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CHARTERED ACCOUNTANTS

# BUDGET 2016 – INTERNATIONAL TAX ISSUES

### FOR BUSINESSES AND INDIVIDUALS TRADING, WORKING AND INVESTING IN THE UK

## In a nutshell

The 2016 budget included several measures that will impact businesses and individuals trading, working and investing in the UK. All the changes, some expected and some new, require equal and careful consideration as more information is published.

In the 2016 budget, we have identified several changes to international tax that affect businesses and individuals operating in the UK:

1. Rules governing the withholding of tax on royalties are being extended.
2. Relief for corporate tax losses brought forward from earlier years is to be broadened in scope for all companies but some restrictions apply to the largest.
3. Offshore property structures trading in or developing UK land will now be taxed in the UK, so the cost of buying residential property in the UK will rise.
4. New VAT measures target online marketplaces.
5. Interest relief restrictions will affect individuals with UK buy-to-let residential property.
6. A range of tax measures target non-UK domiciled individuals.

This briefing explains the changes listed above, examines some of the potential implications for individuals and businesses and recommends actions that may need to be taken in response.

## Changes affecting businesses:

## 1. Royalty withholding

All international royalty payments arising in the UK will be subject to the deduction of income tax at source, at a rate of 20%, unless protected by either a double taxation agreement or the EU Interest and Royalties Directive. The definition of a royalty will be broadened and further anti-avoidance measures will be introduced.

## 2. Corporation tax loss relief

From 1 April 2017, there will be more flexibility in how brought forward tax losses can be utilised by companies who pay corporation tax. Under current rules, corporation tax losses carried forward from earlier years can only be used by the company that incurred the loss; and, for certain types of loss, their use is restricted to certain types of profit. For example, trading losses can only be used against trading profits.

The new rules will allow companies to use brought forward losses against profits from other income streams, as well as from other companies within the group. This welcome change should reduce the level of loss that becomes trapped in companies unable to offset it under current rules.

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The picture is not so rosy for larger companies because they will be vulnerable to the change in the amount of carried forward loss that can be offset against eligible taxable profits. Currently there is no restriction for these firms. However, from 1 April 2017, the amount of profit that can be offset against losses carried forward will be capped at 50% of the amount of profits in excess of £5 million. Where the company is in a group, the £5 million profit threshold will apply to the group.

## 3. Interest deductibility

In response to proposals outlined in the final report of the OECD's BEPS project, released last year, new rules will limit the corporate tax deductibility of interest expenditure from 1 April 2017. The changes will restrict the tax relief claimed by large multinational enterprises for interest expenses. To ensure that large businesses are targeted by these rules, there will be a *de minimis* group threshold of £2 million net UK interest expense.

A fixed ratio rule will limit corporate tax deductions for net interest expense to 30% of a group's UK earnings before interest, taxes, depreciation and amortization (EBITDA). There will also be a group ratio rule for groups with high external gearing for genuine commercial purposes, replacing the current worldwide debt cap regime. These new rules could have quite a significant impact on the amount of interest deduction a group can claim.

## 4. VAT fraud

HMRC will be able to hold an online marketplace jointly and severally liable for the unpaid VAT of an overseas business that sells goods in the UK via its website.

## 5. Offshore property development structures

Non-UK companies - namely those in the Channel Islands or the Isle of Man because of their tax treaties with the UK - have often been used to shelter part or all of the profits arising from the development of or trade in UK land. Measures will be introduced to tax these profits in the UK.

## 6. Buying UK property

Any company buying virtually any UK residential property after 1 April 2016 will face an additional 3% Stamp Duty Land Tax charge. The additional charge will apply to individuals who already own a residential property and buy a second one. If six or more properties are purchased in a single transaction, multiple dwellings relief may help reduce the tax cost.

## Changes affecting individuals:

## 1. Investing in UK property

The UK is changing the way tax relief can be changed for interest payments. From April 2017, individuals who invest directly in UK residential property - and who have borrowed in order to do that - will see a reduction in the tax relief that they can claim. In addition, from April 2017, non-UK domiciled individuals investing in UK residential property, whether directly or indirectly via a company or trust, may find themselves exposed to inheritance tax.

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## 2. Non-UK domiciled individuals

The UK traditionally had favourable rules for individuals resident in the UK but not domiciled here. Non-domiciled individuals could opt not to be taxed on their non-UK income and gains, provided that income and gains were not remitted to the UK. Opting for that relief has begun incurring an increasing cost and from April 2017, it will no longer be available to individuals who have been resident here for 15 of the last 20 years. On the positive side, the tax base cost of non-UK assets will be deemed to be their market value at 6 April 2017 rather than their original historic cost.

## Conclusion and Recommendations

In response to the changes to international tax described above, we recommend the following actions:

### ACTIONS FOR BUSINESSES:

- **ROYALTY WITHHOLDING:** Recipients of royalties based outside the UK need to consider what the implications of royalty payments becoming subject to the deduction of income tax at source on their business model. Affected businesses must consider what action they may be able to take.

- **CORPORATION TAX LOSS RELIEF:** Companies and groups need to consider what impact the changes to corporation tax loss relief outlined above will have on their structures and on the use of losses they have within those structures.

- **INTEREST DEDUCTIBILITY**: The new rules will encourage groups to try and ensure that debt is allocated amongst group members in line with where EBITDA is generated. Given the likely practical challenges of this, all UK companies and groups with net interest expenses above the £2 million threshold should review their finance arrangements and ensure they understand how the new rules will impact their particular circumstances, following the summer consultation.

- **VAT FRAUD:** Any online marketplace that allows good to be sold to the UK needs consider the extent of their potential exposure to the new rules targeting VAT fraud and put measures in place to limit it.

- **OFFSHORE PROPERTY DEVELOPMENT STRUCTURES**: Companies being used to shelter profits arising from developing or trading in UK land should decide what action, if any, can be taken to protect their position.

- **BUYING UK PROPERTY:** Potential purchasers of residential property in the UK need to recalculate the return on their investment, taking into account the additional 3% Stamp Duty Land Tax charge.

### ACTIONS FOR INDIVIDUALS:

- **INVESTING IN UK PROPERTY:** Individuals investing directly in UK residential property will need to consider putting in place structures to address the planned reduction in tax relief they can claim, although these may have other tax implications that also need consideration. Non-UK domiciled Individuals investing in UK residential property directly or indirectly will also need what action they could take, if any, to reduce their exposure to inheritance tax from April 2017.

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- **NON-UK DOMICILED INDIVIDUALS:** Non-domiciled individuals likely to be exposed to the end of tax relief on their non-UK income and gains not remitted to the UK need to consider what action to take to address this change well before it comes into effect.

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