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Knightsbridge Wealth

technical news

For professionals working with international clients

Taxing Big Tech

The G7 group of nations has agreed to historic changes in the way multinational companies are taxed. Usually, multinational companies have paid tax in the jurisdiction where they are based. But, as the world economy globalised, it has increasingly fostered a complex web of ownership structures, tax havens and other jurisdiction-hopping that lets profit-making machines pay virtually no corporate taxes in places where they do lots of business. That strikes many people as unfair.

There are two parts to the changes agreed by the G7. First, the 100 biggest global companies with profit margins of at least 10% will henceforth have to pay tax on 20% of profits (above the 10% margin) in the countries where they make sales, rather than where they are legally registered. Second, there'll be an agreed global minimum rate (for countries that agree) of "at least" 15% corporation tax on overseas profits, together with ancillary measures that wipe out the advantages of shifting profits to low-tax jurisdictions. The details have yet to be worked out, and the deal faces a fierce battle to get through national legislatures. But these are potentially historic changes.

The pandemic has seen many rich-country governments scrambling to deal with plunging revenues and ballooning deficits, while tech firms have enjoyed a working-from-home surge in profits. That concentrated minds in Europe. Silicon Valley giants such as Facebook and Google have been criticised for years for paying minimal taxes in markets where they book billions of dollars in sales. Campaign group TaxWatch estimates that tech giants avoided £1.5bn of UK taxes in 2019. But the crucial factor is the departure of the unilateralist US president Donald Trump and the arrival of Joe Biden.

Biden is determined to drive up the corporate tax-take to help fund his $6trn spending plans. Biden originally wanted a 20% global minimum, in the hopes that a sufficiently high level would shield the US economy from the potentially anticompetitive consequences of his planned rise in corporate taxes from 21% to 28%. What we are seeing is a trade-off. The rich nations are heading towards a global tax regime in which America will allow foreigners to tax US companies, without tariff retaliation, in return for an agreement from other countries to a minimum tax rate that allows Biden to proceed with the construction of a European-style, expansive welfare state in America.

Some sceptics worry that higher corporate taxes simply mean higher prices for consumers. And the proposals are pretty modest as they stand, since the way they are framed doesn't even catch Amazon in the net (its profit rate is less than 10%) and the proposed new global minimum tax rate of 15% is low. Indeed, within the OECD club of rich nations, only Ireland (12.5%), Chile (10%) and Hungary (9%) currently set corporate tax rates lower than that. Expectations of a massive tax windfall are therefore misplaced. EU multinationals would have to pay about €50bn or 15% extra in global taxes. Similarly, the UK would collect an extra £7.9bn. But these estimates may be overblown. Scaling up an earlier OECD estimate suggests extra revenues of less than 4%, or $84bn, the biggest share of which would be paid by tech giants and other US multinationals to the US government.

The direct macroeconomic benefits of the deal look limited. What makes it so important is that wealthy nations have found renewed determination under a Biden presidency to cooperate on global issues, which may pay dividends in other areas in years to come. For the rich G7 to agree in principle to give up some tax sovereignty is a genuine milestone, in that it signals a willingness to work together more smoothly on global issues. Against this backdrop, trade disputes among Western allies are less likely, and coordinated action to tackle climate change is more probable.

Who loses? There'll be an impact on low-tax European jurisdictions such as Ireland, Hungary, and Cyprus, though it won't be seismic: 15% is still a very low rate by global standards. But where things look really bleak is in the tax havens such as Bermuda, the British Virgin Islands and the Cayman Islands. The proposed deal would blow up these zero-tax territories' whole business model as it applies to corporates. They may not make anything in direct corporation tax revenues, but they do depend on fees from subsidiaries of large companies and the multitude of accountants, lawyers and other providers that serve them. Some such jurisdictions have other revenue streams at least. But even so they are livid about the G7 plan – and there's nothing they can do about it.

The new deal will cost $50bn-$80bn a year in additional tax receipts for the world's largest multinationals. Yet, big tech stocks were not much moved by the announcement. And the agreement may even prove positive at the margin for global equities. That's because, even though the agreement will be negative for the earnings of the big tech and big pharma companies which have made most use of profit-shifting techniques, the deal will avert the brewing transatlantic trade war over digital taxes.

Longer term, though, there's more for investors to fear. Reduced tax competition between national governments can hardly be healthy for equities.

St Kitts & Nevis Residency Service launched

Individuals and families are becoming increasingly mobile and the ability to hold a second passport is becoming more relevant. Knightsbridge Wealth works with leading immigration lawyers and investment managers to secure residency in the jurisdictions appropriate to our clients' needs. Whilst the UK is the preferred solution, many are simply not able to meet the minimum stay requirements, particularly where they run overseas businesses. In addition to the UK, we have recently advised clients on the schemes available in Portugal, Malta and Cyprus. In addition, we are now launching a new specialist service for those seeking citizenship in St Kitts and Nevis.

The Caribbean is an attractive destination for a number of reasons, including the relaxing lifestyle, beautiful scenery and the climate. There are also opportunities to hold a second passport, even if the immediate intention is not to relocate to the Caribbean.

There are a variety of reasons why people wish to acquire a second or alternate citizenship:

- To offer insurance against political, economic or fiscal change in the individual's country of origin.
- To make international travel easier. Nationals of many countries have to endure lengthy waiting periods to obtain visas for travel. This may be because they are nationals of a developing country or there may be animosity between their country and another.
- To allow the passport holder to avoid discrimination.
- To present new opportunities for the tax structuring of personal tax affairs. Generally, an individual's residence and citizenship are the ultimate basis for the majority of taxation rulings.
- Citizens of the United States of America are subject to tax on their worldwide income, irrespective of their country of residence. They are denied the residence-linked tax planning opportunities that are available to others. It is possible for such individuals to gain fiscal advantages by acquiring a new citizenship and renouncing their original citizenship.

There are a number of different options for Citizenship within the Caribbean. The most popular passport schemes include St Kitts & Nevis, Grenada and Dominica.

Key features of the St Kitts & Nevis scheme are that:

- Passport holders enjoy full Schengen privileges and do not require a visa to visit the UK. A St Kitts & Nevis passport enables travel to approximately 156 countries worldwide either on a visa free or visa on entry basis. This includes residency rights in many Caribbean countries.
- Worldwide income is not taxed.
- Individuals do not need to visit St Kitts & Nevis to apply to the scheme, as long as a licensed service provider is used to coordinate the application.
- There is no obligation to reside in St Kitts & Nevis or to spend any time there if the individual does not wish to do so.
- The application process is simple, and we assist with the collection and completion of the various forms before submission.

The St Kitts & Nevis Economic Citizenship Programme offers three alternate investment routes:

- The Real Estate Option is Investment in an approved property worth a minimum of US$400,000. property must be held for a minimum of five years after citizenship has been granted.
- The Luxury Real Estate option is investment in new luxury real estate worth a minimum of US$200,000. The real estate must be held for a minimum of seven years after citizenship has been granted.
- Sustainable Growth Fund (SGF) Contribution of $150,000 or, for a family of four $195,000. For additional dependants, regardless of age, the contribution requirement is US$10,000 per dependant.

Usually, processing time for any of the routes above to gain St Kitts & Nevis Economic Citizenship is approximately three months. That time can be halved by using a fast-track option.

Please contact us for further information if this may be of interest to your clients.

UK Tax rises

Perhaps we shouldn't fear the UK Chancellors proposed tax rises. A booming economy, tax competition and furious lobbying mean they may never happen.

In 2023, the corporate tax rate will rise from 19% to 25%. True, there will be tiers for smaller businesses and a new 'super-deduction' for capital spending. Even so, plenty of businesses will be nervous about that, and so will investors. Rising tax rates cut right into profits that might otherwise have been given back to shareholders. But don't panic. A week can be a long time in politics – two years is an eternity. It may not ever happen.

If enacted, this will be the steepest rise in tax on businesses since the Labour chancellors Roy Jenkins and Denis Healey were in charge of the British economy in the 1960s and 1970s. It will move the UK into one of a dwindling group of countries where the state takes a quarter of any profits a business makes. And it will reverse a decade-long plan to make Britain one of the most tax-competitive countries in the world for multinationals.

However, it might not be necessary. With the success of the vaccine roll-out and US president Joe Biden's massive

stimulus package accelerating a global recovery, the economy may do a lot better over the next two years than anyone expects right now. Growth in the 6%-8% range is perfectly possible, so tax receipts should soar anyway. Ironically, that may well be led by corporation tax, even at the existing 19% rate, because firms will be making a lot of money in a recovery that strong and also because working from home and shifting business online over the pandemic will have improved the fundamental profitability of many businesses. If money is pouring into the Treasury at a much faster rate than forecast, and with an election looming, the chancellor might decide that a dramatic improvement in the public finances means a tax rise is not necessary after all.

Second, other countries may cut taxes. President Biden's pledge to raise the US corporate tax rate to 28%, reversing part of Donald Trump's dramatic cut, was a key part of the logic behind the British move. If other countries are putting rates up, then it is safe for the UK to do so as well, and it can still maintain its competitive advantage. The trouble is, we don't know if the US will actually raise rates (presidents, after all, don't have the power to raise taxes by themselves – it is up to Congress), and there is no sign of other countries raising taxes. Indeed, with massive stimulus programmes around the world, it wouldn't be a surprise if they were cut elsewhere.

By 2023, a 25% corporate rate may look wildly uncompetitive, especially in a world where taxes are still falling.

Finally, expect some furious lobbying. Over two years, business will have lots of time to campaign against such a steep increase. In the middle of a pandemic, it is hard for anyone to complain about making sacrifices. It looks bad. But as that subsides and life gets back to normal, there will be more and more protests. One or two big companies may decide they can move to Ireland (with a corporate tax rate of 12.5%) or Hungary (9%) or even Sweden (21%), with plenty more putting out statements that they are examining all their options and reminding everyone they have a duty to serve their shareholders to save money where they can. In an ever more mobile, digital economy, it is hard to tax corporations that can move assets from place to place. The UK may be about to learn that the hard way – it may take only one or two big moves to force a change.

One thing we have learned during Sunak's short time as chancellor is that he is willing to change his mind. He was going to wind up the Covid furlough scheme after three months, but a year later it is still going strong.

The self-employed were left to fend for themselves, then rescued; he was in favour of opening up the economy, then locking it down again. Like most effective politicians, he can change his mind in an instant. Business and investors may be worried about a steep rise in taxes. But it is a long way off – and there are compelling reasons to think it won't ever actually happen.

Global Britain's first step

Prime Minister Boris Johnson and Australian leader Scott Morrison recently announced a "new dawn" in the form of a trade deal between the two countries. Although still only an agreement in principle, with details yet to be hammered out, this is the first genuinely new trade deal negotiated by Britain since leaving the European Union.

UK producers of cars, Scotch whisky and confectionery are expected to be winners from the removal of Australian barriers. Australian producers of beef, lamb and sugar will benefit from the removal of UK tariffs and quotas.

Ministers stress that the agreement will mean that consumers will have more choice on the supermarket shelves, but the estimated savings are expected to add up to £34m a year, little more than £1 each per household. Overall, the deal is expected to boost UK GDP by up to 0.02% after 15 years – barely a rounding error for Britain's £2trn economy. Meanwhile, there are fears that British farmers will be undercut by cheap Australian imports and that any relaxation of existing food standards will only aggravate the current dispute over sausage exports to Northern Ireland.

Business groups are already pointing out that on its own the deal with Australia is not nearly enough to counteract what the UK gave up when it chose to exit the EU. The EU accounts for 47% of UK trade; trade with Australia only around 1.2% of the UK's total. The Office for Budget Responsibility estimates that the new trade deal with the EU is expected to lead to a long-run loss of output of around 4%, so the UK has a mammoth task ahead of it if it wants to negotiate enough trade deals to compensate for Brexit.

However, that may miss the point. The deal with Australia will also pave the way for the UK to join the CPTPP – the 11-member Pacific Rim trade deal that includes many key growth economies. More importantly, it shows that the UK is an outward looking, globally trading nation strengthening links with fellow liberal democracies. This contrasts with those countries turning inward – notably the EU itself, which has been unable to do its own trade deal due to "protectionist interests" on the continent.

Whatever deal finally emerges, it's important that the details receive proper scrutiny. One obvious area of disagreement will be over agriculture – many Conservative backbenchers are uneasy about the deal's impact on farming. Indeed, the fact that some aspects of the deal will take 15 years to be fully implemented suggests that the government is itself unsure about how far it wants to go, something it will need to resolve in its mind if it is to have a good chance of striking other trade deals.

Investors ignore inflation danger

US inflation has hit the highest rate in almost 13 years. The consumer price index rose by 5% year-on-year in May, the fastest increase since August 2008. Core inflation, which strips out volatile food and energy costs, rose by an annual 3.8%, the measure's biggest jump since June 1992. This week we also learnt that UK consumer prices rose at an annual pace of 2.1% last month, up from 1.5% in April.

Stock-markets shrugged off the news. Global equities are now up by 13% so far this year. This is the second month in a row that US inflation has come in higher than forecast. You would expect bond yields, which move inversely to prices, to have risen (investors demand higher returns to compensate for higher inflation), yet they actually declined.

What on earth is going on in the bond markets? During the first quarter of the year, talk of inflation sent the US ten-year Treasury yield up from 0.95% up to 1.75%. It has now slid back to 1.5% despite the inflation surge. Investors are being persuaded by the US Federal Reserve's argument that the inflation spike is transitory. Supporters of the Fed's view point out that the inflation spike has been concentrated in a few stressed areas. Used cars and trucks alone accounted for a third of May's monthly inflation. Such reopening bottlenecks can be expected to ease as things get back to normal. The Fed was proven right in 2011, when a similar spike did indeed turn out to be transitory. For all that, the fact that bond yields are falling is undeniably bizarre. Investors have put a lot of faith in the Fed, leaving little room for it to be wrong.

Post-financial crisis, quantitative easing (QE), or money printing, didn't cause a spike because it was used to patch up the then-shaky financial system. But this time support has been poured straight into the real economy, with money sent directly into the bank accounts of households and firms via government furlough and business support schemes. The Federal Reserve added $3trn of QE to its balance sheet last year; the Bank of England's QE pile has more than doubled since the first lockdown.

Oil prices are up by 80% over the past year. Global wholesale crop prices spiked by an extraordinary 40% in May, giving further evidence of inflation.

Statistical effects mean that US inflation may have peaked. But the Fed is wrong to say it will quickly return to the 2% target. Higher commodity prices, soaring consumer demand and labour shortages will keep prices buoyant. High prices in the US property market have also yet to feed through into rents. US inflation looks set to stay above 4% until early next year.

Policymakers' insistence that monetary policy can be left ultra-loose for years to come is looking increasingly silly.

Prepare for a volatile summer

The US Federal Reserve, America's central bank, has repeatedly insisted that surging inflation is "transitory", and that monetary policy must be kept ultra-loose for the foreseeable future. The annual rate of US inflation hit a 13-year high of 5% last month, while other data also shows that the US economy is red-hot. Hence a rethink: last week the Chair acknowledged that "inflation could turn out to be higher and more persistent than we expect".

Policymakers have signalled that they expect to hike interest rates twice in 2023, earlier than previously suggested. While that seems far off, the mere hint that the Fed is taking inflation more seriously was enough to send markets into a spin.

The last seven months in markets have been defined by the "reflation trade." Vaccine-enabled reopening has brought greater interest in beaten-down consumer, financial and commodity stocks. The optimism was underpinned by "super-loose monetary policy": US interest rates are close to zero and the Fed is making $120bn in monthly asset purchases, financed with quantitative easing (QE) – printed money.

Central bank promises of future interest rate hikes have a credibility problem. Policy makers face a brutal choice. Central bankers need to hike interest rates to control inflation but doing so risks provoking an economic crisis. Governments and firms loaded up on debt to get through the pandemic. Hiking their ultra-low borrowing costs could spell ruination. Policymakers will instead be forced to let inflation rip. This quandary is a reminder that the response to any crisis ends up sowing the seeds for the next one. Signs of future trouble are already brewing.

The US housing market is booming, with a pace of price increases unseen since before the 2007 subprime meltdown. Investors should prepare for a volatile summer.

Contact us

If you require further information about our services and how we can assist your clients, then please call us or send us an email about how and when we can contact you.

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