# UK Budget 2016 – Key Tax Measures

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The ***Chancellor of the Exchequer*** delivered the ***UK Budget*** for 2016 on 16 March 2016. The Budget was delivered against the backdrop of international tax developments, relating to the OECD's Base Erosion and Profit Shifting Report and heightened public interest in the acceptability of tax mitigation and avoidance by multinational enterprises. Perhaps unsurprisingly, international and corporate tax measures accordingly take centre stage in the Budget announcements. Also noticeable is that the Chancellor's Budget was the fourth major budgetary announcement in twelve months. The frequency of such announcements has done nothing, however, to reduce the very considerable length of the consultation documents, impact assessments, draft legislation and HMRC notices which comprise the Budget. With another very lengthy Finance Bill awaiting parliamentary consideration in the Spring of 2016, it is difficult to avoid the conclusion that the growing complexity of the UK's tax code, and the increasing frequency of major changes to key areas of tax policy, risks impairing the efficiency of the UK's tax system as a whole.

## Corporate Tax Measures

One of the eye-catching measures in the Budget was the announcement by the Government of a reduction in the rate of corporation tax to 17% in 2020, a change which the Chancellor announced would affect over a million UK companies. The cut in the corporation tax rate is designed to ensure that the UK has the lowest rate of corporation tax in the G20, and by far the lowest rate in the G7. It is notable that the costing analysis of the measure by HM Treasury included the anticipated behavioural response of dis-incentivising multinational companies from shifting profits from out of the UK. While the Chancellor's stated rationale for the corporation tax rate cut is to augment an already attractive and competitive UK tax environment, the macro-economic logic of making tax avoidance less of a priority for multinational businesses through lowering the corporation tax rate itself has a quality which is difficult to ignore.

At the same time, it would be unwise to assume that the introduction of ever more targeted anti-tax avoidance legislation has ceased to be a major tax policy focus for the Government. Previous Budgets have included numerous anti-avoidance rules, accompanied by hundreds of pages of draft legislation. This Budget was no exception, with a particular focus being measures aimed at counteracting cross-border avoidance, including the following:

• the announcement of proposals to restrict the tax deductibility of corporate interest expense consistent with the OECD recommendations in BEPS Action 4 (Interest Deductibility). The Government has proposed that the new rules will apply from 1 April 2017 and will introduce a Fixed Ratio Rule limiting corporation tax deductions for net interest expense to 30% of a group's UK earnings before interest, tax, depreciation and amortisation (EBITDA). To target large business where the Government is most concerned tax avoidance exists, the rules will have a de minimis group threshold of £2 million net of UK interest expense, with the threshold being set at a rate calculated to exclude 95% of groups from the new rules. Broadly comparable to the interest barrier rules in other EU member states, such as Germany, the Government has announced that the rules will recognise that some groups have high external gearing for genuine commercial purposes (with the rules operating through a group ratio rule based on the net interest to EBITDA ratio for the worldwide group as recommended in the OECD report). Clearly, this will be a major legislative change, given that the UK tax community has taken a number of years to become fully familiar with the existing UK worldwide debt cap rules.

• the introduction of anti-hybrids legislation as announced in the Autumn Statement in November 2015. These measures will implement the UK's response to the OECD BEPS Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements). Broadly, these measures propose to correct situations where either one party gets a tax deduction for a payment whilst the other party does not have a taxable receipt or where there is more than one tax deduction for the same expense. As previously announced, these measures will broadly apply to payments made on or after 1 January 2017. The OECD BEPS Project is on-going and it remains to be seen what additional anti-hybrids measures may be implemented, specifically in relation to double tax treaties.

• provisions to make it harder for multinationals to strip profits from the UK to low or no-tax jurisdictions using licencing and royalty payments. The focus of the announcement is to widen the scope of UK withholding tax to cover payments in respect of all intangible assets, including trademarks and brand names. UK withholding tax will be applied to royalty payments (even if the payment of the royalty is not made from the UK) provided that the royalty payment has a UK "source". Legislation will be introduced with effect from the Royal Asset of Finance Bill 2016 to clearly identify the "source" of a royalty payment, being where the royalty is connected to a UK permanent establishment, or an "avoided PE" for the purposes of the UK's diverted profits tax. Mindful of tax mitigation structures in this area, the Government has also proposed a targeted anti-avoidance rule (applying to royalty payments made on or after 17 March 2016) to prevent connected parties using the UK's double tax treaties to facilitate royalty repatriation to tax havens through conduit entities established in treaty jurisdictions.

Other announcements were focused on simply updating the UK's complex corporate tax system, including the announcement of a major overhaul regarding the current regime for corporation tax loss relief. Currently, losses carried forward can only be used by the company that incurred the loss, and not used in other companies in a group. In addition, some losses carried forward can only be set against profits from certain types of income (with trading losses carried forward being utilisable only against trading profits, sometimes leading to the concept of "trapped losses"). In a relaxation of these rules, the Government has announced that for losses incurred on or after 1 April 2017, companies will be able to use carried forward losses against profits from other income streams or from other companies within a group. However, the Government's generosity is balanced by a new rule for companies with profits in excess of £5 million whereby a restriction will be introduced of the amount of profit that can be offset through losses carried forward. From 1 April 2017 the government will restrict to 50% the amount of profit that can be offset through losses carried forward. A consultation on these changes will take place in 2016, with legislation following in Finance Bill 2017.

## Finance Tax Measures

### *Banking*

The tightening of tax rules applicable to the banking sector has been a notable feature of Budgets since the financial crisis of 2007 to 2010. In the Autumn Statement in November 2015, the Chancellor announced that the amount of taxable profits which could be offset by banks' historic carry-forward losses would be restricted to 50% with effect from 1 April 2015. In the Budget, the Government announced that the profit that banks can offset with pre-2015 losses will be further reduced to 25% with effect from 1 April 2016. Banks' post-2015 losses, as well as any pre-2015 losses covered by the existing reliefs for new-entrant banks and building societies, will be treated in the same way as other industry groups.

Other rules in the Budget also tighten the definition of "bank" for corporation tax, UK bank levy and the Code of Practice on Taxation for Banks purposes, further limiting the scope for banking entities to fall outside these and other bank taxation rules by means of undertaking non-banking activities.

These changes will not to be welcomed by UK-located banks and bank branches still utilising pre-2015 losses; it remains to be seen how tax policy focused on penalising the UK's banking sector might fare in the event of a UK BREXIT, when bank location and mobility might be expected to rise on the political agenda again.

### *Securitisations*

One significant success story for the UK tax system in recent years has been the introduction (in 2007) of a defined tax regime for UK securitisation companies, and the use of the regime to facilitate a very wide range of commercial and financing transactions. The Government has announced a Budget measure aimed at refining the regime through the abolition of UK withholding tax on "residual payments" made by UK securitisation companies. These rules, which will take effect following Royal Assent to Finance Bill 2016, should create additional flexibility in structuring profit extraction and residual certificate arrangements for UK securitisation companies. The changes assist in placing the UK's securitisation regime on comparable terms with those of Ireland, The Netherlands and Luxembourg, and are to be welcomed.

Also of importance is the Budget confirmation, following the publication of a public consultation document on 1 March 2016, of the forthcoming drafting of new statutory instruments to establish a new tax regime applicable to insurance linked securities and the issuers of such securities.

### *Stamp Duty and SDRT - Deep in the Money Options*

Further to announcements at Autumn Statement 2015, the Budget proposes the introduction of a stamp duty or stamp duty reserve tax ("SDRT") rate of 1.5% of the higher of the market value or the option strike price where securities are deposited with a depository receipt issuer or clearance services. Currently, where shares are transferred to a depository receipt issuer or to a clearance system, stamp duty or SDRT is levied on the amount or value of the sale at the rate of 1.5%. However, a "deep in the money" option ("DITMO") has a strike price significantly below the market value and HMRC have become increasingly aware of the use of DITMOs to transfer shares with a reduced liability to stamp duty or SDRT.

This measure is proposed to be introduced in Finance Bill 2016.

## Real Estate Tax Measures

### *Offshore Avoidance – taxation of immovable property in the UK*

Measures were proposed in the Budget to ensure trading profits derived by a business from land in the UK will be subject to UK taxation, whether or not the business is resident in the UK and regardless of whether the land is connected with is a UK permanent establishment. For some time, HMRC has been concerned by the use of offshore structures to avoid UK tax on profits arising from trading derived from land in the UK. Specifically, provisions within a small number of the UK's double taxation treaties (notably with Guernsey, the Isle of Man and Jersey) have enabled profits to be derived from UK land by non-UK resident companies and not to be brought into account for UK tax purposes. A number of amendments to these double taxation treaties have now been agreed between the UK Government and the Governments of these territories. These measures are proposed to be introduced at the Report Stage of Finance Bill 2016, which is expected to be in June 2016.

Having regard to the degree of sophistication employed in such structures and the delay between the delivery of the Budget and the date such legislation will take effect, the Budget also introduces with immediate effect a "targeted anti-avoidance rule" which would capture transfers of land or other such arrangements which would, broadly, have the effect of circumventing the proposed new measures.

### *SDLT: Reform of Charging Provisions for non-residential property*

The Budget proposes a change from a "slab system" to a "slice system" in relation to stamp duty land tax ("SDLT") rates in relation to non-residential property and mixed-use property. This will ensure conformity in the basis on which SDLT is calculated across property types following the changes that were made in relation to residential property in the 2014 Autumn Statement. Under the new rules, the proportion of the purchase price within each band will be taxed at the applicable rate. In addition, the relevant rates and thresholds have also changed and an additional higher rate (2%) SDLT charge has been introduced in relation to leases with a net present value in excess of £5 million. These measures take on and after 17 March 2016.

## Other Tax Measures

### *Tackling Disguised Remuneration avoidance schemes*

Historically, "disguised remuneration schemes" have involved the use of certain arrangements and schemes to benefit employees or their families or associates in a way that is designed to avoid or defer income tax and national insurance contributions liabilities. Legislation to tackle these schemes was introduced in 2011. However, certain weaknesses within this legislation have been identified. The Budget proposes measures to address these weaknesses. Specifically, the Government has proposed introducing a new "targeted anti-avoidance rule" with effect on and after 17 March 2016 aimed at counteracting perceived weakness in the existing anti-avoidance legislation in this area. In addition, transitional relief that was intended to work alongside the Employee Benefit Trust Settlement Opportunity, which closed on 31 July 2015, is also proposed to be withdrawn with effect from 30 November 2016.

## Trading Income Received in Non-Monetary Form

Proposals have been made in the Budget for the clarification of HMRC's interpretation of the existing requirement to bring into account income in non-monetary form from trading or property. This will apply for the purposes of UK income tax and corporation tax and will be introduced in Finance Bill 2016. This is one of the more surprising additions to the lengthy Budget press releases and draft tax legislation, aiming to put beyond doubt the HMRC's interpretation which the Government notes "has been challenged in some instances".

***Asset Managers Performance Linked Rewards***

The Budget confirms the introduction of legislation in Finance Bill 2016 which will confirm the circumstances in which performance-related rewards (or "carried interest") paid to asset managers may be charged to capital gains tax rather than being charged to tax as income. These controversial measures were consulted on during 2015 with draft legislation published on 9 December 2015. Broadly, these measures propose to determine whether such carried interest should be taxed as capital or income by having regard to the average period for which the fund holds the asset. This is intended to ensure that a carried interest is only subject to capital gains tax treatment in relation to funds which carry on long-term investment activity. However, the Government has granted a concession from the draft legislation published in December 2015, reducing the length of time for which the underlying scheme holds it investments on average in order to be eligible for capital gains tax treatment from 48 months to 40 months. The Budget also sets out the Government's intention to introduce "bespoke calculation rules" for additional asset classes including venture capital and real estate.

A more general reduction in the rate of capital gains tax announced in the 2016 (the higher rate falling from 28% to 20%, and the basic rate falling from 18% to 10%, both with effect for disposals on or after 6 April 2016) will not apply to carried interest. As such, the current rates of capital gains tax, being 18% for basic rate taxpayers and 28% for higher rate taxpayers will continue to apply in respect of carried interest (as well as to UK residential property).



National Law Review, Volume VI, Number 77