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UK Chancellor's Autumn Statement 2012: Key Taxation Aspects

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The Autumn Statement of the UK Chancellor of the Exchequer, presented to Parliament on 5 December 2012, was delivered with attention to three main themes: protecting the UK economy, growth and fairness. Within the overall strategy of combining deficit reduction with stimulating economic recovery, the UK taxation features of the Autumn Statement make interesting reading. The taxation provisions outlined in the Autumn Statement can be divided into those focused on "growth" and those which are more concerned with "fairness". At a time when short-term economic forecasts have been downgraded by the Office for Budget Responsibility and the Government's austerity programme has been extended until 2018, it is perhaps unsurprising that the taxation provisions relating to "fairness" (or, in other words, ensuring that tax evasion and tax avoidance is firmly counteracted) feature more than tax-stimulus measures to propel growth.

Growth

Corporate Tax Competiveness

The Government announced in the Autumn Statement a surprise reduction in the main rate of UK corporation tax by an additional 1 per cent. from April 2014. This will result in the main corporation tax rate falling to 23 per cent. in April 2013 and to 21 per cent. in April 2014. In consequence, HM Treasury have stated that the UK will have the lowest main corporation tax rate in the G7, and the fourth lowest in the G20. While the reduction is undoubtedly headline-grabbing and will be welcomed by UK companies, the reductions in the main rate of corporation tax are part of a co-ordinated strategy to improve UK tax competitiveness, particularly when placed alongside other tax-attractive jurisdictions in the EU such as Ireland and the Netherlands. The main corporation tax rate reduction also complements other key components of the UK Government's strategy of increasing tax competitiveness, such as the extensive reform of the UK controlled foreign companies legislation in Finance Act 2012 and the introduction of a UK "patent box".

Such visible encouragement to UK companies (and non-UK companies looking to establish, or augment, existing operations in the UK) was balanced with some very carefully chosen words regarding the current media-fuelled debate in the UK regarding the low amounts of corporation

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tax paid by a number of non-UK headquartered multinational companies. Media reports concerning the amount of corporation tax paid by companies such as Starbucks and Amazon on UK generated revenues stimulated a robust discussion in the Parliamentary Public Accounts Committee in late November 2012.[1] HM Revenue & Customs ("HMRC") were criticised by the Chairwoman of the Committee and urged to be "more aggressive and assertive in confronting corporate tax avoidance" when faced by a number of tax planning arrangements regarding which certain multinationals were accused of "using the letter of tax laws both nationally and internationally to immorally minimise their tax obligations".[2]

In such an environment, the Chancellor's statement that the Government will invest further funding in HMRC to enhance its "risk assessment capability for large multinational companies" and increase the recourses available to HMRC's transfer pricing specialists to increasing the identification, challenge and resolution for transfer pricing disputes may appear to be rather downbeat. However, it seems unlikely that the Government will be complacent in this area. The parallel announcement in the Autumn Statement that the UK, along with France and Germany, would provide resources to the OECD to accelerate action aimed at eliminating "profit shifting and erosion of the corporate tax bases at the global level" is strongly suggestive that firmer cross-EU action against sophisticated tax planning by multinationals, perhaps those offering digitally-based services in particular, is likely to be forthcoming if not necessarily imminent. These statements also follow the earlier joint announcement by the Chancellor and the German Foreign Minister on 5 November 2012 regarding action to prevent tax base erosion by multinationals within the EU, G7 and G20.

It will be interesting to watch during the course of 2013 how the media-driven debate regarding multi-national companies' tax burden is balanced with the Government's aspiration for UK tax competitiveness.

Banking Sector

While in the Chancellor's words the main rate of corporation tax cut is "an advert for our country that says: come here, invest here, create jobs here; Britain is open for business",[3] the good news was not extended to the British banking sector. In the Government's determination to ensure that the UK bank levy raises at least £2.5 billion per year, the rate of the bank levy is to be increased to 0.130 per cent. with effect from 1 January 2013. This might be considered to represent a fine line being followed in tax policy terms. Politically, there are obvious difficulties for the Chancellor in permitting banks to also benefit from a reduction in the main rate of corporation tax, and to some extent the two measures (corporate tax rate cut and bank levy increase) may therefore broadly be expected to cancel one another out.

1 House of Commons Public Accounts Committee minutes of proceedings – Nineteenth Report into the Annual Report and Accounts of HM Revenue & Customs, December 2012, section 1: "*Tax Avoidance by Multinational Companies*" ("House of Commons Public Accounts Committee Minutes").

2 See paragraph 12 of section 1, House of Commons Public Accounts Committee Minutes.

3 Autumn Statement 2012 to the House of Commons by the Rt. Hon. George Osborne MP, Chancellor of the Exchequer.

There remains, however, no direct correlation between the rate of the bank levy and the actions undertaken by individual banks to stimulate lending to, and credit liquidity for, UK businesses (such as the Bank of England Funding for Lending Scheme launched in August 2012[4]). The bank levy is imposed regardless of any steps taken by banks in recent years to meet Government lending targets. To this extent the bank levy remains a fairly blunt tool in tax policy terms, albeit currently a politically expedient one. With an EU financial transactions tax introduced through the enhanced cooperation procedure (but not extending to the UK) looking increasingly like a realistic possibility, the Chancellor may find that any consequent increase in banking business in the City of London could lead to an uncomfortable position of tacitly encouraging intra-EU migration of banking activities to the UK while continuing the markedly unfavourable corporation tax treatment for the banks when compared to other UK companies.

Regardless of how these tensions may be resolved, the Autumn Statement includes measures to ensure that foreign bank levies will not qualify as a deduction for UK corporation tax purposes. Legislation will be enacted in Finance Bill 2013 to make it clear that a deduction for corporation tax purposes will not be available where a bank's expenditure relates to an equivalent foreign levy and a claim has been made for bank levy double taxation relief in respect of the levy for the period in question.

Fairness

Corporation Tax and Income Tax Avoidance Schemes

Although the Autumn Statement is not generally intended to serve as a mini-Budget, a number of announcements invoked the tone of typical Budget press releases in addressing a variety of sophisticated tax avoidance arrangements. Four tax-driven arrangements are targeted in the Autumn Statement:

- *Group mismatch schemes*: Amendments will be made to the group mismatch legislation in in part 21B of Corporation Tax Act 2010 ("**CTA 2010**"). The group mismatch legislation prevents tax advantages arising as a result of asymmetries existing between different companies in the same group. The legislation prevents "scheme profits and losses" from being brought into account for the purposes of the loan relationships rules and the derivatives contracts rules as respects any matter (or for any other corporation tax purposes as respects that matter) where a company is party to a "group mismatch scheme" and is a member of the "scheme group". The Autumn Statement introduces amendments to the legislation, which will apply to accounting periods beginning on or after 5 December 2012, and which aim to counteract schemes where a company benefits from a tax advantage by creating certain mismatches, in particular where a company enters a loan relationship or

[4] The Bank of England Funding for Lending Scheme works by reducing funding costs for banks and building societies, which allows them to reduce the price of new loans and increase their net lending. Data for the period to September 2012 is available at: http://www.bankofengland.co.uk/publications/Pages/news/2012/153.aspx

derivative with a partnership of which it is a member, with the loan or derivative being accounted for differently by the company and the partnership to create the tax advantage. The legislative additions, to be introduced as part 21 BA of CTA 2010 (section 938O to 938V CTA 2010) are extensive, and are additional to the existing tax mismatch scheme legislative provisions.

- *Property Total Return Swaps*: Legislation will be introduced in Finance Bill 2013 to apply to accounting periods beginning on or after 5 December 2012 to respond to tax avoidance schemes involving property total return swaps (as identified in section 650 of the Corporation Tax Act 2009 ("**CTA 2009**")). Where a derivative has an underlying subject matter of land, or an index of changes in the value of land, a return relating to that derivative can be taxed or relieved as a chargeable gain for a UK company. HMRC has become aware of arrangements within corporate groups which effectively seek to convert capital losses into income losses through total return swaps with the subject matter being land or a capital value index over land entered into between UK group members. The legislation targets such schemes, adding a tax avoidance "main purpose test" filter into section 650 CTA 2009, making the benefits of the existing provisions unavailable to members of the same group and limiting any capital return on a property total return swap to the actual return under the derivative contract.
- *Manufactured Payments and Stock Lending Arrangements*: The complex and labyrinthine provisions of the UK's stock lending and repo legislation have been fertile ground for tax avoidance schemes for many years. The Autumn Statement contains further amendments to the legislation in Income Tax Act 2007 and CTA 2010 to counteract tax avoidance arrangements where manufactured payments on a stock loan are paid in the form of an intra-group write-off or some other non-taxable form, thereby avoiding a tax charge on a manufactured payment being made. The current legislation provides that in certain circumstances manufactured payments are deemed to be made by the stock borrower to the stock lender, with the stock lender being taxed accordingly. The arrangements targeted by HMRC are where part of the manufactured payment representative of the dividend or interest takes a non-taxable form, such as an intra-group loan write-off or other release of liability. The legislation, to be included in Finance Bill 2013 and to apply to any dividend or interest paid, or treated as paid, on or after 5 December 2012, has the effect of treating the stock lender as being taxable on any benefit representative of the dividend or interest on the lent stock as though an actual manufactured payment had been received by the stock lender (with appropriate legislative adjustments being made to switch off the rules exempting tax charges on the intra-group release of certain loan relationships).
- *Patent Royalties*: The income tax relief for payments of patent royalties is to be abolished for all payments made on or after 5 December 2012. Payments of patent royalties by individuals and other persons subject to income tax are relievable against other income of the same year where those payments are not deductible in calculating income tax liability from any source (such as a trade). No explanation is given in the Autumn Statement of the schemes which have been identified by HMRC as exploiting the income tax relief, except for

the remark in the HMRC impact summary relating to the legislative change that the amendment will affect a "handful of businesses".

Although the number of legislative anti-avoidance changes announced in the Autumn Statement are not greatly excessive when compared to some recent Budgets, it is difficult to avoid the suspicion when reading the closely-articulated legislation governing the counteraction of the schemes referred to above that such legislative changes will continue to proliferate despite the introduction of a general anti-abuse rule into the UK tax statutes in Finance Bill 2013.

Evasion

A very visible theme of the Autumn Statement, and one intrinsically linked to the concept of "fairness", is the Government's approach to combating tax evasion. On 3 December 2012, HM Treasury issued a press notice entitled "*New Government clampdown on tax dodgers*". Clear resonances with that initiative, if not the language used by HM Treasury, are present in the Autumn Statement.

Further Government investment of £77 million in HMRC aims to secure additional revenues of £2 billion a year by the end of the current Parliament. The investment is intended to fund specific activities, including:

- expanding the number of HMRC investigators and "risk intelligence staff" targeting avoidance and evasion by wealthy individuals;
- increasing "specialist resources to tackle offshore evasion and avoidance of inheritance tax";
- establishing a "centre of excellence" for HMRC to bring together and enhance their experience in tackling offshore evasion, including the use of "external experts" in using data to identify offshore tax evasion and to review HMRC's legal powers; and
- increasing the capacity of HMRC to tackle "aggressive avoidance schemes" including long-running cases involving partnership losses. "Settlement opportunities" are contemplated in which the Exchequer would receive "a good deal" but allow HMRC's resources to be concentrated on proceeding to litigation with cases where no settlement is achieved.

These measures should be considered alongside the forthcoming introduction of the UK's general anti-abuse rule in Finance Bill 2013 and the response to the consultation on expanding the scope of the Disclosure of Tax Avoidance Schemes legislation in Finance Act 2004 which is expected on 11 December 2012. A "comprehensive offshore evasion strategy" is also promised by the Government in spring 2013, presumably to draw together the now numerous, and sometimes potentially disparate, initiatives against tax evasion currently being undertaken by HMRC.

With fiscal austerity showing no sign of immediately easing, it seems more than likely that 2013 will see the heightening of the Government's attempts to eliminate tax evasion and prevent what it perceives as aggressive tax avoidance.

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