

Part I: The Corporate Tax Road Map

Foreword

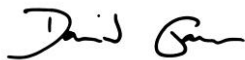
The Government wants to send out the signal loud and clear that Britain is open for business.

We must do all we can to support a private sector recovery. The UK is an open economy and many of the best known businesses in the world are located in the UK, generating growth, creating jobs and making a significant contribution to the public finances. We want to see those businesses grow strongly over the coming years, and attract new ones to join them.

In recent years too many businesses have left the UK amid concerns over tax competitiveness. It's time to reverse this trend. Our tax system was once viewed as an asset. And it needs to be an asset again.

That is why the Government is prioritising corporate tax reform. Responding to the concerns of business, the UK is headed for a more competitive, simpler, and more stable tax system in the future, creating the right conditions for business investment.

At the Budget, the Government set out a plan to reduce the main rate of corporation tax to 24 per cent, its lowest ever rate. This action will start to rebuild the UK's competitiveness. The Road Map sets out how the Government will build on this with a package of reforms to the UK's outdated Controlled Foreign Company rules and a commitment to introduce a Patent Box. We will work hard together with business to deliver them.



David Gauke

Exchequer Secretary to the Treasury

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Introduction

The Corporate Tax Road Map

1.1 As set out in its Growth Paper, published alongside this document, the Government's priority is returning the UK economy to balanced, sustainable growth.¹ To achieve this, the Government is focusing on creating the conditions for private sector investment and growth. This means a competitive and stable tax system which provides business with the confidence to invest and expand.

1.2 The Coalition Agreement sets out the Government's aim to create the most competitive corporate tax regime in the G20. The primary aim of the tax system is to raise revenue, and therefore provide the fiscal stability that is a precondition for business success. At the same time, the Government believes that the corporate tax system can and should be an asset for the UK, improving the business environment and helping to attract multinational businesses and investment to the UK to support the recovery.

1.3 The Corporate Tax Road Map sets out how the Government intends to approach reform of the corporate tax system over the next five years. This involves open and transparent consultation with business and Chapter 5 sets out a clear plan of engagement so that business and other interested parties can input at each stage of policy development.

1.4 The approach in this Road Map builds on the discussion paper on improving tax policy development published alongside the Budget.² It aims to ensure greater stability and certainty in the tax system, and also a more consultative approach to policy making.

Why the UK needs a more competitive and stable corporate tax system

1.5 There are four key ways in which the corporation tax system impacts on business:

- the main rate of corporation tax;
- the definition of the corporation tax base;
- the quality of tax policy making; and
- the way in which corporation tax is administered and collected.

1.6 The UK's lead on corporation tax rates had been eroded, as other countries cut their corporation tax rates further and faster than the UK. In 1997 the UK had the tenth lowest main rate among the EU27 countries; by this year it had slipped to twentieth. The reduction in the main rate from 28 per cent to 24 per cent announced in the Budget demonstrates the Government's commitment to take action to improve UK competitiveness.

1.7 The definition of the corporation tax base is important as it determines the burden placed on businesses to compute their liabilities and also the scope and reach of the UK tax system. As such it has a significant impact on the decisions of global business based and investing here. The

¹ HM Treasury and BIS, November 2010

² *Tax Policy Making*, HM Treasury and HMRC, June 2010 (http://www.hm-treasury.gov.uk/junebudget_tax_policy_making.htm)

Government wants to deliver a simpler tax system and ensure that the corporation tax system continues to place a relatively low compliance burden on business. In addition, its aim of creating the most competitive corporate tax system in the G20 means it should look at areas where the UK is uncompetitive or where legislation has not kept pace with wider developments. Two particular areas where business has concerns are the taxation of income that is earned abroad and income from intellectual property (IP). These are addressed in Part II of the Road Map.

1.8 The quality of tax policy making and the frequency and predictability of changes is a key concern of business and has the potential to undermine perceptions of stability, which can make businesses less likely to invest in the UK. In recent years the way that changes have been made to the tax system has damaged business confidence. Particular concerns have been raised about a lack of clear direction, the frequency of change and, on some occasions, the lack of attention paid to the real impacts on business.

1.9 Tax administration also plays a role, and developing and maintaining effective relationships, as HMRC are doing with their large business customers, enables a strong focus on the most significant issues and quicker resolution of tax disputes, helping to improve both tax compliance and the customer experience.

Other taxes

1.10 The Government understands that other taxes, and in particular personal taxes and environmental taxes, impact on business and competitiveness. It is the Government's intention to work with business to consider their impacts and where appropriate it will approach reforms in other areas in a way that is consistent with the principles set out in Chapter 2. For example, in its recent consultations on Pension Tax Reform, the Government prioritised avoiding complexity and maintaining stability as well as taking careful account of the impact on competitiveness.

1.11 The Government has already set out that its objective with regard to taxation of the banking industry is to maximise sustainable revenues.³ The Government wants the UK to be one of the most competitive global centres for financial services. However it is only right that during difficult times, steps are taken to ensure that the banks make a full and fair contribution. The Government is taking forward its announcement in the Budget of a Bank Levy as an additional and permanent tax on the industry.

The Corporate Tax Road Map: How the Government will apply the new approach

1.12 The remainder of the Corporate Tax Road Map sets out how the Government intends to address these issues; Chapter 2 of the Road Map provides the principles that the Government will apply to all areas of corporate tax reform; Chapter 3 sets out how the Government will approach each of the key areas of the corporate tax system identified above; Chapter 4 provides a timetable for reform and Chapter 5 sets out how the Government will engage with business to help develop corporate tax reforms.

³The Chancellor's statement on the Comprehensive Spending Review, Official Report, 20 Oct 2010 : Column 956

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Principles for corporate tax reform

2.1 The Government's aim is to create the most competitive corporate tax regime in the G20. It will adopt the principles set out below (in Box 2.A) to give business the certainty it needs to invest in the UK and to provide a clear and consistent direction for reform.

Box 2.A: Principles for corporate tax reform

Lowering rates while maintaining the tax base – It is the Government's view that in general a low corporate tax rate with fewer reliefs and allowances will provide the best incentive for business investment with the fewest distortions.

Maintaining stability – A stable tax system is vital to business. The Government will avoid unnecessary changes to tax legislation. In bringing forward reform, the Government will work with business to ensure that any changes improve the sustainability and long-term stability of the corporate tax system.

Being aligned with modern business practice – The way businesses operate changes over time, and with globalisation and technological development the pace of change over the last 20 years has accelerated. The tax system needs to keep pace with these developments and not stifle adaptation or create perverse incentives for business.

Avoiding complexity – The Government considers simplicity to be a feature of good tax policy. However, complexity in how businesses operate and the diversity of the business population will mean some complexity in the corporate tax system is unavoidable. In bringing forward reforms, the Government will seek to avoid complexity where it can.

Maintaining a level playing field for taxpayers – The tax system should be fair across corporate tax payers without distorting commercial decisions. This can support a limited number of special allowances and reliefs, for example where there are market failures.

2.2 In practice, there will be a degree of tension between these principles. For example, the pace of change in business practices can mean that there is pressure to make quick changes to the tax system, which can affect its stability. Similarly, widespread grandfathering of existing arrangements, while improving stability, may create excessive complexity. Government and business need to debate these trade-offs openly in order to get the balance right.

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The Government's approach

3.1 This chapter sets out in more detail how the Government intends to approach the corporate tax system over the next five years. It is structured around the four areas in which the corporate tax system affects business, as identified in Chapter 1. These are the main corporation tax rate, the corporation tax base, tax policy making and tax administration. The approach set out here is consistent with the principles of Chapter 2.

The main corporation tax rate

3.2 The Government believes that the headline rate of corporation tax is important to the UK's competitiveness. Reducing corporation tax rates benefits businesses across the economy and can boost investment and growth. The Budget announced a phased reduction in the main rate to 24 per cent, its lowest ever rate. This was funded through other changes announced in the Budget including changes to capital allowances. The reductions in the main rate continue to lower effective tax rates for business even after the reductions in capital allowances take effect in April 2012. Based on announced plans in other jurisdictions, these reforms will give the UK the lowest main rate in the G7 and the fifth lowest in the G20 and are a clear sign that the UK is open for business. The Government's direction of reform is clear – to prioritise rate reductions, which will benefit all businesses, over introducing or broadening reliefs.

The corporation tax base

How territorial should the UK corporate tax system be?

3.3 Globalisation has meant that the world's markets have become more open and competitive. As a result companies increasingly operate across national borders and the ownership of UK businesses has become more internationally diverse. A competitive tax system should recognise this. In particular, the Government needs to ensure that the way the tax system operates for UK headquartered multinationals does not inhibit commercial business practices or make them unattractive to international investment.

3.4 To be more competitive, the UK's corporate tax system should focus more on profits from UK activity in determining the tax base rather than attributing the worldwide income of a group to the UK. Moving towards a more territorial system in this way will better reflect the global reality of modern business and will allow businesses based here to be more competitive on the world stage supporting UK investment and jobs.

3.5 Some aspects of the UK corporate tax system have changed in recent years to become more territorial, but in key areas it operates on the same basis as when the world economy was significantly less globalised. Accordingly, to address this, the Road Map confirms that the Government will take action to reform the Controlled Foreign Company (CFC) regime and the taxation of foreign branches by adopting a more territorial approach.

The UK's regime for interest deductibility

3.6 As part of its assessment of the potential benefits of moving towards a more territorial system, the Government has considered options for restricting the corporation tax deduction given for interest expenses. Some in business have suggested that a more territorial interest

regime could help deliver fully territorial CFC rules (see Part IIA). Having considered this carefully, the Government does not intend to pursue significant changes to the UK's competitive regime for interest.

3.7 OECD countries' tax systems generally recognise the distinction between debt and equity and give deductions for interest as a business expense. This is also reflected in international accounting standards. The Government remains committed to interest being relieved as a normal business expense irrespective of where the proceeds of the loans are put to use. Any fundamental changes to these rules would have disruptive and potentially damaging effects on existing arrangements and could undermine the Government's commitment to providing the stability and certainty needed to promote investment and growth.

3.8 The UK's current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage and it is the Government's view that this advantage outweighs potential benefits from moving towards a more territorial system for interest. In coming to this conclusion, the Government has considered the difficulty of designing workable rules to restrict relief for interest, which are fair to all businesses without creating complexity and uncertainty.

3.9 As ever, the Government does need to consider the potential for some businesses to seek to exploit the UK's current rules for avoidance purposes. The UK already has a series of rules designed to stop this but the Government will, as with other avoidance risks, continue to keep this area under review.

Controlled Foreign Company (CFC) reform

3.10 Reform of the UK's Controlled Foreign Company (CFC) rules is frequently identified by UK multinational businesses as the key priority needed to improve the UK's tax competitiveness. In common with other developed tax systems the UK needs CFC rules to protect against artificial diversion of UK profits to low tax jurisdictions, but there is scope for significant modernisation. The Government recognises that the current rules, which have been in place for more than 25 years, need to better reflect the way that businesses now operate in a globalised economy. The current rules can be seen as going further than what is needed to protect the UK tax base; new rules must instead minimise the impact on commercial decisions and not interfere with the efficient management of overseas operations.

3.11 The Government wants to provide businesses with certainty on what it will deliver on the key issues of monetary assets and IP for CFC reform and this is set out in Part II A. The Government will introduce a simple partial finance company exemption that allows groups to manage their overseas financing operations more efficiently while protecting the UK tax base. It also proposes a new approach to managing the risks arising from CFCs with IP related profits. Discussions with business in this area are vital to ensuring that new rules support a sustainable UK corporate tax base by focusing on taxing artificially diverted UK profits and not catching commercial operations. The Government will publish further details on the new CFC rules in spring 2011, followed by publication of draft legislation in autumn 2011.

3.12 The Government recognised the importance of reforming CFC rules in the Budget and committed to introducing interim improvements to the existing CFC rules in 2011. These will provide improvements for business ahead of full reform and are discussed in Part III A.

Foreign Branch reform

3.13 Part III B contains details of the Government's plans to bring forward proposals in Finance Bill 2011 to reform the taxation of foreign branches in line with its aims to move towards a more territorial corporate tax system. The Government will introduce an opt-in exemption from corporation tax for the profits of foreign branches of UK companies.

Innovation and Intellectual Property (IP)

3.14 Over recent years businesses have become more focused on building and deriving value from creating and exploiting intangible assets. The taxation of intellectual property (IP), and the impact this has on attracting and encouraging further innovation to the UK therefore plays a key role in the Government's corporate tax system ambitions. The business community has identified the taxation of IP, and patents in particular, as a specific target for reform to enhance the competitiveness of the UK's tax system. Part II B of this document covers IP and R&D tax credits.

3.15 The Government intends to introduce a preferential regime for profits arising from patents, known as a Patent Box. Encouraging innovative business to invest in the UK will play a key part in securing a strong and growing private sector. The Patent Box will encourage companies to locate the high-value jobs and activity associated with the development, manufacture and exploitation of patents in the UK. It will also enhance the competitiveness of the UK tax system for high-tech companies that obtain profits from patents.

3.16 The Government believes that Research and Development (R&D) tax credits play a valuable role in supporting innovation and productivity in the UK. The Government wants to ensure that the R&D tax credit schemes play their part in creating the right environment for such companies to prosper.

Tax Simplification

3.17 The Government has established the Office of Tax Simplification (OTS) to provide advice on where the tax system can be simplified to reduce compliance costs on business and individuals. The OTS will draw together expertise from across the tax and legal professions, the business community and other interested parties. Its first two reviews will cover tax reliefs, and small business tax and the intermediaries' legislation (IR35). An interim report on the reliefs review will be published in the autumn. At Budget 2011 the OTS will publish final recommendations on the reliefs review and interim findings on the review of small business tax and IR35. More information can be found at www.hm-treasury.gsi.gov.uk/ots.

Tax policy making

3.18 To demonstrate its commitment to improving levels of predictability and stability in the tax system the Government will ensure significant reforms are designed and planned effectively with fewer small changes, and commits to extensive and timely consultation with business. In Chapters 4 and 5 of the Road Map the Government has set out its timetable for reform and how it wants to involve business in reform.

3.19 The Government will adopt a more strategic response to the risk of avoidance to address increasing complexity and reduce the need for frequent legislative change.¹ This will include building in sustainable defences against avoidance when undertaking policy reform. It may still be necessary from time to time to introduce immediate changes to legislation in order to close off avoidance risks. However, to make clear the Government's commitment to stability, it will shortly publish for comment a draft Protocol setting out the circumstances in which it will consider making such changes.

The administration of business tax

3.20 The Government sees continuing to develop an enhanced relationship between HMRC and large businesses as a priority. Openness and transparency are not just important when

¹ See *Tax Policy Making*, HM Treasury and HMRC, June 2010 (http://www.hm-treasury.gov.uk/junebudget_tax_policy_making.htm)

considering policy issues but also play a role in tax administration, in building an understanding of the framework within which businesses operate and make decisions on tax. HMRC and business have worked successfully over recent years to increase trust, transparency and open communication. This has led to more effective working relations, improving both tax compliance and customers' perceptions of HMRC's service. The Government will discuss with business how it can further strengthen this approach, consistent with the need to operate a cost-effective tax administration.

3.21 A stable and sustainable corporate tax system will also require responsible judgements from both large businesses and HMRC as to how the law is interpreted on a day-to-day basis. In complex areas of commercial life, particularly international corporate tax, the Government cannot legislate for complete certainty. HMRC should always seek to understand the commercial background to any tax issue before arriving at a view. Equally, businesses need to consider the wider impact on the tax system when arriving at decisions on particular tax arrangements and share these with HMRC where they believe that the law is unclear or uncertain. Stability and sustainability can only be achieved if there is a shared sense of responsibility for the overall health and competitiveness of the corporate tax system.

4

Timetable for reform

4.1 The Government intends to make fewer and better planned changes to corporate tax. It has set out below its plans for the next five years. While the Government is keen to hear representations from business where affordable changes can be made to improve UK competitiveness, it does not intend to make any further significant reforms over the first three years of the Road Map other than those below. The Government must though retain the ability to make certain changes, for example, to prevent revenue losses from avoidance or to ensure the corporate tax system keeps pace with wider events, such as legislative or regulatory changes.

Table 3.A: The Government's timetable for corporate tax reform.

Year 1	
Autumn 2010	<ul style="list-style-type: none">• Publish paper on reforming CFC rules• Publish paper covering IP, the Patent Box and R&D tax credits• Publish further details on the CFC interim improvements and on chosen option for foreign branch reform
Year 2	
Spring 2011	<ul style="list-style-type: none">• Introduce rate cuts in Small Profits Rate and the main rate to 27 per cent• Publish further details of new CFC rules for consultation• Publish further details of the Patent Box for consultation
Finance Bill 2011	<ul style="list-style-type: none">• Legislate for capital allowances reductions• Legislate CFC rules interim improvements and foreign branch reform
Autumn 2011	<ul style="list-style-type: none">• Publish draft legislation on (a) new CFC rules and (b) the Patent Box
Year 3	
Spring 2012	<ul style="list-style-type: none">• Introduce further cut in main rate to 26 per cent and reductions to capital allowances
Finance Bill 2012	<ul style="list-style-type: none">• Legislate outcomes following consultation on (a) new CFC rules and (b) the Patent Box
Year 4	
Spring 2013	<ul style="list-style-type: none">• Introduce further cut in main rate to 25 per cent and the Patent Box
Year 5	
Spring 2014	<ul style="list-style-type: none">• Introduce further cut in main rate to 24 per cent

5

Engagement strategy

5.1 As set out in *Tax Policy Making: a new approach*,¹ the Government recognises the value of effective consultation and this section sets out the Government's engagement strategy for corporate tax reform.

5.2 Businesses can and should play a key role in developing and testing tax policy. The Government wants to continue the dialogue with business and other interested parties to ensure it delivers on its objective to have a more competitive tax system. The Government encourages all interested parties to engage in consultation to ensure that a full range of views is heard.

5.3 An open and consultative approach to policy development must be balanced with a timetable that permits officials to undertake the work necessary to deliver these reforms. This document provides a framework for consulting with business, but it is not possible to set out a timetable of planned workshops or publication of more detailed policy papers at this stage. This approach needs to be flexible and adaptable to deal with the different issues that will arise as policy develops. For example, the working groups will meet when appropriate, not on a pre-set schedule.

5.4 The Government is committed to open and transparent consultation and will use its website http://www.hm-treasury.gov.uk/corporate_tax_reform.htm and email distribution lists to provide regular updates including dates and minutes of working groups and other publications, where possible. If you would like to be added to the email distribution list, please contact corporatetaxreform@hmtreasury.gsi.gov.uk.

5.5 If you have any comments on the material set out in this paper please email corporatetaxreform@hmtreasury.gsi.gov.uk by 22 February 2011.² Richard Williams (Corporate Taxes Team, HM Treasury) will coordinate this work and can be contacted via the email address above.

Consultation groups

5.6 Different levels of consultation will take place, to ensure that both strategic oversight and more detailed input is provided into policy development from business and other stakeholders:

- **strategic oversight** will be provided by the Corporate Tax Reform Liaison Committee; and
- **policy development** will be supported by working groups considering different areas of reform.

¹ *Tax Policy Making*, HM Treasury and HMRC, June 2010 (http://www.hm-treasury.gov.uk/junebudget_tax_policy_making.htm)

² Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004. If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury and HM Revenue and Customs (HMRC). HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Strategic Oversight

5.7 The Government will establish a new Corporate Tax Reform Liaison Committee to provide strategic oversight of the overall corporate tax reform. This will be jointly chaired by HM Treasury and HMRC. The membership will include up to eight business representatives.

5.8 In addition the Government has established the Business Forum on Tax and Competitiveness, chaired by the Exchequer Secretary, to consult with large businesses on the UK's tax competitiveness, including the long term aims of reform of the corporate tax system. Details of the Forum are available on the HM Treasury website: http://www.hm-treasury.gov.uk/tax_forums_business_tax_competitiveness.htm.

Policy Development: Working Groups

5.9 This document discusses several specific areas of policy reform. While the Corporate Tax Reform liaison committee will maintain a strategic oversight of the overall, five self-contained consultations, some of which follow on from previous consultations, will focus on specific policy areas. These consultations are:

- Patent Box: Stage 1 consultation – developing policy proposals;
- Foreign Branches: Stage 3 consultation – final consultation on draft legislation;
- R&D tax credits: Stage 1 consultation – developing policy proposals;
- CFC full reform: Stage 2 consultation – determining the best option; and
- CFC interim reforms: Stage 3 consultation – final consultation on draft legislation.

5.10 A number of working groups will be established to focus on detailed policy issues. Working groups will work with officials to test policy as it develops and also to test the likely impacts of changes on business and the resulting impact on tax revenues. All working groups will have the same terms of reference, to be agreed at the first working group meetings, and will meet when appropriate.

5.11 A new working group will be established for the Patent Box while the Government will retain the existing working group for foreign branch reform. The R&D tax credits working group will be based on the existing R&D Consultative Committee.³

5.12 New CFC working groups will be established under the following headings: monetary assets, IP, insurance, banking and property. The existing CFC interim rules working group will continue in its current form.⁴

5.13 It is expected that there will be a high level of interest in working group membership. To permit an efficient policy development process, working groups will be limited to up to six representatives. To ensure a broad representation from a variety of sectors and businesses, the majority, if not all, members will be drawn directly from businesses. To ensure that the working group are as open as possible the Government will consider nominations from key representative bodies where nominees work for specific businesses or have other relevant experience.

³ More information on the R&D Consultative Committee can be found at <http://www.hmrc.gov.uk/consultations/rdcc.htm>

⁴ A list of members of the working group on CFC interim improvements can be found here: http://www.hm-treasury.gov.uk/controlled_foreign_companies.htm

5.14 Nominations for working group membership should be sent to corporatetaxengagement@hmtreasury.gsi.gov.uk by 9 December 2010.

Wider Engagement

5.15 Alongside these consultation groups, officials will continue to meet separately with businesses, representative bodies and tax advisers. Given the impact on a wide and varied cross-section of businesses, the Government would welcome hearing a wide range of views.

5.16 The Government will also hold regular open events while consultations are live. The next open events will cover the entire programme of corporate tax reform and will be on:

(a) 13 December at 1pm

(b) 11 January at 4.30pm

5.17 To attend please email corporatetaxengagement@hmtreasury.gsi.gov.uk.

Timetable

5.18 For Stage 1 and 2 consultations focused on developing policy, the initial stage of consultation will occur between 29 November and 22 February 2011. Policy proposals will be published in spring 2011.

5.19 Following the Budget, a further period of consultation will build on these proposals to develop draft legislation. Consistent with the proposals set out in *Tax policy making: a new approach*, the Government will publish draft Finance Bill 2012 clauses in autumn 2011, ahead of introduction of the legislation in Finance Bill 2012.

5.20 Stage 3 consultations on draft legislation will close on 9 February in order to allow drafting changes to be made in advance of Finance Bill 2011.

