Non-resident companies chargeable to Income Tax and non-resident CGT

Consultation document

Publication date: 20 March 2017
Closing date for comments: 9 June 2017

Subject of this consultation:	Non-resident companies who are chargeable to income tax and/or non-resident capital gains tax ("NRCGT"), particularly those receiving rental income from UK property.
Scope of this consultation:	The government is exploring the case for bringing certain non-resident companies with UK sourced taxable income and/or the disposal of certain UK residential property interests within the corporation tax regime. The consultation also aims to identify how existing legislation could be adapted to bring about this change.
Who should read this:	The government welcomes comment from those who would be affected by these changes, including companies, advisors and representative bodies.
Duration:	The consultation runs from 20 March 2017 to 9 June 2017.
Lead officials:	Susan Gardner – Business, Assets and International Directorate, HMRC Nicholas Broadway – Business & International Tax Group, HM Treasury
How to respond or enquire about this consultation:	Responses, request for hard copies, and general queries about the content or scope of consultation can be sent by email to nrc.incometax@hmrc.gsi.gov.uk, or by post to: NRC Income Tax Consultation, Room 3/63, HMRC, 100 Parliament Street, London, SW1A 2BQ. For queries over the phone, please call 03000 563 815.
Additional ways to be involved:	As this consultation largely concerns complex technical issues; the government is keen to arrange meetings with external bodies but equally welcomes written technical responses. It is envisaged that meetings with those with specialist interests will be held both during the consultation and after all responses have been evaluated.
After the consultation:	The government will publish its response in Autumn 2017.
Getting to this stage:	This is a new consultation which arises out of issues identified in recent corporation tax reforms such as interest restriction and loss reform as well as the planned reductions in the corporation tax rate.
Previous engagement:	This consultation is at the first stage of the consultation process.

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1. Introduction

1.1 When corporation tax ("CT") was introduced in 1965, non-resident companies were brought within its scope in respect of their income and gains attributable to trading activities in the United Kingdom carried on through a permanent establishment in the United Kingdom. Other UK source taxable income remained subject to income tax.

1.2 In recent years, the taxation of non-resident companies in respect of UK real property has changed significantly. For instance, a non-resident company was not liable to UK tax on non-trade gains until the introduction in April 2013 of Annual Tax on Enveloped Dwellings related capital gains ("ATED-related gains"). In April 2015, gains in respect of the disposal of UK residential property interests by certain non-residents, including closely-held non-resident companies, became chargeable to non-resident Capital Gains Tax ("NRCGT"). More recently, the Finance Act 2016 introduced legislation to bring non-resident companies which carry on a trade of dealing in or developing UK land into the CT regime.

1.3 Legislation will be introduced in Finance Bill 2017 which may limit a company's interest expense if it is chargeable to corporation tax. The CT loss relief rules are also being fundamentally reformed in the same Finance Bill to increase the flexibility of the regime whilst ensuring firms making substantial profits pay tax; and from April 2017, the headline CT rate will be reduced from 20% to 19% (and to 17% from 1 April 2020).

1.4 The government announced at Autumn Statement 2016 that it would explore the case for moving non-resident companies from the income tax regime to the CT regime in order to achieve consistency of treatment, in particular when applying the corporate interest restriction and loss reform rules.

1.5 For the purposes of this consultation, all references to a "non-resident company" are to a company which is not resident in the UK for tax purposes.

1.6 Chapter 2 discusses the policy proposal and Chapter 3 sets out how the CT principles might apply. The estimated impact of the proposal is set out at Chapter 4. The questions on which the government welcomes your views are summarised at Chapter 5, and Chapter 6 explains the ways in which you can respond.

1.7 Annex A provides links to the current tax rules for charging non-resident companies to income tax and NRCGT. A link to the Corporation Tax Acts is also provided.

2. Proposal

Bring income within the scope of CT

2.1 Introducing interest restriction and loss reform for non-resident companies by amending the income tax rules would involve significant changes and the use of concepts and approaches which, while established in the CT code, are not mirrored in the income tax regime.

2.2 In particular, responses to the consultation on the proposed corporate interest restriction suggested that applying the corporate interest restriction rules to non-resident corporate landlords within the income tax regime would require careful consideration. This is because very different rules apply when calculating interest expense and other financing costs for the purposes of each tax.

2.3 For these reasons, the government thinks that the better option for this category of income is to consider the case for moving income from UK real property into the CT regime. The government recognises that this would be a fundamental change to the taxation of the majority of non-resident companies who currently file self-assessment returns. However, this change would ensure that the taxation of income from UK real property is consistent.

2.4 The same issues could also apply to income arising from a trade carried on in the UK otherwise than through a permanent establishment which, technically, remains within the charge to UK income tax – though in practice this applies to only a very small number of companies. The UK's treaty network means the amounts of income tax paid on the profits of a trade carried on in the UK otherwise than through a permanent establishment are of a de minimis level.

2.5 Bringing any remaining UK source trading income within the charge to corporation tax would introduce considerable uncertainty for little practical benefit especially since virtually all of the UK's double taxation treaties contain a business profits article which hinges on the presence of a permanent establishment. For this reason the government does not propose to bring the residual income tax charge on trading profits realised by non-resident companies within the corporation tax code. However, the government will keep this under review and act if necessary.

2.6 As a consequence of this, the focus of this consultation will concern income from UK real property and whether and how this income is to be brought into CT. If this category of income is to be brought into CT, the policy will include bringing NRCGT gains within the CT regime at the same time.

2.7 The government has no plans to alter the status quo of the withholding regime for the deduction of tax at source within income tax which has been established for many years and is known and understood by taxpayers and market participants. The government does not consider that there is a requirement for a separate corporate rate given the UK's extensive treaty network which generally provides for an effective rate lower than the headline withholding rate.

Question 1: Do you agree that it is more appropriate to apply interest restriction and loss reform to UK real property income within the CT regime rather than the income tax regime? If you consider that they could be applied within income tax, how would the interest restriction and loss reforms be applied in a consistent manner to companies within CT?

Bring NRCGT within the scope of CT

2.8 As part of this policy proposal, the government proposes to bring NRCGT gains within the scope of CT at the same time. Non-resident companies are chargeable to CGT (and not CT) on NRCGT gains under Sections 1; 14D and 188D of the taxation of Chargeable Gains Act 1992 and section 2(2A)(a) of CTA 2009. The government intends that the existing computational rules for NRCGT would remain broadly the same with some adaptation for group companies.

Question 2: If non-resident companies liable to NRCGT are brought within CT, what features of the NRCGT provisions do you think may give rise to difficulties if adapted for CT?

3. Applying CT principles to UK rental income

3.1 If the profits of a UK property business of a non-resident company are brought within the charge to CT, the government intends for the general CT principles to apply as usual to this category of income although some transitional provisions may be needed to cover the transition from income tax to corporation tax. The government has identified the following areas which may require consideration as part of the design of the policy.

- **Accounting period**

3.2 If a non-resident company is brought into the CT regime for the first time in respect of its UK property business, then for CT purposes, the first accounting period would start on the first day on which they come into charge to CT which would be 6 April of the relevant financial year. There would be a deemed cessation of the UK property business at 5 April for the purposes of the charge to income tax. Consideration is being given to the treatment of assets which qualify for capital allowances; the government's current thinking is to avoid the creation of balancing allowances or charges which require a market valuation.

3.3 If the non-resident company is already within the charge to CT because it is also in receipt of profits which are already chargeable to CT, its CT accounting period would remain unaffected. The UK property income newly brought into charge for CT purposes would be apportioned on a just and reasonable basis between that which is chargeable to income tax to 5 April and that which is chargeable to CT from 6 April. The same considerations for capital allowances would apply.

- **Computation of UK property business profits**

3.4 Bringing the profits of a UK property business of a non-resident company within the scope of CT would affect the vast majority of non-resident companies who file self-assessment tax returns for income tax. While the territorial scope of the CT charge would remain the same, the computational rules which are set out at Part 4 of CTA 2009 are very different to those found in Part 3 of ITTOIA 2005.

3.5 Under the income tax regime, relief for interest accrued in the tax year is given as a deduction in calculating the net chargeable income whereas for CT, the profits of a property business are calculated without regard to interest. This is because any credits or debits of loan relationships and derivative contracts are dealt with elsewhere within CTA 2009 (at Parts 5 to 7).

3.6 Although this would mean that the net profit on this source of income will be nominally higher under CT, it would ultimately be reduced by any "deficit" that has been calculated under the loan relationship and derivative contract regimes. Under CT, a commercial UK property business loss, (excluding a loss from a furnished holiday lettings business) can be offset sideways against other CT profits of a non-resident company, for example if it also carried on trading activities in the UK through a permanent establishment which provides flexibility.

Question 3: Is there an alternative approach that could be taken in calculating the taxable profits or losses of a UK property business carried on by a non-resident

company? If they differ to those applied to a UK resident company carrying on a similar property business, please explain why different rules should apply.

- **CT loss reform**

3.7 The CT loss reform rules introduced by Finance Bill 2017 would also apply to non-resident companies who are brought within CT. This would mean that only 50% of the profits recognised by a company in any period of account could be sheltered by CT losses carried forward from previous accounting periods (subject to an annual allowance per group of £5 million profits which can be relieved in full). Equally the loss relaxation would apply so that a non-resident company could surrender its brought forward CT losses, (excluding those from furnished holiday lettings) and its non-trade loan relationship deficits as group relief to a related UK resident group company. These reforms would not apply to losses that arose before the UK property business profits came within the scope of CT.

- **Interest restriction**

3.8 The changes to the CT rules for corporate interest expense are to take effect from 1 April 2017. If non-resident companies are brought into the CT regime, the potential restriction of the interest expense would be calculated in the same way as that of a UK resident company so that the rules for restriction apply equally. In this way, the government considers that consistency of treatment is achieved.

3.9 The proposed rules provide for a de-minimis exemption of £2 million net interest expense to be shared by the worldwide group. If the non-resident company does not have any group associates, the worldwide group would only consist of that company and it would then be entitled to access the £2 million exemption in its entirety. A non-resident company may qualify for exemption in respect of its third party debt under the public infrastructure rules where the UK property business consists of the provision of UK property for third party rental.

Question 4: Irrespective of the tax regime, what would be the effect on non-resident companies from the application of corporate interest restriction? Please explain how any effect is different to the effect on UK resident companies.

- **Disregard Regulations**

3.10 For income tax, following the introduction of the new UK GAAP rules, the calculation of the interest expense now requires non-resident companies to report fair value movements on financial instruments in certain circumstances.

3.11 Under the CT regime, there are special rules known as the Disregard Regulations (S.I. 2004/3256) which specifically allow companies to 'disregard' the fair value movements on derivative contracts and instead bring amounts on the derivative into account in line with the hedged item. The Disregard Regulations would consequently apply to those non-resident companies brought within CT.

- **Management expenses**

3.12 A non-resident company holding an investment property may fall within the definition of an investment company. Because of the limited territorial scope of the charge to tax on a non-resident company, there is a risk that expenses may be claimed for an investment, the income from which would not be charged to UK tax.

3.13 The government considers that this risk might be addressed by limiting the deductibility of management expenses of a non-resident company to those amounts which have been wholly expended for the purpose of managing the part(s) of the investment property business which have a UK source and are within the charge to CT. An expense with both qualifying and non-qualifying purposes would be apportioned on a just and reasonable basis between both purposes.

3.14 If a non-resident company ceased to carry on a UK property business, and so no longer within the CT charge on that income, any unused property losses from the UK property business would not be carried forward as management expenses. At the point that the UK property business ended, the losses would be extinguished. If the non-resident company later commenced a subsequent UK property business, it may be possible to reinstate the unused loss to be carried forward and set against profits from that later UK property business.

Question 5: Do you agree that relief for management expenses for non-resident companies should be limited to those which are directly linked to the taxable UK sourced income? What are your views on the extinguishing of unused property losses at the point the UK property business has ceased?

Transitional provisions

3.15 Transitional provisions would be required to cover profits from loan relationships and derivative contracts to ensure that amounts are not taxed or relieved twice and they would also be needed to deal with any 'capital' profits and losses ensuing from the change of regime.

3.16 Any unused losses from the UK property business at the deemed cessation of 5 April would have been computed under income tax principles. A complete recalculation based on CT principles is not envisaged at this stage. On the assumption that the income tax loss is a commercial loss, the government considers that it would be reasonable to carry forward this loss from the income tax regime into the CT regime as "*income tax property losses*".

3.17 The government would propose that these losses could be grandfathered and would only be carried forward against profits of the UK property business and would not be available to be surrendered as group relief or set against other CT profits of the non-resident company. It would be possible to carry the loss forward to the next accounting period and for the loss to be set against that future income without restriction.

3.18 If the UK property business activity was to cease, or the non-resident company ceased to be within the charge to CT, the income tax property losses would be immediately extinguished for tax purposes.

Question 6: Do you think that the suggested treatment of the unused income tax losses carried forward is reasonable? If you consider that there is an alternative approach, please explain what that would encompass.

Question 7: Are there other CT principles that you think would require transitional arrangements to be provided for?

4. Assessment of impacts

Summary of Impacts

Exchequer impact (£m)	The Exchequer impact of any changes to the tax treatment of non-resident companies will depend on the detailed policy design, which could be informed by this consultation, and on any behavioural responses by affected businesses. If the government chooses to implement this policy change, any final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at a future fiscal event.
Economic impact	A full assessment of economic impacts would be undertaken when detailed policy options were developed.
Impact on individuals, households and families	It is not thought that there would be an impact on individuals, households and families.
Equalities impacts	It is not anticipated that moving non-resident companies from income tax to corporation tax in respect of their UK sourced taxable income would adversely affect any group with protected characteristics.
Impact on businesses and Civil Society Organisations	No firm estimate of the impact on businesses is available at this time. The government hopes to gather more information on these impacts through the consultation process.
Impact on HMRC or other public sector delivery organisations	This would depend on the detailed policy design
Other impacts	None have been identified as yet

Question 8: Do you have any comments on the assessment of equality and the impact on business as a result of this potential change in tax regimes?

5. Summary of consultation questions

Question 1: Do you agree that it is more appropriate to apply interest restriction and loss reform to UK real property income within the CT regime

rather than the income tax regime? If you consider that they could be applied within income tax, how would the interest restriction and loss reforms be applied in a consistent manner to companies within CT?

Question 2: If non-resident companies liable to NRCGT are brought within CT, what features of the NRCGT provisions do you think may give rise to difficulties if adapted for CT?

Question 3: Is there an alternative approach that could be taken in calculating the taxable profits or losses of a UK property business carried on by a non-resident company? If they differ to those applied to a UK resident company carrying on a similar property business, please explain why different rules should apply.

Question 4: Irrespective of the tax regime, what would be the effect on non-resident companies from the application of corporate interest restriction? Please explain how any effect is different to the effect on UK resident companies.

Question 5: Do you agree that relief for management expenses for non-resident companies should be limited to those which are directly linked to the taxable UK sourced income? What are your views on the extinguishing of unused property losses at the point the UK property business has ceased?

Question 6: Do you think that the suggested treatment of the unused income tax losses carried forward is reasonable? If you consider that there is an alternative approach, please explain what that would encompass.

Question 7: Are there other CT principles that you think would require transitional arrangements to be provided for?

Question 8: Do you have any comments on the assessment of equality and the impact on business as a result of this potential change in tax regimes?

6. The consultation process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the potential policy design. As part of this process, it has been necessary to consider what the detail of the policy design might look like and views on suitable possible alternatives are encouraged.

How to respond

A summary of the questions in this consultation is included at chapter 5. The deadline for responses is 9 June 2017.

Responses should be sent by 9 June 2017:

- by e-mail to: nrc.incometax@hmrc.gsi.gov.uk, or
- by post to: NRC Income Tax Consultation, Room 3/63, HMRC, 100 Parliament Street, London, SW1A 2BQ.

For queries over the phone, please call 03000 563 815. If you are calling from a text phone, prefix the number with 18001.

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure

of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles. As this consultation largely concerns complex technical issues; the government is willing to arrange meetings with external bodies but equally welcomes written technical responses. It is envisaged that further meetings with those with specialist interests will follow when all responses have been evaluated.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A: Relevant (current) government legislation

The full text of the legislation referred to in this document can be found on the Office of Public Sector Information (OPSI) web site. Links to the legislation are provided below:

Income Tax Act 2007
Income Tax (Trading and Other Income) Act 2005
Corporation Tax Act 2009
Corporation Tax Act 2010
Disregard regulations S.I. 2004/3256
Taxation of Chargeable Gains Act 1992
Schedule 7 of the Finance Act 2015 (which amended the Taxation of Chargeable Gains Act 1992 for NRCGT)