THE BUDGET STATEMENT

WHAT YOU NEED TO KNOW

CORPORATE TAX RATE

2017 – 19% | **2020** – 17%

SUMMARY

Anyone looking forward to the quiet budget for business that was trailed will not be disappointed. There were few surprises and little new detail. But some important themes remain. The Chancellor re-emphasised the desire to have the most competitive tax system of major economies. Interestingly he considered it enough to re-pledge previously announced reductions. Whether Trump reforms force a reassessment in the autumn remains to be seen.

A focus on a simpler R&D system will make this welcome relief more attractive but those expecting the Chancellor to have taken steps to attract the digital economy may be disappointed that there was no extension of the UK's innovation regime to include software copyright in the way that key rival regimes do.

The expected focus on tax gap resulted in a few measures at the margin targeted at 'avoidance'; perhaps the bigger headline was the way in which the difference in treatment between employed, self-employed and shareholders/directors was portrayed as a tax gap of £9.5bn. There is a careful balance to be struck between raising revenue and encouraging the wealth generation from entrepreneurship.

Overall, it was a measured and arguably confident budget that attempted to balance the needs of competitiveness and fairness.

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CORPORATION TAX

> These changes are a welcome development to ensure that the UK remains an attractive holding company location.

Substantial shareholding exemption: the Government has confirmed, as previously announced in the Autumn Statement 2016, that it will introduce various reforms to simplify the Substantial Shareholding Exemption (the UK's participation exemption system applicable to disposals of trading companies by corporate shareholders). The reforms will make the exemption more widely available to a broader range of investors such as private equity and sovereign wealth funds. These changes will have effect from 1 April 2017 and are a welcome development to ensure that the UK remains an attractive holding company location.

Corporation tax loss reform: as originally announced in the 2016 Budget, reforms are being introduced to the corporation tax loss relief rules with effect from 1 April 2017. There are, broadly, two main changes: (i) giving companies more flexibility to use losses carried forward which arise on or after 1 April 2017 against different types of income and profits from other companies in the same corporate group, compared to the current rules where utilisation of brought forward losses is rather restricted; (ii) restricting the use of carried forward losses so that a company (or group, where there is more than one UK company) cannot shelter more than 50% of current year profits through the use of carried forward losses, subject to a de minimis of £5 million of taxable profits in an accounting period. The announcement also notes that previously published draft legislation will be revised to include provision for oil and gas companies and oil contractors.

Anti-hybrid rules: the Government is at the forefront of tackling "aggressive tax planning" by multinationals through being one of the first adopters of domestic legislation in response to the BEPS Action 2 recommendations ("Neutralising the Effects of Hybrid Mismatch Arrangements"). The UK's domestic legislation in this regard took effect from 1 January 2017. The Spring Budget 2017 announcement states that two minor changes will be made to this regime in Finance Bill 2017. These changes, in response to representations received, will remove the need to make a formal claim in relation to the permitted time period rules in Chapters 3 and 4 of the anti-hybrid legislation (which is contained in Part 6A of TIOPA 2010) and also provide that amortisation deductions are not to be treated as relevant deductions for the purposes of chapters 5 to 8 of the rules.

Appropriations to trading stock: to counteract tax planning which the Government sees as resulting in some businesses obtaining an "unfair tax advantage", rules are introduced with immediate effect from 8 March 2017 to prevent companies with loss-making capital assets being able to undertake certain transactions to convert those losses into more flexible trading losses.

Non-resident companies: there will be a consultation on the case and options for bringing non-UK resident companies, who are currently chargeable to income tax and capital gains tax on their UK taxable income and gains, within the scope of corporation tax. This was first mentioned in the Autumn Statement and would mean that those companies would be subject to the rules which apply generally for the purposes of corporation tax, including the limitation on corporate interest expense and loss relief rules. Such a move would particularly affect companies owning UK real estate.

Oil and gas sector: in order to maximise returns from so-called "late-life assets" in the oil and gas sector, a review of North Sea tax rules will be launched to make it easier to buy and sell oil and gas fields, with input from a panel of experts.

Innovation: for the UK patent box regime, rules will come into effect on 1 April 2017, as announced in the Autumn Statement, meaning that entering into cost-sharing agreements will not affect the amount of income qualifying for the reduced rate, subject to sharing expenses proportionately.

FINANCE

> Further changes to the new regime limiting tax deductions for corporate interest expenses have been announced.

Deductibility of corporate interest expense: Further changes to the new regime limiting tax deductions for corporate interest expenses have been announced at Spring Budget 2017. The new regime, which takes effect from 1 April 2017, will restrict a group's net interest deductions to 30% of taxable EBITDA in the UK, with the option to apply a group ratio rule based on worldwide group net interest/EBITDA if that produces a more favourable outcome. These rules only apply to net interest expense (as measured on a group basis) in excess of £2 million. The further changes announced are intended to ensure that the rules do not give rise to unintended consequences or impose unnecessary compliance burdens, and include (i) the removal of certain restrictions from the modified debt cap that could prevent deductions for carried forward interest expenses from being available, and (ii) carving out certain performance guarantees and all guarantees granted before 31 March 2017, and all intra-group guarantees in the context of the group ratio rule, from being treated as interest arising from related party debt which is subject to restriction.

Banks and insurance companies: these have received considerable attention in Budgets and Autumn Statements in recent years. On this occasion it is more a case of "no news is good news". The only development in the Budget related to banks is found in the implementation of the corporate interest restriction rules. It was established in the Autumn Statement, as well as the subsequent draft legislation, that the rules will apply to banks and insurance companies in the same way as they apply to companies in other industries. The Budget notes that the definition of interest will include income and expenses from dealing in financial instruments as part of a banking trade. The Budget also announced a special method that may be used by insurance companies to calculate interest for the purposes of applying the corporate interest restriction rules. The method (details to follow) will allow the use of an amortised cost basis as an alternative to fair value accounting.

VAT

Focus on the digital sector

- VAT will be charged on mobile non-EU roaming. This comes at a difficult time for the telecoms sector that has been dealing with various regulatory changes designed to reduce roaming charges, and the new measure will increase costs for them. Telecoms providers have limited time to react to this change as a statutory instrument to implement it will be published before 20 July 2017.
- The UK has followed the example of other countries in exploring the "split payment" method of collecting VAT on online transactions. That means that online market-places would "split" the payment received from the customer, transfer the VAT directly to HMRC and send the balance (net of VAT) to the supplier. The Government will issue a call for evidence on 20 March 2017 and businesses will want to make sure that their voice is heard by the Government as there will be potential challenges, particularly for small and medium-sized traders who sell via online market-places.
- The proposed new law on the "Fulfilment House Due Diligence Scheme" has been confirmed and will be introduced by the Finance Bill 2017. This will require online market-places/fulfilment houses to register with HMRC from 1 April 2018 and comply with record-keeping and due diligence standards. Following the consultation, there is a welcome tweak to the proposed law, where HMRC will share information with the fulfilment houses to help them meet their obligations under the scheme.

> "The new measure will increase costs for telecoms providers."

PERSONAL TAX

Changes to incentives for self-employment or quasi-employment a sign of things to come?

The Chancellor has proposed a couple of changes which are intended to attack what it considers to be incentives for individuals to enter into self-employment or personal service company arrangements as a means of reducing their tax bill.

- Class IV National Insurance Contributions for the self-employed will increase by 1% to 10% for profits (between, currently, £8,060 and £43k per year) in April 2018, and by a further 1% to 11% in 2019. This doesn't appear to affect the 2% rate that applies to profits over, currently, £43k.
- The tax-free dividend allowance is reduced from £5k to £2k from April 2018, in part to reduce the tax incentive for individuals to incorporate personal services companies rather than being engaged as employees.

> "Is this a precursor to further attacks on the so-called "gig" economy?"

The Government has been clear for some time that it considers too many individuals are engaging in inappropriate self-employment or quasi-employment arrangements as a means of avoiding tax and NICs. These steps will marginally reduce some of those incentives for certain individuals, but there remain significant National Insurance and employment incentives for those engaging such workers in the private sector to continue to do so in this way.

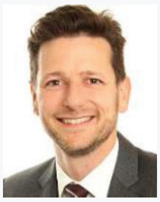
However, the Chancellor's statement that these changes are in part driven by initial conclusions of the Taylor review on modern employment practices is interesting. Is this a precursor to further attacks on the so-called "gig" economy when the conclusions of that review are published later this year?

A word on pensions

It's good that some of the potentially more drastic changes to restrict pensions tax relief for high earners didn't come through, as the constant Government tinkering with pensions means individuals lose faith in the system. Not making changes at this time seems sensible, as the annual allowance taper introduced last year already addresses the issue about pensions tax relief for very high earners.

One new 'under the radar' tax change is a 25% tax charge on certain transfers to overseas pension schemes, which is expected to raise £65 million next year. The tax charge doesn't apply if the pension is being transferred to a country where the individual is resident, so it's clearly intended to catch scams rather than a genuine reason to transfer overseas. Pension schemes already have to do a lot of due diligence at present before transferring a pension overseas, so they won't welcome the extra burden of having to do even more checks to see if the individual is resident in the overseas country.

YOUR BAKER MCKENZIE CONTACTS



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CORPORATION TAX

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FINANCE

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PERSONAL TAX

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