Technical Connection

BUDGET ISSUE CONTENTS

Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

INTRODUCTION

This was Mr Osborne's third Budget within the space of a year, even if you disregard the quasi-budget measures announced in November's Autumn Statement. Since the March 2015 pre-election Budget Mr Osborne has been quietly tightening the tax screws with, for example, the changes to dividend taxation.

So what did emerge from the 2016 Budget? As is often the case these days, much of the answer to this is to be found in the previous year's Autumn Statement or earlier announcements. That said, there were a few surprises, and the key changes in the Budget of relevance to financial planners included:

- The introduction of the Lifetime ISA from April 2017
- The reduction of the CGT rates to 20% (from 28%) for higher and additional rate taxpayers (individuals and trustees) and to 10% (from 18%) for basic rate taxpayers
- The continuation of salary sacrifice to fund pensions - income tax and NIC effectively
- More anti-avoidance provisions
- Some technical changes to the pensions freedom rules
- An increase in the personal allowance to £11,500 and the higher rate threshold to £45,000 in 2017/18

- The announcement of consultations on investment bond taxation and on personal portfolio bonds

- A reduction in the corporation tax rate to 17% from 2020

In what follows, we cover both the changes we already knew about and new changes announced in the Budget which are of relevance to financial services.

INCOME TAX

1. Rates of tax 2016/17

(i) The limit for the starting rate for savings income remains at £5,000 and the rate of tax on income in this band is held at zero.

(ii) The basic rate of income tax remains at 20%. The basic rate limit increases to £32,000 so that the higher rate tax threshold [ie. the basic rate limit (£32,000) plus the basic personal allowance (£11,000)] becomes £43,000. The higher rate tax threshold will increase further to £45,000 in April 2017 as announced in the Budget.

(iii) The basic rate of tax will apply to taxable income in the band £1 to £32,000. Taxable income in excess of £32,000 will be taxed at 40% or 32.5% (for dividends) up to the threshold of £150,000 when the additional rate of tax applies.

(iv) The additional rate of tax (which applies to taxable income in excess of £150,000) is 45% (38.1% for dividends).

(v) Trustees of discretionary trusts are subject to income tax at 45% (38.1% on dividend income) on income above their standard rate band (normally £1,000).

2. Personal allowances 2016/17

- The personal allowance increases from £10,600 to £11,000 and it was announced in the Budget it would rise to £11,500 in April 2017. Where an individual's adjusted net income exceeds £100,000, the level of the basic personal allowance will be reduced by £1 for each £2 over £100,000 until it reaches zero. This means that the basic personal allowance will reduce to zero where adjusted net income is £122,000 or more.

- The personal allowance of £11,000 is now the same for everyone regardless of their age. In other words, the age-related personal allowance has gone.

- The married couple's allowance (MCA), which is only available provided at least one spouse was born before 6 April 1935, is unchanged at £8,355. There is a reduction in the MCA of £1 for every £2 additional income in excess of the total income threshold which is held at £27,700. The MCA will not reduce below £3,220 (the "minimum amount").

- Relief in respect of the MCA and maintenance payments continues to be given as a tax reduction at the rate of 10%.

- Spouses and registered civil partners will be entitled to transfer £1,100 of their personal allowance (called the "marriage allowance") to their spouse or registered civil partner provided that after the transfer neither spouse pays tax at above the basic rate.

3. The Personal Savings Allowance

The personal savings allowance (PSA) was revealed in last year's Spring Budget, but only begins in 2016/17. Broadly speaking, if an individual is a:

- *basic rate taxpayer*, the first £1,000 of savings income will be untaxed;

- *higher rate taxpayer*, the first £500 of savings income will be untaxed;

- *additional rate taxpayer*, they will not receive any personal savings allowance.

'Savings income' in this instance is primarily interest, but also includes gains made on offshore investment bonds. Although called an allowance, the PSA is actually a nil rate tax band so it is not quite as generous as it seems. The PSA means that from 6 April 2016, banks and building societies will no longer deduct tax from interest and neither will National Savings & Investments from those products it currently pays net interest on. The Budget announced that from 2017/18 the removal of the requirement to deduct tax on interest payments would be extended to open-ended investment companies, authorised unit trusts, investment trust companies and peer-to-peer loan arrangements.

4. The Dividend Allowance

The dividend allowance was a surprise announcement in last year's Summer Budget and also begins in 2016/17. It was part of a reform of dividend taxation, ultimately designed to raise more revenue. The main target was private company shareholders who use dividends rather than salary to extract profits and thereby avoid National Insurance contributions.

The allowance will mean that the first £5,000 of dividends received in a tax year will not be subject to tax, regardless of the investor's marginal tax rate. Once the £5,000 allowance is exceeded, there is a higher tax charge than last tax year, as the table below shows, so an investor could ultimately pay more tax on dividend income, in spite of the new allowance. The existing 10% dividend tax credit disappears from 6 April 2016, so those rates in the table below for 2016/17 are the rates to be paid.

Marginal tax rate	**Tax on dividend received**		**More tax payable in 2016/17 if total dividends exceed**
	2015/16	**2016/17***	
Basic	0%	7.5%	£5,000
Higher	25%	32.5%	£21,667
Additional	30.56%	38.1%	£25,250

* *Above £5,000 dividend allowance on which 0% is chargeable*

Like the personal savings allowance, the dividend allowance is in reality a nil rate band, so up to £5,000 of dividends will not disappear from tax calculations, even though they are taxed at 0%.

Budget announcements

- The personal allowance will increase from £10,600 to £11,000 in April 2016, followed by a further increase to £11,500 in April 2017.

- The higher rate threshold will increase from £42,385 to £43,000 in April 2016, followed by a further increase to £45,000 in April 2017.

NATIONAL INSURANCE CONTRIBUTIONS

The Upper Earnings and Upper Profits Limits (beyond which employee NICs are charged at 2%) for 2016/17 increase from £42,385 to £43,000, in line with the higher rate tax threshold.

The main rates for 2016/17 are as follows:-

- The Employee's Primary Class 1 National Insurance rate is 12% on earnings between the Primary Threshold (£155 per week - £8,060 pa) and Upper Earnings Limit (£827 per week - £43,000 pa).

- Employees, in addition, pay 2% Primary Class 1 National Insurance on all earnings above the Upper Earnings Limit (£43,000 pa).

- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£156 per week - £8,112 pa) is 13.8%. This rate applies also to Class 1A and Class 1B contributions.

- The self-employed Class 4 rate on profits between the Lower Profits Limit (£8,060 pa) and Upper Profits Limit (£43,000 pa) is 9% and 2% above £43,000.

Budget announcements

- From April 2018 Class 2 NICs for the self-employed will be abolished. Following the abolition of Class 2 NICs, Class 4 NICs will be reformed so they continue to build entitlement to the State pension and other contributing benefits.

- From April 2018 termination payments over £30,000, which are subject to income tax, will also be subject to employer NICs. The first £30,000 of a termination payment will remain exempt from income tax and the full payment will be outside the scope of employee NICs.

- The National Minimum Wage rates for those aged under 25 are increased by between 3.0% and 4.7% from October 2016.

CAPITAL GAINS TAX

Budget announcements

- The annual exempt amount remains at £11,100 for individuals and £5,550 for trustees (subject to dilution when the same settlor has created more than one trust).

- The lifetime limit on gains qualifying for capital gains tax (CGT) entrepreneurs' relief remains at £10 million as does the 10% rate of CGT for such gains.

- For individuals, the rate of CGT reduces from 18% to 10% where total taxable gains and income are less than the basic rate limit (£32,000 or the extended basic rate limit). The 28% rate is reduced to 20% and applies to gains (or any parts of gains) above this limit. For trustees and personal representatives of deceased persons, the rate of CGT reduces to 20%. The 28% and 18% rates will continue to apply to chargeable gains on residential property, for example buy-to-let properties, and carried interest (carried interest is a share of any investment fund profits that the general partners of private equity and hedge funds receive).

- A new form of entrepreneurs' relief (ER), known as investors' relief (IR), will extend the benefits of ER to external investors in unlisted trading companies. IR will apply a 10% rate of capital gains tax to gains accruing on the disposal of ordinary shares in an unlisted trading company held by individuals, provided such shares were newly issued to the claimant and acquired for new consideration after 16 March 2016, and have been held for a period of at least three years starting from 6 April 2016. A person's qualifying gains for IR will be subject to a lifetime cap of £10 million, which is in addition to the existing ER cap.

INHERITANCE TAX

Budget announcements

There was only one announcement in the Budget in relation to IHT and this concerns some technical changes to the legislation dealing with objects granted exemption from Estate Duty.

The government will introduce, in the Finance Bill 2016, a number of technical amendments to the current legislative framework for Estate Duty to ensure the legislation works in line with the publicly stated policy objective.

This relates to a relief which is available for either IHT or CGT and allows the charge to be deferred provided certain conditions (e.g. keeping the object in good condition and on public display for a number of days each year) are met. If the conditions are broken, e.g. the item is sold, tax becomes payable.

There are some inconsistencies between the relevant treatment under IHT and under the old Estate Duty regime, and between the position on death and lifetime transfers. The changes are intended to bring these into line and in some cases to give HMRC the choice of which charge to raise.

SAVINGS AND INVESTMENTS

Budget announcements

- ### Individual Savings Accounts (ISAs)

The annual ISA investment limit for 2016/17 will be unchanged at £15,240, but in 2017/18 will increase to £20,000. The limit for the Junior ISA (JISA), which is attracting more university-fee-planning investors, will stay at £4,080 for 2016/17.

6 April 2016 has also seen the launch of the Innovative ISA, which allows investment in peer-to-peer (P2P) lending. This potentially offers higher rates than the current yields on cash ISAs, but without security of capital or any deposit protection scheme coverage. From the same date new flexibility will be introduced to cash ISAs, allowing investors to replace any amount of withdrawn money without it counting towards the ISA allowance, provided the replacement occurs in the same tax year. This feature has been added because the arrival of the personal savings allowance, offering up to £1,000 of tax-free interest, has reduced or eliminated the benefits of a cash ISA for many savers.

Nevertheless, ISAs remain one of the simplest ways to save tax, with nothing to report or claim on the investor's tax return. The annual limit may be modest, but over time substantial sums can build up: if an investor had maximised the ISA investment since they first became available in April 1999, they would by now have placed over £150,000 largely out of reach of UK taxes.

Remember, ISAs are now inheritable by a surviving spouse or a civil partner, a process which is due to be simplified later in 2016 to avoid any income or CGT during the estate administration period. Alternatively, a surviving spouse can effect a new cash/stocks and shares ISA (outside of their personal limit) with a contribution equal to the value of the deceased's ISA at the date of death.

- ### Lifetime ISAs

One of the Budget's big surprises was the announcement of the Lifetime ISA (almost certain to be called a LISA), to be launched in April 2017. Details of this will be subject to consultation, but the main features already decided are:

- Only those under the age of 40 will be eligible to invest.

- The maximum annual contribution will be £4,000 to which the government will add a 25% bonus, eg a £100 contribution will become worth £125 in the plan.

- The government bonus will be paid on contributions up to age 50.

- Funds, including the government bonus, can be used to buy a first home (valued at up to £450,000) at any time from 12 months after opening the account, and can be withdrawn tax-free with the government bonus from age 60 for any use (although the intention here is that the funds will be used to boost financial provision in retirement).

- Withdrawals can be made at any time for other purposes, but with the bonus element of the fund plus any interest or growth on it forfeited *and* a 5% charge applied.

The government will examine the possibility of allowing penalty-free repayable loans against the plan and allowing penalty-free access before age 60 for specific life events other than purchasing a first home. Monies built up in a Help to Buy ISA will be transferable into the new plan during 2017/18. Savers with both a Help to Buy ISA and a Lifetime ISA will only be able to use the government bonus from one of these schemes to buy their first home.

- **Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs)**

No major changes to these investment vehicles were announced.

VCTs and EISs have been subject to a range of rule changes in recent years, with some of the most significant being introduced last year in response to revised EU state aid rules. As a result, the nature of some schemes has changed; for example, VCTs can no longer make fresh investment in management buy-outs (MBOs).

Interest in VCTs and EISs has grown as more aggressive forms of tax planning, such as film leasing schemes, have come under sustained HMRC attack and pension opportunities have been further constrained. To recap, the main tax advantage of a VCT/EIS is the 30% income tax relief on contributions (of up to £200,000 per tax year in the case of VCTs and £1 million per tax year in the case of the EIS). Other attractive reliefs apply such as the ability to take tax free dividends from VCTs and to obtain CGT deferral relief with EIS.

LIFE POLICY TAXATION

Budget announcements

- **Chargeable event rules**

The government wishes to review the current rules for taxing chargeable event gains on partial withdrawals and part assignments and will consult later this year with a view to making changes in Finance Bill 2017. The reason for the changes is to prevent "excessive tax charges" arising on transactions such as those that were the subject of the recent "Joost Lobler" case.

These "excessive tax charges" can arise when a large withdrawal (outside of the 5% tax-deferred allowances) is taken from a single premium investment bond using a part surrender/withdrawal facility as opposed to full policy (segment) surrenders. Particularly in the early years or with a substantial withdrawal, a chargeable event gain can arise on a deemed chargeable event gain in cases where there is little or no economic profit.

In such a situation, had the bond been segmented and individual segments encashed, tax will be due on the actual profit under those segments which will frequently be significantly less than the "deemed" profit on a large part surrender of the whole bond.

The government and HMRC have been made aware of the desirability of retaining, broadly, the same tax system – particularly the availability of the 5% tax-deferred allowances. It will therefore be interesting to see what proposals are made to improve the position.

- **Personal portfolio bonds**

Later this year the government will also consult on changes to the categories of asset that can form the underlying investments of a life insurance contract without it being classified as a "personal portfolio bond" (PPB). A policy which is a PPB gives rise to a penal annual income tax charge under the chargeable event rules.

We believe that this review may be motivated by the need for the rules to be brought up to date to reflect the more modern investment choices available to investors.

If changes are made following consultation they will need to be carefully factored into the decision making on whether a bond is or isn't "caught" by the PPB rules.

PENSIONS

Budget announcements

- Legislation to amend Finance Act 2004 will be introduced to permit:
    - Dependants who cease to meet the dependants criteria on reaching age 23 will be able to continue to receive dependants flexi-access drawdown or dependants annuity as an authorised payment, aligning the treatment with that of a nominee.
    - A serious ill health lump sum may be paid from crystallised funds and, if paid post age 75, will be taxable at the recipient's marginal rate(s)
    - A charity lump sum death benefit will be tax free when paid on the death of a member before age 75 and the two year rule for payments to a charity to be tax free is also removed.
    - A trivial commutation lump sum may be payable from a money purchase pension that is in payment.
    - On the death of a member of a cash balance scheme, the scheme may need to top up the funds to meet the promised level of death benefits payable to the beneficiaries and the full amount of the lump sum payable will be authorised.
- A pensions dashboard to be designed, funded and launched by the pensions industry by 2019
- No change to salary sacrifice arrangements where the 'sacrificed' salary is used to fund pensions
- Discount rate reduction for public service pension schemes which means an increase to employer contributions from 2019/20

- Government to restructure Money Advice Service, The Pensions Advisory Service and Pension Wise to create a new pensions guidance body and a 'slimmed down' money guidance body.

- A proposed increase in the tax and NIC relief available for employer-arranged pension advice from £150 to £500 – this will ensure that the first £500 of any advice is eligible for relief. The change is scheduled to take effect from April 2017.

- The government will consult on introducing a Pensions Advice Allowance which will allow those over age 55 to withdraw £500 from their defined contribution pension to redeem against the cost of financial advice.

- Consultation to take place on amending the definition of regulated financial advice in line with the recommendations made in the Financial Advice Market Review.

- Reponses to the consultation on pensions tax relief "Strengthening the Incentive to Save" were published but with no indication of any preferred government strategy for relief in the future.

EMPLOYEE BENEFITS

Budget announcements

- The current £150 income tax and National Insurance relief for employer-arranged pension advice will be increased to £500.

- A package of measures will be introduced to further simplify the tax administration of employee benefits and expenses.

- A series of measures aimed at preventing attempts to exploit the disguised remuneration legislation were announced. These include a new targeted anti-avoidance rule that will apply from 16 March 2016; the withdrawal of transitional relief on investment returns after 30 November 2016 and a new charge on loans paid through disguised remuneration schemes which have not been taxed and are still outstanding on 5 April 2019.

- Measures have been introduced to simplify the share identification rules where shares acquired on exercise of an EMI option are subject to a rights issue.

CORPORATION TAX

Budget announcements

The rate of corporation tax remains at 20% for the financial year starting on 1 April 2016. A cut to 19% is due next year, with the further reduction scheduled for 2020, originally to 18%, now to be to 17%.

PROPERTY TAX

Budget announcements

- The government announced that there would be no relaxation in the 3% increase in stamp duty charges on second residential properties – even in cases where an individual owned 15 or more properties and so ran the lettings as a true business.

- Following consultation, purchasers of additional residential properties will now have 36 months (extended from 18 months) to claim a refund from the higher rate of stamp duty in the event that there is a period of overlap or a gap in ownership of a main residence. Furthermore, small shares in recently inherited properties will not be considered when determining if the higher rates apply; there will be no exemption for large scale investors (see above) and the higher rates will apply equally to purchases by individuals and corporate investors.

- Disposals of residential property that do not qualify for private residence relief will continue to be charged to capital gains tax at the previous 18% and 28% rates - see the section on capital gains tax above for more information.

- From 6 April 2017, tax free income under the rent-a-room scheme increases to £7,500 per annum. The government will also introduce a new £1,000 allowance for property income. Individuals with property income below £1,000 will no longer need to declare or pay tax on that income. Those with income above the allowance will be able to calculate their taxable profit either by deducting their expenses in the normal way or by simply deducting the relevant allowance.

TAX AVOIDANCE AND EVASION

Budget announcements

The relentless onslaught on (what the government perceives as) aggressive tax avoidance continues….

- Tougher action and sanctions on tackling the hidden economy.

- A new criminal (strict liability) offence of tax evasion in relation to failing to declare offshore income and gains.

- New civil penalties for offshore tax evaders and those who enable tax evasion.

- Further consideration of options and clarification in relation to marketed tax avoidance.

- New tough measures in legislation to be introduced against serial avoiders and promoters of tax avoidance schemes.

- Legislation will be introduced to impose a new penalty of 60% of the tax due to be charged on cases successfully attacked by the GAAR.

- The scope of the £30,000 exemption for termination payments is to be tightened to prevent manipulation.

- Possible limitations on the range of benefits that attract income tax and NIC advantages when provided as part of salary sacrifice schemes – pensions though appear to be excluded.

- Off-payroll engagement in the public sector to be seriously reviewed which will negatively impact on those providing services to the public sector through their own limited companies.

- A tougher regime to be imposed in relation to loans to participators ("LTP") ie. loans from companies to shareholders in substitution for taxable salary or dividends. The LTP tax rate is to increase from 25% to 32.5% from April 2016 in relation to loans/advances made on or after 6 April 2016.

- Legislation to be introduced to combat disguised remuneration - £2.5bn target has been set for tax from those provisions.

TAX SIMPLIFICATION AND TAX ADMINISTRATION

Budget announcements

- The government is to respond in due course to the report from the Office of Tax Simplification (OTS) on income tax and NIC alignment.

- A system of "simple assessment" is to be consulted on to allow HMRC to assess a person's income tax and CGT liability without the completion of a self-assessment return.

- Further consultation on making tax digital from 2018.

- OTS to be made a permanent office of HMRC from April 2016.

- Government to accept or consider nearly all of the OTS recommendations on small companies including the ongoing design of a "look through" taxation system.

- Legislation to amend the simplified expenses rules to permit partnerships to fully access the provisions in respect of the use of a home in a business and where business premises are also the partner's home.

- Pay as you go tax payments to be possible for the self-employed and landlords keeping their records digitally.

- VAT registration threshold to be increased to £83,000 from 1 April 2016.

- Following agreement with the Scottish government, the UK government will legislate to separate the income tax rates that apply to savings (the savings rates) from those that apply to non-savings, non-dividend income (the main rates).

DOMICILE AND RESIDENCE

Budget announcements

No results of the recent consultation on the reform of the taxation of non-domiciliaries have been announced but the Budget confirmed that non-domiciliaries who become deemed domiciled in April 2017 can treat the base cost of their non-UK situs assets as being the market value of those assets on 6 April 2017.

Individuals who expect to become deemed UK domiciled under the 15 out of the past 20 tax years rule will be subject to transitional provisions with regards to offshore funds to provide certainty on how amounts remitted to the UK will be taxed. No details of these provisions are yet available.

Legislation to deal with the above will be included in the Finance Bill 2017.

A separate consultation will be published on the proposal to charge UK inheritance tax on those non-domiciled individuals who hold UK residential property indirectly through an offshore structure like a company and/or a trust.

INCOME WITHDRAWAL RATE FOR APRIL 2016

The appropriate gilt yield, used to determine the ‘relevant annuity rate’ from HMRC’s tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in April 2016 is 2.0%.

As usual, the contents of this Bulletin are based solely on the proposals put forward by the Chancellor in his March 2016 Budget and need to be approached with caution as details may change during the passage of the Finance Bill through Parliament.