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Clients&FriendsAlert

Budget 2024 – Key Tax Measures

31 October 2024

The Chancellor of the Exchequer delivered the United Kingdom ("**UK**") Budget for 2024 on 30 October 2024.

The Budget was the first to be delivered by the new Chancellor of the Exchequer, following the election of the Labour Government in July 2024. The Budget was, in many ways, typical of many new Labour governments after the Second World War, featuring the reinforcement of election manifesto promises, some widely predicted tax increases, and an impressively large raft of spending announcements.

In this Client & Friends Alert we have outlined the key tax measures that we expect to be of interest to Cadwalader's clients and friends.

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UK Domestic Tax Measures

Capital Gains Tax Increases

As was predicted widely in the media in advance of the Budget, the Government has announced increases in the lower rate of UK capital gains tax ("**CGT**") from 10% to 18%, the higher rate of CGT increasing from 20% to 24%.

The headline CGT rate increases are complimented by some other rate changes. The CGT rate applicable to disposals which are subject to "Investors' Relief" (which provides for a lower rate of CGT to be paid on the disposal of ordinary shares in an unlisted trading company where certain criteria are met) will rise gradually from 10% to 14% from 6 April 2025, and match the main CGT lower rate of 18% from 6 April 2026. This change is matched by an increase in the CGT rate on assets qualifying for "Business Asset Disposal Relief" (a more widely used exemption than Investors' Relief).

Furthermore, an individual's lifetime cap on Investors' Relief is to be decreased from £10 million to £1 million, to match the current lifetime cap for Business Asset Disposal Relief.

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The political optics of these rises is interesting. While these increases in tax rates are significant (according to the UK Office for Budget Responsibility, the measures are intended to raise £2.5 billion by 2029-30), the increases are less than some commentators had feared. Post-Budget discussion is likely to focus around whether such tax rises discourage investment, or whether the measures affect only a small proportion of the UK population and are an essential economic component in the Government delivering its economic agenda.

Taxing Carried Interest

Another domestic tax measure which was discussed extensively in the media before the Budget is "carried interest". Carried interest is a performance-related reward received by a small population of private equity and fund management executives. Unlike other rewards, carried interest can currently be taxed at lower capital gains tax rates, compared with income tax rates of up to 45%, where certain conditions are met. The Government has announced an increase in the CGT rate applicable to carried interest returns to 32% from April 2025 (up from 28%). Further reform in the area, to be completed by April 2026, has been confirmed by the Government, so that the Budget increases are an interim measure only. The increase of 4% in the CGT rate applicable to carried interest is lower than many commentators had feared.

However, any sense of relief is tempered by the proposals for reform which were outlined in the Budget in a Government "response document" following a "call for evidence" on the taxation of carried interest published in July 2024.

Under these proposals for a new carried interest regime, broadly, all carried interest will be treated and taxed within the UK's income tax framework as trading income – with all carried interest treated as trading profits and subject to UK income tax and Class 4 National Insurance Contributions. This results in a tax burden on carried interest at rates of up to 45% plus Class 4 National Insurance contributions. The Government proposes, to take account of the "*unique characteristics of the [carried interest] reward*", that an amount of "qualifying carried interest" subject to tax will be adjusted by applying a 72.5% multiplier. As a result, "qualifying carried interest" will be subject to a lower effective rate of income tax, based on only 72.5% of the carried interest being subject to tax at the individual's marginal rate of tax. Carried interest will be "qualifying carried interest" where it is currently taxed to CGT (and not, in technical terms, "income based carried interest"). The Government has published a consultation on policy options for introducing "*further conditions to ensure that access to the computational rules for qualifying carried interest is appropriately limited*".

The revised regime for carried interest will sit alongside the existing disguised investment management fee rules, which will be retained. Furthermore, the Government has stated its intention to remove the current distinction between employees and self-employed fund managers in the taxation of carried interest.

In some respects, the proposed reforms offer the hope that the taxation of carried interest may be simplified. The reforms have the potential to eliminate the process of determining the underlying source of the carried interest being received. However, the consultation published

by the Government regarding the addition of further conditions relating to the identification of "qualifying carried interest" opens the door to the possibility of a number of complex tests which could negate the simplification of subjecting all carried interest to the UK's income tax framework as trading income The Government's consultation will continue until 31 January 2025.

Tax Avoidance involving Close Companies

The Government has announced measures to counteract tax avoidance arrangements aimed at avoiding existing legislation which is intended to prevent untaxed extractions of company funds by their shareholders.

The UK tax code imposes a tax charge on loans made by (generally) smaller, unlisted companies to their controlling shareholders. Such companies are termed "close companies" in the relevant UK tax legislation. The purpose of this tax charge on a close company's "participators" (including shareholders in that close company) is to deter such companies from making untaxed loans to their participators, or allowing the participators to otherwise extract company funds in an untaxed form, rather than paying wages, dividends or other income chargeable to tax. The UK legislation allows the close company to claim relief for any such tax charge if the loan, other monies, or value is repaid by the participator to the close company.

The Government has become aware (presumably under the disclosure of tax avoidance schemes legislation, although this is not confirmed by the Government) of arrangements using a group of companies or amongst associated companies. The intention of such arrangements is that new loans are made and then repaid in a chain such that no participator loan tax charge arises on the increasing amounts extracted. The current tax legislation does not effectively counteract the identified tax avoidance. Accordingly, a new targeted anti-avoidance rule is to be introduced, with effect from 30 October 2024, where close companies and their shareholders are attempting to avoid (or obtain relief or increased relief from) the loan tax charge on any extractions by the company, or where there is an income tax advantage for the participator.

The measure will have effect for any tax avoidance arrangements made on or after 30 October 2024.

Tax Avoidance involving Limited Liability Partnerships ("LLPs")

The Government's Budget proposals include the counteraction of an avoidance scheme involving the liquidation of LLPs. Section 59A of the Taxation of Chargeable Gains Act 1992 provides that assets held by an LLP are treated as if held by its members in a tax-transparent general partnership. Consequently, no chargeable gains accrue when a member contributes an asset to the LLP.

This treatment ceases to apply on the appointment of a liquidator. However, under current legislation, the appointment of such a liquidator does not give rise to a disposal of any assets by the members of the LLP (creating the circumstances for potential tax avoidance, in respect of

capital gains that accrue pre-contribution). The Government has announced that legislation will be introduced in Finance Bill 2024-25 to introduce provisions to deem a disposal to arise when a LLP is liquidated. Accordingly, chargeable gains that accrue up to the date of contribution to the LLP are charged to tax when the LLP is liquidated and the assets are disposed of to the member, or a person connected to them.

The change will apply to liquidations that commence on or after 30 October 2024.

Introduction of the Reserved Investor Fund ("RIF")

Buried in the rearward pages of the Budget is the confirmation that will introduce the Reserved Investor Fund (Contractual Scheme). The RIF is a new investment fund designed to complement and enhance the UK's existing funds framework. The RIF is intended to meet the demands of the fund industry demand for a UK-based unauthorised contractual scheme, with lower costs and more flexibility than the existing authorised contractual scheme. Secondary legislation on the RIF will be introduced by 5 April 2025.

International Tax and Tax-Reporting Measures

Non-UK Domiciled Individuals

As anticipated, significant changes to the UK's "non-dom" regime have been announced. Whilst the previous Government had intended to make certain changes to the regime, the current Government has confirmed its intention to abolish the current non-dom regime in favour of a residence based regime with effect from 6 April 2025.

Among other things, the new residence based regime will provide 100% relief on foreign income and gains for new arrivals to the UK in the first four years of tax residence (subject to having not been UK tax resident in any of the 10 consecutive prior years). Transitional arrangements relating to capital gains tax and individuals who have previously been taxed under the remittance basis (including relating to foreign income and gains arising on or before 5 April 2025) are also contemplated in the new regime. The changes will also affect the taxation of non-UK property brought within the scope of UK inheritance tax.

The proposed changes will significantly reform a contentious feature of the UK tax system. The Government has described the measures in the context of the Government's commitment to "*addressing unfairness in the tax system*". Specifically, the new residence based system is intended to ensure that those who are long-term resident in the UK "*pay their taxes here*".

These collective measures are expected to raise £12.7 billion over the next five years and therefore represents a significant component of the Government's budget proposals.

Transfer Pricing, Permanent Establishment and Diverted Profits Tax

As a further part of the international aspects of the Budget, the Government announced that it intends to consult on reforms to the UK's transfer pricing, permanent establishment and diverted profits tax rules. Various measures will be subject to a consultation including the

removal of UK-to-UK transfer pricing, considering lowering the thresholds for exemption from transfer pricing for medium-sized businesses and introducing a requirement for in-scope multinationals to report cross-border related party transactions. These consultations are expected to commence in Spring 2025. Cost contribution arrangements will also be subject to review.

The Government's objectives as regards these issues are to provide improved certainty to taxpayers and better alignment with the UK's double tax treaties whilst at the same time protecting the UK tax base.

In relation to the proposed requirement for cross-border related party transactions to be reported to H.M. Revenue & Customs ("**HMRC**"), the data gathered will be used to inform compliance activity, permitting more efficient and targeted use of HMRC resources. The consultation will consider how to ensure the reporting obligations are proportionate and appropriately targeted.

OECD Pillar 1 and Pillar 2

By way of recap, Pillar 1 looks to reallocate certain amounts of profits to market jurisdictions and was intended to address the tax challenges that arise from the digitalisation of the economy. However, certain aspects of the Pillar 1 proposal are still subject to ongoing negotiations between member countries of the OECD/ G20 Inclusive Framework. As part of the Budget, the Government has confirmed its commitment to finding an international Pillar 1 solution, albeit that this relies on those jurisdictions with remaining issues working to reach an agreement.

The Government has also confirmed its commitment to the repeal of the UK's digital services tax subject to the implementation of the Pillar 1 global solution.

Pillar 2, which is intended to ensure that large multinationals (i.e. those with annual revenues of more than €750 million) pay a minimum effective tax rate of 15%, has already been partly introduced in the UK. Specifically the "Income Inclusion Rule" and the "Domestic Minimum Tax" have had effect for accounting periods beginning on or after 31 December 2023. As part of the Budget announcements, the Government will continue with plans to introduce the Undertaxed Profits Rule with effect from 31 December 2024.

UK reporting for the Cryptoasset Reporting Framework ("CARF")

The Government has published a summary of responses to the consultation entitled "*Cryptoasset Reporting Framework, Common Reporting Standard amendments, and seeking view on extension to domestic reporting*", extending the CARF to include reporting on UK resident taxpayers by UK service providers.

The CARF is the OECD's flagship transparency standard to help combat criminal activity using crypto-assets to evade taxation. The consultation sought to obtain views from stakeholders on

the implementation of the CARF in the UK, whilst also addressing certain optional proposals and amendments to the CRS.

The majority of respondents were in favour of the proposal to extend the CARF by including the UK as a reportable jurisdiction. The CARF and amendments to the CRS will be implemented in the UK from 1 January 2026. The Government will introduce legislation in Finance Bill 2024-25 to provide H.M. Treasury with the power to make the CARF regulations. H.M. Treasury will make the CARF regulations in 2025 in time for implementation on 1 January 2026.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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