AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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A PUBLICATION FROM THE BDO UK/US TAX DESK

SUBJECT

THE UNITED KINGDOM GOVERNMENT ANNOUNCES 2016 BUDGET

SUMMARY

On March 16, 2016, Chancellor George Osborne announced the United Kingdom's 2016 Budget. At the heart of the Chancellor's speech was a business tax road map designed to take the economy to 2020 and beyond.

The main principal underpinning the road map is that taxes should be low, but must be paid. Further, there should be a level playing field, both between large and small businesses and between different corporate structures. The tax system should encourage entrepreneurship and not reward aggressive tax planning.

Key business measures included in the road map that are likely to impact United States businesses investing in the United Kingdom are summarized below.

DETAILS

Further reduction in the rate of corporation tax

Since 2010, the main rate of corporation tax in the UK has reduced from 28 percent to 20 percent, which is now the rate for all companies regardless of size. This rate is further set to reduce to 19 percent from April 1, 2017, and was to reduce to 18 percent from April 1, 2020. The Government announced in the Budget that the rate of corporation tax will now reduce to 17 percent from April 1, 2020.

Corporation tax payment dates

Very large groups, i.e., those with UK profits in excess of GBP20m (divided by number of group companies) are to have their corporation tax payment dates accelerated by 3 ½ months, so that payments are now due in the third, sixth,

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ninth, and twelfth months of the accounting period. This change was due to commence for accounting periods starting on or after April 1, 2017, but has been pushed back two years to April 1, 2019.

Corporation tax loss relief

Currently trading losses carried forward may be offset fully against profits arising from the same trade in the same company during future accounting periods. There are similar restrictions on other types of losses. For losses incurred on or after April 1, 2017, two changes are to be made:

Companies will be able to use carried forward losses to offset profits arising from other income streams it has or from other companies within the group (by way of "group relief") in future periods; but

Losses carried forward can only be used against 50 percent of profits in excess of GBP5m. Where there are a number of companies in a group, the GBP5m allowance will apply per group not per UK entity.

Tax deductions for interest expense

Action Item 4 of the Organisation for Economic Cooperation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") project seeks to prevent erosion of the tax base through the use of excessive interest deductions. Following consultation on how the OECD's recommendation in Action Item 4 should be implemented in the UK, a restriction on the amount of interest that companies can deduct will be introduced from April 1, 2017.

The restriction to be introduced is a fixed ratio rule limiting net interest expense (third party and group) to 30 percent of the group's UK earnings before interest, tax, depreciation and amortization ("EBTIDA"). In recognition that many groups have genuine commercial needs for borrowing; a group ratio (net interest to EBITDA) may be applied instead.

The proposed rule has a de minimis threshold of GBP2m net UK interest expense.

As a result of the new rule, the existing "world-wide debt cap" rules will be repealed.

Hybrid mismatch arrangements

The UK has already issued comprehensive draft legislation that implements the OECD's BEPS Action Item 2 in respect of neutralizing tax advantages arising from hybrid mismatch arrangements. These new rules are effective from January 1, 2017.

This draft legislation is to be extended to eliminate the tax advantage arising from the use of mismatches involving permanent establishments. The example given in the Budget documents is that of a company with a non-taxable branch (e.g. Luxembourg with a non-trading Irish branch) lending to the UK.

Withholding tax on royalty payments

Three new measures will be introduced to extend the circumstances in which UK withholding tax (at 20 percent) will apply to royalty payments:

1. UK withholding tax will apply to a wider definition of royalty payments, bringing more royalties within the scope of the rules;
2. UK withholding tax will now apply to royalty payments attributable to UK permanent establishments; and
3. A targeted domestic anti-treaty abuse rule was introduced.

The first two measures will apply to payments made on or after the date that the 2016 Finance Bill receives Royal Assent (expected to be in July 2016), and the anti-treaty abuse measure is effective for payments made on or after March 17, 2016.

Transfer pricing documentation

Legislation will be introduced to amend the definition of "transfer pricing guidelines" within the current UK legislation to incorporate the revisions to the OECD Transfer Pricing Guidelines as part of the BEPS initiative. Interpreting the UK transfer pricing rules will therefore be done by reference to the revised OECD Guidelines. This will apply from April 1, 2016.

Patent box

The UK will introduce legislation to reform the Patent Box so that it is aligned with the nexus approach agreed as part of the BEPS project. Under this approach companies will only benefit from the beneficial (ten percent) regime where they undertake R&D investment. The new approach will apply from July 1, 2016, although existing IP currently included in the patent box regime will be grandfathered until June 30, 2021.

Given the further reduction in the corporation tax rate, the UK Government has said that it will keep the case for reducing the ten-percent patent box rate under review.

Taxation of profits from dealing in and developing land

The UK tax system is to be changed so that trading profits arising from dealing in or developing UK land will always be chargeable to UK tax irrespective of the residence status of the landowner and regardless of whether this activity is conducted through a permanent establishment or not.

Protocols amending double tax agreements with a number of jurisdictions have already been agreed and take effect from March 16, 2016. The charge to tax will apply universally from the date that the Finance Act passes the report stage in its passage through the House of Commons.

Substantial Shareholding Exemption

The Substantial Shareholding Exemption ("SSE") was introduced in 2002 and applies in certain circumstances to exempt capital gains incurred by UK companies disposing of qualifying shareholdings. The UK Government will consult on the extent to which the SSE is delivering on its policy objective of ensuring that tax does not act as a disincentive to commercial transactions or group restructurings and whether changes could be made to increase its simplicity, coherence and international competitiveness.

BDO INSIGHTS

The UK Government continues to move forward with its stated ambition of making the UK's corporation tax regime the most competitive in the G20. The UK's low corporate tax rate together with incentives for innovation are designed to encourage inbound investment, yet are balanced by rules designed to ensure that businesses in the UK pay the tax that is due in the UK.