ICAEW

REPRESENTATION 26/18

ROYALTIES WITHHOLDING TAX

Issued 23 February 2018

ICAEW welcomes the opportunity to comment on the consultation document *Royalties Withholding Tax* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/663889/Royalties_Withholding_Tax_-_consultation.pdf published by HM Treasury and HM Revenue & Customs on 1 December 2017.

This response of 23 February 2018 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 149,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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THE PROPOSAL

1. The intended target of the new measure is "a narrow range of arrangements that achieve low effective tax rates through holding intellectual property in low or no tax jurisdictions" (paragraph 2.1 of the consultation document).

2. It is proposed that royalty payments between related parties outside the UK will be brought within the scope of UK tax where the royalty is paid for the exploitation of Intellectual Property (IP) and that IP is exploited to make sales in the UK but in such a way that those sale do not, under current law, give rise to a Permanent Establishment (PE), or deemed PE, in the UK.

3. If such a new regime is to be introduced it will need to be clear what sort of activity is going to be caught, and what sort of sales in the UK will be the trigger, which relate to IP being exploited in the UK but without creating a PE in the UK for those involved paying, or receiving, the non UK royalty payments.

GENERAL

4. We have serious concerns about the practicality of the proposed withholding tax and how it could be made to apply to non UK royalty payments by foreign entities that do not have a taxable presence in the UK.

5. We are also very concerned about the potential impact on some prominent and iconic UK business sectors which are major contributors to the UK economy and to the standing of the UK in the world.

6. The music industry is underpinned by royalty payments and a number of the most prominent music businesses have major set ups in the UK and the US and royalty payments flow between the two countries and between other countries in the world.

7. At the moment the UK and US Double Tax Agreement has a non discriminatory clause so royalty payments would not be caught under the current proposals which do not apply if such a clause is in place. However, there is genuine concern that if this condition was modified in the future then any royalty payments involving the US might be brought within the amended provisions.

8. We are also concerned that the very recent US tax reform provisions are going to have an impact on US based companies operating in the rest of the world. Any proposals need to be "tested" against the post US tax reform environment.

RESPONSES TO SPECIFIC QUESTIONS

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?

9. There is clearly merit in a generic approach but we are concerned about the uncertainty the extension of the existing law will create.

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

10. We do not at the moment have a clear answer to this question until it is clearer the sort of arrangements and payments that the new provisions are intended to catch.

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?

11. We believe the rules should be restricted to payments between related parties.

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?

12. There are going to be a range of different arrangements and it would certainly be sensible to have a just and reasonable basis possibility.

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?

13. Both these questions relate to the "recipient jurisdiction".

14. A concern is that while the current proposal only applies when there is not a non-discriminatory article in the DTA that could be amended in the future.

15. We note that if the sales are made in the UK then there is likely to be VAT payable so it is not a transaction which escapes tax altogether even though it can be argued that the tax in question, VAT, is paid by the UK customer.

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?

16. These questions all relate to reporting.

17. Our members are very much against any new forms being introduced and favour the appropriate amendment of existing forms CT61 and CT600H.

18. If there is to be a requirement to report which falls on a foreign person which has not previously come within the scope of UK tax, then, given the scope for uncertainty, it would be sensible to include a formal clearance procedure in relation to the obligation to notify.

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

19. We are very concerned that this will place an unreasonable burden on UK entities potentially caught by such a provision.

Double taxation

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

20. The US tax reform measures are going to make the elimination of potential double taxation a much more difficult issue. It is not clear that the new US tax rules will give credit for the royalty withholding tax to the extent the same profits from the low tax jurisdiction are also taxed in the US under the Global Intangible Low-Taxed Income (GILTI) rules as there may not be sufficient link with the tax which may be paid by a different entity in a different country. Even if a tax credit is available it may be limited to 80% of the tax paid as a consequence of the way the rules on expenses operate.

21. The proposed US tax rate is 13.5% and the UK tax rate is 17% so a withholding tax of 20% looks, in the circumstances, to be on the high side.

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?

22. The proposal is anticipated to bring in an extra £800m over the four year period 2019-20 to 2022-23.

23. Since the consultation document was published, 1 December 2017, the US has agreed to a major reform of its tax system which could have a significant impact of the way its international businesses organise their international trading arrangements and we strongly recommend that the exchequer impact of these changes are reassessed.

APPENDIX 1

ICAEW Tax Faculty's ten tenets for a better tax system

The tax system should be:

- Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
- Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
- Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
- Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
- Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
- Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
- Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
- Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
- Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
- Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).