The In-House Lawyer: Comparative Guides

United Kingdom: Tax

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This country-specific Q&A provides an overview to tax laws and regulations that may occur in the United Kingdom (UK).

It will cover witholding tax, transfer pricing, the OECD model, GAAR, tax disputes and an overview of the jurisdictional regulatory authorities.

This Q&A is part of the global guide to Tax. For a full list of jurisdictional Q&As visit http://www.inhouselawyer.co.uk/index.php/practice-areas/tax-2/

1. How often is tax law amended and what are the processes for such amendments?

An annual Finance Act is passed by the UK Parliament enacting substantive changes to tax law. In some years there may be more than one Finance Act. Procedural or administrative changes to tax law may be included in secondary legislation which may be passed at any time although there may be prior public consultation.

There is public consultation in relation to most substantive changes, often linked to the Autumn Statement of the Chancellor of the Exchequer. Draft clauses to be included in the next Finance Act are often published several months before the Act is introduced to Parliament to allow for comments. On occasion, however, changes are implemented without prior consultation.

2. What are the principal procedural obligations of a taxpayer, that is, the maintenance of records over what period and how regularly must it file a return or accounts?

The principal procedural obligation on a UK taxpayer is to file a tax return. Companies are required to provide self-assessments of their corporate tax liability on delivering the return. Returns must normally be filed within 12 months of the end of the accounting period for which the return is made.

Most employees pay their income tax through the employer company's payroll system and are therefore not required to submit a tax return. However, where an employee's tax affairs are complicated in some way (for example, by having a source of untaxed income) or where an individual is self-employed, that person is required to complete a tax return providing a self-assessment of any tax due.

3. **Who are the key regulatory authorities? How easy is it to deal with them and how long does it take to resolve standard issues?**

Her Majesty's Revenue and Customs (HMRC or the Revenue) is the regulatory authority for tax matters. 2015/16 surveys show mixed outcomes, varying according to customer segment. Outcomes from large businesses are generally positive with 82% saying that they had a good experience overall with HMRC. Outcomes from agents acting for small businesses and individuals were less positive with 62% finding HMRC to be approachable and only 26% being satisfied with time taken by the Department.

The resolution of disputes with HMRC, particularly if leading to litigation, tends to be a relatively lengthy process. In 2012, HMRC published a commentary on its litigation and settlement strategy (LSS), the aim behind which was to provide a mechanism for HMRC to settle disputes in a non-confrontational and collaborative way. However, in practice, HMRC often approach disputes in a litigious and uncompromising manner, particularly in cases where the revenue exposure is high. This means that a large number of tax disputes still proceed all the way to courts and tribunals.

4. **Are tax disputes capable of adjudication by a court, tribunal or body independent of the tax authority, and how long should a taxpayer expect such proceedings to take?**

The first instance tribunal for most tax disputes is the Tax Chamber of the First-tier Tribunal (FTT). The Upper Tribunal (UT) commonly deals with appeals from the FTT only on matters of law. However where the case is categorised as complex and where the UT and both parties consent, the UT may hear the case at first instance. A case requiring a hearing of less than a week will usually be heard by either tribunal within a year.

Certain types of claims must be brought in the High Court. For example, claims concerning public law matters are generally best brought by way of application for judicial review in the High Court. Cases in the High Court are unlikely to take longer than in the Tribunal.

Appeals from the Upper Tribunal and the High Court are to the Court of Appeal, then to the Supreme Court. In both instances, permission is required and appeals can only be made (except in extreme cases) on questions of law. Cases usually take around 18 months to complete in the Court of Appeal and two years in the Supreme Court. All tax tribunals and courts mentioned above are independent of HMRC.

5. **Are there set dates for payment of tax, provisionally or in arrears, and what happens with amounts of tax in dispute with the regulatory authority?**

For businesses with taxable profits of up to £1.5m, tax must be paid nine months and one day after the end of the accounting period. Where taxable profits exceed £1.5m, businesses must pay their tax in four equal installments spread over approximately 16 months after the end of a 12 month accounting period. The date for payment of self-assessed income tax is set at 31 January for the tax year ending in April the previous year.

It is possible on application to delay paying tax where the amount is in dispute. However, since 2014, in the case of tax avoidance schemes which are or should have been registered under the Disclosure of Tax Avoidance Schemes (DOTAS) rules HMRC has the power in certain circumstances to require payment of disputed tax in advance of ultimate resolution of the dispute. HMRC exercises the power to require prior payment by issuing an “Accelerated Payment Notice” or “Partner Payment Notice” (APN or PPN) depending on whether the scheme in question involved a partnership (sections 199-233 and Schedule 30-33 Finance Act 2014). The taxpayer has 90 days to object in writing, following which HMRC will confirm, withdraw or amend the notice. There is no right of appeal against the confirmation of an APN or PPN.

6. **Is taxpayer data recognised as highly confidential and adequately safeguarded against disclosure to third parties, including other parts of the Government?**

Section 18 of the Commissioners for Revenue and Customs Act 2005 (CRCA) imposes a duty on HMRC officials to ensure that taxpayer information is kept confidential. It is a criminal offence to contravene section 18 by disclosing information to a person whose identity is specified in the disclosure or can be deduced from it. The s18 duty is not absolute and it does not apply to a disclosure which "is made for the purposes of a function of the Revenue and Customs and does not contravene any restriction imposed by the commissioners"

A case of particular interest on this exception is R (Ingenious Media Holdings plc) and anor v The Commissioners for HMRC [2013] EWHC 3258 (Admin). Mr David Hartnett, the Permanent Secretary for Tax at HMRC, expressed views "off the record" to two journalists from The Times newspaper concerning films schemes and the involvement of Mr Patrick McKenna in the schemes. The Times published an article including statements from a 'senior revenue official' such as "we would like to recover lots of tax relief he's generated for himself and for other people". Ingenious and Mr McKenna brought proceedings inter alia for damages for breach of HMRC's statutory obligations of confidentiality. The High Court held that these disclosures were made for the purposes of a function of HMRC, meaning that they fell within the scope of the exception to the s18 duty. The decision has been appealed all the way to the Supreme Court and the decision is expected later this year.

7. **Is it a signatory (or does it propose to become a signatory) to the Common Reporting Standard? And/or does it maintain (or intend to maintain) a public Register of beneficial ownership?**

On 6 April 2016, Part 7 of the Small Business, Enterprise and Employment Act 2015 came into force providing that companies' annual returns to Companies House must from now on contain beneficial ownership details. These provisions require the directors or partners must take reasonable steps to find out if there are "persons with significant control" (PSC) over the company. A PSC is an individual who:

- owns more than 25% of the company's shares
- holds more than 25% of the company's voting rights
- holds the right to appoint or remove the majority of directors
- has the right to, or actually exercises significant influence or control
- holds the right to exercise or actually exercises significant control over a trust or company that meets any of the other 4 conditions.

Information of beneficial ownership of companies is now publicly available on the Companies House website.

8. **Are there any plans for the implementation of the OECD BEPs recommendations and if so, which ones?**

A considerable number of the OECD BEPs recommendations were, in effect, already reflected in the law of England and Wales. For example, in relation to Action 3 (Designing Effective Controlled Foreign Company Rules), the UK updated its CFC rules in 2013 and therefore further changes were deemed to be unnecessary at present. However, the UK is planning to implement a number of the OECD BEPs recommendations that are not already enshrined in law. For example, legislation designed to implement new rules relating to Actions 2 (Hybrid Mismatch Arrangements) and 4 (Base Erosion Involving Interest Deductions and Other Financial Payments) are likely to enter into force in early 2017.

9. Is there a GAAR and, if so, how is it applied?

A GAAR was introduced in the UK in 2013 and is intended to target abusive tax avoidance schemes. To determine whether a scheme should be counteracted, the question is whether there are abusive arrangements that give rise to a relevant tax advantage and it is reasonable to conclude that the tax advantage was the main purpose, or one of the main purposes, of the arrangements. The objective test for abuse is whether entering into the tax arrangements, or carrying them out, cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances. This is termed the double reasonableness test.

The Finance Act 2016 has introduced several new measures to bolster the GAAR in the UK. These include allowing HMRC to issue provisional counteraction notices within normal assessment time limits and the introduction of GAAR penalties of up to 60% of the counteracted tax.

It is HMRC's intention that the GAAR be applied initially by taxpayers themselves, through their own counteraction using self-assessment or in their accounts and adjusting any tax advantage on a just and reasonable basis. HMRC also has powers of counteraction and matters may therefore proceed to litigation to be decided by the courts.

To date there have been no reported decisions on the GAAR. It is noteworthy that notwithstanding the GAAR legislation is currently invariably implemented with its own targeted anti-avoidances rules (TAARs) so that the GAAR exists as a mechanism of final resort.

10. Does the tax system broadly follow the recognised OECD Model?

Does it have taxation of; a) business profits, b) employment income and pensions, c) VAT (or other indirect tax), d) savings income and royalties, e) income from land, f) capital gains, g) stamp and/or capital duties.

If so, what are the current rates and are they flat or graduated?

The UK does broadly follow the recognised OECD model of taxation. The current rates are as follows:

a. Corporation tax is at a flat rate of 20%. The corporation tax rate is planned to go down to 19% by 2017 and 17% by 2020 although there has been a change in government since those forecasts were made.

b. Personal income and pensions are taxed on a gradated basis – each band of income is taxed at a different rate:

- Personal allowance up to £11,000 – 0%
- Basic rate between £11,001 to £43,000 – 20%
- Higher rate between £43,001 to £150,000 – 40%
- Additional rate over £150,000 – 45%

c. VAT is set at a flat rate of 20%, although some goods are subject to a reduced of 5% or a zero rate (such as children's car seats or children's clothes)

d. If your total taxable income is £17,000 or less, no tax is paid on savings income. Otherwise the tax free allowance on savings depends on the tax bracket into which the taxpayer falls. Domestic UK law imposes a 20% royalty withholding tax on limited types of payment and on specific categories of intellectual property.

e. Income from land will generally be added to an individual's overall taxable income in a given year and is therefore taxed on the same basis as income from other sources (see b above).

f. The tax free allowance on capital gains is £11,100. Higher and additional rate taxpayers pay 28% on gains from residential property and 20% on gains from other chargeable assets. Basic rate taxpayers generally pay at a lower rate, but this depends on the size of the capital gain.

g. Stamp Duty Land Tax is a tax on the purchase of a property. The first £125,000 for the purchase price of the property is tax free and following bands of the purchase price are taxed rates of 2%, 5%, 10% and 12%. Stamp Duty Reserve Tax (SDRT) is a tax on the purchase of shares. The SDRT rate is 0.5% and is automatically imposed where shares are purchased electronically and imposed on transactions over £1,000 were purchased using a stock transfer form.

11. Is the charge to business tax levied on, broadly, the revenue profits of a business as computed according to the principles of commercial accountancy?

Yes. Corporation tax in the UK is a tax on profits. Taxable profits include the money the company or association makes from doing business ('trading profits'), investments and selling assets for more than they cost ('chargeable gains').

12. Are different vehicles for carrying on business, such as companies, partnerships, trusts, etc, recognised as taxable entities?

Companies, partnerships and trusts are treated as different taxable entities. In contrast to a company, a conventional partnership is not a legal entity and does not exist separately from its members. Tax on partnership profits is not a joint liability of the partnership. Rather, each partner is taxed on their individual share of profits. The profits of a Limited Liability Partnership ('LLP') are taxed in an almost identical manner.

Trusts can attract income tax, capital gains tax or inheritance tax. The tax payable and the person responsible for ensuring the tax is paid largely depends upon the type of trust. For example, in the case of an accumulation or discretionary trust, the trustees are responsible for paying tax on income received. In the case of a bare trust, the beneficiary is responsible for declaring and paying tax on the trust's income.

13. Is liability to business taxation based upon a concepts of fiscal residence or registration?

Yes. The UK observes the principle of territoriality: it taxes the worldwide profits of its residents and the UK profits of non-residents. There are two tests for determining whether a company is resident for tax purposes in the UK: (1) the incorporation test (the process is also referred to broadly as company registration), or (2) the central management and control test. A company will automatically be resident in the UK for tax purposes if it is incorporated in the UK, unless it has to be treated as resident in another country under the tie breaker provisions of a double tax treaty. For companies incorporated outside the UK, they will be deemed UK tax resident if they are centrally managed and controlled in the UK.

14. Are there any special taxation regimes, such as enterprise zones or favourable tax regimes for financial services or co-ordination centres, etc?

Perhaps the most innovative special tax regime in the UK in recent times was the introduction of enterprise zones. Established in 2012, enterprise zones are designated areas across England that provide tax breaks and government support. Examples of the benefits that may be available to businesses located in an enterprise zone are 100% enhanced capital allowances, government support to ensure superfast broadband throughout the zone and up to 100% business rate discount worth up to £275,000 per business over a 5-year period. The aims of the regime are to attract foreign investment into the country and to deliver long-term, sustainable growth across England. After early success, more enterprise zones are planned to be in place by April 2017.

15. Are there any particular tax regimes applicable to intellectual property, such as patent box?

The Patent Box enables UK companies to apply a lower rate of corporation tax to profits earned after 1 April 2013 from its patented inventions. The patent box regime was designed to attract companies with intellectual property overseas to choose the UK as a jurisdiction in which to develop the asset. Following OECD concerns that Patent Box was open to abuse, the UK government committed to making changes to the regime. In particular, it is no longer possible to use the standard method of calculating the percentage of taxable profits that could benefit from the regime. Instead, only profits derived from research and development activities carried out by the company will be allowed in a claim.

16. Is fiscal consolidation employed or a recognition of groups of corporates for tax purposes and are there any jurisdictional limitations on what can constitute a group for tax purposes? Is a group contribution system employed or how can losses be relieved across group companies otherwise?

The UK does not provide for fiscal consolidation of company groups. Each company within a corporate group must pay corporation tax on profits. However, group relief, which allows certain types of loss of one group member to be surrendered to another, is available. Any amount of trading losses, non-trading loan relationship deficits and excess capital allowances may be surrendered and do not need to be used first by the loss-making company. However, all other current-year losses (such as property business losses, qualifying charitable donations) can only be surrendered as group relief to the extent that they exceed the surrendering company's other profits in the accounting period.

17. Is there a CFC or Thin Cap regime?

The UK CFC regime is based on rules designed to prevent diversion of UK profits to low tax territories. Where UK profits are diverted to a CFC, those profits are apportioned and charged on a UK corporate interest-holder that holds at least a 25% interest in the CFC. There are a number of exemptions to reflect the fact that the majority of CFCs are established for genuine commercial reasons.

The Finance Act 2004 abolished the separate thin capitalisation requirements that had existed previously and subsumed them within the general transfer pricing rules in the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010).

18. Is there a transfer pricing regime and is it possible to obtain an advance pricing agreement?

The UK transfer pricing (TP) regime is contained in Parts 4 and 5 of TIOPA 2010. The UK TP regime must be considered in light of the recently implemented Diverted Profits Tax (DPT) rules, which were introduced by the Finance Act 2015. There is also an advanced pricing agreement (APA) programme through which unilateral, bilateral and multilateral APAs can be obtained. The process by which such an agreement can be obtained is detailed in HMRC's Statement of Practice 2/2010. HMRC will determine the taxpayer's DPT position before agreeing to an APA.

As a result of the Starbucks and Apple decisions, any business which has secured a favourable APA in the EU could, potentially, be at risk of having those arrangements reviewed under the State Aid rules and be faced with having to make significant payments to repay tax benefits received under APAs that, allegedly, do not comply with State Aid rules. The UK has made no formal reaction to the Starbucks and Apple decisions. It is anticipated that APAs will generally be more difficult to obtain until the ECJ has ruled upon those cases.

19. Are there any withholding taxes?

There is no withholding tax (WHT) on dividends paid by UK companies, save for a 20% WHT applied to certain dividends paid in respect of income profits and capital gains of a UK real estate investment trust. Interest and royalties are subject to a 20% WHT unless the rate is reduced under a double tax treaty or exempt under the Interest and Royalties Directive.

In *Coal Staff Superannuation Scheme Trustees Limited v Commissioners for Her Majesty's Revenue & Customs* [2016] UKFTT 450 (TC), the tax tribunal held that EU law allowed HMRC to charge UK withholding tax on manufactured overseas dividends owned by a pension fund when it did not charge an equivalent tax on manufactured dividends in relation to UK shares. According to the Tribunal, this regime did not breach Art. 63 TFEU. Even if the regime did involve a restriction on the free movement of capital, it was justified for reasons of fiscal cohesion.

20. Are there any recognised environmental taxes payable by businesses?

Yes. The UK imposes a Climate Change Levy (CCL) on industrial, commercial, agricultural businesses and public services on electricity, gas and solid fuels. Businesses can get a reduction on the rate of CCL if the business has entered into a climate change agreement with the Environment Agency. There are two further environmental taxes of note:

a. A tax on top of normal landfill fees if the business gets rid of waste using landfill sites

b. A tax on sand, gravel and rock that has either been dug from the ground or dredged from the sea in UK waters or imported.

21. Is dividend income received from resident and/or non-resident companies exempt from tax? If not how is it taxed?

Until 2009 where a UK company received a dividend from a UK company the income was exempt from tax however dividends received from non-resident companies were taxed with credit for any foreign withholding tax and tax on the underlying profits. Following adverse rulings from the ECJ, in 2009 the UK introduced a general exemption system. UK and non-UK source dividends and other distributions received by a UK company or a UK permanent establishment are subject to corporation tax unless the distribution falls within a number of exemptions. The exemptions are drafted broadly such that their overall effect is to exempt all dividends from corporation tax unless they fall within certain anti-avoidance provisions called Targeted Anti-Avoidance Rules (TAARs). TAARS include rules that, for example, prevent the artificial transfer of value out of a company resulting from either an intra-group asset transfer otherwise than at market value or the payment of a dividend out of artificial profits.