International Tax

United Kingdom Tax Alert

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2014 Autumn Statement contains BEPS measures

Contacts

Bill Dodwell
bdodwell@deloitte.co.uk

Christie Buck
cbuck@deloitte.co.uk

Alison Lobb
alobb@deloitte.co.uk

The UK Chancellor delivered the 2014 Autumn Statement on 3 December 2014. The Chancellor was able to give this year's statement with the UK set to post a very strong 3% growth rate in FY14, with levels of public debt falling, and a corporation tax rate that will drop to 20% from 1 April 2015, making it the lowest in the G20. The Chancellor made it clear that protecting and maintaining this economic momentum is the key to the 2014 statement, and this is reflected in the areas of focus.

The Chancellor also reaffirmed the UK government's continued support for the OECD's work on base erosion and profit shifting (BEPS) and the modernization of the international framework for taxing multinational companies. The Chancellor announced a consultation process on new rules to counter "hybrid mismatches" (arrangements where a multinational can claim a tax deduction in one country without equivalent taxable income in another country). An announcement also was made with respect to country-by-country reporting of information to tax authorities. A surprise measure is the introduction of a "diverted profits tax."

On 10 December, the government will release for comment draft legislation intended to be included in the Finance Bill 2015. The draft legislation will contain details of some of the measures announced in the Autumn Statement.

The key measures for multinational groups are summarized below. For detailed coverage and comment on all of the announcements in the Autumn Statement, visit Deloitte's dedicated website at www.ukbudget.com.

Countering tax avoidance

The Autumn Statement includes measures aimed at countering perceived tax avoidance, the latest in a wider package of anti-avoidance measures announced in recent years.

Country-by-country reporting for transfer pricing purposes: As widely anticipated, the Chancellor announced that the UK intends to introduce legislation in Finance Bill 2015 that will enable the UK to implement the country-by-country reporting as set out in the OECD paper published in September 2014 as part of its BEPS project. The new rules would require UK multinational groups to provide high level information to the UK tax authorities (HMRC) on their global allocation of profits and taxes paid, along with indicators of economic activity in a country. (The announcement does not make reference to wider transfer pricing documentation proposals under Action 13 of the OECD's BEPS Action Plan in relation to a master file and local file approach.)

The OECD will finalize the key question of how the country-by-country template will be filed and shared with other tax authorities in early 2015. In addition, the OECD also is considering whether the requirements will apply only to "large" multinationals (not yet defined). The UK government expects that legislation will be introduced internationally with effect from 1 January 2016, for reporting in 2017.

***Hybrid mismatch arrangements*:** As expected, the Chancellor announced that the government will consult on the implementation of the recommendations set out in the OECD BEPS paper on hybrid mismatch arrangements published in September 2014. The consultation document was released on 3 December and the consultation period will close on 11 February 2015.

The consultation proposes rules intended to neutralize the tax advantage arising from payments under hybrid mismatch arrangements that otherwise would give rise to:

- A tax deduction in the payer country without a corresponding inclusion in ordinary income in the hands of the payee ("Deduction/No Inclusion" (D/NI) outcome); and
- Double tax deductions for the same payment ("Double Deduction" (D/D) outcome).

The UK proposes two rules to neutralize the tax advantage arising from hybrid mismatch arrangements:

Rule A – A primary rule that would:

- Deny a deduction for a payment by a UK corporate taxpayer under a hybrid mismatch arrangement where there is a D/NI outcome; and/or
- Deny the deduction in a UK parent in the case of a D/D outcome under a hybrid mismatch arrangement.

Rule B – A defensive rule that would apply where either:

- A UK corporate taxpayer is the recipient of income under a hybrid mismatch arrangement and the counterparty jurisdiction has not implemented appropriate anti-hybrid rules in line with the OECD's proposals. In such circumstances, the payment would be included as ordinary income in the hands of the UK payee; and/or
- A UK corporate taxpayer is the payer in a hybrid mismatch arrangement that gives rise to a D/D outcome. In such circumstances, the deduction would be denied in the hands of the UK corporate taxpayer if the parent jurisdiction has not implemented appropriate anti-hybrid rules in line with the OECD's proposals.

These rules are intended to apply to payments made under direct and indirect hybrid mismatch arrangements and also would apply to both related party arrangements and structured arrangements between unrelated parties. In contrast to current UK legislation, the proposed rules would not include a purpose or motive condition.

The proposed rules closely resemble the proposals put forward by the OECD, although it is notable that the UK's proposals would apply to both cross-border and intra-UK hybrid mismatch arrangements. In practice, mismatches are less likely to arise in the latter context, although we would expect this approach to result in an additional compliance burden for UK groups.

The government has provided additional clarity with respect to arrangements that are not intended to fall within the scope of the proposed rules, including:

- Timing mismatches where the mismatch unwinds within a "reasonable" period of time, where "reasonable" is considered to be within five years;
- Mismatches that arise as a result of differences in the respective rates of tax in different jurisdictions; and
- Payments that are deemed to be made only for tax purposes and do not result in the creation of economic rights between the two parties (for example, notional interest deductions on equity capital).

The proposed rules would apply only to corporation tax, and with respect to payments made on or after 1 January 2017.

It is worth noting that the OECD announced that it will develop its own commentary on the recommendations set out in its September paper, which it intends to issue by September 2015. Clearly, the UK government will need to manage the interaction of its own consultation process with the OECD commentary.

***Diverted profits tax*:** A new tax, known as the "diverted profits tax," would be introduced as from 1 April 2015 to counter the use of what is considered to be aggressive tax planning by multinational groups in order to divert profits from the UK. The proposed tax would be targeted at "complex structures" between connected parties that have been entered into to achieve a tax advantage and will seek to tax diverted profits at a rate of 25%. The Chancellor specifically referred to technology groups when announcing this measure, but there is no indication that the tax would apply only to specific industries. No further detail is available on structures that would fall within the scope of the diverted profits tax or on the amount of profits to which the tax would be applied. More details are expected on 10 December.

Utilization of tax loss carryforwards by banks: The amount of profits generated by banks that can be offset by loss carryforwards is to be restricted. From 1 April 2015, banks would be able to offset only 50% of their relevant profits with carried forward losses that have accrued up to that date. Currently, there is no such restriction. This stems from a concern that many banks would not be tax paying for many years owing to losses incurred during the financial crisis. The rule will not apply to new market entrants post-2010.

Innovation

***R&D relief*:** The R&D incentives available to both large and small and medium-sized (SME) companies would be increased for expenditure incurred from 1 April 2015. The taxable credit available to companies claiming under the large company (or "above the line") regime would be increased from 10% to 11%, providing an after-tax benefit of 8.8% of qualifying R&D expenditure. The uplift rate for the SME relief would be increased from 225% to 230%, providing a benefit of 26% of qualifying expenditure. (The large company super-deduction regime will remain unchanged.) There also would be a tightening of the definition of qualifying expenditure, such that relief would not be available in respect of the cost of materials incorporated into products sold to third parties. More detail will be provided in draft legislation.

***Creative sector tax reliefs*:** Building on the wide range of reliefs already available for the creative sector, there would be a further consultation on the high-end television tax relief, in addition to proposals for new reliefs targeted specifically at children's television programs (from April 2015) and orchestral productions (from April 2016).

Employment taxes

While the headline rates of personal tax remain unchanged, the Chancellor reiterated the commitments made as part of the 2014 budget to simplify the employer administration of employee benefits and expenses. The following would apply as from 6 April 2015:

- A statutory exemption would be granted for trivial benefits in kind costing less than GBP 50;
- The GBP 8,500 threshold below which employees do not pay income tax on certain benefits in kind would be abolished and replaced with limited new exemptions; and
- Certain reimbursed expenses would be exempt and a statutory framework for voluntary payrolling would be introduced.

These simplification measures will be included in Finance Bill 2015 and should ~~be~~ broadly be welcomed by employers. However, more detail is anticipated on the scope of the proposed new exemptions and the statutory framework for voluntary payrolling of taxable benefits and expenses.

Other items

***Repeal of late paid interest rules*:** The Chancellor had announced as part of the 2013 budget that there would be a wide scale review of corporate debt legislation. This review is ongoing, but one initial outcome is that many parts of the late paid interest rules in relation to loans and deeply discounted bonds are to be repealed with effect from 3 December 2014. Loans or bonds entered into before that date will be subject to the repeal of these provisions on interest or finance expense arising on or after 1 January 2016. However, if there are major changes to the loan after 3 December 2014 and before 31 December 2015, the repeal will apply from the date of those changes.

***Stamp duty/stamp duty land tax reform*:** The Chancellor announced a sweeping reform of the UK stamp duty land tax provisions in relation to UK residential property. The Chancellor announced that the government will bring forward to 2015 a new stamp duty charge at 0.5% where a company is acquired through a share capital reduction by way of a scheme or arrangement. The government considers that the reduction in the amount subject to stamp duty has contributed to the increasing popularity of such capital reductions.

Consortium relief: A relaxation of the consortium relief provisions has been proposed, such that there would no longer be a restriction on the location of the "link company" where existing legislation stipulates that this company must be a UK company. This is likely to extend the scope of this relief to groups that had not previously qualified on the basis that their link company was not UK resident. The change follows the decision of the Court of Justice of the European Union in April 2014, which in effect decided that the current legislation was not consistent with EU law.

Taxpayer interaction with HMRC: The Autumn Statement includes details of some changes to the ways taxpayers may interact with HMRC. The government will consult on measures to allow HMRC to conclude inquiries more swiftly by closing agreed points while other points can remain open. In addition, HMRC is trialing measures that will give mid-sized businesses access to expertise within HMRC, particularly during periods of key business change. Both measures are likely to be welcomed by business as helpful developments in their interaction with HMRC.

Comments

It is encouraging that the foreword to the hybrids consultation paper reconfirms the UK government's commitment to creating the most competitive tax environment in the G20. However, if implemented, the UK proposals on hybrids would impact many common financing structures and would significantly affect many multinational groups with UK operations, not least because the UK tax treatment of cross-border transactions would become dependent on the tax treatment in other countries, regardless of whether those transactions are tax motivated. It seems inevitable that some additional compliance burden would arise.

In light of the complexity of the proposed rules, business will welcome the consultation period and the further opportunity to comment on draft legislation in due course. It also is welcome that the UK has indicated that the consultation responses will inform its input into the forthcoming OECD commentary on hybrid mismatches.

While the hybrid proposals provide greater clarity on the UK government's intended approach, it is important that business takes the opportunity to engage with the UK government throughout the consultation process, given the potential complexity of the proposals and the impact for corporate taxpayers. It also is important that the development and impact of the anti-hybrid proposals are considered by business in light of proposals in other areas, e.g. the remaining BEPS actions, law changes in other countries and other measures announced in the 2014 Autumn Statement.

The country-by-country reporting announcements indicate the UK government's desire to see this aspect of the OECD's work implemented swiftly, as part of the agenda to ensure transparency between taxpayers and governments. The practical implications of gathering and reporting data by country have been widely discussed but the 3 December announcement makes it clear that UK multinationals will need to prepare in 2015, particularly to ensure that their systems and data can produce the details required.

Further details of the proposed diverted profits tax are expected. It is somewhat surprising that the UK government is not waiting for the OECD to complete its work in relation to modernization of the international tax framework, and any changes will need to comply with the UK's tax treaty obligations.