UK tax: evolution over the last ten years

How things have changed.

At the beginning of the last decade attitudes to company taxation in the UK had already begun to change. The corporation tax rate, stable at around 30% for most of the previous decade, had just begun its downwards trajectory to what looks like being the low water mark, its current rate of 19%. At the same time, the ability of companies to manage the rate they actually paid had already begun to come under scrutiny. The story of the first half of the decade was a lower rate, but one which needed to be paid. The UK introduced a general anti-avoidance rule in 2013, which could come as a surprise to the political parties which currently have a GAAR in their manifestos. This made a point of specifically disavowing some old tax cases which were used to justify tax avoidance, most famously Lord Tomlin from the Duke of Westminster case in 1936: 'Every man is entitled if he can to order his affairs so that the tax attracted under the appropriate Act is less than it otherwise would be.' Attitudes also shifted among the judiciary and HMRC has been able to claim a very high success rate in cases where it argued tax avoidance. While political parties routinely make up the numbers by identifying billions to be collected by closing down unspecified tax avoidance schemes, experience on the ground at the end of 2019 is that it is extremely rare to see a company contemplating entering into a tax avoidance scheme.

Meanwhile, in the first half of the decade, on the international front, the UK, following the plan set out in the 2010 corporate tax road map, focused on enhancing the international competitiveness of the tax system, looking to attract and maintain companies that had begun to move their headquarters abroad. The main plank was to continue the UK's move to a territorial tax system by reforming the UK's controlled foreign company rules. The UK would only seek to top-up tax on profits earned by non-UK subsidiaries of UK companies where those profits had artificially been diverted from the UK. Combined with the distribution exemption and the substantial shareholdings exemption, this meant that MNEs could headquarter in the UK and pay very little corporation tax. In the middle of the decade, this led to some US companies 'inverting' to the UK, until US rules changed to prevent this. The roadmap also confirmed the UK's proud adherence to the principle that interest should remain deductible in full in line with the accounts for tax purposes.

In the second half of the decade, the focus on avoidance, enhanced by whistle-blowing leaks such as the Panama Papers, brought scrutiny on the arrangements adopted by 'tech giants'. This meant looking at the way in which tax systems interacted with one another and the gaps that could arise as a result of different transactions or entities being treated differently. Arrangements such as the 'double Dutch' or the 'Irish sandwich' became infamous. The extraordinary achievement of the OECD's base erosion and profit shifting project, in which the UK played a prominent part, was to identify and address these issues and build a reasonable degree of consensus as to how to address them. These changes are ongoing and are just entering arguably their most ambitious phase, with rules aimed at the digital economy looking set to change fundamental principles as to the allocation of taxing rights among jurisdictions and effectively curtail jurisdictions' ability to compete for business by maintaining very low tax rates. Unfortunately, this type of seismic change brings significant uncertainty as to how the new rules will be applied in even simple situations. The new trend in UK tax law is to tax by legislation and untax by guidance; however, there are still only limited instances of the courts applying the same leeway to the taxpayer as is afforded to the authorities to argue by reference to the purpose of the rules.

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From the UK perspective, an important aspect of these international changes was to impose significant limits on the deductibility of interest, hitherto sacrosanct. Combined with domestic changes such as loss relief restriction, erosion of capital allowances and relief for amortisation of intangibles and the imposition of capital gains tax on non-residents investing in UK real estate, this has significantly widened the UK tax base.

The final trend that is worth highlighting relates to tax and good citizenship. This goes well beyond the attitude to tax avoidance described above. The UK authorities have been very keen to bring tax to the boardroom and to change the mindset that tax is just a cost to be managed. Further there are a number of rules, most notably the corporate criminal offence of failure to prevent facilitation of tax evasion, but also to the collection and sharing of account holder information pursuant to the OECD's common reporting standard and led by the US's FATCA, that require businesses to take an active interest in the tax affairs of others they interact with. Large UK businesses are required to publish and be accountable for their tax strategy and businesses' tax affairs are critically evaluated by the growing ranks of environmental, social and governance (ESG) investors.

My hope for this decade would be that having reached consensus on the digital economy, there would be a significant pause in changes to UK tax rules to allow businesses, advisers and tax authorities to adjust to the new tax rules (and to adjust the rules themselves where they are not working) and reprioritise certainty. However, that is not a prediction. ■

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DAC 6 update

Key points from the UK's final regulations implementing DAC 6.

On 13 January 2020 the final UK regulations for the implementation of the EU Directive on Administrative Cooperation in the field of taxation (DAC 6) were issued alongside HMRC's official response to the consultation previously published in July 2019. The regulations come into force on 1 July 2020 and aim to ensure that HMRC is provided with early information about cross-border arrangements which contain certain features, or 'hallmarks', which the EU view as representing potentially aggressive tax planning.

The final regulations follow the release of draft regulations and the aforementioned consultation process, key themes of which were the potential for duplicate reporting, how the regulations will apply in instances of legal professional privilege, the penalty regime, and a general desire for further guidance on when an arrangement might be reportable and by whom. A number of queries around the impact of Brexit were also raised.

The main updates to the regulations (The International Tax Enforcement

(Disclosable Arrangements) Regulations, SI 2020/25) and HMRC's official response to the consultation (available at bit.ly/30XZrMk) are discussed below.

- **Overall reduction in territorial scope:** The regulations introduce new definitions of 'UK intermediary' and 'UK relevant taxpayer' to ensure that the rules do not apply to intermediaries without a connection to the UK. This is in line with the intention of DAC 6 and should, in principle, reduce the overall reporting burden.
- **Territorial scope of 'tax advantage':** The regulations have been amended in order to limit the territorial scope of tax advantages to those relating to taxes within the scope of DAC 6, i.e. direct taxes arising in EU member states. However, in determining whether an EU tax advantage has arisen, arrangements may still need to be looked at as a whole which could in turn require non-EU tax advantages to be considered.

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- **Elimination of duplicate reporting:** Although HMRC has acknowledged that some duplicate reporting of arrangements is inevitable, the regulations have been amended to ensure that the same intermediary does not have an obligation to report in multiple jurisdictions. In addition, HMRC has advised that its guidance will seek to reduce duplicate reporting in other circumstances. For example, secondary intermediaries (i.e. service providers) may essentially be able to assume that a report filed by a primary intermediary (i.e. promoter) includes all of the information that they would need to report, as long as they have evidence that such a report was made.
- **Legal professional privilege (LPP):** The regulations have been amended to ensure a disclosure that would breach LPP does not have to be made. In line with DAC 6, the obligation to report should in principle be passed on to another intermediary or relevant taxpayer to whom LPP does not apply.
- **Penalties and governance:** There is a fixed penalty of £5,000 for failure to comply in many cases, and daily penalties of £600 which should in principle only be charged in the instance of a serious failing, such as where the behaviour leading to the failure was deliberate. Penalties may be cancelled if there is a reasonable excuse. The possibility for the tribunal to increase penalties up to £1m remains.
- **Brexit:** The final regulations do not directly take account of the fact that the UK should soon cease to be a member state of the EU. However, in the consultation response HMRC has confirmed that, under the terms of the Withdrawal Agreement, the UK is legally obliged to implement DAC 6 prior to the date that the UK leaves and during the subsequent implementation period. It remains to be seen how this might change, given the uncertainty surrounding the precise nature of the UK's future relationship with the EU. ■

Janette Wilkinson, KPMG (KPMG's Tax Matters Digest)

Will entrepreneurs' relief be abolished?

Described as the worst tax relief in the UK, entrepreneurs' relief is an anachronism in a country which prides itself on ensuring that every tax relief is underpinned by a robust policy objective. Will it survive the chancellor's Budget on 11 March 2020?

The general purpose of encouraging entrepreneurship has been vague since entrepreneurs' relief (ER) was introduced. Its origins lie in rushed-through legislation introduced by Alistair Darling in 2008. This followed an outcry at the abolition of taper relief, previously available to business owners on the sale of business assets. Taper relief had in turn replaced retirement relief. Such a muddled genealogy is not conducive to the development of a well thought-through, policy-based tax system.

Mr Darling did his best, promising that ER would 'represent significant help to a lot of small businesses' at a cost of around £200m a year. By contrast, it is estimated that the cost of the relief now exceeds £2.4bn annually with the benefit heavily skewed towards owners of large businesses.

Critics, a group which includes bodies as diverse as the Association of Accounting Technicians, the Institute for Fiscal Studies and the Resolution Foundation, express concern that there is little or no evidence that ER encourages entrepreneurialism. While there is some debate about that, the very structure of the relief leaves it open to the criticism that it does nothing whatsoever to foster serial entrepreneurialism.

Faced with growing calls to reduce tax breaks for the wealthy, it would be a simple matter for the government to scrap ER. However, this would not accord well with the post-Brexit messages that the UK is open for business, that entrepreneurial businesses are the backbone of the UK economy and that innovation is the way forward.

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I therefore expect to see ER changed into a form of rollover relief, with qualifying gains sheltered to the extent that related proceeds are reinvested in a further qualifying business within a defined period of time. Gains not reinvested after, say, three or five years would be subject to capital gains tax. This would also apply to gains when the entrepreneur finally cashed-up. With losses available to be offset against other gains during the entrepreneur's business lifetime, there would be a certain policy logic in charging non-reinvested gains at the prevailing capital gains tax rate. Whether some of those gains should be taxed at a reduced rate is a question of political optics. ■

George Bull, RSM UK (RSM UK's Weekly Tax Brief)