SLAUGHTER AND MAY/

CLIENT BRIEFING

June 2021

TAX AND THE CITY REVIEW

The *Ramsay* principles of statutory construction are applied by the Court of Appeal in *Khan* and the Supreme Court in *Hurstwood*. The Court of Appeal in *Dodika* concludes that the notice of a tax covenant claim does contain sufficient detail to meet the contractual requirement and is, therefore, valid because there were not any further specific details which could usefully have been provided. The European Commission shares its latest plans to harmonise tax rates and tax rules and introduce a new digital levy across the EU but it is unclear how these proposals will sit with the new taxing right and minimum rate of tax currently being discussed globally to reform the international corporate tax framework.

Statutory construction: latest '*Ramsay*' cases

Two recent cases illustrate how the courts are applying the *Ramsay* principles of statutory construction i.e. looking at the purpose of the legislation and asking whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically. In both cases, the relevant statutory provision happened to be about entitlements. The entitlement in *Bostan Khan v HMRC* [2021] EWCA Civ 624 was to a distribution on a share buy-back following a share purchase to buy out the vendor shareholders. The entitlement in *Hurstwood Properties v Rossendale Borough Council* [2021] UKSC 16 was to possession of property under a lease that formed part of a business rates avoidance scheme.

Mr Khan argued he was not entitled to a distribution because although he had received the distribution it was part of a series of transactions in which the distribution benefited the vendor shareholders and he wanted to be taxed on the basis of a single composite transaction. The Court of Appeal, in its judgment at the end of April, held that he was so entitled, however, because the focus of the relevant charging provision ((ITTOIA s385(1)) was on the transaction under which the taxable distribution arose and was not 'concerned with the overall economic outcome of a series of commercially interlinked transactions'. And even if the transactions were looked at as a whole, they could not produce the result contended for by the taxpayer that there was a distribution not to him, but to the vendor shareholders whose shares he had already purchased using a loan which was then repaid by the proceeds of the share buyback.

The purpose of s385 is that tax chargeable on any distribution is to be recovered from the actual recipient of the distribution or, where someone else is entitled to the distribution, from that person rather than the actual recipient. At the time of the distribution, Mr Khan was the only shareholder and the only person entitled to the distribution. It was irrelevant for the purposes of s385 what Mr Khan did with the money or how the distribution fitted into the overall transaction - Mr Khan was 'the person receiving or entitled to the distribution'.

Then in May, we had the Supreme Court's judgment in *Hurstwood*. Where non-domestic property is unoccupied, business rates are charged on the owner, subject to certain exceptions. The 'owner' is defined in the relevant legislation as the 'person entitled to possession of the property'. The avoidance scheme involved the properties being leased to SPVs and one of the questions before the Supreme Court was whether the lease to the SPV was ineffective to make the SPV the 'owner' of the unoccupied property within the meaning of the legislation.

The Court of Appeal had held that the existence of the leases to the SPVs could not be disregarded under the *Ramsay* principles and decided the case in favour of Hurstwood Properties. Henderson LJ's reasoning, with whom the other judges agreed, was that the concept of entitlement to possession in the legislation is an "intrinsically legal one" which meant that the legislation was not amenable to a wider, purposive interpretation that would allow scope for the *Ramsay* approach to operate.

The Supreme Court, on the other hand, disagreed that the *Ramsay* approach would require the existence of the leases to be disregarded but instead held that the leases should be closely examined in their context and in light of the purpose of the legislation. The legislation discouraged owners from leaving properties unoccupied by imposing a charge on the 'person entitled to possession of the property'. The purpose of the charge is to incentivise owners of unoccupied premises to bring them back into use and the burden of the business rates is accordingly focused on the person who has the ability, in the real world, to do that.

This led the Supreme Court to conclude that the leases did not, in fact, transfer to the SPVs the entitlement to possession required by the legislation as a badge of ownership and so set aside the order to strike out the claims. This is an important conclusion not only for the local authorities involved in this test case, but for all local authorities facing similar business rates avoidance schemes awaiting the outcome. It is a shame, however, that this issue went all the way to the Supreme Court in the context of an application to strike out the council's claims rather than as part of the trial which will now proceed.

Some useful takeaways from these two cases are as follows. First, the purpose of the legislation is key - whether a court should focus on specific transactions, or the overall economic outcome of a series of commercially linked transactions depends on the particular legislation concerned and the purpose of that legislation (per Lord Reed in *UBS* [2016] UKSC 13).

Second, tax does not always follow the economics and so it is important to obtain specialist advice on the tax consequences of each part of a transaction to avoid any nasty (and expensive!) surprises such as befell Mr Khan.

Third, *Ramsay* is a principle of statutory construction which should always be applied when construing legislation. It is not the case that some legislation is simply not amenable to a purposive interpretation as suggested in earlier caselaw. The Supreme Court clarified in *Hurstwood* that the conclusions reached in *MacNiven* [2001] UKHL 6 and in *Barclays Mercantile* [2004] UKHL 51 that the statutory provisions relied on in those cases were intended to apply to particular transactions undertaken solely for the purpose of obtaining tax relief were the result of close analysis of the legislation and facts, following the *Ramsay* approach. They were not a determination that the *Ramsay* approach did not apply in the first place. This is contrary to Henderson LJ's suggestion in the Court of Appeal in *Hurstwood* that in cases such as *MacNiven* and *Barclays Mercantile* arguments based on the *Ramsay* principle were rejected.

Dodika: compliance with notice provision for tax covenant claim

The Court of Appeal in *Dodika Ltd and others v United Luck Group Holdings Ltd* [2021] EWCA Civ 638 overturned the High Court's decision, breaking the current trend in tax covenant claim cases for the court to side with the seller.

In this case, in the context of a claim by some of the sellers for summary judgment to release funds held in escrow, the issue was whether the buyer had validly given notice of a tax covenant claim in respect of a transfer pricing issue under investigation by the Slovene tax authority. The High Court had concluded that the notice provisions in the share purchase agreement had not been fulfilled because although the notice gave reasonable detail of the nature of the claim, it failed to give reasonable detail of the matter which gave rise to the claim as required. The notice failed to set out the facts, events or circumstances giving rise to the claim and so the High Court gave summary judgment to allow the escrow funds to be released.

The High Court had construed the phrase in the contract 'the matter which gives rise to such Claim' as referring to the factual basis – this meant facts unearthed during a tax authority investigation from which a tax liability might result rather than the mere existence of such an investigation.

The Court of Appeal agreed with the High Court that the 'matter' giving rise to the claim is the underlying facts and not the fact of the tax investigation, but concluded that the notice did contain sufficient detail to meet the contractual requirement and was, therefore, valid. The share purchase agreement did not specify precisely what information would need to be included in a notice, but merely required "reasonable detail". Nugee LJ observed that what is reasonable depends on all the circumstances. That includes in the present case the fact that the sellers knew all about the details of the course of the investigation, including the fact that the Slovene tax authority had declined to give chapter and verse for its suspicions that the transfer pricing was inappropriately low, and indeed had several times resisted attempts to obtain any further detail.

The Court of Appeal considered the purpose of the notice provision as being to enable the sellers to make such inquiries into the factual circumstances giving rise to the claim with a view to: gathering/preserving evidence; assessing the merits of the claim; participating in the tax investigation to the extent desirable or possible with a view to influencing the outcome; and taking into account the nature and scope of the claim in its future business dealings, whether by way of formal reserving or a more general assessment of the potential liability. The question was would the additional details that the sellers' Counsel argued should have been provided have advanced any of these purposes?

Although the decision is unanimous, Popplewell LJ and Underhill LJ took a more robust view than Nugee LJ who felt some hesitation about concluding that the notice did not need to give any more details about the tax authority's position. Popplewell LJ was of the view that the additional level of detail said to have been required would not have furthered any commercial purposes for giving such a notice. He explained this in a no-nonsense manner: 'What is reasonable takes its colour from the commercial purpose of the clause, and what businessmen in the position of the parties would treat as reasonable. Businessmen would not expect or require further detail which served no commercial purpose. That would be the antithesis of what was reasonable.'

This is a good, fair, result for the buyer on the facts in this case but it is important to bear in mind that notice provisions are part of a seller's contractual protection and the courts generally expect them to be followed to the letter. So a buyer making a claim should take care to provide all the information required pursuant to the contract, in as much detail as possible, within the prescribed time limits to avoid ending up in court arguing over whether notice provisions have been complied with.

EU harmonisation and other proposals

The European Commission's Communication titled 'Business Taxation for 21st Century' published 18 May sets out both a long-term and short-term vision to support Europe's recovery from COVID-19, to ensure adequate public revenues over the coming years and create an equitable and stable business environment. The proposals will be of interest to multinational groups operating in the EU and comprise a mixture of old and new ideas. As unanimity is required to get them through, however, it is hard to see some of them being implemented where similar ideas previously failed.

BEFIT replaces CCCTB

The Commission will present by 2023 a new corporate tax rulebook for the EU, providing for fairer allocation of taxing rights between member states. It will be called 'Business in Europe: Framework for Income Taxation' (BEFIT) and will replace the proposals for a Common Consolidated Corporate Tax Base (CCCTB) which faced considerable opposition and stalled. It remains to be seen whether the member states previously opposed to the CCCTB will be any more willing to accept a single corporate tax rule book and rate.

New EU digital levy

In July 2021 a proposal for an EU digital levy will be published. It will be designed to co-exist with Pillar 1 (the new taxing right under global discussion facilitated by the OECD which does not ring-fence digital companies) and be compatible with WTO and international obligations. We have to wait for the proposal to see the detail but it is not going to make the global discussions any easier with the EU planning its own separate, additional measure to tackle the digital economy. This highlights concerns, shared by the UK, that Pillar 1, if narrowed so much that it does not catch the main digital players (which appears to be the case under the US proposal to limit it to the largest 100 multinationals), will not solve the issue of how to tax digitalised businesses fairly and without creating distortions.

Financial transaction tax

Remember the financial transaction tax which was discussed for years but never happened? It may make a comeback as the Commission will propose additional new own resources, which could include a financial transaction tax and an own resource linked to the corporate sector.

Encouraging equity funding

There has been much debate in recent years about the debt-equity bias and so the Commission proposes the introduction of a Debt Equity Bias Reduction Allowance (DEBRA) to incentivise companies to use more equity funding which will give more protection from shocks and create a more stable business environment.

Publication of effective corporate tax rate

The Commission will put forward a new proposal for the annual publication of the effective corporate tax rate of certain large companies with operations in the EU, using the methodology agreed for the OECD's Pillar 2 calculations for the global minimum tax.

What to look out for:

- The consultation on draft regulations for the DOTAS, DASVOIT and POTAS regimes closes on 13 June. These regulations are required because of substantive amendments to these rules made by Finance Bill 2021 and will take effect from 9 September 2021.

- The call for evidence on the effectiveness of the Office of Tax Simplification closes on 6 July 2021. The outcome of the review is expected to be published in the autumn.

- The Upper Tribunal is scheduled to begin hearing the appeal in RALC Consulting Ltd between 6-8 July. The First-tier Tribunal allowed an appeal against HMRC's determination that IR35 applied because the hypothetical contract lacked the requisite mutuality of obligation.

- The European Commission will publish the EU legislative proposal for a digital levy on 14 July.

This article was first published in the 11 June 2021 edition of Tax Journal.

CONTACT

Mike Lane
PARNTER
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
PSL COUNSEL & HEAD OF TAX KNOWLEDGE
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com