The UK tax outlook

March 2024

Welcome to the latest edition of our UK tax outlook which offers legal and practical insights into UK tax developments that have cross-border interest and relevance for your clients.

Since the last edition the UK has held two fiscal events, an Autumn Statement in November 2023 and the Chancellor's annual Budget in March 2024. The main takeaway from the Autumn Statement was that full expensing for plant and machinery would become permanent. The March Budget built on the Chancellor's policy to reduce taxes for workers with further reductions in national insurance contributions for employees and the self-employed. But grabbing the headlines was the announcement that UK tax regime for individuals resident but not domiciled here (so-called non-doms) will be abolished in 2025 and replaced with a new residence-based system. The announcement reverses the Government's previous position that the non-dom tax regime is an important part of the UK's internationally competitive tax system. However the fact that this is an election year (the latest an election can possibly be held is January 2025), and the fact that the Labour party had already promised to scrap the non-dom regime if elected, may have been a factor in the Government's change of heart.

In other developments, we report on the UK's implementation of Pillar 2 and on the Government's plans to update the Diverted Profits Tax legislation and to align transfer pricing rules and the definition of permanent establishments with OECD model rules. We note other Government activity, including a consultation on disclosing more information on trusts and a new tax fraud offence.

HMRC (the UK's tax authority) also remains busy. In a surprise move, HMRC updated its guidance on the way in which it treats foreign entities. We explain how the guidance changes the settled position for US LLCs and that this may create a double tax risk for some taxpayers.

Finally, a number of UK domestic tax cases have caught our eye and in this edition we focus on the UK Supreme Court decision that supported the Danish tax authority's (SKAT) recovery proceedings for withholding tax refunds paid out as a result of (allegedly) fraudulent claims.

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Budget highlights

From 6 April 2025, the non-dom tax regime will be abolished. It will be replaced with a preferential tax regime for new UK residents who will not pay UK tax on any foreign income or gains for their first four years of UK tax residence. Transitional arrangements for existing non-doms claiming the remittance basis of taxation (paying UK tax on their foreign income only when that income is received or remitted to the UK) will permit re-basing of capital assets to 5 April 2019 and set a reduced rate of UK tax to accrued foreign income and gains brought into the UK. Read our detailed analysis of the proposals.

The headline rate of corporation tax of 25% will be maintained as will the current small profits rate of 19%. Most personal income tax rates and thresholds are similarly unchanged.

Full expensing will be extended to plant and machinery used for leasing as soon as "fiscal conditions allow". Current rules prevent companies making use of this benefit for expenditure on assets used for leasing.

There are to be new and extended reliefs for the creative sector. These include a new independent film tax credit as well as additional tax reliefs for virtual effects costs and business rates. The Chancellor was keen to point out that if film studio space continues to expand at the current rate, the UK will be second only to Hollywood by the end of 2025. Permanent increases in the tax relief available to orchestras, theatres, museums and galleries were also announced.

The Energy Profits Levy (a windfall tax on the oil and gas sector) is extended to 31 March 2029, but the levy will cease to apply before then if energy prices fall below pre-set thresholds.

Real estate changes include the following.

- Cutting the rate of capital gains tax payable on disposal of residential property from 28% to 24%. The change will apply from 6 April 2024.
- Legislating for Reserved investor Funds (RIFs) - onshore unauthorised contractual scheme fund vehicles that (in a real estate context) are broadly intended to be an onshore equivalent of a Jersey Property Unit Trust (JPUT).
- Abolishing Stamp Duty Land Tax (SDLT) muti-dwelling relief (MDR) from 1 June 2024. MDR currently reduces the rate of SDLT payable when two or more dwellings are acquired under the same, or a linked, transaction. Residential property developers and investors should update their transaction models to reflect the potential for increased SDLT costs. Land transaction taxes are devolved, and at the time of writing this change only applies to property located in England and Northern Ireland. The approach of the Scottish and Welsh governments, whose land transaction taxes each have their own form of MDR, remains to be seen.

Finally, the Chancellor announced changes to UK anti-avoidance legislation known as the transfer of assets abroad (ToAA) regime. If certain conditions are met, an offshore transfer of assets made by a closely-held company (whether UK or non-UK) will now be capable of being treated as a transfer by a UK resident individual who has financial or other interests in that company, with the effect that income accruing offshore following the transfer is attributed to the individual. The change will come into force on 6 April 2024 and will effectively reverse the recent UK Supreme Court decision in *HMRC v Fisher*. It may affect not just simple transfers into trust or to non-UK companies owned by UK residents, but also steps in wider group reorganizations by closely-held groups.

See more about the Spring Budget 2024

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Next up:

UK Pillar Two update

UK Pillar Two update

The UK was one of the first countries to enact Pillar Two legislation, with the Finance (No. 2) Act that was passed on 11 July 2023 making provision for both an IIR (known as multinational top-up tax or MTT) and a QDMTT (known as domestic top-up tax or DTT). Both new taxes are now in force, having effect in relation to groups' accounting periods beginning on or after 31 December 2023. Notably, domestic top-up tax applies not only to groups that would otherwise be in scope of Pillar Two but also to large wholly domestic enterprises that meet the €750m revenue threshold.

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The UK's approach has been to closely align the MTT and DTT legislation with the OECD Model Rules, Commentary and Administrative Guidance. That desire for alignment has meant that the Government has already enacted one major package of amendments to the legislation to give effect to the February and July 2023 Administrative Guidance – those amendments were made in the Finance Act 2024 that was passed on 22 February 2024. We expect further amendments will be made in due course to give effect to the December 2023 Administrative Guidance.

It is possible there are some deviations between the UK legislation and the OECD materials on points of detail, however we expect that these would be inadvertent and that the Government would rectify them as they are identified with further legislation.

While the Government has stated it intends to implement the UTPR in relation to groups' accounting periods beginning on or after 31 December 2024, it has not yet enacted the required legislation. It has, however, published draft clauses and we expect it will be able to implement the UTPR according to the planned timetable.

The UK has not announced any new incentives alongside the implementation of Pillar Two. It should be noted, however, that two of the UK's flagship business tax incentives will be unaffected by the new top-up taxes:

- the R&D Expenditure Credit (or RDEC) is a Pillar Two-compliant Qualifying Refundable Tax Credit; and
- accelerated "full expensing" capital allowances for plant and machinery will not reduce a group's ETR.

See more about BEPS 2.0

See more

Next up:

Reform to transfer pricing, permanent establishments and diverted profits tax legislation moves ahead

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During the summer of 2023 the Government carried out a public consultation on proposals to reform the UK's transfer pricing, permanent establishment (PE) legislation and diverted profits tax (DPT). Broadly, the proposals sought to align the UK rules with international standards and double tax treaties as well as bring clarity and certainty.

The Government published its response to that consultation on 19 January 2024. The most significant announcement is that the Government intends to move ahead with its proposal to remove DPT as a separate tax and bring it within the scope of corporation tax. The unique compliance features of the DPT regime (a higher rate and advance payment) will be retained however this change will ensure that future diverted profits charges are unequivocally subject to the UK's double tax treaties (which HMRC has historically disputed). This move will be welcomed by multinational businesses.

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With respect to the rules around PEs, the Government appears to be buying some time by undertaking further consideration on whether to align the UK domestic definition of a PE with the revised definition in the 2017 OECD Model Tax Convention. The main effect of this change would be to widen the range of arrangements that would constitute a dependent agent PE (DAPE). Asset managers that rely on the UK's Investment Management Exemption (IME) will welcome the confirmation that, irrespective of whether these reforms are implemented, the IME will be retained. However, the Government is still considering whether changes are needed to the IME to ensure the industry is not negatively affected – the industry should therefore monitor how this unfolds. The Government has committed to revising the UK domestic legislation on attribution of profits to a PE so that it aligns with the Authorised OECD Approach.

On transfer pricing the Government has committed to making a series of benign technical changes. One welcome easement relates to narrowing the range of circumstance in which transfer pricing applies to UK:UK transactions, which will reduce the compliance burden on businesses.

The Government has stated it will undertake a technical consultation in 2024 on draft legislation relating to the proposals it has committed to take forward. We expect this will be published as part of a draft Finance Bill in the summer. As mentioned, the changes to the permanent establishment definition are subject to further consideration which may involve more consultation with stakeholders, so we expect this aspect will run to a longer timetable.

Next up:

Government consults on expanding access to information on trusts involving UK land

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The Government is consulting on proposals to make information on trusts and their beneficial owners more publicly available. The proposals sit within the context of providing greater transparency in relation to the true economic owners of land within the UK.

Currently, the Government collects information on trusts connected with the UK through different means, including through the UK's Register of Overseas Entities (ROE) and its Trust Registration Service (TRS). However, information on trusts in the UK is effectively private and not available to the general public.

The Government has floated three options for the future treatment of this trust information.

1. Public disclosure by default

All trust information filed by an overseas entity would automatically be publicly available on the entity's file (other than any information that has been suppressed from public view under a successful protection application).

2. Partial disclosure

Some, but not all, information about trusts would be publicly available. The consultation does not state definitively which information would be private and which would be public, although it suggests that the name of the trust, its date of creation and the name of its settlor and any interested persons could be public, whereas the information about beneficiaries could remain private.

3. No change

Trust information would remain private (subject to any application for access).

Whatever option is pursued, the Government will not make information on members of pension fund trusts available. In addition, an individual's residential address and the "day element" of their date of birth would not appear on the public record (which is consistent with the approach for directors and persons with significant control). Under option 2 or 3, it would be possible to apply to Companies House to obtain trust information that has not been made publicly available. No such application would be necessary under option 1, as, under that option, the information would automatically be public.

There is currently no single register of trusts over land in the UK. If trustees became the registered proprietor of land in the UK on or after 6 October 2020, they must register the trust under the TRS. However, the TRS holds very little information about the land itself. As a result, the Government is asking more open-ended questions about the potential disclosure of land-based trusts. These include what information should be collected on trusts of land, for what purposes and in relation to what kinds of property.

Trusts are used to facilitate ownership of land by creating tradeable interests but are not designed to obscure ownership. These include Jersey property unit trusts (or JPUTs), where property is held on trust by nominees and investors simply trade units issued by the trust itself. In many cases, where the investor base is more dispersed, decisions are taken by an independent property manager, rather than underlying investors. The value of public disclosure in these circumstances will need to be carefully scrutinised so as not to deter legitimate institutional investors from pursuing investment opportunities in the UK.

The consultation makes it clear that, at this stage, the Government is looking only at trusts that are in some way connected with land in the UK. Other trusts, such as trusts over UK company shares and other securities, are not within the scope of the proposals. The consultation recognises the sensitivities involved with disclosing details of children and vulnerable persons (although it does suggest that this may be justified in some circumstances). The key question will be whether information on these persons should be public by default, or private but accessible with a legitimate interest.

Disclosure of trusts has been a talking point for years now and so the consultation comes as no surprise. Although the paper does contemplate the possibility of not making any changes, the Government has made its objectives clear and we should likely expect some element of public disclosure in due course. The consultation closed on 21 February 2024, however how quickly the Government intends to take this forward is not clear.

Next up:

New tax fraud offence

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A new tax fraud offence has been introduced in the UK through the Economic Crime and Corporate Transparency Act 2023 (ECCTA). The new "failure to prevent" regime addressing fraud sits in tandem with other "failure to prevent" regimes introduced by the Criminal Finances Act 2017 and the Bribery Act 2010.

The regimes have much in common. They are designed to drive better behaviours and include a defence based on taking reasonable preventative measures. There are important differences too. The corporate criminal offence (CCO) that features in the Criminal Finances Act 2017 is focused on tax evasion and applies to all businesses irrespective of size, whereas the ECCTA offence is focused on fraud and only applies to "large organisations" (defined as meeting at least two out of three of the following criteria: more than 250 employees; more than £36m turnover; or more than £18m total assets per the Companies Act 2006).

The definition of fraud includes the common law offence of cheating public revenue but is wider in scope. It extends to false accounting and false statements by company directors amongst other offences. Organisations will not be liable to the offence if they can demonstrate that they have reasonable prevention procedures in place to prevent fraud.

The jurisdictional scope of the offence is wide. Organisations can be liable wherever they are formed and while the fraud can occur anywhere it is subject to UK jurisdiction, with an example provided in the Government factsheet of an organisation and its employees based overseas that targets UK victims. As a result, overseas organisations might want to conduct a risk assessment to ensure they are compliant with the new rules. The effective start date of the regime is unclear, but it is expected to commence during 2024 once guidance has been published.

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Next up:

Entity classification for UK tax purposes

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HMRC has recently revised and expanded guidance in its International Manual on its approach to foreign entity classification i.e. whether an entity is treated as “opaque” or “transparent” for UK tax purposes. The distinction is relevant for the purpose of deciding who is liable to UK tax on what profits, income, or gains although the labels “transparent” and “opaque” are informal and the words are not usually used in UK tax legislation. How an entity is classified is more complex than simply identifying whether an entity is a partnership, company, or trust. Fiscal transparency will not follow simply from finding that an entity is “a partnership” or is “not a company”.

The purpose of HMRC’s updated guidance is to set out:

- the criteria HMRC use to reach a general view on classification;
- provide a list of entities where HMRC have expressed a view on classification; and
- explain HMRC’s view of Delaware LLCs in light of the UK’s Supreme Court’s decision in *Anson v HMRC*.

HMRC’s general view

HMRC will take the following factors into account in order to reach a general view about how an entity should be classified.

1. Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?
2. Does the entity issue shares in its capital or something else which serves the same function as shares in capital?
3. Is the business carried on by the entity itself or jointly by persons who have an interest in it that is separate and distinct from the entity?
4. Are the persons who have an interest in the entity entitled to share its profits as they arise; or does the amount of profits to which they are entitled depend on a decision of the entity in accordance with its constitution?
5. Who is responsible for the debts incurred as a result of carrying on the business: the entity or the persons who have an interest in it?
6. Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?

Some of those factors may point in one direction, others may point in another. An overall conclusion is reached from looking at all the factors together, though some have more significance than others. In considering these factors, HMRC look at the foreign commercial law under which the entity is formed and at the internal constitution of the entity. How the entity is classified for tax purposes in any other country is not relevant.

List of entities

The guidance provides a list of foreign entities where HMRC have previously given their view on the question of transparency/opacity, together with the date when they last considered the matter. The list is only intended to give a general view and HMRC may take a different position in a particular case depending on:

- the specific terms of an applicable UK tax provision;
- the provisions of any legislation, articles of association, by-laws, agreement or other document governing the entity’s creation, continued existence, and management; and
- the terms of any relevant double taxation agreement.

US LLCs and the Supreme Court decision in Anson

George Anson v HMRC is a UK Supreme Court decision concerning the treatment of a Delaware LLC for UK income tax purposes. The Supreme Court focused on the interpretation of the US/UK double tax treaty and did not base its decision on a traditional analysis of whether the Delaware LLC was transparent or opaque for UK tax purposes. Following that decision, HMRC issued Revenue and Customs Brief 15 (2015) which set out its view that the Anson decision was specific to its facts and that HMRC generally continued to view US LLCs as opaque entities.

HMRC's revised guidance is intended to provide further clarification of HMRC's view of LLCs following Anson with regards to who the profits belong to and the availability of double tax relief. Based on HMRC's understanding of Delaware LLC law as at 12 December 2023, and their understanding that the LLC law of other US states is substantially the same as that of Delaware, HMRC continue to believe that the profits of an LLC will generally belong to the LLC in the first instance and that members will usually not be treated as receiving or entitled to its profits. Individual members will therefore only be liable to UK tax on any dividends or other distributions from the LLC. If the LLC is treated as a company for US tax purposes, individual members will generally be entitled to credit in respect of US tax charged on any distributions from the LLC.

However, if the LLC is treated as a partnership or is disregarded for US tax purposes such that the member suffers US tax on their share of the profits, they will not be entitled to double tax relief nor will any deduction be available in respect of such US tax. This gives rise to the real possibility of double taxation. We consider that there are arguments that the Anson decision can apply more widely than HMRC assert and therefore that relief for US tax may be available under the US/UK double tax treaty. Individuals with interests in LLCs that have suffered US tax will have to decide whether to maintain positions they have previously taken or whether to complete their tax returns in accordance with the HMRC's latest view.

As might be expected, HMRC's updated guidance on the treatment of LLCs follows the same logic for UK resident corporate members. Corporate members will not usually be regarded as being liable to UK tax on the LLCs profits and, where profits are distributed, may be able to benefit from a distribution exemption from UK tax. If a distribution exemption is not available, a UK resident corporate member may be entitled to double tax relief in respect of any US tax withheld on the distributions.

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Next up:

Recovery of foreign taxes – scope of the "revenue rule"

Recovery of foreign taxes - scope of the "revenue rule"

It is a long-standing principle that the English courts will not enforce claims based on foreign revenue laws and will not act as tax collectors for foreign governments and public authorities. Known as the "revenue rule" or "Dicey Rule 20" referencing the leading textbook Dicey, Morris & Collins on the Conflict of Laws, the principle has seen the English courts refuse to enforce foreign claims to recover unpaid taxes or enforce debts where it was shown that the proceeds would be payable to a foreign tax authority. Many EU Member States and Commonwealth countries have similar rules and, as a result, tax recovery is generally dealt with by specific provision in an applicable double tax treaty or by multilateral agreement providing for mutual assistance.

The revenue rule has been criticised for raising the prospect that taxpayers may avoid lawfully imposed foreign taxes. Perhaps as a result, some inroads have been made into its application. Most importantly, not every sum payable to a government or public authority constitutes a "tax" to which the revenue rule can apply. What constitutes a tax for these purposes was explored recently by the UK Supreme Court in *Skatteforvaltningen (Danish Customs and Tax Administration) v Solo Capital Partners LLP* where the question for decision was whether the Danish tax authority could reclaim dividend withholding tax refunds paid out as a result of (allegedly) fraudulent claims.

The Supreme Court found that the revenue rule only applies to proceedings in which there is an unsatisfied demand for tax which foreign authorities seek directly or indirectly to recover. Although the rule encompasses claims to recover tax which has been fraudulently evaded, that did not apply in this case where the recipients of the refunds of Danish withholding tax were never required to pay tax. Therefore the substance of the claim was not to recover tax but to recover payments made by the tax authority which were induced by fraud and to which the recipients were not entitled. It was a claim by a victim of fraud for reimbursement of the sums of which it has been defrauded. The recipients could not take advantage of their own wrongdoing in order to bring themselves within the revenue rule.

A second trial will now be held to determine whether or not the claim for refunds represent valid claims under Danish law. The case is listed for April 2024 and is scheduled to last for over a year.

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