that already applies to corporate income losses will also cover corporate capital losses.

Companies will be able to choose how to allocate the £5 million cap between income losses and capital losses, and between members of the corporate group. Where a company's carried forward capital losses are restricted, the unused capital losses will be available to carry forward against future capital gains.

2. Hybrid Capital Instruments

Some companies raise funds by issuing corporate debt instruments ("hybrid instruments") which have equity-like features. For accounting periods beginning on or after 1 January 2019, new rules will ensure that if such instruments meet certain specified conditions, any tax mismatches arising in the lender and borrower are avoided (ie interest payable will be deductible for the issuer and taxable for the holder).

3. Intangible Fixed Assets - Purchased Goodwill

In a bid to maintain the attractiveness of the UK as a place to do business, and to bring the UK into line with typical international practice, the government is to introduce targeted relief for the cost of eligible goodwill acquired as part of a business purchase from April 2019.

As a further measure, from 7 November 2018 the government will also reform the de-grouping charge rules which apply where a group sells a company which owns intangibles. This will eliminate the anomalies which currently exist between intangibles acquired or created before and after the intangible assets regime was introduced in April 2002, and will also more closely align these rules with equivalent rules in other parts of the tax code.

4. R&D SME tax credit restriction

The government remains committed to the R&D tax relief scheme as a stimulus for innovation in the UK. However, in response to concerns from HMRC about structures set up to claim R&D tax credits where there is limited UK activity or employment, a cap on R&D tax credits claimable under the SME scheme has been introduced from April 2020.

The cap is set at three times a company's total PAYE and National Insurance contribution liability. Any losses which cannot be surrendered for tax credits are not lost and will be carried forward for use against future profits.

The cap is not intended to be as restrictive as the previous PAYE and National Insurance contributions SME scheme cap on R&D tax credits which was withdrawn in 2012. Only a small percentage of companies claiming R&D tax credits are expected to be affected.

International Tax Updates

Although the headlines are dominated by the government's proposal to introduce a Digital Services Tax ('DST'), there were a number of additional changes announced which focused on the clamping down on cross-border tax avoidance and to ensure that the UK's legislation remains aligned with the OECD's Base Erosion and Profit Shifting ('BEPS') initiative and the EU Anti-Tax Avoidance Directive ('ATAD'):

- The DST is a 2% tax on UK generated turnover which is scheduled to be introduced from 1 April 2020 in the event that global/OECD agreement is not reached on the taxation of online technology businesses by that time. The tax is targeted at businesses operating search engines, social media platforms and online marketplaces. The DST will be applicable to businesses with global turnover exceeding £500m and with revenue linked to UK participation in the services that exceeds £25m per annum.

- Following consultation, legislation will be introduced in Finance Bill 2018-19 targeted at UK businesses which hold intangible property in companies based in low taxed jurisdictions and divert profits related to UK sales to the low taxed company. Tax will be collected directly from offshore entities that are subject to this legislation although a £10 million de minimis will apply for income taxed at appropriate levels or where there is deemed to be sufficient substance in the low taxed jurisdiction.
- From 1 January 2019 the definition of what constitutes a UK permanent establishment ('PE') will be amended to align with the OECD's recommendations under the BEPS initiative and the PE definition under the UK's double tax treaties (as amended by the multilateral instrument). This change is designed to stop businesses taking advantage of the "preparatory and auxiliary" exemption from creating a PE where operations are fragmented across multiple UK locations or businesses.
- International tax enforcement – New legislation will be introduced to allow the introduction of international disclosure of offshore tax avoidance structures.
- With effect from the Budget day, minor, immediate, changes to the Diverted Profits Tax legislation were introduced. These changes generally related to extending HMRC's review period and the company's right to amend its corporation tax return from 12 months to 15 months.
- Hybrid and other mismatches regime – Two small changes will be introduced to the legislation in January 2020 to ensure the rules align with ATAD. First, situations in which a PE is not recognised by the jurisdiction in which the PE is based will be brought within the scope of the rules and second, specific rules relating to the treatment of regulatory capital will be introduced.
- Profit fragmentation – targeted legislation will be introduced in Finance Bill 2018-19 to prevent UK businesses from artificially allocating UK taxable profits to entities resident in lower taxed jurisdictions.

H. Value Added Tax

In his 2018 Budget Statement the Chancellor announced that the current VAT registration threshold of £85,000 will be maintained until April 2022, when the government will then review the VAT registration mechanism once the terms of the UK's EU exit is known. The government will also legislate in the Finance Bill 2018-19 to allow non-corporate entities to join a VAT group, as currently only corporate entities are eligible to form a VAT group.

Various technical measures were announced to combat VAT fraud and VAT avoidance within the construction and insurance industries as well as measures to ensure the correct VAT value is used for vouchers.

It was also announced that an Industry Working Group is to be established to address online VAT fraud by non-EU sellers. The working group will look at measures to prevent the VAT loss through such sellers not accounting for VAT on their sales.

With effect from 1 March 2019, rules will be introduced on how suppliers will have to account for VAT on prepayment for goods or services but no supply is ever made. These rules will also cover VAT adjustments for price reductions and how credit notes should be used.

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