# UK BUDGET UPDATE

Robert Venables QC[1]

## 1 Introduction

The Chancellor's Budget Speech on 17th March and the associated Press Releases are most notable for what they did not contain.

It is clear that the Chancellor does not appreciate, any more than did his predecessors, the technicalities of Revenue Law and that the civil service are running rings round him on technical matters.

## 2 Inheritance Tax

There will be virtually no change made to inheritance tax, beyond the increase of the nil rate band in line with inflation and some tinkering with the rules for conditionally exempt property. Many had expected the abolition of potentially exempt transfers and sweeping limitations on business and agricultural property relief.

## 3 Capital Gains Tax

### 3.1 Tax-Free Uplift on Death

This is to continue to be available, even where the estate is exempt from inheritance tax.

### 3.2 Indexation Relief and Taper Relief

As from April 1998, indexation relief will be gradually replaced with taper relief.[2] The

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2 This applies to capital gains tax proper and not to corporation tax on chargeable gains which is, however, to be reviewed.

new system will be allegedly much simpler. It will also be less fair. Broadly speaking, the greater the gain as a percentage of the base cost and the greater the period of ownership, the greater the benefit. Indexation relief will still be allowed on disposals whenever made, but only up to April 1998. Taper relief will operate by reducing the amount of chargeable gain (after deducting any indexation relief) depending on the number of complete years the asset has been held, starting with 6th April 1998, except that assets held at 16th March 1998 will be deemed to have been held an extra year. After ten years, 75% of a gain on business property and 40% of a gain on non-business property will drop out of charge. One consequence of taper relief is that pooling will cease for shares and securities acquired after 5th April 1998.

3.3 Retirement Relief

Retirement Relief is to be phased out beginning 6th April 1999 and ending 5th April 2003.

3.4 Temporary Non-Residence of Individuals

Under current law, an individual is not in general liable to capital gains tax on the disposal of an asset if he is not resident or ordinarily resident in the United Kingdom in the year of assessment in which the disposal occurs, even though the gain may have accrued during a period when he was so resident. By Extra Statutory Concession a year of residence in which an individual begins or ceases to be so resident is split and he is taxed only on gains realised during the resident period.

Some countries, such as Canada, deem all assets to be disposed of and reacquired for a market value consideration on the immigration and emigration of an individual. The Chancellor has not gone that far but proposes that an individual who has ceased to be resident and ordinarily resident in the United Kingdom shall still be taxable if he disposes of an asset which he owned during his period of residence. He will be caught if the disposal is made in the year of emigration or return or in any intervening year unless he remains non-resident for five complete tax years. The rule does not apply to a person who has been resident in the United Kingdom for less than four out of the seven tax years immediately preceding the year of departure.

It would appear that the rules will apply to gains of offshore trusts and closely controlled companies which can be imputed to the individual irrespective of when the assets in question were acquired.

There is no relief for disposals by UK residents of assets acquired while they were non-UK resident.

3.5 Capital Gains Tax on Trusts and Personal Representatives

As from 1998/99, capital gains tax payable by trustees and personal representatives who are United Kingdom resident or otherwise within the charge to capital gains tax, e.g. because they carry on a business in the United Kingdom through a branch or agency, will be "rationalised", i.e. increased, so that everyone is taxed at the highest level, to which currently only certain trusts are subject. This reform is one proposed in the Trust Consultative Document in 1990 and which was wisely rejected by the last government.

United Kingdom resident settlements will in general be subject to capital gains tax at the trust rate. Up to now, interest in possession trusts were taxed at the basic rate only. The trust rate has remained at 34% for some years and was 35% for many years before that. With the gradual fall in the rate of corporation tax, to between 20% and 30% as from 1st April 1999, it is too high.

3.6 Non-UK Resident Trusts

3.6.1 Pre-19th March 1991 Settlements

A settlement created before this date was not a "qualifying settlement" for the purposes of the Offshore Settlor Provisions unless one of four trigger conditions was satisfied. As from 6th April 1999, this will no longer be a bar to a settlement being a "qualifying settlement". Children of the settlor who are under 18 at 5th April 1999 will apparently be disregarded, but it is not yet clear for how long.

As regards trusts created after 16th March 1998 or a trust created at any time in respect of which one of the four trigger conditions is satisfied, the grandchildren of the settlor or of his spouse, the spouses of such grandchildren and any companies any of them control will be added to the class of "defined persons" so that, if any of them can benefit, the provisions can apply to deem gains of the trustees to be those of the settlor.

3.6.2 Trusts Created by Non-UK Domiciled or Resident Settlors

As regards gains realised or capital payments made after 16th March 1998, all non-UK resident trusts fall potentially within the Offshore Beneficiary Provisions, irrespective of the domicile or residence status of the settlor at any time. If a recipient beneficiary is not himself UK resident or domiciled at the time that a gain is imputed to him under the provisions, he will still not be taxable on it. The change will catch, for example, a government minister who receives a capital payment from an offshore trust funded exclusively by a lady friend who was at all material times domiciled on the Continent.

3.6.3 Disposal of Interest in Formerly Non-UK Resident Trust

The exemption from capital gains on the disposal of non-purchased interests in trusts is to be removed as from 6th March 1998 in the case of trusts which are UK resident but which have at any time been non-UK resident. This is a particularly inept reaction to

schemes which involved non-UK resident trustees liquidating their assets in year one and becoming UK resident in year 2, the beneficiaries then selling their interests to non-residents.

## 4 Income Tax

### 4.1 Taxation of Personal Portfolio Bonds

The Revenue can be notoriously bad losers. A unanimous House of Lords agreed with a unanimous Court of Appeal in *IRC v Willoughby*[3] that Professor Willoughby was not engaged in tax avoidance in taking out offshore personal portfolio bonds, even when UK resident. The Revenue shamelessly assert in Budget Press Release 38 that "this type of bond is designed primarily for tax avoidance purposes". Although all gains on such policies are subject to income tax without the benefit of indexation relief, it is now proposed that there should be an additional charge to income tax each year on deemed income of the bond equal to 15% of the premiums paid and compounded annually! This is in addition to charging the full gain to tax under the present provisions! The Revenue have the impudence to claim, in Budget Press Release 38, in which the proposal is contained, that it "will help to bring greater fairness to the tax system"! Sir Humphrey Appleby is alive and well.

### 4.2 Taxation of Non-Qualifying Insurance Policies Held in Trust

The rules for taxing gains from non-qualifying policies under the chargeable events provisions are notoriously technical. If a policy is held on trusts created by an individual, the gain is deemed to form part of that individual's total income, even if he and his spouse are completely excluded from benefit; whereas if he is not alive in the year of assessment in question, it is not taxed at all.[4] It appears to be proposed that in future, if the gain is not taxed as the settlor's, it will be deemed to be income of the trustees. If they are UK resident, they will be taxed on it: whether at the basic rate (currently 23%) or the trust rate (currently 34%) is not specified. If they are not, it would appear that it will form income for the purposes of section 740. While one cannot be dogmatic before one has seen the Finance Bill, it would appear that there will still be opportunities for deferral or avoidance. It would appear that the Revenue are not going to remove the anomaly which works in their favour, namely that the gain is deemed to be income of the settlor so long as he is alive. Ideally, the gain should be deemed to be income for all the purposes of the Taxes Acts. The settlor could then be taxable on it under e.g. Taxes Act 1988 Part XV if he or his spouse was capable of benefiting under

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3 [1997] STC 995.

4 Taxes Act 1988 section 547(1)(a).

the settlement. There is no reason why the settlor should be taxable if he is not caught by some other anti-avoidance provision.

4.3 Abolition of Advance Corporation Tax: Income Tax Consequences

Although advance corporation tax will be abolished as from 1st April 1999, this will have no affect on the tax credit attached to a dividend or other distribution paid by the company.

4.4 FOTRA Gilts

As from 6th April 1998, all gilts will have FOTRA (Free of tax to residents abroad) status.

4.5 Abolition of Foreign Earnings Deduction

The 100% foreign earnings deduction for earnings from employment carried out abroad during a qualifying period of 365 days is to be abolished. Taxpayers could arrange to remain UK resident throughout this period and rely on such residence to claim exemption from tax in other counties, by making a claim under a suitably worded double taxation agreement.

## 5 Stamp Duty

Under the last government, ad valorem stamp duty on a conveyance on sale was 1% (except in the case of shares). It was raised last year to 2% where the consideration was more than £500,000. It is now to be raised to 3% where the consideration exceeds £500,000. Stamp duty is the most archaic and least justifiable of taxes. It is not at all clear why it is being increased in a reforming Budget. A 200% increase in a tax in less than twelve months does seem somewhat excessive. Documents executed abroad can be liable to UK stamp duty, if they have a sufficient UK connection, but are not dutiable until they are brought into the United Kingdom.

## 7 Foreign Domiciliaries

The taxation of foreign domiciliaries has not itself changed, no matter how long they have been resident in the United Kingdom. The tax treatment of beneficiaries of non-UK resident trusts established by persons not both domiciled and resident in the United Kingdom has. See 3.6.2 above.

## 8 Corporation Tax

8.1 Double Taxation Relief for Companies

Double taxation relief for companies is to be reviewed after consultation with businesses. In the meantime, legislation is being amended to counter schemes aimed at circumventing provisions which deny "excessive" tax relief in respect of interest received from abroad.

8.2 Controlled Foreign Companies Legislation

The Controlled Foreign Companies legislation is to be amended in several respects. Some of the amendments will be beneficial to taxpayers.

8.3 Modernisation of Transfer Pricing Legislation

The Transfer Pricing legislation is to be modernised, to bring it within self-assessment and to make it more in line with the principles of OECD and best international practice. A statutory procedure for advance pricing arrangements is to be introduced in the next Budget, which will enable companies to agree in advance that their transfer pricing arrangements are acceptable to the Revenue.