

# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT DOUBLE TAXATION RELIEF AND  
INTERNATIONAL TAX ENFORCEMENT  
(ISRAEL) ORDER 2019

DRAFT DOUBLE TAXATION RELIEF  
(CYPRUS) ORDER 2019

*Tuesday 18 June 2019*

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**Saturday 22 June 2019**

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**The Committee consisted of the following Members:**

*Chair:* STEWART HOSIE

† Baron, Mr John (*Basildon and Billericay*) (Con)  
 † Chishti, Rehman (*Gillingham and Rainham*) (Con)  
 Cooper, Rosie (*West Lancashire*) (Lab)  
 † Day, Martyn (*Linlithgow and East Falkirk*) (SNP)  
 † Dodds, Anneliese (*Oxford East*) (Lab/Co-op)  
 † Forbes, Lisa (*Peterborough*) (Lab)  
 † Jayawardena, Mr Ranil (*North East Hampshire*)  
 (Con)  
 † Johnson, Diana (*Kingston upon Hull North*) (Lab)  
 † Knight, Julian (*Solihull*) (Con)

† Latham, Mrs Pauline (*Mid Derbyshire*) (Con)  
 † Milling, Amanda (*Cannock Chase*) (Con)  
 † Norman, Jesse (*Financial Secretary to the Treasury*)  
 Rashid, Faisal (*Warrington South*) (Lab)  
 † Smith, Henry (*Crawley*) (Con)  
 † Smith, Jeff (*Manchester, Withington*) (Lab)  
 † Walker, Thelma (*Colne Valley*) (Lab)

Nina Foster, *Committee Clerk*

† **attended the Committee**

## Second Delegated Legislation Committee

Tuesday 18 June 2019

[STEWART HOSIE *in the Chair*]

### Draft Double Taxation Relief and International Tax Enforcement (Israel) Order 2019

2.30 pm

**The Financial Secretary to the Treasury (Jesse Norman):**

I beg to move,

That the Committee has considered the draft Double Taxation Relief and International Tax Enforcement (Israel) Order 2019.

**The Chair:** With this it will be convenient to consider the draft Double Taxation Relief (Cyprus) Order 2019.

**Jesse Norman:** It is a pleasure to serve under your chairmanship, Mr Hosie.

The draft orders, as colleagues will be aware, are narrow and technical pieces of legislation. They give effect to amendments to the 2018 double taxation agreements, or DTAs, with Cyprus and Israel. Double taxation agreements remove barriers to international trade and investment, and provide what are widely regarded as a clear and fair framework for taxing businesses that trade across borders. By doing so, they benefit both business and the wider economies of the countries that sign them. I will say a few words about each agreement.

The amending protocol that we agreed with Cyprus implements a transition period for changes made to the taxation of Government service pensions in the 2018 double taxation agreement. Under the previous agreement with Cyprus, such pensions paid by the UK to residents of Cyprus were taxable only in Cyprus. The 2018 DTA gave the UK sole taxing rights if the pension is paid to a UK national who is resident in Cyprus.

The treatment in the 2018 DTA is in accordance with international standards, but concerns were expressed in Committee and by members of the public that the changes would lead to hardship for pensioners due to the increased rates of tax that they would pay on their income. I am grateful to colleagues who raised this in the House. Having listened to the arguments, my predecessor asked officials of Her Majesty's Revenue and Customs to review the position with Cyprus. The protocol before us is the result of that review. As requested by those affected, the new provision will allow individuals to elect to continue to be taxed only in Cyprus for a period of up to five years, and so is designed to give them adequate time to plan for the change after that period elapses.

The current double taxation agreement with Israel dates from 1962, as amended by a protocol in 1970. Its age means that it is in need of updating to reflect changes to the OECD model tax convention and the domestic tax laws and treaty preferences of both states. We were therefore happy to accept Israel's suggestion

that the situation should be rectified. In line with the request of the hon. Member for Oxford East in an earlier Committee, the explanatory memorandum spells out in paragraph 7.8 and following where the amended DTA reflects the OECD model treaty.

The amended DTA also introduces a number of improvements for businesses, individuals and HMRC. It removes a provision that denied many UK residents access to reduced withholding tax on dividends paid by Israeli companies. In addition, the updated agreement reduces withholding tax on dividends in respect of direct investments from 10% to 5%. The rate of 15% applicable to portfolio investments remains unchanged, and that rate also applies to dividends paid by a real estate investment trust. The rate of withholding tax applicable to interest is reduced from 15% to 10% generally, with a 5% rate for interest paid to banks.

A drafting error at paragraph 7.6 of the explanatory memorandum erroneously states that interest paid to UK-resident companies will not be taxed in Israel. That will be corrected in the final explanatory memorandum published with this instrument, if approved.

The updated DTA also contains important exemptions for interest paid to pension schemes and relating to listed corporate debt. It provides the option for taxation of interest on a net basis in the territory from which it is paid. Withholding tax on royalties is reduced from 15% to 0%. That range of reductions in withholding tax is designed to encourage cross-border trade and investment between the two countries, to the benefit of both.

The new DTA also contains a number of modern anti-avoidance provisions that meet the minimum standard agreed under the OECD and G20 base erosion and profit shifting, or BEPS, project. The provisions include: an updated preamble that makes it clear the purpose of the DTA is not to create opportunities for tax evasion and avoidance; and a principle purpose test that denies treaty benefits in cases of abuse.

Other anti-avoidance rules in the new treaty that go beyond the BEPS minimum standard include a tiebreaker provision for determining corporate residence based on competent authority agreement. Another provision preserves UK taxing rights on gains from shares which derive their value principally from immovable property in the UK. Finally, the new DTA brings the exchange of information article into line with contemporary international standards and provides for mutual assistance in the collection of debts.

**Mr John Baron (Basildon and Billericay) (Con):** I fully endorse what the Minister has been saying about tax avoidance schemes. In future deliberations, I ask him to resist any temptation to increase tax on dividends. He will understand that, over the long term, the reinvestment of dividends over time has accounted for the vast majority of investment returns, which has benefited pension funds, charities and large swathes of society, particularly those in retirement.

**Jesse Norman:** I am grateful to my hon. Friend for his comment. He is right that dividends are an important stream of revenue. I hope he welcomes the changes made in this double taxation agreement.

As I have said, the provisions include an exchange of information article, which brings that information exchange into line with contemporary international standards

and provides for mutual assistance in the collection of tax debts. Together, we believe these features will strengthen both countries' defences against tax avoidance and evasion.

In summary, the orders implement important improvements to our DTAs with Cyprus and Israel. The Government have listened to the arguments presented by UK nationals living in Cyprus and agreed to delay the introduction of the change to the taxation of Government service pensions for up to five years. The agreement with Israel is one the UK and Israel can be happy with. It protects UK revenue and provides a stable framework in which trade and investment between the UK and Israel can continue to flourish. I commend the orders to the Committee.

2.36 pm

**Anneliese Dodds** (Oxford East) (Lab/Co-op): It is a pleasure to serve in this Committee with you in the Chair, Mr Hosie. I am grateful to the Minister for his opening remarks, and congratulate him on joining the Treasury team. I am sure this will be one of many double taxation agreements that we discuss. I hope he enjoys debating each one just as much as he has enjoyed debating these.

As the Minister has outlined, the Double Taxation Relief (Cyprus) Order 2019 amends the entry into force provisions of the 2018 DTA so that a person in receipt of a Government service pension can elect to continue to be taxed in accordance with the provisions of the previous 1974 DTA for a period of up to five years. As was mentioned by the Minister, this has been introduced in response to concerns raised by the Opposition and other members of the Committee when it met previously about the new regime's potential impact on British servicemen and women who live in Cyprus and others. I am pleased that the Government listened and that they sought to introduce a transition period in the light of these concerns.

In relation to the Double Taxation Relief and International Tax Enforcement (Israel) Order 2019, I am pleased to see that the DTA is being updated. It is encouraging to see the UK broadly following the OECD model and adopting the base erosion and profit-shifting compliant principal purpose test. None the less, there are a couple of issues: taxation of royalties and the principal purpose test.

As many Members know, aggressive tax avoidance schemes have been developed by multinational companies, often using loopholes in the international taxation of royalties. By artificially locating the legal ownership of their intellectual property in avoidance-facilitating jurisdictions such as the Netherlands and Luxembourg, a multinational can avoid UK tax on UK royalties. These royalties are within the scope of UK income tax but UK DTAs with those jurisdictions create exemptions meaning only the avoidance-facilitating country may tax them. At my estimate, almost a third of our tax treaties currently create an exemption on royalties-withholding taxes, including the Netherlands and Switzerland. Israel does not have the same reputation for that type of activity as those countries, but I am concerned that the Government's prevailing approach to royalties-withholding taxes in DTAs is leaving us vulnerable.

The Government introduced measures to prevent such abuse in the previous Finance Act, but previously negotiated DTAs appear to be preventing them from applying them to the most problematic jurisdictions. In particular, it appears that the intangible property measure contained within the Finance Act 2019 does not apply to the jurisdictions with which we have a DTA, so it would not apply in the case of these DTAs with Israel and Cyprus. It would be helpful to understand from the Minister, either now or in a letter afterwards, the Government's intended scope of that measure—if all DTA-covered jurisdictions are exempted, it will be applied to only a handful of jurisdictions.

Secondly, although I am pleased that the Government are adopting the BEPS-compliant principal purpose test, I am concerned that the test remains largely untested. Tax justice activists and academics have raised concerns about the burden of proof necessary as part of the test. It would be helpful if the Minister could help us understand, either in Committee or via letter, how practically workable the Government believe the principal purpose test will be.

In conclusion, while putting together these DTAs, the Government surely need to more carefully consider how they interact with attempts they are making to control the use of profit-shifting via royalties through mechanisms such as those set out in the Finance Act 2019. Surely they also need to look more closely at the implications of their approach to the principal purpose test for the workability of the measures for HMRC.

Finally, I have asked before in Committee for an indication from the Government of the schedule of negotiation of DTAs. They have stated that they are trying to work through the corpus of DTAs to bring them into line with the OECD's multilateral instrument. It would be helpful to have a clearer picture of the exact stage. Some are being renegotiated, and others are taking much longer. As mentioned by the Minister, the Israel measure has not been renegotiated since the 1970s. Others were changed after being in force for just a few years. It would be helpful to have a clearer perspective of where we are going.

2.41 pm

**Jesse Norman:** Having read accounts of previous debates on double taxation agreements, it was clear to me that to broach this topic would be to encroach on an area of considerable expertise amounting to genius on the part of the hon. Lady. She has shown it today. You do not need to be at the cricket world cup to see bouncers on a sticky wicket. I am grateful to her. I could not understand why she was not sitting directly opposite me. I think it is because she is bowling over the wicket rather than round it.

The hon. Lady raises three topics: the taxation of royalties, the purpose test and the schedule of negotiations. She will be aware that the taxation of royalties, particularly in the Finance Act 2019, is an area in which she is a great expert while I am a great novice. It is aimed at abusive structures where there has been no double taxation agreement. The point is to try to crack down on procedures whose purpose is only, or in many cases principally, to avoid tax.

I am happy to write to the hon. Lady on the specific question of the treatment of intangibles in the Finance Act. There should be no ambiguity about the Government's desire to crack down on abusive avoidance of the kind described here.

*[Jesse Norman]*

On the purpose test, the hon. Lady will be aware that purposive readings of the tax code are not by any means limited to Government—they are adopted in different parts of the law. A historic case is the Rangers case in the Supreme Court and the loan charge. A new international standard agreed was agreed following the BEPS project. The UK is a world leader. Although it is true that, to some extent, all world leaders face the possibility of being under question and legal challenge, we believe that the measure is robust and will prove to be so.

On the publication of priorities and negotiation schedules, the hon. Lady will be aware that we conducted a consultation on negotiating priorities at the end of 2018 and published conclusions. I would be happy to write to her on that topic if there is anything further.

*Question put and agreed to.*

**Draft Double Taxation Relief (Cyprus) Order 2019**

*Resolved,*

That the Committee has considered the draft Double Taxation Relief (Cyprus) Order 2019—(*Jesse Norman.*)

2.45 pm

*Committee rose.*



