Royalties withholding tax: CIOT responds to consultation

International Tax | Large Corporate

01 April 2018

Following an announcement at the Autumn Budget, the government published a consultation document on Royalties Withholding Tax on 1 December 2017. Following a meeting with HMRC and HMT, the CIOT responded to these proposals, reiterating our view that, following the US tax reforms, which occurred after the announcement, the proposed measures would not raise any significant revenue for the Exchequer, but would result in significant costs for HMRC (as well as taxpayers) in terms of compliance.

The digital economy was identified as an action point of the G20/OECD BEPS project in 2013 and the CIOT has engaged with the OECD and the EU Commission, as well as with the UK government since then.

At the Autumn Budget 2017 the Chancellor announced that the government will introduce legislation in Finance Bill 2018-19 that broadens the circumstances in which certain payments made to non-UK residents have a liability to income tax. More detail on these proposals were given in the consultation document on Royalties withholding tax published on 1 December 2017. These proposals form part of government's response to the challenges presented by the digitalised economy and are intended to be 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 met with HMT and HMRC in January 2018 to discuss the consultation document and the position paper and subsequently responded in writing to both.

Our response to the position paper on Corporate tax and the digital economy was reported in March's edition of Technical Newsdesk and can be found on the CIOT website.

In our response to the Royalties withholding tax proposals, we noted that the new tax would impose a UK tax liability on profits which under the existing international tax system are profits which fall to be taxed in another jurisdiction and that any such measures should be introduced with great caution.

We also reiterated the importance of a multilateral global response because of the potential dangers of unilateral measures, such as double taxation and a significant compliance burden for businesses which would stifle economic growth and innovation, whilst also, perversely, possibly giving rise to arbitrage/tax planning opportunities as a consequence of the resulting differences between tax systems.

In addition, while recognising 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, we said that it is important that any such measures that are introduced are, in fact, cost effective for the UK as a whole. We said that the expected revenue that may be raised should be weighed against the negative impact on the UK competitiveness at this sensitive economic time. Our strong view was 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.

Our response also raised a number of technical issues with the proposals that would need to be resolved. 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, we said that 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.

In his Spring Statement (on 13 March) the Chancellor said that the government was continuing its work in this area, looking at the tax treatment of multinational digital companies and a position paper update on Corporate tax and the digital economy was published. We are pleased to note that the government's position paper update once again reiterated the government's commitment to existing international tax principle – that the profits of a business should be taxed in the countries in which it creates value. The position paper update also recognises that the preferred approach is multilateral reform of the international corporate tax framework to reflect the value of user participation, noting that this would provide the most sustainable solution. We welcome this, having consistently advocated a global approach.

However, the paper also sets out for consideration a possible interim measure based on taxing revenue of certain digital businesses which are perceived to be deriving significant value from UK user participation. The Chancellor also announced consultations to look at how split payment mechanisms could be used to combat online VAT fraud and how online platforms could work with HMRC and taxpayers to help people who make money through the platforms understand and meet their tax obligations.

We will be looking closely at these proposals over the coming weeks and months and will continue to engage fully with the UK government in relation to them. Also, as noted in the position paper update, further proposals and reports on work in this area are expected from the OECD and the EU imminently. Notably, the position paper update says that any interim measure should also be implemented on a multilateral basis and the government undertakes to continue to work closely with the OECD and the EU in this area. We would support this.

Our full response can be found on the CIOT website.