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a closer look

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SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

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The UK Budget 2016 – Implications For UK Employers

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The UK Budget speech on March 16, 2016, will probably become best known for two things: firstly the resignation of Iain Duncan Smith, the then Secretary of State for Work and Pensions, over the proposal to make GBP4bn (USD4.46bn) of savings from cuts in disability benefits that triggered a U-turn and the Government's withdrawal of this proposal; and secondly the slightly less controversial introduction of the Sugar Levy, intended to encourage the manufacturers of sugary soft drinks to reformulate their products as part of the battle against the health risks associated with high levels of sugar consumption.

However, employers based in the UK should be aware of a number of key changes that were also announced. This article summarizes the proposals included in the 2016 Budget and a reminder of some changes previously announced.

1. Benefits And Incentives

1.1 Employee Share Schemes

The introduction of Employee Shareholder Status (ESS) in September 2013 brought a new employment status into existence – that of the "employee shareholder" (ES). To become an ES, individuals gave up a package of employment rights (including rights to statutory redundancy pay and the right not to be unfairly dismissed except in protected circumstances) in return for the issue of free shares worth at least GBP2,000. The plan offered generous tax breaks, with income tax being charged on the value of the shares awarded over the GBP2,000 lower limit; while on sale, gains on shares worth up to GBP50,000 on issue were completely free of capital gains tax with no upper limit on the exemption.

The Chancellor however has now introduced a lifetime limit of GBP100,000 on the gains from ESS which will be exempt from capital gains tax. This limit applies on the disposal of shares acquired under the terms of ESS agreements entered into on or after March 17, 2016.

While this change was not widely predicted, it should not be a surprise, as the plan was originally introduced to provide smaller packages of shares to wider workforces and thereby reduce employment red tape. Instead, however, ESS has typically been taken up by key executives and utilized to shelter significant gains from tax, and the new lifetime cap on this benefit is a logical way of addressing this issue.

Meanwhile, the top rate of capital gains tax has been reduced to 20 percent for taxable gains accruing on or after April 6, 2016. This means that the maximum CGT benefit from an ESS arrangement is reduced to GBP20,000, so more potential participants may question whether it is worth giving up their employment rights for such a sum (or less). As such, we may see more key employees seeking equity incentives enabling them to qualify for Entrepreneur's Relief, which gives a capital gains tax rate of just 10 percent on qualifying gains up to a lifetime limit of GBP10m.

In addition, as part of the provisions introduced to simplify employee share schemes, new rules will apply to those participating in an Enterprise Management Incentive (EMI) plan where a rights issue takes place on or after April 6, 2016; the share identification rules will apply so that new shares will be treated as acquired at the same time as the original shares.

1.2 Salary Sacrifice Schemes (Flexible Benefits)

The Government is considering limiting the income tax and National Insurance Contribution (NIC) benefits of salary sacrifice arrangements to certain key benefits – these would include pensions, health-related benefits (such as the Cycle to Work Scheme), and child care.

The potential implications for the large number of companies that operate flexible benefits schemes should not be underestimated, as potentially income tax and NIC is operated on a notional salary figure and benefits that would be tax free if provided outside a salary sacrifice arrangement are brought into the charge to tax/NIC.

1.3 Preventing The Liability To Charge Being Removed From Certain Taxable Benefits In Kind

Where an employee receives a benefit in the form of goods or services from their employer and the employee pays the same cost under the same terms and conditions as an unconnected third party, there is no charge to income tax. This is known as a "fair bargain."

New legislation will be introduced from April 6, 2016, to remove the concept of fair bargain from certain benefits in kind where the chargeable amount is set out in the relevant UK statute. This will apply to living accommodation, company cars (except where provided to the employees of car hire companies), vans, and related benefits and loans.

1.4 Tackling Disguised Remuneration

The Chancellor stressed that the attack on tax avoidance schemes would continue and the first step is the introduction in the Finance Bill 2016 of new provisions relating to "disguised remuneration" and the use of Employee Benefit Trusts (EBTs) and other third parties. The new provisions will include the insertion of a Tax Anti-Avoidance Rule (TAAR) into the disguised remuneration legislation (Part 7A Income Tax (Earnings & Pensions) Act 2003). This will take effect from March 16, 2016, and will seek to ensure that no scheme can be used to avoid tax where there is a connection with a tax avoidance arrangement.

The other change applies to remove the transitional relief on investment returns on amounts of disguised remuneration within EBTs where a settlement has not been agreed with HMRC prior to November 30, 2016.

Companies or employees still operating disguised remuneration schemes should consider the potential impact of these new measures. Further measures will be introduced, and there will consequently be a consultation in Summer 2016 to which such companies may wish to contribute.

1.5 Company Car Rates

New rates were set for the three years to the UK tax year commencing on 6 April 2019.[1]

2. Pensions Flexibility 2016

With a view to increasing pensions flexibility, a number of minor changes to the pensions tax legislation have been introduced. These include:

- A removal of the requirement that a serious ill-health lump sum can only be paid from an arrangement that has never been accessed.
- Replacement of the 45 percent tax charge on serious ill-health lump sums paid to individuals who have reached age 75 with tax at the individual's marginal rate.
- Provisions to enable dependents with a drawdown or flexi-access drawdown pension who would currently have to use all of this fund before age 23 or pay tax charges of up to 70 percent on any lump sum payment, to continue to access their funds as they wish after their 23rd birthday.

- Removal of the rule on paying a charity lump sum death benefit out of drawdown pension funds and flexi-access drawdown funds where the member dies under the age of 75 because the equivalent tax-free payment may be made as another type of lump sum death benefit.
- Provisions to enable money purchase pensions in payment to be paid as a trivial commutation lump sum.
- Provisions to enable the full amount of dependents' benefits to be paid as authorized payments where there are insufficient funds in a cash balance arrangement when the member dies.

These provisions will apply from the date that the Finance Act 2016 receives Royal Assent.

3. Termination Payments

The Chancellor announced the termination of the employers' NIC break on termination payments. More wide-ranging changes are expected as the Government has the chance to digest the substantial volume of comments received in response to the consultation issued on this subject in Summer 2015. In the meantime, the first GBP30,000 of termination payments remain tax and NIC free.

Therefore, amounts over GBP30,000 will be subject to Class 1 secondary (employers) NIC but will remain free of Class 1 primary (employee) NIC. This does not apply until April 6, 2018, so employers will be able to plan and consider other ways to structure termination payments to include more employer payments into pension arrangements to save NIC.

Further consultations on payments in lieu of notice, compensation payments and foreign service relief should be expected.

4. Public Sector Bodies Engaging Workers Via Personal Service Companies

It is estimated that non-compliance with the legislation governing the provision of services via an intermediary costs the UK Treasury GBP440m. As part of the plan to address this, from April 2017, new rules applying to certain public sector bodies (PSBs) will require the PSB to deduct PAYE (UK wage withholding) and NIC on payments where the set of UK rules known as IR35 applies (contrary to the current position where the personal service company (PSC) is required to deduct PAYE and NIC).

From the proposals in the Budget, it appears that the key points in the new rules are as follows:

- Where a PSB engages a worker via a PSC, the PSB must assess whether IR35 applies (as is currently the case).

- If IR35 applies, the PSB must deduct PAYE and NIC. This is a departure from the current position, *i.e.*, the IR35 rules that currently apply generally and going forward will continue to do so in the private sector.
- Where there is an agency or other intermediary involved, the body nearest to the PSC in the chain of service providers will be responsible for deducting PAYE and NIC whether or not they are a PSB.
- HMRC will provide a range of online tools in order to assess whether IR35 will apply – we do not yet know whether these will be based on the Employment Status indicator, but it seems likely that there will be similarities.
- A consultation will be undertaken to clarify matters such as what constitutes a "public sector body" and the form of the online tools.

No change from the present procedures is currently required and PSBs have a year to put in place the new arrangements to make payments to IR35 companies via the payroll going forward. It is expected that non-PSBs will also be able to use the online tools, albeit they will not currently be required to operate PAYE and NIC on payments made to a PSC.

5. Other Previously Announced Changes

- Trivial benefits-in-kind costing less than GBP50 will be exempt from income tax and NIC from April 6, 2016.
- Workers employed via intermediaries will no longer benefit from tax relief on home-to-work travel and subsistence. This puts them on a level footing with employees.
- Income from sporting testimonials and benefit matches for employed sportsmen/women will be subject to income tax from April 6, 2017, where the testimonial has been awarded on or after November 25, 2015. In certain circumstances, a GBP100,000 exemption may apply.

Changes to the draft legislation can be expected as the Bill progresses through Parliament.

Endnotes

1 Details of the new rates can be found at www.gov.uk/government/publications/setting-company-car-tax-cct-rates-for-the-3-years-to-2019-to-2020/setting-company-car-tax-cct-rates-for-the-3-years-to-2019-to-2020