Executive summary

The UK’s Finance Bill 2017, published as Finance (No.2) Bill 2016-17, could be considered to be the end of a cycle of the Government’s plans for the UK tax system. The new rules governing corporate interest relief, the use of corporation tax losses and the reform of the substantial shareholding exemption complete a large part of the Business Tax Roadmap launched in 2016.

Although these rules in particular will come into force at the beginning of April 2017, they have been subject to ongoing changes over many months. A key action for taxpayers will be to consider the updated version of these rules to understand how the rules will apply in their own circumstances. Given the Bill is unlikely to receive Royal Assent before July 2017, there is still scope for changes to be made in Committee and Report stages. However, as the rules will effectively be in force in a matter of weeks, taxpayers will need to work from this version of the Bill. In particular, taxpayers may need to consider the impact on any quarterly installment payments they are due to make (and the possible associated interest cost), as well as how they will account for any changes at any reporting dates before the Bill is substantively enacted.

This Alert summarizes the key areas in Finance Bill 2017, showing where further information or new provisions are contained in the version of the Bill published on 20 March 2017. It also highlights the response documents and new consultations published alongside the Bill.
Detailed discussion

Business Tax – key measures

Corporate interest deductions

Previous announcements: Draft Finance Bill clauses
5 December 2016, updated version 26 January 2017,
Budget updates 8 March 2017

Summary: From 1 April 2017, the new rules in clause 31/schedule 10 will restrict each group’s net corporation tax deductions for interest and other financial payments to 30% of earnings before interest, tax, depreciation and amortization (EBITDA) that is taxable in the UK, subject to a modified debt cap based upon the worldwide group’s net interest expense. An optional group ratio rule, based on the net-interest to EBITDA ratio for the worldwide group, may permit a greater amount to be deducted in some cases, again subject to a modified debt cap. All groups will be able to deduct up to £2m of net interest expense per annum under the regime. The existing worldwide debt cap rules will be replaced by these rules.

Changes in the Finance Bill: The Bill includes the measures announced in the Budget to:

- Correct the rules which would have prevented groups, in particular domestic groups, from being able to fully carry forward disallowed interest for use in a future period due to the interaction of the modified debt cap and carry forward rules. However, the rules released do not fully address the issue of volatile earnings. In particular, where a group makes profits followed by a loss in a later year, it might have greater interest restrictions than if its profits had accrued evenly over the years or made a loss initially followed by profits in later years. This demonstrates that the complexity of the rules can lead to unexpected results and there is accordingly a need to carefully consider the application of the rules to the specific facts.

- Narrow the circumstances where third party debt can be deemed to be related party debt for the purposes of the group ratio rule by virtue of guarantees.

- Amend the public benefit infrastructure exemption to allow this to be easier to apply in practice, including removing the need to compare the level of debt of qualifying group companies with non-qualifying group companies, allowing groups to elect to assess the qualifying criteria of several companies taken together, as well as clarifying the interactions with joint ventures, partnerships and transparent entities. Transitional rules will also apply in the first year to allow businesses time to restructure to qualify for the exemption, if necessary.

- Include all debits and credits arising directly from dealing in financial instruments as part of a banking trade in the definition of tax-interest for banking groups.

- Provide that, where an insurer elects to use an amortized cost basis of calculation for the purposes of the rules, simplifying modifications will apply and enabling regulations will allow changes to be made to definitions. The language is not fully aligned with the underlying accounting and it may be that further changes, whether in primary or secondary legislation, will be needed.

In addition, the Bill also includes changes to the January 2017 text to make amendments to the way the rules work, notably:

- Excluding gains and losses on derivatives hedging non-debt items from the definition of tax interest

- Including regulatory capital and other amounts recognized in equity or shareholders’ funds in the definition of adjusted net group-interest. Regulatory capital is also explicitly not treated as a results-dependent security or an equity note when considering adjustments to arrive at the group ratio percentage. Regulatory capital should therefore not reduce the group ratio unless held by a related party

- Allowing the nomination of a reporting company, that will be responsible for filing the interest restriction returns on behalf of the group, to continue to have effect for each period until revoked, rather than needing the nomination to be remade each period

- Extending the time in which an abbreviated interest restriction return can be replaced with a full return. Where an abbreviated return is filed, it is not possible to carry forward surplus interest allowance, which is only possible with a full interest restriction return. Previously it was only possible to submit a revised return up to three years after a period, which might have resulted in some of the capacity for the previous five years being unavailable

- The rules provide for alternative calculations to be used to arrive at the group EBITDA. Under the previous draft, a single election covered these such that it was necessary to adopt all or none of the alternative calculations. While the rules do now separate out the alternative chargeable gains calculation, a single election still covers the remaining alternative calculations (in respect of capitalized interest, pension contributions, employee share acquisitions and changes in accounting policy). Groups will therefore still need to carefully assess the implications before making such an election
Global Tax Alert

Corporation tax losses

Previous announcements: Draft Finance Bill clauses 5 December 2016, updated version 26 January 2017, Budget updates 8 March 2017

Summary: The rules in clauses 29 and 30, together with schedule 9, broadly restrict the offset of brought forward losses to 50% of profits arising on or after 1 April 2017, and enable carried forward losses incurred on or after 1 April 2017 to be offset against profits of any description (or group relieved).

Changes in the Finance Bill: The Bill includes a number of changes to bring in provisions for oil and gas companies and oil contractors, as promised in the Budget, together with changes relevant to insurance companies and numerous consequential amendments (including extending the provisions to cover losses being offset against profits taxable at the Northern Ireland rate).

There were, however, very few amendments to the draft legislation published in January, though one noteworthy change relates to the change of company ownership rules.

The draft legislation published in January had proposed extending the time period over which a major change in the nature or conduct of a trade can be considered, from three to five years from the ownership change. It also proposed a similar time period in new change of ownership rules dealing with post April 2017 trading losses. The Bill has amended both of these slightly so that, while consideration needs to be given to a five year period, this cannot start any further back than three years prior to the ownership change.

While this is a welcome change, it is disappointing that the provisions continue to provide for such a long period, which will adversely impact many commercially driven company sales.

However, the Bill does not include an extension to the provisions that allow trade losses to transfer with an intra-group trade sale to include post April 2017 trade losses.

There continues to be extensive engagement with HM Treasury and HM Revenue & Customs (HMRC) on the potentially significant impact of the loss reform proposals on the Solvency Capital Requirement calculation for insurers, though there were no new announcements in this regard. In the most extreme case, the loss restriction could eliminate 50% of the loss absorbing capacity of deferred taxes previously anticipated.

Substantial Shareholding Exemption (SSE)

Previous announcements: Draft Finance Bill clauses 5 December 2016

Summary: In order to improve the attractiveness of the UK as a holding company location, certain aspects of the SSE are being reformed with effect for disposals on or after 1 April 2017. These include the following:

- Removal of the investing company/group trading requirement
- Removal of the post-disposal investee company trading requirement for most unconnected party disposals
- Relaxation in the substantial shareholding holding period requirement from 12 months within the previous 2 years to 12 months within the previous 6 years, to allow greater time for fragmented disposals
- Introduction of a new full or partial exemption for investing companies directly or indirectly owned by Qualifying Institutional Investors (QIIs). This exemption does not include the investee company trading requirement and allows the substantial shareholding requirement to be satisfied if the cost of the investment is at least £20m even if that is less than 10% of the ordinary shares in the investee company

Changes in the Finance Bill: Clauses 39 and 40 contain a number of changes, including:

- In relation to acquisitions from group companies, the substantial shareholding holding period can be deemed to be extended by the holding period of previous owners, regardless of their residence. This removes a disincentive to non-UK groups setting up a UK holding platform in that they might otherwise have had to wait 12 months before they made a disposal
- Listed companies now no longer prevent the QII exemption from applying if they are either QIIs in their own right or Real Estate Investment Trusts that have an institutional investor as a participator or are controlled by the Crown
- The legislation has made clear that partners in a partnership are treated as owning a proportion of the share capital of a company owned by a partnership when establishing whether an investing company is owned by QIIs
- The draft legislation provided for a £50mn alternative substantial shareholding threshold for the QII exemption. This has now been reduced to £20m
While the consultation document highlighted issues arising with partnerships, the Government has chosen not to clarify the impact of partnerships except in relation to the QII exemption.

The introduction of the QII exemption itself is welcome but it is disappointing that, despite representations, there has been no change to the 80% ownership threshold that confers full exemption for disposals under the QII exemption, as this may adversely impact mixed funds.

Anti-hybrid rules
Previous announcements: Technical note 5 December 2016

Summary: The UK’s new anti-hybrid rules were introduced in Finance Bill 2016 and came into force on 1 January 2017 to broadly counteract tax advantages arising from the involvement of hybrid entities or instruments or where there is a company with a permanent establishment which generates a similar advantage.

Changes in the Finance Bill: Following discussions with stakeholders, two measures were announced at Autumn Statement 2016 and these have now been included in the Bill as clause 35 with retroactive effect from 1 January 2017:

- Removal of the requirement to make a formal claim to extend the time period during which temporary mismatches relating to hybrid financial instruments or hybrid transfers can be ignored. This is intended to reduce the compliance burden for groups, as it is envisaged that a large volume of financial instruments will fall within the scope of the hybrid mismatch rules. The requirement to make a formal claim for other scenarios falling within the scope of the rules will remain

- Preventing a deduction for amortization from being within the scope of the rules for the purposes of the provisions counteracting deductions without inclusion of the relevant income. However, amortization will remain a relevant deduction when considering the counteractions relating to double deductions for the same expense

Patent Box cost-sharing
Previous announcements: Technical note 5 December 2016

Summary: Amendments to the patent box regime were introduced in Finance Act 2016 to reflect the Organisation for Economic Co-operation and Development’s “modified nexus” recommendations and these took effect (subject to transitional provisions) on 1 July 2016. Rules have now been developed to address cost-sharing arrangements (CSAs) with effect for accounting periods beginning on or after 1 April 2017.

Changes in the Finance Bill: The rules in clause 34 use the existing definition of a CSA for patent box purposes and are intended to ensure that companies undertaking research and development under CSAs are neither advantaged nor disadvantaged under the modified nexus rules.

The rules deal with buy-in payments and receipts when entering into a cost-share as well as balancing (true-up) payments made or received during the course of the cost-share.

The rules also extend the grandfathering rules for existing intellectual property (IP), which allow companies to delay application of the modified nexus rules until 1 July 2021. Where a company already has grandfathered IP which it contributes into a CSA, that IP should not lose its grandfathered status as a result. Where a company enters into a CSA before 1 April 2017 in relation to another party’s IP that would have been grandfathered under the normal grandfathering rules, that IP can also be grandfathered.

Other changes included in Finance Bill 2017
Northern Ireland Corporation Tax (clause 36/schedule 12): The definitions of Northern Ireland company and Northern Ireland firm have been expanded in the Northern Ireland corporation tax regime rules, currently due to be introduced with effect from 1 April 2018 with a tax rate of 12.5%. Changes include giving an option for a business within the small and medium enterprise (SME) rules with a trading presence in Northern Ireland, but which is not a Northern Ireland employer in the period, to elect to be a Northern Ireland company (or a Northern Ireland firm in the case of a partnership). The election cannot be made if the SME is a disqualified close company in respect of the period. If the election is made, the SME will then apply the Northern Ireland rate of corporation tax to its Northern Ireland trading profits. There is also an anti-abuse provision to ensure that the regime is used only where there is genuine economic activity in Northern Ireland.

Museums and galleries relief (clause 32/schedule 11): The new tax relief will allow qualifying companies engaged in the production of exhibitions to claim an additional tax deduction based on qualifying expenditure, or, where that additional deduction results in a loss, to surrender those losses for a payable tax credit (up to a maximum credit). Where live performances are only incidental to the exhibition, an exhibition may still qualify for the relief on the production costs, however the live performance costs would not be eligible for the additional relief. The Government will review the relief in 2020 and set out plans beyond 2022.
Treatment of grassroots sport (clause 33): The measure provides companies with a deduction for all contributions to grassroots sports through “qualifying sport bodies” and deductions of up to £2,500 in total annually for direct contributions to grassroots sports.

Petroleum Revenue Tax (PRT) administrative savings (clause 63): The Bill removes the conditions for opting fields out of PRT so that opting out can be achieved by an election.

Measures substantively unchanged from draft clauses

Taxing profits from trading in and developing land in the UK (clause 53): The Finance Bill takes forward unchanged the proposal to tax all profits arising on or after 8 March 2017, regardless of the date the contract was entered into.

Tax treatment of appropriations to trading stock (clause 38): The new rules mean that the market value election for appropriations of assets to trading stock may not be made where an allowable loss would arise. There are equivalent rules for assets which are now within the Annual Tax on Enveloped Dwellings (ATED), but the election (and therefore the restriction on when it can be made) is only applicable to the non-ATED related loss.

First-year allowances for electric charging points (clause 52): This allowance is already in effect and applies from 23 November 2016.

Authorized Contractual Schemes (clauses 54-56): The new provisions relating to co-ownership authorized contractual schemes (CoACS) simplify the process for calculating any capital allowances which may be claimed by investors in CoACS, introduce new requirements for information which the operator of a CoACS must provide to investors and to HMRC and provide for new rules to clarify what is to be treated as an investor’s income when a CoACS has invested in an offshore fund. Draft regulations containing the detailed requirements of the last two measures have also been published.

Consultation and discussion documents

New consultation on nonresident companies chargeable to income tax and nonresident capital gains tax (NRCGT): As announced at Autumn Statement 2016, this consultation explores the case for moving nonresident companies from the income tax regime to corporation tax regime. Responses are sought by 9 June 2017.

The Government has now confirmed that the focus of the consultation concerns income arising from UK real estate. It does not propose bringing residual income arising from a trade carried on in the UK otherwise than through a permanent establishment within the corporation tax code, although this will be kept under review.

There are no plans to alter the withholding regime or the rate of withholding tax, which the Government proposes remains at the higher income tax rate of 20%. This is on the basis that it considers that the UK’s treaty network generally provides for an effective rate lower than the headline withholding rate.

As expected, there is no mention of the gains of nonresidents becoming subject to corporation tax, save for those already within the scope of NRCGT.

Double Taxation Treaty Passport scheme: In publishing the responses to the consultation of 26 May 2016, the Government has advised that:

- The scheme is to be made available to all UK borrowers that have an obligation to deduct withholding tax, including UK partnerships, individuals and charities.
- Transparent entities (including partnerships) can be lenders within the scheme where all of the constituent beneficial owners of the income are entitled to the same treaty benefits under the same treaty.
- Sovereign wealth funds and pension funds that are utilizing withholding tax treaty rates will be admitted into the scheme as lenders.
- The scheme’s terms, conditions and guidance will be updated and published on 6 April 2017.

New Oil and Gas proposals: The Government has published a discussion paper entitled Tax issues for late-life oil and gas assets. The paper considers the tax issues associated with the transfer of such assets to new investors and whether any changes to the tax rules could better facilitate these transfers and support the Government’s aim of maximizing economic recovery. Specifically, the discussion paper considers three main areas:

- The possibility of introducing a transferable tax history whereby part of a company’s corporate tax history could be transferred between buyer and seller
- The PRT issues arising where all or part of the decommissioning liability is retained by the seller, cognizant of the clarification that was issued in the HMRC Technical Note in Budget 2016 in relation to ring fence corporation tax
- The provision of greater certainty on the treatment of losses on a transfer of trade

Responses are sought by 30 June 2017.
The Government has also issued the terms of reference that will apply to the established panel of upstream oil and gas experts, created so as to enable a detailed debate on the issues identified. The findings of the expert panel meetings shall not be binding on the Government but any proposals from the panel will be considered alongside the other responses to the discussion paper.

The Government will present its findings at the Autumn Budget 2017.

**New consultation on withholding tax exemption for debt traded on a multilateral trading facility:** UK businesses are required to withhold income tax on payments of annual interest but exemptions exist in a number of situations, notably the Quoted Eurobond Exemption (QEE).

The Government proposes to introduce a further exemption for debt traded on Multilateral Trading Facilities (MTFs), in order to develop new wholesale MTFs to enhance the UK’s reputation as a jurisdiction in which to issue and trade debt.

The consultation document published on 20 March proposes extending the QEE to include debt traded on wholesale UK MTFs, with effect from April 2018. The proposal is intended to be revenue neutral as the Government expects the debt covered by this new exemption to have largely otherwise been introduced on foreign exchanges already benefitting from the QEE. However it will test this understanding as part of the consultation, on which comments are sought by 12 June 2017.

**Tax Administration**

Partial closure notices

Previous announcements: Draft Finance Bill clauses 5 December 2016

**Summary:** The new rules in clause 123/schedule 26 will allow HMRC and taxpayers to bring finality to discrete matters in large, high risk and complex cases, which have been the subject of HMRC enquiry, by means of a partial closure notice.

**Changes in the Finance Bill:** A number of refinements have been introduced, including:

- Consequential changes limiting the powers of HMRC to give transfer pricing notices and counteraction notices where the matters in question have been the subject of a Partial Closure Notice.
- Consequential changes limiting the powers of HMRC to give notices in respect of certain capital gains anti-avoidance legislation where the matters in question have been the subject of a Partial Closure Notice.
- Alignment of the due date for income tax self-assessment repayments triggered by Partial Closure Notices so that the same due date applies where the repayment arises from taxpayer amendments to their self-assessment during an HMRC enquiry as to a repayment arising from HMRC amendments. In each case such repayments will be due 30 days after the Final Closure Notice in respect of the enquiry is issued.

Penalties for errors in taxpayers’ documents

Previous announcements: Draft Finance Bill clauses 5 December 2016

**Summary:** The new rules clarify what constitutes the taking of reasonable care for the purpose of the existing penalty regime in Schedule 24 FA 2007 in relation to inaccuracies arising in a person’s tax return from the defeat of tax avoidance arrangements.

**Changes in the Finance Bill:** Amendments in clause 124 mean that the new limitation on what constitutes taking reasonable care will not apply in the case of arrangements if they accord with established practice at the time they were entered into and HMRC indicated its acceptance of that practice at that time. This is a welcome clarification.

The amendments also provide that advice from a person who has facilitated the arrangements for consideration is not automatically disqualified in considering whether reasonable care has been taken in situations where an avoidance-related rule applies to the arrangements but they are not subject to Disclosure of Tax Avoidance Schemes, the Value Added Tax (VAT) disclosure rules, the General Anti-Avoidance Rules or counteraction following the issue by HMRC of Follower Notices. This exclusion provides that advice is not disqualified where the person giving the advice had appropriate expertise and the advice took account of the taxpayer’s individual circumstances. This change has narrowed the scope of advice which is disqualified and is likely to remove the need for taxpayers to take a second opinion in relation to many significant commercial transactions, as might otherwise have been the case.

**Making Tax Digital**

Previous announcements: Draft Finance Bill clauses 5 December 2016

**Summary:** The Bill introduces new digital record-keeping and reporting requirements for businesses within the charge to income tax.
Among the proposals the Government intends to take forward is the proposal that the profit allocation set out in the partnership return will be used as the basis for the allocation of taxable profits. However, where there is a dispute, the Government intends to legislate to protect partners from being taxed on incorrect profit shares. This is different from the approach consulted upon. Furthermore, any retrospective variations to a partnership's profit sharing arrangements after the period end will not be accepted, although at this stage it is unclear how flexible allocation arrangements may be impacted.

It is proposed that unless the ultimate recipients of partnership profits are notified to HMRC, a partnership will need to compute taxable profit under four different bases (i.e., as if the partner was a UK and non-UK resident individual and a UK and non-UK resident company). However, the suggestion of a payment on account being required where the reporting requirements were not complied with (so as to ensure full collection of tax) is not being pursued.

The Government will also legislate to ensure the beneficiary of a nominee or a bare trust arrangement is treated as a partner and named on the partnership return.

Legislation is expected in the next Finance Bill, applying to accounting periods starting on or after 5 April 2018.

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**Changes in the Finance Bill:** Clause 120 gives authority for the Commissioners to make regulations about the new digital requirements which cannot have effect before the tax year commencing 6 April 2018. For businesses with gross income (turnover) below the VAT registration threshold, the income tax regulations will not have effect before the tax year commencing 6 April 2019. Clause 122 enables the Commissioners to make regulations requiring businesses to keep digital records and report digitally for VAT purposes (in addition to existing powers to regulate to require returns to be rendered digitally). These requirements are expected to come into force from 6 April 2019 onwards.

**Measures not in the Finance Bill:** The Government had promised to publish draft regulations for the new requirements at the same time as Finance Bill 2017. It will now provide a working draft of the regulations before the committee stage debate. In addition, a full version of the draft regulations will be published in summer 2017 for technical consultation.

**Consultation and discussion documents**

**Partnerships:** The response to the August 2016 consultation into certain aspects of partnership taxation has also been released. The consultation did not consider the underlying principles of how a partnership's taxable profits are determined, but instead focused on identifying the taxable partners and reducing the scope for non-compliant taxpayers to avoid or delay paying tax.
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