
The United Kingdom as a business hub

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In brief

The UK government is committed to attracting business by creating the most competitive corporate tax system in the G20. Recently implemented changes to the UK corporate tax regime — together with the existing strong business environment and the UK tax authority's desire to engage with business — make a compelling proposition for businesses to locate activities and functions in the United Kingdom.

In detail

As businesses become more global in nature and ever more sophisticated, tax authorities are increasingly challenging low-substance, low-tax, high-margin models. Therefore it is important for business models to have the requisite substance.

The United Kingdom is a familiar gateway into the rest of Europe for many US multinational companies. Its open market, diversified economy, successful history of international trade, strong international business community, and diverse and highly skilled workforce make it an attractive business location. Recent major corporate tax reform, combined with the UK tax authority's active engagement with businesses, have increased the attractiveness of the United Kingdom as a business hub.

Competitive tax regime

The UK tax regime has undergone a substantial transformation over the last 10 years, essentially moving from a worldwide corporate tax system to a territorial system that taxes only UK-source profits. In addition, the UK corporate tax rate, currently 23%, will be reduced to 20% beginning April 1, 2015. These factors, together with new incentives for innovation, a favorable interest deductibility regime, an extensive tax treaty network, European Union (EU) membership, and an internationally respected and robust tax authority make the United Kingdom a highly competitive contender when multinationals are considering business locations.

Territorial tax system

The UK has moved from a worldwide corporate tax system

to a system that effectively taxes only UK-source profits. This was achieved by introducing exemptions for foreign dividends and foreign branches, and modernizing controlled foreign company (CFC) rules that now seek only to tax profits artificially diverted from the United Kingdom. The United Kingdom also exempts the sale of certain shareholdings (substantial shareholding exemption).

Patent box regime

The United Kingdom has encouraged innovation by introducing a reduced corporate tax rate of 10% that applies to qualifying patent box profits earned on or after April 1, 2013. The reduced patent box tax rate applies to worldwide profits from patented inventions protected by patents registered with the UK Intellectual Property Office (IPO), the

European Patent Office (EPO), or other certain named EU territory patent offices. The UK company does not have to legally own the patent to qualify: an exclusive license to exploit the patent suffices. Further, all profits (minus a routine profit and deemed marketing royalty) arising from the sale of products that include the patented invention fall within the patent box, not just the profit attributable to the patent itself.

IP amortization and royalty/service charge deductions

Any intangibles purchased from an unrelated party, or intangibles brought into existence on or after April 1, 2002, that were purchased from a non-UK related party can be written down for tax purposes. The amount qualifying for a tax deduction generally corresponds to the accounting write-down, although a four percent straight-line amortization also is available.

Further, arm's-length payments to connected parties for the use of IP (that is, royalties) or the provision of services, or payments under operating agreements generally are deductible in the United Kingdom, provided the recipient has sufficient substance to support the payment.

R&D credits

The United Kingdom has introduced an above-the-line (ATL) credit that applies to research and development (R&D) expenditures incurred on or after April 1, 2013. The pretax ATL credit – 10% of qualifying R&D expenditures – offsets R&D costs. The credit is paid by a reduction in corporation tax, but also may be payable to companies with tax

losses, subject to a limitation based on payroll taxes (PAYE/NIC) paid.

Debt financing

Although the United Kingdom has a territorial tax system, interest on loans taken out to fund the purchase of shares generally is deductible, provided that the borrowing is on arm's length terms. Taxpayers must consider the various anti-avoidance provisions, such as anti-arbitrage and unallowable purpose, but these are unlikely to apply when the overall UK proposition is accretive to the UK exchequer. It is, however, important to note that the United Kingdom has a debt cap rule under which intra-group net UK interest expense generally cannot exceed the group's consolidated gross external financing cost.

Dedicated HMRC resource

Just as important as the UK corporate tax system changes is the UK tax authority's approach to providing businesses with certainty regarding their tax positions. The UK tax authority has set up a specific team that will enter into discussions with taxpayers at the feasibility stage (including on a no-names basis) and will ultimately provide certainty on tax treatment. This could include items such as Advance Pricing Agreements; permanent establishment rulings; interest deductibility clearances; patent box rulings; CFC clearances; and application of the substantial shareholding exemption. This resource is available to groups that are considering investing in the United Kingdom through the establishment of a parent company, a holding and financing company, a headquarters

company, or a trading principal company, if the net proposition is accretive to the UK exchequer.

Tax in the media, impact on UK government policy, and stability of the reformed UK system

Recent hearings by the UK Public Accounts Committee (PAC) have raised the profile of international tax planning. The PAC is not a legislative body in the United Kingdom; the House of Commons appoints it to act as the voice of the public. The hearings are not government sanctioned, and have not diverted the UK government from its policy of making the UK tax system the most competitive in the G20. The UK government is committed to dealing with tax avoidance and is fully supportive of the calls to ensure that tax systems around the world conform to international standards so that global companies pay the taxes owed.

Also note that from a longevity and consistency perspective, reforms to the UK tax system have been an ongoing process over the last 12 years through successive governments. The most recent reforms were started by the prior government and brought in by the current coalition government.

The takeaway

The UK's close ties to the United States, its competitive corporate tax system, and the active engagement of the UK tax authority make the United Kingdom an attractive choice for US multinational companies considering locations for parent, holding, headquarters, or principal companies.

Let's talk

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