

## **Business tax round up**

**(Lecture B1106 - 20.15 minutes)**

### **Capital allowance for structures and buildings**

Since the abolition of industrial buildings allowance there has been no relief available for structures and buildings. Responding to a longstanding request from business representative groups and looking to improve the UK's international competitiveness, the government is introducing a new Structures and Buildings Allowance (SBA) for non-residential structures and buildings

#### *The relief available*

Businesses chargeable to income tax and companies chargeable to corporation tax will be able to claim 2% straight line on qualifying costs, time apportioned for short accounting periods, over a fixed 50 year period. The 50 years will start running from when a structure or building first comes into use.

If relief is not claimed, it will not be able to be carried forward to a later period and will be lost. This will simplify the claim process by ensuring that a consistent amount of relief is available each year over the whole of the 50-year qualifying period for each qualifying spend.

#### *Qualifying structures*

Capital expenditure on the construction of new qualifying structures and buildings, as well renovations or conversions of existing qualifying structures or buildings will qualify. Where a structure or building is renovated or converted so that it becomes a qualifying asset, the expenditure will qualify for a separate 2% relief over the next 50 years.

The relief will be available for UK and overseas commercial structures and buildings including offices, retail and wholesale premises, hotels, care homes, walls, bridges, tunnels, factories and warehouses.

Where a structure or building is divided into separate parts, some of which qualify, an appropriate proportion of expenditure will qualify for relief. SBA will not be due where 10% or less of the costs would meet the conditions for relief.

Expenditure on dwellings will not qualify for the new allowance so that excludes residential property, university, school and military accommodation and prisons. In addition, there will be no relief for expenditure on workplaces that are an integral part of a dwelling, such as home-offices. Shared areas which cover both use as a dwelling and commercial use will not qualify. The government welcomes views on the appropriate definition of a dwelling.

### *Qualifying costs*

Relief will be limited to the costs of physically constructing the structure or building. This will include the costs of demolition or land alterations necessary for construction, and direct costs required to bring the asset into existence. However, it will exclude the cost of the land, stamp duty land tax and legal costs and any planning permission that is required.

The relief will apply to newly constructed commercial structures and buildings where all the contracts (not letters of intent) for the physical construction works of the structure or building (including any contract for preparatory works) are made in writing, and are entered into (signed and dated by the bound parties) on or after 29 October 2018. Where construction is undertaken by an internal workforce, for example by contract or on payroll, the relief will apply where that physical work commenced on or after 29 October 2018.

Any costs that qualify as plant and machinery should continue to be treated as such with the taxpayer claiming AIA, FYAs and WDAs as appropriate.

If a business buys an unused asset constructed by a developer, the qualifying cost will be the price paid less any amount relating to land. Clearly, a valuation will be required to separate the amount of the land cost from the cost of the structure or building.

### *Additional costs*

Capital expenditure undertaken on a structure or building after the date on which it enters into use will qualify for the SBA, but treated as a new, separate asset. Its 50-year life will extend beyond the writing down period of the original construction costs on that structure or building.

### *Activity yet to commence*

Where an asset is being constructed for a qualifying activity that has not yet commenced, then expenditure will not qualify if incurred more than seven years before that qualifying activity commences.

### *Damaged structures and repair*

Where a structure or building is damaged and can no longer be used for qualifying activity, allowances will remain available for a period of two years, allowing reconstruction work to take place. If the reconstruction takes longer allowances will not be available after that two-year period until the reconstructed structure or building comes back into qualifying use. This two-year period may be extended up to five years where the structure or building substantially no longer exists following extensive damage.

Any new expenditure on reconstruction will qualify for relief in its own right, and will qualify for relief at the rate of 2% annually over the following 50 years. The total eligible cost will be net of any costs covered by compensation or insurance etc.

Where a structure or building is demolished, and the owner decides not to replace that building, it can continue to claim the SBA on that asset, for the remaining term of the previous structure or building.

### *Example*

Company A builds a new commercial building on which the construction costs were £50m. 10 years later, there is a fire, which causes heavy damage. The building is partially insured, and insurance payments will cover £10m of the £12m rebuilding costs.

At the time of the fire, Company A is claiming SBA at a rate of £1m per year ( $50m \times 2\%$ ).

For the period after the fire, Company A continues to claim £1m per annum while it decides on a replacement.

Whatever happens, it may claim £1m pa over the remaining 40 years.

- If it rebuilds, it will continue to claim £1m for the remaining 40 years of the original building. The net cost, after insurance payments received, is £2m and this will be treated as a new qualifying structure eligible for relief at a rate of 2% over 50 years.
- If it does not rebuild, it may continue to receive a “shadow SBA” on the original construction costs of £1m pa.

### *Sale of the asset and subsequent use*

There will be no balancing adjustments on sale. When calculating any gain on disposal, the allowable cost of the asset will be reduced by the total amount of relief that they have claimed.

Provided that the asset is used for a qualifying purpose, the buyer will continue to claim the same 2% allowance annually until the full 50-year period has expired. The relief will be apportioned in the year of sale. To ensure that relief is given on an agreed amount, there will be a need to retain evidence of actual costs incurred where a building or structure has qualified for relief and provide this to a purchaser.

### *Example*

Company A buys a new office building from a developer at a total cost of £15m of which £5m relates to the land. It brings it into use for the purposes of its trade at the beginning of its accounting period ending on 31 December 2021.

On 31 December 2030 the building is sold to Company B for use in its trade. The price paid was £12m of which £7m relates to the land.

Company A's annual writing down allowance will be £200,000 ( $£10m \times 2\%$ ).

By sale, Company A will have claimed 10 years of allowance totalling £2m.

The allowable cost when calculating its capital loss on the land and building the original cost, including land of £15m less the £2m allowances claimed.

	£
Proceeds	12,000,000
Original cost	15,000,000
Less SBAs	<u>(2,000,000)</u>
	<u>(13,000,000)</u>
Capital loss	<u>1,000,000</u>

The price paid by Company B is irrelevant. Company B will be entitled to claim SBA on the original construction costs of £10m for the remaining part of the 50 years.

If in 2032 Company B decides that the building needs improvement and it becomes unoccupied for two years during a £4m renovation project. The company can continue to claim the original £200,000 allowance because this period it is less than two years (or up to five years where the building substantially no longer exists following extensive damage). When the building is brought back into use, then a separate SBA of £80,000 (£4m x 2%) can also be claimed once renovated.

#### *Changes in the use of the structure or building*

Where a structure or building that was originally used for a qualifying activity undergoes a change in use and becomes a dwelling then SBAs will no longer be available for the period for which the structure or building is in use as a dwelling. If a qualifying activity resumes in the building after a period of time then allowances will recommence but no relief will be given for the period of non-qualifying use. Apportionment will be needed where there is a change in use part way through a period.

#### *Leases*

Where the granting of a lease is substantially no different from a purchase of the interest in land, the SBA will be allocated to the lessee. In more complex cases, the allowances will remain with the lessor if the term of the lease is less than 35 years.

If the term is longer, a calculation will be required. Where the amount paid as a capital sum for a lease is  $\geq 75\%$  of the sum of that capital amount and the value of the retained interest in the property, then the lessee will become entitled to the full amount of the SBA. (i.e.  $\geq 75\%$  has effectively been applied in calculating the gain).

#### *Example*

Company X owns a building on which it claims the SBA. It grants a lease over the entire building to Company Y that will use it in its trade. The term of the lease is 40 years and Company X will receive a premium of £50 million but only a token rent is payable. Company X's retained interest in the property is agreed to be £10 million.

To check the relevant percentage that applies, the standard part disposal calculation needs to be performed and so the premium needs splitting between income and capital. 78% of the premium, or £39 million, is treated as capital gains disposal proceeds (calculated as  $2\% \times (40-1)$ ).

The proportion of the capital gains base cost that is deducted in working out the gain on granting the lease is calculated:

Disposal proceeds

Disposal proceeds + Value of asset retained

This is  $39 / (39 + 10)$ , approximately 80%.

Because the lease is for over 35 years and more than 75% of the capital gains base cost is applied in calculating the gain, this means that Company X is no longer entitled to claim SBA. Company Y will be able to claim instead.

If only part of the property is subject to a lease, the test will apply only to that part and allowances will transfer if the capital sum is  $\geq 75\%$  of the value of that part.

Where a person is entitled to SBAs in respect of an asset that they lease, and the lease expires or terminates before the end of the 50 years, then the SBAs will be able to be transferred to the person holding the retained interest, as long as they hold their interest as part of a qualifying activity.

*Anti avoidance*

Rules will be included in the legislation to prevent manipulation of the relief for a tax advantage. In particular, there will be rules to:

- Prevent relief through attempts to manipulate contracts, such as by revoking agreed contracts for construction works entered into before 29 October 2018,
- Disallow leases being used to give more than one party separate interests in the same structure or building.

*Views welcome*

The government welcomes views on the following aspects of the SBA:

1. To ensure the necessary exclusion of residential use, are there specific types of buildings or activities for which the draft legislation should provide?
2. It has been necessary to reflect situations where the grant of a lease is akin to a sale of a property interest. Is the proposed boundary of 35 years for the transfer of the SBA from a lessor to a lessee appropriate?
3. Are there specific issues regarding overseas property that require provision in the draft legislation?
4. The government has proposed a period of disuse during which the structure or buildings retains its eligibility for relief – up to two years ordinarily, or up to five years where it substantially no longer exists following extensive damage. Are there any significant practical problems would prevent the proposed policy from working?

[www.gov.uk/government/publications/capital-allowances-for-structures-and-buildings-technical-note](http://www.gov.uk/government/publications/capital-allowances-for-structures-and-buildings-technical-note)

## Consultation on Digital Services Tax

On 8 November 2018, the government issued a consultation document on the introduction of a digital services tax (DST). The proposal is that DST will be introduced in Finance Act 2020 and will come into effect from April 2020. The summary below sets out what the consultation proposes. The government emphasise that this is a temporary tax that will be replaced by a global solution based on the BEPS project and is subject to review in 2025.

The consultation states that DST is looking to address the concern that multinational companies have highly-digitised business models which create value from user participation in a territory but that the profit from that value is not being taxed in that territory.

### *What is the DST?*

The DST is a 2% tax on the UK revenues of digital businesses that are considered to derive significant value from the participation of their users. These businesses are ones, which provide social media platforms, search engines or online marketplaces ('in-scope' business activities) and will apply to the revenues linked to the participation of a UK user base. Businesses could be incorporated or unincorporated.

DST will only apply if a business has in-scope business activities which, on a group basis:

- generate more than £500m global revenue annually;
- are linked to the participation of UK users and which generate more than £25m annual revenues.

Any UK taxable revenues below £25m will be free from the DST. There will also be a 'safe harbour' as defined below.

The tax will be deductible against UK corporation tax under general principles of being wholly and exclusively for the purpose of its trade but will not be creditable. There may therefore not be a deduction against UK corporation tax if the DST is paid by an overseas group company that is not subject to UK corporation tax.

### *Definition of user participation*

The DST is based on taxing value created by UK users' participation in the relevant digital businesses, so what is user participation?

The consultation notes that users have a role beyond creating demand for a product, they now also contribute to what the business is offering in a number of ways:

- by creating the content that the digital business has on their platforms;
- by using the online platforms for significant periods of time and thereby generating data which the business can use to collect data on their activities;
- by building networks with other users by sharing online content or rating products etc;
- by providing ratings for goods and services which build the brand and is then the content sold by the online business.

The DST is intended to focus on businesses where these functions are the central value driver of the business.

A lot of digital businesses will benefit from more than one of the above user participations e.g. Facebook's content is generated by users, but they then collect data on users' activities and use that to promote other relevant content to the user. Other digital businesses may have user participation activities, but their main business activity is the direct sale of goods services and value is created by developing, producing and marketing the goods or services, these businesses are not intended to be covered by DST.

The government's proposal is to define the business activities that derive most value from user participation and tax the revenues that those activities generate when they are linked to a UK user, whatever characteristics those revenues have i.e. they could be in the form of subscription fees or through online advertising income etc.

#### *In-scope business activities*

As noted above, in-scope business activities are the provision of a social media platform, the provision of a search engine and the provision of an online marketplace.

The consultation then provides further examples of these activities as follows:

#### **Provision of a social media platform**

This would include those platforms that build social or business communities online, blogging or discussion platforms, content sharing platforms for videos etc., review platforms and dating platforms.

#### **Provision of a search engine**

This would cover situations where the search engine generates income by advertising directly against search results or where the income derives from using the search engine as access to websites.

#### **Provision of an online marketplace**

This would not cover the activity of the sale of goods online where the business has legal ownership of the goods being sold but would cover businesses that for example take commission from matching third-party buyers and sellers of physical goods or which allow third parties to list products and communicate with buyers.

The expectation is that businesses will isolate the in-scope business activities and pay the DST on revenues that those activities generate for the group where linked with UK users.

#### **Activities not in-scope**

Activities which should not be in-scope therefore include the sale of goods online, the provision of financial or payments services, the direct sale of online content e.g. TV or music subscriptions and online games where the business owns the content but the consultation notes that there will need to be further review where online games also create value from the high level of user participation.

### *Revenues that will be taxed*

DST will apply to third party revenues that are generated from in-scope activities from whatever channel e.g. from subscriptions fees, sales of data, delivery fees, advertising revenues and these could be in UK or non-UK entities. Any apportionment of the income between in-scope and out-of-scope activities would be on a just and reasonable basis.

There will be no allowable costs for DST and revenues declared will be net of VAT.

### *UK revenues*

Once the business has established the in-scope activities and the revenues they generate, they will need to confirm which are linked to the participation of UK users.

A user can be a company, individual or any other legal person.

Where revenue is derived from online advertising, UK revenue will be defined as revenue from adverts displayed at UK users or has involved a UK user action e.g. a click. Where revenue is derived from other forms e.g. subscription, commission etc. it will depend on whether the payment comes from a UK user, or relates to a transaction that involves a UK user.

Generally, a UK user will be one that is normally resident in the UK and therefore is primarily located in the UK when participating in the in-scope business activity. However, the consultation says it will allow business to look at other determinants e.g. where the IP address of the user is located or the delivery or payment address of the user. The consultation notes that there could be some difficult areas where the user location may be hard to establish and is taking views on this, for examples where user location is not tracked or where a UK user signs up for online content whilst abroad for work or holidays.

DST would tax transactions where only one user is based in the UK but would look at relief if the revenue was also subject to DST in another country.

### *Safe harbour*

The DST is based on gross revenues and DST may therefore be disproportionately high on businesses with low profit margins or losses. To counteract this a safe harbour is proposed in the consultation document.

Businesses will be able to elect to calculate their DST liability according to the following formula:

*'Profit margin' multiplied by 'in-scope revenues (less £25m allowance)'  
multiplied by 'X'*

X would be set at a level that would not be less than 0.8 so that a safe harbour is only of benefit to businesses with very low profit margins.

The profit margin could not be less than 0% and would be based on a UK and business activity-specific profit margin and not on consolidated accounts figures. There would be several issues in terms of calculating this profit margin including which costs could be taken into account, which period the profit margin relates to and the treatment of any exceptional items. The consultation therefore is proposing to explore this calculation further.



### *Example*

A business has in-scope revenues from UK users of £100m and so would pay DST of £1.5m (£100m - £25m allowance x 2%).

The businesses profit margin is 1%; the safe harbour DST would therefore be £0.6m (1% x £75m (£100m - £25m allowance) x 0.8).

### *Reporting and paying the DST*

Every company that is chargeable to DST will need to notify HMRC that it is liable and self-assess the amount of DST, regardless of whether it is a UK or non-UK company. The consultation is reviewing the option of a nominated company for a group.

Reporting will be done annually matching with accounting periods for corporation tax returns and returns will need to be filed by the end of the calendar year following the end of the accounting period.

The consultation does not consider the reporting treatment of non-incorporated entities.

Payments of DST will be made quarterly on the same payment schedule as Very Large Corporate Quarterly Instalment Payments.

### *Anti-avoidance and penalties*

Anti-avoidance provisions would be introduced to:

- address the risk that taxpayers accelerate the recognition of revenue before 1 April 2020 so it is outside the scope of the DST (anti-forestalling rules); and
- prevent taxpayers artificially re-characterising revenue streams so they fall outside the relevant business activity.

The government is also considering introducing new penalties for the DST as a preventative measure.

*Contributed by Joanne Houghton*

## **VAT**

### **Aborted takeover**

*Summary - As the holding company had intended that it would provide taxable management services for an acquired subsidiary, such preparatory acts could be an economic activity even though the subsidiary was never acquired.*

Ryanair had incurred input tax on expenditure relating to professional services incurred on a proposed takeover bid for all the shares of Aer Lingus.

After the takeover, Ryanair had intended to get involved in the management of the new subsidiary by providing taxable management services to that airline.

However, due competition legislation, Ryanair had only been able to acquire part of the share capital but had sought to deduct the relevant input tax relating to the professional services. The Irish tax authorities denied the claim.

#### *Decision*

The CJEU was satisfied that Ryanair was a taxable person when it incurred the input VAT in question. A company that carries out preparatory acts as part of a proposed acquisition of shares in another company, with the intention of pursuing an economic activity is a taxable person.

The provision of management services was an economic activity and it did not matter that this activity was not actually carried out due to the failed takeover. The only issue was whether the exclusive reason for the expenditure was to be found in the intended economic activity. This would be for the Irish courts to decide.

*Ryanair v HMRC (Case C-249/17)*

*Adapted from Tax Journal (26 October 2018)*

## **Supplies closely related to the supply of education**

*Summary - Even if Loughborough Students' Union was an eligible body, it was not an eligible body making supplies that were "closely related" to the supply of education. The supply of stationery, art materials and other items were not exempt supplies.*

Loughborough Students' Union operates a range of commercial activities on its campuses, mainly bars and catering but it also has three retail outlets. Although most of the customers are students, there is no restriction on other people using the shops and there is no distinction at point of sale between student and non-student sales.

Loughborough Students' Union had appealed HMRC's decision to deny its claim for repayment of output tax in respect of sales of stationery, art materials and other items from their shops. They maintained that the sales were exempt supplies as supplies closely related to the supply of education

The relevant EU provisions are contained in Articles 132 – 134 of the Principal VAT Directive. Schedule 9 Group 6 implements these articles into domestic law and provides for exempting where the supply is by an eligible of body and is the supply of goods or services which are closely related to the principal supply by or to the eligible body making the principal supply provided. In addition, the goods or services must be for the direct use of students receiving the principal supply.

#### *Decision*

The Upper Tribunal concluded that regardless of whether Loughborough Students' Union was an eligible body (group 6 para 1(e)), it could only claim the exemption on supplies closely related to education. The Tribunal found that Loughborough Students' Union's supplies were not closely related to education within item 4.

The food, newspapers and household goods were 'ends in themselves' and not ancillary to education: 'the education provided by ..... would be just as good if the students did not buy these items'. The art materials could be closely related to the courses offered by the university but there was no evidence as to what these art materials were or how they related to the course work that the students may be undertaking. The supply of stationery, art materials and other items were not exempt supplies.

*Loughborough Students' Union v HMRC [2018] UKUT 0343 (TCC)*

## **Domestic reverse charge for construction services**

VAT fraud in construction sector labour supply chains presents a significant risk to the Exchequer. Organised criminal gangs fraudulently take over or create shell companies to steal VAT whilst operating alongside actual construction services. This is commonly referred to as 'missing trader' fraud.

### *Proposed revisions*

From 1 October 2019, a statutory instrument will introduce a VAT reverse charge on the supply of specified building and construction services as well as goods supplied with those services. Rather than the supplier charging and accounting for the VAT, the recipient of those supplies accounts for the VAT.

### *Supplies that will be affected*

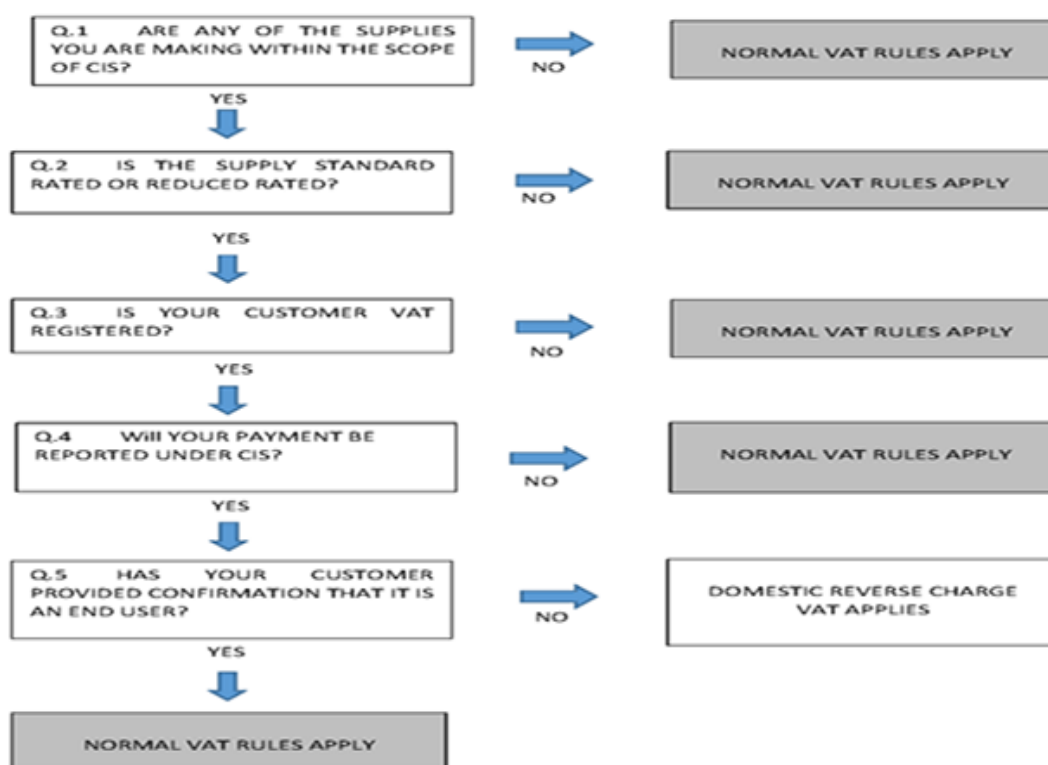
The domestic reverse charge will affect supplies at the standard or reduced rates if payments must be reported through the Construction Industry Scheme (CIS). Supplies between sub-contractors and contractors, as defined by CIS, will be subject to the reverse charge unless they are supplied to a contractor who is an end user. End users will usually be recipients who use the building or construction services for themselves, rather than to sell the services on as part of their business. Those connected to end users, including landlords or tenants, can be treated as end users so intra-group and leasing re-charges of building and construction services connected to the end user are also excluded from the reverse charge. If the end user does not provide its supplier with confirmation of its end user status, it will still be responsible for accounting for the reverse charge.

### *How a domestic reverse charge operates*

A domestic reverse charge means that the customer receiving the supply of specified construction services must account for the VAT due rather than the supplier. In turn, the customer deducts the VAT due on the supply as an input, meaning no net tax is payable to HMRC. This removes the scope to evade any VAT owing to HMRC.

A domestic reverse charge only applies to supplies between UK taxable persons therefore unless the customer is registered or liable to be registered for VAT it will not apply.

Annexe 1 to the guidance provides a useful summary flowchart and is reproduced on the next page:



### *Implementation of the reverse charge*

HMRC understands the difficulties businesses may have in implementing the domestic reverse charge and will apply a light touch in dealing with related errors that occur in the first 6 months after introduction, where businesses are trying to comply with the new legislation. However, businesses that knowingly claim end user status when the domestic reverse charge should have applied will still be liable for the output tax that should have been paid and may be liable for penalties.

The guidance provides detail as to the types of building and construction services that need to be accounted for under the new system as well as a list of services that are excluded if supplied on their own. This list is not exhaustive.

### *Mixed supplies*

The legislation is designed so that if there is a reverse charge element in a supply then the whole supply will be subject to the domestic reverse charge. This is to make it simpler for both supplier and customer and to avoid the need to apportion or split out the supply.

If in doubt, provided the recipient is VAT registered and the payments are subject to CIS, it is recommended that the reverse charge should apply.

### *Further guidance*

Detailed guidance on the other domestic reverse charge measures can be found in Domestic reverse charge procedure (VAT Notice 735).

[www.gov.uk/government/publications/vat-reverse-charge-for-building-and-construction-services-guidance-note](http://www.gov.uk/government/publications/vat-reverse-charge-for-building-and-construction-services-guidance-note)