Global tax guide to doing business in the United Kingdom

Overview

The UK imposes corporate and personal income taxes and capital gains taxes on the worldwide income and gains of its residents. Non-residents who carry on business in the UK, who are entitled to income with a source in the UK or who hold interests in land or buildings situated in the UK may also be subject to UK taxation.

Although the UK does not have a fully federal system of government, competence for certain taxation matters has been devolved from the UK Parliament to the devolved administrations in Scotland and Wales.

The UK imposes a 20% withholding tax on non-residents who receive certain interest payments, rents or royalties from the UK. The payer of any such amounts is liable for withholding and remitting this tax on behalf of the non-resident recipient. Generally, no withholding is imposed on dividends paid by UK companies or payments for management or other professional services.

The UK has an extensive double taxation treaty network that will reduce or eliminate the 20% withholding tax rate in many cases. While it has also been possible for EU residents to benefit from the provisions of the EU Interest and Royalties Directive in respect of relevant UK withholding taxes, this is not expected to continue once the UK ceases to be a member of the EU.

The UK is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), which it ratified on June 29, 2018. The ratification process for individual UK treaties is not yet complete.

Value-added tax applies to supplies of goods and services made in the UK and will continue to apply in a modified form following the UK's departure from the EU. In addition, land transaction taxes apply in each of the UK's constituent jurisdictions, while stamp taxes apply to the purchase of securities.

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Legal system

The UK is a constitutional monarchy consisting of three separate jurisdictions: England & Wales, Scotland and Northern Ireland. Each jurisdiction has its own legal system, based on a mixture of statutory and common law. The principal legislative body is the UK Parliament, which may pass legislation that applies to all or some of the jurisdictions. The monarch's role in the legislative process is now ceremonial, although it remains the case that primary legislation takes effect only once Royal Assent has been given.

Following the passage of the Scotland Act 1998 and the Government of Wales Act 1998, legislative competence over certain matters was devolved from the UK Parliament to the Scottish Parliament and the National Assembly for Wales respectively. These include the power to make legislation in respect of certain aspects of the taxation system in Scotland and Wales. The Good Friday Agreement in 1998 led to the establishment of the Northern Ireland Assembly, the devolved legislative body for Northern Ireland. Taxation is outside the field of competence of the Assembly.

The UK ceased to be a member of the European Union on 31 January 2020, but remains subject to European law, including the EU customs and value-added tax regimes, for a transitional period until 31 December 2020.

Taxation authorities

HM Revenue & Customs (HMRC) is the unitary taxation authority in the UK, formed following the merger of the Inland Revenue and HM Customs and Excise in 2005. HMRC is responsible for the administration and collection of all UK taxes, including value-added tax and customs and excise duties.

The taxation authorities responsible for the administration and collection of taxes devolved to Scotland and Wales are, respectively, Revenue Scotland and the Welsh Revenue Authority.

Business vehicles

A non-UK resident may establish either a UK business vehicle to carry on business in the UK or operate directly through a non-UK entity (with or without a UK permanent establishment). UK business vehicles include companies (limited or unlimited) and partnerships (general, limited or limited liability). While it is also possible to use certain trust structures to carry on business in the UK, these are less commonly used.

Partnerships

Most forms of business in the UK may be carried on by a partnership, provided two or more partners carry on business with a view to a profit. General, limited and limited liability partnerships are available in the UK.

General partnerships are unincorporated partnerships in which the constituent partners have unlimited liability for the debts and obligations of the partnership. Limited partnerships are similarly formed, but must have at least one general partner (which may itself be a limited liability company or other limited liability entity) with unlimited liability for the debts and obligations of the partnership. A limited partner in a limited partnership is liable for the partnership's debts only up to the amount of its capital contribution.

In Scotland (but not England & Wales or Northern Ireland), both general and limited partnerships have legal personhood separate from that of their partners.

Unlike general and limited partnerships, limited liability partnerships are bodies corporate. A limited liability partnership has legal personality separate from that of its members, who generally have no personal liability for the debts and obligations of the partnership.

For UK tax purposes, general, limited and limited liability partnerships are each normally treated as fiscally transparent for direct tax purposes, meaning that taxes on income and capital gains are assessed on the members individually according to their attributable share of the income or gains, rather than on the partnership itself.

A partnership (or its designated nominee partner) is required to file an annual partnership tax return on behalf of all the partners showing, among other things, the taxable profits or losses of the partnership and their allocation among the partners. Returns for partnerships that have partners who are not resident in the UK do not need to include full details of the non-resident partners if the remaining partners reasonably believe the non-resident partner(s) will not have a UK tax liability in respect of their partnership profits.

The partnership return is then used by each partner that has a UK tax filing obligation as the basis for the partnership section of the partner's individual tax return.

Private companies limited by shares

The private company limited by shares is the most common form of trading entity in the UK and is generally incorporated as a subsidiary of a non-UK holding company or as a stand-alone company. The liability of the shareholders is limited to the fully paid-up amount of the shares in the company. There is no minimum share capital requirement for a private limited company, nor any requirement that the capital must be paid up. A single shareholder/director may incorporate the company, and there is no maximum number of directors or any legal requirement for any of the directors to be a UK resident or national. Such companies may be incorporated quickly (often same day).

A company will be UK-resident if it is incorporated in the UK or if its place of central management and control is in the UK, unless a double tax treaty applies to allocate the company's residence elsewhere. A UK-resident company is subject to corporation tax on its worldwide income profits and capital gains, with credit generally granted for overseas taxes paid.

Private companies limited by guarantee

Private companies limited by guarantee are normally incorporated for non–profit making functions (e.g., charities, property management companies, trade and research associations). With no shareholders, members undertake to contribute a predetermined nominal sum to the liabilities of the company, which becomes due in the event of the company being wound up.

As a corporate body, the tax treatment rules are the same as for private companies limited by shares. However, a company limited by guarantee does not have ordinary share capital and therefore cannot benefit from grouping provisions in UK tax law (which can allow tax neutral asset transfers and utilization of tax losses within a group).

Unlimited liability companies

The UK permits the incorporation of a private unlimited liability company, which may be formed with a single member. Such a company does not provide protection to members or shareholders from the liabilities of the company in event of formal liquidation. As the members and shareholders have no limit on their liability, rules regulating the maintenance of capital do not apply to unlimited companies to the same extent as they apply to limited companies. An unlimited company can therefore help to facilitate the free movement of capital within a group. In terms of reductions of share capital, redemptions and purchases of its own shares, an unlimited company enjoys far greater flexibility than a limited company.

An unlimited company is not required to have a share capital, and there are only limited circumstances in which an unlimited company is required to file accounts with Companies House (the body responsible for maintaining the UK register of companies) or to return allotments of shares.

An unlimited liability company is subject to tax on the same basis as a private company limited by shares.

Companies incorporated outside the UK

Companies incorporated outside the UK seeking to set up a place of business in the UK will be required to register with Companies House as an overseas company (note that partnerships and unincorporated bodies are not able to register). Companies are not required to register with Companies House unless they have a base in the UK.

A company that is incorporated outside the UK is only liable to UK tax on its worldwide profits if it is UK tax resident because its central management and control is in the UK. In other situations, a company incorporated outside the UK is liable to UK corporation tax only if it carries on a trade in the UK through a UK permanent establishment (and then only in respect of the profits or gains attributable to the permanent establishment), if it carries on a trade of dealing in or developing interests in land or buildings situated in the UK (in respect of the profits of that trade, if it receives rental income from land or buildings situated in the UK (in respect of the income) or if it makes gains within the scope of the non-resident chargeable gains rules (and then only in respect of these gains). The non-resident chargeable gains rules extended the territorial scope of corporation tax from April 2019, to non-UK resident companies that realize capital gains from the disposal of interests in land or buildings situated in the UK or from the disposal of certain interests in certain UK property-rich entities. The extension of corporation tax to non-UK resident companies that receive rental income from land and buildings situation in the UK has only applied from April 2020.

The current rate of corporation tax is 19%. The UK's corporation tax rate is lower than that of several major economies, and is particularly attractive in comparison to many European countries' rates.

A non-UK resident company that is not subject to corporation tax may be subject to income tax if it derives income from a source in the UK, although the charge to income tax in respect of passive income is typically limited to the amount of tax (if any) withheld at source.

In each case, relief may be available if the relevant income, profits or gains are already subject to tax in another country, where a relevant double taxation treaty is in force.

Furthermore, an overseas company may have to register and account for VAT and account for PAYE income tax and National Insurance Contributions in relation to employees.

Financing a corporate subsidiary

Equity financing

Contributions for shares

Where an equity investment is made into a UK company with a share capital in exchange for new shares, the amount of the investment is first allocated to the nominal value of each share acquired (which value is governed by the articles of association, for example £1 each) and the excess will be included in the share premium account.

A company's share capital is made up of the shares that it has issued to its members, whether on, or subsequent to, its incorporation. The UK companies legislation allows significant flexibility in the formation of a company, as well as the ability to change the articles of a company at a later date and divide shares into various different classes.

Specific additional rules apply to different forms of body corporate. For example, public companies are required to have a minimum issued share capital of £50,000.

Returns to shareholders

Subject to solvency requirements and, in certain cases, the consent of the court, a UK company limited by shares may reduce its share capital by making payments to shareholders out of capital or by redeeming shares. A company may also purchase its own shares, but only where it is able to fund the purchase out of distributable reserves or the proceeds of a fresh issue of shares. Other than attracting stamp duties (at a rate of 0.5%) in certain cases, a return of capital funded from cash resources would not ordinarily have significant tax consequences for the company.

A company limited by shares may only make a distribution to its members (including the declaration of a dividend) out of "distributable reserves." Generally, distributable reserves are made up of the profits generated or accumulated by that company.

Except in certain limited cases, there is no withholding tax in the UK on the payment of dividends by a UK-incorporated company.

Corporate capital

There is no tax on corporate capital, branch remittance tax, excess profits or alternative minimum tax in the UK.

Debt financing

Withholding tax implications

Payments of "yearly" interest with a UK source are generally subject to withholding tax at a rate of 20%. An exception may apply where the recipient of the interest is subject to UK corporation tax in respect of the interest, so that interest payable in respect of loans made by non-UK companies or banks through a permanent establishment situated in the UK should normally be exempt from withholding. The rate of withholding on interest payable to a non-resident lender may be reduced or eliminated under an applicable double taxation treaty or, in relation to EU lenders (while the UK remains part of the European Union), under the EU Interest and Royalties Directive.

There is no withholding in the UK on the repayment of the principal amount of a loan.

Thin capitalization

If a UK subsidiary is financed with debt, it may be subject to thin capitalization rules. These rules, which now form part of the UK's transfer pricing regime, restrict the deductibility of interest paid or payable by a corporation that is tax-resident in the UK to certain non-resident shareholders where the ratio of interest-bearing debt to equity exceeds what a third party would agree to lend to that company, taking into consideration the borrower's particular circumstances. To the extent that debt is excessive, there will be a proportionate denial of the interest deduction.

Since the UK does not operate a safe harbour in relation to thin capitalization, each case will need to be considered in light of its own facts and circumstances and benchmarked for transfer pricing purposes.

Corporate interest restrictions

The UK has introduced rules to counter the use of perceived "excessive debt" interest deductions. However, the rules only apply to net interest expenditure that exceeds £2 million and, thus, a significant portion of companies would not have to consider these rules.

Broadly, the rules limit the deductibility of interest that exceeds 30% of the UK "tax EBITDA" and the group's global ratio of net interest to "tax EBITDA".

The rules are complicated and apply on a group by group basis and require more complicated ratio analysis and calculations. Corporations that may trigger these rules should seek to run the calculations and obtain advice on their applicability.

Stamp tax

The UK does not impose a stamp tax in respect of debt or equity financing.

Corporate income tax

Rate of corporation tax

The rate of corporation tax is currently 19%. The rate was due to reduce to 17% for the financial year commencing April 1, 2020, however at Budget 2020 the Government confirmed its pre-election pledge that the rate would be maintained at 19% for financial year 2020. Finance Bill 19-21 (at draft stage at the time of writing) includes legislation to implement this. The rate applies to both income profits and capital gains, and to both UK-resident companies and non-UK resident companies within the corporation tax regime.

Non-UK resident companies that are subject to income tax in respect of their UK-source income are subject to tax at the income tax basic rate of 20%. However, from 6 April 2020, non-UK resident companies in receipt of income from UK property are subject to corporation tax on that income, rather than income tax, as was previously the case.

Capital gains

A UK-resident company must include chargeable capital gains that arise on the disposal of its worldwide assets in its taxable profits for the purposes of corporation tax, while a non-UK resident company which carries on a trade in the UK through a UK permanent establishment must include such chargeable capital gains as arise on the disposal of UK-situs assets held for the purposes of the permanent establishment.

Currently, a non-UK resident company that realizes capital gains from residential property situated in the UK may be subject to capital gains tax in respect of the gains. With effect from April 2019, the charge to corporation tax was extended to non-UK resident companies that realize capital gains from the disposal of all interests in land or buildings situated in the UK or from the disposal of certain interests in certain UK property-rich entities, subject to certain exemptions.

Computation of taxable income

Taxable base

The taxable base depends on the source of the income and on whether the entity is subject to corporation tax or income tax in respect of the income.

In the case of a company that carries on a trade or property business, its taxable trading profits will be based in the first instance on its accounting profits—provided that its accounts are computed in accordance with UK generally accepted accounting principles (GAAP) or international accounting standards (IAS)—as adjusted for tax purposes. For example, it will be necessary to adjust the accounting profit or loss to exclude receipts and expenses of a capital nature, and to exclude expenditure that is not wholly and exclusively incurred for the purposes of the trade or property business.

Companies deriving investment income from passive sources will generally be subject to corporation tax or income tax on the gross amount of the income, although a company within the corporation tax regime carrying on an investment business may be entitled to a deduction for the expenses of managing its investments, provided that the expenses are revenue in nature.

Chargeable gains

Broadly, chargeable gains are calculated by deducting the acquisition cost and any enhancement expenditure incurred in respect of the assets from the proceeds of disposal. Generally, capital losses arising on the disposal of an asset must be offset against gains arising in the same taxable period or carried forward and offset against gains arising in future periods.

Corporation tax reporting

Companies are subject to a self-assessment regime in the UK and must notify HMRC when they first come within the charge to UK tax.

A company within the charge to corporation tax is required to report by reference to accounting periods, which will generally be aligned with the company's own period of account, provided that such period does not exceed 12 months. The company must file its tax return within 12 months after the end of the accounting period to which it relates.

A company within the charge to income tax will generally be required to report its income by reference to the UK tax year, from April 6 to April 5, and to submit its income tax return by the next January 31 following the end of the relevant tax year.

Cross-border payments

Transfer pricing

The UK's transfer pricing regime largely conforms to the principles of the Organisation for Economic Co-operation and Development (OECD) and generally seeks to prevent connected parties obtaining a UK tax advantage by entering into transactions on the basis of non–arm's length pricing. Under the applicable rules, it may be necessary for companies to make a transfer pricing adjustment in respect of a transaction that is not made on arm’s length terms, to the extent that a UK tax advantage as been obtained. UK taxpayers must maintain contemporaneous documentation in respect of transactions subject to the transfer pricing rules.

Generally, an exemption from the transfer pricing rules applies to companies that are classified as small or medium-sized entities under European guidelines (entities with fewer than 250 employees and either a turnover of less than €50 million or an annual balance sheet value of less than €43 million).

Withholding tax on passive income

Payments made by a resident of the UK to a non-resident in respect of certain types of interest payments, royalties and dividends may be subject to UK tax withholding. Specifically, UK withholding at the rate of 20% may be imposed on payments of "yearly" interest where such interest payments have a UK source, and also on payments of royalties paid in connection with certain types of IP rights, including patents, copyright and design rights.

The UK does not impose withholding tax on dividends paid by UK-incorporated companies, except in limited circumstances.

Payments for professional services and other services outside the above descriptions may generally be made free from UK tax withholding.

In all cases where a UK withholding tax obligation does arise, the rate may be reduced or relieved entirely under an applicable double taxation treaty.

Direct tax on UK related IP sales

The UK also has provisions which, broadly, can apply to non UK residents generating income of greater than £10 million from IP that is derived from UK sales, and that income is received in an offshore territory where it is taxed at nil or low effective rates. Income tax at 20% may apply to the relevant proportion of their income which is related to the sale of goods/services in the UK.

Payroll taxes

Employment tax

Employees (including, for these purposes, directors and other officeholders) are subject to UK income tax in relation to their employment income and benefits. Individuals have a tax-free personal allowance, with all income above this amount being taxable. The rates of income tax are progressive, with different rates applying depending on how much annual income falls into different bands. Employers are responsible for deducting amounts of income tax from the sums paid to employees and paying them to HMRC under the pay as you earn (PAYE) regime.

Employment insurance

In addition to income tax, employees (including directors and other officeholders) and their employers are liable to pay National Insurance contributions (NICs) based on the employees' employment income. The contributions are made up of a deduction from the employee's pay, and an amount paid by their employer. The employer is responsible for withholding the employee's NICs and for paying this (along with the employer's NICs) to HMRC. Employers' NICs are currently chargeable at a rate of 13.8%.

Indirect taxes

Value-added tax (VAT)

Value-added tax (VAT) is imposed on the final consumption of most goods and services supplied in the UK. Specific rules with respect to the place of supply exist to determine whether a supply is deemed to be made in UK.

The current VAT rate is 20%, with a 5% rate for certain prescribed supplies (e.g., energy for domestic use). In addition, certain "zero-rated" supplies are subject to VAT at the rate of 0% (e.g., exported goods and services, prescription drugs, newly constructed residential property and basic groceries) or are exempt from VAT (e.g., health care services, educational services and most financial services).

Since the burden of VAT is intended to fall on the final consumer of the relevant goods or services, businesses engaged in making only supplies of goods or services that are subject to VAT (whether at the 20%, 5% or 0% rate) will generally be entitled to recover their VAT costs in full.

VAT in the UK was implemented on the basis of EU law. While it is expected that VAT will remain predominantly unmodified following the UK's exit from the EU at the end of the current transition period, substantive changes to the regime cannot be completely written off.

Land transaction taxes

Land transaction taxes are payable in the UK in respect of the acquisition of interests in UK real property, including the grant of a lease. In England and Northern Ireland, this is stamp duty land tax. In Scotland and Wales, competence for the imposition and administration of land transaction taxes has been transferred to the devolved administrations. The Scottish and Welsh equivalents of stamp duty land tax are known as land and business transaction tax and land transaction tax, respectively. The different regimes are based on broadly the same principles, but with certain local variations, including in respect of rates, reliefs and their application in certain situations.

Stamp duty and stamp duty reserve tax (SDRT)

Two transfer taxes, stamp duty and SDRT, are payable in the UK by a purchaser on the acquisition of securities (which can include both shares in a company and certain loan instruments) pursuant to a transaction of sale. In the normal course, the taxes apply only to the purchase of securities issued by UK-incorporated companies.

Stamp duty is charged on the document transferring the security and, where payable, the document must be submitted to HMRC for the duty to be physically stamped onto it. Technically, SDRT applies to all agreements to sell securities, but is waived where stamp duty is paid. In practice, SDRT applies only to agreements for the sale of securities held in uncertificated form. The rate of both stamp duty and SDRT is currently 0.5% of the consideration paid for the securities. Both taxes are subject to numerous exemptions and reliefs.

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