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United Kingdom

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The following statistics reflect the position as at April 2022.

*Mergers and acquisitions ("**M&A**")*

The value of outward M&A (UK companies acquiring foreign companies) increased by £30.5 billion to £46.0 billion in 2021 compared with £15.5 billion in 2020. The total value of inward M&A in 2021 was £71.1 billion compared to £19.2 billion in 2020. The higher values of outward and inward M&A transactions can be explained by an increase in both the number and average value of transactions in 2021.[1]

The total value for domestic M&A during 2021 was £28.3 billion, an increase compared to 2020 (£17.6 billion). This increase can be explained by a general increase in the number and value of domestic M&A transactions of independent companies and between company groups. The majority of the inward M&A deals in 2021 (approx. 89.4%) came from the Americas (approx. 52.46%) and Europe (approx. 36.90%). This is very similar to 2020 where the Americas and Europe made up 91.0% of inward M&A, although Europe made up 47.4% in 2020, perhaps showing a shift towards US over European investment in the UK. The majority of total outward M&A deals in 2021 (79.8%) was in the Americas.[2]

Financing

In a record year for initial public offerings ("**IPOs**"), the London Stock Exchange was the largest centre for IPOs globally outside of the US and China. Over 120 inspiring companies chose to list on the London Stock Exchange, raising £16.8 billion. This is the strongest year for IPO capital raising since 2007 and the highest number of IPOs since 2014. Deliveroo was the largest IPO, raising £1.5 billion and opening with a market capitalisation of £4.9 billion.

*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 £1,454 million in 2019/2020 to £2,162 million in 2020/2021.[3] In addition, the DPT yield figures published by HMRC increased from 2019/2020 (£17 million) to 2020/2021 (£151 million).[4]

Key developments affecting corporate tax law and practice

The below section on UK tax law developments reflects a summary of the key developments in 2021/early 2022 (reflecting the position as of 31 May 2022), but it is not a comprehensive or detailed discussion of all tax measures in the past year.

Domestic legislation

Rate, allowance and tax credit changes

From April 2022, a number of rate increases occurred, with the UK government keen to pay off increases in government debt incurred for COVID-19-related expenditure. The rate of national insurance contributions ("**NICs**") was temporarily increased by 1.25% (to 15.05% for employer NICs and for other classes, broadly, at regressive rates of 13.25% and 3.25%), ahead of the introduction of the new 1.25% Health & Social Care Levy in April 2023, when NIC rates will return to their 2021 rates. Similarly, the rate of income tax payable by individuals on dividends increased by 1.25% from 6 April 2022 to 8.75%, 33.75% and 39.35% (depending, based on the individual's annual taxable income, on whether the individual is a basic, higher or additional rate taxpayer).

Taxpayer-friendly developments have been more limited. From 6 July 2022, the thresholds below which NICs do not apply was increased to £12,570 (from £9,880) *per annum* and it has been announced that in April 2024, the basic rate of income tax will be reduced from 20% to 19%. The government has faced widespread criticism that these measures do not go far enough to mitigate the "cost of living" crisis arising from rising inflation and energy prices. While more warmly received, actions to relieve pressures on businesses were similarly conservative. "Business rates" (a tax on non-residential property usage that is calculated by reference to the property's 1 April 2015 open market rental value and a multiplier based on consumer price index inflation) have been frozen at 2021 rates until 2023 and subject to a number of reforms, including a 50% relief for retail, hospitality and leisure properties and (until 2024) relief from increases caused by property improvements. Changes were also made to existing reliefs to stimulate investment. The annual investment allowance (a form of capital allowances relief, entitling certain taxpayers to a deduction for expenditure of up to £1 million on certain plant and machinery in the year of acquisition) had been due to decrease to £200,000 but will remain at £1 million until 31 March 2023. Further, "R&D tax credits", which give relief against trading profits for expenditure on specific research and development activities (in the form of enhanced 130% deductions and in some cases, cash credits from HMRC) will, from 2023, cover data storage and cloud computing costs and expenditure on pure mathematics activities.

Industry-specific taxes

The UK government has shown renewed enthusiasm for targeted, industry-specific taxes, with the introduction of a new Residential Property Developer Tax and Energy Profits Levy (as to which, see further "Industry sector focus" below). In contrast, from 1 April 2023, the banking surcharge (broadly, a surcharge payable by banks on profits subject to UK corporation tax that was introduced in reaction to the financial crisis of 2008) will be reduced from 8% to 3%, and the allowance (below which the surcharge does not apply) will increase from £25 million to £100 million. The UK has long prided itself on its stability as a place to do business. It remains to be seen whether the uncertainty created by the introduction, and amendment, of industry-specific taxes (which have tended to coincide with, and move in step with, popular sentiment) could undermine its reputation and the effectiveness of recent measures (discussed below) to attract inward investment.

Limitation on EU loss surrenders into the UK

The UK government has exercised its post-Brexit legislative freedom to remove preferential treatment regarding the use of losses that had been available to companies resident in the European Economic Area (the "**EEA**"). In the UK, members of the same group do not form a fiscal unity, but can, subject to certain limitations, "surrender" losses intra-group to reduce the taxable profits of other group members. Previously, EEA losses (of EEA subsidiaries or permanent establishments) could, broadly, be surrendered to UK taxpayers if they had not already been used to shelter non-UK tax – whereas non-EEA losses could only be offset against UK tax if all possibilities for non-UK relief had been exhausted. With effect for accounting periods beginning on or after 27 October 2021, the beneficial treatment of EEA losses was abolished, and the rules for EEA losses were aligned with those for non-EEA losses. The change will, of course, impact many loss-making groups with cross-EEA/UK activities. More generally, however, it may signal further striking of so-called "retained EU law" from the UK tax statute book.

Basis periods

The period by reference to which a business calculates its taxable profits/losses is known as its "basis period". Currently, the basis period for UK income tax (which applies, for example, to sole traders, individuals with a profession or vocation and individual partners in partnerships) is the business's accounting period (rather than the tax year, which runs from 31 March to 1 April for businesses, and 6 April to 5 April for individuals each year (although, in practice, these often align). From April 2024, income tax basis periods will be abolished and businesses will (like individuals) calculate their tax liability by reference to the tax year. (The change had been intended to take effect from 6 April 2023, but has been deferred by one year.) One of the key benefits is that complex rules for basis periods upon a business commencing, and ceasing, business will also be abolished. For 2023/2024, transitional rules will apply: the basis period will be the 12 months to the end of its accounting period, plus a "transitional basis period" from the end of the accounting period to April 2024 (when the new rules will apply). If the business is profitable, this longer basis period would result in higher taxable profits – so profits from the transitional basis period will be spread equally over five tax years, starting from the transitional period. Taxpayers can, however (provided an election is made at any time before 31 January 2025), opt out and pay tax on profits from the full basis period in line with normal due dates. For partnerships, an election will be made on a partnership level, meaning that consensus will need to be reached between partners. To ensure that businesses that change their accounting reference date to match the tax year are not prejudiced, the ability to spread has been extended accordingly. For businesses that do align their accounting period with the tax period, the changes are expected to increase the cost and complexity of tax compliance.

Notification of uncertain tax treatments

Large companies, partnerships and groups (with UK turnover exceeding £200 million and/or a UK balance sheet total exceeding £2 billion) must notify HMRC of uncertain tax positions taken in their UK tax returns due or filed after 1 April 2022 (in respect of corporation tax, VAT, income tax and PAYE, but not the bank levy or banking surcharge). A position is characterised as uncertain if it has been provided for in the accounts or is not in accordance with HMRC's known position, and is notifiable if the tax advantage in taking that position exceeds £5 million. (For partnerships, the tax advantage is calculated as the aggregate advantage to all partners.) Notification is not required if HMRC already has sufficient information about the uncertain tax position taken – whether as a result of separate disclosure regimes (such as the Disclosure of Tax Avoidance Scheme rules) or dealings with HMRC, and certain entities (such as collective investment vehicles, open-ended investment companies and certain qualifying asset-holding companies) are outside the scope of the regime. The time limit for notification varies depending on the type of tax and the entity gaining such advantage, but is generally related to the final return due for such tax in the relevant year. Despite the UK's decision to implement the EU's "DAC6" mandatory reporting regime in a reduced form, the regime illustrates that HMRC remains focused on information-gathering powers (see also the proposals for HMRC to request transfer pricing documents below). In particular, it suggests that HMRC's attention will be in deploying resources toward the early receipt, and scrutiny, of targeted information. The changes may lead to an uptick in advance clearance applications and/or (it is hoped) HMRC guidance, so as to contribute to tax certainty within the UK tax system.

Updates to HMRC guidance

While guidance published by HMRC is not legally binding, it provides insight to UK taxpayers as to how HMRC interprets, and applies, UK tax law. Key updates to HMRC's published guidance in the course of 2021/early 2022 are described below.

VAT treatment of termination/cancellation fees

In February 2022, HMRC published materials announcing its revised policy on the VAT treatment of termination/cancellation fees. HMRC's position is that such fee will generally be subject to VAT if the underlying supply is. More specifically (irrespective of whether the contract provided for the fee or described the fee as "damages"), the fee will be subject to VAT if: (a) it is directly linked to the underlying VATable supply so as to be additional consideration for it (e.g. if it covers the supplier's cost of making the supply available or equates to the amount that would have been charged had the supply run its course); and (b) there is reciprocity between the payer and payee (i.e. the supplier agrees to provide the service and the customer, and not someone else, benefits from it). However, the fee would not be subject to VAT if punitive, in the sense of being so high that it is designed to prevent a breach, rather than compensate for it. Moreover, if a supplier breaches a contract and the fee payable by the customer is reduced to take account of that, then it is not a separate supply for VAT purposes, but rather a reduction in the consideration for the underlying supply (with retrospective adjustments requiring the invoice and VAT returns to be updated accordingly). Notably, HMRC draws a distinction between: (a) a fee for something that (though not permitted) might be "normally expected", such as a penalty for the late return of hired goods (which will be subject to VAT unless punitive); and (b) compensation for an unexpected event, such as the accidental destruction of hired goods, which might be contemplated by the contract but is not realistically expected (which will not be consideration for a supply, as there is no reciprocity between the parties). The policy change must be applied from 1 April 2022 (and will override any prior confirmations from HMRC). Prior to September 2020, HMRC's view was that termination payments provided for in, and made pursuant to, a contract, or that were compensatory in nature, were not subject to VAT. In September 2020 (as a result of EU case law), HMRC published guidance revoking that position and stating that (as a termination fee was given for the (failed) supply that the customer contacted for) most termination fees would be subject to VAT. Following representations from stakeholders, the guidance was suspended while HMRC considered the position further. Taxpayers will be disappointed (if not surprised) that HMRC did not take the opportunity to revert to its pre-September 2020 position. The policy also raises questions as to when termination/break fees are sufficiently high as to be punitive and how that interacts with the non-enforceability, under English law, of excessive penalty clauses. However, some comfort can be taken that break fees payable in an M&A context (for failed transfers of shares and/or land that is not opted to tax) should remain outside the scope of VAT.

Decentralised finance

In February 2022, HMRC published guidance clarifying its position on the tax treatment of certain decentralised finance (so-called "**DeFi**") transactions. Broadly, the term "DeFi" transactions refers to the use of crypto-assets to generate a financial return, through, for example, lending or borrowing of crypto-assets and/or using crypto-assets to validate other blockchain transactions on a platform (through a process known as "staking"). Lending, or staking, is generally expected to involve the transfer of ownership of the crypto-assets to the platform/borrower. Broadly, where certain securities (such as shares) are the subject of a securities lending transaction (which requires equivalent securities to be returned), there are specific exemptions that prevent the lending constituting a disposal for capital gains tax purposes (the so-called "stock-lending relief"). Unfortunately, HMRC has confirmed that it does not consider that the exemption applies for crypto-assets. Instead, if the borrower or platform receiving the crypto-assets has the ability to deal freely in them, the lending or staking will constitute a disposal. HMRC also confirmed that it does not generally consider that any return received for lending or staking would be interest for tax purposes. Rather, it would need to be considered, depending on the exact circumstances, whether the return was capital or income in nature. If income in nature, it would either be treated as trading income or miscellaneous income. If capital in nature, the return is expected to be characterised as deferred consideration for chargeable gains purposes. The guidance has been criticised by the crypto-assets industry for the disparity of treatment between financial transactions in crypto-assets and financial transactions in other securities. Given proposals to expand exemptions in other parts of the UK tax regime to crypto-assets (as to which, see "UK consultations about potential changes" below), it is hoped that HMRC may review its position regarding the scope of the stock-lending relief.

VAT grouping

In March 2022, HMRC published guidance addressing delays in the processing of applications to join, disband or change the membership of UK VAT groups. The guidance provided that while waiting for a response, a taxpayer could (provisionally) treat the application as having been accepted from the date of online submission (or the date it should have been received, if posted), and submit returns, and account for VAT, on that basis. The guidance notes that taxpayers may receive automated notifications of late submission and penalties owed while waiting for a response, but confirms that HMRC will not take recovery action in respect thereof if they arise from the taxpayer having followed the guidance.

<u>UK consultations about potential changes</u>

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 2021/ early 2022 are described below. In addition, consultations of particular interest to specific industries are discussed in "Industry sector focus" below.

Online sales tax

The UK government is exploring arguments for and against the introduction of an online sales tax on online retailers ("**OST**").[5] The intention is that an OST (which proponents have suggested should apply at a rate of 1% or 2%) might neutralise the difference in tax treatment of physical retailers, who pay business rates in respect of their physical retail presence, and online retailers who do not suffer this expense. (It should be noted, however, that online retailers are subject to business rates in respect of their storage warehouses.) At present, the government has not decided whether to proceed with an OST, and is only exploring the potential design and scope of such a tax, were it to be implemented. Questions raised include whether an OST would: (i) extend to all forms of remote sales (e.g. sales made by phone or post), or just "internet only" sales; (ii) cover tangible goods only, or extend to services that are provided in connection therewith; and (iii) apply only to "business-to-customer" sales or also "business-to-business" sales (i.e. as part of a supply chain). If introduced, it is likely that an OST would, in practice, not be borne by online retailers, and would instead be passed on to consumers. The consultation closed on 20 May 2022. While the aim of the tax is UK-specific, many jurisdictions have taxes equivalent to business rates. As such, if the UK government decides to proceed with an OST, as with the digital services tax, it is expected that other jurisdictions could follow suit. In such circumstance, it is hoped that an international multilateral approach could be taken, with a view to reducing compliance costs and the risk of double tax. Alternatively, it might also be asked whether a more efficient approach to the issue would be merely to amend VAT rules applying to online sales.

Transfer pricing

In March 2022, the UK government announced proposals to expand transfer pricing documentation requirements.[6] The government had contemplated introducing a requirement for large businesses to maintain and file annually a schedule of data about intra-group cross-border transactions, but has decided not to proceed with that proposal – due, in part, to stakeholder desire for consistency with Organisation for Economic Co-operation and Development ("**OECD**") standards. Instead, the proposed changes build upon the OECD's "country-by-country reporting" ("**CbCR**") rules, which (broadly) require parent companies of large multinational groups (with global revenues of over €750 million) to annually report (typically to their home tax authority) key financial information for each jurisdiction in which the group operates. Under CbCR, this information for each jurisdiction (including revenue, (pre-tax) profits/losses and tax paid and accrued) is called the "local file", and a "master file", providing a high-level overview, must also be prepared. Under the UK government's proposals, UK taxpayers in groups subject to CbCR will be required to: (a) prepare master and local files in advance of submitting its UK corporation tax return; (b) submit local and master files to HMRC within 30 days of request; and (c) maintain a "summary audit trail" of work carried out in preparing that documentation.

Expansion of the investment management exemption

Trading income of non-UK residents is subject to UK tax if earned through a permanent establishment in the UK (including, in some circumstances, an agent acting on behalf of the non-resident). In principle, this raises a concern that the trading activities of UK investment managers could bring their non-UK resident clients within the scope of UK tax. To counteract this risk, and make the UK a more attractive location for asset managers, the UK introduced the "investment management exemption" (the "**IME**"). The IME prevents certain activities in respect of specified investments (the so-called "investment transactions list", or "**ITL**") from creating a permanent establishment for their clients (provided certain conditions are met). The ITL is kept under regular review to reflect the evolution of the investment management industry. In April 2022, the government announced its intention to expand the ITL[7] to include transactions in respect of crypto-assets. In May, it published a consultation seeking input from stakeholders on the appropriate definition of "crypto-assets" for this purpose and the characteristics of crypto-assets that can be used as investment products. As the ITL is also used elsewhere in the tax code (in the tax regimes specific to certain kinds of funds), HMRC is also seeking input as to whether there is a case for extending the change to these other regimes. The consultation closes on 18 July 2022, with a summary of responses expected later this year.

Domestic case law

In 2021 and early 2022, the UK tax courts provided further colour on some frequent sources of UK tax uncertainty (the application of the "unallowable purposes rule" to disallow loan relationship debits) and reinforced well-established principles (as to when interest has a UK source, and that jurisdictions will not necessarily enforce another's tax laws).

JTI Acquisition Company (2011) Ltd v HMRC TC/2019/04496

JTI addresses the unallowable purposes test, pursuant to which UK taxpayers' right to deductions for interest payments can be restricted if their main purpose (or one of their main purposes) was to obtain a tax advantage. More specifically, it: (a) is a departure from the *status quo* that HMRC would not (generally) seek to disallow acquisition debt on unallowable purposes grounds; (b) provides that (if a taxpayer is considered to have obtained a tax advantage) the burden falls on the taxpayer to prove that it is not a main purpose; and (c) notes that if the persons deciding to pursue a structure are not the directors of the taxpayer, it is the subjective intentions of those decision makers that will be considered. Here, a US group had used a UK acquisition vehicle ("**UKCo**") to acquire a US target, and funded the UKCo with interest-bearing debt, interest-free debt and a small amount of equity. The acquisition structure was a typical one, but for the insertion of a UK company into an otherwise US transaction. The case was a somewhat surprising one for HMRC to pursue, given commentary from the UK government when the unallowable purposes rule was introduced that "the borrowing cost (on commercial terms) of acquiring shares in a company at an arm's length price from an outside vendor is not and was never intended to be caught". However, HMRC adduced into evidence internal correspondence referencing, and quantifying the tax benefits from, "the global tax planning idea" (after the acquisition had already been signed) and commentary from UK directors (who resisted the planning pursued by the UK parent) that the planning was aggressive. The case illustrates the importance that the courts will place on surrounding discussions (not protected by legal privilege, such as internal correspondence and slide decks from the accounting firms), and not just company minutes, in determining whether a loan relationship has an unallowable purpose. It will therefore be important that non-tax personnel understand that the presence of tax input is not synonymous with structuring intended to achieve a tax advantage (and that any inaccurate remarks to that effect in correspondence are corrected). Moreover, the case illustrates that (while it is unusual to finalise acquisition structuring between signing and closing of an acquisition) it may be more difficult to justify the structure as not having a "main purpose" of obtaining a tax advantage if it is not considered until after signing of the acquisition agreement.

Hargreaves Property Holdings Limited v HMRC [2021] UKFTT 390 (TC)

Hargreaves addresses when interest has a UK source (and hence may be subject to withholding tax) and when interest constitutes "short interest" (which is not subject to UK withholding tax). UK case law establishes that in determining whether interest has a UK source, regard should be given to where the debtor is "resident" for the purposes of the Brussels Convention (i.e. its corporate seat), the location of the debtor's assets, where the contract is performed and how payment is made (i.e. the substantive, rather than the immediate, origin of the funds to pay the interest) and the governing law of the contract. In this case, the borrower was UK resident and its assets were in the UK. However, interest was payable under a (non-UK law-governed) loan agreement that provided for enforcement outside the UK, and care was taken to ensure that payments were, in fact, made offshore. Notably, the debtor was replaced with a non-UK debtor prior to each interest payment date (via a transfer of the debt to a Guernsey-resident related company). The tribunal echoed that regard must be had to the "underlying commercial reality", concluded that the "real" debtor was the UK parent, and found that the payment had a UK source. In particular, it did not consider the loan's non-UK enforcement provisions particularly significant, as a foreign judgment would be recognised in the UK and enforced against the UK assets. As regards the "short interest" question, here, the lender could call for repayment of the loans on short notice, and each loan was left outstanding for either less than, or a little over, a year. However, the tribunal found that, here, the debtor had a long-term funding need and the underlying commercial reality is that the loans were, in fact, "intended to form part of a longer term funding arrangement". This was so, notwithstanding that the loans were, for short periods, owed by the Guernsey company. This case highlights that attempting to artificially structure out of having UK-source interest is unlikely to be successful. Where there is any doubt as to whether interest has a UK source, depending on the circumstances, it may be preferable (notwithstanding the administrative costs) for taxpayers to consider relying on available statutory exemptions, such as the quoted Eurobond exemption.

Kwik-Fit Group Limited and Others v HMRC [2021] UKFTT 283 (TC)

In this case, interest on a number of loans (that were part of a wider reorganisation) was increased, with a view to accelerating the use of a large carried-forward non-trading loan relationship debit. The result was that the non-trading loan relationship debit was utilised in three years, as opposed to 25 years. The first-tier tribunal held that: (a) in determining whether a loan was transferred for tax avoidance purposes, it is the main purpose of the transfer (and not the main purpose of the underlying loan) that will be considered; and (b) merely increasing the interest on a loan that was originally borrowed for commercial purposes could still be (and here, was) an "unallowable purpose" (with the result that deductions for the increased interest could, and here, would, be denied).

Skatteforvaltningen v Solo Capital Partners LLP [2022] EWCA Civ 234

Skatteforvaltningen involves the application of the "revenue rule" – in broad terms, the principle that the courts of one jurisdiction should not enforce the tax laws of another. Solo Capital Partners ("**Solo Capital**") had received payments subject to Danish withholding tax and successfully applied for a refund. Skatteforvaltningen ("**Skatte**"), the Danish tax authority, paid the refund, but subsequently reached the view that it was paid on the basis of a misrepresentation by Solo Capital (whom they alleged had undertaken fraudulent "*cum-ex*" trades). Skatte had applied to the English courts to enforce its rights against Solo Capital's UK assets, claiming that the Court of Appeal would not be breaching the revenue rule if it ruled in Skatte's favour, as Skatte was not seeking to recover tax, but was instead claiming for damages caused by multiple withholding tax refunds being paid (which can commonly arise in *cum-ex* trades). The argument was accepted by the Court of Appeal in respect of the Solo Capital trades, and foreign tax authorities will note this case with interest given the subtle distinction made between tax amounts and recovery in respect of damages for tax amounts paid. Subject to any further appeal to the UK Supreme Court, the recovery proceedings will now continue in the High Court.

International tax developments

The below is a summary of the key EU and OECD developments in 2021 and early 2022 (reflecting the position as of 20 June 2022), which may influence the direction of UK policy. It is not intended to be a comprehensive or detailed discussion of all measures introduced or proposed in the last year.

<u>EU</u>

Anti-Tax Avoidance Directive III

The EU Commission (the "**EC**") has introduced a draft Anti-Tax Avoidance Directive III (the "**Directive**") to increase transparency in respect of, and restrict the tax benefits available to, certain "shell" companies with limited substance. The draft Directive is expected to be approved without material amendment.

- Under the current draft, a company will be "at risk" of being a shell company if: (a) in the previous two years, more than 75% of its revenue consisted of passive or mobile income; (b) at least 60% of its activities are cross-border or 60% of its assets are located outside of a Member State; and (c) it has outsourced the administration of day-to-day operations and decision-making on significant functions to a third party.
- Such "at-risk" companies must report, in their annual tax return, whether they meet specified substance requirements, i.e. whether they have: (i) an EU bank account; (ii) local (exclusive) office space; and (iii) (broadly) at least one suitably qualified local director that is neither an employee nor a director of a non-associated enterprise. Those not meeting these requirements can demonstrate substance on other grounds or apply for exemption annually on the basis that the arrangements do not create a tax benefit for the group or its beneficial owners.
- Otherwise, the company will lose access to the benefit of the Parent-Subsidiary Directive and Interest and Royalties Directive and would effectively no longer be able to obtain a certificate of residence in that country (which is likely to inhibit its ability to access double tax treaties). Certain entities are outside the scope of the Directive, including those listed, EU-regulated or whose shareholders are in the same jurisdiction.
- The Directive contemplates that it would be transposed into national law by 30 June 2023 and come into effect from 1 January 2024. That said, it is expected that the implementation may be delayed. For example, a delay of one year has been proposed by the European Parliament's Committee on Economic and Monetary Affairs ("**CEMA**"). Other key amendments proposed by CEMA include widening the exemption for "regulated financial undertakings" to their subsidiaries, and permitting outsourcing of day-to-day operations to associated enterprises in the same jurisdiction (without this causing an entity to be "at risk").

Public country-by-country reporting

For accounting periods beginning on or after 22 June 2024, large companies/groups, with global revenue in excess of €750 million and operations in the EU, will be required to publicly publish their effective tax rate annually (so-called "public CbCR"). The effective tax rate would be calculated using the methodology employed under BEPS Pillar II proposals (discussed below). The rate must be published on a jurisdiction-by-jurisdiction basis for each Member State (as well as EU non-cooperative jurisdictions and those on the EU "grey" list for the last two or more years). Until recently, tax disclosure rules had focused on the provision of information to, and the exchange of information between, tax authorities. However, the rules are part of an increasing trend toward tax transparency. This suggests that tax may increasingly become a reputational, as well as an operational, matter for taxpayers, as they consider how their tax position will be viewed by tax authorities, investors and the general public. In particular, it remains to be seen whether taxpayers will move toward voluntary disclosure of tax information to provide greater context to public disclosures.

Debt-equity bias reduction allowance

On 11 May 2022, the EC published a consultation on its proposal for a directive implementing its so-called "debt-equity bias reduction allowance" (the "**DEBRA Directive**"), which is intended to take effect from 1 January 2024. The proposed DEBRA Directive aims to encourage companies to finance their investments through equity contributions rather than debt financing (having a wider aim of combatting concerns of over-indebtedness). It seeks to achieve this with two key proposals. The first is a new allowance awarding tax relief for equity funding received, in the form of deemed tax deductions. The deemed deductions would be calculated as notional "interest" (at 1–1.5% over the 10-year risk-free interest rate for the relevant currency) on deemed principal (being the difference in "net equity" over the course of the year, where "net equity" is the difference, in the entity's accounts, between the amount at which its own equity is recognised and the carrying value of its investment in subsidiaries). Relief would be capped (like actual interest) at 30% of EBITDA (i.e. earnings before interest, tax, depreciation and amortisation) and subject to an anti-avoidance condition. The second limb of the proposal is a further restriction on deductions for interest expenses, which would limit deductions at 85% of net borrowing costs (i.e. interest paid minus interest received). Given the number of competing regimes seeking to limit interest restrictions (transfer pricing, EBITDA-based corporate interest restrictions, any hybrid rules, and local anti-avoidance rules), it may be questioned whether another form of disallowance (which will have to work in conjunction with existing regimes) is necessary or useful. Nevertheless, it may increase the UK's attractiveness as a treasury company, given its already wide treaty network and withholding tax exemption for interest payable for debt listed on certain exchanges. Notwithstanding this, from a UK perspective, the more interesting proposal may be the allowance for equity funding, which (if introduced) could give jurisdictions such as Luxembourg and the Netherlands an advantage over the UK as a holding-company jurisdiction. Given recent UK efforts to attract asset-holding companies (as to which, see "Industry sector focus" below), it will be interesting to see whether the UK follows suit.

<u>OECD</u>

BEPS 2.0

In July 2021, the OECD' s Inclusive Framework on Base Erosion and Profit Sharing (the "**IF**") reached high-level agreement on international tax reform – specifically, for changes to international tax-nexus rules (so-called "Pillar I") and a global minimum effective tax rate (so-called "Pillar II"). At the time of writing, 137 of the 141 IF members have agreed to implement the reforms (described below), with only Kenya, Nigeria, Pakistan and Sri Lanka abstaining (although the OECD continues to try and bring them on board). Nevertheless, it is not yet finalised exactly how, and when, these reforms will be implemented, and the details of the proposals are still continuously developing. The original target was for both Pillar I and Pillar II to be implemented in 2023, with the framework for each being finalised at the end of 2022. However, more recently, the head of the OECD has admitted that the proposals will not come into effect until 2024 at the earliest.

Pillar I

Pillar I is a set of proposals (to be implemented by way of a multilateral convention) updating tax allocation rules for large multinational enterprises ("**MNEs**") (i.e. those with a global turnover above €20 billion or equivalent and profitability above 10% before tax). MNEs in the extractive and regulated financial services industries are excluded from Pillar I reforms. Pillar I provides for:

- a new right for "market jurisdictions" (broadly, jurisdictions in which goods or services are used and enjoyed) to tax so-called "Amount A" – being 25% of profits that exceed a normal rate of return (10%); and

- a new standardised methodology for taxing, on a fixed-return basis, marketing and distribution activities (for related parties, *vis-à-vis* third parties) in market jurisdictions (i.e. effectively a simplified extension of the "arm's length" principle). Amount B has received less attention to date, so specifics have not yet been considered. The OECD previously stated that a public consultation is planned for mid-2022, although it has not been published as at the time of writing.

Over the last year, there have been a number of short OECD consultations on "building blocks" of Pillar I (described in further detail below). Significantly, the consultations derive from the IF Secretariat, and have not yet received IF member approval.

Title	Addressing	Comments
Nexus and revenue sourcing[8] (Open: 4–18 February 2022. Responses published: 22 February 2022)	The consultation addressed rules for determining when market jurisdictions should have taxing rights over Amount A (generally, when more than €1 million of the MNE's revenue arises therein, although the threshold may be €250,000 for smaller jurisdictions), and how much revenue can be allocated thereto.	• The proposed rules state that whether revenue will be considered to arise in a market jurisdiction will be based on the transactions that occur therein (on a transaction-by-transaction approach). • The rules recognise that for each transaction, there may be different categories of revenue (e.g. sale of finished goods, provision of services, etc.) and provide guidance as to how to identify the source jurisdiction (e.g. through specifying allocation keys if unclear). • Generally, the responses call for further simplicity and certainty in the design of the rules. In particular, respondents have raised concerns in relation to the transaction-by-transaction approach, stating that it is complex and may be practically unworkable.
Tax base determin-ations[9] (Open: 18 February–4 March 2022. Responses published: 8 March 2022)	Broadly, the tax basis (i.e. the amount to which the "normal rate of return" test will be applied) will be calculated on the basis of the audited consolidated group financial accounts, with a limited number of adjustments. The consultation addressed the specific of those adjustments.	• The consultation identifies certain figures that should be backed out of the consolidated group accounts in determining the tax base: (i) current or deferred tax income/expenses; (ii) certain kinds of expenses disallowed on policy grounds (e.g. illegal payments, fines and penalties); and (iii) dividends/distributions in respect of, gains or losses deriving from dispositions of, and/or changes in the fair value of, subsidiaries or other ownership interests. • It is proposed that losses can be carried forward and offset against profits (for determining whether in-scope thresholds are surpassed), but that such losses can only offset profits in the immediately subsequent period. Respondents consider that it should be possible to carry forward unused losses indefinitely (or at least for a longer period), particularly those arising prior to the new rules.
Scope[10] (Open: 4–20 April 2022. Responses published: 22 April 2022)	Model rules for domestic legislation on scope (i.e. which MNEs should be subject to Pillar I rules).	• These draft rules provide that, for MNEs to be in-scope, the €20 billion revenue/10% profitability must be exceeded: (a) for at least two of the last four periods; and (b) on average across the four periods (to address volatility in results). • There is ongoing discussion as to whether this test will apply on a rolling basis, or whether there will be an "entry test" (to be satisfied once, and thereafter the MNE would apply the thresholds by reference only to the year in question). Respondents generally preferred the former approach. • Additionally, there have been calls for MNEs to be able to elect to be in scope for a period of time after meeting both tests, to ease compliance/admin burdens.

Title	Addressing	Comments
Extractives exclusion[11] (Open: 14–29 April 2022. Responses published: 3 May 2022)	Broadly, MNEs' profits and revenues from third parties derived from certain "extractives" activities are excluded when determining whether the MNE is in scope for Pillar I purposes. The consultation includes draft model rules addressing the details of the exclusion, including conditions that must be met.	• Broadly, the exclusion is limited to profits and revenue that satisfy both the "product" test (i.e. the MNE must sell minerals, mineraloids, hydrocarbons and/or similar materials extracted from the earth's crust to third parties) and the "activities" test (i.e. the MNE must itself carry out exploration, development and extraction activities). Revenues and profits from only trading in extractives, or only carrying out extractive services, will therefore not be excluded. • A key policy intention is not to cut across the importance of "source"-based taxation in this context. • Generally, responses felt the exclusion was unduly restrictive, and called for: (a) its expansion (in particular to MNEs carrying out manufacturing and processing activities); and (b) the products and activities tests to be capable of being satisfied by connected MNEs.
Regulated financial services exclusion[12] (Open: 6–20 May 2022. Responses published: 25 May 2022 and updated on 30 May 2022)	Similarly, MNEs' third-party profits and revenues derived by certain regulated financial institutions are excluded when determining whether the MNE is in scope for Pillar I purposes. Again, the consultation includes draft model rules addressing the details of the exclusion, including conditions that must be met.	• The exclusion here will be applied on an entity-by-entity level. Accordingly, provided the relevant conditions are met, a "regulated financial institution" in the MNE is excluded entirely when considering whether the MNE is in scope. • Broadly, excluded "regulated financial institutions" include depositary, mortgage, insurance and investment institutions, together with asset managers, "mixed" financial institutions and entities that exclusively provide services to the foregoing. Definitions are set out for each excluded institution, but broadly, each must meet a licensing requirement, regulatory capital requirement and activities requirement. • It is possible that the exclusion of entities exclusively providing services to other "regulated financial institutions" may lead to the restructuring of operations within financial institutions.
Tax certainty aspects[13] (Open: 27 May–10 June 2022. Responses published: 15 June 2022)	The consultation proposes mechanics for addressing widespread concerns about risks of double taxation and dispute resolution (e.g. should market jurisdictions, or market jurisdictions and jurisdictions with taxing rights under existing nexus rules, disagree about the Amount A they are entitled to tax), as well as tax authority resources.	• The proposals contemplate rights for the MNE to seek: (a) clearance as to whether it is in scope; (b) advance clearance of its methodology for calculating Amount A, which (once agreed) will apply for a number of future periods; and (c) an "after the event" multilateral review, binding on all relevant jurisdictions, in respect of periods that have ended. • Each mechanism is supported by a binding process to resolve any disagreements that arise during the application of such mechanisms. These mechanisms include the potential use of panels comprising experts (which is the subject of ongoing IF member debate). • Responses indicate that this is a critical aspect of the proposals. However, there are concerns as to whether taxpayers will be able to obtain clearances within reasonable time frames and tax authorities will have sufficient resources to meet taxpayer needs. Additionally, concerns were raised that the current mechanics do not adequately address the risk of double taxation and calls were made for a more streamlined approach.

Pillar II

Pillar II seeks to ensure that MNEs (with annual revenues exceeding €750 million) pay a minimum effective tax rate of at least 15% of profits in every jurisdiction in which they operate. Broadly, this is to be achieved by imposing top-up taxes where, in any jurisdiction, the effective tax rate is below 15%. These top-up taxes comprise an "income inclusion rule" ("**IIR**") (to be levied by the parent jurisdiction or, as has become apparent, the jurisdiction in question) and a fall-back "under-taxed payments rule" ("**UTPR**") (enabling other jurisdictions to levy a top-up tax if the above-mentioned jurisdictions have not). The IIR and UTPR are together referred to as the "**GloBE**". There have been a number of significant GloBE publications in the last year:

Publication	Key developments/comments
Model rules (Published December 2021 by IF Secretariat)[14]	• The model rules suggested (for the first time) that the IIR "top-up" tax could be levied in the jurisdictions in which the effective tax rate is below 15% ("**non-parent IIRs**"), and credited against the parent jurisdiction tax. This has raised concerns about compliance costs, cash flow impacts and potential double tax (should there be differences in local implementation). • The IF Secretariat acknowledged that the rules would include (yet to be developed) "safe harbours", i.e. effective exclusions for MNEs to prevent administrative costs disproportionate to policy objectives, e.g. where MNEs are subject to "equivalent" regimes (such as, potentially, GILTI in the US).
Technical guidance on the model rules, and illustrative examples (Published March 2022 by IF Secretariat)[15]	• The guidance acknowledges the need for consistency, across member states, in the implementation and interpretation of the rules to prevent double taxation. It provides definitions for certain key terms and detail as to the intended outcomes of the model rules (with a view to achieving substantive consistency). • The commentary and illustrative examples each address scope, computation and administration, with examples illustrating the rules for: (a) adjustments to be made to consolidated accounts; and (b) which member(s) of the MNE will be subject to top-up taxes. • The commentary stresses that the IIR is intended to be the primary collection mechanic, and that (as a result) lower thresholds should not apply for the UTPR. It noted that IF members could, however, apply lower thresholds for the application of the IIR (although it does not address that IIRs imposed by tax authorities of the non-parent MNE members at lower thresholds could undermine expected outcomes). • The commentary notes the IF Secretariat's preference that thresholds be implemented in EUR (even in jurisdictions with non-EUR currencies) but, if not possible, recommends annual rebasing against the EUR.
UK government consultation on implementation (Open: 11 January–4 April 2022. Responses not yet published)[16]	• The consultation sought views on the appetite for an additional wholly domestic minimum effective tax rate. • The expectation is that UK implementation of the GloBE would broadly follow the model rules. The consultation notes that the top-up tax would apply at different levels of the MNE depending on the group's circumstances. For example, it is contemplated that: (a) the IIR would apply to UK-headquartered parents, certain UK intermediate parents (e.g. if the parent is not subject to the IIR) and UK members of in-scope MNEs with an effective UK tax rate below 15%; and (b) the UTPR would only apply to UK members of non-UK-headquartered in-scope MNEs in limited circumstances (e.g. if top-up taxes on low-taxed entities have not been collected under IIRs in other jurisdictions and/or there are low-taxed profits in the parent jurisdiction).
Call for input on Implementation Framework (Released in March 2022 by IF Secretariat)	The Implementation Framework will address the practical aspects of implementation, including filing obligations and review procedures. Responses address the need for: • a grace period during which honest mistakes would not trigger penalties; • standardised returns (in which vein it is proposed that GloBE returns be filed with the tax authorities of the parent, and each other member, of the MNE within 15 months of the end of the reporting year); and • safe harbours, such as a proposal that GloBE calculations will not be needed for (and no top-up tax will apply to) members of the MNE likely to be taxed above the 15% minimum rate (together with a challenge right for tax authorities, which, if triggered, places the burden of proof on the MNE).

Publication	Key developments/comments
Draft EC directive (Most recent draft published March 2022)[17]	• The major departure from the model rules is that the directive (if implemented in its current form) would apply equally to wholly domestic groups (in order to comply with EU rules). • In April 2022, the draft directive was vetoed by Poland (which considered that implementation of Pillars I and II should be legally linked), thereby forcing the EC to extend the directive's date for full implementation to 31 December 2024. At a meeting of EU finance ministers on 17 June 2022, Poland withdrew its veto, but progress was stalled when Hungary exercised its veto and withdrew its support (citing existing pressures on economies/multinational corporations from the war in Ukraine and inflation). While widely considered a setback, the delay will have its advantages, giving the EC an opportunity to more faithfully mirror the final shape of the rules and reducing the scope for disparities (and resulting compliance issues).

Crypto-Asset Reporting Framework

At the request of the G-20, the OECD has published, and launched a public consultation on, new rules for the reporting and exchange of crypto-asset information.[18] The new rules would consist of a separate standard, known as the "Crypto-Asset Reporting Framework" (on terms similar to the Common Reporting Standard, which provides for the reporting and exchange of information relating to financial accounts, the "**CRS**"), as well as changes to the scope of the CRS itself to include electronic money products and Central Bank Digital Currencies. The UK government has not announced whether it intends to implement the changes, but given its G-20 membership, it is widely expected that it will. It is worth noting that HMRC already has significant powers (under domestic laws and treaties) to request information from third parties relating to crypto-assets, and it has been reported that HMRC used such powers on a number of occasions in recent years (including to obtain information on crypto-asset holders from exchanges such as Coinbase). The new rules would have the benefit of automating the processes through which HMRC could obtain such information – although that would require a corresponding commitment of resources to the review at its disposal, and is somewhat at odds with HMRC's preference for more targeted information reporting of late (as to which, see "Notification of uncertain tax treatments" in "Domestic legislation" above).

<u>Other international developments</u>

UK-Luxembourg Double Tax Convention and Protocol

On 7 June 2022, Luxembourg and the UK signed a protocol updating their double tax treaty (the "**new DTT**"). The most notable change in the new DTT is that gains from the sale of shares in property-rich companies can be taxed in the jurisdiction in which the underlying property is located. When the new DTT takes effect, the UK will therefore be able to impose UK non-resident capital gains tax ("**NRCGT**") on Luxembourg resident sellers of "property-rich" holding companies (broadly, under the NRCGT regime, those deriving more than 75% of their value from UK land). The change (which has been expected since the UK introduced the NRCGT charge in 2019) will not impact new structures, as the NRCGT regime already prevents non-residents from deliberately structuring around the charge. Other notable updates include: (a) enabling certain Luxembourg collective investment vehicles to access treaty benefits by deeming them resident in Luxembourg for the purposes of the new DTT (broadly, collective investment vehicles receiving UK-source income that are treated as corporates for UK tax purposes, UCITs and those 75% owned by persons with treaty access); (b) an updated residency tie-breaker (switching from "place of effective management" to a competent authority mutual agreement process); (c) the reduction of withholding tax on royalty payments to 0% (from 5% under the existing treaty, thereby reversing the effect of Brexit in denying UK residents the benefit of the 0% rate under the EU Interest and Royalties Directive); and (d) the reduction of withholding tax on dividends to 0% (from 5–15% under the existing treaty, thereby giving Luxembourg residents an alternative to the Luxembourg participation exemption). The new DTT will not enter into force until ratified by the UK and Luxembourg (the timing of which is not yet clear). Once ratified, it will apply: (a) for accounting periods beginning on or after the following 1 April for UK corporation tax purposes (e.g. for companies and collective investment vehicles treated as companies, such as alternative investment funds and collective investment schemes ("**CIS**")); (b) from the following 6 April for UK income tax and capital gains tax purposes; and (c) from the following 1 January for withholding tax purposes.

Developments affecting attractiveness of the UK for holding companies

Qualifying asset-holding companies regime

With effect from 1 April 2022, a new favourable tax regime will apply to "qualifying asset-holding companies" ("**QAHCs**") – both at the level of the QAHC and its investors. The aim is to build on the UK's location as a desirable location for asset management (as to which, see the discussion of the IME above), and encourage funds to consolidate their entire operations (including fund administration, such as setting up and running fund holding vehicles) in the UK. To be a QAHC, a company must meet a number of conditions. It particular: (a) it must be resident in the UK for tax purposes; (b) at least 70% of its investors must be so-called "Category A" investors, which include, among others, widely held funds, collective investment vehicles and UK real estate investment companies ("**REITs**"); (c) its main activity must be the carrying on of an investment business (and any other activities must be ancillary to that and non-substantial); (d) it must not be a REIT or have shares listed on exchange; and (e) it must have notified HMRC that it intends to be a QAHC. QAHCs benefit from special tax treatment, including exemptions from: (i) corporation tax on the disposal of certain assets (broadly: shares; non-UK land if tax has been paid in another jurisdiction; and related loan relationships and derivatives); (ii) rules disallowing deductions for results-dependent interest and under UK hybrid mismatch rules (but adjusting the application of the transfer pricing rules, so that they apply); (iii) withholding tax on interest paid to QAHC investors; and (iv) stamp duty and stamp duty reserve tax on its repurchase of its shares and/or loan capital. In addition, investors can receive returns in the form of dividends (which is preferable for corporate shareholders subject to UK corporation tax, as dividend income is typically exempt) or as capital on a buy-back (which is typically preferable for individual shareholders, as it is taxed at a lower rate) without any premium being recharacterised as income under anti-avoidance rules. Due to the requirement for substance (as to which, see "EU" above), fund managers have typically consolidated operations in a single or limited number of jurisdictions – with Ireland and Luxembourg being the most popular. It remains to be seen whether the changes (which are generous in substance) will be sufficient in practice to move commercial activity to the UK.

Proposed changes to allow corporate redomiciliation

Currently, UK corporate law does not: (a) allow non-UK-incorporated companies to migrate their corporate seat (i.e. their place of establishment) to the UK (so-called "inbound redomiciliation"); or (b) recognise any attempts by a UK-incorporated company to migrate its corporate seat to another jurisdiction (so-called "outbound redomiciliation"), even if that other jurisdiction does. If a group wants to replace a non-UK-incorporated company with a UK-incorporated one (e.g. as the group's holding company), or *vice versa*, it must instead carry out a corporate reorganisation – which can lead to significant adviser fees, and (depending on the steps involved and the availability of intra-group reliefs) taxes. In April 2022, however, the UK government reversed its position and announced plans to permit inbound and outbound redomiciliation. At the same time, it published the results of a stakeholder consultation held in late 2021 on the subject,[19] addressing key tax issues that would need to be considered, and stakeholders' responses. Stakeholders considered that, amongst other things: (a) inbound migration should automatically cause a company to become UK tax resident (to align with the position for UK-incorporated companies), and should not trigger UK stamp duty; (b) inbound redomiciliation should not carry an increased risk of loss importation (i.e. non-UK resident companies migrating to the UK for the purpose of using its foreign losses to shelter the group's UK profits) because non-UK resident companies could already become UK tax resident by changing their central management and control; and (c) more generally, thought would need to be given to the impact on the company's shareholders' own taxation. (It is, of course, worth noting that only stamp and shareholder tax considerations will be relevant to companies migrating to the UK that are already UK resident.) The proposed changes will bring the UK in line with around 50 other countries and jurisdictions (e.g. Canada, New Zealand, Singapore, and a number of US states) that currently permit redomiciliation. It is hoped that the flexibility achieved with the proposed changes will increase the attractiveness of the UK as a destination to locate a corporate seat. However, the mechanical flexibility to redomicile to the UK (while welcome) will not remove substantive issues and costs associated with UK shares, including stamp duty on transfers, difficulties with listing on US markets and audit/accounting costs.

Industry sector focus

Property

Changes to the REIT regime

UK resident REITs and their subsidiaries (so-called "REIT groups") are subject to particular tax rules (the so-called "REIT regime"). REITs/REIT groups are exempt from corporation tax on income and gains generated from (or from shares in) a property rental business. However, against that: (a) they must distribute 100% of profits/gains derived from their property business (and 90% of other profits/gains) within 12 months of the end of the accounting period in which they are generated; (b) dividends payable by the REIT that are derived from this property income/gains (so-called "property income distributions" or "**PIDs**") are subject to withholding tax at a rate of 20% (subject to any applicable treaty); and (c) a REIT is subject to a 10% charge (the "**ERHC**") if it makes a PID to a "holder of excessive rights" (i.e. holding more than 10% of the voting or economic rights). Further, to qualify as a REIT group, a number of conditions must be met. For example: (a) shares in the REIT must generally be listed on a recognised stock exchange (the "**Listing Requirement**"); and (b) the REIT/REIT group must satisfy the "balance of business test" (the "**BoBT**"), which requires that at least 75% of each member's profits must arise from, and assets must be involved in, a property rental business. For accounting periods commencing on or after 1 April 2022, the conditions to benefit from the REIT regime have been relaxed, with a view to reducing costs and removing unnecessary administrative burdens. For example: (i) the Listing Requirement has been removed if at least 70% of REIT shareholders are institutional investors; (ii) the test for non-UK REITs to qualify as "institutional investors" has been removed; (iii) the ERHC has been removed where PIDs are paid to investors entitled to gross payment; and (iv) an alternative simplified BoBT has been introduced requiring simply that 80% of a REIT group's total income and assets for the relevant accounting period are income and assets from the property rental business. Post-Brexit, there has been a significant focus on making the UK a more attractive place to invest, with the introduction of the QAHC regime and proposals for a corporate redomiciliation regime. The changes will make the REIT regime more accessible, materially improve the compliance burden of REITs/REIT groups, are consistent with the government's aim of promoting the UK as a business-friendly jurisdiction, and will, it is hoped, increase the UK's attractiveness as a property-holding jurisdiction.

Residential Property Developer Tax

From 1 April 2022, Residential Property Developer Tax will apply, at a rate of 4%, to profits from UK residential property development (in excess of a £25 million annual allowance per group). The rules contain flexibility for the allowance to be allocated between members of the group in accordance with their discretion. In a joint venture context, therefore, it is expected that each developer will need to contractually allocate the amount of their allowance that will be available to the joint venture.

<u>Oil and gas</u>

On 26 May 2022, the UK government announced that a temporary "Energy Profits Levy" will apply, with immediate effect, at a rate of 25%, to UK oil and gas profits (bringing UK tax on their profits to a combined rate of 65%). To encourage investment, an "Investment Allowance" will offer in-scope taxpayers an 80% deduction from the levy, in the year of expenditure, for expenditure on UK oil and gas extraction. Legislation has not yet been published. The short-term revenue-raising and public popularity benefits of the measure are clear. However, as discussed in "Industry-specific taxes" above, concerns have been raised that the charge prejudices the long-term reputation of the UK as a stable and business-friendly place to do business.

<u>Funds</u>

UK funds review regime

One of the aims of funds is to broadly achieve tax neutrality (i.e. that fund investors are not in a worse tax position than they would have been in had they invested directly). In January 2021, the UK government called for stakeholder input as to how UK tax neutrality can be maximised, potential reasons for the declining use of UK fund vehicles and issues with the UK VAT treatment of fund management services. The government published responses in February 2022 and, at the same time, announced a number of related policy developments regarding fund taxation, including the following highlights:[20]

- *VAT*: The review does not address the VAT treatment of fund management (which will be the subject of a separate consultation "in the coming months") but did note respondents' firm view that the VAT treatment of fund management services will be critical to UK competitiveness. Significantly, the government has ruled out a zero rate for fund management services (which would have the result that recipients did not suffer the cost of VAT, without prejudicing fund managers' VAT recovery).
- *Tax-exempt funds*: Last year, the government mooted a potential new exemption from UK tax for authorised funds and new unauthorised fund structures. Stakeholders felt that this would not represent a material substantive improvement (as such funds largely achieve

tax neutrality already). Nevertheless, many felt it would be of significant benefit, as the simplification would save costs and increase the overall perception and attractiveness of the UK funds regime. The government intends to explore the option further.
- *Genuine diversity of ownership*: CIS are not subject to UK corporation tax (although UK investors may be liable to capital gains tax on disposal of units therein). To be a CIS, the "genuine diversity of ownership" condition must be met. Currently (broadly), this requires interests in the fund to have been marketed widely (to ensure that the structure has not been set up to provide beneficial tax treatment to a limited group of investors). In response to stakeholder feedback that the current condition is too restrictive, the government intends to review it, and in particular to consider allowing a "look-through" to the ultimate pool of investors in determining how widely the fund has been marketed.
- *English limited partnerships*: The complexity of the tax rules applying to English limited partnerships was noted as a potential cause for their low uptake in fund structures. Areas singled out included capital gains tax, stamp duty and stamp duty land tax. Some respondents further suggested that the stamp duty charge that can apply to transfers of partnership interests also be abolished.

Tax climate in the UK and year ahead

With an uncertain economic outlook, and based on a number of the changes summarised above, it is clear that the UK government is in "revenue-raising" mode. While it has signalled its intention to potentially reduce rates before the next election (scheduled for 2024), it has also been clear about the need to pay down debts incurred during the COVID-19 crisis.

The government has therefore used industry-specific taxes as one lever to pull in these uncertain times. These are always unpopular, because (as against simple rate increases) they complicate in-scope taxpayer profiles, increase compliance costs, heighten the risk of double taxation and are viewed as populist (potentially putting the UK's business-friendly reputation at risk). In recent years, business has increasingly called for tax stability, and the UK does not appear inclined to heed the call.

Another measure open to HMRC (which it seems poised to seize upon) is the tightening of enforcement. Here, indications of a stricter stance can already be seen – both from the types of cases HMRC is taking and the expansion of HMRC's information-gathering powers.

Lastly, the UK government has increasingly signalled its comfort in using its post-Brexit flexibility to depart from EU "retained" legislation (as to which, see "Limitation on EU loss surrenders into the UK" above). It remains to be seen whether other parts of the UK tax code derived from pre-Brexit EU law will survive the next few years. Similarly, it will be interesting to see whether the UK follows in the EU's footsteps in adopting measures targeting shell companies, granting relief for equity investment and/or addressing public CbCR.

At the same time, the UK government is seeking to attract new investment by emphasising the UK's suitability as a jurisdiction in which to locate holding companies. Whilst counterintuitive to some, it is hoped that the above-mentioned revenue-raising goals will not overshadow this message, and that the UK government will be able to strike the appropriate balance.

Lastly, the uncertainty around Pillar I and Pillar II looks set to continue. The UK has always sought to present itself as a thought leader and early mover in this process, but questions remain as to the specifics of the UK's implementation proposals. For example, it will be interesting to see whether the UK will follow the EU's example in applying the Pillar II rules to purely domestic MNEs. More importantly, if the UK does seek to implement the agreed proposals sooner than others, will they be the G8 "guinea pig" for any "top-up tax".

Endnotes

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