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United Kingdom – Some Personal Taxation Changes, New Anti-Avoidance Measures in 2014 Budget

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For coverage of last year's budget, see *Flash International Executive Alert* 2013-052, 21 March 2013

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The U.K. Budget Statement for 2014/2015, delivered on 19 March 2014, by the Chancellor of the Exchequer, confirms many of the measures communicated in December's Autumn Statement; but it also contains a measure to abolish from 1 April 2015 the starting rate of tax (at 10 percent), and instead apply a 0-percent rate, on savings income up to £5,000.[1] And while the government is moving forward on "anti avoidance," the Budget Statement included clarification that deferred compensation earned prior to 6 April 2014 would not be subject to the new rules nor would directors with small shareholdings (less than 5 percent) in a company's ordinary share capital.

The Finance Bill 2014, which embodies the proposals articulated in the Budget Statement and supporting documents, is due to be published on 27 March 2014, and a *Flash International Executive Alert* will follow at that time.

Why This Matters

There are numerous measures that were announced and others contained within the supporting documents to the Budget Statement that could affect employees – including those on international assignment – and their employers.

The anti-avoidance measure regarding dual contracts is relevant only to individuals who are resident and non-domiciled in the United Kingdom. The offshore employment provisions are aimed at offshore employers and may consequently catch non-U.K. domiciled individuals. In general, the extra cost of this measure will only be relevant if the individual is from a country with no social security agreement with the United Kingdom or cannot qualify for a certificate of coverage.

In respect of the onshore employment consultation, in many organizations the individuals/departments dealing with globally mobile employees may be the same individuals/departments that are impacted by this proposed legislation.

With respect to the changes in thresholds (income tax, NICs, and capital gains) and possibly, if applicable to taxpayers, the childcare cost relief, international assignment cost projections and budgeting for those individuals on assignments to the United Kingdom and outside of the United Kingdom still subject to U.K. taxation should reflect these adjustments. Where appropriate, adjustments by payroll administrators to PAYE withholdings will need to be made when the changes are enacted.

Tax equalizations could also be affected.

We have provided some additional details and updates on some of the measures announced in the December 2013 Autumn Statement and outlined in our earlier report, *Flash International Executive Alert* 2013-161 (6 December 2013).

Personal Income Tax (Including National Insurance, Capital Gains Taxation)

Tax Thresholds

It had already been announced in the 2013 Autumn Statement that the higher rate (40 percent) tax threshold and the capital gains tax annual exempt amount would be increased by 1 percent in 2014/2015 and again in 2015/2016. This was confirmed in the 19 March Budget Statement.

Personal Allowance

The personal allowance (U.K. exempt amount) will be raised to £10,000 from 6 April 2014 – again in line with previous announcements. This is an increase of £560 over the 2013/14 allowance of £9,440. As announced in the Autumn Statement, £1,050 of this amount will be transferable between married couples or civil partners for the 2014/15 U.K. tax year provided both partners are not liable to tax at the higher (40 percent) or additional (45 percent) tax rates.

For the 2015/16 tax year, the personal allowance is to be increased to £10,500.

A consultation was also announced to see whether the U.K. personal allowance could or should be restricted to U.K. residents and those living overseas who "have strong economic connections in the U.K." A further update will be provided once the consultation document has been published.

Income Tax – Rates & Brackets

	Rate	2013/14	2014/15
Starting rate for savings *	10%	£0 - £2,790	£0 - £2,880
Basic rate	20%	£0 - £32,010	£0 - £31,865
Higher rate	40%	£32,011 - £150,000	£31,866 - £150,000
Additional rate	45%	Over £150,000	Over £150,000

* There is a 10-percent starting rate of tax – but only for savings income. If an individual's non-savings taxable income exceeds the starting-rate limit, then the 10-percent starting rate for savings will not be available for savings income. The rates applicable to dividends are 10 percent for dividend income up to the basic rate limit and 32.5 percent up to the additional rate above that. The rate applicable to dividend income above the additional tax rate limit is 37.5 percent.

From 6 April 2015, the 10-percent starting rate of tax will be abolished and replaced with a 0-percent tax rate on savings of up to £5,000. Therefore, for individuals with combined earnings and savings of up to £15,500, no tax will be paid on the savings income and the individual can register to receive their savings income tax-free (the £15,500 is made up of the personal allowance of £10,500 and nil rate savings band of £5,000).

KPMG Note

Individuals earning over £15,500 will pay tax on their savings at their marginal rate of tax, subject to the special rates applicable to dividend income. Individuals who do not earn over £15,500 but earn more than the personal allowance and receive savings income in addition to their earnings may be able to reclaim some of the tax withheld on their savings income.

National Insurance Contributions (NIC)

Employee and Employer NIC Rates and Thresholds			
	Employee (Class 1 Primary)		Employer (Class 1 Secondary)
Earnings per week (£)			
Below £111 (Lower Earnings Limit) (£109 in 2013/14)	0%	Below £153 (Secondary Threshold) (£148 in 2013/14)	0%
£111 - £153 (Primary Threshold) (£109 to £149 in 2013/14)	0%		13.8%
£153 - £805 (Upper Earnings Limit) (£149 to £797 in 2013/14)	12%	Above £153 (£148 in 2013/14)	
Above £805 (£797 in 2013/14)	2%		

Capital Gains Tax

	2013/14	2014/15
Individuals, personal representatives, and trustees for disabled people	£10,600	£11,000*
Other trustees	£5,300	£5,000**

*This will rise to £11,100 from 2015-16

** This will rise to £5,500 2015-16

Anti-Avoidance

Dual Contracts

In the Autumn Statement it was announced that the Finance Bill 2014 would include provisions aimed at preventing the avoidance of income tax by a small number of non-U.K. domiciled individuals who work under arrangements commonly known as "dual contracts." The announcement stated that tax was avoided "by creating an artificial division of the duties of one employment between contracts in both the U.K. and overseas." Non-U.K. domiciled individuals were then able to take advantage of the remittance basis of taxation relating to that overseas contract whereby income is not subject to U.K. income tax unless remitted to the United Kingdom.

KPMG Note

On 19 March, the Chancellor announced a number of changes to the original proposals following representations from the KPMG International member firm in the United Kingdom and others that included the observation that the original draft legislation was too widely drawn and caught arrangements that were effected for commercial and regulatory reasons.

The draft legislation will be amended to prevent the legislation catching directors with less than a 5-percent shareholding in the company's ordinary share capital. The amended legislation will also take account of employment contracts held for regulatory or other legal reasons.

The original legislation included a "comparative rate" test such that to escape being caught any earnings from the offshore contract had to be subject to a foreign tax rate equivalent to at least 75 percent of the additional U.K. rate of 45 percent. This comparative test is being amended to 65 percent of the additional rate of 45 percent. This will potentially benefit, for example, U.S. citizens who could be able to more easily assess whether they are caught by this anti-avoidance legislation or not.

The government has also confirmed its intention not to subject to the new anti-avoidance rules deferred remuneration that is received after 5 April 2014, but relates to employment duties performed in tax years before 2014/2015. (This point was not clear in the original draft legislation.)

The legislation will apply from 6 April 2014. The amended legislation will be included in the Finance Bill which will be published on 27 March 2014.

Onshore Employment Intermediaries

As previously announced, the government is introducing measures to prevent employment relationships being disguised as "false" self-employment through U.K. intermediaries. The rules will apply to workers who provide services to a person (the client) under, or in consequence of, a contract with a third party (the agency). They will apply from 6 April 2014.

Workers within the scope of the revised legislation will be treated as employees of the agency for tax purposes, unless it can be demonstrated that no party exercises *supervision, direction, or control* (SDC) over the worker. If treated as an employee, all remuneration receivable by the worker (from any person) as a consequence of the provision of services is to be treated as earnings from the deemed employment and subject to PAYE accordingly.

Parallel rules will apply for NIC purposes.

HMRC has already confirmed that[2], in its view, the revised agency rules (as they are known) would not apply, under normal circumstances, to workers engaged via their personal service companies.

Guidance has been issued by HMRC on the application of the SDC test with a series of examples – although practically the test will be difficult to apply. The need for agencies to be able to *evidence* that SDC is not present in order for the worker to be considered self-employed is also expected to lead to uncertainty.

KPMG Note

Businesses within the staffing sector will need to consider carefully how they can put in place controls and monitoring activities to satisfy HMRC that the SDC tests are correctly applied. Where they are now caught by the new rules, they will also need to factor in the additional secondary NIC costs.

The government has also introduced an associated "Targeted Anti-Avoidance Rule" (TAAR). The TAAR will apply the new rules if the main purpose, or one of the main purposes, of an arrangement is to fall outside the new rules.

A new quarterly reporting will be introduced for the third-party agency from the first quarter of 2015/16.

Offshore Employment Intermediaries

The government has confirmed that following the consultation by HMRC, new rules to address PAYE/NIC compliance by offshore employment intermediaries will apply from 6 April 2014. A modified version of the scheme will apply to "oil & gas" workers on the U.K. continental shelf.

KPMG Note

We understand that HMRC will issue updated guidance shortly on these matters. However, it is clear that many practical issues will need to be resolved in the very short timeframe to 6 April 2014. Consideration will also need to be given to the contractual arrangements in the labor supply chain in order to help ensure compliance and to manage any additional costs.

Capital Gains Tax on Sales of Residential Property by Non-U.K. Residents – Consultation

As previously announced, a consultation will be issued in due course to consult on proposals to charge capital gains tax on gains made by nonresidents disposing of U.K. residential property. The proposals would take effect from April 2015.

Employee Share Plans

As announced in December 2013 (see *Flash International Executive Alert* 2013-165, 12 December 2013) a raft of changes to both approved and unapproved share plans are due to come into force on various dates starting from April 2014. The proposed changes include a move to online registration and filing of annual returns for share plans, which will require both new and existing plans to be registered by 6 July 2015.

There are also to be changes to the tax treatment of awards held by internationally mobile employees that will affect, in particular, employees inbound to the U.K. with existing share incentives. The changes for mobile employees were due to come into force for awards granted from September 2014. In response to complaints about the complexity of changing the tax treatment of share incentives part way through a tax year, it has now been announced that the share plan changes affecting internationally mobile employees will be delayed until April 2015.

KPMG Note

There is also a suggestion in the Budget commentary that the statutory corporation tax deduction for share incentives will be extended in relation to internationally mobile employees, although we will need to await publication of the Finance Bill to confirm the position.

A consultation on two further recommendations made by the Office of Tax Simplification ("OTS") in January 2013 is also to take place. The first is to change the current rule that employees are taxed when they acquire a beneficial interest in shares so that, unless employees elect to be taxed on acquisition, the tax point will be delayed until the share can be sold for cash, i.e., becomes marketable. (This is still at an early stage, but would be a significant change if it goes ahead.)

The second is to introduce a new vehicle for holding shares (such as a statutory "safe harbor" employee benefit trust) to help employers manage their share plans. This is in response to complaints that commercial employee benefit trusts (EBTs) used in conjunction with share plans have to navigate a maze of anti-avoidance legislation aimed at employee trusts used for tax avoidance.

Pensions

Taxation of U.K. Pension Schemes

The Chancellor has announced major changes to the tax treatment of Defined Contribution (DC) pension schemes.

From April 2015, everyone aged 55 or over will have full flexibility when accessing their DC pension "pot." There will be no requirement to buy an annuity – pension plan members will be able to leave their funds invested and draw as much as they wish from the fund each year, taxed at their marginal rate. It will still be possible to take 25 percent of the fund as a tax-free lump sum.

To help equip people to make the best decision for their circumstances, the government will introduce a new guarantee that everyone who retires with a DC pension will be offered free and impartial face-to-face guidance on their choices at the point of retirement.

As a result of this reform, the government will legislate to prevent members of public sector pension schemes transferring to a DC scheme except in very limited circumstances. It is also consulting on whether transfers from private sector defined benefit schemes should still be permitted, and if so, subject to what restrictions.

As an interim measure before the full reforms are introduced, from 27 March 2014, the government will:

- reduce the flexible "draw-down minimum income" test from £20,000 to £12,000 per annum;

- increase the capped draw-down limit from 120 percent to 150 percent of the annuity that could otherwise be purchased;
- increase the ”small pots limit,” raising the size of a single pension pot that can be taken as a lump sum, from £2,000 to £10,000 (and it will be possible to draw three rather than two personal pension pots this way);
- increase the total pension wealth that people can have before they are no longer entitled to receive lump sums under the “trivial commutation” rules, from £18,000 to £30,000.

KPMG Note

Members will welcome this flexibility in the way they can access their retirement savings. But there are several potentially significant implications for pension schemes in terms of member communications, investment options, and the requirement for providing guidance at retirement. Annuity businesses will need to adjust to an environment where volumes of new business could be considerably lower than previously expected.

Non-U.K. Pension Schemes

The government announced its intention to consult on ways of extending relief given to U.K.-registered pension schemes to qualifying non-U.K. pension schemes (QNUPS). This is to help ensure fairness and to remove opportunities to avoid inheritance tax. Legislation will be introduced in Finance Bill 2015.

Childcare

Measures were announced on 18 March 2014, regarding a new government scheme to assist with childcare costs. Details of the new scheme (which have been modified following announcements made in the Autumn Statement) have been published recently[3] by the government. (For further coverage of this matter please see *Flash International Executive Alert* 2014-031, 19 March 2014.)

Footnotes:

1 See:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf and
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293887/OOTLAR_19_March_2014.pdf .

2 See:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275993/Interaction_of_Personal_Service_Companies_with_the_Proposed_Changes_to_Chapter_7_S44-47_ITEPA_2003.pdf .

3 See:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293084/PU1607_Tax_free_Childcare_response.pdf .

The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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