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Autumn Statement
Tax Budget Briefing

30 November 2016

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Debbie Payne, tax director

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Funds update
Performance fees

Debbie Payne, tax director

Funds update

Offshore Funds

UK taxpayers invested in offshore reporting funds pay tax on their share of a fund's reportable income, and Capital Gains Tax (CGT) on any gain on disposal of their shares or units.

The government will legislate to ensure that performance fees incurred by such funds, and which are calculated by reference to any increase in the fund's value, are not deductible against reportable income from April 2017 and instead reduce any tax payable on disposal gains. This equalises the tax treatment between onshore and offshore funds.

BEPS update

Losses and interest deductibility

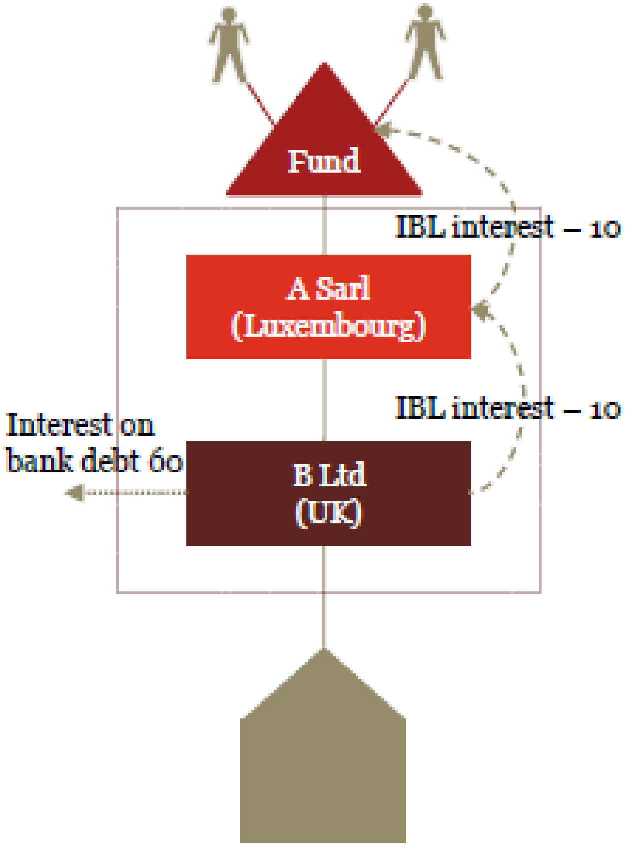
Justin Woodhouse, tax partner

Consultation on interest deductibility

- UK implementation of BEPS Action 4.
- Scope of the rules – corporates only:
  - Non resident landlords (NRL's) – are they in? If so, how and when?
- Commencement – 1 April 2017:
  - Split accounting period for tax for straddle period (just and reasonable apportionment).
- Draft legislation expected on 5th December
  - UK Interest deductions limited to fixed ratio of 30% of interest: EBITDA ratio for 'UK Group'.
  - A group ratio based on interest: EBITDA will be introduced for highly leveraged industries which can increase 30% number.
  - Existing debt cap rules to be repealed. New absolute limit on UK net deductions = group net interest deductions.
  - A de-minimis amount of £2m will always be deductible for the 'UK Group' (even if that exceeds 30%, group ratio and modified debt cap).
  - Public benefit projects will be exempt.
  - Restricted interest is carried forward indefinitely and may be deducted in future periods if there is capacity.
  - Spare capacity can only be carried forward for three years.

Group ratio

Example 1



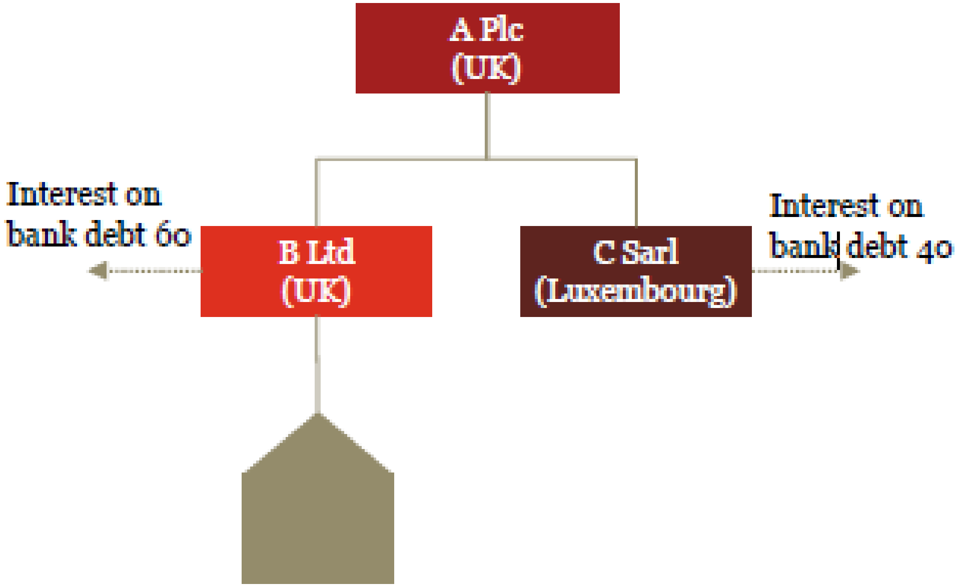
Fund debt not treated as external debt for group ratio

Accounts	A Sarl	B Ltd	WW Group
Operating profit/Tax EBITDA	0	100	100
Net Interest expense	-	(70)	(70)
Profit before tax	0	30	30

Calculation of Group Ratio (WW Group)	
Qualifying group-interest expense (1)	60
Group profit before tax (2)	30
Group interest expense (3)	70
Group EBITDA (4)=(2) + (3)	100
Group ratio (1)/(4)	60%
Tax deductible interest expense (60%* UK Tax EBITDA 100)	60

Group Ratio

Example 2 (Diverse debt profile)



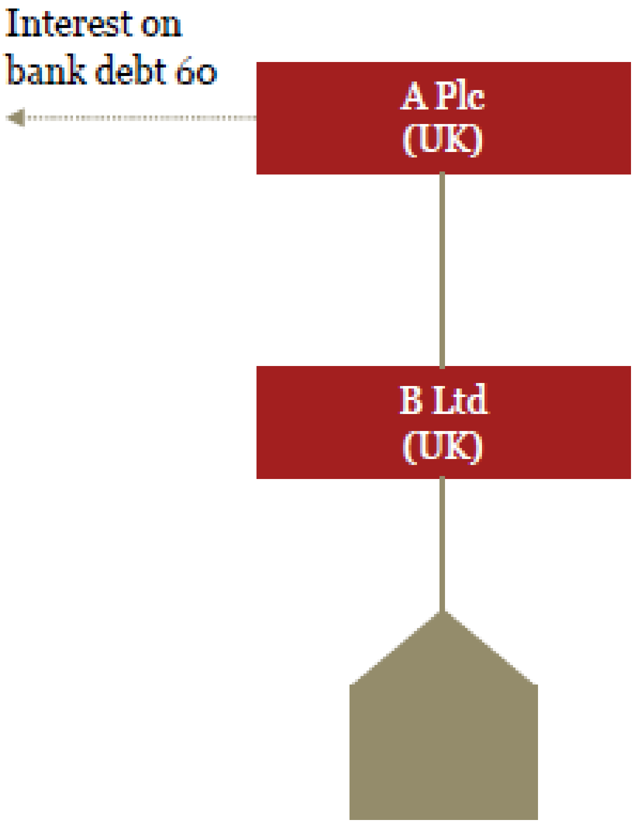
Accounts	A Plc	B Ltd	C Sarl	UK Group	WW Group
Operating profit/Tax EBITDA	0	100	100	100	200
Interest expenses	–	(60)	(40)	(60)	(100)
Profit before tax	0	40	60	40	100

Group ratio test

Calculation of Group Ratio (WW Group)	
Qualifying group-interest expense (1)	100
Group profit before tax (2)	100
Group interest expense (3)	100
Group EBITDA (4)=(2) + (3)	200
Group ratio (1)/(4)	50%
Tax deductible interest expense (50%[1] UK Tax EBITDA 100)	50

Group Ratio

Example 3 (Tax to book differences)



Same example as Example 1 – But B Ltd has recognised an increase in value of properties of 50 (non-taxable as no disposal)

Group ratio

Accounts	A Plc	B Ltd	Group
Operating profit/Tax EBITDA	0	100	100
Property revaluation		50	50
Interest expense	(60)	-	(60)
PBT	(60)	150	90

Calculation of Group Ratio (WW Group)	
Qualifying group-interest expense (1)	60
Group profit before tax (2)	90
Group interest expense (3)	60
Group EBITDA (4)=(2) + (3)	150
Group ratio (1)/(4)	40%
Tax deductible interest expense (40%[1] UK Tax EBITDA 100)	40

Corporate losses rules

Who is affected?

Groups that have brought forward tax losses of more than £5m and current year taxable profits of more than £5m then the new rules will be relevant.

What is the restriction?

- Brought forward losses will be restricted. Groups can offset £5m of losses without restriction.
- Beyond this only 50% of taxable profits can be sheltered by brought forward losses.
- Losses arising post April 2017 can be used more flexibly against all classes of income, both within a company and within a group.

Corporate losses rules

Amendments

Groups need to assess their current position as they may want to amend their prior year returns.

Amendments to a return can be made up to 2 years from the end of the accounting period.

Claiming capital allowances and carrying forward more losses may no longer be the right choice.

2016 transactions

Events taking place in 2016 will affect how the rules apply in 2017. For example, an event such as making a pension contribution could affect the losses a company can claim next year.

Corporate losses rules

Groups at risk

- Groups with fluctuating profits.
- Businesses with fixed life cycles.
- Groups with lots of different types of tax attributes.
- Groups with carried forward deferred interest debits.
- Groups making pension payments.

The Changing Landscape 2015

- The Base Erosion and Profits Shifting (‘BEPS’) package.
- Diverted Profits Tax (‘DPT).
- Restricted income tax relief for interest for residential landlords.

The Changing Landscape 2016

- BEPS action 4 and the proposed ‘interest capping’ provisions.
- BEPS action 2 & the ‘hybrid mismatch’ provisions.
- BEPS action 15 and the multilateral instrument.
- Extension of scope of corporation tax to non-resident companies with a trade of dealing in or developing UK land.
- The updated transactions in UK land provisions.
- The ‘Anti-Fragmentation’ provisions for all companies trading in UK land.
- SDLT rate increases (residential and commercial).
- Consultation on reforms to corporation tax loss relief.
- Proposed Substantial Shareholdings Exemption reforms and a potential ‘Qualifying Fund’ exemption.
- Seeding relief for PAIFs and CoACS and CoACS capital allowances consultation.
- Impact of new UK GAAP changes for non-resident landlords.
- Partnership taxation consultation.
- Making tax digital.
- Lease accounting changes.

Real Estate update

Including NRL's into CT

Justin Woodhouse, tax partner

Trading in Land

1 April 2015 – DPT, the first attempt

- New tax, penal rate, not subject to treaties, if activities designed to avoid a PE
- BUT HMRC can only tax "attributable profits" of avoided PE
- Significant people functions offshore versus land onshore – no clarity on attribution
- Technical, complex, hard to make stick
- Some forestalling by on-shoring before 1 April 2015

Trading in Land, the second attempt, 5 July start date (trading <u>not</u> investment)

Legislation: "the main purpose, or one of the main purposes, of acquiring the land was to realise a profit of gain from disposing of the land".

PwC to HMRC

"... potentially the new test could inadvertently apply to many straightforward investments where capital growth is not the main, but one of the main purposes..."

HMRC to PwC

"... the transactions themselves must have the character of trading... we are confident that taxpayers undertaking investment activity should not be impacted by these updates to the rules..."

Factors:

- Length of time the land is owned
- Intention at purchase date
- Any change of intention
- How the acquisition is funded
- The usage of the property by the owner
- Whether it is developed or improved (rather than repaired) before disposal
- Whether there is a connection with an existing trade – for example a builder buying a property to renovate and sell

Trading in Land

5 July 2016 start date (16 March 2016 for anti-avoidance)

Four new rules: 1 and 2 overlap: apply for corporation tax and income tax

1. Scope of corporation tax extended: non UK resident companies carrying on trade of dealing/developing UK land fully taxable in UK on ALL profits, regardless of permanent establishment, and wherever profits arise. Level playing field with UK companies.

   - Jersey co

2. Amounts treated as trading profits if:

   (i) A person realises profit or gain from disposal of UK land.

   (ii) Main purpose or one of the main purposes of realising profit or gain.

   Also, anti-enveloping rule for disposal of property deriving 50% of value from UK land.

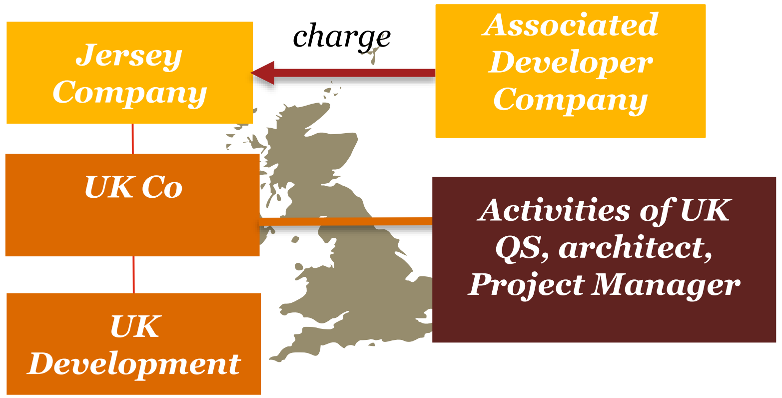
   - Jersey co disposes UK co

3. Anti-fragmentation rule, taxing “relevant contributions”:

   - Associated developer co charge is taxed on Jersey co

4. Anti-avoidance rule:

   - Migrating Jersey co to a better treaty



Trading in Land

TREATIES OVERRIDE

BUT

Jersey protocol 16 March 2016 to remove 1952 treaty protection

A few other treaties block trading in land but will be amended

Trading in Land

Intention change – vital importance of evidencing intention

HMRC examples

1. NR investor buys for rental but with capital appreciation a factor. Repairs and sells after 7 years. Not trading.
2. NR investor buys to develop and sell. After developing, rents for 6 months, then sells. Trading.
3. NR investor buys and rents for several years. Then demolishes and develops. Change of intention. Investment intention period should not be taxed.

Effects of BREXIT?

Autumn Statement – NRL's

4.26 Bringing non-resident companies' UK income into the corporation tax regime

– The government is considering bringing all non-resident companies receiving taxable income from the UK into the corporation tax regime. At Budget 2017, the government will consult on the case and options for implementing this change. The government wants to deliver equal tax treatment to ensure that all companies are subject to the rules which apply generally for the purposes of corporation tax, including the limitation of corporate interest expense deductibility and loss relief rules.

- Currently Corporation Tax only applies to non-residents companies trading in the UK through a permanent establishment, or trading in land. Where the non-resident company does not have a trading business in the UK, rental income is subject to income tax rather than corporation tax under NRL scheme
- It is unclear how much further the scope of Corporation Tax will be extended. It is possible that the scope will apply to the non-resident landlord scheme in order to prevent non-resident companies from adopting high levels of gearing in order to fund acquisition of UK property.
- This will affect non-resident companies that hold physical real estate from jurisdictions such as Jersey.
- One side effect of this could be the requirement to bring disposals of UK property by non-resident companies into the scope of chargeable gains. Effectively, Capital Gains Tax on the sale of residential property could be extended to commercial property.
- The Government have not limited the scope which could mean the scope might go wider than just Non-Resident Landlord income.
- In a more extreme scenario, the scope could include all passive income such as royalties and savings income that would become subject to UK tax – Although this is unlikely and would have a significant impact on offshore funds with investment income.

Non-doms

Kerry Emblem, senior tax manager

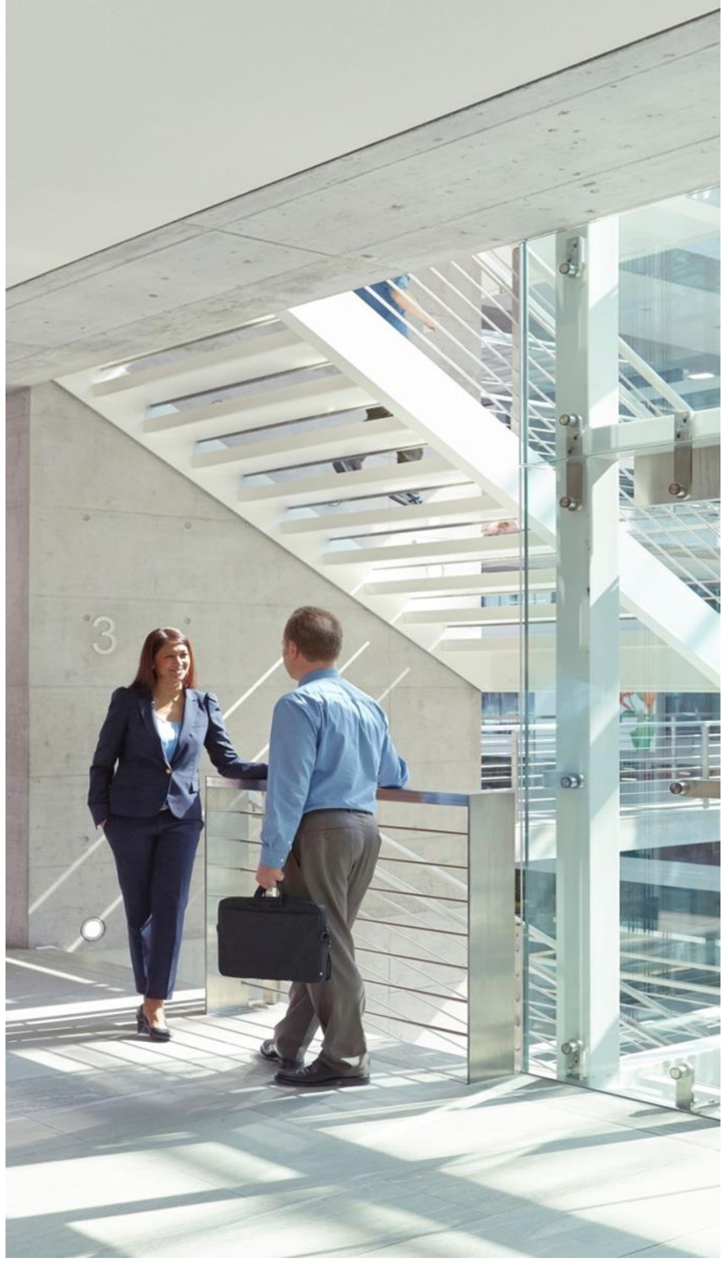
Where are we now?

Changes will come into force on 6 April 2017

Summer consultation which closed on 20 October 2016

Autumn statement – 23 November 2016

Draft legislation – expected 5 December 2016



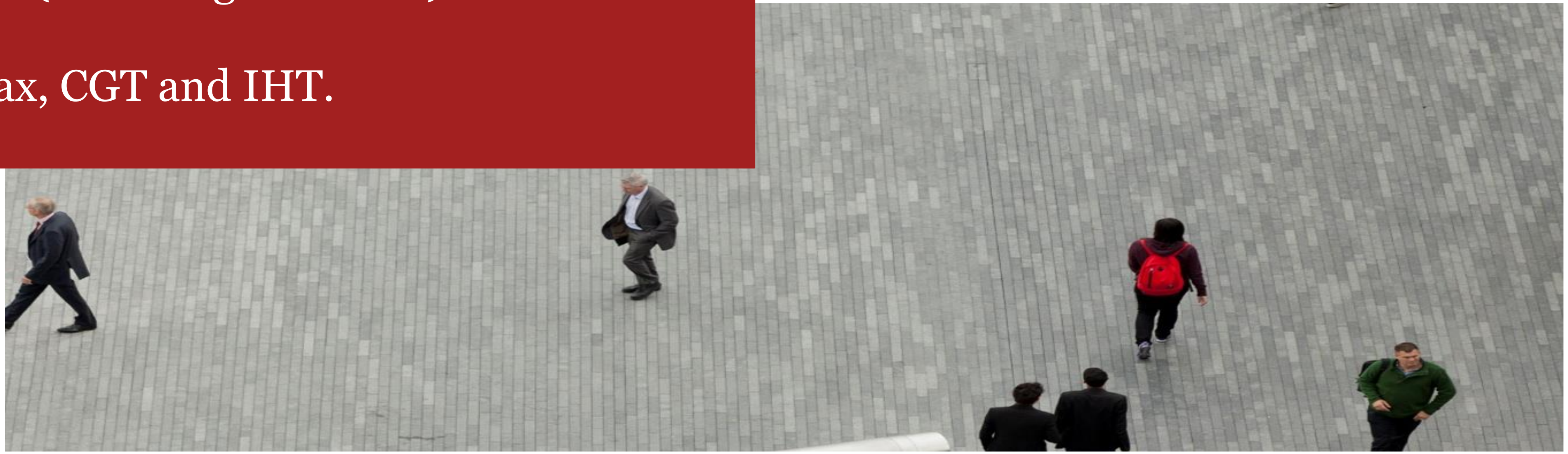
What's the big change?

Individuals will be deemed domiciled if:

Income and capital gains tax

- Resident in 15/20 immediately preceding tax years (long term UK residents).
- Born in the UK, domicile of origin in the UK & resident in the UK (returning non-dom).

Applies for income tax, CGT and IHT.



Asset rebasing

How will it work?

Ability to “re-base” foreign assets to 6 April 2017 value

- Available to 6/4/17 deemed doms only (long-term UK residents).
- Personally held assets only.
- Asset must be foreign situs asset owned on 8 July 2015.
- Must have paid RBC at some point.

- Asset by asset basis.
- Not available if UK domicile of origin (returning non-dom).
- Pre 6/4/17 gain can be remitted without tax (but if purchased using offshore income or gains, still tax on that remittance).

Bank account cleansing

How will it work?

Ability to "tidy up" offshore bank accounts

- 6/4/17 – 5/4/18 : Opportunity to 'un-mix' mixed funds
- No time limit on remittance from the separated accounts
- Only applies in relation to bank accounts or similar
- Must be able to determine component parts
- Available to **any non-dom** (unless born in UK)

Trusts
Still worth using?

- IHT position remains broadly unchanged.
- Position for non-settlor interested trusts remains unchanged.
- New income tax and CGT rules apply to deemed dom settlors of settlor interested trusts.

Residential property and IHT

	Now	*Post April 2017*
IHT	No	Yes
ATED	Yes	Yes
NRCGT CGT	Yes	Yes

Key points

- Offshore structures holding UK residential property transparent for IHT.
- No deduction for connected party debt.
- No relief for "de-enveloping".
- TAAR.

The changing tax landscape for UK residential property

ATED – April 2013

NRCGT – April 2015

- SDLT - 4 December 2014 – changes to residential property
- - 1 April 2016 -Additional 3% for second homes

Removal of wear and tear allowance – April 2016

Interest relief restriction (individuals) – April 2017

IHT for non-domiciled individuals – April 2017

The changing tax landscape for UK residential property

To de-envelope or not?

Is the structure still required?

Consider SDLT, ATED CGT and NRCGT

Non tax reasons for holding property through a structure

Cost benefit analysis

Action to consider before April 2017?

Review existing structures – collapse/simplify?

Review domicile and residence status

Pay out income/gains from trusts, dividends from companies

Pay the RBC to achieve rebasing

Review mixed funds for segregation

Set up new structures?

Any questions?

Panel

1. *Enablers of tax avoidance*
2. *EBT structures*
3. *Corporate criminal offences*
4. *Correct past failures*
5. *Public registers of offshore structures*
6. *Substantial shareholding exemption*

Questions and closing remarks