

Corporate NR property businesses: Other issues

(Lecture B1193 – 29.28 minutes)

Calculation of rental profits

The calculation of taxable rental profit or loss for corporation tax purposes is similar to income tax rules. The major difference is in the relief for interest.

Under income tax rules, interest on loans relevant to the property rental business are deductible in arriving at the rental profit.

Under corporation tax rules, interest is not a deductible expense against rental income, but dealt with separately under the 'loan relationship rules'. They will still get relief but in a separate part of the return. There are also restrictions for late paid interest in some circumstances (e.g. lender is an individual and interest not paid within 12 months of the end of the company's AP).

Corporation tax loss reliefs

Rental losses under income tax rules can only be carried forward and offset against future rental from that property business.

Corporate rental losses and non-trade loan relationship deficits can be offset in the following ways:

1. Reduce total income chargeable to UK corporation tax in the same period (including chargeable gains);
2. Group relieve to another '75% group company' with profits chargeable to UK corporation tax;
3. Carry forward against future total profits (including chargeable gains).
 - Set off of losses brought forward is limited to £5m plus 50% of profits above £5 million against which loss will be offset (group wide limits) in any one year
 - This cap does not apply to income tax losses carried over from the old regime – they will be fully deductible against future profit without restriction

Corporate rental losses brought forward must first be used by the company that incurred them in a later period

- Then any excess can be group relieved against profits of another 75% group company in the same brought forward period;
- Subject to the group limit above.

Corporate interest restriction

One major change for non-resident companies might be the imposition of a limit on the maximum deduction for interest expense loans used in the UK property business.

This could lead to disallowed interest expense if it exceeds the 'interest allowance' for the period (which has a minimum value £2 million).

Disallowed interest carried forward and can be reactivated in future periods if interest expense is less than the interest allowance in that period.

If interest expense is less than the interest allowance in a period, the excess allowance can be *carried forward for up to 5 years and used to increase interest capacity in later periods, but the company must file a full CIR return to do this* (see below).

If there is any chance that future interest expense may be affected by CIR, it is advisable to file an abbreviated return (which just sets out the UK group structure and a statement that there is no disallowance this period). It then allows company to come back and file a full return up to 5 years later (to activate the brought forward unused interest allowances) should this be necessary.

Basic CIR calculations

Interest allowance can be calculated using either:

1. Fixed ratio rule;
2. Group ratio rule.

With a minimum value of £2m (group-wide where relevant)

1. Fixed ratio rule – smaller of:

- a) 30% (the 'fixed' part) x Aggregate UK companies' **tax-EBITDA***
- b) Adjusted worldwide net-group interest expense (**"ANGIE"**)

2. Group ratio rule – smaller of:

- a) Qualifying worldwide net-group interest expense (**"QNGIE"**) ÷ worldwide group **EBITDA** x 30% x Aggregate UK companies' **tax-EBITDA***
- b) QNGIE

Example

- Aggregate net tax-interest of UK group companies £50m
- Aggregate tax-EBITDA of UK group companies £100m
- (Worldwide) Group EBITDA £200m
- ANGIE £95m
- QNGIE £90m

Interest allowance calculation

Fixed ratio method - max allowable interest is the lower of

1. 30% of aggregate UK tax-EBITDA (100m) 30m
 2. ANGIE 95m
- i.e. 30m
 - Under this method, (50 – 30) 20m of the interest would be disallowed.

Group ratio method - Group ratio % = QNGIE (excludes related party interest) ÷ (Worldwide) Group EBITDA:

- i.e. $90 \div 200 = 45\%$

Max allowable interest is the lower of

1. $45\% \times$ aggregate UK tax-EBITDA (100) 45
 2. QNGIE 90
- i.e. 45m
 - Using group ratio gives higher allowance. Only (50 – 45) £5m interest would be disallowed

Reporting company

A return will be required if HMRC nominates a reporting company (within three years of the period end – which it will do if there is any disallowance under the rules), or a group elects a reporting company (which must be done within 12 months of the period end).

The reporting company is responsible for collating the necessary information and completing and filing the CIR return.

If other group companies consent, reporting company allocates any disallowance as it sees fit, otherwise the disallowance is allocated pro-rata to each company's net-tax expense.

Once a reporting company is appointed (by election or by HMRC), it will have an obligation to file a return by later of:

- 12 months after period end, or
- 3 months from its appointment.

The return can be amended within 3 years from the period end (5 years if replacing an abbreviated return with a full return) or, if later, 3 months from the reporting company's appointment.

CIR variables

UK net-tax interest expense

- Aggregate of interest expense subject to UK CT net of interest income which is subject to UK CT in the period
- Would include capitalised interest if immediate deduction allowed for it (e.g. on tangible fixed assets)

ANGIE

- Starting point is accounting net interest expense in accounts
- Add interest capitalised in period (can make election to only include capitalised interest when recognised for tax purposes where taxed on a GAAP basis – e.g. intangible assets and development property stock)
- Ignore preference dividends recognised as interest expense

QNGIE

- ANGIE minus interest payable to related parties that are not consolidated
- Includes companies that would be consolidated if not for an exemption, common participation in management, control or capital, and common 25% interest between the parties or held by 3rd party in both

UK tax-EBITDA

- Tax adjusted EBITDA (e.g. add back entertaining, capital items in P&L, accrued pension expense etc., ignore CAs)
- Include capital gains
- Exclude losses from other periods and effects of special tax reliefs (e.g. RDEC, R&D enhancement, patent box etc.)
- Ignore special pension contributions needing to be spread into future periods
- Aggregate of all UK-liable profits and losses (so include LBITDA for an individual group company but if overall group LBITDA, call it zero)

Worldwide group EBITDA

- Accounting figure so not tax-adjusted
- But ignore RDEC, revaluation gains/losses, grant income that funds capex
- Ignore accounting gains/losses on disposal, replace with [proceeds – cost]

Public infrastructure exemption

An exemption can be claimed from the CIR rules for 'qualifying infrastructure companies' if they meet certain conditions. This might be difficult for non-resident companies (see below).

If PIE is claimed, Tax-EBITDA is assumed to be zero (so doesn't affect CIR for other group companies) and the company's UK net tax-interest expenses is ignored in the CIR calculations.

A Qualifying Infrastructure Company (QIC) must derive its income and the value of its assets from qualifying infrastructure activities (QIA) i.e. it provides a public infrastructure asset or carries on any other activity that is ancillary to, or facilitates the provision of a public infrastructure asset.

A building or part of a building, is a public infrastructure asset if the company or another member of the worldwide group carries on a UK property rental business; and

- The building, or part, is or is to be let (or sub-let) on a short term basis (lease term \leq 50 years to unrelated parties;
- Expected economic life of the building is \geq 10 years; and
- The building or part is recognised on the balance sheet of the PIE company or an associated company, which itself must be subject to UK corporation tax on all sources of income.

Derivatives and hedging

A non-resident company might hold currency or interest rate derivatives as hedges for its UK property income (e.g. currency forward contracts to hedge fx risk on rents, or interest-rate swaps to hedge interest-rate risk).

FRS 102 and IFRS require derivatives to be fair-valued. If not using hedge-accounting the gains and losses on revaluing the derivative are recognised in profit and loss.

If using cash-flow hedge-accounting, gains and losses are recognised in OCI until the hedged item affects profits, then recycled to P&L. Sometimes, no recycling will occur (e.g. swap from variable to fixed rate).

Primary UK tax law requires derivative gains/losses in P&L to be taxed/deducted. Gains losses in OCI are only taxed if they will not be recycled to P&L later, other they will taxed when recycled.

If using derivatives as a hedge, a company can elect to use 'disregard' regulations, to ignore gains and losses in P&L (or OCI if not going to be recycled) until the hedged item affects profits.

Once an election is made, it cannot be revoked for 2 years. Once revoked, a company cannot elect to use the disregard rules for a further 2 years.

Contributed by Malcolm Greenbaum