BUDGET 2000

Gordon Brown's hidden blow to 'mixers'

When Gordon Brown removed the ability of UK-based multinationals to use dividend mixer companies in his Budget on 21 March he delivered a serious blow to the UK's future as a base for global businesses. However, it is not quite true to say that he delivered this blow because, like so many important measures introduced in previous years, there was no mention of this change in the Budget speech; it was buried in one of the many Inland Revenue press releases accompanying the Budget. But it was no less effective for that.

Dividend mixer companies have been used by UK-based multinationals for many years to compensate for one of the failings of the UK system for double tax relief, and as such have become an accepted tax planning technique. In much the same way, companies have been allowed to transfer capital assets intra-group prior to an external sale in order to obtain effective group relief for capital losses, in spite of the obviously artificial nature of this. The difference is that this latter technique has been satisfactorily replaced in the March Budget by an election mechanism whereas dividend mixers have simply been eliminated.

Overseas investments

When the current system of double tax relief was created, in the early 1950s, the UK was predominantly a manufacturing country which exported much of its output. Few UK companies had substantial overseas investments and the profits which they generated overseas were small in comparison with those generated by the main manufacturing operation in the UK.

This basic double tax relief system did unfortunately have a vital flaw in that dividends received in the UK from overseas subsidiaries are subject to tax again in the UK, but credit is given against the UK tax liability for any tax paid by the overseas subsidiary, thus avoiding double taxation. This credit is however calculated on a source-by-source basis such that if the overseas tax paid in respect of a particular dividend is higher than the UK tax payable, then no further UK tax is payable, but, if the overseas tax paid on that dividend is higher than the UK tax payable, then UK tax equal to the difference is payable. This means that the amount of tax paid overall is the greater of the overseas rate of tax or the UK rate of tax.

Dividend mixing, usually by the use of an intermediate Dutch holding company, enables the parent company to mix the rates of tax paid by its overseas subsidiaries and, in effect, offset the tax paid in excess of UK rates in high tax territories against the UK tax which would otherwise be due in respect of dividends received from low tax territories. This undoubtedly can be seen as an artificial arrangement but it does, as the Inland Revenue has admitted in its own consultative document published last year, deliver capital export neutrality, which most economic commentators would see as a good thing for the parent company of a global business.

Competitiveness

Over the years since its creation therefore, the UK's double tax relief system has been modified by this practice such that the UK has maintained its international competitiveness. The changes in this year's Budget, by eliminating offshore mixing, have taken the essential elements of the system back to its original structure as designed in the 1950s. The UK's position in the world has changed since then and it is clearly essential for the future economic health of the country that it has a tax system which reflects this change.

It is of vital importance to the UK's global commercial position that it should remain 'a good place to do business in and a good place to do business from'. Having multinational companies based in the UK is essential for a robust UK economy and to enable the country to retain a high quality, well educated workforce. It is essential therefore that it has a tax system which does not drive them away.

The changes to double tax relief in this year's Budget mean that the UK now has the least attractive tax environment for the parent company of a multinational group of any of the G7 countries. Most continental European countries have an exemption system which means that no further tax is charged at the parent company level when dividends are remitted, and even the US, which is not usually renowned for its taxpayer friendly policies, permits dividend mixing. Why, when he is clearly so proud of having one of the lowest corporate tax rates in the OECD, does Gordon Brown think we should have a double tax relief system that is so clearly worse than that of our major competitors?

The net result of these changes is likely to be that existing UK multinationals will not remit profits to this country from overseas subsidiaries, or will even be tempted to move outside the UK to a more attractive tax regime, perhaps on mainland Europe. It is certain that foreign multinationals from outside the EU who would previously have looked to the UK as a natural base for their EU headquarters operations will now look elsewhere.

It is clear that the only rationale for these changes is to raise more revenue. In this case however, for the long term health of the country, it looks like the Government has chosen the wrong target. The Association is lobbying hard for the government to reconsider the Budget proposals on the changes to double tax relief. ■

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