Slaughter and May Podcast
Tax News: July 2024

Zoe Andrews	Welcome to the July 2024 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Tax PSL Counsel. We will discuss recent tax-related statistics published in the UK, the Court of Appeal's decisions in *JTI* and *Altrad Services* and the Upper Tribunal's decision in *Watts*. Following on from our special series on international tax disputes, we also provide an update on two cases that were mentioned in the series – *Moore* in the US and *PepsiCo* in Australia. In the context of the former, we'll also talk a bit about wealth taxes and, finally, we'll touch on the EU's FASTER proposal. The podcast was recorded on the 9th of July 2024 and reflects the law and guidance on that date.
Zoe Andrews	Let's start with the UK elections! The unsurprising result is a Labour victory. Sir Keir Starmer won a majority just a few seats shy of Tony Blair's 418 in Labour's 1997 landslide victory. What does this mean for tax? One answer might be "not much" and another that we have to wait and see. In the run-up to the election, Labour promised a business tax roadmap and a consultation on changes to the taxation of carried interest, so it remains to be seen what exactly will happen on these fronts. There was also a promise of an international summit by the middle of October to encourage inward investment into the UK. As to the "not much" bucket – Labour has already ruled out raising rates of income tax, national insurance, VAT and corporation tax above current levels.
Tanja Velling	The Labour manifesto did include a few more things on tax (for example, in relation to business rates, the energy profits levy and the apprenticeship levy) but I don't think it's worth going into any detail on this now. I've previously written about the proposals on the European Tax Blog, and I'm sure we'll get to talk about (at least some of) them again following the Labour government's first Budget which may be some time in the second half of September.
Zoe Andrews	When formulating new tax policy, I hope that the new government can learn from the recent IFS report on the Conservative government's record on tax from 2010 to 2024 which looks at the tax policy changes and the policymaking process during that period. As widely reported in the press in

	the run up to the election, the report shows that tax revenue as a share of national income is at the highest point since 1948. A common theme over the period is increasing complexity. There have been more than a dozen new taxes introduced since 2010 (including the bank levy and bank surcharge, digital services tax, diverted profits tax, the energy profits levy and the electricity generator levy, to name but a few). This is what happens when politicians promise not to raise existing taxes but need to get more revenue from somewhere! Many new rates and reliefs have been added to existing taxes. As any of us who keep a set of orange and yellow books by their desk can testify, the tax code has never been longer! As the report notes, none of the major tax policy challenges that existed in 2010, including how tax will adapt to address climate change, has been addressed and they are now more urgent. My wish is that the Labour government will develop policies that will make the tax system fairer, more economically efficient and less complex.
Tanja Velling	And what about the tax gap, which is the difference between the tax that HMRC actually collects and the amount it thinks it ought to be paid?
Zoe Andrews	Ah yes, the tax gap was another pre-election hot topic with all sorts of unrealistic amounts expected to be raised by different parties from closing the tax gap. I've had a look at HMRC's tax gap estimates for 2022 to 2023, which were also published in June. Although the tax gap in 2022/23 is estimated to be 4.8% of total theoretical tax liabilities (which translates to £39.8 billion), which is lower than in previous years, the tax gap for corporation tax has increased from 11.4% in 2005/06 to 13.9% in 2022/23.
Tanja Velling	The breakdown of the reasons for the tax gap is interesting. The statistics show that the amount of tax gap caused by mistakes is 30%, which to me highlights the complexity of the tax system and the need to make compliance simpler, particularly for small businesses which account for 60% of the overall tax gap. Only 11% of the overall total tax gap is attributed to large businesses. Tackling the remaining tax gap (and avoidance in particular) is on Labour's radar. Indeed, the manifesto referred to a "renewed focus on tax avoidance by large businesses…and the wealthy". But the statistics show that only 4% of the tax gap is in fact caused by tax avoidance so further measures to tackle avoidance would not bring in as much additional revenue as making compliance simpler to cut down on the part of the tax gap caused by mistakes.
Zoe Andrews	Let's have a look now at some cases. The Court of Appeal's decision in *JTI* completes the trilogy of unallowable purpose cases for now (although, it is not necessarily the end of the story as we wait to see if there will be any appeals to the Supreme Court!). We discussed *BlackRock* and *Kwik-Fit* last month, so what does *JTI* bring to the party?

Tanja Velling	In *JTI*, a scheme was devised for a funding structure for the acquisition of a US company by a US headed group, using a UK acquisition vehicle with debt pushed down to the UK from the US. It resulted in approximately £40 million of non-trade loan relationship interest debits being claimed as group relief. HMRC issued closure notices disallowing the interest debits pursuant to section 441 of the Corporation Tax Act 2009. Around £9 million of corporation tax is at stake.
Zoe Andrews	So, the facts were similar to *BlackRock* except that the UK taxpayer in *JTI* directly acquired the US target, whereas in *BlackRock*, a US company was inserted below the UK taxpayer because, for US regulatory reasons, the *BlackRock* acquisition had to be out of a US company. Is that right?
Tanja Velling	Yes, that's right and many expected a better outcome in *JTI* because of the acquisition was made directly by the UK taxpayer. Here we had a UK taxpayer issuing loan notes to fund the direct acquisition of a US company. However, the Court of Appeal concluded that the First-tier Tribunal's decision was correct and there was no basis for it to be overturned. The FTT had found that there was a main tax avoidance purpose (the generation of the loan relationship debits for the UK members of the group) and no commercial purpose for the taxpayer being party to the loan relationship, so all of the debits were attributable to the unallowable purpose and disallowed.
Zoe Andrews	It certainly didn't help the taxpayer, did it, that the FTT found the witness' evidence of commercial purpose was "vague, elusive, lacking in substance, contradictory to the factual matrix, and ultimately unconvincing"?
Tanja Velling	No, it did not. It was an uphill struggle for the taxpayer to try and get this finding of fact of no commercial purpose overturned. The Court of Appeal found that the Upper Tribunal was right to decline to interfere with the FTT's finding. A differently constituted FTT might have taken a different view, but that is not relevant to the appeal. There are very limited circumstances in which a finding of fact or an evaluative assessment can be interfered with on appeal which were not present in this case.
Zoe Andrews	This certainly sounds like there is scope to say *JTI* should be distinguished on its facts then. But are there any aspects of the case that might be relevant to other unallowable purpose challenges?
Tanja Velling	Yes, and as we like things in "threes", I've picked three points that we may see HMRC raise in other cases. First, the Tribunal is not required to adopt a "tunnel-visioned" approach by looking at just what the loan was to be spent on when determining what the taxpayer's purpose is.

	Second, a taxpayer's purpose can be playing a part devised for it in a wider scheme so as to obtain a tax advantage. And third, even if there is a main commercial purpose (as a matter of fact), it is possible that, nonetheless, all the debits have to be apportioned to the main tax avoidance purpose (and disallowed). This is what happened in *BlackRock.* In *JTI*, the FTT did not find a commercial purpose. But the Court of Appeal concluded that, even if the FTT had found a commercial purpose, all the debits would have been apportioned to the unallowable purpose because, "but for" the scheme to secure a tax advantage which was "bolted on" to the purchase of the US company, there would have been no loan relationship and no debit.
Zoe Andrews	And what did you make of Lord Justice Lewison's paragraph at the end expressing his surprise that both sides had argued the appeal as though the Supreme Court had never decided *Rossendale v Hurstwood*?
Tanja Velling	That was rather odd, wasn't it? Especially because he didn't explain why he thought it was relevant. By way of reminder, *Rossendale* is a case on the *Ramsay* approach to statutory construction (which requires you to construe the relevant statutory provisions purposively and apply them to the facts viewed realistically). The quote Lord Justice Lewison referred to was about the need to consider a scheme to avoid tax as a whole where it involves a series of steps planned in advance. It is difficult to see how this is relevant in the context of the test of the taxpayer's purpose for being party to a loan relationship unless Lord Justice Lewison simply meant that you need to look at all the facts in the round – which is what Lord Justice Newey and Lady Justice Falk did do anyway in *JTI, Kwik-Fit* and *BlackRock*. So, I don't think it really adds anything. But it does bring us neatly on to the next case, the Court of Appeal's decision in *Altrad Services.* Let's look at how and why *Rossendale* was relevant to the Court of Appeal's decision to overturn the Upper Tribunal.
Zoe Andrews	The case involves an artificial series of transactions which the FTT found to be devoid of business purpose and which were effected just to achieve a "magical" uplift in qualifying expenditure for capital allowances purposes. The scheme had been disclosed under DOTAS and HMRC had issued closure notices reducing the taxpayers' entitlement to capital allowances. The success of the scheme depended on a sale of assets being a disposal event under section 61(1)(a) of the Capital Allowances Act 2001, even though the assets were immediately leased back and ownership was regained after a few weeks by the exercise of a put option.

	The FTT had decided that, on a realistic view of the facts, there was no disposal event. This was based on a *Ramsay* argument. But the Upper Tribunal considered that this amounted to a misconstruction of section 61(1)(a) which operated by reference to a snapshot in time - whether a person had ceased to own an asset at any time – and not over a period of time. It did not expressly invite any analysis of why a person had ceased to own an asset nor of whether it was possible, likely or pre-ordained that the person would own the asset again. The Upper Tribunal considered that this conclusion was supported by the fact that, unlike paragraph (a), other limbs of section 61(1) looked at whether, for example, a loss of plant or machinery was "permanent".
Tanja Velling	The Upper Tribunal also hinted that HMRC had run the wrong *Ramsay* argument by focusing on section 61(1) and that another *Ramsay* argument might have been successful. So, HMRC appealed with their original and an alternative *Ramsay* argument. Which one persuaded the Court of Appeal?
Zoe Andrews	The Court of Appeal allowed HMRC's appeal based on the original argument and it reinstated the FTT's decision. In contrast to the Upper Tribunal, the Court of Appeal considered that the other limbs of section 61(1) "support an inference that the section is in general concerned with events that have enduring consequences in the real world".
Tanja Velling	So where did the Upper Tribunal go wrong?
Zoe Andrews	The key error was to conclude that section 61(1)(a) must be applied by reference to a snapshot in time as, in the words of Sir Launcelot Henderson in the Court of Appeal: "confining attention to a "snapshot in time" is normally the very antithesis of what the *Ramsay* approach requires". Instead, the Court of Appeal decided that a brief interruption of the legal and beneficial ownership of the assets fell outside the scope of the statutory language and the intermediate steps could be disregarded and that this fell comfortably within the principles stated by the Supreme Court in *Rossendale*.
Tanja Velling	The Upper Tribunal in *Watts* took a similar approach to *Altrad* in a different context. The case concerned a gilt strip scheme. The taxpayer bought gilts for £1.5 million and granted an option to a trust to purchase the gilts at an exercise price of around £150,000. The trust, however, paid £1.3 million for the option and then sold it to a third party for roughly the same price. The third party then exercised the option and acquired the gilts for the around £150,000. The idea behind the scheme was to create a tax-deductible loss of around £1.3 million, being the difference between the amount paid by the taxpayer for the gilts and the exercise price under the option.

	And the success of the scheme hinged on the question: what is “the amount payable on the transfer” of the gilts? In order to succeed, that amount had to be only the exercise price, and not the exercise price plus the amount paid by the third party to the trust to acquire the option (as argued for by HMRC). The Upper Tribunal sided with HMRC, looking at the scheme realistically, as a composite whole, and interpreting the legislation purposively as intended “to give effect to real economic outcomes”.
Zoe Andrews	I’m sure you’ll recall our tax disputes podcast series where we got together with local experts from Brazil, the US, Australia, India, Nigeria and France to discuss the tax disputes landscape around the world. Both the US and the Australian episodes discussed important cases pending before the courts and those decisions have come out during the last month.
Tanja Velling	I’m assuming that, for the US, you’re referring to the Supreme Court’s decision in *Moore*?
Zoe Andrews	Yes, that’s quite right! The case concerned the constitutionality of the mandatory repatriation tax which, very broadly, taxed US shareholders on undistributed profits of their foreign companies. A majority of 7-to-2 Justices at the US Supreme Court upheld the tax. This is a significant win for the US government and for legal certainty; commentators had expressed concern that a widely worded win for the taxpayers could have called into question reams of US tax legislation. But the decision does also signal that the legislature’s taxing powers are not unlimited. It leaves open to what extent unrealised income can be taxed – the majority opinion makes clear that it narrowly focusses on the mandatory repatriation tax which taxes income that was realised by the foreign company. So, the question answered here is whether the attribution of that realised, undistributed income to the shareholder for taxation in the shareholder’s hands was constitutional. A footnote to the majority opinion mentions, in particular, that the analysis “does not address the distinct issues that would be raised by…taxes on holdings, wealth, or net wealth; or (iii) taxes on appreciation”. So, the Supreme Court’s verdict on something like the “Billionaire Minimum Tax” (most recently proposed as part of the Biden Administration’s Budget for Financial Year 2025), which would involve taxing unrealised capital gains, could well be different.
Tanja Velling	That’s quite interesting especially in the context of calls for further taxation of the wealthiest – including by some of the wealthiest themselves. In advance of the World Economic Forum in 2024, over 250 millionaires and billionaires called for the introduction of additional taxes on themselves.

Zoe Andrews	And wealth tax could be one such option and it is also a topic at the OECD. The Brazilian G20 presidency commissioned Gabriel Zucman at the EU Tax Observatory to prepare a report on ways to ensure "effective taxation of ultra-high-net-worth individuals". The report proposes a minimum tax on individuals worth more than $1 billion which would equal 2% of their wealth per year. Around 3,000 taxpayers would be affected and the tax would raise $200-$250 billion per year globally. Extending it to centimillionaires would add $100-$140 billion a year. Like the global corporate minimum tax under Pillar Two, this minimum standard would be optional, and it could be implemented in different ways. The report acknowledges implementation challenges around measuring wealth, availability of information and international cooperation, coupled with the individuals' ability to move to a non-participating country. This last point could be addressed through a continued liability to the minimum tax in the departure state following the relocation. Otherwise, there could be a UTPR-style rule whereby participating countries could tax undertaxed billionaires resident in non-participating countries, for instance on the basis of their assets located in the participating country.
Tanja Velling	I'm tempted to say that this all sounds very interesting, but rather difficult and unlikely to ever come off the ground. But many would have probably said the same thing about the Pillar Two minimum tax a few years ago – and look where we are now! So, instead I'd say that a minimum tax on wealth is certainly not imminent, but I don't think it can be discounted as a possibility for the next five to ten years. This is all the more so, given that the 'Zero Draft' Terms of Reference for a United Nations Framework Convention on International Tax Cooperation (which was published on the 7th of June) mentions "taxation of high-net-worth individuals" as a priority area for early protocols. Also given that this doesn't overlap with the OECD's corporate tax work, it is not inconceivable that European countries looking for additional tax revenues may show some enthusiasm for UN efforts in this area. Back in February, then French Finance Minister Bruno Le Maire was quoted as having said on the sidelines of meetings with his G20 counterparts that "We want Europe to take this idea of minimum taxation of individuals forward as quickly as possible, and France will be at the forefront". But I've side-tracked us here – what was the development in Australia?
Zoe Andrews	Australia's Full Federal Court decided the *PepsiCo* royalties, withholding and diverted profits tax case in favour of the taxpayer! The case concerned payments under an agreement between Pepsi and the third-party who bottled and distributed Pepsi products in Australia. Under the terms of the agreement, the payments were solely for the concentrate that goes into making the drinks, and the third party was granted a royalty-

	free licence to use Pepsi's IP. Nonetheless, the Australian Taxation Office had argued that the payments included an embedded royalty. It's good news for taxpayers that this argument didn't succeed here, but the decision is fact sensitive, and companies will want to assess carefully whether their arrangements would be on the right side of the line by reference to the economic analysis outlined by the court. What other international tax developments did you want to talk about?
Tanja Velling	Let's start with two other OECD-related developments. The deadline of the 30th of June for concluding negotiations on the Multilateral Convention on Amount A of Pillar One came and went. Manal Corwin, director of the OECD's Centre for Tax Policy and Administration, has since been quoted as saying that they "remain optimistic" and that "commitment remains high". As discussed in the last podcast, we'll wait to see what this means in practice, including for the compromise agreement on trade sanctions and digital services taxes between the US and a number of jurisdictions including the UK. On a more positive note, the OECD did publish updates on Amount B under Pillar One and a 4th tranche of Administrative Guidance for the global minimum tax under Pillar Two. We won't have time to go into detail here, but have a look at our European Tax Blog for some thoughts on the Pillar Two Administrative Guidance. Let's now turn to the EU.
Zoe Andrews	Back in June 2023, the European Commission had proposed a directive on the faster and safer relief of excess withholding taxes, generally referred to as "FASTER" (all capital letters). The proposal is intended to streamline procedures for obtaining relief from withholding tax whilst also preventing tax fraud and abuse. Its cornerstone is the establishment of national registers of certified financial institutions who would have to fulfil additional record-keeping and reporting requirements but would also be able to request relief from withholding tax on behalf of account holders. At the ECOFIN Council meeting on the 14th of May 2024, delegates reached what the document calls a "general approach to the draft Directive" – which I would rather describe as a significantly revised version, although the broad structure remains the same. Given the extent of the changes, however, there needs to be a re-consultation with the European Parliament on the Directive. The Commission expected that EU Finance Ministers would adopt the Directive in early 2025; the Council's text envisages that implementing legislation would apply with effect from the start of 2030. This is three years later than the 1st of January 2027 start date which the Commission's proposal had

	envisaged – which is good news for financial institution as it will give them more time to put the necessary systems in place. So, that's something to keep an eye on over the medium term. What else is there to look out for?
Tanja Velling	I can't actually think of anything tax-related at the moment! Or perhaps that is wishful thinking because I'm hoping for a quiet, sunny summer – which reminds me to tell you that the regular news podcast is taking a break in August. Thank you for listening; I hope you have a great summer! 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.