Tax Talk

Simplifying the complexities of Tax

February 2022

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Tax Talk: February 2022

Priority tasks for the New Year

No doubt the festive season feels like a distant memory. But after another challenging year have you managed to meet all your goals so far? We hope you've submitted your Self Assessment tax return and that you can now focus on our Tax Team's New Year's resolutions and tips.

Plan ahead

Think about the future, today. Consider inheritance planning, especially if the value of your estate exceeds the Inheritance Tax (IHT) allowances. These start at £325,000 for the basic allowance and £175,000 for the main residence allowance. Have you written a will? If not, don't put it off. Dying intestate may mean your estate passes to individuals outside your control. If you have already written a will, make sure you update and review it regularly.

Working abroad

If you run a business which is now adopting a more flexible working policy, make sure you know where your employees are, particularly if they are outside the UK. When employees are residing in another jurisdiction, the duration of time they spend there and the nature of the activities they undertake can have tax consequences, both for the individual and the company. If you are planning to send an employee to work abroad, seek appropriate tax and legal advice.

Tax on transactions

Ensure that you plan ahead for any forthcoming transactions. For example, selling a business, buying a property, or inheriting assets. Make certain that your tax team are the first people to know, rather than the last. If there are issues that need to be resolved, it is nearly always easier and more cost effective to do so in advance, rather than in the heat of a transaction.

Check out allowances

Supported by your independent financial advisor, maximise your tax-free allowances. The personal savings allowance permits £1,000 or £500 of interest to be earned tax free for basic and higher rate taxpayers respectively. The dividend allowance is £2,000 and the ISA allowance is £20,000. Consider, too, the level of your pension contributions. The pension annual allowance is £40,000.

What else should I consider?

Our annual year end tax planning guide is now available. This considers the above points, and many more, and can be found on our website here.

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UK residential property - how should you own it?

Changes in the last few years have transformed the tax landscape for residential property ownership in the UK. How should this affect your choice of acquisition vehicle?

A wide variety of taxes apply at different stages of property ownership. These are Income Tax, Stamp Taxes (SDLT), Corporation Tax, Inheritance Tax (IHT), Capital Gains Tax (CGT), VAT and Annual Tax on Enveloped Dwellings (ATED).

There are many ways to structure a property purchase. We look at three principal vehicles for holding a property: in your own name, through a company, or through a trust.

Individual ownership

This is the simplest option and may also be the most cost effective for raising finance. Generally, banks are happier lending to individuals than to companies, and often at lower rates.

On purchase, SDLT rates are up to 15% for UK residents or 17% for non-residents. The respective bandings are wider at the lower rates of SDLT, meaning that the rate tends to be lower than for company ownership.

Rental income is subject to tax at the owner's marginal rate of tax (i.e. between 0% and 45%). In many cases, exposure to the top rate of Income Tax on property rental profits will be enough to discourage investment in UK real estate.

Expenditure wholly and exclusively related to the rental business, including maintenance and finance costs, may be deductible to reduce the total tax payable on rent. Under new rules, restriction to interest relief on residential properties means that relief for finance costs is limited to the basic rate of Income Tax (20%). This is a major drawback when compared to corporate ownership, as we explain below.

On disposal of the property, the gains may be subject to CGT at 18% or 28% (depending on total UK income and gains in the year of the sale or gift) and may need to be reported to HMRC within 60 days of the completion date. (Until the August 2021 Budget, the reporting period was 30 days).

If you lived in the property you may be able to claim Private Residence Relief (PRR) for the period of occupation and for certain periods of non-occupation.

Special rules apply for disposals by non-UK tax residents, where the base cost may be uplifted to the value at April 2015. For more information on individual disposals, please see our insight.

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On an individual's death, UK-situs assets (which include UK residential property) will form part of the deceased's UK estate. These will potentially be subject to UK IHT at 40%, after taking into account the IHT nil rate band of £325,000. If you hold a property in your own name and leave it to someone else on your death, the CGT value of the property for the new owner would be reset on your death.

Corporate ownership

As with individual ownership, on purchase SDLT rates could be up to 15% for UK residents or 17% for non-residents.

The main attraction of holding property in a company is that rental profits are subject to Corporation Tax at 19% (increasing to 23% from April 2023) rather than Income Tax of up to 45%. However, during the lifetime of the company the most common way of extracting profits is by way of dividends. This means that the aggregate tax payable on profits received by a shareholder via a company will be higher than if the profits had been received directly. Alternatively, the company could be set up by way of a loan, and repayment of this loan could be a tax efficient way of extracting profits, however withholding tax could apply in certain situations.

In a similar way to individual ownership, income expenditure associated with the property may be deductible to reduce the total tax payable on rent. But unlike personal ownership, there are no restrictions and the full element of mortgage interest is deductible from the landlord's taxable rental income - provided that the borrowed funds are applied "wholly and exclusively" for the property business and that the interest is "not excessive". This is a major benefit compared to personal ownership.

One drawback of owning UK residential property via a corporate structure is the ATED requirements (for more on this, please see our insight). But if the property is used for business purposes (i.e. letting or property development), there should be no ATED charge.

Disposals of the property are subject to Corporation Tax on gains at a rate of 19% (increasing to 23%). Unlike direct ownership or ownership via a trust, PRR cannot be claimed to reduce the gain.

For individual gains on the disposal of the company's shares (on the basis that it is treated as a property rich company, i.e. which derives 75% or more of its gross assets value from UK property) the rate of tax is either 10% or 20%. The indirect disposal must be reported within 60 days.

Another consideration when selling the property is that the purchaser may be more attracted to buying the shares in the property holding company, as the SDLT rates are considerably lower (0.5% compared to 17%).

Following changes made to the UK IHT provisions in April 2017, shares in closely controlled non-resident companies which derive their value from UK residential property are subject to UK IHT at 40% on death. A closely controlled company is one which is broadly controlled by five or fewer shareholders. Note, too, that loans made to such companies to acquire, improve or refurbish UK residential property will also be subject to IHT.

Trust ownership

The transfer of UK residential property into a trust may give rise to an IHT charge of 20%. There may also be CGT implications. In certain circumstances, where the settlor is non-UK tax resident and the assets transferred into the trust are non-UK situs assets (i.e. cash held abroad), the 20% initial IHT charge can be avoided, however, for income tax purposes the transfer of assets abroad provisions may need to be considered.

Once the assets are held within the trust and the settlor cannot benefit from the trust, they may not be part of the settlor's estate and therefore not subject to UK IHT at 40% on the death of the settlor.

UK situs assets held within the trust may be subject to IHT at a maximum of 6% on the trust's 10-year anniversary (periodic charge) or when the property is distributed out of the trust (exit charge).
The SDLT rates charged when a trust acquires a property may also be up to 15% for UK residents and 17% for non UK residents.

Trustees owning UK residential property are subject to UK CGT on realised gains. The rate of tax will be 28%.

Capital gains from disposing of property rich companies are subject to tax at 20%.

Generally, trustees are liable for Income Tax at 45% on rental profits. But this could be reduced to 20% at trust level if a life interest in the income is granted to a beneficiary.

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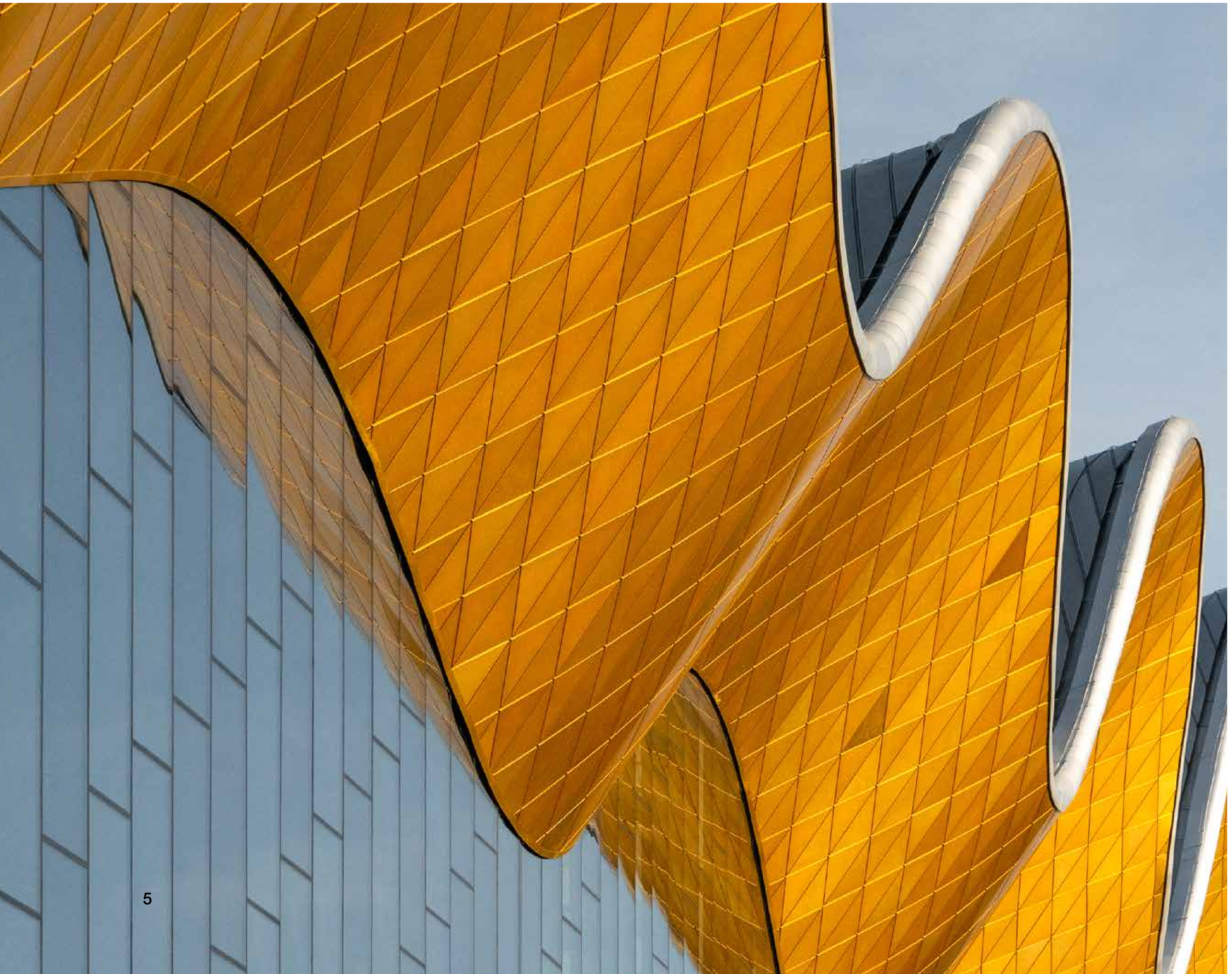

Subject to the trustees' agreement, any income distributed to a beneficiary will have a 45% tax credit attached, which may be reclaimed by the beneficiary if they are not a higher rate taxpayer. Special rules apply for settlors who could benefit from the trust.

VAT implications

Residential lettings are exempt from VAT regardless of the ownership structure. However, it is important to take into account that there are exceptions when lettings are not used for permanent residential use (i.e. guest houses, serviced accommodation, bed and breakfast etc). But the rules around this are quite complicated, and we recommend you seek advice first.

Time to decide

The decision whether to hold property directly, via a company or through a trust is not necessarily a straightforward one.

Personal ownership may mean lower rates of SDLT on purchase, avoiding an ATED charge during ownership, and may exclude any capital gain on a sale or gift if the property is to be your main residence.

But there are circumstances where trust or corporate structures are more suitable and offer certain benefits. For example, for property rental, development or trading, your business may benefit from being held in a company. This is primarily because of the difference in rates between Corporation Tax and personal Income Tax. Company ownership can be advantageous where limited liability is required. And there may also be non-tax reasons to hold properties through a trust, such as confidentiality, estate planning and asset protection.

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The accidental goodbye: what happens if your company leaves the UK unintentionally?

It should be easy to establish where your company is based for Corporation Tax purposes. But it can be surprisingly complex. Shona Barker, Senior Manager in our Business Taxes team, explains how it can all go wrong and how to fix it or better yet, avoid the pitfalls in the first place.

When you incorporate a company in the UK, the law assumes your company is tax resident here unless you do something explicitly to change that. But tax, just like life, can sometimes get messy.

Usually, when you register a company at Companies House, you don't need to do a whole lot of thinking. HMRC will automatically set up a Corporation Tax record for the new company and write to your registered office with the details. You need to pay your taxes and file your returns. And that's about it.

It is possible for a company to deliberately migrate abroad and shift its tax residency somewhere else, although this is not straightforward. There's a convoluted procedure, and it might not give you a favourable tax outcome. But sometimes the commercial rationale makes the cost worth it.

It is also possible for a company to 'accidentally' leave the UK, which is a special kind of headache…

How could this happen?

When it comes to residency, if the big decisions all take place somewhere else, the place of incorporation can become less relevant.

Just because the directors of a company are not personally UK tax resident, it doesn't necessarily follow that the company has an effective place of management overseas. Nor does it mean that central management and control are not exercised from the UK. It's a bit of a red flag, but not definitive on its own.

On the other hand, it is entirely possible for the management and strategic direction of a company to gradually change over time, until there's no real substance left in the UK. (Other than perhaps goodwill, which can be problematic. You can't see it, but it can be worth a lot. And HMRC isn't going to let you escape without paying tax on its full value.)

Similarly, care must be taken where the impact of COVID-19 and the improved technical ability to work 'from home' has changed the location of where some people are now working.

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If you look at the relevant double tax treaties, along with the fact pattern of what has transpired, it can be the case that a company has drifted abroad over time, and a tiebreaker clause now puts that company outside the UK. Or possibly both in the UK and overseas. (The only thing messier than drifting overseas is ending up resident in two jurisdictions at once.)

To leave the UK, a company strictly needs advance approval from HMRC. Failure to obtain it can result in penalties and a long, drawn-out process involving discussions with tax offices in multiple countries.

So, how can it be resolved?

When leaving the UK, HMRC will insist on a guarantor, which must either be a UK resident company or a UK branch of a foreign bank. This is the case even if there's no exit tax payable, or if you've already settled it. There's no compromise to be had.

If your company is part of a wider group, finding a UK company to act as guarantor won't be a hardship. But standalone companies are going to have to make friends with their bank managers, pronto.

Your company may need to register in the overseas jurisdiction first to prove to HMRC that it has definitely left the UK.

I was never there, guv'nor!

Although a company is assumed tax resident by virtue of its incorporation, if it has been run abroad since day one it may be possible to argue that it was never within the charge to UK Corporation Tax after all. Should this argument hold up, it has the rather neat effect of HMRC cancelling all accounting periods and avoiding the dreaded exit tax.

Should I stay or should I go?

You might not want to leave the UK, but if your corporate governance has deteriorated to the point where you are struggling to argue that the company is still tax resident in the UK, you may not have a choice.

Some overseas jurisdictions can offer a lower tax rate, which can be appealing. But bear in mind that when you leave the UK an exit tax is calculated on your deemed chargeable gains and, if there are intangibles that you need to suddenly revalue, this can be significant.

You'll need expert advice not just from a Corporation Tax specialist, but a valuations specialist too.

How to stay out of trouble

It's always far better to avoid being in this kind of mess in the first place. Companies with overseas elements should review their corporate governance periodically to make sure that they're really tax resident where they think they are.

If you think your company might have a residency issue, or if you would like to plan a corporate migration the right way, please get in touch with Shona Barker or your usual PKF Littlejohn contact.

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International tax webinar series

Watch our free series of International Tax webinars on demand.

We recently ran a free series of International Tax webinars. For further information on each webinar and to watch on demand, see our overview.

Structuring your international expansion
19 October 2021

Are you thinking of expanding overseas? Have you thought about if you need to form an entity or a branch? If you do where is the best place for it to sit within your group or do you even need one? How will you finance the operation and how will you repatriate funds back to the parent? Join Corporate Tax Partners **Chris Riley** and **Catherine Heyes** as they consider these questions and more.

Watch on demand

International movement and equity incentivisation of your team
16 November 2021

As the world opens up again, join Global Mobility Director **Louise Fryer** and Employment Tax Senior Manager **Dan Kelly** as they discuss some of the challenges that can be presented when a company operates internationally including making sure you have a robust global mobility policy in place, are meeting employer "in country" reporting and payroll obligations and, of course, the tax and social security implications for the individual.

Watch on demand

Indirect taxes issues of global trading
25 January 2022

The movement of goods and services cross border can create indirect tax issues in many countries, which can include the location of your customer. There is an increased focus on businesses that trade online and even for more traditional sectors such as manufacturing, indirect taxes can be complicated especially post Brexit. Join VAT Director **Luigi Lungarella** as he presents three case studies to explore these issues and more.

Watch on demand

Global Indirect Taxes Webinars

We are delighted to invite you to register for a free series of Global Indirect Taxes webinars

The series will help you and your organisation navigate the significant changes that have been made to indirect taxes globally and provide an overview of technical and commercial considerations across all key jurisdictions.

Our webinars will also cover e-commerce, cross-border services, the concept of an establishment from a VAT and direct tax perspective, and customs duties. Attendees will be provided with real-world examples of how to minimise cross-border indirect tax issues.

Each event will be led by VAT Director, Luigi Lungarella who will be joined by indirect tax experts from across the PKF International global network, including the USA, Russia and the EU.

Join us for our series of Global Indirect Taxes Webinars:

Session 1 - Global Indirect Tax Update - Watch on demand
Session 2 - 1st December 2021 - Watch on demand
Session 3 - 2nd February 2022 - Cross-border services – navigating local requirements
Session 4 - 6th April 2022 - The servitization of the economy and the importance of establishments
Session 5 - 8th June 2022 - Cross-border goods – The hidden costs and challenges of Customs

About PKF
Simplifying complexity for our clients

PKF is one of the UK's largest and most successful accountancy brands.

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 large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF International, a global network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

9th largest Tax practice in the UK

£165 million annual fee income

2,050 UK partners and staff

6th ranked auditor of listed companies in the UK

Our tax services
At a glance

> "By bringing together the extensive expertise and experience of our tax specialists we can provide a fully rounded service that offers excellent value for money."

We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

Corporate and business taxes

Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

Read more

Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

Read more

VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

Read more

Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

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