A new generation of freeports

Large Corporate

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Victoria Alford considers the objectives behind the government's new freeport policy and how the tax reliefs will be implemented

Key Points

What is the issue?

Freeports are designated geographical areas, recognised in law, where businesses can benefit from more generous tax reliefs, customs benefits, simpler planning and wider government support.

What does it mean for me?

In the March 2021 Budget, the government announced new tax reliefs for eight new freeport tax sites with the aim of incentivising business investment in capital assets, increasing employment and increasing productivity.

What can I take away?

Whilst there are valid concerns surrounding this new generation of freeports, these must be balanced against the opportunities they could bring for the UK economy, businesses and port communities.

In February 2020, the government published a consultation on freeport policy outlining plans to introduce at least ten freeports in the United Kingdom following our departure from the European Union. During the Budget on 3 March, and following a competitive bidding process, the locations of eight of these new freeports were announced: East Midlands Airport, Felixstowe and Harwich, Humber, Liverpool City Region, Plymouth, Solent, Thames and Teesside.

Freeports are intended to play a large part in the government's policy to level up opportunities across the country and its Covid-19 crisis recovery plans, providing the opportunity to enhance trade and investment across the UK, boost growth and high-skilled jobs, and increase innovation and productivity in deprived port regions.

It is hoped that these new freeports will be up and running by late 2021, but what will they look like and how will they operate to achieve these objectives?

The new freeports model

Freeports are designated geographical areas, recognised in law, where businesses can benefit from more generous tax reliefs, customs benefits, simpler planning and wider government support. They are usually located around shipping ports and airports.

Freeports are not a new concept. The government is adopting a bespoke UK freeport model which it explains draws on international best practice and builds upon the previous UK freeport model which expired in 2012. These new freeports will have a primary customs site designated in or near a port of any mode – air, rail or sea – or at an inland location with an economic relationship to the port. The government is also allowing multiple additional customs sites (customs subzones).

Freeports will also include a single defined tax site in which freeport tax reliefs will apply. Interestingly, whilst the tax site may encompass all or part of the primary customs site and any subzones, they do not have to. Nonetheless, only customs sites located within the freeport tax site will benefit from specific freeport tax site reliefs.

The customs and tariff policies

The core customs and tariff benefits for businesses bringing goods into a freeport customs site include:

- Duty suspension: No tariffs, import VAT or excise duties are payable on goods brought into the freeport from overseas until they leave the freeport and enter the UK domestic market.
- Duty inversion: If the duty on a finished product is lower than that on the component parts, a business could import components duty free and manufacture the final product in the freeport, paying the duty at the rate of the finished product when it enters the UK domestic market.
- Duty exemption for re-exports: This would allow a business to import components duty free, manufacture the final product in the freeport, and then pay no tariffs on the components when the final product is re-exported.
- There are also simplified customs procedures.

The tax site benefits

The government has announced the following tax reliefs for freeport tax sites with the aim of incentivising business investment in capital assets, increasing employment and increasing productivity:

- an enhanced capital allowance of 100% for company investment in plant and machinery for use in freeport tax sites in Great Britain;
- an enhanced 10% rate of structures and buildings allowance for constructing or renovating non-residential structures and buildings within freeport tax sites in Great Britain;
- full relief from stamp duty land tax on the purchase of land or property within freeport tax sites in England where it is purchased and used for a qualifying commercial purpose; and
- full business rates relief available to all new business and certain existing businesses that have expanded.

The government will also introduce NICs relief for eligible employees in all freeport tax sites, subject to parliamentary approval in a separate national insurance bill.

A closer look at the draft tax legislation

The Finance (No.2) Bill 2021 was published on 11 March and it is here that we can begin to understand how some of the reliefs outlined on Budget day will be implemented.

Capital allowances

The draft legislation provides for an enhanced 100% first year allowance for company investment in plant or machinery for use in a freeport tax site. This will provide businesses with a valuable tax-timing benefit. However, a number of conditions will need to be met for this enhanced relief:

- the plant or machinery must be for use primarily in an area which, at the time the expenditure is incurred, is a freeport tax site;
- the plant or machinery must be unused and cannot be second hand;
- the expenditure must be incurred for the purposes of a qualifying activity;
- the expenditure must be incurred on or before 30 September 2026; and
- the company must be within the charge to corporation tax.

In terms of the ‘qualifying activity’ criteria, the focus is on trade activity; notably, ordinary UK property business activities and the special leasing of plant or machinery are excluded.
As expected, there are anti-avoidance provisions to consider where the plant and machinery is intended to be used partly in an area that is not a freeport tax site. There will be complete removal of the first year allowance if it becomes primarily for use outside a freeport tax site within five years.

Finally, the standard first year allowance general exclusions apply, so 100% first year allowances will not be available; for instance, on expenditure incurred in the chargeable period in which the qualifying activity is permanently discontinued; on expenditure on plant and machinery for leasing (whether in the course of trade or otherwise); and on long life assets (with a useful economic life of 25 years or more).

Structures and buildings allowances

A 10% rate of structures and buildings allowance relief will be available for freeport qualifying expenditure. This will provide businesses with a valuable tax-timing benefit; specifically, investments will be fully relieved after 10 years compared with 33.33 years for properties in other locations which only achieve a 3% rate. Nonetheless, it should be remembered that claiming structures and buildings allowance does impact on the level of capital gain on any subsequent sale of the property.

Qualifying expenditure incurred on the construction or acquisition of a building or structure is ‘freeport qualifying expenditure’ where the construction begins in a freeport tax site. The structure must be brought into qualifying use and the expenditure incurred at a time when the area in which the building or structure is situated is a freeport tax site, and on or before 30 September 2026. Whilst only companies can qualify for 100% first year allowances under the draft freeport legislation, the structures and buildings allowance conditions provide that entities subject to corporation tax or income tax will be able to benefit from freeport structures and buildings allowance relief. An allowance statement must be made stating that the person wants the expenditure to be freeport qualifying expenditure.

Expenditure will need to be reasonably apportioned where a building or structure is only partly situated in a freeport tax site or only part of the building or structure is in use on or before 30 September 2026.

Stamp duty land tax

Relief from stamp duty land tax will be available for transactions involving ‘qualifying freeport land’ with an effective date on or before 30 September 2026. Relief must be claimed by way of a stamp duty land tax return or amended return.

To be ‘qualifying freeport land’, the land must be situated in a freeport tax site and intended to be used exclusively in a ‘qualifying manner’ by the purchaser or a connected person; i.e. the land will be:

- used in the course of a commercial trade or profession;
- developed or redeveloped for use by any person in the course of a commercial trade or profession; and/or
- exploited in the course of a commercial trade or profession, as a source of rents.

Notably, references to doing something in the course of a commercial trade or profession will include doing something in the course of a property rental business (as defined in the Income Tax (Trading and Other Income) Act 2005 Part 3 Chapter 2).

The relief will not be available in respect of residential property or if a purchaser is acquiring any interest in land for resale without development or redevelopment.

If the property acquired is a mixture of qualifying freeport land and other property but at least 90% of the consideration can be justly and reasonably apportioned to qualifying freeport land, relief from stamp duty land tax will be available in full. Where less than 10% of the consideration is attributable to qualifying freeport land, no freeport stamp duty land tax relief will be available. Where the consideration is between 10% and 90%, relief will be available on the qualifying proportion. The relief may be withdrawn if, within three years of acquiring the land, it is not being used exclusively in a qualifying manner.

Any problems for UK business?

Much of the concern surrounding the government's freeports policy is around the potential negative impact on port security, the environment, workers' rights, and the risk of freeports being used for tax evasion and money laundering. There is concern that freeports could give rise to economic displacement, as the tax reliefs and customs benefits will depend on whether the business is within a freeport. Businesses relocating into freeport sites could lead to job relocation rather than creation.

There may also be additional complexity to tax affairs. For a company investing in plant and machinery there may be a period of time until 31 March 2023 when it needs to consider each of the 130% super deduction, the 100% first year allowance and the annual investment allowance. However, these valid concerns must be balanced against the opportunities freeports could bring for the UK economy, businesses and port communities.