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Global Tax Alert

UK issues draft regulations and guidance amending Offshore Receipts in respect of Intangible Property legislation

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Executive summary

The United Kingdom (UK)'s Offshore Receipts in respect of Intangible Property (ORIP) rules were introduced by *Finance Act 2019* (FA 2019) and came into effect on 6 April 2019 with anti-avoidance provisions effective from 29 October 2018. FA 2019 also included a power for amendments to the ORIP legislation to be made by regulation by 31 December 2019.

Under the ORIP rules, where intangible property (IP) is held in offshore companies, in a territory with which the UK does not have a full double taxation arrangement (DTA) and the IP is used directly or indirectly to enable, facilitate or promote UK sales, income derived from that IP could be subject to a UK income tax at 20% of the gross amounts. A full DTA for these purposes means a double tax treaty that contains a non-discrimination article.

Following engagement with EY and other stakeholders, the Government has now issued draft regulations which would amend the ORIP legislation, along with an explanatory memorandum and draft guidance on the ORIP rules.

The changes made in the draft regulations address a number of the issues which had been raised with HM Revenue & Customs (HMRC) during the consultations, however a number of issues and areas of uncertainty remain.

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Detailed discussion

Changes proposed by the draft regulations

The draft regulations propose:

- Extending the scope of the income tax charge to no or low tax jurisdictions in certain circumstances where the non-UK person is resident in a jurisdiction with which the UK has a full DTA. The ORIP charge will apply from when the regulations are made where the non-UK person is resident in a treaty territory but is specifically excluded under the terms of the DTA (for example a Barbados International Business Company).
- Amending the definition of "residence" for these purposes to exclude an entity from being resident in a territory where they are liable to tax only in respect of income from sources in that territory, capital situated there or amounts remitted to (or received in) the territory. The inclusion of amounts remitted to or received in the territory is relevant to Singapore entities. However, where the person is actually entitled to treaty relief, this treaty relief may in any case prevent a charge under the ORIP rules.
- Modifying the definition of UK sales. In particular, in determining whether a sale is provided in the UK, or to UK persons, the regulations contain provisions to look through persons who acquire and resell without making any change or modification to the object resold. This change should be helpful in clarifying the position of distributers, and resellers. In relation to online advertising services, UK sales are defined by reference to the person to whom the goods or services being advertised are targeted.
- Introducing provisions to disregard certain UK sales made by third parties where the intangible property (or associated rights) makes an insignificant contribution to these UK sales. HMRC has stated that this change is intended to provide clarification by removing third-party sales where the IP is so diluted it hardly generates any value to the end sale.
- Introducing an exemption for companies which are resident in specified jurisdictions and which would otherwise be liable to tax under ORIP. Further regulations will be made in the coming months under which the Commissioners of HMRC will specify the jurisdictions which will benefit from this exemption (and they will also have the power to add or remove jurisdictions from the list). The indication is that the specified jurisdictions will be those that do not pose a risk to the statutory purpose of the legislation. These further regulations will have retrospective effect and will be subject to a number of anti-avoidance provisions including that, where the concerned territory taxes on a remittance basis, the UK-derived amounts must be remitted or otherwise received and charged in the tax year for the exemption to apply.
- Amending the rules to relieve double taxation by introducing an exemption in certain cases where there are multiple charges under the ORIP rules on group companies in respect of the same underlying IP. Where applicable, the exemption is intended to ensure the tax is only charged once.

The exemption where business activities are substantially carried on in the territory has been slightly amended to ensure that an entity is not excluded due to restrictions on the meaning of "residence," however other relaxations to this exemption, that some may have anticipated, have not been included.

Other changes

In addition to the changes in the draft regulations, the list of territories, contained in HMRC's International Manual, that are considered to have a full DTA with the UK has been updated. This update confirms that territories that are not regarded as States are not considered to have a full DTA, even where the treaty contains a non-discrimination clause. Groups with IP in territories that may not be regarded as States – such as Hong Kong, the Isle of Man and the Channel Islands should review the position, including whether the DTA could in any event prevent an ORIP charge.

Remaining uncertainties

The changes made by the regulations as described above clarify the application of the ORIP rules to certain scenarios, but issues remain. Draft guidance was also released alongside the regulations which will help address some concerns but they are silent on a number of areas of uncertainty highlighted to HMRC. We plan to address these again with HMRC during discussions on the draft regulations and guidance.

Many of these areas of uncertainty relate to specific arrangements or specific entities involved in the transactions, such as disregarded limited liability companies where the investors are fully taxable.

However, the application of the targeted anti-avoidance rule (TAAR), especially in situations where taxpayers are looking to unwind their current arrangements, is a key issue that is of general importance. Broadly, the TAAR gives HMRC the power to counteract arrangements which aim to circumvent the ORIP rules. No substantive changes have been made to the TAAR in the draft regulations.

The draft guidance provides some detail of HMRC's view on the application or non-application of the TAAR, but the legislation and the guidance are potentially difficult to relate to many common scenarios in international groups, where DEMPE (development, enhancement, maintenance, protection and exploitation) functions are typically geographically spread.

The draft guidance sets out a list of non-exhaustive factors that may indicate that the TAAR would apply on an outright disposal of IP, these include where "The transferee does not have substantial economic operations in its jurisdiction and in particular the relevant substantive economic activity underlying the IP that has been transferred." No detail has been given a to the meaning of "substantial" in this context. This list of factors also includes the situation where income continues to accrete in a no- or low-tax jurisdiction, specifically where the transferor or a connected person is entitled to amounts which directly or indirectly derive from transferred rights – including amounts such as financing or other returns in connection with consideration for the transfer. Accordingly, the impact of the TAAR on transfers of IP for debt will need specific consideration.

It is noted that the draft guidance provides little commentary on the interaction between DTAs, the ORIP charge and the TAAR.

What next?

A technical consultation on the draft regulations will run for eight weeks, with responses being due by 19 July 2019. We will continue to engage with HMRC on this topic, and will make representations in response to the consultation.

It is expected that the final regulations will be made in Autumn 2019. Parts of the regulations will have retrospective effect.

In the meantime, groups which are potentially affected by ORIP should consider the draft regulations and the draft HMRC guidance in detail. In particular, groups that may have previously considered that they were outside the scope of the rules on the basis that IP is held in an entity with a full DTA (e.g., a Barbados IBC or a Hong Kong company) should consider the impact of the changes.

Some groups may have been anticipating the draft regulations would narrow the scope of the rules. Such groups will now need to consider the detail of the changes included in the draft regulations in order to determine how they are affected and whether they are indeed outside the scope of ORIP going forward.

Any groups which have already transferred IP out of a territory within the scope of the ORIP rules, or are considering doing so, will want to consider what comfort is given by the draft guidance especially in relation to the application of the TAAR.

For many, uncertainty will remain and detailed analysis will be required in determining how to respond.

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