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Corporate Tax

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CONTENTS

United Kingdom

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Overview of corporate tax work over last year

Significant deals and themes

The following statistics reflect the position as at 6 June 2023 (in respect of the period from 1 January 2022 to 31 December 2022).

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

The value of outward M&A (UK companies acquiring foreign companies) decreased by £19.7 billion to £26.2 billion in 2022 compared with £45.9 billion in 2021. The total value of inward M&A in 2022 was £57 billion compared to £76.7 billion in 2020. The lower values of outward and inward M&A transactions can be explained by a decrease in both the number and average value of transactions in 2022.[1,2]

The total value for domestic M&A during 2022 was £14.3 billion, a decrease compared to 2021 (£30.4 billion). This decrease can be explained by a general decrease in the number and value of domestic M&A transactions of independent companies and between company groups. The majority of the inward acquisitions in 2022 (approx. 90.12%) came from the Americas (approx. 43.58%) and Europe (approx. 46.54%). This is very similar to 2021 where the Americas and Europe made up 89.99% of inward acquisitions, although Europe only made up 41.32% whereas the Americas accounted for 48.67% in 2021, perhaps reflecting global economic outlook and a shift toward a more domestic focus in the Americas markets.[3,4]

Financing

Following a record year for initial public offerings ("**IPOs**") in 2021, 2022 was a much quieter year for the London Stock Exchange. While in 2021, over 120 companies chose to list on the London Stock Exchange, raising approx. £16 billion, in 2022 just 45 companies chose to pursue IPOs (a 62.5% decrease) while funds raised reduced by approx. 93.75% down to just over £1.5 billion. Ithaca Energy was the largest IPO of 2022, raising £262.5 million and opening with a market capitalisation of £2.4 billion.[5]

*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 decreased from £2,162 million in 2020/2021 to £1,482 million in 2021/2022.[6] In contrast, the DPT yield figures published by HMRC increased from 2020/2021 (£151 million) to 2021/2022 (£198 million).

Key developments affecting corporate tax law and practice

The below section on UK tax law developments reflects a summary of the key developments in 2022/early 2023 (reflecting the position as of 31 May 2023), but it is not a comprehensive or detailed discussion of all tax developments in the past year.

Domestic legislation

Rate, allowance and tax credit changes

From April 2022, the main rate of UK corporation tax increased from 19% to 25% for companies whose taxable profits exceed £250,000, and a 19% "small profits rate" was introduced for companies with taxable profits of less than £50,000 in the period. Companies with taxable profits of £50,000–£250,000 are taxed at the main rate but eligible for varying levels of relief to reduce their effective tax rate ("**ETR**"). Additionally, the DPT rate was increased from 25% to 31% and the banking surcharge rate was reduced from 8% to 3%.

In September 2022, the UK Government announced significant proposals to cut the basic rate of income tax from 20% to 19%, to abolish the additional rate of income tax of 45% on annual income above £150,000 and to reduce the dividend rate for basic and higher rate taxpayers by 1.25%. However, following a change of Government, these proposals were reversed, and the basic, higher and additional rates of UK income tax (being 20%, 40% and 45%, respectively) and the dividend rate for basic, higher and additional rate taxpayers (being 8.75%, 33.75% and 39.35%, respectively) remain unchanged for the 2023/2024 tax year. Nevertheless, with effect from April 2023: (a) the threshold for the additional rate of income tax was reduced from £150,000 to £125,140; and (b) the dividend and capital gains tax allowances (below which dividend income and capital gains are not taxed) were reduced from £2,000 to £1,000 and from £12,300 to £6,000, respectively for the 2023/2024 tax year (and are to fall to £500 and £3,000, respectively, for the 2024/2025 tax year).

In 2022, 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 proposed introduction of the new 1.25% Health & Social Care Levy in April 2023, when NIC rates were intended to return to 2021 rates. In October 2022, the Government announced that it would not proceed with the proposed Health & Social Care Levy and NIC rates would, from 6 November 2022, fall back down to pre-2022 levels (being, for employee NICs, 12% on earnings from £242.01–£967 per week and 2% on earnings over £967 per week, and for employer NICs, 13.8% of the relevant employee's earnings in excess of £175 per week).

Other changes for the 2023/2024 year include: (a) an increase to the nil-rate threshold for stamp duty land tax ("**SDLT**") on residential property (from £125,000 to £250,000); (b) changes to tax-free pension withdrawals, comprising the abolishment of the lifetime allowance (being, broadly, the maximum amount that can be withdrawn from an individual's pension in their lifetime without the withdrawal being subject to tax, which was previously £1,073,100) and an increase in the annual allowance to £60,000 (being, broadly, the maximum amount by which individuals can reduce their taxable income by making a contribution to a private pension, which was previously £40,000); (c) an increase in the Energy Profits Levy ("**EPL**"), introduced in 2022 as a temporary surcharge (on top of the corporation tax main rate) to address oil and gas companies' extraordinary profits, from 25% to 35%, together with an announcement that the charge would remain in effect until 31 March 2028; and (d) increased capital allowances from 1 April 2023 until 1 April 2026 (to mitigate the effect of the corporation tax increase), comprising: (i) first year capital allowances on qualifying plant and machinery of 100% on main rate expenditure and 50% on special rate expenditure; and (ii) changes to make the £1 million annual investment allowance (pursuant to which a 100% first year allowance is available in respect of expenditure not qualifying for the abovementioned 100% rate) permanent.

R&D tax credits

Broadly, the UK operates two parallel research and development ("**R&D**") tax relief regimes: a scheme for small and medium companies ("**SMEs**") that generates cash payouts; and the R&D expenditure credit ("**RDEC**") scheme for larger companies. From 1 April 2023, broadly, relief for SMEs was reduced from 33.35% to 18.6% (or for loss-making "R&D-intensive" SMEs, 26.97%) of qualifying R&D expenditure, while RDEC increased from 13% to 20% of qualifying R&D expenditure. Administratively, (a) from 1 April 2023, claimants must inform HMRC in advance of their intention to claim (via online form) if claiming for the first time (or the first time in, broadly, three years) or if they claimed late in the previous year, and (b) from 1 August 2023, additional information is required to support RDEC claims.

From January to March 2023, the Government consulted[7] on proposals to simplify these schemes into a streamlined single tax relief, modelled broadly on RDEC with potential for more generous relief for R&D-intensive companies (potentially from 1 April 2024). Results of the consultation have not yet been published. While simplification is, from an administrative perspective, welcome, the proposals appear likely to result in less generous reliefs for SMEs, and the timetable for implementation appears optimistic.

Changes to incentives rules

With effect from April 2023, minor taxpayer-friendly changes will be made to the rules applying to certain tax-advantaged incentives.

Broadly, provided certain conditions are met: (a) proceeds from shares acquired pursuant to company share option plans ("**CSOP**") and enterprise management incentive ("**EMI**") option schemes will be taxed as capital gains; and (b) on exercise, the employer will qualify for a corporation tax deduction on such gains realised by employees:

- For CSOPs: The value (on grant) of the shares subject to option, above which relief cannot apply, will be increased to £60,000 (from £30,000). Additionally, conditions specific to companies with more than one share class will be removed, making it easier for them to qualify.
- For EMI options, to reduce administrative burdens, from April: (a) 2023, it will no longer be necessary for details of restrictions on the underlying shares to be included in the option agreement or to declare to HMRC that the grantee has signed a working time declaration; and (b) 2024, the deadline for notifying HMRC of the grant of EMI options will be extended (from 92 days post-grant, to 6 July following the end of the tax year in which the grant occurred).

EMI and CSOP schemes offer material tax efficiencies. However, thresholds and barriers to access the relief had limited their utilisation. It is hoped that the proposed changes will serve to increase their popularity.

The Government also intends to introduce some limited flexibility regarding the UK taxation of carried interest. Typically, where returns on carried interest are taxed as capital gains, the gain is treated as arising when carried interest arises to the holder. However, where holders are subject to tax in the UK and another jurisdiction, differences in the time of charge can cause difficulties in claiming double tax relief (e.g. in the US, carried interest is taxed on an accruals basis). To address this, the Government will permit holders to voluntarily and irrevocably accelerate the tax point for their carried interest, by electing for it to be taxed in the UK on an accruals basis. The legislation is expected to take effect in summer 2023, and elections apply with effect from 6 April 2022. It is unclear whether HMRC developed the proposals in consultation with the Internal Revenue Service ("**IRS**"), and as such, it is expected that impacted taxpayers may perhaps be somewhat reluctant to (irrevocably) accelerate their UK tax liabilities without certainty that it will improve their US tax position. In particular, where carried interest accruals may be subject to clawback, elections may introduce material complexity for electing taxpayers.

Post-Brexit developments

The Government proposes to limit the effect, in the UK, of (a) jurisprudence of the Court of Justice of the European Union ("**CJEU**") by removing its supremacy (via a new right for lower UK courts to ask higher courts whether its rulings should be applied in a given instance), and (b) "retained EU UK", by treating EU-derived primary legislation (other than that relating to VAT, which is to be addressed separately) as secondary legislation, so that it can be more easily amended. The changes would increase the scope for misalignment between UK and EU rules, and it is hoped that, in deciding whether to depart from the EU's stance, potential increased compliance costs will be considered. Additional proposals to automatically repeal all EU retained law were scaled back and replaced with a limited specific list of legislation (which, from a tax perspective, only includes obsolete legislation implementing the automatic exchange of information between EU Member States).

In February 2023, the UK Government and the EU also agreed the so-called "Windsor Framework", providing for: (a) reduced customs checks and paperwork requirements for goods moving between mainland UK and Northern Ireland; and (b) Northern Ireland not to apply EU limits on reduced and zero rating and proposed EU changes to SME VAT registration thresholds (due to apply from 2025), so the Government can align VAT rates across the UK. The framework has not yet been ratified by the UK Parliament (though such approval is not technically required), and a date for implementation has not yet been announced. However, the process is expected to occur in 2023, and the expected reductions in compliance costs have been warmly met.

VAT interest/penalties

For accounting periods starting on or after 1 January 2023, a new "penalty point" regime, and new interest rules, have been introduced for VAT non-compliance.

Previously, HMRC operated a default "surcharge" regime pursuant to which taxpayers that failed to file VAT returns, or pay VAT, on time would become subject to a "surcharge notice period", during which any subsequent default would attract a surcharge liability (on a sliding scale of 2%–15%). Under the new (broadly similar) rules: (a) penalty points are imposed by reference to the duration of non-compliance (with no penalty for delays of less than 15 days, or where taxpayers have entered into "time to pay" settlement arrangements with HMRC); (b) once a certain number of points have been received, penalties apply; (c) points will only be removed when taxpayers have demonstrated compliance over a specified period (varying depending on the context); and (d) delays in submitting nil returns and claims for repayment (which had been outside the surcharge regime) will be in-scope. Interestingly, VAT penalties (unlike direct taxes) are not calculated by reference to taxpayer culpability (i.e. by reference to whether the error was careless, deliberate or deliberate and concealed) or cooperation (i.e. whether the error was voluntarily disclosed, or discovered through audit). While it is understandable that the Government would wish to trial a new system before introducing more widely, it is hoped that, in due course, a single penalties system will apply across all taxes.

Additionally, interest for late payment of VAT is now calculated in the same way as for direct taxes, with interest charged (from the payment deadline until payment) at HMRC's published rates (currently, *per annum*, the Bank of England base rate plus 2.5%, but updated periodically).[8] Similar rules apply to repayments from HMRC (albeit at lower rates).[9] The move toward alignment represents a welcome simplification.

UK consultations about potential changes

Update on VAT on fund management services consultation

In December 2022, the Government began a long-awaited consultation on the VAT treatment of fund management services.[10] Having previously confirmed that changes would not be made to zero-rate such services, the consultation addresses the scope of VAT-exempt fund management. By way of background, the UK implemented EU law, requiring a VAT exemption for the management of so-called "special investment funds" ("**SIFs**"), by listing certain types of funds whose management would qualify. The Government intends to retain this express list, but also proposes to codify the following criteria for determining whether a fund constitutes a SIF: (a) the return on investment must be performance dependent, and holders must bear risk; and (b) the fund must be a "collective investment", operate on the principle of risk-spreading and appeal to the same pool of investors (and be subject to the same competitive conditions) as Undertakings for Collective Investment in Transferable Securities intended for retail investors. (The Government, in contrast to the EU, would not require funds to be subject to state supervision.) The consultation asks for input on how "collective investment" should be defined and, more generally, for input on any issues arising from the proposals. The proposals offer welcome clarity and continuity, and it is hoped that any EU reforms of fund management VAT (currently under review) will proceed along similar lines, to minimise complexity and preserve the UK's attractiveness as a place for the financial services industry to do business.

Stamp duty on shares: Consultation on modernisation

In April 2023, the UK Government consulted on proposals to simplify and modernise UK stamp duty and stamp duty reserve tax on transfers (and agreements to transfer) of equity interests and loan capital with equity-like features. Broadly: (a) stamp duty applies to transfers of "stock and marketable securities" via paper instruments of transfer, and primarily applies to unlisted securities (where the instrument is executed, or actions are taken in respect thereof, in the UK); and (b) stamp duty reserve tax applies on agreements to transfer such interests (issued by entities incorporated, or with a register kept, in the UK), and primarily applies to listed securities.[11] Currently, certain features of the rules are unsuited to modern transactions: (a) stamp duty is a voluntary tax without an "accountable person" liable therefor (although, as registrars cannot update registers of UK companies without confirmation of payment from HMRC, purchasers therefore typically pay in practice); and (b) it generally takes six to eight weeks for HMRC to respond to requests for stamping (resulting in delays in the registration of ownership changes).

Broadly, the Government proposes to introduce single mandatory tax for transfers of listed and unlisted securities of UK incorporated entities (or registered in the UK), simplifying the jurisdictional scope of such charge. Certain differences may be retained depending on listing status (e.g. the "accountable person" would generally be the clearing system/depositary receipt issuer for listed securities and the purchaser for unlisted securities). A new online portal for reporting and payment (within 14 days) outside of CREST is proposed, with transfers automatically treated as "stamped" following payment. With the introduction of "electronic stamping" procedures during COVID-19, it was somewhat inevitable that existing processes would need to be reformed. The proposals would be a very significant step toward simplification and speed of execution, and have been met warmly. In particular, the proposed changes are reflective of a desire to reinforce the Government's commitment to protecting the UK's reputation as a business-friendly jurisdiction.

Review of hybrid working

In August 2022, the Government publishing a call for evidence relating to the taxation of: *(a) employees of: (i) UK companies working overseas; and (ii) overseas companies working in the UK, (in each case, outside of formal expatriate assignments); and (b) hybrid and distance/home working within the UK (including by self-employed)*.[12] Given recent changes in working practices, the Government seeks taxpayer input on whether businesses consider that remote working is likely to increase going forward, the extent to which it involves cross-border working, and whether such changes have caused any tax, social security, payroll or other compliance issues. In particular, the review will focus on (a) employment tax, and (b) residency/permanent establishment issues. (Interestingly, the review will not focus on VAT, which is also capable of being impacted by cross-border remote working.) While tax authorities were willing to take a relatively light touch to the tax impact of disrupted working policies during the pandemic (in line with OECD guidance on the matter), it has become apparent that such changes in working practice are unlikely to be temporary.[13] Neither the Government nor the OECD (which is also reviewing the subject) has given an indication of whether any proposed changes would likely result in reallocation of taxing rights or (conversely) greater flexibility. However, it is hoped that any changes introduced will align with (then current) international norms, so as to minimise the risk of double taxation.

Decentralised finance involving the lending and staking of cryptoassets

The Government is consulting on proposed changes to the taxation of decentralised finance ("**DeFi**") cryptoasset transactions.[14,15] As discussed in our 2022 review, currently the lending (or "staking") of cryptoassets is treated as a disposal by the lender/staker for UK tax purposes (crystallising gains). In contrast, the lending/repo of securities broadly benefits from relief preventing such treatment if the securities are required to be returned to the lender. The Government intends to develop distinct tax rules for DeFi transactions (likely to be based broadly on the aforementioned securities relief) that would trigger a disposal only when cryptoassets are economically disposed of (e.g. through an outright sale or transfers in return for goods or services, etc.). In particular, it was considered that merely extending the securities relief to DeFi transactions would not cater sufficiently for differences between cryptoassets and securities. While differences between the existing, and proposed new, reliefs remain to be seen, the more tailored approach is reflective of the Government's stated ambition of developing a clear tax and regulatory landscape in the cryptoasset space.

Proposals that will not proceed:

- In July 2022, the Government consulted on proposed changes to sovereign immunity from direct tax in the UK.[16] Broadly, under current rules, governments and their departments (which could, depending on how they are structured, include sovereign wealth funds) are not (under the UK's application of international law) subject to direct UK tax on UK sourced income and gains. Proposed changes would have limited the scope of such immunity to UK source interest (to the extent not related to trading activities). Such loss of tax-exempt status could have necessitated the restructuring of funds such sovereigns invest in and/or prejudiced the ability of UK taxpayers such sovereigns invest in to benefit from the UK participation exemption and/or REIT or QAHC status (discussed further below) (as such status can depend on investors' status as "qualified" or "institutional" investors under the relevant rules). In September 2022, the Government confirmed that it would not proceed with the proposals (although no further explanation was given). The decision is a welcome move in favour of tax certainty and UK inward investment.

- As described in our 2022 review, last year the Government consulted on the potential introduction of an online sales tax ("**OST**") as a means to rebalance perceived disparities in taxes payable by bricks-and-mortar retailers (who suffer business rates on occupation of their retail premises) when compared to their online counterparts.[17] In October 2022, the Government announced that it would not proceed further with a potential OST (due, in part, to complexities in determining the scope of such a charge). Indeed, had such proposal proceeded, it is expected that careful thought would have been needed as to whether an OST may have fallen foul of proposed Pillar I prohibitions on digital services taxes ("**DSTs**", discussed below).

Domestic case law

Throughout 2022/2023, the UK courts have continued to address the tax deductibility of finance expenses and anti-avoidance legislation, while also delivering the first judgment on the so-called "salaried member rules" (introduced in 2014).

Revenue and Customs Commissioners v BlackRock Holdco 5 LLC [2022] UKUT 199 (TCC)

BlackRock centred on the deductibility of interest on acquisition financing. The taxpayer ("**LLC5**") issued *c*. $4 billion of loan notes to its immediate (US-resident) parent ("**LLC4**") in return for cash and shares, which LLC5 then contributed to its US-resident subsidiary ("**LLC6**").

LLC5's deduction claims for interest on the notes were rejected by HMRC on the basis that: (i) the loan relationship contravened the "unallowable purposes" rule (an anti-avoidance provision that, broadly, denies deductions for loan-related expenses "on a just and reasonable basis" to the extent attributable to a taxpayer's subjective, non-business/commercial purpose in being party to the underlying loan relationship); or (ii) alternatively, the notes were non-arm's length (i.e. would not have been available from third parties). The taxpayer won both arguments before the First-tier Tribunal ("**FTT**") (as to which, see our 2020 review). However, on appeal, the Upper Tribunal ("**UT**"), a division of the High Court, overturned the FTT's judgment. The UT: (a) used the absence of covenants (typical for third-party transactions) in the notes to conclude that a third party would not have entered into a comparable transaction; and (b) concluded that the interposition of the taxpayer as borrower in an otherwise wholly US transaction (pursuant to which a US-resident lender ultimately lent money to a US-resident acquirer of a US-resident target) had no commercial purpose beyond obtaining the tax advantage associated with the deductions. The taxpayer has appealed further, with the case expected to be heard next year.

It is relatively rare for "unallowable purposes" arguments to succeed in the context of acquisition financing, so the judgment has created some uncertainty as to the scope of the rule and how it will be applied by HMRC. As regards the transfer pricing decision, it is unusual for shareholder debt to include lengthy covenants (as mitigation techniques, such as equity cures, would not offer any additional support), and it is hoped that this aspect of the judgment will be considered further on appeal. In the interim, taxpayers may consider including more fulsome terms in shareholder debt.

In May 2023, HMRC published guidance elaborating further on their interpretation of the "unallowable purposes" rule through a series of examples that HMRC considers would, and would not, fall foul of the rule. The examples echo the position it has adopted in a number of "unallowable purpose" cases such as *BlackRock*. The examples (a) indicate that arrangements routing debt, for ultimate use by a non-UK borrower, through UK companies with which the borrower does not otherwise have a commercial relationship are likely to be reviewed with suspicion (in particular if there is a more natural choice of intermediate lender within the group), and (b) that HMRC indicate would not fall foul of the unallowable purposes rule seem to disproportionately involve acquisition financing for asset (as opposed to share) transactions. As against that, however, the new guidance suggests that (depending on the circumstances) the fact that a transaction would not have been pursued had tax deductions not been available will not *necessarily* impugn it, and more generally offers some (limited) insight into HMRC's thinking on a matter that has long been a source of some uncertainty.

Revenue and Customs Commissioners v Euromoney Institutional Investor plc [2022] UKUT 00205 (TCC)

In *Euromoney*, the taxpayer ("**Euromoney**") sold its shares in a subsidiary to a third party ("**DTL**"). The shares carried no dividend rights, so the disposal did not benefit from the UK participation exemption (the so-called "substantial shareholding exemption", or "**SSE**"). It was originally contemplated that the consideration would consist of cash and ordinary shares, but (pre-closing) the parties agreed to replace the cash with redeemable preference shares. The change enabled Euromoney to claim: (a) rollover relief (pursuant to which certain share exchanges are treated as non-disposals for capital gains purposes, provided they are undertaken for *bona fide* commercial reasons and are not part of a scheme or arrangement of which the main (or one of the main) purpose(s) is the avoidance of a liability to capital gains or corporation tax); and (b) SSE when the preference shares were redeemed 12 months post-closing. HMRC challenged the availability of rollover relief, arguing that the exchange was part of a scheme or arrangement with a main avoidance purpose.

The UT found in favour of Euromoney, holding that the FTT had not erred (a) in assessing purpose by reference to the "scheme or arrangement" as a whole, rather than its individual elements, or (b) when determining the taxpayer's purpose, in considering (i) the relative size of the tax saving against the size of total consideration, (ii) the small amount of effort, time and money spent by the taxpayer on tax structuring, and (iii) the taxpayer's failure to consider potential downsides of the structure (to conclude that the tax saving was merely a bonus). The judgment is helpful for taxpayers utilising rollover relief. However, in recent years, cases on similar anti-avoidance provisions have tended to consider purpose more narrowly, by reference to particular steps, rather than the commercial arrangement as a whole. As such, its precedential value for avoidance cases in other contexts remains to be seen.

BlueCrest Capital Management (UK) LLP v HMRC [2022] UKFTT 00204 (TC)

BlueCrest is the first case considering the UK's "salaried member rules", pursuant to which partners can be taxed as employees rather than self-employed (resulting in higher national insurance liabilities and payroll withholding obligations), if three conditions are met. The three conditions are that: (a) broadly, it is reasonable to expect that at least 80% of the total remuneration paid to the individual is either fixed, or is variable, but not by reference to (or otherwise affected by) the overall profits/losses of the partnership; (b) partners' mutual rights and duties do not give the individual "significant influence" over partnership affairs; and (c) the individual has not contributed capital to the partnership equal to 25% of drawings expected in the relevant tax year. The case indicates that "significant influence" is a wider concept that may originally have been thought.

HMRC assessed the taxpayer to employment tax on the basis that its partners were salaried members on the basis of conditions (a) and (b) above.

- Condition (a): The case concerned one category of partners' allocations – "discretionary" allocations, which were effectively a bonus. The FTT found that: (i) to fall outside condition (a) (such that allocations are not "disguised salary"), overall partnership profits must determine how the cake is sliced, not merely the size of the cake; (ii) it was not sufficient for allocations to be capable of calculation by reference to overall profits in theory, if in fact they were not so calculated; and (iii) while the allocations need not "track" over profits, there must be a link between the two. Here, the FTT considered that the allocations varied by reference to personal performance of the individuals, rather than that of the partnership.

- Condition (b): BlueCrest argued that: (i) "significant influence" should not just be considered by reference to voting rights and/or managerial influence, but also financial influence; and (ii) influence over one aspect of the partnership's affairs (and not its affairs as a whole) would be sufficient. The FTT agreed but, in considering whether influence over a particular aspect of partnership affairs would suffice, appeared to be guided by the partnership income generated by such part of the business. The case also suggested that it would be critical for taxpayers to provide sufficient evidence of such income generated, and of such influence. For example, the FTT held that while, in theory, significant control over back-office functions could be sufficient, here there was insufficient evidence of income generated therefrom, or of the relevant individuals' control thereover.

For taxpayers, the case brings mixed fortunes. On the one hand, the FTT adopted a wider interpretation of condition (b) than HMRC previously has. However, on the other hand, the FTT's interpretation of condition (a) was more stringent than some had expected. It remains to be seen whether the approach taken by the FTT will, in practice, warrant changes to existing partnership agreements. However, partners seeking to establish that they are not salaried members should ensure that they keep fulsome records of both their influence over any relevant aspect of partnership business, and the significance of that aspect to the business as a whole.

International tax developments

The below is a summary of the key EU and OECD developments in 2022 and early 2023 (reflecting the position as of 31 May 2023) that 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>

Update on Anti-Tax Avoidance Directive III

In 2021, the EU Commission (the "**EC**") first published its draft directive (so-called "**ATAD III**") to increase transparency in respect of, and restrict the tax benefits available to, certain "shell" companies with limited substance (see further our 2022 review). On 17 January 2023, the European Parliament (the "**EP**") approved an updated ATAD III draft, amended to reflect certain proposals from its Committee on Economic and Monetary Affairs ("**ECON**").

Key changes to the updated draft include the following:

- Companies with at least five full-time staff (generating the income described below) are no longer out of scope.
- In-scope taxpayers will now be considered "at risk" (such that they must meet substance requirements or lose treaty benefits). Specifically, if, in the previous two years: (a) more than 65% (down from 70% originally) of their revenue consisted of passive or mobile income; (b) at least 55% (down from 60% originally) of their activities are cross-border or of its assets are located outside of a Member State; and (c) (as was previously the case) day-to-day operations and decision-making on significant functions was outsourced to a third party.

- Substance requirements that "at risk" taxpayers must demonstrate were relaxed slightly. For example: (a) the requirement for an active bank account can be satisfied with an e-money account; (b) the requirement for local office space can be satisfied with premises shared with affiliates; and (c) requirements for local directors to have certain qualifications, and not be an employee/director of an affiliate, have both been removed.

The draft directive will now go before the Council of the EU, where it would require unanimous approval. The proposed date for transposition by Member States remains 30 June 2023 and for implementation remains 1 January 2024 (with rules to apply retrospectively to periods commencing on 1 January 2022). However, given the pace of developments and the apparent absence of momentum among EU Member States, it seems somewhat unlikely that this timeline will be met.

Business in Europe: Framework for Income Taxation

The EC has refreshed proposals (originally mooted in 2011) for a common corporate tax system in the EU (the so-called "**BEFIT**"). Broadly, this would involve applying a common set of rules for determining the tax base (i.e. income/transactions subject to tax) within the EU, with tax allocated between Member States in which the groups had a taxable presence. A consultation ran from October 2022 to January 2023, and responses were published in May 2023.[18] Matters discussed include:

- Scope: Whether proposals should be limited to global revenues in excess of €750 million. Most respondents were in favour, but sought an option for others to opt in.
- Calculation: Whether accounts should form a starting point (subject to limited adjustments) or there should be detailed common rules, which most respondents favoured.
- Allocation of tax base: How to determine the abovementioned "taxable presence", reflecting "the source of the underlying income generation", and in particular, whether, in addition to the location of labour, tangible assets and sales by destination, the location of intangible assets should constitute a relevant nexus (an approach that *c*. 40% of respondents favoured). However, almost 20% of respondents considered that the location of intangible assets should not be a relevant nexus.
- Transfer pricing: Whether simplified transfer pricing rules should be applied to related party transactions with non-EU jurisdictions, a proposal that 50% of respondents favoured. To assist with simplification, the EU is also contemplating a "flag" system similar to Australia's, whereby transfer pricing risk indicators are developed and the risk profile of taxpayers is assessed accordingly.[19]

It remains to be seen whether BEFIT will gain wider traction. It is notable that proposals would require unanimous Member State approval, that previous interactions have failed to garner sufficient support and that the BEPS 2.0 project (described below) has illustrated the difficulties in reaching consensus on multilateral tax projects. While the final proposal is due to be published in September, it seems likely to be longer before clarity on its viability emerges.

FASTER withholding tax

In April 2022, the EC consulted on proposals for a common EU-wide system for relieving withholding tax (on dividends/interest) and related information exchange.[20] The proposals aim (a) to address inefficiencies in availing of treaty relief and related refunds, which it is concerned inhibit investment in the EU securities market, and (b) in light of recent "cum/ex" scandals (whereby multiple refunds of the same tax were claimed), to prevent abuse. The consultation considers three options for reform, which vary in scale: (1) establishing a common system for relief at source; (2) improving refund procedures by standardising and digitising claims forms and procedures; and (3) enhancing information procedures by providing for automatic reporting and exchange of beneficial owner-related information.

Responses were published in August 2022.[21] Most respondents strongly agreed that current processes hinder cross-border investment in EU securities, and responses indicated a strong preference for a common system for relief at source. A legislative proposal, which was originally due to be published in Q4 2022, has not yet been made available. If implemented, such proposals could put pressure on the UK to simplify and digitise its withholding tax processes.

*EU Code of Conduct for Business Taxation (the "**Code**")*

In November 2022, the Code, which is primarily used to characterise preferential (and hence, potentially harmful) tax measures and determine the "non-cooperative" jurisdictions providing for them, was updated to broaden the scope of tax measures subject to scrutiny. In addition to directly preferential measures (e.g. particular exemption regimes) previously in scope, the updates will capture tax features of general application, which will be regarded as harmful if they lead to double non-taxation or the double/multiple use of tax benefits. Although it remains to be seen what particular aspects of jurisdictions' tax regimes will invite scrutiny under the additional criteria, the revision of the Code more broadly reflects a general crackdown on tax havens in recent years.

Subsequently, in February 2023, the list of EU non-cooperative jurisdictions (which is published twice annually) was updated to add the BVI, Costa Rica, Marshall Islands and Russia. Broadly, the list comprises jurisdictions that have refused to comply (or failed to meet agreed timelines for compliance) with recognised standards on good tax governance, e.g. the Code and the OECD Base Erosion and Profit Shifting ("**BEPS**") minimum standards.[22] The EU encourages Member States to apply enhanced audit scrutiny to taxpayers benefitting from regimes in blacklisted jurisdictions, and may cause certain transactions to be reportable under DAC6. The "grey list" (i.e. countries whose commitments are subject to close monitoring while being implemented, and that are at risk of being added to the black list) was updated to remove Barbados, Jamaica, North Macedonia, and Uruguay and add Albania, Aruba, and Curaçao. Other countries currently on the black list are American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos, US Virgin Islands and Vanuatu.

<u>OECD</u>

As discussed in our 2021 review, in October 2021, members of the OECD/G20 Inclusive Framework on BEPS ("**IF**") agreed a two-pillar solution to reform the international tax framework as a response to the challenges posed by the digitalisation of the economy.

Pillar I

Pillar I proposes updated tax allocation rules for large multinational enterprises ("**MNEs**") with a global turnover above €20 billion and profitability above 10% before tax (other than those in the extractive and regulated financial services industries). It 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
- 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), known as "Amount B".

In July 2022, the OECD updated its schedule for Pillar I implementation by way of multilateral convention, targeting 2023 for signing and an effective date in 2024. The delay is unexpected given challenges in securing international political agreement. Nevertheless, as described further below, the OECD Secretariat has progressed proposals this year through a number of consultations. While these were published without IF consensus, in May, G7 leaders reaffirmed their commitment to the swift completion of Pillar I negotiations, with a view to signing the multilateral convention implementing the proposals (the "**MLC**"), which the OECD has indicated should be ready by July 2023.

Publication	Key developments/comments
Progress Report (Consultation open 11 July 2022– 19 August 2022. Responses published: 25 September 2022)[23]	• Addresses updated timing, consolidated model rules and three building blocks not previously covered (segmentation, safe harbour, elimination of double tax). • Confirms that, if the revenue (but not profitability) test is met by an MNE, Pillar I can be applied to a segment that (and to the extent that it) satisfies both tests. • Proposes a three-year transitional period for simplified revenue sourcing rules (to identify market jurisdictions). • For jurisdictions in which MNEs have a physical taxable presence, model rules (a) detail the Marketing and Distribution Profits Safe Harbour, reducing "Amount A" allocable thereto, and (b) allocate responsibility for providing double tax reliefs on Amount A tax. Respondents voiced concerns about the related compliance burden. • Respondents also raised concerns about the absence of a global approach to (i) the administration of Amount A, and (ii) the elimination of double taxation thereunder, which they expect to lead to uncertainty and potential hardship.
Progress Report on Administration and Tax Certainty (Consultation open 6 October 2022– 11 November 2022. Responses published: 16 November 2022)[24]	• Proposes that tax on Amount A constitutes income tax: (a) to benefit from double tax reliefs (the form of which will be left to local jurisdictions); and (b) for the purposes of local admin rules (filings, penalties etc.). Respondents were concerned about non-harmonisation. • Proposes a jurisdiction-by-jurisdiction approach, whereby MNEs must register in all their market jurisdictions (which has given rise to respondent concerns about the resulting compliance burden), although streamlined compliance (whereby filings are made in one market jurisdiction and shared with others) is contemplated. Responses noted that the benefits of streamlined compliance are limited by the "multiple taxpayer" approach, whereby entities from multiple jurisdictions can be liable for tax on Amount A. • Details mandatory mechanisms for resolving disputes on transfer pricing and permanent establishment profit attribution, comprising use of: (a) the mutual agreement procedure ("**MAP**") provided for under an applicable double treaty or, failing which, under the MLC; and (b) where a dispute cannot be resolved under (a), a Pillar I-specific dispute resolution panel, whose decision will be binding. Respondents noted the risk that access to the panel would be restricted if MAP processes were obstructed by a tax authority, and requested an independent review process for MAP availability to mitigate this. • Notes outstanding work on identifying how double tax relief is allocated between MNE entities.

Continued overleaf

Publication	Key developments/comments
Consultation on Amount B (Open: 8 December 2022–25 January 2023. Responses published: 30 January 2023)[25]	• Scope: "Baseline marketing & distribution activities", to which Amount B will apply, is interpreted broadly, to include (a) buy-sell arrangements (i.e. acquisitions from foreign associates, for distribution in the local market) and (b) sales agency/commissionaire arrangements (i.e. distribution in the local market on behalf of foreign associates). Respondents have raised concerns about complexity and have called for guidance on scoping. • Proposes exemptions for non-tangible goods and where advance pricing agreements ("**APAs**") apply. However, respondents have called for scope to be further limited by quantitative, rather than qualitative, thresholds (to remove subjectivity). • Notes challenges regarding pricing methodology, which will require a benchmarking analysis by reference to public comparable financials (e.g. risk of lengthy disputes, difficulty in establishing a harmonised approach). The IF is exploring whether a pricing matrix approach or mechanical pricing tool is preferable. • Proposes documentation requirements built upon OECD transfer pricing requirements, but respondents have called for simplified requirements.
Consultation on DSTs (Open: 20 December 2022–20 January 2023. Responses published: 24 January 2023)[26]	• Sets out draft MLC in respect of DSTs: (a) providing for withdraw of existing, and commitment not to enact, DSTs; and (b) precluding Amount A allocations to jurisdictions with DSTs. • Provides mechanics for an MLC party to determine whether existing local taxes constitute a DST. • Draft contemplates that MLC would include a list of existing DSTs. However, (despite being capable of creating uncertainty) some respondents favoured a principle-based approach to identify DSTs for withdrawal.

Pillar II

As set out in our 2021 and 2022 reviews, Pillar II seeks to ensure that MNEs (with annual revenues exceeding €750 million) have an ETR of at least 15% of profits in every jurisdiction in which they operate, by imposing top-up taxes ("**TUTs**") if, in any jurisdiction, the MNE's ETR is below 15%. These TUTs comprise: (a) an "income inclusion rule" ("**IIR**", a top-down charge, generally levied in the jurisdiction of the ultimate parent, the "**UPE**"); (b) a fall-back "under-taxed payments rule" ("**UTPR**", enabling other jurisdictions to make adjustments, such as denying relief or levying a TUT on MNE group members if the UPE is not subject to an IIR); and (c) as a relatively new development, a qualified domestic minimum TUT (a "**DMTT**", pursuant to which the jurisdiction of MNE group members can impose a TUT, which is credited against any IIR or UTPR). The rules are together referred to as the "GloBE rules".

In 2022, the OECD announced delays to the implementation of Pillar II (which was originally targeted for 2023), with the Pillar II rules now intended to take effect in 2024, other than the UTPR, which shall take effect in 2025.

Implementation updates

In March 2023, the UK Government published draft legislation for the implementation of an IIR and DMTT to apply for accounting periods beginning on or after 31 December 2023.[27] (Draft legislation implementing UTPR measures are to follow in line with the OECD timetable.) The UK draft legislation mostly aligns with the OECD Pillar II model rules and guidance. Notable elements of the UK rules include:

- A UK DMTT, which would also apply to wholly UK groups meeting the thresholds.
- Confirmation that carve-outs for certain kinds of entity (e.g. pension funds, non-profit organisations, investment funds and REITs) will, for the purposes of calculating ETRs and TUTs, extend to certain of their subsidiaries (i.e. 95% asset-holding or investment-making subsidiaries).

- Confirmation that income taxed under the UK controlled foreign company rules (which broadly allocate income from a UK parent's low-taxed subsidiaries to the parent, provided certain conditions are met) would, under the GloBE rules, be allocated to the subsidiary for the purposes of establishing the ETR in its jurisdiction.
- The inclusion of the clear steps for calculating ETRs and TUTs, which expand on the related OECD guidance.

The UK is further down the path toward implementation than many other jurisdictions. While its decision to pre-empt finalisation of the OECD Secretariat's work on Pillar II risks inadvertent non-alignment: (a) it expected that, should any inconsistencies emerge, the draft legislation and related HMRC guidance would be updated accordingly; and (b) it provides some degree of certainty for in-scope UK taxpayers. That said, given the OECD's incremental approach to releasing guidance on Pillar II, affected UK taxpayers will, unfortunately, need to prepare themselves for Pillar II implementation without necessarily having a full picture of how the rules will operate in practice.

Meanwhile, in December 2022, an EU directive was adopted requiring Member States to transpose domestic rules for the implementation of Pillar II by 31 December 2023. The directive generally reflects the OECD's model rules, and (as with the UK rules) it applies equally to purely domestic groups meeting the relevant thresholds (to ensure equivalence between domestic and cross-border arrangements). The directive contemplates that IIR rules would take effect on 31 December 2023 and UTPR rules a year later, although Members States can elect to delay implementation (up to 31 December 2029) if they have fewer than 12 in-scope MNEs in their jurisdiction.

Significant OECD publications

Publication	Key developments/comments
Report on Tax Incentives (6 October 2022)[28]	• Noted that, in calculating ETRs, incentives could reduce "Covered Taxes" (the numerator of the GloBE ETR calculation) or increase GloBE Income (the denominator of the GloBE ETR calculation). • Emphasised the need for Pillar II to be considered if/when governments are considering implementing new incentives (to ensure that benefits are not eroded by TUTs).
Report on Safe Harbours and Penalty Relief (15 December 2022)[29]	• Proposed permanent safe harbours, permitting MNEs to do simplified income, revenue and tax GloBE calculations, in certain circumstances (e.g. for immaterial subsidiaries excluded from consolidated accounts). It was subsequently clarified that such simplified calculations could be based on information in an MNE's country-by-country reporting ("**CbCR**"). • Set-out proposed a transitional safe harbour (with a TUT of nil) for jurisdictions in which an MNE's CbCR reflects: (a) total revenue < €10 million and pre-tax profit < €1 million; (b) ETR for the fiscal years 2023/2024 of at least 15%, 2025 of at least 16% and 2026 of at least 17%; or (c) pre-tax profit not exceeding the amount of that jurisdiction's "substance-based income exclusion". • Detailed rules for transitional "penalty" relief (in initial years) absolving MNEs from GloBE compliance penalties/sanctions if they have taken "reasonable measures" (within the meaning of the relevant local law) to ensure compliance with the GloBE rules.

Continued overleaf

Publication	Key developments/comments
Consultation Document: GloBE Information Return (Open: 20 December 2022–3 February 2023. Responses published: 16 February 2023)[30]	• Detailed information proposed to be included in a standardised GloBE Information Return ("**GIR**"), which it suggests could vary depending on the MNE's industry, and suggested simplified calculations to be used under permanent safe harbours. • Noted that, unless there is an agreement for the contents of a UPE's GIR to be exchanged with other relevant jurisdictions, each MNE group member would need to file its own GIR in its own jurisdiction, and acknowledged resultant strong demand for a single centralised point of filing (on which work is continuing) and exchange mechanics. • Proposed "segmentation" approach whereby not all information required to be reported on the GloBE return will be shared with all jurisdictions, which respondents favoured.
Consultation Document: Tax Certainty (Open: 20 December 2022–3 February 2023. Responses published: 15 February 2023)[31]	• Considered dispute prevention/resolution mechanisms in respect of potential differing interpretations/application of GloBE rules between jurisdictions. • Noted dispute prevention mechanics, including: (a) model rules and guidance (to create common standards) and mechanics for issues not addressed therein to be referred to the IF for clarification; (b) a proposed coordinated compliance programme, pursuant to which tax authorities could give non-binding comfort to MNEs regarding TUT computations, similar to the OECD International Compliance Assurance Programme ("**ICAP**") (a voluntary programme facilitating dialogue between MNEs and tax administrations); and (c) proposed binding certainty mechanisms (e.g. bilateral/multilateral APAs). • Noted that potential dispute resolution mechanisms could be implemented via an MLC (which respondents largely favoured), existing tax treaties or interposition into domestic laws, and could be supported by competent authority agreements under the Convention of Mutual Administrative Assistance in Tax Matters. • Responses favoured a coordinated compliance programme and binding certainty mechanisms (such as APAs), but were generally sceptical about the OECD's assumption that the use of the model rules/guidance as the basis for domestic legislation would sufficiently mitigate the risk of differences in local implementation/interpretation.
Administrative Guidance (1 February 2023)[32]	• Addressed certain issues and uncertainties arising under the model rules/commentary, including by: (a) clarifying that sovereign wealth funds (within the scope of the exemption for "Government Entities") will not be part of an MNE group (and that financial consolidation of their portfolio companies will be ignored when considering whether such companies are part of an MNE group meeting the threshold); and (b) confirming that deemed distributions will be treated in the same way as actual distributions (such that taxes thereon are allocated to the distributing group member for the purposes of calculating the ETR in its jurisdiction). • Suggests that, when determining whether an entity is excluded, a "holistic" view of its activities (including via permanent establishments) be taken, and (if qualifying) its permeant establishments also be excluded. • Stresses that filings for domestic TUTs should be calibrated to ensure accuracy of the GIR, and moots potential work by the IF to develop a domestic TUT safe harbour that aligns with the model rules.

Pillar II implementation is progressing at a substantially faster rate than Pillar I, and the timeline for implementation is fast approaching. There are still a number of issues that have yet to be fully resolved to taxpayers' satisfaction (in particular with respect to dispute prevention and resolution mechanics), and it remains unclear whether all jurisdictions will meet proposed implementation timelines (leading to concerns that staggered implementation will result in compliance obligations shifting between jurisdictions as local rules come online). Nevertheless, taxpayers will need to familiarise themselves with the proposals as they are, rather than as they would like them to be.

Reporting developments

Following the success of the common reporting standard ("**CRS**") developed by the OECD in 2014 (providing for the collection by intermediaries, and exchange, of financial account information), the OECD has, in recent years, advanced proposals for other mandatory disclosure regimes. This year, steps have been taken toward implementation of such regimes.

	Reporting obligation	UK status
Mandatory Disclosure Rules ("MDR") (2018)[33]	• Intermediaries required to report on: (i) arrangements designed to counteract CRS reporting; and/or (ii) certain offshore arrangements to disguise beneficial ownership. • Information exchanged upon request/ spontaneously (if foreseeably relevant to the recipient tax authority).	• November 2022: The UK signed a multilateral agreement for automatic exchange of information reported under the MDR (together with 15 other jurisdictions, including Cayman, Bermuda and Isle of Man). • March 2023: UK MDR rules came into effect (applying to reportable arrangements implemented on or after 25 June 2018), replacing the UK's limited DAC6 rules.
Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy (2020)[34]	• Digital platform operators required to report (annually by 1 January) information on persons selling goods/ services via platforms (e.g. where the seller is established and income earned). • Information reported will be exchanged with the seller's home tax authority.	• July 2022: Responses to the 2021 consultation on UK implementation published. Government confirms that: (i) transport platforms will be in-scope; (ii) there will be no exclusion for smaller platforms; and (iii) no reporting will be required regarding sellers not profiting from payments received, or making < 30 sales (for which they receive < €2,000) in a reporting period. • November 2022: The UK (together with 22 other jurisdictions, including Luxembourg, Netherlands, Spain and Estonia) signed a multilateral agreement for automatic exchange of information reported under the rules. • October 2022: The UK Government published draft regulations to implement the rules (with effect from 1 January 2024). There have since been no further updates.
Crypto-Asset Reporting Framework ("CARF") (2022)[35]	• Intermediaries (e.g. exchanges, wallet providers) required to report on customers' cryptoasset transactions. The standard is akin to CRS for cryptoassets. • CRS expanded to include electronic money products and Central Bank Digital Currencies.	• March 2022: The OECD consulted on proposed CARF. • October 2022: CARF published in final form. • The UK Government has not expressly confirmed that it will implement CARF, but it is widely expected to. While HMRC already has significant powers (under domestic laws and treaties) to request information from third parties relating to cryptoassets (and is widely reported to have exercised such powers), CARF would automate and expediate the process.

Developments affecting the attractiveness of the UK for holding companies

Reserved Investor Fund

In May 2023, the Government announced proposals for a new type of "unauthorised contractual scheme" (i.e. a fund that does not have separate legal personality, and is not required to register with the UK's Financial Conduct Authority) – the so-called "Reserved Investor Fund" ("**RIF**"). RIFs will be targeted at professional and institutional investors and open to all asset classes (although they are expected to be of particular interest to real estate investors).[36] RIFs would be structured as contractual arrangements rather than entities in their own right, and would be taxed similarly to Co-ownership Authorised Contractual Schemes ("**CoACS**"). Specifically: (a) income would be treated as arising directly to investors; (b) for VAT purposes, RIFs would be treated as separate taxable persons (capable of reclaiming VAT on fund management fees); (c) for capital gains and SDLT purposes, interests in RIFs would be treated as separate assets (so investors are taxed on transfers of units therein, rather than transfers of underlying property); (d) transfers of units therein would be free from SDLT; and (e) managers could elect to claim capital allowances at fund level and then apportion allowances to investors. The Government is currently seeking taxpayer input on (among other things): (a) commercial appetite for the introduction of RIFs; (b) eligibility and notification criteria; and (c) feedback on the proposed tax treatment, including how respondents consider non-resident capital gains tax rules should be applied to RIFs (e.g. whether there is appetite for another class of RIF, which would be prohibited from investing in UK property, whose non-resident investors would be exempt from UK tax on gains). Broadly, the RIF consultation represents a positive step forward in the Government's stated ambition of increasing the attractiveness of the UK as a jurisdiction for the location of asset management and fund domicile. However, it remains to be seen whether UK measures will be capable of attracting business away from more traditional centres for fund establishment, such as Luxembourg and Ireland.

Minor changes to QAHC

In March 2023, the Government published draft legislation, proposing certain changes to the Qualified Asset Holding Company ("**QAHC**") regime (described in our 2022 review). Broadly, as a condition to accessing the regime, companies must be 70% owned by "Category A Investors", which include, for example, "collective investment vehicles" ("**CIVs**", e.g. funds) meeting the so-called "genuine diversity of ownership" condition (which tests, broadly, whether the CIV is widely marked). The proposed changes, which are generally expected to take effect from summer 2023, will extend the kinds of entities capable of being treated as "Category A Investors" by: (a) allowing body corporates to be treated as CIVs for this purpose; and (b) allowing parallel and feeder funds that do not themselves meet the "genuine diversity of ownership" condition to fulfil the condition if their associated funds do. HMRC also recently confirmed that (from 15 March 2023) UK securitisation companies will not be permitted to be QAHCs.

The above changes to the QAHC regime generally evidence the UK's continuing commitment to maintaining its status as a business-friendly and tax-efficient jurisdiction in which to establish holding companies.

Corporate interest restriction amendments

The Government intends to make minor tidy-up changes to the UK corporate interest restriction rules (which broadly restrict interest deductions in excess of 30% of EBITDA). One proposed change is to ensure that insertion of a new holding company partway through an accounting period will not prejudice the ability to carry forward unused interest allowances. The changes are intended to correct unanticipated or unintended impacts on taxpayers coming to light since the rules were first introduced in 2017, and are to be welcomed. In particular, while some taxpayers may have hoped for more widescale changes, it seems likely that material changes are unlikely in the absence of international consensus.

UK-Brazil double tax treaty

In November 2022, the UK and Brazil signed their first double tax treaty, provided for reduced withholding tax (a) on royalties (10%, instead of 15%), and (b) technical services fees (applying on a time-correlated sliding scale of 0%–8%, as opposed to 15% currently). However, the effective date of the treaty (which will depend on the legislative processes in both nations) is not yet known. The UK is expected to ratify the treaty within a short timeframe, whereas Brazil typically takes longer (e.g. the Brazil-Singapore treaty did not take effect for four years post-signature).

Industry sector focus

Property

Changes to the REIT regime

HMRC has made certain changes to the UK regime (referred to in our 2022 review) for real estate investment trusts ("**REITs**"). Most significantly, from April 2023, the Government has removed the requirement that a REIT's property rental business must consist of at least three properties, with no single property representing more than 40% by value (provided the REIT owns a commercial property with a value of at least £20 million). The change will allow for single property REITs, thus increasing flexibility on the part of taxpayers wishing to access the benefits of the regime, and is indicative of the UK's continued commitment to tax-efficient commercial property holding.

Changes to VAT processes

HMRC has simplified certain VAT administrative processes (particularly relevant for the property industry):

- VAT options to tax ("**OTT**") enable VAT to be charged on transactions in the relevant land. Evidence of the election having been made will typically be requested whenever relevant property is transferred. Previously, when an election was made, HMRC would provide letters (although receipt was often subject to delay). From February 2023, all OTT applications must now instead be made via email, and on submission, taxpayers will receive an automated response to serve as proof (expediating the process).
- Due to recent delays in processing VAT grouping applications, in March 2022, HMRC published guidance[37] confirming that: (a) from the date of submission until receipt of a response from HMRC, taxpayers can treat their application as provisionally accepted, and account for VAT accordingly; and (b) HMRC will not seek to recover VAT debts arising as a result of taxpayers having followed the guidance (the examples given in the guidance being automated assessments and/or default surcharges for a failure to file a tax return). It is hoped that HMRC will extend this approach to applications for VAT registration, which are understood to be subject to similar delays.

Oil and gas

EPL in effect, rate increase and enhanced investment allowance for decarbonisation

As noted above, the EPL, which was initially introduced in May 2022, has recently been increased: the rate has risen from 25% to 35% and has effect from 1 January 2023 until 31

March 2028. To incentivise investment in decarbonisation, the Government has introduced a "Decarbonisation Allowance" within the EPL for qualifying expenditure on decarbonising upstream oil and gas production. Under the measure, certain oil and gas companies will be eligible for an additional 80% investment allowance on qualifying expenditure (on top of the 100% investment allowance, which the Government considers will give a 91p tax saving for every £1 spent). These changes represent a renewed commitment to the Government's wider environmental aims (which include a 2050 net-zero goal) as seen in the North Sea Transition Deal and the goal of the UK becoming net-zero by 2050.

Electricity Generator Levy

In December 2022, the UK Government introduced the so-called "Electricity Generator Levy" ("**EGL**"). Similar to the EPL, the EGL is designed to address UK generators' recent exceptional profits. From 1 January 2023 until 31 March 2028, the EGL (which will apply in addition to corporation tax) will be charged at a rate of 45% on "exceptional receipts" from the sale of wholesale electricity (being revenue deriving from the sale of wholesale electricity at an average price in excess of £75/MWh over an accounting period). The EGL will be administered through the corporation tax system and, importantly, will not apply to electricity generated outside of the UK that has been imported.

Tax climate in the UK and the year ahead

2022 represented a relatively tumultuous year for UK tax policy. A change of Government in August heralded a (largely uncosted) interim budget, which proposed material tax cuts (primarily benefitting high earners). Resultant scepticism from capital markets regarding the UK's ability to fund the changes devalued the pound, and ultimately led to swift further change of Government.

By early 2023, however, the ship seemed to have steadied. A revised budget heralded stability, in the form of: (a) modest targeted changes, designed to stimulate investment (e.g. a long extension of the annual investment allowance); (b) the shelving of certain proposals likely to frustrate investment and counteract the UK's commitment to its reputation as a business-friendly environment (e.g. the decision not to proceed with changes to the scope of sovereign immunity); and (c) minor, common sense changes to existing regimes (such as the QAHC and REIT rules) to ensure that they can be properly utilised by the taxpayers at which they were targeted. This approach of well-thought-through incremental change is certainly to be welcomed, and is expected to be a path that the Government continues to pursue in the coming year as it seeks to rebuild its reputation internationally.

One area in which a further change may of course perhaps be welcome, however, is the Government's decision to double down on industry-specific taxes (with a new levy for electricity generators introduced this year). Recent years have illustrated that populist opinion can be fickle, and so it is hoped that the Government will, going forward, pursue a more principled approach to new measures that promotes the UK as a stable tax environment.

Lastly, looking internationally, it will be interesting to see whether the EU's ATAD III and FASTER proposals gain traction, and if so, whether the UK will look to follow suit with substance requirements and measures to enhance the efficiency of claiming treaty relief, respectively. With the looming implementation of Pillar II proposals, it seems likely that (even absent such changes) taxpayers will have enough to grapple with. In particular, it is hoped that the UK (as one of the most active IF members) will take the lead in ensuring that concerns about the risk of double taxation, material compliance burdens and dispute resolution mechanics are addressed before the rules go live.

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