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Global Tax Alert

UK issues 2020 Budget

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Executive summary

On 11 March 2020, the new Conservative United Kingdom (UK) Government presented its first Budget, introducing measures to address the immediate but hopefully temporary issues caused by the COVID-19 outbreak as well as measures to deliver on manifesto commitments for the longer-term. The UK Chancellor, Rishi Sunak, sought to give some good news to all, whether through freezing duties on all alcohol, freezing duty on fuel or delivering on promises on research and development (R&D) tax credits and capital allowances. Of the possible tax increases that were considered before the Budget, only the cut in the entrepreneurs' relief lifetime limit to £1m was delivered. The greatest tax increase, the cancellation of the 2% point cut in corporation tax to 17%, was announced last year.

The Budget also introduces new measures, such as an amendment to the corporate intangible fixed asset regime. However, many measures covered were either included in the draft Finance Bill clauses published in July 2019 or had been announced separately. There was confirmation of the digital services tax but no deferral of the commencement date as some respondents to EY's Budget survey had called for.

Certain questions have been deferred, including the wider reform of business rates and funding of social care. There was no focus on tax incentives to address Brexit as respondents to the survey had called for (though there is confirmation

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of postponed import value-added tax (VAT) accounting from 1 January 2021 and there will be another Budget before the transition period ends). There is the promise of consultations to come, including those on disclosure by large businesses of uncertain tax positions to HM Revenue & Customs (HMRC), whether expenditure on data and cloud computing should qualify for R&D tax credits and the detailed implementation of the plastic packaging tax.

Detailed discussion

Corporation tax rates

The Chancellor confirmed that the rate of corporation tax will remain at 19% from 1 April 2020. This measure (cancelling the enacted cut to 17%) will be made under a Budget resolution which has statutory effect under the provisions of the *Provisional Collection of Taxes Act 1968*. As such, it is substantively enacted for UK GAAP[1] and IFRS[2] on the passing of the resolution, though it will not be enacted for US GAAP purposes until Royal Assent.

Digital Services Tax (DST)

The Budget confirmed that the DST will be implemented as a 2% tax on the revenues earned from 1 April 2020 that a group derives from providing a social media platform, search engine or an online marketplace to UK users, if the group exceeds designated thresholds. An exemption for financial and payment services from the definition of an online marketplace will also be included. A group's first £25m of revenues derived from UK users will not be subject to DST.

We will need to see the Finance Bill to determine if there are any changes to the detailed legislation from the draft clauses published on 11 July 2019. In those draft clauses, a UK user is a user that is normally located in the UK and there are rules to determine when, and by how much, revenues are derived from UK users. In respect of online marketplaces there is a provision to reduce the revenues charged when the other user in respect of the transaction is normally located in a country that operates a similar tax to the DST. The draft clauses provided an option for loss-making businesses, and those with very low profits, to use an alternative "safe harbor" election.

The total DST liability will be calculated at the group level but the tax will be charged on the individual entities in the group that realize the revenues that contribute to this total. The group consists of all entities which are included in the group consolidated accounts, provided these are prepared under an acceptable accounting standard. Revenues will consequently be counted towards the thresholds even if they are recognized in entities without a UK taxable presence for corporation tax purposes. A single entity in the group will be responsible for reporting the DST to HMRC.

DST will be payable annually, nine months after year-end. This means that the first payments (for a group with an April year-end with one month within the rules) will be due in January 2021, at which point progress will hopefully have been made on a globally agreed solution concerning changes to the international tax framework, under the auspices of the OECD.[3] The Government has reiterated that the UK will no longer need its own DST if a global solution is reached.

Corporate capital loss restriction

The Government confirmed that it will go ahead with introducing the new corporate capital loss restriction that was first announced at Budget 2018, and which will restrict the use of carried-forward capital losses to 50% of the amount of annual capital gains. This will have effect from 1 April 2020.

The legislation to be included in the Finance Bill will maintain the fundamental design features that were included in the draft legislation published in 2019, including the amount of annual deductions allowance (£5m), and the particular provisions governing the interaction with the life assurance "BLAGAB" rules as well as the oil and gas ring-fence and the REIT (real estate investment trust) property rental business ring-fence.

The July draft of the legislation will be amended such that companies which are insolvent and are being liquidated will be able to offset carried-forward capital losses against chargeable gains without restriction during the period of official liquidation.

Consultation on hybrid mismatch arrangements

We understand that a consultation on the corporation tax rules that apply to hybrid mismatch arrangements will be published on 19 March, alongside the Finance Bill.

It is expected that the consultation will consider in particular the "double deduction" rules, the "acting together" definition and whether it is appropriate in all cases for hybrid counteractions to arise in respect of tax-exempt entities holding interests in hybrid payees which they see as opaque, but which the UK sees as transparent.

Intangible fixed assets

Legislation will be introduced in Finance Bill 2020 to amend the corporate intangible fixed assets (IFA) tax regime. The default rule will now be that all acquisitions on or after 1 July 2020 will prima facie be within Part 8 *Corporation Tax Act* (CTA) 2009.

The general rule in Chapter 16 of Part 8 CTA 2009 that prevents "pre-FA 2002 assets" acquired from related parties coming within Part 8 CTA 2009 will be amended. For intangible assets which are not within the charge to corporation tax prior to acquisition, there will be no need to consider either when the intangible asset was created or whether an intangible asset acquired from a related party was a pre-*Finance Act* (FA) 2002 asset in the related party's hands.

However, it seems that this will be subject to a carve out in respect of acquisitions of an IFA that is already within the charge to UK corporation tax – in that case the existing pre- and post-April 2002 rules will be preserved. The wording of the policy paper published alongside the Budget is not clear and the legislation is expected to clarify precisely how this change will work.

The measure follows on from the consultation to review the IFA regime which ran between February and May 2018.

Transitional rules will be introduced and may apply from 11 March 2020 in some cases. Rules will be introduced to prevent avoidance between related parties where a pre-FA 2002 asset is acquired from a related party on or after 1 July 2020 (including a license in respect of a pre-FA 2002 asset). There will also be rules to address related-party acquisitions of assets from a person who is not a company in relation to assets created April 2002.

Research and development tax changes

As promised in the Conservative election manifesto, the Government will increase the rate of R&D expenditure credit (RDEC) from 12% to 13% from 1 April 2020 and will consult on whether qualifying R&D tax credit costs should include investments in data and cloud computing.

The new RDEC rate will increase the net RDEC benefit from the current 9.7% to 10.5% from 1 April 2020. This is the highest benefit rate for large companies since the introduction of the R&D large company regime and is designed to encourage more investment in UK innovation.

The consultation on the potential inclusion of data and cloud computing as qualifying R&D tax credit costs will also be welcomed by businesses. These costs for many businesses are substantial and keeping the rules of the R&D regime current to reflect how businesses operate is vital to the success of the credit.

Following the consultation last year on the introduction of the Pay As You Earn (PAYE) cap on the payable tax credit for the Small and Medium Enterprise (SME) R&D scheme, this has now been delayed, and further consultation will be undertaken on the cap's design.

Large business notification of uncertain tax positions

The Government will launch a consultation on a new requirement effective from April 2021 for large businesses to notify HMRC when they take a tax position which HMRC is likely to challenge (uncertain tax positions). This policy will draw on the principles outlined in international accounting standards (IFRIC 23). Similar notification requirements are already in place in other jurisdictions, including the United States, Australia and Israel. It is possible that the Government may consider using those regimes as a template for the notification procedure.

Capital Allowances

- **Structures and buildings allowances (SBA)**: The Autumn Budget 2018 introduced a new regime providing tax relief for non-residential structures and buildings for building contracts entered into on or after 29 October 2018. It was confirmed that, as had been promised in the Conservative's election manifesto, from April 2020 the rate of relief will increase from 2% to 3%, on a straight-line basis, providing an acceleration in the tax relief received for such expenditure. The relief obtained through SBA will continue to be clawed back through the chargeable gains calculation upon disposal of the asset. Further technical clarifications and adjustments to the SBA legislation will take effect from 11 March 2020 and will be contained in Finance Bill 2020.

  Businesses will welcome the increase in the SBA rate to encourage investment. However, consideration should first be given to ensure that other forms of capital allowances are optimized, as these continue to provide tax relief faster than SBAs.

- **Business cars**: The Budget extends the availability of first year allowances for business vehicles with zero emissions (0g/km) until 31 March 2025. This enhanced relief was initially due to end on 31 March 2021. Thresholds on the rate of relief provided through the capital allowances regime on business vehicles will also change from 1 April 2021. From this date, cars with CO_2 emissions of up to 50g/km will qualify for the main rate plant and machinery pool (18% Writing down allowance), with cars with emissions larger than 50g/km qualifying for the special rate pool (6% Writing Down Allowance).

Bank surcharge changes for transferred-in losses

The current corporate tax surcharge rules for banking groups and building societies (which apply an 8% surcharge on profits) disregard the effect of elections to transfer allowable losses from a non-banking company to a bank where they are used to reduce future chargeable gains. The new measure announced in the Budget extends this disregard to transfers of allowable losses used to reduce in-year chargeable gains. The new measure applies to losses that are deducted from chargeable gains accruing on disposals made on or after 11 March 2020.

Consultation on use of intermediate holding companies in alternative fund structures

The Government has published a consultation into the use of UK intermediate entities within alternative fund structures – referred to as asset holding companies (AHCs). The consultation will seek to understand why AHCs are used in fund structures, why certain jurisdictions are selected more than others, and whether there are any specific barriers in the UK corporation tax system to UK AHCs being used more frequently.

This is particularly relevant given the increased international tax focus on principal purpose and substance, as many asset management firms have extensive operations within the UK but may have historically chosen to establish their funds or AHCs outside the UK.

The consultation specifically discusses factors relevant to the credit funds, real estate funds and private equity funds. For real estate funds, the Government has specifically identified possible extension of the substantial shareholding exemption regime and relaxation of the UK REIT regime as being under consideration. The former may provide a UK regime that is closer to European participation regimes on disposals and the latter would provide an alternative quasi-tax transparent structure attractive to exempt investors.

The consultation runs from 11 March until 19 May 2020. This consultation is part of the opening steps of a Government review of the UK funds regime. This review will consider taxation and relevant areas of regulation to ensure the ongoing competitiveness and sustainability of the UK regime as it applies to a fundamental area of the financial services sector.

The tax impact of the withdrawal of the London Interbank Offered Rate (LIBOR)

The Government will consult to ensure that where UK tax legislation references LIBOR it continues to operate effectively. The consultation will also enable the Government to ensure it is aware of all of the significant tax issues that arise from the reform of LIBOR and other benchmark rates.

Coronavirus-related measures: time to pay

The Government's package of measure to support individuals and businesses affected by the COVID-19 outbreak included confirmation that all businesses and self-employed people in financial distress, and with outstanding tax liabilities, may be eligible to receive support with their tax affairs through HMRC's "time to pay" service. These arrangements are agreed on a case-by-case basis and are tailored to individual circumstances and liabilities. There is now a dedicated HMRC COVID-19 helpline for advice and support.

Business rates

The Government has announced a number of business rate measures to assist businesses experiencing disruption to their cashflow as a result of the COVID-19 outbreak. The main focus of these been on SMEs in the retail, leisure and hospitality sectors occupying smaller property and include:

- **Business rates reliefs**: The Government had already announced that, for one year from 1 April 2020, the business rates retail discount for properties with a rateable value below £51,000 in England would be expanded to include cinemas and music venues. This discount will now be increased to 100% and expanded to include hospitality and leisure businesses for 2021. In addition, from 1 April 2020, a further discount will be applied to pubs in England, increasing the previously introduced £1,000 business rates discount to £5,000 for one year for those with a rateable value below £100,000 in England from 1 April 2020. There will also be some additional reliefs granted to local newspaper offices and public lavatories.

- **Small business grant funding**: For those businesses already benefitting from small business rate relief and rural rates relief, the Government will provide a cash grant of £3,000 to help meet their ongoing business costs.

The Government has confirmed that local authorities will be fully compensated for the loss of income as a result of these business- rates measures.

- **Business rates review**: The Government has confirmed that it will launch a fundamental review of business rates to report in autumn 2020. This review will have the objective of reducing the overall burden on businesses; improving the current business rates system; and considering more fundamental changes in the medium-to-long term. A call for evidence will be published in the spring.

The Government will also invest an additional £11.5mn in the Valuation Office Agency (VOA) in 2020-21 to support the modernization of VOA systems and processes, to increase efficiency and improve customer service in the future.

The measures announced will provide significant benefit to SMEs but will have little to no application to companies occupying larger properties such as those high street retailers who have been lobbying for a reduction in business rates. The fundamental review into the system is a welcome one, however the application of the findings and the timescale for implementation will not provide any assistance to those larger businesses struggling with the current level of the tax. Any benefit from the review is unlikely to be seen until April 2021 at the earliest.

Corporation tax on nonresident property companies

The Government has confirmed it will introduce technical changes to ensure that the legislation which brings non-UK resident companies that carry on a UK property business or have other UK property income within the scope of Corporation Tax from 6 April 2020, work as intended.

Amendments will make provision so that when non-UK resident company landlords move into corporation tax from income tax they are entitled to the same reliefs for pre-trading financing costs and are subject to the same time limits for making elections as UK resident companies are.

HMRC to increase staffing of tax compliance operations

An increase of around 1,300 HMRC staff in operational compliance teams has been announced, which is estimated to raise an average of £774mn annual compliance yield over the next five years by tackling "emerging tax risks" and by improving collection of overdue tax debt.

It is not clear whether the additional HMRC operational staff will come from redeployment within HMRC or represent additional headcount. If these are additional hires, they will represent an increase in HMRC staffing of some 2% and take overall HMRC full-time equivalent payroll staff numbers back to December 2017 staffing levels of approximately 60,000. The projected additional compliance yield would represent a similar increase of some 2% on the total yield HMRC has reported from its compliance activities for 2018-19 of £34.1bn.

Although no detail has been given of the areas to be covered by the additional compliance teams, HMRC has been clear that it sees international profit diversion as a continuing priority, and some further increase in HMRC's Transfer Pricing, Diverted Profits Tax, and Profit Diversion Compliance Facility teams can therefore be expected to form part of this measure.

Economic crime levy

As rumored before the Budget, the Government has confirmed that it intends to introduce a levy to be paid by firms subject to the Money Laundering Regulations, a so-called economic crime levy, to fund actions to tackle money laundering and reforms committed to in the Government's Economic Crime Plan. A consultation will be published later this Spring.

Tax conditionality

The Government will publish a discussion document seeking views on the wider application of tax conditionality in the spring. Tax conditionality refers to a principle whereby businesses are granted access to Government awards and authorizations (such as approvals, licenses, grants) only if they are able to demonstrate good tax compliance.

What happens next?

The Budget debate is scheduled to conclude on 17 March with the Finance Bill 2019-21 (as it is officially called) due to be published on 19 March 2020.

It is expected that the Finance Bill will receive Royal Assent over the summer of 2020.

This will be followed by an Autumn Budget, presumably returning to the timetable of one fiscal event a year, in October or November. It is possible that there will be draft legislation this year for the next Finance Bill (which HMRC refers to as Finance Bill 2020-21) but the timing is unclear.

Endnotes

1. GAAP – Generally Accepted Accounting Principles.
2. IFRS – International Financial Reporting Standards.
3. Organisation for Economic Co-operation and Development.

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