HM Revenue & Customs

HM Treasury

Offshore receipts in respect of intangible property (previously Royalties Withholding Tax)

Summary of Responses

29 October 2018

Contents

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Executive summary

Background

At Autumn Budget 2017, the government announced that it would be extending the types of income on which non-resident persons are liable to UK income tax to include royalties and payments for certain other rights that are used to support UK sales and are realised in a no or low tax jurisdiction. This measure applies regardless of whether there is a UK taxable presence.

This change reduces the opportunities for large multinationals to gain an unfair competitive advantage by holding their intangible property (IP) in low-taxed offshore entities, and thereby levels the playing field for businesses operating in UK markets.

On 1 December 2017, HM Revenue & Customs (HMRC) and HM Treasury published the consultation "Royalties Withholding Tax" inviting comment on its proposed approach to deliver on the above policy objectives. The consultation closed on 23 February 2018.

Consultation response

Consultation responses recognised the distortive tax outcomes that the government is seeking to address, and noted international efforts and unilateral action by other jurisdictions in this space. Some respondents expressed a preference for policy solutions to be explored and agreed at an international level.

Respondents also raised several challenges arising from the use of withholding tax as a collection mechanism. In particular, respondents noted concerns in relation to economic double taxation and compliance burdens on businesses.

The government has given careful consideration to the responses and intends to make changes to the design of the measure to ensure that it delivers the policy objective in a way that is robust, administrable, and minimises distortions and unfair outcomes for business.

The government will continue to pursue multilateral action to ensure that profits are taxed where value is created. However, it will also take timely and unilateral action where the international tax framework is not working effectively and not being updated.

What is the intended approach?

The objective of the measure continues to be targeting multinational groups that realise income from UK sales in low-tax offshore jurisdictions where intangible property is held.

Rather than achieving that through an extension of UK withholding tax, and in response to concerns that were expressed about that approach, the government now proposes to directly impose UK tax on low-tax offshore entities that realise the income that a multinational group receives from UK sales in respect of intangible property.

- Under the proposal, there will be a UK income tax charge on the gross income realised by a foreign resident entity in respect of intangible property, or rights over that property, that is used to generate UK sales revenues.
- The charge will apply only to the proportion of the foreign resident entity's intangible property income that is derived from UK sales.
- That includes the use of intangible property to support sales made directly by the foreign resident entity or a related party to UK persons. It also includes the indirect, but substantial, exploitation of that intangible property in the UK market through unrelated parties. This is necessary to ensure that groups are not able to side-step the measure, for instance by selling through external distributors, and recognises that a group can generate substantial income from intangible property through the UK market without needing to make sales to UK persons directly.
- The charge will apply unless the foreign entity is resident in the UK or a jurisdiction with which the UK has a full tax treaty, meaning a Double Tax Agreement which contains a non-discrimination provision.
- The charge will not apply where, broadly, the tax on the income paid by the foreign entity is at least 50% of the UK income tax charge that would otherwise arise under this measure.
- The measure will include a £10 million *de minimis* UK sales threshold.
- Income relating to IP which has not been acquired from related parties, and where the business undertakes all (or substantially all) of its trading activities in the low tax jurisdiction, will also be excluded.
- The measure will include anti-forestalling provisions and a Targeted Anti-Avoidance Rule (TAAR), which will protect against arrangements designed to avoid the charge, for instance by transferring ownership of intangible property to another group entity resident in a full treaty jurisdiction.

The government believes that these changes will ensure the measure is targeted at the unfair and distortive outcomes it seeks to address, and is robust and effective, as well as being proportionate.

This document sets out further detail on how the measure is intended to apply, including a series of illustrative examples in Annexe B, and the responses to the consultation that helped to inform the proposed changes.

Next steps

Further details on how the measure will be applied are set out in the draft legislation and Tax Information an Impact Note (TIIN), entitled "Offshore receipts in respect of intangible property", published alongside this consultation response document.

The legislation published alongside this document could be seen to be drawn widely. However, that reflects the diverse and complex nature of the different arrangements this measure could apply to, and the importance of ensuring that the legislation is robust against tax-motivated changes to groups' behaviour.

The government welcomes discussion with interested parties on the legislation, particularly where there are concerns that the provisions are too expansive or widely drafted. The legislation includes a regulatory power to ensure that the government can alleviate any unintended outcomes through secondary legislation.

The measure will be included in Finance Bill 2018/19, and will come into effect from 6 April 2019.

Anti-forestalling provisions will apply from 29 October 2018 to counteract arrangements entered into with a main purpose of avoiding the charge.

HMRC will publish draft guidance by April 2019.

Chapter 1

Introduction

1.1. In common with most other countries, the UK taxes non-resident persons on certain types of income that arise in the UK, for example royalties. The UK typically enforces its taxing rights over royalties arising in the UK by requiring persons making a royalty payment to withhold income tax and account for it to HM Revenue & Customs (HMRC). This is subject to international agreements, particularly Double Taxation Agreements (DTAs).

1.2. At Autumn Budget 2017, the government announced the extension of the types of income on which non-resident persons are liable to UK income tax to include royalties and payments for certain other rights, arising from UK sales, realised in an entity located in a low-tax jurisdiction, and referable to intangible property held by that entity. The tax will apply regardless of whether there is a UK taxable presence.

1.3. This measure aims to ensure that businesses generating income from UK sales are not able to achieve no or low effective tax rates by holding their IP in offshore jurisdictions that are geographically separated from the substantial activities leading to the creation, development and exploitation of that IP.

1.4. The aim is to level the playing field for businesses operating in the UK by reducing the ability of multinationals to achieve artificially low rates of tax on income from UK sales through the holding of IP offshore.

1.5. On 1 December 2017, HMRC and HM Treasury published the consultation "Royalties Withholding Tax". This can be found at:

https://www.gov.uk/government/consultations/royalty-withholding-tax

1.6. The consultation invited comment on the government's proposed approach for delivering the above policy objectives, namely by expanding the application of UK withholding tax. It also invited comment on several design and technical challenges arising from this approach, including those regarding:

- Payments in scope;
- Reporting and payment requirements;
- The risk of double taxation; and
- Impacts.

1.7. The consultation closed on 23 February 2018 having received 21 written responses from law firms, accounting firms, market operators and representatives.

1.8. The purpose of this document is to summarise the responses received to the consultation and to set out the government's response. This document seeks to summarise the wide range of views and opinions expressed by respondents. It does not reproduce all of the individual proposals put forward by respondents.

However, the government's overall response takes account of a full analysis of the individual responses.

Chapter 2

Responses

Payments in scope

Types of payment

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?

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

2.1 Questions 1 and 2 are closely linked, and therefore many respondents combined their response to these questions.

2.2 The majority of respondents agreed that a generic approach would be most consistent with the government's objectives, with some suggesting that it would also allow flexibility to ensure that the measure could respond to technical and commercial developments.

2.3 However, a number of respondents expressed concern that a generic approach could extend the payments in scope beyond that envisioned by the measure, and considered that more precise definitions were needed. Some suggested that the measure should only apply to income falling under the definition of "royalties" set out in the Model Tax Convention (MTC) of the Organisation for Economic Cooperation and Development (OECD).

2.4 Several of these respondents also noted that there would be less need for a more targeted approach if other design changes were made to narrow the scope of the measure and reduce compliance burdens, for instance by introducing a *de minimis* sales threshold.

2.5 Some respondents considered that certain payments should be specifically excluded from the measure, such as those for services, the use of physical assets, and the acquisition of intangible assets or goodwill.

Quote from consultation: "A generic approach will be the most likely to achieve Government's objective provided that it is clear what types of payment are caught by the new measure."

Government response

2.6 The government agrees that a generic approach will best achieve the stated policy objectives, help to prevent groups from side-stepping the measure, and ensure that the measure can respond to technical and commercial developments.

2.7 The measure will apply to all types of income, whether or not they are described as royalties, that are referable to intellectual property or rights over other intangible property. Intangible property will include goodwill, as well as internally generated goodwill. There will be a specific exclusion for financial assets and rights over land.

2.8 The measure will be targeted in several ways. The government therefore believes that a broad generic approach to defining taxable income is appropriate and proportionate.

2.9 This targeting will be achieved by introducing both a £10 million UK sales *de minimis* threshold and an exclusion for income where, broadly, the tax on the income paid by the foreign entity is at least 50% of the UK income tax charge that would otherwise arise under this measure.

2.10 To further target the measure, income relating to IP which has not been acquired from related parties and where the business undertakes all (or substantially all) of its trading activities in the low tax jurisdiction, will also be excluded.

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?

2.11 Respondents considered that the primary scope of the rules should apply to payments made between related parties. Most respondents believed that a participation conditions test, such as that outlined at S148 Taxation (International and Other Provisions) Act 2010 (TIOPA), would be sufficient to determine whether parties are related.

2.12 However, respondents also recognised the risk that transactions with unrelated parties could be used to try to circumvent the rules. Some respondents suggested that a TAAR could help to counter such artificial arrangements.

Government response

2.13 The measure aims to reduce the opportunities for large multinationals to gain an unfair competitive advantage by realising intangible property income in a low tax jurisdiction, and thereby level the playing field for businesses operating in UK markets

2.14 The government agrees that related party transactions give rise to the greatest risk of the distortive and unfair outcomes that this measure is designed to prevent, but also notes that distinguishing between business models which use third parties and those that do not might itself introduce distortions.

2.15 The government also agrees that there is a significant risk that transactions with unrelated parties could be used to circumvent the rules. This would undermine the effectiveness and robustness of the measure in delivering its policy objectives.

2.16 The government therefore considers that the measure should apply to all gross income arising in a low taxed entity in respect of intellectual property that is derived from UK sales. That includes income in respect of intangible property used to support sales made directly by the foreign resident entity or a related party to UK persons. It also includes income in respect of intangible property that is substantially exploited in the UK market indirectly, through unrelated parties. This is necessary to ensure that groups are not able to side-step the measure by selling through external distributors, or routing payments through third parties. This also recognises that a group can generate substantial income from intangible property through the UK market without needing to make direct sales to UK persons.

2.17 The tax liability will be charged directly on the no or low tax entity on the relevant income it receives. This will remove the need to rely on withholding as the collection mechanism, and thereby reduce compliance burdens and the likelihood of economic double taxation.

Calculation of payment

Q4: Do you agree that such a [sales-based] 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?

2.18 Most respondents agreed that a sales-based approach would be an appropriate way to determine the amount of any payment that has a liability to UK income tax.

2.19 The majority of respondents agreed that the legislation should allow for other apportionment methods, where they were "just and reasonable."

Quote from consultation.

"It is … important that the legislation does not adopt a 'one-size fits all' approach."

Government response

2.20 The government agrees that, in the majority of cases, where the entity in scope receives income referable to sales in a number of countries, apportionment by reference to the ratio of UK sales to total sales will be an appropriate measure for determining the proportion of income that is liable to UK tax under the measure.

2.21 However, it is accepted that in some cases an alternative apportionment method may be warranted.

2.22 Chargeable amounts will therefore be calculated by reference to UK sales, but the rules will provide for a different basis if this would lead to an outcome that is "just and reasonable" given the taxpayer's specific facts and circumstances.

Recipient Jurisdiction

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 a non-discrimination article (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 payments made to jurisdictions that are not low or no tax regimes?

2.23 Questions 5 and 6 are closely linked, and therefore many respondents combined their response to these questions.

2.24 A number of respondents welcomed the government's commitment to comply with the UK's international obligations in applying the measure, and noted that in practice this will mean that income arising in only a small proportion of jurisdictions will be in scope.

2.25 Some respondents highlighted that there are jurisdictions with whom the UK does not have a "full tax treaty" (meaning a DTA which contains a NDA), but which are not low or no tax jurisdictions, and that taxing income arising in these jurisdictions would be inconsistent with the overall policy objectives.

2.26 These respondents suggested including a further test based, for instance, on effective taxation or economic substance, to ensure that the measure does not apply more broadly than its stated policy objectives.

Government response

2.27 The government has been clear that this measure will be applied in compliance with the UK's international obligations, and that income arising in jurisdictions with whom the UK has a full tax treaty will not be in scope.

2.28 To ensure that the measure does not have unintended effects, an exclusion will apply where, broadly, the tax on the income paid by the foreign entity is at least 50% of the UK income tax charge that would otherwise arise under the measure.

2.29 However, anti-forestalling provisions and a TAAR will also apply where businesses enter into arrangements designed avoid the charge, for example, by transferring ownership of intangible property to another group entity resident in a full treaty jurisdiction.

Reporting and Payment Requirements

Reporting

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?

2.30 Questions 7 and 8 are closely linked, and therefore respondents combined their response to these questions, or only answered Question 7.

2.31 Respondents noted that it would be helpful to align with existing reporting frameworks, such as the CT61 and CT600H, where possible.

2.32 The majority of respondents highlighted the compliance burden businesses would face if they were required to file a CT600H form despite there being a reasonable belief that the payment did not give rise to a UK tax liability.

2.33 One respondent noted that the proposed credit system, whereby companies would be able to reduce any UK tax liability arising from a subsequent payment, would require multinational groups to implement new global tracking systems to track related payments.

Quote from consultation

“It is not appropriate for onerous reporting obligations to arise in the UK in respect of payments made by overseas entities where no tax liability arises.”

Government response

2.34 We agree that it is preferable to use existing tax machinery and systems where possible, with any necessary adaptations. This is more efficient for both taxpayers and HMRC.

2.35 The income tax charge will be reported and collected under the existing income tax self-assessment provisions provided for in the Taxes Management Act 1970. Draft guidance will be published by April 2019, to ensure the return and other compliance requirements are clear.

2.36 The government notes the concerns expressed about the potential compliance burden, especially for any business that is not ultimately liable to tax under the measure. These will be significantly reduced by applying a direct tax charge on the entity receiving income from the holding of the intangible property, rather than by requiring tax to be withheld and accounted for to HMRC.

Q9: Are there any other administrative easements that would reduce the compliance burden on groups, whilst ensuring provision of appropriate information?

2.37 Respondents questioned the assertion that in most cases groups making payments within the scope of the measure would have a UK taxable presence, and noted that in some instances groups may be unaware of their UK tax obligations, leading to accidental non-compliance.

2.38 Respondents suggested that threshold tests could be used to ensure the measure is targeted at arrangements with a high risk of leading to unfair tax outcomes. Respondents proposed a variety of threshold tests, such as an exemption for small and medium enterprises (SMEs), or a *de minimis* UK sales threshold.

Quote from consultation.

“A single sale to a UK based customer should not trigger a reporting requirement and the introduction of a de minimis value of transactions should be considered.”

Government response

2.39 We note respondents’ concerns that this measure may affect groups that do not have a UK taxable presence, and who may therefore be unaware of their UK tax obligations.

2.40 However, the measure will be narrowly targeted, including through a £10 million *de minimis* UK sales threshold. Groups with such a sizeable market presence in the UK can reasonably be expected to be aware of, and to have considered UK regulations, including tax regulations.

<u>Payment</u>

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?

2.41 Most respondents agreed that joint and several liability is an appropriate method to enable debt collection in the case of non-payment by the foreign entity which is liable to a charge. A number of respondents emphasised that HMRC should first seek to recover the tax from the non-UK resident that is liable to tax, before relying on joint and several liability. One respondent noted that this approach is already used to collect VAT.

2.42 A number of respondents suggested that joint and several liability should only be applied to UK residents that are closely connected to the non-UK resident subject to charge. Specifically, these respondents were concerned that a participation condition, such as that outlined at s148 TIOPA, would be too broad and may result in UK residents, such as joint ventures, becoming liable for tax for an entity to which they were not closely related.

2.43 Some respondents also expressed concern that a UK resident may be held joint and severally liable for the debts of a non-UK resident after their acquisition by a third party.

Quote from consultation. “The test in TIOPA 2010 section 148 would bring some joint ventures and their members within the scope of related parties.”

Government response

2.44 The government continues to believe that joint and several liability is an appropriate and necessary method to enable debt collection, but agrees that it would be preferable for the payment to be made by the entity on which the tax is charged.

2.45 Joint and several liability will be applied using a targeted control group test. This will direct the charge to entities sufficiently economically connected to the non-UK resident on which the tax liability is due.

Risk of Double Taxation

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

2.46 Respondents highlighted a number of circumstances in which the proposed measure could give rise to double taxation, including where:

- Withholding tax is applied on the royalty in another jurisdiction.
- There are a series of sub-licences with the IP rights under each licence not being identical, leading to UK withholding tax being applied to multiple payments.
- The payer of the royalty does not receive a tax deduction for the royalty paid to the entity in the low tax jurisdiction.
- The recipient of the payment is resident in a jurisdiction with whom the UK does not have a full tax treaty, but which is not a no or low tax jurisdiction.

- The parent company of the recipient have Controlled Foreign Company (CFC) rules that bring into charge the income or profits of the recipient and do not give full relief for the tax withheld.

2.47 Some respondents suggested that, to mitigate against the risk of double taxation, a further test looking at the effective rate of tax paid should be applied to determine whether income is in scope of the measure.

Government response

2.48 The measure aims to target large multinationals that are able to achieve no or low effective taxation on income derived from UK sales by holding the value-generating intangible property in certain jurisdictions.

2.49 Rather than requiring persons making payments to the entity in scope of the measure to withhold tax on those payments, the measure will apply a direct tax charge on chargeable amounts ultimately received by the entity in scope. This removes the risk of multiple UK withholding tax charges arising as a result of sub-licensing.

2.50 Double taxation relief will not be available for any foreign tax paid, either in the offshore jurisdiction or in other foreign jurisdictions. Double taxation relief will, however, be available where the same income has already been subjected to income tax in the UK.

2.51 Further, as stated above, the measure will not apply where, broadly, the tax on the income paid by the foreign entity is at least 50% of the UK income tax charge that would otherwise arise under this measure.

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?

2.52 Respondents made a broad range of comments on the impact this measure might have on businesses, including the impact of international tax reform and the effect of this measure on specific business sectors.

International tax reform

2.53 Many respondents suggested that the US tax reform, announced after the release of this consultation, may address the unfair tax outcomes that this measure seeks to address.

2.54 Several respondents also highlighted broader developments in international tax policy, such as the Base Erosion and Profit Shifting (BEPS) initiative, the EU's Anti-Tax Avoidance Directive (ATAD) and the international strengthening of domestic tax avoidance measures, such as CFC rules. In light of such developments, these respondents noted that multilateral reform was preferable to unilateral action.

Specific industry comments

2.55 Two respondents noted that the Hansard Exemption exempts authors, which carry on their profession outside the UK, from withholding tax on royalties. These respondents expressed concern that this measure may unintentionally remove this exemption.

2.56 One respondent noted that the music industry was underpinned by royalty payments, and expressed concerned that this measure may increase the risk of double taxation on such payments.

2.57 One respondent noted the potential for this measure to lead to an additional tax charge on gambling operators. The respondent noted that gambling operators outside the UK, but servicing UK customers, are already subject to UK tax through Remote Gaming Duty and General Betting Duty.

Government response

2.58 The government continues to support multilateral tax reform and has been at the forefront of the BEPS initiatives.

2.59 This is a narrowly targeted measure which will only apply to multinational groups that generate significant income from intangible property through UK sales, and structure themselves in such a way that they are able to secure no or low effective tax rates on that income.

2.60 The government believes that this measure is necessary to help correct the unfair and distortive outcomes of such structures, and level the playing field for businesses operating in the UK.

2.61 The government does not consider that other reform initiatives fully address the specific tax outcomes at which this measure is targeted.

2.62 We understand respondents' concerns in relation to particular sectors. The government believes that the relatively small number of low tax jurisdictions within the scope of this measure, and the use of qualifying thresholds, will help to prevent any unintended impacts in these circumstances.

Chapter 3

Conclusions and next steps

3.1 The design changes outlined in this document are intended to address concerns raised by consultation respondents, and ensure that the measure delivers outcomes which are robust, effective, and proportionate to the policy objectives.

3.2 To summarise, the measure will apply as follows. Illustrative examples are set out in Annexe B.

Who will be affected?

3.3 The measure will affect multinational groups that generate income from intangible property through UK sales, and structure themselves in such a way that that income is realised in offshore jurisdictions, where it is taxed at low effective rates. The measure will apply regardless of whether there is a UK taxable presence.

3.4 Specifically, the measure will apply to entities which receive, or are entitled to receive income in respect of intangible property (or rights over such IP) that is used to support the sale of goods or services in the UK. However, the measure will apply only where those entities are not resident in the UK or a jurisdiction with whom the UK has a full tax treaty (meaning a Double Tax Agreement which contains a non-discrimination provision).

3.5 The measure will only affect groups that generate revenues of £10 million or more from sales in the UK in a given tax year.

3.6 The measure will not apply where, broadly, the tax on the income paid by the foreign entity is at least 50% of the UK income tax charge that would otherwise arise under this measure.

3.7 The measure will include an exemption for income arising in entities that have not acquired their intangible property from related parties and where all, or substantially all, of the trading activities are undertaken in the low tax jurisdiction. Anti-forestalling provisions and a TAAR will apply where businesses enter into arrangements designed to avoid the charge by transferring ownership of intangible property to another group entity resident in a full treaty jurisdiction.

How will the charge be calculated?

3.8 The measure will apply a UK income tax charge on the proportion of gross income received by an entity in scope in respect of intangible property and is derived from UK sales. That includes income in respect of intangible property used to support sales made directly by the foreign resident entity or a related party to UK persons. It also includes income in respect of intangible property that is exploited in the UK market indirectly, through unrelated parties. This is necessary to ensure that groups are not able to side-step the measure, for instance by selling through external distributors, and recognises that a group can generate substantial income from intangible property through the UK market without needing to make direct sales to UK persons.

3.9 As the measure is narrowly targeted in other ways, the reference to intangible property is intentionally of wide application and include, for example, distribution rights, and goodwill (including internally-generated goodwill). This will ensure that the measure delivers effective and robust outcomes.

3.10 There will be specific exclusions for financial assets and rights over land.

3.11 The proportion of income that is liable to UK tax under this measure will be determined through apportionment by reference to the ratio of UK sales to total sales.

3.12 However, the rules will also provide for a different basis where this would lead to an outcome that is "just and reasonable" given the taxpayer's specific facts and circumstances.

How will the charge be reported, collected and enforced?

3.13 The payment obligation arising from the measure will attach to the non-UK resident entity directly. The tax charge will be an income tax charge reported and collected under the existing income tax self-assessment provisions provided for in the Taxes Management Act 1970. Entities will be required to complete and submit a SA700 "Tax return for a non-resident company liable to Income Tax"

3.14 The government is confident that the vast majority of entities in scope of this measure will be aware of and comply with their tax obligations.

3.15 However, the provisions will also be subject to a joint and several liability rule. This means that, where any amount of income tax due from a non-UK resident remains unpaid after the payable date, it will be collected from related parties. International agreements will be used where appropriate.

Next steps

3.16 Further details on how the measure will be applied are set out in the draft legislation and Tax Information an Impact Note (TIIN), entitled "Offshore receipts in respect of intangible property" published alongside this consultation response document.

3.17 The government welcomes discussion with interested parties on the draft legislation, which includes a regulatory power to ensure that the government can alleviate any unintended outcomes through secondary legislation.

3.18 The measure will be included in Finance Bill 2018/19, and will come into effect from 6 April 2019.

3.19 Anti-forestalling provisions will apply from 29 October 2018 to counteract arrangements entered into with a main purpose of avoiding the charge.

3.20 HMRC will publish draft guidance by April 2019.

Annexe A: List of stakeholders consulted

- 100 Group
- Baker McKenzie
- BDO
- BEPS Monitoring Group
- Confederation of British Industry (CBI)
- Chartered Institute of Taxation (CIOT)
- Deloitte
- Ernst and Young (EY)
- Richard Crowhurst – Freelance writer and author
- Grant Thornton
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Institute of Chartered Accountants of Scotland (ICAS)
- KPMG
- Law Society of England and Wales
- Macfarlanes
- Mazars
- Norton Rose Fulbright
- PwC
- Remote Gambling Association (RGA)
- Society of Authors (SoA)
- United States Council for International Business (USCIB)

Annexe B: Detailed examples

4.1 Annexe B sets out a series of detailed examples which illustrate the policy rationale for this measure.

4.2 These examples focus, in particular, on the basis on which income realised by a foreign resident entity from the ownership of intangible property or rights over that property could be considered to support the sale of goods or services in the UK.

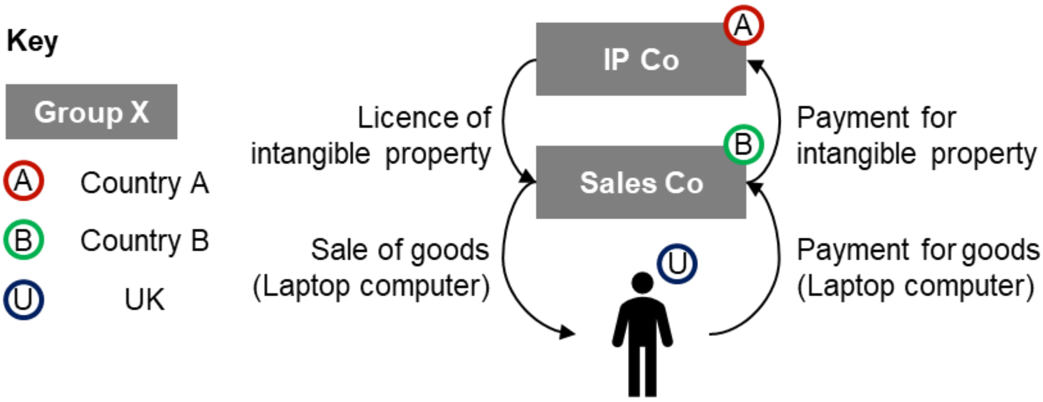
4.3 These generalised examples are not intended to be exhaustive.

Example 1

4.4 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to manufacture and make direct sales of goods, such as laptop computers, to UK customers.

4.5 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the direct sale of goods, such as laptop computers, to a UK customer is the UK sale to which the IP Co's income is referable.

Diagram 1



Example 2

4.6 In this example, the fact pattern remains the same as example 1, except that the Sales Co uses IP Co's intangible property to make direct sales of services, such as the annual licence of software, to UK customers.

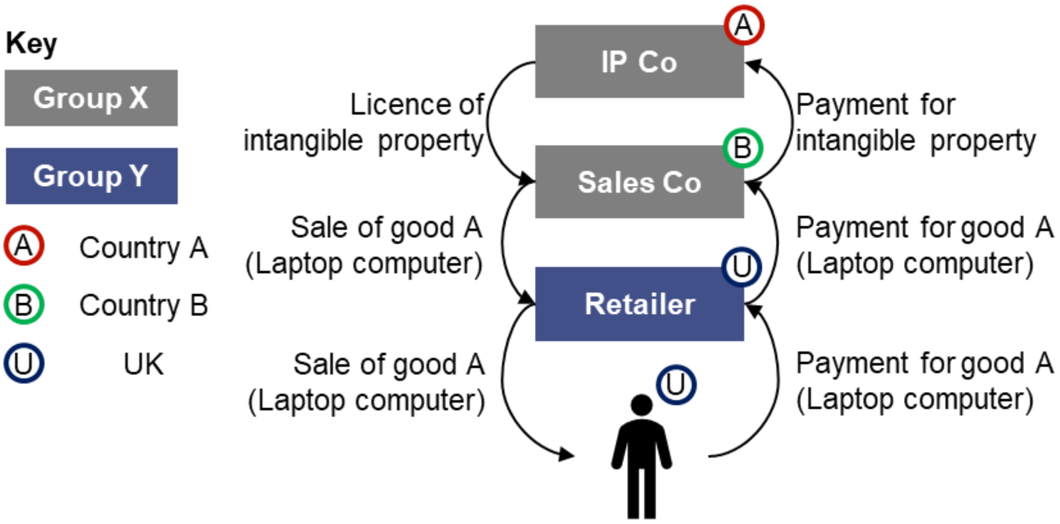
4.7 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the direct sale of services, such as the annual licence of software, to a UK customer is the UK sale to which the IP Co's income is referable.

Example 3

4.8 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to manufacture and make sales of good A, a laptop computer, to Retailer, a member of a large retail group (Group Y), located in the UK. Retailer resells good A, a laptop computer, substantially unchanged, to UK customers.

4.9 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the sale of good A, a laptop computer, to Retailer is the UK sale to which the IP Co's income is referable.

Diagram 2

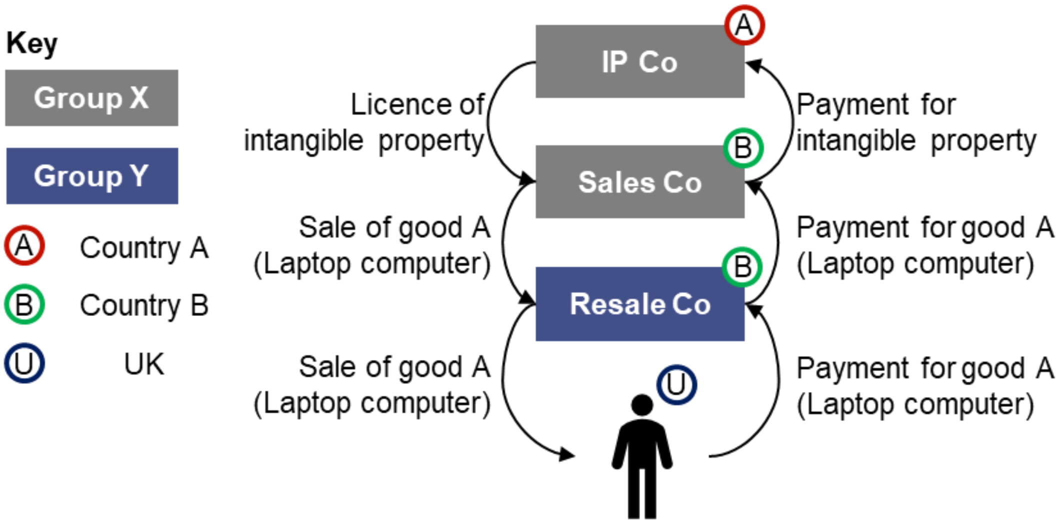


Example 4

4.10 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to manufacture and make sales of good A, a laptop computer, to Resale Co, a third party also located in Country B. Resale Co resells good A, a laptop computer, substantially unchanged, to UK customers.

4.11 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the sale of good A, a laptop computer, to a UK customer by Resale Co is the UK sale to which the IP Co's income is referable.

Diagram 3

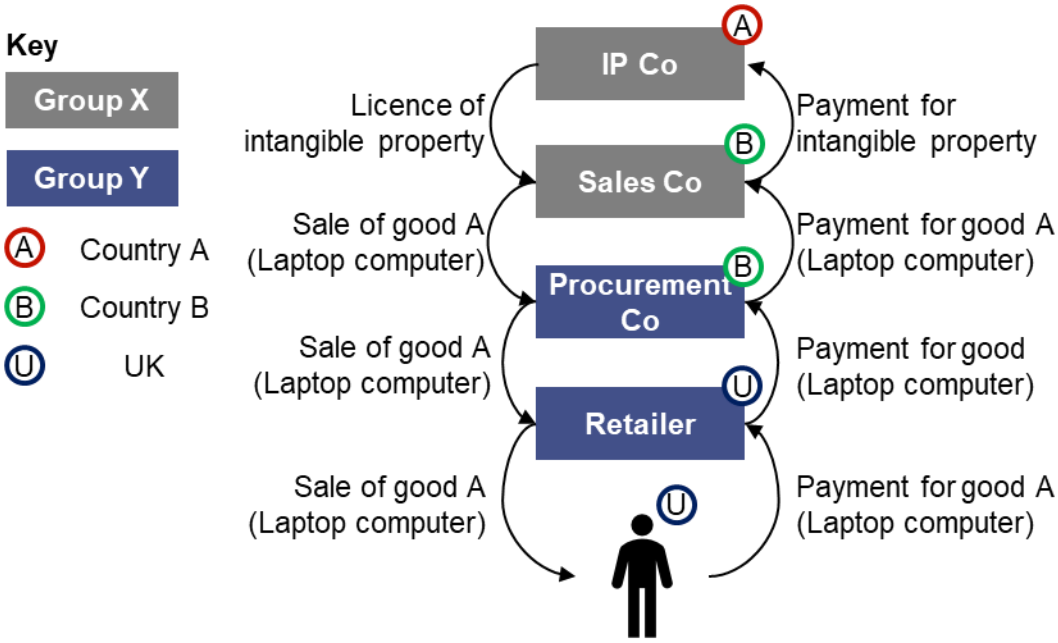


Example 5

4.12 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to manufacture and make sales of good A, a laptop computer, to Procurement Co, a procurement company of a large retail group (Group Y), also located in Country B. Procurement Co resells good A, a laptop computer, substantially unchanged, to Retailer, also a member of Group Y, located in the UK. Finally, Retailer resells good A, a laptop computer, substantially unchanged, to UK customers.

4.13 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, as good A, a laptop

Diagram 4



computer, is substantially unchanged when it is resold by Procurement Co to Retailer, this sale constitutes a UK sale to which the IP Co's income is referable.

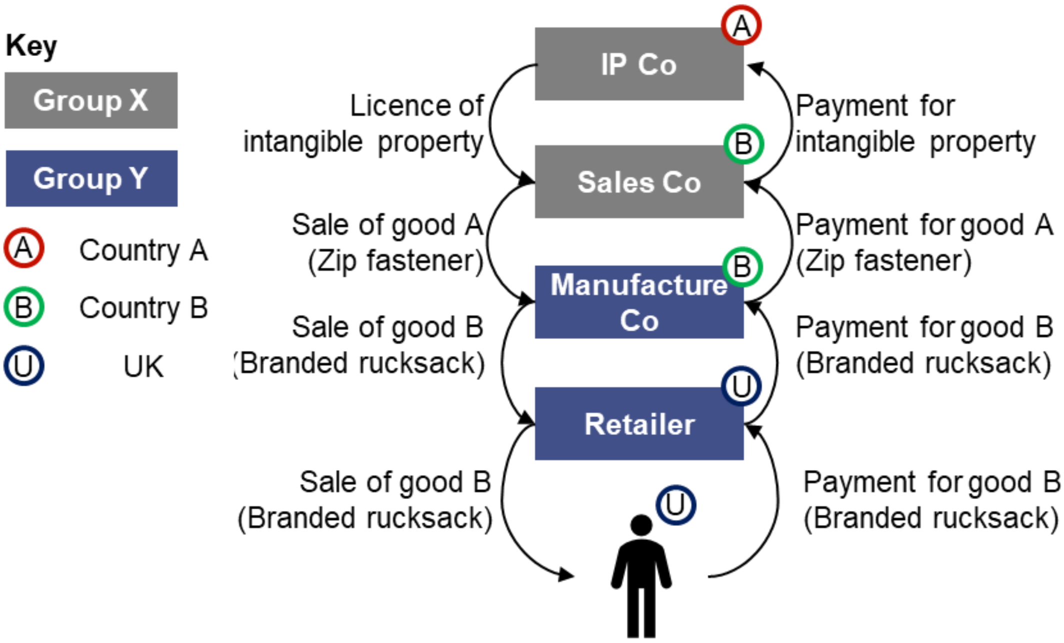
Example 6

4.14 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to make sales of good A, a zip fastener, to Manufacture Co, a member of global fashion and sportwear group (Group Y) also located in Country B. Manufacture Co uses good A as an input in the manufacturing process for good B, a branded rucksack, where the value attributed to good A as an input, and hence the value attributed to the intangible property held in IP Co, is not substantial. Manufacture Co sells good B, a branded rucksack, to Retailer, also a member of Group Y, located in the UK. Finally, Retailer sells good B, a branded rucksack, substantially unchanged, to UK customers.

4.15 IP Co does not realise income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the value of good B, a branded rucksack, attributable to good A, a zip fastener, and hence the value attributed to the intangible property held in IP Co, is not substantial. Thus, the sale of good B by Manufacture Co to Retailer does not constitute a UK sale to which the IP Co's income is referable.

4.16 There are a number of reasons why value attributable to good A, the zip fastener, an in input to good B, the branded rucksack, may not be substantial. For example, the value attributed to the zip fastener may be low when compared to the other inputs incorporated within the design and manufacture of the rucksack. It may be possible for Group Y to substitute the zip fastener sold by Group X without any corresponding impact on the sale of good B to Retailer or

Diagram 5



UK customers. However, it will ultimately be necessary to consider the specific facts and circumstances when determining whether the value of good B attributable to good A, and hence the value attributed to the intangible property held in IP Co, is substantial.

Example 7

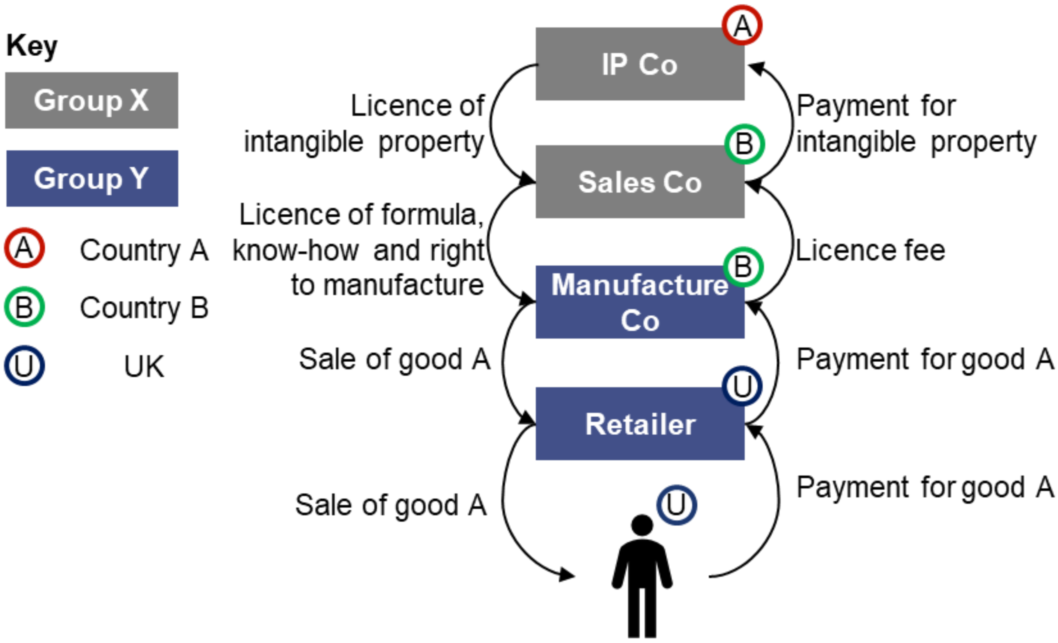
4.17 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes the formula, know-how, distribution rights and rights to manufacture a specific chocolate bar. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co licences the right to this intangible property for a limited geographic market, to Manufacture Co, a member of a regional manufacturer and distributor of food and beverage products (Group Y) also located in Country B. Manufacture Co uses IP obtained under licence as an input in the manufacturing process for good A, a chocolate bar, where the value attributed to good A as an input, and hence the value attributed to the intangible property held in IP Co, is substantial. Manufacture Co sells good A, a chocolate bar, to Retailer, also a member of Group Y, located in the UK. Finally, Retailer sells good A, substantially unchanged, to UK customers.

4.18 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the value of the licence of the formula, know-how, distribution rights and rights to manufacture a specific chocolate bar, attributable to good A, the chocolate bar, and hence the value attributed to the intangible property held in IP Co, as an input is substantial. Thus, the sale of good A by Manufacture Co to Retailer constitutes a UK sale to which the IP Co's income is referable.

4.19 There are a number of reasons why value attributable to the licence of the formula, know-how, distribution rights and rights to manufacture a specific chocolate bar, as an input to good A, the chocolate bar, may be substantial. For example, the value attributed to the licence may be high when compared to the other inputs used in the manufacture of the chocolate bar. It may be not possible for Group Y to substitute the formula, know-how, distribution rights and manufacturing rights purchased from Group X without impacting the sale of good A to Retailer or UK customers. However, it will ultimately be necessary to consider the specific facts and circumstances when determining whether the value of good A, the chocolate bar, attributable to the licence of the formula, know-how, distribution right and manufacturing rights, and hence the value attributed to the intangible property held in IP Co, is substantial.

4.20 In contrast, where Group Y also manufactures and distributors an unbranded chocolate bar in the UK, these UK sales would not lead IP Co to realise income, as a result of its ownership of intangible property or rights over that property. The UK sales of the unbranded chocolate bar are unrelated to the IP obtained under licence by Group Y from Group X.

Diagram 6



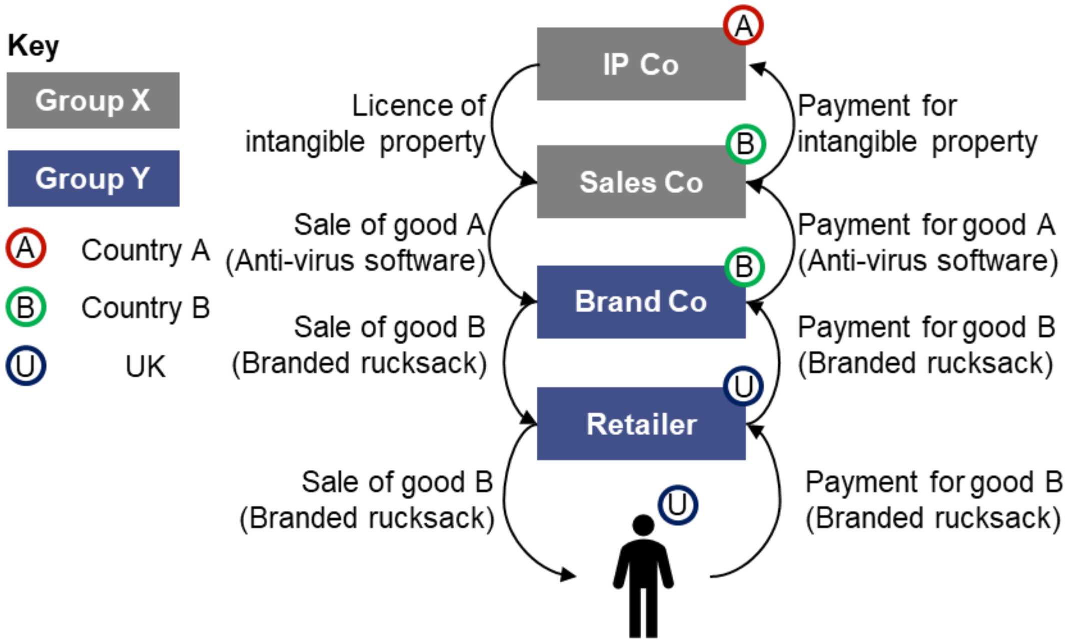
Example 8

4.21 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how, distribution rights and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to make sales of good A, anti-virus software, to Brand Co, a member of global fashion and sportwear brand (Group Y) also located in Country B. Brand Co uses good A, anti-virus software, throughout its business.

4.22 Separately, Brand Co manufactures and sells good B, a branded rucksack, where the value attributed to good A, and hence the value attributed to the intangible property held in IP Co, is not substantial. Brand Co sells good B, a branded rucksack, to Retailer, also a member of Group Y, located in the UK. Finally, Retailer sells good B, a branded rucksack, substantially unchanged, to UK customers.

4.23 IP Co does not realise income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the value of good B, a branded rucksack, attributable to good A, anti-virus software, and hence the value attributed to the intangible property held in IP Co, is not substantial. Thus, the sale of good B by Brand Co to Retailer does not constitute a UK sale to which the IP Co's income is referable.

Diagram 7



Example 9

4.24 In this example, Group X holds intangible property in IP Co, which is located in a low-tax jurisdiction (Country A). This intangible property includes trademarks, know-how and customer lists. IP Co licences this intangible property to Sales Co, a connected party, located in Country B. In turn, Sales Co uses this intangible property to make sales of advertising services to Brand Co, a member of a member of global fashion and sportwear brand (Group Y) located in the UK. The advertising services, in respect of good A, branded trainers, are targeted by Sales Co at UK customers. Brand Co intends that it will subsequently sell good A to UK customers.

4.25 IP Co realises income, as a result of its ownership of intangible property or rights over that property, that supports UK sales. In this example, the provision of advertising services, targeted at UK customers, to Brand Co is the UK sale to which the IP Co's income is referable.

Diagram 8