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CLIENT BRIEFING

JANUARY 2023

IS TAX COMPETITION DEAD? WHAT FACTORS DO MULTINATIONALS TAKE INTO ACCOUNT?

When a business is able to choose where to establish (or relocate) itself, one relevant consideration will be the tax regime in each prospective jurisdiction. The criteria for what makes a jurisdiction attractive from a corporate tax perspective for holding companies is reasonably well defined; however, for the rest of the group, these criteria will be more unique and will turn on factors such as the specific group or company's individual nature, industry, operations or shareholders. The stability of the tax regime as well as tax authority relations with business are also important factors. Ultimately, it is rare to find a jurisdiction that is a clear winner: the answer, like so much in tax, is that 'it depends'.

How important is tax?

Most corporate groups will - at some stage in their lifecycle - have a choice as to where to establish (or move) their operations, headquarters or parent entity. In doing so, they will look for a jurisdiction which they believe offers favourable conditions. One part of that analysis may, of course, be tax. But before getting into the tax considerations in play, there is one important caveat: tax will rarely be the driving factor.

Among other things, each multinational will consider 'jurisdiction factors' (for example, the jurisdiction's political climate and its judicial system) and 'business factors' (for example, how the proposed jurisdiction fits with the group's existing geographical footprint, markets and operations), alongside more 'practical' concerns (such as whether they will be able to attract the right personnel).

Moreover, tax rules (and attitudes towards taxation) mean that, increasingly, tax has moved to a 'supporting role' in the analysis. Public opinion is firmly against companies that try to move just to save tax. And the OECD's global anti-base erosion rules (GloBE rules) can be expected to put a floor on tax competition between jurisdictions (although not eliminate it entirely).

That all said, what do international groups look for when considering the attractiveness of a particular jurisdiction from a tax perspective? The short answer is 'it depends'.

Holding companies

First, we turn to companies whose (sole) role is to hold shares in the group's subsidiaries. Here, the initial pathway is fairly well-trodden. Sara Luder and Charles Osborne discussed this in their 2019 article 'How to choose your holding company location' (Tax Journal, 25 October 2019) and their comments continue to hold true. A competitive jurisdiction is one which:

- minimises tax leakage when profits pass through the holding company up to shareholders (with dividends received by the holding company from its subsidiaries being exempt 'on the way in' - for example, due to a participation exemption - and with no withholding taxes on dividends paid by the holding company 'on the way out' to its shareholders);

- operates a territorial tax system (with manageable controlled foreign company (CFC) rules which target only profits which have been artificially diverted offshore);

- offers exemptions from chargeable gains on future sales by the holding company of shares in its subsidiaries; and

- does not have onerous exit tax regimes which make it difficult to leave again.

Low headline tax rates may also be appealing but are less important. If the above criteria are fulfilled, no (or only a very small amount of) tax should be chargeable in any event.

Several jurisdictions are regularly mentioned as good holding company jurisdictions. The UK is generally one of them, and it performs well against the above criteria. It:

- has broad corporation tax exemptions on the receipt of dividends (CTA 2009 Part 9A);

- imposes no withholding on the payment of dividends (save in certain specialist contexts: UK companies which are real estate investment trusts (REITs) are obliged to withhold income tax at the basic rate in certain circumstances); and

- has a chargeable gains exemption for sales of shares in trading companies or groups, provided a sufficient number of shares have been held for a sufficient period of time (the substantial shareholding exemption in TCGA 1992 Sch 7AC).

Other often-considered jurisdictions include Ireland, Luxembourg, the Netherlands, Switzerland and Singapore (which each have their pros and cons).

Two countries which are often considered to perform less well in respect of the above criteria are France and the United States. France, for example, has a participation exemption which typically does not exempt 100% of dividends received, imposes withholding taxes on dividends (subject to treaty reductions or exemptions) and offers incomplete reliefs on disposals of shares; whilst the US is perceived to have a complex system which struggles with territoriality. A group with widespread global operations will want to determine the likely impact of the Subpart F and GILTI regimes before opting for a US parent company. The new alternative minimum tax enacted in the Inflation Reduction Act 2022 adds another layer of complexity, and the US' anti-inversion rules also, infamously, make it difficult to leave again in future.

When deciding where to locate a holding company, 'traditional tax havens' can be thrown into the mix too, but are generally discounted. Groups are typically put off by:

- reputational concerns: this is particularly so for groups with a retail-focused business and/or a large retail shareholder base;

- small tax treaty networks, which can make it harder to move dividends up and out through a global group without withholding en route (Jersey, for example, has 15 full double tax treaties whilst the UK has more than 100); and

- a risk of increased complexity in the tax affairs of the rest of the group (for example, a number of jurisdictions, including those within the EU, have adopted designated lists of tax havens; those involved in transactions with such places may face consequences, including higher withholding taxes, increased risk of non-deductibility, non-application of participation exemptions and more burdensome transfer pricing documentation requirements).

In addition to the 'basic' holding company considerations, if it is expected that the holding company will have some role beyond purely holding subsidiaries, then other points (naturally) will need to be considered. For example, if it will have a role in group financing, questions about withholding from (and the rate of tax applicable to) expected interest receipts (and deductibility of lending costs) should be analysed. In addition, it will often be sensible to check the employment tax regime (including rules and policies on hybrid and cross-border working) so there are no surprises in terms of how the board's remuneration is taxed.

Stamp duties will also often crop up in a comparison of possible holding company jurisdictions. Groups will be keen to understand costs which they or their shareholders may face on transfers of shares in the parent company, including on key corporate transactions like buybacks. The US's new 1% excise tax on buybacks of publicly traded US corporations will be of interest here. It is important to note that applicability of stamp duties can depend on place of incorporation (which need not match the holding company's place of tax residence). Both places therefore need to be considered when assessing where to locate a holding company and indeed whether that holding company should have split places of incorporation and residence.

Finally, the prospective jurisdiction's implementation of the GloBE rules is a relatively new factor to consider when deciding where to locate a holding company of a potentially in-scope group. The GloBE rules under Pillar Two comprise the introduction of a global minimum tax for big multinationals, implemented in a number of complex parts: importantly the 'income inclusion rule' (IRR) and the 'undertaxed payments rule' (UTPR). Instead of being tempted by jurisdictions without these rules (which instinctively might seem simpler), a group may be incentivised to situate its parent in a jurisdiction which has a qualified IIR (and a qualified domestic minimum top-up tax or which otherwise ensures a sufficient level of taxation of entities resident there so as not to trigger the application of the GloBE rules in respect of them) in order to avoid the requirement to operate the UTPR. (The main assumption underlying that conclusion is, of course, that the UTPR is in fact implemented in the various OECD Inclusive Framework jurisdictions; in the EU at least, this will be the case after the implementation of the Minimum Tax Directive which contains both an IIR and UTPR.)

Other companies

Turning to 'the rest of the group', what makes a jurisdiction attractive from a tax perspective will very

much depend on the nature and activities of the group, company or business in question. This means greater focus is needed on the headline corporation tax rate, the rules for calculating the tax base and the existence of any favourable (or unfavourable) regimes for particular activities (with these factors being relevant in addition to the basic 'holding company' considerations outlined above).

To take an example, businesses involving the development, holding or use of IP are amongst the most mobile. Key tax factors when considering where a group might (or might not) locate such activities include:

- the 'normal' corporate tax regime for intangibles (i.e. the equivalent of CTA 2009 Part 8 in the UK);
- R&D reliefs; and
- any patent box regimes on offer.

To compare patent box regimes, a starting point will be a comparison between the patent box and the headline tax rates. This may lead you to countries like Belgium and Luxembourg as initial options with patent box rates of, respectively, 3.75% (compared to a headline rate of 25%) and 4.99% (compared to a headline rate of 24.94%). In the UK, the rate is 10% (compared to a headline rate of soon-to-be 25%). This also needs to be combined with an understanding of exactly what gets included within the patent box and the extent of any other potentially available reliefs that supplement (or have replaced it). Consistent with Action 5 of the OECD's BEPS Action Plan, different countries have redrawn their patent box regimes (or withdrawn them completely). The UK (like others, including Luxembourg and Belgium) has re-scoped its patent box regime so as to provide tax benefits only where there is the right 'nexus' to local activity. Italy, for example, abolished its patent box regime in 2021 – but this needs to be balanced against the introduction of a 230% super deduction for R&D costs. The UK government is currently consulting on R&D tax relief reform.

Other companies may have different 'special interests' when it comes to tax. A group looking for somewhere to locate its manufacturing operations may care much less about a patent box regime and more about deductions for capital expenditure. Services companies or HR intense businesses may care about generous employee tax regimes. Still other groups may be ambivalent to all that and care simply about the headline tax rate (so long as there is a sensible rule allowing broad-based deductions for business expenditure).

There is an important overlay to the analysis here, which applies particularly if a jurisdiction (at first) appears attractive because it offers a special tax regime covering your particular activities – namely, how long will that regime last (or be useful for)?

In this regard, we have recently seen a number of reliefs (for example, in the wake of the Covid pandemic) which sought to ease tax bills on a short-term basis: the effects of such reliefs unwinding over time needs to be taken into account (the UK's temporary capital allowances super-deduction (introduced by FA 2021) is one example of that). Separately, the risk of a tax relief regime being challenged on the international stage (for example, on competition grounds under the EU's state aid rules) may also be relevant. And, of course, international tax reform pursuant to the OECD's BEPS 2.0 project cannot be forgotten. If the special tax regime would mean that your effective tax rate for the purposes of the GloBE rules is pushed below 15%, at least some of the expected benefits could end up being clawed back.

Stability, tax authority relations and simplicity

Regardless of the group or type of company in question, the stability and simplicity of prospective jurisdictions' tax regimes, alongside applicable tax authorities' relationship with business, are regularly raised as key (interconnecting) points of interest.

First, stability. It is important for a tax regime to balance (a) 'staying still' (which, in theory, makes compliance more manageable) whilst being able to (b) 'flex' where appropriate (i.e. it needs the ability to evolve so it can remain fit for purpose). It would be fair to say that the UK historically has had a fair reputation for having a stable, albeit complex tax regime. However, any reputation for stability is eroding, with the UK's tax regime struggling to 'stay still'. There has been a recent trend of rushing through legislation and then tweaking it over the following years to implement technical fixes. One example is the UK's hybrid and other mismatch rules in TIOPA 2010 Part 6A. These were introduced in the spirit of BEPS Action 2 (with the UK's implementation moving quicker, and arguably going further, than the OECD's recommendation). Originally introduced by FA 2016, these complex rules have since been amended by subsequent Finance Acts in 2017, 2018, 2019 and 2021 and through supporting statutory instruments. The mini-Budget on 23 September 2022, as followed by its nearly comprehensive repeal, was a particularly embarrassing example of instability which was largely unrivalled on the international stage. Then again, the UK does seem to be trying to take a long-term view, for example, on R&D reliefs and capital allowances reforms (with, in relation to the former, a consultation on the unification of the existing R&D relief regime being launched in Mid-January). On the other side (i.e. insufficient 'flex'), one could point to the US where the political climate means that the word 'gridlock' has been used to describe the lack of progress of tax reforms.

Second, tax authority relationships. In a world where tax rules are increasingly complex, a tax authority

which manages audits quickly and collaboratively – and which offers taxpayer certainty (for example, through formal or informal rulings) – will look attractive. The trend is, unfortunately, moving in the opposite direction as a general rule (or, at least, that is taxpayer perception). Recent years have shown tax authorities be inclined to take more aggressive approaches in audit and litigation (including through the threat of criminal sanctions). This was, for example, relevant in a transfer pricing-related dispute between McDonalds and the French authorities, which ultimately resulted in a settlement during the summer of 2022.

The time taken to close complex audits is a common taxpayer complaint (across the board). Transfer pricing disputes can be the most tricky to settle, and can require tax authorities in different jurisdictions to work together. It is telling that the gold, silver and bronze winners in Category 1 of the OECD's Mutual Agreement Procedure Awards 2021 (average time to close MAP cases) – namely Spain, the UK and Germany – closed their MAP cases in (on average) 19.6 months, 20.9 months and 23.1 months respectively. Although within the BEPS Action 14 minimum standard, this is a long time in objective terms.

And when it comes to rulings, some jurisdictions have traditionally been better than others. The UK fairs poorly here. Outside of some of the more well-known statutory clearances (such as under TCGA 1992 s 138), clearances strictly are available only for points of 'genuine uncertainty' (and in practice there can be plenty of genuine uncertainty about what counts as genuinely uncertain!). Other jurisdictions are more 'used' to giving rulings (such as the Netherlands and Luxembourg). Even there, practices have generally tightened. In the EU, this has been in part driven by state aid risk; albeit there could be a return in confidence following the CJEU's judgment in Fiat Chrysler Finance Europe v Commission (Joined Cases C-885/19P and C-898/19P).

Third, simplicity. Simplicity is obviously to be preferred – but this factor's utility in distinguishing between potential jurisdictions seems to be lessening. This is because, setting aside traditional tax havens, the world's tax regimes are becoming more complicated across the board. A whole raft of observations could be made here, but perhaps the biggest is the BEPS 2.0 project: Pillar One and Pillar Two promise increased complexity for all major multinational corporate groups (and almost everywhere). The UK's draft legislation to introduce just the income inclusion rule within the GloBE rules, for instance, runs to 116 pages.

Concluding thoughts

For any given company or group, choice of location is a multifaceted exercise. In recent years, the tax part of this analysis has become substantially less straightforward. In most cases, it will be hard to identify a jurisdiction which is a 'clear winner'. That, of course, feels like it fits neatly with the observation made at the beginning: in real life (unlike in this article) companies should not put the tax cart before the commercial horse. And, with the complex web of factors to be weighed and measured, it would also be pretty difficult to do so.

This article was first published in the 27 January 2023 edition of Tax Journal.

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