ICAEW REPRESENTATION 67/17
TAX REPRESENTATION

CONSULTATION ON NON-RESIDENT COMPANIES CHARGEABLE TO INCOME TAX AND NON-RESIDENT CAPITAL GAINS TAX

ICAEW welcomes the opportunity to comment on the consultation document *Non-resident companies chargeable to income tax and non-resident capital gains tax* published by HM Revenue & Customs on 20 March 2017.

This response of 8 June 2017 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Key point summary

1. As noted in previous consultation responses regarding property taxation the rules governing the taxation of UK property have been introduced piecemeal over several years and would benefit from an overall review rather than yet more tinkering at the edges.

2. The purported reason for suggesting this change is to ensure that non-resident companies renting out UK residential properties do not escape the interest restrictions and loss restrictions applicable to corporates. It is not clear from the consultation how many such non-resident companies exceed the £2m de minimis for interest relief and £5m de minimis for loss relief and as such we do not know what the tax loss might be if the change is not introduced.

3. The reasons for using a corporate vehicle are many fold and those who do want to be within the CT regime for whatever reason could change their structure, for example to an LLP.

4. If the proposed switch to corporation tax (CT) goes ahead steps will need to be taken to ensure such companies do not yoyo in and out of having to comply with the making tax digital regime for income tax (IT) and then CT. There should also be provision to ensure they do not move in and out of cash basis accounting.

General comments

5. There are mixed views regarding this proposal, those individuals working within the personal tax regime generally thinking no change should be made as the switch to CT would present unnecessary complications whilst those working within the CT regime think it would be a simplification to bring such companies within the CT net. Without an impact statement it is not possible to comment on whether the cost and inconvenience of change is justified.

6. Many of the companies that would be affected by this change simply own a single property and are administered by the owners of the company. If they were moved into the CT regime they may need to appoint advisers to assist with all the complexities, such as loan relationship rules, fair value adjustments, and management expenses rules.

7. If the majority of affected companies fall below the de minimis for interest and loss relief should those companies be put to the trouble of changing for the sake of the minority? As stated in our “Ten tenets for a better tax system the tax system”, Appendix 1, should be constant, changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

8. Concern has been expressed that although the consultation is about a move from income tax to corporation tax any changes could add a burden to the businesses. For example if the corporation tax route is adopted will the companies have to submit accounts in iXBRL format, will they have to adopt FRS102 for their UK income, will the rules for withholding tax on interest paid become more onerous?

9. It is noted that a change to the CT basis would greatly simplify issues where both a NRL business and branch are operated in the UK (this is uncommon, but can occur for property developers where a property cannot be sold so is rented out) loss relief between the NRL and the branch should be possible but is very cumbersome and currently two returns are required.

RESPONSES TO SPECIFIC QUESTIONS

Q1: 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?

10. It is difficult to say whether changing to bring all UK real property income within the CT net is more complex than applying the interest restriction and loss reforms to the IT regimes particularly as there is no indication as to the number of companies involved and the tax at stake if the changes are not made.

11. If the companies are to be brought into the corporate regime one method to achieve a change is for the company to be taxed as though it had a permanent establishment (PE) in the UK by adding a deeming principle to s20 CTA 2009 to deem the non-resident landlord (NRL) activity to be a PE for the purposes of the taxes acts, and ideally a second provision to deem profits taxable in the UK to likewise be a PE if otherwise they would be chargeable to IT. The existing PE rules to calculate the accounting profit of the rental activity could then be applied to tax it as though it was a branch. Strictly the rental business would not be a PE as it does not meet the OECD definition so there may be issues with double tax treaties.

12. The interest restriction and loss relief could then be applied as for any other PE. The only issue, as noted later, is that the company would be deemed to have carried on the same activity before the legal change so its NRL IT losses would be carried forward from the previous period as rental business losses for the first period within the new rules.

Q2: 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?

13. If these companies are brought within the CT regime then it should be for all purposes and gains should be liable to CT and not non-resident capital gains tax (NRCGT) or annual tax on enveloped dwellings (ATED) gains. The value of the property could be rebased as at April 2015 as for NRCGT and all subsequent gains treated like any capital gain in a company, so qualifying for indexation and liable at the CT rate. There can be no justification for mixing and matching the IT and CT rules to give non-resident companies the worst of both regimes.

14. If the NRCGT regime is retained even if the companies are brought into the CT regime the time limit for reporting the gains of 30 days will be as much an issue for them as it is now.

Q3: 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.

15. Most NRLs have an accounting period close to 5 April, often Lady day (25 March) or 31 March if different so a sensible approach would be:

15.1 Treat the period 6 April 2018 to the accounting reference date as a single period of accounts, consisting if necessary of 2 accounting periods (one to 5 April 2018 and the next to the accounting reference date);

15.2 Treat the rental business as continuing, but subject to CT not IT – there is no need for any cessation to be considered as the commercial activity continues unchanged and the rules very similar;

15.3 Treat any brought forward NRL losses as rental business losses for CT;

15.4 Require an adjustment such that any income or expenditure which would fall out of account from the transition is deemed to occur in the first accounting period (if need be first day thereof, but that can cause group relief issues).

16. Barring loan waivers in groups, for borrowers the difference between CT and IT rules on interest tend to be disclosure issues, relief is ultimately given for the accounting expense in any event. However, there will be a difference in relation to fair value movements on hedging funds which are taxable/deductible under CT subject to a disregard election. There is confusion and disagreement over the position under IT.

17. If the non-resident company rental business is taxed as a deemed PE then only the income/expenditure relating to the property business would be taxed/relieved, as such if the NRL also had interest income, a share portfolio, non-UK rental property, etc these other income sources would remain outside the scope of UK tax. A UK resident property rental business would have all its sources of income and gains brought into charge.

Q4: 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.

18. The majority of NRL companies will not have interest expense in excess of £2m so no impact and some of those that do would be able to elect for the public benefit infrastructure exemption.

19. A difference will only arise where a NRL company also has a non-UK business activity, and a rule is required to allocate the interest relating to the property business on a just and reasonable basis before considering the de-minimis provisions of the corporate interest restriction and to determine if the interest is UK or non-UK. That said in practice the £2m threshold is vastly above the interest burden of a NRL and most NRL's are special purpose vehicles with no activity beyond a single property rental so most should not be impacted by the interest restriction.

Q5: 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?

20. Relief for management expenses are only available where the expenses are incurred in respect of income within the charge to UK tax, so there is no need for any additional restriction, the potential expenses of concern are already non-deductible under existing legislation.

21. There is no reason to extinguish the property business losses. The property business has continued, if there were no change in legislation then relief would have been available against future profits, if the legislative change had occurred many years ago then the same quantum of losses would still have been incurred and would still be available against future profits (strictly the property business loss would have been a combination of property business loss and non-trade loan relationship deficit brought forward, but both would be available for offset against property business profits or capital gains regardless), so to deny relief would be unjust.

22. No transitional issues will arise for the vast majority of companies regarding profits from loan relationships and derivative contracts beyond, possibly, an accounting period true-up. Given that only borrowings to fund the property purchase are in scope for a NRL it is unclear what loan relationship expenses would fall out of scope or capital profits/losses arise, under IT or CT relief is given for interest actually incurred, with timing based on accounting recognition – the only difference should be disclosure.

23. We agree that any IT losses should be carried forward without recalculation to be set against future profits of the property rental business.

24. On cessation of the UK property business the losses should convert to management expenses as would be the case for a UK company carrying on a rental business. However as most NRL companies are special purpose vehicles the only future activity is the property disposal (generally on the day of cessation) and extinguishing any losses unused against the disposal is accordingly of no consequence. The 'immediately extinguished' rule should not prevent offset of the losses against any gain on the property, particularly as it is common for the rent to cease because it is decided to redevelop and sell a property (triggering a chargeable gain) or because the rental activity was intended to offset running costs while preparing a sale and so is inherently tied to the capital disposal.

Q6: 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.

25. No. It is unnecessarily cumbersome, inconsistent to the tax treatment for a historically UK company in the same position, and risks failure to offset any brought forward loss against chargeable gains if there is a delay between ceasing the rental business and the property sale.

26. A more credible approach is to consider the IT property business losses to have become CT property business losses, this is a much simpler relabelling and the only significant difference to a recalculation along CT principles would be to avoid splitting the loss out into property business loss and non trade loan relationship debits but as both of these can be offset against non-business profits going forward the distinction is unneccessary.

Q7: Are there other CT principles that you think would require transitional arrangements to be provided for?

27. The draft Finance Bill 2017 included clauses to provide that in the absence of an election to the contrary property businesses liable to IT had to calculate their rental income on the cash basis. Although this clause was dropped in the wash up if it is reintroduced non-resident property rental companies could find themselves moving in and out of the cash basis. Provisions should be included to ensure this does not happen.

28. Payments on accounts made under the IT regime should be reallocated to the CT account.

29. Any accrued expenses or rent received in advance should simply be treated as though it was incurred/received on the CT property business.

Q8: 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?

30. No comment.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx).