

FB 2021-22 - Miscellaneous CT changes

Lecture B1292 - 19.07 minutes

Bank surcharge

Clause 6 alters the rate of banking surcharge and the surcharge allowance.

For accounting periods beginning on or after 1 April 2023, the bank surcharge rate will be reduced to 3% (from 8%) and the surcharge allowance will be increased to £100 million (from £25 million).

Where a company's accounting period straddles 1 April 2023 the period will be split on a time apportionment basis for the purposes of the allowance and the reduced rate, with each period being treated as a separate accounting period.

A review of the surcharge was announced at Spring Budget 2021. When this rate change is taken alongside the increase in the headline rate of corporation tax from 19% to 25% from April 2023, banks will be taxed at a combined rate of 28% on their profit.

Annual investment allowance

Clause 12 extends the 100% Annual Investment Allowance (AIA) available for qualifying expenditure on P&M up to £1 million until 31 March 2023, rather than being reduced to its former level of £200,000 after 31 December 2021 as previously announced (which had already been extended from 31 December 2020).

The limit will be subject to transitional rules where accounting periods straddle 31 March 2023. These transitional provisions are the same as have applied when the rate of AIA has changed previously.

Example

A company has a year end 30 June 2023.

The total maximum AIA for the period will be $(£1,000,000 \times 274/365) + (£200,000 \times 91/365)$, i.e. $£750,685 + £49,863 = £800,548$.

For expenditure between 1 July 2022 and 31 March 2023, the actual maximum expenditure that can qualify for AIA is the £800,548.

But the maximum expenditure that can qualify between 1 April 2023 and 30 June 2023 is only $(£200,000 \times 91/365)$ £49,863.

If the company incurs special rate expenditure of £750,000 on 31 March 2023 it will qualify for 100% AIA, saving (at 20.5% if its profits exceed the upper limit of £250,000 p.a. after 31 March 2023), i.e. £153,750 in corporation tax for the period. The company would likely prefer this to claiming a 50% SR allowance to which it would be entitled if there are no other assets against which the AIA would be better used.

If the expenditure is incurred on 2 April 2023, the business would only be able to claim an AIA of £49,863 AIA plus a writing down allowance on the balance of $6\% \times (£750,000 - £49,863)$ in first-year allowances, i.e. £91,871, which would only save £18,834 in corporation tax.

Getting the timing wrong would cost the company extra tax for its year ended 30 June 2023 of $(153,750 - 18,834) £134,916$.

For unincorporated businesses, with no SR allowance or super-deduction, the difference in timing would be far more punitive. If the asset was bought by (say) an LLP on 2 April 2023, it would receive

£49,863 AIA plus 6% WDA on the balance of $(750,000 - 49,863)$ i.e. £91,871 allowance, instead of £750,000 if incurred before 1 April 2023.

Structures and buildings allowances

S270IA CAA 2001 requires the current owner to obtain an 'allowance statement' from the vendor to be eligible to claim structures and buildings allowances (SBA) on the asset they have acquired.

Currently this allowance statement needs to identify the building or structure to which it relates and:

- a) The date of the earliest contract for the construction of the building or structure
- b) The amount of qualifying expenditure incurred on its construction or purchase, and
- c) The date on which the building or structure is first brought into non-residential use.

Where the subsequent (current) owner is entitled to claim SBA it is on the same qualifying expenditure as the person who incurred the original qualifying expenditure and allowances stop after 33 years and 4 months (the allowance is 3% per annum, straight-line).

In order for the current owner to know when to stop claiming allowances, they have to know when the previous owner(s) incurred the qualifying expenditure but this is not currently a required piece of information.

Clause 13 therefore adds the requirement that where qualifying expenditure is incurred on the construction or acquisition of the building or structure after the date when it is first brought into non-residential use, the 'allowance statement' must contain the date on which the expenditure was incurred.

This requirement is mandatory where the qualifying expenditure is incurred from the date of Royal Assent of Finance Act 2022, or where it is treated as being incurred from that date by virtue of s270BB(3) CAA 2001.

S270BB(3) CAA 2001 permits capital expenditure on construction of a building to be treated as incurred on

- a) the latest day on which capital expenditure on the construction is incurred, or
- b) the first day of the chargeable period after this date, or
- c) the first day of the chargeable period in which the day on which the expenditure is actually incurred falls.

Cross-border group relief

Group relief allows losses within the scope of UK corporation tax to be surrendered from one company in a group for relief against profits within the scope of UK corporation tax of another '75%' group company.

The current law distinguishes between companies established in European Economic Area (EEA) states and companies from non-EEA states. There are two specific sets of provisions.

The first relates to the surrender of losses generated by UK permanent establishments (PEs). In specific circumstances, EEA companies can surrender UK losses of a PE as group relief to UK companies on more favourable terms, in that they do not have to consider if they can use the loss for non-UK tax purposes *in any period* (which includes all future periods).

For accounting periods ending after 27 October 2021, Clause 24 amends the law in CTA 2010 to remove the separate rules for EEA-resident companies so that all non-UK resident companies can only surrender losses of a UK permanent establishment as group relief if it is not possible for the loss to be deducted from non-UK profits of any person for any period.

An identical change is made in s188BI CTA 2010 for brought forward losses since 1 April 2017 which can be group relieved.

Where a company's accounting period straddles 27 October 2021, it will be notionally split into two separate accounting periods for these purposes, one up to 27 October and the second from 28 October to the end of the period.

The second provision relates to the theoretical ability to allow EEA losses to be group relieved to 75% UK group members, following the ECJ decision in *Marks & Spencer plc v David Halsey* (C-446/03). This is repealed. In practice, it was almost impossible to meet the conditions set out in Chapter 3, Part 5 CTA 2010.

Hybrid mismatch rules

Chapter 7, Part 6A TIOPA 2010 deals with hybrid payee deduction/non-inclusion ("D/NI") mismatches (which would involve a charge made between related parties where the income is recognised by a hybrid entity – one which is opaque for tax purposes in one jurisdiction but transparent in another jurisdiction).

S259GA sets out the conditions for Chapter 7 to be in point, including:

- A. there is a payment or quasi-payment made under, or in connection with, the arrangement;
- B. The recipient must be a hybrid entity (it is treated as opaque for tax purposes in one of the jurisdictions and transparent in the other);
- C. The payer is within the scope of UK corporation tax, or the investor in a hybrid payee is within the charge to UK corporation tax, or the hybrid payee is an LLP.

S259GB then discusses the extent of the D/NI mismatch. It includes a deeming provision in para 3, so that the relevant amount of the excess deduction is taken to arise where:

- a) The payee is a hybrid entity (e.g. an LLP or an entity liable to US tax where a 'check the box' election has been made rendering it tax transparent);
- b) There is no territory where the payee is resident for tax purposes or there is no territory where ordinary income arises to the payee by virtue of it having a permanent establishment in that territory and no income arises by virtue of a CFC charge (or foreign equivalent).

Para 4 then quantifies the relevant amount of the excess (deduction) as the smaller of:

- a) The amount of the excess; or
- b) An amount equal to ordinary income that would arise from the payment or quasi-payment to the payee for UK corporation tax purposes if:
 - i. The payee was a company; and
 - ii. The payment/quasi-payment was made in connection with a trade carried by the payee through a UK permanent establishment.

Para 4A then assumes that where Para 4(b) applies, no ordinary income arises to the payee if:

- a) A partner in the partnership is entitled to the amount; and
- b) The payee would not be regarded as a hybrid entity under the law of the territory where the partnership is established and the under the law of the territory where the partner is tax resident.

The amendment in Clause 26 creates a new category of 'relevant transparent entities' which are treated the same as partnerships for the purpose of this Chapter of TIOPA 2010. This change is retrospective to 1 April 2017 when the hybrid mismatch rules were introduced.

A relevant transparent entity (s259GB(4C)) is, broadly, an entity which is not a partnership, and which is constituted in a jurisdiction other than the UK which is not a zero-tax jurisdiction and which sees the entity as transparent.

Examples would include many US Limited Liability Companies (LLCs) and S Corporations which have not been "checked closed" for US tax purposes (the default tax treatment for these entities under UK tax law is that they are transparent and their income and expenses are treated as their investors' income and expenses).

In addition, new ss259GB(4AA) and 4(AB) are inserted to ensure that the changes do not prevent the existing rules working where a hybrid entity is established in a zero-tax jurisdiction or where the structure including the hybrid payee involves more than one tier of hybrid entities. These changes are prospective as they could create hybrid adjustments which would not have arisen under the original law.

For example, where a payee which is a relevant transparent entity is owned by another relevant transparent entity which is in turn owned by investors some of which see the relevant transparent entities as opaque and some of which see them as transparent.

In such cases, if the parent relevant transparent entity is not a payee (which it may well not be on general principles), under the existing legislation it may not be the case that any mismatch arises by reason of one or more payees being hybrid entities such that it will fall within Section 259GB(1)(b).

The new provisions will effectively treat the parent relevant transparent entity as a payee for the purposes of Section 259GB(1)(b) alone, so in the example above it will then be the case that the mismatch caused by the investors' differing views of the entities will arise by reason of one or more payees being hybrid entities.

Diverted profits tax

Mutual agreement procedures (Clause 27)

Double tax agreements provide for the two tax authorities to make a mutual agreement to resolve a case brought by a person to one of the authorities concerning their liability to tax otherwise than in accordance with the double tax arrangements in the agreement.

S114A is inserted into Part 3 Finance Act 2015 to extend the scope of a mutual agreement procedure to diverted profits tax. It has effect in relation to solutions arrived at, or mutual agreements made by HMRC on or after 27 October 2021.

A cross reference to s114A is inserted into s124 TIOPA 2010 (in new para 5) which deals with mutual agreement procedures.

Closure notices etc. (Clause 28)

S101A FA 2015 provides a window for amending a corporation tax return where a charging notice has been issued to a UK or non-UK company for a DPT matter involving entities or transactions lacking commercial substance.

The present law gives the company the chance to amend its corporation tax return to reduce the taxable diverted profits arising (which are taxed at a rate 6 percentage points higher than the corporation tax rate – currently 25%) at any time during the first 12 months of the review.

Clause 28 extends the deadline to all but the last 30 days for the review period.

An identical amendment is made to s101B FA 2015 which deals with a charging notice issued to a foreign company for avoiding a taxable presence in the UK.

New s101C is inserted into FA 2015 to clarify that a closure notice (nor a partial closure notice) may not be issued where the review period for a charging notice has not ended. It is then further clarified that a Tribunal direction to issue a closure notice also cannot be issued until the review period has ended. This is treated as having to come into force on 27 October 2021 and applies to any Tribunal direction given on or after this date unless the application for the direction was made before 27 September 2021.

Corporate loss relief

Clause 30 introduces legislation (to apply retrospectively for accounting periods beginning on or after 1 January 2019) to ensure that companies adopting IFRS 16 continue to benefit from the exemption from the loss carry forward restriction for companies in financial distress.

Under the 2017 loss relief provisions, the use of losses is limited to 50% of profits exceeding the deductions allowance. Where a lease becomes onerous, because the costs of meeting the obligations under the lease exceed the benefits that the company will receive in return, accounting standards require the company to recognise a tax-deductible provision for the net losses arising in respect of the lease.

If lease renegotiations result in a rent reduction or subletting of the property, then there may be a reversal of the provisions resulting in taxable profit. The loss provisions could prevent the losses generated by the original provision being offset against the profit on reversal.

To avoid this, there is an exemption from this rule where reversals of an onerous lease provision form part of a corporate rescue package. However, the wording of the exemption is very narrow in its current form and would not apply to companies that are required to adopt IFRS 16.

These proposed changes will allow companies that are required to adopt IFRS 16 to benefit from an increase in the deductions allowance where they enter into lease renegotiations to avoid insolvency. This will ensure that companies accounting under both the pre-existing accounting standards and IFRS 16 will, in substance, benefit from the same treatment.