Slaughter and May Podcast
Tax News Highlights: May 2023

Zoe Andrews	Welcome to the May 2023 edition of our tax news highlights podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Tax PSL Counsel. In this podcast, we will discuss selected materials published as part of the Tax Administration and Maintenance Day, some points on international tax reform, a Brexit-related change to HMRC's practice on late payment interest and an update on the Retained EU Law (Revocation and Reform) Bill. We will also cover several recent decisions: *McClean v Thornhill KC* on duties of care owed in respect of tax advice, *Buckingham* on the tax treatment of a US dividend and *Spring Capital* on whether questions of Scots law are questions of fact or law. And we will touch upon the Advocate General's opinion in *Engie*. This podcast was recorded on the 16th of May 2023 and reflects the law and guidance on that date. Let's start with the cases.
Zoe Andrews	*McClean v Thornhill KC* arose following a number of failed film finance tax schemes involving limited liability partnerships. The sponsor and promoter of the schemes had retained a tax barrister, Mr Thornhill KC, to advise on their set-up and the tax consequences. As part of this advice, Mr Thornhill KC reviewed the information memoranda provided to the investors in the schemes and confirmed that they did not include any statements inconsistent with his opinions. The memoranda also identified Mr Thornhill KC as the tax adviser to the sponsor/promoter and Mr Thornhill KC had consented to a copy of his opinion being made available on request. But the memoranda cautioned that investors would need to obtain their own tax advice and investors could not invest in the scheme without warranting that they had relied only on their own advisers or consulted only their own tax advisers. The Court of Appeal unanimously confirmed the High Court's decision that, in these circumstances, Mr Thornhill KC did not owe a duty of care to the investors. There were factors which pointed towards there being a duty of care – Mr Thornhill KC had given advice knowing that it would be shared without an express disclaimer of responsibility where recipients were likely to take a certain amount of comfort from the advice. But overall, the documentation made sufficiently clear that investing in the scheme was risky and that investors would need to obtain their own advice.

Tanja Velling	This would have been enough to dispose of the appeal, but the Court of Appeal further considered *obiter* whether, if there had been a duty of care, it would have been breached. For the scheme to work, each LLP would have had to have been trading and Mr Thornhill KC's advice had been that "there is no doubt that it is". The Court of Appeal concluded – *obiter* – that Mr Thornhill KC was negligent in expressing his opinion in such unqualified terms. In the Court of Appeal's view, this unequivocal statement did undermine the warnings in the memoranda and "Non-negligent advice would, at least, have acknowledged that no two cases are factually the same, and accordingly no existing authority could be said to cover the circumstances of the LLPs' case exactly; and that the three statutory tests each engaged a risk of challenge by HMRC." Now for the case of *Buckingham*, a First-tier Tribunal decision on the UK tax treatment of a US dividend.
Zoe Andrews	The FTT had to decide how much of a US dividend should be treated as income and/or capital for UK tax purposes. The FTT correctly identified that, under the relevant case law, this would depend on how much of the dividend was, under US company law, in the form of capital and how much was in the form of income. As this raises a question of US company law, you would normally expect an expert in US company law to be instructed to give evidence but because of the relatively small about of tax at stake and a desire to avoid any further delay to proceedings, the FTT decided to make the decision without the benefit of such expert input. And this is where it went wrong, in my opinion. The FTT decided that the US corporate law treatment must be the same as the US tax treatment. The relevant US tax form had shown the dividend for tax purposes as being 30% income and 70% capital. This was on the basis that the 30% was a distribution out of relevant earnings and profits or "E&P". E&P has its own US tax definition. The 70% that was not out of E&P was treated as capital for US tax purposes. The FTT concluded that, for UK tax purposes, the split between income and capital should also be 30/70. The reason the FTT gave for following the US tax treatment is that it was "not credible that the IRS would have signed off on a capital/revenue split which was not in accordance with the applicable company law". But it is credible to have a divergence between tax and company law treatment as we know that tax does not slavishly follow the corporate form.
Tanja Velling	I agree. In the UK, share buybacks are one example of a discrepancy between tax treatment and company law form. A buy back of shares by a UK incorporated company is likely to be split into income and capital based on the extent to which it is treated as a repayment of capital. This is a tax concept, not a company law one.

Zoe Andrews	*Spring Capital* is an Upper Tribunal decision on a preliminary issue in the context of a dispute concerning a liability to tax and penalties in respect of the transfer of a trade. The taxpayer argued that questions of Scots law should be treated in the same way as questions of foreign law where a case before the First-tier Tribunal arises under the laws of England. This would have meant treating Scots law as a question of fact on which evidence is admissible. The Upper Tribunal, however, decided that questions of Scots law were a matter of law. It reached this conclusion primarily on the basis of an earlier decision, but it also explained why this would be the right conclusion as a matter of principle. The Upper Tribunal considered that the approach under the tribunal system established by the Tribunals, Courts and Enforcement Act 2007 is different from the previous system of General and Special Commissioners. Under the Commissioner system, cases were assigned at the outset as being either Scottish or English and the applicable law and appeal route followed this assignment. So, under the Commissioner system, in an English case, Scots law would have been a question of fact. The difference under the 2007 Act is that tribunals are given UK-wide jurisdiction. Cases are no longer assigned as, for example, Scottish at the start. On appeal from the Upper Tribunal, the permission would then be given to appeal to the most appropriate court, and the Upper Tribunal's discretion in this respect would be frustrated, if the laws of a particular jurisdiction within the UK had been treated as a matter of fact at an earlier stage, given that appeals would be limited to questions of law.
Tanja Velling	And now - assuming that the CJEU in *Engie* follows the recently published Advocate General's opinion - for some good news for taxpayers and a blow to the European Commission's mission to use EU State aid rules to challenge tax rulings. In the *Engie* case, AG Kokott has opined that the Commission and the General Court were wrong to find that Luxembourg granted unlawful State aid to the Engie group in connection with the fiscal treatment of the restructuring of the group of companies in Luxembourg. According to her opinion, national law alone is the reference framework and only manifestly incorrect tax rulings under that framework may constitute a selective advantage. AG Kokott emphasised that tax rulings are an important instrument for creating legal certainty and that they are "unproblematic in terms of State aid law as long as they are open to all taxpayers (usually upon request) and – like any other tax assessment – are in line with the relevant tax law. In that respect, they simply pre-empt the outcome of a later tax assessment". AG Kokott opined that, if every erroneous tax assessment (advance tax rulings as well as normal tax assessments) might be considered an

	infringement of State aid law, the principle of legal certainty and the finality of administrative acts would be devalued. In recent case law, the CJEU subjects general taxation decisions to scrutiny for compliance with State aid law only if they have been designed in a manifestly discriminatory manner with the aim of circumventing the requirements of EU law on State aid. AG Kokott suggests that there is no reason not to transpose that case law to situations where the law is misapplied in favour of the taxpayer. So in her opinion, only those rulings manifestly erroneous in favour of the taxpayer constitute a selective advantage. Assuming this is upheld by the CJEU, it will be a further significant restriction on the Commission's power to launch tax State aid challenges. We will report on the CJEU's decision once it comes out.
Zoe Andrews	As has become a bit of a tradition, the Spring Budget was followed by a Tax Administration and Maintenance Day on the 27th of April with further policy announcements and the publication of a number of consultations and responses. We want to highlight two consultations. The first one relates to stamp duty and SDRT and is open for comments until the 22nd of June 2023. Quite sensibly, the government is proposing to (I would like to say "finally") replace stamp duty and SDRT with a single mandatory, self-assessed tax. For transactions undertaken through CREST, the tax would continue to be collected through CREST and the SDRT liable and accountable persons rules be kept in place. For transactions outside of CREST, the purchaser would be liable for the tax which would be notified and paid through a new online portal in a way that sounds similar to the current system for SDLT. Company registrars would be able to update the company register based on the Unique Transaction Reference Number issued by the system; but it is envisaged that registrars would continue to face a penalty, if they update the register without having seen evidence that any applicable transfer tax has been paid. It is proposed that the new combined tax would apply to non-government equity in UK incorporated companies, including stock and bonds with equity-like features, thus enabling the government to do away with the loan capital exemption. The government also proposes to take partnership interests outside the scope of the tax, subject to anti-avoidance legislation to prevent partnership interests being used as a method of transferring share ownership tax-free. The new tax would be chargeable on the amount of consideration in money or money's worth when a transfer is agreed (or a conditional agreement becomes unconditional). It is proposed that the £1,000 de minimis that currently exists for stamp duty would be removed, but group relief and reconstruction and acquisition reliefs would be retained, with possible clarifications. The growth market exemption would also be retained.

Tanja Velling	The Treasury also published a consultation (open for comments until the 9th of June 2023) on the introduction of a new fund structure. The consultation refers to this structure as the "Reserved Investor Fund (Contractual Scheme)" or "RIF(CS)". But the name might still change; the consultation asks whether respondents agree that RIF(CS) is the most appropriate name and invites alternative suggestions if a respondent disagrees. In a previous consultation, the proposed structure had been referred to as the "Professional Investor Fund (Contractual Scheme)" or "PIF(CS)". I shall call it "RIF" for now. The RIF is intended to plug a gap in the UK's funds offering. The RIF would be an unauthorised contractual scheme. So, the scheme itself would not need to be authorised by the Financial Conduct Authority. It would constitute an unregulated collective investment scheme and an alternative investment fund. So, while the fund itself would not be FCA authorised, the managers of a RIF would themselves need to be persons authorised or registered with the FCA. In a sense, this regulatory treatment is the key innovation in respect of the RIF. The tax regime proposed for the RIF should be largely familiar as it would generally mirror the regime applicable to Co-ownership Authorised Contractual Schemes or CoACS. But there is one particularly interesting point where the regimes could differ.
Zoe Andrews	CoACS themselves are generally speaking not subject to direct taxation by virtue of the fact that they are not a legal person in their own right. For obvious practical reasons, investors in a CoACS are treated as owning units in the CoACS rather than the underlying assets for chargeable gains purposes. When applying the non-resident capital gains rules, the end result is that non-resident investors in CoACS would be subject to tax on gains arising from a disposal of their units only where the CoACS derives at least 75% of the value of its total assets from UK real estate. Where a CoACS holds UK real estate, but the 75% threshold is not met, there would be no NRCG charge on a transfer of the units. Neither would there be a charge on a disposal of the real estate as the CoACS is not subject to direct taxes and interests in the underlying assets are disregarded in respect of the investors' capital gains tax position. So, in respect of CoACS that hold UK real estate without meeting the 75% threshold to be considered UK property rich for the purposes of the NRCG rules, there will be no NRCG charge. One might have thought that this outcome is merely the natural consequence of the policy choice of having a 75% threshold for the taxation of indirect disposals of UK real estate. But the government has identified this as an issue to be addressed in the design of the tax regime for the RIF. It is proposed that the regime will draw a distinction between "restricted" RIFs and "unrestricted" RIFs. A RIF would have to meet one of three conditions to be "restricted". It would have to either be UK property rich, have only investors who are exempt from tax on capital gains or not invest

	in UK real estate or UK property rich companies. All other RIFs would be "unrestricted" and subject to more complex tax provisions to resolve the perceived NRCG issue. Although it is raised in the context of this consultation, this NRCG issue is one that already exists for CoACS, and the government acknowledges this. Tucked away in a single paragraph of the RIF consultation is the warning that: "Should it be considered necessary to make any changes to [the CoACS] regime, this would be subject to further consultation." So, watch this space! How are you enjoying making sense of the Finance Bill legislation to implement the Pillar 2 GloBE rules?
Tanja Velling	I'm not sure "enjoying" is the right word but I'm certainly spending a lot of time trying to make sense of Part 3 (the multi-national top-up tax or MTT) and Part 4 (the domestic top-up tax or DTT). And it is even more of a challenge because we expect the rules to be amended (probably multiple times) to align with OECD developments. There is a regulation making power in the legislation for this which permits changes to made in this way until the 31st of December 2026. One change we expect will follow agreement at an international level is the addition of a QDMTT safe harbour. QDMTT stands for "Qualified domestic minimum top-up tax" although the UK rules use the term "Qualifying domestic top-up tax" (QDT) instead which is defined as UK's DTT and any foreign DTTs specified in regulations to be QDTs. As drafted, the Finance Bill provides for a credit for QDT against MTT but noises coming from the OECD suggest the safe harbour will operate as an exemption rather than a credit. I had thought at first that this might mean that a multinational group operating only in territories with a QDMTT should not have to worry about the complexity of the IIR calculations, but in order to be a QDMTT the calculations of profits and top-up tax must be based on the Pillar 2 model rules anyway. So you still have the complexity. Indeed, the UK Finance Bill uses the Part 3 framework for MTT (with necessary modifications) to calculate DTT. So, you can't seem to avoid the complexity one way or another. OECD guidance is expected this summer on QDMTTs. The OECD is also working on the substance-based income exclusion and the deferred tax liability recapture rules amongst many other outstanding issues. So, we may see the power to make amending regulations used quite soon after Royal Assent of this primary legislation! How is implementation looking elsewhere in the world?
Zoe Andrews	EU countries are at various stages of implementing the EU Directive on Pillar 2. Some, like Germany and the Netherlands, have published draft

	implementing legislation. Others at are earlier stages including public consultations. South Korea and Japan have already enacted legislation although further legislation will be required to keep up with international agreement. A number of other jurisdictions (including Canada and Australia) have made announcements about implementation or are in the process of consultation. So all around the world people are trying to work out what it means for their business, or their clients. Although the intention is that there will be consistency in the application of the Model 2 GloBE rules, I can see from the level of the detail of domestic legislation that this is not going to be possible to achieve and it will be very difficult to make comparisons of legislation in different territories because each jurisdiction will have implemented the rules in the way that makes most sense to them, including using defined terms different from the Model Rules, as the UK has done throughout the draft legislation. What's the Brexit-related change in HMRC's practice?
Tanja Velling	With effect from the 4th of May, HMRC has changed its practice on late payment interest where the payor failed to withhold tax on UK source interest or royalties paid to an EU Member State. In practice, it seems likely that the impact of this change will be felt mostly in respect of withholding tax on interest. Unlike royalties which can be paid gross based on a reasonable belief that the recipient is entitled to treaty benefits, in respect of interest, this is generally possible only once a direction to pay gross has been obtained from HMRC (although the position under the treaty passport scheme is slightly more generous). So, problems may arise where interest is paid gross before a direction is obtained. HMRC could assess the payor for the tax it had failed to withhold as well as late payment interest – although by concession, HMRC will, issue an "interest only" assessment, if it is clear that the tax would, in any event, have to be repaid because treaty benefits are available. Following the CJEU's decision in *TTL EOOD*, HMRC had considered that Article 56 of the Treaty on the Functioning of the European Union precluded it from charging late payment interest on intra-EU loan transactions (as well as royalties) where relief under a double tax treaty was available. So, in these circumstances, it would not even have issued an interest-only assessment. (HMRC's manuals did, however, use to state that penalties for failure to make a return could still be charged.) So, where UK source interest is paid gross to a recipient in the EU before a direction to pay has been obtained, HMRC will now charge late payment interest in the same way as it would have if the payee had been resident in a non-EU country.

Zoe Andrews	There has also been an important development in respect of the Retained EU Law (Revocation and Reform) Bill. The government had originally proposed that, at the end of 2023, all EU-derived subordinate legislation and retained direct EU legislation would be revoked unless it was explicitly preserved. This would have required the government to work through thousands of pieces of legislation within a matter of months to decide whether they should be retained on the statute book and, if so, in what form. Otherwise, the relevant instruments would just disappear – which is something that always struck me as a recipe for an undesirable level of legal uncertainty. So, it was welcome news to me that, on the 10th of May, the Secretary of State for Business and Trade, Kemi Badenoch, announced that the government would table an amendment to the Bill to remove this sunset provision. Instead, the Bill will be used to revoke only instruments listed in a schedule. This list is quite large, but I could not see any tax instruments in it about which I would have been particularly excited. I think this is unsurprising, given that the government never intended for this Bill to repeal or amend large swathes of tax legislation. Whether it could still have unintended consequences for tax is a different question, though, and probably one for another day! So what else do we have coming up?
Tanja Velling	As part of the Tax Administration and Maintenance Day, it was announced that, at some point in May, a consultation would be published on changes to simplify and update the diverted profits tax, transfer pricing and permanent establishment legislation. The objective of the changes would be to “ensure that their application is clear to taxpayers, and the outcome of their application remains consistent with the underlying policy intention, international standards and the UK’s bilateral treaties”. The Spring Finance Bill is still making its way through Parliament. We expect that it will receive Royal Assent at the latest before the start of the summer recess on the 20th of July, but likely sooner. The Spring Finance Bill would be a money bill and, according to the Glossary on the UK Parliament’s website this means that, once it has been passed by the Commons, it “will become law after one month, with or without the approval of the House of Lords, under the terms of the Parliament Acts.” Interestingly, this statement misses some of the nuance of section 1(1) of the Parliament Act 1911 on which it is based. This provision requires that a money bill is presented for Royal Assent one month after being sent to the House of Lords, unless the Commons direct to the contrary. So, in theory, there could be a longer period until Royal Assent. It is also theoretically possible for the Lords to examine and comment on a money bill in detail. In practice, however, this is highly unlikely and proceedings in the Lords tend

	to be rapid and perfunctory. So, I would guess that the Spring Finance Bill will receive Royal Assent by the end of June.
Zoe Andrews	And that leaves me to thank you for listening. If you have any questions, please contact Tanja 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.