Kingston Smith

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Across the Pond

Welcome to our spring 2018 edition of Across the Pond, an informative newsletter keeping you up to date on recent changes and topics of interest in the UK-US business corridor. Whether you are a prospective or existing investor from the US investing in the UK or the other way around, you will find something of interest in this newsletter.

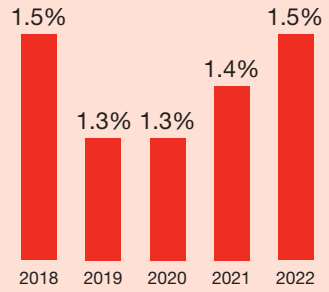
In this edition, our tax team provides an overview of the key aspects of the US Tax Reform affecting businesses and individuals, minus the jargon. We explore four key topical tips that inward investors often miss when setting up or doing business in the UK. Our HR Consulting team recommends what to consider before hiring your first UK employee. And make sure you don't miss our guest article from immigration firm Newland Chase on how the Brexit situation is influencing immigration so far.

Economy snapshot

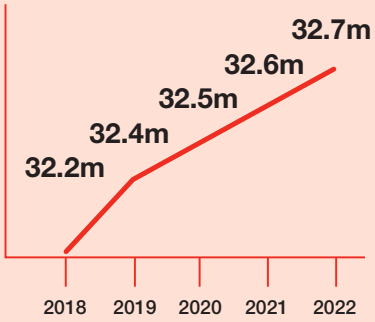
The UK economy exceeded expectations and continued to grow consecutively over the last five years despite growing Brexit concerns. FDI's European Cities and Regions of the Future 2018/19 still ranks London the number one destination for Foreign Direct Investment in Europe and 2017 saw a record year for UK tech investments. Unemployment levels are close to a 40-year low as we expect a further 500,000 people to be in employment over the next five years.

1.5%

UK GDP Growth in 2018



GDP growth over the next 5 years



Over 500,000

more people with a job in the UK by 2022

Longest period of manufacturing growth in 50 years

These are the latest figures as stated by the Treasury in the Spring Statement March 2018.

US Tax Reform – what does it all mean?

By Mike Hayes, Tax Partner, Kingston Smith

Without question, the Tax Cuts and Jobs Act 2017 is the most fundamental overhaul of the US tax system since Reagan's Tax Reform Act of 1986. The new Act was brought into law by the Trump administration on 22 December 2017.

The Act is undeniably positive for corporations and business owners. Arguably, the majority of American taxpayers are likely to experience a reduction in their tax liabilities (at least temporarily – many of the new individual measures expire in 2025) as a result of the new provisions introduced.

However, there is a potential sting in the tail for homeowners and those who usually reside in the US with higher state and local taxes.

The act is complex and wide-ranging, but here we cut through the jargon by providing an overview of the key aspects affecting businesses and individuals.

A flat 21% corporate tax rate

The highlight of the Act is the flat rate of 21% for corporate tax – replacing the previously graduated rates of 15-35%. The big winners here are personal services corporations, whose profits were previously taxed at a flat rate of 35%. The 21% rate helps bring the US in line with other G20 nations, and goes some way to ease the burden of corporate double taxation that has affected owners of C corporations until now.

Taxation of foreign operations and dividend income for businesses

The Act contains provisions that make the repatriation of foreign profits more tax efficient, such as a one-off 15.5% tax on cash and 8% tax on equipment. The aim is again an attempt to stimulate investment in the US.

Deductibility of dividends received by C corporations from business investments has been restricted. Previously where a corporation held over 20% of the common stock of a business, it could deduct 80% of any dividend income – the new Act restricts this deduction to 65%.

A brand new deduction for pass-through businesses

Owners of S Corps, LLCs, Partnerships and Sole Proprietors ('pass-through entities') will now be able to deduct 20% of their Qualified Business Income (QBI) on their own tax returns. The mechanics behind the new deduction are complex, but it is designed to act as an additional itemised deduction on the individual's return. The deduction is however not available for most service businesses and is phased out above certain income levels – $157,500 for single filers and $315,000 for joint filers.

Restrictions on use of business losses

Effective from 1 January 2018, business losses (NOLs) can no longer be carried back to previous tax years to generate refunds against taxes previously paid. Additionally, these NOLs are restricted to 80% of taxable income – previously a business could offset up to 100% of taxable income using accumulated losses.

Restrictions on deductible expenses for meals and entertainment

Previously a business could deduct 50% of meal and entertainment spend against income. The new law eliminates this deduction entirely. Additionally, where previously meals provided to employees for the convenience of the employer were 100% deductible (such as in-office or at a staff cafeteria), this is now reduced to 50%.

Individual income tax rates are reduced

On the surface, this was always going to be a crowd pleaser. Five of the seven income tax rates have been reduced, (albeit temporarily – effective currently between 2018 and 2025). Moreover, the brackets for each tax rate have also been increased – and will continue to increase in line with inflation.

Income $		Tax rate (%)	
Individuals	**Joint**	**2017**	**2018**
Up to 9,525	Up to 19,050	10	10
9,526 - 38,700	19,051 - 77,400	15	12
38,701 - 82,500	77,401 - 165,000	25	22
82,501 - 157,500	165,001 - 315,000	28	24
157,501 - 200,000	315,001 - 400,000	33	32
200,001 - 500,000	400,001 - 600,000	35	35
500,001 -	600,001 -	39.6	37

Standard deductions are doubled; personal exemptions suspended

From 1 January 2018, taxpayers are no longer able to claim personal exemptions ($4,050 for each taxpayer, spouse and dependent in 2017). To compensate for this loss, the available standard deduction is almost doubled to $12,000 for single filers, $18,000 for heads of household and $24,000 for joint filers.

Those who itemise their deductions (and thus cannot make use of the increased standard deduction) are likely to lose out. Similarly, taxpayers with large numbers of dependents may also suffer (although child tax credits have been doubled to $2,000 for children under 17).

Restrictions on state and local taxes

One of the more controversial aspects of the Act is the restriction on the deductibility of state and local taxes paid. From 2018, taxpayers who itemise their deductions can deduct a maximum of $10,000 of state and local taxes paid.

This could penalise tax payers residing in high tax states, as well as homeowners.

Restrictions on mortgage interest deductions

A further controversial aspect of the Act—that will again hit the pockets of homeowners—is the new restriction on the amount of mortgage interest that is deductible. From 2018 to 2025, interest is deductible on mortgage debt only up to $750,000. Moreover, interest incurred on home equity debt is now wholly disallowable.

One concession granted is that the $750,000 ceiling only applies to mortgage debt incurred after 15 December 2017. Mortgage debt charged prior to this date is still subject to the previous $1 million limit. Home equity interest is wholly disallowed, irrespective of the date the debt was taken on.

Estate and inheritance tax exemptions are doubled

The Act doubles the previous exemptions for gift and estate taxes to $10 million. Adjusted for inflation, in 2018 the limit is expected to be $11.2 million, up from $5 million in 2017. This presents significant tax-planning opportunities for high net worth individuals and families. However, these extensions are only in place until 2025.

Other changes to itemised deductions

The Act introduces a raft of measures that restrict the scope of various itemised deductions that were previously allowed. In theory, these restrictions, viewed alongside the doubling of the standard deduction, meaning many taxpayers will be better off simply claiming the standard deduction and not itemising – thus simplifying the annual tax filing process. However, those who itemise may well end up liable for more tax as a result.

- **Moving expenses:** the deduction is suspended until 2025, except for members of the armed forces.
- **Alimony payments:** these are no longer deductible for divorces finalised from 1 January 2019. Likewise, alimony receipts will be excluded from the recipients' taxable income.
- **Miscellaneous itemised deductions:** there will no longer be a general deduction available, subject to the 2% of AGI floor.
- **Use of home as office:** employees working from home will no longer be able to claim use-of-home-as-office expense deductions.

Topical tips for inward investors

At Kingston Smith, our experience and research indicate that inward-investing companies are still missing out on some of the most valuable opportunities. They are also overlooking certain compliance obligations when operating their business in the UK. Below are four significant points that are regularly ignored or inadvertently missed by inward investors.

1. **Business structures:**
   Depending on the needs of your business now and in the future, you will need to decide on a business structure. Each structure is different in terms of its set-up process, taxes, profit distribution and personal responsibility. Many UK structures are created by foreign companies without taking proper advice at the outset, with the default choice being a UK limited liability company set up as a wholly owned subsidiary. A UK company is the right choice in many circumstances, but in others, a UK branch or limited liability partnership might be more appropriate. Structures should also be kept under review, because what is suitable at the start of the UK operations may not be the best option as time passes and the business strategy and operating environment change.
2. **Audit obligations**
   If the group's annual turnover, gross assets or number of employees exceed certain thresholds, or the group contains a listed company, the UK entity's financial statements must be audited. However, many inward-investing groups still look at their UK subsidiary's results in isolation and continue to prepare unaudited accounts in error. International groups, therefore, need to be conscious of the varying audit obligations in the countries in which they operate.
3. **Short-term visitors to the UK**
   When non-UK employees visit the UK for short periods of up to six months, their salary (even if paid outside the UK) falls within the UK employment tax system unless the rules and reporting obligations around Short-Term Business Visitors are followed. The UK's HM Revenue & Customs has publicly announced it will be focusing on this, as it suspects there is widespread non-compliance.
4. **Living allowances for secondees**
   For employees on temporary secondment to the UK, there are certain tax rules which allow, subject to prior agreement of a bespoke scale rate from HM Revenue & Customs, certain living expenses to be reimbursed to them free of tax and National Insurance. Over the years, we have seen many employers miss out on the benefits of these generous rules. Other employers misunderstand the rules and include family-related expenses or non-business expenses within their expense claims which can result in large liabilities for under-paid tax.

Keep a look out for more topical tips in our next edition of Across the Pond.

Starting up in the UK – things you need to know when employing your first person

By Adam Flight,
Kingston Smith HR Consultancy

Recruitment

Recruitment can be a costly exercise, so it is worth taking your time to try to get it right first time. You should weigh up not only the cost of recruitment, but also the potential cost of getting it wrong. This can have an even bigger impact when you are thousands of miles away in a different country and time zone.

When interviewing potential employees for your office in the UK, there are questions you are not allowed to ask that you may be able to ask in your own country. These questions include: How old are you? Do you have children? Are you planning to start a family? What religion are you? More information is available on the UK government website **here**.

If you ask for references, take them seriously and ask specific questions to ensure you find out the information you need. It is better to prevent the wrong person from starting, than take someone on who isn't right for the role or your business and have to manage them later. Finding the right person – especially in certain industries, such as media, tech and IT – can take longer than expected.

Other areas to consider are their eligibility to work in the UK if taking on non-EU nationals. Depending on the role itself, you may need to conduct certain background checks in addition to employment references.

Job description

Do you have to provide one? No, there is no legal requirement to provide one. When you start to recruit for your first position, you may not know the extent of the role until they start. The purpose of the role is always a good starting point and prevents the job description from becoming a list of tasks. You should also think about what they will be responsible for and what you want them to achieve. Having a job description works both ways, as both you and the employee will be clear about what is required from day one.

The job description is changeable but allows you to measure the success of an employee. It should also detail the person specification, including the experience, skills, qualifications and personal qualities required.

Contract of employment

Legally, a contract must be issued within two months of the start of employment. You need to think about what type of contract you want to offer a person – permanent, fixed-term, casual or self-employed/freelance. However, issuing the wrong type of contract may actually reduce the level of protection and flexibility you have as an employer. So, be aware of which contract to use when.

Do not forget to protect your business. For example, if someone invents something for your company while you have been paying them, do you want them to be able to take it with them to their next company? You may also wish to prevent them from soliciting your employees and clients when they leave. All of these restrictions can be included in the contract.

There are certain clauses which must be contained in an employment contract, such as salary, pay date, holiday entitlement, sick pay entitlement, pension, location of work and notice period.

Other things to consider putting in the contract include:

- Restricting employees taking time off during busy periods
- What time employees need to phone in if they are off sick
- Paying more than statutory sick pay
- Probationary period
- Moving to larger premises as the business grows.

Lastly, be aware of implied terms! Even if they are not written down, they could still become contractual. More information is available **here**.

Brexit – is the UK's forthcoming EU departure already influencing immigration?

By Antonio Lam, Newland Chase

The recent migration statistics published by the UK's Office for National Statistics (ONS) revealed that net EU migration is at its lowest for five years.

Some 220,000 EU nationals arrived in the UK in the year to September 2017. But with the number leaving the UK over the same period standing at 130,000, is the EU referendum already influencing immigration trends, even before the UK has left the EU?

The number of EU citizens moving to the UK for work-related reasons has dropped to its lowest level in more than four years. As a result, the reduction in available EU migrant labour is pushing UK employers to cast their recruitment net wider.

Hiring from outside the European Economic Area (EEA)

However, employers have found their recent efforts to hire workers from outside the EU to be further complicated. This is specifically due to the restricted monthly allocation of Tier 2 Restricted Certificates of Sponsorship (RCoS) granted to non-EEA workers.

Demand for RCoS has exceeded supply in each of the last three months. This has seen employers looking to sponsor non-EEA migrants having their RCoS applications rejected where the salary offered is less than £55,000.

Brexit uncertainty affecting business planning

There has been a notable lack of clarity from the British government on what a post-Brexit immigration system might look like. The ONS figures suggest the uncertainty is affecting whether the UK continues to be seen as an attractive destination for EU workers.

In turn, UK employers in all sectors – specifically healthcare, technology, construction and engineering – face challenges in their strategic long-term post-Brexit business planning due to the absence of any concrete government policy.

EU nationals living in the UK

There is, however, some assurance for EU nationals to have the new 'settled status'. This applies to those who have resided in the UK for five continuous years before the cut-off date, expected to be 31 December 2020.

The settled status will permit EU citizens who meet the criteria to continue living in the UK. They can continue accessing public funds and services and, should they wish, eventually apply for British citizenship.

British Prime Minister Theresa May has said she wants all EU citizens living lawfully in the UK to remain post-Brexit, promising a smooth registration system.

The UK government's initial position was that the rights of EU nationals arriving after the cut-off date would be different to those already in the UK. However, a policy paper published on 28 February 2018 confirmed that EU citizens and their families will be able to work and study in the UK without any new constraints during such a transition period.

But, the European parliament's Brexit Steering Group has said that they "cannot accept any form of discrimination between EU citizens who arrive before or after the start of any transition". MEPs have stressed the importance of securing equal and fair treatment for EU citizens living in the UK, and for UK citizens in the EU.

Brexit negotiation cut-off

Brexit negotiations continue, with autumn 2018 seen to be a significant period. An exit deal between the UK and EU must realistically have been made by then. It must then be approved by the UK's parliament in time to meet the 31 December 2020 deadline.

The UK Migration Advisory Committee's important report to the government is due to be published in September 2018. It details the impact of Brexit on the UK labour market and how the UK's immigration system should be aligned with a modern industrial strategy.

Kingston Smith North America Group

Kingston Smith has over three decades of experience working with internationally oriented companies looking to expand and grow globally. Our dedicated team of international expansion specialists understand the nuances of foreign market entry, and work with clients to ensure that their plan to expand their global footprints takes place in a smooth and efficient manner.

Whether you are a UK company planning to expand to North America, or a business from across the Atlantic looking to enter the UK market; the Kingston Smith North America Group can provide a seamless transatlantic service, ably assisted by our associate firms in many key locations including the Silicon Valley, San Francisco, New York, Atlanta and Toronto.

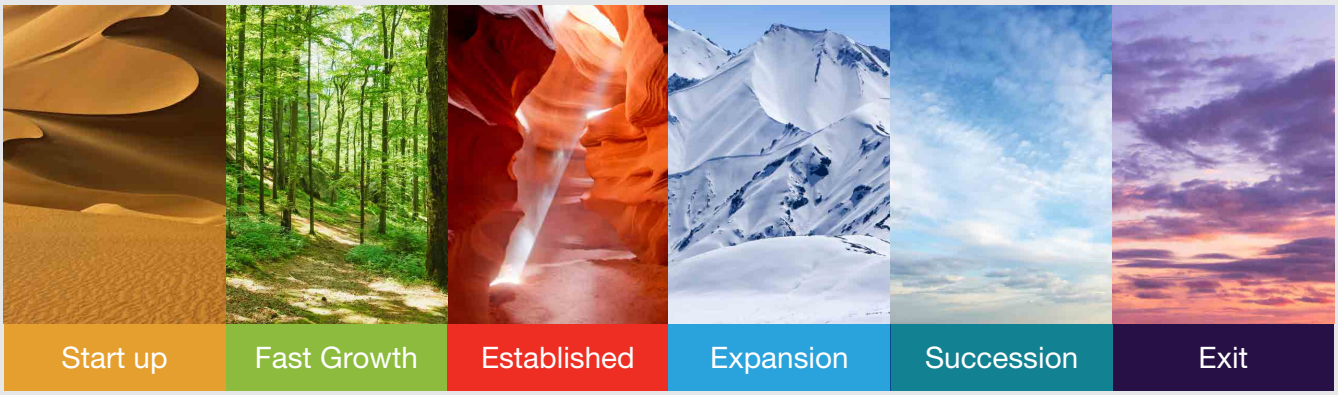
The Kingston Smith North America Group is a 'One Stop Shop' for individuals and businesses operating within the UK, offering professional advisory services in the following areas:

Investors in the UK

- Business structuring
- Accounting and audit
- Tax advisory and compliance
- Payroll management
- HR consultancy
- Company secretarial

Corporate finance

- M&A and JVs
- Financial due diligence
- Market listings
- Raising finance
- NRI services



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