

Chairman's Address Following Budget 2009

RECESSION? WHAT RECESSION?

Recent tax changes and the exponential increase in tax compliance for clients

In the 33 years I have been involved in international tax, I have had the privilege of representing literally thousands of individual taxpayers and entrepreneurs, and today the principal concern we have for our clients is to make sure they comply with the myriad of UK and US compliance obligations, and do so in a way they can both understand and afford.

Having seen the most recent budget changes suggested by the UK and US, I can only assume that lawmakers worldwide have decided that the way out of recession will be led by professional service firms such as ours, as we have an enormous job in getting our clients to understand the complexities of the new legislation as well as keep them compliant and up-to-date with their tax returns. With the introduction of a 39.6% headline rate in the US and a 50% headline rate in the UK, particular attention is going to be placed on ensuring that the two systems interact as intended and that all available allowances and reliefs are taken, both in the UK and US. As a general statement, the higher of the two taxes will be the UK, and for that reason it is vital to ensure that the UK receives its fair share, and no more than its fair share of the worldwide tax 'take'. There is a genuine fear that the 50% UK rate and the much lower 18% capital gains tax rate will also encourage more efforts in the artificial 'tax scheme' world, and see much emphasis placed on performing the alchemists trick of turning income into capital gains on both sides of the Atlantic. This can be to no one's advantage as typically such arrangements operate on the basis of a narrow interpretation of the tax law and will often result in challenges from the authorities coupled with litigation, all of which may take several years to resolve and involve substantial costs on both sides of the argument.

The cumulative effect of the recent changes has presented the picture of the UK as a potentially hostile place for international businesses to operate, and this is particularly felt by our American friends when they look at the potential 'welcome mat' placed out for them by the UK authorities. As a firm we have lobbied hard against the changes to the UK non-domicile rules and the introduction of the £30,000 charge, as well as the reluctance of the Internal Revenue Service (IRS) to opine formally about the availability of a foreign tax credit for the £30,000 charge is a demonstration of the complexities of the situation; and the final resolution of that may require a formal treaty protocol in due course. HM Revenue & Customs (HMRC) have issued literally hundreds of pages of guidance in an effort to provide practitioners and taxpayers with some hope of understanding the post-April 2008 changes. The examples of the calculations required in determining the 'taxable' amounts of remittances from a mixed fund run to several pages for each example. By their nature, the examples shown are simplifications of the real-world examples we will see this tax season when we prepare our clients' 2008/09 UK tax returns, and I shudder to think of the many hours we will spend in forming a 'right answer' on what otherwise would be a straightforward UK return. This is not free and will involve considerably increased costs for the majority of our clients, which again is hardly a message that you wish to give to your clients at the present time in the teeth of the economic recession.

How will this play out in the medium and longer term? The UK remains a fantastic place to start and operate an international business, with terrific social and cultural diversity, and it remains a civil society for the vast majority of our clients. There will be great opportunities for businesses as the economies of the UK and US recover, and the tax issues, albeit complex, can be dealt with in a reasonable fashion with the right advisor on board and part of the team from the start. As a firm, we certainly plan to remain committed to provide the best service we can for our clients at as reasonable cost as the complexities of the law allows!



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INTRODUCTION TO BUDGET 2009

In the 2009 Budget, certain proposed changes for higher rate taxpayers announced in the Pre-Budget Statement last autumn have been brought forward to 6 April 2010. The extent of the measures have been widened and deepened with the consequences for those above, an income limit of £100,000.

For taxpayers with taxable income above £150,000 the tax rate will be 50% rather than the earlier proposed 45%, and will now operate from 6 April 2010.

Also, from 6 April 2010 the personal allowance (£6,475) will be subject to a phase out of £1 for every £2 of income that exceeds £100,000; eliminating any allowance on income over £113,000.

Rates of tax on dividends change for higher rate taxpayers subject to the new 50% rate. Effectively there are now three rates of charge on dividends with a 7.5% differential maintained between your top income tax rates on income and that imposed on dividends. So the 50% higher rate taxpayer will pay tax on dividends at 42.5%; the 40% higher rate payer will continue to suffer a 32.5% rate on dividends, whilst the basic rate payer will continue to be taxable at the 10% rate.

Restrictions will also be placed on tax relief that individuals with taxable earnings of £150,000 or more will obtain for contributions to pension schemes. These changes come into full effect from 6 April 2011 and have the effect of tapering away relief to just 20% for those earning £180,000. The implications of this will start to bite from 22 April 2009 by virtue of some "anti-forestalling" rules which will restrict any attempts to front-load contributions over the next two tax years. Relief will be restricted to the basic rate on any pension savings above £20,000 per year unless they are seen to be "normal ongoing regular pension savings" that the individual has already committed prior to Budget day.

There was an announcement of a change to the benefit-in-kind rules on the provision of accommodation. From 22 April 2009, any new leases entered into will be taxed fully as if the premium was a rent where the lease is for 10 years or less.

Changes were announced in the Pre-Budget Report of a 0.5% increase in the employers and employees national insurance contributions. These will be brought into effect as first proposed from 6 April 2011.

We may recall HMRC had an Offshore Disclosure Amnesty programme two years ago in relation to any offshore bank accounts subject to payment of a fixed penalty. What is being described as the New Disclosure Opportunity is going to be run through to March 2010 with a strict timetable; further details are to be announced.

One positive point is HMRC are to commit to a Charter to guide taxpayers and advisers on the minimum standards. HMRC will adapt in its interactions and behaviours. This is planned to be launched in the autumn of this year.

There were various small amendments to the changes in the remittance basis rules for non-domiciled taxpayers that were introduced in the Finance Act 2008. Paul refers to this in his opening address and we have covered this topic for clients in some detail, as we all grapple with the practicalities following the end of the year and the first UK tax filings to 5 April 2009.



Mark Walters
Managing Director

PRACTICAL IMPLICATIONS - WHERE TO BEGIN?

For UK resident non-domiciles, the simple question still remains: is there any value in claiming the remittance basis of taxation or should I accept worldwide taxation in the UK? As expected, the Budget offered little in the way of tangible changes, although the legislation in last year's Finance Act is still the subject of ongoing consultation and refinement.

Put simply, the answer to the question must be grounded in economics. For those who have not been resident in the UK for more than seven of the previous nine UK tax years, the benchmark is the cost of the personal allowance for income tax and capital gains annual exemption (effectively the exemptions before you step into paying tax). However, for those with UK income in excess of £100,000, the decision may just have been made easier; from 6 April 2010, if you have UK taxable income of more than £100,000, then there will be a tapering away of the personal allowance. So for non-domiciles resident in the UK, from 6 April 2010 if you are losing the personal allowance anyway, where is the additional cost?

For those resident in the UK for more than seven of the previous nine UK tax years, there is the £30,000 remittance basis charge to factor in. Where swallowing the charge is still economic, great care needs to be taken picking the path through the legislation as it is necessary to nominate non-UK income and gains. We must emphasise that the remittance of nominated income or gains to the UK will open up a raft of very unpleasant anti-avoidance legislation – this is an area where planning can pay dividends.

For US individuals, the real cost of the £30,000 is still not known as the IRS has yet to confirm if and how you may credit the charge against US taxes. The proposed acceleration and increase in the top rates of tax will undoubtedly shorten the point where the cost of the £30,000 will become economic. For US taxpayers, the spread between the top rates of tax in the US proposed at 39.6%, and the post 5 April 2010 UK environment of 42.5% for dividends and 50% for other income will cause concern.

It is clear that the new rates make planning that much more crucial – for example, for married couples, one could consider diverting income producing assets to the spouse with the lower income. On a more general note, the increases have now starkly highlighted the differential tax rates between income and capital gains, which are still taxed at a flat rate of 18%. However, before entering into a reorganisation of one's affairs, advice should first be sought from your usual contact at Frank Hirth.

FUNDING UK LIFESTYLE

It is inevitable that from time to time, you will want to draw on non-UK monies for UK spending; at the very least, there is some reassurance in having a safety net. As a result of the restricted way in which the UK taxed non-domiciles by allowing them to segregate their non-UK world from the gaze of HMRC, the UK has a sophisticated set of rules taxing the transfer of value into the UK. Every time, a remittance of value is made to the UK, the question is what is being remitted; income, capital gains or capital? It is of vital importance to understand what you are bringing to the UK and how, or even if, it will be taxed. The most effective tool is correctly structured bank accounts and the mantra must be it is never too late to start. For those individuals accepting UK tax on their worldwide income and gains, bringing non-UK income and gains to the UK that accumulated when they were not subjected to UK tax will still trigger a tax charge. For US taxpayers, particular care is required as this is a minefield for double taxation as you would have already been taxed on the income or gains, although the US/UK tax treaty cannot ride to the rescue. Where in doubt, ask your usual contact at Frank Hirth.

US INVESTMENTS AND UK TAX

As expected, the Budget has brought forward proposals dealing with offshore funds. As with most anti-avoidance, the introduction of the rules dealing with the taxation of funds where the income was not being substantially paid out was too widely drawn. One of the consequences of the changes in last year's Finance Act was to highlight the UK's taxation of US investments, such as the staple mainstay of the investment manager – the mutual fund. It will come as no surprise that both the IRS and HMRC agree on the taxation of foreign investments, although they remain divided on how to do this. In the UK, HMRC retained a system of registration which has never been widely embraced, whilst the US expects the investment to be fiscally transparent with the intention of taxing the investor on the underlying income and gains. The Budget has brought forward plans to redefine the scope of the investments caught within the definition of an offshore fund, which will hopefully step mutual funds outside the definition and match up UK and US treatment of income and gains.

UK INVESTMENT PLANNING

Making pension contributions was a basic planning tool for higher rate taxpayers to reduce their effective rate of tax in the UK whilst saving in a tax free environment for the future. For US citizens, payments into pensions also provided an excellent mechanism to utilise excess foreign tax credits on their US returns by bringing down their effective rate of UK tax. Under proposals brought forward in the Budget, the ability to make contributions has been severely curtailed. The legislation comes in two parts – with tax relief being withdrawn in full from 6 April 2011, and anti-forestalling provisions designed to stop payments into pensions before the new rules bite. Under the anti-forestalling rules, if you earn more than £150,000 per annum and want to make payments into a pension scheme over and above your regular amounts, either personally, through a salary sacrifice or through an employer's contribution, then tax relief will be severely curtailed. Before making such contributions, advice should be sought.

For UK resident taxpayers, the ISA (Individual Savings Account) provides a tax beneficial platform for investment outside the scope to UK tax. Whilst in the ISA wrapper, income, gains and growth are exempt from UK tax. For US taxpayers, the tax free status is clearly not respected, although the wrapper may be appropriate to reduce the effective rate of UK tax on worldwide income and gains. Currently, one can invest £7,200 into an ISA (of which a maximum of £3,600 can be in cash). From 6 October 2009, individuals over 50 will be able to invest £10,200 into an ISA (of which half - £5,100 - can be in cash). From 6 April 2010, the increase in the limits will apply to all taxpayers. It is clear that the more generous limits may attract increased interest in the ISA vehicle, although some care is required for US taxpayers. Many have been caught out by investing into US tax unfriendly assets, such as unit trusts. It is possible to achieve a tax saving for US individuals by ensuring that the investment does not offend US tax rules – again, please do call your usual Frank Hirth contact if you have any queries.

CHARITABLE GIVING

There was an announcement within the Budget dealing the effect of charitable giving on the £30,000 remittance basis charge. However, on a more general level, following the restriction of the tax relief on pension contributions, the availability of tax relief on charitable donations does need some further thought. The basic premise is that there is tax relief out there, both in the UK and US, for those donations meeting the criteria. For the UK, this is a gift to a UK registered charity. In the US, the charity needed to be a qualifying foundation. The difficulty in obtaining relief in both jurisdictions did act as a powerful disincentive for US taxpayers, although there are charitable vehicles available for those individuals.

COMPLIANCE POWERS – ‘SOME MORE STICK’

Within the Finance Act 2008, a provision was made for a new compliance regime, which was built upon in the Budget. From 1 April 2009, HMRC introduced extended powers to call for documents, visit business premises and redefine the penalty regime for under declarations of tax. The net effect of the rules is to bridge the gap between the powers of former Inspectors of Taxes with their erstwhile contemporaries within the former HM Customs & Excise. The new regime will mean a harmonisation of penalties, removing the scope to negotiate a more favourable penalty when concluding an enquiry and could mean a greater likelihood of enquiry.

In the best tradition of the tabloid newspaper, the Budget has announced powers for HMRC to “name and shame” those taxpayers subject to a tax penalty where they have deliberately understated tax due or failed to notify a tax liability, where the tax at risk exceeds £25,000. Presently, HMRC has published information on those taxpayers who are convicted in the criminal courts for tax evasion. Those taxpayers making an unprompted disclosure or making a prompt disclosure when required to do so, will be exempt from the new rules.

DEALING WITH NON-UK PARTNERSHIP INCOME – A PRACTICAL CASE STUDY FOR NON-DOMICILES

Where an employee who is resident but not ordinarily resident in the UK performs the duties of their employment both inside and outside the UK, they are only taxed on the proportion of income in relation to their overseas duties to the extent such income is remitted to the UK. Therefore, any remittance up to the portion of UK duties is deemed to be UK source income with no further charge to UK tax.

By way of example, Joe has a salary of £100,000 paid wholly outside the UK. He carries out 50% of his duties overseas. Therefore, if he claims the remittance basis of taxation, he will pay UK tax on £50,000 of his earnings as it arises and further tax on remittances in excess of the UK element.

Under the prevailing practice up to 5 April 2008, the calculation was made on an annualised basis. However, the changes in Finance Act 2008 deemed that all remittances were to be computed on a transaction-by-transaction basis for remittance basis users.

In a concession, it was announced that the historical practice would continue to apply for the 2008/09 tax year, which allays concerns that those who would otherwise fall into the revised ‘mixed fund’ rules, whereby any remaining unremitted income in relation to UK duties could potentially become taxable if remitted in a later year.

BAD NEWS FOR PARTNERS?

Although the confirmation from HMRC clarifies that the old practice prevails for employees, partners are not protected. For those individuals, you need to calculate the tax effect of remittances in accordance with the complex mixed fund rules.

PARTNER IN A UK AND US PARTNERSHIP?

Up to 5 April 2008, it was common practice for partners with an interest in both a UK and US partnership to deem any remittances made out of the US partnership to be first made out of their UK source partnership income. As both UK and US profits are generally contained within the US partnership's income and the individual is paid out of the US partnership, it was considered impractical to determine which country's profit allocation the drawings related to. Therefore, given that the individual was UK resident, it was deemed that the first portion of any remittance was made from UK profits. Any remittance above their UK profit share would be deemed their share of US profits.

However, the Finance Act 2008 did not explicitly comment on partnership income, thus by default, any situations similar to the above will fall into the complex 'mixed fund' rules. Consequently, a bank account containing both UK and US partnership income will be considered a mixed fund and any remittances will be deemed to be made on a worst case scenario basis. Moreover, remittances will be looked at on a transaction-by-transaction basis and HMRC will therefore consider the make-up of the account at each remittance date, rather than gradually exhausting each category of income.

As such, remittances will be deemed to be made firstly from relevant foreign income not subject to a foreign tax, then from foreign chargeable gains, before relevant foreign income subject to a foreign tax. Therefore, US partnership income is likely to be considered the last category of foreign income to be remitted given that it will contain a foreign tax credit of US tax suffered on such profits. As a result, if an account were to hold any gross foreign investment income, this would be considered to be remitted prior to any US portion of partnership income. Furthermore, US partnership income subject to US tax will be considered to be remitted prior to any UK partnership income. This may therefore result in additional UK tax payable.

The ordering rules above are applied on a current year basis first before looking at prior year income on a 'last-in, first-out' basis. As such, all current year income needs to be exhausted before looking back to prior years.

WHAT ARE YOUR NEXT STEPS?

It is quite clear that this is a further example of additional compliance in a complex area. Careful consideration must be made in terms of the structuring of not only offshore bank accounts, but investments in partnerships and any pay arrangements to see if anything can be done to aid you.

There are ideas and procedures we can help implement to make partners' tax affairs more efficient should they or the partnership require guidance in this area. However, it should be noted that this is our interpretation of how the legislation will work in practice given that HMRC have yet to comment with regards to this type of scenario.

These rules are extremely complex and seeking professional advice is strongly recommended before implementing any changes.

CORPORATION TAX RATES

Corporation tax rates remain unchanged. For companies with taxable profits of less than £300,000, the small companies rate remains at 21% and the full corporation tax rate remains at 28% on taxable profits in excess of £1.5m. The effective marginal rate of corporation for taxable profits between £300,000 and £1.5m is 29.75%.

TRADING LOSS CARRY BACK

Under existing legislation unlimited trading losses can be carried back and relieved against income of the previous twelve months. The 2008 Pre-Budget Report announced an extension of loss carry back from one to three years for losses up to £50,000. This additional relief has now been extended by a further year to cover accounting periods ending in the period 24 November 2008 to 23 November 2010 and for unincorporated businesses the relief will be available for losses arising in the tax years 2008/09 and 2009/10.

BUSINESS PAYMENT SUPPORT SERVICE (BPSS)

Another measure introduced in 2008 Pre-Budget Report, now extended in the Finance Act 2009 is the BPSS. Most businesses will pay tax due on the previous year's profits in the current year. If that business is making losses in the current year, then through measures described above these losses can be relieved against the previous year's profits. As the claim to make the loss carry back is after the payment date of the tax liability for the previous year, HMRC now have the power to extend the period for payment demand if they are satisfied:

- The business is genuinely unable to pay the liability
- The tax owed is corporation tax or income tax on the previous year's profits
- The business is likely to make a trading loss in the current year

CAPITAL ALLOWANCES/TAX DEPRECIATION

A First Year Allowance rate (FYA) of 40% for expenditure on plant and machinery is introduced for the year commencing 1 April 2009 for corporations and 6 April 2009 for unincorporated businesses. The recently introduced Annual Investment Allowance (AIA) allows for full deduction on the first £50,000 of expenditure on most plant and machinery. The FYA is available on expenditure not covered by the AIA instead of the 20% Writing Down Allowance (WDA).

PERSONAL ACCOUNTABILITY OF SENIOR ACCOUNTING OFFICERS

Legislation is to be introduced which will require Senior Accounting Officers of large companies to take reasonable steps to establish and monitor adequate accounting systems to provide accurate tax reporting. Certification will be required annually that the Senior Accounting Officer is satisfied the above is occurring.

HMRC will need to be notified of the identity of each company's Senior Accounting Officer and penalties are potentially chargeable on that person as well as the company.

TAXATION OF FOREIGN PROFITS

A full package of reforms to the taxation of foreign profits are to be introduced by the Finance Bill 2009.

Foreign dividends received by a UK corporation are currently chargeable to UK corporation tax, with a credit often available for foreign tax on that dividend. From 1 July 2009 foreign dividends will in most circumstances be exempt from UK corporation tax. In addition to this there are to be changes to current Controlled Foreign Corporation (CFC) legislation.

New debt cap rules are to be introduced so the deduction for finance expenses payable by UK members of a group of companies will be restricted to the consolidated gross finance expense of the group. Although this will not affect many companies in terms of altering their tax liability (especially as a Gateway Test is to be introduced to apply to inbound investors to exempt them from the rules) it does create an additional compliance burden.

LOAN RELATIONSHIPS

Previously the release of trade debts between connected companies resulted in the debtor being taxable on the release with no deduction available to the creditor. Legislation introduced by the Finance Bill 2009 will eradicate this mismatch with the debtor company no longer being taxable on the release.

Interest payable to connected creditors outside of the UK was previously an allowable deduction on the basis the interest was paid within twelve months of the accounting period end. Interest is now to be allowed on an accruals basis irrespective of when the interest is paid unless the creditor is located in a tax haven.