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Recent Developments in International Taxation

United Kingdom

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Executive summary

From June 2022 to June 2023, the United Kingdom had three Prime Ministers and Chancellors of the Exchequer. That made it, to say the least, a period of marked political uncertainty and economic instability. In comparison, the last year was relatively quiet. It was, however, also the period of lead-up to a general election, which has now led to a change from a Conservative to a Labour Government (the first since 2010). Unsurprisingly, incessant tinkering around the edges of the existing tax system continued, often as an attempt to improvise the previously announced measures.

As announced, the headline rate of corporation tax (CT) rose 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, which were previously temporary, were made permanent. In absolute terms, the changes to the UK's capital allowances regime have been projected to offset about two-thirds of the impact of the rise in the CT rate. Amendments also continue to be made to the UK's legislation to implement the Organisation for Economic Co-operation and Development's (OECD's) Pillar Two income inclusion rule, often with retrospective effect, making it a continued challenge for multinational enterprises (MNEs) operating in the UK (and elsewhere), particularly in the M&A context.

If the Labour Party's election manifesto is anything to go by, the Labour Government will not raise the rates of income tax, national insurance or VAT. The CT rate can also be expected to be capped at 25 per cent for the foreseeable future. The generous new features of the UK's capital allowances regime (discussed in more detail in the section on capital allowances below) are also expected to remain the same, and so is support for the implementation of the Pillar Two rules in the UK. What is expected to change then? Other than various items concerning taxation of (generally wealthy) individuals (eg, private equity owners and 'non-domiciled' persons in the UK), the rate of the Energy (Oil and Gas) Profits Levy ('EPL'), a temporary tax on the windfall profits of oil and gas companies, is expected to increase and there is going to be a 'renewed focus on tax avoidance by large businesses'.[1]

In a low-growth, high-inflation economy, where taxpayers are under considerable financial strain, the current Labour Government has a big challenge ahead in terms of raising much needed tax revenue. A good first step to get taxpayers, particularly corporations, on its side in this journey would be to reintroduce some certainty into the tax law and policy landscape. The Labour Party's manifesto did suggest the aim of working in that direction by holding one major fiscal event a year and giving advance warning of policy changes. It remains to be seen how much of that goal it will realise.

[1] For more detail on the tax measures in Labour's manifesto, see Tanja Velling, 'Change: Labour Party Manifesto 2024' (European Tax, 14 June 2024) www.europeantax.blog/post/102ja3q/change-labour-party-manifesto-2024 accessed 12 September 2024.

Introduction

The 2023 UK tax update set out the measures introduced in the UK by the Finance Act 2023 and the Spring Finance Bill of 2023, which, subsequent to the publication of that update, became the Finance (No 2) Act 2023.

On 22 November 2023, the then-Chancellor of the Exchequer ('Chancellor') Jeremy Hunt (the new Chancellor following the general election is Rachel Reeves) delivered his Autumn Statement (the 'Autumn Statement')[2] and introduced a series of tax measures which were included in the Finance Bill 2023-24. This became the Finance Act 2024 on 22 February 2024. In his last significant act as Chancellor, he delivered the Spring Budget on 6 March 2024 (the 'Spring Budget').[3] This resulted in Finance (No 2) Act 2024 of 24 May 2024.

This report covers certain highlights from the Autumn Statement, the Spring Budget, Finance Act 2024 and Finance (No 2) Act 2024 that are relevant to corporate taxpayers.

Corporation tax

Capital allowances

Capital allowances are the UK tax system's way of giving tax relief for some (but not all) capital expenditure. They are effectively the tax equivalent of depreciation for accounting purposes.

The most significant measure for companies coming out of the Autumn Statement was to make permanent: (1) a 100 per cent first-year allowance (ie, full expensing) for main rate expenditure (meaning expenditure that would otherwise have qualified for writing-down relief at a rate of 18 per cent) on qualifying plant and machinery; and (2) a 50 per cent first-year allowance for special rate (six per cent) expenditure (meaning expenditure that would otherwise have qualified for writing-down relief at a rate of six per cent, and the balance would still qualify for relief at this existing six per cent rate). These allowances were initially intended to apply only to expenditure incurred from 1 April 2023 until the end of March 2026. The objective of making them permanent was to provide 'maximum certainty to businesses and enable long-term investment decisions to be made'.

By that time, the Finance (No 2) Act 2023 had already made the temporary annual investment allowance (AIA) of £1m, which was due to expire on 31 March 2023, permanent. This enables businesses (ie, including unincorporated businesses and

[2] For more detail on the Autumn Statement 2023, see Tanja Velling, 'Autumn Statement 2023: ORIP Out – UTPR In' (European Tax, 22 November 2023) www.europeantax.blog/post/102itg1/autumn-statement-2023-orip-out-utpr-in accessed 12 September 2024.

[3] For more detail on the Spring Budget 2024, see Tanja Velling, 'The UK's Spring Budget 2024' (European Tax, 6 March 2024) www.europeantax.blog/post/102j21x/the-uks-spring-budget-2024 accessed 12 September 2024.

most partnerships and not just companies) to deduct 100 per cent of the costs of qualifying plant and machinery up to £1m in the first year. Although not without areas of overlap, both full expensing and AIA have some differences in scope and are intended to be used together (provided the two are not claimed for the same expenditure).

At the start of 2024, His Majesty's Treasury (HMT) and His Majesty's Revenue and Customs (HMRC) launched a technical consultation on wider changes to simplify the UK's capital allowances regime. The consultation focuses on changes to capital allowances available for expenditure on the provision of plant and machinery, and is not intended to consider reforms to other capital allowances, such as structures and buildings allowances and R&D allowances (different from the R&D relief discussed in the section on capital allowances below).

In the Spring Budget, the then-Chancellor Hunt announced the intention to extend full expensing to leased plant and machinery, that is, plant and machinery not used by the owner, 'when fiscal conditions allow'. However, in the UK's high cost of living, low growth economy, and with the change to the current Labour Government, it remains to be seen when, if at all, the measure will see the light of day. As said above, there is more certainty (based on the Labour Party's election manifesto) in the current Labour Government's intention to cap the CT rate at 25 per cent and maintain, as permanent, the generous new features of the capital allowances regime discussed above.

R&D tax relief

For accounting periods from 1 April 2024, the Finance Act 2024 introduced a merged scheme for R&D relief in the UK, consolidating the previous Research and Development Expenditure Credit (RDEC), which generally benefitted larger companies, and the R&D relief scheme for small and medium-sized enterprises (SMEs). The merged rules broadly follow the RDEC approach. Accordingly, from 1 April 2024, there has been a 20 per cent above the line credit, in most cases (with a 49 per cent credit in the case of ring fence trades).

The merger is, however, not complete in that different rules for loss-making SMEs persist. For instance, there is a more generous basis for calculating R&D reliefs for solely loss-making R&D-intensive SMEs. This allows loss-making R&D-intensive SMEs to make a total of 186 per cent deduction (ie, an extra 86 per cent of their qualifying costs in calculating their adjusted trading loss, as well as the 100 per cent deduction that already appears in their accounts).

Transfer pricing and diverted profits tax

The previous Conservative Government had been consulting on changes to the UK's transfer pricing and permanent establishment (PE) rules and the diverted profits tax (DPT). The consultation closed on 14 August 2023 and a response was published on 16 January 2024.

In relation to transfer pricing, of particular interest was the previous Conservative Government's intention to relax the obligation to apply the transfer pricing rules to transactions between UK entities and replace the UK's transfer pricing legislation on

financial transactions and guarantees. The previous Conservative Government intended to publish draft legislation in 2024, but that did not happen.

MNEs that have business activities in the UK and use artificial arrangements to divert profits from the UK (eg, by avoiding a UK taxable presence) are subject to DPT, a separate tax on such diverted profits.[4] One of the other changes proposed in the consultation was to remove DPT's status as a separate tax and merge it into CT as a separate assessment at the current higher DPT rate, which would be made in the same circumstances where DPT currently applies. The aim was to help to clarify the relationship between the taxation of diverted profits and transfer pricing, and provide access to double taxation relief under the UK's treaty network, while maintaining key features of the DPT regime.

In the summary of responses to the consultation published on 16 January 2024, the previous Conservative Government recognised the predominantly positive reaction to this proposal and intended to hold a technical consultation on draft legislation in 2024. With the change to the current Labour Government, however, it remains to be seen whether this measure will see the light of day (and as there was nothing on the DPT in the Labour Party's manifesto, it is hard to predict).

Interest deductibility and the unallowable purpose rules

UK tax legislation disallows deductions for so much of any interest debit (and other costs) 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 loan relationship is 'any purpose which consists of securing a tax advantage for the company or any other person'. The unallowable purpose rules have been high on HMRC's radar, with three Court of Appeal decisions this year on them.[5] In all three cases, the taxpayer was found to have an unallowable purpose for being party to a loan relationship.

The unallowable purpose rules are relevant in all sorts of scenarios, such as debt-funded acquisitions, and intra-group financing and refinancing. Accordingly, in transactions or arrangements involving debt in the UK, it is crucial to maintain good contemporaneous evidence, such as board minutes, structure papers and transfer pricing studies, to support the commercial rationale.

The unallowable purpose cases are very fact dependent. Therefore, in an unallowable purpose dispute it is critical that all the relevant facts are presented to the First-Tier (Tax) Tribunal (the 'FTT'), the fact-finding body in tax cases in the UK, in the best possible light. If the FTT does not find a commercial purpose, the threshold for

[4] As mentioned in the 2023 version of this update, from 1 April 2023, the rate of DPT increased from 25 per cent to 31 per cent to maintain the six percentage point differential with the main rate of CT www.ibanet.org/document?id=Taxes-Country-2023-UK accessed 12 September 2024.

[5] *BlackRock Holdco 5, LLC v HMRC* [2024] EWCA Civ 330, *Kwik-Fit v HMRC* [2024] EWCA Civ 434, and *JTI Acquisitions Company (2011) Ltd v The Commissioners for His Majesty's Revenue and Customs* [2024] EWCA Civ 652.

overturning this finding of fact on appeal is very high.[6] Given that this is a developing area of law, taxpayers should consider taking advice on how unallowable purpose cases might affect their company and certainly for responding to an HMRC challenge under the unallowable purpose rules.

International tax

UK's implementation of Pillar Two

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 the digitalisation of the economy, the UK Government consulted on the UK's implementation of Pillar Two in 2022. The Finance (No 2) Act 2023 introduced legislation to implement the Global Anti-Base Erosion (GloBE) Pillar Two income inclusion rule in the UK.

The UK's income inclusion rule is called the 'multinational top-up tax'. The law also introduced a new 'domestic top-up tax' intended to constitute a qualified domestic minimum top-up tax for Pillar Two purposes. The new taxes have been applied for accounting periods beginning on or after 31 December 2023.

Broadly, the multinational top-up tax applies to consolidated MNE groups with global annual revenue exceeding €750m or more in any two out of the four accounting periods preceding the tested period. It is charged on the UK parent in respect of entities in foreign jurisdictions where the group's profits arising in the relevant jurisdiction are taxed at a rate below a minimum effective tax rate of 15 per cent.

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

The Finance Act 2024 amended various provisions relating to the multinational top-up tax and domestic top-up tax. These amendments were mainly aimed at correcting drafting errors, ensuring that the law worked in particular areas (eg, securitisation) and ensuring consistency with the latest OECD guidance. The draft law to implement the undertaxed profits rule (UTPR) of Pillar Two was also published in 2023 under the previous Conservative Government, and was intended to have effect for accounting periods beginning on or after 31 December 2024.[7] The previous Conservative Government had also announced that Offshore Receipts in respect of Intangible Property ('ORIP') rules, which broadly impose an income tax charge on gross receipts

[6] For more detail see Zoe Andrews, 'Lessons learned from JTI and other recent unallowable purpose cases', 18 June 2024, European Tax Blog www.europeantax.blog/post/102jac0/lessons-learned-from-jti-and-other-recent- unallowable-purpose-cases accessed 12 September 2024.

[7] Draft legislation published by the Conservative Government in 2023 https://assets.publishing.service.gov.uk/media/651408473d3718000d6d0c70/Draft_legislation September_2023.pdf accessed 12 September 2024.

of non-UK residents in respect of intangible property rights used in connection with the provision of goods or services in the UK, will be repealed when the UTPR comes into effect.

It is expected that the current Labour Government will implement the UTPR. Its manifesto stated that ‘Labour supports implementation of the OECD’s global minimum rate of corporate taxation’. Whether this would be on the terms proposed by the previous Conservative Government (ie, with the contemporaneous abolition of the ORIP rules) remains to be seen.

The Pillar Two rules remain an area where future amendments to legislation are expected (potentially with retrospective effect) to ensure consistency with the developing administrative guidance. This creates a rather uncertain framework, particularly in M&A transactions.

Double taxation agreement (DTA) between the UK and Brazil

In November 2022, the UK and Brazil signed a DTA. The Delegated Legislation Committee debated a draft Double Taxation Relief and International Tax Enforcement (Brazil) Order 2023 (the ‘Brazil Order’) (incorporating the DTA) on 27 June 2023 and the Brazil Order came into force on 24 November 2023.

The DTA will be fully effective 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.

DTA between the UK and Luxembourg

The UK and Luxembourg signed an updated DTA and protocol in 2022, which entered into force on 22 November 2023. It had effect in the UK from 1 January 2024 in respect of withholding taxes; from 1 April 2024 in respect of corporation tax; and from 6 April 2024 in respect of income tax and capital gains tax.

Crypto-Asset Reporting Framework (CARF)

On 6 March 2024, the previous Conservative Government published a consultation on the UK’s implementation of the OECD’s CARF, the new international tax transparency regime for the automatic exchange of information on crypto assets. In addition, the Conservative Government invited views on the extension of the CARF to require UK reporting entities to include information on UK residents.

The previous Conservative Government also consulted on the UK’s implementation of the OECD amendments to the Common Reporting Standard (‘CRS2’), the international tax transparency regime for the automatic exchange of information on financial accounts.

The consultations closed on 29 May 2024. It is likely that the measures will be taken forward by the current Labour Government.

Other UK tax developments

EPL

The EPL is an additional temporary 35 per cent tax on the profits from UK oil and gas upstream activity. It was introduced to tax the record profits of oil and gas companies following Russia's invasion of Ukraine. Finance Act 2023 extended the date on which the EPL expires to 31 March 2028 (from 31 December 2025). The Spring Budget announced a further extension of the EPL's expiration date to 31 March 2029, but this has not yet been legislated for (whether in Finance (No 2) Act 2024 or otherwise).

Finance (No 2) Act 2024 did, however, provide for the previously announced Energy Security Investment Mechanism (ESIM). The ESIM sets out the triggers for an early end of the EPL, which is essentially if oil and gas prices fall to, or below, the 'threshold price' for a 'reference period' of two consecutive quarters. The threshold prices for reference periods beginning after 31 March 2024 are $74.21 per barrel for oil and $0.57 per therm for gas. For subsequent reference periods, the threshold prices are to be adjusted in line with the Consumer Price Index (CPI).

The Labour Party's manifesto said that it would extend the EPL to the end of the next Parliament (which would, on the assumption of a five-year election cycle, take its life to 2029). This matches the end date that had been envisaged in the previous Conservative Government's Spring Budget. Labour's manifesto further stated that it would retain the ESIM for the early phase out of the EPL should oil and gas prices fall below the relevant threshold. It did, however, also mention raising the rate of the EPL by three percentage points and removing the generous investment allowances the EPL legislation currently offers.

Electricity generator levy (EGL)

The EGL is a 45 per cent charge on 'exceptional receipts' (exceeding £10m in an accounting period) generated from the production of wholesale electricity that applies to undertakings that generate over 50 GWh per year. 'Exceptional receipts' mean amounts generated from selling wholesale electricity at an average price above a benchmark price. The benchmark price for the period from 1 April 2024 to 31 March 2025 is £77.94 (to be adjusted in line with the CPI in subsequent years).

The EGL was the previous Conservative Government's response to record profits of companies generating electricity from renewable sources, nuclear and biomass, which benefited from having the price of their output pegged to the high prices of oil and gas, but that did not have nearly the same rise in underlying costs. It is, however, also true that the UK needs to add more clean energy into the mix to reach its net zero goals.

To respond to the EGL's criticism of discouraging clean energy production, the Finance Act 2024 introduced a new investment exemption and excluded from the EGL regime 'qualifying new generating plants'. In general terms, where the substantive decision to

proceed with a project to create a new clean electricity generating station or expand an existing generating station was made on or after 22 November 2023, receipts from that new generating station or additional capacity will not be subject to the EGL.[8]

It is as yet unclear whether the current Labour Government will make any changes to the EGL. Indeed, the party's manifesto was silent on the matter. However, given the party's commitment to 'make Britain a clean energy superpower', it is likely to preserve (and potentially enhance) the investment exemption.

VAT

To support businesses with the administrative and financial impact of VAT charges, the Conservative Government proposed changes to the VAT registration and deregistration thresholds in the Spring Budget 2024.

From 1 April 2024, the turnover threshold that determines whether a person must be registered for VAT increased from £85,000 to £90,000. The turnover threshold that determines whether a person may apply for deregistration increased from £83,000 to £88,000. These thresholds are certainly on the higher end compared to other countries. Germany and the Netherlands, for instance, have VAT registration thresholds of €22,000 and €20,000, respectively.

Removal of 1.5 per cent stamp duty and the stamp duty reserve tax (SDRT) charge

In the UK, stamp duty is charged on instruments to transfer stocks and other 'marketable securities'. In turn, the agreement to transfer stocks and other 'chargeable securities' is subject to SDRT. The rate of stamp duty and SDRT is 0.5 per cent.

A higher 1.5 per cent charge, however, is applied to the issue or transfer of chargeable securities to a depository receipt issuer or a clearance service provider. The rationale was the difficulty in collecting stamp taxes when shares in a UK company are traded on a foreign exchange through a clearance system or in depositary receipt form, so the UK chose to collect a 1.5 per cent 'season ticket' charge upfront when the underlying shares are issued or transferred to the clearance system or depositary.

Owing to certain Court of Justice of the European Union (CJEU) decisions, the charge was treated as contrary to EU law, and it became unlawful for the UK to impose the charge (even though it stayed on the statute book) on the issue of shares, or on their transfer, if the transfer was integral to raising new capital or for the purpose of listing shares without a change in beneficial ownership. The Retained EU Law (Revocation and Reform) Act 2023 ('REULA'), however, meant that the CJEU decisions, as a result of which the 1.5 per cent charge had become unlawful for the UK to impose, no longer had authority in the UK.[9]

[8] The exemption is discussed in more detail in Deeksha Rathi and Ed Milliner, 'Tax and the Energy Sector: What's in Store for 2024?' (Slaughter and May, 24 January 2024) https://my.slaughterandmay.com/insights/briefings/tax-and-the-energy-sector accessed 12 September 2024.

[9] Mike Lane, 'Has the UK Just Reintroduced Its 1.5% Stamp Duty Charge on Share Issues?' (European Tax, 3 July 2024) www.europeantax.blog/post/102iid1/has-the-uk-just-reintroduced-its-1-5-stamp-duty-charge-on-share-issues accessed 12

To prevent the seemingly unintended application of the 1.5 per cent charge as a result of the REULA, the Finance Act 2024 amended (with retrospective effect from 1 January 2024) the relevant legislation to prevent the 1.5 per cent charge applying in respect of a share issue or transfer in the context of capital raising.[10]

Tonnage tax

The tonnage tax regime was introduced in 2000 to make the UK's shipping industry more competitive. The previous Conservative Government had 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.

The previous Conservative Government also legislated in the Finance Act 2024 to permit third-party ship management companies to join the regime, and to raise the limit on capital allowances to £200m for lessors of ships within the regime. These measures took effect from 1 April 2024.

Carbon border adjustment mechanism (CBAM)

The previous Conservative Government announced that it would introduce a CBAM from 1 January 2027, which would place a 'carbon price' on some of the most emissions-intensive industrial goods imported to the UK from certain sectors, such as aluminium, cement, hydrogen, iron and steel.

On 21 March 2024, HMRC and HMT launched a joint consultation that focused on the design and administration of the proposed CBAM.[11] The Labour Party's manifesto envisaged that the party would be 'climate leaders' and act to meet agreed climate targets. On this basis, it is not unreasonable to believe that the CBAM's implementation will continue under the current Labour Government.

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[10] Tanja Velling, 'StampDuty in the Autumn Statement 2023: Update on the 1.5% Charge and Extension of the Growth Market Exemption' (European Tax, 24 November 2023) www.europeantax.blog/post/102itm2/stamp- duty-in-the-autumn-statement-2023-update-on-the-1-5-charge-and-extension accessed 12 September 2024.

[11] For more detail, see Tanja Velling, 'UK CBAM Consultation: Same Stripes or Different Spots? A Comparison With the EU' (European Tax, 29 April 2024) www.europeantax.blog/post/102j6h0/uk-cbam-consultation-same-stripes- or-different-spots-a-comparison-with-the-eu accessed 12 September 2024.