Response from ICAS

Royalties Withholding Tax

23 February 2018
About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland (‘ICAS’) is the world’s oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

Overview

2. ICAS welcomes the opportunity to comment on the HMRC and HM Treasury consultation “Royalties Withholding Tax” published on 1 December 2017.

3. We understand the government’s desire to ensure that multinational groups cannot realise profits in entities with limited economic activity in low tax jurisdictions. Currently, some groups use arrangements which involve payments for the exploitation of certain property or rights in the UK being made to connected parties in low or no tax jurisdictions.

4. However, the proposals for the Royalties Withholding tax were announced before US Tax Reform was implemented through the Tax Cuts and Jobs Act. Going forward US multinationals are far less likely to be able to realise profits in low taxed entities which lack economic substance. The new US rules on Global Intangible Low-Taxed income (GILTI) impose a tax charge on the type of low taxed profits which the UK proposals are aimed at.

5. Other jurisdictions continue to implement BEPS Action 2 recommendations to tackle the use of hybrid entities (and BEPS Action 3 recommendations dealing with CFCs). Furthermore, EU member states will be required to implement anti-hybrid rules and CFC rules under the Anti-Tax Avoidance Directive (from 1 January 2020 and 1 January 2019 respectively). As a result, the circumstances in which a deduction can be taken for royalty payments where the income is not taxable in the hands of recipient or under CFC rules, will be greatly reduced.

6. In the light of US tax reform, BEPS and the EU Directive we suggest that it would be beneficial to reconsider whether the proposals will still produce the expected outcomes – or whether the anticipated benefits in terms of revenue yield will be outweighed by the likely costs and the potential adverse effects on UK competitiveness.

7. The proposed reporting requirements are unduly onerous and are likely to be unworkable in some cases.

8. The proposals create a risk of double taxation in several scenarios because they do not consider the tax position of the recipient. This risk could be reduced by including a minimal tax or local economic substance test, which considers the tax position of the recipient and any other entity in the group.

9. Alongside the proposals in the position paper on the Digital Economy these proposals are primarily (although not exclusively) aimed at global digital businesses. Whilst we recognise that there is public dissatisfaction with the current position, our preference would be for multilateral action at an international level – rather than further unilateral actions by the UK, along the lines of the Diverted Profits Tax (DPT) or these proposed changes to royalties.

10. Increasing numbers of countries are considering changes to the allocation of taxing rights and taxes levied by reference to revenue not profit – in order to deal with the challenges presented by increased digitalisation. This could lead to extensive double taxation and involve companies in disputes with several different tax authorities. It is therefore essential that the UK works with the OECD and EU to reach global consensus on the approach to be adopted.

Payments in scope

Q1: Do you agree that a generic approach will provide greater certainty in the application of this measure? If not, what do you see as the likely areas of difficulty arising from this approach?
11. The government’s preferred option is for a generic approach. However, as currently set out this appears to give rise to a high risk of unintended payments being brought within the scope. For example, it seems unlikely that the rules are intended to catch capital payments for the acquisition of an intangible asset, even where these are paid in instalments. Whilst the wording of paragraph 4.2 of the consultation document refers to payments for the ‘use or exploitation’ of rights over intellectual property and other intangible assets, paragraph 4.6 suggests that the measure could apply to ‘any’ payment for rights over, or interest in, the exploitation of intellectual property and intangible assets.

12. The intention is clearly to bring payments currently outside the definition of ‘royalty’ within the scope of the proposals – but using the very broad generic approach suggested ie ‘any payment’ appears to be widening the scope too far.

13. If the generic approach is adopted, the legislation needs to be as explicit as possible about what is within scope and what is excluded. It should make clear, for the avoidance of any doubt, that payments for the transfer of intellectual property or other intangible assets (including goodwill) are outside the scope. HMRC guidance on the legislation should also include a non-exhaustive list of the types of payment which are not within scope.

Q2: If a more targeted approach is preferred, how should the types of payment within scope best be described?

14. See our response to Q1 above.

Recipient entity

Q3: Do you agree that the primary scope of the rules should be payments between related parties? Are there any circumstances in which the rules should apply to payments between unrelated parties?

15. The stated intention of the proposals is to tackle intra-group arrangements that achieve an artificially low effective rate of tax. It is therefore difficult to envisage any circumstances in which the rules should apply to payments between unrelated parties. As noted in paragraph 4.10 any risk that the measure could be sidestepped through arrangements involving the insertion of unrelated parties will be dealt with through anti avoidance provisions.

Calculation of payment

Q4: Do you agree that such an approach is appropriate in determining the amount of any payment that has a liability to IT? In your experience, what are the most common approaches taken to determine the amounts payable under these and similar arrangements?

16. As set out in paragraphs 4.15 to 4.17 of the consultation document there will be a range of different methods for calculating payments. It is therefore important that the legislation does not adopt a ‘one-size fits all’ approach.

17. In circumstances where the payment made is in respect of a licence that covers a geographic area wider than just the UK there are a number of ways that the amount to be apportioned to the UK could be calculated; it would be wrong to mandate a specific approach which may not agree with the way the underlying payment was calculated. Such an approach could lead to different territories claiming allocation of overlapping amounts, if similar proposals were to be adopted by other jurisdictions.

18. A sales-based approach could be one appropriate way to determine the amount of any payment that has a liability to income tax, but the approach to determining the amount of any payment that relates to the UK should take into account how the underlying calculation is made. Ultimately, the legislation should allow for the apportionment to be made in a just and reasonable way.

Recipient jurisdiction

Q5: Do you agree with the government’s preferred approach of a liability arising only when payment is made to a jurisdiction with whom the UK’s DTA does not contain an NDA, or where there is no DTA in place?
Q6: Given the types of payments likely to be made, to what extent would the rules impact on payments made to jurisdictions that are not low or no tax regimes?

19. The consultation document states that the measure is intended to target a narrow range of arrangements that achieve low effective tax rates through holding intellectual property in low or no tax jurisdictions, but the proposed approach makes no reference to the tax position of the recipient.

20. Under the proposals as they stand, there will be circumstances when a tax liability arises because the intellectual property is held in a high tax jurisdiction that does not have a DTA with the UK, or has a DTA that does not contain an NDA; this could lead to double taxation. A key example is Brazil, where income is likely to be taxed at a higher effective tax rate than the UK. If no double tax relief is available for the UK tax suffered, this could have a negative impact on the UK’s competitiveness for this economy.

21. As noted in the overview, the risk of double taxation could be reduced by including a minimal tax or local economic substance test in the legislation which considers the tax position of the recipient and any other entity in the group. This should supplement rather than replace the test currently proposed, to reduce complexity.

Reporting and payment

Q7: Do you agree that the existing CT61 and CT600H framework, as adapted, are an appropriate way to return a liability under the proposed measure?

Q8: Do you agree that provision of a return of specific information to an Officer of HMRC is a proportionate way of collecting information from groups?

Q9: Are there any other administrative easements that would reduce the compliance burden on groups, whilst ensuring provision of appropriate information?

22. We agree that the existing CT61 and CT600H framework should be the starting point for the reporting framework. However, the proposed reporting requirements are unduly onerous and may be unworkable in some cases.

23. The requirement to report would not only apply to payments within the new rules ie where there is an actual liability, but also to payments that would have been within scope, but for the recipient being in a jurisdiction with whom the UK has a DTA with an NDA. This seems unreasonable, as non-UK entities would have to perform the apportionment calculations even though there is no prospect of any actual liability. The reporting requirement should be restricted to cases where there is an actual liability.

24. Consideration should also be given to including a de minimis reporting threshold to reduce the compliance burden for companies.

25. Paragraph 5.5 of the consultation document notes that the government believes that groups making payments within the scope of the measure will have a UK taxable presence. Even where this is true the UK entity may not have access to the information necessary to comply with the proposed reporting requirements – particularly as noted above where an overseas entity is being asked to provide information where there is no actual liability. Large overseas groups are often unwilling to share data with a small UK entity.

26. In cases where there is no UK taxable presence it is difficult to see how the rules could be enforced. Many groups without a UK taxable presence will have limited sales/activities in the UK and little knowledge of UK tax; they could be completely unaware of the rules.

Payment

Q10. Do you agree that the creation of joint and several liability is an appropriate way to enable debt collection in the case of non-compliance?

27. Paragraph 5.11 of the consultation document acknowledges that pursuit of a liability from a non-UK resident may be difficult and costly, even following the UK’s international agreements. The proposal is therefore to enforce payment through a related party with a UK presence.
28. However, as noted above, where there is a UK entity it may not be in a position to obtain information from the overseas group. The proposal to impose joint and several liability on a UK related party therefore seems problematic and could deter multinational groups from establishing a UK presence – or lead to them restructuring to remove a UK entity.

Double Taxation

Q11: Are there circumstances in which the proposed measure will give rise to inequitable double taxation?

29. There are various circumstances where inequitable double taxation may arise:

30. Other jurisdictions may already withhold tax on the payment.

31. Where there is a series of sub-licences and the IP rights under each licence are not essentially identical, careful drafting will be required to ensure that the payment can be traced through the sub-licences. This will have to be balanced with the need for the legislation to be clear and straightforward, particularly if non-UK resident companies will have to apply it.

32. In the example on page 5 of the consultation document it is assumed that Company A obtains a deduction for the royalty – but this might not always be the case (particularly where BEPS recommendations are implemented). Therefore, there would potentially be tax in A’s jurisdiction – and in some cases both Company A and Company B will not be in low or no tax regimes.

33. Where the recipient of the payment is resident in a jurisdiction that does not have a DTA with the UK, or where there is a DTA with no NDA in place (this would include high tax countries such as Brazil as well as certain other South American and African countries), to the extent that the recipient entity does not give full credit for the tax withheld. As the tax is being withheld by a country other than the territory of residence of the payer and because it applies on payments wider than the OECD definition of royalties, it may be difficult for the recipient to claim tax credit for the tax withheld;

34. Where the parent company of the recipient has CFC rules that bring the payment into the charge to tax on a current year basis, or taxes the profits of its subsidiaries on repatriation, but does not give full relief for the tax withheld. For example, the new US Global Intangible Low-Taxed income (GILTI) provisions do not give full relief for foreign tax credits.

35. As the proposed measures are unilateral, the problem of double taxation could be further exacerbated if the proposals are adopted by other jurisdictions, and there is no agreed global mechanism for allocating between jurisdictions a payment which covers the use of an intangible asset in several jurisdictions.

36. Furthermore, it is proposed that the tax is withheld on the gross payment for the right to exploit the intangible in the UK. However, there could be considerable expense in developing, enhancing, maintaining and protecting that intangible in the company owning it, which is not taken into account because the tax is levied on the revenue not the profit. This is a worrying development; as noted in the overview increasing numbers of countries are considering whether changes to the allocation of taxing rights are required in the modern economy. It is essential that the UK does not exacerbate this problem but works with the OECD and EU to reach global consensus on the right approach to the allocation of taxing rights.

Assessment of impacts

Q12: Do you have any comments on the assessment of equality and the impact on business as a result of this change?

37. As outlined in the overview these proposals were put forward before US tax reform – and may not take account of ongoing implementation of BEPS recommendations or the EU Anti-Tax Avoidance Directive.

38. We therefore suggest that it would be beneficial to reconsider whether the proposals will still produce the expected outcomes – or whether the anticipated benefits in terms of revenue yield will be outweighed by the likely costs and the potential adverse effects on UK competitiveness. As noted
above the rules could lead to international groups deciding against establishing a UK presence – or restructuring to remove a UK entity.