REVERSAL OF FORTUNE

NOVEMBER 2022

Today's Autumn Statement completed the Government's screeching U-turn from September's disastrous Truss/Kwarteng mini-Budget by confirming the reversal of most of the £48 billion of annual tax cuts, and by announcing a broad range of new tax rises which are expected to raise £25 billion annually.

The bulk of today's tax rises will come from opportunistic windfall taxes on energy companies: by increasing the Energy Profits Levy from 25% to 35%, and by introducing a new Electricity Generator Levy of 45% on extraordinary returns from low carbon UK electricity generation. The remainder will come from so-called stealth taxes on individuals and employers by freezing income tax and National Insurance thresholds and allowances until 2028, by cutting the dividend allowance and annual capital gains tax exempt amount, and by imposing road tax on electric vehicles from 2025. R&D tax reliefs will also be reduced, and a global minimum corporation tax rate of 15% will be introduced for multinational groups from 2024.

The Truss/Kwarteng mini-Budget in September had previously unveiled a "Growth Plan to release the huge potential in the British economy" with "the biggest package of tax cuts in generations". By complete contrast, today's Sunak/Hunt Autumn Statement revealed that "the Government has reversed nearly all the measures in the Growth Plan" because, as the latest Chancellor Jeremy Hunt put it in his speech, "you cannot borrow your way to growth."

The reversed tax cuts are expected to raise £27 billion by 2027/28 and include abandoning the 1% reduction in the basic rate of income tax to 19% (it will now stay at 20%); abandoning the abolition of the 45% additional rate of income tax (it will now be retained and extended to those earning between £125,140 and £150,000 from next April); abandoning the corporation tax rate freeze at 19% (it will now increase to 25% from next April); abandoning the 1.25% cut in the dividend income tax rate; and converting the stamp duty cut at the lower thresholds from a permanent to a temporary giveaway expiring in March 2025.

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On the plus side, £21 billion of tax cuts from the Growth Plan still survive, largely due to persisting with the Truss/Kwarteng decision to scrap the Johnson/Sunak 'Health and Social Care' levy before its introduction in April, and by retaining the permanent increase in the Annual Investment Allowance for businesses to £1 million. In addition, the Autumn Statement included no changes to the taxation of pensions and non-domiciliaries (other than a narrow and specific anti-avoidance measure), despite these being trailed in the press beforehand, and there were no increases to the headline rates of tax.

Underlying these announcements, and greatly constraining Mr Hunt's options, was a dire economic situation which was highlighted in today's Office For Budgetary Responsibility (OBR) report which states: "The tax burden will rise from 33.1% of GDP in 2019-20 to 37.1% of GDP in 2027/28…its highest sustained level since the Second World War…Living standards will fall by 4.3% in 2022/23…the largest fall since records began in 1956/57…Rising prices (with inflation currently at 11.1%) will erode real wages and reduce living standards by 7% in total over the two financial years to 2023/24, wiping out the previous eight years' growth…The squeeze on real incomes, rising interest rates, and falling house prices will all weigh on consumption and investment, tipping the economy into a recession lasting just over a year from the third quarter of 2022, with a peak to trough fall in GDP of 2%."

The UK's economic problems are well-known, but perhaps the less appreciated "elephant in the room" is the Government's eye-wateringly expensive interest bill of £120 billion this year. According to the Autumn Statement book, this is "the highest since the late 1940s, both as a share of GDP and as a share of revenue.. This year the Government is expected to spend more than 11% of its revenue on debt interest…If debt interest spending were a Government department, its departmental budget would be second only to the Department for Health and Social Care."

And this really is the nub of the issue, and what brought down the 49 day Truss/Kwarteng administration: the Government's debt is now so large and expensive to service that the debt markets will no longer countenance further Government borrowing because they have lost faith in its ability to pay it back. The debt markets therefore told the Government in no uncertain terms following the September mini-Budget that it needs to balance its books. This message was heard loud and clear by Messrs Hunt and Sunak, and they have swiftly followed this through with this tax-raising Autumn Statement, for which the British people will be paying the bill for years to come.

Income Tax Personal Allowance and the Dividend Allowance

The £12,570 income tax personal allowance is to be frozen for a further two years, to April 2028. With inflation set to continue at significant levels for some time, the Chancellor is expecting frozen allowances and 'fiscal drag' to do much of his work for him.

The dividend allowance, within which dividends are taxed at 0%, will also become much less valuable for taxpayers. This is a continuing trend. An allowance of £5,000 was introduced when dividend tax credits were withdrawn on 6 April 2016, and the allowance was reduced to £2,000 from April 2018. It will now be reduced to £1,000 from April 2023, and to £500 from April 2024.

Dividends in excess of the allowance are taxed at 8.75% for dividend income falling within the basic rate band, 33.75% in the higher rate band, and 39.35% in the additional rate band. These rates include an additional 1.25% introduced from 6 April 2022, alongside the increase in National Insurance rates of the same amount. The additional 1.25% National Insurance rate was removed with effect from 5 November 2022 in the Truss/Kwarteng mini-Budget but, in contrast, the dividend tax rates remained unchanged.

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Income Tax Higher Rate Tax Threshold

Whilst wages are rising, the same cannot be said of tax bands. The Income Tax personal allowance will continue to be removed on a tapered basis for individuals with income in excess of £100,000. So for every £2 of income above £100,000, the personal allowance is reduced by £1. This results in there being no entitlement at all to a personal allowance once income reaches £125,140.

In a widely trailed move, the threshold at which the top 45% rate becomes payable has been reduced from £150,000 to £125,140, and this will take effect from 6 April 2023. As will be obvious from the above, this rate of tax now starts at the point at which the personal allowance of £12,570 is fully tapered. As a result the effective marginal tax rate goes from 60% on income between £100,000 and £125,140 to 45% being paid on any income in excess of that.

With all the talk of inflation and fiscal drag, it is worth noting that both the £100,000 and £150,000 thresholds had remained unchanged ever since their introduction back in 2012. Had they risen in line with inflation then the amounts would have increased by approximately one third.

Capital Gains Tax Annual Exemption

While there is no change to capital gains tax rates, the current £12,300 annual exemption is now cast as overly generous; it will be reduced to £6,000 from April 2023 and £3,000 from April 2024.

Inheritance Tax

There had been speculation about changes to Inheritance Tax, but the only announcement was a freezing of the £325,000 nil rate band for a further two years. Unreasonably, some may think, the nil rate band has been fixed at this level for over 13 years, since April 2009, and the freeze had been set to last until April 2026; it will now continue to 2028. The additional residence nil rate band of £175,000 is also frozen.

Anti-Avoidance

Off payroll working arrangements

One of the Truss/Kwarteng mini-Budget measures was the proposed reversal of the off-payroll working reforms which were introduced in both 2017 and 2021.

The off-payroll rules, known as "IR35" were originally introduced to prevent workers from performing their work through an intermediary – usually their own personal service company – to avoid PAYE and National Insurance when for all intents and purposes they were an employee of the payer. If the worker was within the IR35 rules then they would essentially be treated as an employee and subject to PAYE and National Insurance.

Prior to the changes in 2017 and 2021, it was the worker's responsibility to assess whether they were within the scope of the IR35 rules and for them to apply the rules appropriately. Following the changes in 2017 and 2021, if the end payer was in the public sector, or was a large or medium business in the private sector, the responsibility was placed on the payer to determine if the worker was within IR35, and apply PAYE and National Insurance deductions if so.

In a reversal of the previous Chancellor's abolition plan, the 2017 and 2021 changes will now remain in place, with the responsibility of determining whether the worker falls within IR35 remaining with the payer, if they are a large or medium business or within the public sector.

Non-Domiciled Taxpayers

There had been speculation in the press that the Government might announce significant changes to the tax treatment of UK resident non-domiciled taxpayers. This did not materialise. The only measure targeted at 'non-doms' was a specific anti-avoidance provision applying in a relatively rare scenario.

The measure applies where an individual who (together with associates) owns or controls 5% or more shares and securities in a closely held UK incorporated company exchanges them for shares and securities in a non-UK incorporated close company in which, after the share exchange, the individual (together with associates) holds a 5% participation. This can have the effect of turning UK situated assets into non-UK assets without triggering a CGT disposal. The opportunity then arises for a non-domiciled taxpayer to shelter dividends from the non-UK company or capital gains arising on disposal of the non-UK company shares and securities from UK tax by claiming the remittance basis.

The new anti-avoidance provision operates by amending existing legislation relating to company reconstructions to treat exchanged non-UK company shares or securities which meet the above criteria as UK assets for CGT purposes. It will also apply where the new shares and securities are transferred to the individual's spouse or civil partner or are replaced by new securities.

An election can be made to disapply the rules so the individual pays tax at the time of the exchange. The new rules have effect where securities are exchanged on or after 17 November 2022.

Furthermore, income arising from the new shares or securities 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.

Business Taxes

Rates and incentives

As expected the headline rate of corporation tax remains at 19%, to be increased to 25% from 1 April 2023.

It should be noted that the 19% rate will be retained for small companies with taxable profits of up to £50,000 (with tapering of the 19% rate to 25% on profits up to £250,000). This reverts to the measure announced in the spring Budget 2021, following the intention to retain the 19% rate in the Truss/Kwarteng mini-Budget.

Banking Surcharge

The banking surcharge is a higher rate of corporation tax applicable to certain banking companies. It is presently 8% over the main rate of Corporation tax, resulting in a rate of 27%.

Following the reversal of the decision to retain the increase in Corporation tax to 25%, it has been confirmed that the surcharge will be reduced from 8% to 3%, resulting in a rate of 28%. This decision is aimed at ensuring that the surcharge does not have an adverse effect on attracting and retaining banking companies in the UK's vital financial services industries.

The increase of the surcharge allowance from £25 million to £100 million also remains, which means that the higher banking surcharge rate only applies to profits in excess of the allowance. This supports small and mid-sized banks, for many of which this increase will negate the 1% increase in the headline tax rate applicable to banking companies.

Research & Development ('R&D')

The UK's R&D tax incentives regime is split into the Small and Medium sized Enterprise ('SME') scheme and Research & Development Expeniture Credit ('RDEC') scheme, with the former only being available to SMEs.

There have been longstanding concerns about the effectiveness of the SME scheme, and the risk of spurious or fraudulent claims. Indeed, recent media reports refer to less scrupulous tax advisors referring to the scheme as being 'free money' and claims being submitted in respect of restaurants developing vegan menus and new cocktails!

As such, a number of changes and measures have been announced in recent times, which have been further built on in the Autumn Statement, with the generosity of the SME scheme being significantly reduced.

Whilst there are valid concerns around the SME scheme being taken advantage of, these changes will come as a blow to many SMEs engaged in genuine R&D.

It is worth recapping on these developments:-

- HMRC have recruited a large number of staff in their R&D teams, in order to allow for R&D claims to be examined more rigourously.

- Additional pages relating to R&D have been introduced in the company tax return and it is expected that claims will be required to be made digitally and provide certain supporting information, including details of any R&D advisors.

- The repayable credit under the SME scheme is capped at a company's PAYE and NIC liability, with a £20,000 buffer, for accounting periods commencing after 1 April 2021.

- For accounting periods beginning on or after 1 April 2023:

    1. The relief will be made more UK centric, by requiring that costs for subcontracted R&D and externally provided workers will be limited to UK activity, with narrow exemptions, which do not include cost or availability of staff.

    2. The scope of qualifying R&D expenditure will be expanded to include data costs and cloud computing, in recognition of the the shift in the types of costs being incurred by innovative companies engaged in R&D.

    3. Companies making an R&D claim for the first time from April 2023 (of after three accounting periods) will need to notify HMRC of the intention to make a claim within 6 months of the period end. This will mean that companies have only 6 months to identify the potential for a claim, whereas at present, they have up to 2 years.

From this, it can be seen that the direction of travel has been very much to restrict the scope of the SME scheme, make it more UK centric and police it more heavily.

As an extension to this, the Chancellor announced three further important changes in the Autumn Statement, applying to expenditure incurred on or after 1 April 2023.

The enhancement percentage for expenditure under the SME scheme will decrease from 130% to 86%; and the SME tax credit rate for the surrender of losses will decrease from 14.5% to 10%.

Conversely, the RDEC rate will increase from 13% to 20%.

What this means, taken with the upcoming increase in Corporation tax rates, is that the difference between the two schemes is much reduced.

Under the present rules, in cash terms, the SME scheme can be worth 33p for each £1 spent on R&D, whereas under the RDEC scheme, it is only worth 10.5p for each £1 spent.

However, with the announced changes, for a main rate corporation tax payer, the value of a claim under the SME scheme will drop to 19p for each £1 spent, whilst the value of a claim under the RDEC scheme will increase to 15p for each £1 spent.

With this said, it should however be remembered that there are still other important differences between the two schemes, most notably, that subcontracted R&D is not a qualifying cost under the RDEC scheme.

This levelling off of the two schemes also marks progress on the Government's stated aim of moving towards a single R&D scheme which will be available to all companies; though whether it also moves towards the aim of simplification is questionable.

Creative tax reliefs

The Government has opened a consultation on the creative industry tax reliefs, focussing on the five reliefs applicable to the audio-visual sector.

It is recognised that much has changed since Film Tax Relief was introduced in 2007; and therefore they wish to ensure that the UK's reliefs remain attractive and incentivise the enhancement of the UK's audio-visual industries.

Aspects of the consultation include the proposed merger of a number of individual reliefs into a singular 'above the line' tax credit scheme and also considering features of the schemes relating to EU legacy requirements.

The consultation does not include the orchestra, theatre and museums and galleries reliefs.

Environmental taxes

An Electricity Generator Levy is being introduced from 1 January 2023 until 31 March 2028 (replacing the previously announced Cost Plus Revenue Limit), which will apply a 45% levy on extraordinary profits of low-carbon UK electricity generation. Extraordinary profits will be defined as electricity which is sold for more than £75MWh, which is 1.5 times the average price of electricity over the last 10 years. The overall tax rate which will be applicable to such profits will therefore be 70%.

On another point around electrification, the Chancellor indicated that the continued uptake of electric cars represented a maturing of this market, such that electric car users would now need to start contributing a fair proportion of the taxed raised from road users.

It therefore seems that the tide is turning from the Government subsidising clean energy and electric cars, to these now becoming a source of future tax revenue. As such, from April 2025, electric cars will become subject to Vehicle Excise Duty of £165 per annum, with those with a list price of £40,000 or more paying £530 per annum.

Company car benefit-in-kind rates will also be increased over the coming years for electric cars. For those cars with emissions of less than 75g of CO2 per kilometre, the percentage will increase 1% in each of 2025/26, 2026/27 and 2027/28, up to a maximum of 5%.

Whilst the Chancellor clearly regards this as a maturing market, it would appear that there is also no desire to discourage the uptake of electric cars, as the announcement of rates stretching into the future allows for businesses and individuals to make decisions on capital expenditure on cars with some degree of confidence.

Interestingly, given the changes in the taxation of electric cars, the 100% first year capital allowances for electric car charging points will be extended until 2025. This is to continue incentivising businesses to invest in the charging network, as the current charging network, along with range anxiety, remain two of the most material factors which may dissuade potential car buyers from going electric

International Tax

The Chancellor confirmed that the Government will bring in legislation to implement the OECD Pillar 2 framework, which aligns with the G20 agreement that large companies (meaning those with a consolidated turnover of at least €750m) headquartered in the UK will need to pay a "top up tax" in the UK where foreign operations have an effective tax rate of 15% or less.

Legislation will also be introduced to bring in a Qualified Domestic Minimum Top-Up, where large groups, including those operating exclusively in the UK, have an effective tax rate of less than 15%. Implementing this rule means that any top-up taxes due would be paid to the UK Exchequer rather than to overseas multinational parents. Noting that this would be a charge on effective tax rates by reference to accounting profits, it could give rise to a significant tax charge for UK companies that have variations in book to tax profits due to the use of brought forward tax losses, access to research and development allowances, or unrealised accounting gains/losses and revaluations.

The above legislation will be applicable to accounting periods commencing on or after 31 December 2023.

Additional legislation will be effective for accounting periods commencing on or after 31 December 2024, known as the Undertaxed Profits Rule to ensure that where the above rules do not result in a 15% effective tax rate being applied in a foreign country, that the UK can apply a top-up tax to the 15% rate.

Overall, this maintains a level playing field for the UK with other G20 countries.

It is interesting to note that the Government also announced that the previously proposed Online Sales Tax would not be implemented, so the view may now be that once the Pillar 2 rules are in force, together with the pre-existing Digital Services Tax, the largest multinational online giants are finally going to pay their "fair share" of tax. Given that this has been an ongoing evolution of legislation over the last decade, it seems unlikely that this will be the conclusion of these taxes, but it is clear that HMRC will have more tools at its disposal to collect revenue with £2bn per year forecast to be raised by the Pillar 2 implementation.

As previously announced, for accounting periods commencing on or after 1 April 2023 these same large companies, where UK headquartered, will need to prepare transfer pricing documentation in a master and local file format following a standardised OECD approach. Such documentation must be available to HMRC within 30 days of request, and therefore this will be a further source of data that can be scrutinised to ensure that UK taxes paid by these companies are commensurate with the of the activities performed here.

Finally, from an international tax perspective, as the UK corporation tax rate is due to rise to 25% from 1 April 2023, it was confirmed that the Diverted Profits Tax (an anti-avoidance measure, which is aimed at discouraging large multi-nationals from diverting profits from the UK to low or no tax jurisdictions) would increase to 31%, in order to maintain the differential between the two rates, and retain its deterrent effect.

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AUTUMN STATEMENT

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