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UK TAX POLICY: WHATEVER NEXT?

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Analysis

UK tax policy: whatever next?

Speed read

The dust is still settling from the election. As the Conservatives strive to build a minority government, speculation is growing as to which legislative proposals will survive into the Queen's speech. Significant elements in the draft Finance Bill 2017 that did not make it into the short-form Finance Act still remain to be settled. While certain tax cuts have been pledged, which other taxes will be raised and by how much? And, perhaps most crucially, what impact are Brexit negotiations likely to have on our tax system?

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Whatever next? Opinion polls predicting a Conservative government with a healthy majority (if not the originally anticipated landslide) all proved illusory, leaving the Conservatives as the largest party but scrambling to put together some form of agreement with the Democratic Unionist Party (DUP) to support a minority government.

At the time of writing, there remains some doubt as to which legislative proposals from the Conservative manifesto will make it into the Queen's speech. Similar uncertainty surrounds the direction of UK tax policy. Simply in terms of the personnel involved, although the chancellor remains in post, he has been deprived of some of his key lieutenants at the Treasury. They have either been moved on to other jobs (in the case of David Gauke, the former chief secretary, who has been promoted to secretary of state for work and pensions) or lost their seat (in the case of Jane Ellison, the former financial secretary to the Treasury).

Against that background, it may not be wise to engage in any predictions as to what the next five years will bring. But here goes.

Unfinished business

It is perhaps best to start with the unfinished business.

When the snap election was called, a raft of measures originally included in the draft Finance Bill published on 20 March 2017 did not make it into the short-form Finance Act, which was passed just before the prorogation of Parliament.

The measures left in legislative limbo included:

- the introduction of the new interest barrier provisions designed to implement Action 4 of the OECD/G20 BEPS proposals;
- the reforms to the treatment of corporation tax losses (including the relaxation of streaming rules to restrict the use of certain types of carried forward losses against certain types of profits, the introduction of group relief for carried forward losses, and the limitation on the use of carried forward losses so that they can only shelter 50% of profits in excess of £5m in any accounting period);
- the important changes to the taxation of non-UK domiciliaries, including the introduction of deemed domicile status for those who have been resident in the UK for 15 out of the previous 20 years; and
- the reforms to the substantial shareholding exemption (SSE) to remove the requirement for the company making the disposal to be a trading company or the member of a trading group.

All of these provisions were due to be given effect from 1 April 2017 or 6 April 2017. While their exclusion from the wash-up Bill may have been considered desirable in order to allow further Parliamentary scrutiny of these measures before their introduction, there is now some uncertainty about whether they will be introduced and when.

It would be reasonable to expect that there will be little Parliamentary opposition to the introduction of the new interest barrier rules. They are, after all, designed to implement one of the actions of the OECD/G20 BEPS proposals. On that basis, there seems little reason why they would not be brought into effect from the original expected date, 1 April 2017.

Although one might expect the same to apply to the other measures, it does not necessarily follow. Let us hope that there will be some confirmation soon.

This will be of particular concern for any taxpayers who made disposals of assets on the assumption that the changes to the SSE and the rules applicable to non-UK domiciliaries (which included an element of rebasing) would take effect from 1 April 2017 and 6 April 2017 respectively. But there will be others whose plans were put on hold during the election campaign and who deserve some clarity.

Revenue raising

Taxes were likely to rise whichever party won the election. The only questions were which taxes and by how much.

The Conservative manifesto relied largely on plans that were announced at the time of the March 2017 Budget. The only specific measures included in the manifesto were either actually tax cuts (for example, the proposed increase in the personal allowance to £12,500, the increase in the threshold for the 40% rate of tax to £50,000, and the pledge to cut corporation tax to 17%); or promises not to increase tax rates (such as the pledge not to increase the rate of VAT).

The Conservatives did not repeat in their manifesto the 'triple tax lock' of the previous administration. If the new government needs to raise taxes (and the likelihood is that it will), this will give it more flexibility around the areas in which to do so and avoid the accusation that it is breaking a manifesto commitment when it does so.

Self-employment and the 'gig economy'

So what are the likely sources of revenue?

Notwithstanding the chancellor's rather unseemly retreat from the imposition of increased NICs on the self-employed in the March Budget, it is likely that the government will at some point return to the area of self-employment in order to raise additional revenue.

There are various reasons for this:

- The first is defensive. There is a growing hole in the UK's finances as more and more people work under arrangements outside the scope of traditional

employment. The self-employed pay less income tax and NICs. The shift in working arrangements is predicted to cost the exchequer £4.5bn by 2020/21.

- The second is that the existing system is increasingly seen as unfair: while the self-employed are entitled to fewer benefits, their beneficial tax status is more generous than is required to reflect their diminished social security entitlements. HMRC estimates that the effective NICs subsidy to the self-employed exceeded their reduced benefit entitlements by £5.1bn in 2016/17.
- There is increasing pressure for reform of the law applying to modern working practices outside the area of tax. This will inevitably have an effect on tax policy.

On the latter point, the government established a review of the effect of modern working practices, chaired by Matthew Taylor, the chief executive of the Royal Society of the Arts, in October 2016. It is due to report later in the year. The Taylor review will focus on the rights and responsibilities of workers and employers, in particular those engaged under flexible working arrangements in the 'gig economy'. Such issues have been kept at the forefront of public debate by high-profile cases such as that concerning the status of Uber's drivers as workers for the purpose of employment protection legislation.

This debate is not limited to workers' rights. It is already spilling into the tax sphere. Although the changes to the tax code are beyond the remit of the review, its chair, Matthew Taylor, has suggested that this is simply because the tax issues are under separate review by the Treasury.

The debate is not limited to the gig economy, however. In a paper published in advance of the March 2017 Budget, the Institute for Fiscal Studies argued for wider reform to income tax on earned income to cover not just those employed in the gig economy but the self-employed more generally and owner/managers of businesses. It promoted the redesign of the tax system to align the taxation of legal forms under which people work.

Wider reform is likely to produce a significant number of 'losers' and prove politically difficult. Whether the government has the political appetite or will for such reform may be doubted. So notwithstanding the U-turn, following the Budget it seems likely that there will be a return in the future to more limited increases in NICs for the self-employed, bringing them more into line with employed workers. Although not uncontroversial, these increases will perhaps take place under the cover of proposals to reform workers' rights in the gig economy.

29 March 2019 is not far away

The election result may affect the precise form of Brexit that we can expect to see, but similar issues are likely to arise for the tax system.

The principal issue is, of course, that of customs duties. The Conservatives' manifesto reiterated the commitment to file schedules with the WTO which reflect the EU common external tariff. This assumes a Brexit which includes the UK leaving the EU customs union. Even if that commitment is followed through, it says nothing of the position of the UK in relation to the EU 27 states, which will be the subject of the Brexit negotiations.

Other key issues over the next few years will include:

- whether there is a possibility of preserving the availability for UK companies of directives reducing withholding taxes on cross-border payments of dividends, interest and royalties (such as the parent/subsidiary directive and the interest and royalties directive) in a similar manner to the agreement between the EU and Switzerland;
- the extent to which the UK will retain in its domestic law the provisions which are designed to give effect to freedoms under the EU treaty; and
- the potential effect of the UK ceasing to be an EU member state on the application of the double tax treaties and domestic law of the EU 27.

More BEPS?

Will we see more BEPS-based legislation? Not much. The UK is well on its way to implementing many of the domestic law changes required or recommended as part of the OECD/G20 BEPS proposals (including anti-hybrid rules and the new interest barrier).

We have yet to see the effect of these changes. One thing is certain: the UK has placed itself at the vanguard of the implementation of BEPS, while others (including some EU member states) lag behind. Whether or not this proves to be a wise approach at the time of the Brexit negotiations remains to be seen.

Old certainties: anti-avoidance, transparency and compliance

All of the major parties included commitments to bear down further on tax avoidance in their manifestos. Some may argue that HMRC has already been very successful in changing the attitudes of taxpayers – both corporate and individual – to avoidance and there is now little need for more legislation. The tide of new measures looks set to continue, however. For example, the Conservatives' manifesto included a commitment to introduce the legislation, also originally contained in the Finance Bill but not included in the wash-up Bill, which will enable HMRC to impose sanctions (including fines) on advisers who are 'enablers' of tax avoidance.

That said, it may well be that the greatest impact will be felt from the exchange of information between tax authorities. In the course of this year, HMRC will begin to receive reports from other tax authorities under the common reporting standard and country by country reporting regime. The information gleaned by HMRC will begin to inform its compliance checks, the basis on which it exercises its powers, particularly in relation to offshore and cross-border matters (such as the new criminal and civil sanctions for offshore evasion, the corporate offence for failing to prevent the facilitation of tax evasion and the failure to correct past offshore evasion) and inevitably more legislation.

Some things don't change. ■

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