Slaughter and May Podcast
Tax News Highlights: October 2022

Zoe Andrews	Welcome to the October 2022 edition of our tax news highlights podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Senior Professional Support Lawyer in the Tax department. In this podcast, we will cover several recent case law developments: the First-tier Tribunal's decision in *Burlington Loan Management*, the Upper Tribunal's decisions in *Aozora GMAC* and *Pickles*, the decision of the Inner House of the Court of Session in *Ventgrove*, and the Advocate General's opinion in *Gallaher*. We will also consider the potential impact of the Retained EU Law (Revocation and Reform) Bill and announcements at the mini-Budget. But shall we start with the cases?
Zoe Andrews	Yes. We've had our fill of unallowable purpose cases recently (and the *Kwik-Fit* Upper Tribunal decision is still to come following the hearing last month), but *Burlington Loan Management v HMRC* is the first case on a purpose test in a double tax treaty. And with the multilateral instrument adding a principal purpose test to many treaties for the first time, the FTT's decision has generated lots of interest outside the UK as well as within. The case concerned the question whether Burlington, an Irish tax resident company, could claim relief from withholding tax on UK-source interest under Article 12, the interest article, of the UK/Ireland double tax treaty. The purpose test at issue was the one in Article 12(5). It reads: "The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment." This is intended to catch treaty shopping or treaty conduit cases, but such behaviour did not appear to be present on the facts of this case.
Tanja Velling	Indeed, Burlington was long established in Ireland and had not been set up there or interposed in a structure to get treaty relief. It received interest (on a debt claim it had acquired in the secondary market dealing in claims in the Lehman Brothers administration) so it claimed relief from withholding tax on that interest under the treaty. So what got HMRC so worked up?
Zoe Andrews	The claim had been acquired from a third party that, if it received the interest itself, would have suffered 20% withholding tax and not been able

	to obtain treaty relief. The price paid by Burlington for the assignment of the claim reflected the fact that it was worth more to Burlington because of being able to reclaim the withholding tax, but there was no mechanism to adjust the purchase price had relief from withholding tax not been available. HMRC treated this as, in substance, a conduit or treaty shopping case within Article 12(5) because, in economic terms, the seller of the claim was taking advantage of Article 12(1) by selling to Burlington for a greater sum than it could have realised itself. Fortunately, the FTT concluded that Article 12(5) did not apply. This was a very sensible decision for the smooth running of secondary debt markets. In general, an outright sale of an asset to an unconnected person who is entitled to treaty benefits in respect of it by a person who is not and where both parties are aware of that fact and that is reflected in the pricing of the sale ought not to fall foul of a treaty purpose test. The outcome would be different if the purchaser had been established in the relevant jurisdiction in order to benefit from the relevant tax treaty or there is an adjustment mechanism to the consideration dependent on whether or not treaty relief is actually obtained.
Tanja Velling	Sticking with tax treaties, let's now discuss the *Aozora GMAC* case. Aozora had made loans to its US subsidiary and was subject to US withholding tax on the interest. The sole issue was whether Aozora's entitlement to unilateral relief in the UK in respect of the US withholding tax was denied by section 793A(3) of the Income and Corporation Taxes Act 1988 (which has since rewritten been as section 11(4) of the Taxation (International and Other Provisions) Act 2010). The Upper Tribunal concluded, as had the FTT, that unilateral relief was available to Aozora. Aozora was denied access to treaty benefits under the US/UK double tax treaty on the ground that it was not a qualified person within Article 23, the limitation on benefits provision. This meant that Aozora was not entitled to claim under the treaty for a credit against UK tax for the US tax it suffered on the interest payments. In its tax returns, Aozora claimed unilateral relief by way of credit under section 790 of ICTA against the UK tax due on the interest which brought the amount of corporation tax self-assessed to nil. But HMRC assessed Aozora to tax of nearly £4.5 million on the basis that section 793A applied to prevent unilateral credit relief and so the only relief Aozora was entitled to was by way of deduction under section 811 of ICTA. This meant Aozora suffered UK corporation tax on the net amount received (after deduction of the US withholding tax). The UT adopted a purposive approach, concluding that the purpose of section 793A(3) is not to prevent a claim for unilateral relief whenever there is a double tax treaty, but rather that section 793A(3) captures a situation

	where the “cases or circumstances” in which credit is denied are “specified or described” in the treaty provision. As Article 23 did not contain an express provision that, or words to the effect that, credit will not be available to a non-qualified person if they do not fall within Article 23(3) or (4) and discretion is not exercised, it did not fit the statutory description. So section 793A(3) did not apply to deny relief. This decision is a helpful reminder of the interaction of unilateral credit relief and treaty relief - although it also shows the difficulty in determining whether unilateral relief is available when treaty relief is not. Although in this case, on the wording of the US/UK treaty, the conclusion was that the limitation on benefits provision was not within section 793A(3), the conclusion might differ for another treaty with a differently-worded limitation on benefits provision.
Zoe Andrews	And now let’s look at the *Pickles* case on the deemed distribution which arises under section 1020 of the Corporation Tax Act 2010 when an asset is transferred, at an overvalue, to a company by its shareholders. The *Pickles* case considers the interpretation of “market value” and “new consideration” in section 1020 CTA 2010 and the correct approach to determining the market value of the benefit received by the taxpayers. The UT remade the FTT’s decision in favour of HMRC on the valuation of distributions received. The Pickles, two individuals, incorporated their partnership by selling their farming business and all its assets (save for the land) to a related company. On the sale, the value attributed to the goodwill, £1.2 million, was credited to the directors’ loan account. The company later went into administration, before which time the taxpayers had withdrawn £770,000 from the loan account. The balance of the loan account was not repaid. The FTT determined the value of the goodwill as £270,000 and this was not challenged on appeal to the UT. In calculating the value of the benefit received by the Pickles, the FTT took into account only the £770,000 paid to them rather than the full £1.2 million credited to the loan account and they deducted from that the value of the goodwill transferred, not on the basis that it was “new consideration” but as the market value of assets transferred by members to a company under section 1020(1)(b).
Tanja Velling	The UT concluded that the FTT had materially erred in law and remade the decision in favour of HMRC concluding that the value of the goodwill transferred (so £270,000) is new consideration or forms part of new consideration.

	It further concluded that the benefit for the purpose of section 1020(1)(b) is the benefit of the contractually agreed sum of £1.2 million (not the £770,000 actually withdrawn from the loan account). And finally, the UT considered that the market value of a promise to pay must be assessed by reference to facts as they are known at the date of the transaction, not with hindsight. In this case, the market value is the face value of the promise to pay, so £1.2 million. Therefore, the value of the distributions received was £930,000 (so £1.2 million less the £270,000 of new consideration). So, the UT's decision brings welcome clarity to this area after the confusion created by the FTT's decision in 2020 (which had not been unanimous).
Zoe Andrews	*Ventgrove* concerns the interaction between VAT law, HMRC practice and a break option in a lease. The relevant contractual provision gave the tenant the option to terminate the lease on payment of a fee "together with any VAT properly due thereon". The tenant had paid the break fee, but no additional amount in respect of VAT. The landlord argued that this meant that the break option had not been validly exercised. In this way, the case hinged on the question whether there was "any VAT properly due" on the break fee. The Outer House of the Court of Session had sided with the tenant and concluded that no VAT was properly due on the break fee. This was essentially on the basis that HMRC's policy at the time when the break option was exercised had been that the break fee was not subject to VAT.
Tanja Velling	But the Inner House has now sided with the landlord. It considered the issue to be two-fold. Was VAT due as a matter of law and, if so, were there any circumstances to override this? The answer to the first question was yes. So, the case turned on the question as to the effect of HMRC's policy to the contrary. In this respect, the court had recalled that HMRC's guidance is no more than a statement of its interpretation of the law. Such statements can give rise to a legitimate expectation that HMRC follows its interpretation of the law, but there is a high threshold for holding HMRC to any incorrect interpretation of the law on this basis. In this case, the court considered that the landlord had not formed a legitimate expectation to start with. Hence, HMRC's policy could not impact the question whether VAT was "properly due".
Zoe Andrews	It's also worth noting that the court dismissed the tenant's alternative argument that VAT was not due until demanded. This was on the basis of the wording of the lease. The break option itself required that VAT should be

	included in the payment without the need for a separate demand or invoice. I think the outcome would have been different, if there had been instead a separate clause requiring the tenant to pay VAT on provision of a valid invoice. But, moving on to *Gallaher*, how is the reference to the CJEU progressing in the matter of the UK's group transfer rules?
Tanja Velling	Advocate General Rantos has opined that the UK's group transfer rules are not incompatible with EU law (contrary to Judge Beare's conclusion in the First-tier Tribunal). We will cover this in more detail when the CJEU's decision is handed down but in the meantime you may recall the case concerned two disposals by a UK company: the 2011 disposal of intellectual property to its Swiss sister company, and the 2014 disposal of shares to a Dutch intermediate parent company. Because, in both cases, the transferee was a company outside the UK tax net, the transfers could not be on a no gain/no loss basis under section 171 of the Taxation of Chargeable Gains Act 1992. So, there was an immediate tax charge. Gallaher appealed on the basis that this was contrary to the EU fundamental freedoms (the freedom of establishment and the free movement capital) and argued that instalment payment provisions should be read into the legislation. The FTT held that the relevant freedom was the freedom of establishment and that there was no restriction on it for the 2011 disposal. But there was a disproportionate restriction regarding the 2014 disposal. The Upper Tribunal then referred several questions to the CJEU. The UK legislation has since been amended to permit payment in instalments so this is primarily of interest to historic cases. It will be interesting to see if the CJEU follows the AG's opinion to conclude that the immediate tax charge on the 2014 disposal was not a disproportionate restriction. And that brings us neatly on to the question of the importance of retained EU law going forward. What can you tell us about the Retained EU Law (Revocation and Reform) Bill currently before Parliament and its potential impact on tax?
Zoe Andrews	This Bill is intended to produce a sort of bonfire of retained EU law at the end of 2023 and, at the moment, I think it's quite hard to say what its impact on tax will be. The Bill could result in the revocation of a range of tax provisions, including the Value Added Tax Regulations, and pave the way for a re-imposition of the 1.5% stamp duty season ticket charge on capital raisings. But it appears that the government is alive to these points and may not intend quite such a drastic effect in the tax context. The press release which accompanied the publication of the Bill stated that "all required legislation

	relating to tax and retained EU law will be made via the Finance Bill (or subordinate tax legislation)" and that the "government will also introduce a bespoke legislative approach for retained EU law concerning VAT, excise, and customs duty in a future Finance Bill". So, I think this will be a watching brief for now. To my mind, the press release, does, however, beg the question how the government will prevent the Bill from applying to tax so as to ensure that all relevant tax provisions can be dealt with as the government envisages. Hopefully, this will become clearer as the Bill progresses or once we see the Finance Bill.
Tanja Velling	That is interesting. But perhaps you could clarify one more point for us at this stage. Could the Revocation Bill end up disapplying provisions, for example, in past Finance Acts?
Zoe Andrews	No. The relevant sunset clause in the Bill applies only to subordinate legislation; so primary legislation will be unaffected. This is good news because apparently, HMRC identified things such as the patent box, research and development tax credits and the exempt dividend demerger conditions in section 1081 of the Corporation Tax Act 2010 as EU-derived legislation preserved under the European Union (Withdrawal) Act 2018.
Tanja Velling	On the 23rd of September, the Chancellor set out his "Growth Plan" which has commonly been dubbed the "mini-Budget" even though it was not exactly "mini" in terms of the measures announced. For starters, the Chancellor announced that the planned increase in the corporation tax rate from 19% to 25% in April 2023 would not go ahead. And the concomitant increase in the diverted profits tax rate and change to the bank corporation tax surcharge would also be cancelled. At present it is not, however, entirely clear how this will be implemented. It is possible that the relevant legislation will be included in the Finance Bill 2023 or in a Budget resolution at the time of the Spring Budget. But this now begs the question: when will we see the Finance Bill and when will the Spring Budget be?
Zoe Andrews	Well, the Chancellor promised further details on the Growth Plan, accompanied by the OBR report, for the 23rd of November. This has now been brought forward to the 31st of October. But it looks like we will have to wait until Spring – word on the street is probably in March – for the next "proper" Budget and it looks increasingly unlikely that we will get a Finance Bill this Autumn. So, everything seems a bit up in the air at the moment! But what else did the Chancellor announce as part of the Growth Plan?
Tanja Velling	The temporary increase in national insurance contributions would be reversed with effect from the 6th of November and the health and social care

	levy which was due to take effect in April 2023 on expiry of this temporary increase would be abolished. This measure will be legislated for in the Health and Social Care Levy (Repeal) Bill which was introduced in the House of Commons on the day of the Growth Plan announcements. It is expected that the Bill will be certified as a money bill, meaning that it can become law without the approval of the House of Lords. The increase in the rates of income tax on dividend income that was announced alongside the announcement of the introduction of the health and social care levy would also be reversed.
Zoe Andrews	The Chancellor further announced that the basic rate of income tax would be reduced to 19% a year earlier than planned and that the 45% additional rate of income tax would be abolished. This abolition was stated to apply in relation to the additional rate on employment as well as dividend and savings income. The Chancellor has since explicitly abandoned the proposal to abolish the additional rate on employment income. Whether this means that the proposals to abolish the additional rates for dividend and savings income have also been abandoned is not entirely clear. But it would seem rather odd if the Chancellor were to go ahead with abolishing these despite the U-turn in relation to employment income. It appears that the basic rate cut would still go ahead, with the legislation probably forming part of the Finance Bill (whenever that may appear). The Growth Plan states explicitly that this change “allows workers, savers and pensioners to keep more of their income”. But the basic rate of income tax is also the rate at which tax is withheld from interest and royalty payments or REIT distribution, for example. So, it would appear that such withholding would then also be at the lower 19% rate.
Tanja Velling	Other measures that were announced included repealing the 2017 and 2021 amendments to the IR35/personal service company tax rules from April 2023. Broadly, contractors, who would have been employees if they had provided their services directly to the client, pay broadly the same income tax and national insurance contributions as employees. The 2017 and 2021 amendments meant that the end user is responsible for determining whether the off-payroll rules apply. After their repeal, responsibility for income tax and NICs will revert to the contractor. The Chancellor also announced that the temporary £1 million level of the annual investment allowance would be made permanent and that new tax-incentivised investment zones would be created. We shall not cover these in detail and instead have a look at what is coming up!
Zoe Andrews	Actually – let me mention one more announcement. The Chancellor also announced the demise of the Office of Tax Simplification – but they are cracking on with the hybrid working consultation (the closing date was

	brought forward to 28 October) and are due to report on taxation of property income in October. Then, in terms of other things coming up, we have a number of case hearings. • The Court of Appeal is scheduled to hear the appeal in *Centrica Overseas Holdings Ltd v HMRC* (expenses of management) on the 25th of October. • The Court of Appeal is scheduled to hear the appeal in *Fanning v HMRC* (SDLT scheme) on the 3rd of November. • The Upper Tribunal is scheduled to hear the appeal in *M Group Holdings Ltd v HMRC* (substantial shareholding exemption) on the 7th, 8th or 9th of November
Tanja Velling	And that leaves me to thank you for listening. If you have any questions, please contact Zoe or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog – www.europeantax.blog. And you can also follow us on Twitter – @SlaughterMayTax.