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Quarry Products Association NI Corporation Tax

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Agenda

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1

The landscape – setting the scene

Notwithstanding recovery: NI is bottom of the UK regional league table…

Economic indicator	NI	Wales	Scotland	SE England
Output per head 2013	10th	12th	3rd	2nd
Economic growth 2014	12th	10th	9th	2nd
Employment rate Feb.-Apr.2014	12th	9th	5th	1st
Employment growth Mar.2007-Mar. 2014	10th	6th	11th	2nd
Earnings levels 2013	12th	10th	4th	2nd

Why cut corporation tax anyway?

"…no financial weapon was more important than tax in attracting FDI"

Ray MacSharry.Fianna Fáil Finance Minister in the 1987-88 Irish coalition government

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What are the benefits – and the costs?

There are possible benefits…

- Low profit tax boosts post-tax profitability and should increase investment .
- OECD (2007)- a 1% point reduction in tax rate associated with 4% higher FDI.
- 18th Global CEO Survey says tax increasingly important as location driver
- RoI experience is that low profits tax as part of wider incentives regime, attracts investment, encourages clustering & supply chains

… but they are not always clear

- RoI had a low rate from as early as mid 1950s, but growth in FDI only came in late 1980s. When rate was higher.

- So, any impact from lower rate may be:
  - A slow burn. (*But* Oxford Economics 2011 assumed NI would fully adjust in 2 to 4 years.)
  - Somewhat dependent on having other supply-side factors in place like skills, infrastructure, communications etc…(clustering)

- *"Economies are not like a Pot Noodle, just add water and ready!"* (Graham Brownlow, QUB).

Projected employment impact is slipping.

A range of studies over 9 years illustrate declining projected gain relative to "baseline" *(the UK's average CT rate has declined and global conditions have changed).*

Study	Employment gain by c. 2030
ERINI, 2006	180,000
ERGNI/Oxf.Econ. 2010	90,000
EAG/Oxf.Econ. 2011	58,000
DETI/UUEPC 2014	37,400

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How the system works

Is cutting sub-regional CT not State-aid?

- Potentially not, if it is done in compliance with the Azores Judgement
  - Decision must be taken in the sub-region with the constitutional status and the power to do so
  - Decision must be adopted without central government being able to intervene
  - Fiscal consequences of a reduction must be borne by the sub-region without subsidy, offset or compensation

"Fiscal consequences must be borne by sub-region"

- Estimate cost £300m p.a (David Gauke Financial Secretary to the Treasury. 27.01.2015)
- £300m- plus comes off the NI block grant every year.
- Some issues to be avoided that will boost cost
  - Behavioural changes(e.g. profit shifting,)
  - Tax-motivated incorporation
  - Brass plating
  - Impact on other UK regions that could motivate complaint to EU

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The Corporation Tax (N.I) Bill

Corporation Tax (Northern Ireland) Bill

The Secretary of State outlined the Government's "overarching principles", relating to corporation tax devolution, insofar as the devolution must:

- Encourage genuine economic activity in Northern Ireland
- Be attractive to businesses and ensure that any administrative burden is proportionate
- Satisfy EU State Aid rules.
- Ensure that the cost to the Northern Ireland Executive remains proportionate and a kept to a minimum

Corporation Tax (Northern Ireland) Bill

- Published 8 January 2015 and first reading that day
- 21 & 22 January – HMRC Q&A sessions
- Second reading 27 January and referred to Committee that day
- Committee Stage ends by 12 February
- Must become law before 25 March
- No formal consultation process – written evidence deadline was 12 January!
- Must be "switched-on" by new government
- NI Assembly must make decision to vary the rate

Written evidence to support the Committee

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Ian Hook Esq
Senior Executive Officer
Scrutiny Unit, 7 Millbank
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11 February 2015

Dear Sir,

Re: Corporation Tax (Northern Ireland) Bill

Please find attached our written evidence in respect of the Corporation Tax (Northern Ireland) Bill, which we hope will assist the Public Bill Committee in its deliberations on the technical issues included in Bill.

We note the comments of the Secretary of State for Northern Ireland in her presentation on 8 January where she outlined the Government's "overarching principles", relating to corporation tax devolution, insofar as the devolution must:

- Encourage genuine economic activity in Northern Ireland
- Be attractive to businesses and ensure that any administrative burden is proportionate
- Satisfy EU State Aid rules.
- Ensure that the cost to the Northern Ireland Executive remains proportionate and a kept to a minimum

In responding to your invitation to provide written evidence, we have sought to reflect these principles in our analysis and remarks. Consequently, the majority of our substantive comments seek to further simplify the regime and reduce monetary, time and compliance costs. Where we have made recommendations or proposed amendments to the Bill, these appear in bold and we will be happy to elaborate if required.

We note that the introduction of the new regime inevitably introduces a significant and unavoidable amount of complexity into the UK tax system for those affected and potentially affected. It will be important that the legislation is considered over a longer period and amended and as necessary to ensure it operates in as simple manner as possible. Guidance and support from HMRC for taxpayers will also be of importance particularly in any transitional period.

Please do no hesitate to contact me should you or Members require additional information, as we would be happy to elaborate or to provide oral evidence if the Committee so wishes.

Yours faithfully,

Paul Terrington

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- Limited opportunity to respond
- Implications for Large cos, SMEs and workforce definition issues
- Issues around capital allowances and asset pools
- Implications for financial services – specifically long-term insurance and lending and investment

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Definitions and eligibility

Northern Ireland Rate (NIr) – key points

The *date and the rate*

- Rate to be set by NI Assembly –not yet determined – 12.5% or 10%?
- Commencement date of 1 April 2017 (at earliest)
- Will it be phased in (2.5% x3) or cliff-edge?

Knowns

- Non-trading profits completely excluded in all cases – even group income (eg property rental)
- 'Qualifying' trading profits only (ie there are exclusions)
- Got to be a "Northern Ireland company"

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Place of incorporation – irrelevant!

Excluded trades

1. Oil
2. Lending and investment
3. Investment management
4. Long term Insurance
5. Re-insurance

- But, exception to the exception in relation to "Back office functions" re 2, 3 and 5 above.
- Formulaic calculation of NI profit (for this purpose only) – tax deductible cost base plus 5% mark-up.

“Northern Ireland company”

1. Carries on *“a qualifying trade”* and

2. Meets either the “*SME*” or “*Large company*” test
   - SME
     - ➢ Is an SME (as defined by EU) in period, and
     - ➢ Meets the “*NI Employer*” rule (75% employee time and cost)
   - Large company
     - ➢ Not SME, and
     - ➢ Has a *Northern Ireland Regional Establishment* (“NIRE”)

The SME Test

SME - size

- Must meet the EU definition (with some modifications) of SME in the period or the preceding period:
  - Less than 250 employees *and*
  - Either (i) Turnover less than €50m or (ii) Balance Sheet Gross Assets of less than €43m

NI Employer (The 'In / Out' test)

- NI Employer rule must be met in period or preceding period:
  - 75% of workforce (Ds, Es, EPWs) UK time must be in NI, *and*
  - 75% of workforce costs incurred in UK must be in NI

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If you pass - all qualifying trading profits are NI profits, taxed at NIr. If fail, all profits are 'main rate' profits taxed at UK rate.

Large company test

Large company - size

- Not SME

NIRE

- Place of business in NI

Large company test

Large company - size

- Not SME

NIRE

- Place of business in NI

If you pass –must allocate trading profit between NI operations (Nir) and GB operations (UK rate)

Use Transfer Pricing / Branch Allocation principles. Concept of a 'separate enterprise'.

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The devil is in the detail

Northern Ireland losses

Where company generates a trading loss and that loss or part of it is a Northern Ireland loss, the following applies:

- Can offset against other trading profits
- Can offset against total profits
- Can surrender as group relief
- But, value is restricted if offset against profits other than Northern Ireland profits
- So if main rate 20%, and NI rate 10%, a £1m NI loss will only be worth £500k if offset against main rate (non NI) profits.
- No adjustment in setting main rate losses against NI profits.

Treatment of Intangible assets

- Eg Goodwill, patents, brand income, licence/royalty fees/income
- Rules are complex – give rise to very surprising results!
- 'Pre-commencement asset' – intangible asset created by **anybody** before Commencement Date (ie the date the NIr begins).
- Receipts/expenses re pre-commencement assets – taxed (or relieved) at UK rate!
- For post-commencement assets –
  - SMEs: NIr on receipts/expenses, and 'NI element' on a realisation.
  - Large: NIr to the extent receipts/expenses are attributable to NIRE, and on 'NI element' on a realisation.

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NI element? - ???????????????

Reliefs – adjustments made to neutralise impact

R&D

- RDEC – will be taxable at main rate regardless
- R&D for SMEs – formula adjusted – A x (MR/NIR)
- R&D for SMEs – cash back (currently 14.5%) scaled back by formula.

Note- Similar adjustment for Contaminated land and Creative reliefs

Patent Box

- Formula adjusted in relation to NI profits.
- Patent Box can (broadly) only take tax rate down to 10%.
- Complex – particularly for NI/GB businesses and/or pre Commencement Date IP.

CAs

- Pools to be split between NI activity and GB activity
- AIA to be pro rated between NI and GB activity

Real life bear-traps & complexities…!

- Some types of inter-group income
- Income from intangible assets
- Management charges
- SMEs - size, location of workforce and project pipeline
- SMEs – appropriate corporate structure
- Large – value drivers in your business
- Large – business model
- Property investment companies and management companies

Some pertinent questions…!

- Can I be in a break-even position and worse off under the NIr regime?
- I'm an SME – can I flip/flop in and out of the test?
- I'm an SME – can winning a contract in GB worsen my tax position?

- Can I restructure my company/group to improve my tax position?

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Yes, Yes, Yes, Yes, Yes!

Our observations so far…

1. *This Bill is firmly focused on attracting/rewarding FDI*
2. *The "simple in/out" SME test is not as simple as it looks*
3. *More generally, the NI CT regime test has pitfalls and complexities*
4. *Full implications for indigenous businesses will emerge over the next few months*
5. *and… HMRC are expecting businesses to prepare for the regime in advance*

Thank you, time for discussion…

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