Autumn Statement focus on personal tax

Personal tax

01 February 2017

Caroline McCabe provides a review of the personal tax changes in 2016’s Autumn Statement

Key Points

What is the issue?

Last November’s Autumn Statement included a number of personal tax changes.

What does it mean to me?

These changes, while broadly expected, may nevertheless change the tax treatment for certain clients, so they should be reviewed thoroughly.

What can I take away?

Careful attention should be paid to the changes relating to deemed UK domicile and clients should be made aware of the changes and the potential ramifications. Employers may also wish to consider the structure of their existing salary sacrifice schemes, in order to ensure that the potential protection of certain schemes until April 2021 is not lost as a result of an auto-renewal of the contract.

Last November's Autumn Statement contained few surprises regarding personal taxes. The biggest changes related to salary sacrifice schemes. Also of interest are the introduction of new property and trading income allowances; the changes to non-domiciled status; restrictions on the new pension freedoms and the abolition of employee shareholder shares.

Income tax thresholds

As expected, the personal allowance will increase to £11,500 in 2017/18 and to £12,500 by 2020/21. This follows years of substantial increases in the personal allowance, providing tax cuts for many. However, once the £12,500 figure has been reached, the personal allowance will rise in line with the consumer prices index (CPI), instead of the national minimum wage, as previously announced by George Osborne. This will lead to much smaller increases once the £12,500 figure has been achieved. The Chancellor also confirmed that the higher rate threshold will increase from £43,000 to £45,000 in 2017/18, rising to £50,000 by 2020/21. These increases will be welcomed by many low and middle-income earners.

National Insurance Contributions

However, those earning less than the current personal allowance of £11,000 will not see the benefit of these increases. The Chancellor could have chosen to raise the primary threshold for Class 1 National Insurance Contributions (NIC), currently £155 per week (around £8,060 a year), which would have helped those with very low incomes. Instead he chose to focus on the personal allowance.

There was some minor tinkering around the edges of the NIC system, aligning the secondary threshold for employers and the primary threshold for employees at £157 per week from April 2017. This is a welcome simplification but there remains a strong case for further simplification and better alignment with the income tax system.

As previously announced, Class 2 NIC will be abolished and Class 4 NIC will be reformed from 6 April 2018. This is good news for those with profits between the small profits threshold (£5,965 in 2016/17) and the lower profits limit of £8,060, who currently pay Class 2 NIC. From April 2018, they will be credited with Class 4 NIC and so gain access to contributions-based benefits, even though they will no longer have to pay any NIC. However, there are concerns for self-employed workers with profits below the small profits threshold. Currently they can voluntarily pay Class 2 NIC of £2.80 a week but from April 2018, they will instead need to pay voluntary Class 3 NIC of £14.10 per week if they wish to qualify for contributions-based benefits. Many self-employed workers with such low profits may not think this worthwhile, so will rely instead on means-tested benefits in future.

There were also changes to the way NIC will be charged on termination payments. From April 2018, employers’ NIC will be due on the excess of a termination payment above £30,000 but the full amount will be exempt from employee NIC. In addition, the scope of the current £30,000 income tax exemption will be tightened, for example by removing foreign service relief. This will increase the cost to employers of providing termination payments and adds a layer of complexity for payroll operators as the payment could attract employer NIC but not employee NIC.

Trading and property allowances

A new trading income threshold of £1,000 and a further, separate property income threshold of £1,000 will be introduced. These were initially announced at Budget 2016, but focused only on property or trading income. The scope has since been widened, so payments received for the provision of goods or services are also covered, meaning activities that do not strictly amount to a trade will also benefit from the new allowance. The new allowances will not apply to partnership income from carrying on a trade, profession or property business in partnership. Nor will they apply in addition to relief given under the existing rent-a-room scheme.

Where an individual’s relevant income (before deducting expenses) is completely covered by the new allowance, they will no longer need to declare the income or file a tax return. Individuals with relevant income exceeding the allowance can elect to deduct the £1,000 allowance from their income instead of their allowable expenses, which may be simpler for those with relatively small expenses. This is a welcome development that will simplify the tax affairs of many who earn small amounts from the ‘sharing economy’.

For individuals who report their income and expenses of a trade according to the tax year, the trading allowance will take effect for trading income arising in the year to 5 April 2018.

Otherwise, it will take effect for periods ending on or after 6 April 2017 that form the basis period for the tax year 2017/18. The property income allowance will take effect for property income arising from 6 April 2017.

Salary sacrifice

As covered by Bill Dodwell’s article ‘Fall into line’ in the December 2016 edition, one of the big announcements concerned salary sacrifice schemes. Under these ‘optional remuneration arrangements’ (as they are referred to in the draft legislation), employers can save NIC and employees often pay less income tax and NIC because of the discrepancy between the amount of income tax and NIC charged on cash salary as opposed to certain benefits in kind.

However, from April 2017, the taxable value of most benefits in kind where cash salary has been sacrificed will be fixed at the higher of the current taxable value of the benefit or the value of the cash salary sacrificed, so the current income tax and employer NIC benefits will be lost. The employee NIC benefits will continue but many employers may cease to operate such schemes, as they will no longer be able to benefit from them financially.

These changes will not apply to certain benefits including pension contributions or advice; childcare vouchers; the cycle to work scheme or ultra-low emissions cars. In addition, all arrangements entered into before 6 April 2017 will be protected until April 2018 (or an end, change or renewal of the contract, if earlier) and arrangements involving school fees, cars and accommodation will be protected until the earlier of April 2021 and an end, change or renewal of the contract. As many employers renew these arrangements annually, some employees may miss out on the four-year protection for school fees, cars and accommodation if the legislation remains as currently drafted. This is of particular concern given that the draft legislation specifies that a ‘renewal’ includes a renewal that takes effect automatically.

Benefits in kind provided other than under a salary sacrifice arrangement will continue to be taxed according to their taxable value. However, the Government is reviewing how such benefits are valued for tax purposes. At Budget 2017 they will publish a call for evidence on the valuation of benefits in kind, and an additional consultation on employer-provided living accommodation.

Non-domiciled individuals

As first announced at Summer Budget 2015, non-domiciled status will no longer be permanent for tax purposes. From 6 April 2017, any individual who has been UK resident for tax purposes for 15 of the previous 20 tax years will be deemed to be UK domiciled for all tax purposes. (For inheritance tax purposes, this replaces the old deemed domicile rule for those who have been resident for 17 out of the 20 tax years ending with the tax year in question.) In addition, anyone born in the UK with a UK domicile of origin will become UK domiciled for tax purposes on their return to the UK. Transitional protections ensure that where an individual set up an offshore trust before becoming deemed domiciled, he will not be taxed on income and gains in the trust, provided no benefit is taken. There is also a provision to allow rebasing of offshore assets for CGT purposes under certain circumstances once an individual becomes deemed domiciled.
Furthermore, a loophole whereby non-domiciled individuals could avoid paying UK inheritance tax on UK residential property held through offshore structures will be closed with effect from 6 April 2017.

Pensions freedoms

Prior to the pensions freedom reforms of April 2015, individuals who had already accessed their pension savings were barred from making further contributions to their money purchase scheme. Following those reforms, an individual who had accessed their pensions savings flexibly could make a maximum pension contribution qualifying for income tax relief of £10,000 per annum. Rather than returning to the outright ban on further contributions, the Government is proposing to reduce this limit to £4,000 per annum from April 2017. This change is designed to limit the amount of tax relief available to earners aged 55 and over who can recycle pension contributions (leading to a second round of income tax relief), while still allowing them to rebuild their savings where necessary. The Government is consulting on the detail, with responses due by 15 February 2017, and the re-set limit will be confirmed at Budget 2017.

Employee shareholder shares

From 2013, employees were able to benefit from certain tax reliefs if they received ‘employee shareholder shares’ worth at least £2,000 in exchange for giving up some statutory employment rights under an employee shareholder agreement. However, most of these tax reliefs will no longer be available to new entrants. Broadly, these measures take effect for shares acquired in consideration for an employee shareholder agreement entered into on or after 1 December 2016. The delay until December gave employees who had received independent advice about entering an agreement before 23 November 2016 the opportunity to do so and still receive the tax reliefs expected when the advice was received.