UK issues Summer Finance Bill: a review of corporate tax measures

Executive summary

The UK Summer Budget provided the UK Chancellor with the opportunity to indicate the direction of taxation over the five year life of the present Parliament.¹ This includes reform in a number of areas with a Business Tax Road Map and over 30 consultations promised.

By comparison, this year’s summer Finance Bill necessarily lags behind the Budget approach. Substantial parts of the Finance Bill are given over to areas consulted on by the Coalition Government, such as the reform of loan relationships, changes to venture capital trusts and the enterprise investment scheme along with a power for the direct recovery of tax debts. Measures such as the reform of the taxation of non-UK domiciled individuals, the new income tax regime for dividend taxation and the new payment regime for large companies will be addressed in future legislation.

The Finance Bill does contain the tax lock to prevent the rates of income tax along with the standard rate or reduced rate of value-added tax (VAT) from being increased. The lock to prevent the rates of class 1 national insurance contributions (for employers and employees) from being increased is contained in the National Insurance Contributions (Rate Ceilings) Bill of 14 July 2015. The Finance Bill also contains both the reduction in the main rate of corporation tax to 19% from 1 April 2017 and the reduction to 18% from 1 April 2020.

Of the other new measures announced in the Summer Budget, the Finance Bill provides details of the changes to the banking levy and the new bank corporation tax surcharge along with the proposals for the treatment of carried interest and amortization of newly acquired goodwill, among others.
Detailed discussion

**Corporation tax rates**
The main rate of corporation tax, which applies to all companies subject to corporation tax except for those within the oil and gas ring fence, will be reduced to 19% from 1 April 2017 and 18% from 1 April 2020.

While the second reading of the Finance Bill will take place on 20 July, the remaining stages are expected to take place after the summer recess and indeed the Finance Bill may not be substantively enacted until October.

Companies are, under UK Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), required to measure deferred tax at the rate at which it is most likely to reverse based upon tax rates enacted and substantively enacted at the balance sheet date. Under US GAAP only enacted rates are used. As both the 19% and 18% rate are included within the Finance Bill, for accounting periods ending after the date of substantive enactment or enactment as appropriate, companies will be required to measure deferred tax at differing rates depending upon when deferred tax will reverse. Scheduling of the reversal of timing and temporary differences may therefore become more important as groups aim to quantify the tax impact in future periods.

For interim periods, the tax rate to be used is that as substantively enacted (for UK GAAP and IFRS) or enacted (US GAAP) at the relevant balance sheet date (i.e., the interim period date not the year end date).

**New restrictions on corporation tax relief for business goodwill amortization**
Tax relief is no longer available for amortization of goodwill and customer-related intangible assets acquired or created by a company, with effect from 8 July 2015. Furthermore, any debits arising on the realization of such assets will be treated as non-trading in nature. The effect of this and other recent changes is that there will be limited ways in which such debits can be utilized, other than in the year of realization.

The definition of goodwill and customer-related intangible assets is widely drafted. It includes information which relates to customers or potential customers of a business, a relationship (whether contractual or not) that the transferor has with one or more customers of a business, an unregistered trademark or other sign used in the course of a business, together with a license in respect of any of the above. This mirrors legislation introduced in Finance Act 2015 (which is now superseded) that restricted relief for goodwill and customer-related intangible assets acquired on incorporation of a business.

The changes do not apply in a case where a relevant asset is acquired before 8 July 2015 (or afterwards provided the acquisition is pursuant to an unconditional obligation existing prior to that date). However, notably no such limitation applies to relevant assets created before 8 July 2015.

**Corporate debt and derivative contracts**
A key purpose of the changes in the Finance Bill is to clarify the relationship between tax and accounting and to align taxable loan relationship profits with accounting profit and loss entries. Discussion on the changes now included in the Finance Bill was started by a consultation on modernizing the rules launched by HM Revenue & Customs (HMRC) in 2013 and has been taken forward by working groups in the period since. The majority of changes will have effect from accounting periods commencing on or after 1 January 2016. However, the new “principles-based” targeted anti-avoidance rule along with the new rules enhancing the tax reliefs available during corporate rescues will have effect from the date the Finance Bill receives Royal Assent.

The new “principles-based” targeted anti-avoidance rule seeks to counter arrangements that are entered into with a main purpose of achieving a tax advantage under the loan relationship or derivative contract rules.

Following input from the working groups, the Finance Bill contains a new and an enhanced relief for companies in financial distress which was not included in the December 2014 draft legislation. The new reliefs disapply the deemed
release rules in sections 361 and 362 Corporation Tax Act 2009 for certain corporate rescue situations. Both these rules deem that a loan has been released, thus crystallizing a taxable profit, in certain situations. Currently, there is no such exception from section 362 and the exception from section 361 requires a change in ownership of the debtor company in the period between one year before and 60 days after the acquisition of the debt. The change in ownership condition is no longer required for the exception from section 361 although there is a similar condition attached to the new section 362 exemption. The old debt-for-debt exception to section 361 has been repealed but the equity-for-debt exception remains. As a result of the new and enhanced reliefs, the anti-avoidance rule in section 363A, that was to have been repealed, is now retained.

**Taxation of banks**

The new bank corporation tax surcharge of 8% will be introduced with effect from 1 January 2016. The surcharge will be charged separately from corporation tax and the taxable profits for the purposes of the surcharge will not be capable of being reduced by pre-January 2016 losses, non-banking losses or group relief from non-banking companies. An annual surcharge allowance of £25mn is available to groups and individual banking companies. For groups containing two or more banking companies, it will be necessary to appoint a nominated banking company who will submit a group allowance allocation statement for each period. There are rules addressing the offset of foreign tax credits against the surcharge, as well as anti-avoidance provisions. Consequential amendments are made to the diverted profits tax legislation in order to take account of the introduction of the surcharge.

The Finance Bill contains provision for the announced reduction in bank levy rates in 2016 and further reductions each year from 2017 to 2021. However, it does not take forward at this stage the Summer Budget announcement that in 2021 the taxable base will be redefined to exclude non-UK balance sheets.

With effect from 8 July 2015 (15 July 2015 in respect of firms with a corporate partner) a tax deduction will not be allowed for expenses incurred by banking companies, wherever located, which relate to relevant compensation payments. Furthermore, where a company suffers such a disallowance it is also required to bring in a notional receipt of 10% of the relevant sum in order to reflect the costs associated with making the compensation payment. For the deduction to be disallowed, a disclosure condition must be met. This condition will be met where, broadly, a relevant document indicates that the company is, has been, will or may become liable to pay compensation in respect of a particular matter.

There are exclusions from the compensation provisions for certain expenses and for certain companies. **Investment managers: capital gains tax treatment of carried interest and changes to disguised investment management fee provisions**

Draft legislation setting out changes to the way that carried interest payments from partnerships will be taxed with effect from 8 July 2015 was released at the time of the Summer Budget and is now included in the Finance Bill. The changes affect those who provide investment management services as part of an arrangement which involves a partnership. When calculating taxable gains in respect of carried interest, such individuals will only be entitled to deductions for consideration actually paid (in other words they will no longer be able to claim a deduction for base cost shift).

In addition, any gains related to carried interest in foreign assets received by non-UK domiciled individuals will be taxable on the arising basis to the extent that they relate to services performed in the UK.

The Finance Bill also contains an amendment to the definition of a reasonable return on investments when determining whether amounts received by investment managers should be taxed as a disguised investment management fee.

**Other measures included in the Finance Bill**

Some of the other measures included in the Finance Bill are set out below, together with the date they are effective from.
• The removal of all requirements relating to the location of a “link company” for the purpose of consortium relief. This change applies to accounting periods beginning on or after 10 December 2014, though case law would seem to disapply the previous provision for earlier periods in any event.

• Restriction on use of UK losses against a Controlled Foreign Company (CFC) charge. From 8 July 2015, CFC charges can no longer be reduced by the losses of UK companies, whether the losses are brought forward or from the current year, or losses surrendered as group relief from elsewhere in the group.

• A new market value override on disposal of trading stock not in the course of a trade and intangible fixed assets not at arm’s length. From 8 July 2015, the market value is to be brought into account for transfers of trading stock or intangible fixed assets between related or connected parties. There is a related provision where trading stock needs to be valued for tax purposes on the cessation of a trade.

• A permanent level of £200,000 will be set for the annual investment allowance from 1 January 2016.

Measures not included in the Finance Bill
Some of the key measures not included in the Finance Bill are highlighted below, along with the expected next steps.

• A business tax roadmap for Budget 2016, once the Government knows more about the recommendations coming from the Organisation for Economic Co-operation and Development/G20 project on Base Erosion and Profit Shifting (BEPS) and has concluded on Business Rates reform.

• Implementation of the country-by-country reporting requirements as part of the BEPS project. This will be taken forward by statutory instrument.

• Plans to increase large business tax compliance. A formal consultation is expected on 20 July 2015 looking at the detail of the new measures, which will include a mandatory requirement for large businesses to publish their tax strategy and a voluntary Code of Practice setting out standards HMRC expects of large business in their relationship with HMRC. These measures will be backed up by a “special measures” regime on which the Government is continuing to consult as part of its wider serial avoiders consultation.

• Details for a new private placement relief from withholding tax. A draft statutory instrument is being informally consulted on.

• A wider consultation on the options for deduction of tax from interest, following on from the abolition from 6 April 2016 of the Tax Deduction Scheme for Interest which applies to banks and building societies. One of the six options put forward is the removal of the obligation to deduct income tax from interest.

• The acceleration of corporation tax payment dates for large companies. More information on this is expected to be available in September.

• A consultation on company distributions to be launched in autumn 2015.

Endnote
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