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Recent Developments in International Taxation
United Kingdom

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Executive Summary

(A) The period from June 2022 to June 2023 during which the UK had three different Prime Ministers and Chancellors of the Exchequer was marked by political uncertainty. Especially during Liz Truss's premiership, tax as a policy space provided more excitement than ever. With Prime Minister Rishi Sunak and Chancellor Jeremy Hunt now having been in office for over six months, the excitement appears to have somewhat calmed, but it remains to be seen how long this will last, given that the next general election is scheduled to be held no later than 28 January 2025.

(B) The Government proceeded with the rise in the headline rate of corporation tax from 19 to 25 per cent. from 1 April 2023. To mitigate the impact of this on the UK's tax competitiveness, generous changes to the UK's capital allowances regime have been made to (temporarily) permit full expensing of most capital expenditure during the year in which it has been incurred. The Chancellor has suggested that these changes may be made permanent, but currently they are being legislated to last for three years. As has been noted by other commentators that, unless the changes to the capital allowances regime are made permanent, they are not likely to affect medium to long-term investment decisions, and the bulk of the relief is likely to go for expenditure that has been committed.[1]

(C) Enhancing the UK's attractiveness for businesses is firmly on the Chancellor's agenda. He announced 12 new "Investment Zones" with "special tax sites" offering a range of tax reliefs to businesses operating there. Changes were made to retarget tax reliefs for R&D, with an increase in the rate of R&D tax relief for larger companies and a general decrease in the rate of R&D tax relief for small and medium enterprises which was then balanced through the introduction of more favourable rules for certain R&D intensive small and medium enterprises. There is also an ongoing public consultation on overhauling the R&D tax reliefs regime, making this a space to watch.[2]

(D) The scope of the "Qualifying Asset Holding Companies" regime introduced in 2022 will be enlarged to make the UK a more attractive place for locating asset holding companies. The Tonnage Tax regime has also been updated to attract shipping companies. In parallel, legislation to implement the GloBE Pillar Two income inclusion rule is expected to be passed imminently. The UK's income inclusion rule will be called the "multinational top-up tax", and the legislation also introduces a new "domestic top-up tax" intended to constitute a qualified domestic minimum tax for Pillar Two purposes. Unsurprisingly, the legislation is hugely complex. His Majesty's Revenue and Customs ("**HMRC**") is currently consulting on the first tranche of its limited guidance on the new taxes. Grappling with the new rules will be a challenge for MNEs operating in the UK (and elsewhere), particularly in M&A context.

[1] Michael Lane, "Because it's all about the base, about the base...", 15 March 2023, European Tax Blog, available at https://www.europeantax.blog/post/102iaji/because-its-all-about-the-base-about-the-base.

[2] Kasim Mehmood, "Relief for R&D Expenditure: A Brief Respite or a Change in Strategy?", 15 March 2023, European Tax Blog, available at https://www.europeantax.blog/post/102iaiz/relief-for-rd-expenditure-a-brief-respite-or-a-change-in-strategy.

(E) This coupled with uncertainty in other (tax and non-tax) areas, such as HMRC's "unallowable purpose" challenges to the deductibility of interest, the impact of Brexit-related legislation in the tax space, the possibility of a Labour government following the next general election, and the general low-growth, high-inflation state of the economy, do mean that the recent calm in the UK tax world is a temporary respite for taxpayers and advisers in an otherwise ever changing landscape.

Introduction

(A) It has been an eventful year for UK tax (to say the least). On 23 September 2022, then Chancellor Kwasi Kwarteng announced his "Growth Plan" (more commonly known as the "**Mini-Budget**"), which envisaged that the rate of corporation tax ("**CT**") would be kept at 19% (rather than being increased to 25% from April 2023) and that personal income tax would be cut, including to remove the additional rate applicable to the top tranche of income of the highest earners.

(B) Given the market turmoil that had resulted from the Mini-Budget and the criticism of the measures that had been announced, then Chancellor Kwasi Kwarteng abandoned the proposal to remove the additional rate of income tax on 3 October. Jeremy Hunt then replaced Kwasi Kwarteng as Chancellor of the Exchequer on 14 October 2022 and the reversal of other changes proposed as part of the Mini-Budget was announced.

(C) In his Autumn Statement of 17 November 2022, Chancellor Jeremy Hunt announced that there would be an Autumn Finance Bill in 2022 (the "**Autumn Finance Bill**"), and a Spring Finance Bill in 2023 (the "**Spring Finance Bill**"). The Autumn Finance Bill became Finance Act 2023 on 10 January 2023. The Spring Finance Bill has passed the UK Parliament's first chamber, the House of Commons, and is currently before the second chamber, the House of Lords. Under the UK's parliamentary procedure, the Spring Finance Bill is classified as a "money bill", meaning that it does not need to be approved by the House of Lords to become law. In practice, money bills progress quickly through the House of Lords with no substantive discussion, or amendments being suggested.

(D) This update covers certain measures introduced by both the Finance Act 2023 and the Spring Finance Bill. It is expected that the Spring Finance Bill will become law in summer 2023 (following its Royal Assent).

Corporation tax

3.1 Rate

(A) On 1 April 2023, the UK's main rate of CT rose to 25 per cent. (from 19 per cent.) for companies with profits over £250,000. A "small profits rate" of 19 per cent was introduced for companies with profits of not more than £50,000. Companies with profits between £50,000 and £250,000 will pay CT at the main rate, reduced by "marginal relief", which provides for a gradual increase in the effective corporate tax rate.

(B) Companies that make their profits from oil and gas extraction or oil rights in the UK or the UK continental shelf (the "**ring fence companies**") are subject to different CT rates. From 1 April 2023, the small profits rate for ring-fence companies is 19 per cent., but the main rate of CT for profits above £250,000 is 30 per cent. Marginal relief is available for companies with profits between £50,000 and £250,000. Ring fence companies also pay a "surcharge" at a rate of 10% and may be subject to petroleum revenue tax (which is not covered in this update) and the Energy Profits (Oil and Gas) Levy (see paragraph 6.2).

(C) Banking companies pay a "surcharge" on their profits, in addition to CT. The rate of the banking surcharge was reduced from 8 per cent. to 3 per cent. from 1 April 2023, to mitigate the impact of the increase in the CT rate for banking companies.

(D) Multinational enterprises ("**MNEs**") that have business activities in the UK and use artificial arrangements to divert profits from the UK (e.g., by avoiding a UK taxable presence) are subject to a separate "Diverted Profits Tax" ("**DPT**") on such diverted profits. From 1 April 2023, the rate of DPT increased from 25 per cent. to 31 per cent. (for non-ring fence companies and companies that are not banking companies, separate DPT rates apply which remain unchanged at 55 per cent. and 33 per cent. respectively). The government published a consultation on 19 June 2023 that proposes a potential merger of DPT with CT.

3.2 Capital allowances

(A) The Spring Finance Bill introduces a new 100 per cent. first-year allowance (i.e., full expensing) for main rate expenditure (meaning expenditure which would otherwise have qualified for writing down relief at a rate of 18 per cent.) and a 50 per cent. first-year allowance for special rate (6 per cent.) expenditure (meaning expenditure which would otherwise have qualified for writing down relief at a rate of 6 per cent., and the balance would still qualify for relief at this existing 6 per cent. rate).

(B) These allowances would apply to expenditure incurred from 1 April 2023 until the end of March 2026 (but will exclude expenditure for leasing). Whilst the Chancellor announced a desire to make these allowances permanent, there is no firm commitment.

(C) The Spring Finance Bill also makes the temporary annual investment allowance of £1 million, which was due to expire on 31 March 2023, permanent. This enables businesses to deduct 100 per cent. of the costs of qualifying plant and machinery up to £1 million in the first year.

3.3 R&D tax relief

(A) The Finance Act 2023 decreased the rate at which relief for R&D is available to small and medium enterprises ("**SMEs**") and increased the Research and Development Expenditure Credit ("**RDEC**") (which generally benefits large companies) from 13 per cent. to 20 per cent. The changes apply in relation to expenditure incurred on or after 1 April 2023.

(B) The Spring Finance Bill introduced a new R&D credit scheme for SMEs in the UK which effectively mitigates the reduction of the relief under the Finance Act 2023. From 1 April 2023, "R&D intensive" loss-making SMEs (i.e., an SME where the "qualifying R&D expenditure" is at least 40 per cent. of that company's total expenditure) will be entitled to claim minimum £27 in the form of cash tax credit from HMRC for every £100 of the qualifying R&D expenditure.

(C) The UK Government is consulting on merging the SME R&D tax relief and RDEC schemes. It had previously announced a general restriction on claiming UK R&D tax reliefs on non-UK R&D expenditure, which was intended to take effect from 1 April 2023. That has now been delayed until 1 April 2024 to allow the Government to consider its interaction with a wider reform of the R&D tax relief regime in the UK.

3.4 Interest deductibility and the unallowable purpose rules

(A) The UK tax legislation disallows deductibility for so much of any interest debit in respect of a loan relationship in an accounting period as, on a just and reasonable apportionment, is attributable to an "unallowable purpose". "Unallowable purpose" includes where one of the main purposes for which a company is party to a relationship is "any purpose which consists of securing a tax advantage for the company or any other person".

(B) The unallowable purpose rules are currently high on HMRC's radar (with HMRC also recently revising their guidance on these rules). As the case law on these rules remains unsettled (with several cases making their way through the courts and tribunals), taxpayers need to carefully consider their application.

3.5 Transfer Pricing

(A) The Spring Finance Bill includes provision which will enable the government to specify, by way of secondary legislation in the form of a regulation, the transfer pricing documentation that taxpayers are required to maintain. Draft transfer pricing regulations were published in December 2022, which require MNEs with a turnover of €750m or more, operating in the UK, to keep and preserve a master file and a local file in accordance with the OECD Transfer Pricing Guidelines.

(B) The regulations are intended to have effect (for corporation tax purposes) in relation to accounting periods beginning on or after 1 April 2023. HMRC consulted on the draft regulations in February 2023 and are now considering the feedback obtained.

(C) The draft regulations also give HMRC the power to introduce the requirement for MNEs to produce a "summary audit trail" ("**SAT**"). The SAT is a document covering the steps taken by members of an in-scope MNE in completing their local file. HMRC will undertake public consultation in 2023 on this requirement and so the measure will not come into force from 1 April 2023.

Enhancing the UK’s attractiveness for MNEs

4.1 Qualifying asset holding company regime

(A) The Finance Act 2022 introduced a new qualifying asset holding company (“**QAHC**”) regime in the UK, the purpose of which is to make the UK more attractive as a jurisdiction to locate asset holding companies (“**AHC**”), which are generally intermediaries in a fund structure. The Spring Finance Bill includes targeted changes, mainly to the “genuine diversity of ownership” (“**GDO**”) condition for being a QAHC, to make the regime more widely available to investment fund structures.

(B) A key change is that where a fund is part of a “multi-vehicle arrangement”, either the fund in isolation or the multi-vehicle arrangement (taken as a whole) may satisfy the GDO condition. Multi-vehicle arrangement means any arrangement that consists of two or more funds, where an investor in one of them would reasonably regard that investment as an investment in the arrangements as a whole rather than exclusively in any particular fund.

4.2 Tonnage Tax

(A) The Tonnage Tax regime was introduced in 2000 to make the UK’s shipping industry more competitive. The Government has opened an election window (from 1 June 2023 to 30 November 2024) for the first time in nearly 18 years to enable shipping companies that left the Tonnage Tax regime to return to the UK.

(B) The government also intends to legislate in Finance Bill 2023-24 to permit third party ship management companies to join the regime, and to raise the limit on capital allowances to £200 million for lessors of ships within the regime. These measures will take effect from 1 April 2024.

4.3 Investment zones

(A) The Spring Budget 2023 confirmed the Chancellor’s intention to create 12 “Investment Zones” across the UK, with a focus on the digital and technology sector, life sciences, the creative industries, green technologies, and advanced manufacturing.

(B) The Spring Finance Bill contains provisions to designate “special tax sites” within or connected to an Investment Zone as geographical areas where businesses can benefit from various tax reliefs, including relief from stamp duty land tax, enhanced capital allowances for plant and machinery, enhanced structures and building allowances, and relief from certain national insurance contributions (being the UK’s system of social security).

International Tax

5.1 The UK's implementation of Pillar Two

(A) Following the agreement reached by over 130 countries in the OECD's Inclusive Framework in October 2021 on a two-pillar solution to reform the international tax framework in response to the challenges posed by digitalisation of the economy, the UK government consulted on the UK's implementation of Pillar 2 in 2022.

(B) The Spring Finance Bill includes the legislation to implement the GloBE Pillar Two income inclusion rule. The UK's income inclusion rule will be called the "multinational top-up tax", and the legislation also introduces a new "domestic top-up tax" intended to constitute a qualified domestic minimum tax for Pillar Two purposes. The new taxes would apply for accounting periods beginning on or after 31 December 2023.

(C) Broadly, the multinational top-up tax will apply to consolidated MNE groups with global annual revenue exceeding €750 million or more in any two out of the four accounting periods preceding the tested period. This will be charged on the UK parent when a subsidiary is in a non-UK jurisdiction and the group's profits arising in that jurisdiction are taxed at a rate below the minimum effective tax rate of 15 per cent.

(D) The domestic top-up tax is a separate top-up tax charge applicable to the UK operations of multinational groups, wholly domestic groups and single entities that meet the same revenue threshold as above and have an aggregate effective tax rate of less than 15 per cent.

5.2 Restriction on double tax relief claims

(A) The Spring Finance Bill includes a restriction on extended time limit claims for double taxation relief, where that relief is calculated by reference to a foreign nominal rate of tax. Subject to some carve-outs, this restriction would apply retrospectively to all claims made on or after 20 July 2022.

5.3 Double taxation agreement ("DTA") between the UK and Brazil

(A) In November 2022, the UK and Brazil signed a DTA. The DTA will come into force when both Brazil and the UK have notified each other that the domestic procedures required to bring a DTA into force have been completed. Once this DTA comes into effect, the UK will have DTAs with seven out of the ten most populous countries in Latin America and the Caribbean.

Other UK tax developments

6.1 Electricity generator levy

(A) Following the announcement in the Chancellor's Autumn Budget, draft legislation for the Electricity Generator Levy ("**EGL**") was published in December 2022, which was incorporated with certain revisions into the Spring Finance Bill. The EGL is a 45%

temporary charge on “exceptional receipts” (exceeding £10 million in an accounting period) generated from the production of wholesale electricity, that will apply from 1 January 2023 to the end of March 2028 to undertakings which generate over 50GWh per year.

(B) “Exceptional receipts” mean amounts generated from selling wholesale electricity at an average price more than a benchmark price of £75/MWh over an accounting period (to be adjusted in line with Consumer Price Index in the subsequent years).

(C) The EGL is the UK Government’s response to the rising profits earned by electricity generators following the steep rise in gas prices last year following Russia’s invasion of Ukraine.

6.2 Energy (oil and gas) profits levy

(A) This levy is an additional tax originally charged at a rate of 25 per cent. (which the Finance Act 2023 increased to 35 per cent.) on profits from UK oil and gas upstream activity. The Finance Act 2023 also decreased the rate of the investment allowance which was introduced with the levy from 80% to 29% which was intended to broadly maintain the cash value of the relief following the rate increase. At the Autumn Statement, it was also announced that the 80% rate would continue to apply on expenditure incurred on de-carbonisation of upstream petroleum production on or after 1 January 2023. The legislation for this de-carbonisation allowance is included in the Spring Finance Bill.

(B) Finance Act 2023 also extended the date on which the levy expires to 31 March 2028 (from 31 December 2025). On 9 June 2023, the government announced a new Energy Security Investment Mechanism pursuant to which the levy should be phased out early if oil and gas prices fall to, or below, $71.40 per barrel for oil and £0.54 per therm for gas, for two consecutive quarters. But the announcement indicates that, on current estimates, the government does not expect that these thresholds would be met before the planned levy end date of 31 March 2028. The announcement does not specify when or how the Energy Security Investment Mechanism will be legislated for.

Brexit

(A) The Retained EU Law (Revocation and Reform) Act 2023 (the “**RRA**”) would have revoked all EU-derived subordinate legislation and retained direct EU legislation at the end of 2023, but to the relief of many, earlier this year the Government replaced this proposal with a narrower one, which revokes 600 specific instruments, including some in respect of tax (and all others remain in place until amended or revoked in the future).

(B) The RRA revokes section 4 of the European Union (Withdrawal) Act 2018 (which had preserved certain rights, powers, liabilities, obligations, restrictions, remedies and procedures derived from EU law) and abolishes the principle of the supremacy of EU law with potentially far-reaching consequences for all areas of law.

(C) The government has announced plans to restrict the territorial scope of some tax reliefs for charities and R&D expenditure to focus them on the UK.

(D) Changes to simplify the VAT treatment of financial services are also on the UK Government's agenda, and so is a more fundamental rethink of the VAT system, with a view to encouraging sustainability.[3]

[3] Tanja Velling, "And what about Brexit", 1 June 2023, European Tax Blog, available at https://www.europeantax.blog/post/102ig3q/and-what-about-brexit.