SLAUGHTER AND MAY/

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TAX AND THE CITY REVIEW

In *Muller* the FTT considers the construction of the statutory fiction in CTA 2009 s1259 and concludes that corporate members of an LLP are related parties of the LLP for the purposes of the intangibles regime. Measures in the Spring Finance Bill affecting financial services include improvements to enhance the attractiveness of the UK for investment, amendments to the tax treatment of reinsurance of BLAGAB and changes to the tax treatment of write-downs orders where insurers are in difficulty. The Upper Tribunal concludes in the *Prudential* case that the time of supply rules must be applied before the VAT grouping rules with the effect that the supplies in question were made for VAT purposes after the supplier left the VAT group and so were subject to VAT.

Muller: whether corporate members are 'related parties' of an LLP

The question before the First-tier Tribunal (FTT) in Muller UK & Ireland and others v HMRC [2023] UKFTT 221 (TC) was whether the corporate members of an LLP were 'related parties' of the LLP for the purposes of CTA 2009, s882(1). The definition of "related party" in the legislation was amended by FA 2016 s52 with effect for accounting periods commencing on or after 25 November 2015 but the decision in this case is of interest for its consideration of how, both before and after the legislative change, the intangible fixed assets (IFA) rules apply to a partnership.

The taxpayers, three corporate members of the LLP, had transferred their respective trades to the LLP including certain intangible assets and goodwill which were recorded in the LLP's accounts at fair value and amortised over five years on a straight-line basis. A deduction was taken for amortisation in the calculation of the taxable profits of the LLP for inclusion in the members' tax returns. HMRC challenged the deduction on the basis that the assets were acquired from related parties and so the IFA regime did not apply.

The taxpayers argued that the LLP could not have a related party for one of two reasons. First, that the statutory fiction in s1259, which requires you to calculate the profits of the LLP's trade as if a 'UK resident company carried on the trade', refers to a notional, generic company without any specific characteristics and so cannot be capable of having a 'related party'. Secondly, the taxpayers argued the related party test should be applied to the LLP, not to the notional company, and because the LLP is not a company, it could not have a related party pursuant to the definition.

The FTT dismissed both arguments. The language of s882, which sets out the gateways into the IFA regime, requires the taking into account of both the identity of the persons making a disposal to the notional company and the ownership characteristics of the notional company which should be regarded as matching the ownership characteristics of the partnership. The FTT concluded that this does not involve an extension of the statutory fiction in s1259 beyond computational purposes but is a natural corollary necessary to carry out the computation. The FTT had no doubt that the "related party" concept was applicable to notional companies as well as to actual companies. This conclusion meant that each corporate member was a related party of the notional company at the time when the LLP - and hence the notional company - acquired the assets. The assets were, therefore, not within the IFA regime.

This was sufficient to dispose of the appeals in favour of HMRC but the FTT also set out its conclusions on the submissions on the effect of FA 2016 s52. The FTT concluded that each corporate member was to be regarded, in relation to debits accruing in relation to the assets in accounting periods commencing (or deemed to commence) on or after 25 November 2015, as a 'related party' of the notional company at the time the assets were acquired. Such debits would therefore fall to be disallowed by virtue of the s52 changes.

Budget and Spring Finance Bill measures affecting financial services

Improvements to enhance the attractiveness of the UK for investment

The Budget confirmed the amendments to the REIT regime addressing unnecessary barriers to entry and ensuring the rules operate as intended as announced on 9 December 2022 in the 'Edinburgh Reforms'. In addition, the Budget announced the reduction of administrative burdens for certain partnerships investing in REITs. Legislation has been included in the Spring Finance Bill (SFB) for these changes.

A number of targeted changes to the Qualifying Asset Holding Companies (QAHC) regime are included in the SFB to make the regime more widely available to relevant companies. Most of the changes improve the regime from a taxpayer's perspective but other changes include extending the anti-fragmentation rule and providing that a securitisation company will not be able to qualify for the QAHC regime after 15 March, although a securitisation company which was already a QAHC on this date continues to qualify for the QAHC regime for as long as it remains a QAHC.

Changes will also be made to the genuine diversity of ownership (GDO) rules operating in various regimes to improve the operation of the GDO condition for fund structures involving multi-vehicle arrangements. Although the SFB includes a definition of 'multi-vehicle arrangements' which looks at whether an investor in one vehicle or fund would 'reasonably regard' that investment as an investment in the arrangements as a whole, rather than exclusively in any particular fund or vehicle, guidance would be welcome here to provide examples of what types of arrangements will meet this definition in practice.

Reinsurance of BLAGAB

The SFB includes legislation with effect from 15 December 2022 (when this was first announced) to address the risk of a tax mismatch in the life insurance rules where reinsurance precedes a transfer of BLAGAB. Without this change, a loss of tax can occur if a non-BLAGAB trade loss arises in the reinsurer and is offset against total profits or surrendered as group relief. The SFB classifies the reinsured business in this situation as BLAGAB in the hands of the reinsurer bringing the tax treatment of the reinsurer into line with the seller of the business.

The SFB also amends FA 2012 s92 (which deems certain BLAGAB trading receipts to count as deemed I-E receipts) to restrict its scope where substantially all the insurance risks of a group of BLAGAB policies are assumed by a reinsurer. Amounts received under the reinsurance in such circumstances cannot be deemed to be income for the purposes of the I-E rules which apply to life insurance companies. This change has effect for accounting periods ending on or after 15 December 2022 and addresses industry concerns that the current scope of s 92 may be too wide and inhibiting commercial transactions.

Insurers in difficulties: tax consequences of write-down orders

The SFB also includes legislation to address from Royal Assent the pensions tax and corporation tax consequences of write-downs of liabilities of insurers in financial distress under the proposed new s377A of the FSMA 2000 and any subsequent court-ordered variation or termination of such write-down orders. In the absence of the corporation tax changes, the improvement in an insurer's solvency when its liabilities are written down would be diminished by the corporation tax that would otherwise arise as a result of the write-down. The SFB will also ensure that such write-downs will not trigger unauthorised payments charges for policyholders.

Update on VAT on management fees and VAT treatment of financial services

The VAT on fund management fees consultation set out a proposal to codify current UK policy for the VAT treatment of fund management (based on UK law, retained EU law, general principles, guidance and a body of case law) into UK law. The codification proposal is intended to provide certainty and clarity, simplify the process considerably, reduce the scope for differing interpretations of law and case law and ultimately achieve a reduction in the amount of litigation which takes place in this area. The consultation closed on 3 February and the Budget materials confirmed that the government is now considering the responses and will publish its response in the coming months. In the meantime, the government continues to discuss the proposals with interested stakeholders.

Following the 2020 Spring Budget, the government set up an industry working group to review how financial services are treated for VAT purposes. The Budget confirmed that the government continues to work with industry stakeholders building on the recommendations of the working group to consider reforms to simplify the VAT treatment of financial services, aiming to reduce inconsistencies and provide greater clarity and certainty.

Any radical post-Brexit changes to increase the UK's competitiveness seem unlikely in this area in the current financial climate. Nevertheless, greater clarity and certainty are always welcome.

Prudential: interaction of VAT grouping and time of supply rules

HMRC v Prudential Assurance Company Limited [2023] UKUT 54 (TCC) concerns the interaction of the VAT grouping rules (VATA 1994 s43) and the time of supply rules for continuous services (SI 1995/2518 regulation 90). SCL provided investment management services to Prudential whilst both were members of a VAT group but part of the consideration was based on the performance of the funds SCL had managed and so there were some invoices raised and payments made only after SCL had left the VAT group. The question was whether the payments made after SCL left the VAT group, in respect of supplies rendered when part of the VAT group, were subject to VAT.

Essentially the question was which rule comes first? The FTT had decided the VAT grouping rules applied first and, as the supplies were made within the group, they were outside the scope of VAT. Disappointingly for the taxpayer, the Upper Tribunal (UT) agreed with HMRC that you look at the time of supply rules first which provide that the time of supply of the services for which the performance fees were paid was when they were invoiced or paid. As the parties were no longer in a VAT group at that time, VAT was due.

In reaching its conclusion, the UT looked first at the legislation and then considered whether the construction of the legislation required modification in the light of the key caselaw. The UT determined that s43 only applies to disregard a supply if at the time of the supply the parties were both members of a VAT group. The time of supply is not, as the taxpayer argued, the time the investment management services were rendered in the 'real world'. Regulation 90 fixes the time of supply as the earliest of when the services are paid for or invoiced. As both of these happened after SCL left the group, the disregard in s 43 did not apply. There is nothing in the legislation to qualify, limit or exempt the application of regulation 90 in this scenario.

The key authorities did not deal with the precise issue in this appeal and the UT concluded that there was no reason to depart from the decision it made based on construction of the legislation. The FTT had made material errors of law in its decision, including not distinguishing *BJ Rice* [1996] STC 581 from the present case and considering itself bound by *BJ Rice* to reach its decision in favour of the taxpayer. Accordingly, the UT set that decision aside and allowed HMRC's appeal.

This case reminds us that VAT is not about fairness or common sense (you only have to look at the plentiful caselaw on food categorisation to see that!). The time of supply rules are very prescriptive and there is no scope for arguing that there is an alternative to them based on a 'real world' concept for the purposes of s43.

What to look out for:

- **The government has announced that tax administration and maintenance day will be held on 27 April. So expect more tax policy announcements and updates on ongoing consultations.**
- **International tax reform was on the agenda again at the latest G20 finance ministers meeting on 12-13 April so we may get an update on whether jurisdictions are on track to meet the current OECD timelines for implementation.**

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