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Global Tax Update

United Kingdom

Deloitte Tohmatsu Tax Co.

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Spring Budget 2017 Japanese Business Tax

(1) Introduction

The Chancellor of the Exchequer delivered the last ever Spring Budget on 8 March 2017, before the UK changes to an annual Autumn Budget later in 2017.

The Budget announcement took place against the background of a significant upgrade to the UK's growth forecasts for this year and the second fastest growth rate in the G7.

Following the significant changes to the UK's tax system in recent years this was a Budget to reassure business, without the introduction of significant new measures and the Chancellor reaffirmed that the UK remains "open for business".

This Bulletin sets out the key measures for Japanese owned groups. For detailed coverage and comment on the UK Budget 2017 visit Deloitte's dedicated website at www.ukbudget.com

(2) Business tax

The Chancellor's focus for business tax was on maintaining stability and encouraging investment in the UK economy. He reaffirmed the government's commitment to the Business Tax Road Map, which was announced in Budget 2016, and many of the key measures of the Road Map are discussed below.

1) Corporate tax rates

The Chancellor confirmed the decrease in the Corporation Tax rate from 20% to 19% from 1 April 2017, and to 17% from 1 April 2020. These reductions have been contained in previous Finance Acts and have therefore already been enacted.

On the one hand, these rate reductions are welcome in that they further strengthen the UK's international competitiveness encouraging business investment and growth; in particular, the 17% corporation tax rate from 2020 will be on par with the current corporation tax rate of countries like Singapore.

However, on the other hand, for Japanese groups the reductions give rise to a possible concern under the Japanese anti-tax haven rules ('JCFC'), the threshold for which is currently set at "less than 20%". When these tax avoidance rules are triggered, relevant profits of the UK subsidiaries could be taxed in Japan at the Japanese rate of (currently) c.30% (subject to credit for UK tax paid), resulting in a worse tax position overall for the group than before the rate reduction in the UK. In most cases, it is likely that that the exemption from the JCFC rules available for active businesses will apply for UK subsidiaries even if their effective tax rate falls below the JCFC threshold rate. However, certain UK income defined as "passive" could nevertheless become subject to additional tax in Japan, and, additionally, some large multinational groups with extensive investment as well as trading activities in the UK could also be affected by the UK rate reduction from 1 April 2017. They may therefore need to take prompt action if they are to avoid JCFC charges arising in Japan (if this has not been done already).

It should also be noted that in December 2016, the Japanese government proposed extensive reforms to the JCFC rules applicable from April 2018. The changes proposed are complex but, with limited exceptions for certain industries, generally represent a further tightening of the current rules, in particular, with a significant expansion in scope of income and gains defined as "passive" for the purposes of these rules. This, combined with the rate reductions in the UK, may further complicate the JCFC position of some Japanese owned groups with UK presence.

2) Changes to interest deductibility

The Chancellor confirmed that the government will introduce legislation in Finance Bill 2017 to further limit the deductibility of financing costs with effect from 1 April 2017.

Draft legislation was issued on 26 January 2017 and has been the subject of a consultation process. Several changes were announced to the draft legislation in response to the consultation process, including measures to reduce the potential compliance burden of these new rules, to deal with issues associated with specific industries, and to remove certain restrictions that could prevent deductions for carried forward interest expense.

A key point to note is that the limitation rules will apply on a group basis. This means that Japanese owned groups with highly autonomous and divisionalised operations in the UK may need to consider how to collect the relevant data and coordinate across their various UK subsidiaries.

3) Hybrid mismatch arrangements

The Chancellor did not announce any significant changes to the UK's hybrid mismatch rules, which were enacted in Finance Act 2016 and which came into effect on 1 January 2017. However, the Chancellor did reaffirm a number of technical modifications which were originally announced on 5 December 2016.

The first measure removes the need for formal claims to be made in certain circumstances with respect to hybrid financial instruments and hybrid transfer arrangements. This will reduce the administrative burden on business, given that the formal requirement was anticipated to give rise to a high number of individual claims.

The second measure simplifies the application of the rules and provides for amortisation deductions to be disregarded when considering whether there is a hybrid deduction non-inclusion mismatch. This measure will only apply to Chapters 5 to 8 of the legislation, although specific changes will also be made in the context of imported mismatches.

These changes will apply retroactively from 1 January 2017.

4) Changes to loss relief rules

The Chancellor confirmed that the government will include legislation in Finance Bill 2017 to reform the UK's loss relief rules.

No significant changes were proposed to the operation of the proposed rules. However, the Chancellor announced that the draft legislation issued on 26 January 2017 will be revised to include provisions that will apply to oil and gas companies and oil contractors.

Similar to the new interest deductibility rules, the loss relief rules will apply on a group basis. This means Japanese owned groups with highly autonomous and divisionalised operations in the UK will again need to consider how to collect the relevant data and coordinate across their various UK subsidiaries.

5) Research & Development ('R&D') tax review

The UK's R&D tax credit system has been amended in recently years to enhance its attractiveness, notably in the change from a super-deduction regime to an above-the-line tax credit regime. Following a review of the current system the government has concluded that it remains both effective and internationally competitive.

However, in order to encourage further investment the process of claiming Research & Development Expenditure Credit ('RDEC') will be simplified, to make the administrative burden as straightforward as possible and to provide additional certainty. The regime will be kept under review in the future.

6) Withholding tax

Two changes have been announced in respect of withholding tax on interest payments made by UK companies:

- The UK's existing Double Tax Treaty Passport ('DTTP') scheme enables foreign companies lending to UK borrowers to obtain a DTTP, confirming that it meets the requirements of the respective treaty with the UK. The effect of a DTTP is that the treaty rate should be available to all loans made by that company to UK companies, without the need to apply for advance clearances on each loan. The Chancellor has now announced that the mechanics of the system will be simplified, with the aim of making it easier for UK companies to raise finance; and
- An exemption will be introduced in respect of debt traded on a Multilateral Trading Facility. The government will open a consultation on the implementation of this exemption, which may be similar to the existing exemption from withholding tax for interest paid in respect of Quoted Eurobonds.

7) Substantial Shareholding Exemption ('SSE')

The Chancellor confirmed that amendments will be made to the proposed simplification of the SSE, in advance of the new rules coming into effect from 1 April 2017. The reforms will make it easier to claim the exemption, removing restrictions on ownership whilst still requiring that the company being sold is an active trading company.

(3) Industry specific measures

The Chancellor made a number of announcements relevant for specific industries, including the following:

- **Insurance** – As announced in the Autumn Statement 2016, the rate of Insurance Premium Tax will be increased from 10% to 12% from June

2017. Existing anti-forestalling legislation will be repealed and replaced with new anti-forestalling legislation with effect from 8 March 2017;

- **Oil and gas companies** – In the Autumn Statement 2016 the government announced measures to streamline the process for companies to opt out of the Petroleum Revenue Tax regime, in cases where they have never paid the tax or to simplify the reporting process in other cases. Revised legislation will be published on 20 March 2017 and will have retrospective effect from 23 November 2016; and
- **Offshore property developers** – The government will legislate in Finance Bill 2017 to bring all profits from dealing in or developing UK land recognised on or after 8 March 2017 into the charge of UK corporation tax or income tax, irrespective of whether the contract for disposal was entered into prior to 5 July 2016.

(4) Compliance

1) Large business tax review

HMRC will launch a consultation into its process for profiling the risk of large businesses, with the aim of promoting stronger compliance and further reducing the tax gap. The consultation is expected to be released before summer 2017 and will run for 12 weeks.

2) Making Tax Digital

The Making Tax Digital process was announced in 2015 and will radically alter the way in which the self-employed, landlords, and small companies keep accounting records, including a requirement to submit a quarterly summary to HMRC.

Legislation will be contained in Finance Bill 2017 to bring this into effect from April 2018, with a deferral to April 2019 for those with sales/rents below £83,000. The new regime will apply to small companies subject to Corporation Tax from April 2020.

3) Anti-avoidance

The Chancellor announced limited anti-avoidance measures, including legislation to prevent the conversion of capital losses into trading losses by way of the appropriation of certain capital assets to trading stock. The new rules will have immediate effect.

(5) Indirect Taxes

1) Business rates

A business rates revaluation will take effect in England from 1 April 2017, which will impact the level of business rates that are charged. This Budget announced additional relief for lower-value properties disproportionately affected by increases.

The government has announced that revaluations will take place more frequently in the future, to avoid the large swings that can result in infrequent revaluations. The preferred approach for achieving this will not be announced until the Autumn Budget 2017, but the government has confirmed it will launch a consultation ahead of the next revaluation due in 2022.

2) Value Added Tax ('VAT')

The Chancellor announced that the government will remove the VAT use and enjoyment provision for mobile phone services provided to UK consumers. This will bring services used outside the EU into the scope of UK VAT. Additional legislation and detail of the impact is due to be released later in the year.

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