TRANSITION TO CORPORATION TAX

Key Implications for Non-UK Resident Companies with UK Property Business

From 6 April 2020, non-UK resident companies that carry on a UK property business, or have other UK property income, will now be liable to corporation tax on their profits, as opposed to falling within the charge to income tax.

Broadly, the profits chargeable to corporation tax will be calculated on the same basis as income tax. However, there are certain specific rules and restrictions under corporation tax that will need to be considered by affected companies and their advisors.

This briefing note is intended to provide an overview of both the technical and practical aspects of transitioning to, and operating within, the corporation tax regime. Albeit, every company will have a different set of circumstances which will require specific detailed consideration and advice.

To explore this further, please speak to your regular FTI contact, or contact the team using the details below.

Practical aspects

1. Registration for Corporation Tax

Non-UK resident companies carrying on a UK property business, who are already registered with HMRC under the Non-resident Landlord Scheme, will be automatically registered for corporation tax and will be sent a corporation tax Unique Taxpayer Reference (UTR) from HMRC. The corporation tax UTR will be separate to the current UTR for income tax. However, any existing agent authorisations for income tax will not transfer to corporation tax, and subsequently new agent authorisation forms will need to be submitted.

Once a company receives its corporation tax UTR, it should write to HMRC to notify them of the company's financial year end, otherwise the default accounting period end will be 5 April. Where a company's financial year ends on a date other than 5 April, there would be a short first accounting period for corporation tax purposes, from 6 April 2020 to the company's next year end date, with subsequent periods following normal corporation tax rules.

For new non-UK resident companies that acquire a UK property in the future, it is important to note that they will still need to apply for registration to Non-resident Landlord Scheme, in order to receive UK rental income gross.

2. Corporation Tax Filing Requirements

Under corporation tax, companies must submit their tax returns electronically within 12 months after the accounting year end. Additionally, the accounts must also be submitted with the corporation tax return, either in Inline eXtensible Business Reporting Language (iXBRL) format or a pdf document, dependent on the relevant accounting standard the accounts are prepared under.

Groups are required to submit an annual Corporate Interest Restriction (CIR) return within 12 months of the year end, separately from the company's corporation tax returns. Additionally, CIR groups should also appoint a reporting company by the first CIR return deadline.

3. Payment of Corporation Tax

The UK tax legislation operates on an advanced payment regime, therefore, all companies subject to corporation tax are required to pay tax prior to filing of the tax return.

The payment due dates depend on how 'large' the company is considered to be for UK tax purposes. For 'small' companies, payment of corporation tax is due nine months and one day after the end of the accounting period.

For 'large companies', payments are due quarterly, based on estimated profits, on 14th day of the seventh, tenth, thirteenth and sixteenth months from the start of the accounting period. A company is generally considered 'large' if its taxable profits exceed £1.5m (threshold pro-rated for the length of the period and number of companies within the group).

For 'very large companies', payments are due quarterly, based on estimated profits, on 14th day of the third, sixth, ninth and twelfth months from the start of the accounting period and consequently will all be made before the end on the accounting period. A company is generally considered 'very large' if is within a group whose taxable profits exceed £20m (threshold pro-rated for the length of the period and number of companies within the group).

Interest will be payable or receivable on under- or over-payments respectively.

A one-off transitional rule applies so that the instalments for 'large' and 'very large' companies do not apply for the first accounting period following transition to the corporation tax regime.

4. 'Group' Determination

On transition to corporation tax, it is important to establish the non-UK resident company's 'group' under the various provisions, as what constitutes a 'group' may differ between different areas.

These provisions include determining the relevant 'group' for the relieving of group losses, paying tax under quarterly instalments and applying the CIR rules. There are a number of factors that will be relevant to consider, including the application of International Financial Reporting Standards (IFRS) and whether entities consolidate (or are able to consolidate) up to a corporate parent.

Technical aspects

1. Overview and Transitional Provisions

Broadly, the profits chargeable to corporation tax will be calculated on the same basis as income tax, i.e. expenses are deductible to the extent they are 'wholly and exclusively' related to the property business. The profits chargeable to corporation tax will be at the corporation tax rate, which is currently 19% (and will now remain so) rather than the 20% current income tax rate.

Losses carried forward from the income tax regime will be ringfenced and therefore not subject to the corporation tax loss restriction rules (see below). However, the use of such losses will be limited to offset against future property business profits (which excludes capital profits), rather than being available for offset against other types of profits as is the case for corporation tax losses more generally. Income tax property losses will be offset automatically against the relevant profits of future periods, in priority to post-6 April 2020 losses.

For capital allowances purposes, on transition from income tax to corporation tax the capital allowances will transfer at tax written down value and will not constitute a disposal event.

The focus of these changes is the taxation of property income, since capital gains realised by non-UK residents are already within the scope of UK corporation tax (the rules changed for commercial property on 6 April 2019). However, the changes will mean that the taxation of income and gains is now governed by a single regime, which will simplify compliance obligations.

2. Tax Deductibility of Interest

From 6 April 2020, financing costs will no longer be deductible as property business expenses. Instead these will be deductible through the loan relationships regime.

Corporate Interest Restriction

The CIR rules apply to companies which are subject to corporation tax, and as such will apply to non-resident landlords from 6 April 2020.

Broadly the CIR rules apply a 'fixed ratio' rule limiting interest deductions to 30% of a UK tax adjusted EBITDA, capped at group net interest. However, there is also a £2m de minimis per annum, under which the rules do not apply. This de minimis is shared by the UK tax paying entities that are part of the same 'group', which is assessed on a worldwide group basis (broadly based on the IAS consolidation rules).

An alternative to the fixed ratio method is to elect to apply the 'group ratio' method, whereby the restriction is based on the ratio of net group interest expense to group EBITDA (both being accounting values) on a group basis. This calculation excludes related party interest costs, and therefore only includes interest payments to genuine third parties. This option would typically be adopted if the group ratio is higher than 30%. This percentage is then applied to the UK tax EBITDA, with the deduction capped at the lower of net external worldwide group interest and actual UK tax interest for the period. This can have the effect of ensuring that all external debt interest is deductible, although the effectiveness of this will depend on the wider group EBITDA and debt profile.

Companies are able to elect to apply the fixed or group ratio annually.

There is a further, specific, exception available to ensure that there is no restriction of interest deductions for external debt used to finance property let to third parties, subject to certain conditions. The Public Infrastructure Exemption (PIE) is applied by making an election before the end of the accounting period to which it is to have effect. The PIE has the effect of allowing all the external debt interest, but disallowing any related party interest costs. It also precludes the interest costs and EBITDA in the entity making a PIE election from being included within the fixed or group ratio rule calculations for other entities in the taxpayer's group.

The election is irrevocable for 5 years. Companies holding interests in property through tax transparent structures can also qualify for the PIE in certain circumstances.

Derivative Contracts

From 6 April 2020, financing costs such as derivatives will no longer be deductible as property business expenses. Instead these costs will be brought into the loan relationships and derivative contracts regime. Previously the capital movements in derivatives held by non-UK resident companies would have been outside the scope of UK tax, but (absent the application of the disregard regulations noted below) these value movements will now be subject to corporation tax.

Under the regime, there is an option to apply the disregard regulations or account for annual movements through the P&L and tax returns. Broadly, the disregard regulations 'disregard' for tax purposes, credits and debits arising to a company under fair value based accounting standards, in respect of its derivative contracts where the company uses those contracts to hedge against certain exposures and risks.

This option can be beneficial in circumstances where there are large movements in fair value, as the increases in value may be fully taxable, while any losses arising due to a decrease in value may be capped under the loss rules (mentioned later). Therefore, the option whether to apply to disregard regulations and the deadline for making such an election should be considered on a case by case basis.

Hybrid Mismatch Rules

The hybrid mismatch rules apply for corporation tax purposes, and as such will apply to non-resident landlords from 6 April 2020.

Broadly, the rules seek to disallow interest where either the entities or the instruments possess hybrid features, i.e. the tax treatment of the instrument or entity differs from one jurisdiction to another. Specifically, the rules look to restrict deductions for interest in the UK where:

- the recipient of the interest does not include the interest as part of its income;
- there is a double deduction for the interest but no double inclusion (e.g. where the expense is deducted in the UK and US, but the receipt is only included in US); or
- the mismatch (non-inclusion or double deduction) takes place between two non-UK countries, and are not otherwise adjusted.

These rules are particularly in point in relation to structures involving US investors, where 'check the box' elections are made, such that corporate entities treated as opaque for tax purposes in their local jurisdiction are treated as disregarded or transparent for US tax purposes.

3. Losses

Pre-6 April 2020 property business losses, incurred under the income tax regime, will be carried over as corporation tax losses. The carried forward losses will be preserved under a new category of loss and there will be no requirement to re-categorise into their corporation tax equivalent elements (i.e. property losses, management expenses and non-trading deficits).

These losses will only be available to offset against post-6 April 2020 UK property business profits and therefore cannot be offset against other sources of income, i.e. capital gains or be group relieved. However, these losses will not be subject to the 50% corporation tax loss restriction rules and will take priority over post-6 April 2020 corporation tax losses.

Losses generated post 6-April 2020 will need to be categorised into their corporation tax equivalent elements. Under the UK corporation tax group relief rules, it should be possible for tax losses arising in UK companies to be surrendered to other UK companies in the same 'group', and for those losses to be offset against the taxable profits of those other companies arising in the same period.

Post 6-April 2020 losses can be carried forward and offset against profits of the property business or other income streams, either within a company or other companies within a group. However, for profits in excess of £5m (on a group basis), only 50% of profits can be offset by brought forward losses. Note that this restriction and the £5m group allowance applies across both capital and income losses.

To the extent losses are group relieved, payments for the receipt of group relief are not subject to tax up to a limit of £1 per £1 of loss claimed.

About our Real Estate Tax Team

Our industry-focused team has extensive experience in advising on all aspects of the real estate ownership cycle, from acquisitions to disposals, joint ventures through to compliance and transfer pricing. The team thrives on complexity, advising on high value cross border transactions, and acts as a hub on European investments.

Property transactions often involve specific and potentially complex tax considerations. Whether you are an investor, developer or occupier, FTI Consulting offers a broad range of services – combining tax, surveying and accounting – that delivers practical and innovative solutions for clients involved in significant capital transactions.

Our senior Real Estate Tax team members are recognised as leaders in their field, having advised corporations, funds, governments and industry bodies in both the UK and internationally on all tax aspects relating to complex asset investments.

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