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Summary of significant corporate tax related announcements in the 2016 Budget

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There were a number of significant corporate tax related announcements in the recent budget some of which were anticipated and some of which were unexpected. We have summarised below a selection of those which we regard as most significant.

Business tax roadmap

The roadmap has been eagerly awaited and is supposed to make the UK's tax system fit for the future and to set out the Government's plans for the main business taxes in the period to 2020 and beyond. As expected there is talk of simplifying and modernising the UK's tax system and providing a low tax regime that will be attractive to international businesses whilst ensuring that such businesses pay taxes in the UK. The roadmap covers issues such as the rate of corporation tax, investment in the North Sea and reform of business rates. It also tackles tax avoidance and aggressive tax planning through limitation of interest deductions (BEPS Action 4) and hybrid mismatch arrangements (BEPS Action 2) as well as extending royalty withholding tax and tightening the rules on property development by offshore based developers.

An interesting feature of the roadmap is the introduction of greater flexibility of the use of corporation tax losses combined with a new restriction on the amount of taxable profits against which losses can be used.

Further details of the main features of the roadmap are detailed below.

Corporation tax – Rates and payment dates

Unexpectedly the main rate of corporation tax is cut by an additional 1% to 17% with effect from 1 April 2020. Also, with effect from 1 April 2019, the instalment payment regime will be amended for companies with annual taxable profits in excess of £20 million so that they will be required to make payments four months earlier than under the current system.

Interest deduction restrictions

With effect from 1 April 2017 the UK's existing generous interest deduction rules are set to change. From that date net interest deduction will be limited to a maximum of 30% of EBITDA. There will also be a group ratio rule that will permit larger interest deductions for groups with a third party net debt to group EBITDA ratio that exceeds the 30% limit. The new rules will not apply to the first £2 million of next interest expense and there will also be provisions that ensure that the new restriction does not impact negatively on private finance for certain UK infrastructure projects (which traditionally have relied on high levels of debt financing). These new interest deduction restriction rules effectively implement BEPS Action 4.

Use of corporation tax losses – New rules

Again with effect from 1 April 2017 new rules will permit greater flexibility in the use of corporation tax losses. From that date losses can be carried forward for use against profits not only of the same trade but also against profits in the company from other income streams. Significantly carried forward losses will also be capable of being surrendered by way of group relief to other group companies. The quid pro quo to these greater loss use flexibilities is that only 50% of taxable profits will be capable of being offset via carried forward losses. However, the new 50% restriction rules are subject to a de minimis profits figure of £5 million. This means that if, for example, a company has profits of £7 million it will only be able to offset carried forward losses against 50% of its profits over £5 million. This results in an offset of £6 million with the other £1 million available for carry forward against profits in a future accounting period. It should be noted that the £5 million allowance applies per group as opposed to per company.

These new rules do not apply to oil and gas companies that operate within the ring fence corporation tax regime. The already existing restrictions on the use of bank losses are tightened further. With effect from 1 April 2016 the amount of profits that can be reduced by carried forward pre-April 2015 bank losses is reduced to 25%. Post April 2015 bank losses will, however, be treated in the same way as losses incurred in companies that operate outside the banking sector.

Patent box

It has been confirmed that the existing patent box regime will be modified so as to comply with the OECD proposals (BEPS Action 5) in connection with preferential IP regimes. The main point is that going forward the benefits of the patent box will depend upon the extent to which research and development activity expenditure is incurred by the company electing for the regime as opposed to being outsourced to related companies or bought in IP.

Royalties and tax deduction at source

Royalty payments made on or after 17 March 2016 are subject to a new anti-avoidance rule. This will provide that where royalties are paid between connected parties and a double taxation agreement or other international agreement such as the EU Interest and Royalties Directive is used to avoid an income tax deduction then the benefit of the agreement or directive will be denied. There is a presumption that the rule will apply where it is reasonable to conclude that a tax advantage was the main purpose of the arrangement.

The category of royalty payments to which deduction of tax at source can apply will be widened to make sure that income tax is deducted from all payments of royalties to non-UK residents where the royalty has a UK source (except in legitimate cases of treaty relief). This actually has a simplification advantage over the previous system in that it should no longer be necessary to determine whether or not the payment is an 'annual payment' (which in some cases might possibly have led to withholdings on a non-royalty basis).

Transfer pricing

The UK's transfer pricing rules are still to be updated to reflect BEPS Actions 8 to 10 although the Government is committed to make any necessary changes. The Government is also consulting on whether to introduce 'secondary adjustment' rules into the UK's transfer pricing code. Such secondary adjustments operate by recognising that funds which would have been kept by one party to a transaction if it had been carried out at arm's length have not actually been retained by it. Instead this is done by deeming a secondary transaction such as a loan or distribution to have been made.

Anti-hybrid rules

Such rules had already been announced at the end of last year in order to comply with BEPS Action 2. The rules come into effect on 1 January 2017 and are designed to combat the situation that arises where a payment is deductible in one country for tax purposes but not taxed in any other or where a payment is tax deductible in more than one country. These rules will now be expanded to deal with situations where mismatches arise through the use of exempt branches.

UK land – Trading profits

It has been possible to realise tax free profits from trading in UK land by using a structure with a non-resident property owner without a UK permanent establishment where the property owner was established in Jersey, Guernsey or the Isle of Man. Broadly the double taxation agreements between these countries and the UK did not deem a building site to constitute a UK permanent establishment of the offshore owner so with careful planning profits from trading in UK land could be realised free of corporation tax (or income tax). Provisions will be introduced which will subject profits from trading in UK land to corporation tax whether or not the owner is UK resident and regardless of whether there is a UK permanent establishment. Changes to the double taxation agreements with Jersey, Guernsey and the Isle of Man have also been agreed and these changes have already taken effect.