Slaughter and May Podcast
Tax News Highlights: October 2021

Zoe Andrews	Welcome to the October 2021 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 the consultation response and draft legislation for the economic crime levy, the High Court decision in *Almacantar*, and the First-tier Tribunal decisions in *Shinelock* and *Marlborough*. We will also share some thoughts sparked by the press coverage of the Pandora Papers, although we shall leave the commentary on the actual revelations to the press. This podcast was recorded on the 12th of October 2021 and reflects the law and guidance on that date.
Zoe Andrews	Let me kick off with details of the new tax on anti-money laundering (AML) regulated entities which aims to raise £100m a year from around 4000 entities to help fund action to tackle money laundering. The legislation for the economic crime levy will be included in the Autumn Finance Bill and the levy will first apply in the 2022/23 tax year, but payment of the fixed fee by eligible entities will be due the following tax year.
Tanja Velling	The payee base is very diverse including financial, accounting and legal services, art markets and the gambling sector. How does the levy deal with the different money laundering risk for each sector?
Zoe Andrews	Well, the government opted for simplicity rather than making the levy proportionate to money laundering risk for different sectors. Ease of calculation was prioritised over fairness. But there will be a review of the levy in 2027 and one of the things to be considered is whether it should be amended to reflect money laundering risk. As it stands, according to the draft legislation, however, there will simply be an annual fixed fee for entities within the medium, large and very large size bands. Small entities are exempt.
Tanja Velling	So how are the size bands determined and will the fixed fees for each band be reviewed?

Zoe Andrews	The bands are based on UK revenue. Ideally, UK AML revenue would be the basis, but it is too complex to isolate, so all UK revenue is taken into account. Small entities have UK revenue under £10.2m (this threshold corresponds to the turnover limb of the small company definition in the Companies Act). Medium entities have UK revenue between £10.2m and £36m, and large ones between £36m and £1bn. Over £1bn UK revenue puts you in the very large band. The fixed fees will be confirmed in the Finance Bill but if they follow the top end of the ranges given in the draft legislation it will be £15,000 for medium, £50,000 for large and £250,000 for very large entities. The fixed fee sizes will be updated periodically after a 3 year review but could be updated sooner if the levy does not yield £100m per year, or to reflect new data, or in response to macro-economic changes like inflation. This reminds me of the bank levy which kept getting tweaked to continue to raise the right amount. Although the bank levy also served the purpose of changing behaviour whereas the economic crime levy is quite simply an extra tax and does not have anything to do with good or bad behaviour of those paying it.
Tanja Velling	Let’s move on to *Almacantar*, a High Court decision which brings together two topics which we previously discussed in this podcast: estoppel by convention and contractual notice provisions. Back in our June podcast we covered the Court of Appeal decision in *Dodika* and the High Court decision in *TP ICAP Ltd.* which both served as a reminder that, where contractual disputes are concerned, the devil is in the detail of the drafting, in particular, of notice provisions, and care should be taken to follow notice provisions precisely.
Zoe Andrews	*Almacantar* takes this one step further because no notice of claim had been served by Almacantar before the end of the contractual limitation period and Almacantar sought to rely on estoppel to continue with its claim. The dispute concerned an SDLT indemnity given by the seller, RailPen, to pay half the SDLT arising to Almacantar in respect of its purchase of various property interests.
Tanja Velling	Almacantar argued that RailPen was estopped from denying liability on the basis that no notice of claim had been served. RailPen had been involved every step of the way in the dispute with HMRC over the SDLT and had been provided with correspondence etcetera under the terms of the agreement. Almacantar argued this showed that there was a shared assumption that the notice periods and time limits of the agreement would not apply, but the High Court found that this was not made out on the facts and the estoppel argument failed.

Zoe Andrews	The High Court applied the law on estoppel as laid down by the Supreme Court in *Tinkler*, which Tanja and Nele discussed during the August edition of this podcast. The judgment in *Tinkler* had been handed down after the hearing in *Almacantar*, but the parties were content that, in *Tinkler*, the Supreme Court merely "endorsed established principles". In *Tinkler*, the taxpayer's advisers had acknowledged to HMRC in writing that they understood an enquiry to have been opened and the purported enquiry proceeded on that basis. The taxpayer was then estopped from later denying the existence of that commonly assumed enquiry. In other words, the taxpayer was prevented from denying the existence of the very process in which he had participated through his advisers. The situation in *Almacantar* was clearly rather different. The parties followed the contractually laid-down process for conducting tax authority claims, i.e. for defending claims for additional tax made by a tax authority where such additional tax might fall to be compensated for under the agreement. The tax authority claims process is normally quite separate from the process which has to be followed to claim compensation if or when the additional tax liability actually materialises. It seems quite right that participation in the former should not, in and of itself, form the basis of an estoppel in respect of the latter. The whole contractual matrix is usually set up so as to avoid a situation where the participation of the party providing the indemnity in a tax authority claim would, in and of itself, amount to an admission of liability vis-à-vis the indemnified party. A notice for one contractual purpose (such as tax authority claims) is not necessarily a notice for all purposes (including a notification of a claim under the contract) in respect of which the sender might wish to have given notice, and estoppel is unlikely to come to the rescue.
Tanja Velling	*Shinelock* is a First-tier Tribunal decision which touches on the interaction between the tax rules and net accounting in a way which can be contrasted with the FTT's decision in *West Burton Property Limited*, which we discussed during the July 2021 edition of this podcast. You may remember that West Burton Property Limited had incurred revenue expenditure on maintaining a power station and had capitalised this expenditure. The power station was sold at book value at a time when some of the deferred revenue expenditure (DRE) remained undepreciated. The FTT concluded that, even though the profit and loss account recorded a figure of nil for the sale, a tax deduction was available for the as-yet undepreciated DRE given that it was brought into account as part of the credits and debits making up the nil amount shown on the face of the P&L.
Zoe Andrews	The facts in *Shinelock* were quite different and several other points were at play in addition to the net accounting issue on which we will focus here.

	Broadly, a company had sold a property at a gain and paid that gain over to its shareholder, an individual. One of the arguments advanced to prevent HMRC from taxing the gain was that the entirety of the payment was deductible as a loan relationship debit. It was said to be a cost associated with obtaining from the shareholder a loan and/or a guarantee for certain other borrowings. A deduction as a loan relationship debit would have required the amount to have been recognised in determining the company's profit or loss. On the facts, it, however, appeared that there was no line item corresponding to the sale of the property and adjustments had instead been made on the balance sheet. This was then not a situation where two (or more) gross amounts were set against each other to produce a net amount that was reflected in the accounts. It was rather a case where, in the preparation of the accounts, it was concluded that no amount needed to be shown at all. And in that case, it cannot be said that any underlying gross amounts that were considered in reaching this conclusion were recognised in the accounts in a manner that could give rise to a loan relationship debit.
Tanja Velling	So, the crucial distinction was that, in *West Burton*, it was common ground that the P&L account had recorded a nil amount, rather than recording nothing as it appeared to do in *Shinelock*. And that is the distinction which led Mike Lane to comment on the European Tax Blog: "What's the difference between nothing and nil? A tax deduction!" Clearly, another point to make in relation to *Shinelock* would be around trial preparation. Judge Zaman noted that, "[s]omewhat surprisingly", neither party had provided the relevant accounts in evidence, and that she had to make her determination without the benefit of expert accounting evidence. Whether either of these could have turned around the taxpayer's fate in this case is rather doubtful, but in another case, it could make a crucial difference. Shall we now have a look at First-tier Tribunal's decision *Marlborough*?

Zoe Andrews	The issue in *Marlborough* was whether loans from a remuneration trust to Dr Thomas, a dentist and director and sole shareholder of Marlborough DP Limited which operated a dental practice, were earnings from employment or disguised remuneration. The FTT concluded they were neither, but were instead distributions made to him as shareholder of the company. There are various issues argued in this case but I would like to focus on just one of them because, if HMRC had succeeded in persuading the FTT of its views of the Supreme Court decision in *Rangers,* it would have caused some concern! HMRC had argued that the reasoning of the Supreme Court in *Rangers* applied to this case, but the FTT agreed with the taxpayer that, in the circumstances of this case, the decision in *Rangers* does not provide the answer as to whether the relevant sums are earnings. HMRC argued for a very broad interpretation of *Rangers*, that sums are taxable as earnings just because they are routed through remuneration trust arrangements for tax avoidance purposes.
Tanja Velling	So, what did *Rangers* say? In *Rangers*, there was no doubt that the relevant sums constituted a reward for the services of the relevant footballers and other employees <u>as employees</u>. The issue was whether the sums were prevented from being earnings because they were routed through the trust arrangements. The answer was that they were not. *Rangers* tells us that, if the relevant sums were a reward for Dr Thomas' services as a director, they could not escape being taxed as such merely because they were paid through the remuneration trust arrangements. What *Rangers* does not tell us is that such sums become earnings simply because of the existence of the remuneration trust arrangements.

Zoe Andrews	The FTT concluded that the relevant sums did not constitute earnings as they were not paid as remuneration or reward for Dr Thomas' services provided as director of the company. A finding of fact which appears crucial to this conclusion is that the amounts contributed to the remuneration trust represented the profits of Marlborough as a whole and not, as HMRC argued, the fruits of Dr Thomas' labour because Marlborough engaged other staff (two employees, a hygienist and an associate dentist). This, together with other facts, pointed to the conclusion that the sums constituted distributions made to him as a shareholder in the company. This meant that the relevant sums were not taxable under the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), but also, as was conceded by the taxpayer, that Marlborough was not entitled to a deduction for the contribution to the trust in computing its profits. This case illustrates that there is no "one size fits all" approach when it comes to the application of ITEPA to remuneration trust arrangements. Whether amounts paid under such trust arrangements are taxable as earnings or disguised remuneration or, as in this case, as distributions, will depend on the facts of the case – remembering that, as per the Court of Appeal's decision in *PA Holdings*, if a payment is in substance earnings or profits of the business, its character is not altered by the payment mechanism (and that, if the relevant sums are earnings, they do not cease to be earnings just because of being routed through remuneration trust arrangements).
Tanja Velling	Now, looking at the Pandora Papers, I think it is interesting to note the different perspectives from which the tax-related revelations can be viewed and discussed. Looking at pure tax content, it appears that, at least so far, the revelations in the Pandora Papers relate to tax avoidance. This contrasts with the Panama Papers published in 2016 which tended to concern revelations of tax evasion. You may remember that they resulted in Germany issuing arrest warrants in 2020 for the founders of the law firm at the heart of the offshore bank account scandal. Yet, the Pandora Papers appear to be discussed as if their revelations were equivalent to those in the Panama Papers. To my mind, this can be understood as part of the blurring of the lines between tax evasion and avoidance. Whilst it remains true that only the former is a crime, over the years, tax avoidance has attracted more and more sanctions, through public opinion as well as changes in law. Quite clearly, governments across the world regard the fight against tax avoidance as a priority and as far from complete and taxpayers must be prepared for what are likely to be multiple rounds of additional legislation to clamp down on what governments, tax authorities and the public consider unwanted behaviour.

Zoe Andrews	In the UK, this was most recently borne out in July during the publication of draft legislation for Finance Bill 2022. It included draft legislation which would give HMRC additional powers to seek freezing orders, impose penalties, seek winding-up orders and publish details of promoters and schemes. The accompanying policy paper stated that the "measure is targeted at the most persistent and determined promoters and enablers of tax avoidance". Most people, I think, would take this to mean a reticent subset who should already be caught, but fail to be deterred, by existing measures. Aspects of the draft legislation itself were, however, worded so as to set the threshold conditions for the new powers lower than for existing measures which were targeted more broadly than merely at the "most persistent and determined" of promoters. It seems that, when considering how to tackle tax avoidance, it is hard for policy makers to resist being sucked into a vortex of using more and broader legislation to fix a decreasing problem – the UK's latest tax gap figures published on the 16th of September indicate that only 4% of the total tax gap identified for the 2019/2020 tax year was attributable to tax avoidance. I should add here that the total tax gap was estimated to measure no more than 5.3% of total tax liabilities.
Tanja Velling	And revelations such as those in the Pandora Papers are often used to justify new, or bolster the justification of already proposed, legislative measures. Earlier this month, European Commissioner Paolo Gentiloni gave a two-fold answer to the question which he posed to himself during a plenary session of the European Parliament as to why can we still have revelations such as those coming out of the Pandora Papers, despite everything that the EU has done to tackle tax avoidance. First, we have the significant lead-in time for changes to become operative, in particular, given that Member States need time to implement the rules once a tax directive is been passed at EU level. Secondly, Paolo Gentiloni noted that "tax avoiders and evaders also develop new practices", meaning effectively that legislation tackling these behaviours needs to evolve at the same speed. Combined with the first point, this leads to the situation where additional layers of legislation are being proposed even before a measure has been fully implemented, not to speak of it becoming fully operational and embedded in the legislative scheme and administrative practice. The Commission has, for instance, already started work on the proposal for a measure to require multinational enterprises to publish their effective tax rates whilst the measure logically preceding this, namely public country-by-country reporting which requires publication of the amount of tax paid, is still making its way through the legislative procedure. The interplay of these two factors may also have implications, in particular, for Pillar Two of the international tax reform project of the OECD/G20 Inclusive Framework. Even once agreement is reached, it is likely to take years until the new rules – which are generally portrayed as an anti-tax avoidance measure – will become fully operative. It is hoped that agreement on Pillars One and Two

	will bring a measure of stability to the international tax system. But I wonder how realistic that hope can be, if Pillar Two is unlikely to yield immediate “wins” and policy-makers continue to face significant pressures to take immediate action.
Zoe Andrews	Well, perhaps, it’s best to focus for now on the path to reaching and implementing the international agreement. On Friday evening, it was announced that 136 out of 140 Inclusive Framework jurisdictions, including Estonia, Hungary and Ireland, had reached agreement. The OECD published a statement setting out the agreed principles which are being presented to the G20 Finance Ministers on the 13^{th} of October and will be delivered to the G20 Leaders during their meeting on the 30^{th} and 31^{st} of October. The OECD’s statement clarifies that the aim of the project is not to eliminate tax competition, but to agree on its limitations. The minimum tax rate to be introduced under Pillar Two has been set at 15%, and a formulaic substance carve-out has been agreed. It will initially exclude income equal to 8% of the carrying value of tangible assets and of 10% of payroll. Each of these percentages will decrease to 5% over a transition period of ten years.
Tanja Velling	And I suppose, my concern around pressures to take intermediate action could be addressed by the ambitious implementation plan. The statement indicates that the plan is to aim for the new rules to become effective in 2023. Some of the model rules are due to be published as early as the end of November with more swiftly to follow. It is intended that, by mid-2022, the signing ceremony for the multilateral convention proposed to bring into effect Amount A of Pillar One can be organised and that another multilateral instrument to effect the treaty changes required for Pillar Two will have been developed.
Zoe Andrews	Has anything been agreed yet about how the Pillars will apply to groups?

Tanja Velling	No detail has yet been published on this specifically, but if the final agreement follows the earlier blueprints we would expect for Pillar One that residual profit will be calculated at group level (or segment level if appropriate) on the basis of consolidated accounts (with adjustments) and then allocated to individual market jurisdictions. Amount A losses would be reported and administered through a single account for the relevant group or segment, and kept separate from any existing domestic loss carry-forward regime. For the minimum effective rate of tax rule under Pillar Two, the definition of multinational enterprise group is aligned with the country-by-country reporting threshold and the starting point is the consolidated financial statements prepared by the MNE group. A limited number of adjustments would then be made to the financial accounts to add or eliminate certain items in order to arrive at the GloBE tax base. The OECD/G20 statement makes it clear that, where the income inclusion rule applies, parent entities will be subject to a top-up tax in respect of the low taxed income of a constituent entity, similar to a controlled foreign company rule. But we digress... You had clearly started to move on to telling our listeners what they may look forward to over the next month.
Zoe Andrews	Despite the excitement in the international tax arena, I would still say that, from a UK tax perspective, the key date over the next month would be the Budget on the 27th of October. Speculation as to what might or might not be included is already rife. In my view, the only thing that is clear is that we should not be holding our breath for announcements of tax cuts. Whilst Chancellor Rishi Sunak confirmed during the Conservative party conference that he "want[s] tax cuts", his keynote speech indicated rather clearly that he does not currently regard that the necessary preconditions are satisfied, noting that "in order to do that [namely, make tax cuts], our public finances must be put back on a sustainable footing". The UN Climate Change Conference COP26 will take place from the 31st of October to the 12th of November and may prove to be a catalyst for the introduction or strengthening of green tax measures. Our colleagues have pulled together a range of great content on COP26 – have a look at the "Path to COP26" collection on Slaughter and May's website for further information.
Tanja Velling	We should also add a footnote to something which we mentioned as an item to look out for during the September edition of this podcast. We mentioned that, on the 20th of September, the EU's General Court would hear the appeal against the European Commission's decision that the group financing exemption in the UK's controlled foreign company rules constitutes unlawful State aid. Whilst the hearing did start as planned, we understand that it was suspended part-way through as one of the judges was unable to continue. The

	hearing will be re-listed for continuation in due course and, therefore, remains something to look out for. And on that cheerful note, we shall conclude the podcast. 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.