UK Tax Update: Business Ownership

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trowers & hamlins

Agenda

1. Corporation tax
2. Extension of corporation tax to non residents
3. Digital Services Tax
4. Personal tax on ownership

Backdrop

The Context

- COVID 19 Impact – unprecedented government support to economy

- Changed political direction initiatives including:

  a) EU's DAC 6 – ***Greater disclosure and transparency***

  b) OECD's Base Erosion and Profit Shifting (BEPS) project recommendations - ***Protecting the tax base***

  c) Domestic UK, levelling playing field for all types of investors – ***Fairness***.

DAC 6 – Brexit effect

- EU Directive on Administrative Cooperation (DAC 6) (The International Tax Enforcement (Disclosable Arrangements) Regulations 2020)
- Mandatory automatic exchange of information between EU member states about certain cross-border tax arrangements
- Brexit effect: UK to adhere to OECD (mandatory disclosure rules)
- **AIM: Greater disclosure and transparency**

Corporation tax: key changes

Corporation tax – who is liable?

- UK resident companies
  - UK incorporated companies
  - Central management and control – issue for owner managed businesses
- UK permanent establishments
- Certain non-UK resident companies (real estate profits)

Increase in corporation tax rate

- CT currently 19%
- 1 April 2023 main rate of CT increases to **25%**
- Small profits rate of 19% up to £50,000 profit (and marginal relief between £50k - £250k)
- Special regimes for oil & gas, life insurance companies, shipping, banking.
- Will it happen?

BEPS

- OECD's Base Erosion and Profit Shifting (**BEPS)** project recommendations
- Action 4 (interest) and 10 (transfer pricing) for base protection
- **AIM: Protecting tax base**

Financing deductibility – corporate interest restriction

Aim - Protect tax base

- Historically, financing costs have generally been deductible if market rate.

- New corporate interest restriction ("CIR") rules introduced (also applies to shariah compliant profit rates) – resulted from BEPS Action 4.

- CIR applies to both UK and non UK resident companies from 2020.

Financing deductibility – CIR - de Minimis

Aim - Protect tax base

- £2m financing cost allowance for a ‘group’ before CIR applies.
- This could be both shareholder or third party debt.
- Importance of definition of ‘group’, this follows the accounting definition.
- Identifying each separate ‘group’ is <u>important</u> and often complex.

Financing deductibility - Corporate interest restriction

Aim - Protect tax base

- **Financing costs restricted to the higher of a number of calculations**
- **Fixed ratio**
  - Deductions restricted to 30% of tax EBITDA.
- **Group ratio**
  - the ratio of the company's or group's worldwide net interest expense owed to unrelated parties, to the company's or group's overall profit before tax, interest, depreciation and amortisation multiplied by the company's or group's taxable UK profits before interest and capital allowances
  - the company's or group's worldwide net interest expense owed to unrelated parties

Financing deductibility – Other important considerations

Aim - Protect tax base

- **Transfer pricing**
- **Anti-hybrid rules**
- **Overall – financing cost deductibility now complex**

"Levelling Up"

- UK residents and non-UK residents (UK property)
- Increasing Stamp Duty Land Tax (SDLT) rates
- The problem of the UK high street – online retailers
- **Aim: Fairness**

Domestic UK - Levelling Playing Field for Investors

Aim - Fairness

- Non UK companies brought within the scope of corporation tax regime
- Same tax rate now applies to both UK and non UK resident property companies
- Profits now taxed at 19% (to increase to 25%)
- Review historic investment models

Domestic UK - Levelling Playing Field for Gains – Real Estate

Aim - Fairness

- Historically no tax on non-resident property capital gains
- 2015 – CGT for non-residents on residential property
- 2019 - new capital gains regime extends tax on capital gains to all non-residential property owners including commercial
- Relevant to profits on disposal of UK real estate, or “property rich” companies
- Current non resident companies and indirect owners will benefit for the rebasing of base costs to April 2019
- Recommend a current market valuation of both the company and property is documented – could be an major point of future enquiry

Domestic UK - Levelling Playing Field – Digital Services Tax

Aim - Fairness

- 2% turnover tax

- Applies to "UK digital services revenue" from social media, search engines, online market places

- Will be phased out when international agreement reached

- £25m in UK revenue / £500m in global revenue

UK Tax Update: ownership level

UK tax for owners

- Key factors
  - Domicile
  - Residence
  - Asset

- Main taxes
  - Inheritance tax (IHT)
  - Income tax
  - Capital gains tax (CGT)

UK tax for owners – IHT

- Death tax
- Key connecting factor: domicile and location of assets
- UK domiciled – 40% on worldwide assets
- Non-UK domiciled – UK situated assets only (40%)
- NEW: shares/interests in non-UK companies owning UK residential property – **Offshore companies owning UK residential property do not protect from IHT**
- **Stealth tax rise: exempt amount of £325,000 frozen since 2009 and will remain until 2026!**

UK tax for owners – income tax

- Key connecting factors: source of income and residence of recipient

- UK real restate: all non-residents subject to tax
  – corporation tax for companies (19%)
  – Individuals up to 45%

- Dividends
  – UK residents: dividend rates up to 39.35%
  – Non-UK residents: effectively 0% (no withholding tax) on disregarded income

UK tax for owners – capital gains tax

- Key connecting factors: type of asset and residence of recipient

- Non real estate assets:
  - UK residents: 10%/20%
  - Non-UK residents: not subject to CGT

- UK real restate: all non-residents subject to tax
  - corporation tax for companies disposing of UK real estate
  - Individuals subject to 18/28%

Other

- Stamp duty land tax (SDLT) – property acquisition tax
- Additional 2% surcharge for non-residents from April 2021

Conclusion

Take away points

Protect tax base

- The OECD is continuously reviewing initiatives
- ‘Old’ assumptions no longer apply, especially on financing cost deductions
- Existing investment structures should be reviewed
- Investors should ensure that their administrators and advisors are on top of all of the recent changes

Greater disclosure and transparency

- DAC 6 is a EU initiative, but likely to be greater requirements for disclosure and transparency

Fairness

- UK real estate taxes are substantially more nuanced now
- Effective tax rate now highly variable

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