Lexis®PSL Tax Analysis

Budget 2016 – views from the market

Tax analysis: Views from leading tax practitioners on Budget 2016.

The Lexis®PSL Tax Consulting Editorial Board (CEB) and other leading tax practitioners provide us with their views on the Budget delivered by the Chancellor on 16 March 2016.

For the Lexis®PSL Tax summary and analysis of the key business tax announcements in Budget 2016, see: Budget 2016—Lexis®PSL Tax analysis.

BUDGET 2016 IN OVERVIEW

David Milne QC, Pump Court Tax Chambers and CEB member—For me, two measures stand out, both of which would help to restore the level playing field for companies trading within Britain—if they were to work, that is.

First, the limit on multi-nationals setting interest against taxable profits (set as a maximum of 30% of EBITDA). For decades, multinationals have routinely organised their affairs so that interest is paid from debtor companies in the UK to creditor fellow-subsidiaries in, for example, Luxembourg in circumstances that are outside the scope of current anti-avoidance legislation such as transfer pricing and 'unallowable purposes'. As with the DPT, the Chancellor's announcement foreshadows one of the OECD's BEPS action plans, and is another step in the gallant quest to make UK subsidiaries pay UK tax on the true economic results of their UK trading activity.

Second, the provision designed to curb VAT fraud committed by offshore companies storing goods in the UK and selling them online through the websites of Amazon and e-Bay without accounting for VAT. This is being done by making Amazon and e-Bay liable for the lost VAT if traders using their websites have failed to register, thus effectively transferring the burden of policing the websites to Amazon and e-Bay themselves. It is likely that this measure will go down very well on UK high streets.

Eloise Walker, Pinsent Masons LLP and CEB member—The Budget is proving more interesting than expected, but it is a Budget full of sleight of hand.

Whilst we are all wowed by the cut in CGT rates (unless you are a fund manager or a second home owner, in which case sorry chaps, no reduction for you), promises of a practical approach to the DTTP scheme to include non-corporates, and the extension of entrepreneurs' relief to external investors, a lot of nastiness is hidden in amongst the razzle-dazzle.

Beware of being a single person company, they have you in their sights. Brace for a hurried introduction of the new interest deductibility rules to commence April 2017. I fear this means we should all get ready for some really bad drafting, and the news isn't good—yes, there will be a group ratio rule and a de minimis threshold (yippidoo) but no news yet on the public benefit exemption or how on earth they will make rules on volatility in earnings and interest work alongside carried forward loss restrictions introduced at the same time. We're not even getting shot of the hated worldwide debt cap rules, as they are being abolished only to rise again like a vampire in a new guise. Let's also not forget that the apprenticeships' levy—announced in Autumn Statement 2015—will also be kicking off in April 2017: call it what they like, it's an effective 0.5% increase in employers' NICs on anyone with paybills exceeding £3m.

So suspicious have we become of trumpeted 'improvements' that not even the thought of revamping the substantial shareholding exemption raises the spirits. One fears that increasing its 'simplicity, coherence and international competitiveness' will just turn out to be code for 'it's working, let's mess it up'. I do hope not (but whilst hope springs eternal it is usually disappointed).

My personal favourite piece of sleight of hand this Budget is the loss relief proposals. Just watch and admire as the Chancellor improves the useability of carried forward losses arising post April 2017 whilst restricting all those lovely losses carried forward from the bad years, especially for the banks. One can paraphrase the spin like this: 'Naughty, naughty banks, no-one likes you and the economic crisis was all your fault (never mind it was 8 years ago), so we can cripple your loss relief and no-one will care': and in 2014 when HMRC had their first stab at bank losses, no-one (outside the banking industry) did care. But anyone in big business who laughed in 2014 isn't laughing now. HMRC, emboldened, are having another go—but it's not just banks this time, it's everyone with profits over £5 million (and that's per group, not per company). The subtext reads like this: 'Big business, no-one likes you either, so look at this pretty carrot (added flexibility in loss utilisation) whilst we rip away your right to use the valid losses you generated whilst times were hard.' Will business take this one lying down? It remains to be seen.

John Endacott, Francis Clark LLP and CEB member—Smaller corporate businesses definitely look like one of the winners from George Osborne's latest Budget. Whilst we have got very used to George Osborne's boasts over numerous Budgets that 'we are the builders', about the Northern Powerhouse and most recently about the Midlands Engine, he has concentrated on giving us a stable environment for business tax planning. Also, whilst The Times must take much of the credit, there has been a focus on unacceptable tax avoidance by large multinationals and the government has been very committed to the OECD BEPS project. Whilst George Osborne has certainly undertaken some of the international tax competition that is in itself considered unfair, he does seem to have a vision for the future here and reducing corporation tax rates to 17% is all very positive.

There is a focus on small companies at the expense of large companies. From April 2017 there will be more generous loss relief rules for corporates which will be more flexible and will reduce administration costs. Whilst a restriction has been introduced for larger corporates in terms of using their losses brought forward, this will not be the case for companies with profits less than £5m. The big money raisers in the corporation tax policy announcements are all to do with increasing tax on multi-nationals, and one could construct a David vs Goliath narrative around a Chancellor supporting smaller businesses against the behemoth multi-nationals. Certainly in previous Budgets George Osborne has been accused of favouring big business, so this does seem a noticeable change. Small business rate relief is definitely a measure assisting smaller businesses.

In many ways the capital gains tax regime is returning to something closer to the business asset taper regime which was abolished in 2008 as part of a simplification measure. I think what we are seeing now is a very clear and substantial gap between capital taxation and income taxation as far as profits in corporates are concerned. Very possibly the gap is too big to be sustainable and it is quite clear that we will have clients wanting to achieve capital taxation at the expense of income taxation—especially where the amounts involved are substantial.

Stephen Pevsner, King & Wood Mallesons LLP—Once again the Chancellor pulled out some surprises but trying to simplify and increase consistency in the tax system doesn't seem to have been one of his aims. On the individual level, while welcome, it is hard to see the rationale for reducing the CGT rate at this time, particularly given the even greater difference between capital gains and dividend rates from April and the likely behaviour that it will encourage. We also seem to be moving towards a differentiated tax for certain activities, so that singling out fund managers and residential property owners for a penal charge on their capital gains will just be rubbing salt into their other wounds. And why apply employers' but not employees' NICs to termination payments? On the corporate level, the BEPS provisions and changes to use of losses will have to be assessed. No doubt for some businesses these changes will outweigh the corporation tax rate reduction.

Sam Rippon, Bristows LLP—This was a Budget that had more surprises than we have been used to in recent times. A reduction in the CGT rate, an extension of entrepreneurs' relief and a further reduction in the corporation tax rate (albeit a long way off) were not on anybody's radar.

The speech was full of the giveaways, but light on detail of how they were all being paid for. The Chancellor alluded to the business tax road map, which has clearly played a part in shaping this Budget, but he certainly did not dwell on the restriction of interest deductions or the reform of loss reliefs which the Red Book identifies as being major revenue generators. Other, more specific, revenue generators have come from very focussed areas such as imposing secondary class 1 national insurance contributions on payments as compensation for loss of office over the £30,000 allowance, which is easy to achieve and a guaranteed revenue raiser, but an oddly specific target.

There is an odd juxtaposition of, on the one hand, the pre-announced tightening of the transactions in securities rules (to prevent turning cash that could otherwise be paid as a dividend into capital by selling shares in a company full of cash) with, on the other, extending entrepreneurs' relief to a wider range of shareholders which is sure to encourage more people to try to turn the dividend they might otherwise have got into sale proceeds. It smacks of a lack of joined up thinking.

Nicholas Gardner, Ashurst LLP—This is a Budget designed to benefit small business by reducing business rates and commercial stamp duty land tax for low value properties. Large multinationals, on the other hand, are not such clear winners and will need to weigh the reduction in corporation tax rates to 17% in April 2020 against other changes which widen the tax base or increase other business taxes such as the reforms to interest deductibility, loss relief and the increases in the highest marginal tax rates for stamp duty land tax on commercial property. The changes to the treatment of brought forward losses appear to be a revenue raising measure. The increased flexibility in use of these losses to set against other profits (even in other group companies by way of group relief) comes at a price—the restriction of profits against which the losses can be utilised. The consultation process will need to set out the finer details of the proposals and it remains to be seen whether this will result in an overall simplification.

BUSINESS AND ENTERPRISE

Hilary Barclay, Macfarlanes LLP—The new business tax road map has a mixture of expected changes and surprises for multinational groups. There was always going to be some BEPS implementation, in particular the new hybrids rules, though it is disappointing that HMRC have decided to plough on with the interest barrier rules this early on. Having said that, it is useful to know sooner rather than later what the thresholds will be. The 30% limitation is as high as could be expected and the £2m de minimis is more generous than the £1m mentioned in last autumn's consultation document. The group ratio rule should help in practice too. We have yet to hear how the rules will apply to domestic groups—the rhetoric seemed a little confused on this—but hopefully we will have some draft legislation before too long to clarify the position. Personally I will not be mourning the demise of the clunky worldwide debt cap legislation but the change will inevitably put a new burden on tax managers who have got used to implementing it.

There is mixed news on losses. The theoretical extension of group relief beyond the current accounting period and the ability to use losses against a broader range of income will bring the legislation more in line with the principle of treating a tax group as one economic whole. However, in practice the impact of that change will be limited by the 50% restriction on the use of carried forward losses above a £5 million profits threshold.

The newly announced reviews of the substantial shareholding exemption and HMRC's double taxation treaty passport scheme are very welcome. International clients and advisers find the complexity of the SSE perplexing—inward investors tend to assume that it is as user friendly as participation exemptions in other jurisdictions. Simplification would be a great boost, not to mention having words on the page that say what they mean (I'm looking at you, paragraph 3(3)).

The DTTP scheme is working well for both borrowers and lenders at present and should be extended to a broader range of overseas investors. Personally I think there is now scope for implementation of a US style system (complete a W-8 BEN or similar form and no withholding is required) given the breadth of the exchange of tax information regimes we now have in place. An extension would be a good start, but UK partnerships must not be left behind—it would be absurd to allow access to the DTTP scheme for overseas partnerships but still require withholding on UK partnerships with a mix of corporation tax paying and other investors.

Nick Cronkshaw, Simmons & Simmons LLP—The Chancellor's eighth Budget may make the headlines for its introduction of a sugar tax and the downgrading of the fiscal outlook, but businesses were hoping for the long-awaited second iteration of the government's business tax road map. The road map sets out the direction of travel for corporate taxes on business until 2020 and is seen as an important component in providing the necessary certainty and stability for businesses to invest and plan longer term—though the inherent uncertainties in the run up to an in/out vote over EU membership rather overshadows this in the short term. It was the 2010 road map, which set Britain on the path to a low tax, broad tax base economy, with the aim of making the UK's corporation tax regime 'the most competitive in the G20'. The 2016 version seeks to carry much the same message, but the route this time looks rather less scenic.

Although the Chancellor surprised everyone with yet another cut in the rate of corporation tax to 17% (from 2020), in reality most multinational businesses will be looking at an increased tax (and administrative) burden. The UK government's position as an early adopter of many of the OECD's BEPS recommendations, particularly in restrictions on interest relief, will increase the tax burden on many businesses. On top of this other domestic measures, such as the unexpected restrictions on the ability to use carried forward losses, mean that any further tax reductions are likely to be offset by a broadening of the tax base. The recent furore in the UK over Google's tax settlement shows how fragile the government's reputation in relation to its relationship with Big Business is in some quarters. As such, we can expect the crackdown on tax planning to continue unabated.

Mark Sheiham, Simmons & Simmons LLP—The government announcement that it will introduce significant changes to the way losses can be used, contending that changes are necessary to bring the UK into line with international best practice, certainly came as something of a surprise. The restriction, from 1 April 2017, on the amount of profit that companies can offset through losses carried forward to 50% will effectively increase taxes for many businesses, even though it will only apply to profits in excess of £5 million (calculated on a group basis). The government argues that the UK tax system should be brought into line with the majority of G7 countries, which already have restrictions of this kind in place.

A broader tax base is clearly the quid pro quo for ever lower corporation tax headline rate, but, in practice, many businesses will see tax increases as a result. Nevertheless, the greater flexibility in the use of carried forward losses that has been announced at the same time will do much to sweeten this particular pill. Banks continue to be treated differently (worse), however. In their case, the further 50% restriction on the use of relevant pre-April 2015 carried-forward losses (to 25%) will come into effect from 1 April 2016 (a year earlier than the wider reforms).

Etienne Wong, Tax Chambers, 15 Old Square—Co-opting online marketplaces as a last resort to deal with overseas businesses who persistently fail in their UK VAT obligations is a bold and creative move. It remains to be seen whether it is effective.

Phil Vernon, PwC—Increasing the small business rates multiplier to capture properties with a rateable value of up to £50,000 is a good headline grabber, but will only save business between £160 at the bottom of the scale and £600 per year at the top. However, the decision to permanently increase small business rates relief will be a welcome boost to many small businesses. This relief has been temporarily doubled for many years but has become a significant tax cut that many small businesses have come to rely upon. It was just a matter of time before this increase became a permanent fixture, but we will need to see how this increase ties in with EU state aid restrictions.

The move to change the calculation of business rates by limiting annual increases from RPI inflation to CPI inflation from 2020 is also very welcome, but many businesses will ask why wait until then? With a full property revaluation taking effect from April 2017 and the tax rate being re-set, next year would have been the perfect opportunity to make this change. This decision probably coincides with the announcement that rates revaluations will happen more frequently and so will likely take effect from the next revaluation.

Local government will be particularly interested in the detail of these changes. With 100% of business rates being retained by Local government by 2020, the risk associated with lower business rates receipts could fall on their shoulders and service delivery may be affected.

FINANCE

Gerald Montagu, NGM Tax Law and CEB member—Interest relief is to be capped at 30% of taxable UK earnings or by reference to the net interest to earnings ratio of a worldwide group (subject to a hurdle of £2 million net UK interest expense and special rules for public benefit infrastructure).

Where relief for interest remains available, deriving benefit from that relief may also be deferred as a result of new restrictions which will apply from 1 April 2017 to restrict to 50% (or, in the case of banks from 1 April 2016, to 25% in respect of pre- 2015 losses) the amount of profit that can be offset against losses. On the other hand, the rules governing the use of carried forward losses are to be liberalised (for losses which arise on or after 1 April 2017) so that carried forward losses can be used against profits from other income streams or from other companies within a group. This relaxation is likely to be of more use to some groups than others (and, for example, may be less useful where a group is private equity funded).

A decision has (unsurprisingly) been made to update the version of the OECD's transfer pricing guidelines, with effect from April 2016, to the guidelines which emerged from the BEPS process.

Martin Shah, Simmons & Simmons LLP—Following the 2015 consultation, it came as no surprise that the government announced that it will introduce a restriction on the tax deductibility of corporate interest expense to implement the OECD BEPS recommendations on Action 4 with effect from 1 April 2017. The announcement that the UK will introduce a fixed ratio rule limiting corporation tax deductions for net interest expense to 30% of a group's UK earnings before interest, tax, depreciation and amortisation (EBITDA) is at least welcome to the extent that 30% is at the top of the range proposed by the OECD. Also welcome is the decision to implement, after extensive lobbying, a group ratio rule based on the net interest to EBITDA ratio for the worldwide group.

And perhaps surprisingly, although in line with many responses to the 2015 consultation, the government has also announced that there will no longer be a need for a separate worldwide debt cap and the existing legislation will be repealed. However, rules with similar effect will be integrated into the new interest restriction rules, such that a group's net UK interest deductions cannot exceed the global net third party expense of the group. The interaction of this restriction, the fixed ratio rule and the group ratio rule may well cause some complexities in practice.

Victoria Heard, KPMG—Today's announcement to further restrict how banks can offset their losses is more bad news for the sector—the existing ability to offset 50% of their profits with losses will be reduced to 25% from 1 April 2016. This is only a timing difference, in that these losses will be used up against profits eventually, but it will accelerate the tax take to the treasury at the banks' expense.

The announcement of interest relief restrictions as an anti-tax avoidance measure will have a knock-on effect on bank lending. It will change the economics of borrowing for banks' corporate customers, and so banks will have to review lending criteria and credit assessments, adding further pressure on their already squeezed margins.

FUNDS

Bradley Phillips, Asset Management Tax Group, PwC and CEB member—The Budget confirmed that the third of the trilogy of tax changes affecting asset manager individuals will be introduced from April this year. Following the disguised investment management fee (DIMF) rules and the CGT carried interest rules introduced last year, the government has finalised the proposed rules that will determine when asset managers will have to pay income tax rather than CGT on carried interest. We await the draft Finance Bill next week for the details but it is likely these rules will have a major impact on certain asset managers.

These changes and the 2014 changes to the tax treatment of LLPs plus the further proposed reduction in corporation tax to 17% in 2020 are likely to cause a number of asset managers to consider whether operating as an LLP is really the optimum structure for the future. The changes to the rate of CGT and the proposed extension of CGT entrepreneur's relief to long-term investors may also ultimately impact on asset manager arrangements.

Also of interest to certain asset manager individuals will be the announcements regarding the non-dom tax reform which will now be included in the Finance Bill to take effect from April 2017, in particular, the proposed treatment of existing offshore trusts and the suggestion that there will be re-basing of offshore assets.

The increased ISA allowance, the proposed lifetime ISA and the new personal tax savings allowance are all good news for the industry, as is the proposal to abolish the requirement to deduct income tax at source from interest distributions from open-ended investment companies, authorised unit trusts and investment trust companies, and on interest on peer-to-peer loans.

A number of the Budget measures will impact on investments funds and how they may structure their investments, in particular, the various BEPS inspired changes: interest relief, hybrids, the changes to double tax treaties etc. The new tax rules for UK property development will likely impact various property funds.

The proposal to examine the double tax treaty passport scheme is welcomed if it does result in it being extended to a wider range of foreign investors, including sovereign wealth funds and pension funds and if funds structured as partnerships can get the passport. This will greatly assist in structuring UK debt investments.

In summary, it is rare nowadays for a Budget not to have a serious impact on the asset management sector and this year's Budget is no exception!

Gerald Montagu, NGM Tax Law and CEB member—It is difficult to know quite how to react (other than, perhaps, to despair) to the Leader of Her Majesty's Opposition's verdict that the measures re-announced and announced today in relation to the taxation of carried interest made this a Budget for 'hedge fund managers'. Rather, a fund manager taking a moment to visit the Botticelli exhibitions at the Courtauld or the Victoria and Albert Museums might be forgiven for wondering to what circle of Hell the Chancellor wished to consign him and his private equity brethren. Publication of the Finance Bill will reveal precisely how the new rules on the taxation of carried interest are to work and the only light shed in the Red Book on the 'finalised' new rules was that capital gains treatment will only apply when a fund undertakes investment activity with 'investment horizons longer than 3 years' (rather than the two years originally mooted or the four years referred to in the draft Finance Bill). However, to the extent that capital gains tax treatment does apply, the Chancellor explained that a capital gain is to be subject to an 8% surcharge, thereby subjecting that gain to tax at a rate 40% higher than the rate which will apply to gains on disposals of other assets (except for residential property).

Incentivising management in tax efficient fashion will also become more difficult for fund managers, with a lifetime cap, of £100,000, being imposed on the (previously very generous) capital gains exemption conferred by the employee shareholder scheme. However, fears that the scope of entrepreneurs' relief might be cut back in other respects proved to be unfounded and this will therefore remain a useful tool by means of which senior management may be incentivised.

Catherine Sear, Proskauer Rose (UK) LLP—There are a quite few points of interest for the private funds industry, but as is so often the case we need sight of the legislation to understand the full effect of these announcements. Carried interest is a case in point. Despite featuring in George Osborne's speech, there was very little information on the 'income based carried interest' (IBCI) proposals. The Red Book confirmed that these proposals will feature in FB 2016 and hinted at where the debate on an appropriate average holding period has ended. But it was just a hint. In light of the tapering between 3 and 4 years in the December 2015 draft legislation, it is not clear what 'investment horizons longer than 3 years' means. On another note, the reference to investment 'horizons' may indicate that the test will be intention based rather than based on actual holding periods, which would be good news where a fund exits an investment unexpectedly early. The Finance Bill legislation should clarify these points, and hopefully revised guidance on the new landscape for taxing investment managers' fund participations (disguised investment management fee rules, carried interest CGT charge and IBCI rules) will follow shortly thereafter.

Back in December 2015, it seemed as though the IBCI rules completed this landscape, but the announcement that the new CGT rate cut will not apply to carried interest is an example of how easy it will be for the government to single out carried interest, as defined, for special treatment now that the definition exists.

Staying with the CGT rate reduction, while the overall impression from the Budget documents is that this is a simple rate change for disposals occurring on or after 6 April 2016, the policy paper refers to the new rates applying to gains 'accruing' on or after that date. Is this an intentional reference to some kind of apportionment between gains accruing before 6 April and those accruing on/after, and if so what is the basis for the apportionment? Again we need to see the legislation. In other CGT news, the extension of entrepreneurs' relief is welcome, although the employee shareholder status cap may prove a disappointment to some.

Ceinwen Rees, Debevoise & Plimpton LLP—There was a lot to interest the investment fund industry in the Budget. Some, fairly limited, hints were given regarding the future taxation of carried interest, which is what everyone is waiting for. The average holding period has been reduced to 40 months (from 48) and special regimes will apply for certain asset classes including venture capital and real estate. We need to wait for next week's Finance Bill for the detail, to see if any other asset classes are distinguished and find out the scope of the promised 'minor technical changes'. For UK resident non-doms facing deemed UK domicile, some hope was given in that they will benefit from market value base cost on their non-UK assets and confirmation that funds held in offshore trusts will be respected.

We understand that the UK would like to be viewed as the 'new Luxembourg' for funds looking for holding company structures. The announcement that UK corporation tax will drop to 17% in 2020 is a stark contrast to the recent disappointingly small reduction in Luxembourg's corporation tax rate and certainly a move in the right direction. Combined with the announcement that the UK will consult on the future of the substantial shareholder exemption, the UK is clearly seeking to be an attractive place through which to hold investments, although following the disguised investment management fee and income based carried interest reforms, it may take time for the investment fund industry to trust the UK.

CAPITAL GAINS TAX

Gerald Montagu, NGM Tax Law and CEB member—The belated steps taken to 'tidying up' last year's reforms to entrepreneurs' relief are to be welcomed. These include the ability to claim relief where an associated disposal is made to a family member under 'normal succession arrangements' and the ability to claim relief in relation to the goodwill on incorporation when a business is transferred to a company controlled by five or fewer persons or by its directors, albeit only if the taxpayer holds less than 5% of the acquiring company's shares (although it rather beggars belief that it has taken so long to get there—the change in relation to goodwill applies to disposals made on or after 3 December 2014). Adjustments (with effect from 18 March 2015) to the definitions of 'trading company' and 'trading group', to permit the (trading/non-trading) activities of a corporate partner to be respected and to permit a company invested in a JV to have attributed a share of the JV's activities which is proportionate to its shareholding in the JV, also are positive developments which soften, at least a little, the blunderbuss approach taken last year. One slightly odd effect of these adjustments is that whether a company is a trading company or the holding company of a trading group may depend upon the size of the shareholdings held by different types of investors.

In a helpful (and somewhat unexpected) move, entrepreneurs of a slightly different ilk subscribing for unlisted shares (including shares traded on AIM) issued on or after 17 March 2016 in a trading company (or the holding company of a trading group) will be able to claim entrepreneurs' relief, up to a (separate) £10 million lifetime limit, provided those shares are held for not less than three years (with the clock starting, for issues in the 2015-2016 tax year, from 6 April 2016). Why, other than the fact a 10% rate will apply, the Chancellor chose to describe this as an extension of 'entrepreneurs' relief' is not immediately apparent—although one is left with the sneaking suspicion that this was intended to duck accusations of introducing a tax cut for the wealthy (a basic rate taxpayer paying tax at the new 10% rate would seem not to benefit at all). If this is indeed a piece of nifty political footwork then it will be regrettable if (as seems likely) such rhetoric camouflages the new relief and hinders the quest for a transparent tax code.

John Endacott, Francis Clark LLP and CEB member—For a Budget that was pretty boring, there was a fair amount in it about capital gains tax. I had clients who were expecting increases in capital gains tax on Budget day and were even planning to accelerate transactions to take place ahead of it. They would have been surprised to see the main rates of capital gains tax falling with effect from 6 April 2016, with the new rate for higher rate taxpayers and additional rate taxpayers of 20%—an 8% reduction. The basic rate falls from 18% to 10%, although the old rates will continue to apply to residential property and carried interest.

It means there is an ever greater incentive to retain money within businesses and to invest for the future. The increases in dividend tax rates with a reduction in corporation tax should encourage retention of profits within businesses and investing for the longer term.

Alongside this, a new relief is being introduced for investors in unquoted companies which is being badged as an extension to entrepreneurs' relief. This is going to add to complexity as it is a measure designed to benefit share issues on or after 17 March 2016, and so is designed to motivate external investors to invest in unquoted companies. This new relief has a £10 million lifetime cap. It is not clear whether this is a new lifetime cap to the entrepreneurs' relief lifetime cap, or part and parcel of the same thing. This will be relevant to individuals who already utilise their £10 million lifetime limit for entrepreneurs' relief and creates quite a confusing landscape as far as shareholders' structuring for corporate business is concerned.

The first choice will inevitably be to encourage subscribers to make use of the enterprise investment scheme (EIS) but not all trades will qualify for the EIS. If EIS is not available, then this new investors' relief will be attractive although it may be that entrepreneurs' relief could also apply, which would potentially be more generous depending on the nature of the investment. Over time people may vary between the different categories but there is still the need to consider things such as employment related securities as well. If this sounds a bit of a minefield then it almost certainly is.

Despite concerns that there would be restrictions to entrepreneurs' relief in the budget, no new restrictions have been introduced which may be because George Osborne does not want to aggravate the party faithful. On the Finance Act 2015 changes where restrictions were introduced to entrepreneurs' relief for associated disposals, after several suggestions that these would be unwound this has finally been included in this Budget and changes will be made effective from 18 March 2015 – Budget day last year. Hopefully this year's tax measures have been better thought through, but you never know.

EMPLOYMENT TAXES

Graham Muir, Nabarro LLP and CEB member—In what was in many respects the most interesting Budget for a number of years, the Chancellor made a number of announcements of interest to practitioners in the employment tax and employee incentives field.

Perhaps of most interest, being the least heralded and impacting on a recently burgeoning tax-efficient opportunity, was the swingeing reduction in the tax benefits available under the employee shareholder status (ESS) regime. Previously, to the extent that the ESS shares were worth between £2000 and £50,000 on acquisition, any gain accruing on their disposal would be free of capital gains tax (ie the amount of the gain was unlimited). This contrasted with CGT entrepreneurs' relief, which is a limited to lifetime gains of £10 million. With effect for all ESS share agreements entered into after midnight on 16 March 2016, the capital gains tax relief on ESS shares will be limited to lifetime gains of £100,000 per individual. This limitation has no effect on ESS shares acquired pursuant to agreements entered into on or before 16 March 2016. It seems likely that the change will, at a stroke, significantly stem the flow of ESS arrangements being put into effect (most frequently in the context of private equity transactions). While it is possible that ESS will continue to be used for those whom the government originally intended on its introduction in 2013, it seems more likely that such arrangements will only be introduced in very rare cases from now on.

Probably the next most significant announcement for employers in the Budget, albeit not with such immediate effect, is that relating to the taxation of termination payments. Following a consultation process, the Chancellor announced a package of measures to be included in Finance Bill 2017 to tighten and clarify the tax rules applying to payments made when an employee leaves his employment. It is understood that the proposed changes will include (a) clarifying that all payments in lieu of notice (irrespective of whether they are contractual) will be subject to income tax and National Insurance contributions (NICs) in full as earnings (b) tightening the rules relating to contractual payments paid as damages to ensure that they too will be treated as earnings (and hence subject to income tax and NICs in full) and (c) removing the exemption for foreign service. In addition, employers' NICs will be aligned with the income tax treatment of payments in connection with the termination of employment which are not otherwise taxable (so that any excess of such payments over £30,000 will be liable both to income tax and to employer's NICs). These changes will take effect from April 2018.

As referred to both in the 2015 Budget and Autumn Statement, the government is concerned about the rapid increase in the use of salary sacrifice arrangements and the resulting loss to the exchequer. With this in mind the Budget contained an announcement that the government is considering limiting the range of benefits that attract income tax and NICs advantages when provided as part of salary sacrifice arrangements. However, it is not intended that the income tax and NICs reliefs available in relation to pension saving, childcare and health-related benefits made available through salary sacrifice arrangements will be restricted.

The government has long been concerned by the loss to the exchequer resulting from non-compliance with the tax regime applying to personal service companies and other employment intermediaries (known as the IR35 rules). It is now going to tackle such non-compliance where the customer of the personal service company is a public sector entity. With effect from April 2017, where the circumstances apply, the public sector entity will be responsible for determining whether the rules should apply AND for paying tax to HMRC.

The last significant announcement relating to employment tax in the 2016 Budget was that of a package of measures intended to tighten, and to some extent extend, the disguised remuneration regime introduced in 2011. The most significant aspect of this package is the (effectively retrospective) application of the disguised remuneration rules to charge to income tax as earnings any loan which, had it been made on or after 10 December 2010 (the date the disguised remuneration rules were announced) would have been subject to that regime, to the extent that such loan is outstanding on 5 April 2019. Accordingly, loans which were effectively 'grandfathered' by reason of having been made prior to the announcement of the disguised remuneration rules will nevertheless be effectively caught by those rules if (and to the extent that) they are not repaid before 5 April 2019. It is likely that where such arrangements were put in place prior to December 2010, the relevant taxpayers would have taken advantage of the settlement opportunity offered by HMRC between 2011 and 2015 if they considered that there was any doubt as to the effectiveness of those arrangements under the legislation in force when they were introduced. Accordingly, this is arguably retrospective legislation in its truest, and most egregious, sense, enabling HMRC to tax retrospectively arrangements which (while in most cases clearly tax avoidance and therefore objectionable on policy grounds) were clearly not taxable under the legislation in force when the arrangements were established.

In addition to the above, the Budget contained a number of other minor announcements relating to the taxation of employee benefits and expenses.

Gerald Montagu, NGM Tax Law and CEB member—The jury, it seems, is still partially out on the changes proposed last year to the £30,000 exemption for termination payments. Reassuringly, the Red Book states the government will 'continue to support' those who lose their jobs—although one might wonder at the wholeheartedness of that support when the cap is to remain at £30,000. However, from April 2018, employers' NICs will be imposed on payments over £30,000 and it remains to be seen precisely what the government has in mind when it seeks to 'tighten the scope of the exemption to prevent manipulation'.

John Endacott, Francis Clark LLP and CEB member—The employee shareholder exemption may be starting to look a little too generous as a restriction is being introduced to limit that relief to a lifetime limit of £100,000. That relief is being used as an alternative to enterprise management incentives (EMI) by some companies and the lifetime limit being introduced here needs to be looked at in that context.

Dan Pipe, Jurit LLP—The announcement of a charge on loans paid through disguised remuneration schemes which are still outstanding on 5 April 2019 will likely accelerate the careful unwinding of many EBT arrangements—entered into quite properly and before the introduction of the disguised remuneration legislation—where those involved have chosen not to take up the EBT settlement opportunity.

The change to the intermediaries rules for off-payroll workers in the public sector demonstrates further creep away from the original principles of IR35. It's to be hoped that the digital tool being developed to help public bodies determine the IR35 position of their contractors will be more even-handed than HMRC's existing employment status indicator, as it is clearly intended to be referred to by private sector contractors as well.

The lifetime gains cap of £100,000 for employee shareholder shares effectively kills that method of incentivising senior management.

REAL ESTATE

Gerald Montagu, NGM Tax Law and CEB member—If buy-to-let investors felt somewhat beleaguered at the time of the post-election Budget last year, the Chancellor's announcement that a capital gain from the disposal of residential property is to be subject to a surcharge set at 40% more than the rate of tax otherwise due on a capital gain arising on the disposal of assets (other than on fund manager carried interest) showed that there is to be no-let up in the effort to tilt the tax system away from incentivising real estate investment.

Any hope that the 3% higher SDLT charge might not apply if a purchase is enveloped or a portfolio of a significant size was also dashed. However, where a marriage or civil partnership is on the rocks and couples have separated (but have not formally divorced) the two individuals will not be treated as a single unit for the purposes of 3% charge, nor will an additional property be treated as being owned if 50% or less in a single property has been inherited within the 36 months prior to a transaction. More helpfully, a homeowner will have up to 36 months to, depending on the circumstances, either claim a refund of the higher 3% charge or to establish that the higher 3% charge does not apply.

If such an investor might have been tempted to dabble with non-residential or mixed use land, he or she will be faced with an additional 1% SDLT on consideration for a freehold over £250,000 and 2% SDLT to the extent that the rental NPV exceeds £5 million. It is likely to be scant comfort, that 'we are all in it together', to know that (subject to treaty re-negotiation, where necessary) profits from the development of land are to be subject to income tax even if an offshore developer manages not to acquire a permanent establishment in the United Kingdom. It remains to be seen how these new rules will work—the new provisions are to apply from the date legislation is introduced during Report Stage of the Finance Bill—but it is clear from the consultation exercise that there are many unanswered questions and the interaction with the diverted profits tax may be particularly interesting.

There are some crumbs of comfort for the real estate sector, but they are few and far between. For example, a residential property investor will be able to rest assured that in the event of his death a beneficiary of the estate will be entitled to claim a tax reduction for financing costs.

Robert Langston, Saffery Champness—Non UK residents are subject to UK tax on trading profits which arise from the development of UK property under the transactions in land anti-avoidance rules. However, many double tax treaties restrict this so that UK tax only arises to the extent that there is a permanent establishment in the UK. Many developments have been undertaken in the past by SPVs in Guernsey, Jersey and the Isle of Man, due in part to the relief under the applicable double tax treaty.

HMRC have in the past argued that a permanent establishment does exist as a result of the development, but have not had much success. With effect from 16 March 2016, the double tax treaties with these jurisdictions have therefore been amended so that trading profits which arise from property development are subject to UK tax even where there is no permanent establishment in the UK.

At the same time, the transactions in land rules will be extended so that UK tax also arises where:

- the company undertaking the property development pays a fee to a related party which reduces the profit arising from the development itself, or
- the profits from development of UK property are realised indirectly, from the sale of shares in a company which owns the property

Etienne Wong, Tax Chambers, 15 Old Square—I was intrigued to see the proposals targeting offshore developers of UK land. With the diverted profits tax already in place, this shows the government's clear determination not only to tackle, but eliminate, (what they regard as) avoidance in this area. This is hardly surprising in the current political climate, although I did not expect them to have already agreed protocols to amend the double tax treaties with Jersey, Guernsey and the Isle of Man. It will be interesting to see the detail of the legislation (especially the TAAR to counter fragmentation and the use of 'envelopes').

Sam Rippon, Bristows LLP—Taxes on property have become much more popular (for the Chancellor) than they have been previously: new measures to target offshore property developers (together with a non-resident UK property development taskforce to oversee it) and an increase in the rate of SDLT on high-value commercial leases were also a surprise. The 1% rate of SDLT on leases has always seemed an easy target for revenue raising, but there is cause for alarm here because once the increases start, sometimes they are difficult to stop (and rates of stamp duty rarely, if ever, actually get reduced even if the method of calculation is changed).

PERSONAL AND PENSIONS TAXATION

Gerald Montagu, NGM Tax Law and CEB member—Given all the pre-Budget speculation in relation to pensions, it will be interesting to see if Armageddon for higher and additional rate tax relief has been postponed (perhaps until after the European referendum?) rather than averted. As the new lifetime ISA beds-in, it is only too easy to see the Chancellor (or one of his successors) deciding that a system to tempt those under 40 to save, could be rolled-out more widely (after all, does the choice of whether to invest in the lifetime ISA or a pension not add additional complexity for savers, and would it not be fairer if the same approach applied to all?)

This was not the Budget for filling in detail with respect to the new regime that is to be introduced for non-doms from April 2017. The only slight straw in the wind seems to have been 'confirmation' that a non-dom who becomes deemed-domiciled in April 2017 will be able to elect to treat the cost base of their non-UK based assets as being the market value of those assets on 6 April 2017. It was, hopefully, a sign that the approach to implementing these changes will be relatively pragmatic and balanced.

Andrew Masters, KPMG—The Lifetime ISA announced today really feels like a testing ground for the Pensions ISA and I expect that in the next couple of years we will see a complete abolition of the existing pension tax relief system as we know it today.

The piecemeal approach the government is taking to pension reform adds complexity and uncertainty to an already complex market. We have had changes to pensions in every budget for the past ten years and today's announcement clearly indicates that further changes are afoot. Above all else, we need a period of stability to build trust and understanding in retirement provision.

ISAs are a trusted and transparent vehicle, and the lifetime ISA is to welcomed, but simply tacking this onto the existing system is just a sticking-plaster. It raises a lot of questions for employers and employees. It isn't straightforward for an employee to work out if they are better off in their existing pension or in a lifetime ISA. It will also be a challenge to work out how this works with auto-enrolment. There's a risk that this could result in higher opt-out rates under auto-enrolment. If this scenario comes to fruition, and if people end up dipping into their lifetime ISA before retirement, we could end up with even less money in UK long term savings.

Philip Smith, PwC—Today's announcements mark the start, not the end, of the story in getting people to save more for their long-term future.

Market forces are now likely to drive more younger savers towards ISAs and away from pensions, a trend that will be accelerated if the Chancellor goes ahead with the type of flexibility offered in the US that allows savers to withdraw savings and repay later. It's interesting that older savers have not been included in the new Lifetime ISA. This may point to a future dual track system, leaving the current pension system in place, but introducing the pension ISA by stealth. Once the market beds down, a change to a fully fledged pension ISA becomes much easier.

It will be interesting to see the impact on the auto-enrolment market, and employers' reward strategies as pension saving for those under 40 has just become a whole lot less attractive. For those with a significant proportion of millennials in the workforce, a key question will be whether or not to introduce a Lifetime ISA alongside an auto-enrolment pension. Employers that offer pension and Lifetime ISA from a single platform could be the big winners as the pension reform race heats up.

Joanne Segars, Pensions and Lifetime Savings Association—The Chancellor's decision to make no changes to pension tax relief is the right one. We are pleased the Chancellor has listened and recognised that huge changes to pension tax relief will not act as an incentive to save.

The introduction of a Lifetime ISA is an interesting initiative to help younger people add to their pension and lifetime savings. We look forward to working with the government to help make sure that the Lifetime ISA does help younger people build up their savings. An important part of this will be to make sure that savers' interests are protected by ensuring that the regulation on charges and governance of the Lifetime ISA are comparable to those for pensions, which have been reviewed to make sure they offer savers good value.

The government has extended the way in which people will be able to save for their retirement and should use this opportunity to agree a new consensus for pensions that focuses on the long-term, builds confidence and gives both savers and employers clarity and stability. We call on the Chancellor to create a new independent retirement savings commission to tackle that challenge.

ENERGY AND ENVIRONMENT

Alan McCrae, PwC—The Chancellor's announcement of a reduction in tax rates and effective abolition of Petroleum Revenue Tax is a welcome boost for our oil and gas industry, which has been facing exceptionally challenging times over the last 12 to 18 months. Across the North Sea, this will reduce the rates from 67.5% for the older fields and 50% for the newer fields to 40% for all fields. This is aimed at stimulating investment at a time when the industry desperately needs it. It is a smart move that recognises that the tax prize for the Treasury at this stage in the life of the North Sea is not corporate taxes. Instead the government has more tax revenue to gain by doing all it can to protect investment and jobs and all the tax that goes with that.

The industry is also in line to get help to ensure that companies that incur decommissioning costs get relief for that expenditure. This will help future deals and will be broadly welcomed by operators. However there is a sting in the tail. The restriction in the timing of loss relief could give some companies a nasty and unexpected cash flow shock at a time they can least afford it.

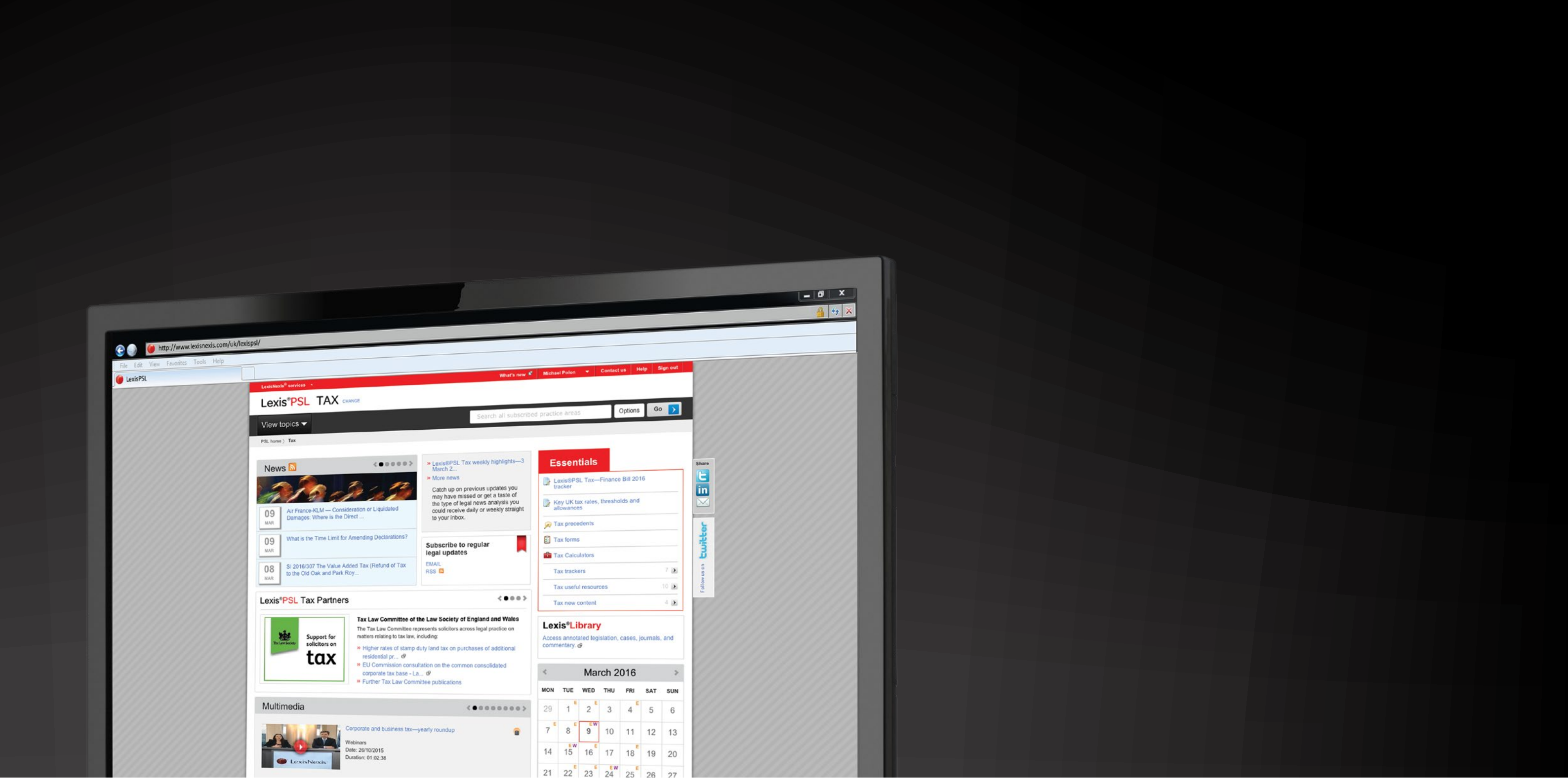
Nicholas Gardner, Ashurst LLP—Oil and gas companies operating in the North Sea have been lobbying for substantial tax cuts to support their activities. It remains to be seen whether the reduction in the supplementary charge to 10% and the 'effective' abolition of petroleum revenue tax with effect from 1 January 2016 will be enough or whether they are just too little too late.

Jayne Harrold, PwC—Energy tax reforms, through scrapping the carbon reduction commitment (CRC) and replacing it with an increased rate of climate change levy (CCL) from April 2019, as well as rebalancing the CCL rates away from electricity and towards gas, will greatly reduce the administration and compliance burden placed on many businesses that fall within the carbon reduction commitment scheme. Now they will receive all of the cost of their energy taxes directly through their energy bills. To counter-balance the CCL rate increase for energy intensive industries there will be larger discounts for businesses that participate in climate change agreements. The Budget also sets out to address one of the past criticisms of climate change agreements which has been the mismatch between the CCL and CRC savings received from business that can't meet the energy efficiency targets. A target review will now be undertaken by DECC that will also review the level of the buy-out penalty that is involved, to address the problem.

While the carbon price support cap has been maintained at £18/tonne plus RPI for 2020/21, the Chancellor announced that he will set out the long term direction for the Carbon Price Support (CPS) in this year's Autumn Statement, with changes to be introduced in Finance Bill 2018.

It's no surprise that the rates of both aggregates levy and fuel duty remain frozen, but the announcement that the government is to consult on an aggregates levy exemption for utilities is a positive outcome. This will be welcome news to the water and power industries as it would exclude their pipe laying activities from the tax, which is difficult to administer.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.



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