PAYING FOR THE PAST

MARCH 2023

BUDGET BRIEFING

Today's Budget, the first since 2021, was delivered by the new Chancellor, Jeremy Hunt, who has been in the post for five months, longer than both his predecessors combined, neither of whom made full Budget speeches.

The gap between Budgets and last year's revolving door of Chancellors were symptoms of the political and economic turmoil that engulfed the UK Government in 2022, as it grappled with the effects of the pandemic, the energy crisis and high inflation. A feature of Mr Hunt's tenure as Chancellor to date, and that of the new administration led by Rishi Sunak, Chancellor himself from 2020 to 2022, has been to end the turmoil, and to bring a calm, cautious and considered approach to the Government's fiscal and economic policy.

Underpinning today's Budget were the scars from the negative market reaction to September's disastrous mini-Budget delivered by Kwasi Kwarteng, which starkly showed that the debt markets would no longer countenance further public sector borrowing without a fully costed plan to pay it back. Mr Hunt therefore took great care to include a cautious and considered plan to reduce the debt burden over the medium term, seeing this as a necessary step towards fiscal stability.

The plan noted that public sector debt now stands at almost £2.5 trillion, which is over 99% of GDP, the highest level since the 1960s, with its recent ballooning being mostly due to the cost of the pandemic and its economic fallout. In addition, large increases in inflation and interest rates mean that the UK's debt burden is becoming very expensive to service: the interest bill is expected to be an eye-watering £115 billion this year, the second highest amount of Government expenditure after Health and Social Care, and 50% more than the entire Education department of £77 billion.

Unfortunately the debt reduction plan also includes large tax rises on individuals and businesses, which were announced previously, that will take effect in just a few weeks' time in April.

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For businesses, corporation tax on large companies will increase from 19% to 25% from 1 April; which is in effect a 32% increase in those companies' tax bills. To help reduce the pain of this increase, the Chancellor therefore announced an expensing relief that will enable companies to write off the full value of any new plant and machinery against profits.

While this is good news for manufacturing companies, it is much less so for businesses within the services sector which makes up 79% of the economy. These businesses generally operate from offices rather than factories, and so do not usually spend very much on plant and machinery. They may periodically spend significant sums on office fixtures and fittings when taking on a new lease, which would qualify for the new relief, but with greater home-working since the pandemic, this type of expenditure, and the related tax relief, may not be significant. Service sector companies are therefore likely to be hit hard by increased corporation tax bills as many will get little benefit from the new expensing relief.

For individuals, a host of previously announced 'stealth' tax changes will take effect from 6 April, including the 45% income tax threshold being reduced from £150,000 to £125,140; income tax on dividends being increased by 1.25%; the £12,570 income tax personal allowance being frozen; the dividend allowance being halved to £1,000; and the Capital Gains Tax annual exemption being reduced from £12,300 to £6,000.

On the plus side, the Government loosened a number of pension tax limits from 6 April, in an effort to encourage older workers to remain in, or return to, the workplace. This measure was explicitly aimed by Mr Hunt, a former Health Secretary, at senior NHS doctors who had retired, or were considering retiring, because their public sector pensions had breached the Lifetime Allowance (LTA) of £1,073,100, the level at which punitive tax charges apply. Mr Hunt has therefore abolished the LTA tax charge in its entirety, but in an unwelcome quid pro quo he has also introduced a £268,275 cap on the maximum amount that can be taken as a tax-free lump sum from a pension, although this will not apply to those who have already secured a form of LTA protection.

Other pension tax changes include the annual allowance ("AA") limit for pension contributions being increased from £40,000 to £60,000; the 'adjusted income' level required for tapered AA increasing from £240,000 to £260,000; and the minimum tapered AA increasing from £4,000 to £10,000.

Ultimately the most important aspect of today's Budget was that it included nothing that frightened the markets. Mr Hunt had made great efforts to trail his measures in the press prior to the Budget, learning from the mistakes of his immediate predecessor, meaning that there was nothing announced today that was a particular surprise. All in all, it appears that Mr Hunt has done what was necessary to keep the markets onside by calmly persuading the British people, using his smooth bedside manner akin to a senior doctor, to start paying back the public debt caused by the pandemic by increasing their taxes.

PERSONAL TAX

Income Tax

Overall, the main continuing theme of today's Budget for income tax is frozen or restricted allowances. The Government's intention is presumably through "fiscal drag" to help restore the post pandemic public finances.

Other continuing themes focus on attempts to modernise the income tax system and to tackle tax fraud.

Many of the changes taking effect from 6 April 2023, or subsequently, were announced by the Chancellor in his 17 November 2022 Autumn Statement.

Personal allowance

The £12,570 personal allowance and various National Insurance thresholds will remain unchanged until April 2028.

Income tax top rate threshold

The income tax additional rate threshold reduces to £125,140 from 6 April 2023; this is the income level at which the personal allowance is fully withdrawn for higher earners. The 45% additional rate and 39.35% dividend rate will apply to income over £125,140.

Dividend allowance

The dividend allowance will be halved to £1,000 from 6 April 2023 and further reduced to £500 from 6 April 2024. Dividends in excess of the allowance will be taxed at 8.75%, 33.75% and 39.35% for basic, higher and additional rate taxpayers, respectively.

Basis period reform

The reform to the basis periods for self-employed individuals from April 2024 (with a transitional year in 2023/24) was announced in the 2021 Autumn Budget. The measure is designed to simplify the rules for the self-employed whereby a business' profits or losses for a tax year is the profit or loss arising in the tax year itself regardless of the accounting date.

Key new announcements in today's Budget included:

Frozen savings tax reliefs

The 0% starting rate limit for savings income will be frozen at £5,000 for 2023/24, enabling individuals with less than £17,570 of employment income to receive up to £5,000 of savings income free of tax.

The annual Individual Savings Account (ISA) subscription limit for adults will also be frozen at £20,000 for 2023/24 and for Junior ISAs/Child Trust Fund accounts at £9,000

Restricted charitable reliefs

The Government will restrict income tax relief so that it applies just to UK charities and Community Amateur Sports Clubs. European Union and European Economic Area (EEA) charities that HMRC previously accepted as qualifying for charity reliefs before 15 March 2023 will have a transitional period until April 2024.

Modernising HMRC's income tax services

The Budget included a discussion document on modernising HMRC's services so taxpayers can "quickly and easily manage their own affairs online". Given recent criticism by accountancy professional bodies of HMRC's service levels this is welcome, but one wonders how effective such modernising measures will be.

Extending the self-employed cash basis

The Government is consulting on proposals to extend this simplified way by which self-employed businesses can calculate profits for Income Tax purposes. The proposals include increasing the turnover threshold for businesses eligible for the cash basis (a business can currently elect to use the cash basis if its total receipts in a tax year do not exceed £150,000), making the cash basis the default option, increasing the £500 limit on interest deductions and relaxing restrictions on loss reliefs.

Tackling tax fraud

New measures include doubling the maximum sentence for the “most egregious cases of tax fraud” from 7 to 14 years.

Capital Gains Tax

Although there were no significant announcements in the Budget about Capital Gains Tax (CGT), there have been some previously announced measures which have recently come into force or will do so from 6 April 2023.

Annual exemption reduction

Firstly, there will be a reduction to the CGT Annual Exemption to £6,000 from 6 April 2023 and £3,000 from 6 April 2024 and subsequent tax years.

Separating couples

There are also new rules being introduced from 6 April 2023 which will mean that separating spouses or civil partners will be given up to three years after the end of the tax year in which they cease to live together to transfer assets under the “no gain, no loss” rule. Previously, it was just one year. There will be an unlimited time for the “no gain, no loss” rule to apply when the transferred assets are the subject of a formal consent order.

Anti-avoidance

From 17 November 2022, a measure relating to share exchanges or schemes of reconstruction impacting UK resident non-domiciled taxpayers was introduced. The measure deems shares/securities in a non-UK company acquired in exchange for securities in a UK company to be treated as located in the UK for the purposes of CGT. An election can be made to disapply these rules, but this would lead to a chargeable gain arising on the exchange rather than the normal ‘paper for paper’ treatment. Furthermore, income arising from the shares/securities in the non-UK company after the exchange, which is foreign source income and would otherwise be protected by a claim for the remittance basis by the non-domiciled taxpayer, is to be treated effectively as though it is UK source income and therefore fully taxable.

Cryptoassets

Although not a legislative change, it has been decided that Cryptoassets are deserving of their own separate and special box on a tax return. This will allow HMRC to identify them with more ease. This change will be introduced for the 2024/25 tax return.

Carried interest

It has been announced that individuals who may be in receipt of carried interest can soon make a voluntary, yet irrevocable, election for their carried interest to be taxed on an accruals basis. The current rules generally tax carried interest when cash (or other “sums”) arise from an investment scheme. The new election is presumably aimed at individuals who have typically been subject to US taxation on their carried interest at a much earlier time than in the UK, which can result in the potential for double taxation. This measure may help mitigate this problem, however it will be necessary to understand the full details of the proposal to understand if it adequately addresses the issue. The rules are already complex and, as the election would appear to be irrevocable, and may only apply from the 2022/23 tax year onwards, it is likely that impacted taxpayers will need to consider their options carefully.

Changes to pension limits from 6 April 2023

In an effort to encourage individuals to remain in (or return to) the labour market, the Government has loosened a number of pension tax limits.

Annual Allowance (AA)

The AA is the maximum amount of pensions savings an individual can make each year with tax relief, without triggering a tax charge that effectively recovers the excess tax relief. The AA limit for pension contributions has been increased from £40,000 to £60,000. The Money Purchase Annual Allowance (MPAA) will also increase from £4,000 to £10,000; the MPAA applies to those who have already started to flexibly access their pension pot.

The AA is tapered for individuals with income above certain levels. The 'adjusted income' level required for the tapered AA to apply has increased from £240,000 to £260,000. The minimum tapered AA has also been increased from £4,000 to £10,000. From 6 April 2023, for every £2 of adjusted income in excess of £260,000, the AA is reduced by £1, down to a minimum of £10,000. The minimum tapered AA will therefore apply once adjusted income is £360,000 (or higher).

Lifetime Allowance (LTA)

The LTA is the maximum amount of tax relievable pension savings an individual can benefit from, over the course of their lifetime. To the extent that an individual's pension savings exceed the LTA, the excess is subject to a tax charge of 55% when the excess is taken as a lump sum, or at 25% when the excess is taken as a pension.

From 6 April 2023, the LTA tax charge has been abolished and so this also removes the need for individuals to rely on 'protections' from previous reductions to the LTA; protections had previously been offered to safeguard individuals who had already built-up significant pension savings on the expectation of a certain level of LTA.

Pension Commencement Lump Sum (PCLS)

The PCLS is the tax-free lump sum that is received when an individual becomes entitled to their pension benefits. The maximum amount that most individuals can claim as a PCLS is currently 25% of their available LTA at the time this sum is taken.

Although the LTA tax charge has been abolished, the Government has introduced a measure that caps (or freezes) the maximum amount that can be taken as a tax-free lump sum (or PCLS) at £268,275, being 25% of the current LTA in respect of the period up to 5 April 2023. A lump sum withdrawal that exceeds this new cap will be subject to tax at an individual's marginal rate of Income Tax, rather than the punitive 55% tax charge that is referred to above.

It has also been confirmed that, for those who have already secured a form of LTA protection, there would be no change to their entitlement to a tax-free lump sum, i.e. the tax-free lump sum will be 25% of the value of the protected (higher) LTA.

Inheritance Tax

Changes to reliefs

The Inheritance Tax reliefs for agricultural property and woodlands will be restricted to land in the UK from 6

April 2024. Historically, the reliefs were available only for land in the UK and, in the case of agricultural property, the Channel Islands and the Isle of Man; following pressure from the European Commission the territorial scope was extended in 2009 to include the European Economic Area. Subject to qualifying conditions, and some exceptions for agricultural property where relief is given at 50%, the agricultural and woodlands reliefs are at 100%, removing the whole of the value from the taxable estate.

The Budget announced a call for evidence and consultation on a proposed extension of agricultural property relief to cover certain types of environmental land management.

Nil rate band

As previously announced, the inheritance tax nil rate band of £325,000 and residence nil rate band of £175,000 available to individuals are frozen until April 2028.

TRUSTS

Simplification

Simplifying legislation will be introduced from 6 April 2024 to formalise a HMRC concession that removes the tax liability of trusts and estates where the only source of income is savings interest and the tax is less than £100. Trusts and estates with income of up to £500 will not pay tax on that income. Beneficiaries of UK estates will not pay tax on income distributed to them that was within the £500 limit, and beneficiaries of interest in possession trusts will no longer have a tax credit for trust income not taxed as a result of the £500 limit. Beneficiaries of discretionary trusts will not be affected by the changes.

Inheritance Tax administration

It was also announced that HMRC intends to make changes to Inheritance Tax regulations to remove non-taxable trusts from reporting requirements.

BUSINESS TAXES

The backdrop to the corporation tax impact of the Budget was already established with the confirmed corporation tax rate increase to 25%, effective from 1 April 2023.

It is well worth remembering that the small companies' rate of 19% will apply for companies with taxable profits below £50,000, and a marginal rate will apply for companies with profits between £50,000 and £250,000. Note that the 19% rate is not available to closely held investment companies (for example many family investment companies).

Furthermore companies will need to be aware that both these thresholds, as well as the thresholds used for establishing whether companies should make tax payments by instalments, are shared amongst associated companies. With regards to instalment payments, this will be a change from the current "grouped" company rules, so taxpayers will need to be aware of the impact on cashflow where companies are under common personal shareholder control from 1 April 2023.

Although the enhanced reliefs today sound generous, economically, the capital allowances expenditure relief simply retains the current benefit of the 130% super deduction. Creative sector reliefs and R&D allowance enhancements may help to reduce the tax burden for a very niche sector of businesses, however companies operating in the service sector will see little benefit from these enhanced reliefs and will bear the full brunt of a 32% increase in corporation tax bills in a couple of weeks' time.

Capital allowances

During today's speech, the Chancellor declared that the 19% corporation tax rise had not incentivised investment as effectively as countries with higher headline rates. Therefore, additional measures have been put into place to address the low capital investment and lower productivity.

One of those measures is the introduction of the full expensing regime which will allow businesses to claim 100% first year allowance ("FYA") for main rate qualifying expenditure incurred on or after 1 April 2023 but before 1 April 2026. The new regime provides companies with the same benefits obtained through the current 130% super deduction which is available until 1 April 2023 (130% relief at 19% or 100% relief at 25%). Therefore companies should have no incentive to defer or accelerate capital expenditure over the next couple of weeks.

The 50% FYA, which was introduced alongside the super deduction, is being extended by three years to 31 March 2026. This relief remains available on special rate assets, with the intention to make this permanent in future years.

The first year allowances are subject to some exclusions such as cars and plant and machinery for leasing.

Furthermore the annual investment allowance ("AIA"), currently at £1,000,000 was due to reduce to £200,000 in April 2023. However, this reduction has been abandoned and the AIA will remain at £1,000,000. This will be beneficial for companies who have a higher level of special rate assets as there is a greater tax saving over the 50% first year allowance.

The Chancellor has also announced the extension of the FYA for qualifying expenditure for electric vehicle charging points to 31 March 2025 for corporation tax purposes, and to 5 April 2025 for income tax purposes.

Associated companies rules

Further to the previous Chancellor's announcement within the March 2021 Budget, associated companies rules (also known as tax associates rules) come into effect from 1 April 2023.

As a reminder, companies which have taxable profits in excess of £1.5 million are required to pay their corporation tax in quarterly instalment payments (QIPs), starting from month seven of the year in question. Where companies have taxable profits in excess of £20 million, these instalments are further accelerated to start in month three.

At present, the QIPs thresholds are divided across 51% group companies whether UK resident or otherwise within a corporate group. However, as part of the increases to the corporation tax rate, the concept of associated companies has been restored to the tax rules and will replace the 51% group company test within the QIPs rules.

The concept of associated companies is wider, as it includes companies which control one another, as well as companies under common control of the same person, or groups of people. Therefore, this will mean that the QIPs thresholds for many companies may become lower, with the consequence of more companies having to pay their corporation tax in QIPs.

It should be noted that being in the QIPs regime does not increase the amount of corporation tax a company needs to pay, however it accelerates the date by which the corporation tax must be paid. In addition, it will also place a greater administrative burden on more companies, in respect of forecasting financial performance and expected corporation tax payments in advance. It will also increase the risk of potential interest payments arising from late payments and incorrect forecasts.

Research & development

In the 2022 Autumn Statement, the Government announced changes, effective from April 2023, to the UK's R&D tax incentive regime, comprising of the Small and Medium-sized Enterprise ('SME') scheme and Research and Development Expenditure Credit scheme ('RDEC').

- A reduction in the enhancement percentage of qualifying R&D expenditure for the SME scheme from 130% to 86%;

- The SME tax credit rate for surrender of losses will decrease from 14.5% to 10% - but see comments on 'R&D intensive' companies below;

- The RDEC tax credit rate will increase from 13% to 20%;

- The extension to the scope of qualifying expenditure to include data costs and cloud computing for both schemes; and

- The requirement for advance notification for first time R&D claimants for both schemes, with first time claimants needing to notify HMRC of their intention to make a claim within 6 months from the period end.

However, it is pleasing to see that the previously announced proposal to limit some overseas qualifying costs to UK activity (although full details are outstanding this would appear to cover subcontracted R&D and externally provided workers) is now being delayed until April 2024.

For 'R&D intensive' SMEs an enhanced relief will be available from 1 April 2023, although claims cannot actually be made until legislation is enacted and so R&D intensive companies, particularly those with accounting periods straddling 1 April 2023, may need to either delay submission of their R&D claim or amend their claim.

SMEs meeting the R&D intensity definition, broadly, SMEs with qualifying R&D spend of at least 40% of their total tax deductible expenditure, will not be impacted by the previously announced 4.5% reduction of the tax credit rate to 10% for SMEs from April 2023. However, they will still be impacted by the April 2023 reduction in the enhancement percentage from 130% to 86% for qualifying expenditure.

The combined impact of the changes from next month will prevent an R&D intensive SME's tax credit claim reducing from 33p currently to 19p for every £1 spent (the value for non-R&D intensive SMEs from April 2023), with instead their claim only reducing to 27p for every £1 spent on R&D.

For R&D intensive companies whose accounting period straddles 1 April 2023, the tax credit rate of 14.5% will only apply to expenditure from 1 April 2023. However, the 40% threshold assessment of the R&D intensity condition will be determined with reference to the expenditure in the entire accounting period.

Creative tax reliefs

The Government announced that it will extend the current temporary rates of tax relief for Theatre Tax Relief, Orchestral Tax Relief and Museum and Galleries Exhibition Tax Relief for an additional 2 years, with the Museum and Galleries Exhibition Tax Relief now proposed to cease on 31 March 2026.

Charitable donations

With effect from 15 March 2023, a company will only be able to obtain corporation tax relief for donations made to charities that come within the jurisdiction of the High Court in England, Wales or Northern Ireland, or the Court of Session in Scotland or Community Amateur Sports Clubs based in the UK and providing

facilities for eligible sports in the UK.
Companies need to ensure that they are not caught out, expecting tax relief when making donations to EU or EEA charities which had previously qualified for relief.

Share schemes - Enterprise Management Incentive Scheme

The Enterprise Management Incentive ("EMI") scheme is a tax advantaged share option scheme which enables employees to acquire shares tax efficiently in their employing company. However, there are complex rules governing the operation of the scheme.

It seems that one of the most common ways in which employees are denied tax relief for options granted under an EMI scheme is the failure by their employer to notify HMRC of the grant of those options within 92 days of their issue, as required under the EMI rules.

Perhaps recognising that the employees who are penalised are not responsible for this technical breach, it was announced that, with effect from 6 April 2024, the date by which the employer must notify HMRC of the grant of EMI options is extended to 6 July following the end of the relevant tax year.

This new time limit coincides with the deadline for submission of the Employment Related Securities annual return, and is therefore a welcome simplification which will streamline the reporting process into a single annual event.

Two further simplifications were also announced, which apply from 6 April 2023:

- The EMI option agreement will no longer need to include details of any restrictions which apply to the shares to be acquired under the options; and

- The company will no longer need to declare that an employee has signed a working time declaration when the EMI options are issued to them. Note, however, it does not remove the need to meet the working time requirement (broadly that they work at least 25 hours per week, or at least 75% of their working time, for the company).

Again these are helpful simplifications which will assist employers to ensure that they comply with the various administrative requirements of the EMI scheme and help to avoid inadvertent technical breaches of the rules.

Share Schemes - Company Share Option Plan

The Company Share Option Plan ("CSOP") is a tax-advantaged employee share scheme available to UK companies and their employees.

As was announced in September 2022, to make the scheme more attractive to both employers and employees, and to enable employers to give a greater stake in the company to employees, the following increases in limits will apply from 6 April 2023, both to new options granted on or after this date and existing CSOP options already granted prior to that date.

- The limit for employee share options will increase from £30,000 to £60,000;

- The requirement for the options to be granted over a class of shares which has overall control over the company, or a class held in the majority by investors (the so called "worth having" condition), will be removed; and

- Future changes to the share options limit will be able to be made through secondary legislation, rather than primary legislation (which requires an Act of Parliament).

One of the issues with the CSOP regime has been the relatively small limit on share options, and the restrictions on the type of share class over which options could be granted compared to certain other tax advantaged schemes (in particular the Enterprise Management Incentive scheme, which is only available to employees of smaller companies). The increase in the limit and removal of restrictions relating to the share class may therefore go some way to address this issue.

Policy papers

A range of policy papers were released to finesse the operation of the Corporate Interest Restriction and Patent Box rules, as well as to reiterate previously announced international tax measures for the very largest of companies with global turnover of over €750m.

Rawlinson & Hunter LLP
Eighth Floor
6 New Street Square
New Fetter Lane
London
EC4A 3A
United Kingdom

and at

Q3, The Square
Randalls Way
Leatherhead
Surrey
KT22 7TW
United Kingdom

T +44 (0)20 7842 2000
E firstname.lastname@rawlinson-hunter.com

BUDGET BRIEFING

This **Budget Briefing** was brought to you by:

Editors: Andrew Shilling and James Randall

Writers: Stephen Yates, Jeremy Stein, Alex McBryde, Ian Gray, Natasha Warren, Sarah Fernando, Preena Vaghela and David Ambrose

Document Production: Steph Bailhache