SQUIRE PATTON BOGGS

Autumn Statement 2016
Changes to the Tax Deductibility of Interest Expenses

The UK government is clearly keen to be ahead of the pack in implementing the G20 and OECD recommendations on interest deductibility. In the Autumn Statement, the Chancellor announced that the government will proceed with its planned implementation date of 1 April 2017.

This is despite widespread concern that such rapid enactment will cause significant difficulties for businesses, leaving little or no time for effective structuring to cater for the changes.

The changes represent a fundamental change to the UK taxation of debt which is likely to have a considerable effect on capital intensive sectors including highly geared energy and infrastructure projects.

What Are the Changes?

From 1 April 2017, the amount of tax relief that can be claimed for interest costs will be capped at 30% of EBITDA. For corporate groups this will be calculated on a group wide basis. Groups can however instead elect to calculate the restriction by reference to the net interest to EBITDA ratio for the worldwide group.

Interest costs include all interest and other financing costs which are economically equivalent to interest and expenses incurred in connection with finance raising.

There is a group de minimis threshold of £2 million (i.e. the first £2 million of interest expense will be deductible for all groups), which the government estimates will exclude around 95% of groups from the rules.

Exemptions

There will be an exclusion for large scale, highly leveraged infrastructure projects that provide a public benefit, the design of which has drawn a high level of response to the government's consultation from various interested sectors.

The exclusion presented in the consultation documents was very narrowly drawn and it was stated that it will only apply where the following conditions are met:

- A project is entered into by a company/group to provide services which it is government policy to provide for the benefit of the public
- The company/group must be contractually obliged to provide those services by a public body or otherwise be licensed by a public body and thus regulated by them
- The project must be on a long term basis (i.e. more than 10 years)
- The project must generate at least 80% of its gross revenue from the provision of public benefit services
- All of the project revenue must be subject to UK corporation tax

The government did confirm in the Autumn Statement that the exclusion will be made wider to protect investment in public benefit infrastructure however until such time as draft legislation is released it is difficult to tell how helpful the exclusion will be.

Based on the current scope of the exclusion projects which encompass an element of public policy progression (such as renewable energy generation) may be able to muster an argument that the public service condition has been met. However, other elements of the project are likely to fall foul of one of the other conditions for exemption.

Other Changes

Another key development relates to the restriction that will be placed on the use of tax losses with effect from April 2017. While greater flexibility is to be afforded in terms of the types of profit that can be relieved by carried forward losses and the extent to which the losses can be surrendered to group members (currently only profits of the same company's trade can be relieved in this way), the amount of profit that can be offset by carried-forward losses will be capped at 50% of profits (subject to a de minimis of £5 million for each standalone company or group).

These developments come on top of the changes that the government made in July to the way in which land transactions are taxed. A new and potentially much wider definition of what amounts to a taxable trade of dealing in or developing UK land has been introduced. The new tests apply to all taxpayers: companies, individuals, partnerships and trustees. The rules apply whether you are tax resident in the UK or not.

In particular, you can now be treated as carrying on a trade in UK land if you:

- Acquire land where your main purpose or one of your main purposes is to realise a profit or gain on sale
- Develop land where your main purpose or one of your main purposes is to realise a profit or gain on sale after the development is completed (and this could include a situation where a company disposes of surplus land which it has previously used for its business but then redevelops before selling it)
- Are involved in an indirect transaction in land, e.g. the sale of an interest in a property owning company, partnership or fund

The rules apply to disposals occurring on or after 5 July 2016, regardless of when the land was acquired. They are wider than the previous rules. Although HMRC have given some comfort in guidance that they are not intended to be applied to genuine investments, this guidance is non-binding and leaves the position unclear given that capital appreciation will be a consideration in many property acquisitions.

These changes together throw up a number of new considerations for infrastructure and energy projects. If you have any questions on any of the changes please do not hesitate to contact a member of our Tax Strategies & Benefits team.

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