PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Third Delegated Legislation Committee

DRAFT DOUBLE TAXATION RELIEF (BASE EROSION AND PROFIT SHIFTING) ORDER 2018

DRAFT DOUBLE TAXATION RELIEF (SWITZERLAND) ORDER 2018

DRAFT DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (UZBEKISTAN) ORDER 2018

Wednesday 9 May 2018

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Sunday 13 May 2018

The Committee consisted of the following Members:

Chair: Stewart Hosie

† Aldous, Peter *(Waveney)* (Con)
Blackman, Kirsty *(Aberdeen North)* (SNP)
Cooper, Rosie *(West Lancashire)* (Lab)
† Djanogly, Mr Jonathan *(Huntingdon)* (Con)
† Dodds, Anneliese *(Oxford East)* (Lab/Co-op)
† Ford, Vicky *(Chelmsford)* (Con)
† Lefroy, Jeremy *(Stafford)* (Con)
† Mackinlay, Craig *(South Thanet)* (Con)
McGovern, Alison *(Wirral South)* (Lab)
† Mann, Scott *(North Cornwall)* (Con)
† Morris, James *(Halesowen and Rowley Regis)* (Con)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
Smith, Angela *(Penistone and Stocksbridge)* (Lab)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Stride, Mel *(Financial Secretary to the Treasury)*
† Walker, Thelma *(Colne Valley)* (Lab)
† Western, Matt *(Warwick and Leamington)* (Lab)

Mike Everett, *Committee Clerk*

† attended the Committee

Third Delegated Legislation Committee

Wednesday 9 May 2018

[STEWART HOSIE *in the Chair*]

Draft Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018

2.30 pm

The Financial Secretary to the Treasury (Mel Stride): I beg to move,

That the Committee has considered the draft Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018.

The Chair: With this it will be convenient to consider the draft Double Taxation Relief (Switzerland) Order 2018 and the draft Double Taxation Relief and International Tax Enforcement (Uzbekistan) Order 2018.

Mel Stride: It is a pleasure to serve under your chairmanship again, Mr Hosie. The base erosion and profit shifting—BEPS—order brings into effect the multilateral convention to implement tax treaty-related measures to prevent base erosion and profit shifting, which is commonly and thankfully referred to simply as the multilateral instrument. The orders in respect to Switzerland and Uzbekistan amend our existing double taxation agreements with those countries. All the instruments bolster the UK's network of international tax arrangements and deepen our commitment to avoiding double taxation while preventing tax evasion and avoidance.

Double taxation agreements—DTAs—are bilateral agreements between the UK and other countries that aim to ensure that profits, income and gains are taxed only once. They develop the UK's economic relationship with other countries and vice versa. DTAs provide critical certainty for cross-border firms and enhance co-operation in tax matters to stimulate economic growth and prevent tax avoidance.

The OECD/G20 base erosion and profit shifting project recommends a number of changes to DTAs, including the introduction of minimum standards to prevent tax avoidance by those who abuse tax treaties, and measures to improve the resolution of tax disputes. In addition, it recommends action to prevent so-called hybrid mismatches and the avoidance of permanent establishment status.

To enable those enhancements to DTAs to be made as soon as possible, more than 100 countries in a group chaired by the UK drew up the multilateral instrument. The group adopted the text of the MLI in November 2016 and it has now been signed by 78 jurisdictions, including the UK. It is in the process of being ratified by those jurisdictions. Individual DTAs will be modified by the MLI only if both jurisdictions have signed it and have given notice that they wish the DTA to be covered by it. The UK intends the MLI to cover all our DTAs that are agreements under international law and that do not already include provisions that we want from the MLI.

Except in relation to certain minimum standards, parties implementing the MLI are also permitted to reserve against provisions. If either party to the DTA has reserved against an MLI provision, that provision cannot modify the DTA. Following consultation, the UK proposes to adopt those provisions that are a proportionate and effective defence against the abuse of tax treaties, in addition to the minimum standard provisions. We intend to reserve against provisions that have a disproportionate effect on commercial transactions or that are unnecessary in the light of other measures taken to address the misuse of the international tax framework.

At the time of signing the MLI, the UK submitted its list of reservations to the OECD, which was published on the OECD's website. Some minor amendments to that list have also been published on gov.uk. Those amendments relate to bilateral arrangements that have been agreed since the submission of our original list of reservations.

To ensure complete clarity for taxpayers, HMRC will prepare consolidated versions of treaties showing how they have been modified by the MLI and will publish those in good time before the modifications take effect. Where possible, it is our intention to agree those texts with our treaty partners. The order ensures that the UK can use the MLI to implement our commitments under the BEPS project and that our DTAs contain robust and proportionate defences against tax avoidance to the benefit of the UK and our treaty partners.

Let me now turn to the other two orders, in respect of Switzerland and Uzbekistan. The Switzerland order amends our existing 1977 DTA. To give effect to DTAs, the Swiss Government transpose them directly into domestic law, so it is much more straightforward for them to amend their law by amending the existing DTA, rather than by adopting the MLI separately. As a result, we agreed with Switzerland to implement modifications that would have been made by the MLI through this order.

For Uzbekistan, the order implements many of the provisions available under the MLI, including minimum standards on preventing treaty abuse and improving dispute resolution. In addition, the order provides for a general update to the existing text to reflect changes to the OECD model tax treaty and the domestic laws of the UK and Uzbekistan. Importantly, the changes remove a barrier to UK companies claiming benefits in respect of dividends from Uzbekistan created by the introduction of a dividend exemption regime in the United Kingdom. That will enhance the investment climate for UK businesses in Uzbekistan, to the benefit of both countries.

The orders enhance our commitment to tackling international tax avoidance and evasion. They also strengthen the integrity of our network of DTAs and remove barriers to investment by UK businesses. I commend the orders to the Committee.

2.35 pm

Anneliese Dodds (Oxford East) (Lab/Co-op): I am grateful to you, Mr Hosie, for chairing today's proceedings. I will focus my remarks on the MLI—I am grateful to the Minister for that shortening, for all our sakes—but I will also refer to the Swiss agreement in passing.

As the Minister rightly explained, the MLI is an innovative new way of effectively spreading, or leading to a convergence of, tax policy, developed by the OECD.

Essentially, it is a set of different amendments to double tax agreements. All countries that have signed up to the MLI will implement all the amendments in all their double tax agreements, if the other country is also a signatory to the MLI.

As the Minister also explained, the OECD has promoted that approach to try to make all double tax treaties better at stopping base erosion and profit shifting. Given that Britain has a comparatively large number of double tax agreements—which are very varied in terms of how they prevent double taxation and, I would say, often facilitate double non-taxation—it appears sensible for the UK to adopt the MLI. As I noted in the discussion of the MLI in the Finance Bill Committee in January, it was encouraging to see the UK taking a leading role in defining and agreeing the MLI, marking—I would say—quite a contrast with its attempts to block international co-operation when it comes to improved transparency for trusts, for example.

None the less, three areas of the legislation raise significant concerns, all of which arise from a point I made on 16 January in the debate on the Finance Bill, when the UK's adoption of the MLI was first mentioned in law. I expressed concern that we lacked sufficient information to understand why the Government had taken certain decisions, and not others, in relation to their implementation of the MLI. As the Minister explained very ably in his introductory remarks, countries that are adopting the MLI have a series of choices to make about how exactly they do so and which of its provisions they take on board.

Back in January, the Government did not provide much information about why certain choices had been made. We did not get a lot more information, to be honest, in the Minister's otherwise illuminating introductory remarks. That is quite a big problem, because traditionally double tax treaties have often led to source countries in particular, which tend to be developing countries, being denied tax revenues, which then accrue to already profitable firms in richer countries—not necessarily even to the revenue of richer countries.

We need more information on three areas, and I hope that the Minister will be able to provide some. That is essential if we are properly to show that the Government are holding to the principle of policy coherence for development in more than just a rhetorical form.

My first question is, why did Britain decide to exclude some of its double tax agreements from the list of countries mentioned in its adoption document? As colleagues may know, when a country signs up to the MLI, it has to indicate the double tax agreements to which it will apply the MLI. The UK excluded double tax agreements with Austria, the Falklands, the Faroe Islands, Guernsey, the Isle of Man, Jersey, Switzerland and the United Arab Emirates.

The Minister explained why Switzerland is not included. Are there any other countries where DTAs are put into primary legislation or passed through national legislation? I would have thought there are quite a few, so that seems like a slightly peculiar explanation of why we have taken a different approach to Switzerland. Does the Swiss system have a unique approach to tax legislation? I did not know that it did. Perhaps the Minister could explain that, because otherwise we would expect to see a similar approach being adopted to lots of other countries. That does not seem to be the case.

Given that a number of the jurisdictions that I have mentioned have been referred to in investigations into tax avoidance and evasion, it seems rather peculiar that they are not included here. It would be interesting to hear what the Government's reasoning was and whether the requirements of the MLI are likely to lead to amendments to the double tax agreements for those jurisdictions too. If they are, what is the timetable to do that?

There are a number of targeted anti-avoidance rules in the MLI that countries can choose to adopt, but our Government decided not to. In the explanation of the MLI that we had previously, it was stated that that was essentially because they were too stringent. The Government stated that

"the mechanical test introduced by those provisions"—

the excluded ones—

"could deny treaty benefits in circumstances that are not abusive and would not target any genuine avoidance structures more effectively than the PPT",

which is the principal purpose test.

The Minister said that the provisions were excluded because it was believed that they would have a disproportionate effect on corporate transactions, or they would be otherwise unnecessary. I find that a rather peculiar assessment, as do a number of experts. The principal purpose test is a very wide test—it includes a lot of discretion. Often, it is quite difficult for tax authorities to use it without being challenged, and most authorities and experts agree that strict and tight rules are better, because they avoid such ambiguities.

It would be helpful to hear from the Minister why we did not adopt articles 8, 9, 10 and 14. They apply a minimum ownership threshold for reduced tax on dividends, which makes rules about capital gains from shares and entities owning immovable property more precise. Those articles apply an anti-abuse rule for permanent establishments situated in third jurisdictions, and prevent the splitting up of contracts where companies game the system and pretend, for example, that one building site is delivered through a whole bunch of different contracts, when really it is delivered by just one firm.

All those measures were designed to prevent the kind of abusive behaviour that is frequently adopted by firms trying to avoid tax, especially in developing countries, yet the British Government have decided not to adopt them. Incidentally, the other country that has done that is the Netherlands, which I do not think has a model that we should aspire to when it comes to policy coherence for development in tax practice.

We need illumination from the Government on the rules on permanent establishment. Indeed, the Minister referred to those in his introductory remarks. I am very confused about precisely where Government are when it comes to the taxation of digital companies and assessing where their permanent establishment is. In relation to this MLI, the Government decided they would not adopt article 12 on the artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies. That contrasts with two other policy positions from the Government, which themselves are contradictory.

We have a new position paper from the Government on corporate tax and the digital economy, which says that they want much more ambitious measures, which

[Anneliese Dodds]

could be agreed as part of the overall EU package of change. But in April, at the informal ECOFIN meeting, the Chancellor seemed to suggest through a spokesperson that the UK would instead only aim in the long run for internationally agreed measures—in particular, only those that the United States would agree to. That could take a very long time because, as we know, the US is directly against any development in this area from the OECD and the EU.

It would be good for the Government to tell us what we will do. Will we take proactive action on permanent establishments, as with the Google tax? Will we co-ordinate that with the EU? Will we try to do that with the OECD? Will we wait for the US? Surely, we should be an example in this regard. It will be interesting to hear the Government's assessment.

Finally, in contrast to previous areas that I just mentioned, where the UK Government should have opted in to certain measures but decided not to, it is very strange that the Government have opted in to so-called mandatory binding arbitration in their adoption of the MLI. That will mean that if a multinational taxpayer triggers a dispute with the UK's interpretation of a treaty and the dispute is not resolved within two years, the ultimate decision about whether the UK or the multinational's home country has the right to tax the income under dispute will be taken by a panel of tax professionals—not through ordinary routes.

There are many problems with adopting that procedure, and they are analogous to some of the concerns raised around the inclusion of investor-state dispute settlements in trade deals, which occasioned a lot of public debate. I am sure that all members of the Committee will have received a lot of correspondence from constituents on that matter. Why did the Government not provide an assessment of the impact of adopting mandatory binding arbitration on the extent to which our tax policy will be coherent with our development goals? I raised this issue in the Finance Bill Committee, and was grateful to the Minister for listening to me there, but we did not get that information before this statutory instrument came before the House, and we need it.

I am well aware that, as the Minister said during the Finance Bill Committee, countries have to agree to arbitration in their adoption of the MLI before it can be applied to them, but that does not detract from the fact that the resources available to developing countries, particularly very low-income countries, to devote to their case and to amassing the information that would need to be provided to those tax professionals are minuscule in comparison with those available to the sort of multinational companies that we might be talking about. It would be a David and Goliath-style contest, and I am very concerned that that would not comply with policy coherence for development.

Finally, it is unclear why the Government have failed to provide an indication of how Parliament will be able to scrutinise the operation of this mandatory binding arbitration. We have gone in the wrong direction on this—the Government have expressly adopted paragraph 23.5 of the MLI. That paragraph requires written agreement from companies and their advisers not to disclose any information they receive in the course of their proceedings, which goes further than the default, to try to prevent that information being publicised. It is not clear to me how that is consistent with ensuring appropriate scrutiny of tax policy by Parliament, which the Government have repeatedly told us they are committed to. It would be helpful if the Minister could explain why that decision was taken.

2.46 pm

Mel Stride: I thank the hon. Member for Oxford East. It is not long since we jousted and debated, and it is good to be back doing exactly that. I welcome the overarching support for the MLI in her early remarks, particularly in respect of tax avoidance and the double taxation avoidance measures, although I understand that she has some issues around arbitration, which I will come to in a moment. I too have fond memories of clause 32 of the Finance Bill last year, which provided the powers under which the MLI is being brought forward for consideration.

The hon. Lady posed a large number of questions and I will attempt to answer as many as I can—I was busy thinking about the answers to some when the next two or three arrived in train, so if I do not cover everything, I would of course be very happy to take a representation from the hon. Lady after the Committee and look at them in more detail.

On advertising and the reservations that we might be seeking from the MLI, we have provided information on the OECD website and subsequent changes appeared on the gov.uk website, so the information is in the public domain. We will be required to provide that information to the OECD some four months before this measure comes into effect and it in turn will advertise the reserved elements that we decide on at that time.

The hon. Lady asked why we do not include all the DTAs. She is absolutely right that the UK has a large number—from memory, I think it is around 130—and about 121 will be potentially covered by this measure. The answer is that, in some cases, the DTAs largely conform to the changes that would be introduced were they to be subject to the MLI. In some cases, it is not necessary, as our treaty contains substantial provisions. Our first-time DTA with Colombia would be one example.

The hon. Lady asked whether Switzerland taking these tax changes directly into domestic law, rather than less efficiently through the MLI, was a unique circumstance. I believe that it is relatively unique—my officials have just nodded. It is something of an unusual situation. That is the reason that both countries have decided to approach the matter in this way.

The hon. Lady mentioned permanent establishments and various related issues, asking why we were reserving against those particular matters. The general response to that and like matters is that the Government do not believe that they would have any major material impact on what happens with the taxation of revenues from one country coming back into the United Kingdom. Of course, those measures would bring with them various administrative burdens on business, which the Government always seek to minimise where possible.

The hon. Lady raised the issue of consultation on digital taxation, slightly at a tangent to the matter at hand. I would welcome her intervention if I have misunderstood her, but I think she was referring to our consultation on the taxation of businesses making profits via digital platforms.

Anneliese Dodds: I am grateful to the Minister for seeking clarification. The reason I mentioned it was that, with the adoption of the MLI, we have what many would view as quite a lax approach to defining permanent establishments, compared with article 12, if we had adopted that. However, in that consultation, the Government seemed to suggest a stricter approach. There seems to be a contradiction, which in itself is contradicted by what the Chancellor said at the informal ECOFIN—he seemed to say that we need to have US agreement before we can have stricter rules.

Mel Stride: I thank the hon. Lady for that clarification. I take this in two parts. These are different situations. When it comes to taxation of profits derived from digital platforms, be they social media, search engines or online marketplaces, the critical thing is to ensure that we tax the value that accrues to the interaction of consumers with those marketplaces. We are working with the OECD and the European Union, as the hon. Lady pointed out, to come up with an appropriate way to address that particular challenge of the current international taxation regime. As to the Chancellor's remarks about whether we might go it alone or have to wait for America, I am not entirely sure that he said what was reported. That is the information I received, although I did notice those comments in the press, as did the hon. Lady.

We have debated mandatory arbitration before. The essential point is that, in order to enter into a DTA, both sides have to agree that it is an appropriate treaty to enter. Both sides have to be comfortable in the round with it. There is no circumstance in which the United Kingdom could therefore force a country against its will to enter into agreement with mandatory binding arbitration.

Anneliese Dodds: Surely it would be helpful, given the differences in resource that could none the less be provided between developing and developed nations, for the Government to carry out that analysis into the use of mandatory binding arbitration, and whether it exemplifies policy clearance for development. It would be wonderful to hear a Treasury Minister say that the Government might consider adopting this and doing so explicitly.

Mel Stride: The Government's view is that mandatory binding arbitration is a very useful element of these agreements. In the absence of that, the process undertaken might be ultimately inconclusive. In order to ensure that these agreements work efficiently, we believe there is great merit to that approach.

I lastly turn to parliamentary scrutiny. Matters reserved against will be for the Government to determine in time although, as I have indicated, we have already put out preliminary suggestions of what we will do. As time goes forward, this or any other Government may decide to remove some of those reserved powers. It is down to this Committee and this moment to take a decision on whether in the round all those possible changes are agreed to or not. On that basis, I urge that we move forward with the recommendations.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018.

DRAFT DOUBLE TAXATION RELIEF (SWITZERLAND) ORDER 2018

Resolved,

That the Committee has considered the draft Double Taxation (Switzerland) Order 2018.—(*Mel Stride.*)

DRAFT DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (UZBEKISTAN) ORDER 2018

Resolved,

That the Committee has considered the draft Double Taxation Relief and International Tax Enforcement (Uzbekistan) Order 2018.—(*Mel Stride.*)

2.55 pm

Committee rose.