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United Kingdom tax alert
Budget 2018 includes new digital services tax

The Chancellor of the Exchequer delivered the government's 2018 Budget on 29 October 2018, against a backdrop of uncertainty in the UK economic landscape. His announcements were largely targeted at the changing dynamic of the economy and promoting the UK as "open for business." No specific tax measures were announced in respect of Brexit, although the Chancellor made it clear that he reserved the right to convert the 2019 Spring Statement into a fiscal event, if required. In the meantime, draft legislation detailing the proposed changes is expected to be published on 7 November 2018.

For the avoidance of doubt, none of the measures outlined below have been enacted; based on previous Budgets, enactment is likely to occur in the spring of 2019.

This alert sets out the key measures for non-UK owned groups. For detailed coverage and comment on the UK Budget 2018, visit Deloitte's dedicated website at **www.ukbudget.com**.

Business tax

Corporation tax rate

Although there was some speculation in the media prior to the Budget that the current UK corporation tax rate could be frozen at 19%, this proved to be unfounded. The UK corporation tax rate, therefore, should fall to 17% on 1 April 2020, as previously enacted in 2016.

Digital Services Tax

The Chancellor has announced the introduction of a Digital Services Tax (DST) as from April 2020. The key elements are as follows:

- The tax will be charged at a rate of 2% of digital revenue generated from UK users, where that revenue arises from search engines, social media platforms and online marketplaces. DST will not be a tax on the online sales of goods, nor will it be a generalized tax on online advertising or the collection of data.
- DST will apply only to businesses that are profitable and that generate more than GBP 500 million a year in global revenue from these activities. The tax will apply only to income generated from UK users in excess of GBP 25 million, which will ensure that only larger amounts of revenue generated from UK users will be subject to the tax.
- The rules will include safe harbor provisions that reduce the effective rate of tax on businesses with very low profit margins. DST also will be an allowable expense for UK corporate tax purposes and it will not be creditable against corporation tax.
- The Chancellor made clear that the government would prefer a global tax framework on this matter, but in the interim, this measure will be introduced unilaterally. DST, therefore, is badged as a temporary measure and will cease to apply when a comprehensive global solution is in place.

The government will issue a consultation on the detailed design of DSP rules and legislate in Finance Bill 2019-20.

Reinstatement of relief for goodwill

The government has announced it will publish details regarding a partial reinstatement of relief for acquired goodwill where businesses are acquired with eligible intellectual property. This would reverse a change announced in 2015 and would apply in respect of goodwill acquired in respect of asset acquisitions.

Proposals are expected to be published on 7 November 2018, followed by a brief consultation. This measure is intended to have effect as from April 2019.

Degrouping charges on post-April 2002 intangibles

Degrouping charges can arise where a company leaves a group, having received a tax-neutral transfer from a related party in previous years. Following consultation earlier in 2018, the government has announced a reform of the degrouping rules in respect of intangible fixed assets created or acquired from unrelated parties as from 1 April 2002, such that a degrouping charge should not arise where the disposal giving rise to the degrouping event qualifies for relief under the substantial shareholding exemption. This measure will bring the treatment of post-April 2002 intangible assets in line with the treatment of other assets.

This measure will have effect for degrouping events occurring on or after 7 November 2018.

Controlled foreign companies (CFCs)

Two changes will be made to the CFC rules with effect from 1 January 2019 to ensure that the UK CFC rules comply with the EU Anti-Tax Avoidance Directive (ATAD), which may be relevant where the UK acts as an intermediary holding company as part of the worldwide group.

These include changes to the definition of control to ensure that any interests held by associated enterprises are taken into account when assessing whether a company is controlled. Changes also will be made such that non-trade finance profits that are within the scope of the rules as a result of having significant people functions in the UK no longer will qualify for the CFC finance company rules.

Offshore receipts in respect of intangible property

Autumn Budget 2017 contained certain rules to expand the scope of withholding tax to cover royalty payments in connection with UK sales, paid to an entity not resident in the UK, where that entity is resident in a low tax jurisdiction. Today's announcement made several changes to the nature of the charge, including the following:

- The tax now will be collected directly from the nonresident company by levying UK income tax, rather than through a withholding tax charge (subject to the provisions of any applicable tax treaties);
- The scope of the measure will be broadened to cover embedded royalties and income from the indirect exploitation of intangible property in the UK market through third parties; and
- A de minimis threshold of GBP 10 million of UK sales will be introduced, along with a carve-out for income that is taxed at appropriate levels (being at least 50% of the UK income tax that otherwise would arise) and an exemption for intangibles supported by sufficient local substance.

The measures will take effect as from 6 April 2019, with an anti-forestalling rule applying from 29 October 2018.

Diverted Profits Tax (DPT)

The Chancellor announced changes to the DPT introduced in 2015 to counteract certain contrived arrangements that result in the erosion of the UK tax base. The changes announced will have effect from 29 October 2018.

The changes extend the "review period" during which the UK tax authorities (HMRC) and taxpayers are encouraged to work together to determine the diverted profits, from 12 months to 15 months and clarify that profits liable to DPT can be reduced by amending the tax return during the first 12 months of the review period.

The announcement also contains a change to close a technical gap that had allowed companies to make changes to the corporation tax return after the review period had ended and the DPT time limits had expired. Legislation also will make clear that diverted profits will either be subject to DPT or corporation tax, but not both.

Loss relief rules

The Chancellor announced changes to the way in which relief will be given for capital losses, bringing this in line with the regime introduced for income losses in 2017. As a result, as from 1 April 2020 companies with chargeable gains exceeding GBP 5 million will be able to shelter only 50% of the excess with capital losses, with the remainder giving rise to cash tax. An anti-forestalling measure will be introduced to support this change in respect of gains realized from 29 October 2018.

Definition of permanent establishment (PE)

Changes have been announced to the definition of a PE to prevent groups artificially fragmenting their business to take advantage of exemptions to avoid creating a PE (e.g. by carrying out certain low value activities in different companies or different locations, such that the activity does not rise above the threshold to create a PE).

These changes were included in the BEPS multilateral instrument (MLI), which entered into force in the UK on 1 October 2018. The announcement reflects the MLI and enables the consequent amendment to tax treaties to become effective on 1 January 2019.

Hybrids

Two minor changes to the hybrid mismatch rules are included in the Budget announcements. These amendments were published in draft form for consultation on 6 July 2018 and ensure that the UK's rules are in line with the amended ATAD II:

- The first change introduces a new provision to the rules dealing with multinational companies (where a company resident in one jurisdiction has a PE in another jurisdiction) to cover situations where a PE is recognized in the jurisdiction where the company is resident but is not recognized by the jurisdiction where the PE is located. As a result, as from 1 January 2020, the disregarded PE will be brought within the scope of the hybrid mismatch rules.

- The second change relates to the treatment of regulatory capital and an exemption currently provided by the legislation. Going forward, the definition of regulatory capital can be amended by regulations to enable certain specifically defined regulatory capital to fall outside the scope of the rules. The current exemption for regulatory capital will stay in place until the new regulations come into force.

Nonresident landlords

As announced in the Autumn Budget 2017, the government will legislate that nonresident landlords carrying on a UK property business or otherwise receiving UK property income will fall within the UK corporation tax regime from 6 April 2020. Nonresident landlords previously have been taxed under the income tax regime. Capital gains also will become chargeable to tax as from 6 April 2019.

In addition, the government has announced further information regarding the application of the loan relationship rules and derivative contract rules to nonresident landlords and a targeted anti-avoidance rule that will take effect from 29 October 2018.

Capital allowances

Structures and Buildings Allowance (SBA)

The Chancellor announced the introduction of a new SBA, providing relief at a 2% flat rate over 50 years for qualifying capital expenditure on new nonresidential structures and buildings. Relief will be available for eligible expenditure incurred where all the contracts for the physical construction works are entered into on or after 29 October 2018 and the asset is brought into use. Relief will not be available for the costs of land or dwellings.

Special Writing Down Allowance rate

The Chancellor has announced a reduction in the rate of writing down allowances from 8% to 6% for qualifying plant and machinery in the special rate pool, taking effect from April 2019.

Annual Investment Allowance (AIA)

A temporary increase in the AIA has been announced, increasing the amount of qualifying expenditure that can be deducted in full in the year of expenditure from GBP 200,000 to GBP 1 million. This change will take effect from 1 January 2019 and will last until 31 December 2020.

Environmental Enhanced Capital Allowances (ECAs)

ECAs and first year tax credits for technologies on the Energy Technology List and Water Technology List will be withdrawn on 1 April 2020.

Industry specific measures

Transferable tax history mechanism and Petroleum Revenue Tax simplification

As previously announced in the Autumn Budget 2017, the government will introduce a transferable tax history mechanism for oil and gas companies operating on the UK Continental Shelf (UKCS) that will remove tax barriers to new investment in the North Sea. The mechanism will allow a seller of an interest in a UKCS oil license to transfer some of its tax history to the buyer of the field, who then will be able to set the decommissioning cost of the field against the transferable tax history.

The Petroleum Revenue Tax rules on retained decommissioning costs also will be amended to simplify the way older fields can be sold to new investors. Relief will be available to the buyer where the seller subsequently incurs decommissioning expenditure or where the seller provides the funds for the buyer to decommission. Both measures will apply for transactions that receive Oil and Gas Authority approval on or after 1 November 2018.

Employment taxes – Off-payroll working

The Chancellor has announced that changes will come into effect from 6 April 2020 to reform the off-payroll working rules in the private sector. To bring the rules in line with the public sector, responsibility for deducting any tax and National Insurance Contributions (NICs) on payments made to workers engaged through Personal Service Companies (PSCs) will move to the third party paying an individual’s PSC. Small companies will be exempt from this change.

Three of the biggest challenges businesses will face are: determining the correct employment status for any worker, dealing with disputed status assessments and implementing significant changes to systems, contracts and commercial negotiations over day rates.

Indirect tax

Legislation will be introduced to tax the production and importation of plastic packaging from April 2022. This tax is expected to apply to plastic packaging that does not contain at least 30% recycled plastic and is subject to a consultation that will be launched in the coming months. Other indirect tax changes are unlikely to have broad application for most non-UK owned businesses.

Contacts

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