Chartered Institute of Taxation
Excellence in Taxation

Royalties Withholding Tax
Response by the Chartered Institute of Taxation

1 Introduction

1.1 We refer to consultation document on *Royalties Withholding Tax* published on 1 December 2017. We welcome the opportunity to comment on these proposals, noting that they form part of government's response to the challenges presented by the digitalised economy. These measures were announced at the Autumn Budget and we understand that they are part of the government's strategy for tackling the perceived imbalances of the digitalised economy (as explained in the government's position paper on *Corporate tax and the digital economy* published in November 2017). The CIOT was pleased to have the opportunity to meet with HMT and HMRC on 29 January 2018 to discuss this consultation document and the position paper and our comments below build on the discussions at that meeting.

1.2 The CIOT has been involved in this debate since the digital economy was identified as an action point of the G20/OECD BEPS project in 2013 and has engaged with the OECD and the EU Commission, as well as with the UK Government since then. We are pleased to continue to contribute to the ongoing debate in this difficult area.

1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.4 In our view, objectives for the tax system should include rules which translate policy intentions into law accurately and effectively, without unintended consequences. The tax system should aim to provide simplicity and clarity, so people can understand how much tax they should be paying and why, and also to provide certainty so that businesses and individuals can plan ahead with confidence. It is also important to balance compliance burdens and bureaucracy against the tax raised for the Exchequer.

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2 Overview

2.1 As discussed at our meeting the proposed royalties withholding tax measure was announced at the Autumn Budget and before the US tax reforms. We reiterate what we said at the meeting around whether, following the US tax reforms, the proposals are necessary or worthwhile. It is not clear to us that, following these tax reforms, these measures would raise any significant revenue for the Exchequer. But it is clear that they would result in significant costs for HMRC (as well as taxpayers) in terms of compliance, in addition to the significant Parliamentary drafting time that would be required to produce the legislation. The expected revenue that may be raised should also be weighed against the negative impact on the UK competitiveness at this sensitive economic time.

2.2 More generally, it was recognised at the meeting that these proposals are imposing a UK tax liability on profits which under the existing international tax system are profits which fall to be taxed in another jurisdiction. In our view any such measures should be introduced with great caution.

2.3 There is a significant risk of other countries following the UK's example and imposing similar measures, which may result in a foreign tax liability in respect of profits which the UK currently taxes. In our response to the government's position paper on *Corporate tax and the digital economy* we highlighted the importance of a multilateral global response because of the potential dangers of unilateral measures. In particular, that position paper set out the government's aim for the UK to be a global digital hub and we suggested that the government should consider how unilateral measures of other countries of a similar type might impact a significant UK company which is a global digital hub.

2.4 We suggest that the proposed measures also need to be better targeted to ensure they do only apply to profits which are not currently taxed at an appropriate level when considering the multinational group as a whole. If a country in which the company paying the royalty has implemented the anti-hybrid rules, a deduction for the royalty should be denied, resulting in the profits being taxed in that jurisdiction. Alternatively a deduction may be denied under another anti-avoidance provision or under the transfer pricing rules. Consequently, it should also be a condition of any new royalty withholding tax rules that before a withholding tax obligation is imposed, either the sales are not taxed in Country A (in the example of paragraph 2.1 of the consultation document) or relief (that is, as a deduction in calculating the profits generated by those sales) is given for the royalty payment throughout the chain so that it does arrive in the ultimate 'low tax' recipient jurisdiction essentially untaxed. If tax relief is denied in full or in part, for the royalty, the withholding tax should only apply to the royalty which is tax deductible.

2.5 Similarly, in addition to the new Global Intangible Low-Taxed Income (GILTI) tax charge in the US, if other countries are taking steps to ensure that their tax rules comply with the agreed BEPS best practice recommendations for CFCs (for example, the EU's Anti Tax Avoidance Directive (ATAD)), the profits arising in the low tax jurisdiction that are the target of this measure will become effectively taxed in the parent company jurisdiction. Such profits should also, therefore, be excluded from the scope of the measures or inequitable double taxation would arise (see paragraph 11 below).

2.6 We recognise the political pressure to be seen to be trying to do something to tax profits of multinational groups which are currently subject to only a very low effective rate of tax. However, it is important that any such measures that are

introduced are, in fact, cost effective for the UK as a whole. As mentioned in paragraph 12 below, we suggest that the impact assessment should be updated to reflect recent changes, and to take account of possible behavioural impacts, so that an updated overall cost/benefit analysis can be done. In particular it would seem appropriate to consider whether royalties that would potentially be in the scope of these proposals arise in groups without US parent companies.

2.7 Our strong view is that the government should seriously consider dropping these proposals as a result of changes in the international tax landscape since they were announced, which we suspect will mean that they will be more costly to implement and enforce than the amount of revenue that would be raised. At the very least it would be sensible to defer the implementation date of these proposals to allow time to assess the impact of the US tax reforms and the implementation by other countries of the BEPS anti-hybrid rules and CFC best practice recommendations.

2.8 Where tax is ultimately paid whether under transfer pricing rules, anti-hybrid rules or CFC rules in other countries these proposals run directly counter to the BEPS Action 2 agreed measures on hybrids, the BEPS Action 3 recommendations on CFCs and the BEPS Actions 8-10 work on development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE) and risk (and the transfer pricing guidelines in general), as well as the basic international principles on residence v source taxation.

2.9 Notwithstanding this view, we are taking this opportunity to set out some of the difficulties with the proposals as these are presented in the consultation document and the areas where we consider further work is required to ensure that the detail of the proposals meets the policy intention. In particular:

- further clarity is required around how the scope of the proposals would be defined by reference to key concepts such as ‘exploitation of the IP in the UK’ and/or ‘UK sales’ and what constitutes a royalty payment;
- in order to reduce the risk of double taxation, a minimum tax (which considers the tax position of the recipient and any other entity in the group) or local economic substance test should be included;
- the reporting obligations should be limited to royalty payments that are within the rules only and not to all royalty payments within a group which relate to sales in the UK;
- joint and several liability would be unduly onerous on UK subsidiaries, joint venture members and minority shareholders which would not have sufficient information (or any way of getting information) in respect of other companies within a worldwide group to determine whether or not liabilities may arise;
- clearly enforcement of the rules for groups without a UK taxable presence remains a significant issue to be resolved. Although we understand the rationale for attaching obligations to a UK presence, it seems unhelpful to place groups with a UK taxable presence at a disadvantage to those that do not; and
- more careful targeting of the measures may reduce the instances of double taxation, however, consideration should be given as to what would happen if other countries respond with similar withholding taxes. Especially as the rate of withholding on gross payments can be high compared with reducing corporate tax rates on profits.

2.10 The consultation on this measure is at the third stage of the consultation process. Given the amount of complexities and issues to be resolved for these measures to operate in accordance with the policy intention and without an overly onerous

administration and compliance burden, it is unfortunate that the measures were not consulted on at an earlier stage of the consultation process.

3 Arrangements in scope

3.1 The proposals are that royalty payments between non-UK related parties are brought within the scope of UK tax where the royalty is paid for the exploitation of IP and that IP is exploited to make sales in the UK. It is proposed that payments 'made for exploitation of IP or certain other rights in the UK have a source in the UK for the purposes of withholding tax' (paragraph 3.5 of the consultation document). This is essentially extending the definition of the 'source' and where royalties arise which is something that other countries may also wish to do.

3.2 There would need to be clarity around what activity is as a result of IP being exploited in the UK in order to determine whether royalty payments made outside of the UK are within the scope of the proposals. For example, are the following UK sales and/or the exploitation of IP in the UK such that a withholding tax obligation would arise:

(a) a sale to someone who is in the UK at the time of the sale but is not ordinarily so (for example a tourist or where a representative of a non-UK company signs/approves a contract whilst in the UK on other business)

(b) a sale to someone who habitually resides in the UK, even if at the time of the sale that person is not in the UK (if so, how does the supplier know this?)

(c) a sale where goods are physically delivered to the UK, no matter who are the parties, where the contract is concluded or the law of the contract

(d) a sale where services are performed in the UK, no matter who are the parties or the law of the contract

(e) a sale where digital content is downloaded by a person in the UK, regardless of where and when the actual sale occurred, this may have been outside of the UK: for example a tourist downloads content while visiting the UK that has been purchased outside of the UK before he travelled.

(f) a sale to a non-resident company where the items in question (i) will be or (ii) are likely to be or (iii) might in some circumstances come to be used for the purposes of a UK PE

(g) a sale to a non-resident company where the items in question (i) will be or (ii) are likely to be or (iii) might in some circumstances come to be used in the UK even if there is no PE

(h) a sale to a UK company for on-sale (in whole or part) to a foreign affiliate (see paragraphs 4.9 to 4.10 below)

(i) a sale where goods are delivered from the UK to a buyer outside the UK but the seller has no UK PE: for example, the goods are in a UK customs warehouse

(j) a sale where the Country A (in the example in paragraph 2.1 of the consultation document) entity supplies UK persons to provide services outside the UK: for

example, UK teachers are recruited by the Country A entity through a non-UK web-site to act as private tutors to non-UK persons

(k) a sale under UK contract law and/or the parties agree that disputes will be resolved in the UK court: for example, ship charters would be UK sales on this basis even though none of the parties is in the UK and the ship is on the high seas.

3.3 Is the concept of UK sales intended to be the same as, or similar to, the concept of UK-related sales and/or UK- related supplies and/or UK activity for the purposes of diverted profits tax (section 87 Finance Act 2015)?

4 Payments in scope – types of payment

4.1 ***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? (Question 1)***

4.2 ***If a more target approach is preferred, how should the types of payment within scope best be described? (Question 2)***

4.3 Paragraphs 4.1 to 4.8 if the consultation document describe how the royalty payments within the scope of the proposals may best be described. We recognise the benefits of a generic approach. However, as noted, this is a broad approach and the consultation document is not entirely clear as to what may or may not fall within the scope.

4.4 It is noted that the measures are intended to apply to a broader range of payments that the current definition of a royalty for the purposes of Part 15 ITA. The extended scope is intended to catch any 'payments for the use or exploitation of rights over intellectual property and other intangible assets in the UK' (paragraph 4.2 of the consultation document).

4.5 We understand that the proposals are intended to catch a component of a payment which is paid for the exploitation of IP which on its face is not a royalty: for example a component of a sales price or a management charge or dividend which relates to the exploitation of IP. However, our understanding from our meeting is that the payment should be in essence a royalty, the point being that royalties should be caught whatever they are called by the parties.

4.6 This should be clarified because if the intention is that the proposals would extend the scope of what is meant by a royalty, this would need to be very carefully defined and considered to ensure that it does not overlap with what is generally considered to be business profits. There is already some international debate around what constitutes a royalty and different countries define royalties differently. It would be unfortunate if these proposals added to that debate and led to disputes under double tax treaties.

4.7 We understood from our discussions at our meeting that these measures would not apply to a capital sum for the sale of an asset (or a premium for the grant of a licence), including payments in respect of goodwill. We suggested that the rules should not, therefore, apply to an instalment payment of a capital sum for the sale of an asset (or grant of a licence) and that this logic should apply even if the

instalments are calculated in same manner as a royalty. At the other end of the spectrum, can a one-off payment ever be a royalty? Can payments under a finance lease or an operating lease be 'royalties' for these purposes?

4.8 While recognising that the government wishes to catch the widest possible range of payments that fall within the types of arrangements being targeted, if the definition of royalty payment for these purposes and applying to a payment from Country A (in the example in paragraph 2.1 of the consultation document) to Country B is wider than the equivalent where there is a direct payment from the UK to Country B, in our view that could be viewed as discrimination under the EU Treaty and/or cause a dispute as to the application of UK's double tax agreement (DTA) with Country A if Country A refers to it as business profits and the UK as a royalty.

4.9 We mention in paragraph 3.2 above, which discusses what may constitute UK sales for these purposes, the situation of a sale to a UK company for on-sale (in whole or part) to a foreign affiliate. In this regard we would like to draw your attention to the existing 'foreign sales exemption' from UK withholding tax on royalties.

4.10 This exemption is discussed at paragraph 342530 of the International Taxes Manual which confirms that royalties excluded from what used to be ICTA 1988 s536 (which otherwise imposed a withholding obligation) include royalties for copies of works exported from the UK for distribution outside the UK. It is logical that there should be no UK withholding tax even in respect of sales to the UK where the UK purchaser then sells the product on overseas as the royalty payment is still essentially 'made in respect of copies of works or articles which have [ultimately] been exported from the UK for distribution outside the UK'.

5 Types of payment - Recipient entity

5.1 **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? (Question 3).**

5.2 We agree that the primary scope of the rules should be payments between related parties and we cannot envisage circumstances where payments between unrelated parties, or a genuine joint venture and its members, should be caught. To apply these rules in relation to payments between unrelated parties would run contrary to the arm's length principle which is an important component of international tax law.

5.3 The participation condition in TIOPA 2010 section 148 would be a suitable test on which to base a determination of whether parties are related in order to determine which payments are subject to the withholding obligation. However, we are concerned that this test is too widely drafted to be suitable for imposing joint and several liability (see paragraph 10 below).

5.4 As noted, anti-avoidance provisions would cover off any risk that multinational groups attempt to circumvent the new rule through the artificial insertion of unrelated parties in their structures.

6 Types of payment – Sub-licencing

6.1 As noted, it is important for the rules to deal with sub-licencing to ensure that a chain of payments for the exploitation of the same IP are not all liable to withholding tax.

6.2 We would caution against the legislation being drafted too restrictively to allow credit to be given for the 'same IP and rights' (our emphasis). As noted in paragraph 4.14 of the consultation document, the credit should be given for IP and rights which are 'essentially identical'. Almost certainly sub-licences will not be for precisely the same thing. A constructive, just and reasonable approach, aimed at matching the payments between A and B and B and C for the same substantive IP and rights that have been exploited in the UK, is required. Difficulties may also arise because a payment may be a royalty at some point in a supply chain but not at other points in the same chain.

6.3 An alternative approach to giving credit through a chain of payments may be more straightforward. The policy intent is that there should be a withholding tax obligation on royalties paid for exploitation of IP in the UK – but only once. Where a chain of licences and sub-licences relates, for example, to different geographical areas or IP, or the chain of payments includes payments which are composite payments (that is, comprising of a royalty element but also a payment for something else), rather than working through the chain and giving credit against the previous payment, it may be simpler to identify a licence or agreement which deals most clearly with a royalty payment in respect of only the UK. Groups should be able to then use the payments under that UK only agreement, even if the company that is making the UK sales is not a party to that licencing agreement, in order to determine quantum. This is a broadening of the principle of using a just and reasonable test to arrive at the quantum of the royalty payment to which the withholding tax obligation would attach.

6.4 The proposals and the reporting obligations could be simplified if the liability to withhold falls only on non-UK companies which are actually exploiting the IP in the UK; that is to say those companies which are making UK sales.

7 Calculation of payment

7.1 ***Do you agree that such an approach is appropriate in determining the amount of any payment that has liability to IT? In your experience, what are the most common approaches taken to determine the amounts payable under these and similar arrangements? (Question 4)***

7.2 We agree that there would be many different methods and approaches of determining the royalties payable under different agreements. Accordingly, it is sensible to have a mechanism which permits a just and reasonable apportionment. However, in relation to this, HMRC should be required to accept an apportionment by the taxpayer unless it can show that the basis on which the taxpayer has apportioned the payment is not just and reasonable. It should not be possible in our view for HMRC to replace one just and reasonable amount with another which is adverse to the taxpayer if the original amount was a within the range of what is just and reasonable.

7.3 In addition to the need to apportion payments between the UK and other jurisdictions covered by an agreement, there would also be a need to apportion for the costs of developing, maintaining and protecting the IP for which the royalty is to be paid. Rules would also be required to unbundle or disaggregate payments where these are for, say, services and use of the IP.

7.4 It would also be necessary to consider whether the rules would require the royalties to be paid or merely payable.

8 Recipient jurisdiction

8.1 ***Do you agree with the government's preferred approach of a liability arising only when payment is made to a jurisdiction with whole the UK's DTA does not contain an NDA, or where there is no DTA in place? (Question 5)***

8.2 ***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? (Question 6)***

8.3 We recognise the policy intent is to impose tax on profits which under the existing international tax system essentially fall to be taxed by another jurisdiction, but which are not currently being taxed (or are suffering very low tax).

8.4 The proposal is to identify countries where this is the case by reference to whether or not the UK has a DTA with a jurisdiction, or a DTA without a NDA. However this test would leave in the scope of the withholding tax some jurisdictions which are not 'low tax', for example, Brazil. If no double tax relief is available for the UK tax suffered, this could have a negative impact on the UK's competiveness for this economy.

8.5 In order to reduce the risk of double taxation, we suggest that a minimum tax or local economic substance test should be included which consider the tax position of the recipient and any other entity in the group. Thus should supplement rather than replace the current proposed test to reduce complexity.

8.6 Further, as mentioned above, CFC rules of other jurisdictions may mean that profits arriving in a low tax jurisdiction may be liable to tax elsewhere. In addition to the new US GILTI rules, ATAD will require all EU countries to have CFC rules. As with the BEPS best practice recommendations, the effect of these should be that any profits arising in subsidiaries of EU holding companies in low tax jurisdictions should fall to an appropriate extent to be taxed in that EU country under its CFC rules. Thus, even if the royalty payments do flow through to a low tax jurisdiction, it will not be the case that they are untaxed, thus removing the basis of the UK's claim to tax on them by reference to UK sales. Therefore the test as to whether tax is paid should be wide enough to consider the level of tax paid globally on the profit being targeted. A withholding tax obligation should only be imposed if the profit arising in Country B (in the example in paragraph 2.1 of the consultation document) is not effectively taxed through CFC rules (including the new US GILTI charge) by the parent company jurisdiction. The alternative would be to consider a more complicated mechanism for giving credit for the double taxation that would otherwise arrive, as discussed at paragraph 11 below.

8.7 More generally, we question whether a UK tax charge can be levied by the UK on, say, a Cayman company when there is no connection (or no internationally recognised connection) to the UK without infringing the sovereignty of the Cayman Islands. At our meeting HMRC indicated that their view was that such taxation was legal, pointing to the existence of double tax treaties as being the rationale for this. However, it seems to us that the purpose of double tax treaties is to resolve valid but over-lapping claims, rather than limiting what would otherwise be the universal taxing jurisdiction of each country. We note that US asserts taxing rights on a worldwide basis. However, the US does so by reference to citizenship or incorporation which is a form of nexus. Thus we are not convinced that the UK would not be violating other countries' sovereignty with these proposals.

8.8 We also envisage that Country A (in the example in paragraph 2.1 of the consultation document), which is taxing the profits as business profits and which will probably consider that the royalty arises in Country A, may challenge the UK's right to tax particularly if there is a DTA between Country A and the UK

8.9 In addition, as previously mentioned, consideration should be given as to whether or not Country A allows a deduction for the royalty. If Country A taxes the sales and does not allow a deduction for the royalty, the treatment in the recipient jurisdiction of Country B becomes largely irrelevant It is likely that, as countries implement the BEPS hybrid rules, relief should not be given by Country A in respect of the royalty payment in the types of arrangements which these proposals are seeking to catch. We suggest that it should also be a condition of any new rules that a withholding tax obligation should only be imposed where relief is given for the royalty payment throughout the chain so that it does arrive in the recipient jurisdiction essentially untaxed.

8.10 With regard to the underlying principle that this tax is intended to target revenues that are currently untaxed, we would note that, in fact, VAT will apply to most of the UK sales resulting from the exploitation of the IP.

9 Reporting

9.1 **Do you agree that the existing CT61 and CT600H framework, as adapted, are an appropriate way to return a liability under the proposed measure? (Question 7)**

9.2 ***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? (Question 8)***

9.3 ***Are there any other administrative easements that would reduce the compliance burden on groups, whilst ensuring that provision of appropriate information? (Question 9)***

9.4 The consultation document suggests that there should be a reporting requirement in respect of all payments across a group falling within the wider definition of 'royalty payment' as devised for these rules, whether or not such payments are subject to the new withholding tax; that is to say that all royalty payments to recipients in jurisdictions with whom the UK has a DTA with a NDA should also be reported. This seems to us to be unduly burdensome and unnecessary.

9.5 The reporting obligations should be aligned with existing reporting obligations to the maximum extent possible to streamline compliance and, to this end, the existing CT61 and CT600H framework are appropriate procedures to build on in order to return a liability under the proposed measure. However, the obligation to report should only apply where a liability to tax arises.

9.6 The consultation document envisages that most of the groups making payments in scope of the measure would have a UK taxable presence. However, it is also noted that the rules should work for groups that do not. Clearly enforcement of the rules for such groups without a UK taxable presence is an issue. It is not difficult to imagine that a group selling only a few things into the UK without a UK taxable presence simply would not be aware of these obligations. Thus the narrower the reporting obligations, the less likely it is that non-UK groups would be inadvertently falling foul of them.

9.7 We also suggest that a de minimis level of UK sales should be considered.

10 Payment

10.1 ***Do you agree that creation of joint and several liability is an appropriate way to enable debt collection in the case of non-compliance? (Question 10)***

10.2 We have serious reservations about the suggestion that there should be joint and several liability for any obligation arising under these new rules on any related UK entity. Such a liability would be unduly onerous on UK subsidiaries which did not have sufficient information (or any way of getting information) in respect of other groups within the worldwide group as to whether or not liabilities may arise. It is possible to imagine a situation where a UK company which is a 100% subsidiary of another UK company would not have any knowledge as to the wider worldwide activities of its parent's ultimate shareholder. Is it reasonable to expect all UK companies to undertake the due diligence to assess their potential exposure to this tax?

10.3 It is not clear from the consultation document whether the test as to what constitutes a related party would be the same for determining liability for payment as for determining which payments are subject to the withholding obligation. We think that the test in TIOPA 2010 section 148 is too wide for imposing joint and several liability.

10.4 The test in TIOPA 2010 section 148 would bring some joint ventures and their members within the scope of related parties. If a UK joint venture company is jointly and severally liable for the withholding tax which a member of the consortium member made to one its affiliates which is calculated by reference to UK sales/turnover, the other members of the consortium would be prejudiced. Assessing this risk would require each member of the joint venture consortium to have an understanding of the tax position of the other members on an ongoing basis. This would make having a UK joint venture company less attractive to potential investors.

10.5 Even if joint and several liability was restricted to companies which are more closely related, for example, a UK company in the same tax group (of at least 50% shareholding, and preferably 75%) as either a company in Country A or Country B (in the example in paragraph 2.1 of the consultation document), there would be

situations in which minority shareholders are prejudiced. This could be addressed with a statutory indemnity for the UK company against the non-resident which is primarily liable for the tax (there is precedent for this; for example, paragraph 6 of Schedule 5 to TCGA 1992 – offshore trusts).

10.6 Consideration should also be given to the possible impact on the balance sheet of UK companies. Would a UK subsidiary which is potentially liable for the tax liabilities of its foreign affiliates, have to include a provision for that tax liability?

10.7 The suggestion of joint and several liability does not address how the rules and enforcement of them would work if there is no related UK entity. The result is to put groups with a related UK entity or presence at a disadvantage which is likely to impact on the attractiveness of the UK as a place to do business.

10.8 The consultation document says that it may be difficult and costly to pursue a liability from a non-UK resident even following the UK's international agreements. Have any discussions been had with other jurisdictions tax authorities to ascertain how the tax payable pursuant to these proposals may be viewed?

11 Double taxation

11.1 ***Are there circumstances in which the proposed measure will give rise to inequitable double taxation? (Question 11)***

11.2 As discussed above, it is not only the taxation imposed by Country B (in the example in paragraph 2.1 of the consultation document) which is relevant. Consideration should be given to the level of tax paid globally on the profit being targeted. The profit could be effectively taxed either as a result of the tax treatment in Country A (or other countries in a chain) disallowing a deduction for the royalty payment and/or as a result of CFC rules in the ultimate parent jurisdiction.

11.3 We suggest that, in order to ensure that there is no double taxation, a withholding tax obligation should only be imposed if the royalty payment is not effectively taxed at a global level.

11.4 To extent this is not achieved, consideration should be given as to how double tax relief would be given. It is not clear, for example, that the new US tax rules would give credit for this proposed royalty withholding tax to the extent that the same profits in the low tax jurisdiction are also taxed in the US under the GILTI rules, because there is not a direct enough link with the tax that would be paid by a different entity in a different country. In any event we understand that any tax credit in the US would be limited to 80% (as a result of how the rules relating to expenses work), so there would be double taxation. It would be important to work through this and ensure that double tax relief can be fully given in respect of US tax paid to ensure that the UK's competitiveness is not negatively impacted.

11.5 We also suggest that consideration should be given as to what would happen if other countries respond with similar withholding taxes. The concern here is that 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, and if each country does not use the same method of calculation to apportion the royalty, double taxation may arise. Would double tax credits be given? If so by whom and on what basis? If tax is

withheld on more than one occasion, it would be difficult for companies to manage to the cash-flow implications even if (possibly some years later) double tax relief is given.

11.6 We would also note that with a proposed effective US tax rate of around 13-16% and a UK CT rate of 17% on profits, withholding tax at 20% is unlikely to be fully creditable.

12 Impact assessment

12.1 ***Do you have any comments on the assessment of equality and the impact on business as a result of this change? (Question 12)***

12.2 There have been significant changes in the international tax landscape since this measure was announced, notably the US tax reform. The government should reassess the expected revenue in light of these tax reforms which are intended to both encourage multinational groups to restructure to take back their intellectual property to the US and to impose tax, through CFC rules, on any profit from intellectual property remaining in low tax jurisdictions.

12.3 Also the impact on the behaviour of groups effected as a result of having a UK taxable presence does not seem to be reflected. For example, why would such groups not respond by either closing or selling their UK operations (and effectively outsourcing them) given that the UK company is ex hypothesi not part of the targeted supply chain. Alternatively, groups may restructure so that the acquisition of any goods or services which could constitute relevant UK sales are done by companies outside of the UK.

12.4 The compliance burden falling on the UK mergers and acquisitions market should also be factored in. Prior to acquiring a UK company, it would be necessary to run due diligence on all companies it its worldwide group in order to identify any possible liability in respect of any such royalty payments.

12.5 We suggest that expected amount of tax to be collected by the Exchequer should be recalculated taking into account the changes to US tax rules and other international tax changes as a result of implementation of anti-hybrid rules and CFC rules (including as a result of ATAD). Also consideration should be given to other possible responses to these rules; for example, the US seeking to renegotiate its treaty with the UK and removing 0% withholding rates if profits which are being brought within the US tax net are made subject to these measures. Is the amount of tax which the Exchequer may collect then significantly greater than:

(a) the cost of collection; and

(b) the amount that the UK could lose if groups decide to scale back trade with the UK and/or to close/not open UK subsidiaries/PEs?

12.6 The rationale behind these proposals is to impose a UK tax on profits which under the existing international tax system are profits which fall to be taxed in another jurisdiction – but only profits that are currently not being taxed at an appropriate rate. It is not clear whether following the US tax reforms there remains any significant pool of such profits. Thus in our view these proposals are no longer required.

13 Acknowledgement of submission

13.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

14 The Chartered Institute of Taxation

14.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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