A Budget for Change?

The Chancellor of the Exchequer, Rachel Reeves, delivered her first Budget today, 30 October, under the new Government. Much had been made about the "black hole" in the UK's finances. In an attempt to plug the gap, the Chancellor has delivered a wide-ranging Budget covering most taxes that were not ringfenced in Labour's manifesto promises.

The Budget offered some much-needed certainty for non-doms. The Treasury has clearly been working hard, with the publication of 103 pages of draft legislation on the abolition of the non-dom regime. At last, this has given non-doms some clarity about the future, and some limited good news about the length of time during which inheritance tax (IHT) will continue to apply to long term residents who leave the UK. Whether the new regime, with its limited relaxations and transitional rules, will stem the anticipated exodus of the very wealthiest non-doms remains to be seen.

The change to the taxation of carried interest, moving from a capital gains tax regime to income tax, was included in the depths of the documents and not mentioned in the speech itself. It seems unlikely to significantly change things in the private equity industry, though, as always, the devil will be in the detail. Much speculated on, and now coming into effect from April 2026, inheritance tax reliefs will be changed to include caps on the amount that can be relieved under both agricultural property and business property reliefs. Similarly touted in the press, employer NICs have been increased and thresholds reduced, significantly increasing the costs for people-heavy businesses. CGT rates increased, as expected, though perhaps not as much as was feared. And a totally unexpected change was the 2% increase in the SLDT surcharge for those buying second homes and buy to lets.

Whether these measures combined will raise the vast sums the Chancellor expects, and make a difference in the budgetary shortfall, will remain to be seen. We discuss the detail of the main changes below.

Reform to 'non-dom' taxation

As previously announced, the taxation of non-UK domiciled individuals will be substantially reformed. Non-doms are, very broadly, people who live in the UK but whose permanent home is elsewhere.

Much of the new regime had already been trailed, although some additional details have now been disclosed:

- The remittance basis of taxation will be abolished from April 2025. The current remittance basis provides that UK resident non-doms are only subject to UK tax on their non-UK income and realised gains if and to the extent that they used those sums in the UK.
- Instead, 'new arrivers' to the UK will, for their first four years of UK residence, benefit from 100% relief from UK taxation on their foreign income and gains (the FIG regime). The relief will apply whether or not the sums are brought into the UK, removing the disincentive to bringing in cash held overseas which is inherent in the current remittance basis regime.

- A temporary repatriation facility will allow previous remittance basis users to remit previous years' foreign income and gains to the UK at reduced rates. It will apply for three years, with the rate being 12% for 2025/26 and 2026/27, then 15% in 2027/28. This represents an especially significant discount against the maximum income tax rate of 45%, which could encourage non-doms with large amounts of previously unremitted non-UK income to remit it to the UK. The facility will also apply to certain benefits received from offshore trusts.

- Non-UK assets held by individuals who have previously claimed the remittance basis, and who have never previously been UK domiciled or deemed UK domiciled, may be eligible for automatic re-basing to their 5 April 2017 market value. In effect, this means that any inherent gain which accrued before 2017 will not be subject to CGT on a post-5 April 2025 disposal. Non-doms considering selling non-UK assets imminently will need advice on whether to sell before or after 5 April 2025.

- Inheritance tax (IHT) will also move to a residence-based system. Those who have been UK resident for 10 of the preceding 20 years will become subject to IHT on their worldwide assets. This is a tightening up of the current rules which apply worldwide IHT exposure only after 15 years' UK residence.

- It had previously been announced that a '10-year tail' would apply to anyone ceasing UK residence after 10 years of UK residence, effectively meaning that they would continue to face worldwide IHT exposure for 10 years after leaving the UK. This has been softened somewhat, with the length of the 'tail' now increasing in line with how long the individual had been UK resident before they left.

- The favourable taxation of certain trusts settled by non-doms will be substantially curtailed. In short, the income tax and CGT protections currently available to trusts settled by a person while non-UK domiciled will cease to apply, unless the settlor is within the four-year FIG regime for new arrivers. The IHT treatment of a trust will be determined by reference to the settlor's status at the time of the charge, rather than at the time the trust was settled. This means that the assets within the trust will be subject to decennial IHT charges at up to 6% under the relevant property regime as well as potentially IHT at up to 40% on the settlor's death if, at the relevant time, the settlor had been UK resident for at least 10 of the preceding 20 years.

Draft legislation has been published so advisors can at last advise clients with certainty on how the new rules will affect them. That said, it will take time for advisors to fully digest all 103 pages of the legislation and appreciate the subtleties. As ever, with such substantial changes, the devil will be in the detail.

Some points are notably absent from today's announcements:

- Campaigners have been pushing for a bespoke new regime to attract ultra-high net worth international individuals to live and work in the UK for longer than the four-year FIG regime, perhaps based on paying a very high annual charge at tiered rates depending on the individual's worldwide wealth. No such regime is being introduced, despite the Chancellor's promise to introduce an "internationally competitive regime".

- The previous government suggested that, in addition to residence, "other connecting factors" might be relevant in determining exposure to IHT. This led to speculation that factors such as British citizenship could become relevant. The draft legislation does not refer to any such factors. This will be a relief to many, particularly long-term British expats who are likely to be the unexpected winners from the new IHT regime. It seems they will be able to return to the UK and pay no UK tax for the first four years on their foreign income and gains and avoid IHT on their global wealth for up to 10 years.

It remains to be seen whether the new rules will provide the "internationally competitive" regime which the Chancellor promised to ensure the UK is an attractive jurisdiction to attract and retain ultra-high net worth individuals. Hopefully, the feared mass departure of non-doms has been stemmed, with today's details finally putting an end to months of uncertainty and enabling such individuals to make informed choices about their next steps.

Inheritance Tax: Agricultural and Business Property Relief Reform

From April 2026, two of the main inheritance tax (IHT) reliefs, agricultural property relief (APR) and business property relief (BPR), are changing:

- 100% relief is limited to the first £1 million of combined qualifying agricultural and business assets and the relief will be reduced to 50% (currently 100%) for any qualifying agricultural and business assets exceeding the combined £1 million threshold.
- BPR for shares that are not listed on a recognised stock exchange, such as those on the Alternative Investment Market (AIM), will be reduced to 50%.

The caps announced will increase the IHT payable by a substantial number of business owners and landowners. The incentives for housebuilding, and the pressure to deliver new homes, means land values often exceed the agricultural value and even small farms can be worth well over £1 million.

The key question for many farmers and business owners is whether they will have a viable business to pass on to their successors after settling the new IHT liabilities. This will particularly impact farming businesses, which are reliant on their acreage.

All business owners will now need to review their succession plans to ensure their business can endure the increased IHT liability from April 2026. For some, this may mean tightening already tight budgets to set aside sinking funds, or to look at life insurance when previously they did not need to do so.

The obvious way to manage these provisions is to start planning earlier and fragment ownership, moving assets out of an individual's estate ahead of a potential IHT charge on their death. Ownership could be spread across the family, for instance. The proposed changes anticipate potential avoidance using trusts: although they do not give details on how, the £1 million cap is likely to be divided between all trusts settled by the same person on or after 30 October 2024. Relief will be limited from April 2026 for trusts settled before this date. Instead, the best route may be to look carefully at family constitutions, corporate governance and partnerships, bringing in family members to hold shares of businesses and spread IHT risk.

In our view, the changes could have the following implications for the sector:

1. It is now more likely that the children of farmers and business owners will need to borrow to new levels or sell land or parts of the business if they wish to keep the bulk of

the family farm or business. This could mean we see more consolidation in the market as landowners with other resources take the opportunity to expand.

2. Life insurance is going to be more important for owners of farms, estates, and rural businesses. Under the current rules, life insurance proceeds will fall outside an individual's estate for IHT, allowing the next generation to pay the IHT bill and keep the business going.

3. The cap may limit the ability of business owners to invest in new equipment, technology, or expansion, which could slow down growth and innovation. Businesses may be forced to divide or sell because of these changes to IHT. We shouldn't forget the main reason for the original introduction of APR and BPR was to keep these businesses intact for the benefit of the economy. Businesses that can survive the IHT bill because they have sufficient surplus resources are likely to increase the prices of their goods and services to maintain profitability.

4. More imaginative family governance structures may be used. Traditionally, family constitutions have been used by international families or families with siblings running estates together. The current changes incentivise fragmentation. Well-advised families might look at spreading assets but with "strings attached", where each family member is bound by a set of rules and must take steps to protect the assets from third parties, such as by entering into pre- or post-nuptial agreements. This could need a different skill set to those of traditional landed estate advisors, both in creating and enforcing the agreements.

Inheritance Tax: changes to unused pension funds and death benefits

From 6 April 2027, unused pension funds and death benefits payable from a pension will be included in a person's estate for IHT purposes. Pension scheme administrators will become responsible for reporting and paying any IHT due on these funds and benefits. This is a significant change to the status quo and may mean that people decide to draw more taxable income from their pension during their lifetimes. This measure, combined with the changes to the availability of Business Property Relief and Agricultural Property Relief discussed in our briefing, will impact how people consider their succession planning and may make more people take advantage of the normal expenditure out of income exemption, which has no cap.

Changes to the Capital Gains Tax (CGT) rates

The main rates of Capital Gains Tax (CGT) are being increased immediately from 10% and 20% to 18% and 24% respectively. The change will take effect for disposals made on or after 30 October 2024.

The rates for CGT reliefs Business Asset Disposal Relief (BADR) and Investors’ Relief are remaining at their current generous 10% rate for the rest of the current 2024/25 tax year but then increasing to 14% for disposals made on or after 6 April 2025, and from 14% to 18% for disposals made on or after 6 April 2026. The Investors' Relief lifetime allowance is being reduced from its current generous £10 million to just £1 million, in line with the existing BADR lifetime allowance. This change will take immediate effect. Investors' Relief is littleused and this change suggests it may have been overlooked when the £10 million BADR lifetime allowance was similarly reduced to £1 million in March 2020.

No changes will be made to the 18% and 24% rates of Capital Gains Tax that apply to residential property gains.

Carried interest: moving from capital gains tax to the income tax framework

Alongside the increase of carried interest capital gains tax (CGT) rates to 32%, the Government has also announced that with effect from 6 April 2026, all carried interest will be taxed as income and not as capital gain. However, the detail contains a considerable carrot. The rate of income tax for "qualifying" carried interest will be "adjusted by applying a 72.5% multiplier". Applying this multiplier to the current top rate of income tax of 45% yields a top rate of carried interest income tax of 32.6%. Interestingly, this effective rate is almost identical to the proposed short term increased carried interest CGT rate of 32%. On top of this, as a result of carry moving from capital gain to income, Class 4 national insurance contributions (NICs) will be payable. The net effect therefore will be a 0.6% increase in the headline rate of tax plus NICs at a rate of 2% for higher earners.

In the short term, the current special 28% capital gains tax rate for carried interest (or carry) will remain until April 2025. After April 2025 that rate will increase to 32% until the switch to the income tax basis of charge in 2026. This may lead to asset and fund management structures being reviewed to ensure that carry arises before April 2025 and again before April 2026. However, there may be anti-forestalling provisions in the new legislation seeking to counter this.

Yet another carried interest consultation has also been launched. This time the focus will be on the conditions for accessing the reduced rate of income tax on qualifying carried interest. In particular, the Government may introduce a co-investment requirement and a minimum time period between the award and receipt of carried interest. Responses are invited on both topics. The Government recognises that "there are a number of practical challenges with implementing a co-investment requirement" and appears to be open to the suggestion of co-investment being determined at a firm level rather than on an individual-by-individual basis. By contrast, any minimum holding period for carried interest rights will apply to each individual and will be in addition to, not instead of, the existing asset holding period requirement under the income-based carried interest (IBCI) rules.

New Stamp Duty Land Tax rates for second-home owners and companies

The Government has announced an increase in the rate of Stamp Duty Land Tax (SDLT) applicable to:

- Higher Rates for Additional Dwellings ("HRAD"); and
- Higher rates for certain acquisitions of "higher threshold" dwellings by companies and non-natural persons.

The current surcharge (3%) for HRAD will be increased from tomorrow (31 October 2024) by 2 percentage points to 5%. Where contracts are exchanged prior to 31 October 2024 but complete (or are substantially performed) after that date, transitional rules may apply. The Government is introducing the increase to ensure that those looking to move home (their main home), or purchase their first property, have a comparative advantage over second home buyers, landlords and businesses purchasing residential property, who will now pay 5% more in SDLT. This will undoubtedly affect the values of properties that are mainly suited to those buyers, such as holiday homes and HMOs. Whether that means those properties will now be bought by owner-occupiers or simply become less valuable remains to be seen. Coupled with the abolition of multiple dwellings relief earlier this year, this could have a real impact for smaller scale investors in residential property (where additional dwellings are purchased, but not more than six in a single transaction).

The Government has also increased the flat rate of SDLT paid by companies and non-natural persons acquiring residential properties worth more than £500,000 (where they are not intended to be let out on a commercial basis) from 15% to 17%.

In addition, there will be an increase in the ATED annual charges of 1.7% from 1 April 2025, in line with the September 2024 Consumer Price Index (CPI).

The Government has forecast that this is expected to result in 130,000 additional transactions over the next five years by first-time buyers and other people buying a residence as their main home.

<u>Budget news for buyers of country houses and a sting in the tail</u>

The additional rate of Stamp Duty Land Tax (SDLT) for additional dwellings has increased from 3% to 5%. We have reported on these changes in more detail above.

This increase means the purchase of a second home for, say, £5 million by a non-UK resident would trigger SDLT of £861,250 as opposed to an already hefty £761,250.

If properties have both a residential and a genuinely non-residential element, they qualify for the non-residential rates of SDLT on the full purchase price – often known as "mixed use". On a £5 million purchase, SDLT would be a "mere" £239,500, so creating a huge differential as compared to the residential rates of up to £861,250.

This "mixed use" premium is going to be brought into sharp focus with today's increase. Given the potential saving, the possibility of qualifying as a mixed use property could be factored into prices and is likely to make houses with farms, forestry, vineyards, yards or liveries or other commercial elements considerably more attractive and therefore more valuable.

Mixed use claims are already heavily scrutinised by HMRC. With the Chancellor also announcing additional resources for HMRC, and the savings going up considerably, this scrutiny is only likely to increase. Where properties are on the cusp of a mixed use claim, it is well worth the parties looking more closely at the use profile and building sufficient evidence to satisfy an HMRC enquiry.

On a separate note, the increase to the additional SDLT rate may also catch out people who have recently made gifts to bank pre-Budget CGT rates. For instance, many clients have chosen to give family property to their children, either by transferring it to them or declaring they hold it on bare trust for them. Higher additional SDLT rates do not apply where someone is replacing their main residence, but the "replacement" element means they need to be selling an existing residence. Where siblings have been given a family property – perhaps a London flat or a holiday home – and that property is not being sold, they will also pay the higher additional rate on the purchase of their own first home. This could become a material incentive to sell the property they were gifted, or otherwise dispose of it, perhaps by arranging further transfers to siblings or other family members who are not about to buy their own home.

National Insurance Contributions (NIC) changes

For employees: There is no increase in rates and no lowering of thresholds. The Government has kept to its commitment not to increase taxes for "working people" including investment bankers and Premier League footballers.

For employers: The employer's Class 1 NIC secondary threshold will be reduced, from £9,100 to £5,000 per annum with effect from 6 April 2025 until 5 April 2028. This means employer NIC bills will increase as the deductions will start to apply at a considerably lower level of earnings than previously. This will disproportionately affect those companies employing large numbers of lower paid staff.

From 6 April 2028, the secondary Class 1 NIC threshold will be increased in line with the Consumer Price Index (CPI).

The main rate of employer's secondary Class 1 NIC is increasing from 13.8% to 15% with effect from 6 April 2025. The Class 1A and Class 1B employer rates will also mirror this increase. This is a significant tax increase and will significantly impact businesses that employ large numbers of employees, whether on low or high salaries.

The Employment Allowance will increase from £5,000 to £10,500 and eligibility will be eased. This will take effect from April 2025 and will mean eligible small employers will be able to reduce their NIC liabilities by up to £10,500 per year.

The employer NIC relief for employers hiring qualifying veterans is extended for a further year i.e. until 5 April 2026. This means that businesses will pay no employer NIC up to the annual earnings of the Veterans Upper Secondary Threshold of £50,270 for the first year of a veteran’s employment in a civilian role.

Employer payrolling of Benefits in Kind

From April 2026, it will be mandatory for employers to payroll all benefits in kind, except for employment-related loans and accommodation. Payrolling for these two benefits will be introduced on a voluntary basis from April 2026 and the government will set out the next steps on when they will be mandated in due course.

Employee Share Plans

The CGT and employer NIC changes announced will impact the taxation of awards under employee share plans. Those executives, employees and employers with share plans should take updated advice. Non-tax-advantaged share plans may now incur a higher employer NIC charge and employees may suffer a higher rate of CGT when shares are sold. Where feasible, companies should consider using tax-advantaged statutory share plans to sidestep some of the planned tax increases.

The retention of BADR is welcomed in terms of maintaining the attractiveness of Enterprise Management Incentives, albeit the planned increase in BADR CGT rates from 10% to 14% and then to 18% will make BADR increasingly less significant.

The Government has not yet published any response to its call for evidence in relation to the two main all-employee share plans, namely Share Incentive Plans (SIPs) and Save As You Earn schemes. This is therefore still awaited. The increase in standard CGT rates, however, makes the SIP all the more attractive for those eligible, with its potential for CGT-exempt gains on the sale of shares acquired under a SIP.

<u>Employee Ownership Trust (EOT) and Employee Benefit Trust (EBT)</u>

A disposal of shares to an EOT can be exempt from CGT and can therefore be an effective business ownership succession arrangement. There has been some concern about potential abuse of the relief. The proposed reforms will ensure that the regimes remain focused on encouraging employee ownership and rewarding employees, whilst limiting opportunities for abuse. The changes take effect from 30 October 2024.

Key changes to note are:

- former owners or persons connected with former owners will be prevented from retaining indirect control of a company after its sale to an EOT by virtue of control (direct or indirect) of the EOT itself;
- the trustees of an EOT must be UK resident (as a single body of persons) at the time of disposal to the EOT and remain so thereafter;
- contributions made by a company to an EOT to allow it to repay the former owners for their shares will not be charged to income tax as a distribution and this will be put on a statutory footing so that a clearance request to HMRC is no longer required on that technical point. Note that this relaxation will only apply to EOT contributions and not EBT contributions;
- the EOT income tax-free bonus provisions will be eased to allow bonuses to be awarded to employees without directors needing to be included;
- an extension of the relief clawback period during which the relief for vendors can be withdrawn if the EOT conditions are breached post-disposal is being materially extended to the end of the fourth tax year following the tax year of disposal;
- the trustees will be required to take reasonable steps to ensure that the consideration paid to acquire the company shares does not exceed market value;
- vendors will additionally need to provide, within their claim for CGT relief, information on the sale proceeds and the number of employees of the company at the time of disposal (in addition to the other information already required under existing disclosure rules);

- restrictions will be introduced on connected persons benefiting from an EBT and these will apply for the lifetime of the trust;
- the Inheritance Tax (IHT) exemption for EBTs will only be allowed where the shares have been held for two years prior to their transfer into the EBT;
- a requirement will be introduced that no more than 25% of employees who are able to receive income payments from an EBT should be connected to the participators of the company.

<u>VAT on private school fees: Minimal alterations to fundamental VAT policy change</u>

A number of relatively non-substantive changes were announced today to the Government's initial proposals announced on 29 July bringing private school fees within the charge to VAT from 1 January 2025. We originally discussed the proposals here.

As expected, today's Budget provides that:

- From 1 January 2025, fees for education, boarding, and vocational training provided by private schools in the UK will be subject to VAT at the standard rate of 20%
- Under the anti-forestalling measures, any fees paid from 29 July 2024 (i.e. the date the rules and draft legislation were initially published) relating to a term starting in January 2025 onwards will be subject to VAT

Despite receipt of 17,502 consultation responses, the general policy has been maintained, subject to the following changes:

- Higher Education courses at private schools have been carved out of the policy and hence will remain exempt from VAT
- Further Education (FE) Colleges, as opposed to private sixth forms where the majority of 16-19 year-old pupils are charged fees, will remain VAT-exempt
- Independent Training and Learning Providers are similarly excluded from the VAT changes. This is purportedly because they are akin to FE colleges in that they provide vocational training and apprenticeships to 16-19 year-olds and adults
- The definition of "nursery classes" has been modified to ensure most remain VAT-exempt.
- Teaching English as a Foreign Language (TEFL) courses have been carved out from VAT if taught by private schools or connected persons, given that they are exempt from VAT when supplied by a commercial provider
- The broader of the two tests of "connected persons" has been removed from the legislation
- Non-maintained Special Schools (NMSS) will now be subject to VAT at the standard rate (where they were previously excluded). However, as they have only just been added to the policy, the July anti-forestalling measures will not apply to NMSS and VAT will only be chargeable on such placements paid for on or after 30 October 2024 (today) relating to terms starting in January 2025 onwards

- Where a single supply fee is paid for "secure accommodation" to cover all aspects of the service provided (such as welfare, education, and residential care), the fee will not be within the scope of VAT, because the predominant element of the supply will not be education
- The anti-forestalling provisions will not be amended

Notably, faith schools, international schools, performing arts schools and online schools will remain within the scope of these changes (where they were not already subject to VAT before), despite vocal responses that they should be exempt.

The Government now estimates 37,000 pupils may leave or not enter private schools because of the VAT policy, which is a lower number than their July estimate. Indeed, the Government now seem even more hopeful that the private schools themselves will absorb the costs, stating that: "On average, the Government expects private school fees to go up by around 10 per cent as a result of the introduction of VAT." Indeed, "The Government is confident that the vast majority of parents will be able to keep their child in private school, even if fees increase." This is based on their view that the vast majority of private school pupils come from top income households. This is rather a stark dismissal of those pupils from middle-income households who, it follows, will likely be the ones who fall within the 37,000 drop-out estimate.

Corporation Tax Road Map

The UK's Autumn Statement outlined a corporation tax roadmap with a decision to retain the 25% headline corporation tax rate, ensuring predictability for businesses. The £1 million Annual Investment Allowance cap is maintained, alongside full expensing for plant and machinery, and the Structures and Buildings Allowance, to encourage capital investment. Tax incentives for merged R&D activities are preserved, with extra support for R&D-focused SMEs, vital for economic growth. The Patent Box and Intangible Fixed Asset regimes also continue, promoting innovation and investment in intellectual property. These measures collectively aim to bolster the UK's competitive business environment.

International corporate tax issues

Announced today, the UK Government is set to consult on reforms to transfer pricing rules, permanent establishment criteria, and the Diverted Profits Tax, aiming to ensure taxation aligns with where economic activity occurs and to prevent profit shifting. These consultations are part of the UK's commitment to adapting its tax system to the modern economy and addressing challenges posed by digitalisation and globalisation. Additionally, the government is focused on achieving compliance with the OECD's BEPS Pillar One and Pillar Two, which aim to ensure fair taxation of multinational enterprises and establish a global minimum tax rate.

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