SQUIRE PATTON BOGGS

UK Spring Budget 2021

The Long Road to Recovery: Taxation

March 2021

The UK Spring Budget Statement delivered by Chancellor of the Exchequer, Rishi Sunak, on Wednesday 3 March 2021, laid bare the scale of the economic damage done by COVID-19.

UK gross domestic product (GDP) fell by just under 10% in 2020 and, despite huge government response, unemployment rose sharply. That response, taking into account all support measures and capital investment, totals £407 billion, which amounts to the largest ever economic support package during peacetime.

The Chancellor did also deliver some good news. The Office for Budget Responsibility (OBR) now expects (largely on the back of the success of the vaccine programme) the UK economy to recover more quickly as lockdown restrictions are lifted, and reach pre-crisis levels in the middle of 2021. However, as it recovers, the UK economy also faces the additional challenges occasioned by its departure from the EU. Government borrowing hit nearly 17% of GDP during 2020/21 and, while levels fall in future years, total national debt is predicted to peak at over 97% of GDP in 2023/24. The sheer level of debt means that while servicing it at current (very low) rates is broadly considered manageable, the public finances are adversely exposed to the risk of interest rates rising and inflation.

Of course, it is not predictions or expectations, but rather what actually happens, that really matters. However, while the Chancellor reiterated his commitment to "do whatever it takes", he also made it clear that the government needed to start to repair the public finances. The hope must be that the recovery is strong enough, broad enough and prolonged enough to do most of the heavy lifting in reducing the deficit. The Chancellor confirmed that he would honour the Conservative Party's Manifesto pledge not to raise the rates on income tax, national insurance contributions (NIC) or VAT, and that there would be no return to public spending cuts (austerity) either.

The Chancellor's focus, then, is on an investment-led recovery, to incentivise investment, productivity and growth and to build a new, innovative and "green", UK economy. In terms of tax policy, the Budget couples some (but actually surprisingly few) tax rises with several innovative tax incentive measures.

This alert outlines some of the more significant new announcements.

COVID-19 Support

Alongside the continuation of the Coronavirus Job Retention Scheme (CJRS) until September 2021 (although government contribution tapers to 70% in July and 60% in August), the announcement of fourth and fifth grants under the Self-employed Income Support Scheme (SEISS) and a six-month extension of the uplift in the Universal Credit Standard Allowance, the Chancellor also announced a new measure designed to provide businesses with more flexibility in the utilisation of losses caused by COVID-19.

Trading Losses – Extension of Carry Back

Any business that has been loss-making during the pandemic will be able to "carry-back" their losses for up to three years (rather than the current one year) to set against prior year profits. The extension of the carry-back rules is available to both incorporated and unincorporated businesses subject to the following caps:

- Up to £2 million of unused trading losses (in each of 2020-21 and 2021-22) for unincorporated businesses
- Up to £2 million of unused trading losses (in each relevant accounting period ending between 1 April 2020 and 31 March 2021 and between 1 April 2021 and 31 March 2022) for companies
- Groups with companies that have capacity to carry back losses in excess of £200,000 will be required to apportion the £2 million cap across the group as a whole. Further detail on exactly how the group cap will work is expected to be announced in due course.

Businesses unable to use trading losses in the current year may choose to carry the loss back and then carry forward any unused balance of the loss. It is worth noting, especially in light of the rise in the main rate of corporation tax in 2023, that the carry back is not compulsory. If sustainable, all of a company's losses could be carried forward (although they may then be restricted by the rules limiting their use against a maximum of 50% of profits in any one year, albeit such profits could be subject to a higher rate than now).

In addition, the Chancellor announced the extension of the main tax policies adopted to tackle the immediate impact of COVID-19.

Stamp Duty Land Tax (SDLT)

The temporary increase in the residential SDLT nil rate band (in England and Northern Ireland) has been extended until 30 September 2021. The nil rate band will continue to be £500,000 until 30 June 2021, before reducing on 1 July 2021 to £250,000. It will return to its normal level of £125,000 from 1 October 2021.

The housing market will be hopeful that transactions already "offered" but not yet completed or substantially performed will now be able to take advantage of the relief. However, there is now a risk of new transactions falling on the wrong side of the new deadlines later in the year.

Business Rates Relief

Eligible businesses in the retail, hospitality and leisure sectors in England will continue to benefit from 100% business rates relief on their premises for the first three months of the new financial year, from 1 April 2021 to 30 June 2021. The relief was originally intended to end on 31 March 2021. In addition, a 66% business rates relief will continue to be available during the remaining nine months of the year (from 1 July 2021 to 31 March 2022). The relief is capped at £2 million per business where affected premises were required to be closed on 5 January 2021, and at £105,000 per business for other eligible properties.

VAT – Reduced Rate for Tourism and Hospitality

The temporary reduced rate of 5% VAT for goods and services supplied by businesses in the tourism and hospitality industry has also been extended to the end of September 2021. In addition, there will be no immediate jump back to the standard (20%) rate in October, but rather a transitional six-month period from 1 October 2021 to 31 March 2022, during which a reduced 12.5% VAT rate will apply.

Affected businesses will welcome the announcement but will also need to be ready to prepare to comply with the increased compliance and administration burden (e.g. simply ensuring the correct VAT rate is applied and reflected on invoices) that fluctuating VAT rates can bring.

Personal Taxes

The Budget is a tax-raising Budget. Although rates have not risen, the Chancellor has chosen to "freeze" a number of rate thresholds. The impact of "fiscal drag" over time means that more people fall into higher rate brackets or realise taxable income or gains that exceed relief thresholds. The result is more tax is payable and paid. The frozen thresholds include:

Income Tax

- **Personal allowance** – will rise (as already announced) to £12,570 from April 2021 but will be frozen at that level until April 2026.
- **Higher rate threshold (HRT)** – will rise (as already announced) to £50,270 from April 2021 but will be frozen at that level until April 2026.
- **Starting rate for savings** – will be frozen at £5,000 for 2021/21.

National Insurance Contributions (NICs)

- **Primary Threshold and Lower Profits Limit** – will rise (as already announced) to £9,568 from April 2021 but will be frozen at that level until April 2026.
- **Upper Earnings Limit (UEL) and Upper Profits Limit (UPL)** – will rise (as already announced) to £50,270 (aligning with the income tax HRT) from April 2021 but will be frozen at that level until April 2026.

Before the Budget, many predicted (based on comments made by the Chancellor himself when unveiling his original package of COVID-19 support measures) that the NICs treatment of income earned by the employed and the self-employed could be aligned. Many small, self-employed, businesses will be relieved that the Budget did not contain this measure. However, the relatively modest number of revenue-raising tax policy announcements in this Budget implies that more major changes are still being considered and, subject to the path of the economic recovery, may follow in the not too distant future.

Capital Gains Tax (CGT)

The CGT Annual Exempt Amount (AEA) will be frozen at its current level (£12,300 for individuals, personal representatives and some types of trusts, and £6,150 for most trusts) until April 2026.

As with NICs, a rise in the CGT rate, to align it either exactly or more closely with income tax, was discussed widely before the Budget. Although the Chancellor did not announce a rate rise during his statement, the possibility of a future rise has not gone away completely. As with a number of areas, the announcement that 23 March 2021 has been set aside to publish tax consultations away from the distraction of the Budget suggests more fundamental tax reform remains on the agenda, and a CGT rate rise could still form part of that.

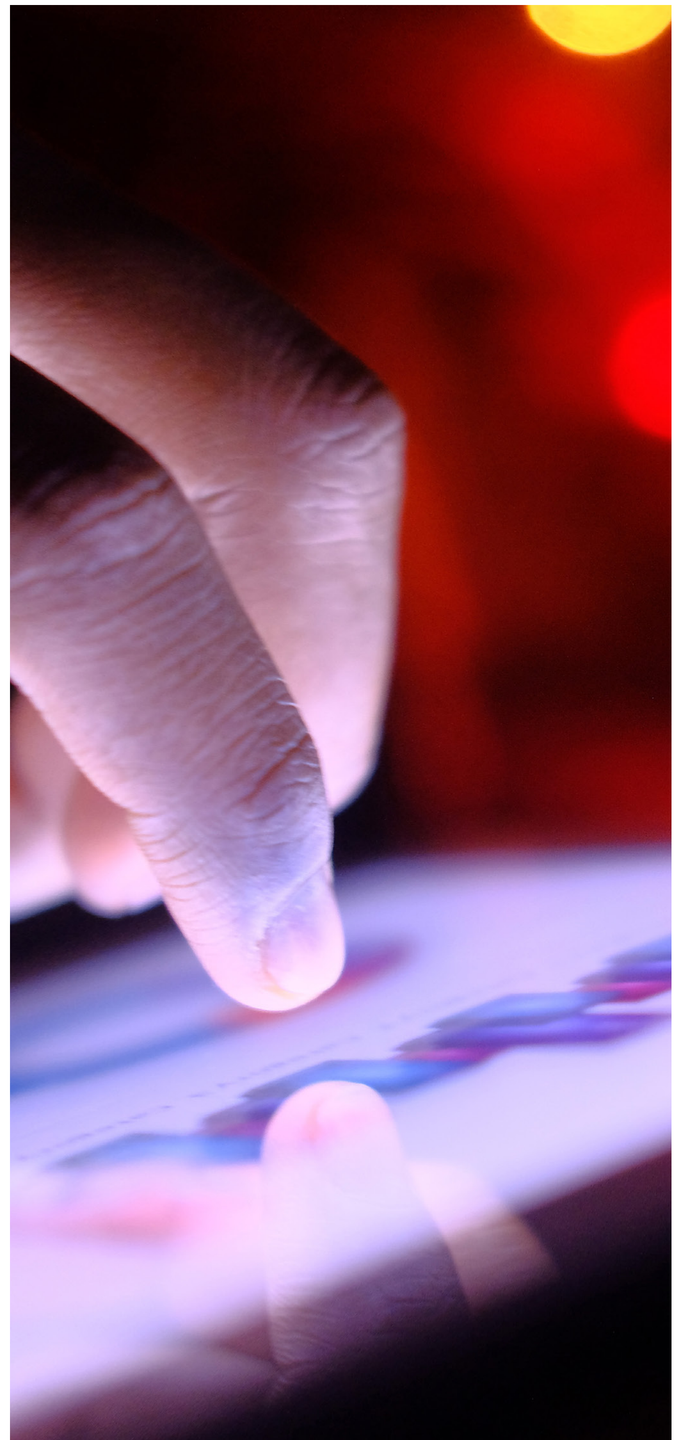
Inheritance Tax

- **General nil-rate band** – will be frozen at its existing level (£325,000) until April 2026.
- **Residence nil-rate band** – will be frozen at its existing level (£175,000) and taper away at £2 million.

Pensions and Savings

The Lifetime Allowance upper limit on tax-efficient contributions to a pension will be frozen at its current level (£1,073,100) until April 2026.

The taxation of pension contributions (much like the alignment of NICs and a rise in the CGT rate) was also discussed widely in the run-up to this Budget, as it has been in the run up to several previous fiscal events. The Chancellor has clearly decided this is not the time to make significant, disruptive changes in the pensions system. However, the justifications for making changes and limiting the extent of tax relief on contributions to pension schemes remain. Future reform cannot be ruled out.



Business Taxes

Corporate Tax Rate

The Budget's headline tax measure is that with effect from in April 2023, the main rate of corporation tax will increase from its current rate of 19% to 25%. The main rate will apply to profits over £250,000. As a result, the Diverted Profits Tax (DPT) rate will rise to 31% from April 2023.

In a move that reintroduces a "small profits rate", the current corporation tax 19% rate will continue to apply to profits under £50,000. A relief will ensure that the effective rate will gradually rise from 19% to 25% for businesses with profits over £50,000 but under £250,000.

The impact of the rate rise, and its interaction with the extension of the loss carry-back provisions (as outlined already), the "super deduction" (discussed immediately below) for capital expenditure and the existing rules restricting the proportion of losses allowed to be carried forward will be interesting to follow.

As an aside, the government has committed itself to reviewing the current bank surcharge (8%), which it considers, when combined with the increase in the main rate of corporation tax, "would make UK taxation of banks uncompetitive and damage one of the UK's key exports". The review is set to take place in the autumn with the aim of ensuring the level of tax on the banking sector does not rise beyond its current value. Twelve years after the financial crisis, and a series of special levies and surcharges on the sector that resulted, this commitment is likely to be broadly welcomed by the banking industry as a move to realign the taxation of banks with other businesses.

Capital Investment – Super Deduction

In what is possibly the Budget's most innovative and intriguing policy measure, the Chancellor has announced that, between 1 April 2021 and 31 March 2023, companies will be entitled to a new "super deduction" for their capital expenditure on plant and equipment. The "super deduction" is equal to 130% of the cost of the investment in most types of equipment (certain types of assets will benefit from a lower 50% allowance). The 130% super deduction equates to a saving of 25p in each £1. There is no upper limit on the quantum available for relief.

This is incredibly generous (the measure is set to cost nearly £25 billion in 2021/22 and 2022/23 alone) and it compares very favourably to the existing main rate of capital allowances on plant and machinery (19%) and the annual investment allowance, which, although it gives relief at the 100% rate, is currently capped at expenditure of £1 million. The hope in HM Treasury must be that the deduction will be used wisely and widely on equipment that will boost productivity, economic activity and, ultimately, taxable revenues significantly.

However, it is an inconvenient truth that for the super deduction to be turned into immediate monetary effect, the claimant company must have taxable profits against which to offset it. Unfortunately, because of COVID-19, many companies will not be in a profit making position to take advantage of the super deduction. Nonetheless, in such cases, subject to the ability to carry the loss back to prior years (and obtaining an immediate cash tax refund), loss-making companies may consider revisiting equipment lease structures that will allow them to make the best use of these super deductions. Rather than buying capital equipment outright, such structures allow companies to lease it from a profitable, tax paying, leasing company. In effect, entitlement to the super deduction will vest with the equipment lessor, but it will be able to pass on part of that benefit to the lessee company through a lower cost of funds.

As always, the devil will be in the detail and how the relief provisions interact with leasing structures (and the other corporate tax announcements on losses and rate). It will be interesting to see how the super deduction is legislated for when the Finance Bill is published on or around 11 March.

In addition, as previously announced, the Budget confirms:

- The temporary uplift to the limit on the "Annual Investment Allowance" (AIA) to £1 million has been extended by one year to 31 December 2021.
- The Enhanced Structures and Buildings Allowance and Enhanced Capital Allowances provisions available in Freeports (as discussed in depth in our alert: Freeports in England: The Tax Offering), the first eight of which have been announced as being: East Midlands Airport, Felixstowe & Harwich, Humber, Liverpool City Region, Plymouth and South Devon, Solent, Teesside and Thames.

Enterprise Management Incentives (EMI)

The government has confirmed that the Finance Bill 2021 will contain provisions that extend the time-limited exception in the EMI regime to ensure that employees who are furloughed or working reduced hours because of COVID-19 continue to meet the working time requirements for EMI schemes. The change applies to both existing participants of the EMI scheme and ensures employers are able to issue new EMI options to employees who do not meet the working time requirement as a result of COVID-19. The measure will be a very broadly welcomed confirmation of an important announcement and will have effect until 5 April 2022.

In addition, following an announcement for the Budget 2020, the government has confirmed that it will review the EMI scheme with the aim of ensuring it remains suitable as a mechanism to support high-growth companies to recruit and retain the talent they need in order to grow effectively and efficiently. The review will also consider whether more companies should be able to access the scheme and whether other forms of remuneration could provide similar benefits for retention and recruitment. A Call for Evidence was published alongside the Budget with responses welcomed by 26 May 2021.

R&D Tax Reliefs

Consultation and Review

The government announced a review of, and published a wide-ranging consultation on, the UK's existing R&D tax reliefs alongside the Budget.

One of the government's core policies as it remodels the post-COVID-19, post-Brexit, UK economy is to reorientate the country towards highly innovative, digitalised, "green" businesses. It has set itself a target to raise total investment in R&D to 2.4% of UK GDP by 2027 and considers R&D tax reliefs to have a key role in encouraging that investment.

This review and consultation (which follows the completion of a consultation on the scope of R&D reliefs conducted during the summer of 2020) will examine all elements of the UK's two current R&D tax relief schemes. It will consider:

- Definitions, eligibility and scope of the reliefs
- How (if at all) to improve the way the reliefs operate
- How the reliefs are targeted to ensure they maximise the value of beneficial R&D activity

The intention is to ensure the UK remains a competitive location for cutting edge research and that R&D reliefs continue to be "fit for purpose" and that taxpayer money is effectively targeted. The government is already considering bringing data and cloud computing costs into the scope of relief.

Small and Medium-sized Enterprises (SME)

In a related development on R&D reliefs, the government has confirmed (subject to minor technical refinements) that it will restrict the amount of SME R&D tax credits payable to a company in any one year to an amount equal to £20,000 plus three times the company's total PAYE and National Insurance contributions liability. This is an anti-abuse measure that is intended to prevent schemes that fraudulently claim the tax credits in order to achieve an immediate cash-flow benefit.

Certain companies that (broadly) are creating or managing Intellectual Property (IP) and do not spend more than 15% of their qualifying R&D expenditure with connected persons are exempt from the restriction.

The new measure will take effect for accounting periods beginning on or after 1 April 2021.

R&D credits have long been associated with tax avoidance and abuse schemes. The government is clearly intent on tackling this abuse. It is reluctant to withdraw the reliefs altogether given its emphasis on boosting innovative businesses. From that perspective, the measures will be welcomed but potentially affected businesses will need to consider the precise impact of the new rules and their wider impact on business valuation in sale situations.

VAT – Registration and deregistration thresholds frozen

The VAT registration (and deregistration) thresholds are to be frozen for two years from 1 April 2022 to 31 March 2024.

As a result:

- VAT registration will continue to be required where a business's taxable turnover is £85,000
- VAT deregistration will continue to available (on application) for businesses with taxable turnover of £83,000

As with the freezing of thresholds outlined in the section on personal taxes, this is a tax raising measure (albeit a moderate one) because of the effect of fiscal drag. Over time, as more business generate more taxable turnover, and the effect of inflation accumulates, more businesses trigger the registration requirement. HM Treasury expects the measure to be generating in the region of £125 million in 2023/24.

Administration and Anti-Avoidance

The Budget 2021 continues a long-established theme of strengthening HMRC powers of enforcement and expanding the UK's anti-avoidance measures to protect the public revenue. In addition to the measures outlined here, the Chancellor announced a major package of measures to provide HMRC with the resources they need to combat avoidance and evasion. This includes £100 million for a Taxpayer Protection Taskforce entrusted with combatting COVID-19-related fraud (i.e. false claims for government support), new rules allow HMRC to recover SEISS payments where an individual ceases to be entitled to all or part of the grant, an additional £180 million investment in HMRC recruitment and technology, and significant new powers to tackle persistent promoters of tax avoidance schemes.

Some of the other key announcements worthy of note include:

Aligning the Penalty Regimes for VAT and Income Tax Self-Assessment (ITSA)

The government will introduce a new:

- **Late submission regime** – The new regime will be points-based with financial penalties imposed when the point threshold is breached.
- **Late payment regime** – Penalties for late payment will be proportionate to the amount of tax owed and how late the tax due is. Late payment (and repayment) interest charges will align VAT rules with those for other taxes.

The new rules take effect:

- For VAT: for periods starting on or after 1 April 2022
- For ITSA:
  - For taxpayers with business or property income over £10,000 per year, from accounting periods beginning on or after 6 April 2023.
  - For all other taxpayers, from accounting periods beginning on or after 6 April 2024.

Combatting Electronic Sales Suppression

In an interesting move that suggests the government's focus is firmly on the impact of digitalisation, the Chancellor has announced that, following a call for evidence over the summer in 2020, the government will introduce new powers targeting "electronic sales suppression" (ESS). ESS occurs where businesses manipulate electronic sales records, either during or after the point of sale, in order to hide or reduce the value of individual transactions. The effect is to reduce reported business turnover and corresponding tax liabilities. It is tax evasion.

The new powers will make the possession, manufacture, distribution and promotion of electronic sales suppression software and hardware an offence. HMRC will also acquire specific information powers enabling them to investigate and identify developers and suppliers in the ESS supply chain and to access software developers' source code and the locations of code and data.

The new measures will take effect from Royal Assent for Finance Act 2021.

In a related development, the Budget 2021 confirms the government will consult on the implementation of OECD model rules (published in June 2020) requiring digital platforms (e.g. online marketplaces) to send information about the income of their sellers to both HMRC and the seller themselves. It is clear that, alongside changes in the VAT treatment of sales made via online marketplaces, the UK's digital services tax and the long-promised review of the UK's business rates, the government is looking carefully at structural changes in the taxation businesses with a digital presence or operation.

The Long Road to Recovery

The UK faces a long road to recovery from the economic devastation caused by COVID-19, which has been exacerbated by its departure from the EU, and it faces renewed calls to "level-up" (what the Chancellor described as a "new economic geography"), resolve the social care crisis, maintain support for the NHS as demographic change unfolds across the country and meet its ambitious target to achieve "net zero" by 2050.

The Chancellor is clearly waiting to see what sort of economic recovery can be achieved as the UK unlocks itself from COVID-19 restrictions. Much remains uncertain, not least the continued effectiveness of the vaccine programme (especially against new variants of the virus) and the true viability of businesses that have been supported by central government for so long. This possibly explains why, with the obvious exception of the hike in corporation tax, so many of the rumoured tax rises were notable for their absence from the Chancellor's statement. There was no mention of any rise in CGT rates, no indication of aligning NICs on the different sources of income and nothing more (other than a side comment relating to resourcing HMRC in readiness for the digitalisation of the system) on the likely direction on business rates that are due for a review later in the year.

Perhaps most surprising of all, with the exception of confirmation of the already pre-announced plastic packing tax and a freeze on Carbon Price Support rates, was the almost total absence of tax measures relating to "green" initiatives. Fuel duty was frozen (for the 11th year in a row); air passenger duty will rise only in line with the RPI; and the proposed Carbon Emissions Tax will not proceed.

However, the absence of so much suggests that the Chancellor's plans for the future of UK tax policy have not yet been revealed. Perhaps the fireworks have been reserved for 23 March – a day dubbed as "Tax Day" – when HM Treasury plan to publish a suite of tax policy consultations held back from being released alongside the Budget. The stated intention is to give the consultations more publicity and prominence but, alongside the relatively muted tax announcements in the Budget itself, it is also suggestive that something far more fundamental is possibly on the near horizon.

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