SLAUGHTER AND MAY/

Slaughter and May Podcast
Tax News Highlights: January 2021

Zoe Andrews	Welcome to the January 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. Just when we were getting ready for a quiet Christmas and New Year following our last podcast in December 2020 to round off the year, there was a veritable flood of developments. So, this podcast will be a bit of a canter through important Brexit-related changes, updates on previously mentioned national and international developments and UK cases. This podcast was recorded on the 12th of January 2021 and reflects the law and guidance on that date.
Zoe Andrews	So, starting with Brexit, we had something of a last minute Christmas present in the form of the EU-UK Trade and Co-operation Agreement which was finally agreed on Christmas Eve. The agreement generally contains very little tax content. It does contain restrictions on the customs duties, export duties and taxes which may be imposed on goods, and there are protocols which provide for co-operation on customs matters and combatting VAT fraud, and for mutual assistance for the recovery of claims relating to taxes and duties. The UK and the EU have committed to retaining the corporate interest limitation, controlled foreign companies rules and hybrid mismatches, in each case to the extent necessary to meet OECD standards. In the area of state aid, the UK no longer applies EU state aid rules (except as provided for in the Northern Ireland Protocol to the EU-UK Withdrawal Agreement) but is required to set up its own subsidy control regime with “an appropriate role” for an independent authority and recourse through UK courts by interested parties such as competitors. At the time of recording, no further details are available on how the UK intends to meet these obligations but the provisions on competition in the Agreement to ensure a level playing field include restrictions on tax state aid measures. If the UK was to introduce subsidies which the EU considers to fall foul of these restrictions, the Agreement envisages that the EU would be able to request an explanation from the UK. Thereafter, the matter could be referred to the snappily named “Trade Specialised Committee on the Level Playing Field for Open and Fair Competition and Sustainable Development”, this is a committee of the Partnership Council established pursuant to the Agreement as a joint-UK-EU institution to oversee the attainment of the objectives of the Agreement. In more serious cases, the EU would be able to “unilaterally take

	appropriate remedial measures", if discussions with the UK do not yield a solution. That the UK and the EU have committed to following global standards rather than the UK being forced to follow EU rules is significant. This gives scope for the UK to deviate from EU tax rules to the extent that they have gone above and beyond OECD standards – which has often been the case. Not least in respect of DAC6, the EU's mandatory disclosure rules in respect of cross-border tax planning arrangements.
Tanja Velling	Indeed, Zoe. Just before the end of the transition period, the UK pared back its implementation of DAC6 to the standards agreed at the OECD level. In practice, this means that DAC6 reporting has been abolished in the UK for the majority of cases. Under the UK's DAC6 implementing regulations, only arrangements falling within DAC6 hallmarks D1 or D2 are now reportable. The hallmarks correspond to the requirements of the OECD's Model Mandatory Disclosure Rules for Common Reporting Standard Avoidance Arrangements and Opaque Offshore Structures. This means that they cover, broadly speaking, arrangements involving attempts to conceal income or assets, or to obscure beneficial ownership. In fact, the UK intends to replace the pared-back DAC6 implementing regulations with Mandatory Disclosure Rules based on the OECD's model rules. We understand that draft legislation should be published later this year, but that reporting under the new rules would be unlikely to commence before 2022.
Zoe Andrews	The UK's decision to pare back DAC6 was certainly a welcome Brexit consequence – even though it came after most businesses would have already incurred significant compliance costs. Another welcome change will be that banks and insurers will now be able to recover input VAT in respect of costs associated with the provision of specified supplies of financial and insurance services to EU customers. As promised, the UK has also reduced the rate of VAT applicable to women's sanitary products to zero. In terms of withholding tax, intra-group dividend, interest and royalty payments to the UK may become more expensive as the Interest and Royalties directive and the Parent Subsidiary directive no longer apply, and not all relevant treaties eliminate applicable withholding taxes in full. But we expect that most relevant intra-group payments would already have been restructured to avoid additional tax costs, and payments from the UK will, for now, remain unaffected as the UK legislation implementing the two directives has been left in place unamended. In any event, in the case of UK dividends, there is generally no withholding tax.

Tanja Velling	What will be really interesting, will be to see how the UK's rules may be amended in the future to deviate from those applicable in the EU. In this respect, it is worth noting that more UK courts than originally envisaged have been empowered to depart from EU case law. In addition to the UK Supreme Court, this power has been granted to the Court of Appeal in England and Wales and certain equivalent courts in Scotland and Northern Ireland. But let's now move on to further news on some other national and international developments which we had previously mentioned. The OECD has finally published guidance on the transfer pricing implications of COVID-19. The UK Government's proposal to give HMRC, the UK's tax authority, additional information powers has been criticised by the Economic Affairs Committee of the House of Lords. And we understand that HMRC intends to withdraw guidance issued in September 2020 on the VAT treatment of early termination fees and compensation payments.
Zoe Andrews	The long-awaited OECD guidance on the transfer pricing implications of COVID-19 gives a clear message: the arm's length principle and the OECD Transfer Pricing Guidelines 2017 are "fit for purpose" in dealing with the transfer pricing implications of COVID-19, and there is no need to adopt a different approach. In a recent post on the European Tax Blog, our colleagues, Dominic Robertson and Deeksha Rathi have highlighted key points. Where a business's internal data indicates that, because of the impact of COVID-19, historic comparables are no longer appropriate, tax authorities should take a flexible and pragmatic approach provided taxpayers are making good faith efforts to obtain contemporaneous data as quickly as possible. Tax authorities should carefully scrutinise claims seeking to allocate a share of group-wide losses to limited-risk entities and businesses should be aware that the corollary would likely be allocating a higher return for those entities in future good times. Government assistance may, depending on its terms and conditions, be relevant to the transfer pricing analysis, in particular if the assistance takes the form of a wage subsidy, a government debt guarantee or short-term liquidity support. Existing advance pricing agreements, APAs for short, should not be affected by COVID-19, unless, for example, COVID-19 has resulted in the breach of a critical assumption, leading to the cancellation or revision of the APA.

Tanja Velling	In an earlier podcast, we spoke about the UK Government's proposal to introduce a Financial Institution Notice, FIN for short, to make it quicker and easier for HMRC to request information from financial institutions on taxpayers' affairs. Quicker and easier because, as proposed, the FIN would do away with the requirement to obtain tribunal approval before the notice is issued. The main reason given for the proposal was the pressure to fulfil information requests from other tax authorities in a timely manner. The House of Lords Economic Affairs Committee has published a report which gives short shrift to this proposal and the reasons given for it. The majority of third party information requests issued under the current rules (which require prior tribunal approval) relate to domestic matters. And delays are not solely attributable to the tribunal approval requirement. Therefore, the main reason given for the proposal is not apt to justify it. The report also considered certain other recent proposals, including proposals to require businesses to notify HMRC of uncertain tax positions and to make certain licences conditional on tax registrations. In general, the report was less than complimentary on the Government's recent tax-policy-making track record. In particular, the report calls on the Government to be more methodical and rigorous in consulting on proposals so as to ensure that plans are properly tested and supported by a strong and transparent evidence base. We sincerely hope that the Government will act on this recommendation, to afford businesses and the advisory community earlier and more extensive opportunities to input into the shaping and realisation of policy proposals.
Zoe Andrews	There has been some good news on VAT. You may recall that we previously discussed Revenue and Customs Brief 12/2020 back in September when it was published. The Brief explained HMRC's change in policy on the VAT treatment of early termination fees and compensation payments. HMRC has now confirmed to the Joint VAT Consultative Committee that the brief will be withdrawn and a revised brief issued. We understand that the new brief will set out a more nuanced approach and that HMRC's changed policy will not now have retroactive effect, but will instead apply from 1 February 2021. I expect that we will update you on the revised brief when it has been published. But now onto a brief update on four cases: the Court of Appeal decision in *Development Securities* on corporate tax residence and the Upper Tribunal decisions in *Gallaher* on exit taxes, *Stephen Warshaw* on the definition of "ordinary share capital" and *Embiricos* on partial closure notices.

Tanja Velling	The decision of the Court of Appeal in *Development Securities* was, at the same time, reassuring and disappointing. The case concerned a scheme to enable the Development Securities group to access enhanced latent capital losses. In order for the scheme to work, it was crucial that three special purpose vehicles incorporated in Jersey were also tax resident there at the time when they acquired assets at a price significantly above market value. The First-tier Tribunal had decided that the SPVs were UK-tax resident at the relevant time. The SPVs' directors had not engaged with the substantive decisions to enter into the transactions, but acted on instructions from the UK parent. On appeal, the Upper Tribunal overturned this decision and the Court of Appeal has now overturned the Upper Tribunal's decision. The narrow question before the Court of Appeal was whether the Upper Tribunal's criticism of the First-tier Tribunal's decision had been well founded. All three judges agreed that the answer was "no". Because the taxpayer had not put in a respondent's notice, it was not open to the Court of Appeal to uphold the Upper Tribunal's decision on any other grounds once it found the reason for the decision to not have been well founded. Which brings me to the disappointing part. One of the judges in the Court of Appeal went on to resoundingly criticise the First-tier Tribunal's decision on different grounds. But another considered that the First-tier Tribunal had got it right. And the third declined to comment. So, where does this leave us?
Zoe Andrews	Well, we still don't know really know whether the First-tier Tribunal got the residence question right or not in this case. But – and now comes the reassuring part – this should not matter all that much. The Court of Appeal decision does mean that there been no change of principle since the 2006 decision in *Wood v Holden*. Whatever the differing views on residence expressed in this case, it is clear that this is an extreme case which turns on its (extreme) facts and should be limited to similar scenarios. In practice, there should be no read-across to SPVs which enter into transactions which make commercial sense for them.

Tanja Velling	But now, onto *Gallaher*. We mentioned this case in our December podcast in the context of noting *Panayi* as a case to look out for in 2021. Differently constituted First-tier Tribunals reached opposing conclusions in *Gallaher* and *Panayi* on whether or not it was possible to interpret legislative provisions on exit taxes so as to make them compatible with EU law. In *Gallaher*, the answer was no that could not be done; in *Panayi*, the answer was yes.
Zoe Andrews	There were two key issues in *Gallaher*. First, whether the imposition of an immediate tax charge on intra-group transfers when the assets left the UK tax net was contrary to EU law. The First-tier Tribunal considered that this was clearly the case. And secondly – and this is where *Panayi* and *Gallaher* part company – what the appropriate remedy would be. The First-tier Tribunal decided that the remedy would be to disapply the charge (rather than, as was done in *Panayi*, to read an instalment payment regime into the legislation). It could be said that only the disapplication of the charge as per *Gallaher*, and not the reading in of an instalment payment regime as per *Panayi*, is a real win for the taxpayer in economic terms. Deferring tax, but charging interest for the deferral, seems the same in economic terms as an immediate charge. In economic terms, disapplication of the charge, as per *Gallaher*, is a real win for the taxpayer whereas any requirement to pay by instalments, especially if interest is to be charged for the deferral, puts the taxpayer in a worse economic position. The Upper Tribunal has now referred questions on both issues to the Court of Justice of the European Union in what must have been one of the last such referral from the UK.
Tanja Velling	It is hard to see that the CJEU would follow *Gallaher* in full and confirm that the charge is contrary to the EU law and must be disapplied. Nonetheless, its answers to the questions referred are likely to have an impact beyond the facts of this case (and *Panayi*). They could be particularly relevant to anyone who has moved assets to an EU27 country as part of Brexit planning. The answers may also inform the interpretation of the provisions in Finance Act 2020 which introduce an instalment payment

	regime for tax payable on intragroup asset transfers to companies resident in the EEA.
Zoe Andrews	In *Stephen Warshaw*, the Upper Tribunal has given a very clear decision on the bright line definition of "ordinary share capital" in section 989 Income Tax Act 2007. The Upper Tribunal dismissed HMRC's appeal and concluded the First Tear Tribunal had made the right decision that the cumulative, compounding preference shares held by Mr Warshaw were "ordinary share capital" and that the company was his "personal company" for the purposes of entrepreneurs' relief (now renamed business asset disposal relief). Section 989 is necessarily formalistic and looks at the rights attached to the share, not the subjective intentions of the parties as to its tax status or what happens in practice. The Upper Tribunal did not accept HMRC's proposition that the statutory distinction between a share which is ordinary share capital and one which is a fixed rate preference share should be based, or even informed by, whether in economic terms it is "debt-like". Following these principles, the Upper Tribunal concluded that in order to have a right to a dividend at a fixed rate, both the rate and the amount to which it is applied must be fixed. The effect of the compounding was that the amount to which the rate was applied was not fixed. The Upper Tribunal sees no principled basis for a distinction between a dividend expressed as a fixed percentage of profits and the dividend on the preference shares in this case which had a right to compounding. Although the case is about entrepreneurs' relief, the term 'ordinary share capital' is also relevant to other parts of the legislation such as group relief, consortium relief and stamp duty group relief. It is a good reminder that this is an area where the devil is very much in the detail.
Tanja Velling	The Upper Tribunal decision in *Embiricos* limits taxpayers' ability to force HMRC to bring enquiries to a close. In the *Embiricos* case, HMRC had concluded that the taxpayer, who was an individual, was domiciled in the UK and had requested further information on the income and gains which would consequently become taxable. The taxpayer wanted to have the domicile question settled in court before providing this information due to the cost involved. So, the tribunal was asked to direct HMRC to issue a partial closure notice, stating its conclusion on the domicile question, which could then be appealed. The Upper Tribunal has now clarified that a partial closure notice cannot be issued merely to state a conclusion on a preliminary legal matter; it must also state the amount of additional tax due.

	This limits taxpayers' ability to force a judicial determination of a preliminary legal issue, such as the domicile question. A preliminary judicial determination can only be achieved through a joint reference to which HMRC would need to agree.
Zoe Andrews	Following this canter through some recent developments, you may ask whether any respite is in sight. Well, not all that much. During the next few weeks, there are plenty of things to look out for. • Replacement Revenue and Customs Brief on the VAT treatment of early termination fees and compensation payments • The public consultation on the OECD blueprints for international tax reforms which is scheduled for 14 and 15 January and can be viewed on OECD Web TV – as you'll see, it has not yet made Netflix • The Court of Appeal is scheduled to begin hearing the appeal in the case of *South Eastern Power Networks* (and others) on consortium relief and closure notices on 2 or 3 February. • 5 February is the closing date for the consultation on insurance premium tax: looking at administration and unfair outcomes.
Tanja Velling	That leaves me to 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