



International tax - UK update

July 2010

PKF (UK) LLP's newsletter designed to help you keep track of developments in UK tax.

Corporation tax rates

As part of the UK Government's plans to make the UK one of the most competitive jurisdictions in the G20, the main rate of corporation tax will reduce from 28% to 27% from April 2011 and will be reduced by 1% each year until April 2014 when the rate will be 24%. The small companies' rate will reduce to 20% with effect from 1 April 2011, on the first £300,000 of taxable profits.

Capital allowances

The rates of capital allowances for businesses investing in plant and machinery will be reduced from April 2012 as follows:

- from 20% to 18% a year for the main rate pool
- from 10% to 8% a year for the special rate pool.

CFCs and taxation of foreign profits

Consultation will continue with a view to reforming the rules relating to the taxation of foreign profits. It is intended that wider reform of the controlled foreign company rules will be introduced in 2012, but interim improvements are expected in 2011 to make the current rules easier to operate and to enhance UK competitiveness.

Consultation will also continue on moving to a more territorial basis for taxing the profits of foreign branches, while considering options for retaining foreign branch loss relief.

Corporation tax - filing online

From 1 April 2011, company tax returns for accounting periods ending after 31 March 2010 must be filed online. Additionally, accounts and computations must be filed in a standardised format www.pkf.co.uk/taxinternational

known as iXBRL. This requires the tagging of thousands of pieces of data. Companies must also pay all corporation tax and related payments electronically from 1 April 2011.

If a company is not considered to be resident in the UK but is still carrying out a trade in the UK through a permanent establishment, or through a branch or agency, it must submit the accounts and computations relating to the company's UK activities in iXBRL format. See <http://digbig.com/5bcaks>.

Capital gains tax

A new 28% capital gains tax (CGT) rate has been introduced from 23 June 2010. Gains falling within the basic rate band will still be taxed at 18% but gains falling in higher bands now suffer CGT at 28%.

From 6 April 2010, the first £2m (previously £1m) of gains on the disposal of qualifying business disposals were liable to tax at an effective rate of 10% (where entrepreneurs' relief (ER) applied). For disposals occurring on or after 23 June 2010, the ER lifetime limit has increased to £5m.

VAT

The standard rate of VAT will rise from 17.5% to 20% from 4 January 2011. Zero rated supplies, exempt supplies and supplies subject to VAT at the 5% reduced rate are not affected by this change but a new table of rates has been published for those businesses using the UK's flat rate scheme.

The European Commission has started infraction proceedings against the UK and six other EU states on their interpretation of VAT Grouping rules: it thinks they are wrong to allow non-taxable and/or non-

trading companies to be members of group VAT registrations. If the Commission's interpretation is upheld by the European Court Of Justice, groups of companies may have to revise the membership of their VAT groups, potentially losing the VAT advantages. However, rulings on such proceedings do not normally apply retrospectively.

Treaty passport for interest payments

Currently an overseas lender has to submit a clearance application to HMRC for each loan it makes to a UK party, if it wishes to benefit from a reduced treaty rate of withholding tax on interest payments.

From 1 September 2010, a new double taxation treaty passport scheme (DTTP) is being introduced. Any overseas company that lends money to a UK company can apply for this passport. Once granted, the lender will provide these details to a UK borrower who will pass this information to HMRC, along with details of the loan. HMRC will then issue a direction for the withholding tax on the interest payments to be levied at the appropriate treaty rate, rather than the current rate of 20%.

UK-Hong Kong DTA

A first-time comprehensive double taxation agreement (DTA) between the UK and the Hong Kong Special Administrative Region of the People's Republic of China was signed on 21 June 2010 (although will not enter into force for some time). The Agreement generally follows the OECD model double taxation convention and important features include:

1. **Exchange of information** - the latest OECD provision but limited to taxes covered by the Agreement.
2. **0% withholding tax on interest payments.** There is currently no withholding tax on the payment of interest from a resident in Hong Kong, but the UK does levy a non-treaty rate of 20%. The new treaty provides for withholding taxes on interest to be reduced to zero, but with a provision

to ensure the benefits of the interest article can only flow to residents of the other state.

3. 3% withholding tax on royalties

The non-treaty withholding tax rates on royalties are currently 4.95% in Hong Kong, and 20% in the UK. The treaty now limits this to a maximum of 3%, subject to the usual 'beneficial ownership' requirements.

4. Income and pensions

Income and pensions arising in one state and paid to residents of the other state may, in some circumstances, only be taxed in the first mentioned state. For example, pensions arising in Hong Kong in consideration of past employment and paid to a resident in the UK will only be taxable in Hong Kong.

5. Non-discrimination

Under UK transfer pricing legislation, small and medium sized entities (SMEs) are exempt from general transfer rules provided the other party is resident in a state with which the UK has a DTA with an appropriate non-discrimination article. Once the treaty takes effect, all transactions between UK SMEs and Hong Kong entities will benefit from this exemption. This is particularly helpful where a UK business has made an interest free loan to a related party in Hong Kong.

Dividends receivable from countries that do not have a DTA with the UK with an appropriate non-discrimination article would normally form part of the taxable income of small companies. Once the treaty enters into force, dividends received by a UK small company from a company resident in Hong Kong will not be taxed in the UK provided that the payments do not form part of a scheme seeking to obtain a tax advantage. It may, therefore, be appropriate to consider delaying the payment of dividends until the DTA enables these to be tax-exempt if received by a UK company.

If you would like to discuss any of the matters raised in greater depth, please contact your local PKF international tax specialist or e-mail katherine.brown@uk.pkf.com

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