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ICEbreakers: Unlocking United Kingdom

Hot topics

- **Finance Bill 2017-19:** The Finance Bill 2017-19 and explanatory notes published on September 8, 2017 include the clauses introduced in March 2017 that were withdrawn after the calling of the general election. These measures (some of which are described in more detail below) include the corporation tax loss carryforward rules; the corporate interest deductibility restriction; the substantial shareholding exemption; changes to the non-domiciliary rules; and enabling legislation for Making Tax Digital. It is expected that the committee stage will start by mid-October, with Royal Assent likely in the first or second week of November.
- **Hybrid mismatch arrangements:** The hybrid mismatch rules, enacted on September 15, 2016 and that became effective on January 1, 2017, seek to counteract arrangements that otherwise would give rise to double deductions (DD) for the same expense or deduction/non-inclusion (D/NI) mismatches. The rules apply to direct DD or D/NI mismatches and they also seek to catch situations where a mismatch has been imported into the UK. The rules can apply to both financing and operating structures. Guidance on the legislation issued by the UK tax authorities (HMRC) on December 9, 2016 and updated on March 31, 2017 still is in draft form.
- **Tax deductibility of corporate interest expense:** A full draft of the UK corporate interest restriction legislation was released on January 26, 2017 (followed by amendments published in March) and broadly follows action 4 of the OECD's BEPS project. The law has an effective date of April 1, 2017 and is included in Finance Bill 2017-19, which is expected to be enacted in the first or second week of November 2017. Under these rules, all groups will be able to deduct GBP 2 million of net interest expense. The deduction of amounts exceeding GBP 2 million will be restricted to the lower of 30% of UK taxable profits before interest and tax depreciation ("tax EBITDA") or the group ratio percentage (based on the ratio of accounting net interest expense to accounting EBITDA) of tax EBITDA. Both ratios are limited by a modified debt cap to the worldwide group's aggregate net interest expense of the period.
- **Tax strategy publication:** A new tax transparency rule could affect foreign-owned businesses with UK operations because the rule will require many large businesses to publish their UK tax strategies on their websites before the end of each financial year for accounting periods beginning on or after September 15, 2016 (i.e. for a December 31 year end, the first relevant year will be December 31, 2017).
- **Diverted profits tax (DPT):** The DPT applies at a rate of 25% from April 1, 2015 on profits deemed to have been artificially diverted from the UK. The definition of notional permanent establishment (PE) profits for purposes of the DPT was amended with effect from June 28, 2016. Based on the amended rules, even where a company previously concluded that it met the requirements for the DPT to apply under the "avoided UK PE" part of the rules, but that it had no profits chargeable to the DPT, a DPT charge could be triggered.
- **Withholding tax on royalty payments:** The categories of royalties that are subject to withholding tax have been expanded to include royalty payments paid in respect of all intellectual property, and the definition of "UK-sourced" has been amended such that withholding will apply where the payments are connected with a UK PE. These changes apply to payments made on or after June 28, 2016. In addition, a new anti-avoidance provision has been introduced for payments made on or after March 17, 2016.

Other legislative changes to note

Measures previously announced through the 2016 budgets and expected to be enacted as part of Finance Bill 2017-19 include:

- The **substantial shareholding exemption**, under which certain corporate disposals take place free from tax, would be simplified and the investing company requirement would be removed from April 1, 2017.
- Significant changes to the **loss relief** rules would apply from April 1, 2017. From that date, UK taxable profits in excess of GBP 5 million would be able to shelter only 50% of profits in excess of GBP 5 million with brought-forward losses. In addition, the rules would be relaxed to allow tax losses (except capital losses) against any type of income in any company in the UK group, where that income is generated after April 1, 2017.

Attracting innovation

- An opt-in **patent box regime** is available to profits arising from the use of patented products or processes, providing an effective tax rate of 10%. To qualify, a company must own or exclusively license a patent related to technology developed in the group and R&D expenditure must be tracked to demonstrate substance (or "nexus").
- An "above-the-line" **R&D tax credit regime** for large companies provides a credit that is recognized in the profit and loss account. The credit is 11% of qualifying expenditure and can result in a tax refund, even for companies with no tax liability. There is a two-year time limit on filing claims that runs from the end of the accounting period.

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Contacts

Anne-Mari Davidson
Director
Tel: +1 718 508 6153
Email: anndavidson@deloitte.com

David Miles
Senior Manager
Tel: +1 718 508 5042
Email: damiles@deloitte.com

Laura Digirolamo
Senior Manager
Tel: +1 212 436 2826
Email: ladigirolamo@deloitte.com

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