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Personal Perspectives

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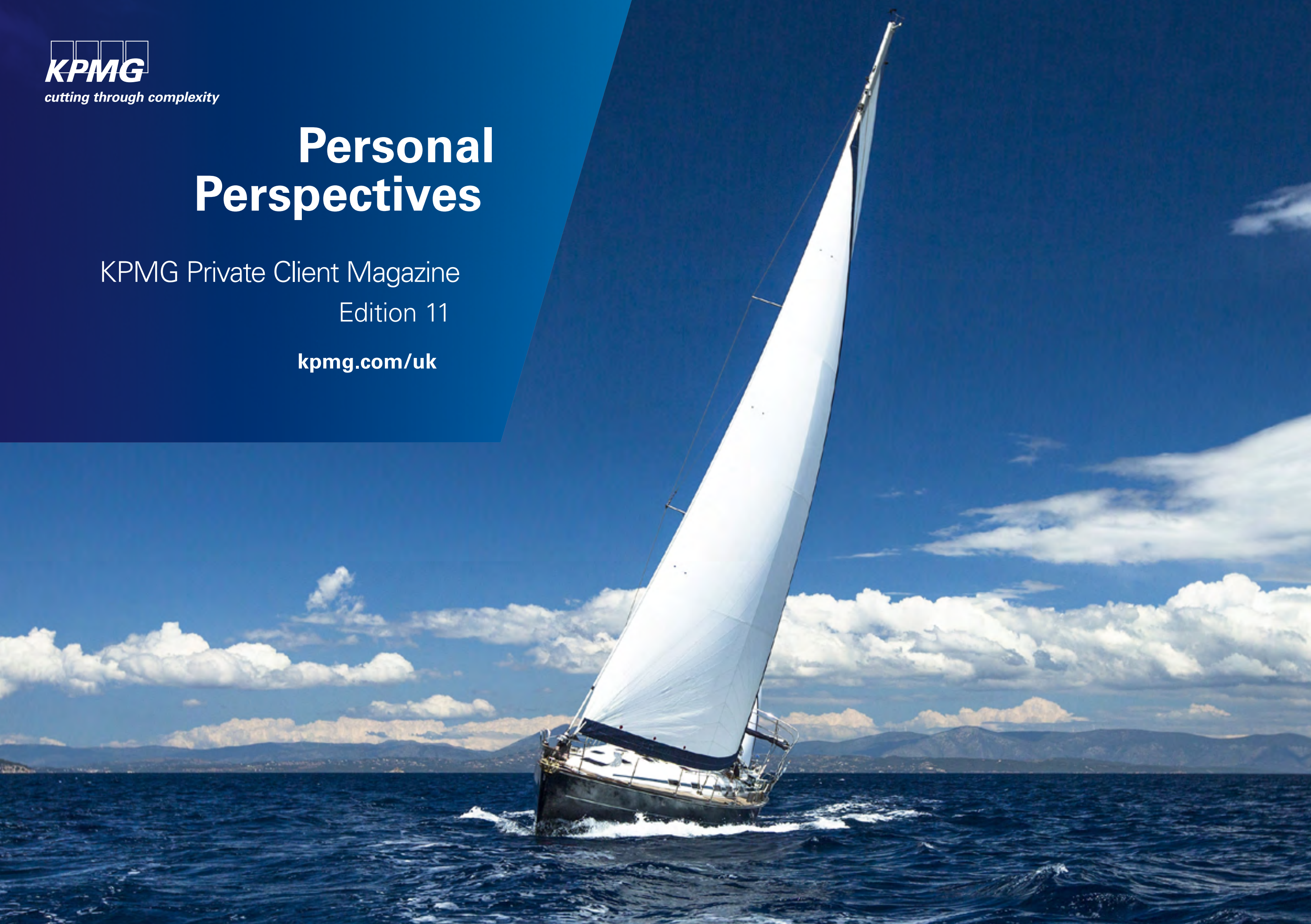
kpmg.com/uk



Introduction

Welcome to Personal Perspectives, issued at a time when the General Election of 7 May 2015 has ushered in a Conservative government with a 12-seat majority.

The Conservatives pledged spending on health, education and other public services which means that the Government will need to raise the required tax revenues. In this edition we explore some of the Conservatives' pre-election tax pledges and the likely direction of UK tax policy travel during the 2015 Parliament.

If you are a non-UK resident who enjoys coming to the UK or are interested in developing business interests in the UK our article "Non-UK resident – no UK tax?" identifies some of the potential UK tax costs and filing obligations that could be triggered by your actions.

Most people have borrowed or lent funds at some point in their life, but how many understand the tax implications of debt? We encourage you to consider if your debt is in the right place, with the right person, used for the right purpose and if your funding will result in the tax outcomes you might expect.

Several recent changes tighten the qualifying criteria for Entrepreneurs' Relief (ER). These changes affect individuals owning shares in holding companies and companies owning an interest in a joint venture. As most claims for ER require all of the qualifying criteria to be met for the full 12 months prior to a sale, we highlight the commercial impact of some of these changes and encourage an early review of business structures.

How individuals will react to the dramatic new pension freedoms is not yet known. Our article entitled "Choose your route carefully" looks at some of the dilemmas and opportunities for all, even for those in defined benefit schemes.

Sometimes concepts used in tax law can be hard to apply to real life. We look at whether HM Revenue and Customs can help clarify your tax position, and give you some expectation of a particular tax treatment. We also consider when the expectation might not be met.

We hope you enjoy this latest edition of Personal Perspectives. As always, if you have any comments, feedback or suggestions of what you would like us to cover in future editions, please do get in touch.

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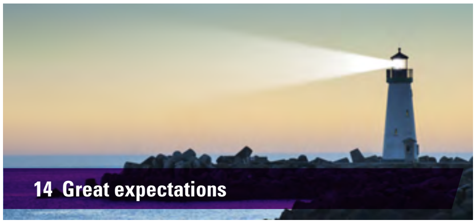

Slim Conservative majority

What does the UK election result mean for the tax landscape?

Following the election of a Conservative majority government, we explore some of the Conservatives' pre-election tax pledges and the likely direction of UK tax policy travel during the 2015 Parliament.

The nation was braced for weeks of political manoeuvring in the formation of a coalition government. Contrary to expectations created by polls and pundits alike, the general election of 7 May has ushered in a Conservative government with a 12-seat majority. Chancellor George Osborne has announced that he will hold "a Budget for working people" on 8 July, but what will he have in store?

The Tories have pledged to continue austerity measures in order to eradicate the budget deficit, and their manifesto includes a further £12 billion of as yet unspecified cuts from welfare spending.

The party has nonetheless promised a five-year 'tax lock' under which it will not increase income tax rates, VAT or its scope, or national insurance, and has committed to increasing the personal allowance to £12,500 and the 40% threshold to £50,000 by the end of the next Parliament.

What options remain to find the additional revenue required to plug the gap between spending cuts and tax freezes? Traditionally, the Tories would hope to increase corporate and personal tax revenues organically using policy incentives to boost growth and productivity. Will this be enough?

Non-domiciled ('non-doms') taxation – while Labour had promised to abolish the remittance basis altogether, the Tories have pledged to increase the annual tax charges paid by non-doms (it is not yet clear whether this is above and beyond increases effective from April 2015) and to continue to tackle perceived abuses of the status.

In order to "ensure a fair contribution" from non-doms, a consultation, which began before the election, is ongoing as to whether to introduce a three to five year minimum claim period for the remittance basis. The aim is to reduce the scope for opting in and out of the remittance basis and to ensure the annual charge is paid on a regular basis.

Property – with the spectre of a mansion tax off the agenda, shares in property-related companies raced ahead in the immediate aftermath of the election. They plan to take the family home out of the scope of inheritance tax (IHT) for all but the wealthiest by raising the effective IHT threshold for married couples and civil partners to £1 million from April 2017. This will be achieved by creating a new transferable main residence allowance of £175,000 per person, which, added to the existing £325,000 threshold, would allow a married couple to pass on their £1 million property tax free to their heirs.

Pensions – the Conservatives have suggested they will reduce the tax relief on pension contributions for people earning more than £150,000, with the current £40,000 annual allowance reducing by 50p for every £1 of income above £150,000 to become £10,000 for individuals with income above £210,000.

Tax evasion/avoidance – the Conservatives will continue to crack down on tax evasion and aggressive tax avoidance, by which means they hope to raise at least £5 billion a year.

Capital Gains Tax – although there has been no official indication that the Tories will tinker with capital gains tax, a closer alignment with income tax rates and/or reduction in the more generous reliefs would be one avenue for additional revenue raising that is not explicitly precluded by the Conservatives' manifesto pledges.

Thresholds – fiscal drag (where tax thresholds increase at a lower rate than inflation) has seen the number of higher and additional rate taxpayers increase from 3.2 million to 4.9 million since the Conservative-led coalition came to power in 2010. It should not be assumed that all thresholds will increase in line with or above inflation; the Conservatives have not publicly ruled out a change in the additional rate threshold in the new Parliament, despite their pledge to freeze tax rates as outlined above.

In conclusion, as many people were expecting a coalition government, the election of a Conservative majority means more certainty for taxpayers than may otherwise have been the case. However, pledged spending on health, education and other public services dictates that the Tories will need to find the required tax revenues by some means; the road ahead is not necessarily smooth.

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Non-UK resident – no UK tax?

You might think that if you are non-UK tax resident you have no exposure to UK taxes – but is this correct?

A non-UK tax resident individual thinking of visiting the UK, working here or buying assets here (such as property) may incorrectly assume that there is no exposure to UK tax or filing obligations. The following examples give a flavour of some of the triggers to be aware of.

The general rule is that income which has a 'UK source' is subject to UK income tax. For example, if a non-UK resident individual rents out a residential property situated in the UK, any rental profits are taxable and they will need to submit UK tax returns. Unless they are registered for the Non-Resident Landlords' Scheme, tax at 20% may need to be deducted from the rents by the tenants or property agents.

Similarly undertaking 'substantive' work in the UK for an employer can result in all or part of the employment being taxable here. Working in the UK exercising control or decision making powers can have UK tax implications for the employer. This can include companies owned by the individual or their family.

UK income tax is due on UK savings and other investment income, but the amount is typically limited to tax deducted at source.

Individuals operating unincorporated businesses may be liable to UK income tax on the income arising from activities or establishments in the UK, whether the activities are carried out by them or, in some cases, by others on their behalf.

In the past non-UK resident individuals have not paid UK tax on investment gains realised on UK assets. But a key new exception is UK residential property, with gains accruing from 6 April 2015 now liable to capital gains tax at a current rate of up to 28%, although main residence relief may be available in exceptional cases.

UK assets used in a trade carried on in the UK are also liable to UK capital gains tax.

UK situated assets are potentially liable to UK inheritance tax (IHT), although liabilities associated with those assets (e.g. mortgages) may in certain circumstances reduce the extent of any UK IHT exposure. For a non-UK resident but UK domiciled or deemed domiciled individual assets situated anywhere in the world are within the scope of UK IHT.

There are other taxes to consider too, such as national insurance, the annual tax on enveloped dwellings or 'ATED', VAT, council tax and corporation tax.

Most of these potential UK tax issues may be mitigated (generally in the taxpayer's favour) by the provisions of any appropriate double tax treaty between the UK and, for example, the country of residence. This article is focused on the non-UK resident. However, sometimes individuals need to first consider whether they are in fact UK tax resident. The UK has a Statutory Residence Test (SRT). Visits to the UK, working in the UK or owning UK homes could, perhaps unexpectedly, result in triggering the conditions to become UK tax resident.

For example, if a non-UK resident has a UK home, but fails to spend a sufficient amount of time in their overseas homes, spending as little as 30 days visiting the UK home in a tax year could automatically trigger UK tax residence under the SRT. Once UK tax resident an individual can be subject to UK tax on worldwide income and gains. Again the effect is subject to double tax treaties.

If you are a non-UK resident who enjoys coming to the UK or are interested in developing business interests in the UK you might want to consider and ensure you understand, at the earliest opportunity, the potential UK tax implications of your actions.

For further information on the UK's Statutory Residence Test:
www.kpmg.com/uk/statutoryresidencetest

For further information on UK residential property:
www.kpmg.com/uk/ukresidentialproperty

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Who should a lender or a borrower be?

Most people have borrowed or lent funds at some point in their life, but how many understand the tax implications of debt? Are you aware of the potential tax costs of your funding structure?

Lending

When individuals are lending funds, considering the potential tax implications may not be their top priority, but if tax is not considered it is possible to inadvertently trigger a UK tax charge in the future or miss out on a potential tax relief.

Inheritance tax (IHT) can be particularly important. One example is loans to private companies which don't normally qualify for IHT Business Property Relief, whereas preference shares can.

Generally individuals that are non-UK domiciled for IHT purposes are only subject to UK IHT on UK situs assets – however there are complex rules surrounding the question of where a debt is deemed to be located, which can cause confusion.

A debt is normally located where the borrower physically resides but this is not always the case and care is needed – particularly when a property is involved. If the debt is secured on a property situated in the UK, this could create IHT consequences in certain circumstances.

> Is your debt in the right place, with the right person and used for the right purpose to give the tax treatment you might expect?

Borrowing

Well planned borrowing is vital from a tax perspective. The structure and location of a debt can inadvertently trigger an unexpected tax consequence. However if considered before borrowing/spending the funds, the debt can potentially be structured to make it more efficient from a tax perspective. For existing funding, it may be possible to refinance or reorganise if required.

The purpose of a loan is important. If there is already loan funding in place as well as available cash resources, it may be worthwhile using the loan to increase tax efficiency. For example, interest on a loan to a business may qualify for income tax relief, whereas a loan to buy a personal asset such as a car or house is not likely to qualify for such income tax relief.

With regard to non-UK domiciled individuals, HM Revenue and Customs (HMRC) announced on 4 August 2014 that they were withdrawing their "concessional treatment" of unremitted foreign income and gains used as security for commercial loans enjoyed in the UK. Any new arrangements of this type will be treated as taxable remittances. In addition if interest on the debt is settled using foreign income and gains this will also be treated as a taxable remittance. This means that there is potential for two sources of taxable remittances to arise from one debt!

Although we await the final guidance on the 4 August 2014 announcement, HMRC's current published position is that existing loan arrangements made by affected non UK domiciled individuals, where foreign income or gains were used as collateral, must be notified to HMRC by 31 December 2015. This security has to be replaced by 5 April 2016 with 'clean' funds to avoid being classed as a taxable remittance. Swift action may therefore be required to avoid a possible tax charge.

There may be an obligation to withhold tax if the interest is UK source and the borrower may need to consider if they can apply to HMRC to pay the interest gross.

Loans/debts are generally deducted when calculating an individual's IHT positon. There have always been some restrictions to this in the form of anti-avoidance legislation which prevents certain debts being deducted for IHT purposes; increasing the IHT exposure in certain circumstances. These restrictions were expanded in 2013 to prevent relief in some cases where funds borrowed are invested in assets not subject to IHT.

Conclusion

When individuals are either borrowing or lending funds, considering if the debt is in the right place, with the right person and used for the right purpose is vital. Failing to do so can result in a tax cost; perhaps unexpectedly. We are seeing clients taking advice, often early in the process, as the rules can be complex. Are you confident your funding is structured to make it efficient and results in the tax outcomes you expect?

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Entrepreneurs' relief – are you sure you will qualify?

A transaction is often the culmination of many years of hard work nurturing and growing a family business. Individuals often assume that they will be able to increase their after tax return by using tax reliefs introduced to reward such growth – but are often surprised to find that they don't qualify.

Over time various incentives for growth, in the form of relief from capital gains tax, have been introduced or changed by different governments. But for a number of years the direction of travel has increasingly been to restrict such relief and this trend is continuing.

A November 2014 report of the National Audit Office identified that the cost to the Government of Entrepreneurs' Relief (ER) was £2 billion more than forecast for the 2013/14 tax year. This was reviewed by the Public Accounts Committee, which resulted in a number of newspaper headlines about the relief, and has led to several changes to the rules which seek to tighten the qualifying criteria. The changes to the rules applied immediately, are far reaching and will impact many individuals who in the past would have qualified for ER.

Practical implications of recent changes

The practical impacts of the new anti-avoidance rules affecting joint ventures are much wider than the perceived misuse of ER that they are designed to stop. The new restrictions may also remove the relief for the individuals it is intended to help. The key issue is the structure in which a trading company is held. Those most impacted include:

Personal holding companies

A major casualty of the rule change is any individual who owns up to 50% of the ordinary shares of a trading company, but holds the shares via a separate holding company. By using a separate holding company, which might be used for any number of commercial reasons, a sale of an indirect 50% interest in a trading company would no longer benefit from ER.

Individuals either setting up new structures or with existing holding companies who wish to benefit from ER in the future, now need to carefully check if they meet the necessary conditions and, if not, take action to address this issue.

On a cautionary note, unwinding holding company structures already in place may not be straightforward.

Interests in trading partnerships and/or joint ventures

A company owning an interest in a trading partnership or a joint venture could also now be regarded as holding so called 'bad assets' i.e. those which taint the trading status of a company for ER purposes. Partnership interests will always be treated as non-trading. However a wider review of the group is needed to ascertain whether a shareholding in a joint venture company is treated as non-trading.

Where 'bad assets' such as partnership interests and shares in joint venture companies are held within a business, it is often possible to extract these tax efficiently, leaving behind a business that qualifies for relief.

What to do next?

The above highlights just a few of the unexpected implications of the recent rule changes. The qualifying conditions for ER were complex to start with and these changes may further restrict the availability of the relief for individuals who expect to qualify.

It is important for individuals hoping to benefit from this relief to review business structures in advance of any potential sale to check that the qualifying conditions for ER will in fact be met. As most claims for ER require all of the criteria to be met for the full 12 months prior to a sale, the sooner the business structure is reviewed the more time there will be to ensure that anticipated reliefs will be available when undertaking a transaction.

> Individuals either setting up new structures or with existing holding companies who wish to benefit from ER in the future, now need to carefully check if they meet the necessary conditions

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Choose your route carefully

The new pension freedoms and final salary schemes

How individuals will react to the new pension freedoms is not yet known, but they create dilemmas and opportunities for all, even for those in defined benefit schemes

It has been well publicised that the rules around UK pensions have changed significantly, increasing access to pension savings.

These changes are dramatic. The most significant is that pension savers are no longer forced to purchase an annuity when they retire; instead, pension pots can stay invested for as long as people wish, and can be withdrawn as cash as quickly as people wish, once they reach age 55.

In exercising this freedom to extract cash up front, it is necessary to recognise that this will typically trigger a substantial income tax charge. Although this may be managed by withdrawing the pension over several years, after withdrawal it is easy to overlook the potential to create a new exposure to inheritance tax when funds are no longer held within a pension; all tax implications need to be carefully considered.

While the pension changes are largely directed at those with defined contribution (DC) schemes, it is possible for members of defined benefit (DB) schemes (also known as final salary schemes) to benefit. They can do this by taking a 'transfer value' from the DB scheme which is then paid into a DC scheme. Once in the new DC scheme the scheme member can benefit from the new freedoms.

Generally the amount a DB pension pays out is based on time spent in the scheme and salary whilst a contributing member. Pensions are paid irrespective of their ultimate cost, with the pension scheme being topped up by the sponsoring employer as required. In contrast, the amount a DC pension pays out has generally depended on the amount of annuity the individual's pot of savings in the scheme can afford. With annuity prices soaring, this has often been less than the member hoped.

It is perhaps not surprising that although DB members have, before their pension payments start, been able to transfer into a DC scheme, they have often not found it attractive to give up a 'guaranteed income' and become exposed to volatile investment markets and annuity prices. Even at the point of retiring, the annuity they could purchase would usually be lower than the pension the DB scheme would provide – so what would be the point?

But it is possible to transfer from a DB scheme and enjoy the new pension freedoms – so does this change things?

What an annuity and a DB pension have in common is that both typically provide a flat (or inflation linked) income for life. By contrast, retirement spending patterns often follow a 'smile' shape. In their 60s people's income needs are relatively high. People are in good health – common items of expenditure include adventurous holidays, final mortgage payments, or in the current economic climate getting children started on the property ladder. Lifestyles may be slowing down a bit in their 70s, although people are still in good health, typically income needs reduce. In the end, as people reach old age, income needs may rise again, as people need to fund care requirements.

The new flexibilities enable people, whether from DB schemes or DC schemes, to design income streams to suit their specific financial objectives and spending needs. For many, steady secure income streams will still be best, but for others the opportunity to do something more bespoke will be attractive.

But great care is needed. These are hugely important decisions and decisions to give up guarantees should never be taken lightly.

It is likely that insurance companies, facing a huge drop in demand for annuities, will provide 'smarter' products that combine continued investment, access to cash and longer term protection. And for those with high value pension savings, a bespoke approach might be worth the effort.

We will likely also see many companies that sponsor DB schemes seeking to make sure people consider all their options carefully. For the employer, people transferring from their DB schemes reduces the risks the employer bears, and for some members they might get something more suitable for them, so 'win win' solutions exist.

Whatever you do it is important that you get appropriate advice on the pensions and tax implications.

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Great expectations

Sometimes concepts used in tax law can be hard to apply to real life. We look at whether HMRC can help clarify your tax position, and give you some expectation of a particular tax treatment. We also consider when the expectation might not be met.

Sometimes tax rules are not that clear. Normally the tax adviser can analyse all the detailed rules in the extensive statute law produced by successive governments, put them together with the even more extensive case law produced by the Courts and give clients a conclusion which is clear, if not what they were hoping for.

Sometimes we meet unavoidable uncertainty in the system. This is often down to concepts used in tax law being hard to apply to real life.

Questions like "Is this activity a business?", "Where do I reside?" and "Is this transaction undertaken to obtain a tax advantage?" can be crucial to how a person is taxed and yet fiendishly difficult, in some cases, to answer definitively.

If the tax adviser can't be sure what the law is, the next best thing is to understand what the tax authority thinks the law is. After all, if HM Revenue and Customs (HMRC) agree with you then who is going to argue. Right? Wrong.

The first challenge can be to find out what HMRC thinks. There are a number of ways in which taxpayers try to understand the mind of HMRC to find out what it thinks, which include:

- HMRC's published guidance
- HMRC's written confirmation of a tax treatment in response to a clearance application. (A clearance application is a letter sent to HMRC setting out facts and expected tax treatment and seeking HMRC's agreement to the tax treatment, or aspects of it)
- HMRC's apparent acceptance of a tax treatment in previous years' tax returns, because no enquiries were raised

To perhaps state the obvious, it is important to recognise that HMRC does not have a mind or an opinion as such because it is not an individual. It is an organisation comprising many individuals with their own minds and opinions, all governed by objectives, processes and policies.

Fortunately though, provided some safeguards are followed, it should generally be possible to rely on guidance given by HMRC's officers, whether published or directed at specific circumstances or taxpayer. That is not the end of this article though, because the safeguards are where the problems start, and this is perhaps best illustrated by three examples.

There is a tax case, which is famous in tax circles at least, which involved Robert Gaines-Cooper who, among other things, sought to argue that even if he was UK resident under tax law, HMRC should treat him as non-UK resident on the basis that he had relied on their published guidance which he believed indicated someone in his position would be non-UK resident. The Court found that whilst he was entitled to rely on any unequivocal HMRC guidance, the residence booklet he referred to was written in such a convoluted way that, contrary to what he thought, it did not in fact indicate that he would be non-UK resident! He lost the case.

A recently published Upper Tribunal case involving film partnerships, known as Samarkand, comes to the same answer by a different route. It appears that although the guidance the film partners relied on was clear and unequivocal, they were not entitled to rely on HMRC's guidance in cases of perceived tax avoidance. The partners lost that case too.

There is an older case, known as Matrix Securities, which established that you may rely on a tax clearance provided you have obtained the clearance having "laid your cards face up on the table" before HMRC. In a recent test of that case, we experienced HMRC seeking to revoke a clearance that they had given some months earlier. Fortunately we were able to quickly agree with HMRC that the cards had been face up and that we could rely on the clearance given. We sincerely hope we can rely on that.

So the conclusion is that unfortunately there's often not a clear answer. Obtaining HMRC's views can be very helpful but it is important to ensure you understand what those views mean and whether they establish a 'legitimate expectation' which may be relied upon. It does really come down to getting the best advice you can from an adviser you trust.

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On the horizon

Highlighted below is a snapshot of developments on some of the more significant areas of change that are relevant for Private Clients. Further information and comments are available via the links to information on www.kpmg.com/uk

- From 2016 information about overseas income and assets will be passed to HM Revenue & Customs (HMRC) under Inter-Governmental Agreements. The Liechtenstein Disclosure Facility (LDF), will now close at the end of 2015, meaning only a few months remain to participate and make a disclosure on the best possible terms. The Crown Dependencies Disclosure Facilities will also expire at the end of 2015. A tougher 'last chance' disclosure facility will be offered between 2016 and mid-2017, with penalties of at least 30% on top of tax owed and interest, but no guaranteed immunity from criminal prosecutions. We expect that when all facilities expire HMRC will intensify the number of investigations. In addition the Government has confirmed it will consult on a new strict liability criminal offence for those who have not paid the tax due on offshore income.

  We would encourage those with undisclosed historic UK tax liabilities to make the most of the current opportunities available to bring their affairs up to date.
  www.kpmg.com/uk/personaltaxinvestigations

- A recent Court of Appeal case concluded that the gain on the disposal of a valuable painting was exempt from capital gains tax (CGT). For gains accruing on and after April 2015, the CGT exemption for certain wasting assets will now only be available where qualifying assets have been used in the seller's own business.

- It is proposed that Peer-to-Peer (P2P) lenders who suffer bad debts on P2P loans from 6 April 2015 and meet the conditions, will be able to claim bad debt relief against other P2P income. It is expected a claim will be made via their self-assessment tax returns. Draft legislation for consultation is expected later in 2015.

- The Government is considering extending the list of qualifying ISA investments to include both debt and equity based securities for both P2P and crowdfunded platforms. A consultation is expected to take place over the next few months.

- The Small Business and Enterprise and Employment Act 2015 has been enacted into law. From January 2016 companies will be required to keep a register of 'persons with significant control' (PSC). They will need to file this information with Companies House from April 2016; and to check and confirm this information at least once every 12 months. It appears that where trustees have significant control of a company, then the individual trustees will be recorded as being the beneficial owner. It is hoped that the guidance, expected in October 2015, will clarify the scope of the look through clause that could potentially require the registration of details of settlors, protectors and (although less likely as they would not normally be exercising control over the trusts) beneficiaries.

- The European Parliament has approved the text of the Fourth Anti-Money Laundering Directive which will, for the first time, oblige EU member states to keep central registers of information on the ultimate 'beneficial' owners of corporate and other legal entities, as well as trusts.
- UK residents owning residential property overseas (e.g. holiday homes) and non-UK residents with residential property in the UK (e.g. those who have retired abroad but retained their UK home) may, from 6 April 2015, need to meet a new 90 day test in order for the residential property to be eligible for Principal Private Residence relief (broadly, an exemption from CGT on disposal of their main residence). Evidence to support the new day count test needs to be maintained from April 2015.
  www.kpmg.com/uk/ppr
- For disposals of UK residential property on or after 6 April 2015, non-UK residents will be required to complete an online form (the NRCGT return) within 30 days of conveyance of a property. Details required include any exemptions or reliefs (including Principal Private Residence relief) claimed.

  Unless a non-UK resident owner has been given notice to file a Self-Assessment return, a corporate tax return, or has delivered an annual tax on enveloped dwellings (ATED) return for the property in question in the preceding tax year, the NRCGT return will also need to include an assessment of any tax due and the tax will need to be paid within the 30 day period.
  www.kpmg.com/uk/ukresidentialproperty
- Sums arising on or after 6 April 2015 to investment fund managers for their services will be charged to income tax. This will affect managers who have entered into arrangements involving partnerships or other transparent vehicles, but not sums linked to performance, often described as carried interest, nor returns which are exclusively from investments by partners.
  www.kpmg.com/uk/investmentmanagementfees
- Changes to the calculations of inheritance tax (IHT) on relevant property trusts were expected to come into force from 6 April 2015 for settlements created on or after 10 December 2014, and to same day additions (affecting so called 'pilot trusts') on or after 10 December 2014 for pre-existing settlements. These changes were postponed prior to the election and will now instead be included in future legislation.
  www.kpmg.com/uk/iht

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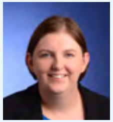

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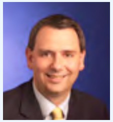

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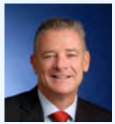

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