Introduction

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Taking action can be difficult when planning for future ownership and succession of a family business. We give a flavour of the type of help that can be effective for business families which have unresolved concerns about future ownership and succession.

Some recent changes to personal taxes have been contradictory in their effect and appear to lack a clear tax policy direction. We look at why individuals are prioritising flexibility when making future plans for themselves and their families.

For individuals hoping to benefit from Entrepreneurs’ Relief when selling their business, we give examples of how the unwary can be caught out by the ‘5% test’. We highlight Investors’ Relief, the new tax relief for investors in private companies that can secure a 10% tax rate on qualifying capital gains.

Family business, the challenge of change

ER: Does your shareholding meet the 5% test?

New CGT incentive for certain long term investors

Are you dwelling on your UK property investment?

I’m a UK resident non-dom, what should I do now?

Could transparency changes impact me?

On the horizon

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Danny Wyler talks about making key decisions which have resulted in significant business transformations and explains why we all can benefit from an interest in the Performing Arts.

The early years
Danny's professional career began with his family's grain trading company based in the Netherlands, which was founded by his grandfather in 1912. As grain prices increased during the 1970s, and with increased global competition, the business was put under pressure. In 1980 Danny and his brother Joel made a critical strategic decision, restructuring the now diversified business and selling the international grain business, retaining the domestic animal feed trading and distribution company. Under new ownership, Danny remained with and led the grain trading business for a further nine years growing it to a leading and very profitable company with well over $3 billion in revenues.

On returning to the family business, he soon identified the urgent need to restructure its small, heavily loss making, nut processing company which he subsequently built into Europe’s largest. Having previously divested the animal feed business, the brothers decided to sell the nut processing business, leaving the family holding company that remains today.

Beside the family business
Danny met his wife in Mustique whilst on holiday and since then the island has always remained extremely close to their hearts. Visiting frequently, with his past corporate restructuring experience and fresh perspective, Danny was invited to become Chairman of the Island, a role he fulfilled for six years. He focused this time on the long-term viability of the island’s community by first establishing financial stability. At the same time Danny concentrated on the family’s investments and wealth. Connections he made resulted in him being asked to join the board of a Professional Trust Company.

A subsequent merger with an investment firm, led Danny to his current position as Chairman of ACPI Investments Group. He is proud of the independent service this firm provides to families needing wealth management services.

Significance of the performing arts
Over the last decade much of Danny’s focus has been on the performing arts, particularly ballet and opera. The contrast with his professional life was a revelation to Danny, measuring success not just by the bottom line, but rather by striving for excellence in something one feels passionate about. He considers the perspective gained through the Performing Arts vital for future generations that are growing up in an increasingly interconnected, fast moving, but also dangerously virtual world. In a recent speech Danny said “you can Google knowledge but not judgement or wisdom”.

As a Trustee of the Royal Opera House and of St John’s Smith Square, Danny has been involved with essential fundraising, helping convince others of our responsibility to support the Performing Arts; he feels deeply about Education and Community outreach programs and spends a substantial amount of time producing fundraising performances. Working for these causes he finds both humbling and truly rewarding.

Family — the most important factor enabling success
Throughout his varied career, Danny’s family have played a pivotal role and he attributes much of his success to their support. He is grateful to his brother Joel, who is his constant business partner and lifelong best friend, and to his wife and daughter, always supportive and continually providing perspective when he has had to take a risk or make difficult decisions.

Perspective gained through the Performing Arts is vital for future generations. . . you can Google knowledge, but not judgement or wisdom.
Families often prefer to take evasive action — flight or freeze — rather than suffering further stress by trying to deal with — or fight — the issues that are causing anxiety. The good news is that there is a growing body of knowledge and practice about how business families can cope effectively with succession planning and change. This is not just about providing technical information or a tax solution, although these are always part of the economic equation. Rather, it is about providing practical help with the process of making crucial decisions about creating and transferring wealth, power, roles and titles, while being fair, loving and considerate with the family and their business interests.

The effective and helpful family business adviser should have plenty of information about how other families have navigated succession, but they also must know how to facilitate discussions on sensitive matters between generations of the same family and sometimes other stakeholders, like non-family directors and trustees. This requires hard knowledge about how to balance the competing priorities. It is particularly important that change is led from the top, by the senior family members. For example, only the seniors can address the affordability of retirement and contemplate life outside the family business. Only when the seniors are ready to let go can the next generation begin considering if any of them are able and willing to take on new ownership and management responsibilities.

If either generation side steps the challenges of personal change because the costs in terms of change of career, lifestyle and status, among other things, are too high, then change will not happen. A bit of creative help from experienced and independent advisers will help to ease the process.

Planning for future ownership and succession is one of the most pressing concerns for every business family. So what type of help is effective?

Families often prefer to take evasive action — flight or freeze — rather than suffering further stress by trying to deal with — or fight — the issues that are causing anxiety. The good news is that there is a growing body of knowledge and practice about how business families can cope effectively with succession planning and change. This is not just about providing technical information or a tax solution, although these are always part of the economic equation. Rather, it is about providing practical help with the process of making crucial decisions about creating and transferring wealth, power, roles and titles, while being fair, loving and considerate with the family and their business interests.
In March 2016 KPMG published the results of its survey of the competitiveness of the UK tax regime. For the UK’s largest companies, a key conclusion was that their perception of a country’s tax competitiveness depends on the regime’s predictability and simplicity. Companies value stability over the long term and advanced warning of major changes.

**Business tax — stability over the longer term**

The Government’s Business Tax Road map published in March 2016, contained a summary of recent changes; its stated aim is to give businesses the certainty they need to plan and make long term investments. One of the principles underlying future reform is lowering tax rates whilst maintaining the tax base. The latter to be achieved by tackling evasion and aggressive tax avoidance.

To stimulate economic growth in the UK, the Government has maintained consistently low rates of corporation tax (reducing to 17% by 2020) and generous tax reliefs. For example using tax incentives to encourage investment in high value research in the UK through R&D tax credits and the Patent Box. The OECD consultation on Base Erosion and Profit Shifting (‘BEPS’) also gives a clear direction on global tax policy over the years ahead.

As a result, although they generally prefer less change and more advance warning, businesses are, to a certain degree, able to plan for the future and the Government’s intention is to make the UK a particularly attractive place to do business.

**Personal tax — where’s the plan?**

In contrast, the position for personal taxes is often contradictory and lacks a clear direction. Without a strategy, personal tax policy changes appear to be reactionary to particular issues rather than a planned approach to the wider structural questions around income generation and personal wealth. But we need a plan because there are major issues to be addressed.

Take for example pensions. By their nature, plans for the provision of funds needed in retirement require a long term consistent approach. The restrictions on personal pension relief for high earners now make long term saving less attractive. The solution for many has been purchasing buy to let property, but this is now also being penalised and itself subject to increases in tax costs to discourage this type of investment. The numerous tax changes aimed at UK residential property have resulted in no clear policy message. Initially the aim was to discourage ownership via corporate structures with the introduction of the Annual Tax on Enveloped Dwellings (or ATED). However shortly after these changes were introduced, another new rule was announced restricting the tax deduction for interest costs for direct holdings of UK residential property, but not for property owned via a corporate structure, thereby seemingly encouraging holding of such property via a company.

Whatever the solution, a plan is needed so that the UK remains an attractive and stable fiscal environment for business owners as well as the businesses themselves.

**What action should I take?**

Individuals are identifying and confirming their long term commercial and family objectives then implementing strategies, with tax recognised as one part of the cost and cash flow equations. Taking into account the prevailing direction of travel of the personal tax rules, they are choosing options that maintain some flexibility.

**Given the uncertainty, individuals are choosing options that meet their overall commercial and family objectives whilst maintaining flexibility.**

Individuals are prioritising flexibility when making future plans for themselves and their families.

To discover more about KPMG’s competitiveness survey, see kpmg.com/uk/homeforbusiness.

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Shares carrying limited economic rights (at least initially) may be issued for a variety of reasons, including incentivising key employees and/or facilitating succession of a family business. But recent Tribunal cases show how difficult this area can be.

In the first case, ER was denied as a result of a class of deferred shares in issue. These shares carried no voting rights and no rights to dividends and in reality were economically worthless. However, they were regarded as ordinary share capital for ER purposes diluting the claimant’s interest below the 5% threshold.

A second recent case also looked at a class of preference share with no dividend rights, but came to the opposite conclusion. It was decided in this case that a preference share with no right to dividends did represent a dividend at a fixed rate. The Tribunal had sympathy for the unfairness of the taxpayers’ position and concluded there was enough flexibility in the definition to find in the taxpayers’ favour, but was very careful to emphasise that this finding was strictly on the facts of this case.

With such uncertainty in how the law will apply in a given situation it is best to ensure that your shares meet the ‘5% test’ on any interpretation, if you can.

Entrepreneurs’ Relief (ER) provides a 10% rate of capital gains tax on the disposal of shares in a trading company. To benefit from this relief, a number of qualifying conditions need to be met throughout the 12 months prior to the date of disposal.

**Ordinary share capital**

One condition, known as the ‘5% test’, is that an individual must hold at least 5% of the ordinary share capital (tested by reference to the nominal value of shares in issue) and be able to freely exercise at least 5% of the voting rights. Ostensibly, these are simple arithmetical tests, but dilution can easily occur. Share options exercised ahead of a sale are a common example of how a holding of ordinary share capital can be diluted.

Also, what counts as ‘ordinary share capital’? This is broadly defined to be all issued share capital other than shares that carry a right to a dividend at a fixed rate but have no right to share in the company’s profits.

In effect, with the general exception of fixed rate preference shares, the ‘5% test’ requires consideration of all shares in issue, even those which, on the face of it, have little or none of the characteristics of an ‘ordinary’ share.

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**New CGT incentive for certain long term investors**

### The new relief in summary

In his 2016 Budget speech, the Chancellor, somewhat confusingly, suggested that he would be introducing an "extension" of Entrepreneurs' Relief (ER). Although the new relief delivers a similar 10% capital gains tax (CGT) rate to ER, the criteria for receiving it are quite different.

**Very broadly, Investors’ Relief works as follows:**

- It applies to sales of qualifying shares on or after 6 April 2019 in an unlisted trading company or a holding company of a trading group;
- Ordinarily the investor (and those connected with him) must not be either an officer or employee at any time during the period of ownership, although this is relaxed for unpaid directors and those who take up paid employment after 180 days;
- Shares must be newly issued, acquired for new consideration on or after 17 March 2016 and be held continually for a minimum of three years from 6 April 2016 before disposal;
- Unlike ER, there is no requirement to hold a minimum shareholding in the company.

### The relief in practice

John Brown made a gain of £7 million when he sold his stake in a successful business. The gain was taxed at 10% due to ER. John invests some of the proceeds in a new venture run by his friend, Bob and subscribes for 10% of the ordinary share capital as an external shareholder. After 6 months, Bob offers him a position on the Board which John accepts. Three years later, the business is sold realising a gain for John of £500,000.

If John is not paid for his role as director, his shares should qualify for Investors’ Relief. Additionally, as an officer of the company, he could also qualify for ER and so has the choice of which relief to use.

In this example, John still achieves an effective tax rate of 10% on his gain but it demonstrates that care will be needed when investors wanting to benefit from Investors’ Relief, accept employment or board positions.

### Who will benefit

The new relief will be attractive to investors not intending to get actively involved with the running of the business or who are directors but on an unpaid basis.

Some investors in this category will also be eligible for Enterprise Investment Scheme (EIS) relief, an established tax incentive. EIS is more generous exempting the entire gain on sale of CGT with no £10m cap on relief. However, it has more stringent conditions and the new Investors’ Relief will apply in a whole range of situations where EIS will not.

It is now quite hard to make generalisations about who will benefit from the 10% CGT rate. For instance, ER favours business involvement so that to qualify for the 10% tax rate an investor with a 5% shareholding must also be an employee or officer. With Investors’ Relief, paid business involvement is discouraged so that to qualify for the 10% tax rate an investor acquiring a 3% shareholding normally must not be an employee or paid officer.

### Conclusion

Individuals looking to invest in businesses should take appropriate advice to ensure that they understand whether they meet the conditions to qualify for one of these reliefs.

For further information, see kpmg.com/uk/FB2investorsrelief

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Investors are reconsidering both the nature of their investment and the suitability of holding structures

In recent years, the ownership of UK residential property has been affected by a number of new tax measures. For those investing in residential property, the choice of ownership structure needs to be reconsidered as the tax changes can apply differently to corporate and personal ownership.

UK residential property
Recent tax changes which impact investment in residential property include:

- From 6 April 2016, a higher rate of capital gains tax (CGT) for individuals and trustees disposing of residential property compared to most other assets — 28% instead of 20%.
- Since April 2016 a new 3% SDLT surcharge applies when purchasing buy to let or second homes.
- Restrictions on the tax deductibility of finance costs for let residential property apply for some taxpayers from 6 April 2017.
- Non-resident CGT has applied since 5 April 2015 for non-UK residents disposing of UK residential property.

The combined effects of these changes can significantly increase the tax costs of acquiring, holding and disposing of residential properties.

Commercial property as an alternative to investment in residential property
Some residential property investors are now considering investing in commercial rather than residential property. Very broadly, commercial property in this context is any property that is not suitable for use as a dwelling. Such properties are not affected by the 3% SDLT surcharge, or the 28% CGT rate, or non-resident CGT for non-UK resident investors. The above restrictions on tax deductibility of finance costs are also not applicable to commercial property investments.

Clearly investment in commercial property has a range of different investment considerations compared to residential property, besides tax.

Company ownership of residential property
The ownership structure for investing in residential property may need to be reviewed in light of the recent tax changes. In many cases, corporate ownership may now be more cost effective as the higher rate of CGT does not apply to companies, although restrictions on corporate tax deductions for finance costs need to be taken into account.

However, there is no ‘one size fits all’ structure and there are at least two sides to the story. Whilst in some instances the use of a company to invest in residential property will be attractive this will need to be weighed against the potential pitfalls, such as:

- Increased administration — accounts and company tax returns will be required as well as potentially ATED tax returns;
- Two ‘layers’ of tax on profits — rental profits would be subject to corporation tax and then income tax if profits are paid to UK resident shareholders as a dividend.

Existing residential buy-to-let landlords thinking about the use of a company need to be aware of potential CGT and SDLT costs of moving their property portfolio into a company. However, in some circumstances tax reliefs may be available. Again there are other considerations, such the rights of tenants and secured lenders.

Conclusion
As with every property acquisition, careful thought needs to be given to the commercial objectives and the specific circumstances. Anyone already holding property or considering an acquisition should take professional tax advice as the tax rules are complex and the potential tax costs could be significant.

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I am about to pay UK tax on worldwide income and gains for the first time — and my UK residential property might be newly exposed to IHT both during my lifetime and when I die — what should I do now?

Proposed new rules introducing fundamental changes to the way UK resident non-UK domiciled individuals (non-doms) will be taxed in the UK, have been announced with effect from 5 April 2017. Many non-doms would wish to implement changes in their financial affairs before 5 April 2017 to prepare for the new rules. However, there is an awkward period of uncertainty whilst HMRC try to guide the Government through the tricky process of drafting the new tax law and prepare guidance to explain how the rules should work in practice. This is awkward because experience tells us that we may not have final legislation until close to 5 April 2017 and we may not have access to guidance until after that date.

Today’s dilemma for a non-dom is — do I wait until the proposed new rules are clear and final — or do I act now? To answer that properly, each non-dom needs to weigh up the risk of making changes that may eventually turn out to have a higher cost than was initially anticipated against the risk of running out of time to make changes that, if implemented earlier, would have been commercially desirable.

Identifying and confirming short, medium and long term commercial and family objectives is key. This often involves multigenerational aspirations as parts of the family approach retirement and the next generation come of age. There may be a wide range of assets (such as property, businesses, bonds and other investments, antiques, yachts etc.), located in various countries each with different funding arrangements. Usually asset protection, growth and cash flow requirements all need to be balanced.

It takes time to identify and decide upon a suitable strategy and then, for more complex situations, it may take several months to implement a chosen plan. The tax impact is just one element of this equation, but once clear commercial and family objectives have been confirmed, appropriate action becomes easier despite the uncertainties of changing tax rules.

Some issues being considered by non-doms include:
• Given that worldwide income and gains will for the first time be subject to UK tax, are the existing structures for holding and managing assets and indeed the assets themselves still appropriate?
• How to balance direct ownership of assets against ownership via trust structures when there are both pros and cons of the new trust proposals?
• Is it clear how new UK tax liabilities may be funded?
• How might any changes dovetail with other commercial considerations?
• Is it possible to segregate pre and post April 2017 bank accounts?
• Do individuals or companies need to review their residence status?

We are finding it is best to start now to work out what is at stake, to prepare a plan and to work out when the decision to implement it would have to be taken for completion by 5 April 2017.

Following the surprise Brexit result, there is no information currently available on whether these changes will still go ahead. However, some non-doms are finding that, because of their own circumstances and objectives, there is enough information to act immediately. Others are pleased to obtain a better understanding of the risks of action versus inaction, and to establish the date when they would need to decide to commence implementation.

For further information see: kpmg.com/uk/nondoms

It’s best to start now to work out what’s at stake, prepare a plan and to work out when the decision to implement it would have to be taken for completion by 5 April 2017.
Recent developments reinforce the need for anyone owning offshore assets to take sensible precautionary measures in advance of anticipated HMRC activity. The next wave of information has been released by the Panama Data Leak. A searchable database published of nearly 320,000 entities created in 21 jurisdictions covering nearly 40 years up to 2015. At the anti-corruption summit hosted by David Cameron, commitments were made by governments around the world to implement new measures to tackle tax evasion and broader corruption in a further push towards global tax transparency. Among other key areas, it was set out that the UK will establish a public register of company beneficial ownership information for foreign companies who already own or buy property in the UK. A number of countries have agreed to create public registers of beneficial ownership of companies. Additionally, under a separate initiative several countries have agreed to automatically exchange details of the beneficial ownership of trusts and companies in their jurisdiction. Over 100 countries are committed to the Common Reporting Standard (CRS) for automatic exchange of information from either 2017 or 2018. UK residents with bank accounts and interests in entities such as trusts and overseas companies will have their identity and financial information reported to HMRC from these jurisdictions.

What do we expect from HMRC? We anticipate HMRC will systematically risk review and closely analyse all data available to them and in turn seek to commence civil, or criminal, investigations if they believe tax has been evaded or there is any other tax non-compliance. Given the volume of data, we would not rule out a more general approach of HMRC asking groups of taxpayers to reconfirm their compliance or, if they cannot, to make a voluntary disclosure. HMRC’s new worldwide disclosure facility is due to go live in 2016 and run through to 2018.

Could this impact me? What should I do? Regardless of how data or information regarding an individual’s assets finds its way to HMRC, most individuals with offshore assets will be in one of the following three categories and the action they need to take will differ.

1) Assets and/or underlying income have been fully and correctly declared on tax returns submitted to HMRC — no further action.

2) Assets and/or underlying income have not been disclosed on tax returns on the basis there is no requirement to do so. The key question is has current tax advice been taken to confirm this is the correct filing position and if so, has the advice taken been properly implemented.

3) Assets and/or underlying income have not previously been disclosed to HMRC but should have been — a disclosure should be made to HMRC as soon as possible to ensure that an individual’s affairs are brought up to date and penalties are kept to a minimum. Advice should be taken on how best to make a disclosure to HMRC.

For further information on making a disclosure or if your affairs are under enquiry by the tax authorities see: kpmg.com/uk/personaltaxinvestigations

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Highlighted below is a snapshot of developments on some of the more significant areas of change relevant to Private Clients. Further information and comments are available via the links to information on kpmg.com/uk:

• For capital gains accruing on or after 6 April 2016, capital gains tax (CGT) rates will be reduced from 18% to 10% for basic rate taxpayers, and from 28% to 20% for higher rate taxpayers. These reduced rates will not apply to gains on the disposal of residential property (other than those qualifying for private residence relief) and the receipt of carried interest which will continue to be taxed at a new ‘upper rate’ of 28%.

kpmg.com/uk/CGT

• There have been significant changes to the taxation of investment management executives’ reward including the disguised investment management fee and carried interest rules.

kpmg.com/uk/carriedinterest

• A consultation has been published on the substantial shareholdings exemption (SSE) which provides exemption from corporation tax for capital gains and losses realised on the disposal of certain shareholdings. This could impact Family Investment Companies.

kpmg.com/uk/SSE

• For those acquiring Employee Shareholder Shares after 16 March 2016, a lifetime limit of £100,000 of CGT exempt gains that a person can make on the disposal of those shares will apply.

• The Supreme Court ruled in HMRC’s favour and refused the Eclipse Film Partners (No 35) LLP permission to appeal the Court of Appeal’s decision. Therefore the findings of the Court of Appeal stand. We may now see HMRC starting to issue Follower Notices to taxpayers who invested in any Eclipse or similar partnership.

• If any assets of a trust are located in France or if one of the beneficiaries, the settlor or trustees are French tax resident then the trustees are required to make reports to the French tax authorities. These reports are annual but can also be event-triggered. The French register of trusts is to be made publically available.

• From 6 April 2016 banks, building societies etc. stopped deducting tax at source on interest. Individuals should consider putting aside the tax that will in future be due on such interest received, which will either be paid through adjustments to PAYE code numbers or via Self-Assessment (for example in January 2018 for the 2016/17 tax year, plus increased payments on account).

• Alongside the introduction of new anti-avoidance rules in respect of profits arising from trading in and developing UK land, there have been amendments to certain double tax agreements. Although the genesis for these changes appears to be the activities of non-UK resident developers, the changes impact both UK and non-UK residents equally.

• If a close company (e.g. typically owned by five or fewer shareholders) makes a loan to a shareholder which is not repaid within nine months of the end of the accounting period, tax is due on the loan (and repayable when the loan is repaid). From April 2016 the tax rate increased to 32.5% (previously 25%) bringing it in line with the rate a higher rate taxpayer pays on dividends.

• Digital Tax Accounts will apply to some individuals registered for Self-Assessment from 2018, and may provide an overview of an individual’s tax liabilities in 2017. By 2020 there will be a requirement to keep track of affairs digitally and update HMRC quarterly, with a ‘pay as you go’ method moulding tax payments with actual cash flow.
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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CREATE | CRT062899 | July 2016 | Printed on recycled material.