

## Q4 Commercial Forecast

Welcome to the autumn edition of our [Commercial Forecast](#) for 2017.

This year has been a year of a great deal of change, uncertainty and speculation. In the developing post-Brexit landscape there is a lot for our business clients to have to grapple with, both in terms of novel legal issues and the practical realities of running a business in an uncertain financial climate. Looking towards 2018, this uncertainty will no doubt continue to affect many different sectors and businesses, as Brexit negotiations continue and we adapt to a new legal, political and economic landscape. At Farrer & Co, our aim is to understand and assist our clients in a forward-thinking, practical and commercial way. For our business clients, we recognise that change is not always a bad thing, and we help our clients understand and adapt to change, and use it to create opportunities and grow their businesses.

This edition of the Commercial Forecast highlights some recent and upcoming changes to legislation and regulation about which our business clients should be aware heading into 2018. In this edition we look at cross-border judicial cooperation after Brexit; the simplification of employee termination payments; minimum energy efficiency standard regulations; the end of rip-off surcharges on credit and debit card payments; investment product sales and leasebacks; and the reform of corporation tax loss relief.



David Fletcher

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### Cross-border judicial cooperation after Brexit

On 22 August 2017 the UK Government published a paper on cross-border judicial cooperation after Brexit. The Paper expands on the Government's vision for the *'future deep and special partnership'* between the UK and the EU.

The Paper outlines the Government's position on the extent to which current EU rules on applicable law, jurisdiction and the recognition and enforcement of judgments should continue to apply.

What are the key points?

- The Rome I and Rome II Regulations on choice of law and applicable law in contractual and non-contractual matters will be incorporated into UK domestic law. This means that courts in the UK and the EU27 would continue to apply the same rules to determine which law governs the parties' relationship.
- The UK has expressed an intention to continue to participate in the Lugano Convention, which means we will be required as a non-EU member state to "pay due account to" decisions of the Court of Justice of the European Union.
- There have been no specific proposals as to the jurisdiction and enforcement of judgments. The Government says that it will seek an agreement with the EU which allows for close and comprehensive cross-border cooperation on a reciprocal basis "*which reflects closely the substantive principles of cooperation under the current EU framework*". This suggests the Government will be seeking to reach an agreement with the EU reflecting the position under the Brussels Regulation.
- The Government intends to continue to participate in the Hague Convention on Choice of Court Agreements 2005 which sets out jurisdiction rules where there is an agreement as to the exclusive choice of court.

Commercial parties will be pleased to see the Government is seeking a close and comprehensive reciprocal framework, which will support cross-border trade after the UK's withdrawal. The Paper stresses the importance of civil judicial cooperation, particularly the predictability and legal certainty which it provides for citizens and businesses from both the EU and the UK.

It seems reasonable to assume the Government's vision will be accepted, although precisely when the European Commission will be prepared to move away from looking at separation issues, and turn its attention to negotiating a workable agreement for the future, remains to be seen.

For further information please contact [Kate Allass](#) and [Lizzy Sainsbury](#).



### The "simplification" of employee termination payments

Certain payments to employees at the end of their employment can have beneficial tax treatment. However, the tax regime for termination payments is to be reformed and 'simplified' from April 2018. Readers will be all too aware that in the current climate, a 'simplified' tax regime is often a more costly one and this article explains the impact of this 'simplification'.

The tax treatment of a termination payment depends primarily on what grounds the payment is made; whilst some types of contractual payments are taxable in full, other payments are not. Two types of tax-advantaged termination payments are particularly common:

1. Non-contractual payments, which can qualify to be paid tax-free up to £30,000 and then only subject to income tax (but not National Insurance Contributions (**NICs**)) in excess of that.
2. Payments relating to injury or disability, which can be completely tax-free.

From April 2018, the tax treatment of these two types of termination payments will change:

1. Non-contractual payments will cease to be exempt from NICs. So although the £30,000 tax-free exemption will remain (and is anticipated to rise with inflation), sums in excess of that will attract both income tax and NICs in full.
2. Although payments made on account of injury will still be eligible to be paid tax-free, legislation will now formally exclude an injury to feelings from qualifying. So any termination payments made in relation to injuries to feelings from April 2018 will potentially be subject to income tax and NICs in full.

Employees and employers who are contemplating a departure over the coming months are therefore advised to finalise the terms of their termination arrangements and make any payments before the new 'simplified' regime arrives in April 2018.

For further information please contact [James Bromley](#).



### Minimum Energy Efficiency Standard (MEES) Regulations

Commercial landlords are preparing for new legislation promoting energy efficiency. Landlords will not be permitted to let properties below Energy Performance Certificate (EPC) rating 'E'. Below is a summary of the key changes and what they mean for landlords, tenants and EPCs.

#### What is the date for compliance?

- New lettings (& renewals/extensions) from 1 April 2018
- Existing lettings from 1 April 2023

#### What properties are affected?

All properties which (i) are required to have an EPC on sale/letting/development, and (ii) already have an EPC.

#### What tenancies are affected?

All tenancies (including extensions and renewals) other than:

- tenancies for a term of 99 years or more

- tenancies for a term of 6 months or less

**Who is a 'landlord'?**

Government guidance suggests that only the immediate landlord of the tenant is required to comply. Regulations themselves allow multiple 'landlords' for underlet properties. Either way, tenants granting underleases will be affected.

**Are there any exemptions from penalties?**

Yes, if:

- the landlord has made all 'relevant energy efficiency improvements' and the EPC rating is still F or G; or
- there are no relevant energy efficiency improvements that can be carried out to the property; or
- the only relevant energy efficiency improvements that can be carried out would reduce the open market value of the property by more than 5% (as assessed by an independent surveyor); or
- the landlord has been unable, despite making reasonable efforts, to obtain the required third party consents to carry out the relevant energy efficiency improvements

**Exemptions are personal to landlords and temporary (they apply 5 years from the date of registration in most cases), and they must be registered with current evidence on the PRS Exemptions Register which opened on 1 October 2017.**

**What penalties may apply?**

- £5,000 for providing false or misleading information to the Exemptions Register.
- £5,000 for failure to comply with compliance notice.
- £5,000 or 10% of rateable value (max £50,000), whichever is greater, for less than 3 months' letting in breach.
- £10,000 or 20% of rateable value (max £150,000), whichever is greater, for three months' or more letting in breach.

Details of breaches may be published but non-compliant leases are not invalidated.

For further information please contact [Fred Lee](#) or [Shona Ferguson](#).



**An End to Rip-Off Card Surcharges**

On 13 January 2018, the Payment Services Directive 2 (**PSD2**), a piece of EU legislation, will be implemented in the UK and surcharges paid by consumers for using credit and debit cards will be banned.

The surcharge ban arises from PSD2's amendment of the Consumer Rights (Payment Surcharges) Regulations 2012, which will be amended to state that a payee cannot charge a payer any fees merely for using a card based payment instrument as defined in the Interchange Fee Regulation (**IFR**).

While the card instruments defined in the IFR only cover retail MasterCard and Visa cards, HM Treasury (**HMT**) have decided to extend the ban to all retail payment instruments. This action by HMT is designed to ensure that there is a level playing field between payment instruments and greater upfront clarity for consumers when they are buying goods and services, for example, flight and theatre tickets. This would include bans on surcharges on retail American Express cards as well as services such as PayPal.

The ban does not apply to commercial payment instruments, which include payment cards limited in use for business expenses. Thus, merchants could continue to impose surcharges where such commercial cards are used, although it is difficult to see how this would be implemented in practice.

For further information please contact [Nandini Sur](#).



### Reform of corporation tax loss relief – the good and the bad

After being temporarily shelved due to the summer election, changes to corporate loss relief will shortly become law. Despite the pause, the provisions are effective from 1 April 2017 as originally announced.

The new rules apply to all companies and unincorporated associations which are subject to corporation tax. Broadly speaking their effect is twofold:

**Limitation:** It will only be possible to relieve 50% of profits over £5m using carried-forward losses. This limit will apply to trading and non-trading losses arising at any time. Companies can allocate the £5m allowance within their group.

Consequently, the use of losses for companies with large profits will be more protracted.

**Relaxation:** The distinction between trading and non-trading profits will be eased and group relief expanded. From now on, most carried forward losses arising from 1 April 2017 will be available for set off against the total taxable profits of a company and its group members, rather than against only profits of the same trade or of the same type.

New restrictions on the surrender of carried forward losses to group companies include the following:

- Losses must first be set against the company's own profits.
- If the company is dormant (i.e. it had no assets capable of producing income at the end of the accounting period) there can be no surrender.
- If the losses relate to an overseas permanent establishment and relief is available in that territory, relief in the UK will not be permitted.

Many companies will welcome the new flexibility of being able to set off losses against different income streams and having greater access to group relief. Other companies (e.g. those investing heavily in R&D and subsequently generating large profits) could suffer adversely and may need to adjust profit projections to account for delays in utilising losses.

For further information please contact [Charlotte Black](#).



### Sale and Leaseback – a mutually beneficial arrangement for investors and owner/occupiers

Commercial property sale and leaseback structures between corporate entities and property investors are becoming increasingly prevalent in the current market, with investors looking for secure long term income in a low interest environment and owner/occupiers looking to realise capital.

From an investor's perspective, the arrangement provides a secure source of income usually from a corporate seller with a strong covenant for a number of years - typically 20-25 years - in comparison with more standard commercial lease terms of less than ten years.

For the owner/occupier, there is the advantage of a capital receipt to invest in the growth of its business whilst enabling continued operation from the property without any relocation and its associated disruption. In addition, sale and leaseback arrangements have a current relevance in the context of updated international financial reporting standards which will affect the reporting of such transactions.

Key points for the investor to note when negotiating the lease are:

1. **Rent Provisions** – rent should be reviewed on an index-linked basis annually compounded with, say, five yearly uplifts with the potential for an additional open-market review to protect against inflationary erosion. The heads of terms should be clear as to the review basis.
2. **Transfers of the Lease** – investor protection on any transfer of the lease will need to ensure that the initial tenant/guarantor investment grade covenant is maintained. There may be a limit on the number of permitted transfers or a condition preventing any transfer if the incoming tenant's covenant is not at least equivalent to the original tenant/guarantor. There are specific provisions which may be inserted to ensure a landlord's right for the outgoing tenant/guarantor to guarantee the incoming tenant.

3. **Tenant's Items (alterations, fixtures and fittings)** – these items should be identified with appropriate tenant's repairing, insuring and removal/yielding up obligations, and an appropriate treatment should apply on open market rent review.

4. **VAT** - provisions should be included to mitigate cash-flow impact.

The corporate seller will need to engage specialist property advice at an early stage and often even the investor team will need to be in close liaison to ensure the correct lease product (particularly in respect of rent review and protection on lease transfer) is achieved.

For further information please contact [Charles Anderson](#) and [Henry Stevens](#).



**Tell me more...**

If you'd like to discuss any of these issues further, please contact the authors or speak to [David Fletcher](#) on 020 3375 7117.

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