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The U.K.'s Corporate Tax Landscape 2021

By David Klass
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The big corporate tax headline arising from this year's U.K. Budget, delivered on March 3, was the leap in the rate of corporation tax from its current rate of 19% to 25%, as of April 2023, for companies with profits exceeding 250,000 pounds ($345,000).

It was clear the hole blown in the public finances by the fallout from the Covid-19 pandemic had somehow to be filled. It turns out that the U.K. government resisted calls for any explicitly targeted form of super-taxation of those businesses whose profits have soared during this period; equally it has rejected other potential revenue raisers, such as an increase in the rate of capital gains tax (widely thought to have been on the cards) or the creation of a new "wealth" tax. These are perhaps for future budgets; for now, the focus is on the increase in the rate of corporation tax.

To take a step back and put this proposed rise into context: this represents the first rise in the rate of corporation tax since 1974. And it is only recently that the government had been telling us that it planned to cut the 19% rate further: a drop in the rate to 17% had been slated for 2020, although this was ultimately scrapped (pre-pandemic) on the basis of being probably a little too generous.

The amount of additional tax take that the government anticipates as a result of the planned 6% increase is significant: an additional 12 billion pounds in the year 2023–2024, rising to 16 billion pounds the following year and 17 billion the year after, when compared with current corporation tax receipts.

A Resurgence of Tax Planning?

Where the standard rate of corporation tax is low—as is currently the case—then the incentive for avoiding that level of taxation will inevitably be less pronounced than where the rate is much higher.

The higher the headline rate of taxation, the greater the push toward avoidance.

One wonders therefore to what extent, post-April 2023, taxpayers will be inclined to engage in behaviors which, absent such a material increase in the standard rate, they would have been less inclined to pursue. There is—it is sometimes argued—a level of taxation that corporates are willing to bear.

This measure turns up the dial significantly.

Interestingly, the government makes an oblique reference to this in its Impact Assessment of the new measure:

"A behavioural adjustment has been made [to the amount of tax expected to be collected] to account for changes in the incentives for multinational companies to shift profits in and out of the UK."

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The desire to drive down the effective rate of taxation is not however limited to multinationals.

One can expect the directors of all affected companies whose profits are subject to U.K. corporation tax to consider whether, and if so how, they might mitigate the impact of the planned rate rise.

The New Landscape

The landscape is however markedly different from the one which obtained on the last occasion when the corporation tax rate was at the mid-20% level, around 10 years ago: the U.K. government has introduced a raft of additional measures to narrow the gap that it perceives to exist between taxpayer and the U.K. tax authority HM Revenue & Customs (HMRC).

For example, although introduced more than 15 years ago, the Disclosure of Tax Avoidance Schemes rules continue to be expanded and strengthened. And one of the most significant developments in recent anti-avoidance history was the introduction in the U.K. of a general anti-abuse rule in 2013.

Furthermore, and of particular relevance in this context, there is now among HMRC's armor the Diverted Profits Tax, the rate of which will be increased from April 2023 to ensure that it remains several percentage points higher than the rate of corporation tax, in order to continue to act as a deterrent against the perceived that is its target.

Consequently, the types of technique that multinationals might have employed 10 years ago in order to drive down the effective rate of U.K. taxation are somewhat less available.

Then there are also what could be described as the "softer," less direct methods employed by HMRC to discourage taxpayer behavior that they dislike, and further to reduce the perceived "tax gap."

One such method is the proposed code targeting "uncertain tax positions." This is considered further briefly now, since it is one of the measures expanded upon by means of a Consultation document issued by the government, shortly after the budget, in late March.

The U.K. as a Competitive Corporate Tax Jurisdiction

We have in recent times witnessed an extended period during which the U.K. has acquired a reputation as a viable holding company location—standout features of the U.K. tax code including a broadly applicable participation exemption for dividends and gains; an absence of withholding tax on dividends paid out of the U.K; and a very broad tax treaty network. A low headline rate of corporation tax on top of this was in the nature of the icing on the cake (and materially more competitive in this regard than most other major EU economies).

Post-Brexit (but pre-Covid) there were even suggestions emanating from government that the U.K.'s tax regime might be made ultra-competitive, to bolster the U.K.'s reputation in this regard still further.

The pandemic has fully upended such plans (as it has of course many others).

Uncertain Tax Positions—a Consultation

As mentioned above, the government has begun to adopt various "indirect" methods of discouraging taxpayer behavior which deviates from that which it would ideally like to see.

This is one such proposal.

Although some of the details have changed as a result of feedback to the first consultation, the aim of the proposal remains unchanged: to identify and reduce tax losses caused by delays in identifying and resolving disagreements in how the law should be interpreted.

What the government refers to as the "legal interpretation tax gap" is estimated to be 4.9 billion pounds.

As an aside, one is used to hearing the concept of "tax gap" in the context of discussions around tax evasion and tax avoidance. To describe the situation where a taxpayer takes a differing view of legislation from that adopted by the tax authority as a "tax gap" represents an interesting position; arguably however merely a logical development along the road of belief that those who take a different view from HMRC on any particular point are members of a group not paying their fair share of tax.

That is not however how the Consultation document puts it!

Its stated aim is to highlight and clarify legal interpretation differences between taxpayer and HMRC earlier, either through notification, or by encouraging more businesses to discuss areas of uncertainty with HMRC before they submit their returns.

To quote the Consultation:

"This measure is not intended to promote any assumption that HMRC's interpretation is correct, nor that HMRC is a final arbiter of tax law. The measure aims to ensure that HMRC is aware of all cases where a large business has adopted a treatment that is contrary to HMRC's known position and to accelerate the point at which discussions occur on uncertain treatment."

An uncertain tax treatment is one where there is more than one way to interpret or apply tax legislation in relation to a transaction.

It will apply only to "large" businesses, namely businesses with a turnover exceeding 200 million pounds or a balance sheet total of over 2 billion pounds, and it is suggested the threshold for notification would be 5 million pounds, being the "tax impact" of the transaction, e.g. the amount of tax at stake.

It will be interesting to monitor how this development, when introduced into law, affects taxpayer behavior.

Public Perception of Tax Avoidance

The climate is now very different when it comes to the public perception of tax avoidance.

Whereas previously companies would have seen it as their duty to minimize their tax liabilities as far as legally possible, engaging in the legal avoidance of tax as the norm, this imperative is now balanced against a desire to be seen as responsible taxpayers.

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The public and the media are more focused than ever before on the amount of corporation tax paid by large corporates, and the once oft-heard phrase from the mouths of companies to the effect that "we comply with our legal obligations in all of the jurisdictions in which we operate" is far less likely to pass muster than it used to—including with shareholders themselves.

Corporates now regularly prepare annual reports highlighting the amounts of taxation paid (whether corporate, employment, or other taxes).

Matters in this regard were arguably at fever pitch back in 2012 when Starbucks, in a high-profile move, "offered up" 20 million pounds of tax voluntarily. This was unprecedented—as was the boycotting of branches by those purportedly objecting to the group's U.K. tax-paying habits. But the most striking feature of the gesture was arguably the fact that the company felt motivated to make it at all.

This represented something of a watershed moment (which was not even greeted warmly by HMRC, who were keen to point out that tax was not something people could pay as and when they saw fit). But it was important because it showed the pendulum had swung to a position where an established multinational felt unable simply to dismiss the situation as "noise" which, with the passage of time, would disappear.

And so, when considering the imperative to maximize shareholder funds, company boards are no longer able to focus entirely on reducing their corporation tax bills as far as legally possible. Not only the public but shareholders themselves now expect to see public statements of responsible taxpayer behavior.

The reputational risk of pursuing aggressive tax avoidance schemes may be seen as outweighing the (typically shorter term) cash flow benefits of saving tax. And where precisely "aggressive" begins and ends on the scale of taxpayer behavior is likely to continue to drift.

The power of negative tax-related publicity means that corporates must now ask themselves the question: "Would we be happy if every aspect of our tax planning were to be revealed in the press?"

All in all, corporates' room for maneuver will be much more limited than the last occasion on which corporation tax rates were of the order of 25%. A decade can be a long time in tax, arguably none more so (in terms of developments in the perception of tax avoidance) than the one just ended.

It has been said more than once over the past year that we are living in interesting times. It looks as though that will remain true for the foreseeable future.

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