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Stamp duty surcharge has unintended consequence

Flat-owners 'stamped' on.

Collective enfranchisement refers to the process where leaseholders in a building join together to buy the freehold of the building. SDLT imposes 3% higher tax rates on purchases of 'additional' dwellings (such as second homes and buy to lets) by individuals. It is not obvious why those two concepts should interact. Indeed, the government recognised this by providing an exception to the higher rates where the buyer has a prior interest in the purchased dwelling. Regrettably, for a combination of reasons, the higher rates can apply to collective enfranchisement transactions harshly. Those reasons are these:

- the participating leaseholders would be treated as the buyers where, as usual, the purchase of the freehold is made by a nominee company;
- the higher rates apply to the whole transaction if having regard to *any one of the participating leaseholders* the conditions are met;
- one of the conditions is that the leaseholder owns a dwelling other than the purchased dwelling – let us suppose one leaseholder does; and
- the exception where the buyer has a prior interest in the purchased dwelling does not apply where the prior interest is a lease that has less than 21 years to run.

So, mashing this together, where a participating leaseholder has a lease with less than 21 years to run and another dwelling (anywhere in the world), then the purchase by all the participating leaseholders will be taxed at the higher rates – even if the other participating leaseholders have a lease with more than 21 years to run or do not own another dwelling. That is unfair. In my view, only the proportion of the price attributable to the 'non-qualifying' leaseholder should be taxed at the higher rates.

It would be difficult to criticise the participating leaseholders for excluding the 'non-qualifying' leaseholder initially, so as to ensure that the purchase of the freehold is taxed at the standard rates and for the 'non-qualifying' leaseholder to subsequently buy a share of the freehold at the higher rates. This is similar to the strategy of a person buying a replacement main residence and an additional dwelling from the same person in separate (linked) transactions, which has tacit support from HMRC. Either HMRC should confirm publicly that in their opinion leaseholders are permitted to act in a coordinated way to avoid the higher rates applying to the whole purchase price or the government should amend the legislation.

I have drawn this to the attention of the Association of Leasehold Enfranchisement Practitioners and the Law Commission, which are consulting on how to reform the leasehold enfranchisement legislation. ■

Sean Randall, head of stamp taxes, KPMG

The author thanks Patrick Cannon (Old Square Tax Chambers) for bringing this point to his attention.

Entrepreneurs' relief change

A New Year's resolution to the 5% test?

The Autumn Budget included an important change to CGT entrepreneurs' relief (ER) which extended the 5% qualifying requirements beyond just voting rights and ordinary share capital (tests that were, and remain, relatively straightforward to apply) to a third test imported from elsewhere in the Taxes Acts and focused on entitlements to profits and rights to net assets.

The policy driver behind the extended 5% qualifying requirement was straightforward – the previous tests did not limit ER to shareholders who had a substantive 5% plus equity interest in the company – nominal value and voting rights could be structured so that ER could be preserved for shareholders whose economic interests were, and may remain, well below that threshold level.

The solution proposed by HMRC was anything but straightforward: take tests used elsewhere in the Taxes Acts, write them into the ER legislation and require them to be met throughout the two-year period before the shares were sold. This required an analysis of not just the ordinary share capital, but also certain classes of preference shares and non-commercial debt. It also potentially required the tests to be applied in hypothetical scenarios – something that would sit uncomfortably with a relief such as ER. The difficulties of applying the new test in practice soon became clear – particularly with private equity backed companies with multiple share classes designed to deliver structured returns for different classes of shareholder at different valuations.

HMRC has listened to those concerns and on 21 December 2018 announced an alternative third test in place of the problematic requirement based on distributable profits and net assets.

This alternative test requires the individual in question instead to be beneficially entitled to at least 5% of the proceeds in the event of a disposal of the whole of the ordinary share capital of the company. It is intended to allow individuals to use their entitlement to sale proceeds as evidence of their economic interest in the company, in circumstances where entitlement to the profits and the net assets of the company cannot be demonstrated. Importantly, in contrast to the distributable profits/net assets test, the reference to 'ordinary share capital' helpfully means that entitlements will not be diluted by certain types of preference shares or non-commercial debt.

The new alternative test must again be met throughout the one year (two years from 6 April 2019) period prior to disposal – however this requirement is deemed to be met where the test is satisfied at the time of disposal, and it would be reasonable to expect that the individual would have satisfied the test had a disposal of all the ordinary share capital taken place at the same market value throughout the preceding one (or two) year period, ignoring the effect of any avoidance arrangements in place. This may now give individuals holding so called ratchet or growth shares the right to qualify for ER (assuming all other conditions are satisfied), even if the ratchet/growth hurdle only crystallises on exit.

The legislation is still draft; it contains the now customary tax avoidance qualification and there is little substantive guidance yet from HMRC on how it will be applied in practice. Further guidance on the changes is expected but in the meantime, care should be taken when assessing any individual's current entitlement to ER and in particular when contemplating making any changes to articles to accommodate these changes.

As a wider comment, this process has demonstrated the obvious perils of introducing broadly applicable legislation with immediate effect and without any prior industry consultation or accompanying guidance. It became apparent soon after the original draft legislation had been published that it failed to address the issue identified by HMRC whilst giving rise to a number of unintended consequences for a broad variety of commercial ownership arrangements. As a result, costs have been incurred since the Autumn Budget as businesses have sought clarity regarding the application of the changes to their ownership structures. Following this latest amendment, in many cases this disruption and cost appears to have been entirely avoidable.

At a time when businesses have more than enough uncertainty to deal with in the wider economy, one of the government's New Year's resolutions should be a more judicious approach to introducing new legislation without prior consultation. ■

Robert Birchall & Helen Coward, Charles Russell Speechlys

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Scottish Budget 2018

Ten key takeaways.

The 2018 Scottish Budget has introduced a number of key changes that will affect individuals and businesses. Here are our top ten takeaways:

1. There are to be no changes to income tax rates, so the five rate bands introduced in 2018/19 remain as the structure. The starter (19%) band will run for £2,049 above the (UK) personal allowance of £12,500. Scottish basic (20%) and intermediate (21%) rate thresholds will be increased by inflation from April 2019 but higher and top rate thresholds will be frozen.
2. The Scottish government is not replicating the increase in the higher rate threshold to £50,000 announced for the rest of the UK. This means that there would be a marginal rate of tax and NI totalling 53% on the slice of earned income between £43,430 and £50,000, as compared to 32% in the rest of the UK.
3. Those on an MSP's salary (some £62,000) will pay approximately £30 a week more than those on equivalent salaries elsewhere in the UK; but those on a £25,000 salary will pay about £20 less a year than their counterparts in the rest of the UK.
4. On land and buildings transaction tax, the additional dwelling supplement (ADS – mainly on second homes and buy-to-let properties) is to increase from 3% to 4% from 25 January 2019. The ADS increase was not expected, but perhaps this is the Scottish government's response to the 1% SDLT surcharge proposed for purchases of residential property by non-residents. Everyone will be treated as a non-resident for Scottish ADS purposes.
5. From 25 January 2019, the lower rate of non-residential LBTT will be reduced from 3% to 1%, the upper rate will be increased from 4.5% to 5%, and the starting threshold of the upper rate will be reduced so that it applies from above £250,000 instead of £350,000. This is claimed to make Scotland the most 'competitive' part of the UK for non-residential land transaction taxes.
6. There was an announcement that there would be new reliefs, this time replicating the rest of the UK, in relation to 'seeding' (the initial transfer) of properties into entities known as property authorised investment funds and co-owned authorised contractual schemes. There will also be a relief when units in CoACS are exchanged. There is to be further consultation on these and no timescale is given.
7. There is no change to the position on aggregates levy and air departure tax (APD in the rest of the UK). While these are to join the ranks of devolved taxes, various difficulties over state aid (in relation to ADT with particular reference to the Highlands and Islands) mean that their introduction is delayed. There remains a stated commitment to reduce the impact of ADT by 50% and abolish it entirely 'when resources allow'.
8. Scottish landfill tax rates are increasing with inflation to a standard rate of £91.35 per tonne in 2019/20, a lower rate for less polluting materials (referred to as qualifying material) of £2.90 per tonne in 2019/20.There is a warning that because of decreasing use of landfill, overall receipts from the tax are expected to decline.
9. On business rates, the non-domestic rates poundage will increase by less than inflation, so it will be the lowest in the UK. The overall impact of this, various targeted reliefs and the recent revaluation process is likely to be of particular (relative) benefit to smaller and medium-sized businesses.
10. The process for assigning half of VAT on expenditure in Scotland to the Scottish government will continue to develop, as the model for what is essentially a block adjustment is tested and adjusted. This will have no effect on VAT rates and rules in Scotland, but once fully in effect, targeted at 2020/21, this will have quite a significant effect on the overall Scottish Budget. ■

Isobel d'Inverno & Alan Barr, Brodies

Taxing cryptocurrencies

Will Bitcoin profits give HMRC a new year to remember?

It is a little over a year since Bitcoin fever hit the headlines with its value peaking at approximately £17,275 on 31 October 2017, leading many to cash in their investments and trigger tax liabilities payable by the end of this month.

As many casual investors jumped on the Bitcoin bandwagon heavily last year, Andrew Bailey, CEO of the Financial Conduct Authority, warned in an interview with the BBC that Bitcoin carried a similar level risk to gambling. Unlike gambling winnings however, HMRC will seek to tax cryptocurrency profits and published new guidance in December 2018 to that effect.

For the majority of casual cryptocurrency investors, the CGT 'annual exemption' will usually be available. It is important to note that even if gains fall within the annual exemption, HMRC still require a tax return to be submitted if the total amount sold was more than £45,200 (i.e. four times the annual exemption). Where capital gains exceed the annual exemption, these will be subject to CGT at 10% or 20% depending on whether they are a basic or higher rate taxpayer.

HMRC has summarised the following scenarios as ones in which a cryptocurrency tax liability could be triggered:

- selling cryptoassets for money;
- exchanging cryptoassets for a different type of cryptoasset;
- using cryptoassets to pay for goods or services; and
- giving away cryptoassets to another person.

Some of these may come as a surprise to cryptocurrency investors, particularly those who trade regularly between different cryptocurrencies and may not have realised that every such trade represented a disposal they needed to report to HMRC.

In practice, trying to report such disposals is likely to be extremely difficult, particularly where more niche cryptocurrencies are involved. It requires the investor to try to ascertain the sterling equivalent of their cryptocurrencies sold and acquired, not an easy task and one which may sometimes be impossible to find out as no official sterling prices are published.

In addition to publishing when Bitcoin and other cryptoassets are taxable, HMRC has also outlined when losses might be used. Generally speaking, capital losses operate in their normal way, in that they can be carried forward against future capital gains made.

One of the few times a loss can be carried backwards is if it represents a 'negligible value claim'. This isn't defined in legislation but is generally taken to mean something that is 'worth next to nothing'. That's a difficult test to meet for a cryptocurrency as if it has a market value, even a low one, it is hard to argue it is effectively worthless. It might apply in certain circumstances where a cryptoasset is no longer traded and has effectively gone bust, meaning it might be possible to take the loss back two years to offset against historic capital gains.

In addition, whilst cryptocurrencies are digital in nature, it's possible to hold them in physical form, such as on a USB stick. That of course leaves them open to being stolen in the same way as other currency. Theft, however, means the individual 'still owns the assets and has a right to recover them', meaning no capital loss is available.

It could therefore be a busy couple of weeks for those Bitcoin entrepreneurs who enjoyed a bumper Christmas in 2017 as they figure out their forthcoming tax liabilities, particularly if they have reinvested and are now sitting on big losses. ■

Chris Etherington,
RSM (RSM's Weekly Tax Brief)