Slaughter and May Podcast
Tax news highlights: November 2020

Zoe Andrews	Welcome to the November 2020 edition of our tax news highlights podcast. I am Zoe Andrews, Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Professional Support Lawyer in the Tax department. Zoe and I will cover some recent cases: the First-tier Tribunal decision in Blackrock, the Court of Appeal decision in Total and the CJEU decision in Sonaecom. We will also discuss VAT recovery and financial services, Budget and Finance Bill timings and the draft legislation published on the 12th of November 2020. This podcast was recorded on the 17th of November and reflects the law and guidance on that date.
Zoe Andrews	*Blackrock* is a very interesting decision by the First-tier Tribunal as it considers two of the weapons HMRC use to challenge deductions for interest payments: namely, transfer pricing and the unallowable purpose rules. HMRC had disallowed the deductibility of interest on $4bn worth of intra-group loans that were put in place as part of a funding structure to enable the Blackrock group to acquire the US part of the business of Barclays Global Investors from Barclays. The Tribunal found in favour of the taxpayer on both issues.
Tanja Velling	Taking transfer pricing first, HMRC's argument in *Blackrock* differed from its usual argument that the debt was more than a third party lender would have provided or that the terms, including the rate of interest, were not what a third party lender would have agreed. Instead, HMRC argued that the taxpayer would never have borrowed from a third party lender because it would have been more expensive than borrowing from a US entity higher up the group. But Judge Brooks concluded that is not how the "separate entity approach" in transfer pricing works. The right comparator was a hypothetical $4bn loan with the covenants which an independent lender would have required.
Zoe Andrews	On the unallowable purpose point, this is a rare win for the taxpayer but HMRC are likely to appeal, and in any event will seek to distinguish the case on its particular facts. *Blackrock* is a case of mixed main purposes – a commercial purpose and a tax main purpose so the question was how much, if any, of the debits should be attributable to the tax main purpose. The Tribunal attributed all the debits to the commercial purpose because on the evidence, the tax advantage had not increased the debits because the loans would have been entered into anyway, even absent the tax advantage. What is interesting, though, is that the route to this conclusion was different from what you would usually expect.
Tanja Velling	Normally, to determine if there is a tax advantage, there is a comparison with the transaction that would have taken place absent the tax advantage. But in the judgment, there is no discussion of what the comparator transaction would be in order to test if there was a tax advantage, rather the judgment recorded that it was "common ground" that the interest deductions were a tax advantage. Judge Brooks then concluded that because securing a tax advantage was an inevitable and inextricable consequence of the loans, it is a purpose, and because it can't be described as merely incidental, it is also a main purpose. The disallowance was avoided only because of also having a main commercial purpose to which the debits are attributable. So instead of using a comparator as a threshold point at the earlier stage to determine if there was a tax advantage, the comparator came through at the apportionment stage.

Zoe Andrews	A comparator that we have seen HMRC use in other similar cases (bearing in mind this was a US-UK-US structure) was that no investment had been made in the UK at all, so no funding should have been raised here. That is obviously a difficult comparator to support in the light of the case law (particularly the Tai Hing case) and the reality of what else is happening. It will be interesting to see whether HMRC deploy that on any appeal because it seems to be the only way in which you can avoid having to resolve the conflict between a tax main purpose and the commercial main purpose so that the tax main purpose wins hands down So tell us about the *Total* case, Tanja that was another win for the taxpayer wasn't it?
Tanja Velling	Yes, it was. *Total* is a helpful decision on how to apply a provision which allows taxpayers to elect out of time apportionment. It is quite common where there is a change of law or change of tax rates that straddles a company's accounting period, for the relevant legislation to require an apportionment of the profits on a time basis, but with the possibility to elect for a different apportionment method in certain circumstances. In the *Total* case, the change of law in question was an increase in the rate of the supplementary charge on oil trades from 20% to 32% with effect from the 24th of March 2011. The legislation provided that accounting periods straddling that date should be split into an earlier and a later period and the profits for the accounting period be time apportioned between the earlier period and the later period. Companies could elect out this time apportionment if the time basis of apportionment would work unjustly or unreasonably in the company's case.
Tanja Velling	In that case the company could elect for its profits to be apportioned on another basis that is just and reasonable and specified in the election.
Zoe Andrews	The taxpayers' accounting periods straddled 24 March 2011. They sought to elect out of the time apportionment to allocate a large amount of capital allowances to the later period on the basis that that was the period when their expenditure was incurred. The result was that more than 100% of the accounting period profits were allocated to the earlier period, and a loss to the later period. So none of the profits were in fact subject to the increased supplementary charge. HMRC did not dispute that each taxpayer was entitled to make the election, but argued that a different alternative calculation should be used which spread the capital allowances and allocated some of the profits to the later period. The Upper Tribunal had upheld HMRC's alternative calculation, taking a very narrow view of the scope of the election stating that "time apportionment will apply unless, for reasons specific to the company, time apportionment would work unjustly or unreasonably" and that the alternative basis of apportionment must go no "further than was necessary to counteract or compensate for the effect of those factors".
Tanja Velling	But the Court of Appeal sided with the taxpayers. Any company which earned profits at a significantly faster rate in the earlier Period than the later Period, stands to be materially prejudiced by time apportionment and can avail itself of the election. It does not matter whether the difference in profitability arose from something exceptional or something routine. There is no need to show any reasons specific to the company.

	Although the *Total* case is about apportionment in the context of the supplementary charge on oil-related activities, the principles may be equally applicable in other cases when an election for just and reasonable apportionment is available. For instance, in respect of the corporate interest restriction rules. While we are talking about good news – there has been a helpful announcement about VAT on financial services, hasn't there Zoe?
Zoe Andrews	Yes, you may recall that, in anticipation of a no deal Brexit, regulations on the VAT treatment of supplies of insurance and financial services to EU customers were made, but never brought into effect. These regulations would have aligned the treatment of insurance and financial services exports to the EU with the treatment of those exports to the rest of the world, allowing UK suppliers to recover input tax attributable to those exports. During a statement on financial services made on 9 November 2020, Chancellor Rishi Sunak confirmed that, "to make sure UK financial services exports to the EU remain competitive, we will treat those exports the same as we do for other countries. This means UK firms will be able to reclaim input VAT on financial services exports to the EU." I therefore expect that the regulations will finally be brought into force and that HMRC will issue guidance in due course.
Tanja Velling	When speaking about VAT, we should also provide an update on the Sonaecom case which we mentioned in our last podcast. The CJEU decision has now been published. It concerned a holding company's ability to recover input tax in respect of supplies of services received in the context of an abortive share acquisition, where the holding company would have provided management services to the target post-acquisition if it had been successful. The input tax at issue related to fees for a market study and services related to a bond financing. When the share acquisition fell through, the proceeds from the financing were used by Sonaecom to make a loan to its parent. Following its decision in the Ryanair case, the CJEU decided that input tax in respect of the market study could be recovered as the costs formed part of Sonaecom's general overheads. But input tax in respect of the other services was not recoverable – the costs did not form part of Sonaecom's general overheads as there was a direct and immediate link between these services and the exempt intra-group lending activity.
Tanja Velling	In this way, the actual use of the services trumped their intended use.
Zoe Andrews	Now normally, the Budget would be held around now, and the Finance Bill published soon, with the aim of enactment before 1 April 2021. But the Chancellor has already stated that there will not be a November Budget; and Tom Scholar, the Treasury's permanent secretary told the Public Accounts Committee on 12th November that the Budget will be in March 2021. He is reported to have said: "There will be a Budget in March. We know a lot will change between now and March and we'll know a lot more about the pandemic." Which sounds rather ominous!
Tanja Velling	Yes, that's true. In particular, when taking into account the fact that, only one day before the statement, the Office of Tax Simplification, commonly referred to as the OTS, published a report on capital gains tax which has given additional fodder to rumours that major CGT changes could be afoot.

	The very first recommendation made by the OTS was that "If the government considers the simplification priority is to reduce distortions to behaviour, it should either: consider more closely aligning Capital Gains Tax rates with Income Tax rates, or consider addressing boundary issues between Capital Gains Tax and Income Tax". Somewhat predictably, the first part of this recommendation has attracted significant press coverage and has been portrayed as something of a money spinner for the government. What do you make of that Zoe?
Zoe Andrews	Well, the OTS does state that a closer alignment of the rates "has the potential to raise a substantial amount of tax for the Exchequer." But the report also contains words of caution. Such a rate alignment is expected to result in significant behavioural effects which could result in lower than expected revenue gains. The OTS also warns that taxpayers would be incentivised to hold assets through companies and recommends that, if the government opts for rate alignment, it should consider reintroducing a form of relief for inflationary gains and allowing a more flexible use of capital losses. At least to me, this does not sound like a straightforward money spinner. And most commentators are not expecting general tax increases which might depress the economy during the recovery period. Obviously, imposing higher capital gains charges on rich private investors and private equity might have voting appeal in some places, but it would also no doubt be opposed by many in the Conservative party. So, there are a lot of variables for the government to consider. Whilst the Finance Bill may have been expected to be published this side of Christmas (with a placeholder for any rate changes that might be announced as part of the Budget), this looks increasingly unlikely. Further draft legislation for the Finance Bill was published on 12 November, inviting comments by 7 January, noting that "the final contents of Finance Bill 2021 will be subject to confirmation at Budget 2021." So, we may not see a full draft of the Finance Bill until March – which is likely to mean that, once again, Royal Assent is likely to be after the start of the tax year.
Tanja Velling	And this makes it all the more important to keep an eye on the draft legislation. Amongst the draft clauses published on the 12th of November are provisions which would introduce a new plastic packaging tax. The plastic packaging tax would be charged from 1 April 2022 at a rate of £200 per metric tonne of plastic packaging components produced in, or imported into, the UK where the proportion of recycled plastic, when measured by weight, is less than 30% of the total amount of plastic in the component. The draft legislation also includes provisions addressing the withdrawal of LIBOR and provisions amending the hybrid and other mismatches regime.
Zoe Andrews	Most of the hybrids changes are technical amendments to make the regime work as intended and, as such, they apply with effect from 1 April 2017 when the regime came into effect. One new feature of particular interest, which would apply from 1 January 2021, is a mechanism to allow one company's excess dual inclusion income to frank the counteraction amount which another company within the same group would otherwise have to bring into account under the hybrids rules.

Zoe Andrews	In respect of the withdrawal of LIBOR, the legislative changes which the government is proposing to make are limited to the replacement of three references to a rate of LIBOR plus 1% with references to an 'incremental borrowing rate' as defined for accounting purposes. The consultation response, published alongside the draft legislation, confirms that, "the government does not intend to make any further substantive legislative changes at this time", there will however be included in the Finance Bill 2021 a time limited power to make further regulations if further changes are required.
Tanja Velling	But businesses can derive from some comfort from the updated guidance which sets outs HMRC's views on the tax implications for businesses when financial instruments are changed because of the benchmark reform. The draft guidance published in March 2020 was already fairly comprehensive. And the updated version published alongside the draft legislation on the 12th of November contains additional helpful details. In particular, the additional guidance on one-off payments is welcome. As per the March draft, such payments, if made by the lender, would not be interest. If made by the borrower, they would, however, normally be treated as interest. The updated guidance clarifies that "any exemptions or reliefs applying to interest under the instrument…would be expected to apply" also the one-off payment. For VAT purposes, additional payments (regardless of the payer's identity) would be treated as adjustments to the consideration for the original supply, for example of loan finance, and their VAT treatment should be determined by reference to that original supply. As such, "HMRC does not envisage any unusual VAT consequences arising from the discontinuation of the use of LIBOR."
Zoe Andrews	HMRC has also issued a consultation on Making Tax Digital or MTD for Corporation Tax which makes clear that the project could bring changes beyond a mere digitisation of current processes. For instance, the government is considering the alignment of the filing dates for company law and tax purposes by bringing forward the time limit for filing company tax returns. This might mean that, whereas all companies currently have 12 months after the end of the accounting period to submit a company tax return, this would be reduced to 6 months for public limited companies and 9 months for private limited companies.
Tanja Velling	And now on to some anticipated developments: • On the 1st of December, the Priority on Insolvency Regulations will come into force. These regulations will give HMRC secondary preferential creditor status in respect of certain debts, including PAYE, Construction Industry Scheme deductions and VAT, in insolvency procedures commencing on or after 1 December 2020; • on the 7th of December, the Upper Tribunal will hear the appeal in the *Andreas Rialas* case concerning the transfer of assets abroad rules; and • On the 14th of December, the OECD consultation on the blueprints for its two-pillared international tax reform proposal will close for comments.
Zoe Andrews	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. You can also follow us on Twitter - @SlaughterMayTax