1. TAX TREATIES AND RESIDENCE

1.1 How many income tax treaties are currently in force in the UK?

The UK has one of the most extensive treaty networks in the world, with over 100 comprehensive income tax treaties currently in force. The Government reviews the UK’s tax treaty priorities each year and there is a rolling programme for the negotiation of new treaties to replace current treaties.

1.2 Do they generally follow the OECD Model Convention or another model?

They generally follow the OECD model, with some inevitable variation from one treaty to the next.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Yes. A tax treaty must be incorporated into UK law and this is done by way of a statutory instrument. A treaty will then enter into force from the date determined by the treaty and will have effect in relation to each tax covered from the dates determined by the treaty.

The UK’s diverted profits tax (discussed at question 10.1 below) was deliberately engineered as a new tax so as to fall outside the legislation which incorporates tax treaties into UK law.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation on benefits" articles)?

In general, the UK has avoided wide limitation on benefits articles and prefers specific provision in particular articles. For example, the Dividends, Interest or Royalties article may provide that the UK will not give up its taxing rights if, broadly, the main purpose or one of the main purposes of the creation or assignment of the relevant shares, loan or right to royalties is to take advantage of the article.

The OECD’s Base Erosion and Project Shifting (“BEPS”) project is considering various options for countering perceived treaty abuse, notably a limitation on benefits clause and a “principal purpose test” (PPT). The UK favours a PPT.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

The UK’s General Anti-Abuse Rule (the “GAAR”, discussed in question 9.1 below) can in principle apply if there are abusive arrangements seeking to exploit particular provisions in a double tax treaty, or the way in which such provisions interact with other provisions of UK tax law.
1.6 What is the test in domestic law for determining corporate residence?

There are two tests for corporate residence in the UK. The first is the incorporation test. Generally (that is, subject to provisions which disapply this test for certain companies incorporated before 15 March 1988), a company which is incorporated in the UK will automatically be resident in the UK.

Secondly, a company incorporated outside the UK will be resident in the UK if its central management is in the UK. This test is based on case law and focuses on board control rather than day-to-day management, though its application will always be a question of fact determined by reference to the particular circumstances of the company in question.

Both tests are subject to the tie-breaker provision of an applicable double tax treaty. If the tax treaty treats a company as resident in another country and not as a UK resident, the company will also be treated as non-UK resident for domestic UK tax purposes. It is notable that some of the treaties which the UK has renegotiated in the past few years do not contain the standard tie-breaker based on the company’s “place of effective management”. As a result, the status of a company which is managed in the UK but incorporated, for example, in The Netherlands, will be uncertain pending agreement between the two revenue authorities (“competent authority agreement”). The UK Government has said it will propose similar provisions in its bilateral negotiations in the future.

2. TRANSACTION TAXES

2.1 Are there any documentary taxes in the UK?

Stamp duty is a tax on certain documents. The main category of charge takes the form of an *ad valorem* duty, at 0.5% of the consideration, on a transfer on sale of stock or marketable securities (or of an interest in a partnership which holds such stock or securities). In practice stamp duty has little relevance if the issuer of the stock or securities is not a company incorporated in the UK.

See question 2.5 below for details of the stamp duty land tax that applies to land transactions in the UK.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The UK has had VAT since becoming an EC Member State in 1973. The UK VAT legislation gives effect to the relevant EC Directives. There are three rates of VAT:

- the standard rate of VAT is 20% and applies to any supply of goods or services which is not exempt, zero-rated or subject to the reduced rate of VAT;
- the reduced rate of VAT is 5% (e.g. for domestic fuel); and
- there is a zero rate of VAT which covers, for example, books, children’s wear and most foodstuffs.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

The exclusions from VAT are as permitted or required by the Directive on the Common System of VAT (2006/112/EC) (as amended) and some examples of exempt supplies are:
• most supplies of land (unless the person making the supply, or an associate, has “opted to tax” the land);
• insurance services; and
• banking and other financial services.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person (a person who is, or is required to be, registered for VAT). Input tax is attributed in accordance with the nature and tax status of the supplies that the person intends to make.

Input tax on supplies wholly used to make taxable supplies is deductible in full. Input tax wholly used to make exempt or non-business supplies is not deductible at all. Where a taxable person makes both taxable and exempt supplies and incurs expenditure that is not directly attributable to either (for example, general overheads), the VAT on the expenditure must be apportioned between the supplies.

The basis on which input tax can be recovered continues to be a vexed topic, generating some important judicial decisions. The subject is examined in detail in the introductory chapter to this book.

2.5 Are there any other transaction taxes payable by companies?

Stamp duty land tax (“SDLT”)

SDLT is a tax on transactions involving immovable property and is payable by the purchaser. The main rate of SDLT, where the consideration exceeds £500,000, is 4%. However, for transactions involving residential property, the rate can be as much as 15% if the consideration exceeds £500,000 and the property is acquired by a company or other "non-natural person". The standard charge on the rental element of a new lease is 1% of the net present value of the rent, determined in accordance with a statutory formula.

SDLT is a compulsory, self-assessed transaction tax and is chargeable whether or not there is a written document.

From 15 April 2015, SDLT ceased to apply to land and buildings in Scotland; in its place is a new tax which will have a similar scope to SDLT. This was provided for in the first piece of tax legislation from the Scottish Parliament in 300 years, the Land and Buildings Transaction Tax (Scotland) Act 2013.

Stamp duty reserve tax (“SDRT”)

SDRT is charged in respect of an agreement to transfer chargeable securities for money or money’s worth whether or not the agreement is in writing. Subject to some exceptions, “chargeable securities” are stocks, shares and units under a unit trust scheme. SDRT is imposed at the rate of 0.5% of the amount or value of consideration.

A higher rate of 1.5% is imposed if shares or securities are transferred (rather than issued) to a depositary receipt issuer or a clearance service and the transfer is not an integral part of the raising of share capital. (Following two cases brought by HSBC citing the Capital Duties Directive, HMRC now accept that the charge cannot be applied where shares or securities are issued to a depositary or clearance service, or transferred to such an entity as an integral part of the raising of share capital. There is a group litigation order pending before the UK courts which will address the remaining question of the 1.5% charge on other transfers.)
SDRT liability is imposed on the purchaser and is directly enforceable. Where a transaction is completed by a duly stamped instrument within six years from the date when the SDRT charge arose, there is provision in many cases for the repayment of any SDRT already paid or cancellation of the SDRT charge.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties are generally payable on goods imported from outside the EU. Excise duties are levied on particular classes of goods (e.g. alcohol and tobacco). Insurance premium tax is charged on the receipt of a premium by an insurer under a taxable insurance contract. Environmental taxes include the following: landfill tax; aggregates levy; climate change levy; and a carbon reduction charge.

3. CROSS-BORDER PAYMENTS

3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

In most cases, no withholding tax is imposed on dividends paid by a UK resident company. “Property income dividends” from UK Real Estate Investment Trusts (REITs) are, however, subject to withholding tax at the rate of 20% if paid to non-resident shareholders (or to certain categories of UK resident shareholder); this may be reduced to 15%, or in some cases less, by an applicable double tax treaty.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the EC Interest and Royalties Directive (2003/49/EC) does not apply, the rate of withholding tax on most royalties is 20%. There is no withholding tax on film and video royalties.

The UK legislation implementing that directive provides that there is no withholding tax on the payment of royalties (or interest) by a UK company (or a UK permanent establishment of an EU company) to an EU company which is a “25% associate”. The exemption does not apply to the extent that any royalties (or interest) would not have been paid if the parties had been dealing at arm’s length. An EU company for these purposes is a company resident in a Member State other than the UK.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

In the absence of a double tax treaty and provided that the UK legislation implementing the EC Interest and Royalties Directive does not apply, the rate of withholding tax on “yearly” interest which has a UK source and is paid to a non-resident is generally 20%.

There is no withholding tax, however, where interest is paid on quoted Eurobonds; and by the end of 2015, legislation should be in place that provides for a new exemption from withholding tax on interest paid on private placements, a form of selective, direct lending by non-bank lenders (such as insurers) to corporate borrowers.

Further changes may be in the offing: HMRC published a consultation document in July 2015 which considers whether the UK withholding tax system needs revisiting more generally.
3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

The UK has a thin capitalisation regime which applies to domestic as well as cross-border transactions following the Lankhorst-Hohorst case (C324/00).

A borrower is considered according to its own financial circumstances for the purposes of determining the amount which it would have borrowed from an independent lender. The assets and income of the borrower’s direct and indirect subsidiaries can be taken into account to the same extent that an unconnected lender would recognise them, but the assets and income of other group companies are disregarded.

3.5 If so, is there a “safe harbour” by reference to which tax relief is assured?

There are no statutory safe harbour rules. Historically, HMRC adopted a rule of thumb that a company would not generally be regarded as thinly capitalised where the level of debt to equity did not exceed a ratio of 1:1 and the ratio of income (“EBIT”) to interest was at least 3:1. HMRC’s current guidance moves away from this to apply the arm’s length standard on a case-by-case basis and sets out broad principles that should be considered; and the ratio cited most often is debt to EBITDA (earnings before interest, tax, depreciation and amortisation).

3.6 Would any such rules extend to debt advanced by a third party but guaranteed by a parent company?

Yes. A company may be thinly capitalised because of a special relationship between the borrower and the lender or because of a guarantee given by a person connected with the borrower. A “guarantee” for this purpose need not be in writing and includes any case in which the lender has a reasonable expectation that it will be paid by, or out of the assets of, another connected company.

3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

There is a further restriction on tax relief for finance expenses of groups of companies in certain circumstances. The “worldwide debt cap”, as it is known, limits the aggregate UK tax deduction for the UK members of a group that have net finance expenses to the worldwide consolidated gross finance expense of that group. The main intention is to prevent non-UK multinationals from reducing the tax paid by their UK subsidiaries by “dumping” debt in the UK.

So that most groups can ignore the regime, it includes a “gateway test” based on principal rather than interest. This simply compares the aggregate of the net debt of the UK-taxpaying members of the group for an accounting period with the worldwide gross debt of the group as a whole. If the aggregate UK net debt does not exceed 75% of the worldwide gross debt, then the debt cap will not apply.

Financial services groups fall outside these rules if certain conditions are met.

3.8 Is there any withholding tax on property rental payments made to non-residents?

In principle, such payments will be subject to withholding tax (by the tenant or agent) at 20%, being the basic rate of income tax in the UK. However, the non-resident can register as an overseas landlord under the Non-resident Landlords Scheme and then account for income tax itself (again at 20%). Most commercial landlords that are non-resident opt for registration under this scheme.
One notable consequence of the reductions in the rate of corporation tax (see question 4.1 below) is that a UK corporate landlord may soon be paying less tax on UK source rent than a non-resident landlord.

3.9 Does the UK have transfer pricing rules?

Yes. The UK transfer pricing rules apply to both cross-border and domestic transactions between associated companies.

If HMRC do not accept that pricing is arm’s length, they will raise an assessment adjusting the profits or losses accordingly. It is possible to make an application for an advance transfer pricing agreement which has the effect that pricing (or borrowing) in accordance with its terms is treated as arm’s length.

In cross-border transactions, the double taxation caused by a transfer pricing adjustment can be mitigated by the provisions of a tax treaty.

Transfer pricing is also on the BEPS radar, of course, with changes to the OECD Transfer Pricing Guidelines expected. Consequential changes to the UK rules are likely to follow fairly promptly.

4. TAX ON BUSINESS OPERATIONS: GENERAL

4.1 What is the headline rate of tax on corporate profits?

The current Government continues to reduce the headline rate of tax, as part of a package of tax reforms designed to enhance UK competitiveness. From a starting point of 28% (in 2010) it is now 20% (from 1 April 2015) and the Government has said it will fall further, to 19% in 2017 and 18% in 2020. Banks, however, are an exception; from 2016 they will pay an 8% surcharge on top of the headline rate of corporation tax.

4.2 Is the tax base accounting profit subject to adjustments, or something else?

In general terms, tax follows the commercial accounts subject to adjustments.

4.3 If the tax base is accounting profit subject to adjustments, what are the main adjustments?

Certain items of expenditure which are shown as reducing the profits in the commercial accounts are added back for tax purposes and deductions may then be allowable. For example, in the case of most plant or machinery, capital allowances on a reducing balance basis (at various rates depending on the type of asset and the level of expenditure incurred – the rules are not very generous) are substituted for accounting depreciation.

UK tax legislation has been amended to deal with various issues arising from companies adopting International Accounting Standards for their accounts and in certain circumstances related adjustments are required for tax purposes.

In June 2013, HMRC published a consultation document which proposed an overhaul of the rules governing the tax treatment of corporate debt and derivative contracts. Consequential legislation should finally take effect in Autumn 2015. One of the innovations will be a broad anti-avoidance provision and this may lead to an increase in the circumstances in which the taxation of such financial instruments deviates from their accounting treatment.
4.4 Are there any tax grouping rules? Do these allow for relief in the UK for losses of overseas subsidiaries?

Yes. The UK does not permit group companies to be taxed on the basis of consolidated accounts but the grouping rules achieve a degree of effective consolidation for various tax purposes. A group consists, in most cases, of a parent company and its direct or indirect subsidiaries, but the exact test for whether a group exists depends on the tax in question.

**Group relief group**

Losses (other than capital losses) can be surrendered from one UK resident group company to another UK resident group company. Losses can also be surrendered by or to a UK permanent establishment of a non-UK group company. A UK permanent establishment of an overseas company can only surrender those losses as group relief if they are not relievables (other than against profits within the charge to UK corporation tax) in the overseas country. Similarly, a UK company can surrender the losses of an overseas permanent establishment if those losses are not relievables (other than against profits within the charge to UK corporation tax) in the overseas country.

Following the judgment of the European Court of Justice (as it then was) in *Marks and Spencer v David Halsey* (C446/03), the UK legislation was amended to permit group relief to be given in the UK for otherwise unrelievables losses incurred by group members established elsewhere in the EU, even if they are not resident or trading in the UK. However, the applicable conditions are very restrictive and a challenge from the European Commission was dismissed by the CJEU in February 2015 (C172/13), so in practice UK companies will rarely be able to benefit from this change.

**Capital gains group**

There is no consolidation of capital gains and losses, but it is possible to make an election for a gain (or loss) on a disposal made by one capital gains group member to be treated as a gain (or loss) on a disposal by another group member.

Capital assets may be transferred between capital gains group members on a no gain/no loss basis. This has the effect of postponing liability until the asset is transferred outside the group or until the company holding the asset is transferred outside the group. When a company leaves a capital gains group holding an asset which it acquired intra-group in the previous six years, a degrouping charge may arise. However, in many cases, the degrouping charge will be added to the consideration received for the sale of the shares in the transferee company and will then be exempt under the substantial shareholding regime (see question 5.2 below for details of this regime).

**Stamp duty and SDLT groups**

Transfers between group companies are relieved from stamp duty or from SDLT where certain conditions are met.

**VAT group**

Transactions between group members are disregarded for VAT purposes (although HMRC have powers to override this in certain circumstances). Broadly, two or more corporate bodies are eligible to be treated as members of a VAT group if each is established or has a fixed establishment in the UK and they are under common control. This restriction to corporate bodies currently prevents a partnership from being a member of a VAT group but this may have to change following the recent case of *Larentia + Minerva* (C-108/14).
4.5 Do tax losses survive a change of ownership?

Tax losses may survive a change of ownership but, like many other jurisdictions, the UK has rules which can deprive a company of carry-forward losses in certain circumstances following such a change. The policy objective is to combat loss-buying but the rules can easily apply where there is no tax motivation for the change in ownership.

The Finance Act 2014 contained legislation to ease the rules for changes occurring on or after 1 April 2014; HMRC’s stated intention was to bring the rules more into line with modern commercial practice. The legislation was welcome but, as the rules continue to lack a motive defence, they will remain a problem for some entirely commercial transactions.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, it is not.

4.7 Are companies subject to any significant taxes not covered elsewhere in this chapter – e.g. tax on the occupation of property?

Business rates are payable by the occupier of business premises based on the annual rental value. The rate depends on the location of the business premises and the size of the business. Business rates are a deductible expense for corporation tax purposes.

An annual tax on enveloped dwellings (“ATED”) is payable by companies and certain other “non-natural persons” if they own interests in dwellings with a value of more than £1 million. From April 2016 this threshold will decrease to £500,000. There are reliefs available, including where the dwelling is being or will be used for genuine commercial activities.

There are special regimes for the taxation of certain types of activity or company, such as oil exploration (profits from which are subject to a “supplementary charge”) and UK REITs (which are not generally taxed on income or gains from investment property).

5. CAPITAL GAINS

5.1 Is there a special set of rules for taxing capital gains and losses?

Corporation tax is chargeable on “profits”, which includes both income and capital gains. There is, however, a separate regime for computing capital gains. This contains more exemptions, but also has the effect that capital losses can only be used against gains, not against income.

5.2 Is there a participation exemption for capital gains?

Yes. A substantial shareholdings exemption allows trading groups to dispose of trading subsidiaries without a UK tax charge, though it is narrower and more complex than the participation exemption found in some other countries.

Capital gains realised on the disposal of assets by non-residents are not subject to corporation tax unless the assets were used for the purposes of a trade carried on through a UK permanent establishment, a point which is discussed...
further in question 6.3 below. See also question 8.1 for a new capital gains tax charge that can apply in certain (very specific) circumstances.

5.3 Is there any special relief for reinvestment?

There is rollover relief for the replacement of certain categories of asset used for the purposes of a trade. Rollover is available to the extent that the whole or part of the proceeds of disposal of such assets is, within one year before or three years after the disposal, applied in the acquisition of other such assets.

It is a feature of the UK’s rules that the replacement assets have to remain within the UK tax net. A similar requirement was recently held by the CJEU to be a restriction on freedom of establishment (European Commission –v- Germany (C-591/13)): the Court ruled that the taxpayer should be able to choose between immediate payment or bearing the administrative burden of deferring the tax. So it is surely only a matter of time before the UK changes its rules to permit a deferral or faces infringement proceedings itself.

5.4 Does the UK impose withholding tax on the proceeds of selling a direct or indirect interest in local assets/shares?

This occurs only in very specific circumstances; one example is on the sale of UK patent rights by a non-resident individual who is subject to UK income tax on the proceeds of the sale (or by a non-resident company which is subject to UK corporation tax, if the buyer is an individual).

6. LOCAL BRANCH OR SUBSIDIARY?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary.

6.2 What is the difference, if any, between the taxation of a locally formed subsidiary and the branch of a non-resident company?

A UK resident subsidiary would pay corporation tax on its worldwide income and gains, unless it makes the election described in question 7.1 below, whereas a UK branch would be liable to corporation tax only on the items listed in question 6.3. The charge to UK corporation tax imposed on a non-resident company only applies where the non-resident company is trading in the UK through a permanent establishment. This means that a branch set up for investment purposes only, and not carrying on a trade, is not subject to UK corporation tax, though certain types of income arising in the UK – notably rent and interest – may be subject to income tax through withholding (at 20%).

6.3 How would the taxable profits of a local branch be determined in its jurisdiction?

Assuming that the local branch of a non-resident company is within the UK statutory definition of “permanent establishment” (which is based on the wording of Article 5 of the OECD Model Convention), it will be treated as though it were a distinct and separate entity dealing wholly independently with the non-resident company. It will also be treated as having the equity and loan capital which it would have if it were a distinct entity, which means that the UK’s thin capitalisation rules will apply to it.
Subject to any treaty provisions to the contrary, the taxable profits of a permanent establishment through which a non-resident company is trading in the UK would comprise:

- trading income arising directly or indirectly through, or from, the permanent establishment;
- income from property and rights used by, or held by or for, the permanent establishment (but not including exempt distributions); and
- capital gains accruing on the disposal of assets situated in the UK and effectively connected with the operations of the permanent establishment.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profits tax.

6.5 Would a branch benefit from double tax relief in its jurisdiction?

The UK domestic legislation does not give treaty relief against UK tax unless the person claiming credit is resident in the UK for the accounting period in question. This means that the UK branch of a non-resident company cannot claim treaty relief.

Unilateral tax credit relief may be allowed for tax paid outside the UK in respect of the income or chargeable gains of a UK branch or agency of a non-UK resident person if certain conditions are fulfilled. Tax payable in a country where the overseas company is taxable by reason of its domicile, residence or place of management is excluded from relief.

6.6 Would any withholding tax or other similar tax be imposed as the result of a remittance of profits by the branch?

No, it would not.

7. OVERSEAS PROFITS

7.1 Does the UK tax profits earned in overseas branches?

As a general rule, and subject to tax treaty provisions, the UK taxes the profits earned in overseas branches of UK resident companies. A UK company can, however, elect for the profits (including capital gains) of its overseas branches to be exempt from UK taxation. The downside of such an election is that the UK company cannot then use the losses of the overseas branch. An election is irrevocable and covers all overseas branches of the company making the election.

7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Foreign dividends and UK dividends (other than “property income dividends” from a UK REIT) are treated in the same way. They are generally exempt in the hands of a UK company, subject to some complex anti-avoidance rules and an exclusion for dividends paid by a “small” company which is not resident in the UK or a “qualifying territory”.
It was announced at the Summer Budget (July 2015) that there would be a consultation on the taxation of company distributions in the Autumn. It is expected that this consultation will focus on how individuals are taxed on company dividends; legislation was introduced earlier in 2015 to stop UK companies offering retail shareholders a choice between income and capital, and HMRC is understood to have continuing concerns in this area. But the consultation may also seek views on a wider range of issues in relation to distributions.

7.3 Does the UK have “controlled foreign company” rules and, if so, when do these apply?

The UK first introduced a CFC regime in 1984, allowing the attribution of the profits of a CFC to UK corporate owners in specified circumstances. A CFC is a company resident outside the UK but under UK control.

The regime has been overhauled for accounting periods beginning on or after 1 January 2013, as part of the UK’s shift away from taxing the worldwide profits of UK companies to a more territorial approach. Under the revised rules, profits which arise naturally outside the UK are not supposed to be caught.

There are also various exclusions and exemptions. These include a finance company partial exemption which (while the main rate of corporation tax is 20%) results in an effective UK corporation tax rate of 5% on profits earned by a CFC from providing funding to other non-UK members of the relevant group. Indeed in some instances such profits will not be caught by the CFC charge at all.

The new CFC regime may still not, however, comply with the criteria laid down by the ECJ in Cadbury Schweppes (C-196/04), as it is not restricted to “wholly artificial arrangements” which do not reflect economic reality. It is therefore vulnerable to further challenge under EU law.

Moreover, a change that took effect from 8 July 2015 adds a punitive element to the new regime: a group which has losses can no longer use them against a CFC charge. This reduces the attractiveness of the finance company partial exemption for groups with carried-forward losses.

8. TAXATION OF REAL ESTATE

8.1 Are non-residents taxed on the disposal of real estate in the UK?

Non-residents are not generally taxed on the disposal of real estate in the UK. However, a company (or other “non-natural person”) which disposes of a residential property worth more than £1 million will be liable to capital gains tax if no relief applies; the rate is 28%, to match the higher rate applicable to individuals. The £1 million threshold decreases to £500,000 from April 2016.

8.2 Does the UK impose tax on the transfer of an indirect interest in real estate located in the UK and, if so, what constitutes an indirect interest?

No, it does not.

8.3 Does the UK have a special tax regime for Real Estate Investment Trusts (“REITs”) or their equivalent?

Yes. Since 2007, the UK’s REIT regime has enabled qualifying companies to elect to be treated as REITs. The conditions for qualification include UK residence, listing (on a main or secondary stock market), diversity of
ownership and a requirement that three-quarters of the assets and profits of the company (or group) are attributable to its property rental business.

The aim of the regime is that there should be no difference from a tax perspective between a direct investment in real estate and an investment through a REIT. Accordingly, a REIT is exempt from tax on income and gains from its property rental business but distributions of such income/gains are treated as UK property income in the hands of shareholders and, as noted in question 3.1 above, are liable to 20% withholding tax (subject to exceptions).

9. ANTI-AVOIDANCE

9.1 Does the UK have a general anti-avoidance or anti-abuse rule?

Although a GAAR was enacted in the UK for the first time in 2013, it is likely to be some time before the UK courts are asked to make sense of it. One reason for this is that, before invoking the GAAR, HMRC must ask an independent advisory panel (the GAAR Panel) for its opinion as to whether the GAAR should apply. The GAAR Panel has not yet published any opinions so it is too early to tell whether there will be “mission creep” on the part of HMRC, taking advantage of the lamentably vague drafting of the GAAR.

The legislation contains two tests: are there arrangements which have as their main purpose securing a tax advantage; and if so, are they arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action (the justly maligned “double reasonableness” test)? This is to be assessed “having regard to all the circumstances”, including consistency with policy objectives, whether there are any contrived or abnormal steps and whether the arrangements exploit any shortcomings in the relevant provisions.

If the GAAR applies, HMRC can counteract the tax advantage by the making of “just and reasonable” adjustments.

As predicted, the GAAR has had little impact on corporate taxpayers, as they had already begun to adopt a more conservative approach to tax planning.

9.2 Is there a requirement to make special disclosure of avoidance schemes?

The UK has disclosure rules which are designed to provide HMRC with information about potential tax avoidance schemes at an earlier stage than would otherwise have been the case. This enables HMRC to investigate the schemes and introduce legislation (often a new “targeted anti-avoidance rule”) to counteract the avoidance where appropriate.

The UK Government sees these mandatory disclosure rules as the answer to Action 12 of the BEPS project (that taxpayers be required to disclose their aggressive tax planning arrangements).

10. BEPS AND TAX COMPETITION

10.1 Has the UK introduced any legislation in response to the OECD’s project targeting Base Erosion and Profit Shifting (BEPS)?

The UK was the first of 44 countries to commit formally to implementing the country-by-country template and an enabling power was included in Finance Act 2015.
The UK has, controversially, pre-empted the BEPS project and introduced with effect from 1 April 2015 an entirely new tax - the "diverted profits tax" - which is intended to protect the UK tax base. It has two main targets: where there is a substantial UK operation but sales to UK customers are made by an affiliate outside the UK, in such a way that the UK operation is not a permanent establishment of the non-UK affiliate; and where the UK operation makes deductible payments (e.g. royalties for intellectual property) to a non-UK affiliate, these are taxed at less than 80% of the rate of corporation tax and the affiliate has insufficient "economic substance". As a deterrent, the rate applicable to the "diverted" profits will be 5% higher than the rate at which tax would otherwise have been payable.

The UK has agreed to modify its patent box regime in response to Action 5 (Countering Harmful Tax Practices) (see 10.2 below).

10.2 Does the UK maintain any preferential tax regimes such as a patent box?

The UK has a patent box regime which allows an arm's length return on IP held in the UK to qualify for a low tax rate (of effectively 10% by 2017) even if all the associated R&D activity was done outside the UK.

Following a complaint from Germany that this "transfer pricing approach" encourages patent profits to be shifted to the UK, the UK has agreed to cut back its regime. The proposal is that the current rules should continue to apply until June 2016 and that any IP then in the patent box should be taxed under them for a further five years. Under the revised UK patent box, however, the benefit for what is perceived to be “bad” patent income will be only 30% of what it is under the current regime.

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