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UK Spring Budget 2021: Measures affecting corporates – the reckoning

Budget 2021 brought few surprises; as most commentators predicted, the immediate focus is on measures to support the economy and encourage investment as the UK recovers from the effects of the COVID-19 pandemic. The government's generosity seems set to continue for some time, with the extension or introduction of several tax relieving regimes such as a new 'super-deduction' for expenditure on plant and machinery. By 2023, however, these regimes will have expired or been phased out, and the government has signalled that its intention then is to start recovering the costs of this support through a series of tax raising measures, including a substantial increase in the main rate of corporation tax from April 2023.

Budget 2021 comes after a year that has seen unprecedented disruption to the UK economy, which the UK government has sought to mitigate with numerous financial support measures (many of which were extended or renewed by the Budget). The unsurprising message from the chancellor, reflected in many of the measures announced, is that government support will continue as the economy recovers from the effects of the COVID-19 pandemic but that there will, in the future, be a reckoning in the form of more tax to pay.

The rate change

The headline announcement for companies, which fits with this overall theme, is the change to corporation tax rates: no change for the next two years but, from 1 April 2023, an increase of six percentage points to a main rate of 25%, which will apply to profits over £250,000. A lower rate will be reintroduced so that companies with profits of £50,000 or less will continue to pay corporation tax at 19%, with marginal relief to ensure a tapered increase in the effective corporation tax rate for companies with profits between £50,000 and £250,000. There will be a corresponding increase in the rate of diverted profits tax, to 31%, to maintain the current differential.

There is, however, good news (relatively speaking) for banks: the government recognises that a 25% corporation tax rate combined with the current 8% banking surcharge would be excessive (and internationally uncompetitive), and will set out plans in the Autumn to ensure that the combined rate of tax on banking profits is not increased substantially from its current level. (The timing of this – with the change to the main rate being enacted in Finance Bill 2021 but the surcharge changes seemingly following later – raises the prospect of there being a period during which any bank valuing its deferred tax assets will have to do so on the basis of a 'substantively enacted' future tax rate of 33%, which is an anomaly that the government might have been expected to try and avoid.)

The super-deduction

The other eye-catching announcement for corporates is the introduction of the so-called 'super deduction'. For a limited period (1 April 2021 to 31 March 2023), companies investing in qualifying new plant and machinery will benefit from a new first-year capital allowance at a rate of 130% for main rate assets. Special rate assets, including integral features and long-life assets, will benefit from a 50% first year allowance. (Expenditure on cars will not qualify for the new allowances.) This will clearly act as a welcome incentive to capital investment in the relevant period; and judging from the projected Exchequer impact, the government seems to hope that its short-term generosity will be repaid through a higher level of taxable economic activity in future years.

The choice of a 130% rate is interesting: some commentators have suggested that the additional 30% deduction on top of the basic expenditure was designed with the upcoming change in corporation tax rates in mind, essentially to compensate taxpayers for the 'disadvantage' of benefiting from a first year allowance only at a time when the corporation tax rate remains at 19%. Mathematically, this is in effect what the super-deduction achieves: relief at 130%

in a 19% corporation tax environment equates to 100% relief at a 24.7% corporation tax rate, very close to the proposed 25% rate. There is perhaps some further support for this view in the way the draft legislation for the measure deals with expenditure incurred in periods straddling 1 April 2023. Broadly speaking, the availability of the 'excess' 30% deduction is pro-rated by reference to the proportion of the period that falls before the introduction of the 25% rate. When combined with the way in which the corporation tax rate increase is pro-rated for such a straddling period, the effect is that up-front relief for the expenditure is again given at a rate of approximately 25%.

In any event, it should be noted that the acceleration of allowances under the super-deduction regime (as compared to the normal 'reducing balance' basis which would otherwise apply) represents a significant benefit in its own right, even absent the 'excess' 30% deduction, and that benefit is only available for expenditure incurred before the corporation tax rate goes up on 1 April 2023.

Looking a little further at the detail of the draft super-deduction legislation, it is worth highlighting the relevance of 3 March 2021 (i.e. Budget day) to the operative provisions: expenditure incurred pursuant to a pre-Budget day contract is excluded from the super-deduction regime – presumably reflecting the policy desire to incentivise 'new' expenditure. Lest taxpayers think they might get around that by cancelling a pre-Budget day contract and then re-entering into it post-Budget day, the draft legislation contains a broadly-framed anti-avoidance rule, effective from Budget day. That rule prevents advantage being taken of the super-deduction regime by arrangements with a main purpose of achieving such an advantage if those arrangements are contrived, abnormal, uncommercial, circumvent the intended limits of relief under the Capital Allowances Act 2001 or otherwise take advantage of shortcomings in that legislation. Presumably HMRC would expect that to catch the simple device of cancelling and re-entering into a pre-existing contract.

Lastly, the regime contains specific rules to deal with a disposal of an asset on which a super-deduction has been claimed. As might be expected, the normal disposal value is increased (generally by a factor of 30%) in order to reverse the benefit of the super deduction; and a balancing charge of that amount arises in the disposal period. (In effect, therefore, assets on which a super-deduction has been claimed are treated as if they were in a single asset pool.)

Extension of the carry-back period for trading losses

Turning to other measures designed to support economic recovery, as widely predicted the chancellor has taken inspiration from previous economic crises and introduced a temporary (two-year) extension of the carry-back period for trading losses, from one year to three years. The extension will be available for losses incurred (broadly speaking) in the two-year period from 2020 to 2022, and there will be a cap of £2m of losses per year which can benefit from the extended carry-back. For groups of companies, that cap will operate on a groupwide basis. Interestingly, the projected exchequer impacts of this measure are negative until 2021/22, but then positive in succeeding years, and positive overall. This may to some extent reflect an expectation that the measure will support the survival and future profitability of business which would otherwise have failed (potentially accessing the three-year carry-back rule for terminal losses in the process). It is also the case, however, that losses which are carried back and used against profits of earlier years will not be available for use in future years when the corporation tax rate has increased.

R&D: hints of government dissatisfaction?

The other measure worth mentioning in this context is a consultation reviewing the UK's R&D relief regimes. This seems to be a relatively open-ended review, motivated by a desire to ensure the UK remains an attractive jurisdiction for R&D activity. There are hints, however, that the government is dissatisfied with the current regime, and in particular with the relief available for SMEs (convertible into a payable tax credit in certain circumstances). This seems to be regarded as both generous and inefficient in stimulating R&D activity. (It is also regarded as a target for abuse, which is why the government is pressing ahead with the introduction of a cap on the amount of SME payable R&D tax credit that a company can receive in any one year, at £20,000 plus three times the company's total PAYE and national insurance contributions liability.) It may therefore be that the days of the SME R&D relief are numbered, and the availability of the existing RDEC relief will be expanded to compensate. Taxpayers who incur significant expenditure in the R&D field may wish to take this opportunity to register their views and, perhaps, bid for improvements to the current rules.

Beyond Brexit

The other trend that can be detected in the Budget is that of taking advantage of the flexibility afforded by the UK's departure from the European Union. Following on from the substantial repeal of the DAC 6 rules in January, the UK appears to be taking incremental steps towards a position that is based more on current OECD recommendations than

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on equivalent EU rules. In this vein, the Budget indicates the government's intention to implement both developing OECD rules that will require digital platforms to report information about the income of their sellers, and the OECD's existing mandatory disclosure rules. (The latter will presumably replace the remnants of DAC 6.)

Other measures that may have been more difficult to implement as a Member State of the EU include the further extension of the reduced 5% VAT rate for tourism and hospitality (which will be phased out only gradually, remaining in place as a 12.5% rate from 1 October 2021 until 31 March 2022), and a swathe of measures dealing with the tax advantages associated with the government's proposed freeports. A call for evidence seeking views on whether and how to expand the current enterprise management incentives rules may also benefit from increased room to manoeuvre.

One other change in this category is the repeal of the UK legislation implementing the EU Interest and Royalties Directive. This provides an exemption from withholding tax on intra-group interest and royalty payments between UK and EU companies, and in practice it is usually either inapplicable (because the 'association' conditions under the Directive are very tight), or redundant (in light of the UK's double tax treaty with the relevant member state). Quite why the government has chosen this measure for repeal (and with almost indecent haste – those taxpayers who do currently rely on it have until 1 June 2021 to find an alternative solution, and an anti-forestalling rule to contend with) is a little unclear. Perhaps it is a simple tit-for-tat, given that EU member states are no longer required to apply corresponding relief to UK-bound payments.

In other news

Finally on substantive tax measures, there are a smattering of technical changes to the anti-hybrids rules, the corporate interest restriction rules and the post-2017 loss relief rules. Some of these changes have been the subject of prior consultation. As described in the Budget materials, most sound innocuous and/or taxpayer-friendly; but with regimes as complex as these it will be difficult to fully assess the implications until the draft legislation is made available in next week's Finance Bill. Also benefiting from some technical improvements are the off-payroll working rules – and the Budget materials confirm that the extension of those rules to the private sector will go ahead from 6 April 2021 as planned.

Turning to avoidance and compliance measures, this is a relatively quiet Budget. Anticipated changes to the rules on promoters of tax avoidance and follower notices are confirmed, as is the introduction of a new power for HMRC to serve a 'financial institution notice' requiring a financial institution to provide information about a specific taxpayer. What's new about this is that a financial institution notice will not require prior approval from the First-tier Tribunal. In large part, HMRC's concern seems to be to speed up the process by which it obtains this kind of information in response to requests from foreign tax authorities; no doubt, though, HMRC will also use the new power for its own purposes.

Lastly, it would normally be the case that Budget day heralded the publication of a number of consultations on future tax changes. This year, although a number of future consultations are promised, few have yet been published. In a break from tradition, the chancellor has indicated that a number of consultations and policy documents have been held back from Budget day and will be published on 23 March. We wait to see what that will bring, although it is probably unlikely to include any of the major reforms that were the subject of speculation but which have failed to materialise (e.g. windfall/excess profits taxes, or equalisation of the CGT and income tax rates). With the Finance Bill due to be published on 11 March, tax advisers can look forward to a busy month.

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