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PREFACE

This is the ninth edition of *Global Legal Insights – Corporate Tax*. It represents the views of a group of leading tax practitioners from around the world.

One consistent trend across each jurisdiction is the impact of the COVID-19 pandemic, which has created once-in-a-generation pressures on tax revenues and the capacity of tax administrations. Coinciding with the continuing evolution of international tax rules, tax professionals continue to be challenged both from a technical and a compliance perspective. The long-term impact of the lockdown restrictions and the fiscal measures taken by governments worldwide remain to be seen; however, it is likely that tax policy will play an important role in revitalising the global economy.

We have also seen the OECD Inclusive Framework reach a consensus on taxation of the digital economy. The Biden government had recently re-committed the US to the Pillar I and Pillar II process, and this proved crucial in ensuring that an agreement was reached. Further details on implementation are expected in October 2021.

Authors were invited to offer their own perspective on the tax topics of interest in their own jurisdictions, explaining technical developments as well as any trends in tax policy. The aim is to provide tax directors, advisers and revenue authorities with analysis and comment on the chosen jurisdictions. I would like to thank each of the authors for their excellent contributions.

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Overview of corporate tax work over last year

Significant deals and themes

The following statistics reflect the position as at April 2021.

*Mergers & Acquisitions ("**M&A**")*

The value of outward M&A in 2020 was £15.2 billion, which is lower than the total outward M&A value in 2019 (£21.9 billion) and the lowest recorded since 2010 (£12.4 billion) and significantly lower than the £77.5 billion value recorded in 2017. The total value of inward M&A in 2020 was £16.3 billion compared to £55.5 billion in 2019. The lower values of outward and inward M&A transactions can be explained by fewer higher value acquisitions compared to recent years.

The total value for domestic M&A during 2020 was £10.8 billion, an increase compared to 2019 (£9 billion). This increase can be explained by the completion of more larger value domestic M&A transactions. Year-on-year comparison also shows that the value of completed domestic M&A during 2020 was still lower than levels in 2017 and 2018, when the value was £18.9 billion and £27.7 billion, respectively. One notable domestic M&A transaction that took place in 2020 was RWS Holdings plc of the UK, which acquired SDL plc. The majority of the outward M&A deals in 2020 (70.2%) came from the Americas (34.9%) and Europe (34.3%). This is lower when compared with the area analysis reported in 2019. The majority of total inward M&A deals in 2020 (90.1%) came from Europe (43.2%) and the Americas (46.9%). The European figure is the second-highest proportion of the annual totals since 2011. However, the Americas figure is lower than in 2019.[1]

Financing

London IPO proceeds were £6 billion in 2020, which is in line with the £5.9 billion in 2019. THG Holdings plc was the largest IPO to list in 2020, raising £2,041 million of capital. This was followed by Conduit plc, which raised £909 million.[2]

*Transfer pricing and diverted profits tax ("**DPT**")*

HM Revenue & Customs ("**HMRC**") approximated that the annual amount of additional actual tax secured from transfer pricing challenges increased from £1,169 million in 2018/2019 to £1,454 million in 2019/2020.[3] In addition, the DPT yield figures published by HMRC have increased from 2018/2019 (£12 million) to 2019/2020 (£17 million).[4] HMRC stated that the figures reflect the net amount received as a result of HMRC issuing DPT charging notices that are not repaid. HMRC also noted that in previous years, an amount was included in the DPT yield equating to additional corporation tax arising from transfer pricing enquiries as a result of behavioural change relating to the DPT. Due to the close

association between DPT and transfer pricing enquiries, HMRC stated that they now "no longer consider this subdivision of transfer pricing yield to be appropriate" and will report on the additional corporation tax relating to behavioural change in the wider figure for transfer pricing yield.

Key developments affecting corporate tax law and practice

The below section on UK tax law developments reflects a summary of the key developments in 2020/early 2021 (reflecting the position as of 22 May 2021), but it is not a comprehensive or detailed discussion of all tax measures in the past year.

Budget 2021

Proposed future increase in corporation tax rates

While not taking immediate effect, one of the most significant changes to the UK corporation tax landscape this year was the announcement (as part of the 2021 Budget in March this year) that the UK corporation tax rate will increase to 25% from April 2023 on profits over £250,000. A "small profits" rate, applying to profits of under £50,000, will be introduced, and will remain at 19%, while businesses with profits between £50,000 and £250,000 will benefit from reliefs, so that they pay less than the 25% rate. The DPT rate would correspondingly increase to 31% from April 2023.

Changes to the UK hybrid mismatch rules

In 2017, the UK introduced legislation to combat cross-border tax advantages arising from hybrid mismatches (the "**Regime**") – giving effect to (and in some cases, going beyond) the OECD's recommendations to address such mismatches. In very high-level terms, the Regime disallows deductions in respect of certain types of payment giving rise to a deduction in one jurisdiction without the income being brought into account in another jurisdiction (a so-called "deduction/non-inclusion" mismatch) or a deduction in more than one jurisdiction (a so-called "double deduction" mismatch), if (in either case) it is reasonable to suppose that the mismatch arises from certain kinds of hybridity (subject to the application of certain "assumptions" that must be applied). Broadly, the payments subject to the Regime are those between certain related parties or made under an arrangement that splits the economic benefit from, or that it is reasonable to suppose was designed to achieve, the hybrid mismatch. The Regime is considered complex, running to over 100 pages of legislation and 600 pages of guidance, and is capable of denying tax relief in some circumstances lacking any economic mischief. In spring 2020, the UK launched a public consultation regarding potential changes to the rules, and legislation has been published in Finance (No.2) Bill 2021 ("**Finance Bill 2021**") proposing changes to the Regime:

Changes to dual inclusion income rule: Deductions that would otherwise be subject to disallowance will not be if they are deducted from "dual inclusion income" (being, broadly, income that is brought into account by both the payer and the investor in the payer). The proposals broaden the circumstances where this exclusion may apply:

- *Surrender of excess dual inclusion income*: First (subject to making a claim to HMRC), the proposals contemplate that, from 1 January 2021, "surplus" dual inclusion income in one entity could be surrendered to another member of the same group.
- *Dual inclusion income*: Second, it is proposed that the definition of dual inclusion income be widened to include income that is fully taxed but not subject to any corresponding deduction in any territory (e.g. where payments are made from a US parent to a subsidiary that is checked open for US tax purposes). Though it had been suggested that this change would have mandatory retrospective effect, taxpayers can

elect as to whether to apply this change retrospectively, or only from the date that Finance Bill 2021 takes effect.

Changes to scope of illegitimate overseas deductions: Provisions denying UK deductions for "illegitimate overseas deductions" (payments in respect of which a double deduction is available that are not set against UK taxable income) would be narrowed, to deny relief only where a person other than the UK taxpayer payee or its investors obtains relief in respect of the payment outside the UK.

Changes to definition of hybrid entity: Many aspects of the Regime only apply if either the payer or the payee is a hybrid entity. Currently, an entity is a hybrid entity if, taking into account all jurisdictions, it is treated as transparent in one jurisdiction and opaque in any other (irrespective of whether the entity has any nexus to the jurisdictions resulting in this hybridity). The proposals contemplate that whether an entity is a hybrid entity would be tested by reference to whether it was opaque/transparent in the jurisdictions in which it is established and its investors are resident. However, HMRC subsequently announced that the proposals had "unintended consequences" (having inadvertently removed reverse hybrids from the scope of the Regime), and that changes to the definition of hybrid entity would be postponed to next year's Finance Bill (but given retrospective effect to 2017).

*Changes for minority investors in collective investment vehicles ("**CIVs**")*:

- In determining whether a payment between a payee and payer is a related-party payment within the scope of the Regime, the interests of persons "acting together" are aggregated – increasing the likelihood that payments to or from persons acting together are subject to the Regime. In the context of CIVs (such as fund vehicles), investors are often considered to act together for this purpose. Under the proposals, when applying the "acting together" rules, no account will be taken of persons with a direct or indirect equity stake in a paying entity no greater than 5% (by reference to votes and economic entitlement).
- Counteractions will not be applied to the extent they arise in respect of any investor holding less than 10% of a partnership that is (for UK regulatory purposes) a collective investment scheme or alternative investment fund.

Temporary extension to loss carry-back

For companies and unincorporated businesses, Finance Bill 2021 provides for a temporary extension to the carry back of trading losses (from one year to three years), for losses up to £2 million per 12-month period. If enacted, this would have effect for companies with accounting periods ending between 1 April 2020 and 31 March 2022 and for the tax years 2020–21 and 2021–22 for unincorporated businesses.

There will be no limits on the carry back of losses to the immediately preceding taxable period. However, thereafter, quantitative limits will apply: carried back losses will be prevented from being offset against profits of more than £2 million. For corporation taxpayers, this limit will apply on a group basis.

Super-deduction

To encourage capital expenditure, Finance Bill 2021 makes provision for a temporary "super-deduction" against corporation tax for expenditure incurred on plant or machinery. In some instances, the tax relief available may exceed the amount of expenditure. Broadly, corporation taxpayers would benefit from:

- capital allowances equal to 50% of expenditure in the year of expenditure for expenditure that would otherwise qualify for the 6% special rate writing down allowance (including expenditure on "integral features" and items with a long life); and

- a 130% super-deduction for expenditure that would normally qualify for the 18% main rate writing down allowances (being all other plant and machinery qualifying for capital allowances).

The relief is subject to anti-avoidance rules and exclusions and limitations, including provisions precluding relief for expenditure:

a. incurred before 1 April 2021 or after 1 April 2023 (or incurred under contracts entered into prior to 3 March 2021);
b. on plant or machinery that is second-hand; and/or
c. on plant or machinery used wholly or partly for the purposes of a ring-fenced trade (e.g. oil and gas).

The relief applies in addition to the Annual Investment Allowance, which provides a 100% first-year deduction for capital allowances of up to £1 million (having been increased from £200,000 until 31 December 2021) – provided that the same expenditure cannot benefit from both the super-deduction and the Annual Investment Allowance.

Other domestic legislative changes

Off-payroll working rules take effect

The so-called "off-payroll working rules" ("**IR35**") apply where persons working through their own personal service company ("**PSC**") would be employees if engaged directly. They are designed to ensure that such arrangements do not benefit from any saving in employment income tax and national insurance contributions. Though IR35 originally only applied to persons working in the public sector, draft legislation published in July 2019 extended its scope to those engaged by large and medium-sized private sector businesses. This expansion in scope was due to come into effect on 6 April 2020 but was delayed until 6 April 2021 because of the COVID-19 pandemic.

The changes shift the responsibility of operating payroll withholding and reporting in respect of the individual from the PSC to the business engaging the PSC. In addition, businesses engaging PSCs will be required to determine whether each individual engaged via the PSC would be an employee if he or she was engaged directly.

Changes to the scope of UK DAC 6 reporting

DAC 6 requires UK intermediaries (or failing which, taxpayers) to report, and HMRC to exchange, information regarding cross-border arrangements that meet one or more specified characteristics (hallmarks) and which concern at least one EU country. Under the Free Trade Agreement agreed between the UK and the EU on 24 December 2020 (the "**FTA**"), the UK is only required to ensure that any legislation it implements at the end of the Brexit transition period, relating to the exchange of information concerning potential cross-border tax planning, offers the level of protection provided for in the "*standards and rules which have been agreed in the OECD…*". Accordingly, on 31 December 2020, the scope of UK legislation implementing DAC 6 was narrowed, in line with the OECD's Mandatory Disclosure Rules ("**MDR**").

As a result, only cross-border arrangements (i.e. those concerning the UK and an EU Member State) that fall within "hallmark D" of DAC 6 will be reportable to HMRC. Broadly, this captures any arrangement that either: (i) has the effect of undermining reporting obligations under agreements for the automatic exchange of information (e.g. the OECD's Common Reporting Standards; or (ii) involves non-transparent legal or beneficial ownership chains that: (a) do not carry on a substantive economic activity; (b) are incorporated, managed, resident, controlled or established in any jurisdiction other than the

jurisdiction of residence of one or more of the beneficial owners of the assets held by such persons, legal arrangements or structures; and (c) have unidentifiable beneficial owners. The narrower reporting obligation also applies to arrangements from before 31 December 2020. However, arrangements to which UK taxpayers are subject that fall within the scope of hallmarks A to C and E may nevertheless be reportable to EU tax authorities.

The government intends to consult, later this year, on amendments to replace the above legislation with new legislation implementing the MDR in the UK. Given the similarities between the current legislation and the MDR, it not clear whether this will have a substantive impact on the scope of reporting in the short term.

Improvements to input VAT of suppliers of financial services outside the UK recovery

Generally, in order to obtain full recovery of input VAT incurred on costs, either: (a) the relevant costs must be directly related to the provision of taxable supplies; or (b) the costs must form part of general overheads (and may be only partially recoverable to the extent the taxpayer makes exempt supplies). Financial services are generally exempt for UK VAT purposes and input VAT incurred in connection therewith is generally irrecoverable. However, since the end of the Brexit transition period on 31 December 2020, suppliers of financial and insurance services outside of the UK have benefitted from new rules improving their VAT recovery position and can now recover input VAT incurred on: (i) financial and insurance services supplied to customers belonging outside the UK (including to persons belonging in the EU) or directly related to an export of goods; or (ii) the making of arrangements for these supplies.

Change to VAT treatment of termination and damages payments

HMRC has changed its view on the VAT treatment of early termination and damages payments. Previously such payments were considered compensation payments outside the scope of VAT. In September, HMRC announced that such payments would, with retrospective effect, be treated as consideration for the original supply contracted for. In January 2021, however, HMRC announced that the change in treatment would apply from a "future date". Until further guidance is issued, HMRC has clarified that businesses may (i) treat payments as consideration for a supply and therefore as subject to VAT, or (ii) regard the payments as outside the scope of VAT (if that is how they were treated before the September announcement).

Possible changes to UK stamp duty procedures

UK stamp duty is a "voluntary tax" payable on the transfer of stock and other market securities. The charge is not strictly limited to transfers of stock and securities of UK companies. However, as transfers of shares in UK companies cannot be registered (and legal title cannot accordingly be transferred) until the instrument effecting the transfer (typically a stock transfer form) has been "stamped", this is the paradigm scenario in which the charge applies. "Stamping" is typically an analogue process, requiring the instrument of transfer to be posted to HMRC, a physical stamp affixed to the instrument of transfer once HMRC was satisfied that the duty had been paid, and the stamped instrument posted back to the taxpayer or its advisers. The process typically takes approximately six to eight weeks, and generally requires sellers to give a power of attorney to buyers (so that buyers can exercise their voting rights in respect of the shares and take other actions in respect of them) pending registration of the transfer.

Procedures have been relaxed during the COVID-19 pandemic, as HMRC staff could not typically access its offices. Since March 2020, HMRC has accepted, via email, instruments

of transfer signed electronically, or PDF copies. Instead of physically stamping the instrument (once HMRC is satisfied that stamp duty has been paid), HMRC has provided taxpayers with a letter of acknowledgment directing registrars that the register of the company transferred can be updated to reflect the change of shareholder. While the process still generally takes four to six weeks, the changes have been widely welcomed, and HMRC issued a consultation in the summer of 2020 about modernising the stamping process, and potentially putting the measures on a permanent footing. While HMRC has yet to make an announcement to that effect, guidance first published in March 2020 to explain the above-mentioned change in procedure was updated in April 2021, to remove references to "temporary measures" in place "during the pandemic", and instead refer to "new measures".

UK consultations about potential changes

Prior to the introduction of material changes to UK tax rules, HMRC often engages in a consultation exercise with stakeholders. Key consultations launched in the course of 2020/ early 2021 are described below, while further information about significant consultations on asset holding companies ("**AHCs**") and the regulatory and tax framework applying to funds is described in "*Industry sector focus*" below.

Notification of uncertain tax treatments for large businesses

Following an initial consultation in spring/summer 2020, the UK government published a second consultation[5] in March 2021 regarding proposals to require large businesses to notify HMRC where they have adopted an uncertain tax treatment. Notably, original proposals defined "uncertainty" by reference to the likelihood of HMRC, rather than the courts, disagreeing with the position taken. The proposals were met with criticism, and the implementation of the new mandatory reporting regime was delayed by 12 months.

The second consultation, which closes on 1 June, attempts to address past concerns with a range of more objective triggers for notification, including where the income, corporation or VAT position of the taxpayer: (a) results from an interpretation that is different from HMRC's known position; (b) was arrived at other than in accordance with known and established industry practice; (c) departs from the position taken in a past return (other than as a result of a change in law or change in HMRC's position); (d) has been the subject of professional advice that has not been followed (or that contradicts other advice received or has not been followed; (e) results in a deduction greater than the related economic loss; (f) has resulted in a provision in the accounts (in recognition of a possible different treatment applying); or (g) is in some way novel such that it cannot reasonably be regarded as certain. HMRC is seeking input on these proposed triggers, as well as exclusions (such as a proposed £5 million materiality threshold) and penalties for breach.

Transfer pricing documentation

In March 2021, the UK government launched a consultation about proposals to bolster transfer pricing record-keeping obligations.[6] Currently, businesses are required to keep sufficient records to deliver complete and accurate tax returns, but the form of such records is not prescribed. The proposals, which would generally apply to large businesses only, contemplate new obligations to: (a) keep transfer pricing information in a standardised format; (b) provide such information to HMRC promptly upon request; and (c) provide a supplemental schedule to the annual corporation tax return, setting out information about material cross-border transactions with associated entities (albeit that this latter requirement may be subject to materiality thresholds). In addition, businesses that are part of a group that is subject to country-by-country reporting obligations (in any jurisdiction) would be required to provide HMRC with a copy of the master and local file within 30 days of request.

Consultation by Office of Tax Simplification on possible alignment of capital gains tax and income tax

In November 2020, the UK's Office of Tax Simplification (an independent office tasked with examining ways to resolve complexities within the UK tax system and making related proposals for the Chancellor's consideration) published its first report on potential changes to the UK capital gains tax regime.[7] While the second part of the report was generally expected to be published in spring this year, it has not yet been made available. The report focused on the tax treatment of individuals, and made 11 recommendations. The most fundamental recommendation was to address the disparity between rates of capital gains tax (20%, with carried interest subject to 28%) and income tax (from 20% to 45% for higher income earners), which was highlighted as one of the main sources of complexity in the area of individual taxation (as tax planning to achieve capital characterisation has spawned a raft of targeting anti-avoidance rules). Whether such proposals will be adopted is a matter of political decision-making for the government.

Domestic case law

In 2020 and early 2021, the UK tax courts provided further colour on some frequent sources of UK tax uncertainty: the disallowance of interest expense under the so-called "unallowable purposes rule" and UK transfer pricing rules (in *Blackrock HoldCo 5 LLC v HMRC*); the practical application of the "central management and control" ("**CMC**") test for determining residence (in *HMRC v Development Securities*); the meaning of "ordinary share capital" for UK tax purposes (in *HMRC v Warshaw*); the interaction of domestic law with double tax treaties (in *Fowler v HMRC*); and the application of the "*Ramsay*" line of anti-avoidance cases (in *Dunsby v HMRC*).

Blackrock HoldCo 5 LLC v HMRC [2020] UKFTT 443 (TC)

This case concerned the disallowance by HMRC of deductions in respect of interest payable by the taxpayer on loan notes issued to its parent company on two grounds:

- *The "unallowable purposes rule"*: This is an anti-avoidance provision that, broadly, denies deductions for loan-related expenses "on a just and reasonable basis" to the extent attributable to a taxpayer's (subjective) non-business/commercial purpose in being party to the underlying loan relationship (including where (one of) the taxpayer's main purpose(s) is to obtain a tax advantage for the taxpayer or any other person). The taxpayer was found to have both a commercial and tax purpose in issuing the notes, but the latter was not considered to have increased deductions beyond what would otherwise have been claimed (due to its commercial purposes). Accordingly, the first-tier tribunal (the "**FTT**", being the court of first instance) held that it was "just and reasonable" to attribute all the taxpayer's deductible interest expense to the (allowable) commercial main purpose (with the effect that no disallowance arose).
- *Transfer pricing*: In considering whether the loan notes were on arm's length terms, the FTT concluded that in a third-party context, the taxpayer could have borrowed the same amount on the same interest rate (albeit subject to stricter financial covenants). Accordingly, a transfer pricing adjustment was not required.

HMRC v Development Securities plc [2020] EWCA Civ 1705

Three Jersey-incorporated companies were party to tax-planning arrangements, the effectiveness of which relied on them being tax-resident in Jersey – in turn requiring their CMC to be located in Jersey. The CMC test generally looks to where high-level executive decisions are made (including policy and strategy). The question was whether decisions in respect of the companies were taken by: (a) the (largely Jersey-based) board of

the companies (meeting in Jersey); or (b) their UK tax-resident parent (and merely rubber stamped by the Jersey board). The UK Court of Appeal considered that it was the latter, noting "*the question is not why the directors made the decision they did, or how much thought they gave to it, or what they did or did not take, or should or should not have taken, into account. The question is a much simpler one, namely: did they make the decision?.... [Here,] the directors regarded themselves as in effect instructed [by the parent] to [take a particular course of action] on the basis that [the parent] certified that it was for the group's benefit, and without discussing or considering the benefit for themselves*". While the question of where CMC is exercised is highly fact-sensitive, the case highlights that the location of board meetings is not the only factor to be taken into account in establishing where CMC is exercised, and that taxpayers must also ask *who* is making decisions.

HMRC v Warshaw [2020] UKUT 366 (TCC)

For UK tax purposes, the question of whether a security is "ordinary share capital" is relevant in a number of contexts, including for the purposes of establishing an entitlement to group relief, the UK's participation exemption for capital gains (the "substantial shareholding exemption") and "business asset disposal relief" ("**BADR**") (formerly "entrepreneur's relief"), which, if it applies, reduces the tax rate on capital gains to a lower (10%) rate. For BADR purposes, "ordinary share capital" means "*all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits*". In *Warshaw*, the UK's Upper Tribunal (the "**UT**", an arm of the UK High Court) considered whether cumulative preference shares came within scope of the definition. Specifically, the terms of the shares provided that if there were insufficient reserves to pay dividends (calculated at 10% of the share subscription price) in a particular year, payment would be deferred to a subsequent year and the unpaid dividend added to the amount subject to the 10% fixed dividend. HMRC argued that the share could not be ordinary share capital, because it provided for a fixed (10%) *rate* of dividend. The UT found that: (a) for a share not to be ordinary share capital, the rate, and the amount to which it applied, must be fixed; and (b) the share here was "ordinary share capital", because its terms contemplated that the amount of the dividend could vary (even if, in particular years, the dividend was paid on time and there was no compounding).

Fowler v HMRC [2020] UKSC 22

The *Fowler* case highlights the potentially limited effect of domestic deeming provisions in an international context. The UK Supreme Court held that certain deeming provisions in UK domestic legislation (which re-characterised employment income as trading income) did not apply for the purposes of the double treaty (specially, the allocation of taxing rights thereunder). This was on the basis that the purpose of the deeming provisions was not to alter the meaning of terms for the purposes of double tax treaties between the UK and other states.

Dunsby v HMRC [2020] UKFTT 0271 (TC)

The "*Ramsay* doctrine" is a line of UK anti-avoidance case law. Historically, the doctrine was viewed as empowering courts to re-characterise transactions by ignoring steps lacking any (non-tax avoidance) purpose. More recently, however, it has been reformulated as a principle of statutory construction, requiring courts to ask whether "*the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically*" (the "**statutory interpretation approach**"). In *Dunsby*, the taxpayer took

part in a (multi-part) tax-avoidance arrangement. HMRC, relying on the historic approach to the *Ramsay* doctrine, argued that certain steps in the arrangement should be ignored on the basis that they lacked commercial purpose. However, the FTT dismissed HMRC's approach as "*going too far*" and reiterated that the statutory interpretation approach was the correct one. The case serves as a reminder of the limits of the *Ramsay* doctrine.

EU/OECD tax developments

The below is a summary of the key EU and OECD developments in 2020 and early 2021 (reflecting the position as of April 2021). It is not intended to be a comprehensive or detailed discussion of all measures introduced or proposed in the last year.

EU/UK Social Security Protocol

EU social security regulations generally prevent internationally mobile workers from paying social security contributions in more than one EU Member State, with tax usually paid in the Member State in which the work is performed. The regulations provide for limited exceptions where work is carried on in more than one Member State or a worker resident in one Member State is seconded to an employer in another for a period of no more than two years (so-called "detached workers", who are required to pay contributions in their jurisdiction of residence). At the end of the Brexit transition period on 31 December 2020, existing arrangements will continue to be subject to the EU regulations for "so long as the [existing arrangements involving the UK taxpayer] continue without interruption". New arrangements, however, will be subject to a new Social Security Protocol (the "**Protocol**") agreed between the UK and the EU in the FTA. The Protocol largely replicates the existing position under the EU regulations, subject to minor differences: there is no ability to extend "detached worker" status where a secondment continues for more than two years; and EU Member States can opt out of the Protocol at a month's notice, creating a degree of uncertainty. Separate (broadly similar) cooperation agreements exist between the UK and EEA countries (Iceland, Norway, Lichtenstein and Switzerland).

EU consultation on the VAT treatment of financial services

In early 2021, the European Commission (the "**EC**") launched a public consultation on the VAT rules applying to the supply of financial and insurance services. Such supplies are generally exempt for VAT purposes, and while this makes the cost of the supplies more competitive to customers, it restricts the ability of financial and insurance businesses to recover their input VAT. The EC is particularly concerned: (a) that the VAT rules in this area may not have kept step with increasingly sophisticated financial products; (b) with the piecemeal nature in which the law has developed through case law, and the resultant absence of a coherent uniting policy decision; and (c) about the inconsistent implementation of the rules across Member States. In light of the recent changes to the recovery position of UK-based financial businesses (discussed above), the EU is also likely to be keen to maintain competitiveness for EU-based finance businesses.

The consultation puts forward alternatives for addressing these concerns – each involving a trade-off between the benefit of greater simplicity, and policy concerns about increasing costs for consumers. Proposals include the possibility of: (a) removing the VAT exemption entirely for financial and insurance supplies, with VAT charged at the standard rate, or alternatively, reduced rates; (b) limiting the scope of exempt financial and insurance supplies; (c) granting businesses the option to tax financial and insurance supplies; and (d) reinstating financial and insurance businesses' flexibility to address irrecoverability through VAT group and cost-sharing groups (mechanisms that have, in recent years, been curtailed[8] or removed for financial services providers,[9] respectively).

EC digital levy

As part of the EC's plans for generating additional "own resources", it launched a public consultation in early 2021 regarding proposals for an EU-wide turnover tax on digital businesses (with draft legislation expected to follow later this year). The consultation contemplated different options for addressing the taxation of certain digital activities carried on in the EU: (a) a corporate income top-up tax payable by companies conducting certain digital activities in the EU; (b) a tax on revenues created by certain digital activities conducted in the EU; or (c) a tax on business-to-business digital transactions in the EU. The consultation specifically noted that digital levy is not intended to interfere with BEPS Pillar I proposals (discussed below). However, given the degree of cross-over between the subject matter, the proposal may serve the dual purpose of increasing pressure on the OECD to broker global consensus, while (if enacted) stemming and reversing unliteral measures by EU Member States (and the resulting risk of double taxation) in the interim.

BEPS

BEPS 2.0 update

In October 2020, the OECD's Inclusive Framework (the "**IF**") released blueprints for its Pillar I and Pillar II initiatives – addressing, respectively, (a) new nexus rules for the taxation of the digital economy, and (b) "top-up tax" mechanics to achieve an effective international minimum tax rate. The blueprints are technical documents, which largely do not address key issues of political disagreement (most significant among them the reluctance of jurisdictions in which major tech businesses are resident, such as the US, to share taxing rights, and agreement regarding the level at which a minimum global tax rate would be set).

Pillar I focuses on the allocation of taxing rights (rather than the tax base itself). It seeks to redistribute taxing rights in respect of certain supplies away from traditional taxing jurisdictions (i.e. jurisdiction of residence or in which permanent establishments are based) in favour of so-called "market jurisdictions" (i.e. jurisdictions into which a group's "in-scope" services and products are supplied and/or its users are located). Significantly, while proposals originally targeted a limited category of automated digital services (such as social media platforms, online search engines and cloud computing businesses), they are now more broadly aimed at "consumer-facing" services (with exemptions proposed for certain industries, such as the financial and extractive industries). The proposals have drawn criticism for: (a) their complexity – allocating "excess" taxable profits (i.e. profits above a yet-to-be-determined agreed level) to market jurisdictions based on highly mechanic rules, rather than principle; and (b) the risk of double taxation, due to the potential for disagreement among the larger number of jurisdictions to which taxable income will need to be allocated (despite proposals for novel "dispute prevention mechanics", which many felt did not offer a practical solution).

Various jurisdictions (including the UK, France, Austria, Hungary, Italy and Turkey, as well as the EU) have implemented or have put forward proposals for digital services taxes to address the taxation of the digital economy, putting pressure on the OECD to reach consensus. However, resistance from the US (where many of the businesses likely to be subject to the proposals are resident) has stalled progress at the political level.

In contrast, Pillar II (also referred to as the "Global Anti-Base Erosion" or "GloBE" proposal) seeks to increase, rather than reallocate, the amount of tax payable internationally. Broadly, parent companies whose subsidiaries are taxed below a new "global minimum

tax rate" (which has not yet been agreed between IF members) would be given the right to impose a "top-up" tax payable at the parent level and withholding taxes would be imposed on payments to low-tax jurisdictions (in each case with corresponding changes to double tax treaties to facilitate the new taxing rights). Significantly, the blueprint: (a) contemplated that subsidiaries' effective tax rate would be calculated on a jurisdiction-by-jurisdiction basis, rather than applying a global "blending" calculation – significantly increasing the compliance burden; and (b) uses the financial accounts (rather than the actual tax liabilities of group members) as a starting point – creating concern for taxpayers in industries (such as financial services and insurance) where permanent differences between the "accounting" taxable profits and the tax actually paid could create distortions. The blueprint also considers difficulties arising from the interaction of the proposals with the US' global intangible low-taxed income rule.

While the OECD has announced its intention to reach consensus about the IF on all outstanding issues in the course of 2021, it remains to be seen whether this is achievable. Despite hopes that a change of the US administration would reinvigorate political discussions, comments from the Biden Administration, advocating a minimum 21% global tax rate (and suggesting that its support for Pillar I is likely to be contingent thereon), indicate that there are significant differences to be bridged.

BEPS 1.0 update

In 2020 and early 2021, the UK continued to tweak its implementation of the BEPS Actions 1 to 15 (so-called BEPS 1.0):

- *Action 1 – Addressing the tax challenges of the digital economy*: As trailed in last year's update, with effect from 1 April 2020, a 2% digital services tax took effect, levying tax on the revenues of search engines, social media services and online marketplaces that derive value from UK users.
- *Action 2 – Hybrids*: The UK hybrids legislation has had effect since 1 January 2017. As discussed above, draft legislation was published to make a number of changes to the hybrid and other mismatches regime, including broadening the scope of dual inclusion income and amending the definition of "acting together".
- *Action 4 – Interest deductions*: Legislation took effect in 2020 to make minor technical and administrative amendments to the UK's corporate interest restriction rules ("**CIR**"), to: (a) clarify the manner in which the rules apply to real estate investment trust ("**REIT**") groups comprising non-UK-resident entities with both UK property business that is, since April 2020, subject to UK corporation tax and residual income subject to UK income; and (b) disapply penalties arising from the late filing of CIR returns (as is the case for corporation tax returns).
- *Action 13 – Transfer pricing documentation and country-by-country reporting*: The UK is party to the automatic exchange of country-by-country reports, and as of March 2021, has activated 64 exchange relationships. On 23 March 2021, the government published a new consultation to seek views on the clarifying and strengthening of UK transfer pricing documentation requirements (as to which, see further above).

Developments affecting attractiveness of the UK for holding companies

Repeal of the Interest and Royalties Directive

The EU Interest and Royalties Directive (the "**IRD**") prevents Member States from levying withholding tax on intra-group payments of interest and royalties where the payer

and the payee are resident for tax purposes in EU Member States. At the end of the Brexit transition period, legislation implementing the IRD in EU Member States ceased to apply to payments to the UK. As a result, since 31 December, intra-group interest and royalties paid between UK- and (a) Italian-resident companies has generally been subject to withholding tax of at least 10% and 8%, respectively, and (b) Portuguese-resident companies has generally been subject to withholding tax of at least 10% and 5%, respectively (in each case subject to any domestic reliefs).

In contrast, prior to the end of the Brexit transition period, the UK enacted legislation providing that (unless repealed) UK legislation deriving from the EU would continue in effect, notwithstanding the end of the Brexit transition period – with the result that UK withholding tax did not apply on payments of interest and royalties from the UK to the EU Member States. Pursuant to Finance Bill 2021, however, the UK proposes to repeal UK laws implementing the IRD, with effect from 1 June 2021. As a result, recipients of intra-group payments of royalties and interest (other than interest on debts that were not, when incurred, expected to remain outstanding for more than one year) from UK-resident companies to recipients in EU Member States will, *prima facie*, be subject to withholding tax at 20%. While the UK has double tax treaties with all EU Member States (where relief is available), not all treaties provide for withholding to be reduced to nil (e.g. the UK/Malta treaty reduces withholding tax on both interest and royalties to 10%, the UK/Polish treaty reduces withholding on royalties to 5% and, as mentioned above, the UK/Portugal treaty reduces withholding tax on interest and royalties to 10% and 5%, respectively).

Industry sector focus

Funds

The UK government launched a number of consultations as part of its aim to make the UK a more attractive location to establish, administer and manage funds. Given the trend within the funds industry to accumulate activities (including fund AHCs) in a single jurisdiction (with a view to meeting ever more stringent substance requirements for tax purposes), it is helpful that the UK government is taking a comprehensive and coordinated approach to its review. The scope of the review also provides opportunity for relatively sweeping changes, rather than incremental tinkering and/or tweaks. However, it remains to be seen whether the UK government is willing to go far enough, in offering incentives that materially improve upon the well-established fund regimes in Luxembourg and Ireland, to challenge the *status quo* for funds locating fund activities in those jurisdictions.

Consultation on the tax treatment of AHCs in alternative investment fund structures

During 2020, the UK government consulted on potential changes to the UK tax treatment of AHCs, with a view to making the UK a more competitive location for entities through which funds investment occurs (and ultimately, as a location for fund management generally). A consultation in March 2020 identified issues specific to particular kinds of fund:

- *Credit funds*: The disallowance of deductions for results-dependent interest and the relative narrowness of the UK's securitisation regime (which, at a high level, taxes loan securitisation vehicles on a *de minimis* retained margin).
- *Real estate funds*: Restrictions that limit the UK's participation exemption for capital gains to trading groups, and impose relatively stringent conditions to accessing the specific UK tax regime for real estate investment funds (discussed in further detail below).

- *Private equity*: The absence of flexibility as to whether proceeds from disposals of underlying assets are returned to investors in income or capital form. (Inflexibilities in UK corporate law mechanics were also identified as a potential issue, given that the characterisation of payments for tax purposes is generally determined by their characterisation for UK corporate law purposes.)

The government collected stakeholder input over the course of the summer, and launched a further consultation in December 2020,[10] setting out proposals for a new ring-fenced regime for the taxation of AHCs. The consultation addressed proposals for:

- *Eligibility criteria for the new regime*: The new regime is intended to apply to the use of AHCs "in structures where capital from diverse or institutional investors is pooled and managed by an independent, regulated or authorised asset manager in which the AHC plays an intermediate, facilitative role". Through the consultation, the government is seeking feedback on precise eligibility criteria, including whether (and if so, how) eligibility criteria should be based on the character and activities of the AHC and/or those of its investors. Significantly, HMRC has not given a clear policy statement as to who it considers should benefit from the regime.
- *AHC taxation at a level "proportionate for its intermediary role"*: UK-resident holding companies do not generally pay tax on dividend income, the UK does not impose withholding tax on dividends, and it is proposed that the AHC would be granted exemption from withholding tax on interest paid to investors. However, it is not proposed that the AHC would be fully exempt from tax, so as not to prevent the AHC from accessing benefits under the UK's double tax treaty network (e.g. in respect of potential withholding taxes that may be levied in other jurisdictions on payments to the AHC from other). Difficult questions remain as to whether/how complex rules like the UK hybrid mismatch rules (discussed above) and transfer pricing rules, which are likely to lead to significant compliance costs and burdens, should apply to AHCs (and in particular, whether disapplication of such rules may fall foul of the UK's state aid obligations under the FTA).
- *Taxation of investors*: The AHC rules are intended to operate so that, in the hands of UK taxpaying investors, returns derived from: (a) disposals by the AHC are taxed as capital; and (b) sums that are income or in nature in the AHC's hands, as income. However, proposals for how this would be achieved under existing rules contemplate complex tracing requirements, which are unlikely to be practical in a fund context. Moreover, the proposals do not take account of the nature of returns for non-UK taxpayers (in respect of which flexibility may be limited by UK company law).

Wider funds review

In January 2021, the government published a call for tax (as well as regulatory and other) input as part of its broader review of the UK funds regime.[11] The review addresses areas particularly relevant to UK asset managers and fund administrators. In addition to addressing barriers to the success of the REIT regime (discussed below), the government called for (relatively high-level) input on:

- *Ways in which tax neutrality can be maximised*: "Tax neutrality" here describes the principle that investors investing through a fund should not be in a worse tax position than if they had invested directly. The review recognises that the existing regime does not always achieve this (e.g. certain multi-asset funds are taxed on interest income at fund level, without corresponding deductions).
- *Issues with the UK VAT treatment of fund management services*: The government identifies potential areas of improvement as including: (a) recoverability of VAT on

management fee costs at fund level; and (b) recoverability of input VAT incurred by managers in providing management services to UK funds (which, as a result of the changes discussed above, puts managers providing services to UK funds in a worse recoverability position than those providing services to UK funds).

- *Reasons for the declining use of UK fund vehicles*: The government seeks to understand why: (a) the use of UK limited partnerships has declined in recent years; and (b) there has been a low take-up of the "tax-elected fund regime", which was introduced to address the above-mentioned issues with mixed assets funds by distinguishing between dividend and non-dividend income. In particular, the government acknowledges that the perceived complexity of these regimes (when compared with the exemption model adopted in other jurisdictions) is likely a factor.

Overseas property investors

Proposals to relax the conditions applying to the UK tax regime for REITs

Provided certain conditions are met, UK REITs (and their UK taxpaying subsidiaries) can elect to be taxed pursuant to a specific UK tax regime (the "**REIT Rules**"). The REIT group is not subject to UK tax on its UK property income. Instead, withholding tax at 20% is deducted from dividends paid by the REIT to investors (albeit that, to the extent treaty relief is available, the tax can be refunded on the application of the investor). However, taxation in line with the REIT Rules is subject to relatively onerous conditions, such as requirements that the REIT (or parent of the REIT group) be listed (albeit that it need not be widely held) and requirements as to the balance of the REIT group's property and non-property business. Moreover, certain rules create compliance burdens without clear policy objectives, such as rules that tax REITs in respect of distributions to investors holding more than a 10% interest, but which can be sidestepped via fragmentation of investor interests. As part of its AHC consultation (discussed above), the UK government also consulted on changes to the REIT Rules, with a view to making the UK a more internationally competitive location for holding real estate assets. Although no changes have been announced, it is widely expected that the conditions for the application of the REIT Rules will be relaxed.

Changes to non-resident capital gains tax for CIVs

Since April 2019, non-UK residents are subject to UK capital gains tax on gains arising from disposals of: (a) directly held interests in any type of UK land; and (b) interests in "property-rich" entities (deriving at least 75% of its gross market value at the time of disposal from UK land) if the non-UK resident has at the time of disposal (or the two years prior) held a "substantial interest" (i.e. at least a 25% direct or indirect interest) in the property-rich entity.

For this purpose, specific rules apply to UK property-rich CIVs, a defined term encompassing various forms of investment funds, as well as REITs, and their investors: CIVs other than partnerships are treated as opaque, but they can elect to be treated as transparent or, in certain circumstances, as exempt (subject to meeting certain conditions and agreeing to reporting obligations). However, against that, the "substantial interest" condition is generally switched off for investors in property-rich CIVs, who are within the scope of non-resident capital gains tax irrespective of the size of their interest in the CIV.

Provided certain conditions are met, new legislation deems non-resident investors in CIVs *not* to hold a substantial interest (taking them outside the scope of UK non-resident capital gains tax). The conditions include requirements that the CIV is widely held and derives less than 75% of its value from UK property and that the investor does not hold more than a 10% interest in the CIV.

Finance

Proposed review of the VAT treatment of financial services

Though expected to have been published earlier this year, the UK has yet to launch its review of the VAT treatment of fund management fees (announced in last year's budget). It is possible that the UK Treasury may be waiting until there is greater clarity regarding potential amendments to the VAT treatment of financial supplies at EU level (discussed further above).

Measures addressing the cessation of LIBOR

London Interbank Offer Rates, which are used as reference rates in the loan, bond and derivatives markets, will cease to be published from June 2023 for certain USD LIBORs and December 2021 for all others. Instead, markets are transitioning to so-called "nearly risk-free" benchmark rates. In the course of 2020, the UK government published guidance clarifying the tax treatment of amendments to existing contracts in preparation for the transition.[12] In Finance Bill 2021, legislation was introduced to (a) update legislative references to LIBOR (used in the context of provisions addressing the tax treatment of leasing) to instead refer to the "incremental borrowing rate" as determined by generally accepted accounting practice, and (b) give the UK Treasury the power to legislate to address any unexpected consequences arising from the transition.

Tax climate in the UK and year ahead

The last 12 months have seen unprecedented economic contractions in the UK, coupled with previously very high levels of government spending. The UK government now appears to have directed its mind to the realities of restoring public finances, with a 6% increase in the rate of corporation tax from 2023. While it remains to be seen whether this is the right strategy and whether other jurisdictions will follow suit, the delay in introducing the increase is perhaps indicative of a desire to initiate economic recovery before the rate raise takes effect. Policies directed toward incentivising taxpayer capital expenditure in the immediate aftermath of the crisis (with the temporary "super-deduction"), bolstering taxpayer flexibility to utilise losses suffered during the pandemic (via new rules for longer loss carry-back) and seeking to attract new investment into the UK (through proposals to increase the UK's competitiveness as a location for funds) have this ambition in mind.

With its limited implementation of DAC 6, the UK government's approach toward mandatory disclosure is to align itself with the OECD, rather than EU, standards of disclosure and exchange. However, proposals for the mandatory disclosure of uncertain tax positions suggest that mandatory disclosure is likely to continue to be a key tool used by the UK government to monitor trends and increase tax collections going forward.

Looking outward, the UK will continue to be one of the members of the OECD's IF eager for a global solution under the ongoing Pillar I and Pillar II processes, despite having been an early mover with the implementation of a UK digital services tax in 2020. A corporation tax rate of 25% (from 2023 onwards) will almost certainly clear the threshold of the most ambitious proposals for a minimum tax rate. However, notwithstanding the US' public commitment to the process, its proposal for a minimum tax rate is unlikely to be warmly received in some quarters. Coupled with concerns about the complexity of current proposals, it remains to be seen whether consensus can be achieved.

Endnotes

1. https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/mergersandacquisitions/bulletins/mergersandacquisitionsinvolvingukcompanies/octobertodecember2020 and https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/mergersandacquisitions/articles/ukmergersandacquisitionsactivityincontext/2020.
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8. See, for example, *Skandia* (Case C-7/13) and *Danske Bank* (Case C-812/19).
9. As to which, see *DNB Bank* (Case C-326/15), *Minister Finansów v Aviva* (Case C-605/15) and *EC v Germany* (Case C-616/15).
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