Tax Alert
Autumn Budget 2018

October 29, 2018

This afternoon the Chancellor delivered the 2018 Budget speech. Despite being a champion of the "single fiscal event", the Chancellor indicated that, depending on Brexit outcomes, a further Budget may be needed in early-mid 2019.

Although, as is often the case, a number of the changes had been previously announced, this year's Budget did contain some new and potentially significant developments. The key announcements included the following:

1. **Digital Services Tax:** a new digital services tax ("**DST**") was announced. The draft legislation is not currently available, but the broad parameters are that the DST will be a 2% tax on the revenues of large (i.e., global revenues in excess of £500m) digital services businesses (including search engines, social media platforms and online marketplaces) relating to value derived from UK users, subject to a £25 million per annum allowance. Further details – including in relation to targeting, thresholds and how the government proposes to collect the tax from non-UK established businesses – are awaited.
2. **Entrepreneurs' Relief:** for disposals made on or after today's date, individuals realising gains on a disposal of shares in a company must satisfy two further conditions to benefit from Entrepreneurs' Relief ("**ER**"). The new rules require, in addition to (among other things) the existing 5% ordinary share capital and voting rights conditions, that the individual shareholder has a 5% interest in both the company's distributable profits and its assets available for distribution to equity holders on a winding up in order to qualify for ER. Additionally, for disposals made on or after 6 April 2019, individuals will need to have satisfied the qualifying conditions for ER for a minimum period of two years, thereby extending the existing minimum period of 12 months. The stated rationale for the extension is a government focus on supporting longer-term investment.
3. **Tax in insolvency:** the tax and insolvency rules are to be amended so that:
    a. in a liquidation (and, presumably, administration) HMRC becomes a preferred creditor in respect of (only) amounts previously collected by the insolvent business as "agent" for HMRC (broadly, VAT collected on sales and deductions (PAYE and employees' NICs) from employee wages). This is likely to impact recoveries by creditors with floating charges and unsecured creditors, as the funds remaining within the estate to pay their claims will be reduced; and

   b. directors and other persons involved in tax avoidance or evasion in an insolvency setting (e.g., "phoenixism" - the practice of carrying on the same business or trade successively through a series of companies where each is dissolved) will become jointly and severally liable for company tax liabilities (e.g. if they deliberately enter the company into insolvency to enable the company to avoid paying taxes).

4. **Off-payroll working ("IR35"):** in a much anticipated announcement in an area long an HMRC focus, measures recently imposed on Government departments and public bodies engaging the services of personnel who work through their own companies (effectively requiring the business to decide if the person is an employee or an independent contractor and to withhold and account for income tax and employees' and employer's NICs accordingly) are to be extended to all medium and large private sector businesses from April 2020. This will increase the tax compliance burden on, and tax risks for, certain businesses engaging personnel on a "non-employee" basis.

5. **Gains on UK immovable property:**

   a. **non-residents:** as previously announced, from 6 April 2019 gains arising to non-UK residents on the disposal of non-residential UK property will be subject to UK capital gains or corporation tax, so that from that date all non-UK residents will be taxable on gains on disposals of interests in any type of UK land (as there are already similar rules in place that tax non-UK residents disposing of UK residential property). Non-UK residents will also be subject to tax on gains on interests in UK property-rich entities (for example, shares in a company that derives at least 75% of its value from UK land, whether commercial or residential), although an exemption from the new charge may apply to disposals of interests in entities that are trading before and after the disposal, and in certain other cases; and

   b. **non-resident companies:** as published in draft legislation over the summer, from 6 April 2020 non-UK resident companies that carry on a UK property business, or have other UK property income, will be charged to UK corporation tax (rather than income tax as at present). This is expected to have a number of consequences; for example, such non-UK companies will become subject to the UK interest restriction, loss restriction and anti-hybrids rules in respect of their UK rental income.

   The precise impact of the new rules on the funds industry is still unknown. For example, draft legislation in respect of the filing of tax returns by non-UK resident companies that invest in UK property only through large transparent collective investment funds and the reporting obligations of those funds is still awaited.

6. **SDLT surcharge for non-residents:** the government will publish a consultation in January 2019 on a SDLT surcharge of 1% for non-residents buying residential property in England and Northern Ireland.

7. **Anti-avoidance:** fragmentation of profits/permanent establishments: as announced in last year's Autumn budget, the government will introduce legislation in Finance Bill 2018-19 to ensure that UK businesses' taxable profits reflect actual, commercial levels, and that businesses cannot avoid UK tax by having their "UK" profits accrue to non-UK entities resident in low-tax jurisdictions. The government is also planning to introduce legislation (effective from 1 January 2019), to ensure that foreign businesses in the UK cannot take advantage of rules which exempt certain low value "preparatory or auxiliary activities" from creating a permanent establishment in the UK by splitting their activities between different locations/companies where, if those activities were carried on in a single company, they would otherwise create a permanent establishment.

8. **Hybrid capital instruments:** new rules have been announced in relation to the tax treatment of so-called "**hybrid capital instruments**" (which allow for the deferral or cancellation of interest payments, or conversion into equity). The nature of these instruments may lead to confusion around whether the yield should be taxed as interest (which is often deductible for tax purposes) or as a distribution (which is not). In addition, the stamp duty and SDRT position in respect of the transfer of such instruments is often complicated due to the presence of "equity-like" features. Provided certain specified conditions are met, interest payable on a hybrid capital instrument will be deductible for the issuer and taxable for the holder, and no stamp duty or SDRT will be payable on transfer. The changes will broadly have effect for accounting periods beginning on or after 1 January 2019.

9. **Offshore receipts from intangible property:** from 6 April 2019, income from intangible property held in low-tax jurisdictions will be subject to UK income tax to the extent that it is attributable to the sale of goods or services in the UK and arises from the ownership of relevant intangible property. The measure will generally apply to non-UK entities that are located in jurisdictions with whom the UK does not have a full tax treaty (i.e. a treaty containing a non-discrimination provision). Specific anti-avoidance and anti-forestalling rules will apply to arrangements entered into on or after 29 October 2018.

10. **Reform of the Corporate Intangible Fixed Assets Regime:** the government intends to reform the corporate intangibles regime by, amongst other things, changing the existing de-grouping charge rules so that a charge will not arise if de-grouping is the result of a share disposal which qualifies for the "Substantial Shareholding Exemption" from UK corporation tax. This change is intended to have effect for de-groupings occurring on or after 7 November 2018.

11. **Hybrid mismatch changes:** changes are to made to the rules seeking to prevent hybrid-mismatches arising – one change deals with an additional permanent establishment mismatch that may arise and another operates to "save" certain regulatory capital instruments from giving rise to adverse treatment under the hybrids rules.

12. **Stamp duty / SDRT on transfers of listed securities:** for instruments executed, or agreements to transfer made, on or after 29 October 2018, where listed securities are transferred to a company (whether or not for consideration) and the person transferring the securities is connected with the transferee company, the transfer will be chargeable to stamp taxes (stamp duty or SDRT) based on the higher of: (i) the consideration for the transfer (if any); and (ii) the market value of the securities.

13. **Annual Investment Allowance:** with effect from 1 January 2019, there will be a temporary (two-year) increase in the annual investment allowance to £1 million (from the current £200,000), which is intended to stimulate business investment.

14. **Capital allowances for structures and buildings:** the government will introduce a new "Structures and Building Allowance" for new non-residential structures and buildings. Tax relief will be available for eligible construction costs incurred on or after 29 October 2018 at an annual rate of 2% on a straight-line basis.

15. **Special rate writing down allowance:** the rate of the writing down allowance on special rate expenditure on plant and machinery will reduce from 8% to 6% with effect from April 2019. Special rate expenditure includes expenditure on long-life assets, thermal insulation and integral features. Businesses will continue to receive full tax relief but over an extended timeframe.

16. **Restrictions on carry-forward losses:** from 1 April 2020, the use of carry-forward capital losses is to be restricted (such that, broadly, no more than 50% of a company's income and gains in any year can be offset by carry-forward losses). This brings the use of carry-forward capital losses into line with the new regime applying to carry-forward income losses.

17. **Value Added Tax – Specified Supplies:** the Specified Supplies Order allows companies who "export" certain financial services outside the EU to reclaim VAT which could not otherwise be reclaimed in respect of supplies made within the EU. The government will legislate to restrict the application of the Specified Supplies Order as it pertains to insurance intermediaries, to prevent a version of VAT avoidance (known as "**looping**") that involves UK insurers setting up associates in non-EU territories and using these associates to supply their UK customers. The measure is due to be implemented on 1 March 2019.

18. **Changes to higher SDLT rates for additional dwellings:** since 1 April 2016, individuals have been liable to higher rates of SDLT (an extra 3%) for additional dwellings if they buy a new home before completing on the sale of their old home. Where the old home is sold on or after 29 October 2018, the time limits for claiming a refund of the additional SDLT will be extended to the later of: i) 12 months from selling the old home; and ii) 12 months from the filing date of the SDLT return for the new home.

19. **Consultation on taxation of trusts:** a consultation on the taxation of trusts has been announced to make it "simpler, fairer and more transparent". The devil will certainly be in the detail here.

Finally, some of the high level detail on changes particularly impacting upon individuals:

20. **Tax rates, thresholds and allowances:**

    a. **Income tax:** personal allowance and thresholds: from 6 April 2019, the personal allowance will increase to £12,500 (currently £11,500). The basic rate limit will increase to £37,500 (currently £34,500). The higher rate threshold will increase to £50,000 (currently £46,350). These rates are expected to remain the same until April 2021, after which both the personal allowance and basic rate limit will be linked to the Consumer Price Index.

    b. **CGT annual exempt amount:** for the 2019-20 tax year, the capital gains tax annual exempt amount for individuals and personal representatives will increase to £12,000 (currently £11,700) and, for trustees of settlements, to £6,000 (currently £5,850).

    c. **Pensions lifetime allowance:** the lifetime allowance for pension savings will increase (in line with the consumer price index) for tax year 2019-20 to £1,055,000 (it is currently £1,030,000).

21. **Private Residence Relief (Lettings):** subject to a consultation, from April 2020 the government intends to reform the letting relief rules (a component of the principal private residence relief from capital gains ("**PRR**")), so that it is more narrowly targeted at owner-occupiers. Under the reforms: (i) PRR will only apply to lettings where the owner of the property is in shared occupancy with the tenant; and (ii) the "final period exemption" (which effectively disregards a short period of non-residence in the final period of ownership) will be reduced from 18 months to 9 months.

22. **Rent a Room Relief:** the proposed changes requiring shared occupancy of the home in order to be eligible for the rent-a-room allowance will no longer be legislated. This means that if you plan to move out and let your house for two weeks over Wimbledon you can (potentially) still qualify for rent a room relief.

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DISCLAIMER

The above summary (the "**Summary**") is intended only as a general guide to some (and not all) of the proposals contained within the Government's Autumn Budget 2018 (the "**Budget**"). The Summary does not purport to be a complete analysis of any such proposals or any other aspect of the Budget, any of which may be subject to alteration, possibly with retrospective effect. The Summary is not to be used or relied upon by, nor is any responsibility accepted towards, any party which receives it, whether such party receives the Summary directly from an officer, employee or partner of Weil, Gotshal & Manges (London) LLP ("Weil"), or through a third party. Weil does not accept any responsibility to any party to whom the Summary may be shown, or who may acquire a copy.

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