Is the UK is proposing to use the worst form of unitary...

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Deep in the Autumn Statement documentation there is the following paragraph:

4.26 Bringing non-resident companies' UK income into the corporation tax regime — The government is considering bringing all non-resident companies receiving taxable income from the UK into the corporation tax regime. At Budget 2017, the government will consult on the case and options for implementing this change. The government wants to deliver equal tax treatment to ensure that all companies are subject to the rules which apply generally for the purposes of corporation tax, including the limitation of corporate interest expense deductibility and loss relief rules.

I have checked the HMRC press releases to see if I can find more on this and I can't. This is pretty obviously a Treasury initiative.

So what does this mean? At first sight it seems like a quite extraordinarily radical proposal. What it seems to be saying is that the UK is considering moving off the principle that taxable income arising to a company in the UK can only be taxed here in exceptional circumstances (e.g. it is rent) unless there is a management presence in this country (for the technically minded, I know I am summarising). That presence can either be in the form of a UK managed subsidiary that accounts for the income or a permanent establishment which is the effective branch of an overseas company which does, nonetheless, manage the UK revenue. Without one of these two situations existing then unless the income falls into an exceptional category the fact that it arises in the UK does not make it taxable at present. The logic has always been that just because you sell into the UK this does not mean you are taxable in the UK. So an overseas company making exports to the UK did not get a taxable presence here as a result.

And that looks to be subject to change now. It would seem as though the UK is toying with the idea of a destination based corporation tax. This is an idea of Mike Devereux's at Oxford that was recently described to me by a senior tax partner in the Big Four accountants as 'bonkers'. The person in question knew precisely where the idea came from. I won't descend to such criticism. Let me offer some more constructive thoughts instead.

First, I think it safe to say that this issue arises because of the activities of companies like Google who have been abusing the UK by selling into it from Ireland whilst taking enormous steps to avoid being deemed to have a permanent establishment in the UK so they do not pay a proper tax rate here. But we already have a Diverted Profits Tax to supposedly deal with this situation. I think we can safely say that this hopeless pieced of legislation, that was introduced buy George Osborne without proper parliamentary scrutiny in the run up ti the 2015 election, will now be consigned to the bin: it always was a bizarre 90 odd pages of tax nonsense.

Second, let's not beat about the bush: this tears up large chunks of every international tax agreement the UK has, all of which, rightly or wrongly, are based on the idea of permanent establishment. How this is to be managed is hard to understand.

Third, such a policy carries enormous risks. It means every exporter from the UK faces the chance that they will in future be asked for tax abroad on that part of their profits arising in the UK at present but which can be attributed to their overseas sales. Unless we continue to assume that we will run trade deficits this may not appeal to UK business. And given that overseas tax rates are intended to be higher than UK rates this will significantly increase the tax bills of UK based business without in any way contributing a penny to the UK Treasury.

Fourth, it's hard to think how this will work unless the UK is thinking of using country-by-country reporting data for the purposes of tax assessment. Country-by-country reporting will now show for the largest companies alone what level of sales they generate in the UK, assuming that CBCR reporting for tax will always be delivered on a destination basis. Sales can also be recorded, of course, on a source basis i.e. where they come from. By definition the two can be very different. What seems possible is that sales by destination might be used by the UK as a basis for assessing the fair share of the economic activity of company that arises in the UK to then demand that an equivalent proprtion of its profits be taxed here. This is a form of unitary taxation, of course.

Fifth, the UK has always opposed unitary taxation. It is doing so right now in the EU, where a sales formula is included in the Common Consolidated Corporate Tax Base, which is precisely designed as a way of tackling the abuse the UK is now worried about. But, and this is where the reference to bonkers comes in, at least the CCCTB recognises the economic reality that profit is not wholly attributable to the location where a customer is located. It also attributes profit to the location of labour and where assets are located because of course labour and production also must have profit attributed to them. Devereux's scheme ignores this and utterly fails to reflect any known economic reality by assuming profit can only arise in the place where a customer is located, which is bizarre.

In summary, this announcement means that the UK is flirting with unitary taxation, is flirting with making country-by-country reporting data a basis for taxation, is threatening to tear up all known tax convention, and is thinking of moving corporate tax onto a wholly arbitrary basis that does not reflect economic reality and which will impose heavy costly on UK business. I support proper unitary taxation, with the caveat that the accounting has to be good enough to support it (which it is not at present). But to propose a change to such an absurd tax base is really quite incredible. I suspect I will not be the only one to say so.

NB: It has already been put to me that I have got over excited here and that this just relates to the exceptional sources of income of non-resident companies now subject to income tax so that they get the benefit of new UK corporate tax rates. On re-reading I accept that is plausible and that my commentary may be an over active imagination before breakfast. If so, this is a false alarm but I leave it just in case the counter suggestion is wrong. The commentary on Devereux's proposal remains relevant come what may.