SLAUGHTER AND MAY/

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CORPORATE TAX 2021

1. Tax Treaties and Residence

1.1 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 140 comprehensive income tax treaties currently in force. One of the consequences of the UK's 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 Base Erosion and Profit Shifting ("BEPS") project (see question 10.1 below), changes were made 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 Has your jurisdiction signed the tax treaty MLI and deposited its instrument of ratification with the OECD?

Yes: the UK has signed the MLI and deposited its instrument of ratification with the OECD on 29 June 2018. It has also 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.

1.4 Do they generally incorporate anti-abuse rules?

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 in its drafting approach 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? Has the application of the test been modified in response to COVID-19?

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 and control 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 tiebreaker 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 tiebreaker 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.

The disruption caused by COVID-19 has led to various concerns in this area. For example, the central management and control (and/or the place of effective management) of a non-UK incorporated company might be thought to have shifted to the UK if UK-based directors could not travel outside the UK for board meetings.

Guidance published by Her Majesty's Revenue and Customs ("HMRC") at the start of April 2020 states that HMRC [does] "not consider that a company will necessarily become resident in the UK because a few board meetings are held here or because some decisions are taken in the UK over a short period of time". In contrast to the approach being taken by some other tax authorities, however, HMRC will not automatically disregard time spent in the UK because of COVID-19. HMRC is of the view that existing law and guidance relating to company residence already provides flexibility to deal with changes necessitated by the response to the COVID-19 pandemic.

As regards the interpretation of tax treaty tiebreaker clauses, OECD guidance provides rather more comfort. The guidance states that it is unlikely that the COVID-19 situation will create any changes to an entity's residence under a tax treaty. It adds that a temporary change in location of the chief executive officer and other senior executives is an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency, especially once the tiebreaker rule contained in tax treaties is applied. And it notes that the OECD Model tiebreaker clause requires treaty partners to consider all the relevant facts and circumstances to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional and temporary period such as the COVID-19 crisis. Existing HMRC guidance on permanent establishments (requiring a degree of permanence) is consistent with this OECD guidance.

1.7 Is your jurisdiction's tax authority expected to revisit the status of dual resident companies in cases where the MLI changes the treaty "tiebreaker"?

HMRC has confirmed that it does not generally intend to revisit any pre-MLI determinations of the treaty residence position of companies resident in both the UK and a contracting state with which the UK has a double tax treaty whose residence tiebreaker was amended by the MLI. This is provided that:

- all the material facts remain the same; and
- the arrangements are not within the principal purpose test incorporated by the MLI.

If either of these two conditions is not satisfied, HMRC will review the prior determination and may seek a new one.

This approach to grandfathering residence status cannot, however, be applied unilaterally and is subject to agreement with the competent authority of the other contracting state, so the UK is in the process of securing such agreements. Bilateral agreements for the grandfathering of previous company residence determinations have, at the time of writing, been reached with the Netherlands and New Zealand. Similar grandfathering agreements have also been reached with Jersey, Guernsey and Isle of Man (although in these cases the tiebreaker provisions were changed directly in the treaties rather than by operation of the MLI).

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.

One very minor upside of the pandemic has been the Stamp Office's acceptance (on a temporary basis) of electronic workarounds for stamping instead of requiring physical stamping of documents. It is no surprise, then, that a general modernisation of the rules is back on the table. A call for evidence was launched in July 2020, building on a 2017 review carried out by the UK's Office of Tax Simplification on digitising and modernising the stamp duty process. This will be a long-term project which will have several stages but, eventually, it is hoped that there will be a fundamental redesign of the stamp taxes framework, moving away from paper-based stamping.

Please see question 2.6 below for details of the closely related stamp duty reserve tax, and also of the stamp duty land tax (or the equivalent in each of Scotland and Wales) that applies to land transactions in the UK.

2.2 Do you have Value Added Tax (VAT), or a similar tax? If so, at what rate or rates? Please note any rate reduction in response to COVID-19.

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.

Temporary changes to VAT rates have been implemented for a number of sectors to tackle the impact of COVID-19. In particular, a 5% reduced rate of VAT for certain supplies of hospitality, hotel and holiday accommodation, and admissions to certain attractions, applies from 15 July 2020 to 31 March 2021.

Whilst the fundamental VAT rules within the UK may not change much upon its exit from the EU (not least because VAT generates a substantial proportion of total UK tax receipts), 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). 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 currently 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, all 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. Whether the UK should move to "establishment only" grouping in line with much of the EU is currently under review, however, together with other aspects of the VAT grouping rules. Please also see 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 non-residential lease is 1% on the portion of the net present value ("NPV") of the rent over £150,000, determined in accordance with a statutory formula, rising to 2% on the portion of NPV above £5m.

SDLT has been replaced in Scotland with the Land and Buildings Transaction Tax and in Wales with the Land

Transaction Tax, both of which have a similar scope to SDLT.

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.

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 the cancellation of the SDRT charge.

There may be changes made to the SDRT regime as part of the possible modernisation project referred to in question 2.1.

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 are expected to apply to imports from the EU from the start of 2021. The provisions of the Taxation (Cross-border Trade) Act 2018 are meant to replace EU legislation in relation to customs duty, establishing a new customs system for the UK from the start of 2021.

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. The Government proposes to introduce a new tax on plastic packaging from April 2022.

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.

HMRC has confirmed that this UK legislation will continue to apply for the time being. It would, however, be open to the UK to amend or repeal the relevant legislation after the Brexit transition period ends.

Finance Act 2019 introduced a new income tax charge on offshore receipts in respect of intangible property, including royalty payments, received in low or no tax jurisdictions in connection with sales to UK customers. Although it was originally proposed as a withholding tax, it was enacted as a self-assessed income tax charge recoverable from UK affiliates of the person exploiting the intangible property, if not collected directly.

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%.

However, there is no withholding tax where interest is paid on quoted Eurobonds or on debt traded on a multilateral trading facility operated by a recognised stock exchange in an EEA territory. Since 1 January 2016, the tax treaty has also been supplemented by new rules for "private placements". In commercial terms this is a form of selective, direct lending by non-bank lenders (such as insurers) to corporate borrowers, but in practice HMRC appears to be happy for the regime to apply to standard syndicated bank loans. The compliance burden is comparatively light and the regime is particularly useful where the lender is in a jurisdiction whose tax treaty with the UK does not entirely eliminate withholding tax on interest.

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, for example pursuant to BEPS Action 4?

The UK introduced an EBITDA-based cap on net interest expense as recommended in the OECD report on BEPS **Action 4. 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 (the "NRL Scheme") to receive rental payments gross and then account for UK tax itself under self-assessment. Most non-resident commercial landlords opted for registration under this scheme.

Prior to 6 April 2020, the gross income would have been subject to income tax at 20%. From 6 April 2020, in an attempt to level the playing field between UK resident and non-resident companies on the taxation of UK property income, the gross income is instead subject to corporation tax at 19%.

As is noted in question 8.1 below, gains made by non-resident companies on the disposal of a direct or indirect interest in UK land came within the charge to corporation tax from 6 April 2019. One can already see a reduction in the number of non-resident landlords as a result of the fact that such gains are now taxable.

3.9 Does your jurisdiction have transfer pricing rules? Is their application expected to be materially affected by COVID-19?

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

If HMRC does 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 ("APA") 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.

Changes to the OECD Transfer Pricing Guidelines made in response to BEPS are automatically followed in UK domestic law.

Transfer pricing policies and arrangements, including APAs, are underpinned by a set of critical assumptions. These assumptions are likely to be affected by COVID-19 and the resulting economic downturn, which may mean that changes have to be made to policies and arrangements to reflect changes in functions or risks; and in some circumstances, APAs may need to be renegotiated. Appropriate documentation for any transfer pricing policy adjustments is essential to provide evidence in the event of transfer pricing disputes. At the time of writing, no official guidance on the impact of COVID-19 on transfer pricing has yet been released by either HMRC or the OECD, although parts of existing OECD guidance, such as guidance on business restructurings and on financial transactions, will be relevant here.

4. Tax on Business Operations: General

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

The headline rate was 28% as recently as 2010 but is now 19% (though this might creep up again as the UK Government looks for sources of additional revenue in light of the economic impact of COVID-19). However, banks have since 2016 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. In particular, changes have been made in order to preserve the current tax treatment of leases following the introduction of International Financial Reporting Standard 16 (leasing).

The two sets of rules governing the tax treatment of corporate debt and derivative contracts each include a broad anti-avoidance provision which, if triggered, will cause the taxation of such financial instruments to deviate 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 simply be repealed after the end of the Brexit transition period in any event, given that it was only introduced to comply with EU law.

Please also see 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 has 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. Finance Act 2019 extended the eligibility criteria, from a date to be set by regulations, to permit 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. Currently, a group can choose which of its eligible entities join the VAT group but a review is considering whether the UK should move to compulsory VAT grouping in line with some EU jurisdictions. Please also see 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.

With effect from 1 April 2017, significant changes have been made to the carry-forward loss regime more generally. On the positive side, where specified 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 £5m (calculated on a group basis). Unlike the first measure, this applies to historic losses, not just those incurred on or after 1 April 2017. From 1 April 2020, a similar restriction was introduced for carried-forward capital losses and the £5m allowance applies across both types of losses. 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 taxed at 30% and are also 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.

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, though see question 8.1 for an exception relating to 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 end of the Brexit transition period looming, 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 exceptions noted 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 exceptions relate to UK land. 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 have been subject to 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)). And as noted in question 3.8 above, from 6 April 2020 UK-source rent has come within the charge to corporation tax in the hands of non-UK resident companies.

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 distributions" 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. 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 Commission's state aid investigation concluded that the FCPE was partially non-compliant with state aid rules before changes were made to it with effect from 1 January 2019. The Commission concluded that applying an exemption to profits which were attributable to UK "significant people functions" was not a justified derogation. The UK Government and a large number of taxpayers have appealed the Commission's decision. HMRC has (as it is required to) begun the recovery process, working out with taxpayers the quantification of aid and the method of recovery, which will take some time.

The Commission's challenge to the FCPE is discussed in more depth in the 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 have been 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?

Since 6 April 2019, non-UK resident companies have been 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?

Since 6 April 2019, non-resident companies are in specified circumstances subject to a charge to corporation tax on the disposal of an interest in a property-rich entity.

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, the UK courts have not yet been 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. Another 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 on or after 15 September 2016 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 was predicted when it was introduced, 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 shown any signs of implementing the EU GAAR.

9.2 Is there a requirement to make special disclosure of avoidance schemes or transactions that meet hallmarks associated with cross-border tax planning?

The UK has disclosure rules (with the acronym "DOTAS") 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).

The UK has also implemented the EU intermediaries disclosure rules (known as "DAC 6"), which provide for the mandatory disclosure by intermediaries of cross-border "potentially aggressive tax planning arrangements" (EU Directive 2018/882). The UK has, in line with most Member States, deferred the reporting deadlines by six months so the first reports are not due until 31 January 2021. Guidance has been published on how the UK regulations implementing DAC 6 will be applied, but this is work in progress and is expected to be updated by HMRC to address particular concerns/examples as they arise in practice.

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 introduced two new corporate offences of failure to prevent the facilitation of UK or foreign tax evasion. This can make organisations liable 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.

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 is meant to go hand in hand with HMRC's risk assessment strategy and enable 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. As HMRC is under pressure to maximise revenue in response to the pandemic, the number of HMRC enquiries and investigations is likely to increase.

10. BEPS and Tax Competition

10.1 Has your jurisdiction implemented the OECD's recommendations that came out of the BEPS project?

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 25%, which is materially 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 since 1 January 2017 (see question 10.2 below). These rules have been 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 retroactive effect from 1 April 2017.

10.2 Has your jurisdiction adopted any legislation to tackle BEPS which goes beyond the OECD's recommendations?

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

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

A third 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. Finance Act 2019 then introduced a new income tax charge on offshore receipts in respect of intangibles (including royalties) which relate to sales to UK customers.

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 information obtained under Country-by-Country Reporting (CBCR) being made available to the public?

The Government has 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 UK legislation contains a power to switch on public reporting but this is unlikely to be used before a multilateral agreement is in place.

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

For a few years 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. But in 2016, restrictions on this regime were introduced in light of BEPS Action 5. IP which was already in the patent box on 30 June continues to benefit from the old rules until 30 June 2021. IP not already in the patent box on 30 June 2016 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.

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?

Yes. Although the UK is keen to agree a reform of the international tax rules on a multilateral basis, the Government enacted legislation in Finance Act 2020 for a revenue-based digital services tax ("DST") from April 2020 as an interim measure. The DST is imposed at a rate of 2% on the revenues of search engines, social media platforms and online marketplaces which derive value from UK users. Associated online advertising business is also in scope if operated on an online platform that facilitates the placing of online advertising and derives significant benefit from its connection with the social media platform, search engine or online marketplace.

In order to ease double taxation, the revenues from online marketplaces are reduced to 50% of the revenues from the transaction when the other user in respect of the transaction is normally located in a country that operates a similar tax to the DST. HMRC maintain a list of countries with "similar" taxes which includes France, Italy, Malaysia and Turkey.

The DST applies to in-scope businesses when the group's worldwide revenues from these digital activities are more than £500m and more than £25m of the revenues are derived from UK users. If the group's revenues exceed these thresholds, its revenues derived from UK users are taxed at a rate of 2%. There is an allowance of £25m, which means a group's first £25m of revenues derived from UK users is not subject to DST.

Businesses may elect to make an alternative calculation based on UK operating margin. This ensures that where a UK activityis loss-making, no DST needs to be paid on revenues attributable to that activity.

The legislation contains a requirement that it be reviewed by the Treasury before the end of 2025 and a report laid before Parliament. The Government is committed to disapplying the DST once an appropriate international solution is in place.

11.2 Does your jurisdiction favour any of the G20/OECD's "Pillar One" options (user participation, marketing intangibles or significant economic presence)?

The UK favours user participation. The consultation document on the interim DST emphasised that an international solution would need to meet the UK's policy objective of leading to a greater allocation of profit of highly digitalised businesses to the countries in which their users are located, regardless of whether the solution has a broader application.

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