TAX TALK

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JUNE 2020

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THE COVID-19 BUDGET - A LOOK THROUGH A CRYSTAL BALL

I've never been one for crystal ball gazing in public in respect of taxation announcements, as trying to second guess a budget speech is a good way to make yourself look foolish. However these aren't normal times, and with an emergency budget almost certainly on the horizon to both stimulate the COVID-19 affected economy, and raise funds to pay for the costs incurred to date and going forward, speculation as to what changes may be on the horizon will swirl with ever growing intensity.

Income Tax and National Insurance

A Government looking to increase tax Revenue has no stronger lever to pull than the one marked 'Income Tax Rates'. However, the 2019 manifesto removes this from being available (in theory) by the commitment to not raise Income Tax or National Insurance in the current parliament. While most people could probably support the argument that this commitment belonged in a different time, the Prime Minister does seem to be standing by this. However, it is worth noting that from an election cycle perspective – it would be best to get this out of the way early in the term rather than later, if drastic measures do need to be taken.

However, while it is quite likely that the Government will leave the main rates of Income Tax unchanged, it may instead reclassify how income should be taxed. The Chancellor made reference to this for the self-employed, when income support reliefs were introduced in April. I expect to see a greater push to bring more income sources to be taxed in line with the rates of Tax and National Insurance for employed workers – including the reintroduction of the off payroll working rules that were delayed for a year to April 2021.

In addition, I would expect a reintroduction of Fiscal Drag – a policy to prevent further increases in threshold values in line with inflation in future years, so that more taxpayers get captured in the higher rate bands.

Corporation Tax

Corporation Tax was not protected in the Conservative Manifesto, and indeed saw an effective increase in the immediate post election period when the March budget cancelled the long-planned cut to 17% to retain the rate at 19%. Whether the effective rate will increase further will likely depend on steps taken by other economies; the Government is very proud that the UK has the lowest rate in the G20 and will likely want to retain that badge.

As with Income Tax however, I'd anticipate measures that increase the Corporation Tax rate that are not in full sight, such as reducing the threshold values for loss utilisation (perhaps mirroring those which apply to banks) and interest deductibility. Media friendly headlines that sound like tax reductions (but don't necessarily change behaviour) to "incentivise investment" such as a further increase in R&D relief, and the Annual Investment Allowance for Capital Allowances spend would seem likely.

THE COVID BUDGET - A LOOK THROUGH A CRYSTAL BALL CONT

VAT

We've already seen several EU jurisdictions cut VAT rates to stimulate consumer spending, and comments made by the chancellor suggest that (as in 2008) such a measure may be on the cards in the UK, and this could be the biggest driver to making an announcement before, rather than after, the summer recess.

Under current EU law, targeted measures to assist specific sectors are very complex/impossible to achieve. Introducing a new reduced rate (as requested by the hospitality and leisure industry) to stimulate that sector may have to wait until after the Brexit transition period has ended.

Investment Reliefs

Throughout the early part of the Crisis, I have been expecting an announcement from the Government to relax the qualifying criteria, and potentially extend scope for relief from the EIS and VCT schemes to drive much needed funding into small and growing businesses who don't qualify for the various loan schemes. However, EU State Aid rules do place significant limitations on what the Government can do here, but the Commission is showing signs of reviewing these restrictions which gives hope going forward. However, I don't anticipate that the most significant request from the various bodies – a doubling of the rate of Income Tax relief for investors - will be provided to the extent requested.

Capital Taxes

Possibly the most significant possible change here has already been made with the considerable reduction in the availability of Entrepreneurs' relief in the March Budget. While there have been calls from various bodies to reintroduce the relief to stimulate investment in the post-Crisis economy, I expect these to fall on deaf ears.

Inheritance Tax is ripe for reform, but arguably has been for the past 20 years. However, using this as a tool to significantly increase tax revenues is unlikely to be palatable for the core voter base for the Government.

SDLT

After an initial wave of interest, most commentators expect that the Housing market will be in the doldrums for some time, which has effects on a range of supporting sectors. Some form of reduction in SDLT rates, most likely targeted solely at Owner Occupiers may be on the cards. This also aligns with suggestions made by the Prime Minister, even before the Election. Here I will confess a personal interest, and deep disappointment that this wasn't addressed in the March Budget, as my own house was on the market at the time…

Business Rates

Business rates were already in the spotlight as adversely affecting many retail and hospitality businesses before the crisis, and once the current reliefs expire, these are surely in need of significant reform to bring life back to the high street. In addition, the potentially permanent shift to greater working from home will likely result in many service businesses requiring smaller office space going forward, again reducing the tax take here. It is likely that this source of income will give rise to much reduced incomes for Local authorities which will require additional government funding if Austerity MkII is to be avoided.

New approaches to increase revenues from the longer term beneficiaries of this shift will likely be required. The nascent Digital Services tax is focussed very narrowly on large tech service providers operating overseas and the scope of this tax could increase, in addition to other tax increases focused on online businesses. However, any new taxes in this area are likely to require global co-operation to be truly effective without damaging UK businesses, and may take time to put in place.

Tax Avoidance

Here I have the greatest certainty of an announcement being made.

"The Government will commit £XXX m to tackling tax avoidance and abuse, with a view to recovering £x bn of taxes unpaid by individuals and businesses who are not paying their fair share of taxes, and have unduly profited from this Crisis that has affected all ordinary hard working people"

If you have any questions, please get in touch with your PKF Littlejohn contact

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WITHHOLDING TAXES - LEAVING THE EU

As we all know, the focus of the last few months has been on Covid-19, not Brexit. However, let's not forget that the UK left the European Union on 31 January 2020 and will end its transition period on 31 December 2020. During the transition period the UK is still following EU rules and trade agreements.

It is possible that at the end of the transition period, we will leave without a deal, which will mean leaving without a withdrawal agreement. With lots of commentary around at the moment about a no-deal Brexit, we thought it would be a good time to remind companies about the impact that this could have in relation to withholding taxes in respect of cross border payments of intra-group interest, royalties or dividends.

Today, the UK is able to make use of three EU Directives in relation to the above, which provide an exemption for withholding taxes. These Directives are used by the UK to ease cash flow, by ensuring that any payments made to the UK from an EU group company can be paid gross, without the application of withholding taxes where they may otherwise apply.

Equally, for payments made by UK companies to EU group entities, the UK can use the Directive to pay interest and royalties gross. The UK of course does not apply withholding tax on payments of dividends.

If we leave with no deal, the default position will revert to the relevant Double Tax Treaty that the UK has in place with the relevant EU Country, in order to establish the relevant rate of withholding tax. Although the UK has an extensive range of treaties with EU countries, not all permit zero withholding tax, for example Portugal and Italy. In addition to this, where relief has been applied for under the EU Directive historically, additional paperwork will need to be completed to ensure that the relevant Treaty Rate can be applied.

Although we do not know for certain if the UK will leave with no deal, now is the time to start reviewing your cross-border payments and receipts to identify how a no deal Brexit might affect you and what steps you can take to manage this.

If you have any questions, please get in touch with your PKF Littlejohn contact.

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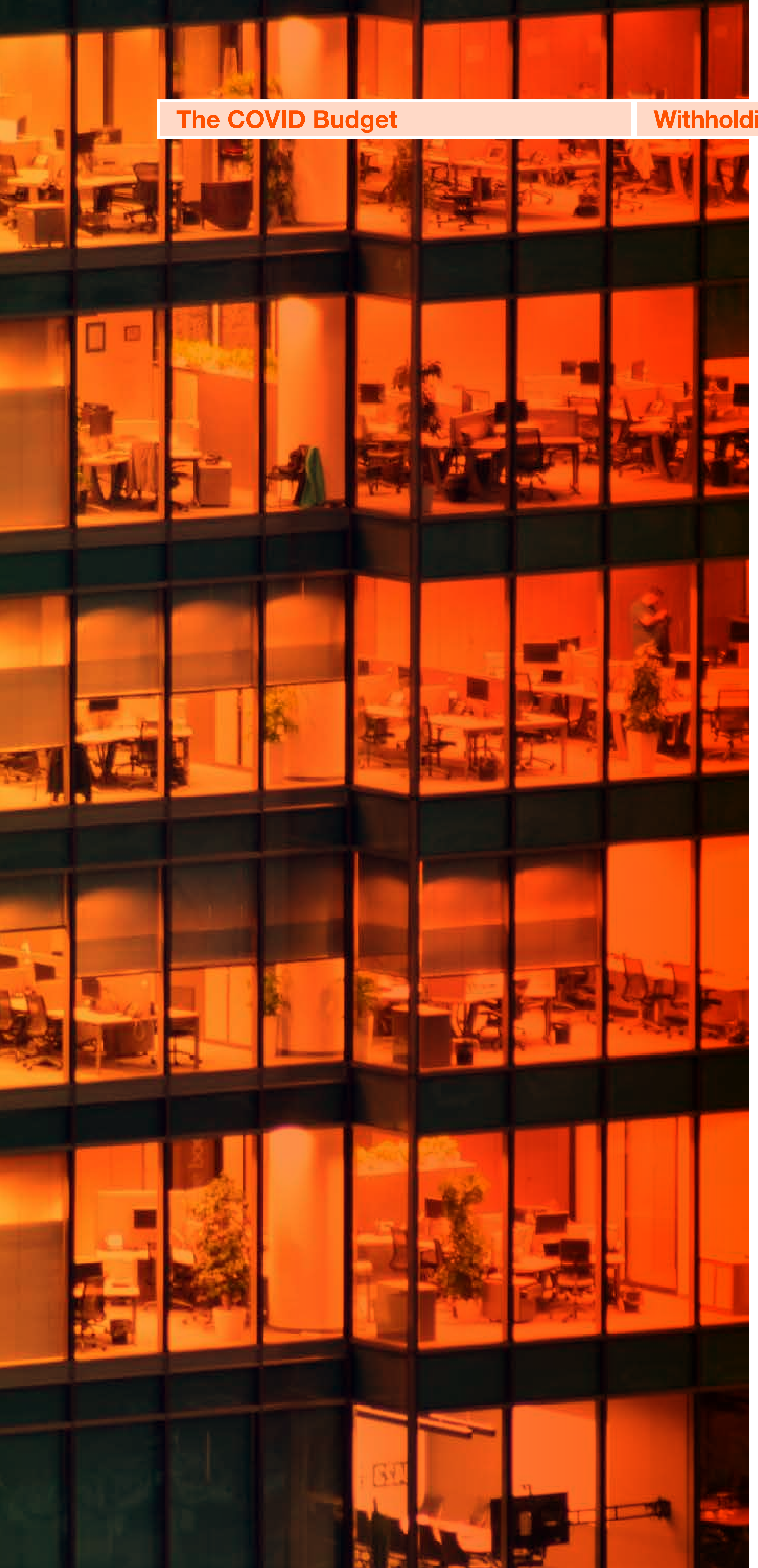

MAKING TAX DIGITAL FOR VAT

The Making Tax Digital (MTD) initiative introduced fundamental changes for VAT in 2019 with the ambition to ease businesses' tax monitoring and ensure they are paying the right amount of VAT.

From April 2019, businesses with a taxable turnover exceeding £85,000 had to submit MTD compliant VAT returns and maintain their VAT records in digital format. In phase 1 of this process, businesses had to sign up for MTD for VAT with HMRC, digitalise the recording of supplies received and made, and use compatible software to submit their VAT returns to HMRC.

Phase 1 of MTD allowed businesses time to adjust to the new procedures and software requirements, the so-called 'soft-landing period'.

Phase 2 of MTD marks the end of the soft-landing period and is likely to cause most issues for businesses, due to its stringent rules and the introduction of penalties for non-compliance. The incoming essential requirement is for businesses to ensure there are sufficient digital links between data in VAT return workings. A digital link is where a transfer or exchange of data is made electronically between software programmes. This brings an end to the 'cut and paste' leniency HMRC has allowed during the soft-landing period. Data must now flow through a business' accounting software or spreadsheet, to a bridging software if relevant, straight to HMRC. Manual inputting of data will no longer be permitted, and penalties could be levied on businesses that fail to comply.

Phase 2 of MTD was due to come into effect from 1 April 2020 but has now been delayed following the Covid-19 pandemic. HMRC has stated the changes in Phase 2 will now be compulsory for the first VAT return starting on or after 1 April 2021. Depending on a business' VAT return stagger, this could result in an extension of up to 12 months.

HMRC published its annual review which highlighted that by 9 March 2020 more than 1.4 million organisations had registered for MTD, with 270,000 of these being small businesses that were beneath the compulsory registration threshold but opted to register for MTD. HMRC's statistics show that more than 4 million VAT returns have been submitted using MTD compatible software.

HMRC's aim is to be a leading digital tax authority and considers the digital preparation and submission of tax returns to be a key step in reducing the tax gap (being the difference between the amount of tax they consider should have been collected and that which was actually paid). HMRC's statistics are that there is £9.9 billion of tax revenue lost each year arising from "avoidable mistakes" by taxpayers and that MTD "…significantly reduced the opportunity to make some types of mistakes in tax returns, particularly simple arithmetical and transposition errors."

MTD has been the first step in a fundamental change to the tax administration system and organisations should be aware that the VAT changes are just the starting point. Businesses caught by MTD should review their current VAT return process, to ensure robust digital links are in place.

Please contact our Indirect Tax Team if you would like to discuss MTD. We can offer guidance and support with your MTD challenges.

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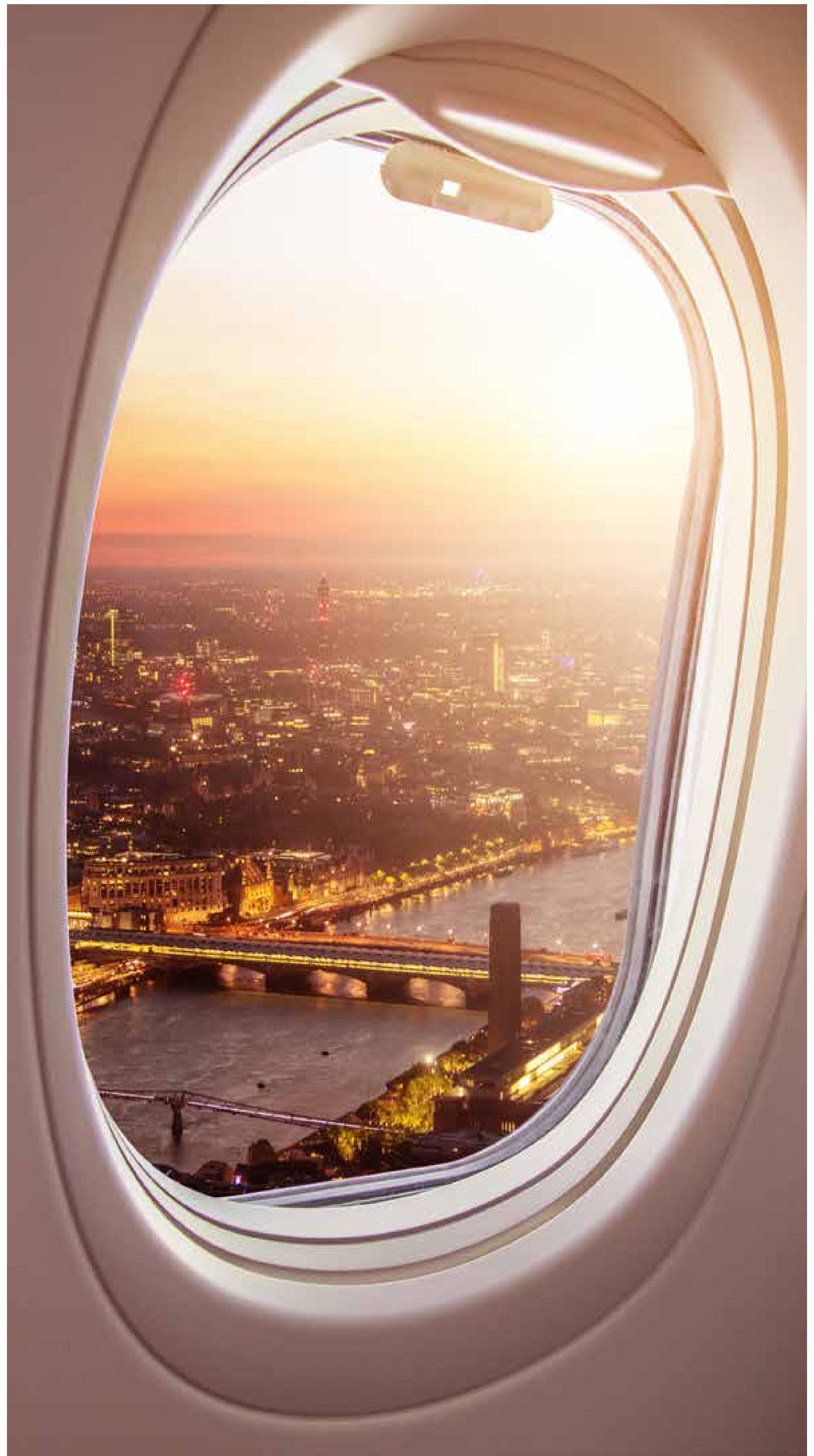
UK RESIDENCE – EXCEPTIONAL DAYS IN THE UK DUE TO CORONAVIRUS

With the effects of Coronavirus (COVID-19) causing the cancellation of many flights along with the closure of several international borders, individuals can find their travel options severely restricted which can have unexpected consequences for their UK tax position. HM Revenue & Customs (HMRC) has recently updated their Statutory Residence Test (SRT) guidance regarding the impact the COVID-19 pandemic may have on an individual's ability to move freely to and from the UK, or where they have been required to remain unexpectedly in the UK.

Under the SRT an individual's UK residence status is often determined by the number of days spent in the UK in a relevant tax year. A day spent in the UK is normally counted if the individual is present in the UK at midnight of that day. For some of the tests of residence there are a maximum number of days an individual can spend in the UK during a tax year without becoming UK resident for that tax year. For more information in respect of the SRT click here.

There is an exemption in the SRT for up to 60 days due to "exceptional circumstances" being spent in the UK as a result of events beyond an individual's control, preventing him or her leaving the UK, provided the individual intends to leave the UK as soon as those circumstances permit. In some cases, excluding these exceptional days will mean that the individual does not exceed the maximum day count and remains non-UK resident for the relevant tax year. Examples of exceptional circumstances include: national or local emergencies such as war, civil unrest or natural disasters and, for example, HMRC previously confirmed exceptional circumstances would cover the 2010 Icelandic volcanic ash cloud that cancelled multiple flights.



HMRC's updated guidance

HMRC's updated guidance regarding the impact of COVID-19 states circumstances are considered as exceptional where individuals:

Are **quarantined** or advised by a health professional or public health guidance to **self-isolate** in the UK as a result of the virus;

Find themselves **advised** by official Government advice **not to travel** from the UK as a result of the virus;

Are **unable to leave the UK** as a result of the closure of international borders; or

Are asked by their employer to **return to the UK** temporarily as a result of the virus.

UK RESIDENCE – EXCEPTIONAL DAYS IN THE UK DUE TO CORONAVIRUS CONT

HMRC's new guidance needs to be considered in conjunction with their current published guidance on exceptional circumstances, and it remains the case that whether days spent in the UK can be disregarded due to exceptional circumstances will always depend on the facts and circumstances of each individual case.

As noted above, for a day to be discounted, the individual must intend to leave the UK as soon as the exceptional circumstances permit. If an individual has been quarantined in the UK for a period, and depending on his or her overall position, it may be necessary to leave the UK as soon as possible after the end of quarantine, in order to avoid becoming UK tax resident in a tax year.

This may prove problematic if an individual is able to leave the UK but is not at that point permitted to return to his or her country of residence. We currently do not know if HMRC will enforce this position and whether it may be necessary for an individual to leave the UK and go to a third country for the exceptional circumstances provisions to apply. HMRC has noted their guidance may be subject to review and further change, so this may become clearer in due course.

When does relief for exceptional circumstances not apply?

There are certain elements of the SRT where relief for exceptional circumstances cannot be taken into account.

One of these is the "Country tie", which is only relevant to those individuals who have been resident in the UK in at least one of the previous three tax years. Where an individual's UK tax residency position is determined by virtue of the "Sufficient Ties Test", having an additional "tie" to the UK can significantly reduce the number of days that can be spent in the UK before becoming UK resident.

The Country tie is applicable if the individual is present in the UK at least as much as any other single country during the tax year. Although up to 60 days in the UK may be disregarded as exceptional circumstances for some parts of the SRT, an individual may nevertheless acquire a Country tie, which reduces the number of days they can spend in the UK before becoming resident.

There are also other parts of the SRT where exceptional circumstances cannot be taken into account and which will be relevant to some individuals depending on their specific circumstances. Please contact us if you would like to discuss how this may affect you.

Working in the UK against COVID-19

In a separate measure, the Chancellor of the Exchequer, Rishi Sunak, has announced further changes to the SRT specifically for highly skilled individuals coming to the UK to work on COVID-19 related activities.

The Chancellor has stated that time spent in the UK by individuals working on COVID-19 related activities between 1 March and 1 June 2020 will not be counted towards the residency tests. Whilst final details are awaited, the Chancellor references "anaesthetists through to engineers working on ventilator design and production."

Finally..

Although the 60 day limit for exceptional circumstances is unlikely to be an issue for the tax year ended 5 April 2020, this is likely to be more relevant for the tax year ending 5 April 2021 as the pandemic continues. The 60 day limit for the year ending 5 April 2021 will have already been exceeded by many of those individuals currently in the UK, who will therefore need to carefully assess their plans for the rest of the year.

It is possible HMRC may change this guidance at short notice as the situation develops, or the Government might consider increasing the 60 day limit depending on how the pandemic continues.

Importantly, individuals need to also be aware that if they are currently outside of the UK and unable to return due to the pandemic, there may be tax implications in the jurisdiction where they have been residing. If this is something that may affect you, please contact us and we will be able to introduce you to one of our PKF International member firms to assist you.

If you would like to discuss how the rules for exceptional days in the UK may affect your personal circumstances, please contact Jonathon Collins or Phil Clayton for more information:

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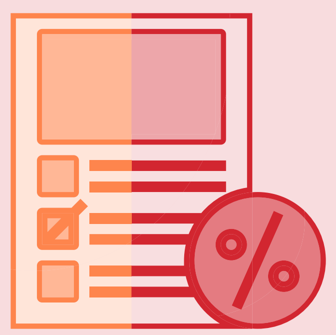
ABOUT PKF

PKF Littlejohn is a fast-growing firm of accountants and business advisers based in London's Canary Wharf.



We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity - we're particularly well-known for working with complex clients with challenging issues in fast-moving and highly technical areas.

Our aim is to understand people, the organisations they run, and what matters to them, so we can simplify complexity and help them achieve their ambitions.

We have three important principles that make a big difference in our business, and they also have a significant impact on our clients' organisations. They are really simple:

1. People matter; making a difference for the people we work with and the people we work for is our priority
2. We're relentlessly curious, because we want to know each client's organisation as well as they do, even better if we can
3. And we're good at getting things done.

We are the London office of PKF UK & Ireland, currently the 10th largest network in the UK with a combined fee income of over £140m.

OUR TAX SERVICES

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Tax planning
In our view, paying the right amount of tax means paying the minimum the law requires of you. We will help you achieve this with tailored strategies that suit your personal and business circumstances

Estate planning and trusts
We can provide sound advice on how to make the best possible use of tax-saving vehicles, ensuring that your family is properly provided for

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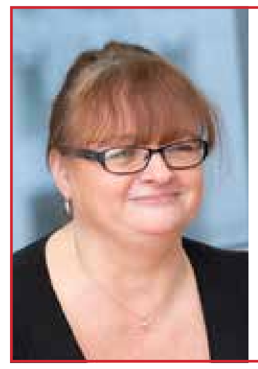

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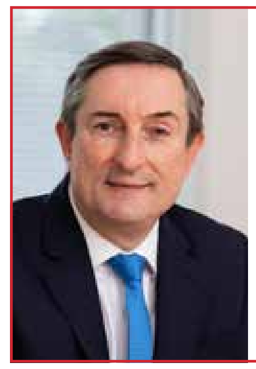

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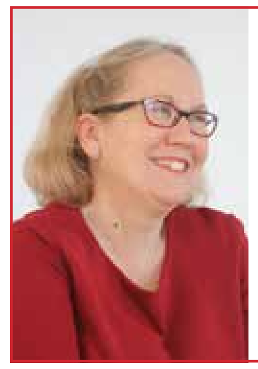

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