These notes refer to the Corporation Tax (Northern Ireland) Bill as introduced in the House of Commons on 8 January 2015 [Bill 149-EN]

CORPORATION TAX (NORTHERN IRELAND) BILL

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Corporation Tax (Northern Ireland) Bill as introduced in the House of Commons on 8 January 2015. They have been prepared by HM Revenue & Customs (HMRC) in order to assist the reader of the Bill and to help inform debate on it. These explanatory notes do not form part of the Bill and have not been endorsed by Parliament.

2. The notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill.

STRUCTURE OF THESE NOTES

3. These notes begin with a brief overview of the measures contained within the Bill. This is followed by an outline of the structure of the Bill, its territorial extent and application and commentary on the Chapters of Part 8B inserted into Corporation Tax Act 2010 (CTA 2010) by the Bill and the amendments to Capital Allowances Act 2001 (CAA 2001) made by Schedule 1 to the Bill. The final part contains information about when the provisions in the Bill come into force.

BACKGROUND

4. The Bill makes provision about the rate at which corporation tax is charged on the profits of certain trades and activities of Northern Ireland companies, the Northern Ireland rate. The Northern Ireland Assembly may set that rate by resolution independently of the percentage at which the normal UK main rate is set. The provisions in this Bill give details of what trades and activities fall within the scope of the Northern Ireland rate, if one is set. The rate will be applied to trading income only with other sources of income remaining chargeable at the main rate of corporation tax.

SUMMARY

5. The Bill contains taxation provisions under which the Northern Ireland Assembly will have the power to set the main rate of corporation tax in respect of certain trading profits, to be called the Northern Ireland rate. The rate, in general, will apply to all of the trading profits of a company if that company is a micro, small or medium-sized enterprise (SME), and the company's employee time and costs fall largely in Northern Ireland. It will also apply to a corporate partner's share of the profits of a partnership trade if that company and partnership are both SMEs and the partnership's employee time and costs fall largely in Northern Ireland.

6. The rate will also apply to the profits of large companies, and (in the case of a corporate partner not covered by the SME rules referred to above) to a corporate partner's share of the profits of a partnership that are attributable to a Northern Ireland trading presence, that presence being termed as a "Northern Ireland regional establishment" (NIRE). The trading profits attributable to the NIRE are computed using internationally recognised principles with some modifications and adaptations.

7. A company (or partnership) that is within the Part 8B regime in an accounting period is referred to in Part 8B as a "Northern Ireland company" (or a "Northern Ireland firm"). In an accounting period in which it is a Northern Ireland company (or Northern Ireland firm), the company's (or partnership's) trading profit or trading loss is split between what Part 8B refers to as "Northern Ireland profits or losses" of the trade (which are taxed and relieved at the Northern Ireland rate) and "mainstream profits or losses" of the trade (which are taxed and relieved at the main rate). It is possible that a company (or partnership) making profits overall could in certain circumstances make a Northern Ireland loss (in conjunction with a mainstream profit) or a mainstream loss (in conjunction with a Northern Ireland profit). Similarly a company (or partnership) making a loss overall could in certain circumstances made a Northern Ireland profit (in conjunction with a mainstream loss) or a mainstream profit (in conjunction with a Northern Ireland loss).

OVERVIEW OF THE STRUCTURE OF THE BILL

8. The Bill has six clauses and two Schedules. Clause 1 inserts a new Part 8B into the CTA 2010. It provides for the application of the Northern Ireland rate to specified trading profits and adapts the rules in a number of areas of the corporation tax regime primarily dealing with reliefs to allow for the existence of different rates of corporation tax.

9. Clause 2 introduces the amendments to CAA 2001 in connection with Part 8B CTA 2010 that are contained in Schedule 1. Clause 3 refers to other

amendments in connection with Part 8B CTA 2010 as set out in Schedule 2. Clause 4 sets out the power to make further consequential provision. Clause 5 deals with the commencement of the Act. Clause 6 provides for the short title of the Act and interpretation.

10. Schedule 1 sets out the amendments to CAA 2001 connected with the new Northern Ireland rate. Schedule 2 contains amendments of the Corporation Tax Act 2009 (CTA 2009) and the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010) connected with the Northern Ireland rate and also contains consequential amendments of CTA 2010.

TERRITORIAL EXTENT

11. The provisions in this Bill extend to all of the United Kingdom. There is a convention that Westminster does not normally legislate with regard to matters within the legislative competence of the Northern Ireland Assembly, the Scottish Parliament or the National Assembly for Wales without the consent of the legislature in question. The Bill does not deal with devolved matters and does not give rise to any need for a Legislative Consent Motion in respect of Northern Ireland, Scotland or Wales.

CLAUSE 1: TRADING PROFITS TAXABLE AT THE NORTHERN IRELAND RATE

12. Clause 1 inserts new Part 8B into CTA 2010.

Chapter 1

13. Chapter 1 is an introductory Chapter which introduces the purpose of each Chapter of Part 8B.

Chapter 2

14. Chapter 2 explains how the Northern Ireland rate is to be set. The Northern Ireland Assembly has the power to set the rate for one or more future financial years by way of a resolution. Once set, the Northern Ireland Assembly may cancel that rate by resolution, which will have effect provided the cancelling resolution is passed before the beginning of the financial year to which the rate applies. Section 357IA (6) authorises the setting of a nil rate.

15. If a rate is not set by resolution for a financial year, the rate for that year will be the rate set for the previous financial year. Until the Northern Ireland Assembly exercises the power to set a rate for the first time, the Northern

Ireland rate will be the UK main rate.

Chapter 3

16. Chapter 3 provides for corporation tax to be charged at the Northern Ireland rate on Northern Ireland profits as distinct from mainstream profits. It also provides for the existing rules on loss reliefs to be modified to deal with the existence of different rates of corporation tax.

17. Section 357JA charges Northern Ireland profits to corporation tax at the Northern Ireland rate. Section 357JB provides for the way in which loss relief under section 37 of CTA 2010 (relief for trade losses against total profits) works if a company has Northern Ireland losses or mainstream losses. If it has both types of loss in a single period, relief is available separately for each. A Northern Ireland loss is to be relieved, so far as possible, first against Northern Ireland profits before relief is given against mainstream profits. Likewise, a mainstream loss is to be relieved first so far as possible against mainstream profits before being relieved against Northern Ireland profits.

18. If a Northern Ireland loss is to be set against mainstream profits and at any time during the accounting period the Northern Ireland rate is lower than the main rate, Chapter 3 provides for that loss to be taken into account by reference to a formula at section 357JJ in order to reflect the difference between the Northern Ireland rate and the main corporation tax rate. The loss carry forward, group and consortium relief rules are similarly modified.

19. Section 257JH modifies Chapter 4 of Part 5 of CTA 2010, (claims for group relief), so that claims made by reference to “available total profits” are made, in the context of a revalued Northern Ireland loss, by reference to the deduction given by the revalued Northern Ireland loss against the available total profits.

20. Section 357JI provides that the reference to a loss in section 944(2) and (3), which concern the transfer of a trade without a change in ownership, has effect as if the reference to a loss made by the predecessor in the transferred trade were to the Northern Ireland loss or mainstream loss of the transferred trade as appropriate. That treatment is sustained in the successor company.

Chapter 4

21. Chapter 4 sets out the basic definitions which apply for the purposes of Part 8B. A company will be a Northern Ireland company if it carries on a qualifying trade and meets either the SME condition at section 357KA(2) or the large company condition at section 357KA(3).

22. Section 357KB provides that a trade carried on by a company (other than in a

partnership) will be a qualifying trade if the company is within the charge to corporation tax in relation to that trade and the trade is not an excluded trade.

23. The definition of "qualifying trade" includes provision enabling a company to make a one-off election under section 357KB to bring in profits attributable to the back-office functions of certain trades which would otherwise be excluded trades. Chapter 17 defines the meaning of an excluded trade and includes the power to define the meaning of back office activities.

24. The SME condition is met if a company is an SME as defined at section 357KC and is a Northern Ireland employer. It will be a Northern Ireland employer if the Northern Ireland workforce conditions set out at section 357KE are met in relation to the relevant accounting period, or in relation to the period of 12 months preceding that accounting period.

25. The Northern Ireland workforce conditions are met if at least 75% of its staff time and costs relate to work carried out in Northern Ireland. If this test is not met then the company is not a Northern Ireland employer, it will not meet the SME condition and all of its trading profits will be chargeable at the UK main rate of corporation tax.

26. Section 357KE(8) provides a regulation-making power for HMRC to specify descriptions of deductions which are, or are not, to be regarded as workforce expenses.

27. The large company condition is met if the company is not an SME and has a Northern Ireland regional establishment (NIRE) which is defined in Chapter 5.

Chapter 5

28. A company will have a NIRE if the company has a fixed place of business in Northern Ireland through which it wholly or partly carries on its business or if it carries on its business in Northern Ireland through a dependent agent.

29. A NIRE will not exist where the business is carried on through an agent of independent status. This Chapter sets out the conditions to determine whether an agent is of independent status.

Chapter 6

30. Chapter 6 determines which profits and losses of a qualifying trade of a company which is a Northern Ireland company by virtue of the SME condition at section 357KA(2) are Northern Ireland profits or Northern Ireland losses.

31. The Northern Ireland profits and losses of a Northern Ireland SME company are all the profits and losses of a qualifying trade except to the extent that they

arise from excluded activities (re-insurance and the exploration or exploitation of seabed). The definition of "qualifying trade" covers cases where a company makes a one-off election under section 357KB to bring in profits attributable to the back-office functions of certain trades which would otherwise be excluded trades.

32. Section 357MB sets out how the back-office profits of an excluded trade for which an election under section 357KB has been made are to be determined. The profits are imputed on a percentage mark-up basis. Each back-office deduction is marked up at a rate of 5 per cent.

33. Section 357MB(3) provides a power for the Treasury to vary the rate which is used to arrive at the value of the imputed profits of back-office activities.

Chapter 7

34. Chapter 7 identifies the profits and losses of a trade of a large company which are Northern Ireland profits or Northern Ireland losses. The rules set out in this Chapter for the attribution of profit to the NIRE follow internationally recognised principles similar to those governing the attribution of profits to a permanent establishment which are set out at Chapter 4, Part 2 of CTA 2009.

35. The profits or losses of the qualifying trade can comprise either Northern Ireland profits or losses, mainstream profits or losses or a combination of both. The Northern Ireland profits and losses of a qualifying trade of a company which is a Northern Ireland company by virtue of the large company condition at section 357KA(3) are those which are attributable to a NIRE and which do not arise from an excluded activity.

36. The definition of "qualifying trade" covers cases where a company makes a one-off election under section 357KB to bring in profits attributable to the back-office functions of certain trades which would otherwise be excluded trades.

37. Northern Ireland profits and losses are attributable to the NIRE on the principle that it is a separate enterprise, engaging in the same or similar activities as if it were wholly independent from the company, and as if transactions between the NIRE and the company were made at arm's length.

38. Provision is made for the attribution of allowable expenses incurred for the purpose of the NIRE, but no deduction is allowable for internal royalties or similar payments paid by the NIRE to any other part of the company for the use of intangible assets. No deduction is allowable for interest or other financing costs paid by the NIRE to any other part of the company. A deduction will, however, be allowed for any contribution by the NIRE to the costs of creating an intangible asset and any contribution received by the

NIRE towards such costs will be attributable to it.

39. Internal royalties or other similar amounts received by the NIRE from other parts of the company will not be brought into account when calculating the profits attributable to the NIRE. Internal interest or other financing income received from any other part of the company will not be attributable to the NIRE.

40. Section 357NB sets out how the back-office profits of an excluded trade for which an election under section 357KB has been made are to be determined. The profits are imputed on a percentage mark-up basis. Each back-office deduction is marked up at a rate of 5 per cent.

41. Section 357NB(3) provides a power for the Treasury to vary the rate which is used to arrive at the value of the imputed profits of back-office activities.

Chapter 8

42. Part 8 CTA 2009 sets out how a company’s gains and losses in connection with intangible fixed assets (IFAs) are calculated and brought into account for corporation tax purposes. Chapter 8 deals with the calculation of Northern Ireland profits or losses where the company holds intangible fixed assets within Part 8 CTA 2009 for the purpose of a trade carried on by it in Northern Ireland.

43. Where Chapter 8 applies, the basic rules for computing Northern Ireland profits are determined without regard to any intangible fixed assets held by the company for the purposes of its Northern Ireland trade. After this amount has been determined, the total “Northern Ireland intangible credits” for the period are added and the total “Northern Ireland intangibles debits” for the period are subtracted.

44. Chapter 8 provides separate definitions for Northern Ireland intangibles credits and debits depending on whether the company is a Northern Ireland company by virtue of the SME condition (NI SME) or by virtue of the large company condition (NI large company). Both definitions use the terms “pre-commencement asset”, “realisation credit”, “realisation debit” and “Northern Ireland element”, which are defined elsewhere in Chapter 8.

45. Where the company is an NI SME, the Northern Ireland intangibles credits are the credits treated under Part 8 of CTA 2009 as receipts of a qualifying trade for the period, except for credits from pre-commencement assets and realisation credits, together with the Northern Ireland element of each realisation credit. Where the company carries on an excluded activity there is an additional restriction to exclude credits and debits attributable to assets held for the purpose of the excluded activity.

46. The Northern Ireland intangible debits for an NI SME are calculated in the same way with the simple replacement of "credit" with "debit" and "receipt" with "expense".

47. Where the company is an NI large company, the definition of the Northern Ireland intangibles credit and debits is the same as that of an NI SME with the additional requirement that credits or debits treated as receipts or expenses of a qualifying trade would, in accordance with the separate enterprise principle, be attributable to the company's NIRE. If the company carries on an excluded activity, the credits or debits attributable to assets held for the purpose of that activity are excluded.

48. A realisation credit or realisation debit is a credit or debit which is brought into account under Chapter 4 of Part 8 of CTA 2009, is treated under section 747 of that Act as a receipt or expense of the trade, and does not relate to a pre-commencement asset.

49. The Northern Ireland element of a realisation credit or debit is the amount that will be charged or relieved at the Northern Ireland rate of corporation tax. It is calculated in accordance with provisions which take account of the extent to which the intangible fixed asset in question has been held for the purposes of an activity that is subject to the Northern Ireland rate.

50. An intangible fixed asset is a "pre-commencement asset" if it was created before the commencement day (as defined at clause 5 of the Bill see paragraph 152 below). The general rule is that intangible fixed assets are treated as having been created before the commencement day if they were held by the company or another person at any time before that day. This rule is subject to two provisions which cover goodwill and film production.

51. Goodwill is treated as created before the commencement day in a case in which the business in question was carried on by any person before that date and on or after the commencement day in any other case.

52. In the case of an asset representing production expenditure on a film, the asset is treated as created when the film is completed.

53. Chapter 8 provides that where the company has fungible assets, and section 858 of CTA 2009 has treated some of those assets as an asset created on or after 1 April 2002, that post 1 April 2002 asset may be further divided into two assets for the purpose of the Chapter 8 commencement rule; one such asset treated as a pre-commencement asset and therefore treated as created before the commencement day, and the other as one created after the commencement day. There are special rules regarding the realisation and acquisition of fungible assets.

54. Any realisation is treated as diminishing the pre-commencement asset first. There are also rules to identify any realisations and acquisitions that are essentially diminishing the pre-commencement asset while increasing the post-commencement asset.

55. There are rules covering the situation where a company acquires an intangible fixed asset from another person where the acquired asset is created on or after the commencement day and that asset derives its value in whole or part from any other asset which was a pre-commencement asset. In such circumstances the acquired asset is treated as a pre-commencement asset so far as its value derives from that other asset. Where appropriate the acquired asset is treated as two separate assets, one a pre-commencement asset and the other a post-commencement asset.

56. There are also rules covering the situation where a company acquires an intangible fixed asset as a consequence of, or otherwise in connection with, the disposal of a pre-commencement asset by another person. In such cases the acquired asset is treated as a pre-commencement asset for the purposes of this Chapter.

57. For related provisions about the disposal by a company that is not a Northern Ireland company of an intangible fixed asset that has previously been held in circumstances where credits and debits relating to it were or would have been subject to the Northern Ireland rate, see the amendment made by paragraph 1 of Schedule 2 (which is dealt with separately below).

Chapter 9

58. Chapter 9 modifies the treatment of research and development (R&D) expenditure credit under Part 3 (trading income) of CTA 2009.

59. Chapter 6A of Part 3 of CTA 2009 makes provision for R&D expenditure credit to be brought into account as a receipt in calculating the profits of a trade. Where a company is entitled to an R&D expenditure credit for a period and the company is a Northern Ireland company, Chapter 9 provides that the credit forms part of the mainstream profits or losses of the trade.

60. Chapter 9 also modifies Chapters 2 and 7 of Part 13 of CTA 2009 with regard to additional relief for expenditure on research and development in relation to expenditure incurred by a company in an accounting period in which it is a Northern Ireland company.

61. Chapter 2 of Part 13 of CTA 2009 makes provision for relief for R&D expenditure incurred by a company which is a small or medium size enterprise. It provides for an additional deduction for qualifying Chapter 2 (R&D) expenditure. Any resultant Chapter 2 loss may be surrendered for a

payable tax credit.

62. Chapter 9 of Part 8B of CTA 2010 provides that where some of the Chapter 2 R&D expenditure is Northern Ireland expenditure (as defined in new section 357P(2) of Part 8B of CTA 2010) an adjusted percentage is used to calculate the amount of additional deduction for the purposes of Chapter 2 of Part 13 of CTA 2009. The adjusted percentage is set to give the same cash value of the relief the company would have received if none of the Chapter 2 R&D expenditure were Northern Ireland expenditure.

63. Chapter 9 of Part 8B CTA 2010 modifies how the amount of R&D tax credit available under Chapter 2 of Part 13 CTA 2009 is calculated where the company has Northern Ireland Chapter 2 surrenderable losses (as defined in section 357PC(3)(a) of Part 8B of CTA 2010) to ensure the same amount of R&D tax credit is payable under section 1054 of CTA 2009, and that any losses carried forward after a claim for R&D tax credits is reduced by the losses surrendered.

64. Chapter 7 of Part 13 of CTA 2009 makes provision for the relief for R&D expenditure incurred by large companies on vaccine or medicine research. It provides for an additional deduction for qualifying Chapter 7 (R&D) expenditure.

65. Chapter 9 of Part 8B of CTA 2010 provides that where some expenditure that is eligible for relief under Chapter 7 of Part 13 CTA 2009 is Northern Ireland expenditure, an adjusted percentage is used to calculate the amount of additional deduction. The adjusted percentage is set to give the same cash value of the relief the company would have received if none of the Chapter 7 R&D expenditure was Northern Ireland expenditure.

Chapter 10

66. Chapter 10 modifies the operation of Part 14 of CTA 2009 (remediation of contaminated or derelict land) in relation to expenditure incurred by a company in an accounting period in which it is a Northern Ireland company.

67. Part 14 provides for an additional deduction for qualifying land remediation expenditure. This deduction together with any tax deductible land remediation expenditure is deducted from the income arising from land remediation. Any resultant loss may be surrendered for a payable tax credit.

68. Chapter 10 of Part 8B provides that where some of the qualifying expenditure is Northern Ireland expenditure (as defined by new section 357Q(2)(a) in Part 8B of CTA 2010), an adjusted percentage is used to calculate the amount of additional deduction for the purposes of Part 14 of CTA 2009. The adjusted percentage is set to give the same cash value of the relief the company would

have received if none of the expenditure were Northern Ireland expenditure.

69. Chapter 10 of Part 8B also provides that the same amount of land remediation tax credit is payable under section 1154 of CTA 2009 and that any losses carried forward from after a claim for land remediation tax credits are reduced by the losses surrendered.

Chapter 11

70. Chapter 11 modifies the operation of Part 15 of CTA 2009 (film tax relief) in relation to expenditure incurred by a company which is a Northern Ireland company in an accounting period.

71. Part 15 of CTA 2009 provides for an additional deduction for qualifying expenditure on a qualifying film. This deduction together with any tax deductible film expenditure is deducted from the income arising from the film. Any resultant loss may be surrendered for a payable tax credit.

72. Chapter 11 of Part 8B provides that where all or some of the qualifying expenditure is Northern Ireland expenditure (as defined by section 357R(2)(a) in Part 8B of CTA 2010), the company is entitled to a supplementary deduction. The amount of the supplementary deduction is set to give the same cash value of the relief the company would have received if none of the expenditure was Northern Ireland expenditure.

73. Chapter 11 of Part 8B also ensures that the same amount of film tax credit is payable under section 1201 of CTA 2009 and that the restricted loss relief rules for film losses are maintained.

Chapter 12

74. Chapter 12 modifies the operation of Part 15A of CTA 2009 (television production) in relation to expenditure incurred by a company which is a Northern Ireland company in an accounting period.

75. Part 15A of CTA 2009 provides for an additional deduction for qualifying expenditure on a qualifying relevant television programme. This deduction together with any tax deductible relevant television programme expenditure is deducted from the income arising from the relevant television programme. Any resultant loss may be surrendered for a payable tax credit.

76. Chapter 12 of Part 8B provides that where all or some of the qualifying expenditure is Northern Ireland expenditure (as defined in section 357S(2)(a) in Part 8B of CTA 2010), the company is entitled to a supplementary deduction. The amount of the supplementary deduction is set to give the same cash value of the relief the company would have received if none of the

expenditure were Northern Ireland expenditure.

77. Chapter 12 also ensures that the same amount of television tax credit is payable under section 1216CH of CTA 2009 and that the restricted loss relief rules for television losses are maintained.

Chapter 13

78. Chapter 13 modifies the operation of Part 15B of CTA 2009 (video games production) in relation to expenditure incurred by a company which is a Northern Ireland company in an accounting period.

79. Part 15B of CTA 2009 provides for an additional deduction for qualifying expenditure on a qualifying video game. This deduction together with any tax deductible video game expenditure is deducted from the income arising from the video game. Any resultant loss may be surrendered for a payable tax credit.

80. Chapter 13 of Part 8B provides that where all or some of the qualifying expenditure is Northern Ireland expenditure (as defined in section 357T(2)(a) in Part 8B of CTA 2010), the company is entitled to a supplementary deduction. The amount of the supplementary deduction is set to give the same cash value of the relief the company would have received if none of the expenditure were Northern Ireland expenditure.

81. Chapter 13 also ensures that the same amount of video game tax credit is payable under section 1217CH of CTA 2009 and that the restricted loss relief rules for video game losses are maintained.

Chapter 14

82. Chapter 14 modifies the operation of Part 15C of CTA 2009 (theatrical productions) in relation to expenditure incurred by a company which is a Northern Ireland company in an accounting period.

83. Part 15C of CTA 2009 provides for an additional deduction for qualifying expenditure on a qualifying theatrical production. This deduction together with any tax deductible theatrical production expenditure is deducted from the income arising from the theatrical production. Any resultant loss may be surrendered for a payable tax credit.

84. Chapter 14 of Part 8B provides that where all or some of the qualifying expenditure is Northern Ireland expenditure (as defined in section 357U(2)(a) in Part 8B of CTA 2010), the company is entitled to a supplementary deduction. The amount of the supplementary deduction is set to give the same cash value of the relief the company would have received if none of the

expenditure were Northern Ireland expenditure.

85. Chapter 14 also ensures that the same amount of theatre tax credit is payable under section 1217K of CTA 2009 and that the restricted loss relief rules for theatre losses are maintained.

Chapter 15

86. Chapter 15 modifies the operation of Part 8A of CTA 2010 (profits from the exploitation of patents etc.) where a company is a Northern Ireland company.

87. Under Part 8A, a company may elect that any relevant IP profits of a trade of the company for an accounting period for which it is a qualifying company are chargeable at a IP rate of corporation tax. Effect is given to an election by allowing a deduction to be made in calculating the profits of the trade for the period.

88. Section 357VA modifies section 357A to provide for a mainstream deduction and a Northern Ireland deduction.

89. The mainstream deduction is calculated in accordance with section 357A but by reference to relevant mainstream IP profits of the trade. The relevant mainstream IP profits of the trade are so much of the relevant IP profits of the trade that are not Northern Ireland IP profits of the trade.

90. Section 357VA sets out how the amount of the Northern Ireland deduction is calculated and provides that a deduction is only due if the Northern Ireland rate is higher than the IP rate of corporation tax.

91. The mainstream deduction is allowable as a deduction in computing mainstream profits or mainstream losses in accordance with Chapters 6 and 7.

92. The Northern Ireland deduction is allowable as a deduction in computing the Northern Ireland profits or Northern Ireland losses in accordance with Chapters 6 and 7.

93. The relevant Northern Ireland IP profits of a Northern Ireland company meeting the SME condition which does not carry on an excluded trade are set out in section 357VB. The company's relevant Northern Ireland IP profits are the relevant IP profits of the trade excluding any amounts treated by section 747 of CTA 2009 as receipts or expenses of a trade in respect of pre-commencement assets. Any relevant IP profits attributable to qualifying IP right or licence to such a right held by the company for the purposes of an excluded activity are also excluded.

94. The relevant Northern Ireland IP profits of a Northern Ireland company

meeting the large company condition which does not carry on an excluded trade are set out in section 357VC. The company's relevant Northern Ireland IP profits are the appropriate proportion of the relevant IP profits. This proportion is the proportion of the profits of the company's trade attributable to relevant rights that are attributable to either the company's NIRE in accordance with Chapter 7 or are Northern Ireland intangibles credits or debits under Chapter 8. Relevant rights are qualifying IP rights, or exclusive licences to qualifying IP rights, which are held by the company.

95. In computing the relevant IP profits section 357VD makes clear that any set-off amounts under Chapter 5 of Part 8A are taken into account before the provisions of this Chapter are applied.

Chapter 16

96. Chapter 16 provides for the inclusion of the profit share of a corporate partner within the Northern Ireland regime where a partnership meets the definition of a Northern Ireland firm as set out at section 357WA. A Northern Ireland firm is a partnership which carries on a qualifying partnership trade as defined at section 357WB and meets either the SME partnership condition or the large partnership condition.

97. The definition of "qualifying partnership trade" means a trade carried on by a firm which is not an excluded trade. The definition includes where a firm makes a one-off election under section 357WB to bring in profits attributable to the back-office functions of certain trades which would otherwise be excluded.

98. The normal rules for determining the amount of a partner's profit or loss apply but where the profits or losses of a firm's trade are a combination of both Northern Ireland profits or Northern Ireland losses and mainstream profits or losses, the firm's profit sharing arrangements are treated as applying separately in relation to each category.

99. If the rules under section 1263 of CTA 2009 require that the corporate partner's share of profit of the trade is neither a profit nor a loss, the corporate partner is similarly treated as having no profit or loss for each category of profit or loss. If the corporate partner's share of the profit of the trade is reduced, each category of profit or loss is reduced by the same proportion.

100. If the rules under section 1264 of CTA 2009 require that the corporate partner's share of loss of the trade is neither a profit nor a loss, the corporate partner is similarly treated as having no profit or loss for each category of profit or loss. If the corporate partner's share of the loss of the trade is reduced, each category of profit or loss is reduced by the same proportion.

101. Northern Ireland profits or losses or mainstream profits or losses may be increased or reduced by capital allowances or charges under CAA 2001.

102. Section 357WE modifies specified provisions of Chapters 6 and 7 in their application to Chapter 16. Section 357WF modifies Chapter 8 (intangible fixed assets) in their application to Chapter 16. Section 357WG modifies specified provisions in Chapter 15 (exploitation of patents etc) in their application to Chapter 16.

Chapter 17

103. Chapter 17 specifies the trades and activities which are excluded trades and activities. An excluded trade is a trade which includes trades of certain lending, investment and investment management, the long term business of insurance companies, re-insurance trade or an oil and gas "ring fence trade". An excluded activity is an activity of effecting or carrying out re-insurance contracts, or an activity carried on in connection with exploration or exploitation activity or in connection with exploration or exploitation rights in the UK sector of the continental shelf.

104. Section 357XH provides for a power for the Treasury to amend, by regulation, the definitions of excluded trades and excluded activities.

105. Section 357XI provides a power for Treasury to specify, by regulation, the activities that are, or are not, back-office activities, or to specify circumstances in which activities are, or are not, to be regarded as back-office activities.

106. Such regulations may make different provision for different purposes and make incidental, supplemental, consequential and transitional provision and savings.

CLAUSE 2 AND SCHEDULE 1: CAPITAL ALLOWANCES

107. Clause 2 introduces Schedule 1, which contains amendments of CAA 2001.

Part 1 of Schedule 1

108. Part 1 amends CAA 2001 as set out in the rest of Schedule 1.

Part 2 of Schedule 1

109. Part 2 amends Part 1 of CAA 2001. Although it uses different terms, section 6A imports the definitions of Northern Ireland companies in Part 8B of CTA 10 into CAA 2001. A "NIRE company" is a company where the large company condition applies and a "Northern Ireland SME company" is one

where the SME condition applies.

110. There are also definitions in section 6B(3) and section 6B(4) which refer to Northern Ireland firms (section 357WA) whose profits are determined under Chapter 6 or 7 of Part 8B respectively.

111. Section 6C also introduces the term "NI rate activity" for the purposes of CAA 2001. An activity, the profits or losses of which are Northern Ireland profits or losses under Part 8B of CTA 10, is an "NI rate activity".

112. Under section 6D the NI rate activity is treated for the purposes of CAA 2001 as a separate trade, distinct from all other activities carried out by a NIRE company or a Northern Ireland SME company. The provision also provides that the NI rate activity carried on by a Northern Ireland firm is to be treated as a separate trade for the purposes of determining the profits of the firm under section 1259 of CTA 2009.

113. Section 6E sets out how allowances are given and charges imposed under the parts of CAA 2001 which deal with: plant and machinery allowances; business premises renovation allowances; mineral extraction allowances; research and development allowances; and dredging allowances. These rules also cover how allowances and charges are given effect in a company's tax computation. In the case of an allowance or charge related to an NI CT rate activity, allowances or charges are treated as a deduction from, or addition to, the NI profits or losses of the period as appropriate. In the case of an allowance or charge related to a main rate activity, allowances or charges are treated as deductions from, or additions to, mainstream profits or losses of the period as appropriate.

Part 3 of Schedule 1

114. Part 3 provides for amendments to plant and machinery allowances under Part 2 of CAA 2001 to take account of the fact that an NI rate activity is subject to a different rate of corporation tax.

115. Paragraph 3 amends section 12 of CAA 2001 to ensure that, if a company incurs expenditure for the purposes of trade for an activity that will, on the company becoming a NIRE company, be an NI rate activity treated as a separate trade, any such expenditure will be treated as incurred on the first day the company is a NIRE company.

116. Similarly, paragraph 3 amends section 12 of CAA 2001 to provide that expenditure incurred by a partnership for the purposes of an activity that will, on the partnership becoming a Northern Ireland Chapter 7 firm, be an NI rate activity treated as a separate trade, will be treated as incurred on the first day

the partnership is a Northern Ireland Chapter 7 firm.

117. Paragraph 4 introduces new subsections (2ZA) and (2ZB) in section 15 of CAA 2001. These rules ensure that activities carried out by a company or firm which are treated as separate trades are also treated for the purposes of Part 2 of CAA 2001 as separate qualifying activities.

118. Paragraph 5 inserts new section 51JA which provides for a restriction to Annual Investment Allowance (AIA) available under Chapter 5 of Part 2 of CAA 2001 where the AIA qualifying expenditure is incurred in respect of an NI rate activity in a financial year for which the Northern Ireland rate is lower than the main rate.

119. Paragraph 6 contains amendments of section 61 of CAA 2001 which deals with disposal events and disposal values. Their effect is that where an asset that is used for the purpose of a main rate activity is sold at less than market value to a company that is within the NI CT regime, the sale will in certain circumstances be treated as being at market value.

120. Paragraph 7 sets out new sections 66B, 66C, 66D and 66E. New section 66B ensures that a capital allowances disposal event will not arise where, in an accounting period which starts on or after the commencement day (again, as defined by Clause 5 of the Bill) , a company becomes a Northern Ireland SME company and as a result of section 15(2ZA) any assets are treated as ceasing to be used for the purpose of a main rate activity and beginning to be used for the purposes of an NI rate activity.

121. There are also rules in new section 66B that govern how any unrelieved qualifying expenditure brought forward to the first period where a company has both a main rate activity and an NI rate activity is treated. This includes a just and reasonable apportionment of the unrelieved qualifying expenditure between a main rate activity pool and an NI rate activity pool.

122. New section 66C contains provision about the application to partnerships of the provisions of new section 66B.

123. New section 66D covers the situation where a company that was a Northern Ireland SME company starts to carry on a qualifying activity that is not an NI rate activity. A capital allowances disposal event will not arise in the case of any assets which are consequently treated as ceasing to be used for the purposes of an NI rate activity. Any unrelieved qualifying expenditure previously used for the purposes of an NI rate activity that is to be carried forward is treated as relating to the qualifying activity the company is carrying on.

124. New section 66E contains provision about the application to partnerships of

the provisions of new section 66D.

125. Paragraph 8 inserts new Chapter 16ZA into CAA 2001.

126. New section 212ZA deals with qualifying expenditure on plant or machinery which is used partly for NI rate activity and partly for main rate activity. For the purposes of any annual investment allowance or first year allowance the expenditure is to be apportioned on a just and reasonable basis between the NI rate activity and main rate activity.

127. New section 212ZB requires that where qualifying expenditure is incurred partially for NI rate activity and partially for main rate activity (if it is to be allocated to a pool) it must be allocated to a single asset pool. Where a company is required to bring in a disposal value because an asset previously used for either NI rate activity or main rate activity begins to be used for both activities, an amount equivalent to the disposal value is allocated to a single asset pool for that chargeable period.

128. New section 212ZC deals with allowances and charges on expenditure in a single asset pool by applying a just and reasonable apportionment between the NI rate activity and the main rate activity.

129. New section 212ZD introduces rules dealing with the disposal value to be applied in the case of a significant change of circumstances affecting the use of plant or machinery in a single asset pool under section 212ZC.

130. New section 212ZE provides for the application of the new Chapter 16ZA to partnerships.

131. New section 212ZF defines the phrase “main rate activity” for the purposes of Chapter 16ZA.

132. Paragraph 9 of the Schedule amends Section 247. The inserted subsection (1A) deals with the way in which plant and machinery allowances are given effect in the case of companies within the NI CT regime which have an NI rate activity. Allowances in respect of the NI rate activity are relieved as deductions against Northern Ireland profits of the relevant accounting period.

133. Paragraph 10 of the Schedule relates to first-year tax credits payable under Schedule A1 to CAA 2001. It amends Schedule A1 so as to give the Treasury power by order to prescribe a different percentage where the surrenderable loss in question relates to an NI rate activity.

Part 4 of Schedule 1

134. In Part 4 of the Schedule, paragraph 11, introduces amendments to section

360Z CAA 2001 to make it clear that where a company or partnership, because of its NI rate activity, is treated as carrying on two separate trades, any business premises renovation allowances, or corresponding charges, relate to the trade the qualifying building is used in. A just and reasonable apportionment applies where the building is used by both trades.

135. The amendment made by paragraph 12 relates to mineral extraction allowances. It amends section 394 to provide that where a company where a company, because of its NI rate activity, is treated as carrying on two separate trades, both trades will be treated as mineral extraction trades if the separate trades together would be so treated. Any allowance or charge applies separately to each trade.

136. Paragraph 13 amends section 432 so as to provide that mineral extraction allowances are given effect, in the case of a Northern Ireland SME company or a NIRE company, in accordance with section 6E.

137. Paragraph 14 inserts new section 439A which governs how research and development allowances will be allowed where a company or partnership incurs expenditure for the purpose of a trade on an activity that will, upon the company becoming a NIRE company, be an NI rate activity treated as a separate trade. Any such expenditure will be treated as incurred on the first day the company is a NIRE company.

138. Paragraph 15 amends section 450 so as to provide that research and development allowances are given effect, in the case of a Northern Ireland SME company or a NIRE company, in accordance with section 6E.

139. Paragraph 16 amends section 484 so as to provide for the purposes of dredging allowances that, where a company, because of its NI rate activity, is treated as carrying on two separate trades, both trades will be treated as qualifying trades if the separate trades together would be so treated.

140. Paragraph 17 amends section 489 so as to provide that dredging allowances are given effect, in the case of a Northern Ireland SME company or a NIRE company, in accordance with section 6E

Parts 5 and 6 of Schedule 1

141. Part 5 provides for consequential amendments.

142. Part 6 sets out rules to cover the transition to the Northern Ireland corporation tax regime.

143. Paragraph 19 defines the "transition period" for a company as the first accounting period in which the Northern Ireland rate applies to the corporation

tax profits and losses of a company or partnership.

144. Paragraph 20 applies to a company or partnership if in the transition period a company is a NIRE company or Northern Ireland SME company or the partnership is a NI Chapter 6 or Chapter 7 firm. It applies if as a result of section 6D of CAA 2001 an NI rate activity begins to be treated for the purposes of Part 2 CAA 2001 (plant and machinery) as a separate qualifying activity. Paragraph 20 provides that any unrelieved qualifying expenditure on plant and machinery to be carried forward into the transition period is to be apportioned on a just and reasonable basis into separate pools for purposes of the NI rate activity and main rate activity. The paragraph provides that this does not create a disposal event.

145. Paragraph 21 also applies to a company or partnership if in the transition period a company is a NIRE company or Northern Ireland SME company or the partnership is a NI Chapter 6 or Chapter 7 firm. It applies if as a result of section 6D of CAA 2001 an NI rate activity begins to be treated for the purposes of Part 7 CAA 2001 (know-how allowances) as a separate qualifying activity. Paragraph 21 provides that any unrelieved qualifying expenditure on know-how allowances to be carried forward into the transition period is to be apportioned on a just and reasonable basis into separate pools for purposes of the NI rate activity and main rate activity. The paragraph provides that this does not create a disposal event.

CLAUSE 3 AND SCHEDULE 2: OTHER AMENDMENTS

146. Clause 3 introduces Schedule 2, which contains amendments of CTA 2009 and of the Taxation (International and Other Provisions Act) 2010 (TIOPA 2010).

Part 1 of Schedule 2

147. Paragraph 1 inserts new section 738A into Chapter 8 CTA 2009. New section 738A provides for rules within Chapter 8 that deal with the realisation by a company that is not a Northern Ireland company of an intangible fixed asset within the Chapter 8 rules that has previously been subject to the NI corporation tax regime.

148. Paragraphs 2 and 3 amend provisions relating to controlled foreign companies (CFCs).

149. Paragraph 2 amends section 371BC of TIOPA 2010. Section 371BC sets out the process for applying the CFC charge on a chargeable company. The amendment makes it clear that in determining the “appropriate rate” it is assumed at all of the chargeable company’s profits of the relevant accounting period on which corporation tax is chargeable are chargeable at the main rate

rather than the Northern Ireland rate.

150. Paragraph 3 amends section 371UD of TIOPA 2010. Section 371UD provides for relief against the CFC charge for relevant allowances. These include loss relief claims under section 37 of CTA 10 and group relief. The amendment makes it clear that the relief due, where the relevant allowance is a Northern Ireland loss, is calculated by applying the appropriate Northern Ireland rate on the relevant amount specified in the claim.

Part 2 of Schedule 2

151. Part 2 contains consequential amendments.

CLAUSE 4: POWER TO MAKE FURTHER CONSEQUENTIAL AMENDMENTS

152. Clause 4 of the Bill provides a power to the Commissioners to make provisions consequential upon any of the provisions on the Act. This power includes the express power to amend or modify any provision of the Taxes Acts (as defined) including any provision inserted by this Act. Regulations may make different provision for different purposes and make incidental, supplemental, consequential and transitional provision and savings.

CLAUSE 5: COMMENCEMENT

153. Clause 5 relates to commencement which is discussed separately below.

FINANCIAL EFFECTS OF THE BILL

154. Devolving the rate-setting power will not of itself have any impact on the Exchequer. If the Northern Ireland Assembly, upon receiving the power, chooses to change the rate of corporation tax in Northern Ireland, any Exchequer impact will depend on what rate is established.

SUMMARY OF THE IMPACT ASSESSMENT

155. A summary of the impacts is provided below. Further detail is contained in the summary of impacts in the Tax Information and Impact Note that is being published by HMRC on www.gov.uk.

156. The one-off administrative costs to businesses will largely relate to the application of transfer pricing principles to allocate trading profits between NI and the rest of the UK. This will be required for a subset of around 2,400 large businesses. There are also some costs, for all companies, associated with familiarisation with the new regime. Ongoing costs relate largely to profit

allocation as above, and also include changes to group relief and capital allowance claims. The operational compliance impacts on HM Revenue and Customs (HMRC) of devolving the rate-setting power are estimated to be negligible. Further costs will depend on the rate of CT in NI set by the Northern Ireland Assembly (NIA). An estimated one-off cost of £3.4m for changes to IT systems will also be required.

EUROPEAN CONVENTION ON HUMAN RIGHTS

157. Section 19 of the Human Rights Act 1998 requires the Minister in charge of a Bill in either House of Parliament to make a statement about the compatibility of the provisions in the Bill with the Convention rights (as defined by section 1 of that Act).

158. The Chancellor of the Exchequer has made the following statement:

"In my view the provisions of the Corporation Tax (Northern Ireland) Bill are compatible with the Convention rights."

159. A number of provisions in the Bill engage Article 1 of Protocol 1 ("A1P1") to the Convention, taken alone or with Article 14 ("A14").

Article 1 Protocol 1

160. A1P1 protects the enjoyment of possessions and is engaged where taxation is in point because taxation deprives the person concerned of a possession, namely the amount of money that must be paid by way of tax. Taxation is however expressly provided for in the second paragraph of A1P1.

161. The Courts have recognised that a State is entitled to a wide margin of appreciation when it comes to general measures of economic or social strategy. The margin is broader when Parliament creates primary legislation than when a Minister of State uses a power to create secondary legislation.[1]

162. The rationale for this wide margin of appreciation in deciding how to make macro-economic decisions of that nature is that "*Because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is in the public interest on social or economic grounds, and the Court will*

[1] *R (Sinclair Collis) v Secretary of State for Health* [2011] EWCA Civ 437, paragraphs 22 and 23.

generally respect the legislature's policy choice unless it is "manifestly without reasonable foundation"."[2]

163. This means that the Court will allow a wide discretion to the State in how it designs its taxation systems, and only interfere where an individual's rights are clearly breached. In ascertaining whether there has been such a breach, the Court will look at the aim of the measure, and then consider whether the measure is a proportionate way to achieve that aim. In doing so the Court will seek to discover whether a fair balance has been struck between interests of the community and protection of individual rights, and whether the measure imposes an excessive or individual burden.[3] Within this wide margin of appreciation, States must still ensure that taxation is imposed according to the law, that the measures pursue a legitimate purpose and that the means employed are not disproportionate to the ends involved.

Clause 1 of the Bill inserting new Part 8B of the Corporation Tax Act 2010: Chapter 2: Determination of a rate of corporation tax by the Northern Ireland Assembly

164. Chapter 2 of new Part 8B of the Corporation Tax Act 2010 sets out how the Northern Ireland rate is determined, giving power to the Northern Ireland Assembly to set the rate for a financial year at any level, higher, lower or the same as the main rate. Chapter 2 is compatible with Convention rights because the interference with taxpayers' property rights under A1P1 is justified as being necessary to secure the payment of taxes under the second paragraph of A1P1. The power of the Northern Ireland Assembly to set a rate of corporation tax allowing it to respond appropriately to local economic conditions pursues the legitimate aim of the Bill in promoting growth and employment in Northern Ireland and proportionate to that aim.

Chapters 3 to 8 and Chapters 16 and 17 of new Part 8B: Application of the rate and identification of Northern Ireland profits

165. Chapters 3 to 8 and Chapter 16 of new Part 8B apply the Northern Ireland rate to Northern Ireland profits. Northern Ireland profits arise from a qualifying trade of a Northern Ireland company or a Northern Ireland firm. Chapter 17 specifies trades and trading activities the profits of which are excluded from the scope of the rate. These Chapters are compatible with Convention rights because the interference with taxpayers' property rights under A1P1 is justified as pursuing the legitimate aim of the Bill in promoting growth and employment in Northern Ireland and proportionate to that aim. Limiting the

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[2] *Stec and others v the United Kingdom* (2006) 43 EHRR 1017, paragraph 52.
[3] For a recent summary of the Court's position in the area of taxation see paragraphs 62 and 63 of *Bulves AD v Bulgaria* (Application no. 3991/03), judgment of 22 January 2009.

application of the rate to Northern Ireland profits ensures that the creation of the Northern Ireland rate is capable of meeting that aim.

166. The method for large companies of identifying profits to which the Northern Ireland rate applies, namely identifying profits attributable to the NIRE, is based on existing transfer pricing principles used in the UK corporation tax regime. SMEs are excepted from transfer pricing because of the disproportionate administrative burden it would impose. Chapter 6 follows the same approach and ensures that the administrative burden of the creation of a Northern Ireland rate is lesser on those companies with fewer resources.

167. The UK corporation tax regime includes separate regimes with a distinct rate for each of the areas of long term insurance business and oil and gas extraction which are tailored to the specific policy requirements in those areas. Exclusion of these trades from the scope of the rate ensures that the Northern Ireland rate creates only proportionate administrative burdens on business.

168. The creation of the separate Northern Ireland rate of corporation tax could, if the Northern Ireland rate were set lower than the UK main rate, introduce potential for shifting profits into a Northern Ireland company without increasing genuine economic activity in the region. Profits arising from lending, investing and reinsurance can be moved to a different geographical area without significant trading activity taking place there. Exclusion of these trades reduces the potential for abuse of the Northern Ireland regime and ensures that the regime meets the aim of stimulating employment and growth in the region.

Chapter 3 of Part 8B: Loss relief for Northern Ireland losses

169. Chapter 3 adapts the rules on certain reliefs for trading losses in the Corporation Tax Acts, including provision that if the Northern Ireland rate is set lower than the UK main rate of corporation tax, the amount of deduction for a Northern Ireland loss against profits arising outside the Northern Ireland regime is restricted in proportion to a fraction derived from the difference between the two rates. This Chapter is compatible with Convention rights because the interference with taxpayers' property rights under A1P1 is justified as being necessary to secure the payment of taxes under the second paragraph of A1P1. Chapter 3 ensures that, if the Northern Ireland rate is set at a lower rate than the UK main rate, companies with profits chargeable at the Northern Ireland rate can use losses to reduce profits liable at the main rate without obtaining excessive relief in respect of losses within the scope of the lower rate.

Schedule 1 to the Bill: Capital Allowances

170. Schedule 1 amends the Capital Allowances Act 2001 (CAA 2001) to introduce

rules to attribute allowances according to whether an asset is used for activities of either the UK and/or NI rate regimes. Schedule 1 is compatible with Convention rights because the interference with taxpayers' property rights under A1P1 is justified as being necessary to secure the payment of taxes under the second paragraph of A1P1. Capital allowances are broadly intended to give a taxpayer relief for the reduction in value of a capital asset over the total period of ownership. This measure pursues a legitimate aim of ensuring that the net reduction in value of an asset used for an NI trade is only available against NI profits.

COMMENCEMENT

171. Clause 5 provides that new Part 8B CTA 2010 and the amendments made by Schedules 1 and 2 have effect in accordance with this clause. The regulation-making powers of the Treasury or the Commissioners in new Part 8B and in Part 3 of Schedule 1 to the Bill have effect from Royal Assent.

172. The power of the Northern Ireland Assembly to set the Northern Ireland rate becomes exercisable for a financial year which is appointed by the Treasury by means of statutory instrument (that financial year being referred to as "the appointed financial year"). This power is then exercisable for subsequent financial years.

173. The remainder of new Part 8B has effect in relation to accounting periods beginning on or after the first day of the appointed financial year (that day being referred to as "the commencement day"). Provision is made for accounting periods which straddle this date.