Chapter 17

United Kingdom

Alice Pirlot and John Vella

Abstract

This chapter discusses the United Kingdom's participation in and response to the Base Erosion and Profit Shifting project. It starts with a short introduction on the UK's economy, and its political and tax system (section 17.1). Second, this report provides an overview of the UK's proactive and leading role in the OECD/G20 project (section 17.2). Third, it analyses the UK's response to the BEPS project, including measures implementing BEPS minimum standards (section 17.3), measures in response to other BEPS actions (section 17.4) and some of the UK's unilateral "BEPS" measures (section 17.5). Generally, the UK has been an enthusiastic and early adopter of BEPS proposals. Fourth, this chapter discusses the role of the UK tax administration in international tax reform (section 17.6). Finally, this chapter sheds light on the opportunities and challenges that characterise the UK's international tax agenda (section 17.7).

17.1 Introduction

The UK is a developed country based on a constitutional monarchy. The UK is one of the original members of the Organisation for Economic Co-operation and Development (OECD) (since 1961) and it is also part of the G20. In 1973, the UK became a member of the European Union (EU). In June 2016, however, a majority (51.9 per cent) of UK citizens voted for the UK to leave the EU in the "Brexit" referendum. Negotiations with the EU started in 2017 after the UK government

triggered article 50 of the Treaty on the European Union (TEU), which regulates the withdrawal of Member States from the EU. Until the UK leaves the EU (which is planned to take place on 29 March 2019, unless the European Council and the UK unanimously agree to extend the negotiation of the withdrawal agreement), the UK remains a member of the EU and maintains its obligation to apply and implement EU law.[1]

Her Majesty's Revenue and Customs (HMRC) is the UK's tax, payments and customs authority. It is a non-ministerial department and is responsible for the collection of taxes.[2]

In 2017, the UK's GDP (at current prices) amounted to USD 2,625 billion,[3] which made up around 15 per cent of the EU's total GDP, ranking the UK second after Germany among EU Member States and fifth in the world.[4] GDP growth rate averaged 1.7 per cent between 2016 and 2017.[5]

In relation to UK trade:

(a) in 2016, the current account deficit averaged 5.9 per cent of nominal GDP;[6]
(b) the total trade deficit averaged 2.2 per cent of gross domestic product. Trade in goods was characterised by a deficit of around 6-7 per cent of GDP where trade in services was characterised by a surplus of around 4-5 per cent of GDP;[7]
(c) the UK main trade partners were the United States (around 13 per cent of exports and 9 per cent of imports) and Germany (around 10-11 per cent of exports and 14 per cent of imports).[8] In 2017, the highest shares of exported goods included nuclear reactors, boilers, machinery (around USD 65 billion), vehicles other than railways, tramways (around USD

[1] See, e.g., the Background Note in HM Treasury, Draft provisions for Finance Bill: Explanatory Notes, Clauses 1 to 40 (6 July 2018), p. 84. On the UK's tax system and Brexit, see also Freedman (2017).
[2] See HMRC, "Our governance", https://www.gov.uk/government/organisations/hm-revenue-customs/about/our-governance (accessed on 16 August 2018).
[3] International Monetary Fund, "World Economic and Financial Surveys: World Economic Outlook Database, Report for Selected Countries and Subjects (the United Kingdom)" (2018).
[4] See Eurostat, "Which Member States have the largest share of EU's GDP?", http://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20180511-1?inheritRedirect=true (accessed on 31 July 2018).
[5] Office for National Statistics, "Statistical bulletin: Quarterly national accounts: January to March 2018" (29 June 2018), https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/quarterlynationalaccounts/januarytomarch2018 (accessed on 25 July 2018).
[6] Office for National Statistics, "UK Balance of Payments, The Pink Book: 2017" (31 October 2017), https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2017 (accessed on 25 July 2018).
[7] Ibid.
[8] United Nations, World Statistics Pocket Book 2017 (Series V, No. 41), p. 241, https://unstats.un.org/unsd/publications/pocketbook/files/world-stats-pocketbook-2017.pdf (accessed 3 September 2018).

53 billion), pharmaceutical products (around USD 32-33 billion) and pearls, precious stones, metals, coins, etc. (around USD 29 billion). Similar sectors were amongst the most important on the import side: nuclear reactors, boilers, machinery (around USD 80 billion), vehicles other than railways, tramways (around USD 73 billion), pearls, precious stones, metals, coins, etc. (around USD 49 billion) and electrical, electronic equipment (around USD 60 billion);[9]

(d) regarding services, the financial services sector contributed to a large share of UK exports of services in 2016 (around GBP 61 billion).[10] Exported services also included other business related services, such as services between related enterprises, business management and management consulting services, telecommunications and computer services.[11] On the import side, travel services were the largest imported service.[12]

17.2 The UK's Role in Countering Base Erosion and Profit Shifting and its Response to the G20/OECD BEPS Program of Tax Reform

17.2.1 The UK's Role in Fighting BEPS Before the OECD/G20 BEPS Package

The UK had measures in place to counter base erosion and profit shifting before the advent of the BEPS project (Economic Affairs Committee, 2013, sections 39ff). They included: anti-tax arbitrage provisions, Controlled Foreign Company (CFC) rules, and thin capitalisation rules. Moreover, provisions that deny treaty benefits when the main purpose or one of the main purposes of a transaction is to obtain those benefits were added in many double tax treaties (DTTs) (Baker, 2017, p. 283). The UK also had a broad array of domestically-focused anti-avoidance legislation, including a disclosure of tax avoidance schemes regime and a General Anti-Abuse Rule (GAAR).

17.2.1.1 Anti-Tax Arbitrage

In 2005, the UK put in place anti-tax arbitrage provisions (*Finance (No. 2) Act 2005*, Part 2, chapter 4) (Boyle, 2005). Moreover, as of 2009, the UK adopted rules to prevent situations of

[9] UN Comtrade, "International trade in goods and services based on UN Comtrade data", https://comtrade.un.org/labs/dit-trade-vis/?reporter=826&type=C&year=2017&flow=2 (accessed on 25 July 2018).
[10] Office for National Statistics, "UK Balance of Payments, The Pink Book: 2017", above n 6.
[11] Office for National Statistics, "Statistical bulletin: International trade in services, UK: 2016" (31 January 2018), https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/bulletins/internationaltradeinservices/2016 (accessed on 31 July 2018).
[12] Office for National Statistics, "UK Balance of Payments, The Pink Book: 2017", above n 6.

double non-taxation arising from mismatches in the tax treatment of profit distributions (*Corporation Tax Act 2009*, ss 931B(c) and 931D(c) introduced by *Finance Act 2009*, s. 34 and Sch 14, part 1). These rules anticipated the inclusion of an anti-hybrid provision in the EU Parent-Subsidiary Directive in 2014 (Council Directive 2014/86/EU).

17.2.1.2 CFC Rules

The UK has had CFC rules since 1984 (*Finance Act 1984*, ss 82-108). These rules were later amended and, in 2012, relaxed in the context of broader reforms towards a territorial system of taxation (*Finance Act 2012*, s 180 and Sch 20). These reforms were undertaken with an eye towards competitiveness but also because of a series of decisions handed down by the Court of Justice of the European Union (CJEU) (HM Treasury and HMRC, 2011, para. 1.12).[13]

17.2.1.3 Thin Capitalisation Rules

Thin cap rules have been in force in the UK for a long time (*Taxes Act 1988*, s. 209). These rules were integrated into UK transfer pricing (TP) legislation in 2004 (*Finance Act 2004*, ss 34-36). Moreover, as of 2010, a worldwide debt cap was introduced so as to limit the deduction of groups' interest expense in the UK (*Finance Act 2009*, s. 35 and Sch 15).[14]

17.2.1.4 Rules on the Disclosure of Tax Avoidance

The UK adopted provisions on the disclosures of tax avoidance schemes in 2004 (*Finance Act 2004*, s 19 and Sch 2; ss 306 to 319). The disclosure of tax avoidance schemes regime (DOTAS) applies to direct taxes and national insurance contributions (*Finance Act 2004*, ss 316ff).[15] The Disclosure of Tax Avoidance Schemes: VAT and Other Indirect Taxes (DASVOIT) applies to value added tax (VAT), customs duties, the climate change levy, hydrocarbon oils duty and other indirect taxes (*Finance (No. 2) Act 2017*, s. 66 and Sch 17).[16]

17.2.1.5 General Anti-Abuse Rule

The UK introduced a statutory GAAR in 2013 (*Finance Act 2013*, part 5). Although the timing of the introduction of this measure coincided with the publication of the first BEPS report, discussions on the need for a UK GAAR started well before the BEPS project (Freedman, 2016,

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[13] In *Cadbury Schweppes plc v IRC* (C-196/04) [2006] E.C.R. I-1995 (ECJ Grand Chamber) the CJEU cast doubt on the compatibility of the UK's then existing CFC regime with EU law.
[14] These rules have been subsequently modified (*Taxation (International and Other Provisions) Act 2010*, ss 260 et seq) and further amended by the *Finance (No. 2) Act 2017* and *Finance Act 2018* (see further below, section 17.4.4).
[15] The regime has been strengthened in 2015 (see the amendments made by *Finance Act 2015*, s 117 and Sch 17).
[16] This regime has replaced the VAT disclosure regime (VADR) (*Finance Act 2004*, Sch 17).

p. 743). The UK GAAR is a domestic measure which was never intended to solve the specific challenges that were identified by the OECD/G20 (Freedman, 2016, pp. 743 and 759).

17.2.2 The UK's Role in the Development of the G20/OECD BEPS Package

The UK played a proactive and leading role in setting the G20/OECD agenda for addressing base erosion and profit shifting (Osborne, 2012), which can be partly explained by the UK's public and political disquiet over the tax affairs of multinational companies in the years preceding the start of the BEPS project.[17]

National newspapers from different sides of the political spectrum ran articles highlighting the tax practices of multinational companies, thus raising the public interest in this issue. In 2012, the Committee of Public Accounts started to investigate the tax paid by multinational companies, including Google, Amazon and Starbucks and issued a list of recommendations in order to restore public confidence in the tax system. Some of the recommendations proposed by the Committee pursued similar objectives as the ones underlying the BEPS project. For example, the Committee suggested that the HMRC should be "much more effective in challenging the artificial corporate structured created by multinationals with no other purpose than to avoid tax" (Committee of Public Accounts, 2013, para. 2). The Committee also recommended that HMRC and HM Treasury "push for an international commitment to improve tax transparency, including by developing specific proposals to improve the quality and credibility of public information about companies' tax affairs, and use that information to collect a fair share of tax from profits generated in each country" (Committee of Public Accounts, 2013, para. 3).

In 2013, the Economic Affairs Committee (2013) issued a report on corporate tax avoidance. In this report, the Committee recognised that "fundamental reform of the international tax framework should be pursued in the OECD" (Economic Affairs Committee, 2013, para. 93). The Committee underlined that the UK should play an active role in the OECD BEPS project while remaining open to "more radical alternative approaches to corporate tax", such as the unilateral adoption of a destination-based cash flow tax (Economic Affairs Committee, 2013, paras 93 and 111). In response to the Committee's report, the UK Government (2013) emphasised its

[17] On the history of the BEPS project, see Hernández González-Barreda (2018, esp. p. 293).

leadership role within the G20 in order to reform international tax rules and fight against BEPS. Moreover, the Government referred to the contribution of EUR 400,000 it made to the OECD in July 2013 as a way to illustrate its commitment to finding a multilateral solution against base erosion and profit shifting (UK Government, 2013).

The UK, together with Germany, played a key role in the definition of the modified nexus approach. In November 2014, the two countries issued a joint statement proposing new rules on preferential IP regimes in the context of the modified nexus approach under BEPS Action 5 (Germany and United Kingdom, 2014).

17.3 The UK's Compliance with the BEPS Inclusive Framework (4 Minimum Standards)

Overall, the UK has been an early and enthusiastic adopter of BEPS measures.

The UK is a member of the BEPS Inclusive Framework, which – at the time of writing – comprises 117 countries. With 22 other countries, the UK is also part of the steering group of the inclusive framework.[18] The UK has taken steps to comply with all four BEPS minimum standards (Actions 5, 6, 13 and 14).

17.3.1 Action 5

In the 2015 BEPS Action 5 report, the UK's patent box regime was considered inconsistent with the nexus approach (OECD, 2015b, p. 63, para. 148, table 6.1). The UK amended its regime in 2016 in order to comply with the OECD recommendations, which, as seen above, it had played a leading role in developing (*Finance Act 2016*, s. 64). The new regime applies the modified nexus approach for the determination of the relevant IP profits of a trade of a company that are eligible to be taxed at reduced rates (*Corporate Tax Act 2010*, ss 357BFff). In 2017, additional amendments were introduced regarding companies undertaking research and development activities under a cost-sharing agreement (*Finance (No. 2) Act 2017*, s. 23). The 2017 OECD

[18] OECD Steering Group, "Steering Group of the Inclusive Framework on BEPS, Members", http://www.oecd.org/tax/beps/steering-group-of-the-inclusive-framework-on-beps.pdf (accessed on 25 July 2018). The UK is represented by Mr. Mike Williams who serves as deputy chair.

Progress Report on Preferential Regimes highlights that the new regime is no longer considered harmful (OECD, 2017c, pp. 15-16).

Action 5 also addresses the compulsory spontaneous exchange of information on tax rulings. In December 2017 the OECD published peer review reports on the status of implementation in 44 jurisdictions, including the UK. The report indicates that the UK has fulfilled all the criteria evaluated under this peer review process, except for the collection and exchange of information on new assets of existing taxpayers who benefit from the grandfathered IP regime. This specific information was only available (and exchanged) in the case of a formal investigation. Consequently, the report recommends that the UK exchange this information if it becomes available in the future (OECD, 2017d, pp. 15 and 285ff).

17.3.2 Action 6

Recent double tax treaties (DTTs) concluded by the UK follow the recommendations of the BEPS Action 6 report. The preambles of these treaties include an express statement of the intention of the parties not to create opportunities for non-taxation or reduced taxation through evasion or avoidance. Moreover, in line with past UK tax treaty practice, these treaties include a principal purpose test (PPT) clause as recommended by the BEPS Action 6 report (OECD, 2015c, para. 26). This is not surprising, as the UK's treaty negotiators were the ones to push for the inclusion of a generalised PPT (Baker, 2017, p. 283). As with most DTTs concluded by the US, the UK/US DTT nevertheless includes a limitation of benefits (LOB) clause (art. 23).

The UK's preference for the PPT clause was confirmed in the framework of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). The UK has also chosen to apply Article 7(4) of the Multilateral Instrument, which requires the competent authority of the relevant jurisdiction to grant treaty benefits (that would otherwise be denied on the basis of the PPT clause) to a person when "such benefits would have been granted to that person in the absence of the transaction or arrangement".[19]

[19] The list of reservations and notifications made by the United Kingdom of Great Britain and Northern Ireland upon deposit for the instrument of ratification, acceptance or approval pursuant to Article 28(5) and 29(1) of the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting (MLI) is to be found on the following website: https://www.gov.uk/government/publications/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-base-erosion-and-profit-shifting (last updated 16 July 2018).

Beyond the BEPS minimum standards, the UK has also modified its withholding regime on intellectual property royalty payments in order to prevent the abuse of DTTs (*Finance Act 2016*, s. 41).[20] The new targeted anti-tax avoidance rule (TAAR) applies to counter arrangements the purpose (or one of the main purposes) of which was to obtain a tax advantage by virtue of any provisions of a double taxation arrangement, while obtaining that tax advantage is contrary to the object and purpose of those provisions (*Income Tax Act 2007*, s. 917A(1)c and (4)). Under these conditions, the new provisions require payers of royalties to deduct income tax from the payments made to connected persons, regardless of any double taxation arrangements.

17.3.3 Action 13

The first OECD annual peer review process for BEPS Action 13 indicates that a legal and administrative framework has been put in place in the UK to implement country-by-country reporting (CbCR) (OECD, 2018b, p. 723ff). The UK signed the Multilateral Competent Authority Agreement for Exchange of CbC reports (CbC MCAA) on 27 January 2016. In February 2016 the Treasury introduced CbC Reporting Regulations (Statutory Instrument (SI) 2016/237). They came into force on 18 March 2016 and were amended in 2017 (SI 2017/497) to comply with subsequent developments that took place in the OECD (the inclusion of partnerships as reporting entities) and the EU (in particular, Council Directive 2011/16/EU as amended by Council Directive 2016/881/EU on CbCR).

The peer review report contains only one recommendation; it concerns UK provisions for calculating the annual consolidated revenue threshold in respect of MNE groups the ultimate parent entity of which is located in a jurisdiction other than the UK (OECD, 2018b, p. 723, paras 2 and 8). The report indicates that the calculation of this threshold may deviate from the OECD guidance on currency fluctuations, which could make the UK's local filing requirements inconsistent with BEPS recommendations.

17.3.4 Action 14

The first stage of the OECD peer review report on BEPS Action 14 highlights that the UK fulfils most requirements of the minimum standards. Most UK DTTs include a mutual agreement

[20] See also Greenfield (2016).

procedure (MAP) provision, which is similar to article 25 of the 2015 OECD Model Tax Convention (before the changes introduced by Action 14 final report), except for articles 25(1), second sentence; 25(2), second sentence and 25(3), second sentence of the OECD Model, which are absent from most UK DTTs (OECD, 2017b, p. 62, para. B.7). The large majority of UK DTTs include a provision that requires correlative transfer pricing adjustment, as in Article 9(2) of the 2015 OECD Model.

Shortcomings in the MAP provisions found in UK DTTs will be addressed through the Multilateral Instrument, which the UK signed and ratified with no reservation as to the MAP provision (article 16) and the provision on corresponding adjustments (article 17). For the few treaties that will not be amended under the MLI, the UK will proceed through bilateral negotiations.

The OECD peer review report indicates that the MAP is accessible and efficient in the UK. Moreover, the report underlines that the UK runs an advance pricing agreement (APA) program (*Taxation (International and Other Provisions) Act 2010*, ss 218-230), which helps to prevent transfer pricing disputes from arising (OECD, 2017b, Part A, pp. 16-19). Roll-back of bilateral advance pricing agreements (APAs) is possible, which also contributes to the prevention of future disputes (OECD, 2017b, p. 18, paras. 9-11).

In addition to its action to meet the BEPS Action 14 minimum standard, the UK is committed to establishing mandatory binding MAP arbitration in its DTTs (G7, 2015; OECD, 2015e, pp. 10 and 41, para. 62). With regard to the type of arbitration process, the UK has opted in to apply Article 23(5) of the Multilateral Instrument, which requires the competent authorities to "ensure that each person that presented the case and their advisors agree in writing not to disclose to any other person any information received during the course of the arbitration proceedings from either competent authority or the arbitration panel".

Twenty-one of 129 DTTs concluded by the UK already include a provision on binding arbitration, which is identical to article 25(5) of the OECD Model Tax Convention. Moreover, the UK is a signatory of the EU Arbitration Convention (Convention 90/463/EEC) that can be relied upon by enterprises to solve cases of double taxation resulting from the application of transfer pricing rules or the attribution of profits to a permanent establishment. The draft Finance Bill published in July 2018 (clause 39) also proposes to give power to the Treasury to make

regulations for implementing the new Directive (Council Directive EU 2017/1852) on tax dispute resolution mechanisms in the European Union, which has a much wider scope than the Arbitration Convention.

17.4 The UK's Responses to Other BEPS Actions

17.4.1 Action 1

17.4.1.1 VAT

The UK's VAT rules, which are harmonised at the EU level, are largely in line with the recommendations of BEPS Action 1. As of 1 January 2015, the UK imposes VAT on the supply of telecommunications, broadcasting and electronic services to non-taxable persons located in an EU Member State (B2C) on the basis of the destination principle (namely where the non-taxable person is established, has their permanent address or usually resides).[21] VAT collection for the supply of these services is facilitated by a simplified compliance mechanism (commonly referred to as the VAT "Mini-One-Stop-Shop" (MOSS)), which allows suppliers not to register in each Member State of consumption.[22]

In the EU, the destination principle – and the MOSS - will be further extended to the supply of intra-Community distance sales of goods as of 1 January 2021 (Council Directive 2017/2455, Art. 2). Moreover, as of 1 January 2021, the exemption provision that applies to the importation of low value goods will be removed (Council Directive 2017/2455, Art. 3). These new rules are aimed at facilitating the collection of VAT for imports of low valued goods, which has been identified as one of the challenges raised by the digital economy in the OECD 2015 Action 1 Report (OECD, 2015a, pp. 120ff; OECD, 2018a, para. 304). They could apply to the UK, depending on the tax arrangements made on the UK's exit from the EU (European Scrutiny Committee, 2018).

[21] See *Finance Act 2014*, ss 103-106 and Sch 22. These new rules transpose the amendments made to the EU VAT Directive (2006/12/EC) in 2008 (Council Directive 2008/8/EC). See also the amendments made by Council Directive 2017/2455 of 5 December 2017 so as to lower administrative burdens on micro-businesses. As of November 2017, the UK no longer distinguishes between telecommunication services supplied to UK consumers that are effectively used in the EU (subject to UK VAT) and those that are effectively used outside the EU (previously not subject to UK VAT) (SI 2017/778). These provisions are in line with the OECD VAT/GST Guidelines (2017) for determining the place of taxation for cross-border business-to-consumer (B2C) supplies of services and intangibles based on the destination principle (SI 2017/778, Explanatory Memorandum, s. 7).

[22] Articles 369a et seq. of EU VAT Directive 2006/12/EC (as amended in 2008). On the MOSS in the UK, see de la Feria (2014).

17.4.1.2 Corporation Tax

In November 2017 HM Treasury issued a position paper (updated in March 2018) on the UK's approach to future changes that need to be made to adapt corporate tax rules to meet the challenges posed by the digital economy (HM Treasury, 2017; 2018).

The position paper considers three approaches to these challenges.[23] First, it argues for a long-term reform of international tax rules in order to give countries the right to tax profits that are generated from user participation, including in the absence of a traditional permanent establishment in the country of the user base (HM Treasury, 2017, para. 4.3). The 2018 updated position paper clarifies the meaning of "user participation" by defining it as "the process by which users can create value for certain types of digital businesses through their engagement and active contribution (HM Treasury, 2018, para. 2.4) and distinguishing it from data collection (paras 2.33ff). The 2018 updated paper also indicates ways to modify articles 9, 5 and 7 of the OECD Model Tax Convention so as to recognise the value created by user participation and tax them accordingly (HM Treasury, 2018, paras 3.53ff). Second, the position paper supports interim solutions, along the lines proposed by the EU Commission (HM Treasury, 2017, paras 4.8ff). The preferred option of the UK government here is to tax revenues derived from digital services provided to the UK market (HM Treasury, 2017, para. 4.10). Third, the position paper sets out the government's intention to extend the scope of the UK's withholding tax regime to royalty payments between foreign related-parties for the exploitation of intellectual property rights that takes place in the UK (e.g., when the IP is used to sell products in the UK), regardless of the absence of taxable presence in the UK (absence of residence, permanent establishment (PE) or "avoided" PE) (HMRC and HM Treasury, 2017; HM Treasury, 2017, para. 4.18). This proposal is aimed at preventing under-taxation: the tax would apply when royalties are paid to an entity located in a low-tax country (HM Treasury, 2017, paras 4.17-4.18). This proposal is expected to mostly affect digitalised businesses (OECD, 2018b, p. 140, para. 357).

Finally, the introduction of the diverted profits tax (DPT) in 2015 can also be understood in the context of BEPS Action 1 as it was introduced partly to address some concerns arising from digitalisation (OECD, 2018a, pp. 148ff). Indeed, it was known as the "Google tax" when first

[23] For a critical evaluation of the UK's position as set out in the position paper see Devereux and Vella (2018).

proposed. The DPT is further analysed in section 17.5 below that discusses unilateral measures that were adopted in the context of the BEPS package.

17.4.2 Action 2

The UK's provisions on anti-tax arbitrage were modified in 2016 in order to comply with BEPS Action 2 (HMRC, 2016; *Finance Act 2016*, s. 66 and Sch 10; *Finance (No. 2) Act 2017*, s. 24).[24] The new legislation contains two direct references to the BEPS Action 2 Final Report. First, foreign provisions which it is reasonable to suppose are based on the BEPS report are deemed to be equivalent to the UK hybrid mismatch provisions (*Taxation (International and Other Provisions) Act 2010*, s. 259BA). Second, the BEPS report may be considered in the context of the anti-avoidance rule targeted at hybrid structures. Indeed, the BEPS Action 2 report may be used to assess whether the obtaining of a tax advantage can be deemed consistent with the principles and policy objectives of UK anti-hybrid rules (*Taxation (International and Other Provisions) Act 2010*, s. 259M(7)).

Additional minor amendments to the hybrid and other mismatch regime have been announced in the draft Finance Bill published on 6 July 2018. They aim at transposing the Anti-Tax Avoidance Directive II (ATAD II, Council Directive (EU) 2017/952), which broadens the scope of EU provisions to mismatches with third countries.[25] The proposed amendments include new provisions to counter mismatches arising in relation to "disregarded" PEs, in line with the OECD 2017 BEPS recommendations on branch mismatch arrangements (OECD, 2017a).

17.4.3 Action 3

The UK considers that its CFC regime is in compliance with BEPS Action 3, despite the fact that these rules were amended in 2012 with a competitive goal in mind, which stands in contrast with the objectives of the BEPS project (Maffini and Collier, 2015, pp. 16-17). To a great extent, the UK regime also meets the requirements on CFC rules that are laid down in the EU ATAD (Council Directive (EU) 2016/1164).[26] Only two minor amendments will be made so as to ensure

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[24] See also Bhogal (2017).

[25] HM Treasury, Draft provisions for Finance Bill 2018-19, Explanatory Notes, Clauses 1 to 40 (6 July 2018), p. 137, clause 38, para. 15, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/723031/Explanatory_Notes_for_draft_Finance_Bill_provisions.pdf (accessed on 25 July 2018).

[26] HMRC, Guidance: Anti-Avoidance Directive about controlled foreign companies and EU Exit (6 July 2018), available at:

full compliance with the provisions of the directive that apply to CFC rules (articles 7 and 8). The notion of "control" will be amended so as to comply with the definition of the ATAD that requires "control" to be assessed by taking into account all associated enterprises, including non-resident associated and related parties.[27] Moreover, the rules on non-trade finance profits will be slightly modified in accordance with the ATAD provisions on the identification of CFC profits.[28]

17.4.4 Action 4

Before the BEPS project, the UK's provisions on interest deductibility were largely unrestrictive and therefore perceived as "a competitive advantage" by businesses (HMRC and HM Treasury, 2010, para. 3.8). This situation has changed. New legislation was introduced in 2017 so as to put a cap on the deduction of corporate interest expenses (*Finance (No. 2) Act 2017*, Sch 5, introducing new part 10 of *Taxation (International and Other Provisions) Act 2010*).[29] These "corporate interest restriction (CRI)" rules are in line with BEPS Action 4 recommendations.[30] The UK applies a fixed ratio that limits the net deduction of interest to 30 per cent of EBITDA, which is in line with EU ATAD Directive Council Directive (EU) 2016/1164) and at the top of the corridor recommended by the BEPS Action 4 report. As underlined by Collier, Devereux and Lepoev (2017, pp. 64 and 70), HM Treasury did not give any explanation as to why the UK chose a 30 per cent ratio.

17.4.5 Action 7

The UK will not implement BEPS Action 7 with the exception of the anti-fragmentation rule. Indeed, the UK has opted out of the provision of the Multilateral Instrument aimed at preventing the artificial avoidance of PE status through commissionaire arrangements (article 12 of the MLI) and of the provision on the splitting-up of contracts (article 14 of the MLI). Similarly, the UK has opted out of the provision on artificial avoidance of PE status through the specific

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https://www.gov.uk/government/publications/anti-avoidance-directive-about-controlled-foreign-companies-and-eu-exit/anti-avoidance-directive-about-controlled-foreign-companies-and-eu-exit (accessed on 25 July 2018). On the UK and the ATAD, see Cédelle (2016).

[27] HMRC, Guidance: Anti-Avoidance Directive, above n 26.

[28] Ibid.

[29] See also Collier (2017).

[30] HM Treasury, Finance Bill. Explanatory Notes (8 September 2017), pp. 156-160, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642806/finance_bill_september_2017_explanatory_notes.pdf (accessed on 25 July 2018).

activity exemptions (article 13 of the MLI), except for article 13, para. 4 which addresses the fragmentation of activities between closely related parties.

Possible explanations for these choices include that the revenues expected from changing the current PE provisions would not justify the change and a desire to protect UK tax competitiveness (Watson, Palazzo-Corner and Haemmerle, 2017). Furthermore, the UK has unilaterally adopted the DPT, which, among other objectives, aims at preventing exploitation of PE provisions.[31]

Finally, it should be recalled that the UK favours reforming PE rules so as to allow jurisdictions to tax profits arising from the value created by user participation in the context of the digital economy (HM Treasury 2018, p. 14, paras 3.1-3.6).

17.4.6 Actions 8-10

The UK tax system explicitly requires the interpretation of transfer pricing provisions in accordance with OECD principles. Transfer pricing provisions should be read "in such manner as best secures consistency" between the effect of UK domestic transfer pricing provisions and the effects to be given to DTTs that include in whole or in part the OECD model (*Taxation (International and Other Provisions) Act 2010*, s. 164(1)(b)). Consequently, OECD recommendations made in the BEPS Actions 8-10 reports were easily integrated into UK tax law. In 2016, an explicit reference to the BEPS Actions 8-10 reports was added in UK transfer pricing provisions (*Finance Act 2016*, s. 75). Moreover, on 2 February 2018, HM Treasury made a designation order to clarify that account should be taken of the latest 2017 version of the OECD transfer pricing guidelines (SI 2018/266). Questions arise as to whether the inclusion of the new OECD transfer pricing approach in UK domestic law has been sufficiently thought through. Indeed, the new OECD approach may not be easy to reconcile with UK domestic transfer pricing provisions, including the definition of the arm's length principle (Collier, 2016, pp. 591-592).

17.4.7 Action 12

[31] HMRC, Diverted Profits Tax: Guidance (30 November 2015), p. 4, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/480318/Diverted_Profits_Tax.pdf (accessed on 25 July 2018).

The UK's provisions on the disclosure of tax avoidance (DOTAS) are referred to in the BEPS Action 12 final report as a concrete example of disclosure rules (OECD 2015d, e.g., in paras 36 and Annex E). However, as noted by Baker, the UK DOTAS regime was initially designed as a "domestic scheme", which was aimed at "reduc[ing] the period of time between the invention of a marketed tax avoidance scheme and the point in time when HMRC became aware of the scheme …" (Baker, 2015, p. 88). Its purpose was not to target international tax arrangements (Baker, 2015, p. 88).

New rules targeted at promoters of tax avoidance schemes and serial avoiders were added to these two regimes in 2014 and 2016. Under the provisions targeted at promoters of tax avoidance schemes, monitored promoters may be required to disclose information related to their products and clients to HMRC, along the same line as the DOTAS regime.[32] With regard to the Serial Tax Avoidance Regime (STAR), the objective is to sanction "serial avoiders", namely those who repeatedly enter into tax avoidance schemes that are defeated (*Finance Act 2016*, s 159 and Sch 18). Tax avoidance schemes covered by the STAR include the schemes that fall under UK GAAR provisions, the DOTAS and the Disclosure of Tax Avoidance Schemes: VAT and Other Indirect Taxes.[33]

In 2016, the UK also introduced new provisions requiring MNEs that meet the OECD turnover threshold for CbCR (namely a turnover over EUR 750 million) to publish their tax strategy on the internet (*Finance Act 2016*, s. 161 and Sch 19). The published information should include information as to the approach of the group to risk management, governance arrangements in relation to UK taxation and its dealings with HMRC; the attitude of the group to tax planning and the level of risk in relation to UK taxation that it is prepared to accept (*Finance Act 2016*, Sch 19, para. 17). Similar provisions apply to qualifying companies and sub-groups for which a tax strategy has not been published at a higher level as well as to qualifying UK partnerships.[34] Penalties may apply in certain circumstances of non-compliance. Moreover, sanctions, including

[32] *Finance Act 2014*, ss 234-283; HMRC, Guidance on Part 5 and Schedules 34 to 36 of the Finance Act 2014, Promoters of tax avoidance schemes (2015), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/454865/POTAS.pdf (accessed on 25 July 2018). See also Salter and Oats (2014).
[33] HMRC, Technical Guidance on the Serial Tax Avoidance Regime (STAR) (12 January 2018), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/671694/Serial_Tax_Avoidance_Regime__STAR__guidance.pdf (accessed on 26 July 2018).
[34] HMRC, Guidance on Publish your large business tax strategy (last updated 22 June 2018), available at: https://www.gov.uk/guidance/large-businesses-publish-your-tax-strategy (accessed on 25 July 2018).

"naming and shaming", may be adopted against large businesses that are deemed to be "persistently unco-operative" (*Finance Act 2016*, Sch 19, Part 3). These sanctions, if used extensively, could undermine the dynamic of trust that underlies co-operative compliance regimes (Freedman and Vella, 2016). In the context of BEPS, it is interesting to note that this new regime entitles HM Treasury to adopt regulations requiring groups to publish their CbCR as part of their tax strategy (*Finance Act 2016*, Sch 19, para. 17(6)). The UK government has, however, made clear that it is in favour of public CbCR only under the condition that it is implemented on an international or multilateral basis (Committee of Public Accounts, 2016, p. 9, para. 7).

Regarding offshore structures, HMRC has announced that it plans to use Common Reporting Standard data to detect and impose new sanctions on undeclared offshore tax liabilities that have not been voluntarily disclosed and corrected on or before 30 September 2018.[35]

Finally, the draft Finance Bill published in July 2018 includes a clause allowing the Treasury to make regulations on disclosable arrangements so as to allow the UK to comply with the EU Directive on administrative cooperation (2011/16/EU) as amended by Council Directive 2018/822, which extends the scope of mandatory automatic exchange of information to reportable cross-border arrangements.[36] The Treasury will also rely on this clause to make regulation if the UK decides to adopt new OECD mandatory disclosure rules.[37]

17.4.8 Action 15

The UK has been actively involved in drafting the Multilateral Instrument. The ad hoc Working Party that completed the work under BEPS Action 15 was chaired by Mike Williams, Director Business and Tax at HM Treasury.

The UK signed the Multilateral Instrument on 7 June 2017 and deposited its instrument of ratification and final list of reservations and notifications on 29 June 2018. This implies that the

[35] HMRC, Guidance on Make a disclosure using the Worldwide Disclosure Facility (last updated 23 July 2018), available at: https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure (accessed on 25 July 2018); *Finance (No. 2) Act 2017*, Sch 18 introducing the "requirement to correct" legislation.
[36] HM Treasury, Draft provisions for Finance Bill 2018-19, Explanatory Notes, above n 25, clause 40.
[37] Ibid.

MLI will enter into force on 1 October 2018, namely three calendar months after the ratification as required by article 34, para. 2 of the MLI.

17.5 The UK's Unilateral "BEPS" Measures

In addition to its active participation in the OECD/G20 BEPS project, in recent years the UK has undertaken further unilateral action to mitigate base erosion and profit shifting.

The DPT is a key unilateral anti-avoidance measure, which the UK government adopted while the BEPS project was still ongoing (*Finance Act 2015*, ss 77-116). The DPT imposes a 25 per cent charge on diverted profits from all business sectors, including digitalised businesses.[38] Two scenarios are covered. First, the DPT applies to situations where UK or non-UK companies use entities or transactions that lack economic substance. Second, it covers situations where a non-UK company avoids a UK taxable presence ("avoided PE rule"). Companies that potentially fall within one of these two scenarios have a duty to notify an officer of the Revenue and Customs (*Finance Act 2015*, s. 92). According to HMRC Guidance on the DPT, this measure "is aimed at large groups (typically multi-national enterprises) that use contrived arrangements to circumvent rules on permanent establishment and transfer pricing".[39]

In the first report produced as part of the BEPS project, the OECD warned against unilateral action as it could undermine the "consensus-based framework for establishing jurisdiction to tax and addressing double taxation which exists today" (OECD, 2013, p. 48). However, HMRC has argued that the DPT's objective "is consistent with the aims of the OECD Base Erosion and Profit Shifting Project".[40] In its 2018 interim report on the digitalised economy, the OECD reiterated its views on the risks that such unilateral initiatives may generate, including economic distortions, double taxation, uncertainty, complexity and compliance costs for businesses (OECD, 2018a, p. 159 para. 368).

The DPT has come under significant criticism by academics and practitioners. It was proposed in the run up to a general election leading many to question the actual motivation behind it. Two leading practitioners expressed this broadly held view succinctly: "[i]t was clear (at least to us)

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[38] For the oil sector, the 25 per cent rate may be increased to 55 per cent plus true-up interest (if the taxable diverted profits are ring-fence or notional ring-fence profits): HMRC, Diverted Profits Tax: Guidance, above n 31, p. 5.
[39] HMRC, Diverted Profits Tax: Guidance, above n 31, p. 4.
[40] Ibid., pp. 4 and 76.

that the main motivation for introducing the DPT was political: it was designed to take what had become a very muddled and hostile discussion about multinational taxation off the table during the election and it succeeded in that first objective" (Edge and Robertson, 2015).

The tax has also been criticised in its design, scope, application and effect. Another leading practitioner provided this scathing evaluation of the tax:

> I continue to be fascinated by the DPT. I still don't know what it's for. A "Google tax" that doesn't apply to Google? A tax aimed at foreign multinationals whose only public victim is Diageo? HMRC boasting to the press about how many companies it is attacking, but refusing to give any figures when asked in Freedom of Information Act requests? All very odd. It's a car crash of a tax, and will keep academics entertained and litigators well fed for many years.[41]

17.6 The UK's Tax Administration and its Role in International Tax Reform

At the domestic level, HMRC's role in countering abusive practices has been supported by additional resources (UK Government, 2013, para. 154). HRMC's capacity to challenge transfer pricing arrangements has been strengthened and the number of transfer pricing experts working for HMRC has been increased (Eden, 2017, p. 754).

At the international level, HRMC has played an active role in the BEPS project, not only in the framework of the OECD/G20 negotiations but also with helping developing countries in coping with BEPS (Harra, 2015). In 2013/2014, HMRC established a tax capacity building unit, aimed at providing advice and expertise to developing countries on G20/OECD tax priorities. Moreover, in 2015, HMRC set up a Tax Expert Unit that provides expertise on international tax technical issues, including transfer pricing and automatic exchange of information (OECD, 2016, p. 46, box 3.11).

HMRC participates in platforms that allow tax administrations to collaborate and exchange ideas on tax administration, the exchange of information and tax avoidance. The UK is part of the Forum on Tax Administration, which was chaired for three years by Sir Edward Troup, who served as HMRC's executive chairman until December 2017. The UK is an original member of

[41] Neidle (2017). See also Neidle (2015).

the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC). Moreover, in 2013, HMRC joined the E6 project, which brings together jurisdictions that exchange information on how MNEs operate in the digital sector.

17.7 The Future of the UK's Agenda for International Tax Reform

Recent UK governments have had a clear, eye-catching, policy goal: "to create the most competitive corporate tax regime in the G20" (HMRC and HM Treasury, 2010). The most notable expression of this policy can be seen in the fall of the headline corporate tax rate from 30 per cent in 2007 to 17 per cent by 2020. But a closer look reveals a more nuanced policy that attempts to strike a delicate balance between competitiveness and clamping down on tax avoidance and aggressive tax planning (UK Government, 2013).

A recent official articulation of UK corporate tax policy emphasised this balancing act (HM Treasury, 2016):

> Taxes should be low, but must be paid. There should be a level playing field, including between large businesses and small, and between different corporate structures. The system must encourage entrepreneurship and not reward aggressive tax planning… The government is committed to low business taxes – but these taxes must be paid. There cannot be an uneven system in which some businesses pay the tax due while competitors can avoid tax. That means clamping down on the artificial structures used to gain a tax advantage. Tackling evasion, avoidance, and aggressive tax planning also maintains the tax base.

The increased competitiveness of the system through rate cuts has thus been counterbalanced by measures such as the DPT and a (broadly) committed and early adoption of BEPS measures. Whether this balance has been struck in a satisfactory manner is open to debate.

There are reasons to believe that the UK will persevere with this broad policy, including the fundamentals of the UK economy, current political debate, public sensitivities and the influence of the media. However, when projecting into the future a number of factors immediately come to mind which could lead to some change – at least change in how the balance is currently struck between the two. One is Brexit and all the uncertainties and challenges (some might argue opportunities) it brings. A second is the possibility of a government that leans towards the hard

left – or, at least, that leans further to the left than any recent government.

From a more technical perspective, in the March 2018 updated position paper on the digital economy (HM Treasury, 2018), the UK positioned itself among the group of countries that favours reforms targeted at certain highly digitalised businesses, but oppose reform of the existing corporate tax system as a whole.[42] In particular, it opposes reform that moves – even partially - towards a destination basis of taxation, i.e. reform that allocates some taxing rights over multinational companies' profit to market countries. The UK has thus taken a clear position on what could become a key battleground for future international corporate tax reform.

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