SUMMER 2024

Hazlewoods

Talking Tax

Changes on the horizon

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Tax changes on the horizon

Following the recent general election and a change of government to the Labour party, we look at some of the tax policies pledged in their manifesto and the possible actions to consider as a result.

Income and corporation taxes

Labour have said that they do not have any plans to raise income taxes and, in fact, would like to lower them, if possible, as it would benefit the 'working people'. In the run up to the previous election, however, the party did pledge to align dividend and income tax rates which could prove a concern for owner managed businesses.

They have also pledged that they will not look to increase national insurance contributions nor corporation tax rates as part of their manifesto.

Capital gains

Whenever there is a change in government or an upcoming Budget, any significant transactions or disposals are often accelerated, in an attempt to circumvent any announcements of immediate changes to the capital gains tax (CGT) regime.

In their manifesto Labour remained silent on CGT with no commitment to maintain current reliefs or rates. In their 2019 manifesto, Labour proposed to align CGT rates with income tax rates, whilst reintroducing an indexation allowance to allow for inflation. They also said that they would abolish entrepreneurs' relief (now known as business asset disposal relief) and would consult on a better alternative. If this comes back on the agenda, there could be another push for people looking to complete affected transactions sooner rather than later.

VAT on school fees

Labour have, for some time, pledged that they would introduce VAT at the standard rate of 20% on private school fees as well as ending their exemption from business rates. The party has estimated that this move would generate an additional £1.5 billion of revenue for the government. Labour have also confirmed that they will bring in some anti-forestalling legislation to prevent a surge of advance payments for school fees in an attempt to avoid paying VAT. Any such plans to pre-pay fees are therefore likely to be ineffective.

As a result of the school becoming VATable, however, it will also be able to offset VAT which it has incurred on goods and services for the business. Therefore, schools may not need to pass on a full 20% increase in fees to parents.

Further, VAT charged on capital expenditure such as new school buildings or other significant renovation projects would also be recoverable, presenting an opportunity for private schools to potentially look back to expenditure incurred up to four years prior to the introduction of a VAT charge. This could result in some schools that have incurred significant capital expenditure in recent years being in a VAT refund position initially, which leaves the question of whether the estimated revenue figures cited by Labour are accurate.

Pensions' lifetime allowance

Whilst Chancellor of the Exchequer, Jeremy Hunt announced the abolition of the lifetime allowance for pensions in his Spring 2023 speech. Previously set at £1,073,100 in 2022/23, the lifetime allowance was abolished with effect from April 2023, such that there is now no limit on the maximum value of a pension pot.

Labour had confirmed that, if elected, they would reverse this policy and reintroduce the lifetime allowance but this was not mentioned in their manifesto, so we may have to wait for their first Budget to see if they proceed with this. We would advise caution to anyone looking to put significant amounts into their pension pot above the 2022/23 limit in the meantime, as this could be short lived and lead to tax charges in the near future.

Non-doms

It had been widely reported that Labour would look to end the current exceptions for certain individuals who are resident but not domiciled in the UK, which allows them to only be taxed on overseas income and gains when remitted to the UK.

This was somewhat trumped by the 2024 Budget, when Jeremy Hunt announced a reform of the regime such that non-doms will be taxed in line with other UK resident individuals after they have been in the UK for four years (as detailed in a later article).

Labour have, unsurprisingly, confirmed that they support the proposals in principle, including the timescales, but commented that they found the transitional measures overly generous and would look to scrap most of these (see our later article for more details).

Stamp duty land tax

The manifesto also confirmed a previous announcement by Rachel Reeves (now Chancellor), that Labour would look to raise the stamp duty land tax surcharge on overseas buyers. Currently, non-residents have to pay a 2% surcharge on the purchase of residential property in England and Northern Ireland but this will likely increase to 3% under the Labour government. This change will only apply in England and Northern Ireland, as Wales and Scotland have devolved powers for land transaction taxes with no non-residence surcharge currently in place.

Summary

Whilst Labour have been quick to highlight which taxes they will not look to increase, they have remained silent on others such as inheritance tax and CGT. The coming months will give us a bit more of an indication of what their plans could include but we will almost certainly need to wait until Rachel Reeves' first Budget, anticipated for later in the year, for real clarity of the tax changes ahead.

The end of the furnished holiday lettings regime

Jeremy Hunt announced as part of his Budget 2024 speech that the furnished holiday lettings (FHL) regime will be abolished with effect from April 2025. With a new government in place, it remains to be seen whether Labour will continue with these proposals but, until this time, we look at what could change if they do plough ahead.

Unfortunately, beyond Hunt's announcement there was no further detail on the proposed abolition which leaves some uncertainty on how the current tax advantages under the regime will be withdrawn, and whether or not there will be any transitional measures introduced. This will now also be down to the new government to legislate, if they do decide to proceed.

FHL businesses can currently claim capital allowances for qualifying expenditure on plant and machinery, including furniture and white goods. If the regime is abolished, it is possible that a disposal may be deemed to have taken place which could lead to a balancing charge. This is yet to be confirmed, however, as well as whether there will be any measures to allow any charge to be spread over more than one tax year. Alternatively, historic qualifying expenditure already pooled may continue to be eligible for annual allowances, with just a block on any new expenditure.

One statement, which was hidden in the various Budget releases, confirmed that an anti-forestalling rule would be published in due course, but that it would apply from 6 March 2024. However, to date, no further information or draft legislation has been released to clarify what this rule will look like. As a result, there has been much speculation, including concern as to whether business asset disposal relief (BADR) is denied for any FHL disposals post 6 March 2024 or whether (and hopefully more likely) the rule will only act to prevent planning to crystalise a gain at the lower 10% capital gains tax rate now (versus the higher rates of 18%/24%) without a known buyer in place.

Until the draft legislation is published, we do not know how this measure will work, which we appreciate isn't a great help to those that are in the process of selling, or have sold, their FHL property since the Budget date! Furthermore, there is still a chance the Labour government could announce that they will not be following through with the Conservatives' plans to abolish the regime.

Pillar II rules for multinational enterprises

New rules have been introduced to address profit shifting by multinational enterprises (MNEs) across jurisdictions. The OECD (Organisation for Economic Cooperation and Development) Pillar Two framework will act to ensure that large multinational groups pay a minimum level of tax in each jurisdiction in which they operate, and applies to accounting periods commencing from 1 January 2024.

The rules will affect MNEs with group consolidated turnover of more than €750 million in at least two of the four proceeding periods, and acts to impose a top up tax on profits in jurisdictions with an effective tax rate of less than 15%.

It is generally the ultimate parent's responsibility to register, report and pay any top up tax required to bring its subsidiary(ies) up to a 15% effective tax rate. However, the UK has also introduced a UK domestic minimum top up tax alongside to ensure that any top up tax payable is collected in the UK, which applies to wholly UK groups as well as MNEs.

Where the group only consists of UK subsidiaries it is likely that the registration, calculations and reporting (where required) will fall to an overseas parent further up the chain, however, the UK domestic top up tax will still need to be considered. This could be particularly relevant to companies which access the patent box regime for a large proportion of their profits.

Further, if the group has a UK intermediary and the entities above this have not yet implemented Pillar II or have lower reporting thresholds, then the reporting requirement may fall to the UK. The first step, therefore, will be determining which group entity has responsibility for operating the rules.

The rules are extremely complex, running to over 100 pages of legislation, so we would recommend that professional advice is sought if your group is potentially within the rules.

R&D tax relief – a new regime

Research and development tax relief has been more in focus in the last four years than the prior twenty years, with the UK government focused on achieving wider R&D tax reform. There is now no avoiding the fact that the biggest change since its introduction in 2000 has now arrived with the single merged R&D tax incentive scheme. This will be relevant for companies with accounting periods commencing on or after 1 April 2024.

As this comes close on the heels of other significant changes to the R&D regimes (as reported in our last issue of Talking Tax), we are all in danger of becoming entangled in the detail, whilst also needing to navigate HMRC's more aggressive approach to claims and enquiries. In this article, we want to set out some of the key headlines to note and to provide an overview on what the changes will mean. It is worth bearing in mind that the single merged scheme was billed as necessary to achieve significant tax simplification – time will tell whether this can truly be achieved!

The single merged scheme will operate on similar lines to the existing R&D Expenditure Credit ('RDEC') scheme for large companies but incorporating aspects of the existing SME scheme as well as introducing new rules for all. This is a big shift in the R&D landscape and is a very different mechanism and approach for many businesses to identify R&D eligibility and to determine the quantum of relief available.

The mechanics of the single merged scheme

Rather than additional tax relief, an 'above the line' credit will be given, reported in pre-tax income as is currently the case with RDEC, and set at 20% of qualifying expenditure. This credit is then subject to corporation tax providing overall tax relief of between 14.7% and 16.2% depending on the tax rate applicable to the company. Companies with tax losses will be able to claim the credit in cash, after a deduction of notional tax at 19%.

Understanding the position as early as possible for the relevant accounting period will become vital to accounts preparation, cashflow forecasting and proactive tax planning as the RDEC increases taxable profit before the credit either discharges the tax liability or gives rise to a repayable R&D expenditure credit.

A further reason for early consideration, is the new advance notification rules which apply to accounting periods beginning on or after 1 April 2023. These rules require notification to HMRC of the intention to make a claim within six months of the relevant period end in cases where the company has not made an R&D claim in the past three years.

A focus on the UK

There are now restrictions on R&D carried out overseas which will see payments to contractors and other externally provided workers being excluded from the claim, where the R&D has not been undertaken in the UK, unless it has been undertaken in particular circumstances (due to legal or regulatory requirements, or to geographical or environmental and social conditions).

There are no exceptions for connected parties so group arrangements will need careful consideration. Furthermore, availability of resource and costs to undertake the R&D activity are not included as exceptions.

New guidance issued by HMRC states that companies must take reasonable care to determine where the R&D takes place but the guidance on evidence requirements does remain in part rather complex, vague and ambiguous.

Contracted out R&D and shift in eligibility

Due to the merging of the two schemes (SME and RDEC), the legislative differences between the two, and the ongoing complexity of interpretation, HMRC has now drafted fairly extensive guidance on which party is entitled to claim the R&D relief. This can be either the customer (Co A) or supplier (Co B) depending on who is the 'decision maker' in respect of the contracted out R&D. All three of the below conditions must be present:

- there must be a contract (either written, verbal or implied); and
- R&D must actually be undertaken to meet the obligations under the contract; and
- it must be reasonable to assume that A intended or contemplated that R&D would be undertaken to meet the contractual obligations.

In summary, under the new guidance, if the R&D is explicit or implicit then Co A (the customer) will claim relief; if hidden R&D then it will be for Co B (as supplier) to claim. Obtaining the right level of detail will be key to making the right decision early in the claim process but will not necessarily be straightforward.

Funding and subsidies

As there is now one merged scheme, rules have changed such that grant funding and other subsidies no longer impact the R&D benefit. This means there are new opportunities to explore additional external funding to support a company's innovation and development plans that can then lead to both R&D and Patent Box benefits.

Enhanced R&D intensive support

Just to ensure it is not as simple as one merged scheme, more favourable provisions will also apply to 'R&D intensive' companies that are loss making. A company will now be deemed to be 'R&D intensive' if 30% of its total expenditure relates to qualifying R&D (originally introduced as 40% on 1 April 2023). There will also be a year of grace provision, allowing R&D intensive SMEs to continue to claim enhanced relief in the year after it ceases to meet the expenditure threshold.

HMRC R&D enquiries and further consultation

Much has been reported in the media and on various forums on the topic of increased HMRC enquiries into R&D tax relief claims, which were in response to the level of 'error and fraud' being identified in the R&D market – from the 'volume' compliance approach, to the nameless case workers involved at HMRC, and to the ultimate rejection of many claims. This culminated in the Chartered Institute of Taxation ('CIOT') presenting a letter to HMRC highlighting concerns which led to some welcome discussions and new initiatives to start to drive a more positive relationship and experience for companies, tax agents and HMRC. It has some way to go but there is acknowledgement that improvements and standards can be implemented on all sides.

What may surprise some companies even now is that tax advisory services are not officially regulated, so anyone can provide tax advice (including advice in relation to R&D tax relief). There have been regular and ongoing updates to ensure members of professional bodies (e.g. ICAEW or CIOT) adhere to a strict code of conduct ('professional conduct in relation to taxation').

In a very recent update provided by HMRC's Research and Development Communication Forum (RDCF) this month, HMRC has introduced a Professional Bodies Mailbox – this has been implemented for members of recognised tax or accountancy professional bodies to report a breach in standards relating to R&D only. It is a way to draw attention to agent malpractice but not to details of specific claims and will be used by HMRC to inform its compliance strategy for R&D agents.

As with any new initiative, and particularly one which is asking the tax agent community to police itself and call out unacceptable and unprofessional behaviour, time will tell whether this proves an effective way to raise standards in the tax advice market. However, this marks the beginning of a potential mood swing as further government consultation remains open until the end of May into raising standards and strengthening the regulatory framework, and we anticipate more widespread changes to impact the tax profession and not just in relation to R&D tax advice.

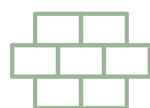
Tax round up

Tax-free childcare

Tax-free childcare is a government funded scheme where parents can receive up to £2,000 per year, per child, towards childcare costs.

In order to access the scheme, certain eligibility criteria need to be met including a 'minimum income requirement'. This provides that you and your partner (if you have one) must be each earning the equivalent of at least 16 hours per week at minimum wage. This equates to £9,518 for the 2024/25 tax year and could therefore present a problem for directors taking a basic salary at the secondary NIC threshold of £9,100.

Dividends, interest and property income do not count towards the minimum income requirement, but benefit-in-kinds can be included. If you would like to continue to access tax-free childcare, a reassessment of your remuneration for the year may be required.



SDLT and multiple property purchases

Budget 2024 brought the announcement that 'multiple dwellings relief' for stamp duty land tax (SDLT) would be abolished with effect from 1 June 2024. This relief previously provided a reduction in the SDLT payable on purchases of two or more dwellings in one transaction (or part of a series of linked transactions) but is no longer available (unless contracts were exchanged on or before 6 March 2024).

It was not a huge surprise to see an announcement in this area after countless court cases contesting whether the relief was due and, in particular, in relation to properties with a 'granny' annex. It was anticipated that the relief may be tweaked to increase the number of dwellings to which it applied, however, rather than a complete abolition.

Going forward, any future purchases of properties of five or less residential properties in one transaction, will be subject to SDLT at the applicable rates for the aggregate value of the properties being acquired, including, most likely, the 3% supplemental rate for additional dwellings, which will significantly increase the cost of investment. Where six or more residential properties are purchased, however, it will still be possible to apply non-residential rates with a much more attractive top rate of 5% (compared to 15% under residential rates or 17% if a non-UK resident).

Accommodation offset and minimum wage

Employers are required by law to ensure employees are not paid less than the national minimum wage (NMW) or national living wage (NLW). It is not as simple, however, as just looking at the employee's hourly rate to determine compliance.

One area of particular complexity is where an employer provides living accommodation to an employee, which must be taken into account when calculating NMW/NLW (although all other benefits are not considered). The rules are complicated further depending on whether the employer charges the employee for the accommodation (and/or any associated bills).

From April 2024 the accommodation offset rate is £9.99 a day or £69.93 per week and the impact on NMW/NLW calculations is dependent upon three scenarios:

1. Accommodation is provided to the employee free of charge – the employee's pay is deemed to be increased by the offset rate and hence can help to bring the employee up to the NMW/NLW.
2. The employer charges the employee rent at or below the offset rate – no adjustment to the employee's pay is made.
3. The employer charges the employee rent at above the offset rate – the employee's pay is deemed to be decreased by the difference between the offset rate and the rent charged by the employer which can result in the employee falling below the NMW/NLW.

It is also necessary to consider whether the provision of accommodation is taxable on the employee as a benefit in kind (BIK). The two rules have to be considered separately but care should be taken as, for example, reducing the rent payable to ensure that NMW/NLW is met, could result in a BIK arising on the employee.

HMRC change the goalposts for salaried member rules

Under the salaried members' rules, LLP members are taxed as employees unless they fail one or more of three specific conditions. Where one or more of the conditions is failed, the member's profit share from the LLP is taxed on a self-employed basis. One of the conditions (Condition C) is that the LLP member has contributed less than 25% of their profit share to the LLP as fixed member's capital.

Since the rules were introduced, many firms have required their fixed share members to contribute a sufficient amount of capital to the LLP to fail Condition C. In our experience, this approach has proved popular due to Condition C being easily measured and offering the greatest degree of certainty.

HMRC have recently made some changes to their guidance, stating that a genuine contribution made by the individual to the LLP, intended to be enduring and giving rise to real risk, will be disregarded if the main purpose, or one of the main purposes, is to avoid the member being taxed as an employee. They have also added a new example indicating that they consider the targeted anti-avoidance rule (TAAR) to apply where there is a separate agreement between the member and the LLP that allows the member to increase their capital contribution periodically in response to increases in their profit share, in order that Condition C continues to be failed.

As a result of HMRC's new stance, it would be prudent to consider whether any changes need to be made to the arrangements between the LLP and its fixed share members going forward. Note, however, that this is just a change in HMRC's guidance and this has not been enshrined in the legislation, nor has their position been tested in courts to date.

Remittance basis, domicile and inheritance tax shake-up

During Jeremy Hunt's Spring last Budget speech, sweeping changes were announced where he promised to *"...get rid of the outdated concept of domicile and the remittance basis...and replace it with a modern, simpler and fairer residency-based system"*. Given that the link between domicile and the remittance basis can be traced back to 1914, it is perhaps unsurprising that modernisation is proposed, particularly in a world where technology, travel and remote working are everyday parts of business and personal life.

A very brief recap of the current system is that a non-domicile ("non-dom") is someone whose origin is overseas but lives in the UK although does not make it their permanent home. This status affords some significant tax breaks, such as immunity to inheritance tax on assets held outside the UK, and a shelter from tax on income and gains retained outside the UK (the remittance basis) subject to paying a remittance basis charge after being resident for at least seven of the previous nine years.

Some criticisms of the current rules are that it mostly benefits the wealthy, discourages investment in the UK, and is complicated in operation.

To summarise, the changes proposed by the outgoing government, which have largely been accepted by the Labour party, were:

1. Abolish domicile as it stands in relation to taxation
2. Abolish the remittance basis
3. Introduce a four-year exemption for foreign income and gains for those who move to the UK (provided they were not resident in the UK at any time in the previous ten tax years). This includes benefits received by individuals from foreign trusts.

This means that people moving here after long periods overseas will not pay tax on foreign income and gains and are free to remit it to the UK for the first four years. This will be much more beneficial for affected taxpayers than the current system but is only short lived.

Current non-doms

Transitional arrangements were also proposed for those who already live in the UK, and benefit from the existing non-domicile regime, as follows:

1. Overseas assets will be rebased to their April 2019 market value (does not include trusts).
2. A 50% relief from income tax on foreign earnings and investments for the first year of the new rules (2025/26).
3. A temporary repatriation facility between 6 April 2025 and 5 April 2027, which will allow amounts, on which the remittance basis was previously claimed, to be sent to the UK at a flat rate tax charge of 12%.

Labour have stated, however, that they will not adopt the Conservative proposals for transitional arrangements including that they would remove the proposal for 50% income tax relief in the 2025/26 tax year.

They also confirmed that they would look to offer additional incentives for non-doms to repatriate untaxed income and gains to the UK after the two year period highlighted above expires.

Inheritance tax

At present, a non-dom born outside the UK will not be charged to tax on their overseas estate unless they have been resident for at least fifteen of the previous twenty years. Non-doms will usually lose exposure to UK inheritance tax on overseas assets after at least six years of non-residence in any twenty year period.

It is proposed that ten years of residence will expose the taxpayer's worldwide estate to UK taxation, and that after leaving the UK, this will continue for another ten years. For many, this will bring assets into charge five years earlier than anticipated and leave assets in charge for four years longer than expected after leaving.

Foreign trust planning

Non-domiciled but resident settlors of offshore trusts also face some stark choices. It is proposed that the "trust protections" will be removed. This means that settlors will be charged to capital gains tax on sales within overseas trust structures, even if they are excluded from benefit. This may also apply to income arising in the trust as well, although exclusion from benefit may be effective depending on the history of the trust and amounts the settlor has previously benefitted from.

Mitigation options to consider could include changing the trust's investment strategy, the settlor leaving the UK, or even sell and rebase the assets while the current rules still apply.

Labour have confirmed that they plan to close down the inheritance tax planning opportunities via excluded property under the new regime which would render offshore trust planning for inheritance tax obsolete. Further, this would appear to have 'retroactive' effect, in that trusts settled before enactment of the law will be caught.

The above summary is based on the announcements made on Budget Day, and supporting releases issued by the Treasury at the same time. There is very little further detail in circulation at present, and given that the proposed changes are from 6 April 2025, along with a new government now in place, it is unlikely there will be draft legislation or guidance issued until the Autumn at the very earliest.

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