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U.K. Budget 2016

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The Chancellor's Budget speech of March 16, 2016 covered a diverse range of subjects, even by the standards of other recent Budgets. This article focuses on the, in any case extensive, tax aspects of the Budget.

I. Introduction[1]

Although it is a crude measure, the increasing shelf space occupied by the books containing tax legislation provides something of an insight into the complexity of the U.K.'s tax system. After 2015, with two budgets, saw a new permanent volume and an interim book added to practitioners' shelves, it had been hoped that, rather than adding a few centimetres' worth of pages, the budget which was delivered on March 16, 2016 might mark the start of a period of recovery, during which practitioners could take stock of the numerous changes made and announced during the course of 2015. However, the breadth of this recent budget is surprising, featuring a number of important new measures, significant extensions to sections of the draft Finance Bill 2016 which were previously published, responses to consultations, and forward looking policy papers. Further changes can be expected as the bill undergoes parliamentary scrutiny.

II. Company Taxation

Amidst all these changes, the "Business Tax Road Map"[2] issued with the budget is an attempt to reassure businesses that the government has a strategy for business tax to 2020. However, many of the announcements cover policies for which legislation or draft legislation was issued before or as part of the recent budget, and only a few firm policies for 2018 to 2020 were announced; there may be some twists and turns which the cartographers of the road map have not yet plotted.

Some of the key company taxation measures announced include:

- a further reduction in the corporation tax rate for 2020–21 to 17% (following on from the government's previously planned reduction from the current rate of 20% to 19% in 2017–18 and to 18% in 2020–21);[3]
- new provisions targeting arrangements which avoid the obligation to withhold U.K. tax on royalty payments, by increasing the range of withholdable payments and overriding the U.K.'s double tax agreements which would otherwise shelter such payments;[4] and
- confirmation of the ambit of a new regime under which large companies are to publish their "tax strategy" and may face a special regime for being "persistently un-cooperative".[5]

A number of wide-ranging consultations were also announced. Perhaps the most unexpected of these is a planned shake up of the current regime for brought forward losses, which will mean that from April 2017 companies in groups will be able to access brought forward losses group-wide (presently, each company in a group can generally just use its own previous period losses against its own similar profits, albeit that group companies can use each other's current period losses). However, together with this favorable change, groups with profits in excess of five million pounds will be restricted to offsetting just 50% (rather than 100%) of current period profits against carried forward losses.[6] Linked to those proposals are further restrictions on banks' abilities to use losses: losses incurred by banks before April 2016 will only be capable of being offset against up to 25% of current profits (instead of 50% as at present).[7]

Other consultations will focus on:

- the substantial shareholder exemption ("SSE"),[8] which exempts companies' gains on disposals from a shareholding of 10% or more where certain conditions are satisfied. The government will consult on how the SSE is performing now and potential "changes to its detailed design in order to increase its simplicity, coherence and international competitiveness";[9]
- potentially amending and broadening the double tax treaty passport scheme,[10] a simplified treaty claim process for interest subject to U.K. withholding tax; and
- a review of "how partnerships calculate their tax liabilities," following on from a lengthy study by the

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Office of Tax Simplification into the taxation of partners and associated administration.[11]

In addition, a paper was released outlining a new regime to come into effect in 2016 which will target offshore property structures avoiding U.K. tax on profits from trading in U.K. property.[12] Together with the diverted profits tax enacted in 2015 and the announcement as part of the budget of amendments to U.K. tax treaties with Jersey, Guernsey and the Isle of Man[13] and of a task force to focus on offshore property developers,[14] this measure brings significant pressure to bear on offshore developers trying to escape U.K. tax on U.K. developments.

III. BEPS

The U.K. has been a keen participant in the OECD's Base Erosion and Profit Shifting ("BEPS") project, and this budget expands on a number of measures announced during 2015 which aim to implement the near-final reports on the BEPS process issued by the OECD on October 22, 2015. The "Business Tax Road Map" mentioned above provides a useful action-by-action guide to the U.K.'s approach to each of the BEPS strands (including the welcome confirmation that some areas, such as the controlled foreign company regime, will be left as they are). Developments in the budget were:

- a fresh draft of complex "anti-hybrid" legislation which was initially released in December 2016 targeting cross-border and domestic structures that seek double deductions and/or non-taxation of income,[15] to take effect from January 2017. Notably, this legislation has now been extended to target mismatches arising from permanent establishments;[16]
- confirmation of a proposed cap on the tax deductibility of interest, from April 1, 2017, so that net deductions (on loans from group members or third parties) will be limited to 30% of EBITDA. This ratio will be calculated from the consolidated accounts of the group with a *de minimis* threshold of two million pounds net group U.K. interest expense. The details of other aspects of this regime, such as an exclusion for infrastructure projects based in the U.K. that have a public benefit and low BEPS risk, are currently shadowy. These changes will be accompanied by the replacement of the current "worldwide debt cap" rules (which broadly restrict companies' U.K. relief for their financing expenses where those expenses are greater than worldwide interest deductions) with rules with "similar effect;"[17]
- the formal incorporation of recent revisions to the OECD's transfer pricing guidelines into U.K. law;[18] and
- a further draft of provisions originally released in December 2015 which are intended to bring the U.K.'s "patent box" regime into line with BEPS guidelines for preferential IP regimes.[19]

IV. Property

New stamp duty land tax ("SDLT") rates and calculation methods for transfers of nonresidential and mixed-use property were introduced with, generally, immediate effect from budget day. These changes are comparable to reforms to SDLT for residential properties in 2014, in that rather than charging a single rate of tax on a transaction, a separate rate of tax will now be payable on the portion of the consideration for lease premises and freeholds which falls within each rate band (zero percent for transactions worth up to 150,000 pounds, two percent between 150,001 pounds and 250,000 pounds, and five percent over 250,000 pounds).[20] Overall, these changes will increase SDLT payable for higher value properties, previously charged at a top rate of four percent. For nonresidential leasehold transactions where SDLT is calculated on the net present value ("NPV") of rent under the lease, a new two percent rate will be introduced for NPVs above 5 million pounds; this too represents an increase on the previous top rate of one percent on NPV.

Budget 2016 also clarified the controversial policy announced in 2015 of charging additional three percent SDLT on purchases of "additional residential properties."[21] These changes will broadly mean that companies generally, and any individual owning a residential property or part of a residential property anywhere in the world worth over 40,000 pounds, will be liable to pay an extra three percent SDLT on each rate band when purchasing U.K. residential property.

On the plus side for property investors, a new "seeding" relief is to relieve from SDLT the transfer of property into property authorized investment funds and co-ownership authorized contractual schemes ("CoACS"), as well as exempting transfers of units in CoACS from SDLT.[22]

V. Personal Taxation

Changes to the thresholds for personal income tax will affect many individual taxpayers in the U.K., with the levels at which 20% and 40% rates of tax apply now set to rise higher in 2017/18.[23] While the changes in the rate of capital gains tax ("CGT") will not have as widespread an effect, they are starker in that they reduce the higher rate from 28% to 20% and the basic rate from 18% to 10%.[24] The current higher rates will continue to apply to gains made on two of the government's obsessions, the disposal of residential property and carried interest.

The higher rate CGT payable on carried interest is unsurprising, given the recent suite of measures targeting such structures. The budget provided clarity on one of these measures, which will only permit carried interest to be taxed to CGT (which will still produce a more favorable outcome than income tax rates) where the average holding period of the relevant fund is at least 40 months.[25]

Entrepreneurs' relief ("ER") allows employees who hold at least 5% of the shares in a company to pay 10% CGT on gains arising from disposals of the shares in the relevant company. ER will now be joined by a new "investors' relief", which will apply to gains accruing to those who have not worked for a business on disposals of ordinary shares in unlisted trading companies if certain criteria are satisfied.[26] "Ordinary" ER will be widened by, amongst other things, becoming available for certain goodwill-related gains where a seller holds less than 5% of the shares.[27]

There has been much uncertainty regarding the future of the U.K.'s pension taxation over the past year, with rumors of a dramatic planned scaling-back of the current system of reliefs. For now, it has been confirmed that there will be no wide-scale change to the system; draft legislation to alter contribution limits[28] and make other more minor amendments has been released, while a new type of savings product to encourage saving for pensions or a first home has also been announced.[29] Other changes to personal taxation include a minor decrease in social security contributions for the self-employed, and a proposed consultation on the tax treatment of severance payments made to employees.[30]

VI. Tax Avoidance and Evasion

Tackling tax avoidance and evasion by companies and individuals has been a key government policy, and the budget inevitably adds to the current panoply of anti-avoidance measures. In the main, this is simply by way of confirmation that measures previously consulted on will be taken forwards, including:

- a new criminal offence that removes the need to prove intent for the most serious cases of failing to declare offshore income and gains;[31]
- new civil penalties for deliberate offshore tax evasion;[32]
- new (alarmingly broadly drafted) civil penalties for people or entities which are enablers of offshore tax evasion;[33]
- special reporting and penalty regimes for "serial avoiders", that is, entities or individuals which routinely try to avoid tax by way of failed schemes;[34] and
- a penalty of 60% of the tax due where schemes are successfully defeated under the "General Anti-Abuse Rule."[35]

The government will also consult on a range of measures aimed at tackling marketed avoidance schemes,[36] and as part of a new disclosure facility in anticipation of the introduction of the Common Reporting Standard, failing to correct past offshore non-compliance within a defined period of time will be met with new sanctions.[37]

VII. Energy

To stimulate the U.K.'s oil and gas sector, petroleum revenue tax (payable on profits from older fields) will essentially be abolished,[38] and the rate of the supplementary charge payable on oil and gas extraction profits will be reduced from 20% to 10%.[39] These changes follow on from substantial reductions in the taxes and rates for the industry which were made in the 2015 budget, and are accompanied by more technical amendments also aimed at encouraging infrastructure and investment in the sector.[40] A number of changes are also set for the tax regime for businesses that consume energy.[41]

VIII. Indirect Taxes

New measures will target businesses which do not properly charge VAT when selling online, and will permit HMRC to make online marketplaces jointly and severally liable for VAT unpaid by overseas businesses using such marketplaces.[42] Other indirect tax changes include a rise in the standard rate of tax levied on insurance premiums from 9.5% to 10.5%,[43] and modest increases in the VAT registration and deregistration thresholds from April 2016.[44]

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NOTES

1 This article provides information and comment on legal issues and developments. The article is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508173/business_tax_road_map_final.pdf.

3 https://www.gov.uk/government/publications/corporation-tax-to-17-in-2020/corporation-tax-to-17-in-2020, clause 42 Finance Bill 2016 ("FB 2016"); cf. s7 Finance (No.2) Act 2015.

4 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508149/Deduction_of_income_tax_at_source-tax_avoidance.pdf and https://www.gov.uk/government/publications/income-tax-royalty-withholding-tax/income-tax-royalty-withholding-tax, clause 40(1) FB 2016.

5 Schedule 19 FB 2016.

6 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508859/OOTLAR_complete_for_publication.pdf, paragraph 2.29.

7 https://www.gov.uk/government/publications/corporation-tax-update-to-bank-loss-relief-restriction/corporation-tax-bank-loss-relief-restriction, clause 53 FB 2016.

8 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508859/OOTLAR_complete_for_publication.pdf, paragraph 2.31.

9 Business Tax Road Map, paragraph 2.65.

10 Business Tax Road Map, paragraphs 2.66 – 2.67.

11 HM Treasury: Budget 2016, paragraph 2.109.

12 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/507766/1044_Budget_Day_Technical_Note__v2_0__3_.pdf.

13 https://www.gov.uk/government/publications/profits-from-trading-in-and-developing-uk-land.

14 HM Treasury: Budget 2016, paragraph 1.214.

15 Clause 62 FB 2016.
https://www.gov.uk/government/publications/corporation-tax-anti-hybrids-rules/corporation-tax-anti-hybrids-rules

16 Schedule 10 FB 2016.

17 Business Tax Road Map, paragraphs 2.30 – 2.37.

18 Clause 71 FB 2016.
https://www.gov.uk/government/publications/income-and-corporation-tax-updating-the-transfer-pricing-guidelines/income-and-corporation-tax-updating-the-transfer-pricing-guidelines

19 Clause 60 FB 2016.

20 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508289/16_03_2016_Main_Guidance_Non_Res.pdf, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508157/SDLT_-_Calculating_tax_on_non-residential_and_mixed_transactions.pdf, clause 116 FB 2016.

21 s117 FB 2016.

22 Schedule 16 FB 2016.

23 https://www.gov.uk/government/publications/income-tax-personal-allowance-and-basic-rate-limit-for-2017-to-2018/income-tax-personal-allowance-and-basic-rate-limit-for-2017-to-2018, clauses 2 and 3 FB 2016.

24 https://www.gov.uk/government/publications/changes-to-capital-gains-tax-rates/changes-to-capital-gains-tax-rates, clause 72 FB 2016.

25 Clause 37 FB 2016.

26 https://www.gov.uk/government/publications/capital-gains-tax-changes-to-rules-to-extend-availability-of-entrepreneurs-relief-on-associated-disposals/capital-gains-tax-changes-to-rules-to-extend-availability-of-entrepreneurs-relief-on-associated-disposals, Schedule 14 FB 2016.

27 https://www.gov.uk/government/publications/capital-gains-tax-changes-to-rules-to-extend-availability-of-entrepreneurs-relief-on-

goodwill-on-incorporation/capital-gains-tax-changes-to-rules-to-extend-availability-of-entrepreneurs-relief-on-goodwill-on-incorporation, clause 74 F (No.2)B 2016.

[28] Clause 19 F (No.2)B 2016.

[29] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508176/Lifetime_ISA_final.pdf.

[30] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508859/OOTLAR_complete_for_publication.pdf, paragraphs 2.65 and 2.10.

[31] Clause 154 FB 2016.

[32] Schedule 22 F (No.2)B 2016.

[33] Schedule 20 FB 2016.

[34] Schedule 18 FB 2016.

[35] Clause 146 FB 2016.

[36] HM Treasury, Budget 2016, Paragraph 2.204.

[37] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508859/OOTLAR_complete_for_publication.pdf, paragraph 2.57.

[38] Clause 128 FB 2016.

[39] Clause 54 FB 2016. https://www.gov.uk/government/publications/oil-and-gas-taxation-reduction-in-petroleum-revenue-tax-and-supplementary-charge/oil-and-gas-taxation-reductionin-petroleum-revenue-tax-and-supplementary-charge

[40] https://www.gov.uk/government/publications/oil-and-gas-taxation-minor-amendments-to-onshore-cluster-area-and-investment-allowances.

[41] HM Treasury, Budget 2016, Paragraph 2.170.

[42] https://www.gov.uk/government/publications/vat-overseas-businesses-and-joint-and-several-liability-for-online-marketplaces/vat-overseas-businesses-and-joint-and-several-liability-for-online-marketplaces, clause 113 F(No. 2)B 2016.

[43] https://www.gov.uk/government/publications/changes-to-insurance-premium-tax-increase-to-standard-rate/changes-to-insurance-premium-tax-increase-to-standard-rate, clause 129 F (No.2)B 2016.

[44] https://www.gov.uk/government/publications/vat-revalorisation-of-registration-and-deregistration-thresholds/vat-revalorisation-of-registration-and-deregistration-thresholds.