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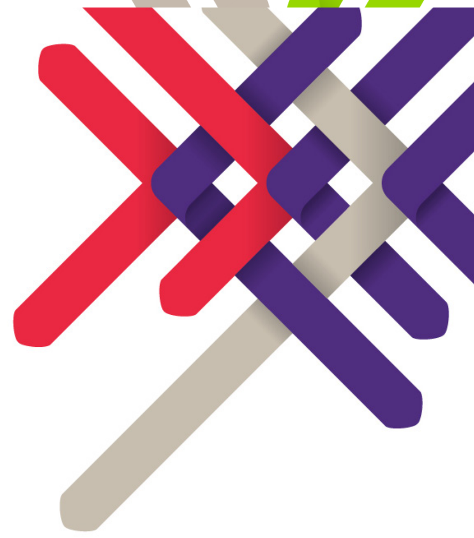

# Tax newsletter

## Issue 7 · September 2018

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### Highlights from the draft Finance Bill 2018-19

**Capital Gains Tax (CGT) extended for non-residents on UK immovable property**

New draft legislation proposes to bring gains on 'direct disposals' of UK immovable property by non-UK residents into the scope of UK tax from **6 April 2019.** Currently, only disposals of UK residential property by non-residents are within the charge to CGT.

The draft legislaton further extends to 'indirect disposals' of UK property where non-UK residents sell an interest in a company where, at least 75% of the gross asset value of the entity being disposed of derives its value from UK land.

**Non-UK resident companies carrying on UK property business**

From **6 April 2020**, non-UK tax resident companies that carry on a UK property business or have other UK property income, will be charged to corporation tax, rather than being charged to income tax as at present. This change will align with the end of the tax year 2019-2020 which ends on 5 April 2020. **This will reduce the rate of tax from 20% to 17% by April 2020.**

Under the new rules, there would be a deemed cessation of the UK property business as at 5 April 2020 for income tax but with no balancing allowances or charges for capital allowance purposes. The first corporation tax period would start on 6 April 2020. If a non-resident company was already within the corporation tax regime then their property profits would be time apportioned around 5 April 2020.

This will mean that the corporate interest restriction rules will become applicable to non-resident landlord companies from 6 April 2020.

**Profit fragmentation**

This legislation aims to target arrangements where UK business profits accrue to entities resident in territories where a lower tax rate is paid. The measure will have effect from April 2019 and will apply to all persons, individual or corporate, carrying on a business within the charge to UK taxation. Where certain conditions are met, there is a requirement for those taxpayers to notify HMRC of the arrangements.

**New penalty regime**

A new penalty regime for late filing and payment has been introduced to replace the existing penalites for late submision of returns and payment. The new system will apply a points-based penalty regime. The penalty points will depend on the filing frequency of the return. **Implementation is expected to start with VAT from 1 April 2020.** The government intends to expand the regimes across the other taxes, dates of which are yet to be confirmed.

## Requirement to Correct (RTC)

From September 2018 over 100 countries, including the UK, will automatically exchange information about non-residents holding assets or bank accounts in that country under the Common Reporting Standard (CRS).

In anticipation of this, from 6 April 2017 HMRC introduced a new Requirement To Correct (RTC) regime. The RTC rules' objective is to minimise taxpayers' non-compliance in relation to offshore matters and to recover any undeclared offshore tax liabilities. The regime applies to anyone who has UK tax liabilities, including non-resident landlords and non-resident trustees.

With access to the information under CSR, HMRC's ability to detect offshore income or assets that have not been declared on taxpayers' tax returns will increase significantly. The RTC was introduced to give taxpayers a chance to review their tax position in respect of offshore matters and put it right before **30 September 2018.**

Under the RTC rules the taxpayer should disclose details of errors resulting in a tax loss on or by reference to:

- income arising from a source outside the UK, such as interest and dividend income, trust income, income from government securities, etc;
- assets situated outside the UK, such as cash, art and antiques, land and building, boats, etc; and
- activities carried wholly or mainly outside the UK.

The RTC applies to non-compliance before 6 April 2017. The time limit for HMRC making an assessment into taxpayer's affairs is normally four years, but this can be extended to six or twenty years, depending on the reason for incomplete disclosure (whether tax loss was caused carelessly or deliberately).

**From 1 October 2018 a failure to correct regime will come into force.** Where a taxpayer fails to correct errors in previous tax returns and make disclosure to HMRC before 30 September 2018, stringent penalties will apply:

- a tax-geared penalty of 200% of unpaid tax – this penalty may be reduced based on co-operation with HMRC and quality of disclosure made;
- potential asset based penalty of up to 10% of the value of the relevant asset where the taxpayer was aware of the error and the tax underpaid exceeded £25,000; and
- a potential additional penalty of 50% of the amount of the standard penalty, in cases where assets or funds had been moved to attempt to avoid the RTC.

**It is strongly advisable taxpayers take immediate steps to make relevant disclosures to HMRC by 30 September 2018 to avoid hefty penalties.**

## No deal Brexit – what now for VAT and customs?

On 23 August 2018, the UK government published technical notices outlining the government's approach in the event of a "no deal" Brexit. These included guidance on the expected VAT and customs duty position.

**VAT**

In the event of a "no deal" Brexit, postponed accounting for import VAT would be introduced. UK businesses would therefore account for VAT on imports on their VAT returns, in the same way as they do at present for acquisitions from the EU, rather than having to pay VAT when goods are cleared at the border. Significantly, this change would also apply to imports from non-EU countries, in order to help businesses make the most of global trading opportunities. This presents a cash flow advantage for business compared to the status quo.

However, there is no guarantee that the EU will reciprocate this treatment, so EU customers of UK businesses are still likely to face a cash flow disadvantage.

Where goods are sold to EU consumers, the current "distance selling" rules would no longer apply and UK businesses would instead be entitled to zero-rate their sales. However, the customer is likely to have to pay VAT on the import in their country.

**Customs**

In a "no deal" scenario, the UK would be outside the EU Customs Union and imports of goods from the EU would be subject to customs duty and controls in the same way as imports from outside the EU (and vice versa). Free circulation of goods between the UK and EU would cease.

Businesses importing and exporting would need to make import and export declarations as appropriate for each consignment of goods. These formalities, along with the need for customs checks at the border, could cause significant delays in the movement of goods between the UK and EU.

Businesses may need to familiarise themselves with complex customs rules for the first time. These include rules relating to classification of goods for tariff purposes, valuation and the availability of reliefs and customs special procedures which could mitigate the customs impact (including customs warehousing, inward processing, temporary admission and authorised use).

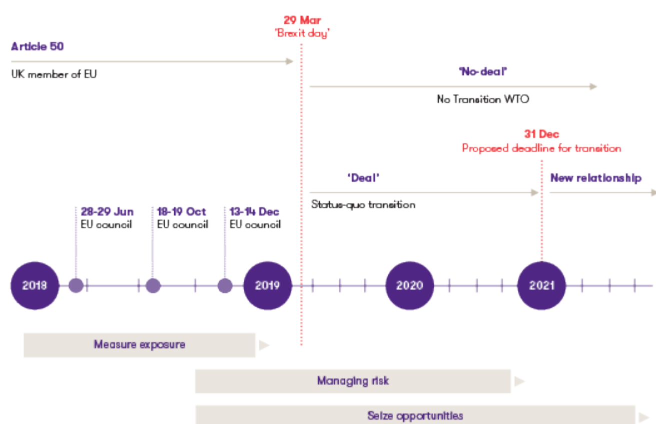
Given that Brexit is now only six months away, businesses engaged in cross-border trade with the EU and the rest of the world should take steps to plan for a "no deal" scenario and consider the impact on their business.

## Brexit timeline

On 29 June 2018, two years after the Brexit Referendum, the EU council met to review the progress of Brexit negotiations. Some progress was reportedly made on parts of the legal text of the withdrawal agreement however, many political leaders highlighted that important aspects still needed to be agreed.

The EU council are due to meet again for the EU summit on 18-19 October 2018 in Brussels, Belgium, which is seen as a deadline for setting out the terms of the withdrawal agreement, to allow enough time for the UK and EU Parliaments to ratify it. A political declaration on the future relationship between the UK and the EU is also expected at this point. The final EU summit before 'Brexit day' is to be held between 13-14 December 2018, as a fall back option if a deal has not yet been agreed and the two sides still want to reach an agreement. If and when a deal is reached the UK government need to ratify the agreement through the parliamentary channels, which even if running smoothly will take up to the week before 'Brexit day'.

### Where are we now?




## Intercompany charges and transfer pricing

With HMRC placing an increased focus on intercompany transactions and transfer pricing compliance, having robust intercompany agreements in place is essential when conducting business within a medium or large group.

An intercompany agreement is the legal document which should exist between related companies and outlines the legal setting for the products, services, charges and financial support which is offered between group companies.

From a tax perspective, there is a growing need for companies to provide evidence of transfer pricing compliance and intercompany agreements are an integral component of the group's transfer pricing policy. It is important for the board to document the discussions and decision making process when devising intercompany agreements in addition to any final agreement, transfer pricing report and associated adjustments. Documenting the decision process and the associated conclusions can give the company a basis as to the pricing of supplies being made and the financial risks arising in the group.

Whilst an intercompany agreement should be reviewed by a legal team generally it should include details of the parties to the contract, governing law and administrative provisions. The agreement should reflect the commercial reality of the transactions taking place and should also be consistent with the group's transfer pricing policy.

As HMRC carries out more challenges on transfer pricing, companies need to be able to produce documentation that provides a method and reasoning for the charges between companies. If this documentation is not in place, companies leave themselves open to fines, penalties and thorough HMRC enquiries.

## Brexit – planning ahead

The upcoming 'Brexit day' on 29 March 2019 is less than seven months away and with it fast approaching, it is important that businesses are considering what steps should be taken to minimise the impact. We have highlighted below examples of planning measures businesses we are working with are undertaking the following.

### Assessing indirect tax implications

A fast food franchise has assessed its potential increased VAT and customs duty costs, using our Brexit Indirect Tax Impact Analysis Tool. Whilst the company's sales are fully within the UK, their cheese supplies are sourced from the EU. Based on a 'no deal' scenario, the cost of sales was increased by nearly

20%. As a result, they have now sourced local cheese suppliers, entering into a long-term contract to ensure price and continuity of supply.

**Reviewing supply chain**
It is important for businesses to review their supply chain to understand underlying risks. A retailer found that they could source more direct suppliers thus saving costs now, irrespective of the Brexit deal.

**Localisation of business**
The majority of local businesses are managed and based in Northern Ireland however, a local manufacturer's assessment of its sales ledger highlighted 70% of sales in Republic of Ireland. Due to the potential impact of selling in Republic of Ireland, the company have entered into a lease on the outskirts of Dublin, which can act as a stock warehouse to ensure no delay in supply to its main customers.

It is clear that steps need to be taken in advance of 'Brexit day', making forward planning essential for businesses to ensure any 'no regrets' decisions are taken, opportunities are availed of and robust contingency plans are in place.

**Cross head tax enquiries**
In the first four months of 2018, our teams have seen a 40% increase in the number of claims relating to corporation tax full enquiries, compared to 2017. It appears that the number of cross tax enquiries conducted by HMRC increased last year and this is likely to continue in 2018 and beyond.

For businesses who receive a cross-tax enquiry, they are not only faced with the financial and time costs of dealing with HMRC but also the distraction from running their day-to-day operations.

Upon receipt of the opening letter, it is advisable for your tax advisor to speak to the lead officer to discuss the perceived risk areas and to agree the best way forward and how to progress the enquiry in a swift and efficient manner.

HMRC generally seek an early meeting with the directors to discuss the business activity, their role and the record-keeping systems in place. Whilst HMRC cannot insist the directors attend, we will advise and consider whether attendance at this meeting will benefit our client or HMRC.

The directors, more often than not, have the best understanding of the business, its systems and processes and are best placed to explain them. The meeting is an opportunity for the directors and their advisers to propose the best approach to deal with HMRC's concerns.

With the reported average length of an enquiry reaching nearly three years for larger cases, having insurance to cover the professional fees in relation to a cross tax enquiry is essential. Local businesses should be looking to learn more about the tax investigation fee insurance to provide peace of mind.

**Business Property Relief (BPR) and holiday lets**
Business Property Relief (BPR) is a valuable Inheritance Tax (IHT) relief which, if available, reduces the value of the individual's estate by exempting partially or in full the value of the "relevant business property". The "relevant business property" includes:

- individual's business or share in a partnership where they are/were a partner;
- asset used in individual's business or partnership where they are/were a partner;
- land and buildings and plant and machinery owned by the individual and used either by their partnership or a company they control;
- any number of shares in an unlisted trading company; and
- any number of shares in a listed company, provided the individual has voting control of a company.

The rate of relief is 100% or 50%. The 100% rate applies to shares in unlisted trading company and business or shares in a partnership. In respect of other assets, the 50% rate applies. In the majority of situations, it is quite clear whether certain property is "relevant business property" however, in some cases particularity where land and buildings are involved, the line between a business asset and an investment asset is blurred. Normally, this has been supported by case law in the past, HMRC's view was that Furnished Holiday Lets (FHLs) as such did not qualify for the BPR. The reasoning behind this was that owning and holding of land in order to obtain an income from it is generally characterised as an activity, which consists wholly or mainly of holding investments. It is accepted that such an investment activity may require some involvement on the part of the property owner, such as taking steps to find occupants, collecting rent, incurring maintenance and repairs expenses, etc. However, more often than not such activities will be regarded as ancillary to the letting and will not change the nature of the business – it will remain an investment business. To determine whether the business is an investment or a trade for BPR purposes, it is the nature and extent of the activities undertaken by the property owner that is taken into account.

This approach has recently been demonstrated in a case of The Personal Representatives of Grace Joyce Graham (deceased) v HMRC 2018, which revolved around a question whether provision of self-contained and self-catering holiday accommodation amounted to trade and therefore qualified for BPR. In addition to renting cottages to holidaymakers, other services provided to occupants included provision of the pool, games room, sauna, bikes to hire, cleaning, home-made marmalade, etc. When each of these services are looked at in isolation none of them can amount to a business trade. However, after considering all the facts and circumstances the First-Tier Tribunal in the above mentioned case decided the provision of additional services could not be regarded as merely ancillary to the use of accommodation.

Interestingly, the First-Tier Tribunal ruled that the late Mrs Graham's business was not one of investment and that BPR should be allowed.

## Investors' relief

In Finance Bill 2016 the government introduced Investors' relief which was aimed at encouraging investments in trading companies that do not have EIS/SEIS status. Investors' relief is a CGT relief which may be available on the disposal of shares, provided certain conditions are met. The essence of the relief is to tax qualifying gains arising on disposal of shares at a flat rate of 10%.

### Qualifying shares

The relief is available on the disposal of shares issued on or after 17 March 2016 and held for a continuous period of three years counting from 6 April 2016. Therefore, the first claims for investors' relief can be made in respect of disposals occurring after 5 April 2019. There is no minimum shareholding requirement, investors may hold any number of shares to avail of investors' relief. The qualifying shares are shares held in an unlisted trading company or a holding company of a trading group. Shares held in a company listed on Alternative Investment Market (AIM) can also qualify for investors' relief purposes. It is important to note that securities such as loans or debts are not eligible for investors' relief.

### Qualifying investor

The investors' relief is only available to individuals who are not "relevant employees". The definition of a "relevant employee" includes an officer or an employee of an issuing company or a company connected with it who receives remuneration for their services. Following this, an unremunerated officer or a "business angel" of the issuing company is not regarded as a "relevant employee" and can claim investors' relief.

Qualifying investors' definition is not limited to individuals, partnerships and trustees of certain trusts can also avail of Investors' Relief provided conditions are met.

### Restriction on qualifying gains

The gains qualifying for investors' relief are subject to a lifetime allowance of £10 million. Once the allowance is exhausted, any gains in excess of this will be taxed at a higher rate of CGT, ie at 20%.

The investors' relief lifetime allowance is separate from the entrepreneurs' relief allowance. Essentially, where investors qualify for both reliefs, they will receive two separate lifetime allowances of £10 million each.

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