TAXE Committee : Country specific fact sheet
United-Kingdom

0) Main data:

•Access to the spider's web of UK tax havens : Isle of Man 0-10% corporate tax and lax residency rules / Guernsey & Jersey letterbox companies regime

•Controlled Foreign Companies

•Low corporation tax

•Patent box

•Non-domicile tax status

1) Low corporation tax

The Corporation Tax rate for company profits from 1 April 2015 is 20% for all companies.

Previous rates

The rate you pay on profits from before 1 April 2015 depends on the size of the profits.

Profits	**Rate**	**From 1 April 2014**	**From 1 April 2013**	**From 1 April 2012**
£300,000 or less	Small profits rate	20%	20%	20%
Above £300,000	Main rate	21%	23%	24%

There are different Corporation Tax rates for companies that make profits from oil extraction or oil rights in the UK or UK continental shelf. These are known as 'ring fence' companies.
Ring fence companies can claim Marginal Relief on profits between £300,000 and £1.5 million.

Rate	**2015**	**2014**	**2013**	**2012**
Small profits rate (companies with profits under £300,000)	19%	19%	19%	19%
Main rate (companies with profits over £300,000)	30%	30%	30%	30%

You may be able to get deductions or claim tax credits on your Corporation Tax. These are known as reliefs.

You may be able to make a claim for:

Research and Development (R&D) Relief
The Patent Box if your company makes a profit from patented inventions (rate: 10%)
reliefs for creative industries (CITR) if your company makes a profit from theatre, film, television, animation or video games
Disincorporation Relief if you're closing your company and becoming a sole trader, ordinary business partnership or limited partnership

2) Specific tax regimes of Crown dependencies (Isle of Man, Jersey, Guernsey)

Crown dependencies are specifically administered territories. Their administrative and legal status is hybrid:
- They are neither part of the United-Kingdom,
- Nor, they are to be confused with overseas territories such as Gibraltar.

According to the UK Secretary of State for Justice, responding to the Justice committee's report on Crown dependencies in November 2010, "*Crown dependencies have their own democratically elected governments responsible for* <u>*setting policy*</u>*,* <u>*passing laws*</u> *[...]they are* <u>*not part of the United Kingdom*</u> *nor,* <u>*except to a limited extent, the European Union*</u>."

However, this does not mean that EU law is out of the scope of Crown dependencies jurisdiction.
Indeed, certain aspects of EU law apply to Crown dependencies through the UK membership.
Article 355 (5)(c) TFEU is relevant here : "*the Treaty shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community"*

Of the four freedoms, only the freedom of goods apply. Isle of Man is part of the VAT area while the Channel Islands are not.

In a nutshell : Certain provisions do apply to the Crown dependencies although these are not at all clearly and exhaustively defined. It is our understanding, however, that as they are affected by EU legislation, they must make sure that they abide by EU law and specifically obligations binding the UK.

a. Isle of Man : 0-10% corporate tax rate

Isle of Man's reputation as low-tax jurisdiction is duly justified and even promoted abroad.

→ Lurid tax planning promotion is a common feature shared by tax havens.

What distinguishes it from its other counterparts is the <u>0% corporate tax rate</u>.
Indeed, other tax havens have at least a somewhat symbolic corporate tax rate - take 10% for Gibraltar for instance - <u>the Isle of Man has none</u>.
This full exemption has been in place since 2006.

The only incomes taxed at a rate of <u>10%</u> are of the following sources :
- Those arising from banking business activities carried out in the Isle of Man

- Those arising from land and property in the Island

The 10% rate has also recently been extended to cover any retail businesses with taxable profits of more than £500,000.

Permanent Establishment = Where an enterprise has a permanent establishment (PE) on the Isle of Man, profits attributable to that PE are taxable on the Isle of Man → So basically 0%

There are no transfer-pricing rules in the Isle of Man = this may open the doors for all sort of abuses

Likewise, as there are no inheritance, wealth, capital gains, insurance premium or stamp duty tax in the Isle of Man, its tax system is clearly taylor-made for rich individuals who want to avoid taxation.

No withholding tax levied on dividend and royalties.

Finally residency conditions are extremely straightforward : acquiring a property suffice.

TAX TABLES	
Company rate	0% (10% for banking, Isle of Man property, large retail)
Personal rate	10% lower / 20% higher (capped at £120,000 per annum)
Withholding Tax	0% (dividends and interest) none (royalties and management fees)
Capital gains	n/a
Inheritance, gifts and estate	n/a
Insurance premium tax	n/a
VAT	20% basic rate (part of EU VAT area)

→ It is rather odd to see Manx officials being embarassed by the term “tax haven” but at the same time considering the term “low-tax jurisdiction” or “responsible business centre” well fitting and acceptable.

In addition to that, Allan Bell, the Isle of Man’s chief minister has acknowledged that “taxation is an issue” “business plans and every single company can’t all be monitored” as well as the everlasting argument “everybody uses such practices, look at London, Dublin or Paris”.

b. Guernsey & Jersey : 0-10% Corporate income tax + letterbox company regimes (residency rules)

Guernsey and Jersey are also an ongoing issue as regards tax matter. They have in common with the Isle of Man very lax Corporate income tax rules with a maximum rate of 10%. The 0% corporate tax rate can be viewed "by default".

→ This tax regime is refered as "0/10"

In principle, all income enjoys a 0% corporate tax rate. There are a few exceptions listed below.

"0/10" in Jersey
Financial services companies are taxed at 10% and the profits from specified utility companies and from importation and supply of hydrocarbon oil are taxed at 20%.

"0/10" in Guernsey
Income derived from a banking business is taxable at 10%. A publicly regulated utility company is subject to tax at the rate of 20%.

In both Islands any income derived from the exploitation of property located in the Island is taxed at 20%.

Spats with the EU Code of Conduct

The 0/10 regimes have been reviewed by the Code Group and found not to be compliant with the Code of Conduct. Zero-rate initially was only available for non-residents (shareholder attribution measures).

CoC Group:
Betr.: Hochrangige Arbeitsgruppe Unternehmensbesteuerung am 17.4.2012 in Brüssel (Hauptstadtgruppe)

Die Gruppe folgte dem Vorschlag der KOM und stufte das Guernsey-Zero-Ten Corporate Tax Regime als schädlich im Sinne des Verhaltenskodex (Unternehmensbesteuerung) ein.

As a result of the CoC pressure, shareholder attribution has been abolished in Jersey and Guernsey.

Letterbox companies regime

Residency is easy to acquire in both of the islands :

- A company incorporated in Jersey or Guernsey is considered to be tax resident in Jersey or Guernsey by virtue of its incorporation.

- A company incorporated outside Guernsey or Jersey is considered to be tax resident in Guernsey or Jersey if its shareholder control is exercised by persons resident in Guernsey or if its management and control is exercised in Jersey

Both Jersey and Guernsey have an exempt company regime for collective investment schemes. Whilst collective investment schemes are subject to tax at 0%, the exempt company regime provides additional certainty that the tax neutrality of funds will be maintained.

Needless to say, that Jersey and Guernsey have all the other traditional features of tax havens :

- No withholding tax
- No tax on royalties, dividends, interest
- No capital gains tax

→ Finance accounts for almost half of the whole economic activity in the Channel Islands.

The Channel Islands have a negative record as regards three elements :

- corporate income tax
- residency rules
- financial institution hub (banks and trusts)

They are dodging behind their ambiguous legal and administrative status known as "Crown dependencies".
Notwithstanding, we have seen that thanks to the EU Code of conduct that they must comply with EU law and cannot enact harmful tax measures.

The EU Code of Conduct could have gone even further by banning the low corporate tax systems in place but did not take this opportunity.

3) Non-Dom rules (not for corporations, but for individuals)

A "non-dom" tax status is a peculiar British ruling whereby wealthy Britons with a foreign indication and foreigners with a permanent home in Britain, known as "non-domiciled residents", can choose whether to pay British taxes on their overseas earnings. It is a 200-year ruling and has never become a statutory rule. Thus, some of the regulations are quite strange, open to interpretation and do not match with internationally agreed principles of residency at all. The most important issue, which leads to a non-dom-status, is the foreign element of an individual with a permanent home in Britain. This may be a burial plot abroad, or a foreign stay of one of the ancestors of the taxpayer via the father's side.

With respect to harmful tax competition the following issues are important:
Foreigners who decide to have their permanent home in Britain may definitely opt for the non-dom-status.
They are not required to pay taxes on their foreign income if it is not remitted to Britain.
Instead, they are required to pay an annual charge of between Pound 30.000 and Pound 90.000.
The result is that the foreign income of non-doms is not subject to ordinary taxation in Britain. Other countries are precluded from taxing the income, because they base their taxation rights on internationally agreed tax principles such as a permanent home or habitual abode.
In addition, some, especially European countries, provide for reduced or zero source-tax rates, so that in the end, combined with the UK non-dom rules, big parts of the income of some rich individuals are not taxed at all.

There is OECD- and EU-agreement that tax rules are to be characterized as harmful, that provide for a preferential tax treatment of foreigners (so called ring-fencing). The effect of these rules is non-taxation of income of foreigners. However, there is no internationally agreement to apply this principle to tax rules for individuals so far. And Britain certainly contributes to this disagreement. If the figures of the April 11th Economist are right (page 14),

non-doms pay about Pound 8.4 billion in income taxes annually. This is a good reason for Britain not to change its non-dom rules.

However, the supposed tax damage of the non-dom rulings is extremely high, especially in the EU where a move to Britain is easily done. However, many other countries are affected, too. EU Member Countries should come to the agreement, that rules such as the non-doms damage their tax base and cannot be accepted in times of financial crisis. Countries with preferential rules such as Britain should be asked to remove them and should be given help to overcome possible budget problems. Otherwise it is most hypocritical of EU-Member Countries pledging to fight tax evasion, where they either offer harmful tax rules or accept to be effectively precluded from fighting tax evasion.
EU Member Countries should agree in unanimity that non-dom rulings favour few rich people only and are not fair at all.

On April 8th, the Labour Party has pledged to abolish the British preferential tax rules for non-domiciled individuals (non-doms), should it win the general election on May 7th. This long overdue move would be a big step towards equitable tax treatment of individuals, notably in the Common Market in Europe. If individuals had been included in the scope of the OECD's BEPS-project, the non-dom-rules would have certainly been characterized as unfair tax competition. The same would apply for the EU, where the unanimity rule for income tax rules has made it impossible to ask Britain for changes so far.

4) UK Patent box regime

The UK Patent Box had come under attack for its provision that allows companies to access the lower effective rates of UK corporation tax on profits derived from patents where the associated R&D activities were not undertaken in the UK. The UK tax relief environment for research and development is set to change as a result of OECD pressure to tighten up the rules, which means the Treasury now plans to withdraw the Patent Box relief.

On 11 November 2014 the German Finance Ministry announced an agreement with the UK on a modified version of the BEPS proposals. If this UK-German proposal were to be accepted by all 44 countries in the BEPS project, would that spell the end of patent boxes? Far from it.

In negotiations, the UK Treasury had originally suggested the use of a transfer pricing approach to decide what patent derived income could benefit from the UK patent box. It has now conceded that a nexus approach (with some modifications) should be used instead. This would mean that patent income received by a UK resident company could only fall within the patent box if it was directly linked to research and development (R&D) expenditure incurred by a company with ‘substantial economic activities’ in the UK.

However, the proposals allow for the R&D work to be outsourced and refer to ‘requiring the tax benefits [of the patent box] to be connected directly to R&D expenditures’. It seems that this potentially allows for the R&D work to be carried out overseas as long as it is the UK resident trading company that pays for it although there will be certain restrictions for connected party outsourcing.

David Gauke, financial secretary to the Treasury, said the compromise proposal adopts the main features of the modified nexus approach, but amends these in order to take account of previously expressed UK concerns. Gauke said: ‘The changes that the government has secured to the original approach proposed by the OECD will protect the interests of the UK as an excellent location for technology based businesses by retaining a competitive Patent Box regime, which will now align benefits more closely to R&D activity carried out in the UK.

’As such, the government is confident that the new regime will continue to incentivise innovation and its commercialisation in the UK.’

Criticism:
First, companies undertaking R&D in the UK will still be able to benefit from Patent Box tax incentives, even after the current regime is closed to new entrants in June 2016. Germany has accepted UK proposals for “grandfathering” the proposed changes, so that companies could join the scheme up to 2016, and continue to benefit until 2021 from a tax break that the UK government itself estimated costs the UK taxpayer £1.1 billion per year. This means that the UK will have to make significant changes to one of the corporate tax breaks George Osborne introduced only last year – though the changes only kick in after seven years.

Second, Germany has agreed to a 30% uplift of what counts as qualifying expenditure to cover related party acquisition and outsourcing expenditure. (So on qualifying expenditure of EUR 10 million, you can call it EUR 13 million for the purposes of the patent box regime.)

Third, although the joint UK-German statement promises the “closure and abolition of IP regimes”, this is untrue. The proposals will, instead, have the effect of regularising them. Countries which already have patent boxes would be expected to bring them into line with the new standards. At the same time, those that don’t will be under strong pressure to introduce their own. So expect plenty more patent boxes. Ireland and Switzerland have already said they intend to do so, and as we’ve noted, media reports suggested Germany itself is also looking to get in on the game.

Fourth, No indication was given that the 10% rate of tax on profits derived from patents will change; just a narrowing of eligible expenditure. So it is still worth planning to take advantage of the low rate of income tax.

5) Controlled Foreign Companies (CFC)

According to UK law, a CFC is a non-resident UK company that’s controlled by a UK resident person or persons.

According to CFC rules UK tax is charged on a UK company that controls a CFC on an amount equal to the taxable income of the CFC.

New rules in 2012
As part of the UK Government’s roadmap to make the UK’s tax system the most competitive in the G20, the controlled foreign companies (CFC) rules were rewritten in Finance Act 2012. The new rules apply to accounting periods beginning on or after 1 January 2013.

The new rules are wider in scope than their predecessor; all foreign companies that are UK controlled are now within the CFC regime, whereas the old CFC rules only applied where a foreign subsidiary’s corporate tax liability was less than 75% of the UK equivalent.

However, whilst the scope is wider, there are also a number of new exemptions available. The
new rules are also much more closely focused on the artificial diversion of profits from the UK, thereby providing greater opportunities for structuring activities offshore without these being subject to a CFC charge.

The new rules provide two types of exemptions:

• Entity level exemptions;
• Activity-based exemptions included within the ‘gateway’ provisions.

Entity level exemptions
The entity level exemptions from the previous regime are retained, but have been renamed and significantly redefined. However, they continue to operate by providing complete exemption from a CFC charge where the accompanying conditions are met. The 75% test referred to above, which previously determined whether the CFC rules applied, is now one of the exemptions that needs to be claimed.

The new entity level exemptions are:
• The tax exemption;
• The excluded territories exemption;
• The low profits exemption;
• The low profit margin exemption;
• The exempt period exemption.

Gateway provisions
The gateway provisions are entirely new and operate by testing the activities of a CFC and leaving only those profits which have been artificially diverted from the UK within the scope of a CFC charge. Thus, depending on the nature of the CFC’s activities, the gateway provisions can provide partial or even full exemption of a CFC’s profits. There is an initial gateway, which can exempt a CFC’s profits entirely if its conditions are met. If not, there are then five further gateways to test the CFC’s profits for diversion from the UK, as follows:

01 Profits attributable to UK significant people functions
02 Non-trading finance profits
03 Trading finance profits
04 Captive insurance business
05 Solo consolidation

Criticism on CFC rules:
Theoretically, CFC rules are measures that prevent the erosion of corporate tax base and profit shifting to tax havens. On the contrary, under the new UK rules, any company with overseas operations may now be able to pay lower rates of tax.

<u>“Safe harbours”</u>: exemption for specific finance profits (either the CFC’s finance profits are no more than 5% of its defined profits or the CFC’s finance profits arise from the investment of funds held for the purposes of an exempt trade or property business).

<u>Partial exemption: Where a CFC has qualifying loan relationships (loans made to connected foreign companies other than those made to UK permanent establishments, nonresident landlords or connected UK companies) only 25% of a company’s qualifying loan relationship profits may be apportioned to the UK. Ultimately, this results in an effective UK tax rate of 5%. As a result, the </u>use of UK holding companies might increase.

According to NGO ActionAid, UK tax cuts including the loosening of CFC rules may induce a £4 billion loss of tax revenue for developing countries annually.

There are no official data about active CFCs.

Strenghtening CFC rules is Action 3 of the BEPS OECD Plan = And yet, the UK are weakening the rules on some aspects (= addition of safe harbours, exemption for foreign finance companies..)

→ In our understanding, the UK strategy is the following :

- claim that they have indeed a set of CFC rules in their national law
- they have strenghtened it thanks to the 2012 Finance bill
- meanwhile they have actually loosened the rules making it easier for companies to be out of the scope of CFC rules.

6) Tax-dodging in the UK banking sector

Barclays, a British multinational banking and financial services company, is the 7th largest bank in the world.

The bank has been involved in huge aggressive tax planning schemes that have besmirched the UK financial sector as a whole.

What happenned exactly?

- In 2009, thanks to whistleblowers and journalists, it was discovered that Barclays designed and sold outrageously aggressive tax schemes through its so-called Structured Capital Markets (SCM) division.

- The most famous aggressive tax planning structure was the benefit of tax credits known as STARS deal.
  I.e. : it conceived and sold a scheme to its american customers (commercial banks) that consisted in "faking" taxation abroad so that they could claim a tax credit to the American tax administration (IRS) for bogus foreign tax charge.

- It is estimated that Barclays SCM division generated approximately £1 billion profit a year in structured tax planning.

→ This is likely to be the biggest scandal regarding tax avoidance in the banking sector.
The lack of true reaction from the UK authorities - a fine and a Code of good conduct in the banking sector - tends to demonstrate that they are not willing to shake up the industry.

7) Rulings

a) Advance Tax Rulings (ATR)

There is no general statutory system of advance rulings.
Although there is no formal system of advance rulings (or clearances from HMRC) in the UK, HMRC provides an extensive clearance service for business taxpayers.
Such non-statutory clearances provide taxpayers with HMRC's view of what is the correct tax treatment.
They do not strictly bind HMRC but HMRC would nonetheless often be obliged to honour them under the doctrine of legitimate expectations. Nonetheless, substantive protection of legitimate expectations by the UK courts has limits.

b) Advance Pricing Agreements (APA)

There is legislation (Taxation Act 2010) in force providing for advance pricing agreements.

Where a transaction affects another jurisdiction with which the United Kingdom has a tax treaty that includes a mutual agreement procedure, that jurisdiction is invited to participate.

The UK transfer pricing rules are said to be aligned with OECD principles.

With effect from 1 April 2004, the transfer pricing regime was extended to apply to thinly capitalized enterprises and to transactions between UK companies.

Exemption is available for small and medium-sized enterprises, as defined for EU purposes (Commission Recommendation 2003/361).

With effect from 4 March 2005, the regime extends to loans and other financing arrangements where any persons act together in relation to such arrangements (e.g. certain private equity transactions).

On 3 December 2014, the government announced that it would introduce legislation to implement the OECD model for country-by-country reporting.

8) Tax avoidance Counter measures

a. General anti-abuse rule (GAAR)

FA 2013 introduced a general anti-abuse rule (GAAR). This took effect from 17 July 2013. The GAAR is applicable to abusive arrangements undertaken on or after that date. The GAAR empowers HMRC to counteract "tax advantages" where these arise from abusive schemes.

"Tax advantage" is defined broadly, and includes the following results:
- relief (or increased relief) from tax;
- repayment (or increased repayment) of tax;
- avoidance or a reduction of a charge or an assessment to tax;
- avoidance of a possible assessment to tax;
- a deferral of a payment of tax;
- an advancement of a repayment of tax; and
- avoidance of an obligation to withhold or account for tax

HMRC has the burden of proof. HMRC must demonstrate that the entering into, or carrying out, of the particular transactions cannot reasonably be regarded as a reasonable course of action.

HMRC may also use the GAAR to counteract any tax advantages obtained through abuse of tax treaties.

b. "targeted anti-avoidance rules" (TAAR)s.

There are over 300 specific anti-avoidance rules in the UK tax legislation. These are referred to by as “targeted anti-avoidance rules” (TAAR)s.

There are also several anti-avoidance measures designed to counter specific tax advantages relating to capital gains.

c. Diverted profits tax

On 3 December 2014, the government announced the introduction of a “diverted profits tax”. The stated aim of this tax is to counter aggressive tax planning used by multinational enterprises to divert profits from the United Kingdom. The tax came into effect on 1 April 2015, and will be levied at a rate of 25% if a company aggressively avoids a permanent establishment in the UK or transactions are lacking economic substance.

HMRC’s guidance states there will be no formal statutory or non-statutory procedure available for the diverted profits tax, but that taxpayers may seek a written opinion from HMRC on the likelihood of a notice for the tax being issued.

d. Controlled Foreign Company (CFC) - See Point 5

FA 2012 brought about wholesale reform of the UK CFC rules. The legislation takes effect for accounting periods of CFCs beginning on or after 1 January 2013.
The CFC charge applies to UK-resident companies with certain prescribed interests in controlled foreign companies. The charge is computed by reference to the chargeable profits of the CFC.

9) The UK: the forefront slinger of any EU-level corporate tax reform

The UK is one of the few member-states that still echo the interest of tax dodgers. Officials have not taken a public stance on tackling harmful tax competition.

Quite the opposite : they surreptitiously attempt to nip in the bud any initiative or step towards a fairer corporate tax system whether it is from the EU institutions or the OECD or other Member-States.

Some piece of evidence :

- Mr. David Gauke, financial secretary to the Treasury recently declared at a conference, organised by the European Tax Policy Forum and Institute for Fiscal Studies (February 2015) that EU plans to fight tax avoidance is "an answer still looking for a question", that he does not see it applying to the UK and specifically on CCCTB "It is a proposal still looking for a justification."
And as the last straw, he publicly stated that his will "to maintain the most competitive business tax regime in the G20".

He also erred in saying that there were plans to introduce minimum corporate tax rates by the Commission for the latter has officially postponed such a plan, giving priority to a common tax base.

- Minutes of the 26 February 2015 meeting between the HM Treasury, HMRC and business interests lobbies and tax officers display exchanges full of wariness towards the BEPS project and the CCCTB.

Concerns were voiced on interest deductibility and the treatment of the banking sector.

On the CCCTB, members argued that the European Commission should work with the OECD BEPS project instead of "setting up processes". → This ought to be interpreted as a clear "no" to the Commission project and on CCCTB as a whole given that it is not explicitly envisaged in the OECD BEPS action plan (only CFC rules, permanent establishment and transfer-pricing framework and assessment) so rely solely on the BEPS action plan for a CC(C)TB amounts to smoke and mirrors.