FIELD COURT TAX CHAMBERS

FCTC DIGEST

Special Budget Issue (3 March 2021)

Producer: Imran S Afzal

MEMBERS OF CHAMBERS

Patrick C Soares

Patrick Way QC

Philip Baker QC

Imran S Afzal

Peter Vaines

Philip Goeth

Katherine Bullock

Dilpreet K Dhanoa

David Bloom QC (Door Tenant, Australia)

Porus F Kaka (Door Tenant, India)

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Dilpreet K Dhanoa

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BUDGET 3 MARCH 2021

SPECIAL BUDGET ISSUE OF FCTC DIGEST

EDITORIAL

This is a special FCTC Budget issue of the Digest.

The Budget contains a number of important changes to the tax landscape.

The most striking one is the rate of **corporation tax is to increase to 25%** at the top rate for the financial year April 2023. Patrick Way covers this in his article.

On the positive side there have thankfully been **no major increases in rates or changes in the capital gains tax and inheritance tax regimes**: all the pre-budget planning proved unnecessary from gifts to avoid IHT to early sales to mitigate capital gains tax. There is to however be a **five year freeze** on the income tax personal allowances and the income tax thresholds and that will take time to sink in. See Katherine Bullock's article.

There is also to be a regime of **super tax deductions** where the taxpayer can get a greater deduction for tax

purposes than the amount he has spent (see Peter Vaines article)

The creation of **Freeports** will give rise to a new investment industry bringing back memories of enterprise zones and "golden building contracts." See Imran Afzal's article.

The **SDLT holiday** will continues for some more months but the **2% penalty provisions for non-**resident buyers will be introduced from 1 April 2021. See my article.

Finally, the Government are free to charge or not charge VAT free of all EU restrictions and Dilpreet Dhanoa shows how it has exercised its new found power in her article on the **VAT changes.**

Patrick C Soares

STAMP DUTY LAND TAX

Patrick C Soares

Non-resident purchasers of residential property penalised after 31 March 2021

The penalty

There will be included in the Finance Bill 2021 provisions increasing the rate of SDLT payable by non-resident purchasers including UK close companies controlled by non-resident persons by 2%. This means the top rate of SDLT will be a colossal 17%.

Act early and avoid the penalty

The new rate only applies if the “effective date” is after 31 March 2021. The effective date is normally the date of legal completion but it can be earlier if for example contracts are exchanged and the purchaser is allowed into possession or if say the full purchase price is paid on exchange of contracts.

Example

Luxembourg Sarl purchases a flat in London and contracts are exchanged before 1/4/21 and the full

purchase price is paid before that date. Legal completion is on 28/4/21. The new 2% SDLT penalty is avoided.

Six or more dwellings – 5% maximum

Note the new penalty only applies to the purchase of residential property and the purchase of six or more separate dwellings in one transaction is deemed not to be a residential purchase (FA 2003 s116(7)): so the maximum rate of SDLT payable in that case regardless of when the transaction takes place is 5%.

Extension of SDLT holiday

The present SDLT holiday will continue until the 30 June 2021. Thus for residential purchases the nil rate band will continue to be £500,000 until that date.

From 1 July 2021 until 30 September 2021 the nil rate band will be £250,000. From 1 October 2021 the nil rate band will revert to £125,000.

Comment

This continuation of the SDLT holiday (which started on 8 July 2020) especially benefits first time buyers and has kept the property market lively. If you are going to buy residential property make sure you buy in this SDLT holiday period.

Freeports and SDLT

SDLT will be available on the purchase of land within the proposed freeports.

Comments

This relief will be part of the package to encourage people to invest in Freeports.

CORPORATE TAX CHANGES

Patrick Way QC

Budget measures that included in Finance Bill 2021

Rates

The rate of corporation tax is increased to 25% from 2023. The current rate of 19% will continue to apply to small businesses with profits of £50,000 or less. There is then a tapered relief for companies with profits between £50,000 and £250,000.

The existing corporation tax charge for all companies therefore remains at 19% until the financial year beginning 1st April 2023.

Comment

It will be interesting to see how this works out. Generally speaking, it can cause problems to have such a large discrepancy between the lower corporate rate for small companies (19%) as opposed to a higher rate for larger companies (25%). So we can expect some complexity around this and perhaps some sort of avoidance steps that

(unwise) taxpayers might want to engage in particularly if their profits increase so as to move from 19% to 25%. For example, one can imagine artificial splitting up of companies to try and retain the smaller rate. This will not work.

Temporary extension of carryback of trading losses

The current rule by which businesses may carry back trading losses for one year is extended to three years on a temporary basis. This extension will apply to a maximum £2m. worth of unused trading losses made in each of the tax years 2020/21 and 2021/22 by unincorporated businesses. Separately, the £2m. maximum carryback applies to unused trading losses made by companies, after carryback in the preceding year, in relevant accounting periods ending between 1st April 2020 and 31st March 2021 and a separate maximum of £2m. for periods ending between 1st April 2021 and 31st March 2022.

Comment

This is a welcome relief albeit that it is temporary.

Change to the diverted profits tax (DPT) rate from 1st April 2023

With effect from 1st April 2023 the rate of DPT increases from 25% to 31%. As an aside, the rate of DPT in respect of ring-fence profits or national ring-fence profits remains at 55% and the rate of DPT on taxable diverted profits which have been subject to the bank surcharge remains unchanged at 33%.

Comment

It was necessary to increase the rate of DPT from 25% to 31% in general circumstances given the increase in the main rate of corporation tax to 25% for the financial year beginning 1st April 2023.

As is well understood, DPT has been used to counter profit-shifting and was principally focused on what HMRC regarded as contrived arrangements intended to erode the UK tax base. The principal aim of the tax is to ensure that profits taxed in the UK reflect the economic activity in the United Kingdom and to that extent the tax is consistent with the OECD Base Erosion and Profit Shifting Project.

It is plain that HMRC regard DPT as a significant tax for them and HMRC are launching very thorough investigations in respect of companies that seek to artificially move their profit base abroad. The reason the DPT is set at a higher rate than corporation tax is simply to encourage businesses with arrangements which fall within the scope of DPT to change those arrangements and, in effect, to pay corporation tax on profits in line with their UK economic activity. DPT includes a requirement to pay the tax upfront which is intended to be an incentive for groups to provide timely information about high-risk transactions and how they fit into the group's global operations.

Preventing abuse of research and development (R&D) tax relief for small and medium-sized enterprises

This change announced in the Budget will affect companies that carry out R&D and claim the R&D tax credit for companies which are small or medium-sized enterprises (SMEs). The new rules limit the amount of payable R&D tax credit which an SME can claim to £20,000 plus 300% of its total PAYE and NICs liability for the period.

Nevertheless, a company will be exempt from this cap if:-

(a) its employees are creating, preparing to create or managing intellectual property; and

(b) it does not spend more than 15% of its qualifying R&D expenditure on sub-contracting R&D to, or the provision of externally provided workers by, connected persons.

Comment

The background to this is that R&D tax reliefs, including in particular the SME R&D tax credit, are intended to incentivise firms to invest in R&D.

However, it seems that the SME tax credit has become a target for fraud and abuse in particular through companies claiming payable tax credit for work carried on by others in circumstances where they have very little substance in the UK. This is the rationale for the change in the legislation.

It remains the case, however, that the R&D regime is worth investigating. It is generous.

Technical amendments to the corporate interest restriction (CIR) for corporation tax

The background to this is that CIR was enacted in Finance (No.2) Act 2017 Schedule 5. Technical amendments were made within the Finance Acts of 2018 and 2019 but it is now apparently necessary for two further technical amendments to be made in order for the regime to work as the Government intends.

The first of these revisions is to have effect from the 21st July 2021; whilst the second proposed revision will be treated as having effect from 1st April 2017 when the CIR rules commenced. The amendments will:-

(a) clarify the way special provisions in the CIR rules apply in the context of a real estate investment trust (REIT) to take into account the UK property business of non-resident companies are now within the charge to corporation tax rather than income tax (s.452); and

(b) make sure that no penalties arise for the late filing of an interest restriction return if there is a reasonable excuse for the

failure, bringing the administrative rules in line with those for corporation tax self-assessment (Schedule 7A).

Comment

By way of background, the CIR rules restrict the ability of large businesses to reduce their taxable profits through what are described as excessive UK interest payments and similar expenses. This government policy is said to be consistent with the UK's "more territorial approach to corporation taxation" and in line with the OECD BEPS Action 4 (Limiting Base Erosion Involving Interest Deductions and Other Financial Payments) recommendations.

The CIR rules are complicated and repay close reading particularly in relation to the situation where loans are received from "related parties" where the ability to obtain a corporate interest deduction can be restricted.

Changes to the reform of loss relief rules for corporation tax

Following extensive evaluation since 2017 various changes have been made to the corporation tax loss

rules which were originally enacted in Finance (No.2) Act 2017. These are extensive and include ensuring that groups have access to the deductions allowance to which they are entitled for the period prior to change in the ultimate parent through an acquisition or demerger and other related changes. All of these require close reading of the draft legislation.

Measures which are part of the Budget but which are not in Finance Bill 2021

A number of measures were announced in the Budget but will not be included in the Finance Bill. These are as follows:-

(a) EMI – call for evidence;

The Government is publishing a Consultation on whether and how to expand the EMI scheme;

(b) R&D tax reliefs: review;

The Government will carry out a review of R&D tax reliefs with a Consultation published alongside the Budget. The review will consider all elements of the two R&D tax relief schemes;

(c) corporation tax: review of the surcharge on banking companies

In the Autumn the Government will set out how it intends to “ensure that the combined rate of tax on banks’ profits does not increase substantially from its current level, that rates of taxation in the United Kingdom are competitive as against the United States and the EU, and that the UK tax system is supportive of competition in the UK banking sector.

Comment

The increase in the rate of corporation tax to 25% is not unexpected. Whilst the Chancellor states that the rate remains one of the lowest nevertheless this is not the full story. Merely raising tax rates does not always increase tax take. Also, one has to look at the overall tax base. The OECD looks at the effective marginal tax rate and this is by reference to how much additional tax is paid for each pound of profit. It takes into account the overall base together with the rate itself. In these circumstances the UK has a high marginal tax rate compared with many of its competitors.

In addition, by announcing, two years before 2023, a significant rise in the rate of corporation tax one can imagine distortion in the business activity which may be undertaken by companies prior to 1st April 2023.

FREEPORTS – THE NEW MAGNETS FOR INVESTMENT

Imran S Afzal

The Chancellor has announced the location of 8 English Freeports.

These will be located at East Midlands Airport, Felixstowe and Harwich, Humber, Liverpool City Region, Plymouth, Solent, Thames and Teesside.

Tax sites will be designated within the Freeports and in turn businesses within those tax sites will be able to benefit from major tax reliefs.

One can foresee these areas becoming magnets for investment!

Enhanced capital allowances

There will be enhanced capital allowances for qualifying expenditure on plant and machinery for use within the Freeport tax sites.

This will apply to qualifying expenditure incurred on or after the date a tax site is designated until 30 September 2026.

The enhanced capital allowance will be for 100% of the qualifying expenditure for the tax period in which it is incurred.

Enhanced structures and buildings allowances

There will also be an enhanced rate of structures and buildings allowances for qualifying expenditure on non-residential structures and buildings within Freeport tax sites.

The enhanced allowance will apply for qualifying assets brought into use on or before 30 September 2026, and after the date each tax site is designated.

The enhanced rate of structures and buildings allowance will be 10% on a straight-line basis.

Stamp Duty Land Tax ("SDLT")

There will be SDLT relief for purchases of land and buildings within a Freeport tax site. This will be

subject to a ‘control period’ of up to 3 years and the land being acquired and used in a ‘qualifying manner’.

The relief will apply to qualifying transactions with an effective date from the date the Freeport tax sites are designated until 30 September 2026.

There will be provision to enable HMRC to require information from claimants, in order to ensure that the relief continued to be available during the control period.

FCTC Comments

A member of Chambers has commented that it is very likely, like the old enterprise zones, that these areas will become magnets for individuals who want to shelter their income from the current 45% income tax rate. FCTC can advise on how these investment structures should be set up.

THE SUPER DEDUCTION

Peter Vaines

The Chancellor announced a Super Deduction which sounded both imaginative and valuable as an incentive to unlock the cash reserves held by many companies – and at the same time, to stimulate investment. The reality is a little disappointing – but anything is welcome in these difficult times.

The proposed Super Deduction is just an enhanced first-year allowance at 130% for expenditure on qualifying plant and machinery in the two years from 1st April 2021 to 31st March 2023. (There is a 50% first-year allowance for special rate assets which presently qualify for the 6% allowance).

The Super Deduction applies only to expenditure by companies – not to unincorporated businesses who

can already obtain 100% relief from the Annual Investment Allowance.

The principle of a first year allowance is familiar and this is a new version, but with a few tweaks. One of these tweaks is a requirement that on the disposal of the asset the proceeds will represent a balancing charge and not just a credit to the pool – and to be fair the disposal proceeds will be multiplied by 1.3 to preserve symmetry with the relief.

The principles are clear enough but of course there are many special rules to ensure that it is closely targeted – for example, no cars, no second hand assets, no leasing and no connected party transactions. And of course there is a TAAR for anybody who takes contrived steps to become entitled to the relief by exploiting shortcomings in the legislation. (It is assumed that this does not mean deliberately taking steps to incur expenditure which qualifies for the relief – an argument which has arisen in the past).

This new relief will provide an effective tax credit of 25% for expenditure on qualifying assets (being 19% x 1.3). This is not perhaps as earth shattering as Mr Sunak tried to make it sound, but I am sure that all such relaxations are gratefully received.

EMI SCHEMES

A Possible Expansion

Peter Vaines

EMI schemes allow employees of SMEs to acquire shares in their employers on highly attractive terms thereby enabling smaller companies to compete with larger companies to recruit high-skilled employees and retain key members of staff. The idea – or the policy – behind EMI schemes is to help companies attract and retain talent, and grow their business both in terms of employment and output.

The Chancellor seems to be keen to expand the scope of EMI schemes. In the Budget he announced a consultation and he is calling for evidence about a number of aspects of EMI schemes, and in particular whether they do in fact help SMEs recruit and retain

employees.

The consultation will also try to identify the aspects of EMI schemes which are most valuable in meeting these objectives and whether the schemes should be extended to more (and possibly larger) companies – and indeed whether other existing approved employee share schemes could be improved to good effect.

There is also the position of high-growth companies which are no longer eligible for EMI schemes because they have outgrown its limits. The consultation will seek to identify whether the lack of access to an EMI scheme has caused them any disadvantage.

All this would appear to presage the introduction of a new and improved version of an EMI scheme which would be widely welcomed by companies and employees alike.

In the meantime, the Chancellor noted that members of existing EMI schemes could be disadvantaged, if they are furloughed or have their working hours reduced below the working time requirement for EMI as a result of COVID restrictions. There is to be an immediate amendment to the EMI rules to ensure that such individuals continue to qualify until 5 April 2022. This will apply to existing participants of EMI schemes and to new EMI share options which are granted.

INCOME TAX, CAPITAL GAINS TAX, INHERITANCE TAX: THE BIG FREEZE

Katherine Bullock

For the next five years until 6 April 2026, personal tax allowances and thresholds are frozen.

The personal income tax allowance will rise to £12,570, as previously announced in the 2020 Spending Review and then remain there, although it is worth noting that those with income in excess of the additional rate threshold (currently £150,000) have no personal allowance in any event. The basic rate income tax band and the higher rate threshold are similarly frozen at £37,700 and £50,270 respectively. The NIC limits remain similarly aligned.

From a capital taxes perspective, the capital gains tax annual exemption for individuals and trustees is also frozen at its current level of £12,300 and £6,150 respectively. The Inheritance Tax nil rate band, currently

£325,000, and residential nil rate band of £175,000 are also frozen, although it is worth noting that the last time there was an increase in the IHT nil rate band was 2009. This impacts not only estates passing on death, but individuals who make lifetime gifts and trustees who are liable to periodic inheritance tax and exit charges. It is estimated that this will bring around 12,700 additional estates unexpectedly within the charge to Inheritance Tax, unless they take advice now.

The annual and lifetime limit on the total amount of tax-relieved pension savings that an individual can have is also frozen, limiting the amount that an individual or their employer can be put safely into their pension fund to grow tax free. The limit has two effects that are worth bearing in mind. Tax relief on benefits taken over this amount is charged at 25% if the excess is taken as a pension or 55% if it is taken as a lump sum. It is not always easy to turn the investment tap off and those close to the limit or invested in a fast growing stock may find it difficult or expensive to slam on the brakes. The maximum tax-free lump sum that an

individual can normally have is subject to an overall maximum of 25% of the standard lifetime allowance. There is therefore also an impact for retirement plans. Whilst in the past where the lifetime allowance was reduced, transitional protection was made available to individuals, no such protection is offered for what may well be a reduction in real terms.

There are few unforeseen technical changes to which attention should be drawn. There is an expected clarification of IR35 with a new targeted anti-avoidance rule. There is a technical change to Capital Gains Tax Hold-Over Relief on business assets to extend section 167(2) Taxation of Chargeable Gains Act 1992 so that the relief is not available where a non-UK resident person disposes of an asset to a foreign-controlled company controlled either by themselves or another non-UK resident with whom they are connected.

Perhaps, the main point is therefore not in the minutiae of the legislation but in the overarching story arch.

What does it mean?

In the short term, there is relief that individuals and trustees are not faced with many of the tax changes discussed over the last quarter - no wealth tax, no abolition of the Capital Gains Tax annual exemption, no alignment of the Capital Gains Tax and Income Tax rates, Entrepreneurs Relief lives to fight another day, the Capital Gains Tax uplift on death is still available. There is no need, for example, to accelerate dividends before the start of the new tax year.

In the medium term, there is certainty as to the personal tax position for the next five years, creating a reasonable period over which to execute and implement measured succession, investment and business plans.

In the long term, the effective rate of personal taxes, whether income or capital, are going up. The effect of fiscal drag will draw more taxpayers into the higher tax bands with more income and capital subject to tax. Even with an increase in corporation tax rates, a personal or family investment company may well remain the most tax efficient vehicle for holding

personal assets. The differential may be smaller but there remains a significant difference between 25% and 45%.

Putting these together, we have an environment where we can help individuals and trustees grasp the opportunity to transition to more tax effective structures and a window in which to do so, although it is clear from the Budget statements that HMRC's focus on tackling tax avoidance remains and their powers to address and penalise those whom they consider crossing that very grey line will be increased. The role of the practitioner asked to advise is set to become more challenging.

Above all practitioners should note the Budget postscript: "The government will publish a number of tax-related consultations and calls for evidence on 23 March, announced through a Command Paper "Tax policies and consultations Spring 2021". None of these announcements will require legislation in Finance Bill 2021 or have an impact on the government's finances". Radical policy changes may yet be on their way!

VAT: SPENDING IS GOOD…

Dilpreet K. Dhanoa

For VAT purposes, the critical points in the Chancellor's Budget 2021 are:

1. The temporary reduced rate of 5% VAT for hospitality, holiday accommodation and attractions is to remain in place until 30 September 2021.
2. Extending the window for starting deferred payments through the new VAT New Payment Scheme by up to three months.
3. Powers to tackle Electronic Sales Suppression (ESS).
4. Reforming the penalty regime for VAT (and Income Tax Self-Assessment) to make it fairer and more consistent.
5. The VAT registration and deregistration thresholds remain unaltered for a period of two years from 1 April 2022, in order to provide businesses with certainty.
6. Adding Channel S4C (Welsh TV) to the special VAT refund scheme for public bodies (per s. 33 of the VAT Act 1994).

What does this mean in practice?

The reduced rate of VAT will likely see a boost in revenues for the hospitality and leisure industries, as things slowly start to open across the country. Given that these are industries which have been severely impacted with the lack of foot-fall during the pandemic, this will undoubtedly be a welcome measure by proprietors of hotels, restaurants and tourism generally. In order to support this measure, alcohol duty rates will also remain frozen for another year. It should be noted that from 1 October 2021 the rate will be increased to 12.5% (so still a reduced rate), and that will remain in place until 31 March 2022 after which it will revert to the standard rate.

The VAT deferral scheme which was originally announced in September 2020, gives businesses the opportunity to make monthly payments of deferred VAT from March 2021. In effect, what this means is that businesses with VAT returns due between 20 March and 30 June 2020 now have the option of paying them in up to 11 interest-free instalments between 2021 and 2022. Businesses that did not choose this option have to pay deferred VAT by 31 March 2021. There remains an option to opt-in (between February-June 2021), but with fewer instalments.

For the purposes of ESS, the government plans to introduce new powers to make the possession, manufacture, distribution and promotion of ESS software

and hardware an offence. This is yet another tax evasion angle that will enable HMRC to target businesses that use software and hardware to hide or reduce the value of transactions and corresponding tax liabilities. HMRC will be given new ESS-specific information powers to identify developers and suppliers and access software developers' source code.

On the new penalty framework, there will be a points-based late submission regime, and a financial penalty will only be issued once the relevant threshold is reached. The new penalty regime plans to introduce penalties proportionate to: (1) the amount of tax owed; and, (2) how late the tax due is. For VAT taxpayers, this comes into effect for periods starting on or after 1 April 2022.

Significantly, The government also plans to review the tax administration for large businesses in order to maximise efficiency and promote investment. The plan is to conduct discussions with stakeholders to further understand the challenges in this area.

The addition of S4C to the special VAT refund scheme. will allow S4C to receive a refund of VAT incurred on its public service activities. This could be a point for other broadcasters to review their positions and see if they are also entitled to be part of this scheme.

Comments

In the wake of COVID-19 the UK and the world has seen much challenge and change, and the Chancellor has delivered what he has called *"a Budget that meets that moment"*. The Budget itself focuses very much on the themes that emerged from the pandemic: protecting the jobs and livelihoods of the British people, strengthening public finances, and an investment-led recovery.

Interestingly, despite VAT being a relatively easy tax to administer and is well known as a method employed by governments to quickly raise revenue, the proposal in the Budget is to, "ask everyone to contribute, with the highest income households paying more." It has thus sought to focus on personal tax allowances and income tax, along with corporation tax. VAT is specifically being used as a measure to boost the retail economy

The Budget also contains numerous proposals for other indirect taxes (not addressed here). Given that this can often be a complex area, members of FCTC are well-placed to assist in advising on transactions, structures and future business planning.