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# AUTUMN STATEMENT 2016

23 November 2016

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- The Chancellor has delivered his first Autumn Statement and has largely confirmed the direction of travel of his predecessor. The Business Tax Road Map remains the approach to be taken, and it has been announced that the new rules on interest relief restrictions and loss reliefs will be introduced as planned next April.

- One key change, already trailed, is that there will be no Autumn Statement in the future. There will be an annual Budget in which detailed tax changes will be announced, and this will move to the Autumn to allow more time for the legislation to be scrutinised before it is enacted. This means that there will be two Budgets in 2017 – a final Spring Budget and the first Autumn Budget. In the future, there will also be a Spring Statement to respond to the Office for Budget Responsibility's (OBR) report, but this is not intended to include any fiscal announcements.

- The corporation tax rate reductions already announced have been confirmed, which means that the rate will reduce to 17 percent by 2020. Contrary to any expectations raised by the Prime Minister in recent speeches, there is neither an acceleration of this process nor any further rate reductions.

- The interest restrictions following Action 4 of the base erosion and profit shifting (BEPS) recommendations will apply from April next year. The changes to loss reliefs, including restrictions for the carry-forward of losses, will also apply from next April, although some detailed amendments are expected to the proposals.

- There will be a consultation on bringing corporate non-resident investors, in particular real estate investors, into the corporation tax net, largely to ensure they are also covered by the rules on interest restrictions and losses.

- On the employee side, salary sacrifice arrangements are targeted and will no longer be effective except in certain very limited circumstances. The tax benefits of Employee Shareholder Status are also being removed, as these are seen by the government as having been used largely for tax avoidance purposes.

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***Business Tax Road Map***

- The government has reaffirmed its commitment to implementing the policies set out in the Business Tax Road Map in March 2016 and in particular the reduction in the rate of corporation tax to 17 percent by 2020.

  *Given that the Business Tax Road Map was a policy device of his predecessor, the Chancellor may have been tempted to set out his own vision for the future of business taxation. He has chosen to leave things alone ostensibly to provide the certainty that businesses require when making long-term investment decisions.*

***Tax Deductibility of Corporate Interest Expense***

- The Chancellor reiterated the proposals to implement the recommendations from the Organisation for Economic Co-operation and Development (OECD) on BEPS Action 4 – restricting interest deductibility from 1 April 2017. The U.K. will implement a fixed ratio rule limiting U.K. corporation tax deductions for net interest expense to 30 percent of a group's U.K. EBITDA (earnings before interest, tax, depreciation and amortisation). If it gives a more favourable answer, groups will be able to use a group ratio rule to determine whether additional interest amounts are deductible in the U.K. This will be based on the net interest to EBITDA ratio of the worldwide group. The rules will not apply to groups with net U.K. interest expenses under £2 million. The government has concluded that banking and insurance companies will be subject to the rules in the same way as other groups of taxpayers, and following consultation, the government has confirmed it will widen the proposed provisions to protect investment in public benefit infrastructure.

  *The government has been at the forefront of the OECD's BEPS initiative. The previous Chancellor has implemented the proposals enthusiastically and at the earliest possible opportunity. For many groups, this will lead to significant rises in effective tax rates. The U.K.'s attractiveness as a location for foreign investment is already suffering as a result of Brexit, and given that these measures further damage our competitiveness, we would have preferred to see them deferred until the dust has settled. These provisions only apply to corporation tax payers, but non-resident companies currently subject to U.K. income tax could also be brought within the charge to corporation tax as a result of proposals announced today. This means, for example, non-resident corporate investors in U.K. real estate could be brought within these provisions at some point in the foreseeable future.*

### *Loss Relief*

- The government has confirmed that from 1 April 2017, only 50 percent of taxable profits can be offset by carried-forward losses with the restriction applying to profits in excess of £5 million. At the same time, there will be greater flexibility over the type of profits that can be relieved by losses incurred after 1 April 2017. Following consultation, the government has also stated it will simplify the administration of the new rules and will take steps to address unintended consequences of the rules. The existing rules for banks will continue to apply.

  *The decision to go ahead with limiting tax relief for historic losses is disappointing, particularly with the U.K. looking like an uncertain destination for investment following the Brexit vote. Businesses have long been able to claim tax relief without restriction for losses incurred in earlier years. Limiting the relief to 50 percent of profits for any particular year is unfair on businesses that would have expected to offset costs incurred during the investment stage of their business plans or in the more difficult years of recession. The policy could have a materially detrimental effect on business investment and the overall economy.*

### *Substantial Shareholding Exemption Reform*

- The government has announced that, following consultation, the Substantial Shareholdings Exemption (SSE) will be reformed to simplify the rules with effect from April 2017. This will take the form of a removal of the “investment” requirement (that the group as a whole is trading) and the provision of a more comprehensive exemption for companies owned by qualifying institutional investors.

  *This is good news for U.K. companies and will simplify the operation of the SSE. Compared to participation exemptions in different countries such as Luxembourg and the Netherlands, the SSE has been broadly criticised for being overly complicated, leading to a lack of certainty for companies making disposals. The removal of the investment requirement should ensure certainty of treatment in circumstances where it is unclear whether a group qualifies as trading.*

***Non-Resident Corporate Landlords to Pay Corporation Tax***

- The government has announced that it will consult on whether and how to bring all non-resident companies who receive U.K. taxable income into the corporation tax regime. This is mainly likely to affect non-resident companies that own U.K. real estate and that currently pay income tax under the Non-Resident Landlord scheme. The effect would be to bring such companies into all the corporation tax rules including the restrictions on interest relief and loss relief being introduced next year and the anti-hybrid regime.

  *The government earlier expressed its intention to include corporate non-resident landlords in the interest restrictions but has faced a number of technical difficulties in doing this as those rules are not designed to apply to income tax payers. Bringing such companies into the corporation tax regime is a logical response to this and will level the playing field between U.K. and non-U.K. investors. However, the consequences could be quite severe as such non-residents have typically used high debt levels, and hybrid financing structures, to fund their U.K. operations. On the upside, these changes are unlikely to happen before 2018 and when they do, investors will be able to take advantage of the corporation tax rates that will be lower than the basic rate of income tax.*

***Insurance Premium Tax (IPT)***

- The standard rate of IPT will rise from 10 percent to 12 percent with effect from 1 June 2017.

  *Of the revenue raising measures announced by the Chancellor today, this was the most significant in terms of the amount of additional tax that the government expects to collect – more than £4 billion over the next five years. Whilst the government claims it is a commercial decision for insurers, it seems inevitable that at least some of this tax hike will hit the pockets of consumers.*

***Bank Levy***

- In the context of the bank levy charge being restricted to U.K. balance sheet liabilities from 1 January 2021, the government has confirmed that there will be an exemption for certain U.K. liabilities that relate to the funding of non-U.K. operations.

  *The process of considering the balance between revenue raising and competitiveness is ongoing and is now of additional importance given the U.K.'s decision to leave the European Union.*

### *Disguised Remuneration*

- The government has announced its intention to tackle disguised remuneration schemes by extending the measures introduced in Budget 2016 (that targeted employers and contractors) to the self-employed. The measure will create a new charge to tax on historic loans drawn from disguised remuneration schemes that remain unpaid on 5 April 2019. The measure will also prevent tax relief for employers' payments into such schemes unless PAYE and NI is paid at the outset or within 12 months from the end of the accounting period in which a deduction is claimed.

  *As with all such anti-avoidance provisions, the legislation will be closely reviewed by those who have implemented such schemes. The government estimates that tax of approximately £630 million will be raised by this measure over a six-year period but acknowledges that the size of the tax base and the behavioral response of taxpayers are the main uncertainties in the forecast.*

### *Strengthening Tax Avoidance Sanctions and Deterrents*

- As anticipated and announced at Budget 2016, the government will introduce a new penalty for any person who has enabled another person or business to use a tax avoidance arrangement that is later defeated by Her Majesty's Revenue and Customs (HMRC). It will also remove the defence of having relied on non-independent advice as taking "reasonable care" when considering penalties for any person or business that uses such arrangements.

  *Draft legislation for this change will be published shortly. It will be important for the legislation to be crafted carefully such that ordinary tax advice on commercial transactions is kept outside of the new penalty regime.*

### *Tax Enquiries – Closure Rules*

- With effect from Royal Assent to Finance Bill 2017, HMRC and taxpayers will have the ability to conclude discrete aspects of a tax enquiry via a Partial Closure Notice. Currently a tax enquiry can only be concluded when all disputed matters have been resolved, and HMRC believes that this can create an unfair cash flow advantage to businesses that are under enquiry into tax avoidance activities or are large and complex cases.

  *Care will need to be taken with the legislation so that any increased power given to HMRC as part of the tax enquiry process is balanced by a measure designed to assist taxpayers who may be due a tax refund for certain aspects of an ongoing tax enquiry in which HMRC is dragging its feet.*

### *Employee Shareholder Status*

- The Chancellor announced today that the tax benefits of the Employee Shareholder Status (ESS) scheme will be removed for ESS agreements made on or after 1 December 2016. Income tax and capital gains tax reliefs will no longer be available in respect of ESS shares issued on or after that date. The legislation will also be amended to enable share buybacks to be taxed as distributions. Employees who received independent advice up to 1:30 p.m. on 23 November 2016 will still be able to access ESS benefits provided they are issued the shares before 1 December 2016. Tax benefits for ESS shares issued before 23 November 2016 remain unchanged.

  *This move reflects the government's concern that ESS was increasingly being used for tax planning rather than the primary purpose for which it was intended, which was to incentivise staff and boost performance in smaller businesses. Given its generous tax reliefs, ESS was often considered as an option for incentivising management in corporate acquisitions and leveraged buy outs in which the potential for significant gains being achieved tax free is high.*

### *Salary Sacrifice*

- The government has announced that the tax and employer NI advantages of salary sacrifice arrangements will be removed from April 2017, excluding those relating to pensions, childcare, Cycle to Work and ultra-low emission cars (those with $CO_2$ emissions of up to 75 grams per kilometer). Arrangements in place before April 2017 will be protected until April 2018 and arrangements for cars, accommodation and school fees will be protected until 2021.

  *Employers that have implemented such arrangements will no longer benefit from the associated tax savings. With the government anticipating an increased tax take of more than £1 billion over the next six years, we expect this change to trigger an increased focus on employee benefit packages in the coming months.*

### *National Insurance Employer Rate*

- The National Insurance secondary (employer) threshold will be aligned with the employee primary threshold from April 2017. This will mean that both employees and employers will start paying National Insurance on weekly earnings above £157.

  *Although presented as a simplification measure that arose from a recommendation made by the Office of Tax Simplification, this will result in increased NI costs overall.*

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