LEGISLATION DAY: CORPORATE TAX

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Introduction

Since 2010, it has become the norm for draft tax legislation to be published late in the calendar year for eventual inclusion in the following year's Finance Bill. This is published one week or two after the Chancellor's Autumn Statement, and the publication date has generally become known amongst tax practitioners as 'Legislation Day'. This year, Legislation Day was on 9 December.

We have divided our commentary on the draft legislation amongst seven subject areas: Income tax & NICs, Corporation tax, Inheritance tax, VAT, Stamp taxes, Pensions & Compliance, avoidance and evasion. Our commentary does not attempt to cover everything for which legislation was published. Instead, we have opted to cover about 25 significant topics on which there is now more detail available than on Autumn Statement day (25 November).

Draft legislation is always subject to amendment of course, both before and after it is introduced to the House of Commons.

See Simon's Taxes Binder 1 for information about recent New Developments which are to be incorporated into the commentary.

Patent box

The current UK Patent Box regime is to be amended in order to comply with the international framework developed by the OECD as part of the base erosion and profit shifting (BEPS) project. Currently, the UK Patent Box gives companies a reduced rate of tax on their profits from patents and similar intellectual property (IP). The amended rules intend to address how the profit attributable to IP is calculated.

The new rules will apply to companies that are new entrants to the Patent Box regime on or after 1 July 2016. For existing companies, the rules are being phased in, with the current Patent Box rules applying to some companies and IP during a transitional period lasting until 1 July 2021. The new rules will apply to all companies and IP after 1 July 2021. Where an accounting period straddles these dates, the periods are split accordingly.

New entrants
For any company entering the Patent Box for the first time on or after 1 July 2016, the company is required to divide its relevant IP income stream into sub-streams corresponding either to individual IP assets (such as patents) or to particular kinds of multi-IP items (products or product families). The appropriate expenses are allocated to these sub-streams and the net amount from each sub-stream is multiplied by the R&D fraction (as defined in the legislation by reference to the company's total expenditure on in-house R&D, sub-contracted R&D and the acquisition of IP rights). The R&D fraction is calculated on a cumulative basis from 1 July 2016 (1 July 2013 in certain circumstances), up to the end of the relevant accounting period. The amounts from each stream are aggregated to arrive at the company's total IP profit for the period concerned.

The effect of the above rules is that the profit is not only calculated at the level of an IP asset, but it is then further adjusted to reflect the proportion of the development activity on the asset (or product, or product category) undertaken by the company itself.

Transitional rules
The current Patent Box rules apply to all companies that are already within the Patent Box regime until 30 June 2021. Transitional rules apply if the company acquires any IP on or after 1 July 2016 (or 2 January 2016, if the acquisition is from a connected individual or from a connected company which is not within the UK Patent Box regime or a similar regime elsewhere) and before 30 June 2021. In such situations, the 'new' IP will fall within the new rules; profits from old and new IP will have to be streamed and the R&D fraction applied only to the new IP.

Companies can elect that 'old' IP may be treated as new and so immediately brought into the modified Patent Box rules.

Company distributions and transactions in securities

For transactions entered into on or after 6 April 2016, the transactions in securities rules are to be strengthened and a targeted anti-avoidance rule is to be introduced.

Both of these measures are intended to restrict the opportunities for shareholders to convert to capital what might otherwise be paid as an income distribution (most commonly a dividend). The incentive for this type of behaviour will increase from 6 April 2016 when changes are made to the way in which dividends are taxed.

Targeted anti-avoidance rule

A targeted anti-avoidance rule (TAAR) will treat a distribution from a winding-up as if it were an income distribution if:

(a) an individual, close company shareholder receives a distribution from the close company on a winding up;

(b) at any time within a 2 year period after the distribution the individual continues to be involved in a similar trade or activity; and

(c) the main purpose(s) of the winding-up is to secure a tax advantage.

This TAAR is designed to address situations where a company is wound up and shortly after a new one is established which carries on substantially the same activities.

Amendment of transactions in securities rules

The transaction in securities rules are anti-avoidance rules which are, in essence, designed to prevent amounts extracted from companies being treated as capital transactions when their effect is in substance the same as a distribution. For transactions entered into on or after 6 April 2016 the existing rules are being strengthened, for example, from this date:

a) a distribution on a winding up in respect of securities will fall within the definition of a transaction in securities and the legislation is to be amended to clarify that a repayment of share capital is a transaction in securities;

b) HMRC will consider “the purpose of the transactions" in place of "the purpose of a person being party to a transaction”;

c) the rules will also apply to a tax advantage obtained by any person, not just the person who is a party to the transaction.

Any clearance given by HMRC in respect of a pre-6 April 2016 transaction will be void should the transaction take place on or after 6 April 2016 and clearance would not otherwise have been given because of any of the Finance Act 2016 amendments made to the rules.

Reform of wear and tear allowance

The wear and tear allowance and the renewals allowance for property businesses will be repealed and replaced, for expenditure incurred on or after 1 April 2016 for corporation tax and on or after 6 April 2016 for income tax. The new legislation will allow instead a deduction for capital expenditure incurred by a lessor on replacing furnishings, appliances (including white goods) and kitchenware provided for the use of a lessee in a dwelling-house. Relief is not available for fixtures.

Where the new item is substantially the same as the old item, the deduction is equal to the expenditure incurred on the new item. Where the new item is not substantially the same the deduction is limited to the amount which would have been incurred if it were substantially the same. In addition a deduction is permitted for incidental capital costs of disposing of the old item or acquiring the replacement, less any amounts received, either by the lessor or a person connected with them, on disposal of the old item.

The deduction will not be available for furnished holiday lettings or if rent-a-room relief is claimed in respect of the dwelling-house.

Large business special measures regime and greater transparency

As announced at Autumn Statement, a special measures regime is to be introduced to tackle businesses that persistently engage in aggressive tax planning. The rules should, in practice, only affect a fairly small number of taxpayers, as they cannot apply unless there are 'significant tax issues' between HMRC and the taxpayer, the value of which is expected to exceed £2 million.

HMRC can only issue notices under this regime in relation to a defaulter's first financial year beginning on or after the date of Royal Assent to Finance Bill 2016.

The regime applies to businesses (including partnerships) that have persistently engaged in un-cooperative behaviour which has caused there to be two or more unresolved, significant tax issues (ie with a value in excess of £2 million) and there is a reasonable likelihood of further instances of the business engaging in un-cooperative behavior which will cause further significant tax issues. Un-cooperative behaviour is defined by reference to members of the business having either engaged in behaviour which has delayed or hindered HMRC and/or being party to a tax avoidance scheme.

Where the regime applies HMRC are able to issue a succession of notices; a warning notice, a special measures notice and finally a confirmation of special measures notice. The final confirmation notice has the effect of removing the defence of reasonable care for the purpose of penalties for any inaccuracy in a document given to HMRC if the inaccuracy relates to a tax avoidance scheme or it is attributable to a speculative interpretation of the legislation. Additionally HMRC are entitled to 'name and shame' the companies etc concerned.

This regime sits alongside a new requirement for large UK businesses (with a group turnover of more than £200 million and/or group balance sheet total of more than £2 billion) to publish their tax strategies as they relate to or affect UK taxation, for all financial years beginning on or after

Royal Assent to the Finance Bill 2016. The strategy must be published on the internet before the end of the financial year and remain freely available to the public for at least one year after it has been published. Failure to comply will result in an appealable penalty of £7,500 on the company, with a further £7,500 penalty due if the strategy is still not published within six months of the deadline for publication. Thereafter, further penalties of £7,500 will be imposed for each month of continued delay.