The home for business?

Assessing the competitiveness of the UK

March 2016

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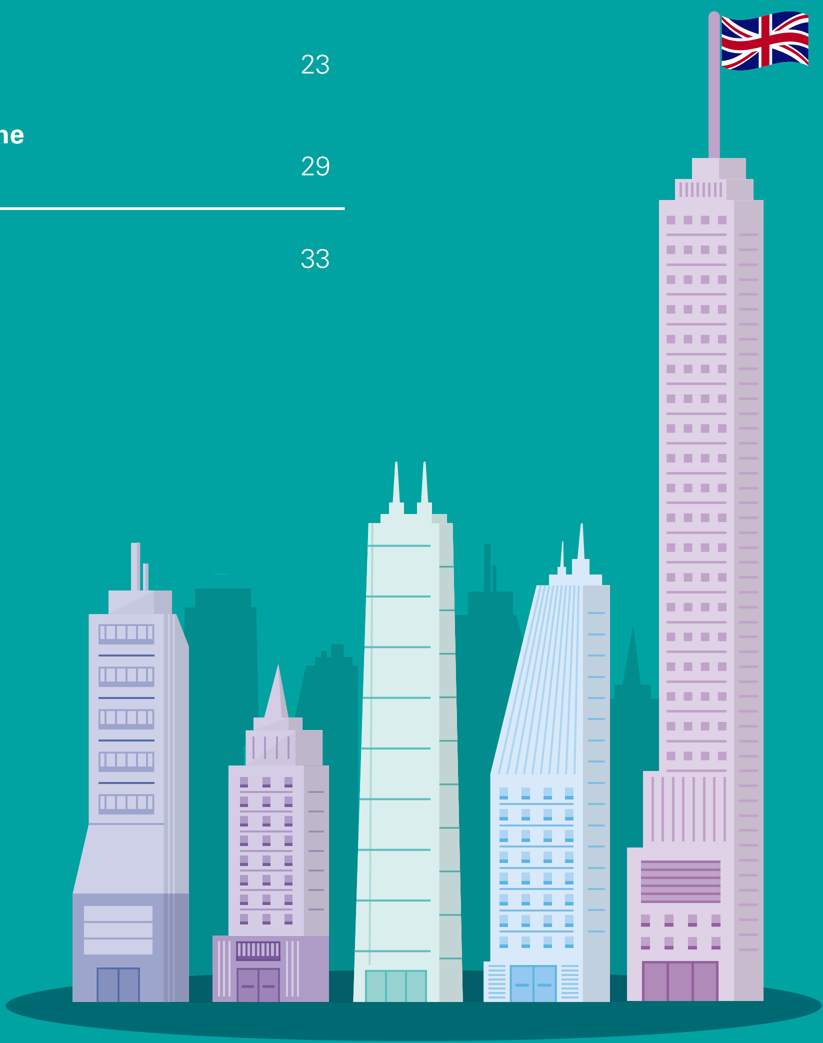
Contents



Executive Summary

It is ten years since KPMG first examined the competitiveness of the UK tax regime versus its international peers from the perspective of the UK's largest companies. When this study was first published in 2006, the attractiveness of the UK's tax regime was in question. A number of high-profile companies had announced plans to relocate their business activities out of the UK, risking jobs, capital investment and tax revenues. KPMG's investigation into some of the reasons behind these departures made it clear that the UK's tax policies were often viewed as less stable, more complex and less competitive than those of other major tax regimes.

In the annual studies completed by KPMG over the following decade, we charted major improvement in the UK's tax competitiveness and identified the benefits this brings to the UK economy. Our research shows that according to the UK companies, perception of a country's tax competitiveness depends more on the regime's stability, advanced warning of major changes and simplicity than specifically on headline tax rates.

As well as a beneficial package of tax policies, the findings show that the availability of a strong workforce, the UK's competitiveness and market opportunity also promote the UK economy versus its international peers. This year's study also reveals that, a number of companies (both UK and non-UK) have expressed that the UK's access to the EU single market is a core strength which encourages them to invest further in the UK.

In this year's study, Ireland retains its place as the most attractive tax regime in 2015 compared to other European countries generally held to have business-friendly tax systems, but the UK has closed the gap considerably this year and is now seen as much more competitive than its European peers generally viewed as having attractive tax regimes. From 2012 to 2015, the number of companies looking to relocate activities out of the UK has fallen sharply and the UK has shown a renewed ability to attract and retain some of the world's most valuable companies. The UK's economy appears to have benefited as a result of a more competitive tax regime.

According to the UK companies surveyed, perception of a country's tax competitiveness depends more on the regime's stability, advanced warning of major changes and simplicity than on headline tax rates.

This year for the first time, we also considered the UK's ability to attract foreign direct investment (FDI) versus its international peers from a tax perspective. These insights reinforce the positive FDI results that have emerged over the last 12 months, which include large increases both in the value and total volume of FDI projects in the UK[1]. We also uncover the broader impact of a stronger, more stable and more competitive UK tax regime on major companies, both in the UK and internationally. To this end, KPMG spoke with more than 100 UK organisations and foreign-owned subsidiaries in the UK, in addition to 65 major businesses from across India, China, Japan, Australia, Canada and the USA.

Over the past few years, efforts have been made to strengthen the UK's position on the world stage as an attractive destination for businesses. In tandem, the UK Government has clearly set out its expectations that businesses make a positive contribution to the UK economy and society. One major expectation of the UK is that companies adopt a transparent and responsible approach to their business activities and tax planning. This year's study reveals that UK companies robustly support this new drive. It also appears that the majority embrace the OECD's Base Erosion and Profit Shifting (BEPS) initiative. Overall, there is an acknowledgement that business should act responsibly when it comes to tax.

Our analysis demonstrates the clear benefits of a rejuvenated, stable and competitive tax regime, which strengthens the UK's economy. Moreover, greater retention of business functions, coupled with increased investment and hiring activity, will support the growth of the UK economy in 2016. But there is more that the UK Government could do to build upon these strengths and encourage further inbound FDI.

Our analysis shows that the Government should renew its commitment to a stable political and tax regime, and ensure that the UK's broader strengths in education, workforce and infrastructure continue to reinforce UK's competitive position. This should in turn result in increasing the attractiveness of the UK for inbound FDI.

Source: (1) https://www.gov.uk/government/publications/ukti-inward-investment-report-2014-to-2015/ukti-inward-investment-report-2014-to-2015-online-viewing

01

Greater stability and increasing competitiveness of the UK tax regime is yielding results

The UK strengthens its position versus international peers for tax competitiveness

Each year since 2007, we have asked major UK companies and foreign-owned subsidiaries to select from a list of European tax regimes generally held to be attractive to businesses, the three tax regimes they believe to be the most attractive — with the option to select any other tax regimes not listed.

Between 2007 and 2011, few major UK companies viewed the UK as having a 'top three' competitive tax regime. These perceptions improved dramatically in 2012–2014 as companies began to benefit from tax policy measures such as the Patent Box, the revised Controlled Foreign Company (CFC) regime and the reduction in the headline rate of corporate tax. In 2015, 70% of UK respondents selected the UK as one of their 'top three' most competitive tax regimes, which is broadly similar to the figures recorded between 2012 and 2014. This year, as in 2014, Ireland leads the rankings, with 71% of respondents choosing Ireland as one of their 'top three' tax regimes.

Figure 1: Countries with the most competitive tax regimes 2009-2015 (overall mention in top three)

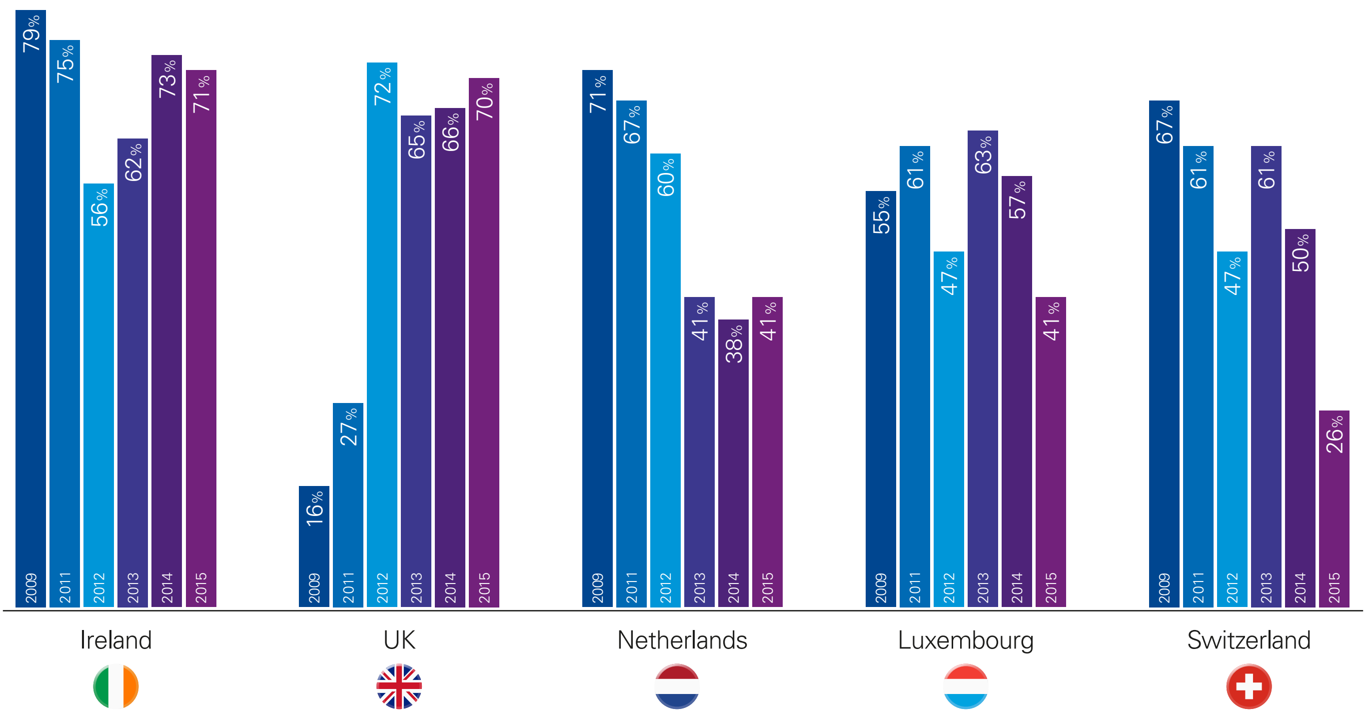


Figure 1: Overall, which of the following countries do you think has the most competitive tax regime... and which do you think has the second most competitive tax regime... and which do you think has the third most competitive tax regime? ANY MENTION

Base size: All UK companies and Foreign-owned Subsidiaries (102). Respondents had the option to name other countries that were not on the list.

Table 1: Countries with the most competitive tax regimes 2014–2015 (most competitive regimes in green)

	2014	2015		
	UK companies & Foreign-Owned Subsidiaries	**UK companies & Foreign-Owned Subsidiaries**	**Rest of World companies**	**Total** (UK & Rest of World companies, Foreign-Owned subsidiaries)
UK	66%	70%	**53%**	**64%**
Ireland	**73%**	**71%**	41%	60%
Luxembourg	57%	41%	**53%**	46%
Netherlands	50%	41%	31%	38%
Switzerland	38%	26%	29%	28%
USA	3%	4%	19%	9%
Germany	1%	0%	7%	3%
France	0%	0%	5%	2%

Table 1: Overall, which of the following countries do you think has the most competitive tax regime... and which do you think has the second most competitive tax regime... and which do you think has the third most competitive tax regime? ANY MENTION

Base size: 2014 (104); 2015 UK Companies & Foreign-Owned Subsidiaries (102); 2015 Rest of World (65). Respondents had the option to name other countries that were not on the list.

For the first time this year, we also asked non-UK companies in six countries (India, China, Japan, Australia, Canada and the USA) to select their 'top three' most competitive tax regimes. The majority of respondents (53%) included the UK in their 'top three' tax regimes, placing the UK alongside Luxembourg as the most popular tax regime for non-UK companies.

But what attributes make a tax regime attractive to companies? Each year, long-term stability has been a key factor and in 2015, this is the most frequently mentioned consideration for respondents. 'Advance warning of major changes' has also become increasingly important over the last 5 years and is the second most common factor mentioned this year. 'Simplicity' follows closely in third place.

Before 2013, a 'low effective tax rate' was consistently one of the two most important considerations for companies. However, UK businesses now place much less importance on effective tax rates and instead focus more keenly on the simplicity, stability and predictability of a tax regime.

UK businesses now focus more keenly on the simplicity, stability and predictability of a tax regime

Over the past five years, the introduction of a package of tax reforms appears to have rejuvenated perceptions of the UK's competitiveness and has arguably supported economic growth. When we asked non-UK companies what single factor they thought had contributed most to the UK's economic recovery, one in five mentioned the UK's favourable tax policies, the other factor more popular being 'low interest rates', which have been fixed at 0.5% since 2009.

Figure 2: Factors that influence the perceived benefits of a country's tax regime (% UK companies)

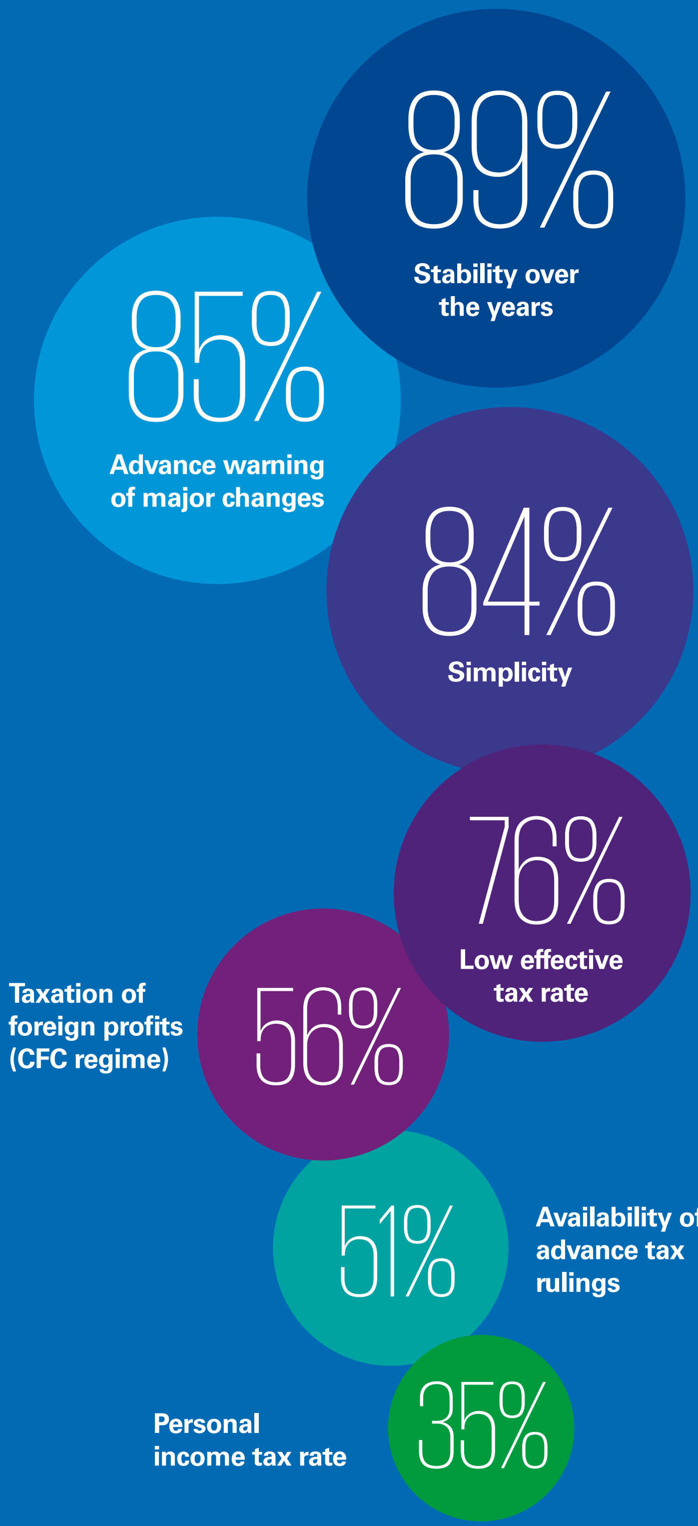


Figure 2: I am going to read out a list of factors that may be important when assessing the benefits of a particular country's tax system. Which of the following factors are important to your company?

Base size: all UK Companies and Foreign-Owned Subsidiaries (102)

The UK is widely viewed as an attractive destination for Foreign Direct Investment from a tax perspective

We asked respondents to identify the main factors that determine the attractiveness of a country for inbound FDI. 'Market size', 'political stability' and 'availability and cost of skilled labour' make up the three most important factors, with 'macro-economic stability' a close fourth.

From an investment perspective for the UK, businesses see political and macro-economic stability as particularly appealing features as shown in Figure 3 below. However, respondents give mixed responses on the availability and cost of skilled labour in the UK: while 42% of companies see this as one of the UK's major strengths, a similar proportion (35%) of companies view this as a weakness.

Figure 3: Strengths and weaknesses of the UK versus international competitors — % respondents

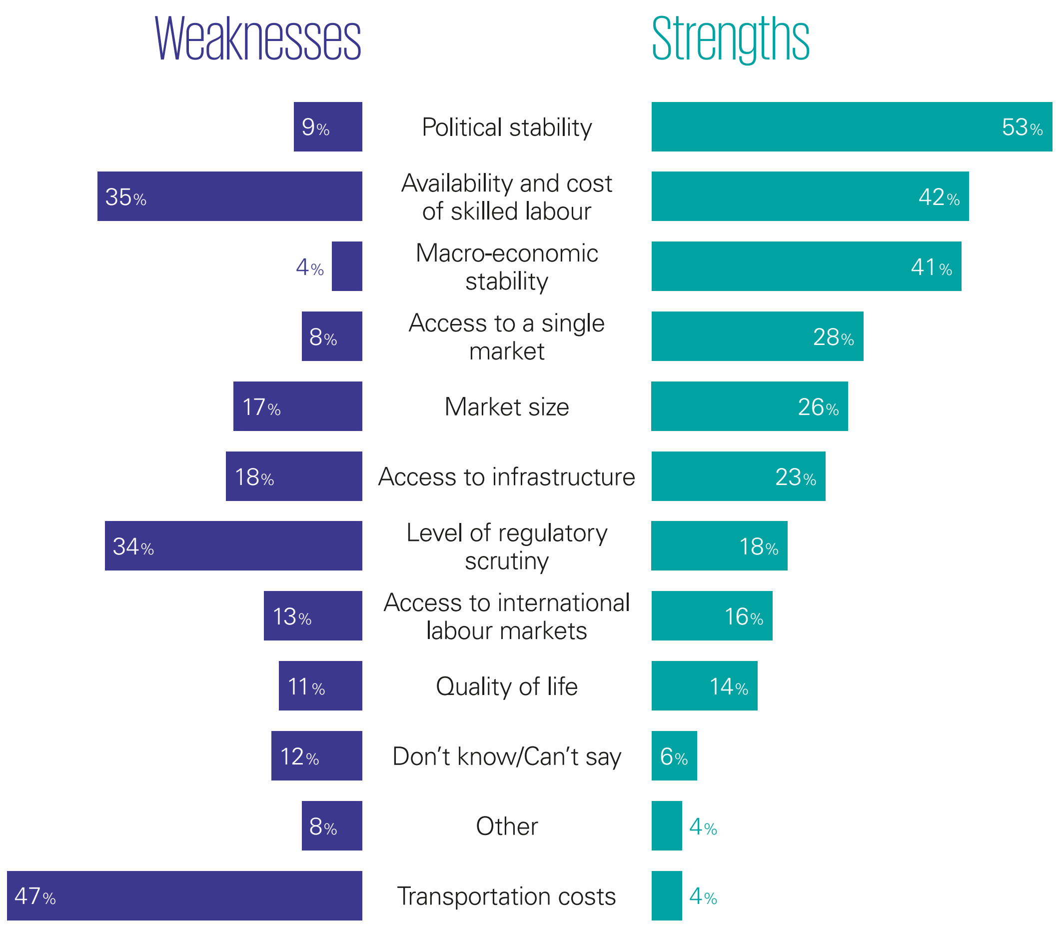


Figure 3: Which three of these factors do you see as particular strengths/weaknesses of the UK versus its international competitors?
Base size: all respondents (167)

A competitive tax regime is by no means the only factor which attracts businesses and foreign direct investment (FDI) into the UK. This year for the first time, we asked companies about their attitudes to FDI and their future plans for investment into the UK to explore this issue further.

Respondents were first asked to select from a list, the country they believe is the most attractive destination for FDI from a tax perspective, with the option to also select any country that was not listed. Overall, UK Companies and Foreign-owned Subsidiaries selected the UK as the most attractive destination for FDI. For non-UK companies, Luxembourg is seen as the most attractive FDI destination, with the UK in second place (Table 2). This sentiment among both UK and international companies would indicate that the UK is well-positioned to sustain its position as the principal destination for FDI in Europe[2].

Both UK and non-UK companies in our survey mention access to the EU single market as a core strength of the UK which attracts inbound FDI.

The research was conducted in the autumn of 2015, which was before the EU Referendum date was announced. Given that the referendum is to be held on 23 June 2016, there will no doubt be further and more detailed analysis on the significance of access to the single EU market in terms of attracting inbound investment.

Table 2: The UK leads as most attractive destination for FDI from a tax perspective — % respondents (rank)

	Overall (rank)		UK companies & Foreign-Owned Subsidiaries		Non-UK companies	
UK	26%	(1)	31%	(1)	16%	(2)
Ireland	21%	(2)	28%	(2)	7%	(6)
Luxembourg	13%	(3)	9%	(3)	21%	(1)
Switzerland	7%	(4)	6%	(4)	9%	(4=)
Netherlands	7%	(5)	6%	(5)	9%	(4=)
USA	6%	(6)	3%	(6)	12%	(3)
Germany	2%	(7)	1%	(7)	3%	(7)

Table 2: And which one of these countries do you think is the most attractive as a destination for Foreign Direct Investment from a tax perspective?
Base size: all respondents (167). Respondents had the option to name other countries that were not on the list.

Source: (2) https://www.gov.uk/government/publications/ukti-inward-investment-report-2014-to-2015/ukti-inward-investment-report-2014-to-2015-online-viewing

02

A competitive tax regime and long-term stability are securing investment in the UK

Our research has shown that many organisations, both in the UK and internationally, regard the UK as an attractive destination for FDI from a tax perspective and consider its tax regime to be competitive versus its international peers. But what impact does this sentiment have on decisions to invest in the UK?

The competitiveness of a country's tax regime has always been an important factor for the companies surveyed in deciding whether to invest into the country. This year, three-quarters of companies indicate that their decisions on where to locate business activities are shaped by the appeal of a country's tax regime, and this figure rises to 85% for non-UK companies.

Figure 4: The influence of tax attractiveness on decision of where to locate business activities (% respondents)

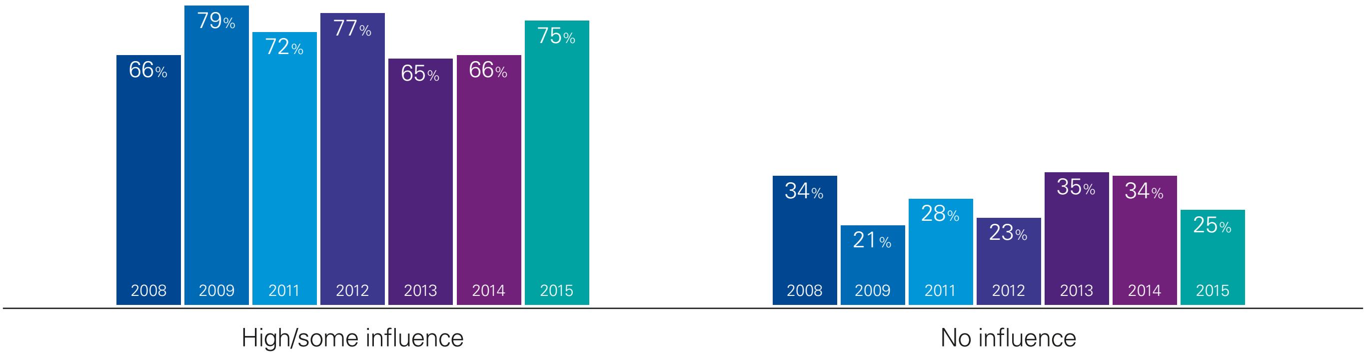


Figure 4: To what extent does the attractiveness of a country's tax regime have an influence on where your company locates its activities? Does it have a...?

Base size: all respondents (167)

Three-quarters of companies indicate that their decisions on where to locate business activities are shaped by the appeal of a country's tax regime

These figures would suggest that improvements in the competitiveness of the UK tax regime should contribute towards greater retention of businesses — and greater willingness to invest — in the UK. This year, there has been a profound reduction in the number of UK companies and foreign-owned subsidiaries looking to move business functions out of the UK.

In particular, the number of companies who have considered relocating their tax residence out of the UK this year has fallen by almost a half. Other strong improvements in retention include finance/treasury activities and group service company functions (Figure 5)

Companies who have considered relocating their tax residence out of the UK

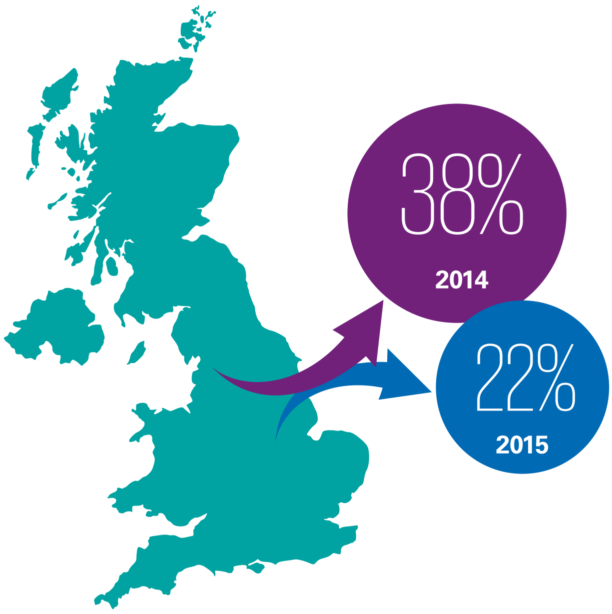


Figure 5: Percentage of companies looking to move business functions out of the UK

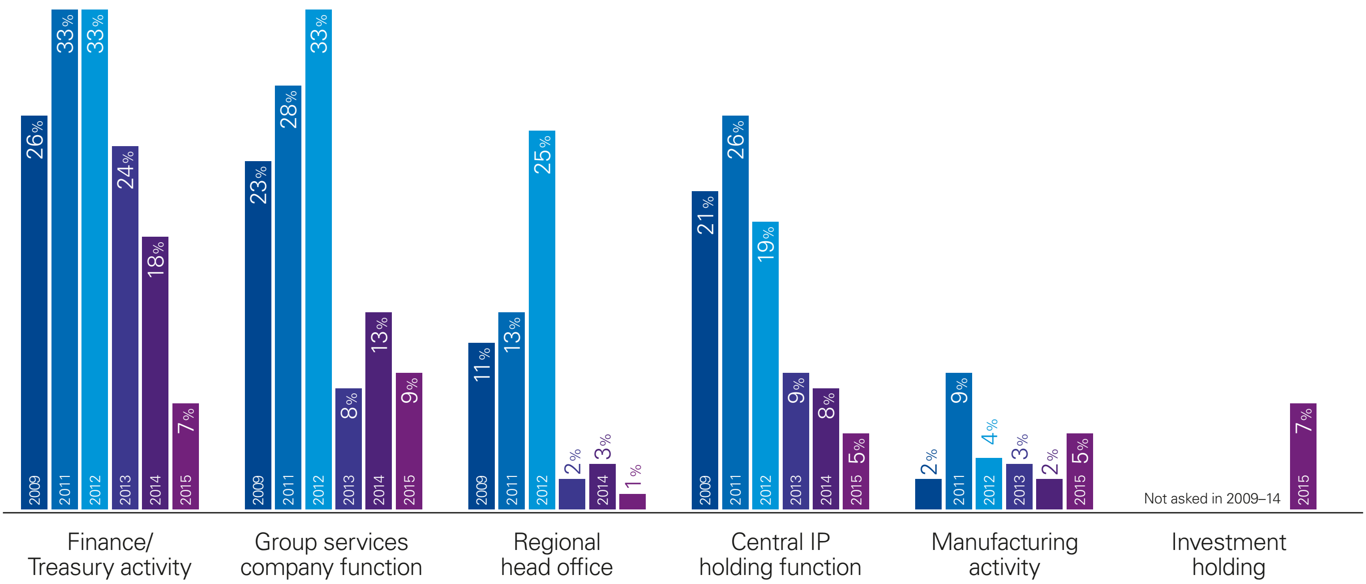


Figure 5: Summary table. Are you considering relocating any of these activities out of the UK for reasons which include tax? MULTICODE 2015
Base size: UK Companies & Foreign-Owned Subsidiaries (102)

The evident attraction of the UK as a destination for inbound FDI is further supported by the considerable proportion of companies that are currently studying the option of relocating their business functions into the UK. Almost one in five non-UK companies are looking to move their investment holding function into the UK, and a further 10% have considered bringing their regional head office to the UK.

Moreover, 12% of all companies have also considered relocating their IP function into the UK. In the case of UK companies and foreign-owned subsidiaries, 13% of these companies have considered relocating their IP function into the UK. This figure includes companies who do not currently have their IP function located in the UK.

Notwithstanding the above, we also note that some UK companies are looking to move their manufacturing activities in particular out of the UK (5% are looking to move manufacturing activities out of the UK and 1% looking to move these activities into the UK). This is also the same trend for group service company functions with 9% of UK companies looking to move these activities out of the UK and 8% looking to move into the UK.

Figure 6: Companies looking to move business activities into the UK — % respondents

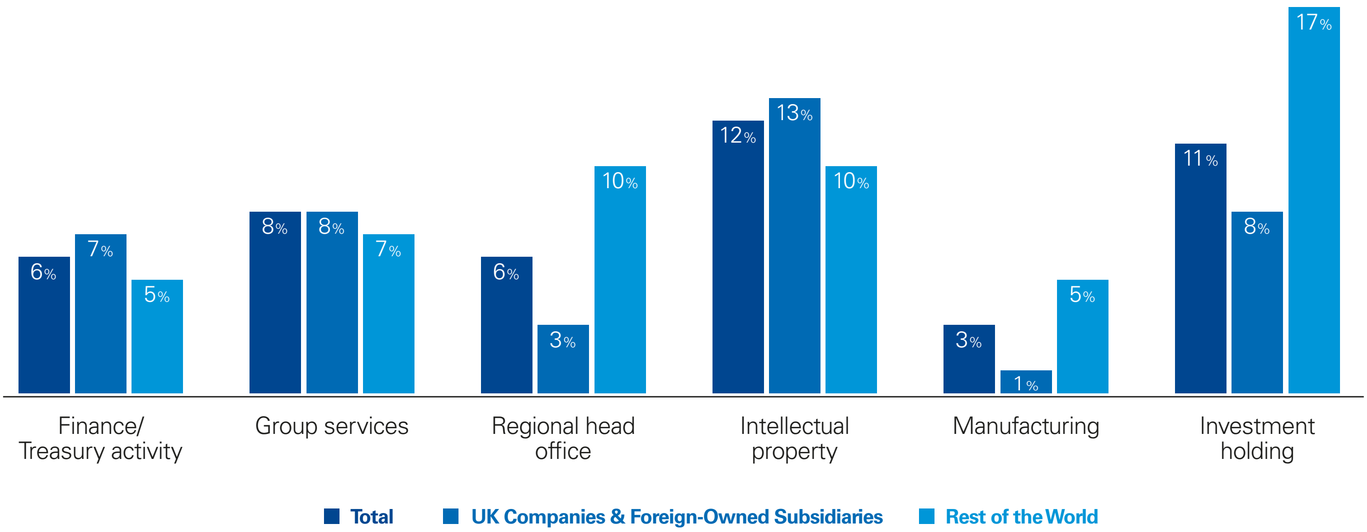


Figure 6: Are you considering relocating any of these activities into the UK for reasons which include tax?
Base size: All respondents (167)

While headline tax rates are by no means the main factor influencing the attractiveness of a country as a destination for business, the planned reductions to the rate of UK Corporate Tax are the most welcomed of all upcoming policy changes we discussed with businesses. The organisations that took part in this year's study are in little doubt that a reduction in corporate tax to 18% will likely generate significant investment in the UK. Not all respondents could estimate exactly what investments their companies may make as a result of this reduction.

However, those respondents that could make such an estimate, believe that reducing corporate tax to 18% would, on average, increase their:

i. capital expenditure by 18%,

ii. research and development spend by 12%, and

iii. headcount by 7%.

It is clear that perceptions of the UK's tax regime have transformed over the last decade. The package of tax policies introduced over the past five years has resonated with companies and has also elevated the UK's tax regime to a position where it credibly competes with the regimes of other major international economies. This new strength and stability should bolster the UK's ability to both retain business functions and attract international companies to relocate into the UK.

Figure 7: The likely impact on investment activity of reducing the headline rate of corporate tax

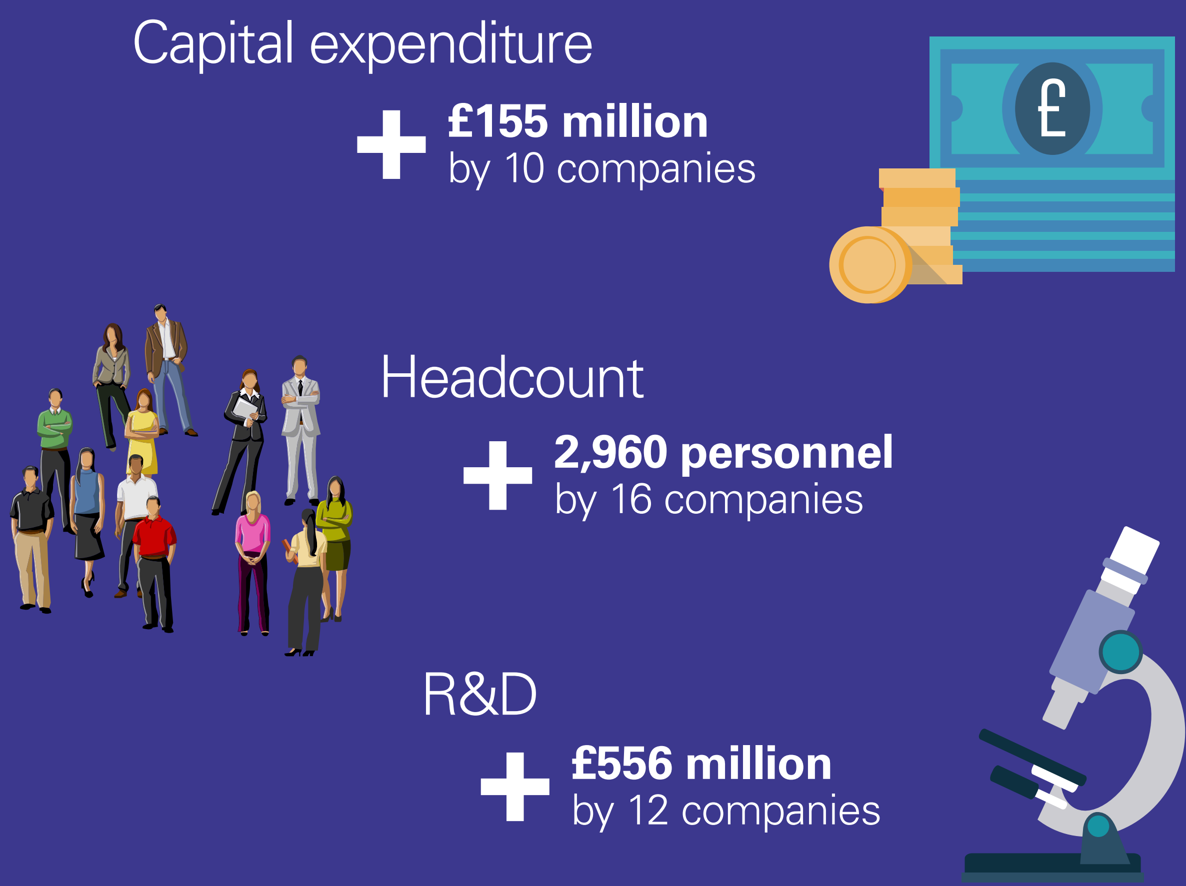


Figure 7: The rate of Corporation Tax in the UK has been reduced to 20%. Further reductions to 19% in 2017 and 18% in 2020 are planned. How are these reductions likely to affect your business? Base size: All UK Companies and Foreign-owned Subsidiaries (102)

03

Tax transparency now central to business in the UK

Over the past few years, tax transparency and responsible tax behaviours have become central themes in both political and public tax debates. This year's study clearly shows that the transparency agenda in the UK has gained considerable traction. Research shows that companies are changing the way they manage tax in the long term and are also responding to greater calls for tax transparency in a responsible and constructive way.

This year, almost half of UK companies and foreign-owned subsidiaries believe they are sufficiently transparent in the way they report their tax affairs — a significant improvement versus 2014 (37%). More than one-third of UK companies have increased their tax transparency over the last 12 months, and 46% believe they will become more transparent in future. This follows a dual trend we have seen as the transparency debate has become increasingly prominent: that many UK companies are engaging with the tax transparency debate and are actively working on improving the transparency of their tax reporting as a result.

Figure 8: Changes to tax transparency over the last 12 months — % respondents

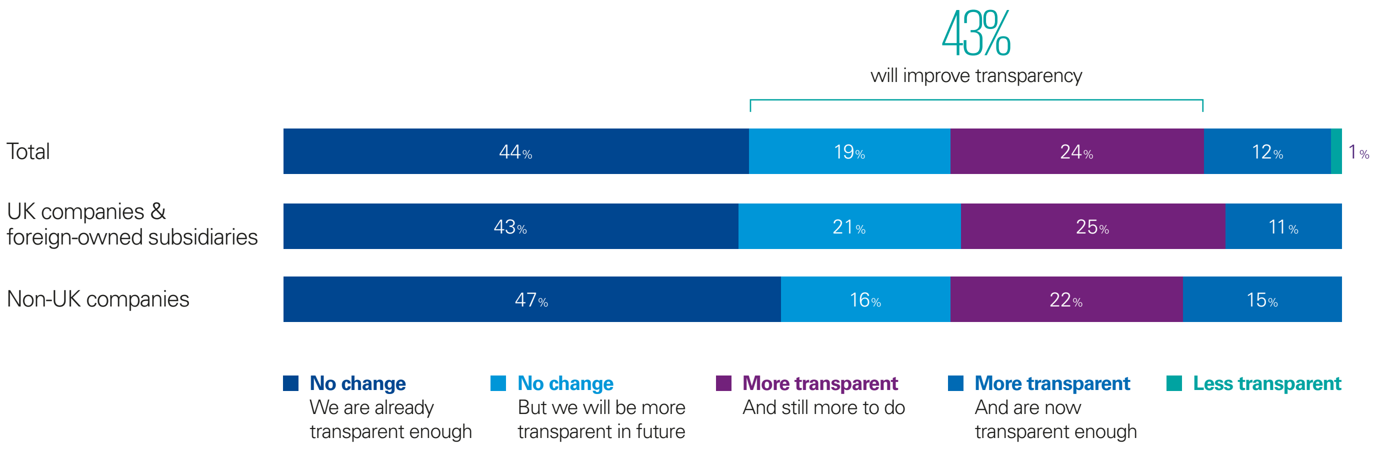


Figure 8: In light of the tone of the media and political debate concerning tax in 2015, have you become more/less transparent in how you report your tax affairs in the last 12 months?

Base size: All respondents (167)

The transparency agenda in the UK has gained considerable traction

Compared to 2014, there is also far stronger agreement this year that responsible businesses need to act in the interests of the common good. Reinforcing this trend, twice as many companies agree that responsible business needs responsible tax behaviours and advice versus 2014. In addition, looking to the 2015 BEPS workstreams, almost three-quarters of companies support the initiative to promote disclosure of aggressive tax planning arrangements to tax authorities.

Figure 9(a): Agreement that responsible business needs to act in the interests of the common good — % respondents

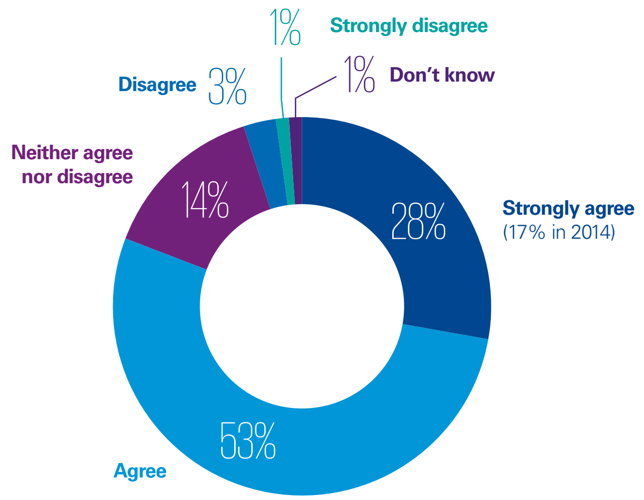


Figure 9(b): Agreement that responsible business needs responsible tax behaviours and advice — % respondents

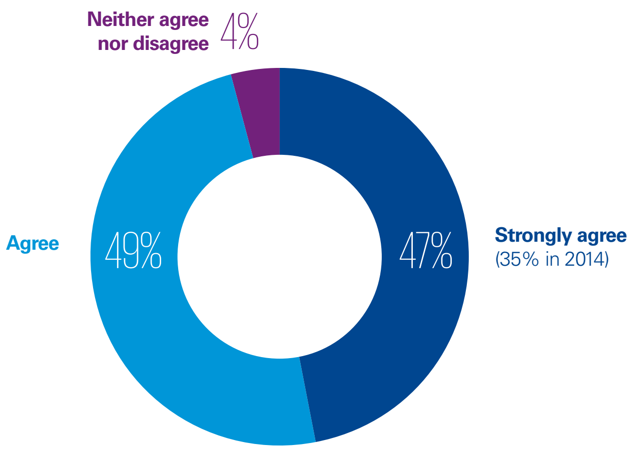


Figure 9: (a) Looking at the role of business in society, can you indicate to what extent you agree or disagree with the statement: 'Responsible business needs to act in the interests of the common good'?

(b) And linking that to tax, can you indicate to what extent you agree or disagree with the statement: 'Responsible business needs responsible tax behaviours and advice'?

Base size: All UK Companies and Foreign-Owned Subsidiaries (102).

Companies remain supportive of increased tax transparency and disclosure of aggressive tax planning. This is also evident from our survey as 53% of companies agree that certain changes should be made and don't oppose the OECD country by country reporting template, which is not currently intended to be publicly disclosed. However, there is still some uncertainty over recent developments promoting mandatory public disclosure.

More than two-thirds of companies believe that tax data should only be reported to tax authorities as intended under the BEPS country by country reporting workstream. Whilst half of all businesses are in favour of public reporting, they consider this should be on a voluntary basis with only a third supporting mandatory public reporting.

Figure 10: Support of country-by-country reporting — % respondents

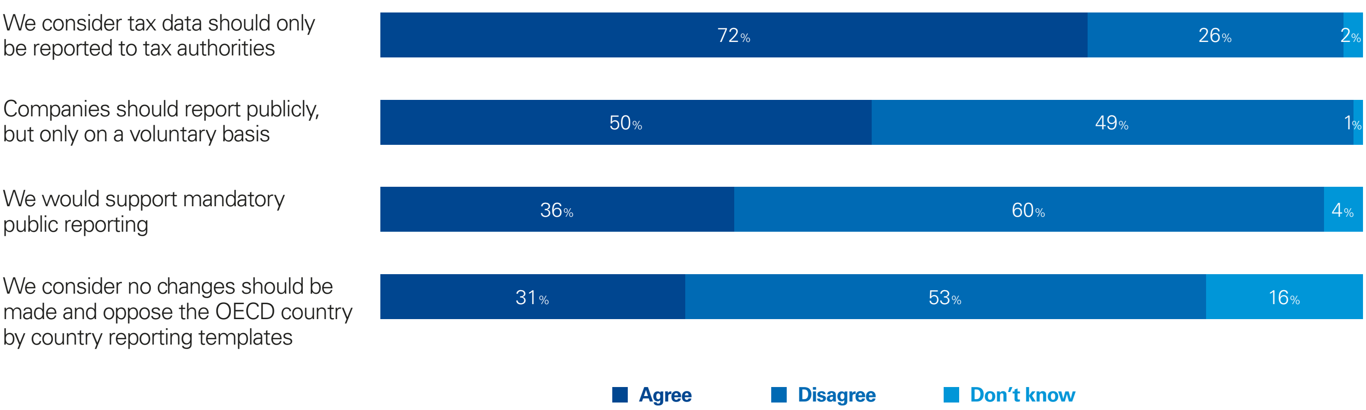


Figure 10: As regards the reporting of tax data on a country-by-country basis, which of these statements do you agree or disagree with?
Base size: All respondents (167)

70% of companies believe that GAAR is effective at reducing highly aggressive tax planning in the UK

Policies to reduce aggressive tax planning appear to be working. 70% of companies believe that the general anti-abuse rule (GAAR) is effective at reducing highly aggressive tax planning in the UK, suggesting it is thus achieving its goal as a deterrent to such behaviour. Additionally, a new policy to impose a penalty of 60% of tax due for cases failing the GAAR (announced in the 2015 Autumn Statement) resonates with over 60% of companies, who believe that such a penalty would increase the GAAR's effectiveness.

Figure 11: Effectiveness of the GAAR at reducing highly aggressive tax planning in the UK — % UK respondents

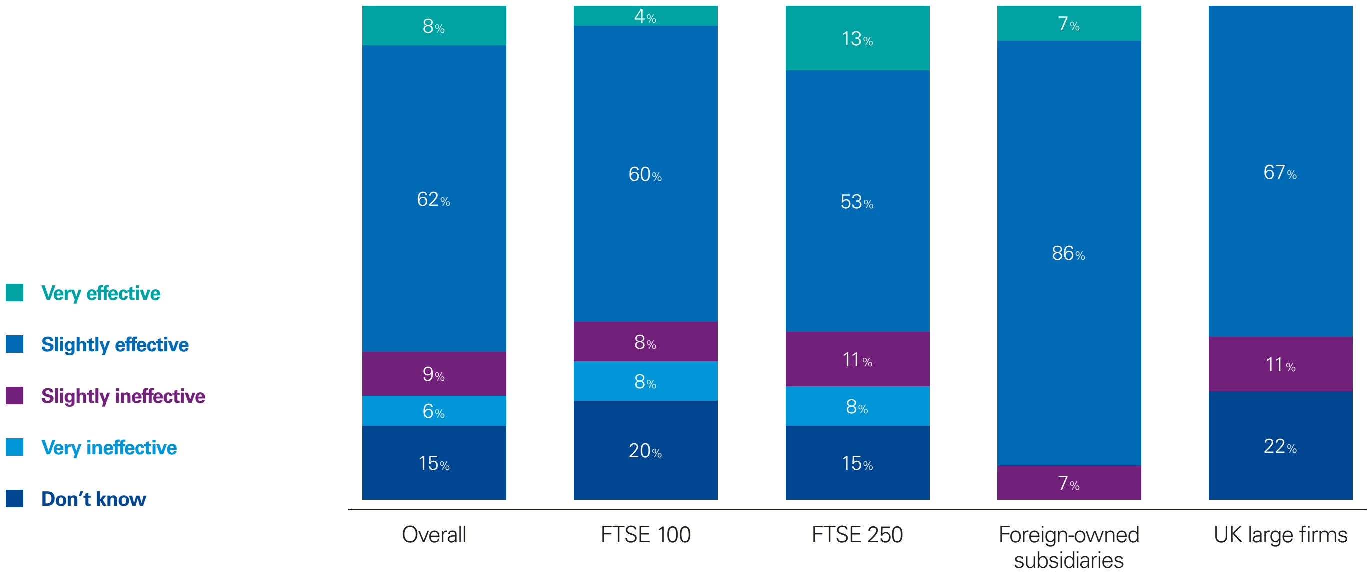


Figure 11: How effective do you think the GAAR has been at reducing highly aggressive tax planning in the UK? (N.B. responses were given before the 2015 Autumn Statement, which confirmed the introduction of a tax-geared penalty for failing the GAAR.)

Base size: UK Companies and Foreign-owned Subsidiaries (102)

04

Broad support for the OECD's Base Erosion and Profit Shifting (BEPS) initiative

2015 saw the OECD's project on base erosion and profit shifting release its final recommendations for governments to consider and implement.

The UK Government has expressed its position as a strong supporter of the BEPS initiative and they will look to implement the recommendations of the OECD on each action plan as much as practically possible.

While overall support of the companies for BEPS remains high this year, concerns around the BEPS interest deductibility and permanent establishment action items highlight the need for governments to continue engaging with and supporting companies as tax transparency — and its implementation into formal tax policy — continues to evolve.

These companies expect that the Action 4 workstream (*Limiting Base Erosion Involving Interest Deductions and Other Financial Payments)* will increase taxation and thus limit their capacity to invest. It is also a concern that the Action 7 workstream (*Preventing the Artificial Avoidance of Permanent Establishment Status*) may produce additional Permanent Establishments for many international companies, increasing both the tax filing obligations and the resulting administrative burden.

The UK Government published a wide ranging consultation document on 22 October 2015 seeking views on the OECD proposals and recommendations on Action 4. The consultation period concluded on 14 January 2016 and the outcome of this process has not yet been published. It is expected that more details as to how the OECD recommendations will be implemented in the UK will be provided following the UK Government budget on 16 March 2016.

The Action 7 proposals are expected to be included in the Multilateral Instrument being developed under the Action 15 workstream (*A Mandate for the Development of a Multilateral Instrument on Tax treaty Measures to Tackle BEPS*), and the precise details as to how this will take place are not yet known.

Figure 12: Support for the 2015 BEPS workstreams

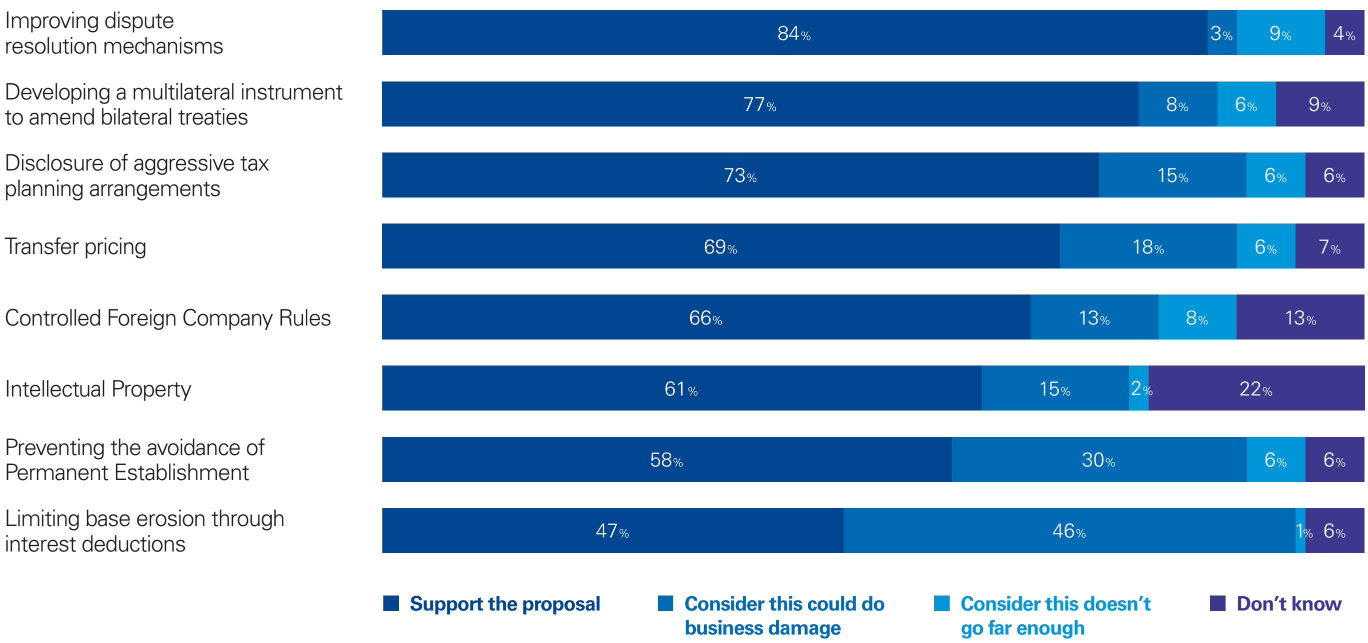


Figure 12: Please state from the following options how you feel about each of the 2015 workstreams.

Base size: Respondents who support/do not support/are neutral about the aims of BEPS (143)

We asked how companies plan to manage the changes brought about by the BEPS workstreams. Just over one in four (27%) are planning to expand their in-house tax team, while two-thirds are planning to engage external advisors to provide greater support around BEPS and its implications for their business.

To summarise, in keeping with the UK Government's commitment to maintaining competitiveness in the UK, it is hoped that the recommendations of the OECD will be implemented in the UK in a manner that is competitive when compared to other countries.

Figure 13: Impact of BEPS workstreams on how companies manage tax matters — % respondents

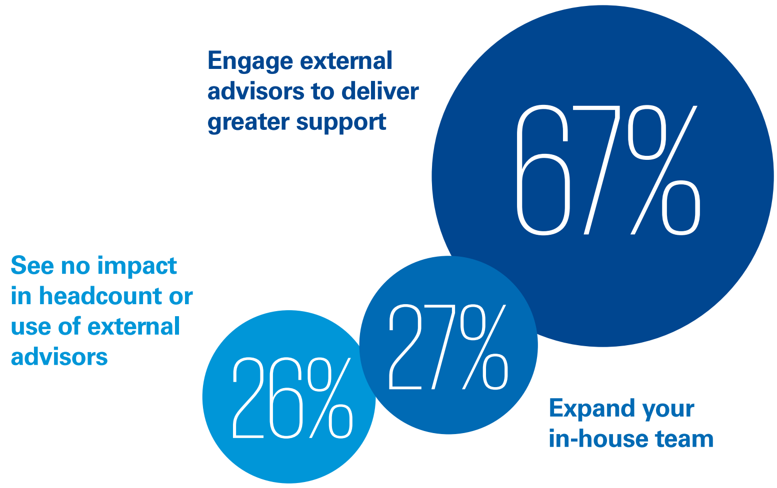
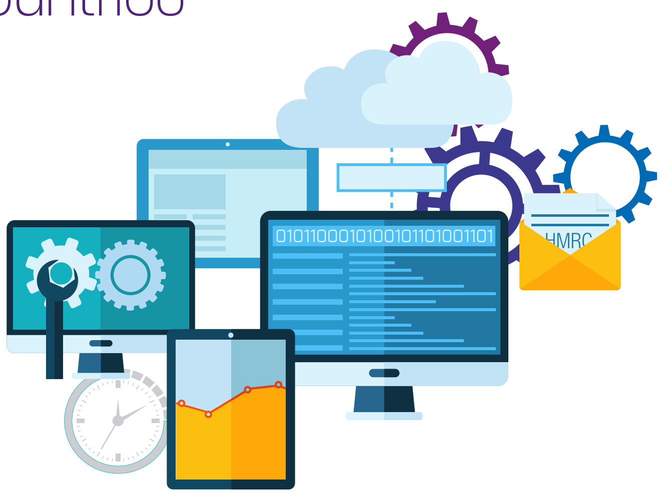


Figure 13: Looking to the next 12 months, what impact will the BEPS workstreams, and country-by-country reporting in particular, have on how your team manages tax matters? Multi Code

Base size: Respondents who support/do not support/are neutral about aims of BEPS (143)

It is hoped that the recommendations of the OECD will be implemented in the UK in a manner that is competitive when compared to other countries



05

Supporting further growth in the UK: Actions for the Government to consider

Opportunity to encourage FDI in the UK

Despite the encouraging messages around FDI into the UK revealed by this study, businesses believe that there is still an opportunity to strengthen the UK's ability to attract further inbound FDI.

When we asked companies explicitly how the UK could increase FDI into the UK, three main priorities were recommended. Generally, for all types of companies surveyed, promoting existing — or establishing new — enterprise zones which offer preferential tax rates, simplified planning rules and other financial benefits was chosen as a key priority. However, for more than one-third of UK companies, clarity on any future tax changes clearly stood out as the most critical priority which is not surprising given the ongoing discussions surrounding how the OECD's BEPS proposals are to be implemented by the UK. The third top priority — which is especially popular amongst non-UK companies — is expanding or simplifying the substantial shareholdings exemption (the UK's participation exemption for capital gains).

Figure 14: Priorities to encourage further FDI over the next 12 months

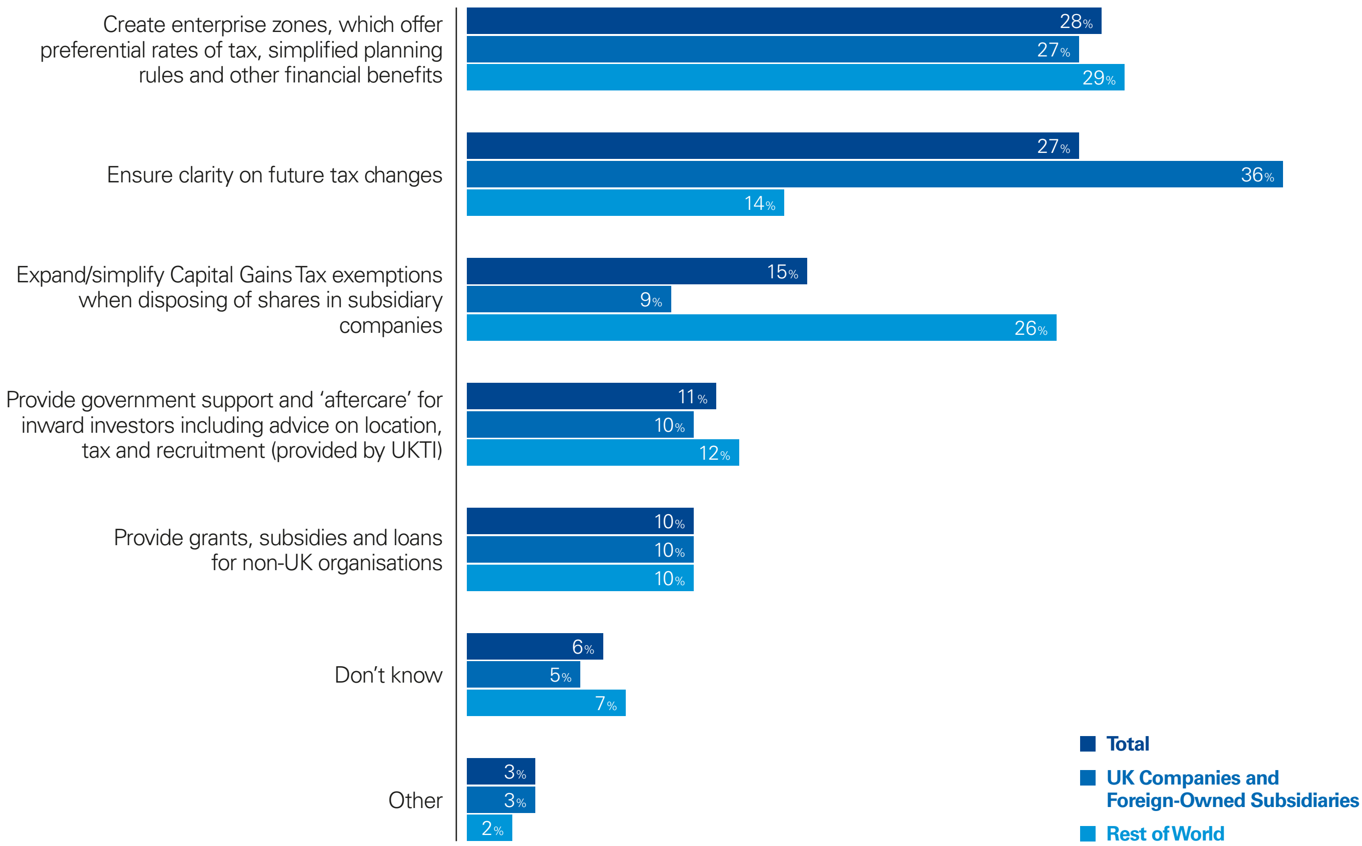


Figure 14: What single measure should the UK Government prioritise to increase Foreign Direct Investment into the UK over the next 12 months?
Base size: All respondents (167)

Ensure clarity on future tax changes

The OECD BEPS initiative has made a number of recommendations to promote a more transparent and responsible approach to business activities and tax planning. As discussed in section 4 of this report 'Broad support for the BEPS initiative', many of these companies expect that Action 4, base erosion through interest deductions, will increase taxation and limit capacity to invest. This has resulted in much uncertainty which is key to continued FDI into the UK, in particular, into the infrastructure sector due to the well-established market practice of naturally higher levels of 3rd party (and shareholder) debt being used for investments. KPMG considers there to be a real risk that, without considerable thought and care being given to the scope and implementation of Action 4, inbound FDI into the UK's infrastructure sector will be significantly impacted as foreign investors (with a finite amount of capital available to deploy) compare how these proposals are implemented in the UK versus its international peers (in the rest of Europe, North America and Australia) and how projected returns then compare. Therefore, if the UK is to achieve its wider aims of attracting institutional investment into new and existing infrastructure (such as outlined in the UK's National Infrastructure Plan) it is critical that the implementation of Action 4 addresses the OECD's concerns without putting at risk the increased value and total volume of FDI projects in the UK which has been seen over the last 12 months.

Encourage investment through reliefs for buildings and structures

In 2015, closely following the sentiment recorded in 2013 and 2014, most businesses surveyed are concerned about the continuing lack of tax reliefs for investment in buildings and structures which were completely withdrawn in the UK from 1 April 2011. The benefits of re-introducing such tax reliefs, in particular, for the infrastructure sector, are clear: almost all companies believe that tax reliefs on building and structures would incentivise investment — a sentiment which has become increasingly entrenched over the last three years.

Moreover, almost 70% of companies believe that the absence of these reliefs damages the UK's competitiveness versus its international peers (such as France, Germany and Italy where such reliefs continue to be available). For the infrastructure sector, such reliefs have a material impact on the cash tax rate of investments (due to the significant capital expenditure involved) which is much higher in the UK (close to 40%–50% despite a headline corporate tax rate of 20%) compared to some of its European peers. Looking to the future, we asked respondents what single action the UK Government should take to drive growth in 2016. In response, a relative majority of companies chose incentives that would encourage investment in buildings and structures.

Figure 15(a): Would tax relief encourage investment in buildings and structures in the UK?

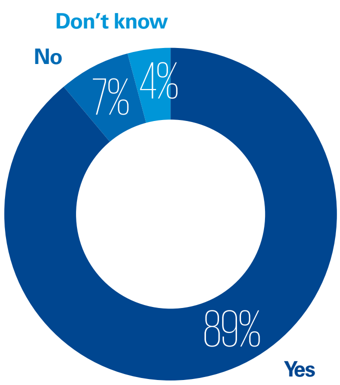


Figure 15(b): Does the lack of such relief damage UK competitiveness? — % respondents

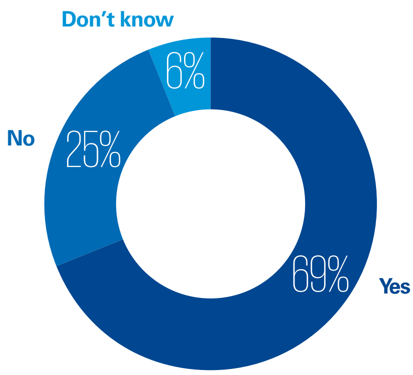


Figure 15: a) Would tax relief for investment in buildings and structures incentivise the making of such investments in the UK?

b) Does the lack of tax relief for investment in buildings and structures damage UK Tax competitiveness or the UK's attractiveness as a destination for investment?

Base size: All respondents (167)

Consider strengthening the Patent Box replacement

In response to the OECD's Action 5 — Countering Harmful Tax Practices report — the current UK Patent Box incentive will be replaced by a new nexus-based approach. Each year since the introduction of Patent Box into legislation in 2012, the majority of respondents taking part in this study have reported that Patent Box not only increases the competitiveness of the UK but also encourages additional investment in high-value activity.

Perhaps unsurprisingly, a significant minority of companies are now concerned about the upcoming modifications to the Patent Box regime. More than one-third believe that the new 'nexus' approach will make the UK's tax regime less competitive. Companies that have benefitted in the past from the Patent Box may now have less incentive to conduct high-value activity in the UK.

Figure 16: Impact of replacing current Patent Box regime with 'nexus' based approach

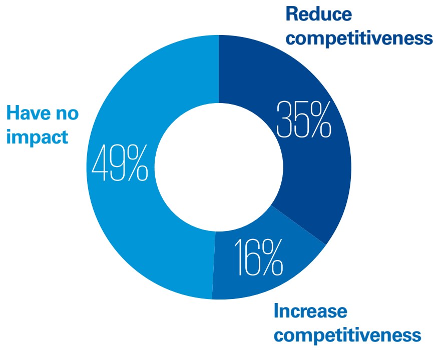


Figure 16: What impact do you think the replacement of the current Patent Box regime with a 'nexus' based set of rules will have on the competitiveness of the UK tax regime?

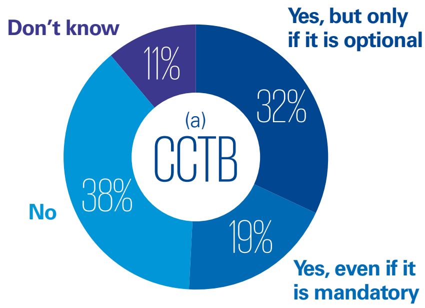
Base size: All respondents (106)

Engage with businesses on Consolidated or Unconsolidated Common Corporate Tax Base

First discussed by the EU in 2001, the Common Consolidated Corporate Tax Base (CCCTB) aims to provide a single set of rules that companies operating within the EU could use to calculate their taxable profits. The European Commission (EC) first published a recommendation on CCCTB in 2011 but the process stalled shortly thereafter. In June 2015, the EC announced their intention to relaunch the CCCTB in its Action Plan for Fair and Efficient Corporate Taxation, with the intention that the new CCCTB will be mandatory for all Member States.

In this year's study, we assessed the extent to which companies support the new CCCTB, and an unconsolidated Common Corporate Tax Base (CCTB), which has been suggested as a likely interim system while the CCCTB is finalised. Overall, a slim majority of all companies broadly support the proposed CCCTB and the CCTB. However, more than half of these companies in the slim majority would only support an optional, rather than a mandatory, system. Furthermore, over one-third of all companies oppose the system altogether. If the EC continues with its plans to introduce a mandatory CCCTB, more than 70% of the companies we spoke to would likely oppose the move.

Figure 17: Support for a C(C)CTB — % respondents



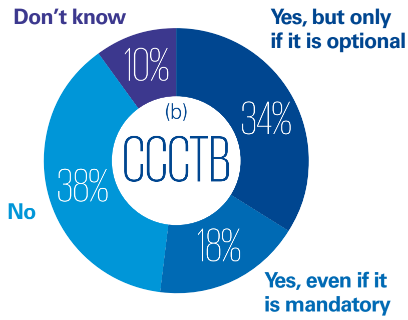


Figure 17: a) Would you support the introduction of a CCTB i.e. unconsolidated? b) Would you support the introduction of a CCCTB — i.e. consolidated?

Base size: All respondents (167)

Continue efforts to simplify the UK tax system

In 2015, we asked respondents to identify the main challenges that they face when managing the tax affairs of their organisation. Their responses highlight the increasing difficulty of keeping on top of complex and changing tax regimes across multiple jurisdictions. The most frequently mentioned challenge facing respondents is the complexity of the tax system including the UK.

Regarding the debate on decentralisation of tax, the preference of businesses is clear: almost 80% believe that tax should not be decentralised at all, and while 15% believe that tax should be decentralised in line with the devolution of different countries only 3% would advocate further decentralisation to city level. Many respondents who oppose devolution are concerned that it will inevitably lead to greater complexity in the tax system.

As the tax system in the UK continues to evolve, the UK Government have the challenge of managing carefully the apparent tension between the demand for further simplification, and anxiety over the disruption caused by major changes.

Figure 18: Challenges faced in managing tax affairs — # mentions

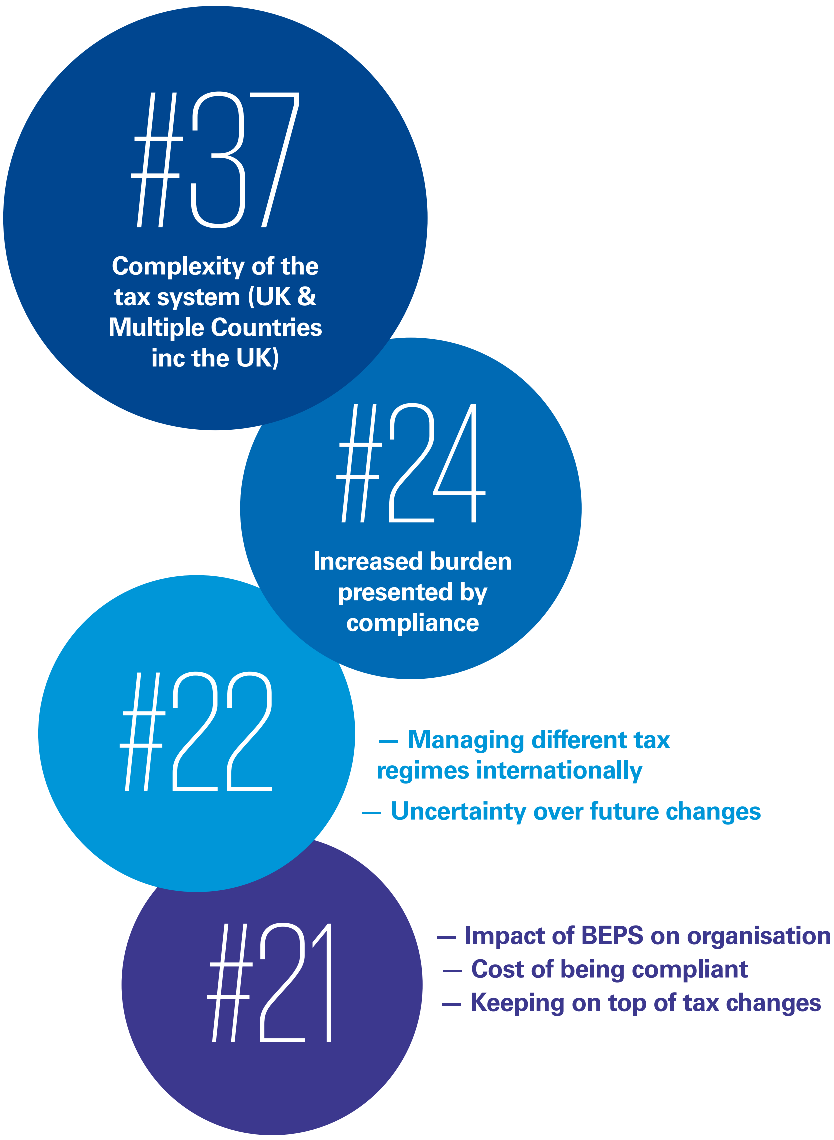


Figure 18: In this context of a changing tax and business environment, what would you say are the main challenges you face in managing the tax affairs of your organisation?

Base size: All respondents (167)

The most frequently mentioned challenge facing respondents is the complexity of the tax system

Improve relationships between companies and HMRC

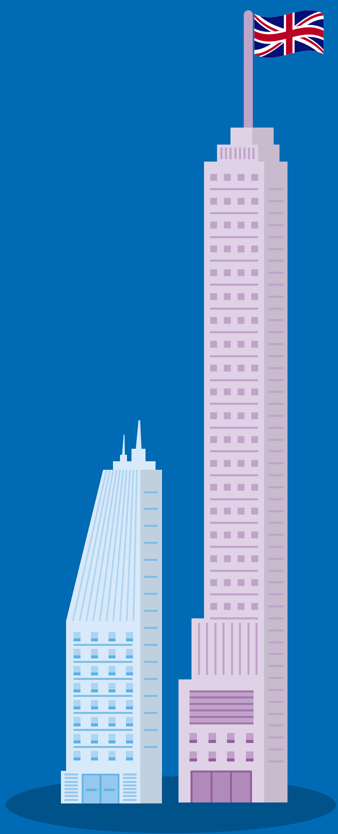
In both 2013 and 2014, we reported that while a significant minority of companies believed that their relationships with HMRC had improved over the previous 12 months, a similar number believed that relationships had deteriorated over that period.

Once again in 2015,16% of respondents believe that their relationships with HMRC have improved over the last 12 months, but almost 20% believe that relationships have deteriorated. This decline is felt acutely by foreign-owned subsidiaries, 30% of whom report worsening relationships with HMRC. Many understood that the reason for this deterioration was due to the resourcing challenges being faced by HMRC. Many also note that obtaining clarity on complex tax issues from HMRC is becoming increasingly challenging.

Conclusion

Over the past five years, the attractiveness and competitiveness of the UK's tax regime have substantially improved in the eyes of businesses. In this year's study, it is encouraging to see that the UK tax regime has maintained its competitive position among its international peers, and that both UK and non-UK companies are positive about the UK's ability to attract FDI. Our research shows that both UK and non-UK companies consider stable tax regimes and advance warning of major changes to be more important in an attractive tax regime than the overall headline tax rates.

The growing support among businesses for both responsible business behaviours and also transparency in tax reporting is also welcome, especially as the international debate on tax — and the BEPS initiative in particular — continue to influence tax policy development. Businesses are broadly happy with recent tax reforms, including those arising from BEPS. Overall, the sentiment among senior tax executives is that the UK should focus on sustaining and building upon recent improvements to the tax regime, rather than pursuing any major reforms.



06

Analysis of the Financial Services and the Manufacturing sector survey results

Financial services sector

Tax competitiveness:

In this year's study, we spoke with 19 financial services (FS) organisations. Overall, 68% of FS respondents select Ireland as one of their 'top three' most competitive tax regimes, making Ireland the most attractive tax regime among this group. 58% also select the UK as a 'top three' regime, making this the second most attractive regime. While the overall ranking of Ireland and the UK reflects views across industry sectors, FS companies appear to be more positive about Ireland's competitiveness than other sector groups. This may in part reflect the regulatory regime in Ireland, but may well be impacted by perceptions of the tax environment.

For 89% of FS companies, advance warning of major changes is a key consideration when assessing the attractiveness of a tax regime. This sentiment has grown versus previous years, perhaps buoyed by the rapid and unexpected introduction of the Diverted Profits Tax in 2015, together with various tax-raising measures targeted at banking groups.

Compared to other sectors, FS respondents are less likely to base decisions on where to locate business activities on the competitiveness of a tax regime. Only 53% of respondents in the FS sector consider a tax regime's attractiveness when making location decisions — around 20% less than in other industry sectors. Again, this is likely to reflect the fact that however attractive a country's tax regime is, it will only be a credible choice if it works from a regulatory point of view and there is an appropriate pool of skilled resources.

BEPS

The BEPS initiative draws mixed responses from FS organisations. Almost three-quarters (74%) support the aims of BEPS, which is in line with the average across all sectors (73%). However, 21% of respondents oppose the aims of BEPS. This resistance is significantly higher than across other sectors, where only 9% of companies oppose BEPS.

Two workstreams in particular seem to be driving resistance to BEPS among FS organisations. Two-thirds of respondents (67%) believe that the workstream to curb base erosion through interest deductions could negatively impact businesses.

Many financial institutions, in particular but not exclusively banks, are concerned that their own lending businesses in the UK will be adversely impacted if there are increased restrictions and uncertainties in respect of their customers' ability to deduct interest costs. There is a concern that some business may migrate to other jurisdictions as a result. In this regard, it is perhaps worth noting that the status quo — where businesses deduct interest in the UK at 20% and banks are taxed on the income at 28% — would seem to favour the Exchequer.

Moreover, 39% predict that the workstream to prevent avoidance of permanent establishment could damage businesses. We do not know precisely what the concern is here given that most international financial institutions are very familiar with operating through permanent

58% of FS respondents select the UK as a 'top three' regime, making this the second most attractive regime, after Ireland establishments, but we expect that in part it may reflect concern about a greater compliance burden arising from a large number of permanent establishments.

It is also possible that financial services groups consider there is a risk the new PE rules will capture more of their activities as they are currently able to sell cross-border in the EU on a Freedom of Services basis (using their home country regulatory licence).

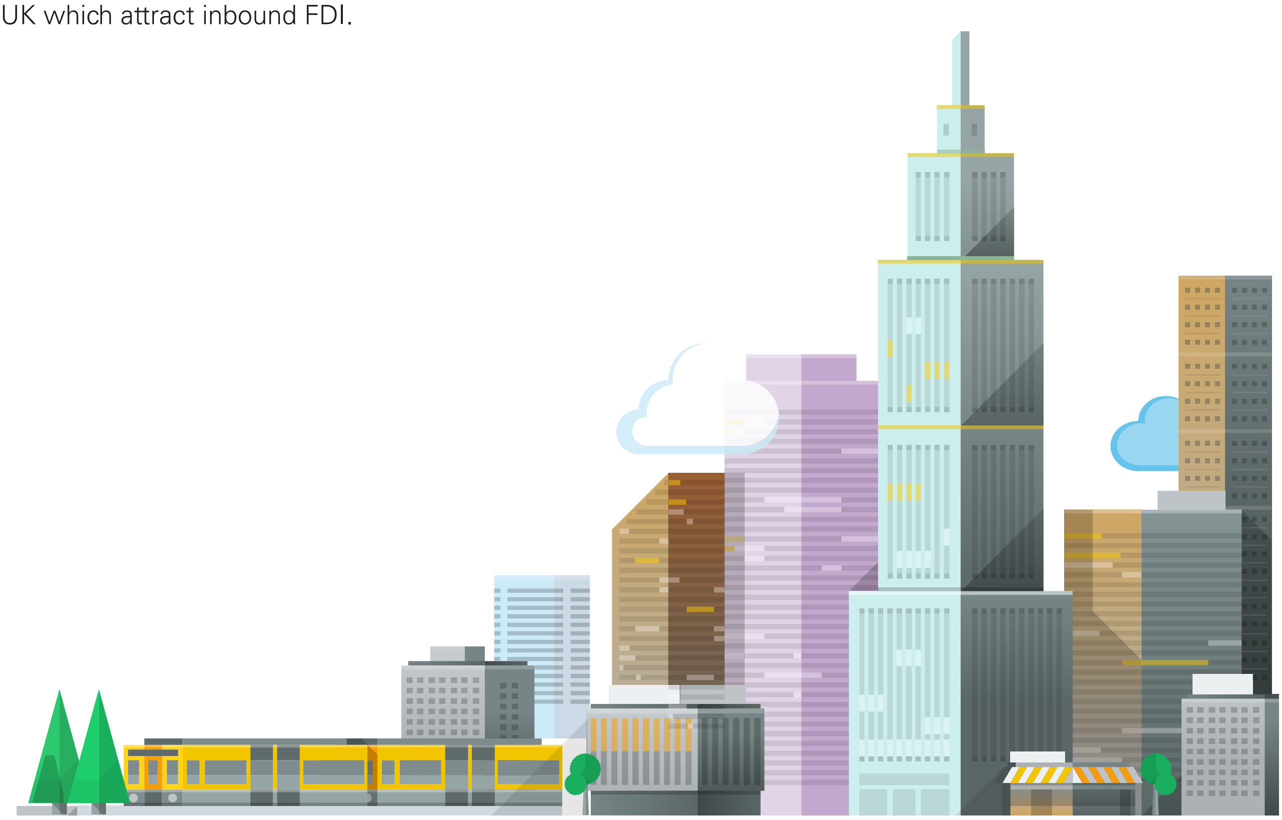
Foreign direct investment and location of business functions:

Ireland is seen as the most attractive destination for FDI by a relative majority of FS organisations. The UK trails significantly behind Ireland, supported by only 11% of FS companies. However, the majority of respondents are clear that political and macro-economic stability are significant strengths of the UK which attract inbound FDI.

A significant minority of FS organisations that participated in the research are looking to relocate business activities into the UK. Group services and investment holding are the two most popular business functions that could be transferred to the UK.

Priorities to drive further investment:

In the eyes of FS organisations, the Government should ensure clarity on future tax changes as a priority to encourage FDI into the UK. In this regard, it may be worth considering whether the financial sector should be explicitly addressed as a separate constituency in any corporate tax roadmap. A significant minority also call for expansion or simplification of the substantial shareholding exemption.



Manufacturing sector

Tax competitiveness:

In total, we spoke with 38 senior tax executives from companies in the manufacturing sector. Their views on the competitiveness of the UK tax regime versus its international peers are broadly consistent with the attitudes of respondents across all sectors. Overall, manufacturing companies see Ireland as having the most competitive tax regime, with 60% selecting Ireland as one of their 'top three' tax regimes. The UK also performs strongly, and is selected as a 'top three' regime by 57% of respondents.

Almost 90% of manufacturing companies identify 'stability' as the most important factor they consider when assessing the benefits of a tax regime, agreeing closely with other industry groups. However, 'tax rate' is more important to manufacturing companies than other industry sectors: headline tax rates are a major consideration for 87% of manufacturing respondents, compared to only 81% across all sectors.

Manufacturing companies are also highly influenced by the relative attractiveness of national tax regimes when deciding where to locate business functions. 82% of manufacturing companies report that tax attractiveness influences location decisions, compared with 75% for all industry sectors.

BEPS

Explicit support for the OECD's BEPS initiative is weaker among manufacturing companies than many other sector groups. A slim majority of manufacturing companies (58%) actively support the aims of BEPS, versus an all-sector average of 73%. Moreover, 26% of manufacturing companies are 'neutral' to BEPS (i.e. neither support nor oppose its objectives), which is three times the all-sector average of 9%.

Foreign direct investment and location of business functions:

Overall, manufacturing respondents regard the UK as the most attractive location for FDI versus international peers. Luxembourg is seen as the second most attractive FDI destination, but it receives only two thirds of the votes awarded to the UK.

Manufacturing companies echo the overall sentiment that political stability is one of the core strengths of the UK compared to international peers. But the UK's access to the EU single market is also crucial for these companies. Access to the EU market is seen as the UK's second biggest strength for attracting inbound FDI.

There is a clear appetite among manufacturing companies to invest in the UK. Almost one in five companies (18%) are looking to relocate their investment holding function into the UK and a further 18% are looking to transfer their intellectual property function to the UK. The appetite to relocate these two business functions into the UK is stronger for manufacturing companies than across most other sector groups.

Priorities to drive further investment:

In order to encourage further investment from this industry group, the UK Government could establish enterprise zones which offer preferential tax rates and other financial incentives. This is the most frequently mentioned initiative which manufacturing companies believe would increase inbound FDI to the UK.

The Government's current plans to reduce Corporate Tax rates to 18% are also likely to encourage further investment from manufacturing organisations. On average, respondents predict that reducing the headline rate to 18% would increase their capital expenditure by 7.5% and would increase R&D expenditure by 13%.

Project participants and approach

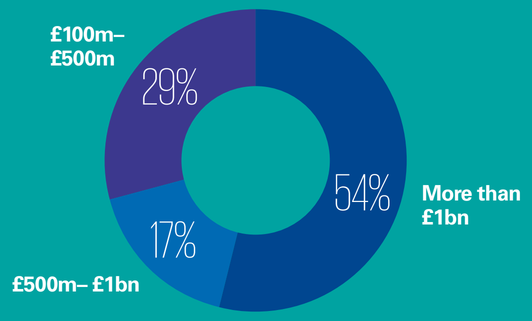
Our approach involved interviewing senior tax decision makers from a significant percentage of the largest publicly listed companies and foreign subsidiaries in the UK.

Interviews were conducted with senior tax decision makers in the largest UK listed companies, foreign-owned subsidiaries and non UK companies. In total, 102 UK companies and foreign-owned subsidiaries and 65 companies from across India, China, Japan, Australia, Canada and the USA were interviewed. These interviews were conducted between September and October 2015 by Gulland Padfield, the specialist consultancy. The sample size of UK Companies and Foreign-owned Subsidiaries is similar to that of the 2014 study.

54% of the companies interviewed had a turnover of over £1bn. 16% of the companies interviewed were members of the FTSE 100, with another 32% in the FTSE 250.

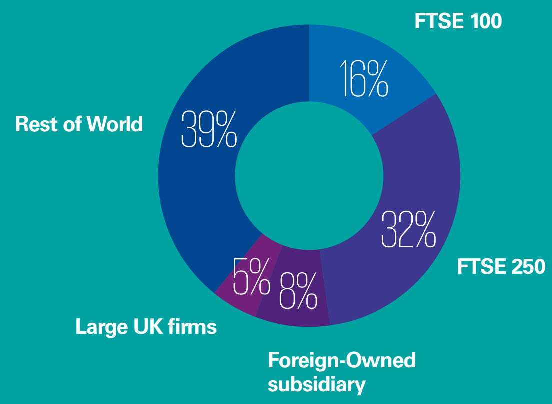
The composition of individuals and companies interviewed were consistent with previous years of the project, allowing for reliable comparison of trends over the last few years. The study was not conducted in 2010.

Figure 19: Turnover (%)



Base size: All respondents (167)

Figure 20: Company status (%)



Base size: All respondents (167)

Figure 21: Job status (%)

Base size: All respondents (167)

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