Corporate Tax 2019: United Kingdom

November 2018

1 Tax Treaties and Residence

1.1 How many income tax treaties are currently in force in your jurisdiction?

The United Kingdom has one of the most extensive treaty networks in the world, with over 130 comprehensive income tax treaties currently in force. One of the consequences of an exit from the European Union (assuming the UK loses the benefit of the Parent-Subsidiary and Interest and Royalties Directives and repeals the UK legislation implementing them) will be greater reliance on the UK's treaty network to provide exemption from withholding taxes. In some cases there will still be tax leakage, such as on dividends received in the UK from Germany and Italy and royalties paid from the UK to Luxembourg (see question 3.2 below).

1.2 Do they generally follow the OECD Model Convention or another model?

They generally follow the OECD model, with some inevitable variation from one treaty to the next. As part of the OECD's BEPS project (see question 10.1 below), changes were proposed to the definition of "permanent establishment" ("PE") in Article 5 of the Model Convention. However, the UK will not apply to its existing treaties the changes extending the definition to "commissionaire" (and similar) arrangements. This is because of the risk that this extension could lead to a proliferation of PEs where there is little or no profit to attribute to any of them.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. A tax treaty must be incorporated into UK law and this is done by way of a statutory instrument. A treaty will then enter into force from the date determined by the treaty and will have effect in relation to the taxes covered from the dates determined by the treaty.

The UK's diverted profits tax (discussed at question 10.1 below) was deliberately engineered as a new tax so as to fall outside the legislation which incorporates tax treaties into UK law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation on benefits" articles)?

In general, the UK has avoided wide limitation on benefits articles and prefers specific provision in particular articles. For example, the Dividends, Interest or Royalties article may provide that the UK will not give up its taxing rights if, broadly, the main purpose or one of the main purposes of the creation or assignment of the relevant shares, loan or right to royalties is to take advantage of the article.

The BEPS project proposed, as a minimum standard, that countries adopt a "principal purpose test" ("PPT") that is very similar to the anti-avoidance rule already seen in the UK's treaties, a US-style limitation on benefits test, or a combination of both. Like most other countries, the UK favours the PPT.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The UK's General Anti-Abuse Rule (the "GAAR", discussed in question 9.1 below) can, in principle, apply if there are abusive arrangements seeking to exploit particular provisions in a double tax treaty, or the way in which such provisions interact with other provisions of UK tax law.

1.6 What is the test in domestic law for determining the residence of a company?

There are two tests for corporate residence in the UK. The first is the incorporation test. Generally (that is, subject to provisions which disapply this test for certain companies incorporated before 15 March 1988), a company which is incorporated in the UK will automatically be resident in the UK.

Secondly, a company incorporated outside the UK will be resident in the UK if its central management is in the UK. This test is based on case law and focuses on board control rather than day-to-day management, though its application will always be a question of fact determined by reference to the particular circumstances of the company in question.

Both tests are subject to the tie-breaker provision of an applicable double tax treaty. If the tax treaty treats a company as resident in another country and not as a UK resident, the company will also be treated as non-UK resident for domestic UK tax purposes. It is notable that the treaties which the UK has renegotiated in the past few years generally do not contain the standard tie-breaker based on the company's "place of effective management" ("POEM"). As a result, the tax treaty status of a company which is managed in the UK but incorporated, for example, in the Netherlands, will be uncertain pending agreement between the two revenue authorities ("mutual agreement procedure" ("MAP")). The UK Government has said it will propose similar provisions in its bilateral negotiations in the future and has agreed to the replacement of POEM with MAP under Article 4 of the Multilateral Convention to implement the BEPS treaty changes.

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

Stamp duty is a tax on certain documents. The main category of charge takes the form of an ad valorem duty, at 0.5% of the consideration, on a transfer on sale of stock or marketable securities (or of an interest in a partnership which holds such stock or securities). In practice, stamp duty has little relevance if the issuer of the stock or securities is not a company incorporated in the UK.

The UK's Office of Tax Simplification ("OTS") published a report in July 2017 on digitising and modernising the stamp duty process the core recommendations of which the Government responded positively to. Some of the changes proposed in the report would be very welcome. Inevitably, though, it also suggests making the stamp duty charge mandatory, ending the current position under which a purchaser that never needs to rely on the document in question can, in some circumstances, ignore the charge.

Please see question 2.6 below for details of the stamp duty land tax (or the equivalents in Scotland and Wales) that applies to land transactions in the UK.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The UK has had VAT since becoming a member of the European Economic Community in 1973 and the UK VAT legislation gives effect to the relevant EU Directives. There are three rates of VAT:

- the standard rate of VAT is 20% and applies to any supply of goods or services which is not exempt, zero-rated or subject to the reduced rate of VAT;
- the reduced rate of VAT is 5% (e.g. for domestic fuel); and
- there is a zero rate of VAT which covers, for example, books, children's wear and most foodstuffs.

Whilst the fundamental VAT rules within the UK may not change much upon its exit from the EU (not least because VAT has generated over 20% of all UK tax receipts over the last seven years), transactions in both goods and services between the UK and the other 27 EU countries are likely to be affected significantly.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The exclusions from VAT are as permitted or required by the Directive on the Common System of VAT (2006/112/EC) (as amended) and some examples of exempt supplies are:

- most supplies of land (unless the person making the supply, or an associate, has "opted to tax" the land);
- insurance services; and
- banking and other financial services.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person (a person who is, or is required to be, registered for VAT). Input tax is attributed in accordance with the nature and tax status of the supplies that the person intends to make.

Input tax on supplies wholly used to make taxable supplies is deductible in full. Input tax wholly used to make exempt or non-business supplies is not deductible at all. Where a taxable person makes both taxable and exempt supplies and incurs expenditure that is not directly attributable to either (for example, general overheads), the VAT on the expenditure must be apportioned between the supplies.

The basis on which input tax can be recovered continues to be a vexed topic, generating some important judicial decisions.

2.5 Does your jurisdiction permit VAT grouping and, if so, is it "establishment only" VAT grouping, such as that applied by Sweden in the Skandia case?

The UK permits VAT grouping but not "establishment only" VAT grouping. Under the UK's VAT grouping rules, where a foreign company is eligible to join a UK VAT group registration and does so, the entirety of that company's activities are then subsumed within the UK VAT group registration, rather than solely the activities of that company's UK branch. Please see also question 4.4 below.

2.6 Are there any other transaction taxes payable by companies?

Stamp duty land tax ("SDLT")

SDLT is a tax on transactions involving immovable property and is payable by the purchaser. The top rate of SDLT on commercial property is 5% and applies where (and to the extent that) the consideration exceeds £250,000. (For transactions involving residential property, the rate can in some cases be as much as 15%.) The standard charge on the rental element of a new lease is 1% of the net present value ("NPV") of the rent, determined in accordance with a statutory formula, rising to 2% on the portion of NPV above £5 million.

From 15 April 2015, SDLT ceased to apply to land and buildings in Scotland; in its place is a new Land and Buildings Transaction Tax, which has a similar scope to SDLT. This was provided for in the first piece of tax legislation from the Scottish Parliament in 300 years, the Land and Buildings Transaction Tax (Scotland) Act 2013.

From April 2018, a new Land Transaction Tax replaced SDLT in Wales.

Stamp duty reserve tax ("SDRT")

SDRT is charged on an agreement to transfer chargeable securities for money or money's worth (whether or not the agreement is in writing). Subject to some exceptions, "chargeable securities" are (principally) stocks or shares issued by a company incorporated in the UK, and units under a UK unit trust scheme. SDRT is imposed at the rate of 0.5% of the amount or value of consideration, though the rate is 1.5% if UK shares or securities are transferred (rather than issued) to a depositary receipt issuer or a clearance service and the transfer is not an integral part of the raising of share capital.

UK legislation still purports to apply the 1.5% charge whenever UK shares or securities are issued or transferred to a depositary or clearance service. However, the charge is not collected by Her Majesty's Revenue and Customs ("HMRC") because it has been found to be contrary to EU law (the Capital Duties Directive). In the Autumn 2017 Budget, the Government confirmed that this practice will continue after the UK leaves the EU in 2019 notwithstanding the Capital Duties Directive will no longer apply.

SDRT liability is imposed on the purchaser and is directly enforceable. Where a transaction is completed by a duly stamped instrument within six years from the date when the SDRT charge arose, there is provision in many cases for the repayment of any SDRT already paid or cancellation of the SDRT charge.

2.7 Are there any other indirect taxes of which we should be aware?

Customs duties are generally payable on goods imported from outside the EU and, depending on the terms of the UK's exit from the EU, could start to apply to imports from the EU. However, the European Union (Withdrawal) Act 2018 will incorporate the latest EU customs code into UK law for the transitional period.

Excise duties are levied on particular classes of goods (e.g. alcohol and tobacco). Insurance premium tax is charged on the receipt of a premium by an insurer under a taxable insurance contract. Environmental taxes include the following: landfill tax; aggregates levy; climate change levy; and a carbon reduction charge.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In most cases, no withholding tax is imposed on dividends paid by a UK resident company. Dividends deriving from the tax-exempt business of a UK Real Estate Investment Trust ("REIT") are, however, subject to withholding tax at the rate of 20% if paid to non-resident shareholders (or to certain categories of UK resident shareholder); this may be reduced to 15%, or in a few cases less, by an applicable double tax treaty.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the Interest and Royalties Directive (2003/49/EC) does not apply, the rate of withholding tax on most royalties is 20%. There is no withholding tax on film and video royalties.

The UK legislation implementing that Directive provides that there is no withholding tax on the payment of royalties (or interest) by a UK company (or a UK PE of an EU company) to an EU company which is a "25% associate". The exemption does not apply to the extent that any royalties (or interest) would not have been paid if the parties had been dealing at arm's length. An EU company for these purposes is a company resident in a Member State other than the UK.

There must be a risk that this UK legislation will be repealed in light of Brexit.

Finance Bill 2019 is expected to include a new withholding tax in respect of royalty payments made to low or no tax jurisdictions in connection with sales to UK customers. The rule, which will also apply to payments for certain other rights, will apply regardless of where the payer is located.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the Interest and Royalties Directive does not apply, the rate of withholding tax on "yearly" interest which has a UK source and is paid to a non-resident is generally 20%.

There is no withholding tax, however, where interest is paid on quoted Eurobonds; nor, since 1 January 2016, on interest paid on private placements – a form of selective, direct lending by non-bank lenders (such as insurers) to corporate borrowers. And in order to make the UK wholesale debt markets more competitive, the Government introduced, from April 2018, a new exemption for debt traded on a multilateral trading facility operated by a recognised stock exchange in an EEA territory.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The UK has a thin capitalisation regime which applies to domestic as well as cross-border transactions. A borrower is considered according to its own financial circumstances when determining the amount which it would have borrowed from an independent lender. The assets and income of the borrower's direct and indirect subsidiaries can be taken into account to the extent that an unconnected lender would recognise them, but the assets and income of other group companies are disregarded.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

There are no statutory safe harbour rules. Historically, HMRC adopted a rule of thumb that a company would not generally be regarded as thinly capitalised where the level of debt to equity did not exceed a ratio of 1:1 and the ratio of income ("EBIT") to interest was at least 3:1. HMRC's current guidance moves away from this to apply the arm's length standard on a case-by-case basis and sets out broad principles that should be considered; and the ratio cited most often is debt to EBITDA (earnings before interest, tax, depreciation and amortisation).

3.6 Would any such rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes. A company may be thinly capitalised because of a special relationship between the borrower and the lender or because of a guarantee given by a person connected with the borrower. A "guarantee" for this purpose need not be in writing and includes any case in which the lender has a reasonable expectation that it will be paid by, or out of the assets of, another connected company.

3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

The UK has introduced an EBITDA-based cap on net interest expense as recommended in the OECD report on BEPS Action 4; this took effect from 1 April 2017 which was, extraordinarily, more than six months before the relevant legislation was enacted. A fixed ratio rule limits corporation tax deductions for net interest expense to 30% of a group's UK "tax EBITDA" (so excluding, for example, non-taxable dividends); there is also a group ratio rule based on the net interest to EBITDA ratio for the worldwide group. A consequence of the new 30% EBITDA cap is the repeal of the UK's previous interest restriction rule known as the worldwide debt cap, although a rule with "similar effect" has been integrated into the new interest restriction rules to ensure that a group's net UK interest deductions cannot exceed the global net third-party interest expense of the group.

3.8 Is there any withholding tax on property rental payments made to non-residents?

In principle, such payments are subject to withholding tax (by the tenant or agent) at 20%, being the basic rate of income tax in the UK. However, the non-resident can register as an overseas landlord under the Non-resident Landlord Scheme and then account for income tax itself (again at 20%). Most commercial landlords that are non-resident opt for registration under this scheme.

One notable consequence of the reductions in the rate of corporation tax in recent years (see question 4.1 below) is that a UK corporate landlord may be paying less tax on UK source rent than a non-resident landlord. This disparity is to be removed from 6 April 2020, however, when it is proposed that non-UK resident companies carrying on a UK property business will be brought within the scope of corporation tax. Accordingly, from 6 April 2020 there will not be any withholding tax on property rental payments because non-resident landlords will be completing a corporation tax self-assessment return instead.

3.9 Does your jurisdiction have transfer pricing rules?

Yes. The UK transfer pricing rules apply to both cross-border and domestic transactions between associated companies.

If HMRC do not accept that pricing is at arm's length, they will raise an assessment adjusting the profits or losses accordingly. It is possible to make an application for an advance transfer pricing agreement which has the effect that pricing (or borrowing) in accordance with its terms is accepted as arm's length.

In cross-border transactions, the double taxation caused by a transfer pricing adjustment can be mitigated by the provisions of a tax treaty.

Transfer pricing is also on the BEPS radar, of course, and changes to the OECD Transfer Pricing Guidelines are under way.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The current Government continues to reduce the headline rate of tax, as part of a package of tax reforms designed to enhance UK competitiveness. From a starting point of 28% in 2010 it had fallen to 19% by 1 April 2017, and the Government has said it will fall to 17% in 2020. Banks, however, are an exception; from 2016 they have paid an 8% surcharge on top of the headline rate of corporation tax.

4.2 Is the tax base accounting profit subject to adjustments, or something else?

In general terms, tax follows the commercial accounts subject to adjustments.

4.3 If the tax base is accounting profit subject to adjustments, what are the main adjustments?

Certain items of expenditure which are shown as reducing the profits in the commercial accounts are added back for tax purposes, and deductions may then be allowable. For example, in the case of most plant or machinery, capital allowances on a reducing balance basis (at various rates depending on the type of asset and the level of expenditure incurred – the rules are not very generous) are substituted for accounting depreciation.

UK tax legislation has been amended to deal with various issues arising from companies adopting International Accounting Standards for their accounts and, in certain circumstances, related adjustments are required for tax purposes. Changes will be made to the UK's tax legislation to deal with the impact of changes in International Financial Reporting Standard 16 (leasing) in order to preserve the current tax treatment of leases.

Since autumn 2015, a revised set of rules governing the tax treatment of corporate debt and derivative contracts has been in place. The revised regime includes a broad anti-avoidance provision which may lead to an increase in the circumstances in which the taxation of such financial instruments deviates from their accounting treatment.

4.4 Are there any tax grouping rules? Do these allow for relief in your jurisdiction for losses of overseas subsidiaries?

Yes. The UK does not permit group companies to be taxed on the basis of consolidated accounts, but the grouping rules achieve a degree of effective consolidation for various tax purposes. A group consists, in most cases, of a parent company and its direct or indirect subsidiaries, but the exact test for whether a group exists depends on the tax in question.

Group relief group

Losses (other than capital losses) can be surrendered from one UK resident group company to another UK resident group company. Losses can also be surrendered by or to a UK PE of a non-UK group company. A UK PE of an overseas company can only surrender those losses as group relief if they are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country. Similarly, a UK company can surrender the losses of an overseas PE if those losses are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country.

The UK legislation permits group relief to be given in the UK for otherwise unrelievable losses incurred by group members established elsewhere in the EU, even if they are not resident or trading in the UK. However, the applicable conditions are very restrictive, so in practice UK companies can rarely benefit from this rule. It remains to be seen whether it will be repealed after Brexit in any event, as it was only introduced to comply with EU law.

Please see also question 4.5 below as regards a legislative change which allows the surrender of carry-forward losses.

Capital gains group

There is no consolidation of capital gains and losses, but it is possible to make an election for a gain (or loss) on a disposal made by one capital gains group member to be treated as a gain (or loss) on a disposal by another group member.

Capital assets may be transferred between capital gains group members on a no gain/no loss basis. This has the effect of postponing liability until the asset is transferred outside the group or until the company holding the asset is transferred outside the group. When a company leaves a capital gains group holding an asset which it acquired intra-group in the previous six years, a degrouping charge may arise. However, in many cases, the degrouping charge will be added to the consideration received for the sale of the shares in the transferee company and will then be exempt under the substantial shareholding regime (see question 5.2 below for details of this regime).

Stamp duty and SDLT groups

Transfers between group companies are relieved from stamp duty or from SDLT where certain conditions are met.

VAT group

Transactions between group members are disregarded for VAT purposes (although HMRC have powers to override this in certain circumstances). Broadly, two or more corporate bodies are eligible to be treated as members of a VAT group if each is established or has a fixed establishment in the UK and they are under common control. The eligibility criteria for the UK's VAT grouping rules are, however, the subject of a current consultation. It is proposed to allow non-corporate entities (such as partnerships and individuals) who have a business establishment in the UK and control a body corporate to join a VAT group, subject to certain conditions.) Please see also question 2.5 above.

4.5 Do tax losses survive a change of ownership?

Tax losses may survive a change of ownership but, like many other jurisdictions, the UK has rules which can deprive a company of carry-forward losses in certain circumstances following such a change. The policy objective is to combat loss-buying but the rules can easily apply where there is no tax motivation for the change in ownership.

Significant changes have been made to the carry-forward loss regime, again with retrospective effect to 1 April 2017. On the positive side, where the conditions are met the changes enable carried-forward losses incurred on or after 1 April 2017 to be carried forward and set off against other income streams and against profits from other companies within a group; this is more flexible than the old rules, although the new flexibility is substantially restricted where there is a change in ownership of the company with losses. The negative aspect of the changes is that the amount of taxable profit that can be offset by carried-forward losses is restricted to 50%, though this only applies to taxable profits in excess of £5 million (calculated on a group basis). Unlike the first measure, this applies to historic losses, not just those incurred on or after 1 April 2017. There are different restrictions for banks.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, it is not.

4.7 Are companies subject to any significant taxes not covered elsewhere in this chapter – e.g. tax on the occupation of property?

Business rates are payable by the occupier of business premises based on the annual rental value. The rate depends on the location of the business premises and the size of the business. Business rates are a deductible expense for corporation tax purposes.

An annual tax on enveloped dwellings ("ATED") is payable by companies and certain other "non-natural persons" if they own interests in dwellings with a value of more than £500,000. There are reliefs available, including where the dwelling is being or will be used for genuine commercial activities.

There are special regimes for the taxation of certain types of activity or company, such as oil exploration (profits from which are subject to a "supplementary charge", the rate of which is currently 10%) and UK REITs (which are not generally taxed on income or gains from investment property).

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Corporation tax is chargeable on "profits", which includes both income and capital gains. There is, however, a separate regime for computing capital gains. This contains more exemptions, but also has the effect that capital losses can only be used against gains, not against income.

5.2 Is there a participation exemption for capital gains?

Yes. A substantial shareholdings exemption ("SSE") allows trading groups to dispose of trading subsidiaries without a UK tax charge. The SSE is narrower and more complex than the participation exemption found in some other countries, though some of the original restrictions have been removed (for disposals made on or after 1 April 2017).

Capital gains realised on the disposal of assets by non-residents are not generally subject to corporation tax unless the assets were used for the purposes of a trade carried on through a UK PE, as noted in question 6.3 below. However, from 6 April 2019 new provisions to be included in Finance Bill 2019 will charge non-UK resident companies corporation tax on their gains from disposals of interest in UK land.

5.3 Is there any special relief for reinvestment?

There is rollover relief for the replacement of certain categories of asset used for the purposes of a trade. Rollover is available to the extent that the whole or part of the proceeds of disposal of such assets is, within one year before or three years after the disposal, applied in the acquisition of other such assets.

It is a feature of the UK's rules that the replacement assets have to remain within the UK tax net. In 2015, a similar requirement was held by the CJEU to be a restriction on freedom of establishment (European Commission v Germany (C-591/13)): the Court ruled that the taxpayer should be able to choose between immediate payment or bearing the administrative burden of deferring the tax. With the UK preparing to exit the EU, however, it seems unlikely that the UK will change its rules to permit a deferral.

5.4 Does your jurisdiction impose withholding tax on the proceeds of selling a direct or indirect interest in local assets/shares?

This occurs only in very specific circumstances; one example is on the sale of UK patent rights by a non-resident individual who is subject to UK income tax on the proceeds of the sale (or by a non-resident company which is subject to UK corporation tax, if the buyer is an individual).

6 Local Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary.

6.2 Is there a difference between the taxation of a local subsidiary and a local branch of a non-resident company (for example, a branch profits tax)?

Yes: a UK resident subsidiary will pay corporation tax on its worldwide income and gains unless it makes the election described in question 7.1 below, whereas a UK branch is liable to corporation tax only on the items listed in question 6.3. Subject to the point immediately below, the charge to UK corporation tax imposed on a non-resident company currently applies only where the non-resident company is trading in the UK through a PE; this means that a branch set up for investment purposes only, and not carrying on a trade, is not subject to UK corporation tax, though certain types of income arising in the UK – notably rent and interest – may be subject to income tax through withholding (at 20%).

The exception results from a legislative change made in 2016. A non-resident company can now be subject to corporation tax even where it does not have a PE in the UK, if it is nonetheless trading "in" the UK and the trade consists of "dealing in or developing" UK land.

From 6 April 2019, non-UK resident companies will be charged corporation tax on their gains from direct and indirect disposals of interests in UK land (where certain conditions are met (see question 8.1 below)).

6.3 How would the taxable profits of a local branch be determined in its jurisdiction?

Assuming that the local branch of a non-resident company is within the UK statutory definition of "permanent establishment" (which is based on, but not quite the same as, the wording of Article 5 of the OECD Model Convention), it will be treated as though it were a distinct and separate entity dealing wholly independently with the non-resident company. It will also be treated as having the equity and loan capital which it would have if it were a distinct entity, which means that the UK's thin capitalisation rules will apply to it.

Subject to any treaty provisions to the contrary, the taxable profits of a PE through which a non-resident company is trading in the UK would comprise:

- trading income arising directly or indirectly through, or from, the PE;
- income from property and rights used by, or held by or for, the PE (but not including exempt distributions); and
- capital gains accruing on the disposal of assets situated in the UK and effectively connected with the operations of the PE.

6.4 Would a branch benefit from double tax relief in its jurisdiction?

The UK domestic legislation does not give treaty relief against UK tax unless the person claiming credit is resident in the UK for the accounting period in question. This means that the UK branch of a non-resident company cannot claim treaty relief.

Unilateral tax credit relief may be allowed for tax paid outside the UK in respect of the income or chargeable gains of a UK branch or agency of a non-UK resident person if certain conditions are fulfilled. Tax payable in a country where the overseas company is taxable by reason of its domicile, residence or place of management is excluded from relief.

6.5 Would any withholding tax or other similar tax be imposed as the result of a remittance of profits by the branch?

No, it would not.

7 Overseas Profits

7.1 Does your jurisdiction tax profits earned in overseas branches?

As a general rule, and subject to tax treaty provisions, the UK taxes the profits earned in overseas branches of UK resident companies. A UK company can, however, elect for the profits (including capital gains) of its overseas branches to be exempt from UK taxation. The downside of such an election is that the UK company cannot then use the losses of the overseas branch. An election is irrevocable and covers all overseas branches of the company making the election.

7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Foreign dividends and UK dividends (other than “property income dividends” from a UK REIT) are treated in the same way. They are generally exempt in the hands of a UK company, subject to some complex anti-avoidance rules and an exclusion for dividends paid by a “small” company which is not resident in the UK or a “qualifying territory”.

7.3 Does your jurisdiction have “controlled foreign company” rules and, if so, when do these apply?

It does, though the UK’s current CFC regime has a more territorial focus than its predecessor. Under the revised rules, profits which arise naturally outside the UK are not supposed to be caught. There are also various exclusions and exemptions. These include a finance company partial exemption (“FCPE”) which (while the main rate of corporation tax is 19%) results in an effective UK corporation tax rate of 4.75% on profits earned by a CFC from providing funding to other non-UK members of the relevant group. Indeed, in some instances such profits will not be caught by the CFC charge at all. The outcome of the European Commission’s investigation into whether the FCPE constitutes unlawful State Aid is eagerly awaited; see also William Watson’s introductory chapter.

A change that took effect from 8 July 2015 adds a punitive element to the new regime: a group which has losses can no longer use them against a CFC charge. This reduces the attractiveness of the FCPE for groups with carried-forward losses.

A couple of aspects of the UK's CFC rules will be revised to ensure that the rules are fully compliant with the EU Anti-Tax Avoidance Directive ("ATAD").

8 Taxation of Commercial Real Estate

8.1 Are non-residents taxed on the disposal of commercial real estate in your jurisdiction?

Under current law, non-residents are not generally taxed on the disposal of commercial real estate in the UK that is held as an investment. However, from 6 April 2019, non-UK resident companies will be subject to corporation tax on their gains from direct and indirect disposals of interests in UK land (whether commercial or residential) where certain conditions are met.

8.2 Does your jurisdiction impose tax on the transfer of an indirect interest in commercial real estate in your jurisdiction?

Not currently but from 6 April 2019 non-resident companies will become subject to a charge to corporation tax on the disposal of an interest in a property-rich entity in certain circumstances.

8.3 Does your jurisdiction have a special tax regime for Real Estate Investment Trusts (REITs) or their equivalent?

Yes. Since 2007, the UK's REIT regime has enabled qualifying companies to elect to be treated as REITs. The conditions for qualification include UK residence, listing (on a main or secondary stock market), diversity of ownership and a requirement that three-quarters of the assets and profits of the company (or group) are attributable to its property rental business.

The aim of the regime is that there should be no difference from a tax perspective between a direct investment in real estate and an investment through a REIT. Accordingly, a REIT is exempt from tax on income and gains from its property rental business but distributions of such income/gains are treated as UK property income in the hands of shareholders and, as noted in question 3.1 above, are liable to 20% withholding tax (subject to exceptions).

9 Anti-avoidance and Compliance

9.1 Does your jurisdiction have a general anti-avoidance or anti-abuse rule?

Although a GAAR was enacted in the UK for the first time in 2013, it may be some time before the UK courts are asked to make sense of it. One reason for this is that, before invoking the GAAR, HMRC must ask an independent advisory panel (the GAAR Panel) for its opinion as to whether the GAAR should apply (though it can use a GAAR Panel opinion in one case to counteract "equivalent arrangements" used by other taxpayers). The GAAR Panel opinions to date have all been in HMRC's favour. The other reason is the massive financial deterrent to challenging HMRC's application of the GAAR. If the GAAR applies, HMRC can counteract the tax advantage by the making of "just and reasonable" adjustments. Taxpayers who enter into arrangements that are counteracted by the GAAR are liable to a penalty of 60% of the counteracted tax unless they "correct" their tax position before the arrangements are referred to the GAAR Panel.

The GAAR contains two tests: are there arrangements which have as their main purpose securing a tax advantage; and if so, are they arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action (the justly maligned "double reasonableness" test)? This is to be assessed "having regard to all the circumstances", including consistency with policy objectives, whether there are any contrived or abnormal steps and whether the arrangements exploit any shortcomings in the relevant provisions.

As predicted, the GAAR has had little impact on corporate taxpayers, as they had already begun to adopt a more conservative approach to tax planning; and the 60% penalty will doubtless prove a strong incentive for taxpayers to settle future cases before they are referred to the GAAR Panel.

The ATAD includes an anti-avoidance rule which is broader than the UK's GAAR but the UK has not yet shown any signs of implementing the EU GAAR.

9.2 Is there a requirement to make special disclosure of avoidance schemes?

The UK has disclosure rules which are designed to provide HMRC with information about potential tax avoidance schemes at an earlier stage than would otherwise have been the case. This enables HMRC to investigate the schemes and introduce legislation (often a new "targeted anti-avoidance rule") to counteract the avoidance where appropriate.

The Government sees these mandatory disclosure rules as the answer to Action 12 of the BEPS project (that taxpayers be required to disclose their aggressive tax planning arrangements).

9.3 Does your jurisdiction have rules which target not only taxpayers engaging in tax avoidance but also anyone who promotes, enables or facilitates the tax avoidance?

Yes: the Finance Act 2017 brought in new rules under which advisers and others who "enable" the implementation of "abusive tax arrangements" can be penalised if those arrangements are ineffective.

The Government has also co-opted third parties in the fight against tax evasion. From 30 September 2017, the Criminal Finances Act 2017 introduces two new corporate offences of failure to prevent the facilitation of UK or foreign tax evasion. This will hold organisations to account for the actions of their employees and other persons performing services for or on behalf of the organisation (so potentially including any contractor or sub-contractor) unless the organisation can show that it has reasonable procedures in place to prevent these offences being committed.

The Government intends to implement the EU intermediaries disclosure rules which provide for the mandatory disclosure of cross-border "potentially aggressive tax planning arrangements" by intermediaries (EU Directive 2018/882).

9.4 Does your jurisdiction encourage "co-operative compliance" and, if so, does this provide procedural benefits only or result in a reduction of tax?

Yes. HMRC have encouraged co-operative compliance for a number of years; it goes hand in hand with HMRC's risk assessment strategy and enables HMRC to concentrate resources on the higher risk, less co-operative taxpayers. It initially led to an improved relationship between taxpayers and HMRC and, while it may not result in lower tax liabilities, it does reduce compliance costs. More recently, though, there has been a perception that HMRC has become more likely to litigate even where the taxpayer is co-operative.

10 BEPS and Tax Competition

10.1 Has your jurisdiction introduced any legislation in response to the OECD's project targeting Base Erosion and Profit Shifting (BEPS)?

The UK was the first country to commit formally to implementing the country-by-country template, and regulations have been in effect since March 2016.

The UK, controversially, pre-empted the BEPS project and introduced, with effect from 1 April 2015, an entirely new tax – the "diverted profits tax" ("DPT") – which is intended to protect the UK tax base. It has two main targets: where there is a substantial UK operation but sales to UK customers are made by an affiliate outside the UK, in such a way that the UK operation is not a PE of the non-UK affiliate; and where the UK operation makes deductible payments (e.g. royalties for intellectual property ("IP")) to a non-UK affiliate, these are taxed at less than 80% of the rate of corporation tax and the affiliate has insufficient "economic substance". As a deterrent, the rate applicable to the "diverted" profits is 5% higher than the rate at which tax would otherwise have been payable.

The UK has modified its patent box regime in response to Action 5 (Countering Harmful Tax Practices) (see question 10.4 below).

Anti-hybrids legislation has been in effect from 1 January 2017 (see question 10.2 below). These rules are being revised to comply fully with ATAD.

Legislation to implement Action 4 (Deductibility of Interest) (see question 3.7 above) was included in Finance (No.2) Act 2017, with retrospective effect from 1 April 2017.

The UK has ratified the Multilateral Convention and notified most of its treaties to the OECD so that (subject to the relevant treaty partner's agreement) the modifications to the UK's treaties required by BEPS can be made.

10.2 Does your jurisdiction intend to adopt any legislation to tackle BEPS which goes beyond what is recommended in the OECD's BEPS reports?

Yes. The first example of a measure not required by the OECD BEPS reports is the DPT (see question 10.1 above).

The second example is the UK's extension of royalty withholding tax. In particular, this will now effectively have extra-territorial scope in some circumstances: where the way in which sales are made in the UK creates an actual PE or, in DPT terms, an "avoided" PE, IP royalties paid out of (say) the European hub for sales activities will be treated for the purposes of UK withholding tax as having been paid out of the UK, to the extent it is "just and reasonable" to do so. A further extension of royalty withholding tax is planned for inclusion in Finance Bill 2019. If enacted, this will require deduction of income tax at source in respect of royalty payments made to low or no tax jurisdictions in connection with sales to UK customers. The rules, which will also apply to payments for certain other rights, will apply regardless of where the payer is located.

A third example is the anti-hybrids regime. The UK has implemented very broad rules which, because of the absence of a motive test or a UK tax benefit test, means that third-party, commercially motivated transactions are potentially within scope.

There has also been a tendency for the Government to accelerate the introduction of measures; besides its pre-emptive strike with DPT, discussed in question 10.1, the Government rushed through a corporate interest restriction (question 3.7) whereas the report on BEPS Action 4 had recommended that reasonable time be given to entities to restructure existing financing arrangements before interest restriction rules come into effect.

10.3 Does your jurisdiction support public Country-by-Country Reporting (CBCR)?

The Government has previously spoken out in favour of public CBCR, though the OECD has subsequently expressed concern that it would do more harm than good if only some jurisdictions require public reporting, and there is a lack of consistency in what has to be reported. The Government has said it is disappointed with the lack of progress towards international agreement on public reporting and, while the UK legislation contains a power to switch on public reporting, this is unlikely to be used before a multilateral agreement is reached.

10.4 Does your jurisdiction maintain any preferential tax regimes such as a patent box?

Until 30 June 2016, the UK had a patent box regime which allowed an arm's length return on IP held in the UK to qualify for a reduced tax rate of 10% even if all the associated research and development ("R&D") activity was done outside the UK. In light of BEPS Action 5, IP which was already in the patent box on 30 June continues to benefit from the old rules for five years. IP not already in the patent box on that date qualifies only to the extent it is generated by R&D activities of the UK company itself, or by R&D outsourced to third parties; and acquired IP and IP generated by R&D outsourced to associates are no longer eligible for the patent box.

Where IP has been generated from a combination of "good" and "bad" expenditure, a fraction of the patent income qualifies for the patent box and, in calculating this, there is a 30% uplift for "good" expenditure, to soften the impact of these rule changes.

Depending on the deal negotiated with the EU, Brexit may lead to a further relaxation of the new rules: departure from the EU might enable the UK to treat all R&D outsourcing within the UK as "good" expenditure, without fear of violating EU Treaty freedoms and State aid rules.

11 Taxing the Digital Economy

11.1 Has your jurisdiction taken any unilateral action to tax digital activities or to expand the tax base to capture digital presence?

Not yet. The UK is keen to engage with the EU and the OECD on this issue with a view to agreeing a reform of the international tax rules to reflect the value of user participation. In a March 2018 position paper, the Government stated that in the absence of reform of the international rules, interim measures such as revenue-based taxes must be considered. The Government thinks there are benefits to implementing interim measures on a multilateral basis and intends to work closely with the EU and international partners on this issue. The position paper explained that the Government continues to refine its position so we have not heard the last on this yet.

11.2 Does your jurisdiction support the European Commission's interim proposal for a digital services tax?

UK officials were party to the initial joint statement made with France, Germany, Italy and Spain that they welcomed the Commission's proposals and intend to study them. Since then, however, a number of other Member States (particularly Ireland and the Nordic countries) have spoken out against the digital services tax proposal and it is not clear that the UK continues to support it.

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