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As we reach the end of the first quarter of 2021 the Covid-19 pandemic has still to be finally beaten. However, thankfully there is now light at the end of the tunnel as a result of the vaccination programme which has proceed especially quickly in the UK. Hopefully by the third quarter of this year business will be returning to something like normality. This article highlights some of the significant current tax issues that impact both the UK and the EU.

Paying for Covid-19

Despite the pandemic tax remains very much a topic of significance and, crucially, will inevitably be one of the mechanisms which governments worldwide use to rebuild their economies. In the UK, for example, the government has provided Covid support totalling £280 billion already and in the Budget on 3rd March additional support was announced which will take that figure to £352 billion. Even considering the large size of the UK economy these are significant amounts and eventually this support will need to be paid for through a combination of tax rises and restraint in public spending.

In the Budget the Chancellor Rishi Sunak announced delayed tax rises in the form of an increase in corporation tax and, at the personal tax level, a freezing of personal tax allowances until April 2026. The rise in corporation tax is highly significant: it has not been increased since as long ago as 1974. It will now rise in 2023 from 19% to 25% with the aim of producing an annual tax revenue boost of £17.2 billion. This tax increase marks a reversal of the trend in the UK to move to increasingly lower corporation tax rates. The intention had been to reach the lowest tax rate in the G20 but now all the UK can claim is that, even after the increase, the new 25% rate will still be the lowest in the G7. It remains to be seen how much of a negative effect the increase will have on the UK's wish to be seen as the inward investment destination of choice for global business. In terms of 'tax competitiveness' ,even though the current 19% corporation tax rate is low, the UK ranks only 22nd out of 36 countries in the Tax Foundation's international tax competitiveness index for 2020. This can probably be explained by the broadness of the UK's tax base combined with the comparatively narrow range of tax incentives available compared with other jurisdictions.

There were certain notable omissions from the Chancellor's Budget. Crucially, no mention was made of the introduction of a wealth tax which, apparently, was considered to be 'unConservative' by the Chancellor. Whilst such a tax cannot be entirely ruled out the possibility of its introduction has certainly receded at least for the short term. What was more of a surprise was the absence of any change to the rate of capital gains tax ("CGT"). An increase in the rates of CGT had been widely expected. It had been feared that rates would rise from the current rate

of 20% (28% in the case of real estate) to match the current higher and additional rates of income tax. This would have resulted in an additional rate taxpayer paying CGT at the penal rate of 45% on gains. Whilst the projected increase to CGT was 'the dog that did not bark' it is unlikely that CGT will remain at its current rate indefinitely as a future increase is still expected.

Of course, the UK is not alone in looking to the tax system to assist in meeting the bill for Covid-19. By way of example, commentators have predicted a rise in the US corporate tax rate from 21% to 28%. In Germany the reintroduction of a wealth tax has been suggested and the Russian income tax rate has increased to 15% from 13% for wealthy individuals. In Latin America wealth taxes are currently being considered by several governments in order to pay for the pandemic. Argentina has just brought in a one-off tax that applies to the wealth over ARS 200 Million of both resident and non-resident individuals. Peru, Mexico, Chile and Brazil are also all examining the possibility of a wealth tax.

The UK and EU – Tax Competition Post Brexit

As is well known the UK ceased to be a Member State of the EU on 31st January 2020. Brexit was followed by the 'transition period' which ended on 31st December 2021. Almost at the last moment the UK and the EU concluded the UK/EU Trade and Cooperation Agreement ("TCA") which imposes a number of restrictions on the UK, including controls on subsidies and commitments to maintain certain OECD tax standards. Outside these restrictions the UK does have the opportunity to make its tax regime more attractive when compared to the remaining 27 EU Member States.

Prior to the signing of the TCA there had been media speculation that the UK might seek to rebrand itself as a kind of 'Singapore-on-Thames' - effectively a tax haven which offered aggressively lower tax rates than its EU neighbours coupled with tax incentives to encourage business to the UK. It was also thought that the UK might to some extent water down its existing rules on tax avoidance.

Under the TCA provisions dealing with 'subsidy controls' (state aid by another name) the UK binds itself to rules equivalent to those in the EU. These prevent the UK from being able to offer a whole range of tax incentives aimed at specific situations so as to attract business to the UK. The UK does have control over its corporation tax rate (as it did when a Member State) but, as already noted, this is increasing to 25% rather than reducing from 19%.

Under the TCA both the UK and the EU have agreed to maintain OECD standards in the area of tax transparency and certain of the OECD BEPS actions. Specifically, these relate to the rules on the restrictions on corporate interest deductibility, anti-hybrid mismatches and controlled

foreign companies. The parties have also agreed to uphold the principles of good tax governance although how this is supposed to be implemented in practice is not clear.

It seems clear that in the short term there is little chance of London morphing into 'Singapore-on-Thames'. If the UK took an action such as abolishing its tax disclosure rules then potentially it could be placed on the EU backlist of non-cooperative jurisdictions. In practice, it is doubtful that the UK would do anything to risk provoking such a response from the EU.

The UK is no longer part of the EU VAT system so it is now free to make changes to its VAT legislation. It is anticipated that in the medium to long term the UK VAT rules will diverge from those of the EU. Crucially, the UK is now free to set its own VAT rate where it wants and is not limited to maintaining a standard rate which is at least 15% or the reduced rate of at least 5%. The UK's current standard rate is 20% but the need to raise revenue post Covid-19 probably makes a reduction to this rate unlikely any time soon.

The UK does not generally apply withholding taxes to dividend payments under its domestic tax law. (The one small exception to this general position is distributions of profit by real estate investment trusts.) Dividends may be paid gross by a UK company whether the recipient shareholder is UK resident or non-UK resident (even if resident in a tax haven) without the need to rely on a double taxation agreement.

Until the end of the transitional period the UK was a party to the EU Parent/Subsidiary Directive which enables dividends to be paid gross between EU Member States (and Switzerland) where, broadly, the companies were associated. This meant that, subject to certain conditions, under the Directive a non-UK subsidiary could pay dividends to its UK parent company without suffering any local dividend withholding taxes. Although the benefit of the Directive is no longer available to UK resident companies many of the double taxation agreements to which the UK is a party reduce the level of withholding taxes on dividends to nil (the UK/Switzerland agreement for example). However, under some agreements a withholding tax will still be charged as the relevant agreement between the UK and the country of the dividend paying company do not reduce dividend withholding tax to zero. This is the case under the both the UK/Germany and the UK/Italy agreements which both allow for a 5% withholding tax on payment of a dividend to a UK company that has at least a 10% shareholding. Although this level of withholding tax may be considered acceptable, unless the agreements can be renegotiated, it does make the UK a slightly less attractive location for a group holding company.

Under the EU Interest and Royalties Directive payments of interest and royalties between companies resident in different EU Member States can be made without withholding tax. Even though the UK is no longer a party to this Directive the provisions had actually been incorporated

in UK law and are still in force. However, in the recent Budget it was announced that they would be repealed for payments made on or after 1st June 2021. This means that from this date a UK company making a payment of interest and certain royalties to an EU company will be obliged to withhold income tax at the rate of 20% unless a lower or nil rate is available under a double taxation agreement. Most of the UK's double taxation agreements do reduce withholding tax on interest and royalties to nil but this is not always the case. For example, a 10% interest withholding tax will apply on payments from the UK to Latvia, Portugal and Romania. This is a small further example of how the UK has become slightly less competitive from a tax viewpoint following Brexit.

Taxing the Digital Economy

In recent years it has become increasingly apparent that the existing tax systems across the globe were unable to keep up with the rapidly changing economic landscape. These systems worked well enough in the pre-Internet age of traditionally traded goods and services but are now struggling to cope with the way in which the digital age works. This struggle has been accentuated by the Covid-19 pandemic which has prevented travel and resulted in a yearlong lockdown that has forced those resident in developed countries to live their lives largely online.

In autumn 2020 the OECD/G20 Inclusive Framework on BEPS published reports on its Pillar One and Pillar Two blueprints. Broadly, Pillar One deals with the allocation of taxing rights between jurisdictions in the context of large businesses that are consumer facing or which are active in the supply of digital services. Pillar Two has the objective of seeing that substantial international enterprises pay a minimum level of tax irrespective of where they have their operational base or are headquartered. Potentially, reforming the taxation of the digital economy should increase tax revenues at a time when governments worldwide are struggling to source revenue to pay for the individual and business support measures that have been put in place due to the pandemic.

The potential changes to worldwide tax systems to deliver pursuant to Pillars One and Two are great and the OECD has struggled to reach a consensus. Therefore, the EU Commission has now come up with its own proposals to deal with taxation of the digital economy pending resolution of the problem at the OECD/G20 level. The purposes of a digital levy is stated to be: "a fairer contribution from companies that operate on the digital sphere for the purposes of the recovery and to support a more stable medium-term outlook".

This EU speak statement of the obvious is hardly a masterpiece of Churchillian rhetoric but the Commission do go on to say that the policy options being considered are:

- a corporate income tax top-up that will be applied to all companies that undertake certain digital activities in the EU;
- a tax on revenues generated by certain digital activities in the EU; and
- a tax on business-to-business digital transactions undertaken in the EU.

At this stage the Commission is reviewing the feedback which it has received on the proposal. There is, as yet, no published material on the likely design of the digital levy but a detailed proposal from the Commission is expected by the end of June 2021.

Whilst the EU is keen to present a united front some EU countries have already announced their own unilateral proposals for a digital services tax. France is the first Member State to have implemented such a tax. This tax came into force on 1st January 2019 and aims to tax the supply of a digital platform allowing users to interact with other users in order to facilitate the direct provision of goods and services between users. The tax also aims to tax the supply of services to advertisers which aim at placing on a digital platform targeted advertising content generated by personal data collected on digital platforms. The tax can apply where a business has a worldwide turnover of Euros 750 Million for digital services and at least Euros 25 Million of turnover on digital services located in France. The tax rate is set at 3% of the revenues derived from in scope digital activity in France.

Italy has now also implemented a digital services tax whilst Spain has so far not implemented the legislative proposals it made in this area. Poland has recently introduced a new advertising levy which charges a 5% levy that will apply to online advertisers in Poland where revenues exceed Euros 750 Million and advertising revenues in Poland exceed Euros 5 Million.

Outside the EU the UK introduced its own digital services tax which came in force on 1st April 2020. If a group has worldwide revenue from digital services in excess of £500 Million and more than £25 Million of these revenues are derived from the UK then revenues that are derived from UK based users will be taxed at 2%. In scope activities are those that provide a social media service search engine or online marketplace to UK based users.

The reaction of the US to the introduction of digital services taxes in Europe has been quite predictable. The US regards such taxes as unfairly prejudicing its own tech gains – Amazon, Apple, Google and Facebook – and has retaliated with the threat of 25% tariffs on imported goods. Tariffs on French goods were threatened and were supposed to be implemented in January 2021. However, action against France was suspended in order to allow Washington to pursue a coordinated response once investigations into similar taxes in India, Italy, the UK and

other countries were concluded. The latest information is that the UK is now also threatened with a 25% tariff on the importation of a whole range of goods to the US. This story is likely to run and run at least until the US is persuaded to engage with international efforts to come up with a “fair” way to tax its multinational tech companies. At the risk of understatement this may take some time.

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