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SPRING BUDGET 2017

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“Spreadsheet Phil” keeps powder dry ahead of future Brexit challenges

- As expected, the Chancellor lived up to his reputation as a cautious operator and made very few significant tax announcements in his final Spring Budget. Both the medium-term economic policy and the direction of travel of the tax regime were confirmed, and the government will proceed with the gradual reduction of corporation tax rates and the introduction of interest and loss relief restrictions.

- The most notable announcements were also widely trailed. The Chancellor has sought to bring the self-employed and those using personal service companies into greater alignment with employees by increasing the main rate of Class 4 National Insurance Contributions by 2% over the next two years, and by reducing the new tax-free dividend allowance from £5,000 to £2,000. Further attention to this area can be expected following the Taylor Review of Modern Employment Practices, which is due to report in the summer.

- Similarly, he has reacted to concerns about the latest business rates revaluation by introducing a series of targeted and transitional reliefs for pubs and small businesses, while announcing a longer-term review of the rating revaluation rules. Many would argue that the system needs a more fundamental review than this and that it should be replaced rather than reviewed. The Chancellor perhaps hinted at this when he also said that ways must be found for digital businesses to pay their fair share.

- Apart from that, there was the usual crop of small anti-avoidance provisions to address particular issues, and some welcome amendments to the corporate interest restriction rules to alleviate particular concerns, but no other announcements of note. It may well be that the Chancellor is deferring any more significant changes until the first of his Autumn Budgets later this year.

Head of Tax A&M Taxand UK LLP

Rates

- The government confirmed the original timetable for the reduction of the corporation tax rate, which will be cut to 19% on 1 April 2017 and 17% in April 2020.

The U.K.'s corporate tax rate is the lowest in the G20. The ability to introduce further rate reductions and other incentives for large businesses unfettered by the rules attached to EU membership is likely to be a useful card at the Brexit negotiating table.

Interest Expense

- The government confirmed that the restrictions on the tax deductibility of corporate interest expense will apply on 1 April 2017 as expected. Where net U.K. interest expense exceeds £2 million, the new rules will restrict each group's deductions to 30% of earnings before interest, tax, depreciation and amortisation (EBITDA). An optional group ratio rule based on the external interest cover of the worldwide group may permit a greater amount to be deducted in some cases. The legislation will also replace the existing worldwide debt cap with a modified version. The final draft legislation was only published on 26 January and the government today announced that there will be a number of amendments arising from representations made during the consultation process. The amendments are to cover the following areas:

  - Changes to the application of the modified debt cap to address an issue that can prevent deductions for carried forward interest expense;
  - A relaxation of the rules relating to the public benefit infrastructure exemption and the introduction of transitional rules in the first year to give groups the opportunity to restructure;
  - Changes to the treatment of interest in respect of debt that is the subject of a related-party guarantee;
  - Extension of the definition of interest to include income and expenses from dealing in financial instruments as part of a banking trade; and
  - Specific rules for insurers regarding the calculation of interest.

Whilst all of these measures are welcome, the rash of late changes less than a month before the rules take effect is indicative of a rushed and ill thought out process. The Chancellor has wasted a golden opportunity to have deferred the introduction by 12 months, which would have enabled more robust legislation to have been drafted and given companies time to arrange their affairs.

Hybrids

- Following its previous announcement in the Autumn Statement 2016, the government has confirmed it will legislate to make two amendments to the anti-hybrid rules backdated to when the legislation was introduced on 1 January 2017. Specifically, deductions for amortisation will not be treated as relevant deductions for the purposes of Chapters 5 to 8 of the anti-hybrid rules and there will no longer be a need to make a formal claim in relation to the extended permitted time period in Chapters 3 and 4.

  The government does not want to discourage companies from bringing intellectual property (IP) into the U.K., and the change to exclude amortisation from falling under these provisions addresses this. The second change is an administrative change as Her Majesty's Revenue and Customs (HMRC) has acknowledged that it would otherwise have to manage a very large number of claims if the rules were left as they are. Now it will be up to the taxpayer to self-assess whether the extended time period applies in relation to when income is brought into account for mismatches arising from financial instruments or similar arrangements.

Corporate Loss Relief Reform

- The government has confirmed that the legislation to introduce the new corporate loss regime will be implemented unchanged apart from the inclusion of provisions for oil and gas companies and oil contractors. Broadly, the regime increases flexibility in the ways that groups can use their losses that arise on or after 1 April 2017 but also restricts the offset of any losses carried forward to 50% of profits, subject to a £5 million allowance.

  Given the short time frame over which the new loss regime has been introduced, it will be welcomed by large companies with losses carried forward that there are no further major changes to the regime at this stage.

Withholding Tax on Interest

- There were two announcements concerning the deduction of income tax at source from payments of interest:

  – The first concerns the extension of the Double Taxation Treaty Passport Scheme to assist foreign lenders and U.K. borrowers. This scheme simplifies access to reduced withholding tax rates on interest that are available within the U.K.'s tax treaties with other territories, and is currently only available to corporate lenders and U.K. corporate borrowers. On 6 April 2017, the scope of the scheme will be extended to include all types of overseas lenders and U.K. borrowers.
  – The second measure introduces an exemption from withholding tax for interest on debt traded on a multilateral trading facility, removing a barrier to the development of U.K. debt markets. The government will consult in spring 2017 on implementation of the exemption.

These measures are welcome and are designed to encourage investment in the U.K. and make it easier for businesses to raise finance.

Elections in Relation to Assets Appropriated to Trading Stock

- The government has introduced amendments to the capital gains legislation that allows taxpayers to elect to rollover a gain or loss when an asset is appropriated to trading stock. For appropriations made on or after 8 March 2017, it will no longer be possible to make an election to rollover a loss into the base cost of the stock. An election in these circumstances has the effect of increasing the base cost of the stock and therefore effectively increasing trading losses crystalised by the taxpayer on a subsequent disposal of the asset. As it is no longer possible to make an election in these circumstances, the impact will be that a taxpayer in this situation will crystalise capital losses on the appropriation rather than trading losses on the disposal. As capital losses are generally less useful in terms of offset, this is a revenue raising measure. The government estimates that the revenue raised will be approximately £15 million per year.

The practical impact of this change is that taxpayers that do not know whether or not their assets are being carried at a gain or a loss will no longer be able to simply make the election and wait until the disposal of the asset to work out their tax position. It may well force real estate groups in particular to perform additional valuation exercises over assets at the point of appropriation. This loss of flexibility seems to outweigh the relatively low level of additional revenues anticipated by the government.

Offshore Property Developers

- The government is amending the rules for offshore property developers introduced in July last year to cover contracts entered into before 5 July 2016 for which the profits are recognised in the accounts on or after 8 March 2017 (Budget Day).

  This is to ensure that long-term, pre-July development contracts for which profits may not arise for months or years are still caught by the new rules.

Making Tax Digital

- The start date for mandatory digital record keeping for unincorporated businesses and landlords with gross turnover below the value added tax (VAT) registration threshold (currently £83,000) has been deferred by one year until April 2019.

  This is a welcome deferral to allow smaller businesses and landlords further time to prepare for digital reporting.

Business Rates

- The government has introduced three specific reliefs for some of those adversely affected by the recent business rates revaluation:

  - Any business coming out of small business rate relief as a result of an increased valuation will have the increase capped at £50 per month for a year, with some further relief possible thereafter;
  - Pubs with a rateable value under £100,000 will get a discount of £1,000 on their rates for 2017; and,
  - There will be a £300 million fund for local authorities to give some discretionary rate relief.

  The government also announced a wider review of the revaluation system to ensure it is more frequent and smoother in future.

  The immediate reliefs are no doubt welcome but relatively limited in scope. The review of the system is also welcome as issues have been exacerbated by the two year delay in undertaking the most recent revaluation. However, many would argue that the whole rating system is fundamentally flawed with its emphasis on bricks and mortar businesses and disincentivisation to upgrade premises. It is notable that the Chancellor also identified the need ultimately to find a better way to tax the digital part of the economy.

Stamp Duty Land Tax (SDLT)

- The reduction in the SDLT filing and payment window from 30 days to 14 days, due to be introduced on 1 April 2017, has been delayed by one year until after April 2018.

  This change is expected to defer £100 million of SDLT receipts. The reduction in the filing and payment window will cause practical difficulties for taxpayers entering into certain complex real estate transactions when it is introduced in April 2018.

Roaming Charges

- The government has announced it intends to remove the VAT use and enjoyment provisions relating to business to consumer mobile phone services. Currently U.K. VAT is charged on the supply to U.K. residents when in the EU but not when outside the EU. U.K. VAT will now be charged on supplies made outside the EU.

  This brings the treatment of roaming charges on mobile phone use in line with the internationally agreed upon approach and also ensures the consistent treatment of consumers within and outside the EU.

Self-Employed

- The government has announced that the main rate of Class 4 National Insurance Contributions will increase from 9% to 10% as of 6 April 2018 and will increase further to 11% as of 6 April 2019. In addition, the dividend allowance, which was introduced last year at £5,000, will decrease to £2,000 on April 2018.

  This much telegraphed raid on the self-employed and those working through personal service companies is set to raise the government approximately £4.7 billion over the next five years.

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