PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (LUXEMBOURG) ORDER 2022

Monday 5 September 2022

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not later than

Friday 9 September 2022

The Committee consisted of the following Members:

Chair: Esther McVey

Berry, Jake *(Rossendale and Darwen)* (Con)
† Blunt, Crispin *(Reigate)* (Con)
† Bristow, Paul *(Peterborough)* (Con)
† Elphicke, Mrs Natalie *(Dover)* (Con)
† Frazer, Lucy *(Financial Secretary to the Treasury)*
† Grant, Peter *(Glenrothes)* (SNP)
† Hart, Sally-Ann *(Hastings and Rye)* (Con)
Lloyd, Tony *(Rochdale)* (Lab)
† Mackinlay, Craig *(South Thanet)* (Con)
† Murray, James *(Ealing North)* (Lab/Co-op)
† Richardson, Angela *(Guildford)* (Con)
† Spellar, John *(Warley)* (Lab)
† Syms, Sir Robert *(Poole)* (Con)
† Twist, Liz *(Blaydon)* (Lab)
† Whittaker, Craig *(Lord Commissioner of Her Majesty's Treasury)*
Whittome, Nadia *(Nottingham East)* (Lab)
† Winter, Beth *(Cynon Valley)* (Lab)

Kevin Maddison, Anna Kennedy-O'Brien, *Committee Clerks*

† attended the Committee

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Monday 5 September 2022

[ESTHER MCVEY *in the Chair*]

Draft Double Taxation Relief and International Tax Enforcement (Luxembourg) Order 2022

6 pm

The Financial Secretary to the Treasury (Lucy Frazer): I beg to move,

That the Committee has considered the draft Double Taxation Relief and International Tax Enforcement (Luxembourg) Order 2022.

It is a pleasure to serve under your chairmanship, Ms McVey.

The draft order gives effect to a new replacement double taxation agreement with Luxembourg. The statutory instrument has five main objectives: in a nutshell, it updates an existing agreement so as to make it easier for businesses to understand; it supports cross-border trade and investment; it reduces the tax burden on UK businesses with subsidiaries in Luxembourg; it improves available dispute resolution mechanisms; and it bolsters provisions to tackle tax avoidance and evasion.

I will now turn to the detail of the draft order and the new agreement. As I am sure the Committee understands well, agreements such as this one remove barriers to international trade and investment; they also provide a clear and fair framework for taxing businesses that trade across international borders. Both those things benefit businesses and the economies of signatory countries—in this case, the UK and Luxembourg.

The reality is that our previous agreement with Luxembourg dates back to 1967. As such, it needs updating, for example to reflect changes to the OECD model tax convention and to the domestic tax laws and treaty preferences of both countries. The new agreement also introduces a number of improvements for businesses, individuals and Her Majesty's Revenue and Customs itself. Updating arrangements to follow many of the latest provisions in the OECD model convention will make it easier for businesses to understand their responsibilities and obligations.

One significant issue for larger companies is continuity in the payment of dividends. Dividends between group companies operating across borders in the European Union were previously exempted from so-called source state taxation under the parent subsidiary directive. The new agreement replicates that exemption for the majority of dividends, ensuring that UK businesses with subsidiaries in Luxembourg will not pay tax in Luxembourg on dividends paid to UK companies. The new agreement exempts the majority of dividends from tax, but it preserves our right to tax distribution from UK real estate investment trusts at a rate of 15%, thereby ensuring that the UK will not lose taxing rights where the profits from those REITs are otherwise exempt.

Disputes are another important issue. The draft order gives effect to the minimum standard on improving dispute resolution set out in the final recommendations of the OECD and G20 base erosion and profit shifting—BEPS—project. It does so by changing how disputes involving the application of the agreements are resolved. The changes mean that where taxpayers consider that the agreement has not been applied correctly, they may present their case to either tax authority, rather than just the authority where they are resident. At the same time, any resolution of a dispute will need to be implemented even if the time limits in the domestic law of either territory would otherwise prevent that.

There are also implications for tackling tax avoidance and evasion. Importantly, the new agreement contains all the minimum standards introduced by the BEPS multilateral instrument to ensure that double taxation agreements are not used to avoid or evade tax. The provisions include the statement in the preamble that it is not a purpose of a double taxation agreement to create

"opportunities for…tax evasion or avoidance",

as well as a principal purpose test that denies treaty benefits in the case of abuse.

Other anti-avoidance rules in the new treaty include a tie-breaker provision for determining corporate residence based on a competent authority agreement. There is also a provision in the capital gains article that preserves UK taxing rights on gains from shares that derive their value from property in the UK. Finally, the new agreement provides for mutual assistance in the collection of tax debts.

In conclusion, all these features together strengthen both countries' defences against tax avoidance and evasion, so this agreement is one that the UK and Luxembourg can both be very happy with. The mutual benefits that I have outlined are many. The agreement makes it easier for businesses to understand their obligations and responsibilities, it reduces the tax burden for UK businesses with subsidiaries in Luxembourg, it improves available dispute resolution mechanisms, and it bolsters provisions to tackle tax avoidance and evasion. Above all, it protects UK revenue and provides a stable framework within which trade and investment between the UK and Luxembourg can continue to flourish. For those reasons, I commend the draft order to the Committee.

6.5 pm

James Murray (Ealing North) (Lab/Co-op): It is a pleasure to serve on this Committee with you as Chair, Ms McVey, and I thank the Minister for her opening remarks. I am pleased to respond briefly on behalf of the Opposition.

As we heard from the Minister, the statutory instrument gives relief from double taxation in relation to capital gains tax, corporation tax, income tax and taxes of a similar character imposed by the laws of Luxembourg, as well as relating to international tax enforcement. As we can see, the schedule introduced by the order is largely technical in nature. It follows an approach that is consistent with similar bilateral agreements with other states and territories, and we will not oppose the order. It is important that bilateral agreements concerning taxation are clear.

We also welcome the objective of this double taxation treaty, which the explanatory memorandum makes clear is to

"protect the Exchequer by including provisions to combat tax avoidance and evasion."

These provisions include

"measures providing for the exchange of information between revenue authorities",

in order to

"make it more difficult for residents of both territories to evade taxation by concealing assets offshore."

As the Minister knows from her time in office, the Opposition have been pushing her and her colleagues at every turn to do more to tackle evasion and avoidance. We have pushed them to implement the global minimum corporation tax rate that the OECD and G20 recently agreed, which the Minister mentioned in her speech. Therefore, I will use this opportunity to ask the Minister briefly about the implementation of the OECD agreement.

On 20 July this year, the Treasury published draft legislation that would introduce the new so-called multinational top-up tax. Can the Minister simply confirm whether the new Prime Minister tomorrow will support this legislation? If she cannot confirm that, will she join me in urging the new Prime Minister to continue with this legislation?

Lucy Frazer: I am happy to respond to the hon. Gentleman and I am very pleased to see him after the break. Of course he will realise that as the Prime Minister has just been appointed as the leader of the Conservative party and is yet to go to see the Queen, it would be a little bit premature to set out her plans.

6.8 pm

Peter Grant (Glenrothes) (SNP): I am very pleased to serve under your chairship this afternoon, Ms McVey, and I am delighted to take part in what is by far the most exciting thing to be happening at Westminster this week.

The policy objectives behind this order are ones that we can all support, and I certainly will not seek to divide the Committee today on it. Nobody should have to pay tax twice on the same income; equally, however, nobody should ever be able to dodge their rightful tax liabilities just by moving their money—or, as in most cases, pretending to move their money—to a different country. For those reasons, I particularly welcome the updates to the previous order that show progress towards closing the loopholes that for far too long have allowed wealthy individuals and organisations to use often completely bogus company structures and other dodges to avoid paying their fair share. I have some queries about the detail of the order, and with your leave, Ms McVey, I will discuss each of those in turn.

I welcome the statement in paragraph 7.12 of the explanatory memorandum that tells us that article 5 of the convention

"includes a rule that prevents companies fragmenting their activities in order to avoid the PE threshold"—

the permanent establishment threshold. However, reading through article 5, it is very difficult to find where it says that. Article 5 does not say that in so many words and it does not say it with anything like such clarity, particularly given the Minister's desire, which she expressed in her opening remarks, to make the regulations easier to understand. What we have in article 5, paragraphs 4 to 7, is a convoluted set of ifs, buts, maybes and exceptions. About the fifth or sixth time I read through them, I thought I understood what they mean. Will the Minister explain why that part of the order had to be worded in such labyrinthine fashion? It seems like a lawyer's dream, but I suspect it will be a legislator's nightmare.

The same paragraph of the explanatory memorandum also refers to the fact that some amendments to the definition of "permanent establishment" recommended by the BEPS project are not adopted in the draft order. Will the Minister briefly outline which amendments those are and why the Government do not think it is necessary and appropriate to incorporate them into the draft order?

Paragraph 2 of article 6 confirms that the order applies to the usufruct of immovable property. According to *Hansard,* the word "usufruct" has only been used three times in Parliament during my lifetime—that is four times it has appeared now—and yes, I did have to look it up to find out what it meant.

There are important and welcome provisions in articles 11 and 12 designed to close down a very frequently abused loophole whereby a company could set up a shell, purely fictitious holding company in a low-tax jurisdiction and agree to pay itself outlandish levels of interest, rents or royalties that could make all the profits of the entire operation appear where they would be least taxed. Article 28 has a more general anti-avoidance provision. Again, I welcome it as an important principle of fairness that companies should pay tax on their profits in the jurisdiction where those profits are generated, but will the Minister clarify how that is going to work in practice? I could see, for example, how interest rates could be benchmarked so that it becomes quite obvious if a company is paying excessively high interest rates to its parent company, but how practical will it be to do that with trademarks? There will be an argument that every trademark has a different value. How do we assess or benchmark the value of the Google or Amazon trademark when those companies are similar to any other company in the marketplace, but are also in many ways unique?

Will, for example, HMRC and its Luxembourg counterparts be looking for evidence that such payments are determined by a long-term, legally enforceable contract between the two companies, and cannot just be made up year by year after the company that is going to pay the money has finalised its accounts and decided how much profit it can have? It is astonishing how often subsidiaries of Amazon, Google and so on seem to pay 99.9% of their in-country profits in the way of rent or other payments to their parent company.

A perhaps more important concern is how HMRC and the Treasury can be sure that they have access to accurate and up-to-date information about company ownerships and directors, and the relationships between companies in the UK and elsewhere, when the official register of companies in the United Kingdom is such an utter mess. The Minister may or may not have been called to higher things by the time these discussions are needed, but when she or her successor is speaking to colleagues in the Department for Business, Energy and Industrial Strategy about when the register will be made

[Peter Grant]

fit for purpose, perhaps they could also suggest that companies legislation in the UK should follow tax legislation—follow HMRC's example—and clamp down on those entirely artificial and bogus company structures that, all too often, are created purely to avoid legal requirements. We have seen examples of how it has been made difficult or impossible for companies to avoid their tax requirements, but why is it possible for them to dodge some of their transparency requirements in the UK? Why is it legal for a company to avoid the requirement to publish full accounts or have them audited just by splitting itself into 20 or 30 mini-me companies so that every single one of them comes down below the reporting threshold, despite the fact that they have identical shareholders and directors?

Moving on to other parts of the order, I note with a passing interest the fact that the UK Government still thought it was necessary to retain the provisions in article 13 giving them the right to tax a Luxembourg company on profits arising from some oil and gas activities in the North sea. That comes as a surprise to those of us who were told in 2014 that the oil and gas had run out. I suspect that between now and October 2023, we are going to be told again that the oil and gas under the North sea is worthless.

Article 21 deals with the taxation of wealth or capital. The memorandum points out that there is currently no tax in the UK based on an individual's wealth, but can the Minister confirm that if any future Government were minded to introduce a wealth tax of any kind, it would automatically fall within the scope of the order and we would not need an additional order to cover it?

The provisions of article 24 relate to arbitration and dispute resolution. I welcome the fact that the emphasis is now on trying to do things by agreement, and only to go to arbitration as the last resort. Will the Minister clarify how the arbitrator is appointed and, importantly, who pays the cost of arbitration, because it can become an expensive business? How do the Government propose to discourage vexatious or entirely groundless applications for arbitration without unintentionally making it impossible for individuals or organisations who may well have valid grounds for testing the validity of a decision?

Finally, I ask the Minister to confirm, on the record, that article 26, on the exchange of information, is entirely compliant with the general data protection regulation. I fully support in principle tax authorities exchanging information when necessary to catch out people who too often use secrecy to conceal what they are doing and their ill-gotten gains, but if two different jurisdictions are exchanging information, it is important that both agree to comply at all times with the higher of the two standards of data protection applicable. Will the Minister confirm that that will be done with the legislation as it is, and reassure us that should there be any divergence between the UK and Luxembourg through one or the other weakening its current data protection laws, the data rights of UK citizens will not be weakened as a result?

With those comments, I will be happy to support the order going through tonight, but I do have some questions on detail that hopefully the Minister can answer. If she cannot just now, she can possibly write to me at a later date.

6.16 pm

Lucy Frazer: I thank the hon. Member for Glenrothes for his detailed and interesting questions. I hope to be able to respond to at least some of them. The hon. Member asked how the principal purpose test applies in practice. The answer is that HMRC has a long history of dealing with avoidance provisions of this type, and the same principles will be applied here, supported by existing guidance and OECD commentary.

The hon. Member asked about anti-fragmentation and the complicated wording; I assure him that it is standard OECD wording, which has been adopted by all countries. He also asked about any potential new capital articles. I would reassure him that the provision would cover any new UK tax on capital. On how arbitration works, the costs will be paid by the states and details of the operation are set out by a competent authority agreement. On whether article 26 complies with GDPR, the answer is yes, it is fully compliant with GDPR provisions.

The hon. Member pointed out the issues of beneficial ownership. He will know that the UK was the first country to introduce a public register of ultimate beneficial owners of companies—the people with significant control register. Recently, we have also introduced a largely public register of beneficial owners of overseas entities that own UK property, and we expect that new register will be useful in tackling tax non-compliance as well as economic crimes.

Peter Grant: On the question of the register of beneficial ownership, how effective—if indeed they exist at all—are the penalties for knowingly providing false information, or for knowingly withholding information? I regularly look at companies' records at Companies House where it is clear from looking at the shareholdings that someone has very substantial control, yet the official register says that no one has significant control. When will the requirement to report that actually be given teeth, so that it becomes mandatory, instead of effectively voluntary as it is now?

Lucy Frazer: It is of course important that we have penalties appropriate to the provisions in any legislation. The hon. Gentleman will know that we are looking very carefully at the issue of beneficial ownership. He also asked about a wealth tax; there is no current intention to bring in any wealth tax. For all those reasons, I commend the draft order to the Committee.

Question put and agreed to.

6.19 pm

Committee rose.